



Department of State **TELEGRAM**

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CAN BE SATISFACTORILY ADDRESSED OR WHETHER MISSION WOULD PREFER TO UTILIZE RESOURCES IN DEVELOPMENT OF ALTERNATIVE PROJECT(S).

1. **GDP POLICY** - ONE PURPOSE OF THE PROPOSED PROJECT IS TO REINTRODUCE COMMERCIAL BANKS TO AGRICULTURE SECTOR LENDING AFTER A DECADE'S ABSENCE. TO SUPPORT THIS PURPOSE, AS A PROJECT OUTPUT DAEC WOULD EXPECT THE PROJECT TO INTRODUCE GDP POLICY CHANGE(S) THAT WILL MAKE IT LIKELY THAT ADDITIONAL CREDIT FROM COMMERCIAL BANKS TO THE AGRICULTURE SECTOR WILL BE FORTHCOMING ONCE AID INPUTS TO THE SPECIAL FUND HAVE BEEN EXHAUSTED. AT A MINIMUM, THE INTERIM REPORT SHOULD EXAMINE THE POSSIBILITY OF UTILIZING PROJECT TO

INFLUENCE CHANGES IN GDP POLICIES AND THE DESIRABILITY OF INTRODUCING SOME OF THE FOLLOWING POTENTIAL POLICY CHANGES INTO PROJECT DESIGN: (A) CHANGES IN COMMERCIAL BANKS' RESERVE REQUIREMENTS FOR LOANS TO AGRICULTURE SECTOR, (B) INCREASING THE MINIMUM PERCENTAGE REQUIREMENT FOR COMMERCIAL BANK FUNDS THAT MUST BE USED IN AG SECTOR LOANS, (C) INDEXING INTEREST RATES FOR MEDIUM TERM LOANS TO THE RATE OF INFLATION, (D) REQUIRE THAT ICI'S PROVIDE COUNTERPART FUNDS FOR PROJECT SUBLOANS, AND (E) CHANGES IN INTEREST RATES AS OUTLINED BELOW IN (4). OTHER POLICIES MISSION CONSIDERS APPROPRIATE OR LIKELY TO FACILITATE IMPLEMENTATION OF BASIC PROJECT PURPOSES SHOULD ALSO BE DISCUSSED IN THE INTERIM REPORT.

9. **IMPLEMENTING AGENT** - AFTER INDEPTH DISCUSSION, CENTRAL BANK AS IMPLEMENTING AGENT REMAINS OUTSTANDING ISSUE, AS THE PRP DID NOT FULLY JUSTIFY THE ROLE OF THE CENTRAL BANK AS THE IMPLEMENTING AGENT. THE INTERIM REPORT SHOULD PROVIDE ADDITIONAL INFORMATION ON THE MISSION'S RATIONALE FOR SELECTING THE CENTRAL BANK AS THE IMPLEMENTING AGENT, PARTICULARLY HOW THE LOAN TO THE CENTRAL BANK WILL CREATE AN ATMOSPHERE FOR DEVELOPMENT WHICH OTHERWISE NOT LIKELY TO EXIST. IN THIS REGARD, INTERIM REPORT SHOULD ALSO FURTHER EXPLAIN USE OF THE AGRARIAN BANK AS AN ICI AND JUSTIFY WHY IT SHOULD NOT BE IMPLEMENTING AGENT FOR SUB-LOANS TO TARGET GROUP AT WHICH ITS PROGRAMS ARE GENERALLY AIMED (I.E., AE'S AND SMALL FARMERS).



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3. DEMAND ANALYSIS - SUBLOANS UNDER THE PROJECT ARE EXPECTED TO BE MADE TO THREE GROUPS: SMALL FARMERS, A&I'S AND AGRI-BUSINESS ENTREPRENEURS. THERE WAS CONCERN WITH THE CHARACTERISTICS AND NUMBER OF SMALL FARMERS WHO MAY BE REACHED THROUGH THE MECHANISM PROPOSED IN THE PRP. IN THE INTERIM REPORT, THE MISSION SHOULD ANALYZE THE EFFECTIVE DEMAND FOR SUBLOANS OF EACH GROUP, ASSESS THE LIKELIHOOD OF THE PROPOSED PROJECT MECHANISM REACHING EACH OF THE THREE GROUPS, AND, BASED ON THIS ANALYSIS, RE-EVALUATE DESIGN OF PROPOSED PROJECT TO DETERMINE WHETHER REDESIGN IS REQUIRED IN ORDER FOR PROJECT TO RESPOND TO THE DEMONSTRATED EFFECTIVE DEMAND.

4. INTEREST RATES - (A) THE PROPOSED 14 PERCENT INTEREST RATE TO END USERS WAS QUESTIONED DURING REVIEW. WITH CURRENT INFLATION RATE OF 20 PERCENT AND ABOVE, IT WOULD APPEAR THAT AN INCREASED INTEREST RATE IS JUSTIFIABLE. IN THE INTERIM REPORT, THE MISSION SHOULD PROVIDE DETAILS SUPPORTING 14 PERCENT INTEREST RATE FOR SUBLOANS. (B) AS PART OF THE DEMAND ANALYSIS DISCUSSED IN (3) ABOVE, THE APPROPRIATENESS OF AN INTEREST RATE DIFFERENTIAL AMONG THE TARGET GROUPS SHOULD BE EXPLORED. (C) THE MISSION SHOULD DEMONSTRATE THAT THE PROPOSED 5 PERCENT RETURN TO THE CENTRAL BANK IS NOT EXCESSIVE IN VIEW OF THE ROLE CONTEMPLATED FOR THE CENTRAL BANK. IN THIS REGARD, THE INTERIM REPORT SHOULD DISCUSS IN DETAIL THE RATIONALE FOR EXCLUDING A MAINTENANCE OF VALUE FUND YET INCLUDING THE PROVISION FOR ADDITIONAL CONTRIBUTIONS BY THE CENTRAL BANK AS A MEANS OF MAINTAINING THE DOLLAR VALUE OF THE SPECIAL FUND. (D) ONE INCENTIVE TO BRING COMMERCIAL BANKS BACK INTO LENDING IN THE AG SECTOR IS A RETURN ON PROJECT SUBLOANS SOME 2-3 PERCENT GREATER THAN CURRENT LOW-RISK LOANS. THE MISSION SHOULD FURTHER ASSESS WHETHER THIS SPREAD IS SUFFICIENT.

5. PROMOTION CAMPAIGN - THE PRP INDICATED A PROMOTION CAMPAIGN WOULD BE UNDERTAKEN BY THE CENTRAL BANK IN ORDER TO ACTIVELY INVOLVE ICI'S IN THE PROJECT. THE MISSION SHOULD PROVIDE ADDITIONAL INFORMATION REGARDING (A) THE MECHANICS OF THE CENTRAL BANK PROMOTION CAMPAIGN

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(B) THE LIKELIHOOD THAT ICIS WILL NEED TO UNDERTAKE
SIMILAR CAMPAIGNS IN ORDER TO ASSURE DEMAND FOR SUBLOANS
WILL EXIST) AND (C) HOW PROJECT DESIGN WILL ACCOUNT
FOR THE CAMPAIGN(S) WITH RESPECT TO COST, SOURCE OF FUNDS,
ETC.

6. TECHNICAL ASSISTANCE - COMMERCIAL BANKS HAVE REDUCED
THEIR LENDING IN THE AD SECTOR BECAUSE AFS AND SMALL
FARMERS ARE CONSIDERED HIGH RISK BORROWERS. THE DAEC NOTED
THAT THE PROJECT DOES NOT CONTEMPLATE TECHNICAL ASSISTANCE
TO THE SUB-BORROWERS AS A MEANS OF REDUCING THIS HIGH RISK
ASSOCIATION. THE INTERIM REPORT SHOULD CONSIDER A TA
COMPONENT TO THE PROJECT, NOT ONLY FOR THE SUB-BORROWERS
(E.G., ASSISTANCE IN IDENTIFYING SPECIFIC AREAS WHERE LOAN
PROJECTS CAN IMPROVE PRODUCTION), BUT ALSO TO THE ICIS
SHOULD IT BE REQUIRED TO REBUILD THEIR TECHNICAL CAPABILITY
TO EVALUATE AGRICULTURE PROJECTS.

7. BASED ON THE MISSION'S INITIAL ENVIRONMENTAL
EXAMINATION, THE AA/LA HAS REACHED A THRESHOLD DECISION
FOR THIS PROJECT INDICATING A NEGATIVE DETERMINATION. K152711

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ENVIRONMENTAL THRESHOLD DECISION

Location : Peru
Project Title : Agricultural Production and Services Fund
Funding : FY 78 - \$10 million - Loan
Life of Project: Three Years

Mission Recommendation:

Based on the Initial Environmental Examination, the Mission has concluded that the project will not have a significant effect on the human environment and therefore recommends a Negative Determination.

The Latin America Bureau's Development Assistance Executive Committee has reviewed the Initial Environmental Examination for this project and concurs in the Mission's recommendation for a Negative Determination.

AA/LA Decision:

Pursuant to the authority vested in the Assistant Administrator for Latin America under Title 22, Part 216.4a, Environmental Procedures, and based upon the above recommendation, I hereby determine that the proposed project is not an action which will have a significant effect on the human environment, and therefore, is not an action for which an Environmental Impact Statement or an Environmental Assessment will be required.



Assistant Administrator
for Latin America

12/3/76

Date

Clearances:
DAFC Chairman (Weinberg) CV
LA Environmental Coordinator (DeMatre) DD

Annex III

INITIAL ENVIRONMENTAL EXAMINATION

Project Location: Peru

Project Title: Agricultural Production and Services Fund

Funding: (First FY) FY-1978 \$10 million A.I.D. loan (Plus \$5.2 million Host Country contribution).

TEE Prepared by:

Date: October 5, 1976

Mr. Carl Leonard, USAID/Peru/CAP

Mr. Dallas Fowler, USAID/Peru/Environmental Coordinator

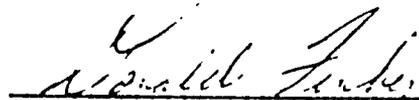
Environmental Action Recommended:

The USAID/Peru project committee for the Agricultural Production and Services Fund loan project has undertaken an Initial Environmental Examination (IEE) of the potential environmental impact aspects of the project and has arrived at a recommendation for a Negative Determination, as indicated on page 2, Threshold Decision section of the IEE.

Concurrence:

Date: October , 1976

I have reviewed the Initial Environmental Examination prepared by the project committee and concur in the Threshold Decision recommendation for a Negative Determination.



Donald R. Finberg
USAID/Peru Director

Annex IIIPart II.Description of the Project

The Project will consist of three components. The first will be a credit fund administered by the Central Reserve Bank of Peru (BCR), making medium-term credit (2-5 years) available to eligible small farmers and cooperatives through the banking system. Credit will be made available for sub-projects which will increase food production for domestic consumption, on-farm improvements, capital investments and marketing, processing and service facilities. The second component will be technical assistance to establish an evaluation system and assist with promotion of the Project. The third will be creation of an office in the BCR within the Credit Division to administer the Loan and promote the participation of lending institutions and eligible farmers and cooperatives under the Project.

Part III.Identification and Evaluation of Environmental Aspects

This is an intermediate credit institution (ICI) project, and actions that are likely to have an effect on the environment are several steps removed from A.I.D.'s action in authorizing the loan. However, the lending criteria summarized in the Project Review Paper for medium-term credit to boost food production and improve product processing and marketing enable an illustrative list of possible sub-projects to be prepared. Such a list, although by no means all inclusive, would include such items as livestock and machinery acquisition, on-farm improvements including drainage, land leveling, erosion control, and irrigation systems, the erection of silos and storage facilities, and the construction or expansion of food collection centers and processing plants.

Within the lending criteria, such contemplated actions as livestock improvements, machinery purchases and on-farm improvements will have little environmental impact except within the small farmers' surroundings and these are of a minor level of change. The same is true of the limited amount of land clearing and water control and utilization measures that are likely to take place. Project funds will not be utilized for the financing of pesticides, insecticides and fertilizer, since these will be furnished from other resources that focus primarily on annual agriculture production. Agro-industrial processing could have slightly larger measurable effects, but given the probable size of the investments and their dispersed location, these can be expected to be minimal.

Threshold Decision

Based on the above analysis, and in compliance with the requirements of A.I.D. environmental procedures, the Project Committee has determined that

Annex III

this Project does not have any significant foreseeable environmental effects on the national environment of the Republic of Peru, its neighboring countries, the global environment or that of the United States, and therefore a Negative Determination is recommended.

Annex III

IMPACT IDENTIFICATION AND EVALUATION FORM

<u>Impact Areas and Sub-areas</u> 1/	<u>Impact Identification and Evaluation</u> 2/
A. LAND USE	
1. Changing the character of the land through:	
a. Increasing the population	N
b. Extracting natural resources	N
c. Land clearing	L
d. Changing soil character	L
2. Altering natural defenses	L
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
B. WATER QUALITY	
1. Physical state of water	L
2. Chemical and biological states	N
3. Ecological balance	N
C. ATMOSPHERIC	
1. Air additives	N
2. Air pollution	N
3. Noise pollution	N

2/ Use the following symbols: N - No environmental impact
L - Little environmental impact
M - Moderate environmental impact
H - High environmental impact
U - Unknown environmental impact

PD AAB-417-C1

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OCT 15 1976

INFORMATION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR

FROM: LA/DR, Mr. Charles B. Weinberg

SUBJECT: ISSUES PAPER: Peru Agricultural Production and Services Fund PRP

*C - Issue Paper. Sp
still discuss
need to
develop state
policy
before
we proceed
with the
project*

A DARC meeting has been scheduled for Monday, October 18 at 11:30 a.m. to review the PRP for a \$10.0 million FY 78 Agricultural Production and Services Fund loan to Peru.

The project proposes to establish within the Central Bank a mechanism for refinancing medium-term loans made by intermediate credit institutions (ICIs) to sub-borrowers which produce, process or market agricultural commodities or provide complementary services to the agriculture sector. The project will consist of three major components: (1) establishing a \$12.7 million Special Fund within the Central Bank (\$9.8 million in loan funds and \$4.9 million in counterpart) from which sub-loan funds will be channeled through the ICIs; (2) providing technical assistance to help design and implement a system within the Central Bank for systematically evaluating the success and impact of the Fund, as well as to evaluate other credit activities of the Bank; and (3) establishing a special office in the Bank's Credit Division to administer the Fund.

*New
Amendment*

The total cost of the proposed project is \$15.2 million of which the GOP contribution will provide \$5.2 million (34%). This exceeds the 25% counterpart contribution required by Section 110 (a) of the Foreign Assistance Act.

The DARC will discuss the following issues and clarification points:

1. Role of Central Bank (Issue):

A. In establishing a Special Fund within the Central Bank for the purposes of facilitating medium-term credit, the project would be creating a system which is parallel to the existing Agrarian Bank system for administering medium-term lending. The function of the Central Bank is to develop and implement GOP monetary policy and to regulate operations of all banks in Peru. Bringing the Central Bank into the agriculture sector through the creation of the Special Fund may be viewed as being outside the purview of the Bank, and it raises questions as to

Does the existing system need to be changed? If so, why not? Or on it?

the appropriateness of involving the Central Bank in the project. The DAEC will discuss this issue and will consider other alternatives (e.g., use of the Agrarian Bank's existing system) as potential vehicles for successfully reintroducing commercial banks to agriculture sector lending.

B. In discussing the existing Agrarian Bank system, the DAEC will also review the Mission's basis for excluding the Bank as the implementing agent for the Special Fund. The Agrarian Bank is currently the only financial institution in Peru providing substantial financial support to the agriculture sector. The PRP analysis indicates this support is concentrated primarily in annual production credit, and that the Bank is an intermediate institution likely to be involved with a significant portion of project funds. However, this present area of concentration does not mean that the Bank could not be effective as the implementing agent for the proposed project, particularly if the Bank's existing system has the ability to reach large segments of the rural population.

C. An alternative not discussed in the PRP but which will be explored by the DAEC, is the possibility of channeling project funds through both the Agrarian Bank and the Central Bank. The Agrarian Bank would then be the implementing agent for subprojects in its area of expertise, while the Special Fund created in the Central Bank could still be used to reintroduce the commercial banks to agriculture sector lending.

2. Institutional Capability (Issue):

A. Since the initiation of the Agrarian Reform, commercial banks have greatly reduced their participation in the agriculture sector because AEs and small farmers have been considered high-risk borrowers. The result has been a severely restricted supply of credit from the banks. It is not clear, however, if this means that the supply of credit has dried up or if the banks are reluctant to make loans to the agriculture sector. In either case, the question arises as to how the availability of funds reduces the high-risk associated with AEs and small farmers. The DAEC will examine the impact of credit availability upon the high-risk of lending to AEs and small farmers.

B. The PRP indicates that as a result of the reduced participation of commercial banks in agriculture sector lending, investment decisions for agricultural sub-projects may require technical expertise which may no longer be available in the participating banks. The paper does not, however, provide any preliminary ideas as to how such a situation would be accounted for as part of project development, nor does it discuss the impact of any

Do you know if you could do it without a license? Do you know if you could do it without a license? Do you know if you could do it without a license?

Could the GOP be encouraged to develop its version of the PCG? a la Chile.

Can the
PCG &
me (Bula) do
the assessment
of the
activity
table

potential resource drain from other duties which may also result. The capability of the ICIs to technically evaluate the sub-projects is critical to the project's success, particularly since the Central Bank's role is limited to checking proposals for conformity to the eligibility criteria. The DAEC will examine what provisions project design should include (e.g., technical assistance) should the ICIs lack this technical capability, and, also, the cost implications of any such provisions.

The DAEC will also discuss the need for technical assistance to the sub-borrowers. The AEs and small farmers have been identified as high-risk borrowers, yet the project does not provide for technical assistance in order to reduce this high-risk association.

What are
the reasons
if any,
does not
high risk
to explain
the extent
credit to
ag. Does
the program
deal
with the
regions?

C. The PRP assumes that the existing Peruvian banking infrastructure with its large number of branch offices located throughout the country "would appear to be a logical conduit for reaching those relatively poor individuals and enterprises requiring, and capable of utilizing credit." For this assumption to be proven correct, the proposed program must provide for an active element of project promotion, by the Central Bank and/or the commercial and other banks and participating ICIs. The PRP's recommended financial incentives to the ICIs are not likely to motivate the ICIs to the degree of promotional activity required to disburse the proposed Fund resources. The PRP indicates a "promotion campaign" will be undertaken by the Central Bank, but does not provide details of what is contemplated. The DAEC will review the Mission's plans for addressing this aspect of the proposed program.

3. Project Beneficiaries and Credit Availability:

Does this
project
complement
the
with
AEs &
farmers?

A. The target groups of the proposed project have been identified as associative enterprises (AEs) and small farmers cultivating 15 hectares or less. While the PRP discusses the two as separate groups, the distinguishing characteristics between them are not clear. It appears that the AEs memberships consist of economically marginal small farmers, although apparently not all small farmers are members of AEs. The DAEC will examine the relationship between the two groups, the extent to which they may overlap, and how projections of project impact are affected where any overlap does occur.

B. The recently signed Agricultural Cooperative Federations (Centrals) Development Loan is designed to strengthen the organizational, financial and institutional bases of up to 20 Centrals.

The Centrals will, upon completion of development plans, finance short and medium-term investment funds for its member organizations. Since its member organizations are the same associative enterprises identified as the target group of the proposed loan, the DAEC will consider the implications of (i) any overlap between the two projects, including how sub-loans to AEs and small farmers will differ from sub-loans under the Centrals loan since many of the eligibility criteria are same for both projects, and (ii) potential implementation problems since the Centrals loan requires a detailed development plan prior to lending to sub-borrowers whereas the proposed loan does not.

Employment and income generated by sub-loans for a group of small farmers should be stressed.

C. In addition to the principal target groups of the proposed loan, agro-industries which provide services to the target groups are also eligible for loans. The DAEC will review the criteria for sub-loans to the agro-industries, the conditions for equity contribution required for sub-loans, and the Mission's initial estimates of the demand for loan funds among the three groups (including the need for promotional activities or technical assistance in order to assure the demand exists). In relation to the demand for loan funds, the DAEC will also discuss the utility of allocating specific quantities of the loan funds to each of the three eligible groups.

4. Interest Rates (Issue):

The PRP states that the interest rate to end users will be 14% and will be divided as follows: 7% to the ICI, 5% to the Central Bank, and 2% to an insurance fund.

The 5% return to the Central Bank appears high given that the Bank assumes none of the credit risks or collection responsibilities. The DAEC will examine the appropriateness of the proposed interest rate spread.

Needs to increase ICE investment

5. Maintenance of Value:

Provision of a Maintenance of Value (MOV) Fund is specifically excluded in the PRP, yet the Central Bank would be required to make additional contributions to the Fund in order to maintain its dollar value. The DAEC will examine other alternatives to

the PRP proposal including establishing a MOV fund through adjustments to the proposed interest rate spreads.

6. Allowable Percentage of Refinancing:

The PRP proposes that eligible sub-loans be refinanceable in their full amount. While such a policy represents a substantial incentive to ICI participation in the program, it may be more of an incentive necessary to gain the desired level of ICI participation particularly in sub-loans to entrepreneurs from eligible agro-industries (e.g., a level of 70, 80, or 85% may be determined to be adequate upon analysis of ICI requirements). Also, with refinancing set at 100%, no financial contributions to the sub-project from the ICI is forthcoming, and the Government "program" will absorb the total burden of financing desired activities. The DAEC will review the Mission's rationale for this initial decision.

7. Collateral Requirements:

The PRP recognizes the need for detailed study of the ICIs' probable collateral requirements, and the ability of sub-borrowers to provide that collateral. The DAEC will discuss how these requirements should be addressed as part of the intensive review.

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PD-AAB-417-D1

ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR (LA)

FROM: LA/DR, Charles B. Weinberg

Problem: To authorize intensive review for the preparation of the Project Paper for the \$10.0 million Peru Rural Development Agribusiness Fund project.

Discussion: The PRP for the Peru Agricultural Production and Services Fund was reviewed in October, 1976. In the guidance cable following the review, the Mission was asked to prepare an interim report responding to DAEC concerns regarding project design. This report has been submitted and reviewed individually by members of the DAEC. Based on this review, it is considered to be responsive to the specific questions outlined in the PRP guidance cable (see TAB B). A formal DAEC review, therefore, will not be held.

Based on guidance provided by the DAEC, the Mission (in conjunction with the GOP) has modified the design of the project emphasizing an agribusiness focus in order to best respond to effective demand for sub-loans. The Mission also changed the project's name to Rural Development Agribusiness Fund to reflect the modification in design. The provision of credit to small farmers for on-farm improvements has been dropped as a component of the project primarily because of recent increases in other donor initiatives in this area.

As a result of the redesign, the purpose of the project has been slightly modified to (1) establish within the Central Bank an effective facility for rediscounting loans made by financial institutions to sub-borrowers which process or market agricultural products or provide complementary goods and services to the agricultural sector; and (2) establish a program of promotion and development of agribusinesses which will maximize benefits to small farmers and the rural poor. Major constraints to be addressed in working toward achievement of project purpose include: inadequate marketing facilities, lack of agro-industrial processing facilities, unreliable goods and service input industry, and incomplete linkages within agribusiness systems.

The following paragraphs summarize the Mission's response to each question raised in the PRP guidance cable:

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1. **GOP Credit Policy** - The guidance cable questioned whether project design should include certain potential GOP policy changes aimed at assuring the availability of additional credit to the agriculture sector once the AID loan is disbursed. Whereas some of the policy changes are not considered feasible (changes in reserve requirements and indexing interest rate to the inflation rate), the Mission has concluded that others are desirable and plans to incorporate them in project design. Specifically, (a) the decree establishing the Rediscount Fund will authorize intermediate credit institutions (ICIs) to engage in medium and long-term lending for agribusiness sub-projects; (b) the Central Bank will be revising the loan portfolio coefficients of commercial banks to include agriculture projects as first priority activities; (c) the project will reinforce the Central Bank's concern for an adequate interest rate structure by confirming the long range GOP goal of moving to a positive real interest rate (including periodic reviews of progress toward meeting the goal), by establishing interest rates in line with interest rates for comparable types of credit, and by adjusting interest rates whenever necessary to maintain parity with comparable credit lines; and (d) ICIs will now be required to contribute 10 percent of sub-loan costs rather than receiving 100 percent refinancing through the Fund as was proposed in the PRP.

2. **Implementing Agent** - the redesign of the project toward an agribusiness focus strengthens the role of the Central Bank as implementing agent for the project. In addition to being the only financial institution in Peru with experience in rediscounting procedures, the Central Bank cites as one of its basic objectives the promotion of credit availability and sectoral allocations of credit to insure economic growth, income increases, and a high level of employment. Thus it has a key role in influencing allocations of credit away from the Lima area to other parts of the country. Also, with its position at the center of the financial system, the Central Bank has the general responsibility of strengthening the country's financial system and, therefore, is the best institution to deliver technical assistance and training to ICIs. By contrast, the Agrarian Bank should not be considered as the implementing agent because (a) its programs are production oriented and (b) it is heavily involved with several other AID and multilateral donor projects.

3. **Demand Analysis** - The earlier DAEC concern of identifying the extent of small farmer demand is no longer applicable as a result of project redesign (as is need for considering differential interest rates to end users). Discussions with ICIs and field surveys conducted by the Central Bank and AID has led to the development of

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a list of over 100 potential agribusiness sub-projects valued in excess of \$30 million. The Mission's analysis makes it quite clear that sufficient demand exists for agribusiness sub-projects and that the ICIs are very anxious to participate in the program. The PP will discuss in detail eligibility criteria for funding of agribusinesses with special emphasis on benefits to small farmers.

4. Interest Rates - The Interim Report proposes an interest rate of 16 percent to sub-borrowers which represents an increase of 2 percent over the rate proposed in the PRP. This rate is in line with basic interest charges for medium and long-term development credit, and, as indicated above, the rate will be adjusted periodically to maintain parity with these rates and move toward the GOP goal of positive real interest rates. The 5 percent spread allotted to the Central Bank will permit a 3 percent profit margin during the loan grace period (and 2 percent thereafter) from which the Bank will pay for Fund administration, promotion, evaluation, and technical assistance to the ICIs. The PP will contain a more detailed analysis justifying this spread. The ICIs have indicated that their 7 percent spread is an adequate incentive for their involvement in the project. Finally, with the increased interest rate, 4 percent of the spread will now be used for Fund recapitalization and maintenance of value.

5. Promotion Campaign - Promotion activities have been recognized as critical elements for successful project implementation, and the Fund's administrative staff will include a full-time promotion specialist. Mechanics of the system will involve direct contacts, brochures and a manual from the Central Bank to the ICIs, and direct contacts and brochures from the ICIs to potential sub-borrowers. The Central Bank will also conduct seminars for the ICIs on the rediscount mechanism. Initial promotion costs will be financed by a Central Bank contribution, and once the Fund is established the Bank and ICIs will support their promotion efforts from the interest spread they retain.

6. Technical Assistance - Provision of T.A. will be facilitated by project redesign. T.A. will be provided at the Central Bank (organization design, operational systems and promotional techniques), ICI (long-term project economic impact analysis), and sub-borrower (preparation of studies to support sub-loan applications) levels. Loan funds will finance the technical assistance to the Central Bank, ICIs will finance technical assistance received from the interest spread they retain, and the cost of technical assistance to sub-borrowers will be included in total sub-project cost.

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7. Relationship to Credit Needs of Sub-Tropical Lands Project - In the Sub-Tropical Lands PRP guidance cable the DAEC requested that the Mission discuss the similarity of purpose between the Rediscount Fund and the medium to long-term credit required for capitalization of farming operations in the Sub-Tropical Lands project. Although some similarity did exist at the PRP stage, it has been eliminated with the redesigning of the Rediscount Fund project. Credits from the Sub-Tropical Lands Project will finance land clearing and leveling and other on-farm improvements. Credits from the Rediscount Fund will be limited to agro-industrial enterprises.

The Bureau believes the Interim Report is responsive to the DAEC's concerns and that the redesign of the project is consistent with the guidance contained in the PRP cable. We therefore believe that intensive review for the Rural Development Agribusiness Fund should be authorized. Members of the DAEC who participated in the PRP review have also reviewed the Interim Report and have cleared this memorandum.

Recommendation: That you approve intensive review for the preparation of the Project Paper for the Peru Rural Development Agribusiness Fund loan by signing the attached cable to the Mission (TAB A).

Attachments: TAB A - Cable to Lima
TAB B - PRP Guidance Cable - 76 State 296084
TAB C - Interim Report

LA/DR:KK~~ly~~:gah:6/7/77

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16 AUG 1977

PDAAB-417-~~E1~~

INFORMATION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR (LA)

FROM: LA/DR, Charles B. Weinberg

SUBJECT: Issues Paper - Peru Rural Development Agribusiness Fund PP

A DAEC meeting has been scheduled for Wednesday, August 17, 1977, at 2:30 p.m. to review the Project Paper for the \$15 million Rural Development Agribusiness Fund loan to Peru.

Following the review of the PRP for the Agricultural Production and Services Fund, the Mission prepared an interim report in which the project was redesigned to emphasize an agribusiness focus in order to best respond to effective demand for sub-loans. The provision of credit to small farmers for on-farm improvements was dropped as a component of the project primarily because of recent increases in other donor activities in this area. The name of the project was changed to Rural Development Agribusiness Fund to reflect the modification in design.

The purpose of the project is two-fold: (1) to establish in the Central Bank a facility for rediscounting loans made by financial institutions to sub-borrowers which process or market agricultural products or provide complementary goods and services to the agriculture sector; and (2) to establish a program of promotion and development of agribusinesses which will maximize benefits to small farmers and the rural poor. Major constraints to be addressed in working toward achievement of project purpose include: inadequate marketing facilities, lack of adequate processing facilities, unreliable goods and services input industries, and incomplete linkages within agribusiness systems.

Under the project, a \$19.6 million Rural Development Agribusiness Fund will be established in the Central Bank (\$14.7 million in loan funds and \$4.9 million in counterpart) from which sub-loans will be channeled through intermediate credit institutions (ICIs). An additional \$300,000 in loan funds will finance short-term technical assistance (to the Central Bank and ICIs) and training. A Special Unit will be established in the Bank to administer the Fund, and \$100,000 in counterpart funds will finance start-up administrative expenses of the Unit.

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The total cost of the project is \$26.0 million. In addition to the \$5.0 million contribution of the Central Bank, participating ICIs will provide \$2.2 million and sub-borrowers will contribute \$3.8 million. The host country contribution, therefore, is \$11.0 million (42.3%) which exceeds the minimum counterpart contribution required by Section 110(a) of the FAA.

An Advice of Program Change will be required for the project as it does not appear in the FY 1977 Congressional Presentation (it is in the FY 1978 CP as a shelf loan). In addition, the AID funding level has been increased from \$10 million to \$15 million based on a higher demand than originally anticipated and because additional funding will contribute to the institutionalization of the Fund.

The Initial Environmental Examination for the project was submitted with the PRP. The Latin America Bureau environmental committee reviewed the IEE and concurred with the Mission's recommendation for a Negative Determination.

In redesigning the project, we believe the Mission has done an excellent job in addressing the concerns considered important to the project's success or failure. Two final concerns will be discussed by the DAEC:

(1) Funding Level

A demand study, conducted over a limited geographic area, has identified over \$34 million in funding requirements. These requirements have been divided into three categories: ready for implementation (\$6.4 million), at a pre-feasibility stage (\$8.7 million), and at a promotion stage (\$19.0 million). With the majority of the projects identified in the pre-feasibility and promotion stage and given the likelihood that only a percentage of these projects will reach the funding stage, the DAEC will examine the rationale for the proposed increase in project funding to \$15 million.

(2) Target Group

A. Although entrepreneurs who provide services financed through sub-projects are the primary beneficiaries of the project, the small farmer target group will benefit indirectly through lowered input costs, a more stable market for their crops, etc. The characteristics of these small

farmers--e.g., size of land holdings and per capita income--are not identified in the PP. The DAEC will ask the Mission to expand upon the characteristics of the anticipated project beneficiaries as they relate to the mandated target group definition.

B. A constraint facing small farmers which the project is designed to alleviate is an inefficient marketing system. For example, lack of adequate transportation limits the market information available to small farmers. As a result, the few independent truckers willing to buy marketable surpluses are in a position to dictate prices (particularly for perishables) which do not reflect true market value. The small farmers' imperfect knowledge of market conditions leaves them no other option but to sell at the quoted price. In dealing with the problem through entrepreneurs, however, the potential exists for perpetuating the constraint confronting the small farmer rather than reducing it (e.g., updating or adding to the fleet of a transportation firm could tighten its control of market information rather than leading to the improvement of the situation of the small farmer). The DAEC will review the Mission's strategy for assuring that a sub-project will not create a situation in which entrepreneurs can use their improved marketing position to manipulate existing inefficiencies for their benefit.

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AID
EXECUTIVE SECRETARIAT

ACTION MEMORANDUM FOR THE/ADMINISTRATOR
DEPUTY

THRU: ES

FROM: AA/PPC, Alexander Shakow

Problem: To authorize the \$15.0 million FY 1977 Rural Development Agribusiness Fund loan to Peru.

Discussion: The purpose of the project is two-fold: (1) to establish in the Central Bank a facility for rediscounting loans made by financial institutions to sub-borrowers which process or market agricultural products or provide complementary goods and services to the agriculture sector; and (2) to establish a program of promotion and development of agribusinesses which will maximize benefits to small farmers and the rural poor. Major constraints to be addressed in working toward achievement of project purpose include: inadequate marketing facilities, lack of adequate processing facilities, unreliable goods and services input industries, and incomplete linkages within agribusiness systems.

The project emphasizes an agribusiness focus in order to best respond to effective demand for sub-loans. Whereas credit to small farmers for on-farm improvements is an area of recent increase in other donor activities, medium and long-term credit to the agribusiness sector is not available and is a critical gap in the development of the entire agriculture sector. The project, therefore, is designed to establish a new credit channel and stimulate the role of Peruvian financial institutions in the development of a viable agribusiness sector.

Sub-projects financed under the loan will be screened to assure that they will benefit the Peruvian small farmer and rural poor. Toward this end, a methodology has been developed which will test each sub-project against ten factors related to target group impact. These factors include impact on the agriculture sector, number of jobs created both on and off-farm, location, size of farms affected by the sub-project, income effect, number of farm families who will be direct beneficiaries, cost per job created, and impact on women. The weighting system devised for each factor is such that a sub-project must clearly demonstrate target group impact in order to receive a score which will qualify it for financing.

Under the project, a \$19.6 million Rural Development Agribusiness Fund will be established in the Central Bank (\$14.7 million in loan funds and \$4.9 million in counterpart) from which sub-loans will be channeled through intermediate credit institutions (ICIs). An additional \$300,000 in loan funds will finance short-term technical assistance (to the Central Bank and ICIs) and training. A Special Unit will be established

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in the Bank to administer the Fund, and \$100,000 in counterpart funds will finance start-up administrative expenses of the Unit. The total cost of the project is \$26.0 million. In addition to the \$5.0 million contribution of the Central Bank, participating ICIs will provide \$2.2 million and sub-borrowers will contribute \$3.8 million. The host country contribution, therefore, is \$11.0 million (42.3%) which exceeds the minimum counterpart contribution required by Section 110(a) of the FAA.

An Advice of Program Change was sent to Congress on August 24, 1977 as the project does not appear in the FY 1977 Congressional Presentation (it is in the FY 1978 CP as a shelf loan). In addition, the AID funding level has been increased from \$10 million to \$15 million based on, first, a higher demand than originally anticipated and second, the need for greater capitalization of the Fund to ensure its long-run viability.

The Latin America Bureau's Development Assistance Executive Committee (DAEC) reviewed the project on August 17, 1977, and recommended approval.

The DLSC approved the project on September 14, 1977.

Recommendation: That you sign the attached Project Authorization and Request for Allotment of Funds (PAF) form, thus authorizing the Mission to negotiate and sign a loan agreement.

Attachments: TAB A - PAF
TAB B - Project Paper

LA/DR:KKelly:cah:9/16/77:X29484

Clearances
GC:MBall *[Signature]* Date 9/28/77
AA/LA:Avaldez *[Signature]* Date Sep 23/77
SER/FM/C:TRBlacka *[Signature]* Date 9/28/77

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT AUTHORIZATION AND REQUEST FOR ALLOTMENT OF FUNDS PART I		1. TRANSACTION CODE <input type="checkbox"/> A ADD <input type="checkbox"/> C CHANGE <input type="checkbox"/> D DELETE	PAF 2. DOCUMENT CODE 5
3. COUNTRY/ENTITY Peru		4. DOCUMENT REVISION NUMBER <input type="checkbox"/>	
5. PROJECT NUMBER (7 digits) <input type="text" value="527-0159"/>	6. BUREAU/OFFICE A. SYMBOL <input type="text" value="LA"/> B. CODE <input type="text" value="05"/>		7. PROJECT TITLE (Maximum 40 characters) <input type="text" value="Rural Development Agribusiness Fund"/>
8. PROJECT APPROVAL DECISION <input type="checkbox"/> A APPROVED <input type="checkbox"/> D - DISAPPROVED <input type="checkbox"/> DE - DEAUTHORIZED		9. EST. PERIOD OF IMPLEMENTATION YRS. <input type="text" value="04"/> QTRS. <input type="text" value="2"/>	

10. APPROVED BUDGET AID APPROPRIATED FUNDS (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. 1ST FY <u>27</u>		H. 2ND FY		K. 3RD FY	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	I. GRANT	J. LOAN	L. GRANT	M. LOAN
(1) FN	130		010		15,000				
(2)									
(3)									
(4)									
TOTALS					15,000				

A. APPROPRIATION	N. 4TH FY		O. 5TH FY		LIFE OF PROJECT		11. PROJECT FUNDING AUTHORIZED		A. GRANT	B. LOAN
	D. GRANT	P. LOAN	R. GRANT	S. LOAN	T. GRANT	U. LOAN	ENTER APPROPRIATE CODE(S) 1 - LIFE OF PROJECT 2 - INCREMENTAL LIFE OF PROJECT			1
(1) FN						15,000				
(2)										
(3)										
(4)										
TOTALS						15,000				
								C. PROJECT FUNDING AUTHORIZED THRU FY <input type="text" value="81"/>		

12. INITIAL PROJECT FUNDING ALLOTMENT REQUESTED (\$000)				13. FUNDS RESERVED FOR ALLOTMENT			
A. APPROPRIATION		B. ALLOTMENT REQUEST NO. <u>1</u>					
		C. GRANT	D. LOAN	TYPED NAME (Chief, SER/FN/FA) <u>FCD</u> SIGNATURE <u>Merrill Baker Jr</u> DATE <u>9-23-77</u>			
(1) FN			15,000				
(2)							
(3)							
(4)							
TOTALS			15,000				

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

15. FOR AMENDMENTS, NATURE OF CHANGE PROPOSED

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

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON

AID LOAN 527-T-060
(AID-DLC/P-2243)

Deputy
THE ADMINISTRATOR

PROJECT AUTHORIZATION AND REQUEST FOR ALLOTMENT OF FUNDS

Name of Country: Peru
Name of Project: Rural Development
Agribusiness Fund
Number of Project: 527-0159

Pursuant to Part I, Chapter 1, Section 103 of the Foreign Assistance Act of 1961, as amended, I hereby authorize a loan to the Government of the Republic of Peru acting through the Central Reserve Bank of Peru ("Cooperating Country") in an amount not to exceed Fifteen Million United States Dollars (\$15,000,000) (the "Authorized Amount") to assist in financing certain foreign exchange and local currency costs of goods and services required for the Rural Development Agribusiness Fund (the "Fund") consisting of a special rediscount facility within the Central Reserve Bank of Peru (the "Central Bank") for financing agribusiness loans (the "Project"). The entire amount of the A.I.D. financing herein authorized for the Project will be obligated when the Project Agreement is executed.

I hereby authorize the initiation of negotiation and execution of the Project Agreement by the Officer to whom such authority has been delegated in accordance with A.I.D. regulations and Delegations of Authority subject to the following essential terms and covenants and major conditions together with such other terms and conditions as A.I.D. may deem appropriate:

A. Interest Rate and Terms of Repayment

The Cooperating Country shall repay the Loan to A.I.D. in United States Dollars within twenty (20) years from the date of first disbursement of the Loan, including a grace period of not to exceed seven (7) years. The Cooperating Country shall pay to A.I.D. in United States Dollars interest from the date of first disbursement of the Loan at the rate of (a) two percent (2%) per annum during the first seven (7) years, and (b) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

B. Source and Origin of Goods and Services

Except for ocean shipping, goods and services financed by A.I.D. under the Project shall have their source and origin in Peru or in countries included in A.I.D. Geographic Code 941 except as A.I.D. may otherwise agree in writing. Ocean shipping financed under the Loan shall be procured in any eligible source country except Peru.

C. Conditions Precedent to Initial Disbursement

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement, Cooperating Country shall furnish to A.I.D. in form and substance satisfactory to A.I.D.:

- (1) A legal opinion from counsel satisfactory to A.I.D. to the effect that the Project Agreement has been duly authorized and/or ratified by and executed and delivered on behalf of the Cooperating Country and represents a valid and binding obligation of the Cooperating Country in accordance with all of its terms;
- (2) A Supreme Decree and/or a resolution from the Central Bank Board of Directors, as required, authorizing the establishment of the Fund and the creation of a special management unit ("Special Unit") within the Central Bank for administration of the Project;
- (3) Evidence that the above-mentioned Supreme Decree and/or resolution authorizes commercial banks to engage in medium and long-term lending under the Fund and allows rediscounted sub-loans made by commercial banks under the Fund to be counted toward meeting the portfolio coefficient requirements of the selective credit system;
- (4) Evidence that the Special Unit has been created and is in operation with key personnel in place.

5. A plan, identifying timing and amounts pursuant to which the Cooperating Country will contribute not less than \$U.S. 5.0 million to the Project.

D. Condition Precedent to Disbursement for Sub-Lending Under the Fund

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement to finance sub-lending under the Fund, Cooperating Country shall furnish to A.I.D. in form and substance satisfactory to A.I.D.:

- (1) A Credit Manual detailing program concepts, objectives and guidelines for participation by financial institutions including subproject impact determination requirements and eligibility criteria.
- (2) An agreed mechanism pursuant to which the Cooperating Country will maintain the value of the assets of the fund at a level, in Peruvian soles, equivalent to not less than the total value in U.S. dollars originally provided to the Fund by A.I.D. and the Central Bank.

E. Covenants

Cooperating Country shall covenant:

- (1) To review the progress of the Fund's operations periodically and with prior written approval by A.I.D. to adjust the rediscount percentage for eligible loans, if necessary, to elicit the broadest possible participation by financial institutions in the Project;
- (2) To assure that rediscounted sub-loans conform to impact determination guidelines and eligibility criteria specified in the Credit Manual;
- (3) To provide as a contribution to the Project not less than the equivalent of US\$5.0 million in accordance with the agreed plan;

- (4) To maintain the value of the Fund for at least the grace period of the Loan at an amount in Peruvian Soles equivalent to not less than the original dollar value of the resources provided by A.I.D and the Central Bank;
- (5) To maintain interest rates charged to ultimate sub-borrowers of the Fund in line with comparable credit sources available in Peru and to adjust interest rates under the Fund whenever necessary to maintain such comparability.

Richard
Deputy Administrator
9/21/77
Date

Clearance:

LA/SA, RWeber BR (6) Date 9/20/77
LA/DR, CWeinberg 57 Date 9/14/77
LA/DR, WStickel NB Date 9/19
PPC/DPR, EBHogan 3/3 Date 9/28/77
GC, MBall JE 4/1 Date 9/28/77
SER/FM/C, TBlacka 7/21 Date 9/28
AA/PPC, AShakow x Date 9/23
AA/LA, AValdez llc Date 9/23

GC/LA, JLY SL :lb:8/23/77

^x
Signed Action Memo

PROJECT FOR INTERNATIONAL DEVELOPMENT
PROJECT REVIEW PAPER FACSIMILE

PROJECT CODE

PRP

A
 B
 C
 D

DOCUMENT CODE
2

1. COUNTRY (Alpha-3)

PERU

2. DOCUMENT SECTION NUMBER

3. PROJECT NUMBER (Alpha-4)

507 0159

4. BUREAU OFFICE

IA

05

5. PROJECT TITLE (Maximum 40 Characters)

Agricultural Production & Services Fund

6. DOCUMENT DOCUMENT

3

1077

7(a)

7(b)

8. ESTIMATED COSTS (DOLLAR EQUIVALENT)

9. FUNDING SOURCE	FIRST FY			TOTAL	LIFE OF PROJECT		
	B. GRANT	C. LOAN	D. TOTAL		E. GRANT	F. LOAN	G. TOTAL
10. APPROPRIATED TOTAL	2,000	8,000	10,000	2,000	8,000	10,000	
11. LOAN	2,000	8,000	10,000	2,000	8,000	10,000	
12. OTHER							
13. TOTAL	2,000	13,200	15,200	7,200	8,000	15,200	

1. PROPOSED BUDGET AID APPROPRIATED FUNDS (USD)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH CODE		E. FIRST FY 78		LIFE OF PROJECT	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	H. GRANT	I. LOAN
01. PR	130		010		10,000		10,000
TOTAL					10,000		10,000

2. PROJECT PURPOSE (Maximum 400 Characters)

"X" IF DIFFERENT FROM PID

To establish in the Central Bank an effective facility for rediscounting medium-term loans made by financial institutions to sub borrowers which produce, process or market agricultural products or provide complementary services to the agricultural sector poor majority.

14. A CHANGE INDICATOR, WERE CHANGES MADE IN PID FACESHEET DATA, BLOCKS 12, 13, 14, OR 15? IF YES, ATTACH ORIGINAL PID FACE SHEET.

1 - NO
 2 - YES

15. PLANNING RESOURCE REQUIREMENTS (Staff/Funds)

Economist - 1 work month

Development Bank Finance Specialist - 1 work month

15. ORIGINATING OFFICE CLEARANCE

SIGNATURE OF

Donald R. Finberg

Mission Director

DATE SIGNED

MM DD YY
10 8 76

16. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W OCCURMENTS, DATE OF DISTRIBUTION

MM DD YY

I. Priority and Relevance

A. The Problem

The GOP will soon complete the first stage in one of the most comprehensive Agrarian Reform programs ever undertaken in South America, under which over 10 billion hectares will have been adjudicated, affecting over 350,000 farm families. While the political and social benefits of the Agrarian Reform have been substantial, serious economic and financial problems have plagued all but a very few of the newly-formed associative enterprises. Prior to Agrarian Reform adjudication, the majority of privately-held estates were severely decapitalized by their former owners, determined to salvage what was possible of their own financial interests. This initial decapitalization was continued during the first years of cooperative ownership, as the new owners tended to maximize year-end profit distribution rather than carry out optimal reinvestment practices required for recapitalization and financial success.

At the level of the small landholder - individuals maintaining title to individual plots of land - economic difficulties have generally been, if anything, even more serious. Until recently, neither the landowners nor credit institutions have been willing to finance on-farm improvements necessary to realize productivity increases because of the farmer's uncertain land tenure status. As a result, the majority of small privately-owned farms producing food crops are severely undercapitalized.

In recent years the performance of the agricultural sector has been poor; in 1975, the sector grew at a rate of less than 1%, compared to 2.3% and 2.4% in 1974 and 1973 respectively. Domestic production of basic food items has failed to keep pace with the high population growth rate (3.1%). This situation, combined with growing demand for food resulting from increasing disposable incomes among the low economic class in cities has forced Peru to import increasing amounts of food, thus adding to an already deteriorated balance-of-payments position.

The reasons for this decline are varied, and include: (i) the general disruptive atmosphere which can normally be expected to accompany massive land transfers; (ii) an unrealistic system of price levels and subsidies which during a large part of the 1973-76 period gave little incentive to farmers to increase production; (iii) the general inadequacy, both in terms of GOP budget allocations and trained field personnel, of technical assistance to small farmers and the newly created associative enterprises; and (iv) the inadequate supply of medium to long-term agricultural credit and the absence of an effective institutional mechanism capable of channeling resources to those individuals and enterprises for

whom credit is the major constraint to increasing agricultural production or improving processing and marketing.

The first constraint will be alleviated by the end of 1976, when adjudication of land and formation of associative enterprises will have been largely completed. The GOP has also issued definite non-affectability limits for purposes of Agrarian Reform expropriation, thereby reducing uncertainty and increasing the incentive for small and medium-sized farmers to more optimally farm their existing holdings. The second problem, that of price levels, has been largely solved by the removal of most commodity price subsidies, allowing agricultural sector cost and price mechanisms to move toward more realistic levels and increasing on-farm profits and net income. The third, inadequate technical assistance, will continue as a problem for the foreseeable future, although the GOP is making efforts, through such entities as the Ministries of Food and Agriculture, the Agrarian Bank and CENCIRA to provide on-going programs of technical assistance to the Agrarian Reform beneficiaries, both in terms of increasing actual production and improving farm management practices. The extension service is being strengthened and a new national production system is being established which is intended to transfer new production methods. Several A.I.D. programs, including the CENCIRA project and the Federation of Agricultural Cooperatives Loan, have been designed to assist the GOP improve farm management.

Even with improved management practices, however, the fourth constraint - lack of medium-term credit - will remain a major bottleneck to reaching GOP sectoral goals of increased food production, increased value added accruing to the rural sector via agro-industrial processing, and increased employment opportunities and income for Peru's disadvantaged rural population.

Currently the Agrarian Bank is the only financial institution in Peru providing any substantial financial support to the agricultural sector, and the bulk (over 90%) of its own resources are directed to annual production credits guaranteed by farm production. The Bank's major interest and expertise reside in the provision of annual production credit and the sector's needs for such credit will continue to require the Bank's priority attention. Although the Agrarian Bank also administers some medium-term sub-lending credit funds available under international lending programs, there exists a critical need to establish other mechanisms for channeling medium-term resources to Peruvian agriculture if credit is to be expanded.

Prior to the initiation of the Agrarian Reform, commercial banks were able and willing to provide agricultural credit and financing

for the purchase of production equipment, processing equipment, etc. While legal restrictions impeded medium-term lending per se, by rolling over short-term credits longer term financing was effected. Since 1969, however, their participation in the agrarian sector has been greatly reduced, since they have considered both the newly-formed associative enterprises and the sector's remaining individual farmers to be high-risk borrowers. The supply of credit is therefore severely restricted and has not kept pace with the sector's growing requirements.

B. Proposed Response

As a means of alleviating the above problem the present Project proposes to facilitate the re-entry of certain Peruvian commercial banks, along with appropriate regional and state development banks, into agriculture and agro-industry. Thus, the Project proposes to establish within the Central Bank an effective facility for refinancing medium-term loans made by financial institutions to sub-borrowers which produce, process, or market agricultural commodities or provide complementary services to the agricultural sector.

The existing infrastructure of the Peruvian banking system with its large number of branch offices located throughout the country would appear to be a logical conduit for reaching those relatively poor individuals and enterprises requiring, and capable of utilizing credit. Indeed, Peru can hardly afford to let this infrastructure remain idle. The challenge of the proposed project is to create the necessary incentives to obtain the desired credit allocations to the agricultural sector and the target group to be reached under the Congressional Mandate in particular. The Mission believes that the chances of success are now high, given the fact that agrarian reform related disruptions have been diminished and that pricing policy has been changed to increase production incentives.

The proposed Project falls within USAID's general priorities for development assistance as the DAP identified the agricultural sector as the primary area of USAID concentration. USAID priorities include: (1) a commitment to develop and implement projects designed to benefit Peru's poorest majority; (2) priority emphasis on development of the agricultural sector and increasing food production; and (3) assistance in the development and strengthening of institutions capable of mobilizing resources to the agricultural sector.

II. Description of the Project

A. Brief Description

The Borrower and Executing Agency will be the Central Reserve Bank of Peru. The Project will establish a rediscount mechanism to finance medium-term credits destined to increase food production and related agro-industrial sub-projects meeting eligibility criteria through the banking system. The Project's target group of small farmers and food-producing associative enterprises created as a result of Agrarian Reform will benefit both as direct sub-borrowers for the medium-term production credit and indirectly through sub-loans made to agro-industrial enterprises providing marketing, processing, or complementary services to the designated target group. The Project aims at institutionalizing a new medium-term credit channel, increasing access to credit, stimulating bank participation in agricultural sector development lending, and achieving a greater out-reach to rural areas by incorporating existing banking infrastructure as credit suppliers to the agricultural sector.

B. Project Components

The proposed Project consists of three major components: (i) a Special Fund (Fund) set up within the Central Reserve Bank which will have the objective of facilitating medium-term credit for eligible sub-projects; (ii) a technical assistance component designed to establish within the Central Bank a system for the systematic evaluation of the proposed line of credit, as well as other on-going or to-be-established credit lines within the Bank; and (iii) establishment of a special office for Fund administration and to promote the participation of intermediate credit institutions (ICI's) under the Project.

1. The Special Fund. Capitalization of the Fund (subject to final demand analysis) is expected to be on the order of \$14.7 million including \$9.8 million from the A.I.D. Loan and \$4.9 million from the Central Bank. Sub-loans will be identified by and channeled through financial intermediaries, including private and state-associated commercial banks, selected state development banks, regional development banks, and private 'financieras'.

Through a circular directed to the banking system, the Central Bank would advise financial institutions of the criteria for lending under the program with particular reference to the type of projects, sub-loan size restrictions, terms, target group eligibility restrictions, etc. The Central Bank would also carry out an active promotion campaign. Sub-borrower wishing to develop or increase the production, processing, or marketing of an eligible product would present an application to

the intermediate bank of his or her choice. The intermediate bank would make the credit judgment and assume the credit risk. Upon approval by the intermediate bank, the sub-loan would be presented to the Central Bank for refinancing. The Central Bank would check the proposal for conformity with the established criteria, but would not review sub-project economic or financial feasibility, and would authorize the transfer of funds to the intermediate bank for approved sub-projects. All collection responsibilities will rest with the intermediate banks.

The following criteria for sub-lending represent preliminary Central Bank and USAID ideas for the program's operations, although they will need to be further studied and negotiated:

a. Target Group - Food producing associative enterprises and small individual landowners cultivating less than 15 hectares. Sub-borrowers would include members of the target group as well as agricultural processing, marketing, and service industries which directly benefit the target group.

b. Interest Rate - In line with AID/W's guidelines offered in response to the PID, the Mission has obtained Central Bank concurrence with an upward adjustment of the interest rates to end-users to 14%. As presently envisioned, the 14% would be divided 7% to the ICI, 5% to the Central Bank, and 2% to an insurance fund which would be redistributed to participating ICI's to off-set bad debts. Periodic adjustments in the interest rate and spreads would be permitted depending on inflationary trends and changes in overall Central Bank interest rate policy.

c. Terms - Medium-term sub-loans (up to 5 years).

d. Maintenance of Value - Sub-loans from the Fund will be denominated and repaid in local currency with no maintenance of value provision. The Central Bank would covenant to make additional contributions to the Fund to prevent its decapitalization, per a formula and for a time period subject to negotiation.

e. Possible types of Sub-loans - In the case of sub-loans made directly to associative enterprises and individual farmers meeting the target group eligibility criteria the following are illustrative:

--acquisition of improved breeds for dairy, pork, or poultry production;

--purchase of machinery (tillers, plows, irrigation equipment, tractors, incubators, etc.);

- construction or renovation of on-farm physical infrastructure (irrigation canals, sheds, silos, stables);
- land habilitation (clearing, leveling, drainage, erosion control); and
- medium-term working capital.

Additionally, sub-loans may be made to commercial, service or industrial establishments not directly owned or operated by farmers or farm groups, but which provide services to the target group. Such sub-projects will be eligible if it can be demonstrated in the sub-project applications that the sub-project will substantially contribute to the welfare of the target group through such means as stimulating production, increasing value-added to farmers, increasing target group farmers' profit margins by organizing economies of scale in the marketing, grading, sorting, storing, transport or processing of food production, and increasing employment opportunities. Example of potential sub-projects under this credit category include equipment acquisition, and construction or expansion of off-farm storage facilities, product collection centers and processing plants.

f. Commodity Emphasis - The Fund would be restricted for sub-lending intended to increase the production, processing or marketing of food crops (principally cereal grains, oilseeds, tubers, animal protein, fruits and vegetables).

g. Allowable Percentage of Refinancing - The Fund would refinance 100% of ICI sub-loans meeting eligibility criteria.

h. Sub-Borrower Equity Contribution - In order to be able to reach the poorer, more decapitalized associative enterprises and individual farmers, sub-lending would not be conditioned upon specific equity contributions by the end-use, sub-borrowers.

i. Sub-Loan Size Restrictions - These will need to be determined based on further study of the characteristics and absorptive capacity of the target group and potential sub-borrowers. Distinct maximum limits will be established for associative enterprises, individuals and agro-industrial enterprises.

2. Technical Assistance/Evaluation

The Project will provide limited funding to improve the design and implementation of a mechanized credit data bank within the Central

Bank and to establish a systematic evaluation system which will be utilized by the Bank to determine the success and impact of the Fund, as well as to evaluate other credit activities of the Bank. A major problem encountered in Peru is the lack of accurate base line data and an institutionalized system by executing agencies to measure project success or failure. The Bank has recently set up a documentation center, and has its own computer system which could serve as the basis for the implementation of a specialized credit data bank. During the course of PP preparation, the Bank and USAID will prepare a study showing the operations of such an evaluation system, which among other things, would include: (1) a methodology for sampling existing conditions at the sub-borrower level; (2) periodic data-gathering on use of sub-loan funds; (3) end-of-sub-project status, including information on production levels, income levels and employment creation. The Loan would provide funding for technical assistance to assist with the design and carrying out of the evaluation methodology.

Additional Loan funds are tentatively allocated for technical assistance to assist with Project promotion should such needs be confirmed during the intensive review. For example, it may be necessary to institute special courses in agricultural project analyses and evaluation techniques and to support limited field promotion activities.

3. Fund Administration

The third component - administration - will be entirely a Central Bank contribution to the Project. The Bank will create a special office with adequate staffing within its Credit Division for the purpose of administering the Fund.

Given the fact that ICI financial participation in the agricultural sector has dropped significantly since the 1960's, it will be necessary for the Central Bank to actively promote banking system participation under the Project. The first step will be to institute short courses -- either in Lima or in selected regional sites, -- on objectives and mechanisms of the Fund. These will be staffed and funded out of Central Bank counterpart funds, with the goal of reaching at least the branch manager level of all participating ICI's. Follow-up seminars may be necessary as operational experience is obtained and to disseminate results of Project evaluation.

C. Anticipated Results

By providing the above inputs the following outputs are anticipated: (i) \$14.7 million of sub-loans over the three year life of the Project; (ii) approximately twelve ICI's participating under the program;

(iii) sub-lending directives distributed and periodically revised; (iv) promotional seminars held reaching ICI branch office managers; and (v) an evaluation system established. Such outputs are necessary to achieve the Project purpose of establishing an effective, permanent rediscounting facility. At the end of the Project we would expect that all Project funds will have been placed in sub-projects meeting eligibility criteria, the Fund will be institutionalized with a demonstrated capability to maintain its level of refinancing, the real capital value of the Fund will be equal to at least \$14.7 million, banking system participation in agricultural sector lending will have increased, and the Fund will continue as an effective and functioning system to promote and finance eligible sub-projects. (See Annex I for the full matrix depiction of the logical framework including important assumptions).

III. A.I.D. and Other Relevant Experience

A. Past Programs and Actions in Peru

As briefly described below, A.I.D. has participated in the recent past in medium-to-long-term sub-lending activities to the agricultural sector in four previous loans, with a fifth loan expected to commence activities shortly. The Mission hopes to capitalize upon past successes and failures of these programs to insure that both Project design and implementation conform to GOP needs and priorities and that the execution phase can be carried out without undue burden on existing administrative structures.

Loan 527-L-051, the Private Investment Fund (PIF), was originally administered by the Central Bank, but subsequent organizational changes eventually placed the Fund under the auspices of COFIDE, the State Financial Development Corporation, which was inexperienced and under pressure to secure priority financing for state enterprises and the newly-created Social Property sector (neither of which qualified for sub-loans under the PIF). The PIF thus received little attention from COFIDE and the bulk of loan funds were deobligated in 1976. Major factors contributing to the Project's lack of success were changing governmental priorities vis-a-vis the private sector; a deteriorating investment climate following 1968; fund administrative changes; lack of adequate incentives for banking system participation; overly complex operating criteria; processing bottlenecks and unanticipated, excessive bureaucratic delays.

Two Supervised Agricultural Credit Loans (054 and 056) provided medium-term sub-loans through the Agrarian Bank Trust Fund to small farmers and agricultural cooperatives which suffered damages in the 1970 earthquake and the 1972 floods. In both the earthquake and flood areas,

the agricultural sector suffered severe decapitalization as a result of the disasters, and loan funds were intended to assist in agricultural recovery and recapitalization. In both areas the demand for credits under these programs greatly surpassed the supply of funds. The majority of sub-loans were used to purchase machinery and equipment, with lesser amounts going for small river defense works, crops and livestock.

Loan 527-W-057, Rural Enterprises Development, provides \$6 million to the Industrial Bank of Peru for relending to rural enterprises in the departments of Cuzco, Puno, Ayacucho, and Junin and \$4 million to ORDEZA for credits to sub-borrowers in the Earthquake Zone. The program aims at rural industries and trade rather than agricultural production or marketing per se. Under the program, much sub-project identification and development begins with and is the responsibility of GOP executing agencies rather than the credit recipients and sub-projects require a considerable input of technical assistance from the moment of sub-project identification through development, study, and implementation.

Progress has been slower than desirable under the Loan, particularly as a result of processing bottlenecks and administrative difficulties. Industrial Bank activity has increased considerably in recent months, however, and the Bank is turning to consulting firms to perform needed feasibility studies and thereby break the processing bottleneck. USAID will undertake a review of both portions of the Loan in November to provide the basis for recommendations to AID/W regarding the Loan's future.

Finally, the recently signed Loan 527-T-058, in the amount of \$7.0 million for Agricultural Cooperative Federations (Centrals) Development will play an important role in strengthening the organizational, financial, and institutional bases of up to 20 Centrals. Following the completion of detailed development plans, financing will be available for short-term working capital requirements, medium-term investment to improve the services provided by Centrals to member organizations, and medium-term project investment. The thrust of the program will be on improving the integration of the member associative enterprises into the second level federations, and the services offered by the Centrals. Thus, the focus of the Loan is distinct and more narrow than envisioned under the proposed Project, and in any event, the preliminary credit supply/demand analysis of Section V.B. indicates a large medium-term credit supply gap even considering 058 availabilities and other possible credit programs through 1980.

B. Applicable A.I.D. Experience in Other Countries

Central Bank rediscount mechanisms have been successfully established in other Latin American countries including Bolivia and Uruguay. The Bolivian Central Bank's Fondo de Refinanciamiento Agrícola, which was successfully established by A.I.D. Loan 511-I-042 and which is now being reoriented and augmented by Loan 511-T-052, has many similarities to the proposed Project. The proximity of Peru and Bolivia may provide the opportunity for an interchange between the two Central Banks regarding Bolivia's experience. The IDB has also provided loans to successful Central Bank agricultural rediscount operations in Mexico, and the Mission will seek information on these and other similar programs during the intensive review.

In addition, the Mission is aware of a recently authorized A.I.D. loan to Paraguay to establish in the Central Bank a rediscount facility for agribusiness projects serving a small farmer target group. The Mission is particularly interested in, and intends to study, the screening process and eligibility criteria established under the program for ensuring that sub-projects benefit the target group.

IV. Project Beneficiaries

The farmers comprising the target group of this Project are among Peru's poor rural majority, both individual small farmers and members of associative enterprises producing food for domestic consumption. While incomes vary widely in the rural sector, they are substantially below the national averages (with the possible exception of the large and relatively affluent sugar estates which will be excluded under this Project). By eliminating the export-oriented associative enterprises and individual farmers cultivating more than 15 hectares, the Mission will be able to assure that actual beneficiaries fall into those categories anticipated under A.I.D.'s Congressional Mandate.

The size of the potential target group is estimated at 193,000 farm families or, assuming six members per family, 1,158,000 rural inhabitants, both members of food producing associative enterprises and small individual landholders. (Annex II) The target group will benefit directly as sub-borrowers in the case of credits for on-farm investments to boost food production and indirectly as a result of sub-loans made to agricultural processing, marketing and service industries when it can be shown that such credits will alleviate constraints to increasing target group farmers' productivity and income. Concerning the latter, the availability of service-oriented enterprises, such as transport, packing, grading and sorting, is viewed as a necessary condition for incentivating production by small farmers, while processing industries can contribute to a more secure market for individual production. In addition, agro-industry can provide employment

opportunities for the landless and extremely small-scale farmers, most of whom cannot be economically absorbed into the associative enterprise structure given ever-increasing pressures on the land.

The first segment of the target group is the associative enterprises. At present there are 1,108 such enterprises created as a result of the Agrarian Reform, with varying degrees of profitability and poverty, depending on soil and land configuration conditions, crop mix, and the level of capitalization existent after adjudication. Generally, the 417 associative enterprises which are oriented toward the export sector -- principally sugar and cotton -- are relatively better off. These export-oriented associative enterprises; i.e., those with more than 50% of their cultivable area devoted to such crops, have been excluded from the Project's target group as their levels of profitability permit them access to alternative credit sources and incomes of their member farmers/workers are relatively higher than other rural families.

The remaining 691 associative enterprises which produce food crops for domestic consumption are expected to be a major category of sub-borrowers and beneficiaries under the Project. Members of these enterprises are considered to be economically marginal, with per capita incomes ranging between \$100 and \$400 a year, depending on geographic location and crop mix. It is estimated that 70%, or 552 of these enterprises could benefit under the program either as direct sub-borrowers or through sub-loans to agro-industrial enterprises serving them.

During the intensive review, detailed profiles of selected food-producing associative enterprises will be prepared with a view toward determining principal production and income constraints, likely investment requirements, probable sub-loan sizes, and necessary sub-loan size restrictions.

The second segment of the target group includes small individual farmers cultivating less than 15 hectares, particularly those who possess sufficient production potential to generate marketable surplus and are in a position to utilize credit. Excluded from the target group will be the very few remaining large farmers in Peru including extensive livestock producers, all of Peru's medium-sized farmers (generally those cultivating 15-50 hectares), and small individual producers of the previously mentioned export commodities. The total universe of small farmers is estimated to be on the order of 900,000 to 1,000,000 in Peru. Of these, the greatest number -- estimated at 500,000 -- currently farm at a subsistence level on plots generally smaller than one hectare. Despite major strides made by the Agrarian Reform in land distribution to former landless peasants,

there simply is not -- nor will there ever be -- sufficient land to go around for all the current rural sector inhabitants. Thus there is a large portion of the rural poor who continue to be landless or possess such small plots of land that they are effectively out of range as direct beneficiaries in the form of credit recipients. The World Bank warns, in its 1975 Agricultural Sector Survey of Peru*:

"The mission believes that many farms, probably over half a million, are so small in terms of potential output, that their owners should not be considered potential borrowers of commercial-type credit... Credit can only aggravate the plight of these people..."

Possible direct Project beneficiaries are, rather, among the estimated 100,000 small commercial farmers now producing partly or entirely for the market but without access to institutional credit, and to a lesser extent among the 300,000 to 400,000 largely subsistence farms with sufficiently unused potential to generate marketable surplus. Assuming that 10% of the former and 5% of the latter group might be reachable, an additional 27,500 potential farm family beneficiaries are identified.

Obviously the present Project will not be equipped to handle some 27,500 individual and 552 associative enterprise sub-loans, and many of the projected beneficiaries will be reached indirectly through sub-lending to agro-industrial enterprises for sub-projects which contribute to the welfare of the target group. The demand study to be carried out during the intensive review will attempt to determine the most likely combination of direct and indirect beneficiaries, likely credit allocations, and sub-loan amounts to insure that the maximum number of beneficiaries consistent with administrative capability are reached.

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V. Factors Affecting Project Feasibility

A. Administrative Feasibility

1. Primary Executing Agency - the Central Bank

As indicated above, the Central Bank will serve as Borrower and Executing Agency for the Project. From its position as the center of the Peruvian banking system, the Central Bank makes and implements GOP monetary policy and regulates operations of all banks in Peru. Its basic objectives are: i) to maintain monetary stability; ii) to promote credit availability and allocations to insure economic growth, production and real income increases, and a high level of employment; and iii) to strengthen the banking system.

The chief official of the Central Bank is the President of the Board, but the policy-making power rests with the full membership of the Board of Directors, composed of high-ranking officials of the Ministry of Economy and Finance and representatives from the major state-managed banks and the private sector. Responsibility for implementing Bank policy rests with the General Manager, five Managers, and three Deputy Managers, all highly-qualified professionals having considerable experience with the Central Bank and other major financial institutions in Peru.

Organizationally the Central Bank is divided into the following five major divisions: Credit and Financial Control; Treasury and Accounting; Administration; Economic Studies; and Foreign Operations. The principal office is located in Lima, with branches in Piura, Trujillo, Arequipa, Cuzco, and Iquitos. As the Credit Division is responsible for administering the Bank's other credit lines and rediscount activities, the Central Bank has indicated its intention to create a special office with full-time personnel within the Division for the purpose of carrying out the Project.

The Project is administratively attractive in that the Central Bank has ample applicable experience with other rediscount operations and long-established relationships with the banking system. For example, the administrative feasibility of the rediscounting mechanism has been demonstrated in the successful operations of the Central Bank's on-going Selective Credit Program. The program was established in the Central Bank in 1971 in an effort to promote credit decentralization and regional development by refinancing projects approved by the state associated and regional development banks. The program is for short-term loans only (generally 180 days). As of June 30, 1976, the outstanding balances of credits effected by the associative and regional banks under the program totalled \$7.37 million.

The Central Bank also administers special lines of short-term credit destined to the state development banks (principally the Agrarian Bank, Industrial Bank, and Mining Bank). The outstanding balances of the Bank under these credit lines to the development banks totalled approximately \$320.2 million at the end of 1975.

Finally, the Central Bank is familiar with A.I.D. Loan implementation requirements. The Bank acquired applicable experience in serving as the fiduciary for the CRECE fund established under A.I.D. loan 527-L-053 which was designed to assist small enterprises located in the Earthquake Disaster Area. The Central Bank capably fulfilled its responsibilities under the program.

In conclusion, the Mission believes the Central Bank possesses the capacity to successfully execute the Project. It has carried out all of the above activities with no noticeable impairment to or erosion of the performance of its traditional functions. The addition of the Special Fund to its activities will not create a major resource drain away from the Bank's financial and economic management duties. The Bank has a keen interest in financing development and in seeing that the sectoral allocations of credit are supportive of the GOP's overall development strategy. Channeling the loan through the Central Bank will enable much of Peru's financial system, including two state development banks, to participate in the Project. The choice enables the use of existing lending infrastructure, as described below, without excluding the participation of traditional agricultural and agro-industrial lending institutions.

2. Secondary Agencies - Participating Intermediate Credit Institutions (ICI's)

The Central Bank estimates that there are 25 potential ICI's which may participate under the Project, with a total of 356 offices located throughout the country outside of the provinces of Lima and Callao. The potential ICI's may be categorized according to mode of ownership and functions as follows: i) the state development banks; ii) the associated banks, in which the GOP has acquired a majority interest; iii) private commercial banks with nation-wide operations; iv) regional banks both state and privately-owned, which are chartered in a geographically limited area, and v) private empresas financieras (development finance companies).

There are five state development banks in Peru of which only two are expected to participate under the Project: the Agrarian Bank and the Industrial Bank. The Agrarian Bank is the largest supplier of credit to the agricultural sector, offering lines of credit for the purchase of annual farm

production inputs, the expansion and improvement of farming and livestock enterprises, the purchase of capital equipment, activities related to commercial and protective forestry, and the marketing and storage of agricultural products. Its authorized clientele include agrarian service and production cooperatives, SAIS, other reformed agricultural production units, and individual landowners. The interest rates on loans range from 10 to 14% depending on maturity, amount of loan, borrower, and use of loan proceeds.

The Industrial Bank (BIP) offers credit to a wide range of industrial borrowers, including several which will fall under this Project, namely those involved in agri-business marketing, conservation, and processing of basic foodstuffs. The BIP lends to both individuals and to reformed enterprises (including industrial communities, social property enterprises, and cooperatives). Interest rates applicable to the sectors to be included in this Project currently range from 11 to 15.5%, plus a maximum commission of 2%, again depending on the maturity and amount of the loan, the borrower, and the end use of the loan proceeds. Amortization periods extend up to seven years, with grace periods of usually six months.

The commercial banking system is composed of the associated, the private, and the regional banks. The associated banks are those in which the government has acquired a majority interest; these are the Banco Popular del Perú, Banco Internacional del Perú, and the Banco Continental del Perú. The private banks are principally represented by the Banco de Crédito del Perú and several international banks. Additionally, there are six regional banks, the Banco Regional del Norte, the Banco Nor-Perú, the Banco de los Andes, the Banco Sur-Medio, the Banco Sur del Perú, and the Banco Amazónico; the coverage of these regional banks is greatest along the north and south coast and in the southern and central sierra, although there exists at least one regional bank for each major geographic zone of the country.

Banking policies of all these commercial banks are similar. In general, they extend credit to all economic sectors and to borrowers who may be individuals or groups, reformed or traditional.

The current maximum interest rate is 15.5% plus a commission of up to 2%. In addition to these normal credit lines, the associated banks and the regional banks, as eligible participants in the Central Bank's Selective Credit Program, offer preferential credits in selected economic activities considered of special importance to regional economic development.

Interest rates to sub-borrowers under this program have been 11% or 12%, depending on the geographic region.

Finally, there are six private "financieras" in Peru, which provide medium and long term credit for investment and development purposes. During the course of Project Paper preparation, the Mission will examine the extent to which these financieras might participate under the Project.

Based on USAID and Central Bank discussions with the banking system regarding the proposed Project, the most active Project participants are likely to be the associated banks, regional banks, and perhaps to a lesser extent the two state development banks. For the PP, the Mission will explore certain aspects of administrative feasibility specific to the proposed Project which focus on these, and other potential agencies' capacity and willingness to service the Project's target groups. As stated in the PID and repeated in Part I above, the Project expects to reintroduce banking institutions to lending in the agricultural sector. The extent to which their organization and staff is able to respond effectively to new clientele and different kinds of investment programs will require further analysis. First, investment decisions for agricultural sub-projects may require certain technical expertise which may not currently exist in the participating banks. Second a significant promotional effort is likely to be required. As the intended Project beneficiaries represent a new clientele to most banks, promotion of the Project will, to be effective, necessitate innovative programs.

The degree of field promotion to be required, and the best means to achieve this, will need to be examined during the intensive review. In addition, the ICI's likely collateral requirements, and ability of the target groups to provide that collateral, will need to be studied. Finally, since the credit risk associated with this Project is bound to be higher than that which has traditionally been assumed by banks in Peru, it will be necessary to continually evaluate the adequacy of the incentives for banking system participation.

B. Economic Feasibility

1. Credit Availability Analysis

One of the key problems in the agricultural sector is the lack of sufficient medium-term credit to allow the GOP to carry out its ambitious plans to rationalize and modernize the beneficiaries of the Agrarian Reform and to improve the production potential of Peru's individual farmers. The

major supplier of credit to the sector is the Agrarian Bank, whose paid in capital at the end of 1975 was \$53.3 million, considerably short of its authorized capital ceiling of \$230.8 million. It was originally anticipated that the Agrarian Bank's capital would grow steadily at a rate of about \$46 million per year until it reached its authorized limit, but Bank officials report that, given the current economic crisis, it is doubtful that the Ministry of Economy and Finance will be able to release additional capital in the near future.

Since 1968, the Bank's policies for lending have changed significantly, and current priorities are to give preferential treatment to associative enterprises. In 1975 66% of total amounts authorized by the Bank went to these groups, as compared to 27% in 1970. During 1975 the Bank extended over 65,000 sub-loans totalling approximately \$230 million at the current rate of exchange. Of these approximately 98% of the number of sub-loans and 91% of the amounts were directed for short-term, crop production campaign purposes. Long-term loans have generally been made using external sources (IBRD and IDB). Despite progress in increasing the supply of credit, the Bank itself estimates that the real need for agricultural credit is still on the order of \$444 million. Given the insufficiency of the Bank's paid in capital, however, it is doubtful that existing shortfalls can be taken up.

Table I shows the Agrarian Bank's projections for long-term credit availabilities over the period 1976 to 1980, considering existing and potential programs relying on external sources. Even assuming new loans from the IBRD and IDB, the table shows that a large amount of "traditional demand" will need to be financed internally or elsewhere. This item covers on-farm improvements as well as services and farm level agro-industry. During the intensive review, USAID and the Central Bank will explore the validity of the Bank's long-term credit projections.

Considering other credit availabilities, the participation of commercial banks in the agricultural sector has dropped considerably over the past decade. While agricultural lending accounted for 8.8% of total commercial bank lending in 1965, this percentage had dropped to 1.9% in 1975. Commercial bank participation in the livestock sector also has fallen slightly, from 2.2% in 1965 to 1.4% in 1975. Finally, the Industrial Bank, in 1975, devoted 6% (approximately \$6.6 million) of its loan portfolio to the food processing industry, falling slightly from the previous year when 8% of loans went to that sector.

TABLE I

FINANCING NEEDS AND PROJECTED AVAILABILITIES OF THE
AGRARIAN BANK FOR MEDIUM TO LONG TERM CREDIT
(in millions of U.S. Dollars)*

PROGRAM	Year				
	1976	1977	1978	1979	1980
I. TOTAL NEEDS	<u>30.8</u>	<u>40.3</u>	<u>45.3</u>	<u>52.5</u>	<u>65.0</u>
II. AVAILABILITIES					
<u>-IBRD 933</u>	<u>9.2</u>	<u>6.8</u>	<u>-.-</u>	<u>-.-</u>	<u>-.-</u>
Financ. External	6.9	5.1	-.-	-.-	-.-
Financ. Internal	2.3	1.7	-.-	-.-	-.-
<u>-IDB 322</u>	<u>5.8</u>	<u>-.-</u>	<u>-.-</u>	<u>-.-</u>	<u>-.-</u>
Financ. External	-.-	-.-	-.-	-.-	-.-
Financ. Internal	5.8	-.-	-.-	-.-	-.-
<u>-AID 058 (CENTRALS)</u>	<u>-.-</u>	<u>0.6</u>	<u>1.6</u>	<u>2.7</u>	<u>-.-</u>
Financ. External	-.-	0.6	1.6	2.7	-.-
Financ. Internal	-.-	-.-	-.-	-.-	-.-
<u>-New IBRD (assumed)</u>	<u>-.-</u>	<u>4.3</u>	<u>13.3</u>	<u>15.3</u>	<u>2.8</u>
Financ. External	-.-	3.1	9.4	10.8	1.9
Financ. Internal	-.-	1.2	3.9	4.5	0.9
<u>-New IDB (assumed)</u>	<u>-.-</u>	<u>5.2</u>	<u>10.4</u>	<u>6.2</u>	<u>1.1</u>
Financ. External	-.-	3.9	7.8	4.6	0.8
Financ. Internal	-.-	1.3	2.6	1.6	0.3
<u>-IDB (Irrigation)</u>	<u>6.6</u>	<u>8.8</u>	<u>3.6</u>	<u>0.6</u>	<u>0.5</u>
Financ. External	3.5	4.9	2.1	0.3	0.2
Financ. Internal	3.1	3.9	1.5	0.3	0.3
<u>-AID 059 (Sierra Irrigation)</u>	<u>-.-</u>	<u>-.-</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>
Financ. External	-.-	-.-	0.3	0.3	0.3
Financ. Internal	-.-	-.-	0.7	0.7	0.7
III. TRADITIONAL DEMAND REMAINING TO BE MET					
	<u>9.2</u>	<u>14.6</u>	<u>15.4</u>	<u>26.7</u>	<u>59.6</u>
	9.2	14.6	15.4	26.7	59.6

SOURCE: Oficina de Planificación y Estudios Económicos,
Agrarian Bank. Julio, 1976

* Calculated at S/.65 per U.S.\$1.00

2. Demand Analysis

It is the opinion of both USAID and the Central Bank that substantial demand for medium-term credit exists in the agricultural and agro-industrial sectors. A major task to be carried out during the course of PP preparation will be to test this hypothesis, and quantify effective demand.

Demand will be calculated on the basis of two distinct methodologies. First, the target group of beneficiaries will be studied, to determine the absorptive capacity of the target group of associative enterprises and small farmers, and potential service, marketing and agro-industrial sub-borrowers serving the target group. While Section IV (Beneficiaries) gives a very preliminary analysis of the probable absorptive capacity of associative enterprises and small farmers, more accurate estimates should be obtainable by reviewing data from regional banks and State development banks outside of Lima. In addition, a survey will be conducted to determine the potential magnitude of readily financeable projects meeting eligibility criteria. The experience of the Industrial Bank under Loan 527-W-057 will also be evaluated to assist in making projections.

A second methodology to be followed will be crop or product specific instead of beneficiary specific. This analysis will determine medium-term investments required to meet GOP production targets in selected food crops and livestock production and increase processing capacity in selected areas. The Central Bank has identified the following crops either for production or associated agro-industrial activities as a possible focus for the Project, which also correspond to first priority areas identified in GOP planning documents: potatoes, rice, wheat, beans, fruits and vegetables, corn, sorghum, edible oils and fats, dairy, animal proteins (pork, poultry, eggs, mutton), and balanced feeds.

Comparing the two analyses, -- that concentrating on beneficiaries and that looking at production estimates -- should give the Mission more accurate projections of loan disbursement possibilities. The PP will further indicate the potential economic benefits of the Project by presenting several "model", readily financeable, sub-projects, to illustrate the impact of the credit program on the welfare of the target group of small farmers and basic food producing associative enterprises. This should enable the Mission to make global projections of the Project's potential impact on production, incomes, and employment.

C. Socio-cultural Feasibility

The Mission does not foresee any significant socio-cultural obstacles to successful implementation of the project, since it will be financing activities in large measure familiar to the target group. The project does not involve major shifts in technology, social organization, or cultural norms, and therefore does not rely on the target group's acceptance of change in its basic patterns and institutions. Nor is it likely to create new sources of social frictions. Therefore, it is the Mission's preliminary judgment that this project will prove feasible from a socio-cultural standpoint.

One question which merits the Mission's closer examination in the course of the preparation of the PP is the potential employment impact of the Project. This relates to the kind of investments which are likely to be made with the credit available under the Project and the degree to which they may displace labor on one hand and introduce demand for additional labor on the other. The likely net employment impact of the Project will be the subject of further study by the Mission. Some consideration to building in incentives for labor-utilizing investments may be warranted.

Another question to be examined is the incidence of Project benefits in the rural sector, and its likely effect on the patterns of future growth of the sector. As indicated in Section IV ("Beneficiaries"), a significant portion of the rural population is not expected to directly participate under this Project, since, lacking adequate natural resources to absorb capital, they are not in a position to effectively use credit. The gap between this group and those who will receive credit under the Project will no doubt widen as the latter group capitalizes its production and processing operations. The prospect of this widening gap, then, will introduce the urgent need to respond to the special conditions of those minifundistas who cannot make a living off the land. The alternatives appear limited to the expansion of the natural resource base primarily through irrigation, the generation of off-farm income and employment opportunities, and resettlement in areas with greater production potential. Several A.I.D. and GOP programs have been designed to support some or all of these alternatives. Similar investments should continue parallel with this Project to mitigate any skewing in the distribution of rural income.

Considering the role of women, the Project has no feature which would preclude the participation of Peruvian women nor restrict their access to Project resources. Since on many small farm enterprises the production and marketing of poultry, eggs and milk are the responsibility and in the hands of women of the family, there will be some positive impact

expected on the direct involvement of women in income growth at the small farm level. During the intensive review, the Mission will need to consider the extent to which the Project may contribute to more fully integrating women into the economy of the rural sector.

D. Financial Feasibility

1. Proposed Interest Rates

The proposed rate of interest from the Fund to final borrowers is 14 percent. It should be recognized that this is somewhat lower than the 15.5 percent annual interest charge (plus 2% commission) which commercial banks charge at present. However, it is not significantly different from the 14.5 percent charge by Housing Banks and the "Mutuales de Vivienda" and the 14.5 percent charge by the Banco Central Hipotecario. Most importantly, it is at the top of the rates charged by the Agrarian Bank (10-14%), the major supplier of comparable credit to the sector. It should also be noted that the interest rates presently in effect represent increases permitted in June, and that previously commercial banks could charge only 12 percent annual interest plus 2 percent commission. Continuation of inflation at historically high levels may induce the GOP to make further upward adjustments in nominal interest rates. Sufficient flexibility should be permitted in the proposed Loan to accommodate any further upward revisions in the GOP's global interest rate policy.

2. Adequacy of Proposed Incentives

The interest rate spreads which commercial banks obtain on their alternate funding sources; i.e., their bank deposit liabilities, may be calculated and compared to the proposed spread under the Project. The bulk of the local currency loan portfolios of commercial banks are financed from bank deposit liabilities. In preparing the calculations presented in Annex II, Table II, we assume (i) that banks receive 17.5 percent annual interest on loan portfolios (inclusive of commissions), (ii) that each bank's loan portfolio is equal to its demand, time and saving deposits less legal reserve requirements, and (iii) that demand deposits bear an annual interest of 2 percent, time deposits bear an annual interest of 1.5 percent, and savings deposits bear an annual interest of 9.0 percent. The assumption in regard to time deposits is a simplification because annual interest is based on the term of the deposits, 10% for periods from 90 to 179 days, 11% for periods from 180 to 269 days, 12% for periods from 270 to 359 days, and 13% for periods over 360 days.

Concerning reserve requirements, the Central Bank is planning a substantial change prior to the end of 1976. The new legal reserve requirements will set a reserve requirement of 46 percent on demand deposits and 31 percent on time and savings deposits, and the present system of marginal reserve requirements will be dropped. The likely new requirements are utilized in the calculations.

As is shown in Annex II, Table II, the returns obtained by commercial banks on their deposits range from 4.6% to 5.8% in the case of the Lima-based banks and 3.3% to 4.5% for the regional banks. The 7% proposed spread to be available to the ICI's under the Project would thus appear to be adequate to handle the bank's cost, cover the higher risks associated with lending to the Project's target clientele, and provide a reasonable profit margin. In addition, it should be noted that the bank's wage costs of the rediscounting operations are probably lower because depositor services are not required. Further analysis of the above variables will be undertaken during the intensive review.

E. Initial Environmental Examination (I.E.E.)

The Mission's I.E.E. for the Project is reproduced as Annex III. As described in the Annex, the ICI - nature of the Project and the fact that the sub-projects to be financed will be small-scale, widely dispersed, and without significant adverse environmental impact have led the Mission to recommend that a Negative Determination be made as the Threshold Decision for this Project.

VI. Other Donor Coordination

Other donor activities in the field of agriculture credit include on-going and planned loans from the IBRD and IDB. IBRD Loan 933, in the amount of \$25 million was initiated in November 1973 for financing medium and long-term credits through the Agrarian Bank to associative enterprises and individual farmers. The loan initially disbursed very slowly, although during the last year activity has increased considerably. As of April 1976, of the total program availabilities (including \$8.3 million counterpart), 66% was committed and 40.5% disbursed. The reasons given for the slow start under the program include the 20% sub-borrower equity contribution requirement, which many of the poorer, decapitalized associative enterprises have not been able to meet, and the insecurity of the individual landowner prior to the December 1975 issuance of definite criteria for Agrarian Reform non-affectability. The Agrarian Bank cites the December decree as a major factor contributing to the acceleration of sub-lending activity. As of June 1976, 213 sub-loans have been made to associative enterprises and 1,321 to individual farmers.

Loan 933 is expected to be fully disbursed by the end of 1977. The Agrarian Bank has indicated its intention to seek a new loan from the World Bank for similar purposes to begin operations in 1977 and help meet the large projected demands for longer-term agricultural credit through 1980. At the time of PRP preparation, a World Bank team was investigating the possibility of a second loan on the order of magnitude of \$25 million. Such a loan would complement rather than duplicate the proposed Project, for it would not be restricted to small farmers and food producing associative enterprises. We understand the World Bank would continue to require sub-borrower equity contributions, thereby directing resources to the more profitable enterprises and medium and larger scale individual producers, including extensive livestock operations.

An additional on-going program is the IDB Loan #322. The loan which was executed in June 1972 in the amount of \$12.0 million is now 100% committed and 70% disbursed. The loan is scheduled for full disbursement by the end of this year. Accordingly the IDB is currently studying the possibility of providing a new loan, in the neighborhood of \$20 to \$25 million, to finance agricultural credit to associative enterprises. An estimated 40% of the program would cover short-term crop production requirements and 60% long-term needs (machinery, irrigation, drainage, on-farm improvements).

The Mission will continue to coordinate with the IBRD and IDB to assure that the various donor credit programs are mutually complementary. While all these agencies' planned programs contemplate sub-lending to associative enterprises, the needs of the sector through 1980 are considerably in excess of projected availabilities.

VII. Financial Plan

A preliminary financial plan for the Project follows below:

Millions U.S. Dollars

	<u>A.I.D. Loan</u>	<u>Central Bank</u>	<u>Total</u>
1. Fund Capitalization	9.8	4.9	14.7
2. Technical Assistance/Evaluation	0.2	0.1	0.3
3. Fund Administration	-.-	0.2	0.2
	<u>10.0</u>	<u>5.2</u>	<u>15.2</u>
	66%	34%	100%

The Loan and Central Bank contribution for the Fund would be disbursed on a two to one basis over a three year period. Thus the 25% statutory requirement for local contributions will be exceeded. Moreover, the Central Bank will be making additional contributions to the Fund to prevent its decapitalization.

VIII. Project Implementation

A. Implementation Arrangements

As described above in Part II, the proposed mechanism to achieve the Project purpose consists in establishing a fund in the Central Bank to refinance eligible sub-lending operations meeting Project eligibility criteria. The steps concerning how the mechanism will function have previously been described.

The critical steps in Project implementation will be, then, those required to institutionalize the refinancing operation. The first of these is the negotiation of sub-lending regulations, which will be done in close coordination with the Central Bank in the course of preparing the Project Paper and formally agreed upon in the Loan Agreement; these will fall within the general guidelines described above in Part II. On the basis of these sub-lending criteria, terms and conditions, the Central Bank will solicit the participation of interested private, mixed, and state financial institutions, and prepare directives for circulation to the intermediate banks for their own reference and for distribution to prospective sub-borrowers. Distribution of the directives will be followed by additional promotional activities to acquaint ICI's with the objectives of the Fund and operational requirements.

Considering USAID monitoring, no additional staff commitments are considered necessary. Staff personnel will work very closely with the

Bank during the initial stages of establishing the Fund, meeting conditions precedent, and the initiation of sub-lending activity. USAID will not normally approve sub-loans prior to their execution but will reserve the right to review all sub-loans for conformity with eligibility criteria.

B. Implementation and Evaluation Plan

There follows below a brief implementation plan depicting major events in the Project's life. A more detailed PPT will be prepared in the PP.

<u>Action</u>	<u>Responsible Party</u>	<u>Timing</u>	<u>Method of Implementation</u>
1. Loan Authorization	A.I.D.	early FY 78 or FY 77 shelf possibility = "A"	
2. Execution of Loan Agreement	USAID/ Central Bank	"A" + 4 months	Loan signed
3. Conditions Precedent Met	Central Bank	"A" + 7 months = "B"	Fund created by Central Bank Resolu- tion; Unit staffed; directives drafted; CP's approved by USAID
4. First Promotion Seminars and Initiation of Sub-lending	Central Bank	"B" + 1 month	Central Bank des- cribes Fund mecha- nism to ICI's
5. Evaluation System Established	Central Bank/ Consultants	"B" + 3 months	Central Bank utilizes loan funds to contract T.A.
6. Annual Evaluations	USAID/Central Bank/ICI's	"B" + 12 + 24 + 36 months	End-user surveys, re- view of eligibility criteria, recommenda- tions and remedial action

<u>Action</u>	<u>Responsible Party</u>	<u>Timing</u>	<u>Method of Implementation</u>
7. Follow-up Field Promotion Seminars	Central Bank	"B" + 13 + 25 months	necessary modifications to directives made and explained
8. Project Assistance Completion Date		"B" + 36 months	

IX. Project Development Schedule

The development of the Project Paper primarily will be carried out by the USAID in conjunction with the Central Bank of Peru. The latter has a team of highly skilled economists who are familiar with the banking community, and will be capable of assisting with the specific studies necessary for Project justification. The USAID Project Development Committee will be comprised of representatives of the Agricultural Division, Controller's Office, Economics Section, and the Capital Development Office.

External resources will be necessary to undertake the effective demand and model sub-project analysis described in Section V.B.2. The Mission would appreciate AID/W guidance on whether this assistance could best be filled by direct TDY help, a contractual arrangement perhaps with a consulting firm, or a combination of the two. Specific needs would be for approximately 2 work months to: i) develop profiles and study the characteristics and likely absorptive capacity of the target group of food-producing associative enterprises and small individual landowners; ii) further identify principal constraints faced by the target group; iii) project the effective demand for credit by the target group and sub-borrowers serving the target group; and iv) present several illustrative and readily financeable sub-projects to indicate the Project's likely impact on target group incomes, employment, and welfare.

The PP is planned for early FY 78 submission, although the Paper could be prepared as early as April 1977 in time to permit its consideration as a FY 1977 Shelf Loan.

ANNEX 2

(PRELIMINARY)
PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Title of Project:
From FY 78 to FY _____
Total U.S. Funding \$10,000,000
Date Prepared 9/2/78

Project Title & Number: AGRICULTURAL PRODUCTION AND SERVICES FUND

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS																								
<p>Prog. or Sector Goal: The broader objective to which this project contributes:</p> <p>To increase food production, employment and incomes of rural poor, and improve nutrition.</p>	<p>Measures of Goal Achievement:</p> <p>Food production increases equal to demand growth.</p> <p>Food import amounts level off at present magnitude.</p> <p>Employment and incomes of target group increase.</p>	<p>National statistics including those of the Ministry of Food, Ministry of Agriculture, and Ministry of Commerce.</p> <p>National census and sample survey data.</p>	<p>Assumptions for achieving goal targets:</p> <ol style="list-style-type: none"> 1. Other donor programs in sector continue. 2. Adequate production incentives (prices) maintained. 3. GOP concern for rural poor continues. 4. Internal stability maintained, especially for land tenure. 																								
<p>Project Purpose:</p> <p>To establish in the Central Bank an effective facility for rediscounting medium-term loans made by financial institutions to sub-borrowers which produce, process or market agricultural products or provide complementary services to the agricultural sector poor majority.</p>	<p>Conditions that will indicate purpose has been achieved: End of project status.</p> <ol style="list-style-type: none"> 1. Agricultural sector lending by banking system increases. 2. Demonstrated Fund capability to maintain its level of rediscounting. 3. All Project funds placed in sub-projects meeting preestablished eligibility criteria. 4. Real capital value of Fund (cont) 	<p>Central Bank and ICI records. Project data and records.</p> <p>*(Cont.) Conditions... equal to \$14.7 million.</p> <p>5. ICI bad debt losses are not excessive.</p>	<p>Assumptions for achieving purpose:</p> <ol style="list-style-type: none"> 1. GOP continues to support entry of commercial banks to agriculture sector lending. 2. Gains of Agrarian Reform continue to be consolidated. 3. Banking system becomes increasingly convinced of viability of ag sector lending. 																								
<p>Outputs:</p> <ol style="list-style-type: none"> 1. Sub-loans rediscounted (value in millions U.S.\$). 2. Number of participating ICIs. 3. Directives distributed. 4. Promotional seminars held. 5. Evaluation system established. 	<p>Magnitude of Outputs:</p> <table border="1"> <thead> <tr> <th></th> <th>Yr. 1</th> <th>Yr. 2</th> <th>Yr. 3</th> </tr> </thead> <tbody> <tr> <td>1.</td> <td>2.5</td> <td>7.0</td> <td>14.7</td> </tr> <tr> <td>2.</td> <td>4.0</td> <td>8.0</td> <td>12.0</td> </tr> <tr> <td>3.</td> <td colspan="3">to be completed within 120 days of loan agreement signat.</td> </tr> <tr> <td>4.</td> <td>7</td> <td>10</td> <td>12</td> </tr> <tr> <td>5.</td> <td colspan="3">formal evaluations conducted annually.</td> </tr> </tbody> </table>		Yr. 1	Yr. 2	Yr. 3	1.	2.5	7.0	14.7	2.	4.0	8.0	12.0	3.	to be completed within 120 days of loan agreement signat.			4.	7	10	12	5.	formal evaluations conducted annually.			<p>Central Bank and ICI records. Project records</p>	<p>Assumptions for achieving outputs:</p> <ol style="list-style-type: none"> 1. Decree establishing Fund authorizes medium-term ag. lending. 2. Central Bank is aggressive in promoting the Fund. 3. Incentives to induce ICI interest and participation are adequate. 4. Effective demand for credit by-target group exists at planned magnitude (to be tested at PP stage).
	Yr. 1	Yr. 2	Yr. 3																								
1.	2.5	7.0	14.7																								
2.	4.0	8.0	12.0																								
3.	to be completed within 120 days of loan agreement signat.																										
4.	7	10	12																								
5.	formal evaluations conducted annually.																										
<p>Inputs: (In millions of U.S.\$)</p> <ol style="list-style-type: none"> 1. A.I.D.: <ul style="list-style-type: none"> Fund Capitalization \$ 9.8 Evaluation/Technical Assistance \$ 0.2 \$10.0 2. GOP: <ul style="list-style-type: none"> Fund Capitalization \$ 4.9 Administ./Evaluation 0.3 \$ 5.2 	<p>Implementation Target (Type and Quantity) Cumulative (In million U.S.\$)</p> <table border="1"> <thead> <tr> <th></th> <th>Yr. 1</th> <th>Yr. 2</th> <th>Yr. 3</th> </tr> </thead> <tbody> <tr> <td>1.</td> <td>\$1.5</td> <td>\$4.5</td> <td>\$9.8</td> </tr> <tr> <td>2.</td> <td>\$0.1</td> <td>\$0.15</td> <td>\$0.2</td> </tr> <tr> <td>3.</td> <td>\$0.75</td> <td>\$2.25</td> <td>\$4.9</td> </tr> <tr> <td>4.</td> <td>\$0.2</td> <td>\$0.2</td> <td>\$0.2</td> </tr> </tbody> </table>		Yr. 1	Yr. 2	Yr. 3	1.	\$1.5	\$4.5	\$9.8	2.	\$0.1	\$0.15	\$0.2	3.	\$0.75	\$2.25	\$4.9	4.	\$0.2	\$0.2	\$0.2	<ol style="list-style-type: none"> 1. USAID records. 2. Central Bank records. 	<p>Assumptions for providing input</p> <ol style="list-style-type: none"> 1. All funds available on timely basis. 2. No unexpected problems in meeting conditions and covenants set forth in loan agreement. 				
	Yr. 1	Yr. 2	Yr. 3																								
1.	\$1.5	\$4.5	\$9.8																								
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TABLE I
PROJECT BENEFICIARIES

	Est. Family Farmers	Farm Family ^{3/} Members	Potential Direct & Indirect Project Farm Fam. Benefic.	Total Potential Rural Farm Popu- lation Benefitted
1. Food Producing Associative Enterprises	207,300 (691 A.Es) ^{1/}	1,243,800	165,600 (552 A.Es)	993,600
2. Small Farmers producing partly or entirely for market but without access to Institutional Credit	100,000	600,000	10,000	60,000
3. Small subsistence farms with sufficiently unused potential to generate marketable surplus	300,000 to 400,000 ^{2/}	1,800,000 2,400,000	17,500	105,000
			193,100	1,158,600

^{1/} Ministry of Agriculture figures on Associative Enterprises (A.E.s)

^{2/} IBRD Agricultural Sector Survey Peru, Vol. I, May, 1975

^{3/} Assumes six persons per family.

Annex II

TABLE II
BANKING SYSTEM RETURNS ON DEPOSITS ^{a/}
 (billions of Soles) ^{b/}

	<u>Total Deposits</u>	<u>Interest Payments on Deposits</u>	<u>Loanable Funds (Deposits less Reserve Req.)</u>	<u>Earnings on Loanable Funds</u>	<u>Net Earnings</u>	<u>Net Earnings ÷ Total Deposits</u>
<u>Lima-Based</u>						
<u>Commercial Banks</u>						
Credito	17.7	0.96	10.71	1.87	0.91	5.1%
Internacional	9.0	0.52	5.44	0.95	0.44	4.9%
Popular	15.4	0.93	9.37	1.64	0.71	4.6%
Wiese	5.0	0.26	3.06	0.54	0.28	5.6%
Comercial	3.2	0.16	1.92	0.34	0.18	5.6%
Continental	9.0	0.40	5.25	0.92	0.52	5.8%
de Lima	2.5	0.12	1.49	0.26	0.14	5.6%
<u>Regional Banks</u>						
Regional del Norte	0.545	0.036	0.337	0.059	0.023	4.2%
Nor-Peru	0.926	0.063	0.574	0.100	0.037	4.0%
Sur Medio y Callao	0.741	0.047	0.458	0.080	0.033	4.5%
Los Andes	0.369	0.030	0.237	0.042	0.012	3.3%
Amazonico	0.719	0.048	0.447	0.078	0.030	4.2%
Sur del Peru	0.552	0.035	0.339	0.059	0.024	4.3%

^{a/} Based on data for June 30, 1975.

^{b/} Note 1.0 billion soles approximates \$15 million.

Annex III

INITIAL ENVIRONMENTAL EXAMINATION

Project Location: Peru

Project Title: Agricultural Production and Services Fund

Funding: (First FY) FY-1978 \$10 million A.I.D. loan (Plus \$5.2 million Host Country contribution).

IEE Prepared by:

Date: October 5, 1976

Mr. Carl Leonard, USAID/Peru/CAP

Mr. Dallas Fowler, USAID/Peru/Environmental Coordinator

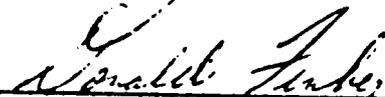
Environmental Action Recommended:

The USAID/Peru project committee for the Agricultural Production and Services Fund loan project has undertaken an Initial Environmental Examination (IEE) of the potential environmental impact aspects of the project and has arrived at a recommendation for a Negative Determination, as indicated on page 2, Threshold Decision section of the IEE.

Concurrence:

Date: October , 1976

I have reviewed the Initial Environmental Examination prepared by the project committee and concur in the Threshold Decision recommendation for a Negative Determination.



Donald R. Finberg
USAID/Peru Director

AA/LA Decision:

Date:

Based upon the Development Assistance Executive Committee review of the Project Paper, including the Initial Environmental Examination, for the Agricultural Production and Services Fund, I approve the Threshold Decision for a Negative Determination.

Assistant Administrator for
Latin America

Annex IIIPart II.Description of the Project

The Project will consist of three components. The first will be a credit fund administered by the Central Reserve Bank of Peru (BCR), making medium-term credit (2-5 years) available to eligible small farmers and cooperatives through the banking system. Credit will be made available for sub-projects which will increase food production for domestic consumption, on-farm improvements, capital investments and marketing, processing and service facilities. The second component will be technical assistance to establish an evaluation system and assist with promotion of the Project. The third will be creation of an office in the BCR within the Credit Division to administer the Loan and promote the participation of lending institutions and eligible farmers and cooperatives under the Project.

Part III.Identification and Evaluation of Environmental Aspects

This is an intermediate credit institution (ICI) project, and actions that are likely to have an effect on the environment are several steps removed from A.I.D.'s action in authorizing the loan. However, the lending criteria summarized in the Project Review Paper for medium-term credit to boost food production and improve product processing and marketing enable an illustrative list of possible sub-projects to be prepared. Such a list, although by no means all inclusive, would include such items as livestock and machinery acquisition, on-farm improvements including drainage, land leveling, erosion control, and irrigation systems, the erection of silos and storage facilities, and the construction or expansion of food collection centers and processing plants.

Within the lending criteria, such contemplated actions as livestock improvements, machinery purchases and on-farm improvements will have little environmental impact except within the small farmers' surroundings and these are of a minor level of change. The same is true of the limited amount of land clearing and water control and utilization measures that are likely to take place. Project funds will not be utilized for the financing of pesticides, insecticides and fertilizer, since these will be furnished from other resources that focus primarily on annual agriculture production. Agro-industrial processing could have slightly larger measurable effects, but given the probable size of the investments and their dispersed location, these can be expected to be minimal.

Threshold Decision

Based on the above analysis, and in compliance with the requirements of A.T.D. environmental procedures, the Project Committee has determined that

Annex III

this Project does not have any significant foreseeable environmental effects on the national environment of the Republic of Peru, its neighboring countries, the global environment or that of the United States, and therefore a Negative Determination is recommended.

Annex III

IMPACT IDENTIFICATION AND EVALUATION FORM

<u>Impact Areas and Sub-areas</u> 1/	<u>Impact Identification and Evaluation</u> 2/
A. LAND USE	
1. Changing the character of the land through:	
a. Increasing the population	N
b. Extracting natural resources	N
c. Land clearing	L
d. Changing soil character	L
2. Altering natural defenses	L
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
B. WATER QUALITY	
1. Physical state of water	L
2. Chemical and biological states	N
3. Ecological balance	N
C. ATMOSPHERIC	
1. Air additives	N
2. Air pollution	N
3. Noise pollution	N

2/ Use the following symbols: N - No environmental impact
 L - Little environmental impact
 M - Moderate environmental impact
 H - High environmental impact
 U - Unknown environmental impact

Annex III

IMPACT IDENTIFICATION AND EVALUATION FORM

D. NATURAL RESOURCES

- 1. Diversion, altered use of water..... L
- 2. Irreversible, inefficient commitments N

E. CULTURAL

- 1. Altering physical symbols N
- 2. Dilution of cultural traditions N
- 3. Changes in cultural patterns N

F. HEALTH

- 1. Changing a natural environment N
- 2. Eliminating an ecosystem element N
- 3. Other factors:.....
 - Nutrition..... L
 -

G. GENERAL

- 1. International impacts N
- 2. Controversial impacts N
- 3. Larger program impacts N

See attached Discussion of Impacts