



INFORMATION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LA)

FROM: LA/DR, John R. Breen

SUBJECT: ISSUES PAPER - Rural Enterprise IRR - Peru

APR 18 1974

John Breen

The DAEC will review the subject IRR on Friday, April 19, at 2:30 p.m. The project proposes a loan of \$10 million to the GOP to assist in establishing a Fund in the Central Bank to provide credits on reasonable terms to rural enterprises which have not had access to such credit before. The GOP would contribute \$4 million to the program, of which \$1 million would be for administrative expenses and technical assistance. The implementing agency would be the Ministry of Industry. The proposed project had its origin in and would be modeled on the two existing A.I.D. loans for community development and small business credit in the earthquake zone. The overall thrust of the program would be directed at accelerating rural development.

The Congress has not been previously notified of our intention to go forward with this project.

The following issues will be reviewed by the DAEC:

1. The presumption as to the feasibility of the proposed program is apparently based in large measure on the experience gained under Loans 052, Community Development, and 053, Small Business, and the similarity of the proposed program to those two existing loans. However, the nature and form of operation of these two loan programs is not described in sufficient detail to permit an evaluation of this similarity or lack thereof. This needs to be discussed. As a part of this discussion, the Mission should also clarify which agency will bear the subloan credit risk, as well as what interest spread and level of effective return to the lending agencies is believed necessary to induce their participation. There are several other questions to be examined concerning the proposed subloan terms, including why a concessional interest rate would be justified, and why a variable rate is proposed.

2. What locational and subsectoral criteria will (or should) be established for the use of the Rural Enterprise Fund? How is "rural enterprise" defined? Should financing be limited to agro-industrial or agri-business operations, or open to all rural-based enterprise?

The IRR states that entrepreneurs and business which "have not generally had access to credit on reasonable terms" will be one of the major groups assisted by the loan. How does the Mission propose that the Borrower/implementing agency insure that the relatively more developed firms located in the rural sector who generally have had access to credit from commercial banks do not avail themselves of the proposed subsidized credit to be made available (i.e., the credit substitution problem)?

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3. On what basis were the areas selected in which it is proposed that program resources be concentrated? What complementary GOP rural development activities are underway in these areas as opposed to other potential areas? The IRR indicates that the Mission believes it desirable to provide "substantial resources" to the earthquake zone. Is this advisable given our desire to signal that we are no longer confining our assistance to the disaster zones? How much of the loan resources, if any, should be allocated in the earthquake zone? What would be the likely impact on the size of the loan if the disaster zone were excluded?
4. How does the Mission propose to firm up the estimates of demand for the proposed credit during intensive review?
5. The IRR does not indicate how the success of the project will be evaluated. What factors or outputs (other than jobs created) will be examined?

~~Seifman~~
Ed Sycowski
29.
C/R File

MEMORANDUM

June 19, 1974

TO : LA/DR, Mr. Frederick Schieck
 FROM : USAID/Peru, C. Gregory Smith, Jr.
 SUBJECT: IADB COPESCO Loan and Its Relationship to USAID's Rural Enterprises Development Loan (RED).

Mr. Sidney Schmukler, in his letter to you dated June 3, 1974, advises that IADB has no interest in financing the RED project, and that their COPESCO project has a project element oriented toward improving the quality of artisanry in the Cuzco and Puno areas.

I met with Snr. Pedro Schlesinger, an IADB loan officer for Peru, to discuss the relationship between AID's RED project and the COPESCO artisanry element. It appears from a joint review of the COPESCO/BID project document that the following information is pertinent:

1. The COPESCO project will be primarily for financing tourism, and will have several stages. Only the first stage is written up at this point, however, for which the IADB financing contribution is about \$26 million.

2. Of this contribution, \$.75 million is due to be spent for technical assistance, of which some \$.16 million will finance advisors in tanning and leatherwork, gold and silver metalwork, and product marketing. These advisors will be deputed to EPPA (Empressa Peruana de Promocion Artesanal), an organization formerly located in the Ministry of Industry and Commerce, and now in the Ministry of Industry.

3. There are no project credits to finance new or expanded artesania operations.

Conclusion: USAID's RED project and the COPESCO artesania program element should prove to be complementary in that the COPESCO program will create more demand for artesania, the RED fund could provide whatever financial assistance might be necessary to create or expand existing artisan operations, and the combination of IADB advisory inputs and the technical assistance envisaged under the RED project should prove adequate to develop both products and enterprises.

Attachment:

Copy of Mr. Schmukler's Letter

cc: LA/DR, MBrown
 LA/DR, ELijewski
 LA/DR, ABacic

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INTER-AMERICAN DEVELOPMENT BANK
WASHINGTON, D. C. 20577

~~B...~~
→ E. Lijowski
TFL

CABLE ADDRESS
INTAMBANC

June 3, 1974

Mr. Frederick Schieck
Assistant Director
Office of Development Resources
Department of State
Agency for International Development
Washington, D.C. 20523

Dear Mr. Schieck:

With reference to your letter of April 30, 1974 regarding a proposed AID loan to the Government of Peru for Rural Enterprise Development, we wish to inform you that at present the Bank is not interested in this project.

We wish to note, however, that at present the Bank is considering the COPESCO project which has a relatively small but important sub-project oriented toward improving the quality of artisanry in the Cuzco and Puno areas. Should the Cuzco and Puno areas be included in the AID project, we feel it would be interesting to examine that part of the project jointly, since the execution of the COPESCO project will increase substantially the demand for artisan products for which increased amounts of credit will be necessary.

Sincerely yours,

Sidney Schmukler
Assistant Program Advisor

PD-AAB-398-C1

527-W-057

4 057 5270141 ①

13p.

January 7, 1977

LA/DR

USAID/Peru

Loan No.527-W-057

Problem

1) To extend the terminal commitment and disbursement dates under the subject loan by eighteen months, making a total loan disbursement period of 45 months, and 2) to amend the Loan Authorization and Loan Agreement to permit a transfer of up to \$3.0 million from ORDEZA management in the Earthquake Zone to the Rural Enterprises Development Fund administered by the Industrial Bank for sub-lending in additional sierra departments.

Background

The subject loan of \$10 million was authorized June 28, 1974, and executed November 25, 1974. Initial CP's were met on April 23, 1975. The current TCD is January 31, 1977, and the TDD is July 31, 1977, 27 months from the date of compliance with initial CP's. The purpose of the project is to provide credit and technical assistance under reasonable terms and conditions to enterprises located in selected rural areas of Peru.

As originally designed, ORDEZA was to continue its activities in the Earthquake Zone initiated under A.I.D. Loan No.527-L-052 (Community Development) and No.527-L-053 (CRECE Fund - Small Business) with up to \$4 million of loan proceeds, which included \$300,000 for TA; as counterpart, the GOP would assume all administrative costs, valued at \$1 million.

The balance of the Loan, or \$6 million, was allocated to the Industrial Bank of Peru to establish a Rural Enterprises Development Fund for lending in four southern departments (Ayacucho, Cuzco, Junin and Puno); with the exception of \$300,000, which was reserved for TA, these loan proceeds were to be used, together with a GOP counterpart contribution of \$4 million, to capitalize the Fund. Pursuant to the Loan Agreement, reflows under sub-loans made by ORDEZA with loan funds would be channelled into the Fund for future re-lending by the Industrial Bank.

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Financial Plan (In US.\$000)

	<u>Industrial Bank</u>		<u>ORDEZA</u>	
	<u>A.I.D.</u>	<u>GOP</u>	<u>A.I.D.</u>	<u>GOP</u>
Sub-lending	5,700	4,000	3,700	-
T.A.	300	-	300	-
Administration	-	500	-	1,000
Total	6,000	4,500	4,000	1,000

Due to changes of key personnel in ORDEZA beginning in January, 1975, which brought critical policy changes, the ORDEZA portion of the project was plagued with delays and administrative problems from the start. ORDEZA submitted its Operations Plan in June 1975 which, after significant revision, A.I.D. approved in September, 1975, fulfilling subsequent conditions precedent to disbursement (Section 3.03). Since then, persistent shortages of personnel and transportation, intra-agency dissension, and poor management have resulted in very little performance. To date, after fifteen months, ORDEZA has committed only S/.13.5 million (roughly \$200,000*) to two approved sub-projects, and has made no disbursements. An additional six sub-projects totalling S/.80.8 million (roughly \$1.1 million*) have been prepared by ORDEZA for USAID review. Two of these have been approved conditioned on the extension of the TDD, three more have been submitted to USAID and are under review, and one is expected to be submitted this month. The Mission has decided to permit the current TCD to lapse, leaving at least approximately \$2.6 million and possibly more, in uncommitted Loan funds.

The Industrial Bank also demonstrated poor performance in the initial phases of the project. It submitted an Operations Plan in May, 1975, which A.I.D. approved in June, 1975, fulfilling subsequent CP's (Section 3.02). Shortly thereafter, the Bank underwent a major internal re-organization which occasioned key personnel shifts. Little attention was given to the Fund, largely because of general confusion regarding allocation of responsibilities for Fund administration within the Bank. There was no sub-lending until November, 1975, and the rate of activity remained low through June, 1976. By that date, 12 months after meeting subsequent CP's, the Bank had committed funds to 143 sub-loans, totalling S/.38,486,000 (roughly \$655,000**).

After consolidation of the re-organized Bank management, the new Bank Manager became actively involved personally in the project and took

* at S/.70 = US.\$1

** at S/.45 = US.\$1

decisive action to clarify administrative responsibilities, to promote Fund activity in the branch offices, and to arrange for technical assistance to accelerate sub-loan identification and study. In July, 1976, in the course of a Mission review of the Bank portion of the project, performance targets were established for July, August, and September. USAID consideration of an extension of the terminal dates was explicitly conditioned on the Bank meeting these targets. These targets were met, and exceeded, and in a formal review with the Bank in early November, it was concluded that USAID would seek an extension of the terminal dates to permit full utilization of the balance of the loan allocation to the Fund. (See Annex I for detailed documentation.)

In the six months from July, 1976, through December, 1976, an estimated S/.160,000,000 (roughly \$2.5 million*) was committed to approved sub-loans; this total is an increase of 400% over sub-loan commitments in the preceding twelve-month period. (Please refer to Annex II, which shows monthly and cumulative sub-lending activity from project initiation.) Moreover, the existing backlog of sub-projects under study will permit the Bank to fully commit by January 31, 1978, the balance of the Fund's existing capital within the four original departments. (See Annex III, showing the Bank's projected schedule of sub-loan commitments of original Fund capital.)

Simultaneously, the Bank has effectively institutionalized Fund operations. An office for management of the Fund has been established within the Bank's Division of Studies and Development; this office is headed by the Fund Coordinator, who has direct lines of communication with the Financial and General Managers of the Bank. A Fund promoter in each branch office participates (as a non-voting member) in all meetings of the branch's credit committee in its pre-qualification of sub-borrowers and approval of sub-loans. Sub-loans requiring approval at the principal office in Lima are presented by the Chief of the Branch Office.

A major step in institutionalizing the Fund in the Bank, and which accounts for much of the recent progress in Fund operations, was the General Manager's decision to sign "umbrella" contracts with several private consultants to provide required technical assistance. Under these agreements, separate contracts have been signed to identify investment possibilities, to develop potential sub-projects, to analyze their feasibility, and to provide on-going technical supervision of sub-project implementation. To date, contracts have been signed for 77 project possibilities covering a potential Fund investment in sub-loans totalling approximately S/.402 million. The great majority of these are for investment possibilities in rural associative enterprises which, for lack of funds and entrepreneurial experience, are unable to develop projects on their own.

* at S/.65 = US.\$1

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Given the excellent progress and active interest shown by the Bank, and the poor performance of ORDEZA, the Mission began considering in its October review a transfer of ORDEZA's uncommitted loan resources to the Fund for investment by the Bank. This possibility has been discussed with the Bank and the Ministry of Economy and Finance, the Borrower under the loan. After extensive discussion and careful study of preliminary data, the Mission has developed this proposal for consideration by the Bureau.

Discussion

The Mission proposal comprises the following actions: first, the extension of the TDD under the ORDEZA portion to permit implementation of only those sub-projects approved prior to the current TCD of January 31, 1977; second, the extension of the TCD and TDD under the Bank portion of the loan by eighteen months; third, the re-allocation of up to \$3 million of loan funds originally intended for sub-lending in the Earthquake Zone by ORDEZA, uncommitted as of the current TCD, to the Fund in the Industrial Bank; fourth, the extension of Fund operations into the sierra departments of Apurimac, Huancavelica, Huanuco, and Cajamarca; and fifth, the negotiation with the GOP of additional counter-part financing to maintain the current 60:40 proportion of A.I.D. and GOP contributions to the Fund.

With respect to the ORDEZA portion of the project, the Mission has concluded that ORDEZA's past performance and present prospects offered no justification to consider an extension of the TCD.* Therefore, the current TCD will lapse, leaving approximately \$2.6 million in loan funds uncommitted if the Mission approves the six remaining sub-projects prepared by ORDEZA for loan financing. The Mission wishes to extend the TDD to permit the orderly implementation of several sub-projects which have been fully developed and analyzed, which are ready for execution, but which require a disbursement period exceeding the six-month period remaining prior to the TDD. (See Annex IV for a list of sub-projects which have been developed by ORDEZA for USAID review prior to the TCD.) Furthermore, an extension is justified in view of the fact that the existing disbursement period is nine months short of the normal period prescribed under PD-57 (i.e. 36 months from the date of compliance with initial CP's).

With respect to the Industrial Bank portion of the project, the Mission has concluded that an extension of the TCD and TDD is both required and justified and that the Bank could effectively utilize (up to \$3 million of loan funds uncommitted by ORDEZA. These conclusions are based on the Bank's demonstrated interest in the loan and its institutional capacity to execute it as designed. The extension request

* Moreover, a recent GOP decision reducing the area under ORDEZA jurisdiction limits ORDEZA's ability to invest Fund resources in the future.

is further justified also by the nine-month shortfall in the existing disbursement period. The Bank estimates that the current balance of Fund resources (i.e. the original \$6 million in A.I.D. loan funds and \$4 million in GOP counterpart) will be fully committed by January 31, 1978. Additional time is requested to permit commitment of new resources transferred to the Fund from ORDEZA and provided as GOP counterpart.

It is not clear at this time how much loan money will be available for transfer to the Bank, since the TCD has not yet passed, and since commitments to several ORDEZA sub-projects approved by USAID prior to the TCD must await AID/W decision on a TDD extension. The minimum amount available for transfer would be \$2.6 million, if all pending ORDEZA sub-projects and associated technical assistance costs are approved as loan commitments. If none of these are approved, the uncommitted balance of ORDEZA funds would total \$3.8 million. However, the Mission proposes to transfer no more than \$3 million to the Bank. It is possible therefore, that a balance of the original ORDEZA allocation may be de-obligated. Below are shown the two extreme cases of alternative allocation of the currently uncommitted balance of ORDEZA funds:

<u>Case I: Maximum ORDEZA Commitments</u>		<u>Case II: Minimum ORDEZA Commitments</u>	
Allocation	\$4,000,000	Allocation	\$4,000,000
Commitments to date	200,000	Commitments to date	200,000
Potential Commitments	<u>1,200,000*</u>		
Minimum uncommitted balance	<u>\$2,600,000</u>	Maximum uncommitted balance	<u>\$3,800,000</u>
Transfer to Bank	<u>\$2,600,000</u>	Transfer to Bank	<u>\$3,000,000</u>
		De-obligation	<u>\$ 800,000</u>

* Including total value of pending sub-loans and supporting technical assistance costs.

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In essence, the Mission's proposal to transfer loan funds for utilization by the Bank is an alternative to the de-obligation of much-needed financing for development of the rural sierra of Peru. The potential development impact of this proposal is major, and fully consistent with the Congressional Mandate of generating income and employment for the rural poor. Rural enterprises development is the sierra's only realistic alternative to a subsistence agricultural economy which is inadequate to support a growing rural population. In order to exploit this alternative financial and technical assistance is desperately needed for investment in new and existing enterprises in small-scale rural industry, services, and commerce. The traditional banking system, both state and private, does not provide investment credit on terms and conditions appropriate to finance inexperienced or marginal entrepreneurs located in depressed sierra departments, nor the required technical assistance to identify, study, and supervise sub-loan investments.

A recent shift in GOP policy favoring the private sector provides an excellent climate for giving additional support to the operations and objectives of the Fund. Fiscal and monetary measures are being designed to encourage private investment in all economic sectors. Coupled with this is a continued concern with generating rural income and employment opportunities to redress regional economic imbalances and to stem the tide of urban migration; an investment promotion program entitled GEAR (Generación de Empleo en Areas Rurales) was launched a few months ago

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under the auspices of the Ministry of Industry and Tourism. The Fund fits exceedingly well into the pattern of these initiatives. In such a climate of increased GOP support, the development impact of additional resources for the Fund would be considerable.

Moreover, the Mission's proposal offers leverage to negotiate additional GOP counterpart to be devoted to activities endorsed by the Congressional Mandate. The Mission proposes to condition the transfer of additional A.I.D. loan funds to the Bank on the provision of GOP financing required to maintain the current 60:40 proportion of A.I.D. and GOP contributions to the Fund. This financing would be made available from the Bank's operating profits, and would therefore not have to compete for exceedingly scarce GOP 1977-78 budgetary funds. This would represent a net increase in new GOP counterpart financing of up to \$2 million, since no cash counterpart for sub-lending was required under the ORDEZA portion of the Loan.

The Bank has proven itself to be an effective and appropriate institution to administer the Fund as designed. Since administrative issues were resolved by June, 1976, the performance of the Bank in operating the Fund and designing a program to meet the project's TA requirements has been excellent. Recent USAID visits to the four branch offices confirmed that sub-lending operations have conformed to Fund criteria and that Fund objectives and procedures are well-established and accepted.

Moreover, the Fund has received maximum support at the highest levels of Bank management, particularly from the General Manager. Under his leadership, and with his continued support of the Fund Coordinator, all Fund-related matters are given priority attention; recent examples are changes and increases in branch office personnel, greater autonomy at the branch level, and increased authority for the Fund Coordinator. Underlying this interest is the commitment of Bank management to the importance of the Fund's replicability throughout the sierra, and eventually, on a national scale. The Fund is viewed as a valuable opportunity to demonstrate the feasibility and effectiveness of alternative banking methods, such as the substitution of feasibility analysis and contracted technical supervision of sub-projects for traditional commercial guarantees and a more aggressive approach by branch offices to lending to new clients in rural areas.

While recognizing the need for a Loan Authorization amendment, the Mission considers its proposal to expand the Fund into additional sierra departments to be consistent with the original concept of the project, as presented in the Capital Assistance Paper. First, the departments originally designated as target areas under the Bank portion of the project were selected on the basis of relative poverty, adequacy of physical and institutional infrastructure, and lack of sufficient development credit. (See p.45 of the CAP.) Apart from meeting these criteria,

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there were no unique features about any of the original departments which would restrict the project to those four. The inclusion of the Earthquake Zone was based on estimates of unsatisfied demand under loans 052 and 053 and the prior existence of ORDEZA's administrative framework for extending such credit. Unfortunately, such a favorable institutional basis no longer exists.

Second, it is clear from the original project design that the medium-term purpose of the project is to institutionalize the Rural Enterprises Development Fund in the Industrial Bank. Both the CAP (p.119) and the Loan Agreement provide for the repayment of sub-loans and all interest under the ORDEZA portion to the Fund in the Bank. This provision indicates that sub-lending by ORDEZA was conceived as an interim measure while the Bank acquired sufficient experience to manage additional Fund capitalization.

In effect, then, the Mission's proposal does not deviate from the project purpose, which, as presented in the CAP, is to institutionalize an integrated program of financial and technical assistance to assist existing and new rural enterprises and to consolidate that program under the Fund established in the Bank.

The selection of the departments for expanding Fund operations was made in collaboration with the Bank on the basis of the same criteria used in the selection of the original four departments. In this selection process, both USAID and the Bank gave careful consideration to retaining the Earthquake Zone as a target area under the project, but ultimately rejected it for reasons of administrative sensitivities. The Bank's reluctance to operate the Fund in the Earthquake Zone stems from a justifiable fear that it would have to overcome a poor image and negative expectations currently attached to the project in the area owing to its history under ORDEZA. Moreover, ORDEZA's jurisdictional sensitivities and understandable resentment over losing its share of loan resources might give rise to obstruction of Bank activities if the Bank were to assume project responsibilities in the Zone. Besides, principal reflows and interest payments under 052 and 053 continue to be a source of concessional credit for future rural enterprise development in the Zone; approximately S/.303 million (roughly \$430,000*) in reflows remain uncommitted to date.

Having rejected the possibility of operating in the Earthquake Zone, the Bank proposed, in the following order of priority, the departments of Huancayo, Cajamarca, Apurimac, and Huancavelica. All of these meet the original criteria stated in the CAP. Huancayo and Cajamarca are ranked 17th and 18th among 23 departments on a scale of socio-economic marginality,** falling into the fourth quintile of relative poverty,

* at S/.70 = US.\$1

** Based on a USAID-financed study of poverty in Peru, which used 1971 census data.

and Huancavelica and Apurimac are ranked 21st and 23rd, respectively, falling into the fifth, or lowest, quintile. (See Annex V for a summary description of these four departments.)

The extension of Fund operations into Huancavelica and Apurimac would complete the coverage of the "mancha india" of southern Peru and would permit a consolidation of the Fund's jurisdiction throughout the poorest region of the country. While these departments are served by "agencies" of the Bank, which do not have the staff and autonomy of a branch, they fall within the jurisdiction of the branches of Junin and Cuzco, where Fund operations are already well-established. While each of these two Bank agencies would require a Fund promotor assigned full-time to the project, additional staff assistance in sub-loan study and approvals would be readily available from the neighboring branch office. In a preliminary evaluation of investment possibilities in these two departments, the Bank has identified sub-projects totalling S/.43 million in Huancavelica. In Apurimac, S/.65.7 million in potential sub-projects have been identified in the province of Abancay alone; the province of Andahuaylas, for which data have not been collected, is expected to offer greater investment potential. (See Annex IV for a detailed listing of investment possibilities.)

The inclusion of Huanuco and Cajamarca in the Fund's jurisdiction would represent a logical next step in extending Fund operations throughout the sierra. These two departments are ranked among the National Planning Institute's priority areas for future investment. Operating the Fund in Cajamarca has the additional advantage of complementing the sierra irrigation loan project; the Bank expects to promote industrialization of dairy products with Fund resources in that zone, which would provide an assured market for livestock production increases realized through irrigation. Both these departments are served by fully staffed Bank branch offices, but would nevertheless require the assignment of one full-time promotor for each branch. Since these departments have greater physical and institutional infrastructure they offer significantly greater investment potential than the southern departments. In Huanuco, the Bank has identified sub-projects valued at S/.121.8 million and an additional S/.156.6 million in investment possibilities have been identified by the regional planning office. (These figures do not include existing proposals which do not have preliminary cost estimates. See Annex VI.). Fund investment potential in Cajamarca has not been quantified, for lack of detailed data, but based on Fund experience in the original four departments,* a minimum of S/.50 million could be committed to eligible sub-projects.

* Where sub-lending under the Fund since January 1976 almost doubled the level of branch office disbursements prior to active operation of the Fund.

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Based on these preliminary data, a conservative estimate of credit demand demonstrates that additional Fund resources can be readily committed. Assuming a maximum transfer of \$3 million of A.I.D. loan funds*, and a negotiated 40% counterpart totalling \$2 million, the amount of additional Fund resources would total \$5 million, or approximately S/.350 million of which approximately S/.330 million would be available for sub-lending.** A cursory review of investment potential in these four additional departments produced a list of potential sub-projects representing a total Fund investment of S/.437.1 million, plus many more proposals which do not yet have cost estimates. More in-depth study by contracted consultants would certainly reveal additional investment opportunities. Additional demand for Fund credit is expected to continue in the original four departments as well. However, this figure is an assurance that additional fund resources could be committed within the expanded area of Fund operation in the time allowed by an extension of the terminal dates. (See Annex VII for a schedule of projected sub-loan commitments of transferred funds through July, 1978.)

Reflows to the Fund of interest and principal from outstanding sub-loans are not expected to be significant enough to meet even a minor share of the immediate credit demand. The cumulative total of reflows is expected to be on the order of \$500,000 by the end of CY 1977, reaching approximately \$1 million by mid-CY 1978. Delayed initiation of sub-lending by both the Bank and ORDEZA and extended maturity periods required in ORDEZA's livestock sub-projects have retarded the rate of capital reflow into the Fund. An injection of new capital to the Fund at this time will permit the Fund to carry on a significant level of sub-lending activity during this period of low sub-loan reflows.

Recommendations

1. That A.I.D./W approve the Mission's request to extend the terminal dates under the subject loan by eighteen months, establishing a new TCD of July 31, 1978, and a new TDD of January 31, 1979;
2. That A.I.D./W approve the Mission's request to amend the subject Loan Authorization (i) to transfer up to \$3 million from ORDEZA management in the Earthquake Zone to the Rural Enterprises Development Fund in the Industrial Bank, and (ii) to expand the jurisdiction of the Fund to include the departments of Apurimac, Cajamarca, Huancavelica, and Huanuco; and

* Of which up to \$300,000 would be reserved for TA, per original allocation of ORDEZA's portion of the loan.

** At S/.70 = US.\$1; future devaluation of the sol will be compensated for by periodic price increases.

3. That the Mission be delegated authority to negotiate with the GOP a Loan Agreement Amendment consistent with the terms and conditions of the amended Loan Authorization.

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- ANNEX I Background Documents Relating to Mission Proposal**
- A. Letter to Industrial Bank Establishing Performance Targets**
 - B. Mission Monitoring Plan**
 - C. Project Committee Recommendations**
- ANNEX II Past Sub-lending Activity by Industrial Bank**
- ANNEX III Projected Sub-loan Commitments of Balance of Original Fund Capital**
- ANNEX IV Sub-projects Prepared by ORDEZA for Loan Financing**
- ANNEX V Summary Description of Additional Sierra Departments**
- ANNEX VI Fund Investment Potential in Additional Sierra Departments**
- ANNEX VII Projected Sub-loan Commitments of Additional Fund Capital**
- ANNEX VIII Project Performance Tracking Network**

Annexes are in
Project file in
LA/DR, Room 2249A

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ACTION MEMORANDUM FOR THE ACTING ADMINISTRATOR

28 JAN 1977

THRU: ES
 AA/PPC, Alexander Shakow *AS*
 FROM: AA/LA, Donor M. Lion, (Acting) *DL*

Problem: To amend the loan authorization and extend the terminal commitment and disbursement dates under Peru loan 527-W-057 - Rural Enterprise Development.

Discussion: This \$10 million loan was authorized June 28, 1974, and the loan agreement was signed November 25, 1974. The current TCD and TDD, January 31, 1977 and July 31, 1977, respectively, were established in the loan agreement in accordance with the three year implementation plan presented in the Capital Assistance Paper. However, several months passed before the loan agreement could be signed, and due to oversight these dates were not revised at the time the agreement was signed. Thus, the present project implementation period is only 32 months from the date of signature of the agreement.

The purpose of the project is to provide credit and technical assistance to enterprises located in selected rural areas of Peru. The loan was divided into two portions, with each portion treated separately in the loan agreement. The first was for \$4.0 million to be administered by the Organization for the Regional Development of the Affected Zone (ORDEZA) to continue its activities in the Earthquake Zone initiated under A.I.D. loan 527-L-052 (Community Development) and loan 527-L-053 (Small Business Fund). The balance of the loan, \$6.0 million, was allocated to the Industrial Bank of Peru to establish a Rural Enterprises Development Fund for lending in four southern departments (Ayacucho, Cuzco, Junin, and Puno). Reflows from sub-loans made both by ORDEZA and the Industrial Bank are to be channelled into the Fund for future re-lending by the Industrial Bank throughout Peru.

Both portions of the loan were plagued by initial delays and administrative problems. Shortages of personnel and transportation, intra-agency dissension and poor management have continued to hamper ORDEZA's operations, and its performance has been poor. Of the \$4.0 million entrusted to ORDEZA, only \$200,000 has been committed to date, with an additional \$.7 to \$1.5 million in sub-projects conditionally approved, under review or just submitted. In the case of the \$6.0 million Fund portion of the loan, the Industrial Bank has been performing extremely well. Performance standards set during a July 1976 Mission review have been met and exceeded (approximately \$2.5 million was committed between July and December 1976), principally due to clear assignment of administrative responsibilities, promotion of Fund activities and arrangements for technical assistance to accelerate sub-loan identification and study.

In view of the poor performance of ORDEZA in contrast with the excellent progress achieved by the Bank, USAID/Peru has requested the transfer of up to

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\$3.0 million* from the ORDEZA portion of the loan to the Industrial Bank and the termination of further ORDEZA involvement in the project. Specifically, the Mission proposed the following: (1) maintain the current TCD of January 31, 1977 for the ORDEZA portion of the loan but extend the TDD by eighteen months to permit implementation of those sub-projects approved prior to the TCD; (2) extend the TCD and TDD for the Industrial Bank portion of the loan by eighteen months; and (3) reallocate up to \$3.0 million of loan funds originally intended for sub-lending by ORDEZA to the Industrial Bank, and extending Fund operations into the sierra departments of Apurimac, Huancavelica, Huanuco and Cajamarca.

An extension of the TDD for the ORDEZA portion of the loan is necessary for orderly implementation of the two approved sub-projects for which funds have been committed, as well as for those sub-projects which have been approved but for which commitment of funds has been conditioned upon extension of the current TDD. These sub-projects are ready for execution, but require a disbursement period exceeding the six months remaining prior to the current TDD.

As indicated above, the performance of the Industrial Bank in operating the Fund since June 1976 has been excellent. The \$2.5 million committed to approved sub-projects between July and December 1976 represents an increase of 400% over sub-loan commitments in the preceding twelve month period, and the existing backlog of sub-projects under study will permit the Bank to fully commit the Fund's remaining capital (\$3.0 million as of January 1977) for eligible sub-projects within the four original departments. In addition, the Bank has conducted a preliminary review of investment potential in the proposed four new departments and has already produced a list of potential sub-projects totaling approximately \$6 million, and will be developing other sub-project possibilities over time. Based on the Bank's recent performance and the efforts currently underway, the Mission feels confident that the Bank can effectively utilize the remaining \$3.0 million of uncommitted Fund resources plus the approximately \$3.0 million of loan funds to be transferred from ORDEZA within the requested terminal date extension.

The proposal to expand the Fund into additional sierra departments is consistent with the original concept of the project: to institutionalize an integrated program of financial and technical assistance in support of existing and new rural enterprises, and to consolidate that program under the Fund established in the Industrial Bank. The extension of Fund operations into Huancavelica and Apurimac would complete coverage of the Fund's jurisdiction throughout the poorest region of Peru, and the inclusion of Huanuco and Cajamarca in the Fund's jurisdiction represents a logical next step in extending Fund operations throughout the sierra.

* The specific amount of loan funds available for transfer to the Bank from ORDEZA cannot be precisely determined since commitments to sub-projects approved by the Mission prior to the TCD have been conditioned upon a TDD extension. The minimum amount available would be \$2.3 million, if all pending ORDEZA sub-projects and associated technical assistance costs are approved as loan commitments. If none are approved, the uncommitted balance of ORDEZA funds would total \$3.1 million. However, the Mission is requesting no more than \$3 million be transferred, and any available funds exceeding that amount would be deobligated.

The selection of Huanuco, Cajamarca, Apurimac and Huancavelica as the departments in which to expand Fund operations was made in collaboration with the Bank on the basis of the same criteria used in the selection of the original four departments (i.e., poverty, adequacy of physical and institutional infrastructure, and lack of sufficient development credit). There were no unique features about the original departments which restricted the project to those four; however, as a means of keeping the fund manageable in its first years of operation the initial project area was limited. Careful consideration was given to retaining the Earthquake Zone as a target area for the Fund, but it was rejected primarily because of potential problems in overcoming the poor image and negative expectations currently attached to the project. The possibility of ORDEZA's jurisdictional sensitivities causing obstructions to Bank activities in the Zone was another factor leading to this decision.

After an initial slow start with the Industrial Bank, the project caught on and has rapidly gained momentum. It has become a priority activity which the Bank seeks to expand nationwide. The potential development impact of the project in the rural sierra of Peru is significant, and its thrust is fully consistent with the Congressional Mandate of generating income and employment for the rural poor. Rural enterprises development is the sierra's only realistic alternative to a subsistence agricultural economy which is inadequate to support a growing rural population. In order to exploit this alternative, financial and technical assistance is needed for investment in new and existing enterprises in small-scale rural industry, services, and commerce. Approval of the recommended actions will help provide this assistance.

The L.A. Bureau has reviewed the Mission request and supports the proposal. If the proposal is approved, the GOP has agreed to maintain the 60:40 AID-GOP contribution ratio to the Fund, which represents a net increase in new counterpart financing since no cash counterpart for sub-lending was required under the ORDEZA portion of the loan. In addition, the Mission has agreed to incorporate the following conditions: to agree with the GOP on commitment and disbursement targets to be achieved within one year from the date of the extension (i.e., January 31, 1978) and to deobligate any shortfall from the target levels; and obtain specific GOP agreement that any approved sub-projects which shall not have been completed by the new TDD shall be completed by the GOP from its own other sources.

The extension proposal would bring the life of the project to 50 months, or slightly over four years and thus within the limit prescribed by PD-57, as amended. Given the type of program involved, and the fact the program directly responds to A.I.D.'s New Directions, we believe this is a reasonable period.

Recommendation: (1) That you approve the extension of the terminal dates of the subject loan by eighteen months, establishing a new TCD of July 31, 1978, and a new TDD of January 31, 1979; and (2) that you sign the attached amended Loan Authorization (TAB A) which authorizes transfer of up to \$3.0 million from ORDEZA management in the Earthquake Zone to the Rural Enterprises Development Fund in the Industrial Bank, and the expansion of the Fund's jurisdiction to include the departments of Apurimac, Cajamarca, Huanuco and Huancavelica.

Approved: Philip Burbam

Disapproved: _____

Date: 1/31/77

Attachments:

- TAB A - Amended Loan Authorization
- TAB B - PP Supplement

Clearances:

GC:GMorgan WW Date 1/28
SER/FM:TBlacka (1/28/77) Date 1/28/77
PPC/DPRE:EHogan (1/28/77) Date 1/28/77

LA/DR:KKelly: gah:1/27/77:X29152

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT AUTHORIZATION AND REQUEST FOR ALLOTMENT OF FUNDS PART I		1. TRANSACTION CODE <input checked="" type="checkbox"/> C A - ADD C - CHANGE D - DELETE		PAF
3. COUNTRY/ENTITY <p style="text-align: center;">Peru</p>		2. DOCUMENT CODE <p style="text-align: center;">5</p>		
5. PROJECT NUMBER (7 digits) <p style="text-align: center;">[527-0057]</p>		6. BUREAU/OFFICE A. SYMBOL B. CODE <p style="text-align: center;">LA/DR [5]</p>		4. DOCUMENT REVISION NUMBER <p style="text-align: center;">[]</p>
8. PROJECT APPROVAL DECISION <p style="text-align: center;"><input checked="" type="checkbox"/> A A - APPROVED D - DISAPPROVED DE - DEAUTHORIZED</p>		7. PROJECT TITLE (Maximum 40 characters) <p style="text-align: center;">[Rural Enterprises Development]</p>		
ACTION TAKEN		9. EST. PERIOD OF IMPLEMENTATION YRS. [0] [4] QTRS. [1]		

10. APPROVED BUDGET AID APPROPRIATED FUNDS (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. 1ST FY		H. 2ND FY		K. 3RD FY	
		C GRANT	D LOAN	F GRANT	G LOAN	I GRANT	J. LOAN	L. GRANT	M. LOAN
(1)									
(2)									
(3)									
(4)									
TOTALS									

A. APPROPRIATION	N. 4TH FY		Q. 5TH FY		LIFE OF PROJECT		11. PROJECT FUNDING AUTHORIZED (ENTER APPROPRIATE CODE(S)) 1 - LIFE OF PROJECT 2 - INCREMENTAL LIFE OF PROJECT	A. GRANT	B. LOAN
	O. GRANT	P. LOAN	R. GRANT	S. LOAN	T. GRANT	U. LOAN			
(1)									
(2)									
(3)									
(4)									
TOTALS								C. PROJECT FUNDING AUTHORIZED THRU FY [7] [9]	

12. INITIAL PROJECT FUNDING ALLOTMENT REQUESTED (\$000)				13. FUNDS RESERVED FOR ALLOTMENT			
A. APPROPRIATION	B. ALLOTMENT REQUEST NO. _____						
	C. GRANT	D. LOAN		TYPED NAME (Chief, SER/FM/FSD)			
(1)				SIGNATURE			
(2)				DATE			
(3)							
(4)							
TOTALS							

14. SOURCE/ORIGIN OF GOODS AND SERVICES 000 941 LOCAL OTHER _____

15. FOR AMENDMENTS, NATURE OF CHANGE PROPOSED

The amendment will extend the TCD and TDD by eighteen months to July 31, 1978 and January 31, 1979, respectively, and will transfer up to \$3.0 million of loan funds from the ORDEZA portion of the loan to the Rural Enterprises Development Fund administered by the Industrial Bank.

FOR PPC/PIAS USE ONLY	16. AUTHORIZING OFFICE SYMBOL	17. ACTION DATE	18. ACTION REFERENCE (Optional)	ACTION REFERENCE DATE
		MM DD YY		MM DD YY

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

OFFICE OF
THE ADMINISTRATOR

A.I.D. Loan No. 527-W-057
(Ref: AID-DLC/P-2051)

FIRST AMENDMENT TO LOAN AUTHORIZATION

Provided From: FAA Section 106 (Selected Development Problems)
PERU: Rural Enterprises Development

Pursuant to the authority vested in the Administrator, Agency for International Development ("A.I.D."), by the Foreign Assistance Act of 1961, as amended, and the delegations of authority issued thereunder, I hereby amend the Loan Authorization, dated June 28, 1974, which authorized the establishment of a loan to the Republic of Peru of not to exceed ten million United States dollars (U.S. \$10,000,000), (The "Loan"), to provide financing and technical assistance to rural enterprises in Peru, as follows:

Sub-part (ii) of the introductory paragraph of the Loan Authorization is amended to read:

"(ii) Notwithstanding Sub-part (i), but within the \$10,000,000 limit of the Loan, up to \$9,000,000 may be used for financing and technical assistance to rural enterprises through the Rural Enterprises Development Fund of the Industrial Bank of Peru in the rural departments of Cuzco, Puno, Junin, Ayacucho, Huancavelica, Apurimac, Cajamarca, and Huanuco."

As amended hereby, the Loan Authorization dated June 24, 1974 remains in full force and effect.

Clearances:

KKelly, LA/DR MLC Date 1/27/77
CWeinberg, LA/DR MLC Date 1/27/77
EHogan, PPC/DPRE MLC Date 1/24/77
PBirnbaum, AA/PPCA MLC Date 1/31/77
TBlacka, SER/FMC MLC Date 1/28/77
GMorgan, GC MLC Date 1/25
EGirard, AA/LA MLC Date 1/27/77

Philip Burton
Acting Administrator
1/31/77
Date

GC/LA, TLGeiger:lb:1/26/77 MLC

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2p.
JUN 17 1977

ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR (LA)

FROM: LA/DR, Charles B. Weinberg

Problem: To extend the terminal date for signing an amended Loan Agreement for the Peru Rural Enterprise Development loan (527-W-057).

Discussion: The Rural Enterprise Development loan was authorized June 28, 1974, and the loan agreement was signed November 25, 1974. The purpose of the project is to provide credit and technical assistance to enterprises located in selected rural areas of Peru.

The loan was divided into two portions, with each portion treated separately in the loan agreement. The first was for \$4.0 million to be administered by the Organization for the Regional Development of the Affected Zone (ORDEZA) to continue its activities in the Earthquake Zone. The balance of the loan, \$6.0 million, was allocated to the Industrial Bank of Peru to establish a Rural Enterprises Development Fund for lending in the southern departments of Ayacucho, Cuzco, Junin, and Puno.

Although both portions of the loan were plagued by initial delays and administrative problems, ORDEZA's operations continued to suffer from poor management and intra-agency dissension. By January 1977 (the original TCD), ORDEZA had committed only \$1.7 million of loan funds. On the other hand, the Industrial Bank overcame its initial problems and has been performing extremely well. Performance standards set during a July 1976 Mission review have been met and exceeded.

In view of the poor performance by ORDEZA in contrast with the excellent progress achieved by the Bank, the Mission requested that the loan be amended to authorize the transfer of uncommitted funds from the ORDEZA portion of the loan to the Industrial Bank in order to extend Fund operations to four sierra departments (Apurimac, Cayamarca, Huanuco and Huancavelica). The Mission also requested that the TCD for the Bank portion of the loan and the TDD for both portions be extended by eighteen months (See TAB B).

The Acting Administrator approved this amendment to the loan on January 31, 1977, and, in conjunction with this approval, the AA/LA, on February 3, 1977, signed a delegation of authority for the Mission to negotiate and sign an amendment to the loan agreement. The delegation was effective through May 28, 1977.

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The Mission has been negotiating the terms of an amendment with the GOP since the signing of the delegation of authority. Switching funds from ORDEZA to the Industrial Bank has been a delicate and time consuming issue in the negotiations. ORDEZA has been arguing that funds should not be transferred but rather that additional time be authorized for it to commit the \$2.3 million remaining at the TCD. Final resolution was not possible until recent discussions between Peruvian Embassy and AID/W officials convinced the GOP that AID would not reconsider its decision to transfer funds to the Bank.

Based on this recent discussion, the GOP on Friday, May 27, 1977, sent a letter to the Mission approving the draft amendment to the loan agreement and advising the Mission that it wishes to sign the amended agreement.

In order to sign the amended loan agreement, however, additional time is required to prepare the necessary legal documents -- i.e., the documentation for issuing a Supreme Decree which authorizes a GOP representative to sign for the government. Although the GOP has indicated that approximately two to four weeks are required for issuance of the Supreme Decree, the Mission has requested that the terminal date for signing the amended loan agreement be extended by 60 days to allow for unforeseen delays.

Even though the effective date of the current delegation of authority has lapsed, I believe the unique circumstances surrounding the negotiation of an amended loan agreement for this project warrant the approval of the requested extension. The Mission could not request an extension until it had received notification that the amended loan agreement would be approved by the GOP, and, as has been noted, it was not until Friday, May 27, 1977, that such notification was received. The Mission contacted AID/W immediately and recommended that the request be approved. We support the Mission's recommendation.

Recommendation: That you authorize a 60-day extension of the terminal date for signing an amended loan agreement for the Peru Rural Enterprises Development loan (527-W-057) by signing the attached delegation of authority (TAB A).

Attachments:

TAB A - Delegation of Authority

TAB B - Action Memorandum for the Acting Administrator, dtd 1/28/77

LA/DR:KKelly:gtah:6/3/77

AUG 9 1977
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ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR (LA)

FROM: LA/DR, Charles B. Weinberg

Problem: To extend the terminal commitment and disbursement dates of the Peru Rural Enterprises loan (527-W-057) by six months.

Discussion: The \$10 million Rural Enterprise Development loan was authorized June 28, 1974, and the loan agreement was signed November 25, 1974. The purpose of the project is to provide credit and technical assistance to enterprises located in selected rural areas of Peru.

The loan was divided into two portions, with each portion treated separately in the loan agreement. The first was for \$4.0 million to be administered by the Organization for the Regional Development of the Affected Zone (ORDEZA) to continue its activities in the Earthquake Zone. The balance of the loan, \$6.0 million, was allocated to the Industrial Bank of Peru to establish a Rural Enterprise Development Fund for lending in the southern provinces of Ayacucho, Cuzco, Junin and Puno.

Both portions of the loan were plagued by initial delays and administrative problems. This has remained the case with ORDEZA and its operations continued to suffer from poor management and intra-agency dissension. By January 1977 (the original TCD), ORDEZA had committed only \$1.7 million of loan funds. On the other hand, the Industrial Bank overcame its initial problems and has been performing extremely well. Performance standards set during a July 1976 Mission review have been met and exceeded.

In view of the poor performance of ORDEZA in contrast with the excellent progress achieved by the Bank, the Mission requested that the loan be amended to authorize the transfer of uncommitted funds from ORDEZA to the Industrial Bank. The additional funds would be used to extend fund operations to four Sierra departments (Aurimac, Cajamarca, Huanuco, and Huancavelica). The Mission also requested that the TCD for the Bank portion of the loan and the TDD for both portions be extended by eighteen months. The Acting Administrator approved this amendment to the loan on January 31, 1977 (see TAB A).

Obtaining GOP concurrence in transferring funds from ORDEZA to the Industrial Bank was a delicate and time consuming issue in negotiating an amendment to the loan agreement. ORDEZA argued that funds should not be transferred but rather that additional time be authorized for it to commit the \$2.3 million remaining at the TCD. ORDEZA's objections were raised at the highest GOP policy-making levels, greatly complicating

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the negotiations and making it politically difficult to reach an early consensus regarding the amendment. It was not until after discussions, in late May 1977, between Peruvian Embassy and AID/W officials that the GOP was convinced that AID would not reconsider its decision to transfer funds to the Bank. After these discussions, the GOP formally advised the Mission of its approval of the transfer and desire to sign the amended agreement.

With the uncertainty surrounding GOP agreement to the amendment, the Industrial Bank was reluctant to begin any activities in the four new departments to be affected by the transfer. At the present time, Bank operations are minimal in these departments and certain initial activities are required in preparation for sub-lending (e.g., orientation of branch office staff, field promotion of the fund, and sub-project identification and study). With the required funding in doubt, however, the Bank--not wanting to raise expectations--refrained from undertaking these preliminary tasks. This resulted in a considerable loss of time which was not anticipated when the Mission originally requested the extension of the terminal dates.

The amended loan agreement providing for an eighteen-month extension of the terminal dates has now been signed. Mission and Industrial Bank officials have reviewed time requirements, however, and have concluded that an additional six months is necessary to make up for the time lost during the lengthy amendment negotiations. Therefore, the Mission has requested that the TCD and TDD be extended by six months to January 31, 1979, and July 31, 1979, respectively.

Policy Determination 57 has recently been revised with the issuance of AIDTO Circular A-268 (TAB B). Mission Directors now have authority to approve extensions of terminal commitment and terminal disbursement dates for a cumulative period of not to exceed one year. Any extension beyond one year, however, must be approved by the Assistant Administrator. Therefore, since the terminal dates for the project have already been extended eighteen months, you have the authority to approve this additional extension request, pursuant to AIDTO Circular A-268.

An extension of six months would bring the life of the project to 56 months which is within the six year project life limit permitted by AIDTO Circular A-268. Given the type of program involved and the fact that it directly responds to AID's New Directions, we believe the additional six month period requested by the Mission is reasonable.

Recommendation: That you approve a six month extension of the TCD and TDD, to January 31, 1979 and July 31, 1979 respectively, for the Peru Rural Enterprises Loan.

Approved: *[Signature]*

Disapproved: _____

Date: Aug 10, 1977

Attachments:

- TAB A - Action Memorandum for the Acting Administrator, dtd 1/28/77
- TAB B - AIDTO Circular A-268

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A. I. D. Loan N° 527-W-057

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LOAN AGREEMENT

Between

THE REPUBLIC OF PERU

and

THE UNITED STATES
OF AMERICA

For

RURAL ENTERPRISES DEVELOPMENT

DATE: NOV 20 1974

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LOAN AGREEMENT dated NOV 23 1974 between the Government of the Republic of Peru ("Borrower") and the United States of America, acting through the Agency for International Development ("A. I. D. ")

ARTICLE I

The Loan

SECTION 1.01. The Loan. A. I. D. agrees to lend to the Borrower in furtherance of the Alliance for Progress and pursuant to the Foreign Assistance Act of 1961, as amended, an amount not to exceed Ten Million United States Dollars (US\$10,000,000) ("Loan") to assist the Borrower in carrying out the Project referred to in Section 1.02 ("Project"). The Loan shall be used exclusively to finance United States dollar costs of goods and services required for the Project ("Dollar Costs") and the local currency costs of goods and services required for the Project ("Local Currency Costs"). The aggregate amount of disbursements under the Loan is hereinafter referred to as "Principal".

SECTION 1.02. The Project. The Project will assist new and existing rural enterprises in Peru by making available an integrated program of credit and technical assistance to such enterprises. Up to four million dollars (US\$4,000,000) will be available under the Loan for the area affected by the earthquake of May 31, 1970 ("Affected Zone") and up to six million dollars (US\$6,000,000) will be available for the departments of Cuzco, Puno, Junín and Ayacucho ("Rural Departments").

The Borrower designates ORDEZA as the Implementing Agency for that portion of the Project being carried out in the Affected Zone, and the

Banco Industrial del Perú ("Banco Industrial") as the Implementing Agency for that portion of the Project being carried out in the Rural Departments.

The Project is more fully described in Annex I attached hereto, which annex may be modified in writing by mutual agreement of the parties.

SECTION 1.03. Use of Funds Generated by Other United States Assistance. The Borrower shall use for the Project, in lieu of any United States dollars that would otherwise be disbursed under the Loan to finance the Local Currency Costs of the Project, any currencies other than United States dollars that may become available to the Borrower after the date of this Agreement in connection with assistance (other than the Loan) provided by the United States of America to the Borrower to the extent and for the purposes that A. I. D. and the Borrower may agree in writing. Any such funds used for the Project shall reduce the amount of the Loan (to the extent that it shall not then have been disbursed) by an equivalent amount of United States dollars computed, as of the date of the agreement between A. I. D. and the Borrower as to the use of such funds, at that rate of exchange between United States dollars and Peruvian soles which yields the greatest number of soles per dollar and which is not unlawful in Peru.

ARTICLE II

Loan Terms

SECTION 2.01. Interest. The Borrower shall pay to A. I. D. interest which shall accrue at the rate of two percent (2%) per annum for ten years following the date of the first disbursement hereunder and at the rate of three percent (3%) per annum thereafter on all outstanding balances. Interest on the outstanding balance of Principal shall accrue from the date of each respective disbursement (as such date is defined in Section 7.04) and shall be computed on the basis of a 365-day year. Interest shall be payable semiannually. The first payment of interest shall be due and payable no later than six (6) months after the first disbursement hereunder, on a date to be specified by A. I. D.

SECTION 2.02. Repayment. The Borrower shall repay to A. I. D. the Principal within forty (40) years from the date of the first disbursement hereunder in sixty-one (61) approximately equal semiannual installments of Principal and interest. The first installment of Principal shall be payable nine and one-half (9 1/2) years after the date on which the first interest payment is due in accordance with Section 2.01. A. I. D. shall provide the Borrower with an amortization schedule in accordance with this Section after the final disbursement under the Loan.

SECTION 2.03. Application, Currency, and Place of Payment. All payments of interest and Principal hereunder shall be made in United States dollars and shall be applied first to the payment of interest due and then to the repayment of Principal. Except as A. I. D. may otherwise specify in writing, all such payments shall be made to the Agency for International Development, Washington, D. C., 20523, Attention Cashier SA 12, and shall be deemed made when received by the Office of the Cashier.

SECTION 2.04. Prepayment. Upon payment of all interest, Principal and refunds then due, the Borrower may prepay, without any other charges, all or any part of the Principal. Any such prepayment shall be applied to the installments of Principal in the inverse order of their maturity.

SECTION 2.05. Renegotiation of the Terms of the Loan. In the light of the undertakings of the United States of America, and the other signatories of the Act of Bogota and the Charter of Punta del Este to forge an Alliance for Progress, Borrower agrees to negotiate with A. I. D., at such time or times as A. I. D. may request, an acceleration of the repayment of the Loan in the event that there is any significant improvement in the internal and external economic and financial position and prospects of Peru, taking into consideration the relative capital requirements of Peru and of the other signatories of the Act of Bogota and the Charter of Punta del Este.

ARTICLE III

Conditions Precedent to Disbursement

SECTION 3.01. Conditions Precedent to Initial Disbursement.

Prior to the first disbursement or to the issuance of any commitment documents under the Loan, the Borrower shall submit to A. I. D. , in form and substance satisfactory to A. I. D. :

(a) An opinion of the Director General of the General Department of Legal Counsel of the Ministry of Economy and Finance or other counsel acceptable to A. I. D. that this agreement has been duly authorized and/or ratified and executed on behalf of the Borrower, and that it constitutes a valid and legally binding obligation of the Borrower in accordance with all of its terms;

(b) A statement of the name of the person holding or acting in the office of the Borrower specified in Section 9.02 and a specimen signature of the person specified in that statement, appropriately certified as to its authenticity;

SECTION 3.02. Conditions Precedent to Disbursement for the Portion of the Project in the Departments of Cuzco, Puno, Ayacucho, and Junin.

Prior to any disbursement or the issuance of any commitment documents under the Loan for the portion of the Project in the Rural Departments, for any purpose other than to finance technical assistance services or commodities for other than sub-borrowers, the Borrower shall submit to A. I. D. , in form and substance satisfactory to A. I. D. :

(a) evidence that the Banco Industrial has been granted the necessary authority to permit it to provide credit and other assistance to commercial and service enterprises under the Project;

(b) evidence of the establishment of a Rural Enterprises Development

Fund ("Fund") within the Banco Industrial;

(c) an Organization and Operations Plan describing how the Banco Industrial will implement its portion of the Project; this plan shall include but not necessarily be limited to:

- (i) a time-phased implementation plan;
- (ii) a credit manual containing the rules, regulations and interest rates of the Fund;
- (iii) provisions for promoting the Fund, identifying sub-projects and furnishing technical assistance to sub-borrowers from the Fund;
- (iv) provisions for adequate staffing.

SECTION 3.03 Conditions Precedent to Disbursement for the Portion of the Project in the Affected Zone.

Prior to any disbursement or the issuance of any commitment documents under the Loan for the portion of the Project in the Affected Zone, Borrower shall submit to A. I. D. , in form and substance satisfactory to A. I. D. :

(a) a plan for the allocation of the funds available under the Loan for the Affected Zone to the Rural Community Development Project financed under A. I. D. Loan 527-L-052 and to the Small Business Assistance Fund financed under A. I. D. Loan 527-L-053;

(b) an Organization and Operations Plan which shall include, but not necessarily be limited to:

- (i) a time-phased implementation plan;
- (ii) a credit manual containing the rules and regulations governing the use of Loan funds made available for relending in the Affected Zone, including a schedule of interest rates;

- (iii) procedures for promoting the Project, identifying sub-projects and furnishing technical assistance to sub-borrowers;
- (iv) provisions for adequate staffing to assure sound implementation of the additional resources for the Rural Community Development Project and the Small Business Assistance Fund;
- (v) provisions for the deposit in the Fund of principal repayments and interest payments derived from sub-loans made with Loan funds in the Affected Zone;
- (c) evidence of the availability of sufficient and timely counterpart contributions by Borrower to carry out the portion of the Project in the Affected Zone.

SECTION 3.04 Terminal Dates for Meeting Conditions Precedent to Disbursement.

(a) If all of the conditions specified in Section 3.01 shall not have been met on or before October 31, 1974, or such later date as A. I. D. may agree in writing, A. I. D., at its option, may terminate this Agreement by giving written notice to the Borrower. Upon the giving of such notice, this Agreement and all obligations of the parties hereunder shall terminate.

(b) If all the conditions specified in Section 3.02 and 3.03 shall not have been met by December 31, 1974, or such later date as A. I. D. may agree to in writing, A. I. D., at its option, may cancel the then undisbursed balance of the amount of the Loan in whole or in part or may terminate this Agreement by giving written notice to the Borrower. In the event of a termination, upon the giving of notice, the Borrower shall immediately repay the Principal then outstanding and shall pay any accrued interest and, upon receipt of such payments in full, this Agreement

and all obligations of the parties hereunder shall terminate.

SECTION 3.05 Notification of Meeting Conditions Precedent to Disbursement. A. I. D. shall notify the Borrower when the conditions precedent to disbursement specified in Sections 3.01 and, as the case may be, 3.02 and 3.03 of this Loan Agreement have been met.

ARTICLE IV

General Covenants and Warranties

SECTION 4.01 Execution of the Project.

(a) The Borrower shall cause the Project to be carried out with due diligence and efficiency, and in conformity with sound financial and administrative practices.

(b) The Borrower shall cause the Project to be carried out in conformity with all of the plans, specifications, regulations, contracts, schedules, and other arrangements, and with all modifications therein, approved by A. I. D. pursuant to this Agreement.

SECTION 4.02. Funds and Other Resources to be Provided by the Borrower.

Borrower shall provide promptly as needed all funds, in addition to the Loan, and all resources required for the punctual and effective carrying out of the Project, including but not limited to the contribution stated in Section 5.01 hereof.

SECTION 4.03. Continuing Consultation. The Borrower and A. I. D. shall cooperate fully to assure that the purposes of the Loan will be accomplished. To this end, the Borrower and A. I. D. shall from time to time, at the request of either party, exchange views through their representatives with regard to the progress of the Project, the performance by the parties to this Agreement of their obligations under this Agreement, and other matters relating to the Project.

SECTION 4.04 Management. The Borrower shall cause to be provided qualified and experienced management for the Project and shall cause to be trained such staff as may be appropriate for the successful implementation of the Project.

SECTION 4.05 Taxation. This Agreement, the Loan, and any evidence of indebtedness issued in connection herewith shall be free from, and the Principal and interest shall be paid without deduction for and free from, any taxation or fees imposed under the laws in effect within the Republic of Peru. To the extent that (a) any contractor, including any consulting firm, any personnel of such contractor financed hereunder, and any property or transactions relating to such contract and (b) any commodity procurement transaction financed hereunder, are not exempt from identifiable taxes, tariffs, duties, and other levies imposed under laws in effect in Peru, Borrower shall, as and to the extent prescribed in and pursuant to Implementation Letters, pay or reimburse the same under Section 4.02 of this Agreement with funds other than those provided under the Loan.

SECTION 4.06 Utilization of Goods and Services.

(a) Goods and services financed under the Loan shall be used exclusively for the Project, except as Borrower and A. I. D. may otherwise agree in writing.

(b) Except as A. I. D. may otherwise agree in writing, no goods or services financed under the Loan shall be used to promote or assist any foreign aid project or activity associated with or financed by any country not included in Code 935 of the A. I. D. Geographic Code Book as in effect at the time of such use.

SECTION 4.07 Disclosure of Material Facts and Circumstances.

The Borrower represents and warrants that all facts and circumstances that it has disclosed or caused to be disclosed to A. I. D. in the course of obtaining the Loan are accurate and complete, and that it has disclosed to A. I. D., accurately and completely, all facts and circumstances that might materially affect the Project and the discharge of its obligations under this Agreement. Borrower shall promptly inform A. I. D. of any

facts and circumstances that may hereafter arise that might materially affect, or that it is reasonable to believe might materially affect, the Project or the discharge of Borrower's obligations under this Agreement.

SECTION 4.08 Commissions, Fees, and Other Payments.

(a) Borrower warrants and covenants that in connection with obtaining the Loan, or taking any action under or with respect to this Agreement, it has not paid, and will not pay or agree to pay, nor to the best of its knowledge has there been paid nor will there be paid or agreed to be paid by any other person or entity, commissions, fees, or other payments of any kind, except as regular compensation to Borrower's full time officers and employees or as compensation for bona fide professional, technical, or comparable services. Borrower shall promptly report to A. I. D. any payment or agreement to pay for such bona fide professional, technical, or comparable services to which it is a party or of which it has knowledge (indicating whether such payment has been made or is to be made on a contingent basis) and if the amount of any such payment is deemed unreasonable by A. I. D. the same shall be adjusted in a manner satisfactory to A. I. D.

(b) Borrower warrants and covenants that no payments have been or will be received by the Borrower, or any official of Borrower, in connection with the procurement of goods and services financed hereunder, except fees, taxes, or similar payments legally established in Peru.

SECTION 4.09 Maintenance and Audit of Records. The Borrower shall maintain, or cause to be maintained, in accordance with sound accounting principles and practices consistently applied, books and records relating both to the Project and to this Agreement. Such books and records shall without limitation, be adequate to show:

(a) the receipt and use made of goods and services acquired with funds disbursed pursuant to this Agreement;

(b) the nature and extent of solicitations of prospective suppliers of goods and services acquired;

(c) the basis of the award of contracts and orders to successful bidders; and

(d) the progress of the Project.

Such books and records shall be regularly audited by auditors acceptable to A. I. D. in accordance with sound auditing standards, for such period and at such intervals as A. I. D. may require, and shall be maintained for five years after the date of the last disbursement by A. I. D. or until all sums due A. I. D. under this Agreement have been paid, whichever date shall first occur.

SECTION 4.10. Reports. The Borrower shall furnish to A. I. D. such information and reports relating to the Loan and the Project as A. I. D. may request.

SECTION 4.11. Inspection. The authorized representatives of A. I. D. shall have the right at all reasonable times to inspect the Project, the utilization of all goods and services financed under the Loan, and the books, records, and other documents of the Borrower or any of its constituent agencies relating to the Project and the Loan. The Borrower shall cooperate with A. I. D. to facilitate such inspections and shall permit representatives of A. I. D. to visit any part of Peru for any purpose relating to the Loan.

ARTICLE V

Special Covenants and Warranties

SECTION 5.01 Borrower's Contribution. Borrower covenants to provide as its contribution to the Project the equivalent of at least five million five hundred thousand United States dollars (US\$5,500,000).

SECTION 5.02 Changes. The Borrower covenants that no substantial changes will be made in the plans, rules, regulations or other evidence submitted in response to Article III of this Loan Agreement without the consent of A. I. D.

SECTION 5.03 Subloans. Borrower covenants that:

(a) Project subloans shall be made only to those enterprises which do not have normal access to credit on reasonable terms and conditions;

(b) Subloan proposals shall be evaluated in accordance with the following criteria, inter alia:

- (i) the potential of the proposed sub-loan to generate employment;
- (ii) its contribution to regional economic development, and vertical integration;
- (iii) the degree to which it is expected to add value to locally produced goods and materials;
- (iv) its compatibility with applicable regional development plans of the Borrower.

SECTION 5.04 Use of Sub-loan Repayments. Except as A. I. D. may otherwise agree in writing, all repayments of principal and all payments of interest derived from Project subloans will be deposited in the Fund and used throughout the repayment period of the Loan for activities associated with the development of rural enterprises.

SECTION 5.05 Approval of Sub-Loans by A. I. D. Except as A. I. D. may otherwise agree in writing, all proposals for sub-loans in excess of two million soles (\$/2,000,000) in the Departments of Cuzco, Puno, Ayacucho, and Junin, and all proposals for sub-loans in excess of three million soles (\$/3,000,000) in the Affected Zone shall be submitted to A. I. D. for the prior written approval of A. I. D. After sixty (60) days of regular sub-lending activities by the Banco Industrial under the Project, A. I. D. and the Banco Industrial will review the two million sol (\$/2,000,000) approval limit for sub-loans made by the Banco to determine whether a higher Banco approval limit for sub-loans is appropriate.

SECTION 5.06 Disposition of Existing Resources in the Affected Zone. Except as A. I. D. may otherwise agree in writing, within twelve months of the date of this Agreement, Borrower shall submit to A. I. D., in form and substance satisfactory to A. I. D., a plan for the disposition of the resources presently administered by ORDEZA under the Rural Community Development Project and the Small Business Assistance Fund.

ARTICLE VI

Procurement

SECTION 6.01. Procurement from Selected Free World Countries.

Except as A. I. D. may otherwise agree in writing, and except as provided in sub-section 6.08 (c) with respect to marine insurance, disbursements made pursuant to Section 7.01 shall be used exclusively to finance the procurement for the Project of goods and services having their source and origin in countries included in Code 941 of the A. I. D. Geographic Code Book as in effect at the time orders are placed or contracts are entered into for such goods and services ("Selected Free World Goods and Services"). Notwithstanding any other provisions herein, motor vehicles to be procured with Loan funds must be manufactured in the United States. All ocean shipping financed under the Loan shall have both its source and origin in countries included in Code 941 of the A. I. D. Geographic Code Book as in effect at the time of shipment.

SECTION 6.02. Procurement from Peru. Except as A. I. D. may otherwise agree in writing disbursements made pursuant to Section 7.02 shall be used exclusively to finance the procurement for the Project of goods and services having both their source and origin in Peru.

SECTION 6.03. Eligibility Date. Except as A. I. D. may otherwise agree in writing, no goods or services may be financed under the Loan which are procured pursuant to orders or contracts firmly placed or entered into prior to the date of this Agreement.

SECTION 6.04. Goods and Services Not Financed Under Loan. Goods and services procured for the Project, but not financed under the Loan, shall have their source and origin in countries included in Code 935 of the A. I. D. Geographic Code Book as in effect at the time orders are placed for such goods and services.

SECTION 6.05. Implementation of Procurement Requirements.

The definitions applicable to the eligibility requirements of Section 6.01, 6.02, and 6.04 will be set forth in detail in Implementation Letters.

SECTION 6.06. Plans, Specifications and Contracts.

(a) Except as A. I. D. may otherwise agree in writing, the Borrower shall furnish to A. I. D. promptly upon preparation all plans, specifications, construction schedules, bid documents, and contracts relating to the Project, and any modifications therein, whether or not the goods and services to which they relate are financed under the Loan.

(b) Except as A. I. D. may otherwise agree in writing, all of the plans, specifications and construction schedules furnished pursuant to subsection (a) above shall be approved by A. I. D. in writing.

(c) All bid documents and documents related to the solicitations of proposals relating to goods and services financed under the Loan shall be approved by A. I. D. in writing prior to their issuance.

(d) The following contracts financed under the Loan shall be approved by A. I. D. in writing prior to their execution:

- (i) contracts for engineering and other professional services;
- (ii) contracts for construction services;
- (iii) contracts for such other services as A. I. D. may specify; and
- (iv) contracts for such equipment and materials as A. I. D. may specify.

In the case of any of the above contracts for services, A. I. D. shall also approve in writing the contractor and such contractor personnel as A. I. D. may specify. Material modifications in any of such contracts and changes in any of such personnel shall also be approved by A. I. D. prior to their becoming effective.

(e) Consulting firms used by the Borrower for the Project but not financed under the Loan, the scope of their services and such of their personnel assigned to the Project as A. I. D. may specify, and construction contractors used by the Borrower for the Project but not financed under the Loan shall be acceptable to A. I. D.

SECTION 6.07 Reasonable Price. No more than reasonable prices shall be paid for any goods or services financed, in whole or in part, under the Loan, as more fully described in Implementation Letters. Such items shall be procured on a fair and, except for professional services, on a competitive basis in accordance with procedures therefor prescribed in Implementation Letters.

SECTION 6.08 Shipping and Insurance.

(a) Selected Free World Goods financed under the Loan shall be transported to the Republic of Peru on flag carriers of the Republic of Peru or any country included in Code 935 of the A. I. D. Geographic Code Book as in effect at the time of shipment.

(b) Unless A. I. D. shall determine that privately owned United States flag commercial vessels are not available at fair and reasonable rates for such vessels:

(i) At least fifty percent (50%) of the gross tonnage of Selected Free World goods financed under the Loan and transported on ocean vessels from United States ports (computed separately for dry bulk carriers, dry cargo liners, and tankers) shall be transported on privately owned United States flag commercial vessels; and at least fifty percent (50%) of the gross freight revenue generated by ocean shipments of Selected Free World goods financed under the Loan and transported on dry cargo liners from United States ports shall be paid to or for the benefit of privately-owned United States flag commercial vessels; and

(ii) At least fifty percent (50%) of the gross tonnage of all Selected Free World goods financed under the Loan and transported on ocean vessels from non-United States ports (computed separately for dry bulk carriers, dry cargo liners and tankers) shall be transported on privately owned United States flag commercial vessels, and at least fifty percent (50%) of the gross freight revenue generated by ocean shipments of Selected Free World goods financed under the Loan and transported on dry cargo liners from non-United States ports shall be paid to or for the benefit of privately owned United States flag commercial vessels. No such goods may be transported on any ocean vessel (or aircraft) which (i) A. I. D. , in a notice to the Borrower, has designated as ineligible to carry A. I. D. financed goods or (ii) has been chartered for the carriage of A. I. D. financed goods unless such charter has been approved by A. I. D.

(c) Marine insurance on Selected Free World goods may be financed under the Loan with disbursements made pursuant to Section 7.01, provided (i) such insurance is placed at the lowest available competitive rate in Peru or in a country included in Code 941 of the A. I. D. Geographic Code Book as in effect at the time of placement, and (ii) claims thereunder are payable in freely convertible currency. If in connection with the placement of marine insurance on shipments financed under United States legislation authorizing assistance to other nations, Peru, by statute, decree, rule or regulation favors any marine insurance company of any country over any marine insurance company authorized to do business in any state of the United States of America, Selected Free World goods financed under the Loan shall during the continuance of such discrimination be insured against marine risk in the United States of America with a company or companies authorized to do marine insurance business in any state of the United States of America.

(d) The Borrower shall insure, or cause to be insured, all Selected Free World goods financed under the Loan against risks incident to their transit to the point of their use in the Project. Such insurance shall be issued upon terms and conditions consistent with sound commercial practice, shall insure the full value of the goods, and shall be payable in the currency in which such goods were financed or in any freely convertible currency. Any indemnification received by the Borrower under such insurance shall be used to replace or repair any material damage or any loss of the goods insured or shall be used to reimburse the Borrower for the replacement or repair of such goods. Any such replacement shall have their source and origin in countries included in Code 941 of the A. I. D. Geographic Code Book as in effect at the time orders are placed or contracts are entered into for such replacements, and shall be otherwise subject to the provisions of this Agreement.

SECTION 6.09 Notification to Potential Suppliers. In order that all United States firms shall have the opportunity to participate in furnishing goods and services to be financed under the Loan, the Borrower shall furnish to A. I. D. such information with regard thereto, and at such times, as A. I. D. may request in Implementation Letters.

SECTION 6.10 United States Government-Owned Excess Property. The Borrower shall utilize, with respect to goods financed under the Loan to which the Borrower takes title at the time of procurement, such reconditioned United States Government-owned Excess Property as may be consistent with the requirements of the Project and as may be available within a reasonable period of time and is consistent with Peruvian Law. The Borrower shall seek assistance from A. I. D. and A. I. D. will assist the Borrower in ascertaining the availability of and in obtaining such Excess Property. A. I. D. will make arrangements for any necessary inspection of such property by the Borrower or its representative. The

costs of inspections and of acquisition, and all charges incident to the transfer to the Borrower of such Excess Property, may be financed under the Loan. Prior to the procurement of any goods, other than Excess Property, financed under the Loan and after having sought such A. I. D. assistance, the Borrower shall indicate to A. I. D. in writing, on the basis of information then available to it, either that such goods cannot be made available from reconditioned United States owned Excess Property on a timely basis or that the goods that can be made available are not technically suitable for use in the Project.

SECTION 6.11 Information and Marking. Borrower shall give publicity to the Loan and the Project as a joint undertaking of the United States and Peru in furtherance of the Alliance for Progress and shall identify the Project sites and mark goods financed under the Loan, as prescribed in Implementation Letters.

ARTICLE VII

Disbursements

SECTION 7.01 Disbursement for United States Dollar Costs-

Letter of Commitment to United States Banks. Upon satisfaction of conditions precedent, the Borrower may, from time to time, request A. I. D. to issue Letters of Commitment for specified amounts to one or more United States banks, satisfactory to A. I. D., committing A. I. D. to reimburse such bank or banks for payments made by them to contractors or suppliers, through the use of Letter of Credit or otherwise, for Dollar Costs of goods and services procured for the Project in accordance with the terms and conditions of this Agreement. Payment by a bank to a contractor or supplier will be made by the bank upon presentation of such supporting documentation as A. I. D. may prescribe in Letters of Commitment and Implementation Letters. United States banking charges incurred in connection with Letters of Commitment and Letters of Credit shall be for the account of the Borrower and may be financed under the Loan.

SECTION 7.02. Disbursements for Local Currency Costs.

Upon satisfaction of conditions precedent, the Borrower may, from time to time, request disbursement by A. I. D. of local currency for Local Currency Costs of goods and services procured for the Project in accordance with the terms and conditions of this Agreement by submitting to A. I. D. such supporting documentation as A. I. D. may prescribe in Implementation Letters. A. I. D. shall make such disbursements from local currency owned by the U. S. Government and obtained by A. I. D. with United States dollars. The United States dollar equivalent of the local currency made available hereunder will be the amount of United States dollars required by A. I. D. to obtain the local currency.

SECTION 7.03. Other Forms of Disbursement. Disbursements of the Loan may also be made through such other means as the Borrower and A. I. D. may agree to in writing.

SECTION 7.04. Date of Disbursement. Disbursement by A. I. D. shall be deemed to occur, (a) in the case of disbursements pursuant to Section 7.01, on the date on which A. I. D. makes a disbursement to the Borrower, to its designee, or to a banking institution pursuant to a Letter of Commitment, and (b) in the case of disbursements pursuant to Section 7.02, on the date on which A. I. D. disburses the local currency to the Borrower or its designee.

SECTION 7.05. Terminal Date for Disbursement. Except as A. I. D. may otherwise agree in writing, no Letter of Commitment, or other commitment documents which may be called for by another form of disbursement under Section 7.03, or amendment thereto, shall be issued in response to requests received by A. I. D. after January 31, 1977 and no disbursement shall be made against documentation received by A. I. D. or any bank described in Section 7.01 after July 31, 1977. A. I. D. at its option, may, at any time, or times after July 31, 1977 reduce the Loan by all or any part thereof for which documentation was not received by such date.

ARTICLE VIII

Cancellation and Suspension

SECTION 8.01 Cancellation by the Borrower. The Borrower may, with the prior written consent of A. I. D. , by written notice to A. I. D. , cancel any part of the Loan (i) which, prior to the giving of such notice, A. I. D. has not disbursed or committed itself to disburse, or (ii) which has not then been utilized through the issuance of irrevocable Letters of Credit or through bank payments made other than under irrevocable Letters of Credit.

SECTION 8.02. Events of Default: Acceleration. If any one or more of the following events ("Events of Default") shall occur:

- (a) The Borrower shall have failed to pay when due any interest or installment of Principal required under this Agreement;
- (b) The Borrower shall have failed to comply with any other provision of this Agreement, including, but without limitation, the obligation to carry out the Project in the manner hereby agreed upon;
- (c) The Borrower shall have failed to pay when due any interest or any installment of Principal or any other payment required under any other loan agreement, or any other agreement between the Borrower or any of its agencies and A. I. D. or any of its predecessor agencies; then A. I. D. may, at its option, give to the Borrower notice that all or any part of the unrepaid Principal shall be due and payable sixty (60) days thereafter, and unless the Event of Default is cured within such sixty (60) days:
 - (i) such unrepaid Principal and any accrued interest hereunder shall be due and payable immediately; and

- (ii) the amount of any further disbursements made under outstanding irrevocable Letters of Credit or otherwise shall become due and payable as soon as made.

SECTION 8.03. Suspension of Disbursement. In the event that at any time:

- (a) An Event of Default has occurred;
- (b) An Event occurs that A. I. D. determines to be an extraordinary situation that makes it improbable either that the purpose of the Loan will be attained or that the Borrower will be able to perform its obligations under this Agreement;
- (c) Any disbursement by A. I. D. would be in violation of the legislation governing A. I. D. ; or
- (d) The Borrower shall have failed to pay when due any interest or any installment of Principal or any other payment required under any other loan agreement, or any other agreement between the Borrower or any of its agencies and the Government of the United States or any of its agencies;

then A. I. D. may, at its option:

- (i) suspend or cancel outstanding commitment documents to the extent that they have not been utilized through the issuance of irrevocable Letters of Credit or through bank payments made other than under irrevocable Letters of Credit, in which event A. I. D. shall give notice to the Borrower promptly thereafter;
- (ii) decline to make disbursements other than under outstanding commitment documents;
- (iii) decline to issue additional commitment documents;
- (iv) at A. I. D. 's expense, direct that title to goods financed under the Loan shall be transferred to A. I. D. if the goods

are from a source outside Peru, are in a deliverable state and have not been offloaded in ports of entry of Peru. Any disbursement made or to be made under the Loan with respect to such transferred goods shall be deducted from Principal.

SECTION 8.04. Cancellation by A. I. D. Following any suspension of disbursements pursuant to Section 8.03, if the cause or causes for such suspension of disbursements shall not have been eliminated or corrected within sixty (60) days from the date of such suspension, A. I. D. may, at its option, at any time or times thereafter, cancel all or any part of the Loan that is not then either disbursed or subject to irrevocable Letters of Credit.

SECTION 8.05. Continued Effectiveness of Agreement. Notwithstanding any cancellation, suspension of disbursement, or acceleration of repayment, the provisions of this Agreement shall continue in full force and effect until the payment in full of all Principal and any accrued interest hereunder.

SECTION 8.06. Refunds.

(a) In the case of any disbursement not supported by valid documentation in accordance with the terms of this Agreement, or of any disbursement not made or used in accordance with the terms of this Agreement, A. I. D. notwithstanding the availability of exercise of any of the other remedies provided for under this Agreement, may require the Borrower to refund such amount in United States dollars to A. I. D., within thirty (30) days after receipt of a request therefor. Such amount shall be made available first for the cost of goods and services procured for the Project hereunder, to the extent justified; the remainder, if any, shall be applied to the installments of Principal in the inverse order of their

maturity and the amount of the Loan shall be reduced by the amount of such remainder. Notwithstanding any other provision in this Agreement, A. I. D. 's right to require a refund with respect to any disbursement under the Loan shall continue for five (5) years following the date of such disbursement.

(b) In the event that A. I. D. receives a refund from any contractor, supplier, or banking institution, or from any other third party connected with the Loan, with respect to goods or services financed under the Loan, and such refund relates to an unreasonable price for goods or services, or to goods that did not conform to specifications, or to services that were inadequate, A. I. D. shall first make such refund available for the cost of goods and services procured for the Project hereunder, to the extent justified; the remainder to be applied to the installments of Principal in the inverse order of their maturity and the amount of the Loan shall be reduced by the amount of such remainder.

SECTION 8.07 Expenses of Collection. All reasonable costs incurred by A. I. D., other than salaries of its staff, in connection with the collection of any refund or in connection with amounts due A. I. D. by reason of the occurrence of any of the events specified in Section 8.02 may be charged to the Borrower and reimbursed to A. I. D. in such manner as A. I. D. may specify.

SECTION 8.08. Non-waiver of Remedies. No delay in exercising or omission to exercise any right, power or remedy accruing to A. I. D. under this Agreement shall be construed as a waiver of any such rights, powers, or remedies.

ARTICLE IX

Miscellaneous

SECTION 9.01. Communications. Any notice, request, document or other communication given, made, or sent by the Borrower or A. I. D. pursuant to this Agreement shall be in writing or by telegram, cable or radiogram and shall be deemed to have been duly given, made or sent to the party to which it is addressed when it shall be delivered to such party by hand or by mail, telegram, cable or radiogram at the following addresses:

TO BORROWER

Mail Address: Ministerio de Economía y Finanzas
Ave. Abancay s/n
Lima, Perú

Cable Address: MINECONOMIA
Lima, Perú

TO A. I. D. :

Mail Address: United States AID Mission to Peru
c/o United States Embassy
Lima, Perú

Cable Address: USAID, AmEmbassy
Lima, Perú

Other addresses may be substituted for the above upon the giving of notice. All notices, requests, communications, and documents submitted to A. I. D. hereunder may be in Spanish and shall refer to "Loan 527-W-057", except as A. I. D. may otherwise require in writing.

SECTION 9.02. Representatives. For all purposes relative to this Agreement, the Borrower will be represented by the individual holding or acting in the office of the Minister of Economy and Finance,

and A. I. D. will be represented by the individual holding or acting in the office of Director, USAID/Peru. Such representatives shall have the authority to designate additional representatives by written notice. In the event of any replacement or other designation of a representative hereunder, Borrower shall submit a statement of the representative's name and specimen signature in form and substance satisfactory to A. I. D. Until receipt by A. I. D. of written notice of revocation of the authority of any of the duly authorized representatives of the Borrower designated pursuant to this Section, it may accept the signature of any such representative or representatives on any instrument as conclusive evidence that any action effected by such instrument is duly authorized.

SECTION 9.03. Implementation Letters. A. I. D. shall from time to time issue Implementation Letters that will prescribe the procedures applicable hereunder in connection with the implementation of this Agreement.

SECTION 9.04 Promissory Notes. At such time or times as A. I. D. may request, the Borrower shall issue promissory notes or such other evidences of indebtedness with respect to the Loan, in such form, containing such terms and supported by such legal opinions as A. I. D. may reasonably request.

SECTION 9.05. Termination Upon Full Payment. Upon payment in full of the Principal and of any accrued interest, this Agreement and all obligations of the Borrower and A. I. D. under this Loan Agreement shall terminate.

SECTION 9.06. Controlling Language. The Loan Agreement is executed in both the Spanish and English languages. In case of ambiguity or inconsistency between the English and Spanish versions, the English version shall control.

IN WITNESS WHEREOF, the Republic of Peru and the United States of America, each acting through its respective duly authorized representatives, have caused this Agreement to be signed in their names and delivered as of the day and year first above written.

THE REPUBLIC OF PERU

UNITED STATES OF AMERICA

/s/ _____

José de la Puente
Under Secretary for Economic
Affairs and Integration
Ministry of Foreign Relations

/s/ _____

Robert W. Dean
Ambassador of the United
States of America

/s/ _____

Franklin Cáceres Salas
Executive Director for
Public Credit
Ministry of Economy and
Finance

/s/ _____

Donald R. Finberg
Director
A. I. D. Mission to Peru

ANNEX I TO LOAN AGREEMENT (057)

I. Purpose of Project.

The purpose of the Project is to develop an integrated program of financial and technical assistance to aid existing and new enterprises and community organizations in selected rural areas of Peru. The Project is specifically designed to facilitate the availability of credit and technical assistance to those enterprises and organizations which have not previously received or had normal access to credit on reasonable terms and conditions. The activities of the Project will contribute to:

- a) the development and strengthening of rural enterprises;
- b) the creation of employment;
- c) the generation and distribution of income; and
- d) a higher level of economic activity in several of the poorer regions of Peru.

II. Description of the Project.

a) The total amount of funding to be provided from all sources under this project is the equivalent of \$16.9 million, with an A. I. D. contribution of \$10.0 million of which \$4 million is allocated to ORDEZA for use in the zone affected by the earthquake of 1970, and \$6 million is allocated to the Banco Industrial for use in the departments of Ayacucho, Cuzco, Junín and Puno. The Borrower is the Government of Peru, through the Ministry of Economy and Finance.

b) Under the portion of the Project administered by ORDEZA, \$4.0 million provided under the Loan will be used to continue the activities of the Rural Community Enterprises Development and the CRECE Fund Small Business Assistance Projects, financed under A. I. D. Loans Nos. 527-L-052 and 527-L-053, respectively. The GOP will contribute the equivalent of \$1.0 million for staff and operating expenses. The Rural Community Enterprises Development Project will continue to be

managed by the Rural Development Division of ORDEZA, which is responsible for the identification of community needs, the development of feasible community sub-projects in industry, agriculture, and infrastructure, and the provision of credit, technical assistance, and training to participating community organizations. The CRECE Fund, established in the Central Reserve Bank and administered through ORDEZA's Program for Financial Investment, will likewise continue extending credits and technical assistance for the development and expansion of new or existing small enterprises.

(c) Under the second portion of the Project, the Banco Industrial will establish a special fund, the Rural Enterprise Development Fund ("Fund"), and create a new organizational unit, the Program Unit, to administer this Fund. The Fund will be capitalized at \$9.7 million comprising \$4.0 million contributed by the GOP and \$5.7 million from A. I. D. funds under this loan. The GOP will also contribute the equivalent of \$500,000 for staff and operating expenses. Credits from the Fund will be made available for sub-lending individuals or community organizations to finance eligible projects developed in the project area. Eligible projects will be in industry, services and commerce which have been shown in appropriate feasibility studies to be economically, financially and technically viable, and which have been approved by the staff of the Bank on the basis of the following criteria:

- (i) employment generation
- (ii) value added
- (iii) extent to which sub-project stimulates other economic activity within project area
- (iv) consistency with the regional development plan of the Government of Peru.

The Program Unit will be the central managing unit in the administration of the Fund. It will be responsible for project promotion, the identification and development of sub-projects, the provision of technical assistance in the study or design of sub-projects, the final approval of sub-projects eligible for credit assistance, and the implementation of sub-projects, including the provision of technical assistance or formal training when required. Where necessary or desirable, the Program Unit will work in cooperation with other GOP agencies as appropriate.

d) To augment the total amount of funds available under the Project both ORDEZA and the Banco Industrial will require financial participation of all individual, and, wherever practicable, community sub-borrowers. The minimum required participation of individual sub-borrowers will be 5% of the value of the total loan to the sub-borrower. The estimated total participation of sub-borrowers is the equivalent of \$400,000. Where sub-lending is implemented through an intermediate financial institution, a minimum participation of not less than 15% of the value of the total loan to the sub-borrower will be required from that financial institution. The estimated total participation of such intermediate financial institutions is the equivalent of \$1.0 million.

e) Each sub-borrower, whether individual enterprise or community organization, will offer any assets created or purchased as part of the sub-project activity as security for their loan.

f) Repayments of all sub-loans under the Project (including both ORDEZA and Banco Industrial sub-projects) together with interest received (after deduction for service fees), will be paid into the Banco Industrial's Rural Enterprise Development Fund and made available for relending under the terms and conditions of the Fund.

g) Of the amounts allocated to ORDEZA and the Banco Industrial under the loan an amount not to exceed \$300,000 will be available to each Implementing Agency for technical assistance. These funds may be used to finance technical services to the Implementing Agencies or sub-borrowers, promotional activities related to the Project, and training programs offered to sub-borrowers.

4

10p.

CONFIRMED COPY

AMENDMENT No.1 to

LOAN AGREEMENT

between

THE REPUBLIC OF PERU

and

THE UNITED STATES OF AMERICA

for

RURAL ENTERPRISES DEVELOPMENT

Date: 3 AGO. 1977

RECORD COPY

Amendment No. 1, dated **3 AGO. 1977** (the "Amendment"), to the Loan Agreement, dated November 25, 1974 (the "Loan Agreement"), between the Republic of Peru ("Borrower") and the United States of America, acting through the Agency for International Development ("A.I.D.").

WHEREAS, Borrower and A.I.D. have agreed on certain changes to the Project described in the Loan Agreement;

WHEREAS, Borrower and A.I.D. have agreed on the necessity of amending the Loan Agreement to make effective the changes agreed to for the Project;

THEREFORE, Borrower and A.I.D. agree to amend the Loan Agreement as follows:

1. SECTION 1.02 is amended to read: "The Project, which is further described in Annex 1, will assist new and existing rural enterprises in Peru by making available an integrated program of credit and technical assistance to such enterprises. Up to one million seven hundred thousand dollars (US\$1,700,000) will be available under the Loan for the area affected by the earthquake of May 31, 1970 ("Affected Zone") and up to eight million three hundred thousand dollars (US \$8,300,000) will be available for the departments of Cuzco, Puno, Junin, Ayacucho, Apurimac, Cajamarca, Huanuco, and Huancavelica ("Rural Departments"). Annex 1, attached, amplifies the above definition of the Project.

Within the above definition of the Project, elements of the amplified description stated in Annex 1 may be changed by written agreement of the authorized representatives of the parties named in Section 9.02 without formal amendment of this Agreement.

The Borrower designates Organismo Regional para el Desarrollo de la Zona Afectada ("ORDEZA") as the implementing agency for that portion of the Project being carried out in the Affected Zone and the Banco Industrial del Peru ("Banco Industrial") as the implementing agency for that portion of the Project being carried out in the Rural Departments."

2. SECTION 3.02. Without affecting the substantive provisions of this Section, the heading of the Section is changed to read: "Conditions Precedent to Disbursement for the Portion of the Project in the Rural Departments."
3. SECTION 5.01 is amended by adding the following: "Borrower further covenants that it shall cause to be maintained a 60:40 ratio of A.I.D. to Borrower contributions to the capitalization of the Fund with respect to all funds allotted under the Loan to the Banco Industrial."
4. SECTION 5.05 is amended to read: "Except as A.I.D. may otherwise agree in writing, all proposals for sub-loans in excess

of the equivalent in soles of US\$100,000 shall be submitted to A.I.D. for the prior written approval of A.I.D."

5. SECTION 7.05 is amended to read: "Except as A.I.D. may otherwise agree in writing,
- (a) no Letter of Commitment, or other commitment documents which may be called for by another form of disbursement under Section 7.03, or amendment thereto, shall be issued in response to requests received by A.I.D. after July 31, 1978
 - (i) from ORDEZA for the Affected Zone in an amount in excess of US\$1,700,000, and
 - (ii) from the Banco Industrial for the Rural Departments in an amount in excess of US\$8,300,000; and
 - (b) no disbursement shall be made against documentation received by A.I.D. or any bank described in Section 7.01 after January 31, 1979. A.I.D. may at its option at any time or times after January 31, 1979, reduce the Loan by all or any part thereof for which documentation was not received by such date.
 - (c) Borrower warrants that of the US\$8,300,000 now allotted under the Loan to the Banco Industrial, the Banco Industrial will commit US\$4,000,000 for sub-loans and disburse US\$2,400,000 for sub-loans by January 31, 1978. Notwithstanding the provisions of sub-section (a) above, the Loan shall be reduced by the amount, if any, by which

commitments and disbursements as of January 31, 1978 do not total US\$4,000,000 and US\$2,400,000, respectively.

(d) Borrower warrants that of the US\$1,700,000 now allotted under the Loan to ORDEZA, ORDEZA will commit US\$1,600,000 for sub-loans and disburse US\$800,000 for sub-loans by January 31, 1978. Notwithstanding the provisions of subsection (a) above, the Loan shall be reduced by the amount, if any, by which commitments and disbursements as of January 31, 1978 do not total US\$1,600,000 and US\$800,000, respectively.

6. ANNEX I is amended to read:

"I. Purpose of Project

The purpose of the Project is to develop an integrated program of financial and technical assistance to aid existing and new enterprises and community organizations in selected rural areas of Peru. The Project is specifically designed to facilitate the availability of credit and technical assistance to those enterprises and organizations which have not previously received or had normal access to credit on reasonable terms and conditions. The activities of the Project will contribute to:

- a) the development and strengthening of rural enterprises;
- b) the creation of employment;
- c) the generation and distribution of income; and

d) a higher level of economic activity in several of the poorer regions of Peru.

II. Description of the Project

a) The total amount of funding to be provided under the Project is the equivalent of US\$16.2 million, with an A.I.D. contribution of US\$10.0 million of which US\$1.7 million is allocated to ORDEZA for use in the zone affected by the earthquake of 1970, and US\$8.3 million is allocated to the Banco Industrial for use in the rural departments of Ayacucho, Cuzco, Junin, Puno, Apurimac, Cajamarca, Huanuco, and Huancavelica. The Borrower is the Government of Peru (GOP), through the Ministry of Economy and Finance.

b) Under the portion of the Project administered by ORDEZA, US\$1.7 million provided under the Loan will be used to continue the activities of the Rural Community Enterprises Development and the CRECE Fund Small Business Assistance Projects, financed under A.I.D. Loans Nos. 527-L-052 and 527-L-053, respectively. The GOP will contribute the equivalent of US\$0.5 million for staff and operating expenses. The Rural Community Enterprises Development Project will continue to be managed by the Rural Development Division of ORDEZA, which is responsible for the identification of community needs, the development of feasible community sub-projects in industry, agriculture, and infrastructure, and the provision of credit, technical assistance,

and training to participating community organizations. The CRECE Fund, established in the Central Reserve Bank and administered through ORDEZA's Program for Financial Investment, will likewise continue extending credits and technical assistance for the development and expansion of new or existing small enterprises.

c) Under the second portion of the Project, the Banco Industrial will establish a special fund, the Rural Enterprises Development Fund ("Fund"), and provide adequate institutional support to administer this Fund. The Fund will be capitalized at \$13.0 million comprising US\$5.2 million contributed by the Banco Industrial and US\$7.8 million from A.I.D. funds under this Loan. The Banco Industrial will also contribute the equivalent of US\$500,000 for staff and operating expenses. Credits from the Fund will be made available for sub-lending to individuals or community organizations to finance eligible projects developed in the Project area. Eligible projects will be in industry, services and commerce which have been shown in appropriate feasibility studies to be economically, financially and technically viable, and which have been approved by the staff of the Bank on the basis of the following criteria:

- (i) employment generation
- (ii) value added
- (iii) extent to which sub-project stimulates other economic activity within Project area

(iv) consistency with the regional development plan of the Government of Peru.

The Banco Industrial will establish adequate institutional arrangements for Project promotion, the identification and development of sub-projects, the provision of technical assistance in the study or design of sub-projects, the final approval of sub-projects eligible for credit assistance, and the implementation of sub-projects, including the provision of technical assistance or formal training when required. Where necessary or desirable, the Banco Industrial will work in cooperation with other GOP agencies as appropriate.

d) To augment the total amount of funds available under the Project, both ORDEZA and the Banco Industrial will require financial participation of all individual, and, wherever practicable, community sub-borrowers. The minimum required participation of individual sub-borrowers will be 5% of the value of the total loan to the sub-borrower. Where sub-lending is implemented through an intermediate financial institution, a minimum participation of not less than 15% of the value of the total loan to the sub-borrower will be required from that financial institution.

e) Each sub-borrower, whether individual enterprise or community organization, will offer any assets created or purchased as part of the sub-project activity as security for their loan.

f) Repayments of all sub-loans under the Project (including both ORDEZA and Banco Industrial sub-projects) together with interest received (after deduction for service fees), will be paid into the Banco Industrial's Rural Enterprise Development Fund and made available for relending under the terms and conditions of the Fund.

g) Of the amounts allocated to ORDEZA and the Banco Industrial under the loan an amount not to exceed \$100,000 and \$500,000 will be available to each implementing agency respectively for technical assistance. These funds may be used to finance technical services to the implementing agencies or sub-borrowers, promotional activities related to the Project, and training programs offered to sub-borrowers."

7. Except as specifically modified or amended in this Amendment No.1, all provisions of the Loan Agreement remain unchanged and in full force and effect.

IN WITNESS WHEREOF, the Republic of Peru and the United States of America, each acting through its respective duly authorized representative, have caused this Amendment No.1 to be signed in their names and delivered as of the day and year first above written.

THE REPUBLIC OF PERU

UNITED STATES OF AMERICA

/s/ _____
Fernando Reus Salinas
Director General for
Public Credit
Ministry of Economy
and Finance

/s/ _____
Leonard Yaeger
Director
A.I.D. Mission to
Peru

PD AAB-398-E1

5270141 (15)

TA/DR-DARC/P-7/1-37

17.

FROM : USAID/Lima
TO : AID/Washington
SUBJECT : Intensive Review Request
PROJECT TITLE : Rural Enterprise Development
LOAN AMOUNT : AID - \$ US 10 million
 : GOP - \$ US 4 million equivalent
BORROWER : Government of Peru
IMPLEMENTING AGENCY : Ministry of Industry and Tourism

IRR OUTLINE

- I. Summary
- II. Description
- III. Priority and Justification
- IV. Borrower
- V. Project Implementation
- VI. Financing
- VII. Intensive Review
- VIII. Issues
- IX. Conclusion

I. SUMMARY

A.I.D. has assisted the rural development programs of developing countries for many years. A renewed emphasis for this type of assistance was recently specified by Congress which included "agricultural, rural development, and nutrition" as one of the priority areas of A.I.D. assistance. In Peru the Government has made it clear that it places its highest priority on rural development, and that it includes the betterment of the rural population through Agrarian Reform and other programs as an essential and integral part of the country's development program.

Considering GOP as well as congressional emphasis on rural development, USAID feels that a project that would complement existing and planned sector development activities and thereby become an element of the GOP's rural development programs is highly appropriate at this time. USAID's preliminary analysis has shown that the activity most likely to make such a contribution would be support of the development of Rural Enterprises.

This project will accordingly provide credits on reasonable terms to Rural Enterprises that have not had access to such credit before. To provide these credits, a fund valued at \$12.5 million will be established in the Central Reserve Bank. A.I.D. will contribute \$9.5 million (out of the total loan value of \$10.0 million) to establish this fund with the additional .5 million earmarked for technical assistance while the GOP will contribute \$3.0 million to establish the fund and \$1.0 million for administrative expenses and technical assistance.

The project is expected to be implemented by the Ministry of Industry Small Business division, with local banks and credit cooperative assuming all banking functions and funding from their own resources at least 10 per cent of each sub-loan with which they are involved. Technical assistance to sub-borrowers will be provided by the implementing agency.

II. DESCRIPTION

The objective of USAID in developing this program is to support the GOP's goals of increased rural employment and income, expanded economic opportunities for the rural population and increased agricultural production.

This project will attempt to further the above stated goals by providing credits and necessary technical assistance to Rural Enterprises meeting certain eligibility requirements. (See Section V(C)). This project will accordingly be an integral element of the GOP's national rural development policy in that it will complement already existing Agrarian Reform and Agricultural Development Programs. (See Section III for a description of the GOP's national development policies for rural areas).

The entrepreneurs or business organizations to be assisted may be classified as follows:

(A) Those which, because of isolation, inexperience, the built-in caution and traditionally conservative practices of the regular commercial banking system, or other factors, have not

generally had access to credit on reasonable terms. This group will consist largely of privately owned enterprises, but would also include enterprises such as community organizations or the various types of cooperative enterprises found (or being developed) in Peru. All would have well-formulated plans for starting enterprises, or would be currently operating a business enterprise and require funds for expansion or modernization.

(B) Community and cooperative enterprises that are in the nascent stages of development and accordingly require considerable technical assistance (resource surveys, pre-feasibility and feasibility studies, management training, etc.) in addition to capital inputs to achieve their development potential.

USAID support of this project is intended to demonstrate to the GOP that we are willing to support activities of nationwide scope rather than those restricted to the disaster area, as has recently been the case. Credits will thus be made available in different areas of Peru, although it is anticipated that to limit administrative costs, to provide adequate supervision and technical assistance, and to assure adequate publicity for the project, the project activities will be concentrated in a few areas of Peru. It is hoped that successful project implementation would stimulate the GOP to support a further expansion of the project.

A.I.D. contributions to the activity will total \$U.S.10 million, and the GOP contribution \$U.S.4 million equivalent. The

central project feature will be a revolving fund totaling \$12.5 million (\$9.5 million from A.I.D., \$3.0 million equivalent from the GOP). Local banks and credit cooperatives will contribute a minimum of 10% of the value of each sub-loan that they handle. This is expected to total \$.8 million. A.I.D. funds will also be used to finance technical assistance and equipment (up to \$.5 million) while the GOP will contribute \$1.0 million equivalent to cover administrative expenses.

The fund will be administered by the Central Reserve Bank of Peru. Sub-loans will be channeled by the implementing agency through local financing agencies such as private and government-owned local commercial banks and credit cooperatives.

III. PRIORITY AND JUSTIFICATION

The depressed standard of living existing in rural Peru, with very high unemployment and underemployment rates and lack of economic opportunity, has led the GOP to place its highest priority on rural development, including agricultural sector development, as an essential, integral part of the country's national development program. Article 2 of Peru's Agrarian Reform Law indicates the nature of the Government's efforts to promote rural development and the inter-relationship of these efforts to national development policy:

"Art. 2.- The Agrarian Reform, as an instrument of transformation, shall form a part of national development policy and it shall be related intimately to the activities planned by the State in other areas essential to the promotion of the rural populations

of the country, such as the organization of an effective Rural Education System, general technical assistance, credit mechanisms, agricultural research, development of natural resources, urbanization policy, industrial development, expansion of the national health system and government marketing mechanisms, among other things."

Rural development has long been an important objective of A.I.D.'s assistance to developing countries. This emphasis was reinforced recently by Congress which specified rural development in one of the five priority areas for U.S. assistance to developing countries. In giving effect to this Congressional emphasis, Section 103 of Public Law 93-189 states:

"In order to alleviate starvation, hunger, and malnutrition, and to provide basic services to poor people, enhancing their capacity of self-help, the President is authorized to furnish assistance, on such terms and conditions as he may determine, for agriculture, rural development, and nutrition."

In accordance with this Congressional mandate and in view of the high priority given to rural development by the Peruvian Government, USAID/Peru has been directing its assistance efforts increasingly toward the rural sector.

The Government's aggressive rural sector development program is designed to increase the economic opportunities of the rural population and to raise the general standard of living of that segment of the population.

The GOP rural sector development program includes as elements the agrarian reform program, allied agricultural sector investment programs, and a large agricultural credit program - all of which have been supported strongly by A.I.D. Moreover, Peru's education and health reforms are now giving much greater emphasis to the rural areas of the country, and the GOP is beginning to develop methods for decentralizing governmental authority and responsibility to further this development policy.

At the same time, industrial decentralization programs have been introduced to provide alternative sources of employment and income; however these are reaching only major cities along the coast outside the Lima area and are involving only large scale enterprises.

Although the Government has made it clear in its rural development policy that encouragement to various types of rural enterprise is essential to overall rural development, little is being done to stimulate indigenous small and medium size enterprises in the rural areas as a means of providing alternative employment and income opportunities and crucial services for the rural population. In the absence of programs to stimulate the enterprise sector of the rural economy, rural sector growth will tend to become further unbalanced with resulting continued or increasing dependence on urban

areas. This proposed loan is designed specifically to fill this gap by providing access to credit on concessional terms and conditions to small and medium size rural enterprises which for various reasons have not been able to qualify for credit from conventional sources.

The benefits expected from making credit available to these enterprises are several.

(A) Additional value added will be produced in the rural economy and a large part of the income flowing into or injected into rural areas will be retained in those areas.

Historically, nearly all of any additional income injected into the rural areas of Peru has been drained to the major urban centers, especially Lima, due to the fact that practically all purchases of raw materials, capital equipment, and durable consumer goods must be made in those centers where the goods are available. Very little value added is produced in the rural areas in industry and processing. Therefore, the multiplier effects of any such injections are quickly diverted to the urban centers. The development of viable rural enterprises will help to retain some of this income in the rural sector by increasing the value added within the sector with resulting increased local multiplier effects.

(B) Additional alternative employment opportunities will be made available to the rural labor force. (Experience under Loan 053 has shown that the average cost per job resulting from this type investment is about \$1600.) As existing small enterprises expand and new ones are established, non-farm rural employment will increase

with concomitant increased rural incomes and reduced labor force pressure on the agricultural sector proper. Moreover, the heavy migration to the coastal cities, especially the Lima/Callao area, should be alleviated somewhat to the extent that rural youth find remunerative employment opportunities closer to home.

(C) Agricultural sector growth will be enhanced through the provisioning of necessary inputs and services on a more timely and lower cost basis. It is expected that a large proportion of the sub-borrowers under the loan will be firms which supply inputs or provide services to other entities in the agricultural sector. The increased accessibility and lower costs of these inputs and services will encourage their use and result in increased agricultural sector production and income.

The experience gained by these small-scale entrepreneurs in the use of credit, the increased flow of new industrial technology into the rural areas, reduced family disintegration, and an improvement in the quality of life of the rural population are additional benefits that should flow from the implementation of this loan.

For these reasons, USAID believes that this loan is fully justified and has highest priority in U.S. assistance efforts in Peru.

IV. BORROWER

The Borrower will be the Government of Peru. The Small Business division of the Ministry of Industry and Tourism is expected

to be the implementing entity. (See Section VIII, Issues.) The Ministry of Economy and Finance and National Planning Institute have stated that the proposed loan is of high priority for the GOP.

V. PROJECT IMPLEMENTATION

(A) Implementing Organization

The Ministry of Industry Small Business division will supply, in addition to administrative personnel, the services of a yet to be determined number of technicians as follows:

- 1) multi-disciplinary teams of technicians to assist enterprises that need a complete package of technical assistance.
- 2) engineer and accountant/analyst teams to assist enterprises that need less than a complete package of technical assistance.

Depending on the needs of the prospective sub-borrower, technicians from the MOI may perform community resource surveys and feasibility studies, assist in project development and presentation, and provide follow-up technical advice in business operations. Moreover, the MOI as the implementing organization will jointly approve each sub-loan with the local financing agent.

The MOI will form or otherwise identify an organization that will develop a manual to assist Rural Enterprises in business operations, and will arrange courses in business operations for approved applicants. T.A. Loan funds will be earmarked to fund this activity.

(B) Fund Operation

- 1) A fund of \$12.5 million (\$9.5 million U.S. \$3.0 million GOP) will be established in the Central Reserve Bank. The local financing agent will be required to contribute at least 10% of the value of each sub-loan. Proceeds from the fund plus the local financing agency contribution will be used to finance sub-loans to eligible enterprises.
- 2) The local financing agent will be responsible for all normal banking functions including review of loan applications.
- 3) The Central Reserve Bank, as trustee of the fund, will forward to the local financing agent a maximum of 90% of the value of commercial paper arising from the sub-loans. The remaining amount represents the participation of the local financing agent.
- 4) A.I.D. would disburse to the revolving fund on a periodic basis against expenditures from the fund.
- 5) All repayments of principal and interest (aside from that amount due the local financing agent) will be channeled back into the fund for relending. NOTE: See Section VIII, Issues, for a discussion of the possibility of including repayment under loans 052 and 053 as part of the new fund.
- 6) The estimated period of disbursement of loan funds is three years.

(C) Sub-borrowers

Sub-loans will be made available on concessional terms to Rural Enterprises utilizing the following criteria:

1) Generation of employment - projected jobs created per \$1 invested will be one measure of the variable.

2) Size of enterprise - preference will be given to small and medium size enterprises with size limits to be determined during intensive review using measures such as total fixed assets, annual sales, and net worth.

3) Generation of income - preference will be given to activities which add the greatest value in the production process.

4) Provision of basic services to rural inhabitants.

(D) Terms and Conditions of Sub-loans

1) Loans to private enterprises will be limited to a probable maximum of S/.3 million (approximately \$U.S.70,000) Based on past experience, however, we anticipate that most loans will be considerably below this maximum. Loans to community and cooperative enterprises will be limited to a probable maximum of S/.10 million (approximately \$U.S.250,000), with the size of the enterprise and the number of members considered in making the loan.

2) Loans will be granted for terms ranging from 3 to 10 years with the interest rate on sub-loans probably dependent on the size of the loan and the nature of the borrower. Larger sub-loans will generally have higher interest rates. Under existing loan 053 interest rates have varied from 8 to 10 per cent. Grace periods of up to three years may be considered on a loan by loan basis.

3) Fixed assets acquired with loan funds will be pledged as security for the sub-loan.

VI. FINANCIAL ESTIMATES (\$U.S. Million)

<u>Item</u>	<u>AID</u>	<u>GOP</u>	<u>LOCAL FINANCING AGENT</u>	<u>TOTAL</u>
1. Rural Enterprise Credits	9.5	3.0	0.8	13.3
2. U.S. Technical Assistance	0.5	-	-	0.5
3. GOP administrative support	<u>-</u>	<u>1.0</u>	<u>-</u>	<u>1.0</u>
	10.0	4.0	0.8	14.8

It is anticipated that most loan funds would be used for local costs although some imported equipment will be required. Up to \$1 million of the loan may be used for this purpose.

VII. INTENSIVE REVIEW

The intensive review will be performed by USAID. Discussions with the Ministry of Industry and other GOP organizations have resulted in the tentative appointment of individuals to be responsible for jointly conducting this review. It is anticipated that the loan paper can be forwarded to AID/W within 8 weeks of the authorization of the intensive review.

Discussions with the Interamerican Development Bank indicate that they have not had nor do they anticipate any projects that duplicate this proposal. Their recently completed project with the Industrial Bank was designed for larger-scale enterprises generally located in cities and any successor project would have a similar emphasis. It also appears that there will be no duplication between IBRD projects and the proposed activity.

VIII. ISSUES

(A) Implementing Organization - Preliminary contacts with several GOP organizations lead us to believe that the Ministry of Industry has, or can develop within a reasonable time period, an organization that could successfully implement the proposed activity. If the intensive review reveals that the MOI does not have or cannot quickly develop this capability, another such organization will have to be identified. Possibilities include the Industrial Bank, Ministry of Agriculture, Ministry of Commerce and ORDESUR. In any event, the MOI recognizes that it would have to coordinate its activities with those of other Government agencies.

The 052 and 053 project teams currently working for ORDEZA have successfully managed projects that include as elements the features of the proposed activity. It is hoped that ORDEZA and the MOI (or other organization) will agree to utilize the currently existing project teams under the institutional framework that emerges.

(B) Coordination of Organizations - Local financing agencies must cooperate with the implementing organization(s) and perform well both the financial and advisory functions of banks. To achieve this cooperation, a system must be devised wherein the banks find the return satisfactory, but which does not represent a financial wind-fall that might make the agency's participation unacceptable to the GOP. Section V B proposes one mechanism for bank participation, but this will obviously have to be carefully studied during the intensive review.

(C) Location of Project Activities - For various reasons, USAID wishes to make sub-loans available to Rural Enterprises throughout Peru. At the same time, however, it will be desirable to provide substantial resources to the ORDEZA area for continuation of the programs already initiated there. For this reason, as well as for ease of project management, economy of operation, and project promotion, it is likely that the bulk of project resources will be concentrated in a limited number of areas. Those which now seem most likely, aside from the ORDEZA area, are Ayacucho, Puno, and Cuzco.

(D) Reflows Under Loan 052 and 053

Consideration will be given to incorporating reflows generated under loans 052 and 053 into the fund. Significant reflows will begin under 052 and 053 in 1976 - 78, at a time when reflows under this proposed project will not yet be significant.

(E) Demand for Credits

Demand for this type of credit has not been formally verified although USAID contacts with various individuals and organizations lead us to strongly believe that there is a significant demand. USAID knows, for example, that there is continuing demand for credits under both loans 052 and 053. Funds available under Loan 053 will be exhausted 18 months ahead of original estimates, and will fall short of current actual demand by an estimated \$3 million. Loan 052 funds should be completely committed on schedule. The proportion of loan funds to be utilized for 052 vs. 053 type of activities is yet to be determined.

IX. CONCLUSION

It is requested that USAID/Peru be authorized to proceed with the intensive review of the proposal described herein.