

Capital Development

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

CAPITAL ASSISTANCE PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

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PERU - RURAL ENTERPRISES DEVELOPMENT

AID-DLC/P-2051

UNCLASSIFIED

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

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June 14, 1974

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Peru - Rural Enterprises Development

Attached for your review are recommendations for authorization of a loan in an amount not to exceed ten million dollars (\$10,000,000) to the Government of Peru to assist in financing the United States dollar and local currency costs of a project to provide financing to rural enterprises in Peru and to provide technical assistance ("Project"). Up to four million dollars (\$4,000,000) of loan disbursements will be available for that portion of the Project being implemented by ORDEZA. The remaining portion of the ten million dollars (\$10,000,000) will be made available for the portion of the Project to be implemented by the Banco Industrial.

This loan proposal is scheduled for consideration by the Development Loan Staff Committee on Friday, June 21, 1974. Also please note your concurrence or objection is due by close of business on Wednesday, June 26, 1974. If you are a voting member a telephone poll has been enclosed for your response.

Development Loan Committee
Office of Development
Program Review

ATTACHMENTS:

Summary and Recommendations
Project Analysis
ANNEXES A -N

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PERU
RURAL ENTERPRISES DEVELOPMENT

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SECTION I - SUMMARY AND RECOMMENDATIONS

1. Borrower: The Borrower will be the Ministry of Economy and Finance representing the Government of Peru. The Implementing Agencies will be the Industrial Bank of Peru and ORDEZA (Organization for the Regional Development of the Affected Zone).

2. Amount and Terms of Loan: The loan will not exceed US\$10 million. Financing is requested on the most concessional terms available, which are expected to be a 40-year amortization period including a 10-year grace period with interest at 2% during the grace period and at 3% thereafter.

3. Purpose: The project is designed to assist rural enterprises by making available an integrated program of credit and technical assistance required to develop, finance, and manage these enterprises

This package of assistance will be available to new or existing enterprises in industry, service, or commerce that are privately or community-owned and that meet selection criteria including employment creation, income distribution, high value-added characteristics and conformance to GOP development plans.

By providing resources to assist these enterprises, the project will aid the GOP in its rural development efforts, will offer employment and income opportunities, and will generate other social and economic benefit.

4. Background of Project: Following the earthquake of May, 1970, a number of loan programs were initiated in the earthquake zone with the assistance of A.I.D. financing. Two of these, the Community Development Program and the CRECE ^{1/} Fund Small Business Assistance Program were very effective in aiding the reconstruction effort in the zone, and are now providing substantial developmental benefits as well. The Community Development Program provides sierra community organizations with the planning, financing, organization and management necessary to successfully start and operate an income-producing enterprise. (There are several housing and community infrastructure projects as well under that project not included in this proposed loan.) The Small Business Assistance Program provides credits as

^{1/} An acronym deriving from "Créditos para la Reconstrucción de Comercio y Empresas"

well as a limited amount of technical assistance to small businesses in the Zone.

Both of these programs have demonstrated that most rural enterprises require technical in addition to credit assistance to achieve their development potential, but that no Peruvian institution, governmental or private, exists which can provide a package of credit and technical assistance for such enterprises. It has been shown, also, that there is wide-spread receptivity toward accepting technical assistance as well as credits when available in an integrated program at reasonable terms and conditions.

5. Project Description: The project is designed to partially fill this institutional void by assisting two agencies of the GOP in developing the capacity to deliver a combination of specialized technical assistance and credits to enterprises located in some of the least developed areas of Peru. The two Implementing Agencies that will receive loan funds to assist them in carrying out respective portions of this activity are the Banco Industrial del Perú (The Bank) receiving US\$6.0 million, and ORDEZA, receiving up to US\$4.0 million.

A Rural Enterprises Development Fund will be established within the Bank to finance sub-projects. This Fund will have a total planned capitalization of US\$9.7 million. ORDEZA will apportion its US\$4 million allocation between its Community Development and Small Business Development projects. Interest charged on sub-loans will be competitive with that now charged by the Bank in its industry programs, (ranging from 6 to 13% depending primarily on the size of the loan and the priority of the activity as determined by GOP norms) and will be in the 8-13% range for loans to service and commerce-type enterprises, the rate depending primarily on the size of the loan. Rates now charged under the CRECE Fund Small Business Assistance program range from 8 to 10%, and from 3 to 5% in the Community Development Program. These rates will be reviewed by ORDEZA in partial satisfaction of a Condition Precedent. Rates as proposed by ORDEZA, subject to A.I.D. approval, are expected to be higher.

Local Financial Intermediaries will continue to participate in the CRECE Fund Small Business Program (where they now generally finance 10% of the loan) and will also serve as banking agents for some of the Bank's loans to commercial and service enterprises. To the extent that local financing institutions participate in sub-loan lending they will assume a portion of the risk; The Fund (and therefore the GOP) will assume the remaining risk.

Technical assistance will be provided to sub-borrowers by both Implementing Agencies, and where appropriate by other GOP agencies. This assistance will be designed to assure proper planning, financing, and execution of sub-projects. The CRECE Small Business Assistance program will be strengthened to provide more technical assistance to sub-borrowers, and to increase the participation of Local Financial Intermediaries. The Bank will create a special office to implement its program with expanded staffing in Lima and branch offices to assure the provision of these services.

6. Financial Plan: The total amount of funding expected from all sources for the project is US\$16.9 million.

The A.I.D. contribution will be US\$10.0 million. Up to US\$6.0 million will be made available for that portion of the project to be implemented by the Banco Industrial, with up to US\$300,000 of this amount available for Technical Assistance to the Bank and sub-borrowers. Up to US\$4.0 million will be available for that portion of the project implemented by ORDEZA, with up to US\$300,000 of this available for Technical Assistance to ORDEZA and sub-borrowers.

The Banco Industrial is expected to contribute approximately US\$4.5 million to the project, composed of US\$4.0 million to the Fund to be established in the Bank and US\$500,000 in staff and operating expenses. ORDEZA is expected to contribute approximately US\$1.0 million for staff and operating expenses of its portion of the project.

Additional funding for the project expected from Participating Financial Intermediaries is US\$1.0 million and from sub-borrowers. US\$400,000. See next page (3-A) for a tabular presentation.

7. Alternate Sources of Financing: Ex-Im Bank, IBRD, and IDB have not expressed an interest in financing this project. A.I.D./W is requested to obtain official confirmation of these positions. Private local and foreign institutions are not appropriate sources of financing for a project of this type.

8. Statutory Criteria: All statutory criteria have been met. (See Annex C)

9. Issues: None.

FINANCIAL PLAN - SOURCES OF FUNDS

Rural Enterprises Development Project

Program Elements	A.I.D.	BANCO INDUSTRIAL	ORDEZA	Participating Financial Intermediaries	Sub-Borrowers
A. <u>BANCO INDUSTRIAL</u>					
1. Rural Enterprises Development Fund Projects	5.7 m	4.0 m		0.7 m	0.3 m
2. Technical Assistance to Banco Industrial and Sub-Borrowers	0.3 m				
3. Banco Industrial Counterpart (Staff)		0.5 m			
	<u>6.0 m</u>	<u>4.5 m</u>			
B. <u>ORDEZA</u>					
1. Rural Community Enterprise Development Projects)	3.7 m				
2. CRECE Fund Small Business Assistance Projects)				0.3 m	0.1 m
3. Technical Assistance to ORDEZA for (1) and (2) above	0.3 m				
4. ORDEZA Counterpart			1.0 m		
	<u>4.0 m</u>				
Sub-Totals	10.0 m	4.5 m	1.0 m	1.0 m	0.4 m
TOTAL PROJECT = <u>\$16.9 million</u>					

10. Recommendations: Authorization of a loan to the Ministry of Economy and Finance acting in the capacity of Borrower for the Government of Peru in an amount not to exceed ten million dollars (US\$10,000,000.00) on the most concessional terms presently available.

A. 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., a designation of the representatives of the agencies which will be responsible for implementing the Project.

B. Prior to any disbursement or the issuance of any commitment documents under the Loan for the portion of the Project being administered by the Banco Industrial, for any purpose other than to finance technical assistance or approved commodity procurement, the Implementing Agency shall, except as A.I.D. may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

- (1) evidence of the creation of a Rural Enterprises Development Fund ("Fund") within the Banco Industrial;
- (2) a Project Organization and Operations Plan, giving a complete description of how the Banco Industrial will implement its portion of the Project. This Plan will include, but not necessarily be limited to;
 - (a) an organization plan showing how Fund activities will be executed by the Banco Industrial, including provisions for adequate staffing;
 - (b) provisions for sub-project identification, Fund promotion, and technical assistance to sub-borrowers from the Fund;
 - (c) a time-phased implementation plan;
 - (d) a credit manual containing the rules and regulations governing the Fund.

- (3) evidence of the availability of sufficient budgetary resources to make the Banco Industrial's contribution to the Project.

C. Prior to any disbursement or the issuance of any commitment documents under the Loan for that portion of the Project being implemented by ORDEZA, the Implementing Agency shall, except as A.I.D. may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

- (1) a Program Organization and Operations Plan giving a completed description of how ORDEZA will implement its portion of the Project. This plan will include, but not necessarily be limited to:
 - (a) a description of how Loan funds will be administered within the Rural Community Development Project and the CRECE Small Business Assistance Fund presently administered by ORDEZA and financed under A.I.D. Loans 527-L-052 and 527-L-053, respectively;
 - (b) provision for the deposit in the Fund (of the Banco Industrial) of principal repayments and interest payments derived from sub-loans made with Loan funds;
 - (c) provisions for adequate staffing to assure proper implementation of the additional resources provided under the Loan to ORDEZA's existing projects;
 - (d) provisions for technical assistance to sub-borrowers;
 - (e) a time-phased implementation plan;
 - (f) a statement of the rules and regulations governing the use of Loan funds;
 - (g) an analysis of sub-lending interest rates for the Rural Community Development and CRECE Fund Small Business Assistance projects with an objective of adjusting these rates upward.

- (2) evidence of the availability of sufficient budgetary resources for ORDEZA's contribution to the Project.

D. The Borrower will covenant to make its financial contributions to the project in a timely manner.

E. The Borrower will covenant that all sub-loan principal and interest of Program funds will be returned to and utilized in the Rural Enterprises Development Fund during the repayment period of the loan, or as otherwise agreed by A.I.D. and Borrower.

F. The Loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

11. Project Committee:

Loan Officers:	Gregory Smith, USAID/Peru-CAP Edward Lijewski, AID/W Gabriela de Perez Albela, USAID/Peru-CAP
Economists:	George Gebhart, USAID/Peru-ECON Rollo Ehrich, USAID/Peru-AGR Janet Ballantyne, USAID/Peru (consultant)
Financial Analysts:	Donald Hickson, USAID/Peru-CON Cesar Espino, USAID/Peru-CON Aurelio Tasso, USAID/Peru-CON
Regional Legal Advisor:	Norman Williams, USAID/Peru-GC
Contributors:	Edward Butler, USAID/Peru-UCD Hector Garcia, USAID/Peru-UCD
USAID Approval:	Donald Finberg, USAID/Peru-D Charles Weinberg, USAID/Peru-AOD

SECTION II - THE PROJECT

A. Program Description

1 Characteristics and Goals of the Project

The goal of this project is to contribute to the efforts of the Government of Peru in rural development. In support of this goal, the purpose of this project is to institutionalize an integrated program of financial and technical assistance to assist existing and new rural enterprises.

Only those enterprises which do not have access to credit on reasonable terms, and which meet other selection criteria described below, will be eligible for assistance.

Specifically, in the rural areas selected, the activities of the Program will contribute to:

- 1) the development and strengthening of rural enterprises;
- 2) the creation of employment;
- 3) the generation and distribution of income; and
- 4) a higher level of economic activity in several of the poorer regions of Peru.

The Program incorporates elements of two previous A.I.D. loan projects described below. Those activities have demonstrated clearly that:

- 1) there is a large potential demand for credits at reasonable terms for rural enterprises not being satisfied by COP or conventional financial institutions;
- 2) this demand can be satisfied by establishing simple banking procedures within already existing COP and private banking institutions;
- 3) many --if not most-- rural enterprises require varying amounts of technical assistance to determine project feasibility, for project design, and for successful project management; and
- 4) rural community enterprise projects require the most technical assistance inputs, a maximum of promotional effort, and substantial interagency cooperation.

The Program design proposed has drawn heavily on the experience of these earlier projects and attempts to provide for the inputs necessary to ensure that the needs of eligible rural enterprises in the priority areas selected for the project emphasis are met.

An important characteristic of the activity is the inclusion of both private and community-owned enterprises as eligible sub-borrowers. To exclude either from the target group would not provide the desirable balance in rural development. Moreover, the inclusion of community-enterprises insures the flow of project benefits to the most needy group of beneficiaries; the poorer individuals.

The project will finance enterprises engaged in either industry, services or commerce. While limiting the loan to small or medium industry development would ostensibly have been attractive, in the sense of assisting in the development of industrialization and manufacturing in general, such an approach should be unlikely to achieve significant results in terms of employment creation and income distribution given the very economically depressed conditions which characterize the rural areas of Peru chosen for this project. In those areas, where little industry exists or can be developed quickly, making financial and technical assistance available to commerce and service activities under this program will facilitate delivery of the benefits of this program to the broadest possible target group in the shortest period of time.

A major objective of the activity is the realization of economic benefits at the micro-economic level. Based on experience gained in the previous A.I.D. projects described below, significant employment creation benefits per dollar of sub-lending are expected to result from the project. Income generated as a result of these jobs will not only benefit the recipients by providing greater disposable income, but will likely be spent or invested in the project regions, thereby generating additional employment and income opportunities. To further maximize the potential micro-economic benefits, projects that contribute a maximum of value added to regional products will be given preference over those which, other things equal, do not have a high value-added benefit. The capacity of the small private entrepreneur and the community owned enterprise to serve as suppliers (of both goods and services) to local and national industries will be enhanced; and alternative employment opportunities will be generated thus helping stem the tide of migration to large cities.

Additionally, the project will stimulate the Implementing Agencies to expand and upgrade their capacity to survey, plan, finance, and provide technical and management assistance to the various types of

rural enterprises. Where in-house capacities to provide all of the needed inputs are insufficient, the implementing agencies will collaborate with other GOP agencies in various phases of the Program, or will contract with private entities for the provision of these services.

Finally, the proposed project is designed to demonstrate that a well-designed program of financial and technical assistance can reach the rural areas, and that sub-projects financed under such a program will be viable and credit-worthy in terms of seeking future financial assistance from regular channels. Thus, the heavy assistance provided to the entrepreneur and his project under the proposed program is envisioned as a single, once-only necessity, essential to enable the entrepreneur to establish a "track record" of business performance and financial reliability. Subsequent credit needs of the entrepreneur should be satisfied by regular, existing credit channels.

2. Background

a. A.I.D. Loan No. 527-L-052

Loan Agreement 527-L-052 signed in November 1971 provided up to U.S.\$3.0 million under the Loan for the following purposes:

a) The major portion of the Loan, approximately \$2,075,000, provided for financing construction materials, equipment, and other costs incident to implementing self-help community sub-projects in housing, small industry, agriculture, and community infrastructure in rural areas in the Sierra region of the zone affected by the earthquake of 1970.

b) Up to \$325,000 provided for the purchase of construction equipment and vehicles, which the Executing Agency required to implement the Project.

c) Up to \$100,000 provided for technical assistance and training activities related to the Project.

d) Up to \$500,000 provided for the development of a pilot self-help housing project in a coastal urban areas of the affected zone.

The GOP agreed to provide funds for the personnel and other operational costs, estimateu at \$1,000,000, required for developing and executing sub-projects.

With the integration of the Executing Agency (PROCOM) into the GOP Social Mobilization Agency (SINAMOS) in early 1972, and the inability of that new agency, as reorganized, to undertake this type of project, the GOP with A.I.D.'s concurrence assigned Executing Agency responsibilities to CRYRZA (now ORDEZA) in March, 1972. ORDEZA subsequently began hiring project directors for the Urban and Rural Projects and preparing Implementation Plans for each, the Rural Implementation Plan being accepted by A.I.D. in July 1972 and the Urban Implementation Plan in October of 1972.

The Rural Development Division of ORDEZA was established in May 1972 to implement the Loan. Administrative and executive personnel were hired and micro-regional planning teams established to analyze the development and reconstruction needs of small rural communities within defined micro-regions. Based upon that analysis, a series of feasible sub-projects were developed in housing, industry, agriculture, community infrastructure and small business with the participation of organized community cooperatives and other groups. Through contractual agreements between ORDEZA and community organizations, credit, technical assistance, and training were made available:

for the implementation of the sub-projects. The first sub-loan was approved in December 1972.

Implementing Agency

In early 1972 CRYRZA was transformed from a Coordinating Agency for Earthquake reconstruction to an executing agency, ORDEZA, responsible for directing and carrying out all sector development and reconstruction activities in the Earthquake Zone. In effect ORDEZA became a regional authority with direct control over other sector agencies in the Earthquake Zone. In this context the Rural Development Division (RDD) was created in ORDEZA especially to implement the A.I.D. Loan which required a coordinated multi-sector approach to rural development.

The RDD Organization administers all the essential components (i.e., professional technical assistance staff for sub-project promotion, planning and implementation, credit, construction equipment, etc.) required for the development of a variety of community projects. Sub-project development is coordinated with, but not dependent upon, the inputs of other sector agencies. Current staff includes approximately 4 executive and administrative personnel, 25 professional staff (i.e., civil engineers, economists, sociologists, industrial engineers, cooperative experts, etc.), and 100 skilled workers (agriculture, construction, maintenance, etc.) Construction equipment (i.e., tractors, bulldozers, dump trucks, cement mixers, etc.) is used for the implementation of sub-projects with the self-help inputs contributed by the community.

Sub-Project Development

Sub-projects are developed in the following manner:

1. Micro-regional studies

Multi-disciplinary planning teams perform a resource survey of selected rural micro regions with the Sierra region of the earthquake zone (ZAS). Basic data are gathered on housing needs, agricultural production, minerals and water resources, rural infrastructure, commercial and industrial activities, population, employment, existing communal organizations, etc. Priorities are established among feasible development and reconstruction activities that could be administered by existing community organizations. Sub-project activities are tentatively identified and designed to support and complement other COP development programs and priorities in the area.

2. Specific sub-project planning

A project development team then develops a detailed sub-project feasibility study. The team (composed of an engineer, architect, social

promotor, economist, and other types of technicians as appropriate) resides in the project locale and maintains close communication with the community which will manage the actual project. The feasibility study includes a time phased plan for implementation, including the required financial, technical, and training inputs.

3. Application and Approval of Sub-Loans

Based upon the feasibility study a loan application is prepared by the planning team in consultation with a community enterprise. The Loan is approved by an ORDEZA committee and sub-loan documents and contracts are prepared and signed.

4. Sub-Project Implementation

ORDEZA purchases all required materials and phases delivery according to implementation needs. The Rural Development Division of ORDEZA provides the necessary technical supervision, construction equipment, and materials; and the community provides the unskilled labor needed for construction of the housing, agricultural production, infrastructure, and other facilities as required under the sub-project.

5. Sub-project operation

During the first year of operation of income producing enterprises, the Rural Development Division generally assigns a technician to advise on management and other technical matters. Prior to and during the operational phase, RDD also arranges for formalized technical training for members of the community organization responsible for operations.

Sub-borrowers, Lending terms and conditions

Sub-loans are made exclusively to those community organizations recognized under Peruvian Law, such as cooperatives, Agricultural Societies of Social Interest, recognized Indian communities, etc. The Sub-borrower organizations are typically rural, based in towns of less than 5000 inhabitants. Sub-borrower experience with credits is, in most cases, non-existent. The Sub-loan project activity, particularly in the case of income-producing enterprises, usually represents a new activity not previously undertaken by the sub-borrower organization.

The maximum sub-loan amount is S/.8,000,000 (\$184,000) with loan terms and conditions depending upon the type of project and capacity for repayment. Loans for housing and supporting infrastructure are made at 3% interest, 20 year maximum repayment period, with the house serving as security. Small industry loans are made at 5% interest,

10 year maximum repayment period, with the security being material or equipment purchased, other installations, and income generated as a result of the project. Agricultural assistance loans are made at 3%, 10 year repayment period, with the production, equipment and materials purchase as guarantee.

The above described sub-loan interest rates were set at lower than prevailing interest rates in the area (i.e., housing 6%, agricultural credit 7-13%, small industry credit 6-13%, small business credit, 8-10%) with somewhat easier terms and conditions. The rationale for this decision was: 1) Target group characteristics - isolated, marginally employed campesinos with little or no previous credit experience, 2) Earthquake reconstruction subsidy factor - the loan was originally conceived as an even more subsidized program than currently is the case with matching grant instead of credit assistance to communities; credit was only introduced because of the GOP's concern that recipients become accustomed to repay credit rather than grant assistance in the development program, and 3) housing construction, which was the most pressing need in rural communities, could only be feasible as a credit program if it were coupled with income production activities in the same community. Lower than prevailing interest rates and easier terms for small industry, agriculture, and business credit were essential considering that income generated would also be used for credit repayment on housing.

Based upon experience to date, ORDEZA feels that if the earthquake reconstruction rationale and housing component were eliminated from the program, sub-lending interest rates terms and conditions could be adjusted to comparable levels being utilized by other GOP Development Institutions assisting the rural, low income target group. It is generally agreed that the level of the interest rate is not a critical factor (within certain limits) in serving this target group, but rather it is the amount and effectiveness of the promotion, training, and technical assistance provided by Implementing Agency which is essential for sub-project success.

Socio-Economic Groups Benefitted

Sub-borrowing organizations are typically located in small rural towns, population 500 to 5,000 people, whose economy is linked directly to agricultural activities. It is estimated that average income of those persons directly benefitting from the sub-loan activity ranges from \$500 to \$1000 year. It is probable that this program reaches those persons already in or on the threshold of the modest cash economy existent in these communities, but who are nevertheless in a state which could be described as economically stagnant and not permitting them to enjoy minimally acceptable standards of health, education, and other community services.

ORDEZA, with A.I.D. cooperation, is establishing a sub-project evaluation system which should provide more precise knowledge as to the social and economic characteristics of those directly and indirectly benefitting from project activities as well how they are benefitting in social and economic terms.

Project Analysis

Seventeen projects totaling approximately S/.50,000,000 (\$1,150,000) or 56% of available Loan funds, had been lent by May 1974. Eight additional projects are scheduled for approval by July 1974. With these approvals a total of approximately S/.70,000,000 (\$1,620,000) or 78% of available loan funds will be committed by July 1974. It is expected that all available funds will be committed by the end of 1974.^{1/}

The average sub-loan amount is S/.2,760,000 (\$63,500). Of the total amount of funds which will be committed by July 1974, 10.6% has been for self-help housing, 36% for agriculture, 16.6% for small industry, 5.1% for commerce, and 31.6% for multi-sector projects. Agriculture projects have included installation of pig and other small animal production facilities, improvement of sheep breeding and production, and storage facilities. Industrial activities include milk processing plants, marble mining and processing, plaster production, brick ovens, etc. Commercial activities have been limited to small rural restaurants, artisan shops, and vehicle service and maintenance stations. Multi-sector projects all include self-help housing components and complementary income production activities (communal restaurants, small animal production, other communal services).

Although the Project has been underway for only a relatively short period of time (the first sub-loan for a non-housing activity was to a Cooperative in Pariacoto for a Hog Farm in August, 1973), initial indications are good that the sub-projects will be viable and repayment will be on schedule. For example, the micro-team feasibility study on the Pariacoto Hog Farm projected a mortality rate of approximately 20%. Actual experience to date has been approximately 8% mortality. Because of this conservative estimate and overall good management of the sub-project, the Hog Farm's profits were larger than planned and the Cooperative recently made an advance payment on its sub-loan from ORDEZA with the unexpected surplus. Based on review and on-site inspections of other sub-projects, the USAID feels confident that repayments of those sub-loans will be prompt. Refer to Annex F for a listing of the total sub-loan portfolio under loan 052.

^{1/} Initially, under 052, ORDEZA had discretionary sub-lending authority up to S/.1,500,000 (US\$34,578). That level was raised to its present level of S/.3,000,000 (US\$69,156) pursuant to USAID's decision that ORDEZA's sub-lending procedures and operations merited a higher discretionary level.

2. Background

b. A.I.D. Loan No.527-L-053

Loan Agreement 527-L-053, signed on July 25, 1972 provided up to \$2.5 million in support of a project which would make credits available to small and medium industry, service, and commerce in the area affected by the earthquake of May 31, 1970. Specific objectives of the project were to:

- a) re-establish and develop local industry and commerce;
- b) stimulate the production of goods and services in the area, particularly those needed for major reconstruction activities;
- c) generate employment opportunities; and
- d) stimulate private initiative.

The bulk of the resources provided under the loan established a fund (called the CRECE Fund - Creditos para la Reconstrucción de Comercio y Empresas) in the Central Reserve Bank of Peru. The loan agreement provided up to US\$50,000 for technical assistance to the Implementing Agency. The GOP agreed to provide US\$150,000 equivalent for overhead and operational costs, including those associated with the "CRECE Teams" responsible for promotion and technical assistance activities.

In the aftermath of the May 1970 earthquake, it became evident that the major economic loss suffered by the region and the country was the destruction of thousands of small business which had provided many essential goods and services and 59% of the non-farm employment of the area affected.

These small businesses, actually mini-businesses by U.S. standards, were at the lowest level of business sophistication. Their limited capital had been painstakingly accumulated; few had ever done business with a bank and their credit worthiness was known only to local suppliers. The devastation of the earthquake completely wiped them out. Larger firms with established credit ratings could and did get money to repair, replace and rebuild; the small business man could not.

The need to replace or rebuild these small businesses which had significant capacity to generate employment and provide essential goods and services was obvious if prolonged economic disaster was to be avoided. It was equally obvious that a major element of the solution

to the problem was the provision of medium to long term credit at reasonable terms. The task was to devise a system which could deliver a loan to someone who had not previously borrowed from the regular banking system, ensure that defaults were minimized and that the project contributed to the overall reconstruction effort. Above all else, in view of the small size of the contemplated sub-loans, a major problem was designing a system which would manage the lending, supervision, bookkeeping and collection responsibilities which did not depend upon a new and large bureaucracy, the creation of which would impede rather than enhance the implementation of the project.

Implementing Agency

A survey of the existing development banks quickly established that their philosophy, methods, and personnel were not suited to the requirements of the project, primarily because of the lengthy period, up to a year, required to process a sub-loan. Also, many of these banks were overly bureaucratized.

The commercial banks and cooperatives appeared to be the only banking agencies with sufficient flexibility to make a loan in a reasonable length of time. Unfortunately, none had any experience with lending to small scale borrowers involved in industry, commerce, and service activities, especially in the more rural, sierra target area. However, all commercial banks contacted expressed great interest in the possibility of participating in a small business lending program of the type under consideration.

With the tentative selection of the delivery agencies, attention was focused on an additional major problem, that of furnishing these small businesses the technical assistance they required in order to submit a sub-loan application to the banking system and to provide them a certain amount of assistance and supervision after they had begun the reconstruction of their businesses. Consultation with officials of the GOP revealed a desire on the part of the Government to participate in and manage the sub-loan approval process to the extent that the Government would furnish and absorb the expenses of a professional staff for this purpose. Since the loan was initiated and developed largely on humanitarian grounds, AID did not require a counterpart contribution to the loan fund; instead, the Government agreed to furnish a small staff of technicians who would investigate applicants, approve sub-loans, and render technical assistance to sub-borrowers necessary to insure a high percentage of successful projects.

At the outset, the proposed project attracted much interest on the part of GOP agencies which wanted to participate in its management and implementation. Various divisions of the earthquake relief agency

(originally CRVZA, subsequently ORDEZA) wanted to modify it or bring it into their area of responsibilities. Resolving these and other problems took several months. The end result was an acknowledgement of the AID position that simplicity and flexibility should be characteristics of the operation, and a staff of dedicated and qualified young technicians was established and made responsible (through ORDEZA) for approval of sub-loans. This staff reports directly to the head of ORDEZA and has been performing competently the technical assistance functions. (See Section IV on Borrower/Implementing Agency for details of ORDEZA organization and staffing).

As the project development continued, it was decided that any bank or cooperative in the disaster area could participate in the program, on the condition it would provide from its own funds a minimum of 10% of the amount of the sub-loan. This element of participation, albeit minor when compared with the sub-loan value provided through the CRECE Fund, made it essential that a bank, in its own interest, would review and approve the sub-borrower's application. Since a commercial bank would not approve a politically motivated loan for fear of losing its money, and the Government (ORDEZA) would not approve the extension of subsidized, concessional credit to favored bank clients who did not need these special credits, this joint participation in the approval process was felt to be the best insurance that good sub-loans would be approved and the purposes of the project achieved.

Once the two parties approve a sub-loan application, the application enters the regular banking system and is forwarded for rediscounting by the Central Reserve Bank, which acts as fiduciary for the CRECE Fund. Experience has shown that under this system a sub-borrower can receive his loan with minimal delays, in some cases within 72 hours after joint approval of the application.

Sub-Borrowers, Lending Terms, and Conditions

Sub-loans can be approved to any individually-owned enterprise or legal entity which is a resident of the designated earthquake zone, whose subscribed or paid-in capital does not exceed S/.2,000,000 (\$46,084.00), whose gross sales do not exceed S/.5,000,000 (\$115,210.00) and which provides at least 5% of the total project value as equity contribution. Each sub-loan application must be supported by a feasibility study and is reviewed and priority ranked according to the contribution made by each project to the rehabilitation and development of the earthquake zone.

Since the sub-loans were for reconstruction purposes, it was decided to allow interest rates of from 8% to 10% depending on the size of the sub-loan. The following rates and terms were established:

Industry and Service Sectors

Minimum sub-loan: S/. 50,000 (\$ 1,152.00)
Maximum sub-loan: S/2,000,000 (\$46,084.00)

Interest Rates

From S/. 50,000 (\$ 1,152.00) to S/. 500,000 (\$11,521.00)=8% annually
From S/. 500,001 (\$11,521.00) to S/.1,000,000 (\$23,042.00)=9% "
From S/.1,000,001 (\$23,042.00) to S/.2,000,000 (\$46,084.00)=10% "

Commercial Sector

Minimum sub-loan: S/. 50,000 (\$ 1,152.00)
Maximum sub-loan: S/.1,000,000 (\$46,084.00)

(In special cases, the maximum limit may be extended to
S/.2,000,000 (\$46,084.00))

From S/. 50,000 (\$ 1,152.00) to S/. 500,000 (\$11,521.00)=8% annually
From S/. 500,001 (\$11,521.00) to S/.1,000,000 (\$23,042.00)=9% "
From S/.1,000,001 (\$23,042.00) to S/.2,000,000 (\$46,084.00)=10% "

Collateral: In each case goods obtained with the loan funds are to be pledged as collateral. For working capital purposes, the collateral requirements for each sub-loan are studied and established by ORDEZA and the financial agents.

Amortization: Amortization for each type of loan is for periods up to 7 years, with provision for amortization periods of up to 10 years in exceptional cases. Grace periods may also be granted, not to exceed two years.

Consistent with the need to ensure full commercial bank cooperation, it was decided that the commercial banks could not be asked to sacrifice normal income from their contribution to the project. Normal interest rates on sub-lending for the type of activities being considered were 13%, and therefore the financial agents (commercial banks and credit unions, etc.) are allowed to collect from the proceeds of each sub-loan, interest at 13% on their 10% participation of the total sub-loan. The difference in interest income is absorbed by the CRECE Fund. In addition, to avoid the necessity of creating a special bookkeeping staff, collection agency, etc., the banks are authorized to deduct the standard fees which they charge for estate and fund management of 3% of the value of the fund being managed for performing all the services of loan management, including collection, supervision, and bookkeeping. To keep the entire system as simple as possible, the fees and charges

are handled on a cash basis which means that when the local bank collects a payment on a sub-loan including interest of say, 8%, it deducts 13% on its 10% (or 1.3%), 3% handling on the remaining 90% (or 2.7%), and remits the balance of 4% to the fiduciary. Monthly the fiduciary sends a statement to USAID showing in detail the sub-loans made from the fund, interest and principal collected, and fund balances, accompanied by a request for reimbursement of the amounts disbursed.

In the event of default by a sub-borrower, the fund and the local bank take joint action and share the collection expenses in the pro rata proportion of amounts contributed by the banks and the Fund.

All of the above, plus eligibility criteria of sub-borrowers and other operational details, was summarized in a pocket-sized Credit Manual freely and widely distributed in the disaster zone as promotional material and delivered to all persons concerned with the operation of the loan. The Manual has been a major success in that the potential sub-borrower has generally read the Manual before applying for a loan, and, finding that the banks and Fund officials use the same manual, has shown greater confidence in seeking a loan from the banking system. This effect is of great importance since individuals in the target group have traditionally been suspicious of any actions of the Government or large, wealthy institutions.

Project Analysis

The system has, as of March 31, 1974, been operating 9 months. In that period, 127 sub-loans have been made, covering many kinds of businesses, such as new sewing machines for a factory making industrial gloves; new investment in a rock quarry and equipment for a business school. The average size of sub-loan has been \$ 10,008, with the average amortization period of 66 months, and the average grace period being 7 months. In each case, the Government technicians have investigated the feasibility and desirability of the project and the effect on employment. Seventy-eight of the total projects approved, requiring \$969,000 were approved in the Coastal area, and 49 of the projects, requiring \$ 303,000 were approved in the Sierra. The majority of the remaining balance of available funds is committed, and disbursements are expected to be completed by December 31, 1974, 18 months ahead of initial projections. Demand for these funds has far outstripped availability.

In the Sierra area, 172 new jobs were created through the 49 sub-loans at an average cost of \$1,760. In the Coastal area, 427 new jobs were created through 78 sub-loans at an average cost of \$2,270. Over-

all, within the combined Coastal and Sierra areas, 599 new jobs have been created at an average cost of \$2,122. Industrial type enterprises created 64% of the new jobs at a cost of \$1,793, compared with 15% created by commercial enterprises at an average cost of \$2,801, and 21% created by service enterprises at an average cost of \$2,627. On the basis of experience to date and applications already in process of review, it is estimated that 1,154 jobs will have been created when the loan is completely disbursed by December 31, 1974.

Meaningful analysis of the overall portfolio repayment records cannot be made as yet since most sub-projects are still in the early stages of sub-project development (and within the grace periods). However, of 127 enterprises financed under Loan 053 since the first disbursement in December, 1972, there has been one instance of a business failure, and another business in financial difficulties. The business failure, a brick factory which went into bankruptcy, has been taken over and is being operated by ORDEZA which has brick-making technicians on its Staff. The business presently in trouble (UNINSA - a foundry) will also be taken over by ORDEZA. ORDEZA indicates that it has received a feasibility study from a third party who wishes to rebuild the operation.

A new accounting system, using accrual rather than cash accounting, was recently instituted in the CRECE Fund at the USAID request. Preliminary figures received by the USAID on the status of sub-loan repayments suggest a delinquency rate of slightly over 5%, representing accounts due (interest) for 60 days or more. The figure for outstanding principal payments of 60 days or more is approximately 2% of total principal due. The USAID intends to review these data in greater depth with ORDEZA shortly for the purpose of determining if special action is necessary.

In the Coastal area, there are thirty sub-borrowers that now have developed sufficient financial strength and business reputation such that local banks have given them supplemental credits averaging \$1,000.

Refer to Annex G for a listing of the total sub-loan portfolio under loan 053.

J. Program Operation

a. Banco Industrial

To carry out the objective of the Rural Enterprises Development Program - to provide both financial and technical assistance to existing and new, individually and community owned, enterprises in the rural sierra areas of southern Peru - the Banco Industrial (The Bank) will establish a special fund, the Rural Enterprises Development Fund, and create a new organizational unit within the Bank's existing structure composed of the management and technical expertise required to carry out the Program (The Program Unit).

The Rural Enterprises Development Fund will be capitalized initially at \$9.7 million composed of a \$4.0 million contribution from the GOP and \$5.7 million from A.I.D. Credits from this fund will be available for sub-lending to eligible projects developed or approved by either the Banco Industrial through its own efforts, or in collaboration with other organizations active in rural development such as the Agrarian Reform agency or the National System of Social Mobilization (SINAMOS), or by participating financial intermediaries in the Project area which may be banking institutions, cooperatives, credit unions, etc. In the latter case, the financial intermediaries will contribute not less than 10% of the total of each sub-loan approved, with the fund contributing the balance of the sub-loan amount.

The major portion of sub-project development and sub-lending will be accomplished through the individual efforts of the Banco Industrial's Program Unit, or in collaboration with other GOP Agencies. However, both The Bank and USAID are in agreement that an objective of this Program is to bring together both potential borrowers and potential lenders to the maximum degree possible, in the belief that subsequently normal or regular banker-client relationships can be developed which will enable these enterprises to continue to have access to credit at normal or prevailing terms and conditions. For this reason, the participation of local financial intermediaries in the Program will be encouraged. Nonetheless, it is the mandate of The Bank's Charter to promote industrial development; this same function is not given to other financial institutions. Other financial entities give support to commerce and service activities. Thus, all industry-type enterprises developed under the Program will be processed by The Bank, while service and commerce enterprises will be eligible for assistance through the participating financial intermediaries as well as The Bank.

Through the operations of the Program Unit, the technical

experts in the Branch offices (an economist, engineer, cooperative specialist, etc.), backed up by additional expertise within the Branch office and the Unit in line, and outside technical assistance as necessary, will undertake an active program of project identification, promotion, and development. The program will place heavy emphasis on technical assistance and training as required.

The target group for sub-lending consists of rural enterprises, either privately or community owned (partnerships, cooperatives, or other community organizations) which, due to conservative requirements of existing sources of credit with respect to collateral terms, etc., combined with the perceived high risk of lending to "marginal" entrepreneurs or entrepreneurial groups, do not have access to credit from traditional sources for the activity (project) for which financing is sought.

To be eligible for a sub-loan under this program the rural enterprise must meet the locational and economic integration criteria. In addition, each sub-loan proposal will be evaluated and assigned a priority on the basis of its contribution to the economy of the area in which it is located. The following guidelines are to be established for evaluation of this contribution.

1. Employment creation. - The number of jobs to be created under the activity and the cost per job created.
2. Value added. - The amount of value added produced by the activity. Value added coefficients will be established as general guidelines to measure the magnitude of this variable.
3. Area content. - Each proposed activity to be supported by a sub-loan will be judged according to the degree to which it stimulates other economic activities within the selected area.
4. Consistency with the GOV's regional development plans. - The proposed activity must be consistent with the Government's development program for the selected area.

The Program Unit will focus on two general categories of potentially eligible projects: a) existing or new small businesses whether engaged in industry, service or commerce activities which are individually or privately owned, and b) new or existing community-owned enterprises engaged in the above activities as well as agriculture or agricultural activities.

The Program Unit will offer credit and technical assistance to: a) projects which are already bankable (i.e., accompanied by a feasibility study establishing the economic, financial, and technical viability of the enterprise) and which require little or no refinement in project design and credit application, b) projects which need extensive technical study and assistance, and c) to potential projects which are identified and developed largely through the efforts of the Program Unit itself, and with coordination of other GOP agencies as required.

To achieve the above, the Program Unit will develop and execute an active program of publicizing and promoting the objectives and benefits of the Program to the target group. This promotional effort may include the printing and distribution of informative literature, meetings or seminars with communities, social or business groups, the use of radio, television, and newspapers, and the distribution of credit manuals. Project applications and interest in submitting applications will be generated through this effort. The Program Unit in the Branch office of the Banco Industrial will receive and review all formal requests and work closely with others who exhibit an interest in establishing a new business or expanding an existing business but who are unsure of procedures and requirements.

In addition to responding to those applications generated by the above, the Program Unit will also be responsible for developing and coordinating "global" studies in a determined geographic area to identify and assess the local resources and the existing or proposed project development potential. To achieve this, the Program Unit will draw on the backstop support of the Lima Unit (on other expertise from within the Bank's other Divisions, and on regional planning entities, as appropriate), with technical experts assigned to TDY duty for this purpose. Based on the resource evaluation, the Program Unit in Lima will prepare feasibility studies for those projects which appear most favorable. If a community organization does not exist to manage the activity, one will have to be formed. For that the Program Unit will depend heavily on other GOP agencies such as Agrarian Reform, SINAMOS, etc., but The Program Unit will also provide the services of cooperative specialists, etc., as required to provide continuity for the activity. Once the proposed project feasibility is established, the project can be approved with the required technical assistance and community collaboration efforts coordinated to ensure efficient project implementation. For the community enterprise projects, it is expected that a technician provided by the Program Unit will remain with the project for the first 4-8 months to ensure that the community organization is able to handle all aspects of the activity.

For all projects considered, the Program Unit will assess and determine the technical assistance requirements needed. The Unit will provide the assistance and advice necessary in regard to technical, economic, financial, accounting, administrative and any other aspects of the enterprise considered, with the objective of solving or overcoming those elements of the operations which compromise or restrain their efficient operation and development. To the extent that the technical assistance required is a resource available within the Unit itself or the Lima office, it will be made available directly to the project; to the extent that professional advice is required which the Unit and the Lima office do not possess, the Unit will make arrangements for it with other agencies or contract with private firms or individuals.

In addition to direct technical assistance to the sub-project as described above, the Program Unit will provide for training as needed. The Unit will organize and or participate in training courses or seminars designed to treat those problems of business which can be effectively treated through group training programs. Such programs, sub-contracted to an educational organization in the area (e.g., the University of Puno), would include emphasis on basic accounting, business management, cooperative management, marketing, sales, promotion-advertising, etc. For those individual or community enterprises requiring training in a field not common to others, the Program Unit will arrange for the training or assistance on an individual basis.

3. Program Operation

b. ORDEZA - Rural Community Development and CRECE Fund Small Business Assistance Projects

\$4 Million of the proposed Rural Enterprises Development Loan will be made available for the continuation of the activities initiated by ORDEZA in the earthquake zone under loans 052 and 053. Allocation of the total resources between the two activities has not been determined and will be proposed by ORDEZA as an element of a condition precedent to disbursement under the loan. ORDEZA's satisfaction of this condition will include:

(1) a Program Organization and Operations Plan, indicating how the Program will carry out

- Project Identification, Development, and Promotion
- Technical Assistance
- Training

(2) a Time-Phased Implementation Plan

(3) a revised Credit Manual for the CRECE Fund

A.I.D. must review and approve ORDEZA's suggested apportionment of the resources both by activities and geographical areas prior to disbursing funds to ORDEZA.

The rationale for USAID's proposal for additional resources for these projects derives from the joint USAID/GOP (Ministry of Economy and Finance; National Planning Institute) judgement that both 052 and 053 are successful projects which have generated large amounts of unsatisfied demand. (See Section IV, Borrower and Implementing Agencies). The concepts and mechanisms of each program were initially innovative and experimental in Peru and the Implementing Agency (ORDEZA) was inexperienced. However, ORDEZA has demonstrated its effectiveness. For example, to work with its projects ORDEZA has recruited and continues to attract well above average caliber personnel, who bring professional expertise and dedication to the tasks of implementing these projects. As a result of the ORDEZA efforts to date, both of these projects have proven effective in the earthquake area and have the potential to help satisfy the large demand for the benefits they bring to the target groups.

As the Background Sections on these loans indicated, remaining loan funds from those projects will be fully committed not later than December 1974. Demand for CRECE Fund (053) Credits has been exceptionally high; the loan paper for 053 estimated a 30 month disbursement period while in fact, since the beginning of Fund operations in July 1973 until the total funds are expected to be disbursed in December 1974 or earlier, no more than 18 months will have elapsed. Original demand for much of the 053-type activities and some of the 052-type was created by the devastation of the 1970 earthquake. While there yet remains some "reconstruction" demand in the zone, it appears from sub-loan applications received as well as from discussions with ORDEZA and other GOP officials in the zone that the bulk of current demand is for development of new enterprises and expansion of existing enterprises, rather than for the reconstruction of destroyed enterprises.

There is substantial demonstrated demand for credit to finance Rural Community Development project activities already induced by ORDEZA's project promotion and development teams. Furthermore, potential demand is believed to be high. This demand is in fact induced demand; it is responsive to the degree of promotion and project development effort directed to stimulating it. Theoretically, a very large amount could be placed through a program of this type, given corresponding administrative support from the implementing agency in terms of personnel and operating costs.

It is the intention of A.I.D. and ORDEZA to continue the projects in essentially, if not identically, the manner that they are implemented under 052 and 053 as described earlier. The target groups, terms and conditions of sub-loans, sub-project activities will not be changed substantially. Those elements which it is planned to change are for example, the eligibility of urban housing construction activities under the Rural Community Development project (to be deleted), the interest rates for Rural Community Development projects (probably raised two percentage points or more above the present very concessionary levels), the present technical assistance and administrative component of the CRECE Fund teams (augmented and strengthened above present levels), and the accounting and reporting procedures used by the 052-Banking institution and the CRECE Fund and Participating Financial Intermediaries (revised to reflect accrual accounting methodology and provide more sub-project data).

It is USAID's judgement that the most productive uses of the original 052 project were those which focused on the development of community industry, agriculture, and infrastructure in the

depressed rural areas of the sierra region. While the need for housing in those areas is undeniable, the more urgent developmental need is for activities which attack the economic backwardness and stagnation of those areas. It is precisely on that point that observers of ORDEZA's activities under loan 052 agree that progress is now being made where little was observed earlier.

Agreements reached between ORDEZA and A.I.D. on the above points will become a part of the Program Organization and Operations Plan required to be submitted as a condition precedent for the disbursement of loan funds.

ORDEZA will implement the Rural Community Development portion of the project through its Rural Development Division. That Division will use existing administrative and executive personnel and micro-regional planning teams to analyze the development and reconstruction needs of small rural communities within defined micro-regions of the earthquake zone. From these analyses, the Division will develop feasible community projects in industry, agriculture, and community infrastructure with the participation of existing or newly organized community cooperatives and other groups. The Rural Development Division of ORDEZA will provide or arrange for the credit, technical assistance, and training requirements of the community projects.

ORDEZA will also continue to administer the CRECE Fund project which makes credits and technical assistance available to small businesses in the earthquake area with the objective of developing local industry and commerce, stimulating the production of goods and services in the area, and generating employment opportunities.

Since the demand for the type of credits has been demonstrated to be quite large, especially in the Coast area, special care will be exercised to insure that these funds are allocated in such a manner as to provide maximum employment benefits, generate maximum value-added, and reach the lower levels in the target group. The economy of the Coast is much more affected by outside variables which have lately been relatively favorable (world price of food commodities, fishing conditions, etc.) than is that of the Sierra. ORDEZA will accordingly be requested to justify - if they wish to program a significant portion of loan funds to the Coast - the reasons for this allocation, and to demonstrate how these funds will reach the lower levels of the target group.

For both activities, the "Criteria for Measuring Project Success" as outlined in the discussion on Evaluation in Section VI-B, Implementation Plan, will apply.

SECTION III - ECONOMIC ANALYSIS

A. Overview of Economy - Structure of the Peruvian Economy

The Peruvian economy can be characterized as follows: diversified structure of production; high external dependence; high but diminishing concentration of ownership of economic resources and power; severe inequality in the distribution of income; high concentration of economic activity on the coast and especially in the Lima/Callao metropolitan areas; high underemployment; large percentage of population dependent on agricultural sector; low productivity in the agricultural sector; low investment ratio; heavy migration to the coast and to urban areas; large external debt and debt service ratio; and huge but largely unexploited natural resource wealth. In order to resolve the country's economic and social problems, the Government has initiated a series of major sectorial reforms which will radically alter existing economic and social structures, and has implemented a series of economic policies designed to stimulate economic growth and to provide increased economic opportunities to all Peruvians.

The Peruvian economy produced approximately \$8.4 billion of goods and services at current prices during 1973, for a per capita income of \$560. The corresponding figures for 1972 were \$7.2 billion and \$501 respectively.

The structure of the Peruvian economy is highly diversified with respect to the sectorial composition of real GDP. As shown in Table III-1., the manufacturing sector is the major single contributor to GNP, accounting for nearly 22% of the country's production of goods and services, followed by the agricultural sector which contributes 14%. The latter sector, while generating a relatively small proportion of GDP, provides nearly 45% of the employment in the country. The commercial and services activities included in the "other" sector and listed in Table III-1. are of increasing importance to the economy and account for an estimated 15% of the GDP. The mining sector, which annually earns nearly 50% of the country's foreign exchange proceeds from exports contributes a moderate 7.5% to the national product.

Expenditures on GNP during 1972 were distributed as indicated in Table III-2. Exports accounted for 18.6% of the total demand for goods and services, and were slightly greater than expenditures on imports. Total consumption expenditures, private plus government, were approximately 85% of GNP, with total investment at about 15%. Adverse reaction by investors to the structural reforms of the Government has drastically reduced domestic and foreign private investment in the last few years.

Looked at from the point of view of payments to the factors of production, National Income is distributed as shown in Table III-3. The sole proprietorship and partnership, etc., income figure of 73.5 billion soles includes the incomes of professionals plus the profits of sole proprietorships and partnerships (including income kind) the "home consumption" in the agricultural sector and the return to "family" labor for each of the various types of enterprise mentioned above. This item plus the wages and salaries paid is referred to in Peruvian national accounting terms as the "return to the worker" and constituted 80.5% of National Income in 1972. Corporate profits have accounted for a relatively small percentage of National Income during the past five years (1968-1973), averaging about 2% of factor income during this period.

Concentrations of resource ownership and wealth in the past have resulted in severe inequality in the distribution of income. Incomes in the modern sector on the average are estimated to be more than ten times the average incomes in the traditional rural sector.^{1/} Basic education, health services, etc., have been out of the reach of a large part of the population on the lower end of the income scale, especially those persons living in the sierra and the jungle. The major objective of many of the Government's structural reforms is to redistribute ownership of economic resources and thereby the future distribution of income.

Income, wealth, and economic opportunity are concentrated heavily on the coast. Most of the country's modern industry is located in coastal cities and agricultural productivity is much higher on irrigated farms along the coast than on sierra or jungle farms. The coastal cities are also major centers of commercial and service activities and Lima is the center of government. The economy of the sierra is basically agricultural with high labor/land ratios reducing the marginal productivity of labor to nearly zero. Productivity is affected also by the absence of proper price incentives and by the lack of an effective technology for maximizing output given the inputs available to the sector.

Most of the sierra is isolated from the major markets along the coast by the lack of access roads due to the severe topography of the Andes. For this reason, industrial activity is generally limited to small scale production for the local market at relatively high cost.

^{1/} Richard Webb Government Policy and the Distribution of Income in Peru, 1963-1973, unpublished doctoral dissertation, Harvard University, 1974.

This and the high cost of transport severely reduce the competitiveness in coastal markets of products produced in the sierra and the jungle, most of the young, able-bodied members of the population migrate to the urban coastal areas where they add to the massive "barriadas" surrounding the cities, thus placing heavy social infrastructure burdens on municipal governments. The necessity of providing urban infrastructure for those areas further deprives the provinces of investment resources, thus completing the vicious circle.

The Peruvian jungle is thought to hold the greatest potential for the future development of the country. Still largely untouched, it contains large areas suitable for agriculture and is thought to hold vast natural resource wealth, including oil. Exploration for oil in the jungle has begun in earnest, and the GOP is planning to develop its agricultural potential through colonization and other programs. Geographic isolation appears to be its major obstacle to development.

Recent Economic Performance

The rate of growth of real Gross National Product of the Peruvian economy has averaged about 5.5% over the last five years. Due to the impact of the reforms imposed by the present Government, especially the Agrarian and Industrial reforms, the relative growth of the various sectors of the economy has altered significantly from that of the past. Agricultural sector growth has slowed somewhat, especially the production of basic foodstuffs of internal consumption. Production of the manufacturing sector is also growing more slowly than in the past. Over the past couple of years, private investment has been limited to reinvestment of earnings as a result of the industrial community and social property reforms which have shaken the confidence of the private business sector. Recent growth in industrial production has resulted from fuller use of existing capacity and increased labor productivity rather than from additional capital investments.

The construction (housing and public construction), commercial, and government (especially public investment) sectors have been growing most rapidly in recent years, as the result of a consumer spending boom plus a government policy of economic expansion. Real growth of the mining sector has been very modest due to productive capacity limitations and the reluctance of foreign investors to invest.

Although the overall growth rate of the economy has been moderately good, budgetary and balance of payments difficulties have plagued Peruvian economic policy makers for the past several years. These difficulties have become much more severe in recent months due to increases in inflationary pressure internally and much higher prices for some of the country's most essential imports.

An inelastic tax revenue structure combines with sharply increased government spending on development programs has resulted in large and rapidly growing budgetary deficits over the past four years. Tax changes introduced at the beginning of 1973 increased revenue by simplifying the administration of the system and reducing tax evasion; however these changes did little to increase the income elasticity of the tax structure. On the other hand, government spending is expected to increase much more rapidly in coming months since many development projects are just entering the execution stage and the international prices of some heavily subsidized imports (petroleum and wheat) have increased substantially.

In the past, budgetary deficits have been covered largely through external borrowing (primarily debt refinancing) and the internal sale of treasury bonds largely to the banking system. Future deficits will probably be financed in the same manner even though greater competition for private savings is expected as industrial sector investment recovers.

Inflation has become a more serious problem over the past few years also as a result of growing shortages of basic consumer goods, especially food items, sharply higher prices for essential imports, and continuing deficit spending by the Government. The rate of price increase reached 14.6% in calendar year 1973, compared with 7.2% the previous year, 6.8% in 1971 and 5.1% in 1970. Prices are expected to increase by around 18 to 20% in 1974 for many of the same reasons listed above. In addition, there are indications that consumer spending is beginning to respond to inflation as the relative utility of holding idle balances declines.

Balance of Payments

Following an overall surplus of \$13 million in 1973, Peru's balance of payments has undergone wide fluctuations during 1974. At the end of March there was an overall deficit of \$169 million; in late May, the Ministry of Economy and Finance reports a surplus of \$14 million. These fluctuations are thought to be the result of sharply higher imports and debts repayments early in the first quarter followed by large exports of fishmeal and delayed drawdowns of debt refinancing loans during the following two months.

It is estimated that the final 1974 balance of payments will show a deficit of approximately \$120 million (in spite of expected very large inflows on long term capital account). This estimate is subject to substantial uncertainties regarding further fluctuations in commodity prices of both major exports (copper, fishmeal) and principal imports (petroleum, wheat). Should the former show considerable gains in relation to the latter, final figures could show a surplus in the magnitude now estimated to be the deficit; if, on the other hand, export prices should deteriorate with regard to the

prices of Peru's principal imports, the estimated deficit could be increased.

The country's balance of payments problems should be alleviated by 1976, when new copper deposits currently in the exploitation stage (Cujones, Cerro Verde) come into production, and definitely reversed by 1978 when the trans-Andean oil pipeline begins to carry crude to the Pacific coast for export to foreign markets.

The Ministry of Economy and Finance reports that Peru's total foreign debt (disbursed) is currently \$1,490 million. The Government has concluded three major debt rescheduling agreements since 1971, and has reportedly negotiated another agreement for this year. Based on the GOP's expectations under this agreement, the Ministry has released the following calculation of projected debt service to exports ratio (Figures in millions of US dollars):

<u>Year</u>	<u>Debt Service</u> ^{1/}	<u>Exports</u>	<u>Debt/Service Ratio</u>
1972	143.9	945.7	15.2%
1973	194.1	1,119.0	17.3%
1974	322.9	1,600.0	20.2%
1975	340.5	1,792.0	19.0%
1976	318.6	1,950.0	16.3%

^{1/} Net of prepayments and refinancing

Source: Ministry of Economy and Finance, May 1974.

TABLE III-1.

GROSS DOMESTIC PRODUCT BY SECTORS
(Millions of 1970 Prices)

	1968	Percent of Total	1973	Percent of Total	Percent Increase	Compound Rate of Growth 1968-73
Agriculture	34,249	16.0	40,408	14.4	2.4	3.4
Fishing	4,991	2.3	2,105	0.7	- 23.4	- 58.0
Mining	19,369	9.0	21,057	7.5	3.3	1.7
Manufacture	43,006	20.1	60,202	21.6	7.5	7.0
Construction	10,033	4.7	19,425	6.9	12.0	14.1
Energy	2,542	1.2	3,648	1.3	5.1	6.7
Housing	10,238	4.8	12,419	4.4	4.5	4.0
Government	17,416	8.1	22,631	8.1	6.0	5.4
Others	72,480	33.8	98,088	35.1	6.6	6.2
<u>G.D.P.</u>	<u>214,424</u>	<u>100.0</u>	<u>279,983</u>	<u>100.0</u>	<u>5.8</u>	<u>5.5</u>

TABLE III-3.

NATIONAL INCOME AT FACTOR COST-1972
(Constant 1973 Prices)

	<u>Billions of Dollars</u>	<u>Percentage</u>
Wages and Salaries	123.2	50.4
Rent	30.8	12.6
Interest	11.8	4.8
Profits of Sole Proprietorships, Partner- ships, Professional and Farm Income, etc.	73.5	30.1
Corporate Profits	5.1	2.1
National Income	<u>244.4</u>	<u>100.0</u>

TABLE III-2

ESTIMATED EXPENDITURES ON REAL

GROSS NATIONAL PRODUCT 1972
(Constant 1978 Prices)

	<u>Billions of Dollars</u>	<u>Percentage</u>
Private Consumption	130.6	72.0
Private Investment	18.5	7.0
Government Consumption	34.6	13.0
Government Investment	12.5	4.0
Net Foreign Investment (Exports-Imports)	8.5	3.2
	<hr/>	<hr/>
GNP	264.7	100.0

B. GOP Economic Restructuring Programs^{1/}

Shortly after coming to power in 1968, the current Military Government established a Long Term National Development Strategy which contained the following three broad permanent national development goals:

1. Formation of a more just society.
2. Accelerated and self-sustained development.
3. Strengthened national sovereignty.

To accomplish these goals, the GOP has embarked upon a vigorous program of economic and social structural change which will greatly reform the economic and social bases of the country. This program is being implemented through a series of reform laws which are described below.

Agrarian Reform

The agrarian reform program seeks a radical change in the land tenure pattern of Peru and the full incorporation of some eight million landless peasants into the economic and social life of the country.

To cope with problems arising from the great diversity of Peruvian agriculture (coast, sierra and jungle) as well as the complexities of implementing the new law, the GOP created the Center for Investigation and Training of Agrarian Reform (CENCIRA). Its most salient accomplishment was the creation of the Agricultural Societies of Social Interest (SAIS), a quasi-cooperative model designed to operate large livestock estates which had been expropriated in the highlands. In addition, agricultural cooperatives are being promoted.

An evaluation made in July 1972 of both agricultural production cooperatives and SAIS disclosed the existence of several disturbing problems. It seemed that these units were becoming isolated enclaves enjoying a quasi-capitalistic environment while areas immediately adjacent were economically and socially stagnant. The evaluation also pointed out the need for decentralization of authority from Lima in order to accelerate the reform so as to achieve the goals of the National Development Plan. It also identified the need for applying an integrated approach which would achieve not only a more equitable distribution of income but also the active involvement of the "campesino" in the decision making process.

^{1/} See Annex K for complete description. The above section and Annex K are descriptions of the GOP's Restructuring Programs, and are not presented as a Country Team endorsement of all aspects of those programs.

The strategy being tested and planned for future application contemplates the establishment of Integrated Rural Settlement Projects (PIAR) in each of Peru's 12 Agricultural Zones. Plans for 1973-1974 call for establishment of 26 PIARS, 213 enterprises, covering 990,969 hectares to benefit 52,760 families, and the generation of 307,800 new jobs by 1975.

Measured against the medium term Agrarian Reform expropriation objectives laid out in the National Development Plan (1971-75) of affecting 9,000 estates and expropriating 10 million hectares; progress attained as of 30 April, 1974 was as follows:

6,044 estates have been affected

5,804,409 hectares have been expropriated. Of these actual transfers of land have been carried out on 4,475,996 hectares benefiting 187,228 families.

While the Agrarian Reform program poses primarily a political problem, the impact on production and the enormity of resources required to maintain the pace set forth under the National Development Plans add substantial complexity to its implementation. The GOP is aware of the potential problems, but is nevertheless confident that the change from private to collective tenure of lands will result in a substantial increase in production in the long run. It realizes, however, that turning expropriated farms immediately to collective exploitation may raise havoc with production. To avert such a development it has retained the farm management structure intact until new managers are trained to take over, and has appointed professional managers to administer large holdings.

Industrial Reform

The GOP is effecting a radical transformation of the country's industrial sector which, when completed, will have left few remnants of the previous structure. The new structure will emphasize state and cooperative forms of ownership and control, with the purely private sector encompassing only the very small business and commercial establishments.

To this end, mechanisms have been established: to involve the State much more in the activities of the industrial sectors, to distribute ownership and income more widely amongst the workers, to channel resources to those industries considered as priority (essential) industries, and to lessen dependence on foreign sources.

The new structure of the industrial sector will consist of the following sub-sectors:

1. Those industries reserved for the State, including all of the "basic" industries such as steel, cement, paper, etc.
2. The reformed private sector, which involves a 50-50 mix of private (corporation or individual)/worker ownership and management. Each year the firm will grant 15% of profits in form of ownership and equivalent management to the workers until the 50% target is reached.
3. The social property sector, involving social ownership and management, with the government providing the majority of the financing and the management being predominantly the function of the members of the enterprise.
4. The purely private sector, encompassing small scale industry and commerce.

In addition to these structural changes, the GOP has established a system of industrial priority which it uses in allocating resources, especially investment resources and resources devoted to importation. All industries and firms are assigned one of four priorities (1st, 2nd, 3rd, and 4th) and receive the benefits, obligations, etc., of that priority.

As a result of this system, the GOP is able to encourage those industries it considers essential to the national interest and to discourage those it considers as non-essential (luxury) industries. This fits well with the GOP's goals of utilizing the national resources to produce those goods and services most needed by the majority of Peruvians and to eliminate vestiges of rank and privilege.

The role of the foreign firm seems to be very limited in the future in Peru, not only because of Peruvian legislation, but because of the Andean Foreign Investment Code to which Peruvian legislation already largely conforms. The GOP has repeatedly said that it welcomes foreign investment, however only if it contributes to Peruvian development priorities and goals and if it is willing to abide by the conditions prescribed for it. It should be noted that little new foreign direct investment has entered Peru in the last few years, except for some large new investments by some of the existing mining and smelting companies (Southern Peru Copper Corp. and Marcona especially), and some investment in oil exploration in the Peruvian jungle.

One can say then that the industrial reform is progressing towards the goals of the revolution. Barring any abrupt, unforeseen changes in implementing the reform, the State will play an increasingly large direct and indirect role in the industrial sector in the future, resources will be allocated within the sector in accordance with the needs of the majority of Peruvian people (as determined by the GOP), and external dependence will be reduced.

Education Reform

The education reform began in 1969 with initial focus being on the restructuring of the university system. This was followed in early 1970 with the appointment of a National Commission consisting of some 120 leaders in education and other fields to prepare a basic design for overall education reform. The draft of the Reform Law was completed in early 1971, distributed for public discussion and suggestions, then reconsidered by the GOP and finally promulgated on 21 March 1972.

Basically the Reform is a strategy for the transformation of the very fundamentals of Peruvian education, which is to be an integral part of a profound transformation of traditional structures and is aimed at eliminating the inequalities in Peruvian society.

It has its foundation in three major goals: education for development and employment, education for the structural transformation of the society, and education for the self-affirmation and independence of the Peruvian nation.

To achieve these goals, the structure of the system is to change from a highly centralized one to a community controlled "nucleo" structure coordinating all of the learning resources in each community and serving the needs of all individuals throughout their lifetimes. These learning resources are organized according to three different levels: initial, or overall child development; basic education; and higher education.

The curriculum is to become more vocationally oriented throughout the system, more relevant to Peru's socio-economic development, and more relevant to all people, ages and regions. Science and technology will be stressed, and the role of women will be revalued. Indigenous languages and cultures are to be preserved and the private schools' curricula more Peruvianized. Self-education is to be emphasized, and public service is to be made an integral part of the curriculum at the higher level.

The teacher is to become a "teacher educator", a manager of the learning resources in the community and a catalytic agent in awakening abilities of children, adolescents, and adults and stimulating in them a permanent process of self-development. Teacher training then is to be reformed and all existing teachers retrained.

The major concern critical to successful implementation of the Reform is the lack of adequate human and financial resources to carry it out in the time frame established which may lead to its distortion.

Mining Reform

Peru's mining reform when fully implemented will result in substantial State ownership and full State control over the utilization of the country's mineral resources. Also, the commercialization of all mineral products will be accomplished by a State Trading Board.

The cardinal purposes of this reform are to regain for the country disposition over its mineral resources and to make more efficacious use of these resources in meeting the most urgent needs of the Peruvian people. Some of the more general goals of the "revolution" are expected to be served by the reform also, e.g., lessened external dependence, redistribution of income.

To effect its reform, the GOP caused all unexploited concessions to revert to the State (with the important exception of Southern Peru Copper Corporation's Cuajone concession which was declared to be outside the reform), declared all mineral resources to be the property of the State, and reserved to itself the right and responsibility of marketing all mineral products. The "community" concept has been extended to the mining sector and each mining company is required to have its community. The general purposes and goals underlying this concept are the same as in the industrial communities, however the details vary somewhat.

Telecommunications Reform

The telecommunications reform is one of the most important of Peru's social and economic reforms. The principal idea underlying the reform is to preserve and to nourish Peruvian culture, or stated oppositely, to prevent the alienation of the Peruvian people, especially the youth.

In carrying out this reform the government has taken ownership, and thus control, of the country's television stations, and has begun the progressive (over time) Peruvianization of TV and radio programming. It is unclear at this time how far the GOP intends to extend its influence over the dissemination of information, etc.; within the country, however, there is no doubt of the potential seriousness of this reform.

SINAMOS (National System of Support to Social Mobilization)

SINAMOS, established in June 1971 but not active until its organic law was promulgated in April 1972, was created to stimulate support for the reforms of the Military Government by building a network of grass-roots organizations to institutionalize the reforms sought by the revolution and to bring about social democracy with full participation. It operates on two major fronts: (a) the political, wherein it fosters the involvement of marginal groups in planning and implementing national programs; and (b) the economic, wherein it creates mechanisms and institutions to provide a means through which low income groups can exercise ownership and control of available resources.

SINAMOS is trying to decentralize actions to its 13 regional offices as a means of giving power to the people and of stimulating their support. Its main thrust for the time being lies in continuing community infrastructure projects for which it inherited both funds and staffing from the National Office of Community Development.

C. GENERAL BACKGROUND: Peruvian Sierra

In Peru in general wide social and economic disparities occur in two distinct areas: the coast vs. the rest of the country (sierra and jungle), and urban vs. rural areas. Ranking the distinct areas of the country in term of their relative development reveals the following pattern:

Most Developed: Urban Coast
Followed by: Urban Sierra (eg. Arequipa)
Urban Jungle (eg. Iquitos)
Rural Coast
Rural Jungle
Rural Sierra

A composite of selected socio-economic indicators reinforces that wide discrepancies occur between predominantly coastal departments and other-than-coastal regions. (See Table III-4). Of the ten sierra Departments listed, only two are not among the last ten in terms of relative development - the Departments of Junin and Pasco. This is due primarily to the existence of large scale mining ventures in these areas; discounting these mining activities, which benefit only a small percentage of the total departments' population, the relative development scale would be altered in a downward fashion for Pasco and Junin, and the total sierra area could collectively be termed the bottom sector of the country.

If the distinction between 'coast' and 'non-coast' is great, the disparities between 'urban' and 'rural' are even greater in Peru. While accurate statistics showing the breakdown between urban and rural income, shares in productivity, and standard of living are not available, it would be fair to estimate the wages are four to five times higher in urban areas, and that some 80% of the productive wealth of Peru is located in urban areas or modern capital intensive mining enclaves.

The sierra region is characterized by traditional agriculture, comprising small land holdings, high man-to-land ratios, intensive use of labor, and low productivity. There are few economic alternatives to agriculture in most parts of the Peruvian Sierra, which has resulted in a high level of migration to urban areas; it is estimated that Lima may be growing at a rate of close to 10% a year and that Arequipa at a rate near 7%. In these areas, as well as other smaller urban centers, the bulk of migrants become part of the unemployed masses crowding urban "pueblos jovenes" (young towns or marginal urban areas).

This migration has contributed to reducing the economic strain on rural agricultural land, but the price has been the concomitant growth

TABLE III-4
SOCIO-ECONOMIC INDICATORS IN PERU^{1/}

(3)	Per Capita Income (Soles) (1961)	% Eco. Active Pop. in Agric.	% Population over 17 yrs illiterate	% Population not Speaking Spanish	% Total Dwelling units with- out elec .	Rural Pop.as % of Total Population	Rank Ordering 1=Most Develo 24=Least Dev.
PREDOMINANTLY (S/43.38 = \$1) COAST DEPTS.							
Callao	9,869	9	23	.2	36.7	4.1	1
Lima	9,869	15	27	1	36.7	14.7	2
Ica	6,258	50	33	1	65.3	52.7	5
Arequipa	5,697	35	39	8	56.2	51.2	4
Tacna	9,543	39	44	5	60.4	44.4	3
Moquegua	9,205	58	51	12	77.0	65.6	9
Tumbes	4,861	42	32	0	75.9	45.0	6
Lambayeque	4,532	49	49	2	69.8	43.6	7
La Libertad	4,196	57	52	0	79.4	64.5	11
Piura	4,259	56	62	0	84.7	59.9	13
PREDOMINANTLY JUNGLE DEPTS.							
Madre de Dios	4,308	52	32	4	78.4	76.4	8
San Martin	2,364	76	44	5	94.9	67.4	15
Amazonas	3,008	74	49	7	95.7	92.1	17
Loreto	2,966	58	45	5	85.5	67.6	14
PREDOMINANTLY SIERRA DEPTS.							
Junin	4,547	53	50	11	76.5	67.7	12
Ancash	3,808	64	65	36	89.0	81.3	16
Pasco	5,491	48	53	14	63.3	79.7	10
Cajamarca	2,873	78	61	.3	95.5	92.8	18
Huánuco	2,589	76	64	32	92.7	92.1	20
Cuzco	3,721	61	79	60	87.1	79.4	19
Puno	3,223	71	71	61	95.7	88.2	21
Ayacucho	2,566	77	79	66	96.7	89.2	22
Huancavelica	2,848	78	75	62	96.4	95.4	23
Apurimac	2,675	77	84	71	94.3	93.4	24

1. Statistics taken from 1961 Census data compiled and analyzed by D.S. Palmer in "Revolution from Above": Military Government and Popular Participation in Peru, 1968-1972, Cornell University Latin American Studies Department Series #47, January 1973
2. Rank ordering is based on a correlation of eleven variables, six of which are included here.
3. The classification as to Coast, Jungle and Sierra refers to the general characteristics of the economy, not actual land extension; thus department such as Arequipa and Moquegua are considered coastal despite a predominantly sierra geography.

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of urban unemployment and underemployment.

The concern of this loan is to provide a credit infrastructure in certain selected sierra areas, which will (a) provide employment alternatives to subsistence agriculture in rural areas, (b) create jobs in sierra areas where migration has caused employment problems, i.e. in intermediate towns and small cities.

ECONOMIC BACKGROUND: Description of Target Areas

The Departments of Cuzco and Puno are located in the southeastern section of Peru, a region topographically composed of sierra, altiplano (high plateau), and jungle. The Departments of Ayacucho and Junin are located in the Central Sierra. Two of these Departments will be selected as the priority target areas for the following reasons:

- (1) Using traditional social and economic indicators (per capita income, literacy rates, employment by economic sector, etc.)^{1/} these departments are among the most depressed areas of Peru.
- (2) Despite the economic and social marginality of the region, there generally exists adequate physical and institutional infrastructure to assure successful implementation of the project.
- (3) The existing supply of credit in the region is insufficient to assure maximum development potential as determined by the GOP.

PUNO

A. Population and Geography: According to the National Direction of Statistics and Census of Peru (DNEC) the 1972 population of the Department of Puno was 779,594 inhabitants, the vast majority of whom (76%) live in rural or semi-rural areas of less than 2,500 persons. There is one significant urban area, composed of the cities of Puno, the capital of the Department (population: 41,000) and Juliaca (population: 38,000). These cities are located some 30 km. apart and are joined by a paved highway. The Puno-Juliaca area serves as the administrative, financial, and commercial center of the Department, and all major GOP offices are located in the city of Puno.

^{1/} D.S. Palmer, " Revolution from Above: Military Government and Popular Participation in Peru, 1968-1972, Ph D Thesis, Cornell University, Latin American Program series #47, January, 1973. Using eleven different variables to arrive at a composite marginality index for each of Peru's 24 Departments, the most marginal of the target areas was Ayacucho which ranked third, Puno ranked fourth, Cuzco sixth and Junin thirteenth.

There are several other minor urban areas, located in provinces, but most inhabitants live in dispersed rural communities.

The bulk of the population is located in the high plateau region of the Department, where the elevation above sea level ranges between 10,500 and 13,000 feet. The northernmost part of the Department drops off into the jungle, which is relatively less populated, but which the GOP feels is a prime area for colonization and future economic activity.

B. Economic Activity: The economic activity of the Department is overwhelmingly agricultural. The 1961 Peruvian census gives the following occupational breakdown of the economically active population:^{2/}

<u>Economic Activity</u>	<u>Persons Employed</u>	<u>% of Total</u>
Agriculture (farming and livestock)	162,231	71.5
Mining	4,188	1.8
Mfg. Industry	20,082	8.8
Construction	4,479	2.0
Utilities	164	0.1
Commerce	13,779	6.1
Transport	2,534	1.1
Services	15,291	6.7
Other	<u>4,368</u>	<u>1.9</u>
TOTAL	227,116	100.0

Source: República del Perú, Dirección Nacional de Estadística y Censos, VI Censo Nacional de Población, Tomo IV, Características Económicas.

For the most part the agricultural sector is characterized by subsistence farming; local GOP authorities in the Puno region estimate that the average individual land parcels are slightly over one hectare in arable extension.

Since the land cannot support increases in population and there are few alternate rural employment opportunities there is a constant migration to the urban sectors of both the Department of Puno and neighboring departments. Because of this migration to other areas the internal population growth rate of the Department of Puno is one of the lowest in Peru.

^{2/} Note: The 1972 Census figures are not yet available.

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^{2/} Note: The 1972 Census figures are not yet available.

The modern agricultural sector, both large scale production of crops and breeding of livestock, is for the most part being altered by the GOP Agrarian Reform programs, which is reorganizing production into community cooperatives of SAIS (Social Interest Agrarian Societies). A major problem involved in this process is that the total number of agricultural workers must be reduced in order to increase labor productivity -- and as yet there are few alternate employment opportunities for those who must leave the land.

The manufacturing-industrial sector has its base in traditional home-oriented artisan activities. The 1961 Census estimated that fully half of the persons employed in this sector are weavers, potters, leather workers, etc., the majority of whom produce goods for the tourism industry. There is little processing of raw materials or agricultural products produced in the zone, the bulk of which is exported in crude state to other sections of the country for intermediate and final processing.

The tourism industry is growing in the Puno area, famed for its proximity to Lake Titicaca and the monolithic Tiahuanaco ruins bordering the lake. Puno is also an important intermediate point for travel between Peru and Bolivia. COPESCO, the Peruvian Commission for study and evaluation of the tourism industry, shows growth in the total number of tourists arriving in the Puno area, which has grown from 7,754 in 1965 to 23,595 in 1971 ^{3/} The GOP is currently giving top priority to the development of an adequate infrastructure (hotels, services, and other tourist facilities) to assure steady growth in tourism in Puno.

GOP authorities, however, recognize that present productive patterns in the Department are inadequate to take full economic advantage of projected increases in tourism in Puno. That is while the macroeconomic advantages which will accrue to Peru as a whole may be great, the microeconomic advantages accruing to Puno per se are likely to be fairly minimal. This is due to the almost complete lack of industries in the area that can serve as backward linkages into the tourism industry -- i.e. hotel furniture and equipment, processed food, and other like industries. Most inputs into the tourist trade will then have to be 'imported' from Lima, Arequipa or other industrial centers. There is, as well, a fairly low value-added component in the artisan industry in the Puno area. Since there is little local capacity for intermediate processing of raw materials used in the production of artisan goods,

^{3/} COPESCO-UNESCO, La actividad turística y el desarrollo económico y social del Perú : un estudio de diagnóstico, undated, p. 143.

the local economy effectively loses that portion of the value-added in the artisan industry which must be processed outside of the region. The processing of sheep and alpaca wool is a case in point: given lack of local processing capacity, wool is sold in crude form to the processors in other areas, and then purchased back by Puno artisans for final weaving, knitting, etc. The same holds true in the leather industry, since there is no local capacity for treatment of animal skins.

C. Institutional Infrastructure: The zonal office of ORDESUR (Oficina Regional de Desarrollo del Sur, a dependency of the National Planning Institute) is technically the coordinating agency for the development of the Puno region; in practice the Regional offices of the Agrarian Reform and SINAMOS (National System of Social Mobilization) are taking the bulk of the initiative in both the organization and implementation of development plans. The SINAMOS office, for example, has initiated a series of feasibility studies in the area which have two economic goals: (1) greater utilization of existing raw materials and livestock production in the area via small-to-medium size agro-industries to supplement traditional agricultural activities within communities and rural cooperatives, and (2) providing communal cooperative-type enterprises which will allow area artisans to vastly increase the value added of their production.

Studies thus far carried out include the financing and construction of community ceramic ovens and related facilities, food processing facilities, and the establishment of wool processing centers which would reduce the costs of artisan materials.

The Ministry of Industry and Tourism (MIT) has an area tourism office which is essentially charged with collecting statistics on the arrival of foreign and national tourists; MIT does not have an office in charge of industry, but plans to establish one during the course of 1974.

Financial institutions in the Department are, for the most part, dependent upon policy decisions made at principal office - Lima in the case of the commercial and state banks, and Cuzco in the case of regional bank, El Banco de los Andes. Savings and credit cooperatives are relatively underdeveloped and only two cooperatives in the entire Department have inscribed capital of over one million soles, ^{4/} Production and service cooperatives are equally small in the Department.

^{4/} Estimates taken from 'Directorio de Cooperativas Reconocidas en el Departamento de Puno al 31 de Octubre de 1973',

CUZCO

A. Population and Geography. The DNEC give the 1972 population of the Department of Cuzco as 712,918 inhabitants, of which 64% are living in rural areas or small urban populations of less than 2,500 inhabitants. There are two major urban poles: the city of Cuzco, capital of the Department, with a population of 67,000 and Quillabamba, capital of the province of La Convención, with a population of 10,850.

Both the geography and the economic geography of the Department are well defined. The sierra region, located to the south, is an area marked by subsistence agriculture and tourism; the montaña area, to the northeast bordering on the departments of Madre de Dios and Loreto, is a region of high agricultural productivity, especially in citrus fruits, tea, coffee, and other semi-tropical crops.

The two geographic zones are connected by highway and railroad ; the road system is judged to be insufficient for the movement of heavy transport and the GOP is currently considering construction of a direct road connecting Cuzco and Quillabamba.

The City of Cuzco also has railroad and road connections with both Arequipa and Cuzco, and roads connect the city with the coast.

B. Economic Activity . The 1961 Peruvian Census gives the following breakdown of the economically active population:

<u>Economic Activity</u>	<u>Persons Employed</u>	<u>% of Total</u>
Agriculture	126,237	61.4
Mining	1,554	0.8
Mfg. Industry	24,568	12.0
Construction	4,468	2.2
Utilities	294	0.1
Commerce	17,435	8.5
Transportation	2,779	1.4
Services	22,633	11.0
Other	<u>5,481</u>	<u>2.6</u>
TOTAL	205,569	100.0

As in the Department of Puno, the major activity - - agriculture - - can be divided into two areas: small subsistence farming in the sierra and the more highly productive livestock and export crops in the montaña area. Diminishing returns on the land in the former area have caused the Agrarian Reform to propose that large numbers of agricultural workers leave the land in the sierra, and the idea is to open up new areas for agricultural production in the montaña region. The montaña area is considered to be one of the most promising agricultural areas of Peru, and the GOP has initiated plans to (1) increase the area

under cultivation; (2) colonize the lower areas; and (3) increase the value-added in agricultural production by fomenting agro-industries for the intermediate and final processing of crops. It is expected that the bulk of new industries created will pertain to either the new Social Property sector or rural cooperatives.

The tourist industry is fast becoming Cuzco's most important sector. COPESCO notes that the number of visitors to the Cuzco region has grown from 42,211 in 1965 to 55,482 in 1971; tourist industry spokesmen in Lima claim that the rate of growth in tourism would be much greater if adequate infrastructure were provided (flights, first class hotels, and services). The GOP is currently planning to expand the State Hotel system with two new facilities in Cuzco, and there are additional plans for the construction of a modern hotel at Macchu Picchu. (Section III-K discusses the Inter-American Development Bank Loan for the development of the tourist industry).

Artisan activities are also important within the manufacturing industrial sector, and over 500 artisans are registered with SINAMOS in the Cuzco region. The majority of these work alone, but SINAMOS is working closely with them to form credit and production cooperatives.

Plans for the development of the region call for (1) increased attention to agro-industry in the La Convención area, including canning and processing plants for citrus fruits and other tropical crops and possible dehydration facilities for other crops; (2) promotion of a more highly organized artisan activity, to supply the tourist trade to the area and meet foreign demand for Cuzqueño artifacts.

C. Institutional Infrastructure: GOP offices are located in the city of Cuzco, and most major commercial and state banks have offices in both Cuzco and Quillabamba. The Ministry of Industry and Tourism maintains a small office in Cuzco, and is under pressure from SINAMOS to expand in order to lend technical assistance to small industries. The most dynamic bank is the Banco de los Andes, the regional bank serving the Cuzco-Puno area, which is working closely with artisans in the area. SINAMOS and the office of the Agrarian Reform, again as in the case of Puno, are the most active organizations in pursuing development plans.

JUNIN

1. Geography and Population

The Department of Junin is located in the Central Sierra region of Peru. The 1972 population was 691,130, with 40% living in rural areas. The capital of the Department is Huancayo, with a population of 176,200, which serves as the commercial and industrial center of the entire central region of the country.

2. Economic Activity

The following table give a breakdown of economic activity within the Department as of 1962:

<u>Economic Activity</u>	<u>Persons Employed</u>	<u>% of Total</u>
Agriculture	84,057	52.8
Mining	10,687	6.7
Mfg. Industry	19,843	12.5
Construction	4,313	2.7
Utilities	330	0.2
Commerce	12,309	7.7
Transport	4,779	3.0
Services	17,791	11.2
Other	<u>5,136</u>	<u>3.2</u>
TOTAL	159,245	100.0

The Department of Junin is a good example of the existence of traditional and modern sectors working side by side, with the former accounting for the bulk of the population and the latter accounting for the bulk of productivity and economic benefits. A strong modern economic center has grown up in the Mantaro River valley, some 70 kilometers long and seven-to-eight kilometers wide. Agricultural units within the valley are of sufficient size to permit mechanization, and crop yields per acre are among the highest in Peru. It is estimated that some 20% of department agricultural workers are located in the Mantaro Valley, producing some 80% of agricultural yield. The production pattern outside the valley is, however, more typical of the sierra as a whole - i.e. high man to land ratios, low land yield and generally marginal farming.

The city of Huancayo is another example of the micro modern sector within a depressed macro region. Virtually all industry and the majority of commerce is carried out in Huancayo, and per capita income is several times higher than in other urban and semi-urban areas of the department.

The GOP has indicated the department of Junin as a future economic growth center, specifically in small to medium industrial expansion. The Mantaro River hydroelectric project, currently in the execution phase, will triple the amount of electric power in the central sierra by 1976, and the government hopes to channel this additional energy into three major sectors: (1) mining, thus increasing processing capacity for minerals from small to medium size mining ventures; (2) rural electrification, to improve both the general standard of living and allow for expansion of small industry, and (3) medium sized industry, to be centered in the Huancayo urban area.

In general the infrastructure favoring the growth of small and medium industries in the Department of Junin is much more adequate than in most of the Peruvian sierra. Along with the electrification program mentioned above, the area is physically more accessible to the major supply and market centers on the coast; the city of Huancayo is connected to Lima by the central highway (5-6 hours), and there is daily railroad service via the Central Railway. There is further rail service from Huancayo south to Huancavelica, capital of the department of the same name.

There is an active and diversified artisan industry in the department, which supplies the local tourist industry (centered around the Huancayo Sunday fair), and a growing export market.

3. Institutional Infrastructure: All major government offices have branches in the city of Huancayo.

AYACUCHO

1. Geography and Population

The population of the Department of Ayacucho in 1972 was 459,747, of which 66.6% (306,144) were classified as living in rural areas. There is one significant urban area in the Department, the city of Ayacucho, with a population of 34,600.

The Department is mostly located in the Sierra, sloping off into the jungle on the east. The topography of the area is extremely rugged with high mountain peaks divided by narrow valleys and gorges.

2. Economic Activity

The 1961 census gives the following occupational breakdown, by categories employment:

<u>Economic Activity</u>	<u>Persons Employed</u>	<u>% of Total</u>
Agriculture (farming and livestock)	87,133	76.7
Mining	983	.9
Manufacturing Industry	7,282	6.4
Construction	1,376	1.2
Utilities	56	.1
Commerce	5,454	4.8
Transport	697	.6
Services	7,875	6.9
Other	<u>2,716</u>	<u>2.4</u>
TOTAL:	113,572	100.0

As the data above indicate, the economy of the Department is primarily agricultural, with approximately 75% of the labor force engaged in agricultural activities. The major agricultural products produced in the Department include wheat, potatoes, rice, peanuts, camote and yuca. There is considerable wool production, and some meat and milk and other dairy products produced in the area also, with most of these products consumed practically in their entirety within the area. Small scale subsistence farming predominates, and attempts to cooperativize the existing structure of individual holdings have met with considerable resistance.

Area sources report that total agricultural production in the Department has fallen substantially in the past two years as a result of these attempts and that much of the expropriated land presently lies fallow awaiting the resolution of this problem.

Agricultural productivity is extremely low in the area for several reasons, including a lack of price incentives resulting from the GOP's policy to subsidize consumers through low food prices, lack of water for irrigation, poor soils, and low levels of applied technology. Complementary inputs such as fertilizers, insecticides, etc. are not available at reasonable cost and the cost of transport to markets outside the area is prohibitive in relation to the present low fixed prices. Thus, the local production is used for farm household consumption and for sale in the local market, with very little exported to outside markets. Even then, the local market has been subject to recurring shortages of basic food items in recent months due to the drastic decline in area production.

Due to the lack of adequate income-producing opportunities an estimated 50% of the owners of small farms and of the farm labor force move to the coast and into the larger cities in the sierra seeking work during the off season, then returning to work the farms during the growing season. There are 261 established farm communities organized as such in the Department with a total of around 240,000 members who devote an average of 20 days per year to communal work activities. The economic activities of these communities are limited by a lack of resources with which to work, so they currently function more as political organizations.

Industrial activity within the Department is very limited. Ministry of Industry officials estimate that there are only a few firms (perhaps 20) in the Department which could be classified as medium-size and perhaps three times that number of small size firms. There are several factors which limit the potential for

industrial development in the area, among the most important of which are the relatively small effective market of the area and the high cost of transport to outside markets which restricts firms to small scale, high cost production. In fact, in many cases locally produced manufactured goods cannot compete even in the local market with goods produced in other areas. The resulting large net import of goods represents a significant capital outflow and deprives the area of the much needed multiplier effect which would followed from the sale of locally produced goods.

Probably equally as serious a limiting factor, however, is the lack of sufficient electricity and water in the Department to sustain additional industry. The present demand for electricity exceeds the available supply and local electric company officials say there are no existing short term plans to increase the supply. Eventually, probably in 1978, the regional network will be tied in with the nearby Mantaro hydroelectric complex which will provide it with sufficient electricity to cover foreseeable needs.

The lack of water is also a serious limiting factor especially for the food processing industry which seems to have the evident potential for investments in the area. There are few rivers running through the area and the rainfall is seasonal. Apparently, there is little that can be done to tap new sources of water except at very high cost.

There have been several industrial projects identified by the area development committee, mostly agro-industrial projects, which appear to be feasible. The University of San Cristobal de Huamanga located in the city of Ayacucho has developed several projects also, and while full feasibility studies have not yet been done on any of these projects, they are designed to make maximum use of inputs produced or available in the area and many of them appear to have export potential (to other areas of Peru, at least). Among the projects identified are: manufacture of cheeses; plant producing concentrated milk; production of liquors based on pisco; plant to process fruit juices; wool processing plant; development of the wood industry; production of vegetable oils; large scale wheat mill (permitting economies of scale); processed food plant; pig farms; honey processing plant; dye plant, and the production of wine.

The artisan industry has exhibited strong growth in recent years in the Department and is expected to continue to grow rapidly under incentive programs currently being implemented by the GOP. SINAMOS is organizing individual artisan producers into cooperatives to increase their market power in purchasing inputs and to facilitate

the marketing of their final products. Moreover, the Industrial Bank is providing loans to the artisan industry at concessionary rates and terms and the Ministry of Industry is currently developing programs to promote the sale of artisan products.

Tourism has not been a major source of income to the Department in the past; however there has been steady growth in the number of tourists visiting the area over the years. The city of Ayacucho is billed as a quaint, picturesque colonial village, largely untouched by the economic progress afflicting the rest of the world. It, and most the other villages in the Department contain many very old churches and other building, but little else in the way of tourist attractions. There are some spectacular ruins, still undeveloped, near Ayacucho which are reportedly the equivalent of Macchu Picchu in grandeur, however the cost of their restoration is extremely high. In the absence of additional attractions and facilities, the tourist industry probably will continue its slow growth.

There is a small amount of mining activity in the Department, but it is oriented economically to the Lima/Callao metropolitan area and to the external market, thus it has only a marginal impact in the area. Some of the income generated by this activity remains in the area in the form of wages and salaries; however nearly all of the other inputs are purchased outside the area. Moreover, the profits generated from the sale of the minerals, remain outside the area and little of the tax revenue produced by the mines flows back into the Department.

Growth in the commercial and service activities of the Department is restricted by the general economic stagnation in the area, by the area's limited money economy and by the slow rate of population growth occasioned by the large net out-migration. Much of the commercial demand in Ayacucho is provided by the approximately 6000 students attending the two Universities located in the city, about 50% of whom are from outside the area. Competition from goods produced in other areas, often of both better quality and lower price, provides yet another obstacle to the expansion of local retail outlets. Finally, the lack of credit on reasonable terms effectively prevents the vast majority of commercial and service enterprises from expanding should they see a potentially profitable opportunity to do so.

As is the case in most of the sierra, the absence of sufficient remunerative opportunities in the Department has led to a massive migration to the coast and a concurrent movement from rural to urban centers within the region. ORDECENTRO has estimated that over

30% of the persons born in the Department move to other regions during their lifetime, and although the birth rate exceeds 3.1%, the rate of growth of the area's population, during the last decade was only 2%. Since the persons migrating are generally the younger, more able-bodied of the labor force, there is probably some loss in overall efficiency, since these workers are replaced on the farm, etc., by others with lower marginal productivity. Moreover, the dependency ratio in the region, which is high to begin with due to the high birth rate, is increased even more by the large outmigration.

Because of its remoteness and lack of economic ties with the major economic centers of the country, the Department largely has been by-passed by Government programs providing economic and social infrastructure and other public services. Access by land is very difficult via tortuous mountains road, and air service, while regularly scheduled, is undependable. The area's lack of adequate water and electricity are examples of the neglect in the provision of basic services.

3. Institutional Infrastructure

Most of the Government agencies have offices in the Department, practically all of which are located in Ayacucho. These agencies have formed a Departmental development committee headed by SINAMOS which has begun a development plan for the area. This committee includes representatives from ORDECENTRO (Regional Development Office of the INP covering Central Peru), the Banco Industrial, the Ministry of Agriculture, and the Agricultural Bank, in addition to SINAMOS. A large number of possible projects have been identified by the Committee, however financing for the feasibility studies or for the execution of these projects has not been secured as yet.

EARTHQUAKE ZONE

On May 31, 1960, Peru was struck by what has been termed "the most destructive earthquake in the history of the Western Hemisphere", in which approximately 70,000 people were killed, 150,000 injured and material damage was estimated at over \$500 million. International response to the emergency was immediate, and with this assistance and its own resources the GOP has made heavy investments in reconstruction and development efforts. Four years after the earthquake the zone is beginning to return to normal economic functioning. ORDEZA is working intensively in the zone to complete reconstruction and progressively moving into development activities.

The Department of Ancash was the area most severely affected by the earthquake. Both in the coast and sierra areas, Ancash's economic life was severely disrupted by material damage to industrial facilities and commercial and service establishments. Agriculture was also affected by damage to irrigation, loss of equipment and stocks, and ruptured transport lines.

1. Geography and Population

The 1972 Census gives the population of Ancash as 726,665, of which 53.3% are living in rural areas. There are two major population centers, Huaraz (the capital of the Department) with a population of 29,719, and Chimbote on the coast with a population of 159,045.

The geography of the Department is well defined between coast and sierra. 60% of the coastal population is located in urban areas, mostly in Chimbote which is a major center of the Peruvian fishing industry and site of the Peruvian steel plant. The sierra is predominantly rural, with some 60% of the population scattered on the slopes of the white and black cordillera mountains, and the remaining 40% living in intermediate towns and small cities of which Huaraz is the largest.

2. Economic Activity

The 1961 Census gives the following occupational category breakdown for the Department of Ancash:

<u>Economic Activity</u>	<u>Persons Employed</u>	<u>% of Total</u>
Agriculture	106,538	63.5
Mining	2,681	1.5
Mfg. Industry	21,506	12.8
Construction	4,014	2.4
Utilities	359	0.2
Commerce	8,220	5.0
Transport	2,816	1.7
Services	15,225	9.1
Other	6,429	3.8
TOTAL:	167,788	100.0

It is recognized that the above absolute figures may be somewhat distorted given substantial migration from the area following

the 1970 earthquake and the significant loss of employment; since 1972 Census analysis has not been completed, however, we assume that the percentages are at least indicative of overall employment distribution.

The coast and sierra areas of Ancash have very distinctive economies. The coastal areas are linked more to the economies of the Lima metropolitan area and the cities of Trujillo and Chiclayo in the north than they are to the sierra regions of Ancash. Chimbote alone contains more than 40% of the industry in the Department, and along with smaller coastal urban areas such as Casma probably contains 100% of modern industrial establishments. The sierra is highly agricultural, and what industry exists is of the small variety, rarely employing over 10 or 15 persons. Tourism as yet is not well developed, although the GOP has plan for constructing facilities in the sierra Callejon de Huaylas region. There is a small amount of local tourism and during the months of July and August, Huaraz is a center for foreign mountain climbing expeditions.

3. Institutional Infrastructure

ORDEZA is directly responsible for all reconstruction and development activities in the earthquake affected zone. It is, in effect, the first regional government established in Peru, having an independent budget and supreme authority over all other government entities working in the area. ORDEZA has established close working relations with SINAMOS and rural development activities are coordinated between the two agencies. (See CAP Section II A.2 and IV for a complete description of the ORDEZA organization).

D. Economic Benefits of Project.

The anticipated economic benefits of the project will be felt in three distinct areas: first, the immediate and primary impact will be upon the micro-economic level of the individuals and communities having access to credits provided; second, the employment and income generated at this individual and community level will have a secondary effect upon the target regions selected; third, there will be benefits generated which will be felt on the macro-economic level of the national economy as a whole. The project's real and measureable effects at the level of the community or the individual will be most apparent whereas the effects upon the national economy will be more difficult to identify.

Individual and Community Benefits. Employment and Income : The major economic and social problems of the Peruvian rural sierra may be summarized in the following manner:

1. There are limited employment alternatives to traditional agriculture in the rural sierra;
2. The net population in these areas is growing faster than new arable land is becoming available. This increased population pressure has led to an increasing man to land ratio, with the consequence of increasingly lowered per capita incomes and underemployment.
3. In general the only escape mechanism from this vicious circle is by migration from the Sierra to urban areas; if such migration has had a somewhat stabilizing effect on rural agriculture, in that it draws off part of the population excesses, it has also created enormous problems for the urban migration centers.

Table III-5 below gives a breakdown of the agricultural and non-agricultural labor force in Peru and in the southern and central areas of the country, according to condition of employment or unemployment. The figures are, however, to some degree misleading since underemployment (defined as those part time workers who earn less than the minimum wage or work less than 35 hours a week) is not identified. Especially in rural agricultural sectors there are indications that underemployment is the rule rather than the exception; for example in the southern department of Puno it has been estimated that fully 70% of agricultural workers would fall into underemployment categories.

Table III-5 LABOR FORCE, AGRICULTURE AND NON-AGRICULTURE ACCORDING TO
CONDITION OF EMPLOYED AND UNEMPLOYED ^{1/}
(Figures given in thousands)

A) PERU (Total)

Economic Activity	Employed		Unemployed	
	No.	%	No.	%
Agriculture	1,320.6	69.1	591.8	30.9
Non-Agriculture	1,732.2	78.2	483.2	21.8
Not specified	---	-0-	220.3	100.0
Work aspirants	---	-0-	47.1	100.0
TOTAL	3,052.8	71.5	1,215.9	28.5

B) SOUTHERN REGION (Departments of Apurimac, Madre de Dios, Cuzco, Puno)

Economic Activity	Employed		Unemployed	
	No.	%	No.	%
Agriculture	307.5	69.4	135.3	30.6
Non-Agriculture	177.8	71.4	65.1	28.6
Not Specified	---	-0-	10.8	100.0
Work Aspirants	---	-0-	4.2	100.0
TOTAL	485.3	69.3	215.4	30.7

C) CENTRAL REGION (Junin, Huancavelica, Ayacucho, Pasco, Huanuco)

Economic Activity	Employed		Unemployed	
	No.	%	No.	%
Agriculture	399.1	74.1	139.7	25.9
Non-Agriculture	288.3	79.9	72.7	20.1
Not Specified	---	-0-	17.3	100.0
Work Aspirants	---	-0-	7.4	100.0
TOTAL	687.4	74.3	237.1	25.7

^{1/} Source: INP 1971-1975 Plan Global de Desarrollo

This project is designed to facilitate credit for employment generating activities within the Sierra, which will provide an alternative to increasing pressures on agricultural land. Small industries, especially those of the artisan variety, will allow individuals and families to supplement their agricultural income without migrating from the land. At the same time the project places emphasis on the creation of communal industries and agro-industries, which not only provide employment and income for individuals within the community, but provide a source of communal income which can be used for developing social and physical infrastructure. It is anticipated that larger industrial projects, as well as most commercial and service activities, will be centered in urban or semi-urban areas of the Sierra. These types of economic activities will provide employment alternatives to leaving the Sierra entirely and migrating to Lima, as well as involve the purchase of goods and raw materials produced by individuals and communities in the rural areas.

Regional Benefits. The criteria established for approving loans under the project will include not only employment and income generation, but will also consider the value added effects of individual projects. By giving first priority to industries which will process raw materials produced in the zone, it is expected to greatly increase the value added accruing to the regional economy as well as improve the terms of trade of the region vis a vis the modern industrial sections of the coast. Such industries might include processing of wool or leather, dehydration or canning of fruits cultivated in the region, or a sausage factory which purchases from local pig farmers. By increasing the value added in processed or semi-processed goods, local producers will receive higher prices for their products, and local consumers will be able to purchase goods previously imported from other regions at lower prices.

Careful selection and continual supervision of projects by the implementing agency is intended to insure that linkage effects are maximized in projects within a particular region. Two examples of activities where supervised credit could have a high multiplier effect in the region are: the processing of pork products, and the weaving industry. In each case individual projects would be judged on their own specific merits, but by fomenting backward and forward linkages the total economic benefit would be even greater. In the case of the processing of pork products (sausages, etc.), the ideal economic configuration would include the development of the feed industry, the expansion of pig farming, and finally the development of final processing industries; this would insure maximum profitability by reducing intermediate prices in each step. The weaving of artisan goods is another case where supervised credit could be utilized to maximize both regional benefits and benefits accruing to individual weavers, most of whom currently work on a marginal profit basis. Working through artisan cooperatives, raw material processing facilities could be offered to individuals who would not otherwise have sufficient volume

by themselves to justify purchasing the required machinery. Two economic goals would thus be served: increasing individual profitability and increasing the regional value added of finished goods offered to the tourist market or for export.

National Benefits. Increases in employment and income at the local and regional levels obviously have some impact on the national economy. More important, however, is that by offering employment opportunities in rural regions the project is compatible with GOP goals of stemming the tide of rural migration to the major urban areas of the country, which is a drain on the national economy. In the major urban areas of the country the rate of growth, primarily due to migration, has exceeded the rate of growth in new jobs. This has led to widespread unemployment and underemployment in urban pueblos jóvenes. Intensive migration has then led to a situation where rural economic marginality is effectively transferred to the cities -- but at a much higher cost to the society as a whole. We can estimate that the societal costs of urban vs. rural unemployment is in excess of a 5:1 ratio -- i.e. for every private or public dollar needed to subsidize rural unemployment, more than five dollars is needed in the urban setting, where basic services (schools, water, garbage collection, sanitary services, etc.) must grow in arithmetic proportion to the population, whether employed or not.

While this project in itself will not radically change existing migration patterns, it is expected that rural jobs created as a result of the expanded credit system will at least offer rural workers the alternative of staying in the Sierra -- an option frequently not open to them given the present employment patterns.

E. Social Benefits of Project

1. Improved Rural Living Standards

A primary objective of this Project is to increase employment opportunities for the underemployed and unemployed workers. The income thus generated will be available to individuals and groups for obtaining greater share of available health, educational, housing, food and other resources required for improved living standards. Additionally, loan capital will be directed at increasing the quantity and improving the quality of services and commerce located in small rural towns, thus matching supply with the demand emerging in rural areas.

It should also be noted that most of the communal enterprises (potential sub-borrowers) established under Peruvian Law have non-economic or social functions as well as economic ones. Income derived from loan credit resources is not used exclusively for reinvestment in the business activity and a profit distribution among members of the organization but also for obtaining improved health, educational, and other services required by the community. For example a percentage of profits may be used for the construction of a modest medical facility or for additional classrooms in the local school.

2. Job Training and Informal Education

Sub-borrowers will receive technical assistance and a certain amount of job training. In the case of individual sub-borrowers it is expected that the professional technical consultation provided will introduce the borrower to additional aspects of his enterprise, particularly simple budget analysis, elementary planning, and administrative techniques which had heretofore received little or no attention. It is anticipated that more formalized training programs in elementary bookkeeping, management, and planning will also be arranged for sub-borrowers when appropriate. The resources of local universities and technical schools will be utilized to the maximum extent feasible for this purpose.

The educational and training components of the lending program for community enterprises are more significant. The participatory process utilized for management and sub-project implementation, often through self-help construction techniques, assisted by Government provided technical assistance, has application for meeting other community needs which may exist in housing, health, and other areas. In terms of technical skills, rudimentary construction techniques will be taught as well as the skills required for the successful operation of the enterprise. For example, in a small hog production

facility, training in management, accounting and animal care will be provided as an integral part of the project.

In summary, it is expected that the Project will have a beneficial impact on the quality of rural life, will provide marginally employed, low income rural workers with increased skills to meet emerging job demands, and will increase the planning and organizational capability of rural inhabitants to mobilize their resources for community improvement.

3. Integration of Women into the National Economy

The role of women in the sierra economy of Peru is generally far less limited than might be expected, and women have become well integrated into most productive sectors. Table III-6 shows the percentages of men and women in the Peruvian labor force, according to economic activity.

TABLE III- 6 : PERCENTAGE MALE AND FEMALE PARTICIPATION IN OCCUPIED LABOR FORCE BY ECONOMIC ACTIVITY

<u>Economic Activity</u>	<u>Male</u>	<u>Female</u>
Agriculture/Livestock	89.2	10.8
Mining	97.3	2.7
Industry/Mfg.	72.4	27.6
Construction	99.1	0.9
Utilities	95.4	4.6
Commerce	72.7	27.3
Transportation	95.1	4.9
Services	50.8	49.2
Other	78.2	21.8
<u>TOTAL</u>	<u>79.1</u>	<u>20.9</u>

Source: DNEC, VI Censo Nacional de Población, Tomo IV, Características Económicas, 1961

The participation of women has been greatest in Peru in exactly the economic activities in which the present project will be working -- small industry, artesanía, commerce and service activities. In the greater part of the rural sierra, subsistence level family incomes can only be reached if all members of the family are occupied; men have traditionally worked the land, and women engage

in home-industry handicrafts, or small industrial or commercial ventures. The economic marginality of sierra women is less a function of sex discrimination than the generally depressed conditions of the sierra itself. If women are less productive as a whole than men it is primarily because the majority of the area's scarce resources are channelled into the agricultural sector, which is the economic base of the region and the family, and secondary activities - specifically those traditionally run by women - have not had access to credits which would allow them to increase productivity. The present project is designed to increase the overall resource base of the target regions, and it is expected that these secondary activities will thereby be strengthened,

From the experience of the 052 and 053 loans in the Earthquake area, we estimate that women will be significantly benefitted by the increased resource base in the target areas. Under 053, 17% of the individual enterprise loans in the sierra region of the Earthquake zone were made to women (a knit goods factory, commercial enterprises, pharmacy, etc), and 45% of the jobs created under the project have been occupied by women. In the case of community and cooperative enterprises, 41% of jobs created under 052 are held by women. Given the similarity of the new project target areas to the sierra portion of the Earthquake zone, it is expected that women will have an approximately equal participation in Puno, Cuzco, Ayacucho and Junin.

The implementation program will be designed to avoid discrimination in the execution of the loan. Under this program the credit manuals to be developed and distributed and all other forms of program promotion (radio, flyers, newspapers, etc.) materials will indicate equal eligibility of projects sponsored by or employing men or women.

F. Traditional and Existing Sources of Credit (Terms and Conditions)

There are four major existing sources of credit in Peru which offer loans to individuals and communities and cooperatives for the purposes of agro-industry, small industry, commerce and services: (1) the State Development Banks; (2) Associated Banks (those in which the government has acquired a majority interest); (3) private commercial banks, including regional development banks; (4) cooperatives which provide limited credit lines to their own members.

In addition, the Central Reserve Bank of Peru and the Banco de la Nacion, while not extending credit directly, have established programs designed to facilitate credit to small industries and artisans. The Central Bank program of Selective Credit and the Banco de la Nacion program of loan insurance will be discussed below, following a description of actual credit lines.

Table III-7 and Graph III-1 show the growth in loan portfolio balances in selected target rural areas since 1970. The greatest increases have occurred in Cuzco and Junin, and in all cases show progressive increases in the last few years.

1. State Development Banks

There are five such banks in Peru: (1) the Agricultural Development Bank; (2) the Industrial Bank; (3) the Mining Bank; (4) the Housing Bank, and (5) the Central Mortgage Bank. The programs of the first two of these, which have credit lines similar to those anticipated under the present project, are summarized below:

a. Agricultural Development Bank

The Bank offers lines of credit for the expansion and improvement of farming and livestock, the purchase of capital equipment, forestry, marketing, and for the storage and conservation of agricultural products. It is authorized to make loans to individuals, cooperatives, SAIS, and Campesino communities. The following chart shows types of loans granted by the Bank, amounts of loans, and the effective interest rate for each type.

AGRICULTURAL DEVELOPMENT BANK: TYPES OF LOAN, MAXIMUM
AMOUNTS AND EFFECTIVE INTEREST RATES
(amounts given in Peruvian Soles)

<u>TYPE OF LOAN</u>	<u>AMOUNT OF LOAN</u>	<u>EFFECTIVE INTEREST RATE</u>
Small Agriculture:	0 - 50,000	7%
	50,001 - 100,000	9%
	100,001 - 150,000	10%
	Against production	10%
Medium Agriculture:	Up to 300,000	12%
	Against production	12%
Large Agriculture:	Up to 18,000,000	13%
	Against production	13%
Special Loans:	Food Products:	
	Small producers	7%
	Medium producers	9%
	Acquisition of capital equipment	10%
	Jungle loans	Variable: Maximum; 12%
	Loans to associations (cooperatives, SAIS, etc.) working with Agrarian Reform	Variable; concessionary

The following amortization schedules are followed:

- Short term loans: 1-2 years
- Medium term: up to six years
- Long term: up to 18 years

In all cases, the Bank requires guarantees in the form of future agricultural production and/or the goods purchased with the loan.

The Bank's loans are directed towards actual agricultural production, not industrial ventures related to the agrarian sector. Sub-loans made to organizations under the present project will be complementary to the Bank's credit lines and not competitive.

b. Industrial Bank

The Bank offers supervised credit to artesanía, small, medium and large industry, as well as other sectors which fall outside the scope of the present project (fishing, exports, etc.). Loans may be made to individuals or associations. Pertinent credit lines, including the amounts and interest rates, are given in the following table.

INDUSTRIAL BANK: TYPES OF LOANS, AMOUNTS AND EFFECTIVE INTEREST RATES

(amounts given in Peruvian soles)

<u>TYPE OF LOAN</u>	<u>AMOUNT</u>	<u>EFFECTIVE INTEREST RATE</u>
Artisans	Up to 50,000	8%
Small Industry	50,001 to 400,000	7-12%
Medium-Industries	Over 400,000	9-13%

Amortization periods are from 3 to 7 years, according to the amount of the loan and the activity to which it is applied. Grace periods are normally up to six months, but may be extended to one year. For loans over 50,000 soles The Bank requires guarantees in the amount of the loan (or sometimes higher, according to officials in provincial branches); these guarantees may be in the form of real estate, machinery, raw materials or the production of the industry, or personal value guarantees. In the case of loans made to small artisans, The Bank utilizes insurance programs offered by the Banco de la Nación: for a flat fee of 2% the Banco de la Nación will guarantee up to 80% of the value of artisan loans made up to S/.50,000. This raises the effective interest rate on this type of loan -- from 8% in the first year to up to 14% in final years -- but allows artisans without personal property to have access to Bank credits. The Industrial Bank reports that it will shortly accept similar Banco de la Nación insurance to be applied to loans up to S/.250,000.

2. Associated Banks

The Banco Popular del Peru, Banco Internacional del Peru and

Banco Continental del Peru are the associated banks, those in which the GOP has acquired a majority interest. Credits are extended to all economic sectors and borrowers may be either individuals or associations. There are two basic types of credit -- a normal credit line, similar to that extended by the commercial (non-associated) banks, and selective credit, facilitated by special rediscount rates offered by the Central Reserve Bank.

Normal credits fluctuate in amount from S/.50,000 up to a maximum of 10% of the bank's loan portfolio. The current effective interest rate is 14%. Three types of guarantees are accepted: on fixed assets, letters of credit, or government or third party guarantees.

Selective Credits, which grant concessionary interest rates (10% and 11% for jungle and sierra, respectively) will be discussed in a separate section below.

3. Private Commercial Banks

Graph III - 2 give a breakdown of the growth in commercial and savings banks loan portfolio balances since 1970, by regions; Table III - 8 presents this in table form. The private commercial banks maintain credit lines similar to those described under the "normal credits" of the Associated Banks. Regional Development Banks maintain an identical commercial credit line, plus a line of Selected Credits. Their scope of activity is limited to a specific geographic area. Commercial, associated and regional development banks will be eligible to participate with the Banco Industrial in sub-loans under the present project. In the CRECE Fund Small Business Project, two banks and a credit cooperative are participating with ORDEZA, providing 10% of the amount of individual sub-loans, and administering repayments.

4. Cooperatives

The majority of production and credit cooperatives in the sierra are relatively small. Production cooperatives are generally concerned with providing short-term credits for the purchase of raw materials and working capital until production is sold. Credit cooperatives are of the credit union variety and generally limit their loans to two or three times an individual's savings. The majority of loans are for the purchase of household items, not working capital for small entrepreneurs. Interest rates are generally 1% a month on a declining balance.

Selective Credit Program of the Central Reserve Bank. The Central Reserve Bank's Selective Credit Program was established in 1971 in an attempt to promote regional development via a system of preferential credits in selected activities. The Central Bank offers preferential rediscount rates

to State Associated and Regional Development Banks for the financing of projects submitted by individuals or firms which fall into selected categories, and the banks in turn offer preferential interest rates to borrowers (10% or 11%, depending on the geographic location of the project, in comparison to the 14 + % charged by commercial institutions).

Selective Credit lines include the following:

1. for agricultural production destined for internal consumption, particularly that production which contributes to import substitution;
2. fishing activities for human consumption;
3. industrial production, or the production and transport of forest products;
4. tourism;
5. artisan activities.

The Central Bank has set the following guidelines on maximum amounts of loans which may be made under the Selective Credit Program:

1. individuals or companies without assigned capital: S/.250,000;
2. companies with capital of up to one million soles: amount equal to capital of the firm;
3. companies whose capital is between one million and maximum considered under Selective Credit (S/.4 million in sierra and S/.8 million in the jungle) : S/.1 million plus 30% of excess registered capital over S/.1 million.

The total Selective Credit line approved by the Central Bank amounted to S/.336,000,000 at the end of March 1974; of this amount some 58.8% has been actually utilized. Table III-9 gives a breakdown of the Selective Credit activities in the four target areas and for the country as a whole.

In general the Regional Development Banks have adopted a vigorous policy in utilizing Selective Credit. Banco Central figures show that of the S/.113,000,000 assigned to the Associated Banks at the end of March, 1974, they have only loaned S/.39,393,000 or 29.6%. The Regional Development Banks, on the other hand, have placed a total of 77.9% of the funds assigned to them under the program (S/.158,000,000 out of a total of S/.203,000,000). During trips made to the target areas, the Selective Credit Program was discussed with banking officials. Generally they felt

that the relative success of the Regional Development Banks has been due to their active promotion of the program; the Associated Banks, on the other hand, have used the credit line more sparingly--not due to a lack of demand but rather to their own lack of promotion.

Banco de la Nación Insurance Program for Small Borrowers. The Banco de la Nación offers a program of insurance for small borrowers which allows small entrepreneurs to have access to credits which would normally be unavailable to them given their lack of resources and inability to provide guarantees to commercial or state banking institutions. The policy, which has been widely used in making loans to small artisans, assumes the risk for up to 80% of the loan, charging a flat annual fee of 2% during the life of the loan. Policies may be purchased (or often must be) for loans up to S/.250,000. Since the fee charged is a flat one, based on the original amount of the loan and not the declining balance, this effectively raises the interest rate from 6% (concessionary rate offered to small artisans) to about 14% in the final years of loan payment. The banks report, however, that this high rate has not been a major factor, and they feel that the majority of borrowers have not been deterred by the additional interest that the Banco de la Nación Insurance implies.

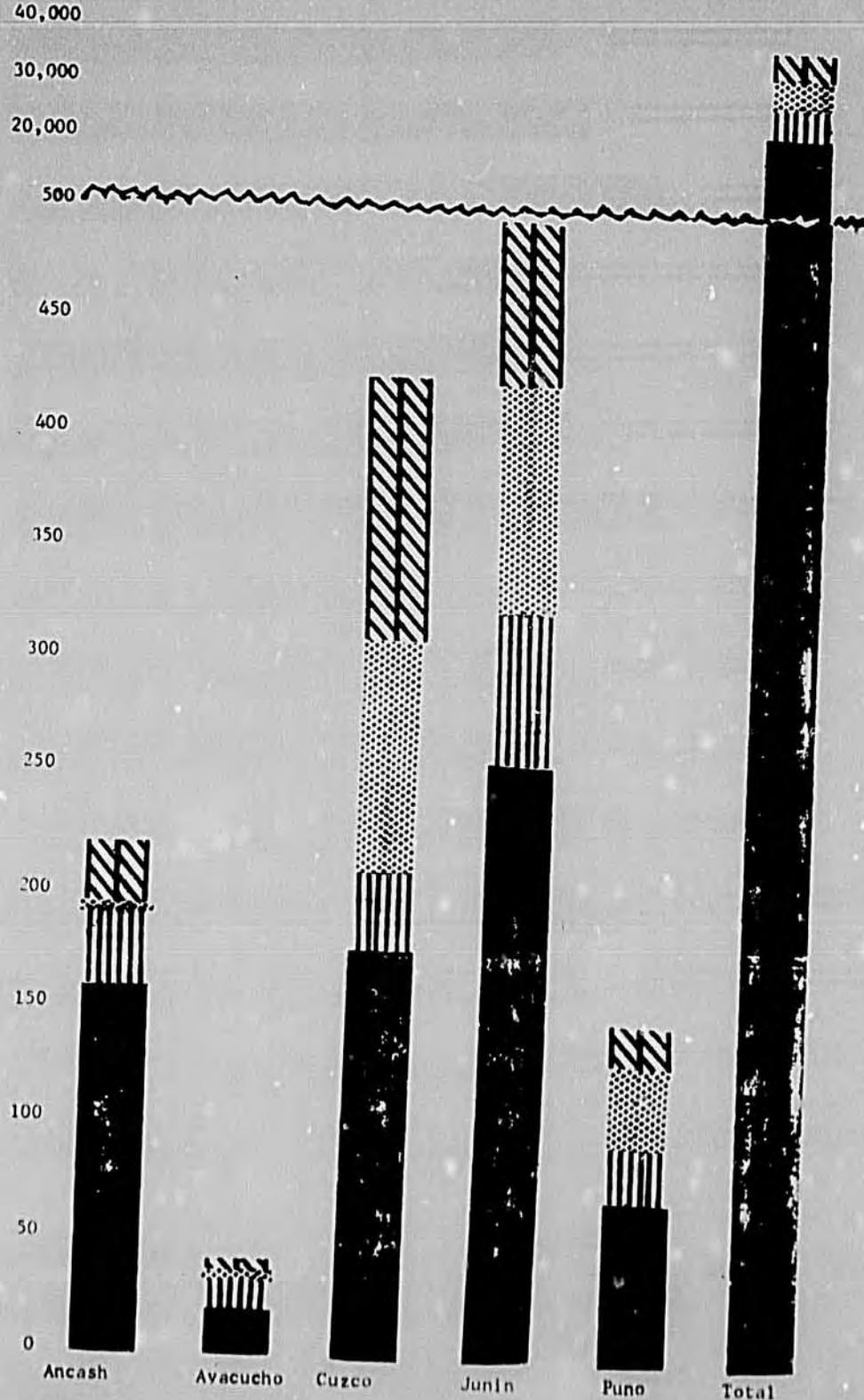
Commercial and Saving Banks - Loan Portfolio/Balances (in million Soles)

		<u>Ancash</u>		<u>Ayacucho</u>		<u>Cuzco</u>		<u>Junin</u>		<u>Puno</u>		<u>Total 1/</u>
		%		%		%		%		%		
Dec	1970	0.7	160.5	0.1	20.4	0.8	177.5	1.1	258.9	0.3	68.4	23,633.1
"	1971	0.7	194.1	0.1	31.9	0.8	223.1	1.1	325.6	0.3	93.6	28,525.2
"	1972	0.6	196.5	0.1	38.1	0.9	312.8	1.2	425.8	0.4	132.1	34,539.3
June	1973	0.6	222.7	0.1	42.3	1.1	427.5	1.3	492.6	0.4	147.2	38,823.1

1/ Total of all Departments loan portfolio balance.

COMMERCIAL AND SAVINGS BANKS LOAN PORTFOLIO BALANCES

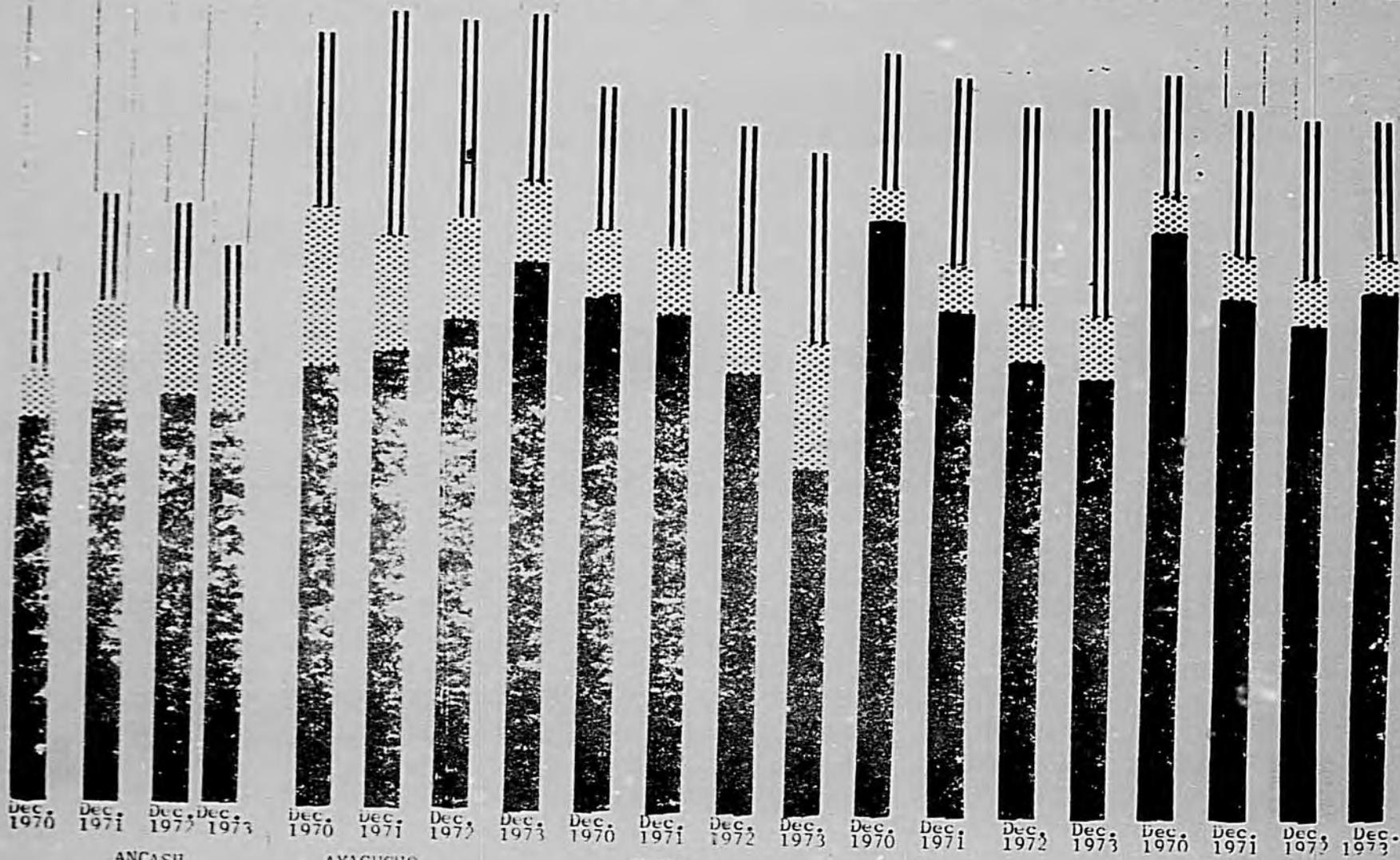
Million S/ (soles)



 Dec. 1970
 Dec. 1971
 Dec. 1972
 June 1973

Source: Banco Central de Reserva
Memoria 1972 and Bulletin 1973

335.1 440.4 487.5 677.0 68.8 90.5 118.5 165.6 568.0 708.4 823.3 899.5 954.8 908.8 1096.7 1347.0 303.8 353.7 443.4 629.7



Loan Portfolio Balances of Commercial and Saving Banks and GOP Development Banks (million of Soles and percentages per Economic Activity)

Agriculture
 Industry
 Commerce
 Other

Source: Superintendencia de Banca y Seguro

Loan Portfolio Balances of Commercial and Savings Banks and Governmental Development Banks
(In million of soles and percentages per Economic Activities)

	Dec 70		Dec 71		Dec 72		Dec 73	
	%		%		%		%	
1. <u>Ancash</u> - Total	100	335.1	100	440.4	100	487.5	100	677.0
Agriculture	46	154.1	48	210.7	49	238.5	47	319.9
Industry	5	17.7	12	53.8	10	48.9	8	52.5
Commerce	12	39.6	13	58.0	13	66.7	12	78.4
Others	37	123.7	27	117.9	28	133.4	33	226.2
2. <u>Ayacucho</u> - Total	100	66.8	100	90.5	100	118.5	100	165.6
Agriculture	53	35.4	55	49.4	59	69.8	66	109.2
Industry	19	12.4	14	13.1	12	14.2	10	16.5
Commerce	21	14.2	27	24.3	24	28.6	20	34.0
Others	7	4.8	4	3.7	5	5.9	4	5.9
3. <u>Cuzco</u> - Total	100	568.0	100	708.4	100	823.3	100	899.5
Agriculture	62	353.4	60	428.0	53	439.9	42	380.2
Industry	8	46.2	8	55.1	10	82.8	15	131.7
Commerce	17	94.5	17	121.4	20	165.5	23	204.3
Others	13	73.9	15	103.9	17	135.1	20	183.3
4. <u>Junin</u> - Total	100	954.8	100	908.8	100	1096.7	100	1347.0
Agriculture	72	688.0	61	558.4	55	606.4	53	718.0
Industry	4	35.2	6	53.3	7	76.1	8	105.6
Commerce	16	156.2	22	200.3	24	259.7	25	336.0
Others	8	75.4	11	96.8	14	154.5	14	187.4
5. <u>Puno</u> - Total	100	303.8	100	353.7	100	443.4	100	629.7
Agriculture	71	214.7	63	224.2	60	265.2	64	401.5
Industry	5	15.5	6	20.9	6	27.1	5	33.4
Commerce	14	41.1	17	61.1	19	83.1	16	101.0
Others	10	32.5	14	47.5	15	68.0	15	93.8

Source: Superintendencia de la Banca y Seguro

SELECTIVE CREDIT PROGRAM OF CENTRAL RESERVE BANK, BY REGION

(amounts given in thousands of soles)

PERIOD ENDING	CUZCO			PUNO			AYACUCHO-HUANCAVELICA			JUNIN			TOTAL REPUBLIC		
	Amount Assigned	Amount Loaned	% Loaned	Amount Assigned	Amount Loaned	% Loaned	Amount Assigned	Amount Loaned	% Loaned	Amount Assigned	Amount Loaned	% Loaned	Amount Assigned	Amount Loaned	% Loaned
December 1971	500	--	--	25,000	--	--	15,000	700	4.6	--	--	--	110,000	6,780	6.2
December 1972	25,000	8,437	33.7	33,000	18,115	54.9	40,000	13,028	32.6	23,000	1,500	6.5	286,000	95,320	33.3
December 1973	30,000	14,934	49.8	33,000	18,773	56.9	40,000	25,909	64.8	23,000	3,830	11.6	336,000	133,183	39.6
March 1974	30,000	13,653	45.5	33,000	28,830	87.4	40,000	29,485	73.7	23,000	6,020	26.8	336,000	197,493	58.8

Source: Central Reserve Bank of Peru, March 1974.

G. Demand Analysis

The demand analysis is based upon a review of existing credit lines in the selected geographic target areas, conversations held with key GOP officials and bankers in these areas, and an analysis of how latent demand was converted into effective demand in the 052 and 053 projects. On the basis of this review it has been concluded that there will be sufficient demand in the target areas to insure disbursement of the loan within a three-year period.

Terms and conditions of existing credit lines of the State Development Banks and the private, associated, and regional banks are rigid. In effect, the banking system imposes conditions which limit demand to the available supply. Effective demand, under these rigid conditions, is low.

The experience under 052 and 053 has shown that by removing some of these rigidities from the system a significant part of what might be termed 'latent' demand becomes 'effective' demand. The majority of small individual enterprises established with loans under the 053 program, and all of the community enterprises set up under the 052 program, are examples of the conversion from latent to effective demand, in that they simply were not eligible for normal commercial or State development bank loans.

The bulk of latent demand in sierra regions of Peru is not eligible for existing credit lines for the following reasons:

1. Interest rates, payment periods and short or nonexistent grace periods have made it necessary for projects to be able to prove a high rate of profitability even during first stages of production; projects which need a six-month to two-year grace period before showing a reasonable profit are then often systematically excluded, despite the fact that they may generate a significant number of jobs and produce other significant benefits.
2. Most lending institutions in Peru require guarantees from prospective borrowers - often guarantees with an effective value well over 100% of the amount of the loan. This requirement has the effect of automatically excluding the vast majority of rural communities or individuals who simply do not have resources considered as adequate guarantee
3. Branch offices of commercial banks are given little autonomy to approve loans for new prospective borrowers, and most local

officers report that they generally deal with a small and known clientele. The manager of the Banco de Credito in Ayacucho, for example, reported that he primarily deals with 30 traditional clients, all well known to him, and that the Banco is not interested in searching out new clients.

4. The bulk of what we term 'latent' demand is not likely to become effective without a promotion effort on the part of the lending institution. Through personal experience or the experience of friends or relatives the majority of potential small entrepreneurs have discovered that they do not qualify for traditional credit, so they simply do not approach the banks. In the case of community enterprises, the community may not be aware of industrial potential in the area, and if they are aware of it generally lack financial resources to contract for feasibility studies which lending institutions require. Of course, they too cannot meet the rigid requirements of the commercial and development banks.

By combining an active program of promotion and project development with a set of sub-loan terms and conditions which are considerably less rigid than those which characterize existing credit lines, the project anticipates that the above-mentioned obstacles will be alleviated in target areas, and that a substantial effective demand for credit will emerge.

Projected Demand: Earthquake Zone

Perhaps the major achievement of ORDEZ, under loans 052 and 053 has been precisely that of turning latent demand into effective demand. Demand estimates for further sub-loans under the new project are based upon projections prepared by the ORDEZA staff, calculated on the basis of their experience and actual pending requests for sub-loans.

With regard to individually owned enterprises, Fondo Crece (053), in nine months of operation, disbursed 127 sub-loans for a total of \$ 1,271,608. An additional \$ 307,073 for 24 projects has been authorized, and 16 further projects, totalling \$ 239,463 are being studied. There are also sub-loan requests totalling \$ 3,630,135 which have not been processed given depletion of the 053 fund.

It is assumed that the bulk of original demand will have been met by the 053 loan, and that there will be a declining number of loans made in the Earthquake zone during the three year disbursement period of the present project, dropping from 150 new sub-loans in the first year, to 125 in the second, and 100 in the third. The average sub-loans will be approximately the same as under 053, \$ 10,000.

ORDEZA reports a continuing demand for 052 sub-loans directed to communities and cooperatives. We assume a constant demand for community owned enterprises of 10 per year under the new project, averaging \$ 100,000.^A This figure is somewhat higher than the average loan amount at present (\$ 75,000), since it reflects a second stage in ORDEZA's operations. New community projects being developed by ORDEZA are somewhat larger in scope than those already executed.

Based on these projections, we estimate that the demand over the next three years will be approximately \$ 6,750,000, broken down as follows:

Year	Individual Enterprises		Community Enterprises	
	No.	Amount	No.	Amount
1	150	\$ 1,500,000	10	\$ 1,000,000
2	125	1,250,000	10	1,000,000
3	100	1,000,000	10	1,000,000
TOTAL	275	3,750,000	30	3,000,000

Projected Demand: Non-Earthquake Target Areas (Departments of Cuzco, Puno, Junin and Ayacucho)

The objective of the project in the target areas outside of the earthquake zone is to try to repeat the ORDEZA experience - i.e. increase the effective demand for credit through a combination of variable interest rates, provision of grace periods, lowered guarantees and promotion and supervision by the implementing agency. Based on the experience of 052 and 053 and visits to the new target areas, we estimate the amount of latent demand which could be converted into effective demand to be about \$ 20 million. Table III-10 presents the demand analysis, by department, according to the type of project and year of disbursement. In the first year, the implementing agency will concentrate its efforts in the Departments of Puno and Cuzco; in the second and third year the project will be expanded to cover the Ayacucho and/or Junin Departments as well.

The individual departmental demand estimates are based on an analysis of the regions, and certain assumptions as to the anticipated breakdown between community and individual enterprise demand. These assumptions include:

^A per sub-loan

TABLE III-10
 PROJECTION OF POTENTIAL DEMAND IN NON-EARTHQUAKE TARGET AREAS, BY PROJECT TYPE AND YEAR OF DISBURSEMENT
 (figures in US dollars)

YEAR	CUZCO		PUNO		JUNIN		ATAUCHO		TOTAL	
	Comunal Enterprise # Amount	Individual Enterprise # Amount								
1	9 675,000	109 1,090,000	12 900,000	54 540,000	--	--	--	--	28 3,175,000	169 1,630,000
2	13 975,000	163 1,630,000	18 1,350,000	82 820,000	12 900,000	163 1,630,000	6 450,000	54 540,000	49 3,475,000	475 4,620,000
3	14 1,050,000	164 1,640,000	18 1,350,000	82 820,000	12 900,000	164 1,640,000	6 450,000	55 550,000	50 3,750,000	475 4,630,000
TOTAL	36 2,700,000	436 4,360,000	48 3,600,000	218 2,180,000	24 1,800,000	327 3,270,000	12 900,000	109 1,090,000	120 9,000,000	1,290 12,900,000

1. There is a constant global relation between individual and community enterprises of 9:1. This figure has been assumed on the basis of the 053 and 052 experience during the first year of disbursement. In other words, for each community enterprise undertaken, there will be nine individual projects.
2. The average loan size for community enterprises will be \$ 75,000, while the average size for individual projects will be \$ 10,000.
3. The departmental demand for community vs. individual enterprise projects will not be the same as the 9:1 global ratio, but rather will change according to the individual economies of the region. In Cuzco and Junin, which have much more developed urban economic centers, it is estimated that the demand for individual enterprise credits will be greater than 9:1; the opposite holds true in Puno and Ayacucho which are much more rurally oriented and where there is a stronger tradition of community organization.
4. Rather than take a straight 9:1 ratio, we have determined the probable percentage of total loans granted for community enterprises and individual enterprises that will be disbursed in each department. For individual enterprises we have estimated that total demand will be divided among the four departments in the following constant proportions Cuzco, 40%, Junin, 30%; Puno, 20%; Ayacucho, 10%. In the case of community enterprises the following proportions were used: Puno, 40%; Cuzco, 30%; Junin, 20%; and Ayacucho, 10%.
5. It is estimated that in the two new initial target areas, Puno and Cuzco, $\frac{1}{4}$ of the total projected sub-loans will be realized in the first year, and that $\frac{3}{8}$ of the sub-loans will be realized in each of the following two years. In the case of Ayacucho and Junin, it is estimated that the disbursements will be split 50-50; in years two and three.

Total Projected Demand

The projected demand outlined above is broken down as follows:

	<u>Amount</u>	<u>%</u>
Cuzco	\$ 7,060,000	26.5
Puno	5,780,000	21.7
Junin	5,070,000	19.0
Ayacucho	1,990,000	7.5
Earthquake Zone	6,750,000	25.3
TOTAL	26,650,000	100.0

The figures given above, as well as breakdowns previously given, are meant to be illustrative and actual disbursement would, of course not be made on this basis. The implementing agency will be given discretion to disburse funds on the basis of actual created demand in the specified geographical target areas. It is felt that potential demand is sufficiently greater than available funds to insure that disbursement will take place in the time frame anticipated.

N. Proposed Conditions and Terms for Sub-loans and Justification for Selection

1. Proposed Rates, Terms, and Conditions

III-

Table II sets forth the proposed sub-loan interest rates, grace periods and amortization periods, for the part of the loan going into new areas (other than Ancash), which vary according to size and category of loan and according to the priority level (1st, 2nd, 3rd and no priority) of the enterprise. The terms and conditions of sub-loans on that portion of the loan which will replenish the 052 and 053 loans will be substantially the same as those provided under these earlier loans. Interest is to be charged on the outstanding balance at the end of each computation period (monthly). There will be no other charges (fees, etc.) to the borrower and the loans will not be discounted, thus these rates are "effective" rates. Other financial institutions are expected to participate in some of the sub-loans, especially in the commerce and services sectors, under the conditions and mechanisms described in Section IV, of this paper. In general, these institutions will contribute up to 15% of the sub-loans in which they participate. They will earn the regular commercial rate of interest on their contribution to the sub-loan and a fixed administration fee on the balance of the sub-loan.

Any changes in the terms or conditions of these sub-loans must be mutually agreed upon by the Bank and A.I.D.

2. Justification for Selection

The GOP utilizes the credit system of the country to attain certain specific development goals. These goals include: supporting inter and intra-sector priorities, encouraging geographical (regional) decentralization; stimulating the creation of new enterprises; promoting and supporting smaller scale enterprises; and providing general stimulus to economic activity. To accomplish these goals the Government has set up a complex system of rates, with lower rates for priority sectors and subsectors, for sierra and selva vs. coast and Lima/Callao, and for smaller vs. larger loans.

All rates of interest in effect in Peru are fixed by the Government and most of these are concessional in that they are no high enough to cover all of the costs associated with lending in the country today; i.e., administrative costs, bad debts, exchange risk, coverage for inflation, and return on investment. The rates established for the State Development Banks are concessional in this sense and these banks are subsidized by the Government. (In

III-
TABLE II - PROPOSED CONDITIONS AND TERMS FOR SUB-LOANS
(In Soles: S/.43.38/\$1)

CATEGORY	AMOUNT OF LOANS	INTEREST RATE	GRACE PERIOD	AMORTIZATION PERIOD
I. Small and Medium Industry	Up to 50,000 (0-\$1,153)	6 ² / ₃ %	Up to 2 years	Up to 1 year
	50,001 to 400,000 (\$1,153-\$9,220)	7-10 ² / ₃ %	"	"
	400,001 to 2,000,000 (\$9,220-\$46,104)	9-13 ² / ₃ %	"	"
II. Commercial and Service Enterprises	Up to 50,000 (0-\$1,153)	8 ² / ₃ %	Up to 1 year	Up to 2 years
	50,001 to 400,000 (\$1,153-\$9,220)	9-12 ² / ₃ %	"	"
	400,001 to 2,000,000 (\$9,220-\$46,104)	11-13 ² / ₃ %	"	"
III. Organizations (Cooperatives, Community Associations, etc.)	Up to 400,000 (0-\$9,220)	5%	Up to 2 years	Up to 6 years
	400,001 to 2,000,000 (\$9,220-\$46,104)	6%	"	"
	2,000,001 to 10,000,000 (\$46,104-\$230,520)	7%	"	"

- 1/ Interest Rate to be charge on the outstanding balance of the loan.
- 2/ Small industry loans up to S/.250,000 are considered to carry the higher risks; for that reason the implementing agency will be given the discretion to seek loan reinsurance under the Banco de la Nación program for loans up to S/.250,000. This reinsurance covers 80% of the loan, and the Banco de la Nación charges a flat annual fee of 2% (i.e. on entire amount of the loan, not the declining balance).
- 3/ These rates vary depending upon the priority of the industry to which the borrowing firm belongs. The Banco Industrial is limited by statute to a maximum interest rate of 13%.

addition, the Central Reserve Bank grants preferential discount rates to the State Development Banks.) The rates that the commercial banks are permitted to charge are also less than the full costs outlined above, however they are able to reduce their costs substantially by restricting their clientele to only the most secure of borrowers (large scale enterprises with high capital base, sound management performance, etc.) and by requiring excessive collateral in support of the loan. Moreover, while the interest rate is fixed, these banks do charge for "auxiliary" services through a carrying charge, a transfer of funds charge, and a charge for "extras" (telephone calls, cables, etc.), which substantially increases the effective rate of interest paid by the borrower.

The system tends to limit total commercial bank credit to the private sector as well, and directs private saving into public sector investments through the bank's purchases of treasury bonds. Thus the Government's public sector investment priorities are supported also.

The proposed rate structure for sub-loans to small industries (see Table II) are identical to those charged by the Industrial Bank of Peru. Since the Industrial Bank is the only effective source of credit for small and medium size industrial firms, there are no other rates of interest with which to compare those proposed in this loan.

The proposed rates are therefore not concessional with respect to other credit available to small and medium industry. They are somewhat concessional, however with respect to regular commercial banks rates of interest and therefore with respect to the costs, risks, etc., associated with lending in Peru today. Concessional rates (in this sense) are justified on the basis of the depressed and stagnant economic conditions existing in the areas in which this loan is to be concentrated and on the basis of the nature of the target groups to which the loan is directed.

Using practically any generally accepted measure of the level of development, the Departments of Cuzco, Puno, Ayacucho, and Junin are among the most economically depressed areas of the country. (See Section C for a description of these areas.) Industrial activity in these areas is limited by a variety of factors, probably the most important of which is their isolation from the major urban markets of the country, which increase the cost of production and the risks of entering into any type of enterprise there. These factors along with the lack of managerial capacity of potential entrepreneurs and the excessively conservative banking practices

of the other sources of credit in the areas exclude practically all potential entrepreneurs and existing small and medium size enterprises from the credit market. Even if they had access to credit, the rates that the other sources of credit (primarily the commercial banks) would charge would place an unduly heavy burden on enterprises already confronted with serious obstacles to their development.

Therefore, the GOP has decided that concessional rates such as those offered by the Industrial Bank and proposed for this loan are justified as economic development policy for these areas. This loan supports the Government's policy in this regard and proposes rates equally concessional, but no more so, for this target group.

Moreover, the utilization of rates of interest identical to those commonly being used by the Bank will greatly facilitate the administration of the loan.

For the second category, small and medium Commercial and Service Enterprises, concessional rates are proposed for reasons similar to those outlined above for small industries. While commercial and service enterprises generally earn a higher return than do manufacturing firms (for that reason somewhat higher rates are proposed for this category) the economic obstacles in these Departments facing new entrants into this category of enterprise and existing enterprises in the category wishing to expand are formidable. To cover the higher costs and risks of doing business in these areas the commercial banks charge a combination of interest rates and fees which result in effective rates of interest of from 18 to 23%. (There is no development bank serving commercial and service enterprises.) In addition, they do not lend for terms exceeding one year - in fact, the vast majority of the commercial bank loans are for periods of 90 and 180 days - and they require collateral in support of the loan equal to an average of no less than 150% of the amount of the loan.

These rigid terms and conditions, imposed by the severe economic conditions of the areas and the highly conservative practices of the existing sources of credit, exclude all but the largest, most sound commercial and service enterprises located in the Departments chosen for this loan.

Moreover, the lack of experience and managerial training of the target group entrepreneur contributes to the risk of lending to him. The commercial banks must also cover this risk with a higher interest charge, collateral, etc.

The proposed terms and conditions are considered to be sufficiently concessional to compensate for most of the obstacles facing this category of enterprise, however not so much so as to eliminate the discipline required of the entrepreneur in efficiently managing his enterprise.

The terms and conditions proposed for the third category, Organizations, are heavily concessional. The reason for such rates is that this target group is the least well-prepared for undertaking any type of enterprise, having had little or no experience in activities other than in the agricultural sector. These organizations consist of "campesino" communities, rural cooperatives, and SAIS, all of which are characterized by relatively low income structures and as a result have had practically no recourse to credit in the past. The purpose of making sub-loans available to these organizations is to provide employment and income alternatives which have not been available in the past.

While the Implementing Agency will carry out full feasibility studies prior to granting the sub-loans made to these organizations to insure that the projects are economically viable and that income and employment criteria are met, there is a high risk factor involved. This is primarily due to the fact that recipient organizations will be, for the most part, untrained in the use of credit, and initially poorly prepared in non-agriculture activities. Thus while feasibility studies will seek to prove profitability, the profit margins are likely to be quite low in comparison to urban industrial projects, and the projects would be judged infeasible if normal commercial interest rates were used.

The interest rates selected (5-7%) are obviously subsidized ones, but justifiable on the grounds that sub-loans will provide a positive impact on community development which could not be secured from traditional credit sources.

Future Sub-borrower Loans

It is expected that sub-loans made under this project will serve to stimulate economically marginal industries, commercial and service activities to the point where borrowers will be eligible

for future loans from regular credit sources. It is therefore anticipated that sub-borrowers will not be eligible, except in extraordinary circumstances for repeat loans under this project. In the case of CRECE Fund Small Business Assistance program (053) sub-borrowers wishing to expand operations have been directed to commercial banks for second loans at strictly commercial terms and conditions.

3. Maximum Sub-Loan Size

It is expected that the maximum sub-loan size to individual enterprises will be S/.2,000,000 (US\$46,104) and S/.10,000,000 (US\$230,520) to community enterprises. The Implementing Agency will have authority to approve loans up to S/.2 million without previous consultation with A.I.D.; for loans over this amount, the Banco Industrial will first review the project with A.I.D. It is anticipated that this ceiling will be reviewed following the first year of disbursement under the loan to determine if it should be changed.

I. Place of Project In Country Program

1. Previous A.I.D. Support to Rural Development in Peru - Loans

The USAID/Peru loan portfolio comprises several loan projects which focus on bringing the benefits of capital assistance to rural areas of the country. Three loans totalling \$17.7 million (047, 054 and 056) implemented by the Agricultural Development Bank (Banco de Fomento Agropecuario) were made during the period of 1966 through 1972 for the purpose of establishing and expanding a Supervised Agricultural Credit Fund to improve productivity and to support agrarian reform activities. The initial loan, 047, was directed to small and medium farmers nationwide, while 054 limited its assistance to farmers in the geographic area of the May, 1970 earthquake and 056 restricted its assistance to farmers affected by the floods of March, 1972. Loan 049, for \$5.5 million, established a Market Development Trust Fund in 1968 to finance the formation or expansion of food marketing activities. Loan 052, for \$3.0 million for Community Development and Reconstruction, supported activities indicated by the project title in the area of the 1970 earthquake. Loan 053 for \$2.5 million established a special fund in the Central Bank for reconstruction and development credits for small business in the same earthquake area.

A 1966 loan, 045 for \$2.1 million, supported rural community development activities through the establishment of a revolving fund for sub-lending to local municipal governments and community organizations for community projects. In 1968 GOP support of locally elected municipal governments was withdrawn, severely limiting the potential market for sub-loans. Subsequent implementation was also hindered by frequent reorganizations within the GOP Implementing Agency. The project ran into further difficulties because of the GOP's failure (due to congressional reluctance to appropriate counterpart funds) to make the required matching contribution to the fund. A.I.D. therefore deobligated \$1.5 million of the original loan amount.

Other loans containing elements related to rural development are the Market Development Loan and the Private Investment Fund. As amended, the former provides up to 30 percent of the total fund to finance rural collection centers for agricultural products. These centers are usually operated by farm cooperatives or other types of associated enterprises formed by the Agrarian Reform and credits generally will be used to finance equipment and buildings for sorting, cleaning, and grading of agricultural products. The purpose of the Private Investment Fund is to finance facilities for processing, transformation, and preservation of agricultural products. This loan

complements the Market Development Loan by enabling increased vertical integration of agricultural processing and marketing enterprises.

Grants

A number of grant programs have been initiated that deal directly with the rural sector. These programs may basically be divided into two categories - those that were made for emergency and long-term rehabilitation of the earthquake and flood areas, and those designed to develop and improve methodology applicable to analysis of systems of production, leading to improved sub-sectorial and sectorial planning.

The grant assistance for emergency and long-term rehabilitation programs totalled \$10.5 million between 1970 and 1972. Additionally, because of the actual and anticipated employment generation effect of the A.I.D. grant and loan financed earthquake reconstruction programs in both rural and urban areas, A.I.D. assisted the Government of Peru in establishing employment services and manpower training programs to help meet the demand for skilled workers. The primary purpose of this grant-funded program is to identify employment opportunities, train unemployed workers to meet skilled job requirements, and provide accurate data in the earthquake zone.

The grant program designed to improve sub-sectorial and sectorial planning in agriculture has askey inputs eight high-level economic advisors whose major tasks are to assist GOP counterparts in evaluation and implementation of priority development programs and to assist in the development of studies of special problem areas. The ultimate objective of this assistance is to introduce greater rationality into agricultural policy and to increase the efficiency of allocation of public capital and resources. All of the above assistance contributes in varying degrees to allocation of capital among rural development programs. Two of the eight technicians are directly involved in the Agrarian Reform Program, developing training courses for managers of associated enterprises and advising on a series of micro-economic studies or representative enterprise types. The results of the latter investigations will contribute essential information to the Implementing Agency and collaborating organizations regarding the community enterprise development portion of this loan. For example, programming analysis of typical enterprises in particular valleys will provide a rational framework for developing specific loan projects.

2. Mission Strategy

The USG, as noted in the CASP for 1975-76 is in agreement with many of Peru's social and economic goals, particularly those that seek to rectify past injustices and broaden access to economic and social benefits. The Peruvians are seeking in a pragmatic way to evolve a "developmental model" which can serve as an alternative to both capitalism and communism. U.S. bilateral and multilateral assistance can be an important factor in maintaining a middle-of-the road posture and exerting a pragmatic influence on development decisions.

The COP is expecting to continue seeking concessional lending from various external sources since the exploitation of petroleum and other mineral resources will not soon be large enough to obviate the need for this financing.

While the GOP has given preference to massive infrastructure projects (irrigation, power, etc.) in seeking foreign lending, it also seeks more modest assistance in key reform areas such as agriculture and education so long as such assistance is recognized as supporting GOP goals. The CASP recommends that modest levels of concessional, bilateral lending programs be undertaken, with agricultural lending directed to assisting the GOP to implement "integrated" development programs in micro-regions which depend heavily on agriculture. The loan proposed in this paper conforms to this guideline in that: 1) its target groups are in rural areas heavily dependent on agriculture; 2) it will foster and support enterprises that are integrated with respect to micro-region development programs; and 3) it supports the development of small business which, directly or indirectly, will relate to the basic economic activity of the regions, i.e. agriculture.

J. Relationship to National Plans and Priorities

The GOP's development policy, as expressed in the National Development Plan 1971-75, places high priority on integrating the country's rural population into the national economy through various programs designed to support and stimulate economic activities in rural areas. First and foremost among these programs is the agrarian reform which enjoys the highest overall priority of the Government. Other policies oriented towards the rural areas include industrial decentralization, provision of basic social services and economic infrastructure, discovery and development of natural resources in rural areas, and the promotion of artesanía and tourism.

Agrarian reform is defined broadly to include not only land redistribution but all programs designed to develop the rural sector. Thus, social mobilization programs, industrial or tourism promotion programs, technical assistance and educational programs, etc., are all embraced by the Peruvian conception of "agrarian reform". (See Section III-B above on the Agrarian Reform).

The various activities to be supported by sub-loans under the proposed loan will directly complement Peru's agrarian reform by providing resources to develop a segment of the rural sector that has been heretofore relatively ignored. As such many of the sub-loans are expected to support or establish agro-industrial or agro-commercial activities with a direct relationship to increased agricultural production, e.g., grain mills, farm implement outlets, etc. Other sub-loans will support or establish activities not directly related to agricultural production, e.g., brick factories, carpenter shops, etc. Each sub-loan activity will be judged on its contribution to the economy of the rural sector.

The Government's industrial decentralization program is designed primarily to spread industrialization to the major urban centers along the coast outside the Lima/Callao area. Nevertheless, substantial benefits are expected for rural areas from the decentralization program, especially in the development of small industries or businesses dedicated to the processing of the agricultural output of these areas or the servicing of the agricultural units and the population producing this output. Resources of the proposed loan will be available for such industry or business activities. Significant tax and other incentives have been provided to stimulate industrial decentralization, however the locational disadvantages of the jungle and sierra areas are formidable barriers to investment therein.

The GOP's program to provide basic social services and economic infrastructure will be indirectly assisted by this program in that demand will be generated for this infrastructure thus providing additional justification for its existence. Also, as additional income is injected

into the area, the community's ability to pay for the additional social services will be enhanced.

Natural resource development may also be supported by this loan to the extent to which small scale projects involving the processing of natural resources are developed and in need of financing. Mining of mineral resources will not be eligible for financing under this loan, nor will projects involving the refining of minerals. The further processing of natural resources into semi-finished or finished products and the manufacturing of items from such resources would be eligible for financing, however, as long as they meet the eligibility criteria established under the loan.

Projects supportive of the artesanía and tourist industries will be eligible for sub-loans also; however, given the special credit programs already existing for these industries, care will be exercised to avoid substitution of credit.

Likewise, the GOP's more general goals of employment creation, increased production, income redistribution, and economic and social integration of the marginal (rural) population will clearly be advanced by this loan.

K. Consistency with MLI Programs

The purposes to be accomplished by this loan conform to the economic and social development needs and priorities of Peru as identified and analyzed by the multilateral institutions: World Bank, International Monetary Fund and the Interamerican Committee of the Alliance for Progress of the O.A.S. The annual reviews of the economic and social conditions in Peru published by each of these organizations support the rural development programs of the country including the agrarian reform, the industrial decentralization programs and the economic and social infrastructure programs as necessary to reduce the large inequalities in the distribution of income within the country. They also see these programs as methods of slowing the migration from the sierra to the coast, especially the migration to the Lima/Callao metropolitan area. The proposed loan will contribute directly to accomplishing these goals through increasing the value added in rural areas, and thus the incomes of rural inhabitants, and through the provision of remunerative opportunities in rural areas which will lessen somewhat the relative attractiveness of the major urban areas. Thus, the loan is directly and fully supportive of the analysis and recommendations of the multilateral institutions.

Several multilateral institution projects should be noted, in that they envision activities which demonstrate their commitment to financing programs which conform to their recommendations, and which are complementary in nature to those anticipated in the present project.

1. Inter-American Development Bank

- (a) The IBD is expected to shortly announce a loan to the GOP for the implementation of the first stage of Plan Copesco (Peru - UNESCO tourism and cultural plan). The Plan calls for the development of tourist infrastructure in the Cuzco-Puno region, and the first stage will comprise the following:
- Highway construction and improvement;
 - Rural electrification;
 - Construction and improvement of hotel facilities;
 - Improvement of sewage facilities;
 - Financing of Cuzco airport improvement studies.
- (b) An IIB loan for Associative Enterprises under the Agrarian Reform Program is presently two years into implementation. This loan was designed to provide credit and technical assistance to selected Associative Enterprises (cooperatives, SAIS,

community enterprises, etc.) in high priority Agrarian Reform areas throughout the country. The GOP contribution is an estimated \$ 14.5 million and the BID contribution is \$ 12 million. Three GOP agencies have roles in implementation; Banco de Fomento Agropecuario, the Ministry of Agriculture and SINAMOS. Projects eligible for financing are, for the most part, related directly to agriculture, but can include road construction, food processing, supply outlets, etc. Sub-project activities are viewed in the context of a detailed development plan for a given associative enterprise. The interest rate on all sub-loans is 9%; grace periods and amortization schedules are determined on a case-by-case basis. There are several important differences between this IDB Loan and the proposed A.I.D. Rural Enterprises Development project:

- The IDB project's average sub-loan size is about \$ 800,000, in comparison to the average estimated size of \$ 75,000 - \$ 100,000 (depending on the area) under the A.I.D. project for Rural Community Projects;
- The IDB project does not provide for centralized technical assistance to potential and actual sub-borrowers;
- The IDB project is designed exclusively to assist in credit and technical problems of high priority agrarian reform areas; the A.I.D. project will not be so restricted.

2. International Bank for Reconstruction and Development

The IBRD in October, 1973, made a \$ 25 million loan to the GOP supporting a three-year nationwide lending program of the Banco de Fomento Agropecuario (Agricultural Development Bank) for medium and long-term investments in agriculture. The loan provides credits to small farmers, including cooperatives, and medium-sized farmers for the following activities:

- Financing livestock farms;
- On-farm development of annual crops, such as alfalfa;
- Development of perennial crops;
- Agro-industrial development of key commodities such as swine and poultry.

The current interest rates charged to cooperatives under this loan are 9% per annum during the first 15 months of execution and 10% thereafter. Individual farmers are charged 13% per annum.

This project is complementary to the Rural Enterprises Development project in that its objective is the improvement of rural economic conditions. The projects differ, however, in that the IBRD credits are used exclusively in the agricultural sector and cannot be applied to alternative types of enterprise. The target groups to which the two loans are directed are also quite different: the A.I.D. project, by emphasizing the technical assistance component both in identifying and supervising sub-loan projects and by offering more concessionary interest rates, is aiming at providing credits to projects which are economically more marginal and would not otherwise qualify for bank loans; the IBRD project is geared to expanding the credit base for less marginal activities, many of which would qualify for commercial bank credit.

SECTION IV - BORROWER AND IMPLEMENTING AGENCIES

I. Borrower - Ministry of Economy and Finance

The Borrower is the Government of Peru represented by the Ministry of Economy and Finance (MEF). The MEF was established in 1969 (under the name of Ministry of Finance) by Decree Law No. 17591, and was later restructured and renamed by Decree Law No. 17703, also issued in 1969. The main function of the MEF is to design and implement national economic and financial policy. This includes economic and financial analysis of the economy resulting in specific monetary and fiscal policy measures designed and implemented on the basis of that analysis; responsibilities incident to the national debt, both internal and external; tax collections; national accounting; public budgeting and finance; and establishment of a short-term (2 year) development plan.

Under Decree Law No. 17703, the MEF was specifically charged with accelerating the process of economic development in Peru utilizing mechanisms which allow the MEF to coordinate with the policies and programs of other governmental and international entities in order to efficiently carry out its assigned responsibilities.

In this context, A.I.D. coordinates directly with the Office of Public Credit of the MEF on all of its loan programs and it will likewise coordinate the Rural Enterprises Development Loan with this office. All accounts with external donors are registered and serviced by the Office of Public Credit of the MEF.

USAID has received a letter from the Borrower represented by the Minister of Economy and Finance requesting a loan equivalent to US\$10 million under the most favorable terms and conditions acceptable to A.I.D. for the establishment of a Rural Small Enterprise Development Fund. A translation of this letter, No. 606-74-EF/75.14, dated May 17, 1974 appears in Annex B.

USAID has received a second letter from the Minister of Economy and Finance in which he designates the Industrial Bank as the Implementing Agency for the Rural Small Enterprises Development Fund program under the loan, and ORDEZA as the Implementing Agency for that part of the loan to be utilized in the earthquake zone. A translation of this letter also appears in Annex B.

II. Implementing Agency - Banco Industrial

A. Implementing Agency and Scope of Authority

The implementing agency for the Rural Enterprises Development Program under the proposed loan will be the Banco Industrial del Peru (The Bank), originally formed as a mixed capital national industrial development bank but now referred to as an independent public enterprise. As of December 31, 1972, the authorized capital of the Bank was S/.2,000,000,000 (\$46,104,195), and the paid-in capital was S/.1,180,731,000 (\$27,218,326). The Bank's shares are in two classes: Class A shares belong to the State, with no rights of dividends; Class B shares are reserved for individual ownership and can receive up to a 12% dividend free of taxes annually as The Bank's profitability allows. When fully paid-in, Class A shares will constitute approximately 90% of The Bank's total capital; as of December 31, 1972, Class A shares constituted 83% of paid-in capital.

The Bank lists total assets of S/.9,647,397,918 (\$222,392,759), including a loan and investment portfolio of S/.4,958,101,274 (\$114,294,635), and capital and surplus of S/.1,455,159,653 (\$33,544,482). The Bank has over 800 employees, more than 200 of which staff the Branch and Agency offices outside of Lima.

An autonomous entity formed originally in 1936, The Bank has as its primary function the promotion of industrial development throughout the country. The Bank's charter, as subsequently modified and elaborated by Supreme Decrees, authorizes it to promote and finance numerous activities supportive of industrial development such as the creation and construction of industrial parks, training centers for laborers and mid-level skilled workers, and certain tourist and hotel activities. The Bank may also receive and manage trust funds for these purposes.

Decree Law No. 20033 authorized The Bank to undertake all the operations authorized for other banking and financial institutions in the country. The Bank accepts current account deposits from individuals and companies, and also accepts time deposits from other financial and insurance institutions.

The Bank is authorized to obtain loans or lines of credit from international institutions and foreign governments; when such borrowing is conditioned on a government guarantee, The Bank is authorized to seek such guarantee.

In the area of small industry, The Bank is specifically charged with sponsoring the organization of small industry in "pre-cooperatives and other cooperatives, and other associative forms, investigating and encouraging respectively, the factors and activities which can serve as precipitating elements of collective interest, permitting The Bank to extend its services to the largest number of people." (Supreme Decree No. 299-68-H8, August 14, 1968).

In addition to the Lima office, The Bank operates 16 Branch offices and 4 Agencies in areas outside of the Lima-Callao area. Each branch office is staffed with an average of twelve personnel (4-5 professionals, 7-8 auxiliary), while an Agency averages three to four personnel in total and depends upon a Branch office for support.

B. Organization and Management

The Bank recently undertook a major internal reorganization. Now complete, this reorganization was begun in 1973 in response to recognition of The Bank's very rapid rate of growth in two particular areas: fishing and export credits. Taking the figures for the period 1971-1972 as illustrative, the following growth rates are noted: Ordinary loans - 50.8%; Supervised Loans (Small industry and artisan) - 32.7%; Fishing Loans - 495%; Export Credits - 205%. With such large demand recorded for sub-lending, The Bank sought to consolidate and streamline certain of its operational activities while giving Branch banks more responsibility and authority as well as emphasize its program of industrial development including specifically fishing, export, and small industry and artisan credits.

The Bank is now organized into seven divisions, two functional and five line, as follows:

- 1) The Administrative Division, which programs, directs, coordinates, and controls the technical administration of personnel, payroll, supplies, etc.;
- 2) The Financial Division, which studies, recommends, and implements the financial policies of The Bank;
- 3) The Operating Division, which organizes, directs, coordinates, and controls the banking operations of the institution;
- 4) The Industrial Credit Division, which studies, recommends, and implements The Bank's credit and assistance policies in support of

the general industrial activity of the country, except those activities in the area of fishing and non-traditional exports;

5) The Fishing Credit Division, which studies recommends, and implements the credit and assistance policies of the Bank in support of fishing activities in the country;

6) The Export Credit Division, which studies, recommends, and implements the credit and assistance policies of the Bank in support of the country's export activities; and

7) The Studies and Development Division, which studies, recommends, and implements The Bank's policies of industrial development assistance within the country. The proposed Rural Enterprises Development Project will be the management responsibility of this Division to elaborate and implement.

Specific responsibilities of the Studies and Development Division are discharged through four separate departments within the Division. These responsibilities involve: the organization, direction, coordination, and control over efforts of the Division in the performing of economic studies and evaluations; the provision of technical assistance to small and medium sized industrial business and also artisan activities; project design and elaboration efforts; intervention by The Bank in businesses which are in default on Bank loans; responsibility for the custody of goods assigned to the bank; and the administration and rehabilitation of businesses operated by The Bank. The Division also supervises the analysis, evaluation and processing of project investment plans submitted by holders of agrarian reform bonds.

Overall direction of The Bank's current and planned activities is provided by the Board of Directors, currently composed of the following eleven representatives: one private representative (for Class B shareholders), five representatives from the Ministry of Economy and Finance (one of which is Chairman of the Board) including one from the Banco Central de la Reserva, three representatives from the Ministry of Industries and Tourism, and two representatives from the Ministry of Fishing. The Directors are appointed by Supreme Decree and serve for a term of two years. The Board holds regular weekly meetings.

C. Experience in Similar Programs

The Bank currently administers a program of Supervised Credits to Small Industry and Artisanry. This program has been implemented primarily through the 16 Branch Offices and 4 Agencies of The Bank in

the areas outside of Lima. The program was originated by the Bank in recognition that small and medium sized industries employ a high proportion of industrial labor force and comprise a high percentage of the total number of industrial establishments. For purposes of The Bank's Program, an eligible small industry activity is any natural or legal entity which, through the use of machines and a certain number of workers, is dedicated to the fabrication or production of manufactured articles, and whose net worth is not larger than S/.1,200,000 (\$27,662) and whose gross income does not exceed S/.5,000,000 (\$115,260) per year. An eligible artisan was defined as one who through special knowledge or ability in a certain art or activity, with inputs of manual labor predominating over those of machines, fabricates or elaborates products for sale or special order.

Two classes of loans are available under this Program:

- a) Up to S/.50,000 (\$1,153); and
- b) From S/.50,000 (\$1,153) up to S/.480,000 (\$11,065).

Interest rates on class (a) loans are 6% annually, for all types. The interest rates on loans above S/.50,000 for fixed assets are calculated in accordance with priorities assigned by the GOP for all industrial development and run from 7% through 11%.

A 1% service charge is assessed in each case. No other special service charge is assessed on these loans, while larger customers needing special attention or supervision under regular lending can be assessed up to a 2% per year service fee.

During 1972 (the Report on all Bank Operations for 1973 was not available at time of this writing) the total of approved loans under this program rose 32.7% from S/.122,508,000 (\$2,824,066) comprising 1,214 loans, to S/.162,476,000 (\$3,745,412) comprising 1,488 loans. (These figures do not include additional small business lending realized by the Bank for small fishing/fish industry operations which is included in The Bank's Fishing Credit Division report). The Bank states that this significant increase was due in large part to the increased autonomy and authority to approve loans given to the Branch Offices in Piura, Trujillo, Arequipa, Tacna, Huanuco, and Cuzco and Puno up to the level of S/.480,000 (\$11,065). (The remaining Branch Offices have sub-loan approval authority up to S/.250,000 (\$5,763). The 4 agencies are dependent upon the Branch office nearest them for loan approval and have no authority of their own). The Bank's conclusion derives from the fact that, in spite of the authorization of the increased discretionary approval level being

in force for just the last four months of the year, the Branch banks mentioned above accounted for S/.28,500,000 (\$656,984) or 72% of the total increase in Supervised Credits during 1972.

The bulk of The Bank's lending under this program has been approved for projects involving industrial processing or production of food and clothing (43% of 1972 total amount approved).

Of the 1972 total, S/.67,227,000 (\$1,549,723) or 42% was for fixed assets and S/.95,249,000 (\$2,195,689) or 58% was for working capital. This ratio was also observed in the Bank's lending operations for 1971, and was unaffected by the increased decentralization of authority realized during 1972.

To date, The Bank has not performed a formal evaluation of the Supervised Credits Program and none is currently planned. Nonetheless, the Bank considers the Program to be successful in view of the increases in lending and the large demand surfacing for these credits. The Bank recently increased its promotional and technical assistance efforts through certain Branch offices. During the month of May, 1974 officials of the Bank's Division of Industrial Credit (which manages the existing Supervised Credits program) spent several days working with the Branch office in Puno, visiting and reviewing the applications of the small industrialists and artisans in the area for these credits. The objective of the effort was promotion of the availability of credits under the Program. In view of the total of 111 loans for S/.4,995,000 (\$115,145) approved as a result of this effort in Puno alone, the Bank feels strongly convinced of the large demand for such credits and intends to do more in this area.

While The Bank's program is called "supervised credits," in fact the program does not presently include all elements of promotion, training, and technical assistance that are contemplated for the proposed project. Additionally the Bank's program still requires guarantees in the amount of the loan for loans over S/.50,000 (\$1,153). Previous promotional activity has not been as intense and continuous as is planned for the proposed project and technical assistance (both before and during project) plus follow-up monitoring activities are less than in the proposed project.

The Bank shares USAID's opinion that for purposes of rural enterprises development more emphasis must be placed on these essential elements of "supervised" credit and sees the proposed project as an excellent way to achieve this result. The proposed project's focus on a special target group and target area, including the eligibility of services and commercial activities as well as small industry - which remains the prime focus of The Bank's Supervised Credit program - and

the use of special technical assistance teams and methods, is viewed by the Bank as the only way to achieve accelerated development of enterprises and contribute to raising the standards of living in parts of rural Peru.

In addition to its own Program of Small Industry and Artisan lending, the Banco Industrial has taken an active interest in promoting study and training in the general area of development banking. The Bank has cooperated closely with the Latin American Association of Development Finance Institutions (ALIDE), in particular assisting in the sponsoring of ALIDE meetings. ALIDE, headquartered in Lima, is the organization which represents the development banks of the region. Recently, The Bank entered into an agreement with ALIDE for the purpose of creating a Center for Documentation and Instructional Materials in Development Banking to be located within the Bank. According to the terms of the agreement, the Center will collaborate its efforts with the Graduate School of Business Administration in Lima (ESAN), the Institute of Fishing Science in Sao Paulo (IPE) and the Central American Institute of Business Administration (INCAE).

D. Ability to Execute Project

1. Appraisal of Operating Experience

As noted above, The Bank has had considerable experience in the development of small industry and artisan programs, particularly through its branch offices where approximately 90% of sub-lending activities are directed at small industry and artisan projects. In the Cuzco and Puno Branch Offices for example loans totalling S/.10,000,000, (\$230,520), and S/.9,000,000, (\$207,468), respectively were made in 1973. This was accomplished with only minimal promotional and technical assistance inputs from the Bank. The Bank estimates that this volume can be significantly increased with the additional technical assistance, promotion, and training inputs proposed under this Project.

The Bank's favorable experience with small industry/fishing/artisan lending notwithstanding, the Rural Enterprises Development Program to be implemented by the Bank under the proposed loan will require special efforts and inputs in several phases of project development some of which might not be available within The Bank's permanent professional staff. In particular, with regard to the more extensive organizational and technical assistance inputs which are expected to be necessary for the development of community or cooperative enterprises, which might involve agricultural activities, it is anticipated that The Bank will enter into inter-agency agreements with other GOP Development Agencies for provision of these inputs.

Within the last year The Bank has entered into several inter-agency agreements of the nature described above which are designed to tap potential credit demand among small entrepreneurs and cooperatives through increased promotional and technical assistance efforts. The Artisan Loan Program represents a special collaborative effort between The Bank, SINAMOS, and EPPA, (Empresa Peruana de Promoción de Artesanía). In this effort, SINAMOS certifies that the potential client is a legitimate, legally registered artisan, and offers some limited assistance in putting the artisan in touch with the Bank. EPPA provides a certification that there is sufficient market and a marketing mechanism for the artisan product. The Program has been in operation for approximately 6 months and has made a total of about 225 loans, 75% of which are located outside the Lima Department.

The Bank is also collaborating with the Public Enterprise for Fishing Services (EPSEP) in a supervised credit program for the development of small fishing industry enterprises, both individually and cooperatively owned. EPSEP, with limited backstopping assistance from the Bank, is responsible for sub-project promotion, administrative organization, implementation supervision, and marketing. The Bank performs the credit review, project feasibility study, loan disbursement and collection, and financial supervision.

2. Proposed Management and Organization of Project

Based upon an analysis of its current operations, in order to administer and implement the Rural Enterprises Development Program, The Bank has agreed to strengthen promotional and technical assistance efforts in the field, increase the lending approval authority of its Branch offices, expand its supervised lending coverage from industrial and artisan activities to include commercial and service enterprises, and increase its utilization of the local commercial banking system in lending activities.

The proposed program will include the following organizational and functional components.

A special office will be created with sole responsibility for the management and supervision of the Program. The Office personnel will report directly to the Chief of one of the principal Bank divisions, probably the Division of Studies and Development, allowing sufficient authority, autonomy, and flexibility for adequate program development. The Office will have the following responsibilities:

- a. Establish policy and operating guidelines for the Rural Enterprises Development Program and ensure that they are carried out.
- b. Supervise Field operations.

- c. Ensure that The Bank's backstopping services (technical assistance, training, promotion, etc.) are provided to field operations as needed.
- d. Inform The Bank's management and AID of Program progress and problems, requesting additional support when required.
- e. Approve those sub-projects which require loan amounts in excess of the approval authority established at the Branch office level.
- f. Coordination with other Bank Divisions and Departments as required.

Regional coordination and support staff will be hired for the Branch Offices selected for Program implementation. Their responsibility will be to implement the Rural Enterprises Development Program utilizing the existing Branch office resources and the technical backstopping assistance available in the Bank's various technical divisions.

3. Program Components

a. Project Promotion

The Bank will carry out an active program of promotion, publicizing the benefits of the Program, both the technical assistance as well as the financial assistance, to reach the target group in the priority areas selected. The means of achieving this may be illustrated by the following examples:

- Publication and distribution of descriptive literature about the Program, e.g., credit manuals, pamphlets, brochures, flyers, newspaper articles, etc.
- Meetings or seminars, conferences with business groups, campesino organizations, social organizations, local participating banks, etc.

b. Project Identification

A multi-disciplinary team (composed, for example, of some or all of the following professionals: an economist, industrial engineer, small business development technician, community organization expert, etc.) will identify potential sub-projects and sub-borrowers (individuals and groups) by:

1. Initiating field surveys in selected towns and micro-regions within the selected areas,

- identifying existing enterprises, their active and potential credit and T.A. needs.
 - identifying industrial, service, and commerce needs for which there is a demand not currently being met.
- ii. Reviewing existing studies on rural enterprise activities and needs, and development priorities in the region.
 - iii. Contacting other GOP development agencies, identifying additional potential projects.
 - iv. Assisting promotional activities in coordination with training and promotion staff.

c. Project Development and Implementation

Additional professional technicians will have responsibility for the development of feasibility studies for those projects identified at the pre-feasibility level by the micro-planning team. These technicians may collaborate with other GOP agencies (SINAMOS, Agrarian Reform, etc.) in the preparation of the studies, or complete the studies independently. This staff will also have responsibility for the supervision of the credits granted by The Bank. Periodic visits will be made to borrowers to identify and assist in resolving problems encountered in implementation.

d. Training

The Bank will determine either in-house or under a contract with an outside entities (e.g. local universities, Ministry of Labor, etc.) those common deficiencies and technical and administrative problems of the small businesses assisted by the Program, and organize or co-sponsor training courses designed to rectify those problems which can be effectively treated through group training programs, such as basic accounting, business management, cooperative management, marketing, sales, promotion, etc.

For those businesses needing highly specialized training, The Bank will arrange to deal with the problem on an individual basis.

4. Technical assistance role of other GOP Development Agencies

It is anticipated that the collaboration of other GOP agencies, such as Agrarian Reform and SINAMOS, will be required for the

development of community enterprises. These GOP Agencies will in most cases: a) identify community enterprises as potential borrowers, b) provide them with assistance in cooperative organization and management, c) collaborate with the Bank in the development of feasibility studies, d) provide technical supervision as needed in implementation, and e) provide the community enterprise with other types of assistance essential for project success.

The Bank will enter into formal agreements with GOP Agencies as may be required. These agreements will define the functions and corresponding resources required of each entity for project development in a given department or sub-region.

5. Project Approval

The existing Branch Office Loan Committee will have authority to approve most of the loan requests; prior to approval all requests will have been reviewed by The Bank staff, and by the local participating financial institution in those cases where requests have been channeled through that source. The Bank will increase the current approval authority of the Branch Offices so that an estimated 75% of the number of eligible projects developed can be approved at the Branch Office level. Branch Offices in the areas selected for initiation of the Program can approve, at the present time, sub-projects requiring no more than S/. 480,000. This authority will be increased for the Rural Enterprises Program.

E. Organization/management strengthening required

As the Bank is an industrial development financing institution, it will have to obtain an amendment of its charter or special decree to enable it to implement the proposed program which will provide credit and technical assistance to commerce and service activities as well as small industry activities. The Bank has indicated its willingness and ability to obtain the special authorization required.

The Bank's current organization and managerial capacity is adequate for the needs of the proposed program. An increase in staff will be required but within the context of The Bank's current Head-quarter's and Branch Office structure. Technical capability in credit analysis, and small industry development is also adequate.

The Bank, however, recognizes that special assistance will have to be contracted for the development of agricultural related projects and for the community organization and training components of the rural enterprise program. It is expected that most of these services

will be contracted locally utilizing the technical assistance allocation of the Loan.

1. Organization and Staffing Proposed by The Bank

The Bank has agreed to set up a special office to implement the proposed Program. The following proposed organizational structure and staffing for the Program to be initially implemented through the Puno and Cuzco Branch Offices has been submitted to USAID for consideration. See Annex I, Organogram of Banco Industrial.

a. Location of Project in Bank Organizational Structure

A special office will be created within the Bank's Studies and Development Division to implement the Program. This Division is the most appropriate given its technical assistance and other project backstopping functions with respect to small industry development. It is also the function of this Division to analyze current industrial program needs, recommend new programs and policies for the Bank, and to initiate new program development to meet identified needs. Given the technical assistance emphasis of the proposed project and its innovative aspects (including commercial/service credits and increasing Branch office responsibilities and authority), it has been proposed to locate the Rural Enterprises Program within the Studies and Development Division.

To the extent the Project proves successful it may subsequently be incorporated into another line Division. It is ~~THE~~ Bank's judgement that the proposed location will allow for maximum flexibility and authority required for the establishment and initial operation of the Program.

b. Organization and professional staffing of Program

i. A Program Director (economist) will be appointed with full time planning, implementation and coordination responsibilities for the Project. He will have the rank of Deputy Manager, reporting directly to the Bank Manager in charge of the Studies and Development Division.

ii. A technical support unit will be established reporting to the Program Director. This unit will be staffed full time by three industrial engineers, an economist, an agricultural expert, a community organization expert, and a statistician. This staff will be supplemented by part time assistance from other Departments within the Studies and Development Division as needed. While the

unit will be based in Lima, over 50% of its work will be in the Departments served by the Program, thus requiring considerable travel by the unit.

iii. Attached to each Bank Branch Office in Cuzco and Puno will be a Regional Program Office with sole responsibility for implementation of the Program. Each unit will be staffed by two professionals (probably an industrial engineer and an economist). The unit will report directly to the Program Director but will have access to Branch Office legal, accounting and other technical services. Branch offices in Cuzco and Puno each contain 5 to 7 professional staff (accounting, legal, engineering, etc.) who will be available on a part time basis to assist the Program.

iv. The Regional Program Offices will also coordinate activities with other GOP development agencies with which the Bank will enter into technical assistance implementation agreements for development of projects in the region.

v. The estimated operational costs required for the above described Bank staffing plus clerical staff exclusively charged with program implementation is S/.24,000,000 or U.S.\$553,250 over a three year implementation period.

USAID considers The Bank's organizational structure and staffing requirements proposed for this Program as tentative and subject to further definition to be contained in the Program Organization and Operations Plan to be prepared by the Bank in fulfillment of the conditions precedent to disbursement.

The Bank has assured USAID that it will be able to draw considerably from underutilized Bank technical resources in both its Lima and Branch Offices, and will provide full time staff in addition to that proposed, should this be required to fully meet Program objectives. USAID will analyze in-depth The Bank's current Branch Office capacity and the quality and timeliness of Lima back-stopping services available to the Branch offices in reviewing the Bank's program plan called for in the conditions precedent. USAID will also review closely with The Bank the field capacity of other GOP Development agencies which will be collaborating in program implementation.

F. Conditions Precedent

As a Condition Precedent to disbursement under the loan, The Bank will prepare for A.I.D.'s review and approval a complete

description (Program Organization and Operations Plan) of the proposed Program and the manner in which it will be carried out (See Section VI for description of Conditions Precedent).

III. Implementing Agency - ORDEZA ^{1/}

A. Implementing Agency and Scope of Authority

In response to the Earthquake in 1970, the GOP created the Commission for the Reconstruction and Rehabilitation of the Earthquake of May 1970 (CRYRZA) to plan and coordinate resource allocation and project execution for the reconstruction effort. During its first year of operation, the CRYRZA role was limited to 1) coordinating the emergency relief programs of the GOP agencies with sector responsibilities in Housing, Agriculture, Transportation, etc. 2) providing short to medium range planning for reconstruction of major regional urban areas, and 3) establishing general norms and regulations governing the reconstruction process. In this effort the GOP line agencies were the primary executors of emergency assistance resources provided by international donors with CRYRZA receiving technical assistance, primarily from the U.N., in urban and regional planning.

In February of 1972, CRYRZA was granted significant new responsibilities including the execution of reconstruction projects and increased control over the line agencies operating in the Zone. Complementing this, CRYRZA headquarters moved from Lima to Huaraz and its Regional Zonal Offices were further strengthened. This decision was prompted in part by the lack of tangible reconstruction projects in execution as well as mounting public discontent in the Zone. CRYRZA's effective power over line agencies had proven to be too limited to ensure prompt project implementation.

Progress following the decision has been dramatic. This is in part due to ORDEZA's strengthened role and physical presence, as well as to the natural evolution from project planning to execution.

Project execution has improved greatly now that ORDEZA has largely overcome administrative and interagency conflicts arising from its role as executing authority. ORDEZA has developed into an effective regional development organization.

^{1/} In early 1973, by Supreme Decree No. 19967, CRYRZA (Comisión de Reconstrucción y Rehabilitación de la Zona Afectada) was renamed ORDEZA (Organismo Regional para el Desarrollo de la Zona Afectada). This renaming was done at the same time the scope of activities was expanded from reconstruction in the earthquake zone to reconstruction and development of the earthquake zone.

USAID has developed a close relationship with ORDEZA in project monitoring and execution. This is well illustrated by the assignment and performance of ORDEZA as implementing agency for the A.I.D. Community Development and Small Business loans, and the cooperation afforded to A.I.D. in the development of this program.

B. Organization and Management

The ORDEZA organization is composed of seven divisions as follows: Chief's Office, Division of Coordination, Division of Consulting Services, Division of Audits and Controls, Division of Planning and Evaluation, Division of Management, and Division of Implementation. The functions of the Divisions are those indicated by their respective names.

Management responsibility is centered in the Chief's Office, and all Divisions report to this office. Special offices reporting directly to the General Manager have been created to implement the A.I.D.-ORDEZA Community Development and CRECE Fund Small Business programs. The Rural Development Division, set up to manage the 052 Community Development project, administers project planning, promotion, implementation, and coordinates inputs from other ORDEZA Divisions. It also supervises construction and credit operations.

The CRECE Fund Small Business Program is likewise administered through a special office, the Program for Financial Investment, which reports directly to the General Manager of ORDEZA. This office coordinates all staff and outside inputs of the Program.

C. Experience of Agency

As described in earlier Sections (Section II, The Project), ORDEZA is now managing programs initiated by financing under loans 052 and 053. The allocation of additional loan funds to ORDEZA under this proposed project will finance a continuation of these programs with modifications as indicated below.

D. Ability to Execute Project

1. ORDEZA has been the implementing agency for the projects financed by loans 052 and 053, and will continue as the Implementing Agency for these projects with the additional funding proposed under this program. It is not anticipated that there will be a major up-surge of activity in either project with the additional funding provided under the loan, but rather that the projects will

continue at much their present rate. The 052 Community Development Program now has a staff which includes 4 executive and administrative personnel, 25 professional staff (engineers, economists, sociologists, etc.) and about 100 technicians. It is anticipated that this staff will be retained (and financed out of GOP counterpart) to continue the implementation of the Community Development Program.

The Small Business group includes one manager, 10 professional staff, (engineers), and 5 technicians. ORDEZA has requested and received A.I.D. approval to add an accountant/analyst and one technician to the Small Business Program, to be financed out of loan T.A. funds under loan 053. This staff will be retained to continue the same activity with the additional resources provided under this loan.

ORDEZA has effectively become a regional development organization with both planning and executing responsibilities in the zone. As such, it is unique in Peru, and often enjoys the advantage of authority over other GOP organizations operating within the zone. Possibly because of this unique status, ORDEZA's relationships with other agencies in the zone are now quite good. A spirit of cooperation rather than competition has evolved, and ORDEZA generally receives the support and assistance of other agencies. In particular, the relationships with SINAMOS and the Agrarian Reform Agency are very good.

2. Proposed Management Organization for the Project

There are not expected to be any changes required in the management of the Community Development Program. There are, however, several changes that will be made in the Small Business Program. The Small Business Program will strengthen its capabilities to provide technical assistance to sub-borrowers. To achieve this, ORDEZA will, through in-house efforts or by contracting with an outside entity, evaluate its existing portfolio of 053 sub-projects and attempt to determine deficiencies in the planning and operations areas of these projects. It is also planning to organize courses or seminars to include training in the technical, economic, financial, accounting, administrative, and other aspects of these businesses, with the objective of solving or overcoming those elements of their operations which restrain efficient operation and development.

In addition, ORDEZA will insure that an adequate number of professionals in business operations/management are available to visit each sub-project at least once a month for the first year of

operation and at least quarterly until the loan is amortized. In addition, ORDEZA will provide enterprises that have special planning or operational requirements with appropriate assistance.

E. Conditions Precedent

As a condition precedent to disbursement under the Loan, ORDEZA will prepare for A.I.D.'s review and approval a complete description (Project Organization and Operations Plan) of the proposed program and the manner in which it will be carried out. (See Section VI for a description of Conditions Precedent).

SECTION V - FINANCIAL ANALYSIS

A. Financial Plan

The total amount of funding expected to be provided from all sources for the activities of the Rural Enterprises Development Project is \$16.9 million.

1. A.I.D.

The A.I.D. contribution will be \$10.0 million. In accordance with the designation of two implementing agencies under the Project, the A.I.D. contribution is divided into two portions: \$6.0 million for that portion being implemented by the Banco Industrial, and up to \$4.0 million for the portion to be implemented by ORDEZA.

2. Banco Industrial Implemented Activities

Under the proposed Program, the Banco Industrial will set up a "Rural Enterprises Development Fund" to finance projects under an approved program. To support this program, A.I.D. will contribute \$5.7 million for the capitalization of the Fund, and the Banco Industrial is expected to contribute \$4.0 million, for a total fund capitalization of \$9.7 million.

Additionally, of the total A.I.D. contribution, up to \$.3 million will be available for the technical assistance requirements of The Bank in implementing the Program, and for technical assistance provided by The Bank to sub-borrowers. In the former case, The Bank is contemplating contracting for the services of a full-time advisor for the program to work as liaison between the Bank and USAID regarding implementation of the Program. Also, The Bank may contract for assistance in project evaluation. In order to provide specialized technical assistance to sub-borrowers, The Bank expects to go outside of its own organization for special skills, - e.g. The Bank might contract with a university or business school for a training course.

To provide adequate staffing for the new program, The Bank will reassign some personnel and hire additional others. The Bank projects the value of the services of the new personnel over three years at more than \$500,000.

3. ORDEZA Implemented Activities

Under the proposed program, ORDEZA will continue the activities of the Rural Community Enterprises Development and the CRECE Fund Small Business Assistance Projects as initiated under previous loan projects 052 and 053. To support this effort, A.I.D. will provide up to \$4.0 million to ORDEZA. ORDEZA, in partial satisfaction of a Condition Precedent, will recommend an allocation of these resources between the two activities for A.I.D. review and approval. Of the

FINANCIAL PLAN - SOURCES OF FUNDS

Rural Enterprises Development Project

Program Elements	A.I.D.	BANCO INDUSTRIAL	ORDEZA	Participating Financial Intermediaries	Sub- Borrowers
A. <u>BANCO INDUSTRIAL</u>					
1. Rural Enterprises Development Fund Projects	5.7 m	4.0 m		0.7 m	0.3 m
2. Technical Assistance to Banco Industrial and Sub-Borrowers	0.3 m				
3. Banco Industrial Counterpart (Staff)		0.5 m			
	<u>6.0 m</u>	<u>4.5 m</u>			
B. <u>ORDEZA</u>					
1. Rural Community Enterprise Development Projects)	3.7 m				
2. CRECE Fund Small Business Assistance Projects)					
		With apportionment to be recommended by ORDEZA, approved by A.I.D.		0.3 m	0.1 m
3. Technical Assistance to ORDEZA for (1) and (2) above	0.3 m				
4. ORDEZA Counterpart			1.0 m		
	<u>4.0 m</u>				
Sub-Totals	10.0 m	4.5 m	1.0 m	1.0 m	0.4 m
TOTAL PROJECT = <u>\$16.9 million</u>					

total AID contribution, up to \$.3 million will be available for the technical assistance requirements of ORDEZA or sub-borrowers.

ORDEZA will contribute an estimated \$1.0 million during the disbursement period for operating requirements of the two activities, including personnel and equipment.

4. Participating Financial Intermediaries (PFIs)

Under the Program, each Implementing Agency will administer a program utilizing a Trust Fund mechanism for sub-project financing which will encourage the participation in sub-lending of existing banks and other financial institutions (credit unions, cooperatives, etc.), in the project areas. Criteria for participating in the program will require a PFI to contribute a portion of the total sub-loan.

In the instance of the ORDEZA CRECE Fund, the minimum PFI contribution has been 10%, with the Fund contribution 90%. Assuming that ORDEZA will allocate approximately 50% of the \$3.7 million AID contribution to the CRECE Fund, this gives a minimum PFI contribution to project financing of a minimum of \$0.2 million based on the experience of O53. (As partial satisfaction of Conditions Precedent to disbursement ORDEZA will be required to review the existing CRECE FUND Credit Manual, in particular to focus on increasing the minimum contribution from the PFI's up to approximately 25%. If this is done, the total PFI contribution would be increased, to an estimated \$0.3 million).

Discussions with the Banco Industrial have considered a somewhat higher minimum PFI contribution for participating in the Bank's program. While no decisions have been reached, this issue will be reviewed further with an objective of setting a higher amount, up to 25% of total sub-loan value. (Based on consultation with Banks in the Cuzco area in particular, this appears feasible since one bank - the Banco de los Andes - indicated a desire to participate in the proposed program with several hundred thousand dollars of its own resources.)

However, for the present calculation, it is conservatively assumed that a figure of 15% minimum PFI contribution in both Programs will result in approximately \$1.0 million total contribution from PFI's.

5. Sub-Borrower

The experience under 053 - the CRECE FUND - which required a minimum sub-borrower contribution of 5% of the total project, was used as a guide for this calculation. Under the CRECE Fund, enterprises in the target area had been effectively devastated, with few or no capital assets remaining; the CRECE Fund will continue to assist some enterprises in that category. The target group in the areas of operation of the Banco Industrial Rural Enterprises Development Fund, while not having been subjected to earthquake or other disasters recently, is specifically directed to those enterprises with little or insufficient assets and which therefore cannot obtain credit from normal sources. Therefore, the minimum percentage of 5% of total project value was also used. It should be noted that since this is a minimum figure, the total contribution will likely be higher.

As a result, a conservative estimate of sub-borrower financial contributions by individual entrepreneurs, is:

a) ORDEZA-CRECE FUND

- 0.1 million and

b) Banco Industrial, Rural Enterprises Development Fund

- 0.3 million

B. Justification for Local Cost Financing

The greater part of the subloans are expected to be for local construction, machinery and equipment, and raw materials. Machinery and equipment purchases will be of a wide variety which can be purchased locally as required; raw materials will be largely local in origin, i.e., from the region or Department in which the enterprise is located. In view of these facts and the purpose of the loan being to provide maximum developmental impact on the target area, (in an effective manner), the bulk of the loan financing available in the form of local currency is justified.

Costs associated with technical assistance from the U.S. and Code 941 countries will be dollar costs and handled under regular AID procedures.

C. Utilization of Repayments

Repayments of sub-loans, together with interest received (after deduction of the Fiduciary's fee in the case of the CRECE Fund) will be handled in the following manner:

1. Repayments to the Banco Industrial's Rural Enterprises Development Fund will be added to the Fund and be made available for relending under the terms and conditions of the Fund.
2. Repayments from sub-loans approved by ORDEZA under the additional inputs to the CRECE Fund Project will flow to the Banco Industrial's Rural Enterprises Development Fund to be made available for relending under the terms and conditions of that Fund in accordance with the plan to be submitted for that purpose by ORDEZA as part of the Program Organization and Operations Plan, required from ORDEZA as a Condition Precedent to disbursement.

Presently, under the 053 loan agreement, ORDEZA must submit to AID within five years from the date of the first disbursement of the loan, a plan satisfactory to AID for the disposition of the CRECE Fund. That plan will be submitted by December 1977, or earlier. ORDEZA indicates that, with the additional resources provided to it under the proposed loan it will, with repayments from 053 and 052, be able to continue to carry out the two activities of Rural Community Enterprises Development and the CRECE Fund Small Business Assistance program at a reasonable level indefinitely. While ORDEZA could prepare the plan sooner, the very large demand generated by the two project activities, as described elsewhere, argues strongly that ORDEZA use its significant organizational capacity to continue to provide and manage the two assistance programs in the earthquake area, although administration of the two programs will over time become more closely coordinated and, perhaps, consolidated. USAID intends to discuss such consolidation of funds with ORDEZA during loan negotiations with a view to requiring that ORDEZA submit a plan for such consolidation.

D. Disbursement Procedures

1. To ORDEZA

It is proposed that disbursements of the \$4 million to be channelled thru ORDEZA as the Implementing Agency will follow existing procedures applicable to Loan 052 and Loan 053, respectively. These

procedures may be later modified as a result of the review to be made of these programs upon the submission by ORDEZA of its Program Organization and Operations Plan, to be required as a Condition Precedent to disbursement.

2. To the Banco Industrial

A proposed disbursement procedure for the portion of the loan resources to be implemented by the Banco Industrial is contained below.

Assumptions

- a. A Trust Fund will be established in the Banco Industrial to control and account for all Project Funds (both AID and the Bank which are channeled for implementation by The Bank.
- b. Net reflows from subloan repayments and interest collections on subloans (including reflows for \$4 million channeled for implementation by ORDEZA) will become a part of the Trust Fund corpus.
- c. The Bank will maintain separate accounting records for the Trust Fund in sufficient detail to enable preparation of annual financial statements showing Trust Fund assets, liabilities, equity and operational accounts, separate and apart from the financial statements of The Bank.
- d. The Bank will establish a Revolving Fund Account (current account) to control all local currency received or disbursed on behalf of the Trust Fund.
- e. Dollar disbursements on behalf of the Trust Fund will be made by Letter of Commitment/Letter of Credit Procedures or other procedures mutually agreed upon.
- f. Contributions to the Trust Fund by AID and the GOP will be made periodically by each in accordance with a schedule acceptable to AID.

- g. AID disbursement of local currency contribution can be made on strictly reimbursable basis or a modified initial advance/reimbursement basis. (See discussion of these two alternatives below.)
- h. GOP contributions to the Trust Fund will be made in soles computed and specified at the highest legal exchange rate.
- i. Any funds provided for technical assistance will be handled separately from the Trust Fund (applicable disbursement procedures will be defined by Implementation Letter).

The preferred method for AID local currency disbursements would be for the Banco Industrial to make an initial contribution to the Trust Fund Revolving Account. Thereafter, AID would periodically reimburse the Trust Fund, based on either the amount of disbursements made or subloans approved. Thereafter AID and The Bank would continue this process until the total of their respective contributions is reached.

The second alternative would be for AID and The Bank to make initial advances equal to 90-day requirements of the Program. Such advances would be deposited in The Bank to establish the Revolving Fund Account. Periodic replenishment of this Revolving Fund would be made pursuant to a schedule by AID and The Bank, based either on disbursements made or loans approved, until such time as the total of respective contributions is reached.

The advance method is one which has been employed traditionally in the past in Peru, is best understood by Peruvians and has not caused problems of funds being held idle in the past. However, given AID/W preference for reimbursement, the USAID will seek to negotiate this method with the Banco Industrial. Since ORDEZA does not have the financial flexibility of a Bank and its contribution consists essentially of administrative costs, the advance method will continue to be utilized with ORDEZA.

E. Government of Peru Capacity to Repay

See Section III, Economic Analysis (A. Overview of Economy) for discussion of GOP Balance of payments situation and projected Debt Service capacity.

SECTION VI - IMPLEMENTATION PLAN

A. Execution

The following schedule estimates the timing for the critical Project events:

<u>Event</u>	<u>Date event completed</u>
1. Authorization of Loan Draft, prepare for negotiating loan agreement	June 21, 1974
2. Termination of Negotiations and Signature of Loan Agreement - prepare Implementation Letter No.1	August 15, 1974
3. Implementation Letter No.1 issued	September 1, 1974
4. Satisfaction of Conditions Precedent to Initial Disbursement by Borrower (Ministry of Economy and Finance) A. Opinion of Borrower's Legal counsel, B. Designation of Borrower's repre- sentatives (Implementing Agency Representatives) (Implementing Agency - Banco Indus- trial or ORDEZA - can proceed to contract for Technical Assistance to itself as eligible for financing under the loan, e.g., full time Project Advisor, and for purchases of equipment and vehicles required for project implementation by both Implementing Agencies.	September 15, 1974
5. Satisfaction of Conditions Precedent to Additional Disbursement of Loan Funds through the Borrower to the Banco Industrial	November 1, 1974

- A. Evidence of the creation of a Rural Enterprises Development Fund within the Banco Industrial for the Program.
- B. Evidence of sufficient budgetary resources to make the Banco Industrial's contributions to the Project
 - for capitalization of the Rural Enterprises Development Fund
 - for additional personnel and operating expenses as required for the project.
- C. Program Organization and Operations Plan, Rural Enterprises Development Program. A complete description of the program and the manner in which the sub-project activities will be carried out, including evidence of The Bank's authority to work with Commerce and Service type businesses and the following:
 - 1) A Plan setting forth the organization, criteria and procedures to be followed in carrying out the Rural Enterprises Development Program. The Plan will include, but not be limited to, the following:
 - The proposed administration of the Program within the Banco Industrial's existing institutional structure, allowing a maximum of decentralization of responsibility and authority for Program execution from the Branch or Field offices.
 - The proposed staffing of the special Program unit, to include sufficient professional, technical, and auxiliary personnel to ensure the Program will achieve the following objectives:

- a. Project Identification
- b. Project Promotion
- c. Technical Assistance
- d. Training

The Plan will also include:

- criteria and methods for selecting sub-projects
- procedures for financing (application; approval)
- procedures for procurement and delivery of goods
- control, inspection and follow-up of sub-projects
- system for evaluation of the Program's activities
- accounting system to be used for funds provided under the loan

2) Annual Time-Phased Implementation Plan

3) Operations Credit Manual

6. Satisfaction of Conditions Precedent to Additional Disbursement of Funds through Borrower to ORDEZA for the Rural Community Development Fund and the CRECE Fund activities.

November 1, 1974

A. Program Organization and Operations Plan, Rural Community Development Project and CRECE Small Business Assistance Project. A complete description of both projects and the manner in which the project activities will be carried out, to include:

- evidence of sufficient GOP budgetary support to ORDEZA to commence and continue the project activities during the life of the project, for additional personnel and operating expenses as may be required.

1) Program Organization and Operations

A plan will be prepared satisfactory to A.I.D. setting forth the organization, criteria and procedures to be followed in carrying out the Rural Community Development Project and the CRECE Fund Small Business Assistance Project. The Program Organization Proposal will indicate, but not be limited to, the following:

- The proposed administration of the Program within the Implementing Agency's existing institutional structure.
- Provision for reflows of principal and interest payments of the additional resources provided under this Program to be deposited to the Rural Enterprises Development Fund to be administered by the Banco Industrial.
- The proposed staffing for both Program activities, to include sufficient professional, technical, and auxiliary personnel to ensure the Program will achieve the following objectives:
 - a) Project Identification
 - b) Promotion
 - c) Technical Assistance
 - d) Training

This Plan will also include:

- A three year projection of sub-project development and sub-lending by type of project and by geographical distribution.
- Criteria and methods for selecting these sub-projects, including measures to obviate any discrimination against women or minority groups.
- procedures for financing including terms, collection methods, provision for adequate maintenance and follow-up, etc.
- provision to consider environmental effects of sub-projects
- inspection/follow-up of these sub-projects
- system for evaluation of the Program's activities.

2) Annual Time-Phased Implementation Plan. Also to be included will be a twelve-month time-phased implementation plan for carrying out both the Rural Community Development and the CRECE Fund Small Business Assistance Projects, and an implementation plan estimating project activities during the following twenty-four months.

This Plan will give starting and terminal dates of activities, personnel, training, technical assistance, and equipment required, and projected costs for these activities showing the source of funding and source of goods and services. Presentation of these activities will be by bar charts, critical path methods or flow charts.

- 3) Operations Credit Manual. The existing CRECE credit manual governing the operations of the Fund will be reviewed by ORDEZA to ensure that the Manual includes, among other things, the rules and regulations established by ORDEZA and the CRECE Fund Trustee, and approved by A.I.D. in writing, governing Participating Financial Intermediaries (with provision for increasing the PFI's minimum contribution to the CRECE Fund program from 10% up to approximately 25%) eligible sub-borrowers, conditions of sub-loans, methods of approving sub-loans, and rules for general operations of the Fund, to reflect any changes resulting from the new Project Organization and Operations Plan referred to above.
7. First Disbursement through the Borrower to either the Banco Industrial or ORDEZA November, 1974
 8. Joint Project Review (with ORDEZA and the Bank) April, 1975
- general assessment of status
 9. Subject to negotiations between USAID and ORDEZA prior to signing of the Loan Agreement, USAID will seek ORDEZA agreement to prepare a plan in form and substance satisfactory to USAID for the consolidation of the two Funds administered by ORDEZA under Projects 052 and 053. Such plan will be due for AID consideration by August, 1975. August, 1975
 10. Joint Project Review (with ORDEZA and the Bank) December, 1975
- general and specific assessment, to focus on progress of projects, evaluation of accomplishments, make Program management recommendations to ensure realization of project goals/targets.
 11. Joint Project Review (with ORDEZA and the Bank) December, 1976
- as above
 12. Final Disbursement June, 1977

B. Evaluation

1. Under loan 052, ORDEZA, with technical assistance to be contracted with USAID assistance, will soon be establishing a sub-project evaluation system which has as its purpose helping ORDEZA to determine the benefits to the population of the rural communities flowing from the 052 Community Development type projects. The technical assistance will focus on defining evaluation criteria, establishing measurement indicators, designing a comprehensive and effective reporting system, and implementing such a system.

Prior to the disbursement of loan funds for ORDEZA's Rural Community Development and CRECE Small Business Assistance Program activities, ORDEZA will submit for A.I.D. review, as one element in a comprehensive Program Organization and Operations Plan, its proposed system for evaluation of the Project's activities. It is expected that the system to be designed for the 052 activities as well as the system for this loan will incorporate major elements of the model Evaluation Plan presented below.

2. During negotiations with the Banco Industrial, the necessity of providing for regular and comprehensive project evaluation in the project design was discussed, including: identification and definition of Program objectives, functions, and sub-project, eligibility criteria. The Banco Industrial agrees in principle with the need for evaluation and regular progress reviews. An evaluation plan and reporting format were developed by the USAID which should effectively assess the progress and relative success of the project in reaching the goals identified during the project design.

To support and assist this effort, The Bank proposed the full-time assignment of an individual from the Statistics Section of the Studies and Development Division to be in charge of gathering, maintaining, and preparing the data required for project reporting and evaluation. This individual will be responsible directly to the Program Director for the Rural Enterprise Development Program in The Bank.

As an additional means of assuring that adequate evaluation procedures are developed for this Program, the Project Committee has suggested to The Bank that it contract with a consultant firm experienced in project evaluation to assist in designing appropriate methodology and systems for establishing criteria, monitoring, getting feed-back, measurement, etc.. The Committee also suggested that financing for this purpose could be made available from the portion of the loan reserved for technical assistance.

The USAID intends to continue discussions with the Bank on the overall subject of project evaluation following loan authorization. An effective evaluation system proposal is one of the elements to be included in The Bank's Program Organization and Operations Plan to be submitted for USAID review in satisfaction of a Condition Precedent to disbursement of loan funds for the Banco Industrial's Rural Enterprises Development Program.

3. The following represents USAID's judgment of the types of targets and objectives of the Project, benchmark data sources and means of verification which will be addressed in the Program Organization and Operations Plan.

EVALUATION PLAN

I. THE PROGRAM OBJECTIVE

<u>Criteria for Measuring Project Success</u>	<u>Benchmark Data and Means of Verification</u>
a. Employment Generated -cost per job created relative to amount of subloan.	a. Data from 053 experience will be used as guide.
b. Value added through sub-project activity.	b. Sub-projects expected to create additional value over cost of raw inputs.
c. Economic integration effects of sub-projects. (i) utilization of locally produced raw materials, inputs. (ii) consistency with GOP policies for vertical industrial integration.	c. (i) sub-projects expected to utilize on average, a percentage (x%) of locally-regionally produced inputs (materials and labor). (ii) (Indicators to be developed).
d. Income generated through sub-projects. -profitability of enterprise (individually or communally owned) -salaries paid to new employees	d. Confirmation of a continued profitable operation of sub-project near or above level of activity when sub-project implemented.

- e. Soci-economic groups benefitted.
 - community enterprise
 - individual enterprise
 - f. Employment-Integration of Women in Sub-projects.
- e. Sub-project application will identify socio-economic category of entrepreneurs, employees and participants.
 - f. Numbers of women in management and other positions.

II. THE INSTITUTIONAL OBJECTIVE

Criteria for Measuring Project Success

Benchmark Data and Means of Verification

- a. Numbers of sub-projects approved and total amount of sub-lending per year or other period as selected. (In conformance with the purpose of the Project, sub-loans will be made only to individuals or community enterprises not having access to credit on reasonable terms and conditions)
 - b. Effectiveness of Promotional Efforts
 - confirmed by wide knowledge of program concepts and procedure within population of target areas, groups.
 - individual enterprise demand level predicated upon promotional efforts achieved; demand for community enterprise type projects induced as projected.
 - c. Technical Assistance
 - project output, i.e. magnitude and kinds of services provided to sub-projects.
 - confirmation of continued utilization of T.A. advice in sub-projects during project implementation.
- a. Target figures selected for sub-projects approved:
 - (18 mos) (24 mos) (36 mos)
 - Communal Enterprise
 - Individual Enterprise
 - Full disbursement by 36 months
 - b. Numbers of sub-projects:
 - identified by T.A./Promotion Team (as either potential or feasible)
 - numbers of actual applications approved.
 - information on how entrepreneur learned of Program to be required on sub-project application sheet.
 - c. Confirmation of actual delivery of TA to sub-projects, as contemplated in CAP through Regular Reports.

d. Repayment experience
-low, or acceptable, level
of delinquencies, accord-
ing to pre-project estimates.

e. Degree of follow-up monitor-
ing and assistance by
implementing agent.

d. Using ORDEZA's -052 -053
experience as a guideline.

e. Number of periodicity of
follow-up visits to be established
in Borrower's Operational Plan
(in satisfaction of Condition
Precedent).

III. The following are considered to be criteria and measurements of
both Program and Institutionalization objectives.

Criteria for Measuring
Project Success

a. Participation in program
by local financial inter-
mediaries

-number and type of institu-
tion participating of those
eligible.

b. Disposition of sub-borrowers
to seek credit through tradition-
al banking/credit systems.

Benchmark Data and Means
of Verification

a. Number of eligible agents
and intermediaries to be
established when program credit
manual prepared (in satisfaction
of Conditions Precedent).

b. Follow-up visits to sub-
borrowers will establish.

C. Project Review Schedule

Joint Project Reviews will be tentatively scheduled with USAID and the Implementing Agencies to assess the general and specific status of the Project as follows:

a. Joint Project Review

- general assessment of Project Status progress to date April, 1975
- Implementing Agencies will assemble information according to Evaluation Criteria for Joint Review.

b. Joint Project Review

December 1975

- general assessment, with specific objective of focusing on sub-project results, evaluation of progress in meeting established objectives and criteria and making management recommendations for overall Program as necessary to ensure realization of goals, purposes and targets.

c. Joint Project Review

December 1976

- general assessment, as in (b) above

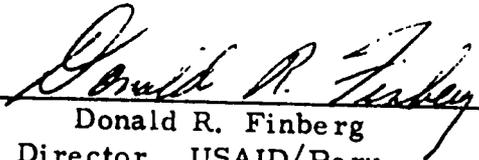
REPORTING

1. Implementing Agencies will be required to maintain records on activities and accomplishments of its Project Staff, especially the Technical Assistance and Promotion personnel, and to obtain information regularly on sub-projects and sub-borrowers as necessary for preparation of regular reports and special Joint Project Review evaluation reports.
2. Implementing Agencies will submit to A.I.D. a monthly statistical summary of sub-lending activities and a quarterly progress report containing an appraisal of the status of the Project describing all major components. The quarterly report will include a work plan for the following six month period.
3. For those periods when a Joint Project Review is scheduled, the Implementing Agencies will prepare the quarterly progress report, and the information on evaluation of the project to that time, for the Joint Project Review Meeting.

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

I, Donald R. Finberg, the principal officer of the Agency for International Development in Peru, having taken into account among other factors the maintenance and utilization of projects in Peru previously financed or assisted by the United States, do hereby certify that in my judgment Peru has both the financial capability and human resources capability to effectively maintain and utilize the capital assistance project: RURAL ENTERPRISES DEVELOPMENT.

This certification is based inter alia on the Government's performance in the execution of comparable credit projects financed by A. I. D. Loans 527-L-052, 527-L-053.


Donald R. Finberg
Director, USAID/Peru

TRANSLATION

Ministry of Economy and Finance

May 17, 1974

LETTER No. 606-74-EF/75.14

Mr. : Donald Finberg
Director, Agency for
International Development

SUBJECT: Small Business and Industry Project

This letter is in reference to the establishment of the Rural Small Enterprise Development Fund whose objective is to provide credit to small businesses and industries.

In order to create the above mentioned Development Fund, my Government officially requests from The US Agency for International Development, AID, the granting of a loan equivalent to US \$10 million dollars under the most favorable conditions acceptable to AID.

The Government of Peru will contribute the equivalent in soles of approximately US \$4 million dollars to the Development Fund.

The establishment of the Small Business Fund lies within the general priorities set forth by the Peruvian Government for national development.

We have not as yet determined the implementing agency for the project but are presently studying the matter and will advise you as soon as we reach a decision.

In the name of my Government, I hereby request AID cooperation in the development and financing of the referenced project.

Please be assured of my highest consideration.

Sincerely,

General of Division of the
Army of Peru
Guillermo Marcó del Pont S.
Minister of Economy and
Finance

TRANSLATION

Ministry of Economy and Finance

June 4, 1974
Lima, Peru

LETTER No. 734-74-EF/75.14

Mr. Donald Finberg, Director
Agency for International Development
LIMA, PERU:

This letter is in reference to the request formulated by my Government for a loan for the implementation of the rural Small Industries and Businesses Project in the amount of US \$10.0 million.

The Banco Industrial of Peru has been designated responsible implementing agent for the credit programs. ORDEZA will act as implementing agency for the portion of the Loan applicable to the earthquake zone.

Consequently, AID and these entities can coordinate as necessary for program development and successful project execution.

Let me take this opportunity to assure you of my highest consideration.

Sincerely,

General of Division of the
Army of Peru
Guillermo Marcó del Pont S.
Minister of Economy and
Finance.

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CHECKLIST OF STATUTORY CRITERIA
(Alliance for Progress)

The following abbreviations are used:

FAA - Foreign Assistance Act of 1961, as amended.

FAA, 1973 - Foreign Assistance Act of 1973.

App. - Foreign Assistance and Related Programs Appropriations Act, 1974.

MMA - Merchant Marine Act of 1936, as amended.

BASIC AUTHORITY

ANSWER OR DISCUSSION

1. FAA § 103; § 104; § 105;
§ 106; § 107. Is loan being made

a. for agriculture, rural de-
velopment or nutrition;

b. for population planning or
health;

c. for education, public ad-
ministration, or human resources
development;

d. to solve economic and social
development problems in fields
such as transportation, power
industry, urban development, and
export development.

a. For rural development.

AID 1240-2 (4-74)

e. in support of the general economy of the recipient country or for development programs conducted by private or international organizations.

COUNTRY PERFORMANCE

Progress Towards Country Goals

2. 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.

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

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

The GOP has an active agricultural credit program for both large and small farms, as does A.I.D. with its Food Marketing Loan. A top priority activity of the GOP is the Agrarian Reform program which is designed to bring new lands under cultivation.

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. The Greene Agreement which resolved outstanding USG-GOP claims arising out of expropriation of the assets of several U.S. firms has improved the climate for foreign private enterprise and investment.

Newly decreed programs in Industry (Industrial Law), fishing (Fishing Law), Agrarian Reform, and Social Property are especially designed to achieve this objective, as are effects to mobilize rural population.

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(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 (18%, 10% and 5% respectively).

"See items No. 10 and No. 19."

(b) Diverting such resources for unnecessary military expenditure (See also Item No. 19) and intervention in affairs of other free and independent nations). (See also Item No. 10).

(5) 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. The Industrial Community and Social Property concepts are supportive of the rights of workers.

(6) 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.

(7) 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.

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(8) 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 by Recipient Country

3. 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 outstanding instance.

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

Outstanding expropriation claims have been settled to satisfaction of GOP and USG.

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5. 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.

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

No deduction has been required.

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

The Administrator will take 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

6. 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 significant trade or assistance to Cuba.

7. 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.

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

No such enterprises to be assisted.

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9. FAA § 620(f). Is recipient country a Communist country? No.
10. FAA § 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression? No.
11. 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.
12. FAA § 620(l). 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.
13. 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.
14. 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.

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15. FAA § 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? No.
16. FAA § 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? According to data available in Peru, Peru is current on all U.N. payments, except for small amounts to be contributed to specialized agencies. These amounts will be paid during CY 74, except for \$10,000 in Soles to be included in CY 75 budget.
17. FAA § 481. Has the government of recipient country failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? 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.

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18. FAA, 1973 § 29. If (a) military base is located in recipient country, and was constructed or is being maintained or operated with funds furnished by U.S., and (b) U.S. personnel carry out military operations from such base, has the President determined that the government of recipient country has authorized regular access to U.S. correspondents to such base? Not applicable.

Military Expenditures

19. FAA § 620 (s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators and Military Assistance Staff (PPC/RC).)
- Of the two-year 1973-74 budget, 14.6% is earmarked for military expenditures.
- Best estimates indicate that in the 1973-74 budget biennium Peru will spend \$167 Million in foreign exchange on military expenditures, and nothing for sophisticated weapons systems.
- The Administrator has taken these matters into account in determining to continue to furnish assistance to Peru.

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CONDITIONS OF THE LOAN

General Soundness

20. FAA § 201 (d). Information and conclusion on reasonableness and legality (under laws of country and the United States) of lending and relending terms of the loan.
- The 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.
21. 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 (Section VII, Annex B).
22. FAA § 251 (b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.
- There are reasonable prospects that Peru will be able to repay the loan fully and promptly. (See CAP Section III A and B).
23. FAA § 251 (b). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.
- See Section I, 7, of CAP.
24. FAA § 611 (a) (1). Prior to signing of loan will there be
- (a) engineering, financial, and other plans necessary to carry out the assistance and
- (b) a reasonably firm estimate of the cost to the United States of the assistance?
- Yes.

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

The Bank will have to obtain GOP authorization enabling it to provide under its charter technical and financial assistance to service and commerce-type enterprises. This authorization will be in the form of a Council of Ministers Resolution or Decree.

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

Yes. See Annex A for Section 611 (e) certification.

Loan's Relationship to Achievement of Country and Regional Goals

27. FAA § 207; § 251 (a); § 113. 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; (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; or (f) integrating women into the recipient country's national economy.

The loan is designed to assist rural enterprises owned by private individuals or community groups. As such, the activity is supportive of the listed rural institutions, will assist Peru in its agriculture program, and will provide significant on-the-job training. There will be no discrimination among potential sub-borrowers or workers in the enterprise due to sex; thus integration of women into the country's national economy will be aided.

AID 1240-2 (4-74)

28. FAA § 209. Is project susceptible of execution as part of regional project? If so why is project not so executed? Not susceptible.
29. 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 project will be consistent with other COP development activities, will contribute to development of the rural sector, and is consistent with AID activities and goals.
30. 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 rural enterprises will contribute significantly to long term self-sustaining growth.
31. FAA § 209; § 251 (b) (8). Information and conclusion on whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America. See Section I.L.C of loan paper. The assistance is not expected to have a significant impact on the economic and political integration of Latin America.
32. FAA § 251 (g); § 111. Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin America. Sub-loans and technical assistance will be available to cooperatives, thus promoting the cooperative movement.
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.

AID 1240-2 (4-74)

34. 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 rural enterprises owned by private individuals and cooperative associations. It is expected to encourage maximum participation in economic development.
35. 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 country. By promoting a cooperative effort, the program strengthens democratic processes at the grass-roots level.
36. 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) the loan will be available to private entrepreneurs and will thus foster private initiative and competition;
(c) cooperatives will be eligible sub-borrowers under the activity. Credit unions and savings and loan associations may also participate;
(d) by fostering new enterprises will promote free competition;
(e) yes, by strengthening enterprises in industry, agriculture, and commerce;
(f) no significant impact.

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37. FAA § 619. If assistance is for newly independent country; is it furnished through multi-lateral organizations or plans to the maximum extent appropriate?

Peru not newly independent.

Loans' Effect on U.S. and A.I.D. Program

38. 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.

39. 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.

Approximately \$3-4 million of loan funds will be allocated to the use of ORDEZA in its ongoing programs which often utilize local banks to lend to private enterprises. All remaining loan proceeds will go to the Banco Industrial, an intermediate credit institution which will also utilize the private banking system. All procurement under the loan will be from private sources. There may be some procurement of U.S. goods and services from private sources.

40. FAA § 601 (h). 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 38.

AID 1240-2 (4-74)

41. 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 procurement of goods and technical assistance as appropriate. All other financing for local costs of sub-borrowers under ICI guidelines.
42. FAA § 602. Information and conclusion whether U.S. small business will participate equitably in the furnishing of goods and services financed by the loan.
- See items 38 and 41.
43. 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.
44. 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.
- Technical assistance will be supplied in the program. Private firms are expected to be utilized on a contract basis to provide some of the technical assistance. There are no current plans to utilize the facilities of U.S. Government agencies.

AID 1240-2 (4-74)

Loan's Compliance with Specific Requirements

45. FAA § 110 (a): § 208 (e). Has the recipient country provided assurances that it will provide at least 25% of the costs of the program, project, or activity with respect to which the Loan is to be made? Yes.
46. FAA § 112. Will loan be used to finance police training or related program in recipient country? No.
47. FAA § 114. Will loan be used to pay for performance of abortions or to motivate or coerce persons to practice abortions? No.
48. FAA § 201 (d). Is interest rate of Loan at least 2% per annum during grace period and at least 3% per annum thereafter? Yes.
49. FAA § 604 (a). Will all commodity procurement financed under the loan be from the United States except as otherwise determined by the President. Yes.
50. 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.

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51. FAA § 604 (d). If the cooperating country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the United States on commodities financed by the loan? Loan Agreement will so specify.
52. FAA § 604 (e). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? No financing of such procurement is contemplated.
53. FAA § 604 (f). If loan finances a commodity import program, will arrangements be made for supplier certification to A.I.D. and A.I.D. approval of commodity as eligible and suitable? The loan will not finance a commodity import program.
54. 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. The loan is expected to be primarily for local expenditures. If appropriate, however, U.S. Government excess personal property will be procured in lieu of new items.
55. FAA § 611 (b); App. § 101. If loan finances water or water-related land resources 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.

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56. 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.
57. FAA § 612 (b); § 636 (h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services. The GOP will contribute to the project sufficient budgetary resources to cover all administrative costs. No excess U.S. owned currencies are available in Peru.
58. App. § 113. Will any of loan funds be used to acquire currency of recipient country from non-U.S. Treasury sources when excess currency of that country is on deposit in U.S. Treasury. No. Peru is neither an excess nor a near excess currency country.
59. 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.
60. FAA § 620 (g). What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property? No such financing contemplated.
61. FAA § 620 (k). If construction of productive enterprise, will aggregate value of assistance to be furnished by the United States exceed \$100 million. No.

AID 1240-2 (4-74)

62. FAA § 636 (1). Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicle manufactured outside the United States, or any guaranty of such a transaction? No.
63. App. § 103. Will any loan funds be used to pay pensions, etc., for military personnel? No.
64. App. § 105. If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms? The loan provides for technical and technical assistance to private, rural enterprises through intermediate institutions. A.I.D. will review these institution's procedures for loan financed contracts. The Loan Agreement will provide for A.I.D. approval of all contractors and contracts.
65. App. § 107. Will any loan funds be used to pay UN assessments? No.
66. App. § 109. Compliance with regulations on employment of U.S. and local personnel. (A.I.D. Regulation 7). Loan Agreement and implementation letters will provide for application of Regulation 7.
67. App. § 110. Will any of loan funds be used to carry out provisions of FAA §§ 209 (d) and 251 (h)? No.
68. App. § 114. Describe how the Committee on Appropriations of the Senate and House have been or will be notified concerning the activity, program, project, country, or other operation to be financed by the Loan. **By special notification on May 24, 1974, Congress was informed of AID's intent to finance this project at a level of \$10 million.**
69. App. § 601. Will any loan funds be used for publicity or propaganda purposes within the United States not authorized by the Congress. No.

AID 1240-2 (4-74)

70. MMA § 901.b; FAA § 640 C.

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

(b) Will grant be made to loan recipient to pay all or any portion of such differential as may exist between U.S. and foreign-flag vessel rates?

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

Consideration will be given to making such a grant available if a situation should arise wherein a differential is substantial. At this time, however, no such situation is anticipated.



Department of State

AID-DI.C. -2051 ANNEX D page 1 of 2

TELEGRAM

ACTION: AID
INFO: AMB DCM ECON CHRON
P 071507Z MAY 74
FM SECSTATE WASHDC
TO AMEMBASSY LIMA PRIORITY 7963
BT
UNCLAS STATE 093519

UNCLASSIFIED

Classification

CONTROL: STATE 993519
7 MAY 74 AT 11:13 HRS

AIDAC

EO 11652: N/A

SUBJECT: RURAL ENTERPRISE IRR

ACTION: CAP (FILES)
INFO: UCD
D
AD/O

Action: No reply necessary
Date: 5/9/74
Initials: [Signature]

- 1. DAEC REVIEWED AND APPROVED SUBJECT IRR ON APRIL 20 SUBJECT TO THE FOLLOWING COMMENTS AND GUIDANCE ON PREPARATION OF CAP. DAEC FOUND RURAL DEVELOPMENT FOCUS OF IRR CONSISTENT WITH CONGRESSIONAL PRIORITIES FOR A.I.D. ASSISTANCE AS SET FORTH IN THE FAA.
2. CAP SHOULD DESCRIBE THE EXPERIENCE GAINED UNDER LOANS 052 AND 053, INCLUDING (A) AN ANALYSIS OF THE SUBLOAN INTEREST RATES, GRACE PERIODS, AND REPAYMENT TERMS; THE CHARACTERISTICS OF THE BORROWERS, E.G., SIZE OF ELIGIBLE FIRMS, PRODUCTS OR SERVICES WHICH THEY PROVIDED, ETC.; SOCIO-ECONOMIC GROUPS BENEFITTED UNDER BOTH PROGRAMS; AND THE FEASIBILITY OF USING THESE RESPECTIVE PROGRAMS AS MODELS/PROTOTYPES FOR THE NEW PROJECT, (B) AN EXPLANATION OF THOSE CONCEPTS/APPROACHES/ELEMENTS OF THE TWO EXISTING PROGRAMS WHICH WILL BE INCORPORATED INTO THE NEW PROJECT, AND (C) THE MANNER IN WHICH THE LATTER WILL BE EFFECTED. THE BASIS FOR THE PROPOSED ALLOCATION OF PROJECT RESOURCES TO THE COMMUNITY DEVELOPMENT AND THE RURAL ENTERPRISE ELEMENTS SHOULD ALSO BE THOROUGHLY DISCUSSED.
3. THE CAP SHOULD CONTAIN A DEMAND ANALYSIS TO JUSTIFY THE SIZE AND SCOPE OF THE PROPOSED PROGRAM. MAJOR ELEMENTS TO BE COVERED IN DEMAND ANALYSIS WOULD LIKELY INCLUDE: (A) A DETERMINATION AS TO WHETHER LATENT DEMAND FOR CREDITS TO RURAL ENTERPRISES EXISTS, AND IF SO, WHY THIS DEMAND HAS/IS NOT BEING SATISFIED; (B) AN ANALYSIS OF THE IMPACT OF INTEREST RATES, GRACE PERIODS, AND PAY-BACK PERIODS ON THE LEVEL OF PROJECTED DEMAND FOR THE TYPE OF CREDITS PROPOSED; (C) A SURVEY OF THE POTENTIAL DEMAND FOR RURAL ENTERPRISE AND COMMUNITY DEVELOPMENT CREDITS IN THE AREAS IN WHICH THE PROGRAM WILL BE OPERATING OUTSIDE THE EARTHQUAKE ZONE, AS WELL AS A PROJECTION OF ADDITIONAL DEMAND IN THE EARTHQUAKE ZONE. SINCE THE LOAN IS INTENDED TO EXPAND THE SMALL ENTERPRISE/COMMUNITY DEVELOPMENT PROGRAMS OUTSIDE THE ZONE, NO MORE THAN 1/3 OF THE TOTAL PROPOSED LOAN AMOUNT SHOULD BE AVAILABLE FOR THE EARTHQUAKE AREA.

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Classification



Department of State

ANNEX D
Page 2 of 2

TELEGRAM

PAGE 2/STATE 093519

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4. SUBPROJECT ELIGIBILITY CRITERIA. THE CAP SHOULD DEFINE THE TARGET GROUP AND INDICATE HOW CREDITS WILL BE LIMITED TO THIS GROUP (I.E., THOSE ENTREPRENEURS WHO HAVE NOT GENERALLY HAD ACCESS TO CREDIT UNDER PREASONABLE TERMS AND CONDITIONS); ESTABLISH THE PROPOSED SIZE LIMITS OF BORROWERS FOR SUBLENDING; AND OUTLINE THE SPECIFIC STANDARDS FOR EMPLOYMENT GENERATION, VALUE ADDED AND INCOME DISTRIBUTION EFFECTS EXPECTED FOR RESPECTIVE SUBPROJECT CATEGORIES.

5. CAP SHOULD DESCRIBE THE TECHNICAL AND MANAGERIAL OPERATIONS AND FUNCTIONS NECESSARY TO THE SUCCESS OF THE PROJECT AND ASSESS THE CAPABILITY OF THE IMPLEMENTING AGENCY, AS MEASURED BY THE NUMBERS, TRAINING, EXPERIENCE, AND PERFORMANCE OF ITS PERSONNEL, TO CARRY OUT THESE FUNCTIONS. THE CAP SHOULD IDENTIFY ANY STAFF ADDITIONS JUDGED NECESSARY TO INSURE THE PROGRAM IS CARRIED OUT IN A TIMELY AND EFFICIENT MANNER. THE CAP SHOULD ALSO CONTAIN A PROJECT IMPLEMENTATION PLAN SHOWING, INTER ALIA, THE TIME REQUIRED TO ACTIVATE THE PROGRAM OUTSIDE THE EARTHQUAKE ZONE.

6. THE QUESTION OF APPROPRIATE SUBLOAN INTEREST RATES SHOULD BE CAREFULLY CONSIDERED. ANALYSIS OF PREVAILING RATES FOR SIMILAR SUBLENDING IN OTHER SECTORS SHOULD BE INCLUDED. IF CONCESSIONAL SUBLENDING RATES ARE PROPOSED, CAP SHOULD ESTABLISH WHY SUBSIDIZED RATES ARE PREFERABLE TO RATES APPROACHING COMMERCIAL MARKET RATES, WHY SUBSIDIZED INTEREST RATES ARE PREFERRED OVER OTHER FORMS OF LOAN CONCESSIONS (LONGER TERMS - GRACE PERIODS), AND WHETHER THE BORROWERS WOULD LATER BE ELIGIBLE FOR, AND ABLE TO USE, CREDITS OF PREVAILING MARKET RATES. CAP SHOULD ALSO CONTAIN A FULL DISCUSSION OF THE PROPOSED INTEREST RATE SPREAD AND THE USE OF THIS SPREAD BY THE VARIOUS ENTITIES INVOLVED IN PROJECT IMPLEMENTATION.

7. CAP SHOULD, INTER ALIA, DESCRIBE EXTENT TO WHICH PROJECT WILL CONTRIBUTE TO MEETING OBJECTIVE OF FAA, SECTION 113.

8. CAP SHOULD CONTAIN AN EVALUATION PLAN, INCLUDING IDENTIFICATION OF BENCHMARK DATA AND CRITERIA FOR MEASURING PROJECT SUCCESS; E.G., JOBS CREATED, REPAYMENTS EXPERIENCE, EFFECTIVENESS OF PROMOTIONAL WORK; SOCIO-ECONOMIC GROUPS TO BE BENEFITTED; AND PERIODICITY OF PROGRAM REVIEWS. RUSH

LAR/

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LOAN AUTHORIZATION

Provided from Development Assistance Funds
PERU: Rural Enterprises Development

Pursuant to the authority vested in the Administrator, Agency for International Development, by the Foreign Assistance Act of 1961, as amended ("The Act") and the delegations of authority issued thereunder, I hereby authorize the establishment of a loan ("Loan") pursuant to Part I, Chapter 1 of the Act to the Government of Peru ("Borrower") of not to exceed ten million dollars (\$10,000,000) to assist in financing the United States dollar and local currency costs of a project to provide financing to rural enterprises in Peru and to provide technical assistance ("Project"). Up to four million dollars (\$4,000,000) of Loan disbursements will be made available for that portion of the Project being implemented by ORDEZA. The remaining portion of the ten million dollars (\$10,000,000) will be made available for the portion of the Project to be implemented by the Banco Industrial.

I. 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 of not to exceed ten (10) years. Borrower shall pay to A.I.D. in United States dollars interest on the outstanding balance of the Loan at the rate of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter.

II. 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 and countries included in Code 941 of the AID 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 country 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., a designation of the

representatives of the agencies which will be responsible for implementing the Project.

(D) Prior to any disbursement or the issuance of any commitment documents under the Loan for that portion of the Project being administered by the Banco Industrial, for any purpose other than to finance technical assistance, or for the procurement of project related commodities, the Implementing Agency shall, except as A.I.D. may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

- (1) evidence of the creation of a Rural Enterprises Development Fund ("Fund") within the Banco Industrial;
- (2) a Program Organization and Operations Plan, giving a complete description of how the Banco Industrial will implement its portion of the Project. This Plan will include, but not necessarily be limited to:
 - a) an organization plan showing how Fund activities will be executed by the Banco Industrial, including provisions for adequate staffing;
 - b) provisions for sub-project identifications, Fund promotion, and technical assistance to sub-borrowers from the Fund;
 - c) a time-phased implementation plan;
 - d) a credit manual containing the rules and regulations governing the Fund.
- (3) evidence of the availability of sufficient budgetary resources to make the Banco Industrial's contribution to the Project.

(E) Prior to any disbursement or the issuance of any commitment documents under the Loan for that portion of the Project being implemented by ORDEZA, the Implementing Agency shall, except as A.I.D. may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

- (1) a Program Organization and Operations Plan giving a completed description of how ORDEZA will implement its portion of the Project. This plan will include, but not necessarily be limited to:
 - a) a description of how Loan funds will be administered

within the Rural Community Development Project and the CRECE Business Assistance Fund presently administered by ORDEZA and financed under A.I.D. Loans 527-L-052 and 527-L-053, respectively;

- b) provision for the deposit in the Fund of principal repayments and interest payments derived from sub-loans made with Loan funds;
 - c) provisions for adequate staffing to assure proper implementation of the additional resources provided under the Loan to ORDEZA's existing projects;
 - d) provisions for technical assistance to sub-borrowers;
 - e) a time-phased implementation plan;
 - f) a statement of the rules and regulations governing the use of Loan funds;
 - g) an analysis of sub-lending interest rates for the Rural Community Development and CRECE Fund Small Business Assistance projects.
- (2) evidence of the availability of sufficient budgetary resources to make ORDEZA's contribution to the Project.
- (F) The Loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

Administrator

Date :

LOANS GRANTED BY THE RURAL DEVELOPMENT DIVISION OF ORDESA

<u>No.</u>	<u>Institution</u>	<u>Project</u>	<u>Date of Approval</u>	<u>Amount</u>
1	Cooperative Señor de Mayo de Pariacoto No. 74	Housing	18/12/72	\$ 20,444
2	Cooperative "Señor de Mayo de Pariacoto" No. 74	Hog Farm	09/02/73	\$ 42,063
3	Cooperative "Artesanos Unidos" de Chavin No. 429	Restaurant	15/04/73	\$ 14,051
4	Rural Community in Catac	Improvement of Sheep Livestock	12/06/73	\$ 60,339
5	Cooperative "Artesanos Unidos de Chavin" No. 429	Housing	14/06/73	\$ 32,638
6	Rural Community in Raquia	Housing, Agric. Support, Small Business	10/07/73	\$128,448
7	Colcas Enterprise	Milk Plant	10/07/73	\$ 17,083
8	Rural Community in Pira	Marble Industrialization	05/11/73	\$113,860
9	S.A.I.S. Atusmaria (Agricultural Society of Social Interest)	Housing, infrastructure, administrative complex, storage facilities	28/11/73	\$108,374
10	Rural Community in Catac	Gasoline/Service Center	21/12/73	\$ 64,229
11	Rural Community in Colcabamba	Small animal production	28/11/73	\$ 42,545
12	Cooperative "Señor de Mayo de Pariacoto No. 74	Addition to Loan No. 2 Hog Farm	05/03/74	\$ 15,766
13	S.A.I.S. Hatun Ayllu	Housing, Hog Farm, Chacchan and Rurashca	(05/03/74)	\$ 10,158
				\$ 11,457

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<u>No.</u>	<u>Institution</u>	<u>Project</u>	<u>Date of Approval</u>	<u>Amount</u>
14	Cooperative "Artesanos Unidos de Chavin" No. 429	Addition to Loan No. 3 Restaurant - Chavin	05/03/74	\$ 3,456
15	San Jacinto de Mita	Hog Farm Chicken Farm	05/03/74 05/03/74	\$ 75,334 \$ 41,517
16	Rural Community in Huasta	Housing, Agricultural Support	19/03/74	\$184,331
17	Community of Catac	Improvement of Sheep Livestock	March '74	\$103,686
				\$1,149,970

Projects to be Approved by July 1, 1974

18	Community of Pampas Grande	Housing		\$ 57,603
19	Community of Galpe	Hog Farm		\$ 32,258
20	Community of Masin	Plaster factory		\$ 18,433
21	Community of Shupluy	Production of Sanitary facilities		\$115,207
22	Community of Anta	Hog Farm		\$ 32,258
23	Community of Anta	Housing		\$ 57,603
24	Community of Shumay	Chicken Incubators		\$ 80,645
25	S.A.I.S. Atusparia	Alpaca Breeding Centers		\$ 46,082
				\$440,092
Grand Total				\$1,590,062

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Average Loan Amount	<u>\$ 63,602</u>	
Housing (4)	\$ 168,311.00	10.59%
Mixed (4)	503,001.00	31.63%
Commercial (3)	81,737.00	5.14%
Industry (4)	264,524.00	16.64%
Agriculture (10)	<u>572,487.00</u>	<u>36.00%</u>
	<u>\$1,590,062.00</u>	<u>100.00%</u>

A.I.D. LOAN No. 527-L-053 CRECE FUND
Sub-LOANS DISBURSED

No.	Borrower	Business	New Job		New Type 1/ Expansion	Coop 2/	Bank 2/	Term	Months Grace	Gross Loaned \$/.	CRECE FUND share fund US Dollars
			Ps	Ns							
1	Coop. El Progreso #408	Carpenter shop & Furniture Mfg.	11		I X	C		48	24	500,000	10,373.44
2	Robert Urquiaga Caballero	Safety glove & Equipm. Factory	16		I X		B	72	24	985,500	20,446.06
3	Daniel Rafael Gomez	Ice Cream Fact.	6		I X		B	68	4	159,000	3,298.76
4	José Kuroda Roldan	Stone Quarry	20		NI	C		48	12	1,000,000	20,746.88
5	Manuel Briceño Araña	Restaurant	2		S X	C		48	6	135,000	2,800.83
6	Genaro Palacios R. (Sta. Isa)	Brick plant	38		I X		B	30	2	330,695	6,860.90
7	Ed. R. Arias Oliveira	Printing Plant	4		C X		B	60	12	1,000,000	20,746.89
8	Jospe M. Vasquez Mendoza	Sales & Repair delivery vehicles	2		C X		B	42	6	50,000	1,037.34
9	Rodolfo Silva Santisteban	Ice Plant	11		I X		B	60	12	1,084,000	22,489.63
10	Torres Drago Hnos.	Const. Material Sal.	3		C X		B	36	3	316,718	5,570.91
11	Rosa Rodriguez Flores	Drug Store	1		NC	C		57	3	86,754	1,799.88
12	Nilo Rios Condor	Confectionery Plant	4		I X	C		58	2	80,000	1,659.75
13	Hernan Moreno Blacido	Ice Cream Factory	8		NI	C		56	4	352,150	7,306.02
14	Manuel E. Rios Castro	Restaurant	2		NS	C		21	6	100,000	2,074.69
15	Carmelo Mamani Quispe	Grocery Store	1		C X	C		72	6	50,000	1,037.34
16	Elvira Leon de Robles	Restaurant/Grocery	4		S X		B	54	6	180,000	3,734.44
17	Americo Castillo Bernal	Straw Furniture Mfg	6		I X		B	60	12	500,000	10,373.44
18	UNINSA	Foundry	9		I X		B	60	12	1,430,000	29,662.05
19	Antenor Paredes Bocanegra	Shirt Factory	1		I X		B	48	12	350,000	7,261.41
20	Emilio A. Sam Ley	Bazaar (General Store)	3		C X		B	60	12	500,000	10,373.44
21	Carlos Rubiños Schemiel	Construction Mat.	2		I X		B	48	6	50,000	1,037.34
22	Manuel Alva Portilla	Stone Quarry	4		I X		B	60	12	1,570,000	32,572.61
23	Luis Yon Kureña	Scrap metal Dealer	25		I X	C		60	12	900,000	18,622.50
24	Columba Ghiglinode Maguina	Bottling Plant	7		I X		B	36	-	300,000	6,224.07
25	Luzmila Sanchez de Romero	Grocery Store	1		C X	C		66	6	109,204	2,265.64
26	Ernesto Fuente Vellochich	Farm supply Store	4		NC		B	36	12	300,000	6,224.07
27	Juan A. Patiño Garcia	Mini Market	4		NC		B	60	12	400,000	8,298.76
28	AUTONIC S.A.	Storage Battery Mfg	10		I X		B	60	12	1,000,000	20,746.69
29	Zoila B. Gonzales de Figueroa	General Store	1		NC	C		66	6	90,384	1,875.19
30	Ruperto Olivera Viglienzoni	General Store	2		NC	C		60	4	100,000	2,074.69
31	Guillermo Castro Alva	Furniture Mfg.	19		NI	C		72	12	1,250,460	25,902.15
32	Leofilo Vasquez Valdeirama	Bakery Supp. Store	1		NC	C		36	4	60,000	1,238.51
33	Mario Torres Mattos	Knit goods Mfg.	2		I X	C		36	2	140,000	2,901.30
34	Fabio Quito Ribastroza	Lumber Yard	2		NC	C		54	6	200,000	4,172.33
										15,659,865	324,693.20

1/ This column shows whether an enterprise is new (N) or expansion (X), and whether it is classified as industrial (I), commercial (C), or service (S).

2/ Private Financial Intermediaries can be banks or credit cooperatives. If the Intermediary is a Cooperative, a C appears in the Coop column; if a bank, a B appears in the Bank column.

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No.	Borrower	Business	New Job Ps Ns	New Type Expansi	Thru Coop Bank	Months Term Grace	Gross Loaned Sales	PRICE FUNG
								US Dollars
35	Nicolas de Tolentino Vega	Fine Furniture Fact	3	I X				
36	Comercial Mavisa S.A.	Comm. Furniture Mfg	8	I X	B	60 12	300,000	5,224.67
37	Vilma Paredes de Leon	Grocery & Snack Shop	1	C X	B	60 12	1,000,000	20,746.29
38	Tulio Guzman Hidalgo	Service Station	33	NS	C	42 6	50,000	1,027.34
39	Alberto Alfaro Beltran	Construction Supplies	6	NC		96 12	1,550,000	37,157.67
40	Edward Olivera Villanueva	Grain Mill	1	I X	B	48 12	800,000	16,597.51
41	Encarnación Alfaro de Mejía	Shoe Making shop	3	I X	C	60 3	50,309	1,043.76
42	Juana de Osorio Vda. Melgarejo	Restaurant	1	NS	B	60 5	54,623	1,133.24
43	Fermina Urbano C. de Huerta	Hardware Mfg.	1	I X	C	60 3	50,900	1,053.94
44	German F. Cadillo Bedova	Ice Cream plant	6	I X	C	72 2	121,855	2,528.11
45	Pablo Tolentino Cordova	Carpenter shop	3	I X	B	88 4	186,240	3,995.39
46	Dionicio Lopez Huerta	Carpenter shop	2	I X	B	84 6	158,010	3,278.21
47	Máximo Cano Keyes	Brick Plant	8	I X	B	60 4	76,078	1,578.39
48	Demetrio Gutierrez Lavander	Grain dealer	3	I X	C	60 12	400,000	8,298.76
49	Petronilo Cruz Bobadilla	Shirts & Suits Mfg.	2	C X	C	84 12	490,000	10,165.98
50	Juvenal Carrasco Bernedo	Bakery	4	NI	C	50 6	185,000	3,838.17
51	Ruben ROJAS Marroquin	Construction Mate.	2	I X	C	48 6	200,00	4,149.38
52	Abelardo Olivera Viglisone	Print Shop	2	NC	C	54 5	200,000	4,149.38
53	Pedro Alba Caballero	Leather Mfg.	3	NS	C	60 12	400,000	8,298.76
54	Inagro S.A. (V. Gonzales)	Animal Feed blendg.	7	I X	C	60 12	270,000	5,501.66
55	Irma Cam de Lerca	Business School	?	I X	B	54 6	780,000	16,182.57
56	Miguel Torres Cano	Service Center-Auto	4	NS	B	66 6	410,000	8,506.22
57	Benigno Garrido Rodriguez	Furniture Store	4	S X	B	120 3	1,397,840	29,000.83
58	Aresio Cadenillas Aranda	Grocery Store	1	C X	B	84 4	270,512	5,612.29
59	Maria Jesus Aguilar Noya	Grocery Store	3	C X	B	54 6	175,000	3,630.71
60	Abando Cruz Baca y socio	Lumber yard	6	C X	B	42 6	956,800	19,850.62
61	Credenciano Rojas Gonzales	Grocery Store	1	C X	B	45 9	680,000	14,107.88
62	Juan Florencio Alamo Villegas	Tailor Shop	5	C X	B	42 6	130,000	2,697.10
63	Teodoro Aranda Rosales	Tailor Shop	2	I X	B	42 6	200,000	4,149.38
64	Cristobal Fermin Maguiña A.	Tannery	2	I X	C	60 5	50,000	1,037.34
65	Walter Vargas Ramirez y socio	Tire Recp. & Repair	13	I X	C	90 6	57,905	1,201.35
66	Julian Quispe Calamamani	Dairy bar	2	NI	C	120 10	2,000,000	41,493.78
67	Luis Vasquez Esparza & socio	Fishing for foodfish	8	NC	C	52 2	149,300	3,097.51
68	Julio Garcia Delgado	Brick oven-Mosaicos	4	NI	C	60 12	1,710,000	35,477.18
69	Angel Burgos Cartes	Bakery	6	NI	C	30 6	50,000	1,037.34
70	Coop. "La Esperanza"	Dressmaking plant	14	NI	B	72 12	250,000	5,186.72
71	Luis A. Zapater Dubreint	Transport Industry	10	NI	C	42 6	399,250	8,281.20
72	Roberto A. Salazar Romero	Furniture factory	3	NS	B	66 6	800,000	16,527.51
73	Alfredo Velasquez Aastre	Ice Plant	8	NI	B	120 5	441,819	9,166.41
74	Felix Honores Alvarez	Agricultural Serv.	1	I X	B	60 12	550,000	11,511.74
				NS	B	48 2	250,000	5,186.72
							33,913,206.	703,593.33

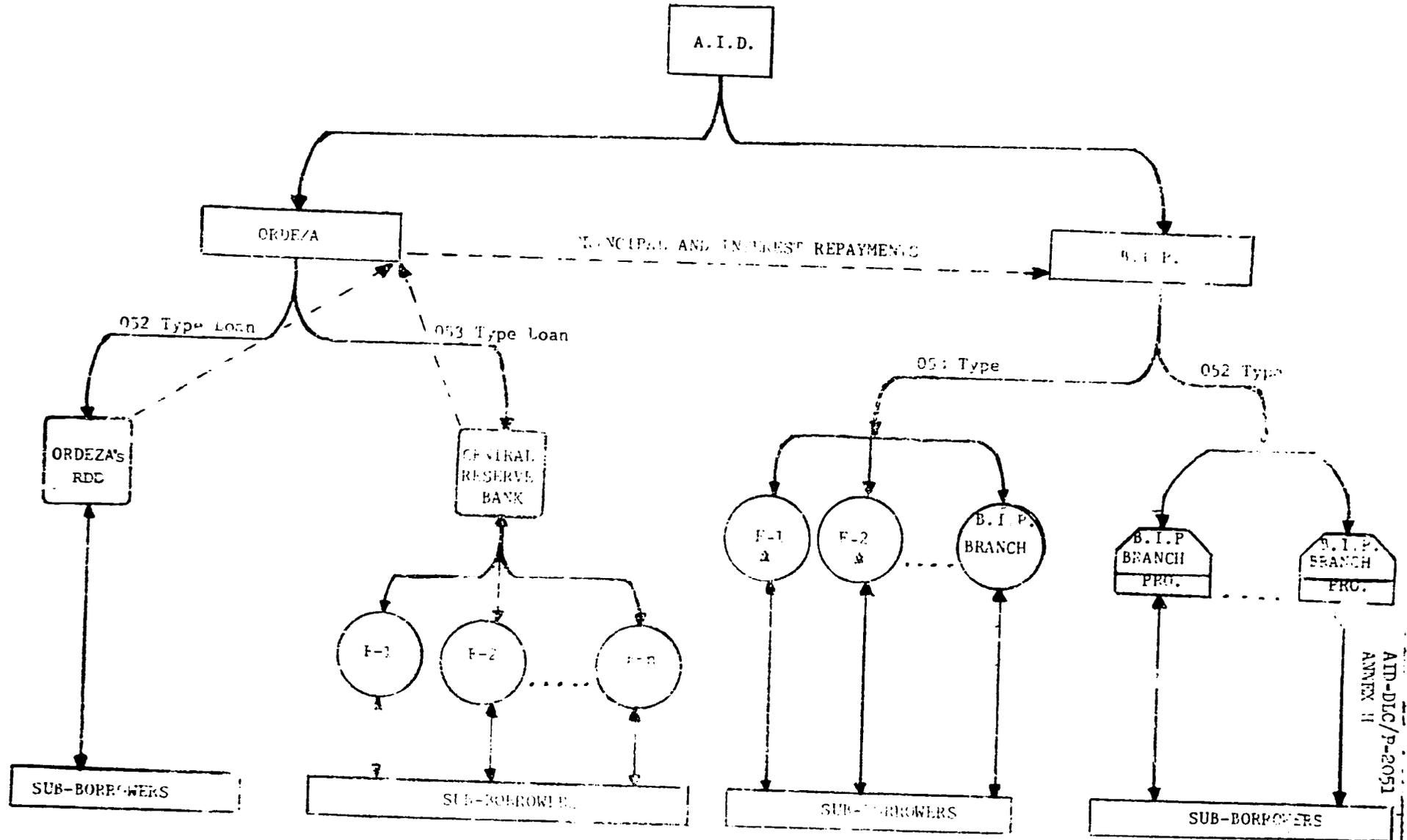
No.	Borrower	Business	New Job psns	New Type Expans	Thru Cop Bank	Term	Months Grace	Gross Loaned Soles	CRECE FUND share fund US Dollars
75	Demetrio Durand Gonzalez	Servicenter	3	I X	B	72	12	402,000	8,340.25
76	Manuel Collantes Preciado	Hardware Store	4	NC	B	120	12	800,000	16,597.51
77	Daniel A. Anaya Rodriguez	Shoe Store	1	C X	C	78	6	228,500	4,740.66
78	Cirila Luna Tafur	Restaurant	3	S X	B	84	4	100,130	2,077.39
79	Tomas Reyes Vasquez	Restaurant	10	NS	B	60	12	600,000	12,448.13
80	Cesar M. Rodriguez Robles	Exp. Hardware Store	1	C X	B	84	6	80,000	1,659.75
81	Romulo Alzamora Giraldo	Exp. Plaster & Saw Mill	2	I X	C	96	12	480,557	9,970.06
82	Orestes Peña Afara	Exp. Gas station	4	S X	B	69	3	824,100	17,097.51
83	Susana A. Morán de Salazar	Knitting plant	3	NI	C	96	4	197,295	4,093.26
84	Hugo A. Cam Terry	Ice Factory	10	NI	B	90	18	1,680,000	34,854.71
85	Rodolfo Haro Ioli	Mini Market	2	NC	B	66	6	360,000	7,468.88
86	Alejandro Ramirez Angeles	Expand. blackmill/stop 2	2	I X	B	90	6	123,712	2,566.64
87	Celia M. de Lazarte	Expand photo Stdy.	2	S X	B	84	4	110,800	2,298.76
88	Juan Lopez Vargas	Mill	3	NI	C	96	6	598,264	12,412.13
89	Balciro Luna	Expands workshop	5	S X	B	120	12	589,700	12,234.44
90	Policarpo Britto Mendez	Expand gas station	4	S X	B	120	3	1,961,197	40,683.74
91	Alpanayo S.C.R.L.	Tile factory	7	NI	B	96	6	990,000	20,539.42
92	Jorge Rolich Gwinza	Expans. workshop	14	X	B	60	12	1,200,000	24,896.27
93	Máximo Colma Diaz	expansion dept. store	3	S X	C	35	5	52,000	1,078.64
94	Pedro Carrillo Cisneros	Expans. car service	7	S X	B	90	6	450,000	9,336.10
95	Isaac Arias Depaz	expans. fertilizer st.	1	S X	C	39	3	60,120	1,247.39
96	Dionisio Paulino Santos	expansion tailor "	4	S X	B	84	4	101,280	2,101.24
97	Maximiliano H. Caro	exp. icecream fact.	1	I X	C	64	4	450,000	9,336.10
98	Antonio Meza Bedoya	Grain Mill	1	NI	B	72	6	89,200	1,850.62
99	Asunción Diaz Salazar	exp. workshop	1	I X	B	84	6	86,370	1,791.91
100	Augusto Alarcón Navarro	Candy Factory	4	NI	B	66	6	180,000	3,734.44
101	Félix Miñano de la Cruz	exp. grocery store	2	C X	B	66	6	200,000	4,149.38
102	Celso Quesada Miranda	exp. repair shop	2	S X	B	42	6	320,000	6,639.00
103	Ladrillero Fortaleza	brick factory	20	I X	B	63	3	1,000,000	20,746.69
104	Jesus Alegre Giraldo	bakery	4	NI	B	78	6	100,000	2,074.69
105	Pablo Lopez Florez	exp. car ser. station	1	C X	B	76	6	199,450	4,137.97
106	Liberato Mejia Pretel	exp. tire recapping	1	S X	B	88	4	102,600	2,126.63
107	Honorato Epifanio Torres O.	exp. tile factory	4	I X	B	72	4	130,000	2,697.10
108	Rita Rojas de Losza	shoe store	1	NC	B	75	3	246,000	5,103.73
109	Otto Vega Gavidia	poultry marketing	3	NC	C	62	2	360,000	7,468.88
110	Maria Perez B. de Huertas	exp. mill		I X	B	51	3	53,553	1,111.06
111	Guillermo Nilla Cerna	exp. shop	2	I X	B	66	6	300,000	6,224.07
112	Alberto Moya Caceres	Knitting factory	2	NI	B	64	4	225,000	4,668.05
113	Enrique de Pierola Espejo	exp. restaurant		S X	B	9	-	200,000	4,149.38
								50,145,034	1,040,553.43

No.	Borrower	Business	New Job nsns	New Type Expansic	Thru Coop Bank	Term	Months Grace	Gross Loaned Soles	CRECE FUND Share Fund US Dollars
114	Andrés Barrientos Anahua	grocery store	3	NC	C	66	6	400,000	8,293.76
115	Maximiliano Pastor La Rosa	poultry slaughter- house	4	NS	C	63	3	500,000	10,373.44
116	Hugo D.Muro Cabrejos	exp.ser.station	7	S X	B	72	12	700,000	14,522.82
117	Marcelina Lopez Espinoza	exp.grocery store	1	C X	B	54	6	90,000	1,867.22
118	Marco La Jara Habitch	laundry	22	NS	C	84	12	1,650,000	34,232.37
119	Olga Balcazar Ramirez	ready made clothes workshop	4	NJ	C	54	6	205,000	4,253.11
120	Embutidos "El Santa"	sausage factory	12	NI	B	120	12	2,000,000	41,493.77
121	Comercializadora Chancoy	tomato sauce mark.	9	NI	B	108	12	2,000,000	41,493.77
122	Luciola H.Vda.de Caballero	exp.plaster factory	3	1 X	B	96	6	1,065,500	22,126.56
123	Hernán Zuñiga Zamora	tricycle assembler	10	NI	B	56	6	700,000	14,522.82
124	Rogelio Benitez Ponce	Furniture Factory	3	NI	B	72	12	300,000	6,224.07
125	Lourdes de Patrocinio	exp.bookstore	1	C X	B	54	3	225,000	4,668.04
126	Maximo & Jorge Adrian	Ceramic shop	6	NI	B	84	12	1,210,000	25,103.73
127	Tomás Henostroza Z.	working capital for auto-body workshop	1	NI	b	84	4	100,000	2,074.69
								61,291,534	1,271,608.60

674

OPERATIONAL FLOW CHART OF AID LOAN

No. 527-L-057



F = Financial Intermediary
 RDD = Rural Development Division

PRO = Promotion Team
 * = Commerce and Services

ORGANIZATION CHART FOR RURAL ENTERPRISES PROGRAM

DIVISION FOR
STUDIES AND DEVELOPMENT

RURAL ENTERPRISES
DEVELOPMENT OFFICE
ATU LOAN 527-L-057
PROGRAM DIRECTOR

TECHNICAL SUPPORT UNIT
-BACKSTOPPING FROM DEPARTMENTS
OF STUDIES AND DEVELOPMENT
DIVISION:
a) Studies and Economic Inves-
tigations.
b) Technical Assistance
c) Projects and Advisory
Services.

TECHNICAL ASSIST-
ANCE AGREEMENTS
WITH UNIVERSITIES
& GOP AGENCIES

REGIONAL
PROGRAM
OFFICE
CUZCO

BRANCH OFFICE
CUZCO

TECHNICAL ASSIST-
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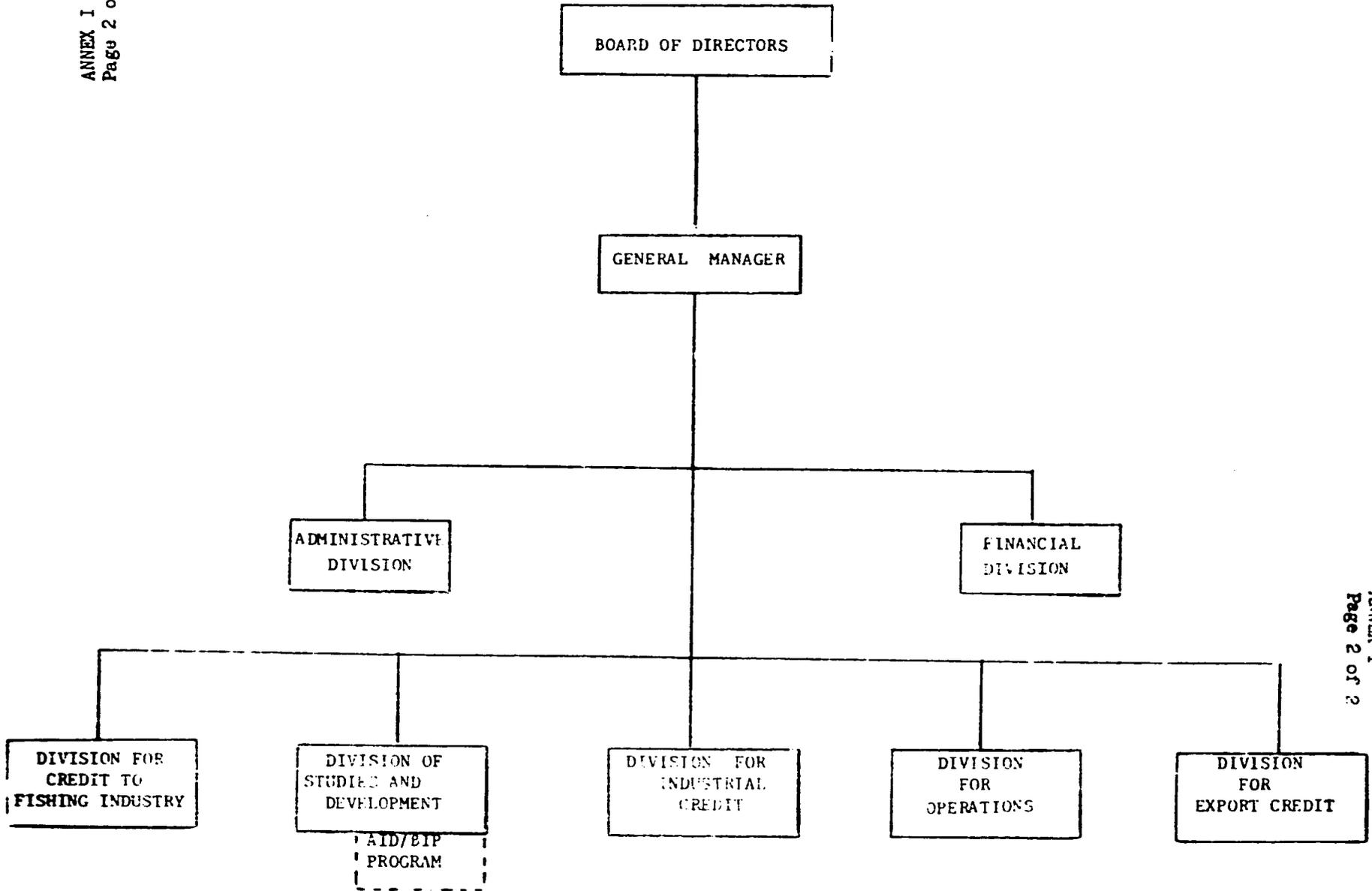
REGIONAL
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1 of 2

ORGANIZATIONAL CHART OF THE INDUSTRIAL BANK



ENVIRONMENTAL CONSIDERATIONS

1. In considering possible adverse effects on the environment which could result from projects financed by this loan, it is noted that the industries and services to be developed will be small and widely scattered. Careful consideration of these factors, in relation to the environmental character of the areas to be benefited by the loan, directs one to the conclusion that there will be very little or no resultant effects.
2. Implications of possible effects on the environment will be difficult to assess. However, to ensure control over potential problems which could arise on individual projects under the loan, the criteria for project selection will include, among other things, a requirement that before each project is approved a determination will be made that it will have no significant adverse environmental effects.

GOP Economic Restructuring Program

Shortly after coming to power in 1968, the current Military Government established a Long Term National Development Strategy which contained the following three broad permanent national development goals:

1. Formation of a more just society, without privileges, devoid of economic, social, political, and cultural marginalization or discrimination, which provides growing possibilities for achieving maximum development of human capacities and for evolving an authentic national culture.
2. Accelerated and self-sustained development, generated primarily by the internal potential of the country through a regionally and sectorially integrated productive structure, characterized by a substantial increase in internal production, greater efficiency in the use of human and natural resources and better use of the national land base.
3. Strengthening of the national sovereignty which implies a drastic reduction in the existing conditions of general dependency and economic vulnerability, guaranteeing national control over the country's internal resources, modifying the traditional scheme of international economic relations, and strengthening the contribution of the external sector in accordance with national development policy.

To accomplish these goals, the GOP has embarked upon a vigorous program of economic and social structural change which will completely reform the economic and social bases of the country. This program is being implemented through a series of reform laws which are described below.

Agrarian Reform

The agrarian reform program seeks a radical change in the land tenure pattern of Peru and the full incorporation of some eight million landless peasants into the economic and social life of the country. When the present administration took over in 1968, one percent of the land owners controlled 14 of the 15 million hectares of cultivable land available, leaving 1 million hectares to all other land owners. Agrarian reform laws enacted by previous administration had been evaded by the large land owners, who thereby had retained both political and economic power. One of the current administration's first actions was to enact a comprehensive agrarian reform law, which it has since vigorously implemented.

To cope with problems arising from the great diversity of Peruvian agriculture (coast, sierra and jungle) as well as the complexities of implementing the new law, the GOP created the Center for Investigation and Training of Agrarian Reform (CENCIRA). This Center was given responsibility for forging a new image of the reform, for changing the mentality of the bureaucrats through continuous training, for promoting "campesino" support and for designing viable strategies for implementation of the Program. Operating with great autonomy, under the Ministry of Agriculture, it was able to forge ahead with relative success. Its most salient accomplishment was the creation of the Agricultural Societies of Social Interest (SAIS), a quasi-cooperative model designed to operate the large privately owned livestock estates which had been expropriated in the highlands. CENCIRA together with other governmental agencies has continued its functions, emphasizing training and research as pre-requisites for successful long-term implementation of Agrarian Reform.

Prior to the enactment of the Agrarian Reform Law the majority of expropriated lands had been transferred to "comuneros" in a mix of private and communal ownership called "cooperativas de integración parcelaria" (integrated parcels' cooperatives). This model provided for 10% of the lands in a community to be operated as an agricultural production cooperative while the remaining 90% were to be individually owned. Over time, this model fostered precisely the conditions which the Agrarian Reform had set out to correct, i.e. minifundia or small, uneconomic land holdings. In the light of these developments, the GOP turned to cooperatives. The SAIS are also operated as giant agricultural production cooperatives.

An evaluation made in July 1972 of both agricultural production cooperatives and SAIS disclosed the existence of several disturbing problems. It seemed that these units were becoming isolated enclaves enjoying a quasi-capitalistic environment while areas immediately adjacent were economically and socially stagnant. The evaluation also pointed out the need for decentralization of authority from Lima in order to accelerate the reform so as to achieve the goals of the National Development Plan. It also identified the need for applying an integrated approach which would achieve not only a more equitable distribution of income but also the active involvement of the "campesino" in the decision making process.

The strategy being tested and planned for future application contemplates the establishment of Integrated Rural Settlement Projects (PIAR) in each of Peru's 12 Agricultural Zones. The PIAR strategy seeks to provide full employment to "campesinos" by developing economically viable enterprises which are functionally integrated within

themselves as well as with Regional Development plans. Plans for 1973-1974 call for establishment of 26 PIARS, 213 enterprises, covering 990,969 hectares to benefit 52,760 families, and the generation of 307,800 new jobs by 1975.

Measured against the medium term objectives laid out in the National Development Plan (1971-75) of affecting 9,000 estates and expropriating 10 million hectares; progress attained as of 30 April, 1974 was as follows:

6,044 estates have been affected;
5,804,409 hectares have been expropriated. Of these, actual transfers of land have been carried out on 4,475,996 hectares benefiting 187,228 families.

It should be pointed out that these have been selective expropriations on the most modernized and productive lands in Peru.

While the Agrarian Reform program poses primarily a political problem, the impact on production and the enormity of resources required to maintain the pace set forth under the National Development Plans add substantial complexity to its implementation. The GOP is confident that the change from private to collective tenure of lands will result in a substantial increase in production in the long run. It realizes, however, that turning expropriated farms immediately to collective exploitation may raise havoc with production. To avert such a development it has retained the farm management structure intact until new managers are trained to take over. It has also appointed professional managers to administer large holdings.

The GOP is seriously trying to cope with the problems which stem from implementation of such an ambitious program and is attempting to respond with a considerable degree of imagination with alternative solutions. These, however, are for the most part untried and not easy to implement.

Industrial Reform

The GOP is effecting a radical transformation of the country's industrial sector which, when completed, will leave few remnants of the previous structure. The new structure will emphasize State and cooperative forms of ownership and control, with the purely private sector encompassing only the very small business and commercial establishments.

To this end, mechanisms have been established:

- a. To involve the State much more in the activities of the industrial sectors, with ownership as well as new forms of control;
- b. to spread ownership and the income flowing from the sector more widely amongst the population (workers);
- c. to channel resources to those industries considered as priority (essential) industries;
- d. to lessen dependence on foreign sources.

The new structure of the industrial sector will consist of the following sub-sectors:

- a. those industries reserved for the State, including all of the "basic" industries such as steel, cement, paper, manufacturing, etc.;
- b. the reformed private sector, which involves a 50-50 mix of private (corporation or individual)/worker ownership and management;
- c. the social property sector, involving social ownership and management;
- d. the purely private sector, encompassing small scale industry and commerce.

The major characteristics of these sub-sectors are as follows:

State Sector.- This involves complete ownership and management by the State of all the "basic" industries. All firms currently operating within these industries, including foreign firms, are required to enter into agreements with the State which provide for their purchase by the State. When agreement cannot be reached, the firm will be expropriated.

Reformed Private Sector.- All firms employing more than 5 workers, must establish an "industrial community" of the employees of the firm. At the end of each year the company must distribute shares in both ownership and management to the community until it reaches 50% participation. These communities include all the employees of the firm, including the management employees, and cut across all other workers' organizations in the firm.

The idea of the industrial community concept is to provide the workers of the firm, and thus of the industrial sector, with ownership in the firm and therefore with some role in the decisions which affect them through their proportionate representation on the Board of Directors. The philosophy underlying this concept appears to contain something of the labor theory of value which attributes the creation of all value to labor. With the workers as part owners receiving a share of the profits, the GOP's goal of better distribution of income is served. Also, it is thought that once the workers become owners, labor-management conflict will be eliminated since the workers would be in conflict with themselves as owners.

The mechanism works as follows. Every firm in the industrial sector must establish a "Community". Each year the Community receives 10% of the firm's gross profits in cash which is divided among the members of the Community on the basis of a formula which considers time of service, etc. In addition, the Community receives 15% of gross profits which must be invested in ownership in the firm, either in new or existing shares, until the Community reaches 50% ownership. Immediately upon being established the Community shares in the management of the company with one member on the Board of Directors, and as the portion of Community ownership increases its representation on the Board increases.

As of this date all firms have established Communities as required by law; however their experience with these Communities has been quite varied. The rate of acquisition of ownership by the Communities depends upon the level of profits which varies greatly by firm. Regarding efficiency, some firms have experienced increases in efficiency through more highly motivated workers, while others have reported little change and still others, substantial reductions in efficiency. Many managers report excellent relationships with their Communities, while others have noted considerable interference in decision making by the Community representatives.

The attitudes of the original owners are equally as varied as that of the workers, with some willing to work with their Communities and others who want at best to ignore their Community. Until recently, new private investment had largely stopped, and is still slow, although recovering somewhat.

The GOP has announced that the "industrial community" concept is under study and that some changes will soon be made in it to correct certain deficiencies. These deficiencies were not made specific but will probably include some mechanism of adjustment for the inequality in worker benefits arising from the varying rates of profit of firms,

the slow progress being made by some communities in acquiring ownership due to low rates of profit, the problem of channeling the investment of these firms into priority areas, etc.

Social Property Sector.- According to GOP plans, the social property sector will become the predominant sector in the industrial structure of the economy. The organization and functioning of the sector and the firms within the sector are far too complicated to explain fully here. However, the basic characteristics include: social ownership and accumulation; formation and management of firms by worker groups; up to 100% initial financing by the State; preferential treatment with respect to financing terms and conditions, taxes, exporting, supply contracts with government entities and on government projects, etc.; continuous upgrading of workers skills through training and educational programs; continuous technical assistance to social property enterprises; a system of preferential labor regulations unique to the sector. The major governing body of social property enterprises will be the General Assembly of workers, however the State will play a strong role in managing the Sector, and to some extent the individual firms through an extensive hierarchy of regional and national commission.

While there is no doubt of the Government's strong commitment to the Social Property concept or of its intention that it become the predominant sector of the industrial structure, it is anticipated that the sector will develop slowly and will need considerable promotion from the Government itself.

Purely Private Sector.- This subsector will consist of small industry and the commercial and service enterprises required by the economy. While a "small enterprise" law is being developed by the GOP, it is reportedly to be only promotional in nature. Likewise, a "commercial" law is supposedly being designed by the Government, however, given the inherent complexity of this sector, this law will probably be promotional in nature also.

In addition to these structural changes, the GOP has established a system of industrial priority which it uses in allocating resources, especially investment resources and resources devoted to importation. All industries and firms are assigned to one of four priorities (1st, 2nd, 3rd, and 4th) and receive the benefits, obligations, etc., of that priority.

It is clear from statements by Government officials that the State is going to play a very active role in the industrial (and other) sectors. It has begun programming its takeover of the basic industries. Moreover, all industrial firms, regardless of priority, must submit annual investment plans to the Ministry of Industry and Tourism (MIT) for approval, which gives the government complete control over which firms (priorities) are to be permitted to expand and which are not. Also, firms must submit their request for foreign exchange to import raw materials, capital goods, consumer goods, etc., to MIT officials for approval, again giving the GOP control over rates of expansion, etc. Customs rights, tax incentives, credit incentives and other similar benefits vary by industrial priority with the greater benefits going to higher priority industries.

As a result of this system, the GOP is able to encourage those industries it considers essential to the National Interest and to discourage those it considers as non-essential (luxury) industries. This fits well with the GOP's goals of utilizing the national resources to produce those goods and services most needed by the majority of Peruvians and to eliminate vestiges of rank and privilege.

The role of the foreign firm seems to be very limited in the future in Peru, not only because of Peruvian legislation, but because of the Andean Foreign Investment Code to which Peruvian legislation already largely conforms. The GOP has repeatedly said that it welcomes foreign investment, however only if it contributes to Peruvian development priorities and goals and if it is willing to abide by the conditions prescribed for it. It should be noted that little new foreign direct investment has entered Peru in the last few years, except for some large new investments by some of the existing mining and smelting companies (Southern Peru Copper Corp. and Marcona especially), and some investment in oil exploration in the Peruvian jungle.

One can say then that the industrial reform is progressing towards the goals of the revolution. Barring any abrupt, unforeseen changes in implementing the reform, the state will play an increasingly large direct and indirect role in the industrial sector in the future, resources will be allocated within the sector in accordance with the needs of the majority of Peruvian people (as determined by the GOP), and external dependence will be reduced.

Education Reform

The education reform began in 1969 with initial focus being on the restructuring of the university system. This was followed in early 1970 with the appointment of a National Commission consisting of some 120 leaders in education and other fields to prepare a basic design for overall education reform. The draft of the Reform Law was completed in early 1971, distributed for public discussion and suggestions, then reconsidered by the GOP and finally promulgated on 21 March 1972.

Basically the Reform is a strategy, based on a probing and frank analysis of the performance of all national sectors, and of the interrelationships of those sectors, for the transformation of the very fundamentals of Peruvian education, which is to be an integral part of a profound transformation of the economic, social and political structures aimed at eliminating the inequalities in Peruvian society.

It has its foundation in three major goals: 1) education for development and employment; 2) education for the structural transformation of the society; and 3) education for the self-affirmation and independence of the Peruvian nation.

The Reform calls for change of the educational system as a whole with each part related to and dependent upon the others, and considers education as a process occurring formally and informally and from birth to death... for all of the people. It is concerned not only with the learning process itself but also with the factors that support individual learning capacity, e.g., health, nutrition and family environment. It seeks education for the arousal, development and expression of the intrinsic value of each individual human being.

It challenges all Peruvians to participate in, and to be responsible for, the content and form of this change, and it calls for continuous experimentation, evaluation, and revision. It requires a utilization and rationalization of all the learning resources available within the community.

Most important, it is a Peruvian reform, growing out of a broad consensus of the need for change, a product of their own self-evaluation, a truly national solution to their own unique problems.

The structure of the system is to change from a highly centralized one of public formal education with individual and uncoordinated private and non-formal schools existing in isolation, basically oriented to a limited part of the traditional school-age population, to a community controlled "nucleo" structure coordinating all of the learning resources in each community and serving the needs of all individuals throughout their lifetimes. These learning resources are organized according to three different levels: initial, or overall child development; basic education, and higher education.

The most innovative aspects of this structural transformation are the following: (a) priority attention is given to the initial level education for both children and parents (involving close inter-ministerial coordination on programs); (b) private schools and non-formal programs lose their autonomy in the sense that they must serve the "nucleo" in meeting the educational needs of all the members of the community, i.e. several systems become one to serve a common purpose; (c) movement of students between the non-formal and formal programs is facilitated at all three levels to meet the needs of individuals as they occur; (d) arbitrary chronological sub-divisions of the structure are ended, i.e. students would move from one learning level to another in terms of their individual accomplishment of the objectives required at each level; (e) movement of students from each of the three basic levels to the other is automatic for those wishing to continue their learning to the subsequent level; (f) what was before the upper secondary level is now absorbed into the higher education level; (g) age is irrelevant as a qualification for learning at any particular level; (h) there is no longer an emphasis on trying to get a target group of the school-age population into formal education programs; and (i) the only route to the university will be through either a formal (ESEP) or non-formal "vocational training" course.

The curriculum is to become more vocationally oriented throughout the system, more relevant to Peru's socio-economic development, and more relevant to all people, ages and regions. Science and technology will be stressed, and the role of women will be "revalued;" Indigenous languages and cultures are to be preserved and the private schools' curricula more "Peruvianized." Self-education is to be emphasized, and public service is to be made an integral part of the curriculum at the higher level.

The teacher is to become a "teacher educator", a manager of the learning resources in the community and a catalytic agent in awakening

abilities of children, adolescents, and adults and stimulating in them a permanent process of self-development. Teacher training then is to be reformed and all existing teachers retrained.

The development and production of low cost, high quality instructional materials in accord with curricular reforms and individual needs will be assured by the Ministry of Education (MINED), and local development and production of materials will be encouraged.

The use of educational technology will be improved and expanded in order to improve instruction and expand educational opportunities.

The organization and administration of the system at the initial and basic levels is to be decentralized giving increasing power to regions, zones and "nucleos". Schools are to be run by all the elements in each community; the MINED will greatly diminish its role of central control and strengthen its support, service, and technical assistance functions. The higher level is to be administered by two groups - one for the undergraduate schools and another for the graduate schools. In both, however, there will be increased participation of students and teachers in the governance of the university. Co-ed education will be encouraged.

In the area of economics and finance, improved utilization and rationalization of existing resources are stressed. However, new sources of revenue are to be explored, such as obligatory contributions to education from private firms, tax deductions for individuals and firms who do contribute to education, and community resources heretofore untapped. Students loans will be used to help expand educational opportunity. National expenditures in education will be directed more towards the underprivileged social sectors and geographic areas of the country. The financing and budgeting processes in general are to be greatly improved. Continuous analysis and planning are essential support features of the system and research is primarily to be directed at studying the process of education as such and at generating data useful for implementing the Reform.

The major concern critical to successful implementation of the Reform is the lack of adequate human and financial resources to carry it out in the time frame established which may lead to its distortion.

Mining Reform

Peru's mining reform when fully implemented will result in substantial State ownership and full State control over the exploitation of the country's mineral resources. Also, the marketing of all mineral products will be accomplished by a State Trading Board.

The cardinal purposes of this reform are to regain for the country control over its mineral resources and to make more efficacious use of these resources in meeting the most urgent needs of the Peruvian people. Some of the more general goals of the "revolution" are expected to be served by the reform also, e.g., lessened external dependence and redistribution of income.

To effect its reform, the GOP caused all unexploited concessions to revert to the State (with the important exception of Southern Peru Copper Corporation's Cuajone concession which was declared to be outside the reform), declared all mineral resources to be the property of the State, and reserved to itself the right and responsibility of marketing all mineral products. Those companies, domestic and foreign, that were working their concessions were permitted to continue; however their investments plans, sales, etc., must be approved by the State. Southern Peru Copper Corporation was required to have its "plan" for exploiting Cuajone approved by the Government, and any default in meeting that plan could be cause for its reversion to the State.

The "community" concept has been extended to the mining sector and each mining company is required to have its community. The general purposes and goals underlying this concept are the same as in the industrial communities, however the details vary somewhat.

The Government's progress in developing these unworked concessions has been slow. Since it does not have the resources to develop these concessions, it has been seeking external financing and technical assistance. Work has begun on the Cerro Verde concession which is being developed under contract by British and Canadian firms in cooperation with Minerio-Peru, the Peruvian State mining agency. Some interest has been shown by foreign firms and governments in developing other concession also. Southern Peru continues to meet its schedule with Cuajone, and so far existing companies appear to be operating under the reformed conditions without too many difficulties. The Government has not rushed to exercise its "rights" with respect to the commercialization of mineral products.

Peru's mining reform probably will provide the country with additional production of mineral products earlier than if the reform had not been forthcoming simply because the previous concessionaires would probably not have begun exploiting their concessions. With good management, this reform could make a very important contribution to the attainment of the economic and social goals of the Peruvian 'revolution'.

Telecommunications Reform

The telecommunications reform is probably one of the most important of Peru's social and economic reforms. The principal idea underlying the reform is to preserve and to nourish Peruvian culture, or stated oppositely, to prevent the "alienation" of the Peruvian people, especially the youth.

In carrying out this reform the government has taken ownership and control of the country's television stations, and has begun the progressive "Peruvianization" of TV and radio programming. It is unclear at this time how far the GOP intends to extend its influence over the dissemination of information, etc., within the country, however, there is no doubt of the potential seriousness of this reform.

SINAMOS (National System of Support to Social Mobilization)

SINAMOS, established in June 1971 but not active until its organic law was promulgated in April 1972, was created to stimulate support for the reforms of the Military Government by building a network of grass-roots organizations to institutionalize the reforms sought by the revolutions and to bring about social democracy with full participation. It operates on two major fronts: the political, wherein it fosters the involvement of marginal groups in planning and implementing national programs, and the economic, wherein it creates mechanisms and institutions to provide a means through which low income groups can exercise ownership and control of available resources.

This strategy seeks to organize the population at the provincial level by creating self-managed institutions to attain political and economic objectives. It is expected that these institutions, over a period of time, will become the core of local governments. This principle could be gradually applied at successively higher levels within the government until it reached the national level.

SINAMOS brings together eight formerly independent agencies and thirteen departmental corporations, with its Chief holding cabinet rank. To date it has made relatively little progress toward the initial objectives of consolidating disparate organizational elements into a cohesive whole. It is trying to decentralize actions to its 13 regional offices as a means of giving power to the people and of stimulating their support. Its main thrust for the time being lies in continuing community infrastructure projects for which it inherited both funds and staffing from the National Office of Community Development.

IMPLEMENTATION PLAN

The following is an elaboration of the Implementation Plan contained in Section VI of the CAP, and represents USAID's present judgment on what Implementation Letter No.1 will contain.

A. Execution

The following schedule estimates the timing for the critical project events:

<u>Event</u>	<u>Date event completed</u>
1. Authorization of Loan; after which draft, prepare for negotiating loan agreement	June 21, 1974
2. Termination of Negotiations and Signature of Loan Agreement - prepare Implementation Letter No.1	August 15, 1974
3. Implementation Letter No.1 Issued	September 1, 1974
4. Satisfaction of Initial Conditions Precedent to Initial Disbursement by Borrower (Ministry of Economy and Finance) A. Opinion of Borrower's legal counsel.	September 15, 1974
B. Designation of Borrower's representatives (Implementing Agency Representatives); supporting documentation. (Implementing Agencies - Banco Industrial, ORDEZA, can proceed to contract for Technical Assistance to themselves with financing under the loan, e.g., full time Project Advisor, and for initial commodity and vehicle procurement as approved by AID)	
5. Satisfaction of Conditions Precedent to Disbursement of Loan Funds to the Banco Industrial	November 1, 1974
A. Evidence of the creation of a Rural Enterprises Development Fund within the Banco Industrial for the Program.	
B. Evidence of sufficient budgetary resources to make the Banco Industrial's contribution to the Project. - for capitalization of the Rural Enterprises Development Fund. - for additional personnel and operating expenses as required for the Project.	

C. Program Organization and Operations Plan,
Rural Enterprises Development Program.

A complete description of the program and the manner in which the sub-project activities will be carried out, including evidence of the Bank's authority to work with Commerce and Service type business and the following:

1) A Plan will be prepared, satisfactory to AID, setting forth the organization, criteria and procedures to be followed in carrying out the Rural Enterprises Development Program. The Plan will include but not be limited to, the following:

- The proposed administration of the Program within the Banco Industrial's existing institutional structure, allowing a maximum of decentralization of responsibility and authority for Program execution from the Branch or Field offices.
- The proposed staffing of the special Program unit, to include sufficient professional, technical, and auxiliary personnel to ensure the Program will achieve the following objectives:

a) Project Identification The Program will identify, promote, and develop projects, and carry out studies and investigations searching for new investment opportunities for either community or individual enterprises.

b) Promotion The Program will carry out an active program of promotion or publicizing of the benefits of the Program, both the technical assistance as well as the financial assistance, to reach the target group in the priority areas selected. The means of achieving this may include some or all of the following:

- publication and distribution of descriptive literature about the program -- credit manuals, pamphlets, brochures, flyers, newspaper articles, etc.
- meetings or seminars, conferences with business groups, campesino organizations, social organizations, etc.
- personal visits to clients
- radio, television

c) Technical Assistance Provide or arrange for technical assistance and advice or counsel to small businessmen and community enterprises (in industry, commerce, or service activities) in regard to technical, economic, financial, accounting, administrative and other aspects of those businesses, with the objective of solving or overcoming those elements of their operations which compromise or restrain their efficient operation and development.

d) Training Determine either in house, or under contract with an outside entity (eligible for loan financing), those common deficiencies and technical and administrative problems of the small businesses assisted by the Program. Arrange training courses, or seminars designed to rectify those problems of clients which can be effectively treated through group training programs, such as basic accounting, business management, cooperative management, marketing advice, sales, promotion, etc. For those businesses needing special training, arrange to deal with the problem on an individual basis.

The Plan will also include:

- criteria and methods for selecting projects, including measures to obviate any discrimination against women or minority groups.
- procedures for financing (application; approval)
- terms of repayment
- collection methods
- procedures for procurement and delivery of goods financed under the loan.
- control, inspection and follow-up of projects
- system for evaluation of the Program's activities
- accounting system to be used for funds provided under the loan.
- provisions to consider environmental effects of sub-projects.

2) Annual Time-Phased Implementation Plan. Also to be included will be a twelve-month time-phased implementation plan for carrying out the Project, and an estimated implementation projection for the following twenty-four months. This Plan will give starting and terminal dates of activities, personnel, training, technical assistance, and equipment required, projected disbursement, and projected costs for these activities showing the source of funding and source of goods and services. Presentation of these activities will be by bar charts, critical path methods or flow charts, as appropriate.

3) Operations Credit Manual. The Plan will indicate how a credit manual designed to be easily distributed and read will be developed to govern the operations of the Fund and will include, among other things, the rules and regulations established by the Banco Industrial, and approved by AID, governing participating financial agencies, eligible sub-borrowers, conditions of sub-loans, methods of approving sub-loans, and rules for general operations of the Fund. These rules shall include, but not be limited to, the following:

- a) A participating financial agency may be any banking institution, credit cooperative, or credit union established within the selected priority areas for the project, or which has devised a method of operating with the Fund which is acceptable to the Banco Industrial and AID, and which undertakes to finance from its own funds not less than 10% of each sub-loan handled by it. The local bank will receive the normal rate of interest allowed under existing legislation on the portion of the sub-loan financed by it, and a reasonable fee for the expenses of administration and collection of the balance.
 - b) An eligible sub-borrower may be any person, firm, association or cooperative residing in the Project Area, engaged in industry, service or commerce activities, which does not have access to credit on reasonable terms and conditions for an otherwise desirable project. Specific sub-project eligibility criteria to be met are: employment creation benefits, value added, profitability, dependence on locally produced inputs, consistency with GOP development plans. In addition, all sub-projects must be approved by Local Financial Intermediaries and the Banco Industrial.
 - c) Sub-loans may be made for the acquisition or repair of capital goods to expand or improve production or services, and for working capital. Sub-loans may be made for terms not to exceed 8 years, with grace periods of not more than 2 years, and will bear interest of from 6 to 13% on the outstanding balance (see section of CAP on Interest Rates).
- The assets acquired with the proceeds of the sub-loan will be pledged as security for the repayment of the sub-loan; no other guarantees will be required.

d) The participating financial agencies and the Banco Industrial will approve the sub-borrowers' applications on the basis of their compatibility with the project criteria.

e) Among other rules for the operation of the Fund will be those governing the use of repayments of principal and interest earned by the Fund, the handling of uncollectible accounts, duties of the administrative and technical assistance staff furnished by the Executing Agency, and such other matters as may be required for the proper operation of the Fund.

6. Satisfaction of Conditions Precedent to Disbursement of November 1, 1974
Funds to ORDEZA for the Rural Community
Development Fund and the CRECE Fund activities.

A. Program Organization and Operations Plan. Rural Community Development project and CRECE Fund Small Business Assistance Project. A complete description of both projects and the manner in which the project activities will be carried out, to include:

- evidence of sufficient COP budgetary support to ORDEZA to commence and continue the project activities during the life of the project; for additional personnel and operating expenses as may be required.

1) Program Organization and Operations Proposal A Plan will be prepared satisfactory to AID, setting forth the organization, criteria and procedures to be followed in carrying out the Rural Community Development Project and the CRECE Fund Small Business Assistance Project. The Plan will indicate, but not be limited to, the following:

- The proposed administration of the Program within the Implementing Agency's existing institutional structure.
- Provision for reflows of principal and interest payments of the additional resources provided under this Program to be deposited to the Rural Enterprise Development Fund to be administered by the Banco Industrial.
- The proposed staffing for both Program activities, to include sufficient professional, technical, and auxiliary personnel to ensure the Program will achieve the following objectives:

- a) Project Identification The Program will identify, promote, and develop projects, and carry out studies and investigations searching for new investment opportunities, for either community or individual enterprises.
- b) Promotion The Program will carry out an active effort of promotion or publicizing of the benefits of the Program, both the technical assistance as well as the financial assistance, to reach the target group in the priority areas selected.
- c) Technical Assistance Provide or arrange for the provision of technical assistance and advice or counsel to small businessmen and community enterprises (in industry, commerce, or service activities) in regard to technical economic, financial, accounting, administrative and other aspects of these businesses, with the objective of solving or overcoming those elements of their operations which comprise or restrain efficient operation and development.
- d) Training Determine either in-house, or under a contract with an outside entity that could be financed under loan TA funds, those common deficiencies and technical and administrative problems of the small businesses and community enterprises assisted by the Program, organize or participate in training courses, or seminars designed to rectify those problems of eligible small businesses which can be effectively treated through group training programs, such as basic accounting, business management, cooperative management, marketing advice, sales, promotion, etc. For those small businesses or community enterprises needing training in a field not common to others, arrange to deal with the problem on an individual basis (e.g., setting up, organizing, arranging, for the individual to get the assistance or training required.)

This Plan will also include:

- A three year projection of project development and sub-lending by type of project and by geographical distribution.
- Criteria and methods for selecting these projects, including measures to obviate any discrimination against women or minority groups.
- Procedures for financing including terms, collection methods, provision for adequate maintenance and follow-up, etc.

- Provision to consider environmental effects of sub-projects.
- Inspection/follow-up of these sub-projects
- System for evaluation of the Program's activities.

2) Annual Time-Phased Implementation Plan. Also to be included will be a twelve-month time-phased implementation plan for carrying out both the Rural Community Development and the CRECE Fund Small Business Assistance Projects, and an implementation plan estimating project activities during the following twenty-four months.

This Plan will give starting and terminal dates of activities, personnel, training, technical assistance, and equipment required, and projected costs for these activities showing the source of funding and source of goods and services. Presentation of these activities will be by bar charts, critical path methods or flow charts.

3) Operation Credit Manual. The existing CRECE credit manual governing the operations of the Fund will be reviewed by ORDEZA to ensure that the Manual includes among other things, the rules and regulations established by ORDEZA and the CRECE Fund Trustee, and approved by AID in writing, governing participating financial agencies (with provision for increasing the PFI's minimum contribution to the CRECE Fund Program from 10% up to approximately 25%), eligible sub-borrowers, conditions of sub-loans, methods of approving sub-loans, rules for general operations of the Fund, to reflect any changes resulting from the new Program Organization and Operations Plan referred to above.

7. First Disbursement to either the Banco Industrial or ORDEZA. November, 1974
8. Joint Project Review (with ORDEZA and The Bank) April, 1975
 - general assessment of status
9. Subject to negotiations between USAID and ORDEZA prior to signing of the Loan Agreement, USAID will seek August, 1975

ORDEZA agreement to prepare a plan
in form and substance satisfac-
tory to USAID for the consolidation of the two
Funds administered by ORDEZA under Projects 052
and 053.

10. Joint Project Review (with ORDEZA and The Bank) December, 1975
- general and specific assessment, to focus on progress of projects, evaluation of accomplishments, make Program management recommendations to ensure realization of project goals/targets.
11. Joint Project Review (with ORDEZA and The Bank) December, 1976
- as above
12. Final Disbursement June, 1977

CONDENSED COMPARATIVE BALANCE SHEET - INDUSTRIAL BANK
PERIOD 1968 - 1973 AND PROJECTED BY BANK FOR DECEMBER 31, 1974

(Millions of Soles)

	1968		1969		1970		1971		1972		1973		Bank's Projection 1974	
	S/.	%	S/.	%	S/.	%								
CASH (Includes Trust Funds and Funds restricted to conform the legal liquid reserve.)	118	2	187	4	455	8	737	12	1,516	16	357	2	99	1
LOANS, DISCOUNTS AND ADVANCES (Includes loan portfolio, discounted notes, and loans for account of third parties.)	4,122	82	3,901	77	3,591	65	3,926	63	6,252	65	11,107	62	13,292	65
INVESTMENTS (Includes Public Debt Bonds, other securities and assets held by the Superintendencia of Banks.)	64	1	148	3	219	4	327	5	175	2	236	1	249	1
BANKING PREMISES, FURNITURE & EQUIPMENT AND OTHER FIXED ASSETS	28	-	30	-	24	-	41	1	49	-	45	-	85	-
OTHER ASSETS ^{a/} (Includes advances, interest receivable and other items listed in footnote <u>a/</u> below.)	729	15	798	16	1,257	23	1,163	19	1,655	17	6,348	35	6,850	33
TOTAL RESOURCES	5,061	100	5,064	100	5,546	100	6,194	100	9,647	100	18,093	100	20,575	100
DEMAND DEPOSITS AND CURRENT PAYABLES	742	15	821	16	474	8	365	6	1,159	12	558	3	661	3
OWED TO BANKS AND AGENTS	2,166	43	1,928	38	1,992	36	2,116	34	3,567	37	6,554	36	8,036	39
TIME DEPOSITS AND OUTSTANDING BONDS	12	-	141	3	201	4	179	3	595	6	1,201	7	926	5
OTHER LIABILITIES ^{a/}	1,109	22	1,083	21	1,606	29	2,170	35	2,871	30	7,908	44	8,670	42
CAPITAL, PROFITS AND RESERVES	1,032	20	1,091	22	1,273	23	1,358	22	1,455	15	1,872	10	2,282	11
TOTAL LIABILITIES AND CAPITAL	5,061	100	5,064	100	5,546	100	6,194	100	9,647	100	18,093	100	20,575	100

a/ Overstatement of Other Assets and Other Liabilities:

The Bank's Balance Sheets reflect an inflation of other assets and other liabilities in equal offsetting amounts for the following years (in millions of soles):

1968	1969	1970	1971	1972	1973
615	631	1002	934	1490	6093

Reasons for the Overstatement are:

1. The Bank's policy of showing contingent liabilities for endorsements and warranties and documentary credits as actual liabilities with a contra account on the asset side.
2. Including offsetting memorandum accounts --i.e. exchange operations-- as other assets and liabilities.
3. The Bank's unorthodox method of accounting for the Fund for Development of the Fishing Industry, for which it acts as Fund Administrator, which results in showing the same assets and liabilities twice in different parts of the Balance Sheet.

COMPARATIVE INCOME STATEMENT - INDUSTRIAL BANK
PERIOD 1968 - 1973 ACTUAL AND PROJECTED FOR 1974 (BY BANK)

(Millions of Soles)

	1968		1969		1970		1971		1972		1973		Combined Income Stat. Banks' Projection for the six-year period		Banks' Projection for 1974	
	S/.	%	S/.	%	S/.	%	S/.	%	S/.	%	S/.	%	S/.	%	S/.	%
INCOME:																
Interest & Commis.earned Exchange, Commis. & Other Income	369	95	409	95	398	95	368	99	510	99	886	94	2,940	96	1,086	96
Total Income	<u>20</u> 389	<u>5</u> 100	<u>21</u> 430	<u>5</u> 100	<u>23</u> 421	<u>5</u> 100	<u>4</u> 372	<u>1</u> 100	<u>4</u> 514	<u>1</u> 100	<u>52</u> 938	<u>6</u> 100	<u>124</u> 3,064	<u>4</u> 100	<u>48</u> 1,134	<u>4</u> 100
DISTRIBUTION OF INCOME:																
Cost of Money Borrowed:																
Interest & Commis. Paid	158	40	168	39	148	35	123	33	149	29	359 ^{a/}	38	1,105	36	516 ^{a/}	46
Other Operating Costs:																
Salaries & Fringe Benefits	105	27	121	28	146	35	156	42	182	35	233	25	943	31	308	27
Other Administrative Expen.	31	8	36	8	49	11	42	11	48	9	63	7	269	9	81	7
Write-offs & Provisions (depreciation, bad debts, etc.)	38	10	54	13	19	5	22	6	49	10	204 ^{b/}	22	386	12	86 ^{b/}	8
Total Other Operating Costs (exclusive of cost of money borrowed)	<u>174</u>	<u>45</u>	<u>211</u>	<u>49</u>	<u>214</u>	<u>51</u>	<u>220</u>	<u>59</u>	<u>279</u>	<u>54</u>	<u>500</u>	<u>54</u>	<u>1,598</u>	<u>52</u>	<u>475</u>	<u>42</u>
Net Income	<u>57</u>	<u>15</u>	<u>51</u>	<u>12</u>	<u>59</u>	<u>14</u>	<u>29</u>	<u>8</u>	<u>86</u>	<u>17</u>	<u>79</u>	<u>8</u>	<u>361</u>	<u>12</u>	<u>143</u>	<u>12</u>
DISTRIBUTION OF NET INCOME:																
-Income to Employees & for Medical Fund, 10% of Income (till 1971)	5		5		6		3									
-Dividends for Class B Stocks, private capital, 12% of nominal value	21		23		24		24		25							
-Reserve Fund	31		23		29		2		8							
-Public Treasury	-		-		-		-		53							
Total Net Income	<u>57</u>		<u>51</u>		<u>59</u>		<u>29</u>		<u>86</u>		<u>79</u>		<u>361</u>		<u>143</u>	

- ^{a/} The Bank anticipates an increased percentage of financial costs because its use of funds from external sources is now greater than in 1973 and also because the cost of capital in the markets of capital is higher than in 1973.
- ^{b/} A provision for loans in arrears of 180 million soles is included in 1973; the provision projected for 1974 is 60 millions soles, which affects the comparability.

COMPARATIVE FUNDS FLOW STATEMENT OF THE BANCO INDUSTRIAL

PERIOD: 1/1/68 - 12/31/73

(In Millions of Soles)

(Statement shows funds made available from increases in debts or capital and conversion of assets and how these funds were applied to reduce the debt or increase the assets in each of the years of operation.)

	1969	1970	1971	1972	1973	TOTAL	1974 (Projected by Bank)
<u>FUNDS WERE PROVIDED BY:</u>							
Profit from operations and capital increases	59	182	85	97	417	840	410
<u>Net Increases In:</u>							
Demand deposits and short-term payables,	79	-	-	1,082	-	-	103
Time deposits, Acceptances and Private Credits	129	60	-	278	744	1,189	
Debt owed to Banks and agents	-	64	124	1,451	2,987	4,388	1,402
Other Liabilities <u>a/</u>	-	523	570	545	5,187	6,799	762
<u>Net Decreases In:</u>							
Cash Balance	-	-	-	-	1,159	-	338
Loan Portfolio	221	310	-	-	-	-	
Investments	-	-	-	152	-	-	
Value of Banking Premises, etc.	-	6	-	-	4	-	
Other Assets	-	-	94	-	-	-	
TOTAL SOURCES	488	1,145	873	3,605	10,498	13,216	3,015
<u>FUNDS WERE APPLIED TO:</u>							
<u>Net Increases In:</u>							
Loan Portfolio	-	-	335	2,326	4,855	6,985	2,185
Cash Balance	69	268	282	779	-	239	-
Investments	84	71	108	-	61	172	13
Value of Banking Premises, Furniture & Equipment	2	-	17	8	-	17	40
Other Assets <u>a/</u>	69	459	-	492	4,693	5,619	502
<u>Net Decreases In:</u>							
Debt owed to Banks and Agents	238	-	-	-	-	-	-
Demand Deposits and Short-Term Payables	-	347	109	-	889	184	-
Time Deposits, Acceptances and Credits	-	-	22	-	-	-	275
Other Liabilities	26	-	-	-	-	-	-
TOTAL FUNDS APPLIED	488	1,145	873	3,605	10,498	13,216	3,015

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a/ Other Assets and Other Liabilities are inflated as detailed in note a/ to the Comparative Balance Sheet (EXHIBIT "A").

CONVENTIONAL RATIOS APPLICABLE - INDUSTRIAL BANK

	1968	1969	1970	1971	1972	1973	1974 (with figures projected by Bank)
<u>1. DEPT. SOLVENCY & SOURCE RATIOS</u>							
1.1 Debt to Equity (Debt = Owed to Banks & Agents)	2.2 Times	1.9 Times	1.6 Times	1.6 Times	2.6 Times	3.8 Times	4.1 Times
1.2 Deposits to Equity (Margin of Security for Depositors)	71 %	73 %	35 %	22 %	101 %	44 %	41 %
1.31 Debt to Assets ^{a/}	49 %	44 %	44 %	40 %	43 %	57 %	57 %
1.32 Equity to Assets ^{a/}	22 %	23 %	27 %	25 %	17 %	15 %	15 %
1.33 Other Claims (not Loans) Against Assets ^{a/} (deposits, current payables, acceptances and trust funds)	29 %	33 %	29 %	35 %	40 %	28 %	28 %
<u>2 RATIOS MEASURING SHORT-TERM LIQUIDITY</u>							
2.1 Cash to Demand Deposits and Current Payables	16 %	23 %	96 %	201 %	105 %	64 %	13 %
2.2 Cash and Short-Term Investments to Demand Deposits and Current Payables	18 %	26 %	125 %	230 %	110 %	74 %	22 %
<u>3 RATIOS MEASURING PROFITABILITY</u>							
3.1 Return on Equity	6 %	5 %	5 %	2 %	6 %	5 %	7 %
3.2 Return on Total Resources ^{a/}	1.30 %	1.15 %	1.29 %	0.59 %	1.28 %	0.78 %	1.10 %
3.3 Profitability of Operations (% of Profit on Total Income)	15 %	12 %	14 %	8 %	17 %	8 %	13 %
3.4 Profitability of Loan Portfolio (Interest Paid for Borrowed Money and Net Income to Average Loan Portfolio)	5.2 %	5.5 %	5.5 %	4.0 %	4.6 %	4.9 %	5.4 %
3.5 Ordinary Income to Average Loan Portfolio	9.0 %	10.2 %	10.6 %	9.8 %	8.8 %	10.0 %	8.9 %

^{a/} To compute the ratios we adjusted the total resources for overstatement detailed in note a/ to the Comparative Balance Sheet of the Bank.

Comments on Comparative Balance Sheet (See Page 1) (To be read using said comparative statement)

General

For the period 1968 through 1971 the balance sheets show a more or less stable level of operation with a slow but steady growth in total assets. In 1970 and 1971 the demand for loans declined substantially and the Bank was forced into a high liquidity position with excessive cash and investments. The decline in loan portfolio and increase in idle cash had an adverse effect on earnings in these years.

Starting with 1972, the balance sheets reflect a marked expansion. The loan portfolio increased 58% from 3,926 million soles in 1971 to 6,252 million soles in 1972. Debt to banks and agents increased by 1,451 million soles but it appears this borrowing exceeded actual needs since cash continued to far exceed the Bank's needs for a safe reserve. The Bank's growth in assets jumped again in 1973 with increases in the loan portfolio of 78% to 11,107 million soles, an increase of debts to banks of 2,987 million soles and an increase in capital of 417 million soles. Cash reserves were reduced to a more acceptable level (although still on the high side). In reviewing the growth of the Bank, caution must be taken to reduce other assets which are overstated by amounts shown under footnote a/ to Page 1. Notwithstanding, these overstatements, 1973 was truly an impressive year of growth for the Bank and should have been a year of record profits. In fact net income dipped slightly to 78 million soles. The reason is that a special adjustment of 135 million soles was made to the provision for loans in arrears, based on evaluation made of individual loan files. This adjustment resulted in a charge against 1973 income to adjust for understatements of the provision for bad debts in previous years. Without this adjustment 1973 net income would have been 213 million soles.

The growth trend is expected to continue in 1974. According to the Bank's projections as of December 31, 1974 the loan portfolio will increase to 13,292 million soles. This increase in portfolio will be financed by increasing debt to banks by nearly 1,500 million soles and increasing capital by 400 million soles. Cash reserves will drop sharply and the Bank will be moved from a historical position of excess liquidity to a position of minimum liquidity bordering minimum reserve requirements. This problem is discussed in greater detail in a following section.

Loan Portfolio Balances - By Major Types of Loans:

The following table shows the growth of the Bank's portfolio:

Type of Loan (in millions of soles)	Balance as of December 31			
	1971	1972	1973	1974 ^{a/}
Ordinary Loans	2,803	2,778	3,044	3,750
Supervised Loans	302	363	369	546
Fishing Industry	448	785	3,862	4,158
Exportation (Non Traditional)	-	112	1,062	1,974
Other	372	2,214	2,770	2,864
TOTAL	3,925	6,252	11,107	13,292

a/ estimated

It can be seen that loans to the fishing sector account for the largest share of growth. These loans were made to consolidate debt and provide working capital to the fishmeal industry during the long period of poor anchovy fishing. A large part of the portfolio is represented by the fund for development of the Fishing Industry, for which the Bank is Administrator, which was formed when the government nationalized the fishmeal industry.

Problems of Liquidity

Referring to ratios on Page 4 it can readily be seen that the Bank has had excess liquidity in recent years. The percentage of cash available to meet demand deposit withdrawals and current payables has ranged from 64% in 1973 to 201% in 1971. An adequate liquidity range would probably be around 30 to 40%, although the exact desirable liquidity at any point in time requires a great deal of detail analysis and is one of the most important matters a Bank must keep under constant review. It can be safely stated that the bank had more than desired or optimum liquidity during the years 1970 through 1973.

The Bank's lending program during 1974 will correct the problem of excess liquidity and, if the Bank's budgetary projections are correct, will tilt the scale to the opposite side of the problem i.e. inadequate liquidity, with the percentage of cash reduced to 15% of demand deposits and current payables. When to arrive at this cash position, the bank will have to run an 80 million sole overdraft with the Central Bank (which overdraft we have reflected in the balance Sheet under Debt owed to Banks). This cash balance suffices to meet minimum legal cash reserves of 65 million soles plus cash necessary for current banking operations but barely and with little or no safety margin.

We met with Bank officials to discuss the above problem. They report that the budgetary projection was prepared in a conservative way with the purpose of substantiating an additional credit line of 400 million soles, which is now being negotiated with the Central Bank. The Bank expects to receive the 400

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1/ Page 4 reflects an error in percentage for 1974 for Item 2.1. Should be 15%, not 13%.

million soles credit within the next two months which could considerably improve their cash position, depending of course on whether they hold on to some of the cash or lend out all of the new credit. The Bank people also explained that they expect the tight cash position to be temporary because, before the end of the year, they will have to prepare the biannual budget for 1975-76 which must consider the augmented cash needs. Therefore they expect that the global loan contract signed with the Central Bank next year will provide for greater periodic cash allotments than in previous years.

Capital, Profits and Reserves

following page

The table on the / shows the capital structure of the Bank as of December 31, for years 1968 through 1973.

The successive increases in capital stock reveal that during all these years there have been additional contributions to the capital of the bank from the Peruvian Government, as well as capitalization of accumulated earnings. The table also reflects that the Peruvian Government is the controlling interest of the bank, since the relatively small private contributions (Class B Stock) were made early in the life of the Bank, prior to the Revolutionary Government.

Bank's Experience with Supervised Lending Program

The Bank's supervised lending program is directed to assisting artisans and small industries. Loans are made mostly through the Branch Offices in amounts less than S/.400,000.

The budget figure for supervised loans in 1973 was 190 million soles and the loans actually made were 176 million soles or 93% of goal. The distribution of supervised loans made was as follows:

<u>Territory</u>	<u>Amount</u>	<u>%</u>
<u>Lima</u>	<u>38.0</u>	<u>22</u>
<u>Provinces</u>	<u>138.1</u>	<u>78</u>
Arequipa	7.5	
Cuzco	10.5	
Puno	9.0	
Ica	7.8	
Tacna	3.0	
Huancayo	17.5	
Ayacucho	7.5	
Huánuco	6.3	
Huaraz	3.5	
Piura	5.7	
Chiclayo	10.2	
Cajamarca	8.5	

TABLE SHOWING COMPOSITION OF EQUITY OF THE INDUSTRIAL BANK OF PERU

PERIOD: 1968 TO 1973

(Millions of Soles)

	1968	1969	1970	1971	1972	1973	
						S/.	%
Class A Stocks, owned by Peruvian State						1,392	74
Class B Stocks, owned by private persons. Dividends of 12% free of taxes have been consistently paid.						205	11
Total Capital Stock	871	906	1,057	1,143	1,181	1,597	85
Reserve Fund	104	134	157	186	188	196	10
Earnings of the Year to be Distributed in the following year	57	51	59	29	86	79	5
TOTAL	1,032	1,091	1,273	1,358	1,455	1,872	100%

Trujillo	32.0
Chimbote	5.2
Iquitos	3.2
Pucallpa	0.7

Collections of both principal and interest, in 1973, were of about 132 million soles, or roughly 75% of loans made during the year, from which could be derived that most of the lending activity in the year was financed by capital returns from supervised loans made in prior years.

Bad Debts Experience with Supervised Loans

The balance of the supervised loan portfolio at the close of year 1973 was 368.8 million soles, broken down as follows:

	<u>Million of Soles</u>	<u>%</u>	<u>% for Lima</u>	<u>% for Provinces</u>
Good Accounts or not due	328.0	88.9	72.7	92.5
In arrears <u>1/</u>	24.7	6.7	12.5	5.4
Overdue <u>2/</u>	<u>16.1</u>	<u>4.4</u>	<u>14.8</u>	<u>2.1</u>
TOTAL	<u>368.8</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

The provision for bad debts recorded for supervised loans as of December 31, 1973 was 48.2 million soles, or 13% of the supervised loan portfolio. This was sufficient to cover the potential losses for loans already determined in default. (loans in arrears and loans overdue) which from above table is 40.8 million soles plus allowance for good loans, which may later become in default.

Summary

	<u>Million Soles</u>	<u>%</u>
Supervised Loan Portfolio	368.8	100
Provision for Bad Debts	48.2	13
Loans in Default	40.6	

- 1/ Loans with delinquent payments for which cause the whole amount of the loans have been declared in arrears and payable.
- 2/ Fully matured loans for which payments are overdue.

For comparative purposes we relate below the provision for bad debts for other types of loan for which provisions for bad debts are made, exclusive of supervised loans. It should be noted that no provision is made for fully secured loans and loans for which no provision is made have been excluded.

Ordinary loans	3,044	
Loans to Fishing Industry	120	
Other Loans	380	
Loans for Exportation	<u>1,061</u>	
	TOTAL	
	<u>4,605</u>	100%
Total Provision for Bad Debts	457	
Less:		
Provision for Supervised Loans	<u>48</u>	
Total Provision for B.D. on Above Portfolio	<u>409</u>	9%

Above table denotes that the Bank's estimate of doubtful accounts for loans other than the supervised loans is of about nine percent (9%).

It can be seen from the above statistics that the Bank actually loses money on its supervised lending program since interest rates are less than the percentage of bad debts losses. An evaluation might show that this is more than offset by accomplishment of development objectives. The losses on this program must be made up either from the Bank's own resources (e.g. profits on other types of loans) or through additional inputs into the Bank from the Public Treasury.

Conclusions Based on the Comparative Income Statement (See Page 2)

- 1) Operating income, derived from lending activities, varies from 95% to 98% of total income; thus only from 5% to 1% of income is derived from other banking activities.
- 2) The operating costs of the Bank averaged 52% of total income for the six-year period, leaving an average margin of 48% to cover cost of money borrowed for purposes of relending and a reasonable profit margin. The percentage of operating costs is projected to decline to 42% in 1974 which will help to offset increases in costs of money borrowed.
- 3) Total income for the six-year period was 3,064 million soles, of which 1,105 million soles (36%) was applied to cover the cost of money borrowed for sub-lending. The cost of money borrowed has fluctuated between 40% and 29% of total income for individual years and the trend is now moving sharply upward from 29% to 38% in 1973 and 45% projected for 1974. Causal factors are increased dependence of the Bank on borrowing as a source of lending capital and the current high interest rates charged in the money market.
- 4) Operations of the Bank in the six-year period have been profitable. In every year there has been an excess of total income over total costs. The lowest surplus was of 29 million soles in 1971 and the highest was 86 million soles in 1972. On the average the surplus was 12% of total income for the period, the absolute figure, being 361 million soles for the six-year period.

Comment on Ratios Measuring Profitability (See Page 4)

3.1 Return On Equity:

Has averaged about 5% a year except for a low period in 1971 when this ratio fell to 2%. Measured by commercial standards this is less than a satisfactory profit on invested capital since the rate of return has not even kept pace with the rate of inflation which presently exceeds 9% in Peru (and related deflation of the Sol). On the other hand, it may be said, that as a government owned development bank, the Industrial Bank's main objective is not to maximize profits. Rather, its real objective is to promote and finance productive activities in the industrial, commercial and fishing sectors. Thus the Bank cannot negotiate rates of interest with only earnings in mind because these rates are set by higher political authorities with social and country benefits in mind. Viewed from the development aspect, the Bank's earning performance can be considered satisfactory and better in fact than other development banks operating in Peru. The bank has achieved self-sufficiency and limited growth through accumulation of earnings.

3.2 Return on Total Resources

This percentage varies from approximately 1/2 of 1% in 1971 to 1 1/4% in 1972 and appears to be extremely low. Pinpointing the reasons for such a low return on resources employed would require much more detail analysis. However, it appears to be related to a low rate of gross income generated on the loan portfolio --average of about 9% in recent years. Since the Bank borrows the majority of funds loaned, possibly interest rates need to be raised to provide more of a spread between interest earned and interest paid by the Bank, i.e. if increased profitability is an objective. The extraordinarily low rate of return in 1971 appears also to be related to too much liquidity and an underutilization of assets (due in part to lack of demand for loans as a result of a decline in industrial activity). It may very well be that this ratio is commonly low for development banks for reasons stated in the section above.

3.3 Percentage of Profit on Total Income

This percentage represents the excess of income over costs (profit %). This percentage averaged 12% for the six-year period 1968-1973 and appears to be reasonable, although, for lack of a standard against which to measure the results of Bank operations, we feel some hesitation in expressing an opinion. Operating costs appear reasonable and low profits in absolute figures are related to a low income generated from investment; not to excessive operating costs. In 1974 the increased costs of money borrowed for relending may cause a pinch on the profit percentage unless the Bank can realize the reduced percentage of operating costs which they have projected (See Page 2).

Comments on the Comparative Funds Flow Statement (See Page 3) . (To be read together with the related statement.)

Our interpretation of this statement is limited because we did not have access to internal data that reflects the actual amounts of uses and sources of funds. Therefore our comments are based on net changes in the assets and liabilities and capital accounts, using 1968 as the starting year for measuring changes.

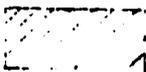
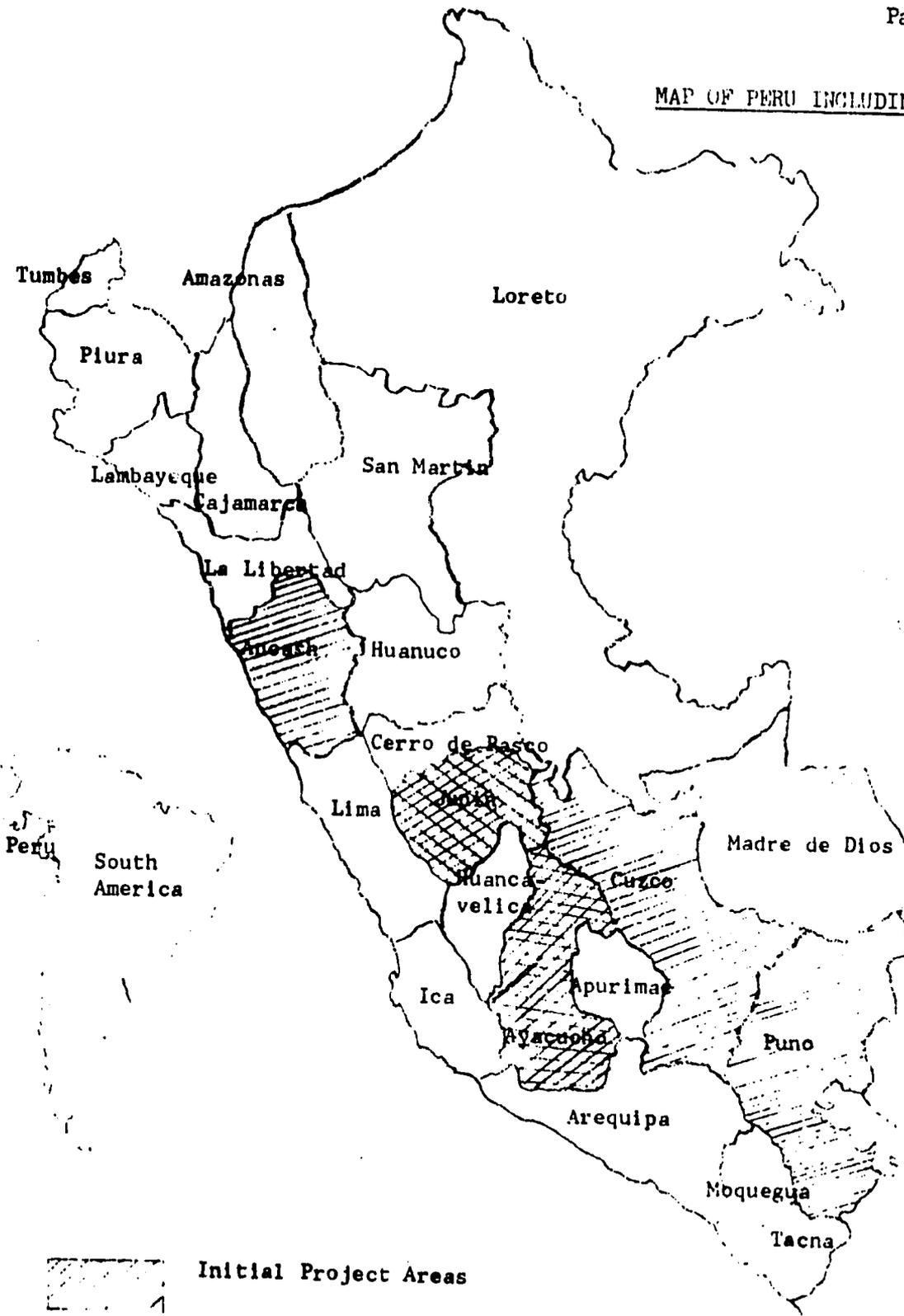
Sources

- 1) The major source of funds for the Bank is the debt owed to banks and agents, over 4,328 million soles, of which the Central Bank is the major creditor with more than eighty percent (80%) of Credits.
- 2) Time deposits, acceptances, and other private credits are the second most important source of funds for the Bank, and the next would be the profits from operations capitalized together with additional capital contributions by the GOP.

Uses

- 3) The greatest use of funds has been to increase the loan portfolio, which in 1972 and 1973 materially increased by 2.3 and 4.8 billion soles, respectively.
- 4) Next comes the use to increase the balance of cash. Cash increased each year from 1969 to 1972 until it was substantially reduced in 1973 by 1.2 billion soles, which is reflected under the Sources of Funds section.
- 5) Increased investments and demand deposit withdrawals absorbed 356 million soles in the five-year period.
- 6) Additions to banking premises and furniture and equipment are relatively small, (17 million soles of net increase for the five-year period). We can infer that additions are financed through charges to operations via depreciation.

MAP OF PERU INCLUDING PROJECT AREAS



Initial Project Areas



Possible Project Expansion Area