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

CAPITAL ASSISTANCE PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

GUATEMALA: RURAL CREDIT AND COOPERATIVE DEVELOPMENT

520-L-024

520-26-140-226

AID-DLC/P-1080

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AID-DLC/P-1080

February 21, 1973

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: GUATEMALA : Rural Credit and Cooperative Development

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $4,500,000 for the local currency costs of a project to assist in increasing the rural productivity and incomes of small farmers; complete the formation of viable, effective and autonomous cooperative federations and stimulate economic activity among small farmer groups in a pre-cooperative stage; and contribute to the development of a rural financial infrastructure in Guatemala.

Please advise us as early as possible but in no event later than close of business on Friday, February 23, 1973, if you have a basic policy issue arising out of this proposal.

Rachel R. Agee
Secretary
Development Loan

Attachments:
Summary and Recommendations
Project Analysis
ANNEXES I - V

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GUATEMALA - RURAL CREDIT AND COOPERATIVE DEVELOPMENT

SUMMARY AND RECOMMENDATIONS

1. BORROWER:

The Republic of Guatemala.

EXECUTING AGENCY:

The National Agricultural Development Bank (BANDESA).

2. LOAN:

a. Amount:

Not to exceed four million five hundred thousand U.S. dollars ($4,500,000).

b. Terms:

The Loan will be repayable in 40 years, including a grace period of 10 years, at an interest rate of two percent (2%) during the grace period and three percent (3%) thereafter.

3. RECIPIENTS OF FUNDS:

a. The National Federation of Regional Agricultural Cooperatives (FENCOAR);

b. The National Federation of Credit Unions (FENACOAC); and

c. The Penny Foundation (Fundación del Centavo).

4. RELENDING TO RECIPIENTS:

a. Amounts:

FENCOAR - US$2,000,000
FENACOAC - US$2,000,000
The Foundation - US$500,000

b. Terms:

Each loan will be repayable in 40 years, including a grace period of 10 years, at an interest rate of three percent (3%) during the grace period and four percent (4%) thereafter.

5. PURPOSE:

The purpose of the Loan is to increase the rural productivity and incomes of small farmers through the attainment of viable, effective, and autonomous cooperative Federations; stimulate economic activity among small farmer groups in a pre-cooperative stage; and contribute to the development of a rural financial infrastructure in Guatemala.

6. PROJECT DESCRIPTION:

The purposes of the Loan will be achieved by channelling development resources through the Trust Fund of BANDESA to FENCOAR, FENACOAC, and the Penny Foundation ("Foundation"). In turn, these institutions will relend the funds to their membership and clientele for agricultural production and marketing activities; small rural business; and social improvements in rural areas, such as farm and home improvements, education of farmers and their families. Additionally, the Federations will use Loan funds, for their own account, for productive investments and investments in fixed assets, such as warehouse facilities, farm machinery, vehicles, communications and office equipment.

The Loan is conceived as an essential part of an integrated program designed to accelerate the development of efficient, farmer-owned institutions in Guatemala. In addition to this Loan the program includes the balance of $2,000,000 of credit available to the Federations and the Penny Foundation under AID Loan 520-L-018, and three USAID grant-funded projects totalling $2,124,000 in technical assistance and direct financial support to the Federations and the Penny Foundation. See Summary of Projections on the following page.

7. FINANCIAL PLAN:

$4,000,000 of Loan funds will be equally divided between the two Federations and $500,000 is earmarked for the Penny Foundation. Another estimated $4,300,000 in capital will be generated during the disbursement period of the Loan through additional mobilization of savings and the Cooperatives' system of mandatory capital investment required by their sublending activities. The GOG contribution to this Project will be of an in-kind nature, covering BANDESA's administrative costs for the execution of Loan funds and the cost of services provided by the GOG Superintendency of Banks and the Ministry of Agriculture Department of Cooperatives. These agencies will provide continued auditing and legislative monitoring of the cooperatives. In addition, the Government, as Borrower, eliminates the need for maintenance of value reserves, which are normally required of private intermediate credit institutions.

8. OTHER SOURCES OF FINANCING:

The IBRD, IDB and Eximbank have been advised of this proposed loan and have indicated no interest in providing financing for this project.

9. STATUTORY CRITERIA:

All statutory criteria, as set forth in Annex I of this paper, have been met.

SUMMARY OF FINANCING NEEDS
($000's)

	1973	1974	1975	1976
Membership/Borrowers (Farm Units):				
a. Regional Agricultural Coops.	3,000	6,000	10,000	13,000
b. Credit Unions	37,432	48,000	59,500	70,000
c. Penny Foundation	2,000	3,000	4,000	5,000
Gross Loan Demand:				
a. Regional Agricultural Coops.	577	1,360	2,210	3,060
b. Credit Unions	2,718	4,032	5,724	7,644
c. Penny Foundation	250	400	650	800
TOTAL	3,545	5,792	8,582	11,504
Less: Equity Capital (System Wide)	1,763	2,467	3,284	4,449
External Financing Requirements	1,782	3,325	5,298	7,055
Sources of External Financing:				
AID Loan 018 Rollover	1,577	2,000	2,000	2,000
Proposed Loan and Rollover	205	1,325	3,298	4,500
Other Sources	-	-	-	555
TOTAL	1,782	3,325	5,298	7,055
Disbursement Schedule for Proposed Loan	205	1,120	1,925	1,250

10. LOAN ADMINISTRATION:

Usual disbursement and procurement procedures will be followed for this Loan. Joint periodic progress reviews will be held to determine if there has been adequate progress in achieving the project goals.

11. VIEWS OF THE COUNTRY TEAM:

The Country Team has given high priority to this Project, as exemplified in Cable Guatemala 00222, dated January 15, 1973, and has recommended approval of the Loan.

12. CONCLUSION AND RECOMMENDATIONS:

On the basis of the conclusions that this Project is technically, economically, and financially sound, it is recommended that a loan be authorized to the Government of Guatemala for an amount not to exceed $4.5 million, subject to the following terms and conditions:

a. Conditions:

In addition to the applicable standard conditions precedent to disbursement, it is proposed that the following requirements be satisfied by the Borrower prior to initial commitment documents or separate disbursements for each of the recipients under the Loan:

(1) Submit for AID approval BANDESA's lending policy for the funds made available pursuant to the Loan.

(2) Execute separate AID-approved subloan agreements with each of the three loan fund recipients, covering the following conditions precedent to disbursement for each recipient institution:

(a) Approved copies of each institution's lending policy for the Loan funds; and

(b) Disbursement schedule of loan funds for the first year period.

(c) In the case of the Cooperative Federations, approved regulations for the Crop Disaster Fund.

In the case of the Penny Foundation it is proposed that, as a condition precedent to the signing of the subloan agreement between BANDESA and the Penny Foundation, the Foundation submit to BANDESA and AID for approval a detailed financial plan of its operations for ten years.

b. Covenants:

BANDESA shall provide in its separate subloan agreements with the recipient institutions the following:

(1) General:

(a) The Federations and the Foundation may not borrow from other sources any amount of money which would result in a debt/equity ratio for each institution in excess of a rate approved by AID. (Initially, 8:1)

(b) Unless AID and Borrower otherwise agree in writing, loan funds will only be used throughout the repayment period of the Loan for activities as may be approved in writing by AID and as further defined by each institution's lending policy. In no event will Loan funds be used to finance activities directly relating to coffee, cotton, sugar or other crops or commodities unacceptable to AID.

(c) The recipient institutions may not incur any indebtedness which would take a senior position to this AID Loan.

(d) Unless AID and Borrower otherwise agree in writing, the approved lending policies of the recipient institutions will be adhered to throughout the repayment period of the Loan.

(e) Net fixed assets of the recipient institutions, such as land, buildings, and equipment, as a percentage of equity capital will be reduced during the disbursement period of the Loan to not more than 15% and shall not exceed such percentage during the repayment period of the Loan.

(f) Annual interest rates on all subloans to farmers will not fall below the rates established by mutual agreement between each recipient, Borrower and AID.

(2) <u>Cooperative Federations (FENACOAC-FENCOAR)</u>

(a) The Federations will maintain a uniform interest rate on all subloans to cooperative affiliates not lower than the prevailing commercial bank interest rates.

(b) The Federations will establish a Crop Disaster Fund equivalent to 2% of each subloan granted. This amount will flow through to the final user and will be deducted off the top of subloans and invested by the Federations in Government securities or similar investments of the highest safety and liquidity.

(c) The Federations will obtain approval from Borrower and AID prior to any investment exceeding $10,000 from any source in fixed assets. Such approval request should be substantiated by a cost/benefit analysis showing a return in investment of not less than 8%.

(d) Until the Federations maintain a debt-equity ratio acceptable to AID, dividends, when declared, must be invested in shares of the Federations, and no shares can be redeemed except upon disaffiliation from the Federation.

(3) Penny Foundation:

(a) The Foundation will not enter into activities outside of the development loan program which would adversely affect the implementation of the Loan program.

(b) The Foundation may not make loans to individuals.

(c) The Foundation will establish and maintain a bad-debt reserve equivalent to 5% of the balance of its subloans outstanding. Pay-in to the reserve will begin with the first drawdown of its subloan funds.

c. Other Terms and Conditions:

The Loan shall be subject to such other terms and conditions as AID may deem advisable.

Project Committee

Loan Officers:	C.A. Balsis, USAID John Shannon, USAID
Pinancial Analyst:	T. Bebout, ROCAP
Economist:	S. Johnston, Embassy
Project Advisor:	D. A. Chaij, USAID
Coordinator of Cooperative Projects:	S. Wingert
Agricultural Cooperatives Advisor:	D. Fledderjohn
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Approved by:	Robert E. Culbertson Director, USAID
	Harlan A. Harrison Deputy Director, USAID

I. THE NATURE OF THE PROJECT

A. Project Description

1. Purpose and Size of the Project

The purpose of the Cooperatives Loan is to increase the rural productivity and incomes of small farmers. Concomitant with this purpose, the Loan is intended to complete the formation of viable, effective, and autonomous cooperative Federations, as well as stimulate economic activity among farmer groups in a precooperative stage. By this means it will contribute to the development of a rural financial infrastructure in Guatemala. These purposes will be achieved by channeling development resources through the GOG National Agricultural Development Bank (BANDESA) to the National Federation of Regional Agricultural Cooperatives (FENCOAR) and its membership, to the National Federation of Credit Unions (FENACOAC) and its membership, and to the Penny Foundation (a private sector non-profit national development foundation) for sublending to farmer groups in a precooperative stage.

The Loan is conceived as an essential part of an integrated program designed to accelerate the development of efficient, farmer-owned institutions in Guatemala. In addition to this Loan the program includes $2,000,000 of credit available to the Federations and the Penny Foundation under AID Loan 520-L-018, and three USAID grant funded projects totalling $2,124,000 in technical assistance and direct financial support to the Federations and the Penny Foundation. The Non-Capital Assistance Papers (PROPs) for the Federations' grant projects identified the necessity of contracting external financing at concessional interest rates for each cooperative institution. The proposed Loan will fill that need. Of the 95,000 member families projected to be part of the cooperative movement by December 1976, approximately 60,000 are expected to be farmers capable of receiving external production credit. Taking into account only agricultural credit and considering the projected average loan volume of $192 per farmer, the credit demand is expected to surpass $11,500,000 by the end of 1976.

The amount of the requested Loan is $4,500,000 of which $4,000,000 will be equally divided between the two Federations and $500,000 will be used by the Penny Foundation for sublending activities to small farmer groups. Another estimated $4,300,000 in capital will be generated during the disbursement period of the Loan through additional mobilization of savings and the Cooperatives' system of mandatory capitalization required in their sublending activities. Since most of the Loan funds will be used for short-term credit operations, the $4,500,000 will roll-over approximately 25 times during the 40-year life of the Loan. (For a full discussion of source and application of funds and of projected credit demand of the cooperatives see Section II.D.)

The GOG contribution to this Project will be of an in-kind nature, covering the following items: BANDESA's administrative costs for the management of Loan funds; services provided by the GOG Superintendency of Banks and the Ministry of Agriculture Department of Cooperatives, such as continued auditing and legislative monitoring of the cooperatives; and agricultural technical assistance by a Ministry of Agriculture specialized staff. The Government of Guatemala, as the Borrower, eliminates the need for maintenance of value reserves, which are normally required of private intermediate credit institutions.

2. The Target Clientele.

A key item of focus is the identification of the target group under this Loan and its relationship to the credit recipients under the BANDESA program. Once identified, the problem exists of reasonable assurance that the Project remains aimed at the target group throughout the life of the Loan.

The Iowa State University Agricultural Sector Analysis defines farm size in Guatemala as the following:

Medium	-	7-45 hectares
Small	-	0.7 - 7 hectares
Smallest	-	less than 0.7 hectares

BANDESA is designed to serve the small and medium farmer with no access to commercial bank credit. There are in Guatemala today over 320,000 farm families in such a category with a need for approximately $105,000,000 of credit per year. Of these totals the small farm category constitutes an estimated 280,000 farm families with a need for approximately $56,000,000 of credit per year. Guatemala's smallest farmer numbers approximately 85,000, corresponding to an estimated annual credit demand of $4,000,000.

Clearly, the need for credit is great and cannot be served in its entirety by BANDESA. There are social and economic costs factors which limit BANDESA's reach and at the same time restrict the individual farmer's access to BANDESA. There are problems of language and culture (see Socio-Economic Analysis, Section II.C.) as well as the need for proof of legalized land tenancy, which effectively eliminates many potential clients. Finally, there is the fact that very small loans entail high administrative costs per portfolio dollar and hence even government development banks, such as BANDESA, cannot feasibly serve small farmers at the lower end of the socio-economic spectrum. The cooperatives and the Penny Foundation can serve such small farmers.

BANDESA's typical customer borrows on the average $1,088 and works at least 7 hectares of land.

The typical cooperative customer farms .4-7 hectares of land and has an annual need for credit of $50-350.

These are typical or average figures which generally describe the target clientele for BANDESA and the Cooperative Federations. However, the lines of division are not clear-cut. In fact, these institutions do overlap in their potential servicing of the small farmer category, even though those farmers requiring loan funded inputs are obviously greatly in excess of either institution's combined physical and economic potential. This becomes particularly evident when it is considered that BANDESA's projected lending for 1973 is $6.1 million.

Given a greater credit demand than can be met by both BANDESA and the Federations, what is the characteristic which differentiates BANDESA's target clientele from the Federation's clientele, a target class which will be ensured service throughout the life of the Loan?

The conventional approach to defining and maintaining institutional focus on a target group is to impose an often complicated set of loan requirements: maximum farm size, maximum net worth and income, and loan size limits. Such criteria are often arbitrary, not consistently applicable to all cases and in a developing country, administering such controls is difficult and evasion is always a problem. For this program an alternative is proposed to the conventional approach. Instead of a cumbersome administrative mechanism, this project relies on the natural individual human tendency to choose the most promising opportunity. It is believed that most individuals will not continue to buy a commodity at $15 when it can be purchased elsewhere for $12.

BANDESA markets credit at an effective rate to the borrower of 8%. The corresponding rate for the cooperatives borrower is 14% (12% plus 2% crop disaster fund). It is maintained that when farmers become sufficiently established, experienced and credit worthy and have gained accessibility to credit beyond the cooperative, they will go to BANDESA, thus freeing funds for reuse with borrowers lower on the socio-economic spectrum.

The average borrower of BANDESA's clientele has a loan size of $1,088. Given the 6% interest difference between the two organizations, the borrower gains $65 by making the switch to BANDESA funds. It is believed that the farmer will in fact borrow cheaper money at the point he has the capacity to do so.

In summation, it is believed that the interest charge, made necessary for reasons of financial viability of the lending institutions (see Section II.D, Financial Analysis), insures that the project has a target class separate from other lending institutions, and that it will not evolve away from performing the original purpose. This is accomplished in an equitable manner with no administrative complications.

3. Interest Rates

The interest rates to be charged under the Loan are the following:

AID Loan:	2% during grace period and 3% thereafter
BANDESA Subloans to Recipients:	3% during grace period and 4% thereafter
Federation Subloans to Cooperatives:	8% (or not less than commercial bank rates) + 2% crop disaster fund charge per loan
Cooperative Subloans to Farmer:	12% + 2% crop disaster fund charge per loan
Foundation Subloans to Farmer Groups:	Illustratively 18%

The final charge to the farmer is neither a burden to him nor is it unfair. Borrowers from commercial banks, the most credit worthy applicants in the country, pay 8% interest, when they can get a loan. Borrowers from BANDESA, a government supported and subsidized bank, pay 8% also. The only other source of credit, outside the Federations and the Foundation, are local money lenders that charge 5% to 10% monthly and have been known to charge as high as 25% per month.

The final interest charge to the farmer is the minimum which will permit financial viability for the Federations and Foundation. The spreads are justified by the costs involved and by the risks to be covered by appropriate reserves.

Is it fair to ask the poor farmers to support these institutions? Not only is it fair, but it is to his advantage to do so. If the institutions which serve the small farmer do not cover their costs, the farmer will not receive the services he requires. The problems of the hundreds of thousands of small farmers are so enormous that the government cannot possibly provide him with all the services he needs. The macroeconomic study of the agricultural sector in Guatemala performed by Iowa State University showed that to provide technical assistance to all of the farmers, the government would have to employ over 2,000 extension agents; present staff is 50 extensionists and 220 lower level promoters.

In order to provide credit to all small and medium farmers, the government would need over $100,000,000. The resources required to help one sector of the economy simply are not available in a country such as Guatemala, nor would it be advisable to establish the required amount of additional external debt. Unless the private sector helps, and especially unless the small farmer helps himself, the job will not get done.

By supporting the institutions that provide him services, the farmer is assured of receiving the necessary inputs when and in the quantity he requires. Can he afford to pay for these services?

The cost/benefit analysis included herein shows that the farmer can expect a minimum three to one return on investment. If a farmer buys a bag of fertilizer which costs $5, he can expect additional income of $15. The 14% cost of money on the fertilizer would be $0.70. If he were charged a subsidized rate, say 5%, his interest would be $0.25. By paying $0.45 more he will receive an additional net income of $9.30. Out of this additional income, the farmer is required to save in the cooperative 5% of his loan, or $0.25. The three to one return is conservatively realistic; in fact, farmers in Quiche have reported returns of ten to one from fertilizer use.

In the case of the Penny Foundation, the same rationale applies. In servicing the isolated, very small farmer, a charge of 18%-20% is reasonable considering that the cost of reaching him and supervising the loans is higher than it is for the cooperatives. Moreover, when credit is available from the local money lenders, interest is around 85% per year.

Use of technical inputs is profitable to the small farmer, but it is also risky. If he loses a crop that has not been fertilized, he can migrate to the coffee plantations to earn enough to subsist. If he has borrowed money to purchase fertilizer, he will have to pay back the loan from income on good crops in later years. The burden to the small farmer from crop losses is in the capital borrowed more than the interest rate on the original loan. By paying a 2% crop disaster charge within the 14% rate, he allows the cooperative to capitalize funds that will provide the resources to refinance his crop losses. This spreads the small farmer's risk and assures him a more secure income.

One must also consider that the expenses of running the Federations are controlled by the farmers' representatives. Increases in expenses of 10% a year were included in the financial analysis to prove project viability. However, the budgets must be approved by the Board of Directors of each institution and it is to be expected that unnecessary increases will be disapproved. Any excess income to the Federations will be returned to the cooperatives and eventually to the farmer in patronage dividends. In the case of the Penny Foundation, expenses are controlled by the Board of Directors, who represent all members that have made donations. The Board will attempt to insure that the donations are used for the intended purpose - loans to Guatemala's poor - and not for unnecessary costs.

In summary, the interest rate to be charged to the small farmer is required to support the institutions that serve him. The government cannot supply him with all of the services that he requires. If he receives these services, the return on investment is high enough that the interest is not a burden. Finally, compared with other sources of credit, 14% and 20% interest charges are cheap for the farmer. The more basic problem is one of availability rather than interest rates.

4. Activities to Be Financed

Loan funds will be used by the Federations and the Penny Foundation to finance the activities set forth below and on the table following:

i. Agricultural and small livestock production credit and marketing activities;

ii. Small rural business activities;

iii. Social improvements in rural areas such as farm and home improvements and education of farmers and their families. Up to a maximum of 10% of loan funds allocated for each institution may be used for this category and these subloans will be tied to prior lending for productive activities.

iv. Investments in productive fixed assets by cooperatives such as multipurpose warehouse construction, farm machinery and office equipment. Whenever any such investments are over $1,000,

TABLE OF ACTIVITIES

		FENCOAR	FENACOAC	PENNY FOUNDATION
1.	Ag. & Small Livestock Production	$1,200,000	$1,200,000	$400,000
2.	Marketing	420,000	200,000	-
3.	Small Rural Business Activities	-	265,000	50,000
4.	Social Improvements	200,000	200,000	50,000
5.	Productive Fixed Assets			
	Cooperatives	175,000	100,000	-
	Federation	5,000	35,000	-
	TOTAL	$2,000,000	$2,000,000	$500,000

a cost/benefit analysis of the proposed project will be submitted to the Federation for prior approval, and proposed investments exceeding $5,000 will require prior BANDESA/AID approval.

v. Productive short-term investments by the Federations for their own account, such as fertilizer procurement and purchase of commodities produced by member cooperatives.

vi. Federation investments, with prior BANDESA-AID approval of expenditures in excess of $10,000, in fixed assets such as warehouse and office facilities, process industries, farm machinery, vehicles, communications and office equipment.

Complementing their supply of credit to the small farmer, the Federations provide a full line of services to their cooperative affiliates and respective individual membership. Such a service package includes the introduction of more advanced production and marketing practices, the selling of agricultural inputs such as improved seed varieties, fertilizer and herbicides, the marketing of products, and the provision of technical agricultural and managerial assistance. A fuller discussion of cooperative services and technical assistance capacity is found in Sections II.B.1. and II.B.2.

It will be established in the lending policies of each Federation and the Penny Foundation that funds from this Loan may not be used for:

i. Cattle operations;

ii. Acquisition of either land or used buildings;

iii. Payment of interest;

iv. Payment of salaries to the Federations', Foundation's and Cooperatives' personnel;

v. Granting of credit by Federations to other organizations or non-members;

vi. Payment of dues to the Federations or Foundation;

vii. Purposes other than those requested in the subloan application;

viii. Distribution of patronage refunds or net profits to members; and

ix. Individual farmer-member loans exceeding Q1,500;

x. Payment of debts;

xi. Other crops or commodities unacceptable to AID (see Covenants).

5. Capital Formation and Institutional Development

Part of the strategy of this Loan is to help the Federations achieve self-sufficiency as viable intermediate credit institutions. With the efficient utilization of Loan funds the Federations will greatly increase their own capital resources and stimulate their institutional growth and development.

Through a program of required capitalization, equity is systematically formed at all levels of the cooperative movement. When a subloan is made by either the Federations to their affiliated cooperatives, or by the local cooperatives to their individual members, 5% is automatically added on to the loan and credited to the account of that member. This process is repeated with every loan. Additionally, all local cooperatives invest 5% of their paid-in capital, which is constantly increasing through the above mechanism plus new member savings, in shares of the Federations. Finally, this paid-in capital cannot be withdrawn unless the member leaves his cooperative or the cooperative disaffiliates from the Federation.

This system represents the most important contribution made by the Federations to their institutional growth and viability. Their system of mandatory savings will strengthen a financial structure which will enable them in future years to qualify for credit from commercial banking institutions, as well as contribute to the development of an ongoing financial infrastructure in the rural areas of Guatemala. The Federations' role in developing a rural financial infrastructure is further discussed in Section II.C.4.

In addition to the institutional development aspects of the Federations, the $500,000 designated for the Penny Foundation will contribute to the initial development of small farmer groups beyond the reach of the Federations as well as assist the Foundation in becoming a viable financial institution. The role of the Penny Foundation within this Loan Project will be to provide credit to precooperative organizations and other small rural groups on a revolving fund basis. In time these groups, or their members, will either form cooperatives or become sufficiently worthy to attract financing from commercial sources. It is not the philosophy of the Penny Foundation to compete with established cooperatives, but rather to assist groups during their early stages of organization.

This part of the Loan is further designed to stimulate the Foundation's capacity of sustaining the development lending program without being unrealistically dependent upon grants, private sector donations, and concessional lending. With present capital structure and operating costs the Foundation is heavily dependent on grants and donations; at the same time it has been suffering serious operating losses and deteriorating liquidity.

The Penny Foundation management and its Executive Committee have recognized the problem of viability and during 1972 requested AID assistance to conduct a detailed financial analysis of all Foundation activities. The results of this analysis show that through a combination of higher interest rates, reduced operating costs, closer supervision of the development lending program, a constant level of donations, and a loan of at least $500,000 on concessional terms, the Foundation can expect to become a self-sufficient institution capable of further growth with the use of commercial borrowing. The Executive Committee has agreed to make the substantive institutional reforms required to reverse the operating losses and to build liquidity (see Annex III, Exhibit A, Minutes of Foundation's Executive Committee).

B. Program Justification

1. Guatemalan Development Strategy and the Cooperative Movement

Guatemala is fundamentally an agricultural country. Its economy is based on agriculture and the majority of the people are engaged in farming, food processing or pursuits based on or related to farming. Because of this the development effort in this country is rurally oriented. Of a total public sector development investment budget of 116.3 Million (1973 projected), 60.1 million or 51.7% is destined for projects and programs aimed directly at the rural sector in one way or another.

A basic strategy of its development effort is to minimize rural to urban migration for a variety of reasons. Rural poverty is easier to deal with than urban; the physical facilities such as housing and municipal services, necessary in urban areas, present huge drains on the limited public resources in any developing country. Additionally, a massive drift to the cities poses the need for employment generation which would be beyond the capacity of the Guatemalan economy. To avoid the inevitable problems

-- political as well as economic -- of urban migration, the GOG has opted for the strategy of raising the quality of life in rural areas.

Directly related to the strategy of an improved quality of rural life are two major goals of the Guatemalan Five-Year Development Plan: The establishment of basic institutional means needed to increase and diversify agriculture and livestock production; and improved income distribution. The cooperative movement and the activities of this Loan address themselves directly to these goals.

The Government of Guatemala, recognizing the complementary effect of cooperative activities to other GOG programs in the rural areas, transmitted to AID on February 7, 1973, an application for the proposed Loan. A copy of this request is found in Annex II, Exhibit B.

2. Place of Project in the Country Program

As in the case of the GOG, the USAID program concentrates on the problems of the low income rural population. At present there are loan projects in the areas of education, health, rural electrification, aid to small rural municipalities, agricultural credit and extension services. Beginning in 1970 with the Rural Development Loan and in 1971 with grant-funded projects for the two Federations, USAID recognized and supported cooperative development as a part of its strategy to improve the standard of living of the rural poor. The proposed Loan, strongly endorsed by the Country Team, is an outgrowth and necessary follow-up to initial AID efforts in the area of cooperative development in Guatemala.

3. Consistency with CIAP Review

The proposed Loan is directly responsive to the 1972 CIAP Review of the Guatemalan Economy, which identified the important role cooperatives could play in the country's agricultural development program.

The Review recommended that credit resources, above the $2,000,000 earmarked for cooperatives under 520-L-018, be made available to the cooperative movement. While the legal chartering delays referred to in the Review do exist, these have been taken into consideration in preparing growth projections and do not represent a significant hinderance for the implementation of this Loan. This is especially true since the Federations are concentrating on horizontal expension of existing cooperatives rather than forming new ones.

C. Project Background

1. History of Cooperativism in Guatemala

Since 1959 the Government of Guatemala has given continued support to the cooperative movement while other organizations and individuals have assisted in the development of cooperative institutions. Unfortunately, many of these promoters had little technical knowledge of the actual functioning of a cooperative as a business enterprise, or viewed the cooperative as a sort of funnel for special favors. The result was the formation of well over 150 cooperatives in small, isolated villages of the Guatemalan highlands, of which93 are considered active by the Ministry of Agriculture, but fewer than a dozen are capable of supplying the services their members require.

During late 1969 and 1970, the leaders of both the agricultural cooperatives and the savings and credit cooperatives movements, in conjunction with USAID, analyzed this situation in an attempt to define the steps to be taken to make cooperatives more relevant to Guatemala's rural economic and social needs. The result of this analysis has been a new orientation of both movements in which they are pursuing the following goals:

a. Full Service Line

In order to be effective in improving the lives of its members, a rural cooperative must offer a full line of services including credit, sale and delivery of farm supplies, marketing and storage, transportation, mechanization and, eventually food processing. In addition, technical agricultural advice and member education must be provided either directly by the cooperative institutions or in combination with other organizations, to insure the efficient use of services.

b. Economic Viability

Achievement of social goals is directly dependent upon the economic viability of the institutions. In order to be viable, the cooperatives must be of sufficient size so that the volume of activities, when combined with a reasonable profit margin, allows the employment of full time, highly qualified managers, administrative staff and other personnel required to provide efficiently the package of services described above.

c. Democratic Representation

The increasing size of cooperatives necessitates the subdivision of their membership into groupings that will preserve individual involvement and participation. This principle has led to the formation of regional agricultural cooperatives working from a base of 30-60 local groups in separate communities, and a similar horizontal expansion of savings and credit cooperatives through branch office formation.

d. Capital Formation

One method by which the cooperative movement has been, and will continue to be strengthened, is by increased paid-in capital. Thus far, capital is formed through direct investment by members, retained earnings and mandatory capitalization of 5% of each loan granted.

e. Vertical Integration

In order to fulfill the objectives noted above, cooperatives have to be integrated into national level federations capable of backstopping a full line of services at the local cooperative level.

The acceptance of the objectives listed above has taken place over varying time periods in the two movements. When the activities leading to the development of FENCOAR were begun in Guatemala, the operations of FENACOAC's affiliates in rural areas were limited exclusively to providing the traditional services of a community credit union. Since that date, FENACOAC has begun to provide several of the services mentioned earlier and to implement horizontal expansion in a way initially begun by the regional agricultural cooperatives affiliated to FENCOAR. At the same time, the regional agricultural cooperatives have adopted capital formation policies similar to those used by savings and credit cooperatives.

Although this institutional development and maturity, and the convergence of goals and activities of these institutions have not been completed at this time, the similarity of the goals and of probable future activities of both Federations have been noted by all parties involved. A series of discussions have been held between the leaders of both cooperative systems in an attempt to define what relationship should exist between them. Among the alternatives being discussed are a complete or partial merger, geographic separation, division of services and parallel development with positive competition. This topic is further discussed as an issue under Section II.E.

2. FENCOAR

FENCOAR is the result of a grant funded USAID project begun in October 1970. It was formed in October 1972 by the three regional cooperatives operational at that time. The fourth regional was formed January 11, 1973 and is waiting approval of its charter. The fifth and sixth regionals will be organized during the remainder of 1973.

By 1976 the six regional cooperatives will be serving 20,000 members in over 240 separate communities. At that time, they are expected to handle approximately 250,000 cwts. of fertilizer and market half of the estimated members' basic grains production of 700,000 cwts. of products. Expected credit needs by FENCOAR to carry on its activities will be in excess of $3,000,000 in 1976.

The growth record of FENCOAR is as follows:

	12/31/71	12/31/72	% Change
Active Regional Cooperatives	2	3	50%
Member Families	1,500	3,000	100
Net Worth	$19,000	$233,700	1,030
Loans Outstanding	$225,000	$447,000	99
Average members per Cooperative	750	1,000	33
Average Capital per Cooperative	$9,500	$19,500	105
Fertilizer purchased	35,000 cwt.	91,000 cwt.	160
Members' Basic Grains Production (partially marketed by FENCOAR)	65,000 cwt.	130,000 cwt.	100

How these figures compare with previous projections see Exhibit D.1 of Annex III. Future growth projections are illustrated in Exhibit D.2 of the same Annex.

See the table on the following page for the projected credit needs of FENCOAR.

FENCOAR - FINANCING NEEDS
($000's)

	1973	1974	1975	1976
Membership:	3,000	6,000	10,000	13,000
Gross Loan Demand 1/	577	1,360	2,210	3,060
Less: Share Capital (System Wide) 2/	115	272	444	611
Liquidty 3/	(115)	(272)	(444)	(611)
External Financing Requirements	577	1,360	2,210	3,060
Sources of External Financing:				
AID Loan 018 Rollover	577	1,000	1,000	1,000
Proposed Loan and Rollover	-	360	1,210	2,000
Other Sources	-	-	-	60
TOTAL	577	1,360	2,210	3,060
Disbursement Schedule for Proposed Loan	-	360	850	790

1/ Assumes average loan size of $192 in 1973 and increasing $10 each year thereafter, based on historical experience. Addtional loan demand shown in 1974 through 1976 is for fixed asset investments.

2/ Share capital equals 20% of loan demand since a debt/equity ratio of 5 to 1 is a requirement of all sub-loans.

3/ The reduction factor equals 20% of gross loan demand composed of 10% delinquent loans; 5% cash on hand; 2½% invested in FENCOAR. An additional 2½% is invested in fixed assets.

3. FENACOAC

FENACOAC was formed in 1964 by 6 savings and credit cooperatives. From that date until the end of 1969, CUNA (Credit Union National Association) was contracted to both advise and manage the Federation. The development of the Federation and its cooperatives was limited, however, due to lack of effective services offered by the Federation and the extremely small size of its affiliates. In 1970, management of the Federation was turned over to Guatemalans and at the same time FENACOAC began to offer a wider range of services and to emphasize cooperative growth rather than new organization. The results of this change are shown below:

FENACOAC

Growth Figures

	12/31/69	12/31/72	% Change
Affiliated Cooperatives	71	80	13
Member families	13,033	32,400	148
Savings (Paid-in Capital)	$358,000	$1,550,000	332
Loans Outstanding	328,112	1,657,500	405
Average Members per Cooperative	183	405	121
Average Savings per Cooperative	$ 5,042	$ 19,375	284
Average Savings per Member	$ 27.46	$ 47.83	74
Fertilizer purchase	--	100,000 cwt.	

See the following page for the projected credit needs of FENACOAC.

FENACOAC - FINANCING NEEDS
($000's)

	1973	1974	1975	1976
Membership 1/	37,432	48,000	59,500	70,000
Gross Loan Demand 2/	2,718	4,032	5,724	7,644
Less:				
Net Share Capital (System Wide) 3/	1,763	2,467	3,284	4,349
External Financing Requirements	955	1,565	2,440	3,295
Sources of External Financing:				
AID Loan 018 Rollover	800	800	800	800
Proposed Loan and Rollover	155	765	1,640	2,000
Other Sources	-	-	-	495
TOTAL	955	1,565	2,440	3,295
Disbursement Schedule for Proposed Loan	155	610	875	360

1/ Borrowing farm units (members) are estimated at 44% of 1973 total membership, and the percentage increasing by 4% in each succeeding year.

2/ Assumes average loan size of $165.00 in 1973 and increasing $10.00 per year based on historical experience.

3/ Reflects a 17.5% reduction factor composed of: 5% delinquent loans; 5% cash on hand; 5% invested in FENACOAC shares; and, 2½% invested in fixed assets.

By the end of 1976, it is projected that FENACOAC's membership will be 75,000 and the annual loan volume within this system will surpass $7,600,000. The above figures of actual growth as compared to previous projections are seen in Exhibit D.1 of Annex III. Exhibit D.2 of the same Annex illustrates future growth projections.

4. The Penny Foundation

Through the initiative of Sam Greene, a retired U.S. businessman living in Guatemala, the Penny Foundation was registered as a non-profit foundation by a decree of the Guatemalan Government on June 3, 1963. The initial capitalization was less than $20,000. Although the broad purpose of the Foundation is to assist in the "integral development" of Guatemala's urban and rural areas, the principal activity has been the development lending program in rural areas for such purposes as production credit, potable water systems and community development activities. The loan portfolio has grown from $42,700 in 1966 to almost $350,000 today.

The Foundation also sponsors the Pan American Development Foundation's Tools for Freedom program in Guatemala and serves as liaison for, and helps support financially, the VITA (Volunteers for International Technical Assistance) program. The Foundation is in the process of divesting itself of an un-profitable cattle sharing program whereby the Foundation loaned beef and dairy cattle to farmers and shared in the returns from production.

Financial resources, both grant and loan, have gone to the Foundation from the following sources:

- Pan American Development Foundation: $21,000 grant; $200,000 loan of which $106,000 is drawndown.

- Inter-American Development Bank:
  $27,000 grant.

- Local Commercial bank:
  $45,000 loan, at 8%.

- OPIC:
  $200,000 line of loan insurance.

- AID:
  $125,000 grant; $200,000 Loan (520-L-018) of which $120,000 is drawndown.

The $200,000 available to the Penny Foundation under AID Loan 520-L-018 has been used satisfactorily. Since July 1972, when these funds first became available, money has been disbursed to seventy different sub-borrowers. The recipients, pre-cooperative groups and ad hoc associations of small farmers, used these funds to purchase fertilizer in conjunction with FENACOAC. The average loan amount has been $1,720 per group or approximately $50.00 per family benefitted (see Annex III, Exhibit B). The Foundation estimates that the remaining $80,000 will be disbursed before May 1, 1973.

5. AID Loan 520-L-018

$2,000,000 of this $23 million loan was designated specifically for cooperatives and pre-cooperatives. By the end of 1972 $997,000 of these loan funds had been drawn down for subloans to 5,196 farmers, who work on 14,280 hectares of land. As of that date, total disbursements had been approximately equal for both Federations and the Foundation had drawn down a total of $120,000. During this past January BANDESA disbursed an additional $400,000 to FENACOAC for sublending during the next six months. For a complete discussion of the effect of disbursed 018 funds to cooperatives, see Section II.C.2 of the Socio-Economic Analysis. Complete drawdown is projected prior to the end of 1973, at which time this money will represent 90% of all external financing to the cooperative movement. Use of these funds is limited primarily to agricultural production credit and marketing, handicrafts development and small rural business financing.

II. PROJECT ANALYSIS

A. Borrower/Executing Agency

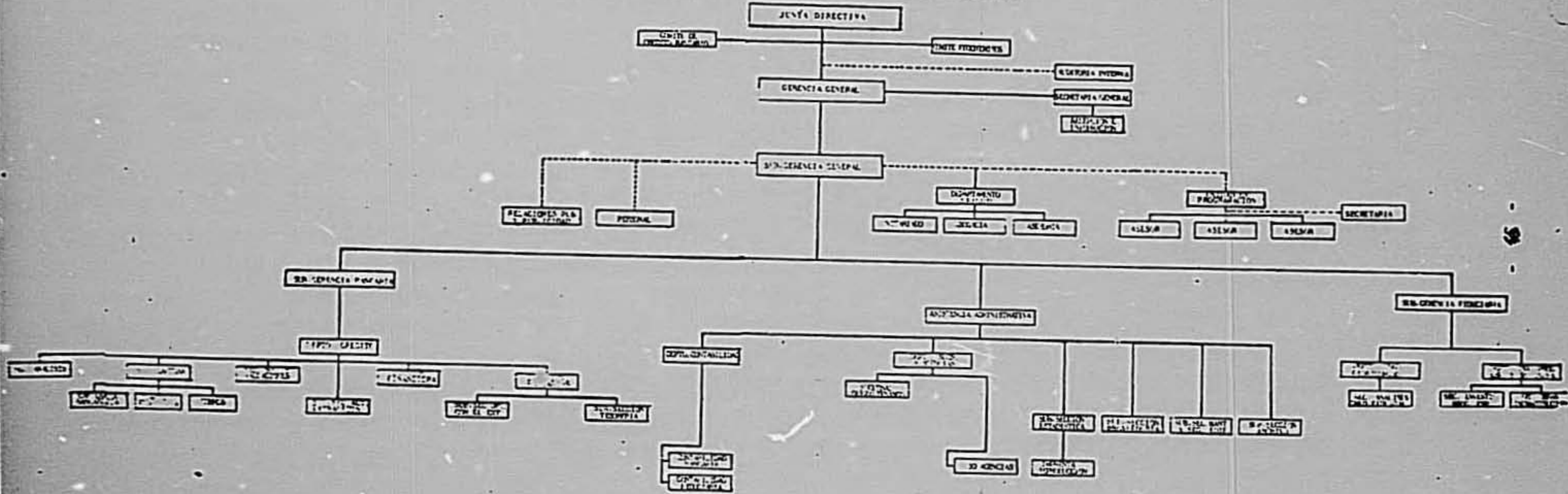
1. BANDESA Organization Structure and Staff Requirements for Execution of Loan Funds

BANDESA's organizational structure at the operational level (as illustrated on the following page) consists of three major divisions, each with the following general scopes-of-work and responsibilities: (a) Administrative Division - provides the accounting and statistical functions, supervises branch bank and agency activities and overall housekeeping requirements; (b) Banking Division - assumes responsibility for the regular portfolio of banking and credit activities; and (c) Trust Fund Division - made up of a Trust Fund Credit Department and a Department of Studies of Special Program and Infrastructure, handles specific funds made available to BANDESA through international agency lending programs. The Trust Fund's present portfolio consists of one AID Loan (520-L-018) including the $2,000,000 for cooperatives and pre-cooperatives groups, and four IDB loans (IDB-204FE, 204FL, 58FE, and 58FL).

Since this Loan will follow the same procedures of the Rural Development Loan funds, additional staffing within BANDESA will not be required for its execution. The entire amount of the Loan will be for disbursements in wholesale-type subloans, to a maximum of three intermediate credit institutions. The lending path will be from BANDESA central offices to Cooperative Federations to affiliated cooperatives to individual cooperative membership, and to the Penny Foundation to small farmer groups.

This system will, in effect, increase the executing agency's trust fund credit portfolio and permit large subloans at insignificant additional cost with an end result of reducing overall average administrative

ORGANIGRAMA ESTRUCTURAL



BANDESA

cost per subloan made from the entire portfolio.

2. GOG Institutional Support

As in the past, the GOG will continue to support the cooperative movement through the activities of its own rural development agencies. BANDESA, the Federations, and the Penny Foundation will exchange lists of borrowers to eliminate the possibility of duplicating clientele. Extension and promotion agents of DIGESA will continue to provide and complement the agricultural training given to cooperative farmers. Based on the experience of last year, growing interaction between INDECA (the GOG marketing institute) and the Federations is anticipated. During the 1972 growing season INDECA assigned a quota to FENACOAC for the purchase of 50,000 cwts. of corn. Finally, it is expected that the cooperatives will play an increasingly larger role in the area of agricultural research. Already, an excellent new wheat seed has been developed as a result from the direct cooperation between the Ministry of Agriculture's research division and the largest agricultural cooperative in the highlands.

3. Lending Procedures

A copy of the proposed BANDESA lending policy for these funds is attached in Annex III, Exhibit C. The procedures which BANDESA will follow will be substantially the same as those used in the case of 520-L-018 funds assigned to the Federations and Foundation.

B. Recipients of Loan Funds

1. FENCOAR

a. Organizational Structure and Technical Assistance Capability

The organizational structure and functional description of both the Federation and

Regional Cooperative levels are illustrated on the following pages.

The core of the technical capacity of the regional cooperatives lies in the permanent, full-time field staff of two agronomists. These men have lengthy experience in credit, extension and technical agriculture and have knowledge of the Highland farmer. Each man works daily in the field and is capable of reaching about 1500 farmers through local group meetings which are organized by the local village committees themselves and center around the topics of credit, agriculture and cooperative education.

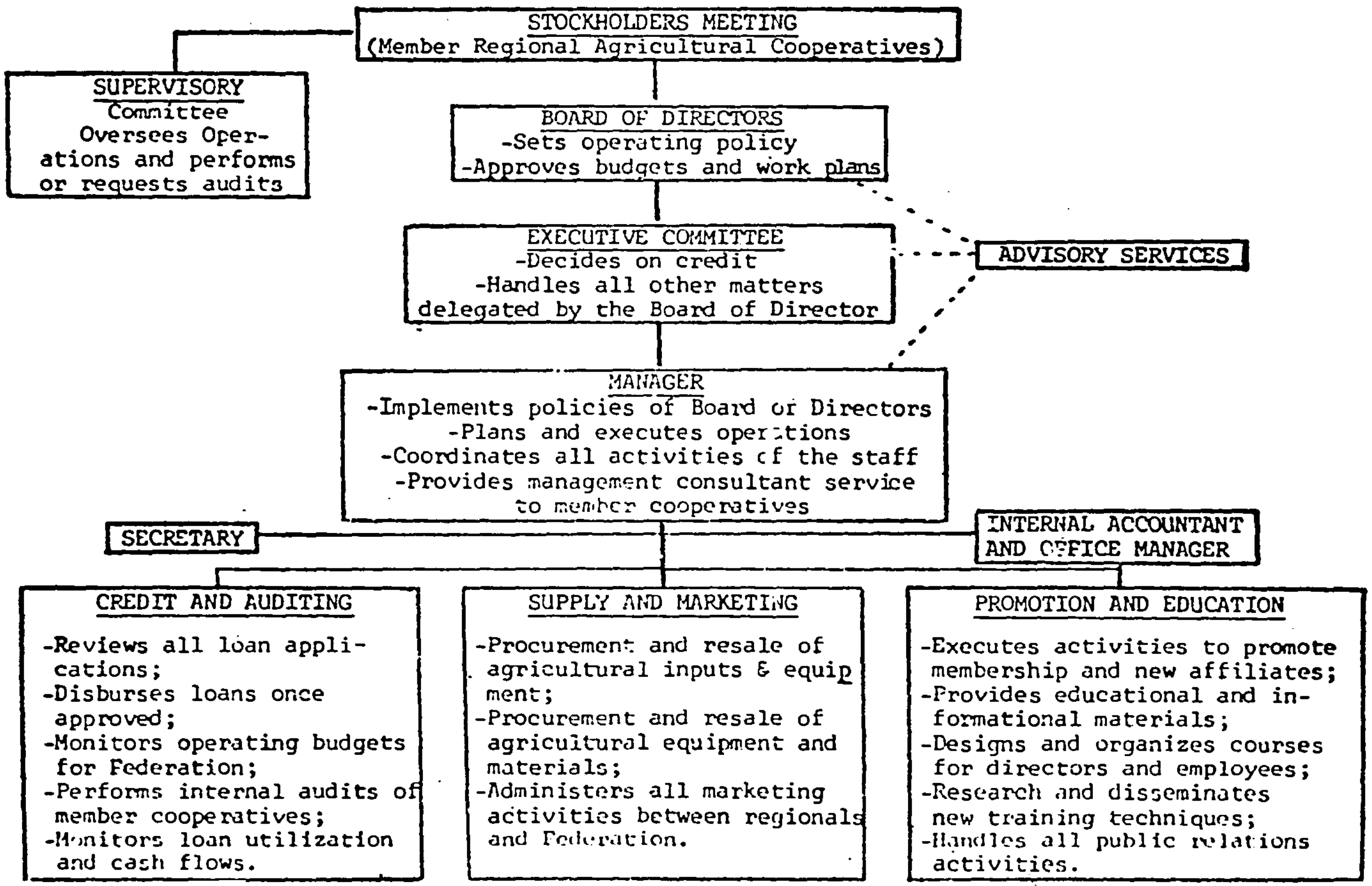
The work of the Regionals' field staff is augmented by twelve Peace Corps Volunteers, whose assistance has been programmed during the first 3 years of the organization's development. The Volunteers, specifically trained in Highland agriculture, credit and cooperative activities, are currently assisting in the training of local leaders and branch warehousemen. Their efforts are also oriented to encouraging and educating the general membership in cooperative services, activities and policies.

The agronomists and volunteers coordinate their efforts with the Regionals' managers, who are also professionally trained and highly experienced agronomists. They lend technical competence in areas of farm machinery utilization, marketing and handling of agricultural products, procurement of supplies, credit and the design of member services.

A typical regional cooperative has a complement of supporting staff, middle level office employees and skilled shop workers, totalling between 20-25 individuals. This complement is composed of two accountants, a master mechanic, tractor and other farm equipment operators, truck drivers and warehousemen, all of whom in their respective activities support the field staff and provide specific member

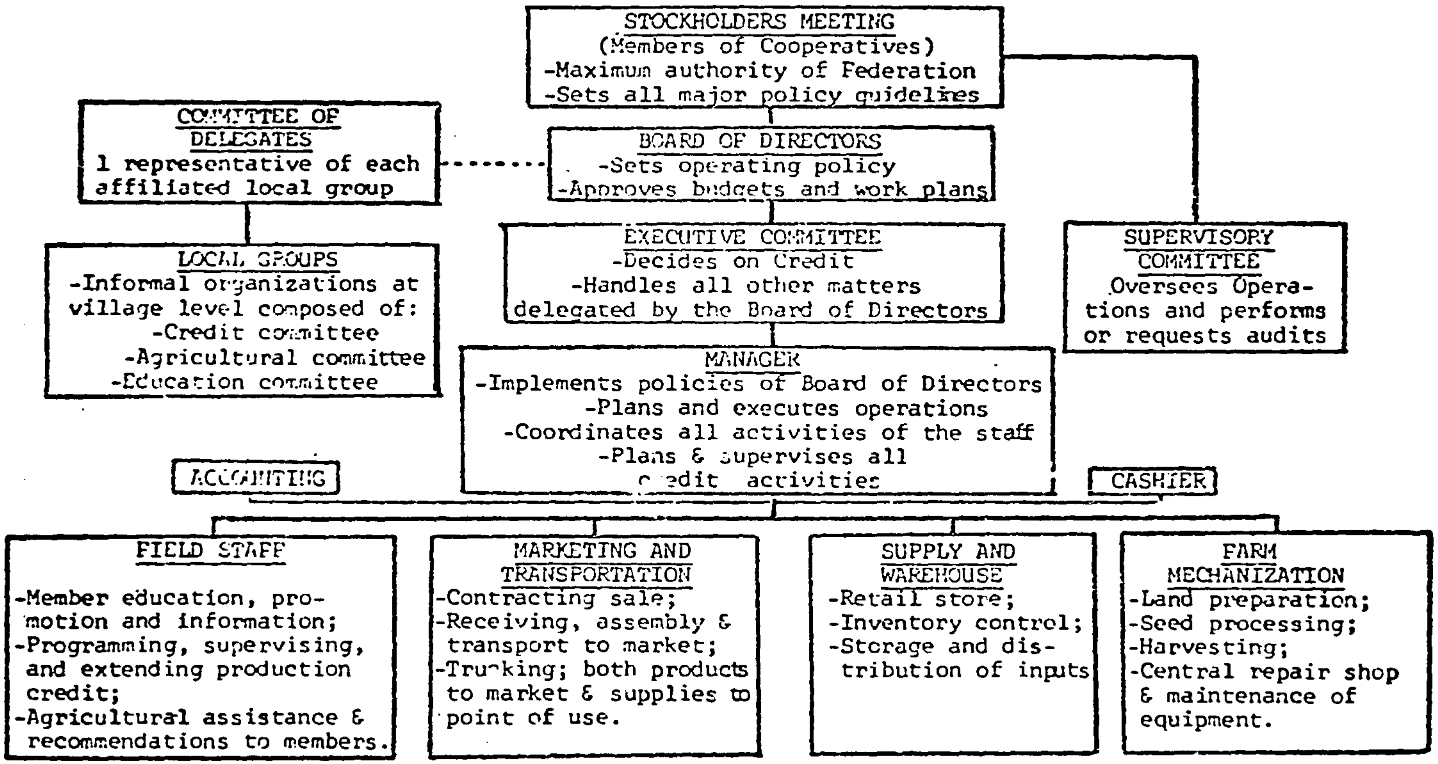
FENCOAR

Functional Organization Chart



FUNCTIONAL ORGANIZATION CHART

Regional Agricultural Cooperative



services. Physical facilities available to the Regional Cooperatives are numerable:

- Radio communications between Regionals themselves as well as with the national office.

- Multipurpose warehouse/office buildings which serve as office headquarters, storage facilities and other production inputs, and farm supplies stores.

- Seed cleaning equipment and grain storage bins.

- A fleet of tractors, threshing machines, and trucks.

- Fully mechanized accounting systems.

FENCOAR enhances the administrative and technical capacity of affiliates through the following mechanisms:

-- Consultation: Federation staff and AID contractors continually provide recommendations and advice on policies and operations, usually through the regional managers.

-- Monitoring: Internal audits are performed regularly by the national staff in addition to outside professional analysis of operating statements.

-- Research: The Federation, many times with assistance from outside sources, responds to agricultural problems which occur in the field.

-- Planning: The national organization participates in the planning exercises of its affiliates, checks performance against projections and budgets, and recommends as needed.

-- Procurement: The Federation is the wholesale procurement and bargaining agent for its affiliates.

Representation: The Federation is directly responsible for public information and public relations on behalf of its affiliates and their member farmers.

b. Lending Procedures

An approved lending policy for this institution is required as a condition precedent to disbursement and will include among other things guarantee requirements, activities to be financed, interest rates, capitalization and formation of reserves. The procedures to be followed by each cooperative, within the limits of the Federation, are the following:

i. A member requesting a loan fills out a detailed farm plan and loan request with the regional extensionist and/or the president of the local group.

ii. The loan request is then discussed and recommended for approval by the local credit committee.

iii. The regional extensionist adds his recommendation to that of the committee.

iv. If the request has received a negative recommendation by the local committee, it is automatically denied by management or the central credit committee of the regional cooperative.

If the records on this individual in the regional office shows a poor credit record, the case will be discussed by the regional committee with management and either denied or approved, depending on circumstances. If neither of these situations occur, the request is approved.

At the level of the Federation, credit is extended to the regional on the basis of projections of capital requirements, cash flow analysis and proposed activities. It is unlikely that a reasonable loan request would be denied, since it is the responsibility of the Federation to anticipate the credit needs of its affiliated regional cooperatives, assist them to continually improve their financial base and credit worthiness, and continually monitor performance. In cases of doubt or differences of opinion in credit worthiness, the National Executive Committee or Board of Directors assists the management in credit decisions.

2. FENACOAC

a. Organizational Structure and Technical Assistance Capability

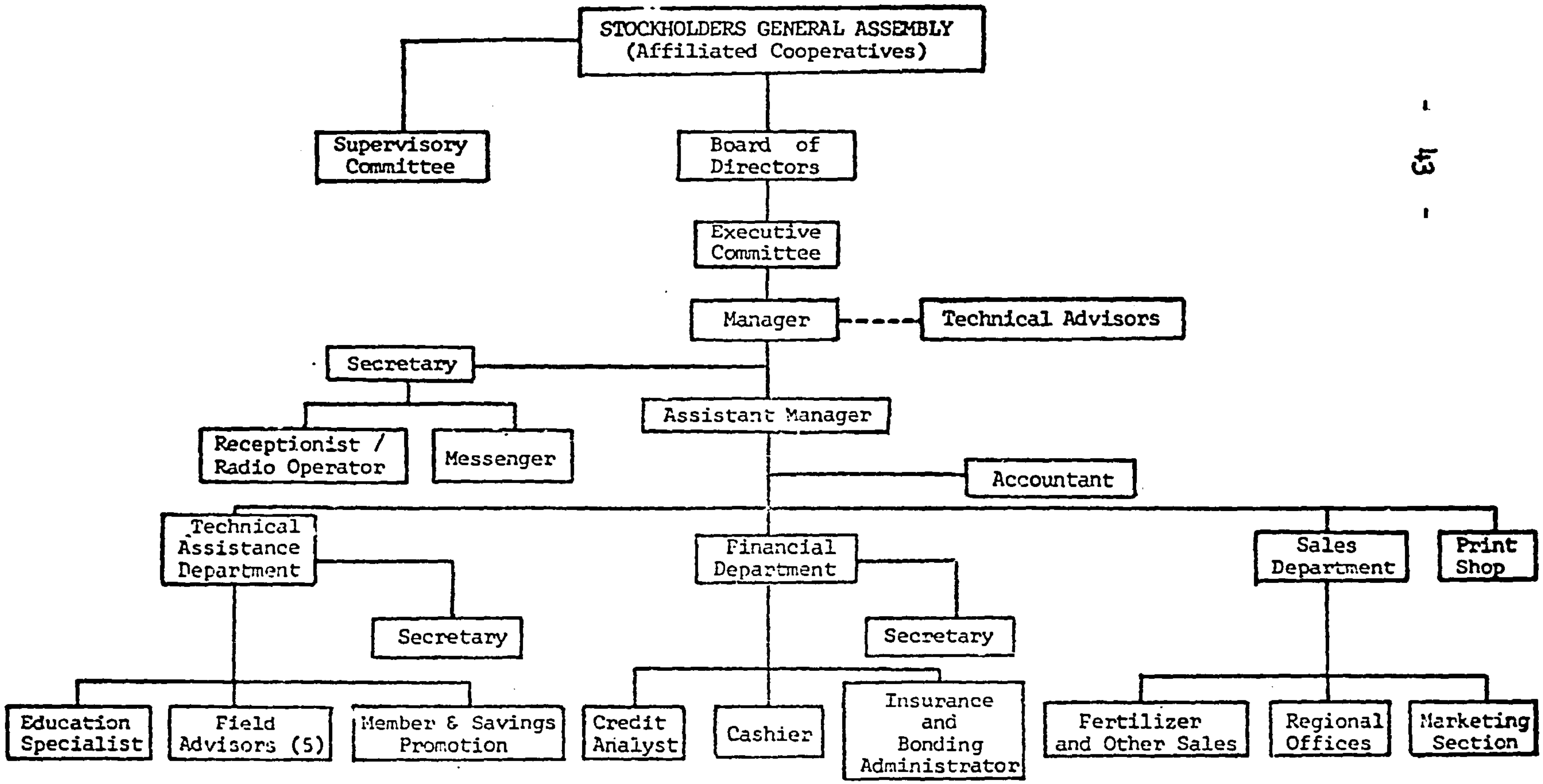
The organizational structure and functional description of each department of FENACOAC, as illustrated on the following pages, was adopted at the end of 1972 following a reorganization process based on the system "Management by Objectives". Services have also evolved as demands from the affiliates have increased.

Similar to the regional agricultural cooperatives, FENACOAC is developing technical capabilities at the local level by training professional, full-time managers who will maintain accurate and up-to-date accounting records, process loan requests, supervise loans and impart basic farm management training to the members.

Presently, 47 full-time managers are employed by the affiliated cooperatives, and all member cooperatives are expected to have managers by early 1974. The presence of these managers has reduced considerably the requirements for technical assistance from the national level in matters such as effective usage of fertilizer, improved seed and plant foods. These managers, supplemented by Peace Corps Volunteers, serve as local extension agents and provide services similar to the FENCOAR agronomists.

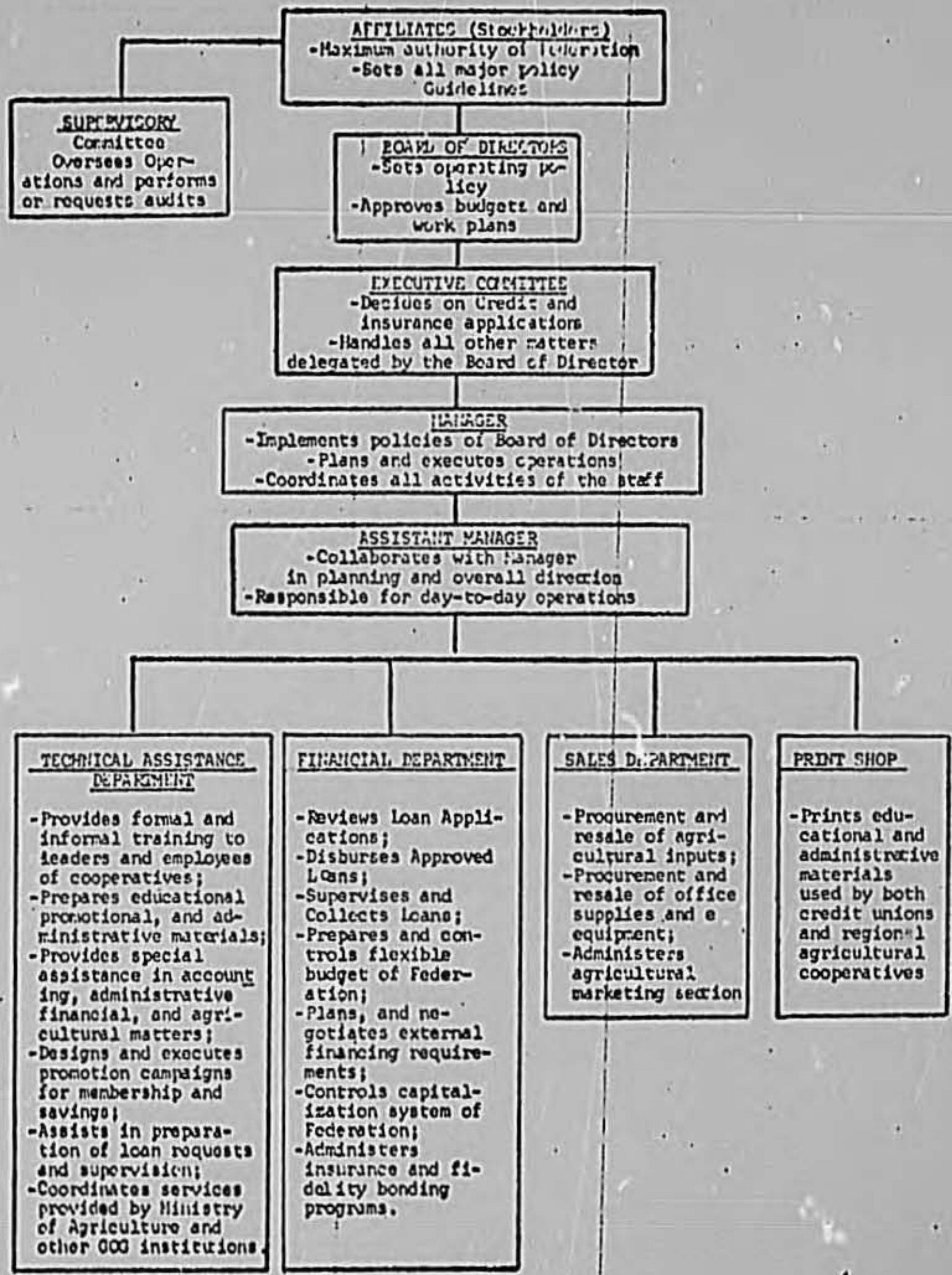
FENACOAC

Organization Chart



FENACOAC

Functional Organization Chart



Seven Peace Corps Volunteers are assigned to FENACOAC in the capacity of local field agents whose main duties are to assist the different member cooperatives with their administrative problems and member promotion and education. They also serve as a communication link with the Federation and its staff.

FENACOAC intends to implement, as income permits, a plan for providing additional assistance to member cooperatives. The important element of this additional assistance will be the use of indigenous farmer-members who have shown capacity for learning administrative procedures. These farmers, who have first-hand knowledge of rural conditions and problems and can also speak one of the Indian languages, will receive intensive training in basic technical agricultural and accounting practices. They will then be employed by the Federation as local field agents working with cooperatives and branch offices in a zone where all members speak the same Indian dialect. They will travel by bus or motorcycle and replace the assistance now given by Peace Corps Volunteers in these areas.

The responsibilities of the local field agents will cover loan supervision, basic agricultural education, identification of plant diseases, consultation with Federation and GOG agricultural technicians on how to solve problems that go beyond their capabilities, assistance in branch office development, coordination of fertilizer sales and marketing activities.

Finally, FENACOAC has working arrangements with the GOG for support in areas which complement its own capabilities. For example, the Superintendency of Banks performs yearly audits of all affiliated cooperatives, the National Agricultural Marketing Institute (INDECA) has purchased corn and beans produced by cooperative members, and specialized technical assistance is obtained on a when-needed basis from Ministry of Agriculture Specialists.

b. Lending Procedures

An approved lending policy for this institution is requested as a condition precedent to disbursement and will include among other things guarantee requirements, activities to be financed, interest rates, capitalization, and formation of reserves. At the level of the affiliated cooperative, the procedures are the following:

i. The loan request is prepared by the member with the assistance of the cooperative or branch office manager.

ii. The request is analyzed by the local credit committee. This review often includes a visit to the farmer by a member of this committee.

iii. Loan application is either ratified by the credit union head office credit committee or turned down.

iv. Once the loan has been made, it is monitored by members of the credit committee and the collection agent.

At the federation level, a loan request, usually prepared by the manager of the local cooperative with the assistance of the Federation's extension agent and approved by the cooperative's Board of Directors, is reviewed by the Financial Department of FENAC C. Included in this review is an analysis of the specific project's viability, the percentage and causes of loan delinquencies, the administrative and accounting procedures used by the cooperative, internal controls for handling funds (use of safes, bonding policies, etc.) and past credit history of the cooperative.

When this analysis has been completed, the Financial Department recommends approval or denial of the request. The final decision is then made by either the Board of Directors or the Executive Committee of the Federation.

3. Penny Foundation

a. Organizational Structure and Technical Assistance Capability

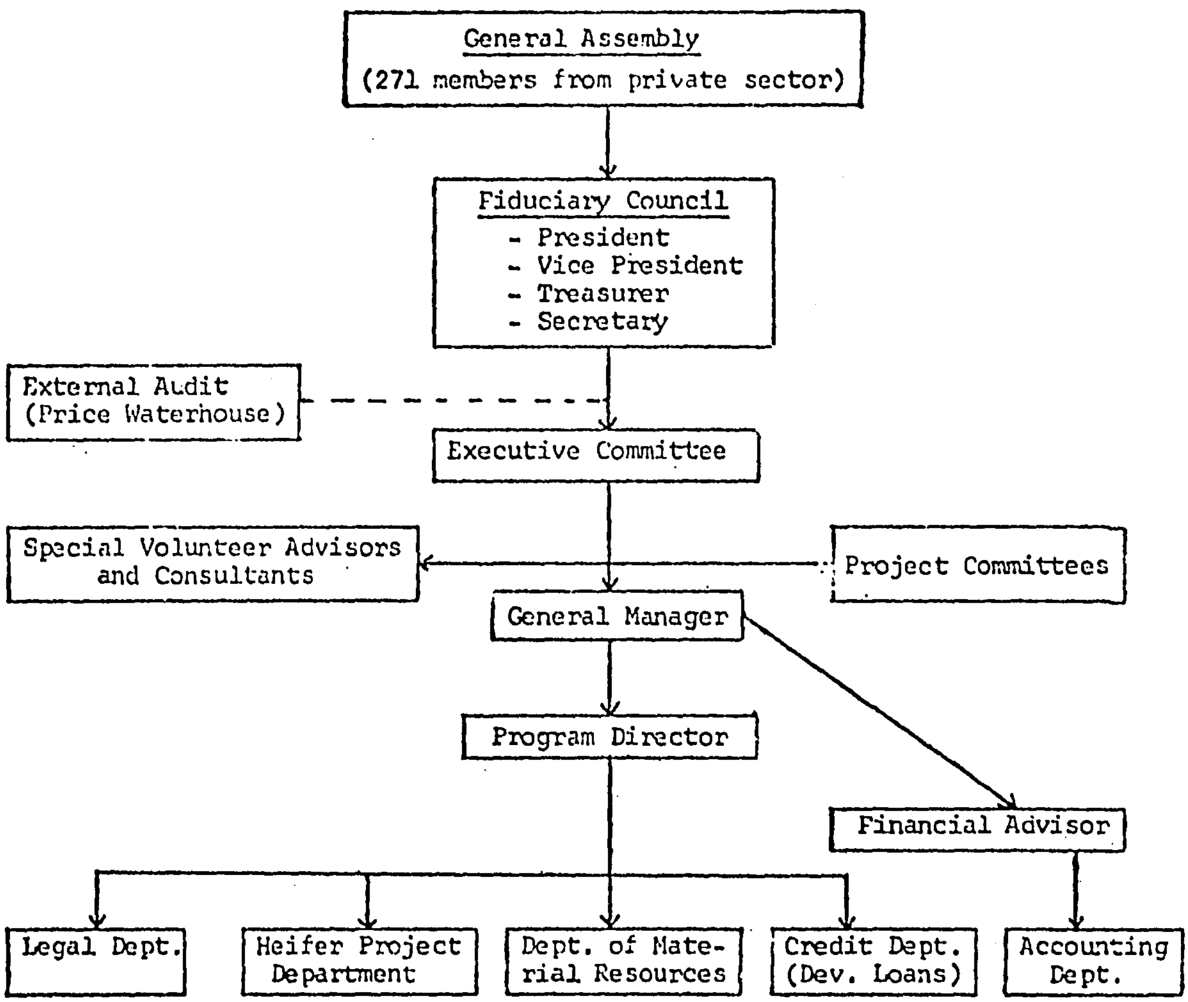
The highest authority of the Penny Foundation is the General Assembly which consists of 271 members or sponsors and meets once a year. The active policy guidance of the Foundation is in the hands of the Executive Committee which meets monthly. Day-to-day administration is handled by a General Manager and a Program Director. The Program Director supervises all daily operations and reports to the General Manager, who is also responsible for fund raising and public relations. These organizational relationships are illustrated below.

The most important Foundation activity is the development loan program which operates through the Program Director and four extensionists, whose staff is augmented by three agricultural extensionists assigned by the Ministry of Agriculture in January of this year. The extensionists are assigned to geographic regions and charged with identifying qualified loan recipients, providing supervision and assuring that there is adequate provision for technical assistance.

There will be a significant increase in the workload resulting from the AID loan and a corresponding increase in the need for technical assistance. The problem will be dealt with in two ways. First, the extensionists will assist prospective loan applicants with the design of projects. In cases where technical assistance is required for the execution of a project, and the work is beyond the time constraints of the extensionists, sufficient funds will be included in the total amount of the subloan to cover such costs. Thus, the sub-borrowers will bear the costs of outside technical services. Second, the Foundation will coordinate with BANDESA, the Ministry of Agriculture, the Federations, the Peace

PENNY FOUNDATION

ORGANIZATION CHART



Corps, and other organizations engaged in rural development activities so that recipients of Foundation loans will have access to technical services from third-party organizations. The Foundation has operated this way in the past and will give greater emphasis to this kind of coordination as the lending program expands.

Particularly in the case of the Federations, there are a variety of goods and services which can be provided to the small farmer who is outside the cooperative system but receiving financing from the Penny Foundation. These goods and services include fertilizer and insecticides, seed, and processing services such as threshing and plowing.

In cases where the pre-cooperative group is located in the geographical proximity of a local or regional cooperative, the Foundation will introduce its borrower to the cooperative, identifying the kinds of services available. When geographical location does not allow this more direct approach, the Foundation may act as an intermediary between its borrowers and the cooperative system by buying goods from the Federations and reselling to its own clientele. Such was the case during this last crop year when the Penny Foundation bought fertilizer from FENACOAC for resale.

b. Lending Procedures

The AID loan will be passed through BANDESA with a 1% surcharge, putting the final cost of money to the Foundation at 3% and 4%. The Foundation in turn will re-lend for approved activities as outlined in Section I.A.3.

The basic lending procedures of the Foundation are as follows:

i. Only groups of ten persons or more are eligible to request a loan.

ii. A regional extensionist is assigned to study the applications received and make written recommendations to the Program Director.

iii. The Program Director and the General Manager then submit the proposal before the Project Committee which, in part, is formed from and is directly responsible to the Executive Committee.

iv. When the project is approved, a loan agreement is signed between the Foundation and the recipient group.

The following considerations guide the selection of Foundation projects:

i. The project must be for purposes of production, health, improvements or general educational improvement (community development).

ii. There must be a reasonably good prospect for repayment, and no loan shall be made for more than $10,000. Repayment prospects are viewed in terms of the group's cohesiveness and administrative ability; no collateral is required.

iii. There must exist the possibility of attracting additional financing beyond the Foundation loan.

C. Socio-Economic Analysis

1. Agriculture in the Guatemalan Economy

Guatemala is a predominantly agricultural country. Of total GNP of $2 billion, over 27% is generated in the agricultural sector. Economically, there are two distinctly different sub-sectors in Guatemalan agriculture. The export oriented farming of coffee, sugar, bananas, cotton and meat uses up-to-date methods and has access to capital markets both in and out of the country. It is pure agri-business. In sharp contrast is the subsistence and near subsistence situation of the smaller Guatemalan farmers who typically work a very small plot of ground at or near the subsistence level using primitive techniques and minimum fertilizer and pesticide inputs.

The GOG, in formulating basic economic development strategy for the country, is placing overwhelming emphasis on rural development through programs to raise rural incomes and to provide such heretofore absent services as health and education. By improving the quality of life in the rural areas, migration to urban centers and its attendant problems will be minimized.

The cooperative movement, one of a number of GOG-assisted programs designed to reach Guatemala's rural poor, is a sound program from the economic and social/cultural point of view and contains significant unique features.

2. Cost Benefit Analysis of Cooperative Investment

The effects of cooperatives' activities in agricultural credit may already be observed in the field after the first year of external financing from resources provided under AID Loan 520-L-018. Research data from various sources have indicated for some time that highly satisfactory returns may be expected by the Guatemalan farmer who applies fertilizers in a reasonably correct manner on the depleted soils of the Highlands. There is also a curiosity, if not total acceptance, on the part of farmers to use chemical additives in the soil. The "word is out", so to speak, that fertilizers work and pay for themselves. What has been sorely lacking has been a vehicle or delivery system to get fertilizers and information to the farmer who has little cash, lives in a largely inaccessible area and has few assets -- other than his willingness to work -- with which to guarantee a loan.

Through the efforts of the cooperatives, 5,196 farmers were reached with $612,000 worth of fertilizer for the 1972 season from AID Loan 520-L-018. To evaluate the effect of this investment, representative samples covering 75 member farms were taken from the eastern, western, and central geographic zones of the Highlands, and the results of production were compared to the farmer's previous experience.

The results of this sampling are detailed in Annex III, Exhibits E.1, E.2, and E.3 and are summarized below:

SUMMARY PRODUCTION EXPERIENCES OF SELECTED HIGHLAND AREAS

	Previous Prod. Experience		Loan 018 Coop. Fertilizer and Seed Credit	Current Product. Experience	
	Prod. cwt	Value $	$	Prod. cwt	Value $
Eastern Highlands					
Totals for 20 members	2187	6,675	1,720.64	3176	11,848
$\bar{x}$	109	333.75	86.03	158	592.40
Western Highlands					
Totals for 20 members	1275	5,587	1,605.20	2065	10,243
$\bar{x}$	63.7	279	80.26	103	512
Central Highlands					
Totals for 35 members	6313	25,122	12,376.81	14187	70,287
$\bar{x}$	180	717.77	353.62	405	2,008

Eastern Highland Cost:Benefit $\frac{\$11,848-\$6,675}{\$1,720} = 1:3.01$

Western Highland Cost:Benefit $\frac{\$10,243-\$5,587}{\$1,605.20} = 1:2.90$

Central Highland Cost:Benefit $\frac{\$70,287-\$25,122}{\$12,376} = 1:3.64$

The three sample studies show that a cost-benefit ratio of 1:3 has been obtained on the average by the member farmer.

It should be pointed out that this calculation of cost-benefit relationships was made under circumstances which, although not exactly quantifiable, affect the results for purposes of projections of economic benefits to farmers during the life of the proposed Loan. The experience in 1972-73 should be viewed in the light of:

-- a poor growing season due to drought

-- higher prices for corn which is now in short supply

-- a first experience with fertilizer and with the receipt of credit for many farmers

-- farmers' changing decisions as to what crops to plant

-- incomplete results from late wheat plantings which are being threshed in February

-- cooperatives' short experience in production credit.

The potential for, and implications of, supplying a large number of small farmers with the necessary ingredients of modernized agriculture may be more accurately observed from research which has been performed for several years in Guatemala. Annex III, Exhibit F describes in sufficient detail the results of cost benefit analyses which show that, if anything, a $3.00 return for each $1.00 invested in improvements and inputs is highly conservative and that cooperative members should expect to do much better than the observed 1972-73 sample.

The economic benefits to farmers from improvements such as the use of fertilizer and improved seed cannot be doubted. Though still of limited experience it is believed that the Guatemalan cooperative system is contributing to the solution of the complicated problem of delivery of information, credit, supplies and services to a segment of the rural population, which, unless reached by this institutional innovation, will continue to live under subsistence conditions.

3. Economic Power and the Small Farmer

In addition to providing the small farmer with access to beneficial inputs, the cooperative movement also has the potential to effect a fundamental reordering of the essential economic relationships in rural Guatemala.

In Guatemala, the small farmer confronts monopoly and oligopoly markets at every turn. The suppliers of inputs and purchasers of output, though they themselves are often of modest means themselves, have such domination of the supply situation as to be able to virtually dictate unfavorable prices and nullify whatever gains the small farmer is able to make. That these local economically powerful groups are not universally rich is a reflection of the fact that the distribution system is so inefficient.

In the purchase of inputs -- fertilizer and seed the farmer generally must turn to a few small village storekeepers whose markups are enormous due to the low volume and inefficient distribution system.

In obtaining credit the very small farmer's only recourse is to the local moneylender. Existing government credit programs are unable to reach the very small holder primarily for cultural and linguistic reasons, but also because these more conventional programs simply cannot efficiently deal with large numbers of very small loans to unestablished credit risks. So, forced to the local moneylenders, the very small farmer pays usurious interest rates: typically 5% per month at minimum.

In selling his crop, the small farmer again losses to middlemen. While the Government, through its grain stabilization entity INDECA, is committed to stabilization of the price of all basic grains, the pegged price applies at the buying station only. In most small municipalities and villages there are no official buying stations and small farmers are forced to deal with truckers who collude to fix the price. Lacking storage capacity, the very small farmer tends to sell disadvantageously at harvest time and must buy back identical commodities later in the year at disadvantageously high prices.

These relationships are the core of the economic life in rural Guatemala; the small farmer is always in the weaker position. The cooperative movement in Guatemala, with its emphasis on providing a full line of services, can radically change the situation by providing the individual with one of the things which he most sorely lacks: power in the marketplace.

How quickly and to what extent this will happen depends, of course, on the dynamism of the movement. What is important to note is the fact that the cooperatives are uniquely able to bring economic power to the very smallest Guatemalan farmer.

4. Existing Financial Infrastructure

The financial infrastructure in those areas of rural Guatemala worked by small farmers serves to channel funds out of these areas where credit is so much needed. Those relatively few commercial banks which do exist in rural areas capture savings and funnel the funds to other areas of the economy: to the export oriented plantations and to the capital city. The government development bank for agriculture, BANDESA, reverses this trend and does serve to channel funds toward the small farmer although to a target clientele which overlaps only marginally with that of the cooperatives.

From the economic point of view, the system whereby borrowers are obliged to buy shares in the cooperative is highly desirable. Not only are voluntary savings kept within the community where they are generated but additional savings are mobilized as well. Of equal importance is the psychological impact of ownership. With respect to this cooperative, the farmer/borrower is not merely a debtor but an owner as well, with a voice in management.

5. Cooperatives as Credit Intermediaries

The cooperatives obtaining funds from one source (AID) and transmitting the funds to others (very small farmers) are in essence financial intermediaries. The relevant standards of evaluation is the test of efficiency. Are the cooperatives fulfilling this function of funds transmission more efficiently than other institutions serving the same target clientele? Existing credit programs simply do not reach the very small farmer. There are the cultural and linguistic reasons and there are commercial reasons as well. Evaluating credit applicants, overseeing use of funds, and collecting is an expensive business and one in which there are tremendous economies of size. It is very nearly as easy to oversee a \$5,000 loan as a \$50 loan. For this reason any loan maker from outside the local community is at a decided disadvantage as against an indigenous organization. In this sense BANDESA and the commercial banks are on an equally disadvantageous footing, both organizations being from outside the local community. By contrast the individual cooperatives are local community-run entities. The members know each other and the local conditions and are hence at an enormous advantage in purveying credit. For this reason the cooperatives are most efficient and indeed the only practical form of credit intermediary for small loans to very small farmers in the Guatemalan context.

6. Social and Cultural Considerations

To fully understand the cooperative movement in Guatemala and the unique role that cooperatives are capable of performing, one must see these institutions in their cultural, linguistic, and locational context.

In considering rural Guatemala, one must not lose sight of the physical isolation in which many Guatemalan farmers live. Large numbers live far from the nearest road; access is by foot and pack animal. They are out of effective reach of existing credit institutions and government extension services. Cooperatives locally organized in the isolated small villages, however, offer the possibility to bring credit and agricultural services to these Guatemalans.

Linguistic considerations are also very important. Roughly one half of Guatemala's total population speaks an Indian language. Of these, a substantial proportion speaks only the Indian tongue. Further complicating the situation is the fact that there are four main Indian language groups, each with dozens of dialects. Outside institutions must get inside this linguistic barrier to be effective. Cooperatives, being indigenous organizations. are already inside the linguistic barrier and can bridge the cultural and linguistic gap.

Another factor is the tremendous cultural fractionalization present in the Guatemalan highlands. Most basic is that between Indian and ladino. And within each group there is further division. Within the ladino population of any given town there may be divisions along religious lines - Roman Catholic and Protestant. Within the Indian community there will also be divisions between traditionalists in religion, Roman Catholics and perhaps a few Protestants. Because of local rivalries, working with one of these social divisions often effectively precludes working with the other factions in the same community. Such a situation argues for several organizations working in the same geographic area for the same goal.

In summary, from the economic and social point of view, the cooperatives are sound in concept and design. They fit into the GOG's overall development strategy, pass cost/benefit tests and are the most efficient form of ICI in dealing with the particular small farmer clientele. The social and linguistic factors also point toward the cooperative concept as the most promising for dealing with the target clientele. Finally, the cooperative movement has an almost revolutionary element: the possibility of effecting a fundamental change in the economic relationship in rural Guatemala.

7. Marketing Aspects

This program contemplates changes in corn production from the present deficit to sufficiency for the area. Projected yield goals of 3,500 to 4,000 kilograms per hectare would require from 16,000 to 18,000 hectares of corn to feed the target population at its present intake level. Other GOG corn production programs cover 35,000 hectares. Thus, total area in corn programs would be between 51,000 and 54,000 hectares or less than ten percent of the total corn acreage planted each year in Guatemala. Local market excesses will be handled and redistributed by INDECA.

Wheat production in Guatemala is deficient and will continue to be so. Improved yields in corn will free lands which can be planted in wheat or other cash crops but should not create marketing problems. In fact, these freed lands should complement the diversification subproject of Loan 018 and open new credit sources to a portion of the target group of this Loan.

8. Environmental Considerations

The project has been reviewed for its environmental aspects. It has been concluded that there will be no significant adverse effects on the environment as a result of the implementation of this project.

D. Financial Analysis

1. FENCOAR

a. Financial Statements

Balance Sheets at December 31, 1972 through 1980 and 1985 are attached as Exhibit G.2 in Annex III. Projected Income Statements for the years ended December 31, 1973 through 1980 and 1985 are on Exhibit G.3, Annex III and Source and Application of Funds Statements for the same years are on Exhibit G.4 of Annex III.

The financial projections are based upon the assumption that FENCOAR will be able to attract sufficient additional debt financing to meet total anticipated credit demand from regional cooperatives. Projections have also been included, however, for the years 1980 and 1985, assuming no additional financing. Other important assumptions, upon which these projections are based, are found in Exhibit G.1, Annex III.

b. Summary

The above referenced financial projections reveal that, based upon assumptions made, FENCOAR has excellent potential of obtaining a level of self-sufficiency within the grace period of the AID loan, with or without additional financing. The projections also reveal that net income and cash generations will be sufficient to allow debt repayment and moderate, continual growth after the end of the grace period.

c. Profitability

At the Federation level, FENCOAR's net income is projected to increase from $22,000 to $145,000 in 1980 and to $185,000 in 1985, assuming full additional debt to meet credit demand. Taking

1985 as an example, the Federation's profitability can be illustrated as follows:

1985	Amount 000's Dollars	As a % of Applied Funds
Interest Income	$ 670	7.2%
Other Income	105	1.1
Total Income	$ 775	8.3%
Interest Expense	$ 340	3.6%
Bad Debts	80	0.9
Other Expenses	170	1.8
Total Expenses	590	6.3%
Net Income	$ 185	2.0%

The total applied capital utilized in the above example is $9,305,000 calculated from that projected. Balance sheets as follows:

Long-term debt	$ 3,900,000
Accumulated capital	5,405,000
	$ 9,305,000

The interest income percent does not come out to 8% in this analysis because all of the capital being employed is not invested in the loan portfolio. The other charges, 2% for the Crop Disaster Fund and the 5% capitalization, are properly excluded from our analysis of income and expense. Both charges affect capital and cash flow but are not part of income and expense at either the Federation or cooperative level.

From this analysis of net income we can readily see that FENCOAR's profitability is a result of its lending margin on the money loaned to member cooperatives. With a net income margin of 2%, FENCOAR could afford a more expensive debt mix. Replacing the remaining $2,700,000 BANDESA loan with 6% money, in 1985 for example, only raises the average cost of funds to about 3.9% and still leaves a 1.7% net income margin. Eight percent money would raise the rate to 4.8% and leave a 0.8% margin. It is important to note, however, that given its long-term debt repayment schedule and the fact that excess cash generation was only $27,000 or 0.9% of applied funds in 1980, an increase of at least 0.3% would be required in Interest and Other Income to reach break-even with 8% money.

A similar situation can be seen in the consideration of variations in expenses or other revenues. Other expenses or bad debts could increase about 0.9% of Applied Funds and still allow FENCOAR sufficient cash flow to meet its debt repayment schedule. "Allowable" increases would be 100% of Bad Debts and 50% of Other Expenses. Similarly, an 80% decrease in Other Income would still allow FENCOAR to meet its debt obligations from current cash flow.

The cash flow analysis in Exhibit G.4 demonstrates that, between 1980 and 1985, with or without additional financing, FENCOAR will be able to continue increasing its loan portfolio by about 5% per year while meeting its debt repayment obligations. With additional debt, however, it would have an option in 1981 to:

i. Increase its portfolio at a faster rate, if demand is there or;

ii. Begin an accelerated payment of its long-term debt or;

iii. Utilize excess funds for construction or other purposes.

In our projections we have assumed accelerated debt repayment. This has the advantage of keeping interest payments in the system as debt is replaced with capitalization.

At the regional cooperative level the entire system's net income picture is expected to be as follows:

1985	Amount 000,s Dollars	As a % of Applied Funds
Interest Income	$ 800	8.7%
Other Income	1,775	19.4
Total Income	2,575	28.1%
Interest Expense	$ 580	6.3%
Bad Debts	320	3.5
Other Expenses	1,575	17.2
Total Expenses	$2,475	27.0%
Net Income	$ 100	1.1%

Total applied capital is

Loan from FENCOAR	$ 7,400
Accumulated capital	1,755
	$ 9,155

At the regional level profitability will lie in Other Income and not in the lending margin. In fact the relending operation is actually losing money since the 8.7% in Interest Income is charged with 6.3% in Interest Expense and 3.5% in Bad Debts before allocation of other expenses is considered. Again, the interest income does not equal the 12% "interest" rate charged to members due to the fact that not all the capital being employed is in the loan portfolio. The additional 2% for the Crop Disaster Fund and the 5% Capitalization are not included because they are not income or expense items.

At 1.1% the regional profit margin is only about one-half the Federation's margin. Smaller variances of expense and income will, therefore, have greater effect. A small 7% increase in other costs, or a 6% decrease in other income would completely erase profit. Management must be diligent to protect such a small profit margin but the system is anticipated to be viable with or without additional debt financing.

Conclusions-Profitability

Based upon the assumptions presented, both the Federation and the regional system of six cooperatives will reach a level of self-sufficiency within the grace period of the loan and will generate sufficient cash flow to repay long-term debt and support a reasonable growth rate.

d. Capital Structure

At the end of 1976, the first year that FENCOAR needs additional outside debt to meet credit demand, total assets are $3,946,000, over 87% of which is in the form of unsecured loans to "campesinos". Liquid assets, cash and investments, account for another 4.3% of total assets and the debt to equity ratio is only 4.93. These facts do not make FENCOAR a prime candidate for preferential credit terms but it is anticipated that the following sources of the needed credit may be available:

i. Bank of Guatemala: Before 1977, a Cooperative Bank may be formed which could rediscount notes from both Federations and thereby increase fund availability. By 1977 the Federations combined capital will be $1,000,000 - the amount required to start a bank.

ii. Government of Guatemala: The debt required by the Federations for additional lending during 1976-1980 could be supplied by the Government through BANDESA on a yearly basis, without affecting other GOG activities. In meeting the growth goals shown in this analysis, the Federations will have more than proven their ability to channel resources to the small farmer, and therefore continue their complementarity to GOG programs in the rural sector.

iii. Additional AID Financing through CABEI or BANDESA: If the Government is not in a position to assist the movement directly, additional development resources could be requested at interest rates higher than those of this loan.

iv. Commercial bank loans: If the Federations go to the commercial market, they will have to pay 8% interest on funds. If this is the alternative they will be required to charge at least 10% to member cooperatives. This would be a viable alternative, although not preferable.

If none of the above sources provide the needed credit, the financial projections show that FENCOAR would still become viable and be able to repay the AID loan. The anticipated unmet demand in this instance would be approximately $1,550,000. In addition, FENCOAR's assets would reach a level of only $7,250,000 instead of $9,705,000 and total accumulated capital would be only $4,240,000 instead of $5,405,000. The institution, however, would still be alive and doing well if the assumptions hold up.

In addition to creating bad debt reserves with annual charges to expense, a 2% Crop Disaster Fund is to be formed at the Federation level to establish a fund for soft loans in the case of crop failures. This system will work as follows:

> In addition to the 1% monthly interest rate charged to member farmers, a flat 2% charge will be taken off each loan before the farmer receives his loan proceeds. The Federation will follow the same procedure with member cooperatives. These funds will be kept in government bonds or other investments that will provide high convertibility and low risk.
>
> In the case of major crop failure, these funds would be withdrawn for three-year loans to members at 3% annual interest. This re-financing would apply only to amount of credit outstanding for the crops that have failed, and the member will qualify for new loans based upon credit requirements for the crops of the year following the crop failure.
>
> If total funds are insufficient to cover the total requirement, they will be divided in the proportion paid in by each cooperative.

Conclusion-Capital Structure

Based upon the assumptions presented, FENCOAR is expected to grow to a Balance Sheet level between $7,250,000 and $9,705,000 by 1985 depending on the utilization of additional outside credit. Capitalization expected to be created is $5,405,000 in the first instance and $4,240,000 in the second. In either case FENCOAR will have developed the resources necessary for its proposed activities.

2. FENACOAC

a. Financial Statements

Balance Sheets as of December 31, 1971 through 1980 and 1985 are attached as Exhibit H.2 in Annex III, and Income Statements for the same years as Exhibit H.3, Annex III. Projected Source and Application of Funds Statements for years 1973 through 1980 and 1985 are also attached as Exhibit H.4, Annex III.

The above financial satements are predicated upon the assumption that FENACOAC will be able to attract sufficient additional debt financing, with a 2% interest spread, to meet total estimated credit demand over the forecast period. Also included in the same Exhibits, however, are projections for 1980 and 1985 which exclude additional debt financing.

Other important assumptions are presented in Annex III, Exhibit H.1 and these assumptions are critical to the conclusions drawn in this analysis.

b. Summary

Although working on a very tight margin, FENACOAC and its affiliates will, based upon the assumptions made, obtain a level of self-sufficiency within the grace period of the Loan. They will also obtain a level of net income and cash generation which will allow debt repayment and moderate, continued growth thereafter.

c. Profitability

At the Federation level, FENACOAC is expected to obtain a net income level of $190,000 by 1985, assuming full debt financing to meet anticipated credit demand from affiliated cooperatives. This profitability can best be illustrated as a percentage of total long-term debt and capital being applied to operations:

Full-Debt Assumption Year 1985	Amount in 000's of Dollars	As a % of Applied Funds
Interest Income	$835	7.0%
Other Income	440	3.7%
Total Income	$1,275	10.7%
Interest Expense	$ 515	4.3%
Bad Debts	105	0.9%
Other Expenses	465	3.9%
Total Expense	$1,085	9.1%
Net Income	$190	1.6%

The interest percentage above is 4.3% and on Exhibit H.2, page 2 of 2 of Annex III it is only 4.0%. The difference lies in trying to compare a year-end percentage, the Balance Sheet figure, to a computation based upon accrued interest expense during a period of significant debt repayment. The 4.3 figure is the more accurate and is the one we will use in this analysis. The Applied figure used above was calculated as follows:

Long-term debt	$4,595
Accumulated capital	7,400
	$11,995

The interest income percentage is only 7.0% because all the applied capital is not earning at the stated interest income rate of 8%. In fact 1.5% is invested in other assets at December 31, 1985. The 2% Crop Disaster Fund charges and the 5% capitalization are properly excluded from this analysis of income and expense.

From this analysis, it is clear that FENACOAC, like FENCOAR, also derives its profitability from the margin between interest paid and interest earned. We note, however, that FENACOAC's purely lending margin is only 7.0 minus 5.2 or 1.8% while FENCOAR's margin was 2.7 in the same year. The difference can be explained by FENACOAC's 0.2% lesser interest income and 0.7% greater interest cost. The former is the result of having a smaller percentage of available capital invested in interest earning assets. The latter is due to FENACOAC's slightly more expensive debt mix. (i.e., $200,000 less in 3% BANDESA money and more required outside debt at the 6% rate due to larger portfolio demand).

Also, due largely to this more expensive credit mix, FENACOAC's total net income margin is 0.4% lower than that anticipated in the FENCOAR analysis. The tighter margin indicates greater susceptibility to fluctuations. Other expenses, for example, would completely eliminate FENACOAC's net income if they rose by 42%. Other income would bring about the same result if it declined by 44%. Similar percentages were 50% and 80% in the FENCOAR projections. Obviously even tighter management control is necessary it FENACOAC is to realize the anticipated success.

At the <u>affiliated cooperatives level</u> combined total income and expense is projected as follows:

Full-Debt Assumption Year 1985	Amount in 000's of Dollars	As a % of Applied Funds
Interest Income	$3,100	9.5%
Other Income	400	1.2%
Total Income	$3,500	10.7%
Interest Expense	$1,975	6.1%
Bad Debts	295	0.9%
Other Expenses	930	2.9%
Total Expense	$3,200	9.9%
Net Income	$ 300	0.8%

Total Applied Funds for the above illustration was calculated as follows:

Loan from FENACOAC	$10,900
Accumulated Capital	21,735
	$32,635

Again we see that profitability at the cooperative level is much less than that forecasted at the Federation level. Unlike the FENCOAR example, however, is the indication that profitability at this level is also dependant on the lending margin. The entire FENACOAC system then will operate primarily as an intermediate credit institution.

At Federation level FENACOAC's lending margin was seen to be 1.8%. At the cooperative level it rises to 2.5% on the assumption that bad debt losses will be no more than 1.0% (0.9% of Applied Funds). This assumption is based upon the experience of other "Credit Cooperatives" in Latin America but may be low relative to other credit-to-campesino experiences in Central and South America. The assumption is especially critical in light of the expected 0.8% total net profit margin at the cooperative level. A 2% bad debt experience would completely erase the profit margin and, thereby, threaten the entire FENACOAC system. The same disastrous effect could be caused by a 67% decrease in other income or a 28% increase in other expenses. The margin of profit is very thin and cooperative-level management too, must be diligent if the system is to succeed.

The Federation level cash flow analysis on Exhibit H.4 of Annex III reveals that, under the full debt assumption, 21% of funds generated in 1976 come from outside debt and 75% from rollover. In 1985, 95% of funds utilized will come from successful rollover of loan funds. In 1976, 89% of funds go back into the loan portfolio and in 1985 the figure is still 81% while 5% must go to debt repayment. By 1980 FENACOAC will have achieved a sufficient level of fund operation to continue a reasonable rate of growth and, simultaneously, to service its debt repayment requirements under either debt assumption.

Conclusions-Profitability

Based upon the assumptions stated, both the Federation and the affiliated cooperative system will reach a level of self-sufficiency within the grace period of this Loan. The Federation will also generate sufficient cash flow to repay long-term debt and simultaneously support a reasonable rate of growth.

d. Capital Structure

From the Balance Sheets on Exhibit H.2 of Annex III the following figures indicate the anticipated growth of FENACOAC from 1972 to 1985:

	1972	1985 Full Debt	1985 No Debt
Total Assets*	$1,212	$12,420	$8,365
Loan Portfolio*	$539	$10,900	$7,325
Portfolio as % of assets	44%	88%	88%
Crop Disaster Fund*	-0-	$1,545	$1,015
Accumulated Capital*	$237	$7,400	$5,330

*: In 000's of Dollars

Obviously the AID Loan is anticipated to have significant effect. In 1985, assuming full additional debt accumulation up to $3,950,000, FENACOAC's Loan Portfolio will be almost nine times the total assets of 1972 and the Crop Disaster Fund will be three times the entire 1972 Loan Portfolio. Even without additional debt, the 1985 portfolio is projected to be six times 1972 assets and the 1985 Crop Disaster Fund almost double the 1972 portfolio.

The prospects of obtaining additional outside credit are about the same for FENACOAC as for FENCOAR. Please see Section II.D.1.d. for comments on this point. The unmet credit demand, assuming no additional financing could be obtained, would be about $26,000,000 in FENACOAC system between 1976 and 1985.

The FENACOAC Crop Disaster Fund is designed to work exactly the same as FENCOAR's. Please refer to the capital structure narrative in Section II. D.1 for information concerning this Fund.

Conclusions - Capital Structure

Based upon the assumptions made, FENACOAC will obtain a level of resources necessary to achieve the large scale intermediate credit activities planned. This can be accomplished with or without additional outside debt but it is anticipated that, without additional debt, there would be a large unmet credit demand.

3. The Penny Foundation

a. Financial Statements

The financial statements attached in Annex III, Exhibit I were computed during September 1972. Projected Income and Expense Statements for 1972 through 1976 as well as an Income Statement for 1971 are seen as Exhibit I in Annex III. Proforma Balance Sheets for years 1972 through 1976, at present levels of financing and programming are presented as Exhibit I.2 of Annex III. Projected Income and Expense Statements, assuming $1,000,000 additional financing, are shown as Exhibit I.3 of Annex III. Project Income and Expense Statements for the same years, assuming additional financing - reduced expenses - and increased interest, are on Exhibit I.4 of Annex III.

b. Summary

Based on the analysis conducted during September 1972 it was found that, at the 10% rate of interest currently employed by the Foundation, self-sufficiency was not probable and, in fact, survival was doubtful. Since then it has been concluded that the institution's financial position has not changed.

At the time of the study it was projected that the Foundation could reach the break-even level, under the following conditions:

- an interest rate on subloans at about 20%;
- a loan portfolio increase of not less than $500,000 at a cost of not more than 3%;
- tighter control of administrative expenses to prevent their increasing more than 25% with the above increase in portfolio.

It is on these assumptions that AID is considering the Penny Foundation's interest in a $500,000 loan at concessional financing. In discussions with the Foundation's management during the Intensive Review AID emphasized the limitations or conditions that would be placed in the event of an AID Loan, namely a higher minimum interest rate and only slight increases in operating expenses. During these discussions 18% was used as an illustrative minimum rate to see the effect a different interest level would have on administrative costs. It had been analyzed that, with a loan of $500,000 at concessional terms and with interest rates at 18%, the Foundation can increase its administrative expenses by no more than 5% with a 2.4 increase in its development loan portfolio.

The Foundation has stated its readiness to take the steps necessary to achieve financial viability under this Loan (see Annex III, Exhibit A). They also have estimated that they can dramatically reduce costs and consequently be able to fix subloan interest rates at less than 20%, possibly less than the 18% level. USAID agreed that the Foundation would present its case for a minimum interest rate in a financial plan, which is now being prepared. Based on these proceedings it is recommended that, as a condition precedent to the signing of the subloan agreement between BANDESA and the Penny Foundation, the Foundation submit to BANDESA and AID for approval a detailed financial plan of its operations for the next ten years. Included in this plan should be a detailed analysis of the institution's administrative expenses, staff requirements for the implementation of the Loan, evaluation of staff curtailment, a minimum interest rate and a plan of action in order to not exceed the appropriate administrative cost increase. Until this analysis is done to the satisfaction of BANDESA and AID, no loan funds may be disbursed to the Foundation.

c. Present Capital Structure

(1) Condensed audited Balance Sheets for the years ended December 31, 1969, 1970 and 1971 are as follows:

	000's		
Assets	1969	1970	1971
Cash	$91	$12	$ 5
Loan Portfolio (net)	151	177	195
Cattle (at market)	-	45	116
Land	2	2	53
Fixed Assets & Other	10	33	87
	$254	$269	$456
Liabilities and Equity			
Accounts Payable	$13	$29	$69
Bank Loans	59	-	120
PADF Loan	106	106	106
Social Fund (Equity)	76	134	161
	$254	$269	$456

Observations:

(i) Total debt to equity has decreased from 2.3

in 1969 to 1.8 in 1971. Without the cattle donation of $116,000, however, the debt to equity ratio would have increased to 6.6.

(ii) Working capital decreased from $90,000 to $55,000 over the same period, assuming a 45% collection of beginning portfolio balance. The addition of bank loans prevented a greater decrease.

(iii)A Pan-American Development Foundation (PADF) forecast, dated 12-1-69, had predicted a portfolio level of over $526,000 by June 1971. The actual level, at the end of 1971, is only $195,000.

(iv) In the opinion of the auditors, the cattle may have been overvalued by $26,000 at 12-31-71.

(2) The Source and Application of Funds over the same two-year period as follows:

Source of Funds	000's	%
Use of Available Cash	$ 86	30
Net Income ($116-Cattle)	85	30
New Bank Loans	61	21
Increase in Accts. Payable	56	19
	$288	100

Application of Funds		
Cattle	$ 116	40
Land	51	18
Loan Portfolio	44	15
All Other	77	27
	$288	100

Observations:

(i) Excluding the cattle donation, the Foundation experienced a $31,000 loss during this period.

(ii) Accounts payable had to increase significantly to support an increase in the loan portfolio. Without this increase, the portfolio would have been reduced to cover the cash outflow from operations.

(iii)The eighteen percent investment in land represents funds employed outside the development loan area in an effort to create an additional income source to support the loan program.

Conclusion - Capital Structure

From the balance sheet totals alone, the Foundation appears to be in a stronger financial position at 12-31-71 than it was at 12-31-69. Its strength is seriously threatened, however, by continuing operating losses and deteriorating liquidity.

d. Profitability

(1) Present Financing and Programming Levels

In Annex III, Exhibit I.2 are Projected Income and Expense Statements for the years 1972 through 1976. These projections are simply an extension of the Foundation's operations without consideration of any new financing or changes in program. The figures show a gradual increase in administrative salaries and a corresponding increase in net losses from $22,500 in 1972 to $72,100 by 1976. It is also seen that income from the loan portfolio and bad debt expense will gradually decrease during the period. In summary current revenue levels (Income + donations) are not adequate to support the Foundation's high level of administrative costs.

(2) Utilizing an $1,000,000 at a 3% interest rate (see Annex III, Exhibit I.3)

This input alone would not be adequate for the Foundation to reach self-sufficiency. The input of the additional capital increases the size of the Foundations losses and only delays the eroding of the portfolio. A high of $1,242,000 would be reached by the beginning of 1975, but would deteriorate to $929,000 at the end of 1976 and then continue decreasing rapidly.

(3) Utilizing Additional Financing, Reducing Expenses, and Increasing Interest Rates

It can be seen in Exhibit I.4 that even based on the assumptions that: expenses are reduced 25%; interest rates are raised 2%; and there is additional financing of $1,000,000 at 3%, the Foundation will continue to incur losses from $5,300 in 1972 to $136,800 in 1981. The only gain under this set of assumptions is that of time; the loan portfolio falls below $1,000,000 in 1977 instead of 1976 and then decreases at a slightly slower rate than it did under the assumptions of (2) above.

(4) Other Options

The previous analyses show clearly that the mere increase of the loan portfolio will not allow the Foundation to reach self-sufficiency. The reason for this becomes clear when we examine the income and expense related to each $100,000 of the loan portfolio. Taking 1973 as a representative year, total expenses are about $130,000. The fixed costs included in this amount are about $83,000 and the costs that vary directly with the amount of capital employed in the fund, or variable costs, are about $47,000. At the present earnings rate of 10%, each $100,000 in the portfolio will show the following performance assuming a 3% cost of money:

<u>$100,000 - 10%</u>

Revenue	$10,000
Expenses -	
Interest	3,000
Credit Super. & Auto	4,500
Bad Debts	5,000
	$12,000
Loss	$(2,500)

At 10%, then, each additional $100,000 of loan funds will lose an additional $2,500 which has to be covered, along with all fixed expenses, by drawing down funds from portfolio repayments.

(ii) What would be the situation at 15%?

<u>$100,000 - 15%</u>

Revenue	$15,000
Expenses -	
Interest	$ 3,000
Credit Super. & Auto	4,500
Bad Debts	5,000
	$12,500
Gain	$ 2,500

At 15%, with the 1973 portfolio level of $350,000, earnings would contribute 3.5 x 2,500 or almost $9,000 to the fixed overhead of $83,000. This would still leave $74,000 annually to be covered by donations, other income or by drawdowns from the portfolio. If the cattle and other projects were eliminated, or at least held to their own break-even level, and, if donations could be maintained at the $40,000 level, the Foundation would still be $34,000 from its break-even on an annual basis. (Miscellaneous income was purposely ignored.) At 15%, an additional $3,000,000 in portfolio would be required to reach break-even, assuming a 3% cost of money and only a 50% increase in fixed expenses for a ten-fold increase in portfolio.

In lieu of increasing the portfolio, break-even could also be obtained at 15% by reducing fixed expenses roughly 50% or by increasing donations almost 100%.

(iii) At 20% the situation would be:

$100,000 - 20%

Revenue	$20,000
Expenses -	
Interest	$ 3,000
Credit Sup. & Auto	4,500
Bad Debts	5,000
	$12,500
Gain	$ 7,500

At the 20% level, the portfolio would contribute 3.5 x $7,500 or about $26,000 toward fixed costs leaving $57,000 to be covered by donations or other income. Now, the additional portfolio required would be just over $500,000, assuming 3% cost of money, 25% increase in fixed overheads, and constant donations.

In lieu of increasing the portfolio, break-even could also be obtained at this level of interest by reducing fixed expenses 25% or by increasing donations 50%.

Conclusion - Profitability Options

The Foundation could reach its break-even point by raising its interest rates to about 20% if it could prevent administrative costs from increasing more than 25% of present levels while adding $500,000 of 3% money to its loan portfolio.

E. Issue: Cooperative Federations - Productive Competition or Duplication of Effort?

The relationship and particularly the possible duplication of effort between FENACOAC and FENCOAR has been a principal concern not only in the planning of the Loan but also in the grant-funding of the cooperative projects. This issue also has been the subject of eight different meetings between the leaders of the two Movements in addition to numerous informal discussions. During the Intensive Review, USAID carefully analyzed the alternative institutional relationships open to the Federations as well as the role AID should play in the development of these relationships. Based on this intensive study the Mission has developed a USAID policy position on this issue.

The alternative relationships are as follows:

(a) Merger of the two Movements

A merger of the two movements would be advantageous to the extent that it would eliminate duplication of certain key positions in the Federations, with a consequent reduction in fixed overhead. It would also lead to close coordination of services to the farmer and facilitate the development of a single voice representing the cooperative movement.

However, such a merger holds disadvantages. Development of a single cooperative federation would eliminate the forces of competition which lead to more efficient and economical services. Also, a single federation representing both urban and rural cooperatives would inevitably face divergent objectives.

Implementation of this alternative does not appear feasible at this time. A combination of these two movements would require changes in the by-laws and charters of the institutions involved. Basic changes in the current Guatemalan cooperative legislation would also be required. Finally, to date this alternative has not been supported by either Federation since strong institutional loyalties and pride exist.

(b) Separation by Geographic Area

This alternative would eliminate a possible overlap of field services but would have the disadvantages described in (a) above with none of the advantages.

(c) Separation of Services by Federation

With this arrangement FENACOAC would assume responsibility for all financial activities for both cooperative movements; FENCOAR would be the supplier of all fertilizer and other inputs, and act as the marketing agent for all produce. An advantage of this arrangement would be the specialization of each Federation in specific activities, thus concentrating the capabilities of the limited human resources. At the same time, however, such a division would require a level of coordination and planning between cooperative managements that could be most difficult to achieve.

(d) Separate Federations with Positive Competition

The existence of two Federations offering similar services to the Guatemalan small farmer is of economic value. Implicit in a competitive relationship of this sort is the effective supply of services at an economically sound cost for the user.

This alternative does not exclude the possibility of joint ventures in fertilizer mixing plants, flour mills and other activities of vertical integration which would require combined institutional capabilities to be economically feasible. Such joint ventures, which in effect represent partial mergers, constitute a fifth alternative which could be implemented simultaneously with this fourth strategy.

The potential disadvantage of two competing Federations is that the competition would become so intense that unsound economic decisions might be made in an attempt to attain hegemony over a larger number of farmers. From the viewpoint of a lender of funds to these institutions this disadvantage weighs heavily when considering the borrowers' repayment capacities.

Preferred Alternative and Mission Policy

In light of the above analysis the USAID Mission considers the most viable policy to be that of promoting the development of two separate Federations and encouraging joint ventures in major fixed investments. Not only does this alternative promise to be the most reasonable in terms of present desires on the part of the Federations, but it is also most in line with the direction into which these institutions are naturally evolving. In order to safeguard the financial viability of the two competing institutions, as well as to insure the repayment of the proposed Loan, the Mission proposes that AID require all conditions and covenants necessary to guarantee institutional and financial stability. It is believed that the suggested conditions and covenants listed at the beginning of this paper will serve these purposes and thus limit competition to that of a positive, non-wasteful nature.

III. LOAN ADMINISTRATION

A. Target Dates for Implementation

Following Loan approval, the following steps and schedule are proposed:

1. The Loan Authorization is to be made by February 23, 1973.

2. Preparation of the Loan Agreement and Loan negotiations will be completed by April 15, 1973.

3. The Loan Agreement will be signed by May 1, 1973.

4. Implementation Letter No.1 will be issued May 8, 1973.

5. The time required for Guatemalan Congressional ratification cannot be reasonably predicted.

6. All Conditions Precedent to Initial Disbursement should be satisfied within one month after Congressional ratification.

7. The disbursement period is expected to cover three years from the date that all Conditions Precedent are met.

B. Administrative Provisions and Responsibilities

1. Project Management

Overall responsibility for the execution of Loan funds will be with the Trust Fund Division of BANDESA. Management of separate project activities will fall within the administrative staff of each Federation and the Foundation.

2. USAID Monitoring Responsibilities

The Chief of the Office of Rural Development and his staff will have primary monitoring responsibilities. Assistance in monitoring will be provided by USAID contracted technical advisors working with both Federations, the Capital Resources Development Officer and the Controller. There is sufficient expertise in USAID to adequately provide the necessary services.

3. Loan Disbursements

Direct disbursement of funds will be made to BANDESA at its request. The relending of funds will be done in accordance with the subloan agreements between BANDESA and the two Federations and the Foundation.

Although the primary intent of this Project is to disburse local currency funds for the activities listed in Section I.A.3, there is the possibility of some U.S. dollar expenditures by the Federations for procurement of office or farm equipment. If this type of case should arise, the Capital Project Guidelines would be followed and disbursements would be made through the issuance of letters of commitment. The Loan Agreement will stipulate the procedures to be followed in the event that there is a request for U.S. dollar expenditures.

4. Fiscal Control

BANDESA will be responsible for fiscal control of loan funds. Audit and review activities will be made by both the USAID Controller, the AID Auditor General, and by the Ministry of Finance of the Government of Guatemala.

5. Reporting and Evaluation

(a) The Project will be evaluated annually, in a joint session by the Borrower, representatives from the recipient organizations, and USAID to measure progress, discuss problems and determine future courses of actions to achieve the objectives of the Project.

(b) Each recipient will submit to BANDESA and AID:

i. Monthly Progress Reports, giving a brief summary of lending activities during the month;

ii. Comparative monthly and year-to-date Financial Statements, including Income and Expense Statements, Balance Sheet and Loan Aging Reports;

iii. Quarterly Progress Reports giving a detailed analysis of lending activities during the quarter, including name and location of borrower, number of individual beneficiaries under each subloan, purpose of the subloan, crops affected, extension of land under cultivation, subloan terms, etc.

iv. Annual Audit (independent), performed by a local, qualified firm, to be submitted not later than March 31 of the following year; and

v. Annual report, summarizing the year, to be submitted not later than February 15 of the following year.

(c) Also there will be before disbursement or commitment of the second half of the Loan, a formal evaluation of how well the recipients' lending performances have matched stated priorities and projections.

February 21, 1973

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CHECKLIST OF STATUTORY CRITERIA

(Alliance for Progress)

In the right-hand margin, for each item, write answer or, as appropriate, a summary of required discussion. As necessary, reference the section(s) of the Capital Assistance Paper, or other clearly identified and available document, in which the matter is further discussed. This form may be made a part of the Capital Assistance Paper.

The following abbreviations are used:

FAA - Foreign Assistance Act of 1961, as amended.

App. - Foreign Assistance and Related Agencies Appropriations Act, 1972.

MMA - Merchant Marine Act of 1936, as amended.

COUNTRY PERFORMANCE

Progress Towards Country Goals

. *FAA § 208; §.251(b).*

A. Describe extent to which country is:

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

(1) In addition to this agricultural production credit Loan, Guatemala has underway a major national program to improve food production, storage, and distribution, begun with a reorganization of the Ministry of Agriculture, the found ing of a grain market institute, and the combining of the government-owned Ag.bank into one new entity with over $20 million available for production credits for smal and medium farmers.

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

(2) The climate for foreign and domestic private enterprise has been favorable in Guatemala and this loan with its built-in savings and capitalization for the cooperative movement will further enhance the climate for domestic private investment.

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

(3) In addition to this cooperative loan the GOG presently has several active projects involved with increasing the public's role in the developmental process: Rural Health, bringing medical services to approximately 3,000,000 rural people; Agricultural Development: approaching small and medium farmers with modern ag. practices and the promotion of cooperatives; INFOM: financing small public works projects in small municipalities;and Rural Electrification.

(4) (a) Allocating available budgetary resources to development.

(4) (a) The GOG allocated approximately 27% of its FY72 budget for development purposes.

(b) Diverting such resources for unnecessary military expenditure (See also Item No. 16 and intervention in affairs of other free and independent nations.) (See also Item No. 14.)

(4) (b) Guatemala does not appear to be making unnecessary military expenditures nor preparing to intervene in the affairs of any other free and independent nation.

(5) Willing to contribute funds to the project or program.

(5) In addition to being guarantor for this Loan the GOG contribution is of an in-kind nature, principally administrative costs and services.

(6) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.

(6) Guatemala has underway a real property tax improvement program (AID Loans 520-L-014 and its extension) which has already generated new revenues, is improving the land fitting system as part of the Rural Development Program (AID Loan 520-L-018 ; and has a free press.

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(7) Adhering to the principles of the Act of Bogota and Charter of Punta del Este.	(7) Guatemala adheres to these principles.
(8) Attempting to repatriate capital invested in other countries by its own citizens.	(8) By continuing a course of political stability and promoting economic development, Guatemala is attempting to induce its citizens to repatriate their capital held overseas.
(9) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.	(9) The GOG's responsiveness to the needs of the Guatemalan people is exemplified by its active involvement in primary education, rural development, rural health services, small municipality development, and rural electrification. The willingness of GOG to be Borrower for the Federations further exemplifies its desire to help the Guatemalan people.
B. Are above factors taken into account in the furnishing of the subject assistance?	B. Yes.

<u>Treatment of U.S. Citizens</u>

2. *<u>FAA § 620(c)</u>. If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government?*	2. The GOG is not known to be indebted to any U.S. citizen in such a manner.

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

3. No.

FAA § 620(o); Fishermen's Protective Act, § 5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters,

4. Guatemala has not seized or imposed any penalty or sanction against any U.S. fishing vessel on account of its fishing activities in international waters.

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

N/A

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

N/A

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Relations with U.S. Government and Other Nations

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

This assistance is not directed towards any production enterprise which will compete in the U.S. with U.S. business.

6. *FAA § 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action, of U.S. property?*

6. Guatemála has not permitted, or failed to take adequate measures to prevent, such damage or destruction.

7. *FAA § 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, in convertibility or confiscation, has the A.I.D. administration within the past year considered denying assistance to such government for this reason?*

7. Guatemala has instituted the investment guaranty program.

8. *FAA § 620(q). Is the government of the recipient country in default on interest or principal of any A.I.D. loan to the country?*

8. No.

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9. *FAA § 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?*

10. *FAA § 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget?*

10. Guatemala is current in its U.N. obligations.

11. *FAA § 620(a). Does recipient country furnish assistance to Cuba or fail to take appropriate steps to prevent ships or aircraft under its flag from carrying cargoes to or from Cuba?*

11. No.

12. *FAA § 620(b). If assistance is to a government, has the Secretary of State determined that it is not controlled by the international Communist movement?*

12. N/A.

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13. *FAA § 620(f). Is recipient country a Communist country?* — 13. No.

14. *FAA § 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression?* — 14. No.

15. *FAA § 620(n). Does recipient country furnish goods to North Viet-Nam or permit ships or aircraft under its flag to carry cargoes to or from North Viet-Nam?* — 15. No.

16. FAA § 481. Has the government of recipient country failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? — 16. No.

Military Expenditures

17. *FAA § 620(s).* What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators and Military Assistance Staff (PPC/RC).)	17. For FY1972, 7.5% of the country's budget was allocated for military expenditures. In the 12 months ending June 30, 1972, approximately $12 million in cash and $6 million in credit financed new materials and equipment for the military. There were no purchases of sophisticated weapons systems.

CONDITIONS OF THE LOAN

General Soundness

18. *FAA § 201(d).* Information and conclusion on reasonableness and legality (under laws of country and the United States) of lending and relending terms of the loan.	18. The proposed loan is legal under the laws of Guatemala and the U.S.A. and its terms are reasonable.
19. *FAA § 251(b)(2); § 251(e).* Information and conclusion on activity's economic and technical soundness. If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to A.I.D. an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?	19. The project has been found economically and technically sound (see Section II.C and D). A Loan application was received with satisfactory assurances that the Loan funds will be used in an economically and technically sound manner. (See Annexx II, Exhibit B).
FAA § 251(b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.	20. It has been concluded that the Federations and Foundations repayment prospects are satisfactory (see Section II.D.).

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21. *FAA § 611(a)(1).* Prior to signing of loan will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the United States of the assistance?

21. (a) No other plans are necessary prior to the signing of the Loan.

(b) N/A.

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

22. Congressional ratification of the Loan will be required. Although it is difficult to predict with assurance when the Guatemalan Congress will ratify the loan agreement, it is reasonably expected that such action will be completed in time to permit orderly accomplishment of the purposes of the loan.

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

23. The Mission Director has certified that the Guatemalans can effectively utilize this project. (See Annex II. Exhibit A.).

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

24. The concessional financing required for this Project is not available from other free-world sources.

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Loan's Relationship to Achievement of Country and Regional Goals

25. *FAA § 207; § 251(a)*. Extent to which assistance reflects appropriate emphasis on: (a) encouraging development of democratic, economic, political, and social institutions; (b) self-help in meeting the country's food needs; (c) improving availability of trained manpower in the country; (d) programs designed to meet the country's health needs, or (e) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and Voluntray Agencies; transportation and communication; planning and public administration; urban development, and modernization of existing laws.

25. (a) The cooperative movement strengthens grass roots democray and participation in the development process;

(b) This agricultural production credit loan will increase food production in Guatemala;

(c) Federations and member cooperatives will train administrative and technical personnel from their ranks;

(d) increased food production will help meet nutritional and health needs of Guatemalans;

(e) the Loan is designed to strengthen cooperative movement and to build rural financial infrastructure.

26. *FAA § 209.* Is project susceptible of execution as part of regional project? If so why is project not so executed?

26. No.

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

27. The role of this Project in the AID/Guatemala development program is described in Section I.B.2.

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

28. This Project will allow the recipients to reach a level of operations which assures financial viability without further concessionary assistance.

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29. *FAA § 281(a).* Describe extent to which the loan will contribute to the objective of assuring maximum participation in the task of economic development on the part of the people of the country, through the encouragement of democratic, private, and local governmental institutions.

29. This Project is promoting private democratic institutions involved in economic development activities at the level of the small farmer. The cooperative movement assures maximum participation in the development process by the beneficiaries themselves.

30. *FAA § 281(b).* Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

30. This Project is encouraging the institutional development of development institutions wholly owned and staffed by Guatemalans.

31. *FAA § 601(a).* Information and conclusions whether loan will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

31. This Project will:
(a) Not applicable.
(b) Encourage private initiative through availability of funds for private investment;
(c) Program is designed for cooperative development;
(d) Discourage monopolistic practices by providing resources to cooperative enterprises;
(e) Provide financing for the expansion and improvement of cooperative agricultural enterprises;
(f) Not applicable.

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32. *FAA § 619.* If assistance is for newly independent country; is it furnished through multilateral organizations or plans to the maximum extent appropriate?

32. N/A.

33. *FAA § 251(h).* Information and conclusion on whether the activity is consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress in its annual review of national development activities.

33. This activity is consistent with CIAP's findings. (See Section I.B.3.)

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

34. By definition this loan promotes the development of the cooperative movement in Latin America. It is expected that with this AID Loan the cooperative Federations involved will be able to reach self sufficiency.

35. *FAA § 209; § 251(b)(8).* Information and conclusion whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America.

35. The accelerated economic development derived from the increased resources generated by this project will enable Guatemala to participate more in the economic and political integration of Latin America.

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

36. *FAA § 251(b)(4); § 102.* Information and conclusion on possible effects of loan on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving the U.S. balance of payments position.

36. This activity will have no significant direct effect on the U.S. economy Although this loan is expected to be entirely for local currency costs, provision will be made for dollar expenditures, USAID procurement regulations will apply.

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37. *FAA § 601(b).* Information and conclusion on how the loan will encourage U.S. private trade and investment abroad and how it will encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

37. The improved economy resulting from this loan project should encourage more U.S. trade and investment in Guatemala.

38. *FAA § 601(d).* If a capital project, are engineering and professional services of U.S. firms and their affiliates used to the maximum extent consistent with the national interest?

N/A

39. *FAA § 602.* Information and conclusion whether U.S. small business will participate equitably in the furnishing of goods and services financed by the loan.

39. To the extent applicable, the U.S. small business community will be advised through the Small Business Notification of all real opportunities to participate in this project.

40. *FAA § 620(h).* Will the loan promote or assist the foreign aid projects or activities of the Communist-Bloc countries?

40. No.

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41. *FAA § 621.* If Technical Assistance is financed by the loan, information and conclusion whether such assistance will be furnished to the fullest extent practicable as goods and professional and other services from private enterprise on a contract basis. If the facilities of other Federal agencies will be utilized, information and conclusion on whether they are particularly suitable, are not competitive with private enterprise, and can be made available without undue interference with domestic programs.

41. N/A.

42. *FAA § 252(a).* Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources.

42. The total loan amount is for lending to Guatemalan cooperative federations. All funds will finance procurements from private sources.

Loan's Compliance with Specific Requirements

43. *FAA § 201(d).* Is interest rate of loan at least 2% per annum during grace period and at least 3% per annum thereafter?

43. Yes.

44. *FAA § 608(a).* Information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.

44. N/A

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45. *FAA § 604(a).* Will all commodity procurement financed under the loan be from the United States except as otherwise determined by the President?

45. Procurement will be from the U.S., Guatemala, Central American and all other Code 941 countries.

46. *FAA § 604(b).* What provision is made to prevent financing commodity procurement in bulk at prices higher than adjusted U.S. market price?

46. No bulk commodity procurement is contemplated under this loan.

47. *FAA § 604(d).* If the cooperating country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the United States on commodities financed by the loan?

47. Yes.

48. *FAA § 604(e).* If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?

48. N/A.

49. *FAA § 611(b); App. § 101.* If loan finances water or water-related land resource construction project or program, is there a benefit-cost computation made, insofar as practicable, in accordance with the procedures set forth in the Memorandum of the President dated May 15, 1962?

49. N/A.

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50. *FAA § 611(c).* If contracts for construction are to be financed, what provision will be made that they be let on a competitive basis to maximum extent practicable?

50. As the case arises, public formal invitations for bids will be advertized pursuant to local law and the AID Capital Projects Guidelines.

FAA § 620(g). What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property?

51. N/A

FAA § 612(b); § 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.

52. N/A

53. *App. § 104.* Will any loan funds be used to pay pensions, etc., for military personnel?

53. No.

54. *App. § 106.* If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms?

54. Yes.

55. *App. § 108.* Will any loan funds be used to pay U.N. assessments?

55. No.

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56. *App. § 109.* Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (A.I.D. Regulation 7).

56. Regulation 7 will be complied with.

57. *FAA § 636(i).* Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicle manufactured outside the United States, or any guaranty of such a transaction?

57. No.

58. *App. § 501.* Will any loan funds be used for publicity or propaganda purposes within the United States not authorized by the Congress?

58. No.

59. *FAA § 620(k).* If construction of productive enterprise, will aggregate value of assistance to be furnished by the United States exceed $100 million?

59. No.

60. *FAA § 612(d).* Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

60. No.

61. *MMA § 901.b.* Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed with funds made available under this loan shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.

61. The Loan Agreement will require such compliance.

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

I, Robert E. Culbertson, the principal officer of the Agency for International Development in Guatemala, having taken into account, among other things, the maintenance and utilization of projects in Guatemala previously financed or assisted by the United States, do hereby certify that in my judgment Guatemala has both the financial capability and the human resources capability to effectively maintain and utilize the capital assistance project, Rural Credit and Cooperative Development.

This judgment is based upon the improving implementation record of AID-financed projects in Guatemala and the quality of the planning which has gone into this new project.

(signed) R. E. Culbertson

(date) February 5, 1973

MINISTERIO DE FINANZAS PUBLICAS

GUATEMALA, C. A.

RESOLUCION 0277

REGISTRO

Guatemala, 7 de febrero de 1973

UNCLASSIFIED
ANNEX II
Exhibit B
Page 1 of 1

Señor Robert E. Culbertson
Director de la Misión AID en Guatemala
Edificio Cruz Azul, 7° Piso,
C I U D A D.

Estimado señor Director:

Como es de su conocimiento, el Gobierno de la República concede, en el Plan de Desarrollo 1971-75, especial interés al mejoramiento e incremento de las condiciones del área rural en sus múltiples fases y, dentro de éstas, dá primordial importancia a proveer ayuda crediticia a las cooperativas agrícolas y fundaciones que, como la del Centavo, están en capacidad de evaluar en forma rápida y precisa las necesidades de sus miembros y de los pequeños agricultores que entran bajo su radio de acción, lo que les permite conceder crédito no sólo para incrementar la producción agrícola, propiamente dicha, sino para actividades de mercadeo, de pequeños negocios rurales y mejoras de su infraestructura ambiental, educacional y sanitaria. Además, las Federaciones de Cooperativas Agrícolas usarán los fondos para mejorar sus propias estructuras, para inversiones productivas e inversiones en activos fijos, tales como facilidades de almacenamiento, maquinaria agrícola, vehículos de trabajo y equipo de oficina.

Por lo anteriormente expuesto, el Gobierno de la República solicita a usted, por este medio, que la Misión a su digno cargo se sirva considerar la posibilidad de concederle un préstamo por el equivalente de US$4.5 millones, en las mejores condiciones posibles, y el cual estaría destinado a formar parte esencial de un programa de desarrollo de instituciones agrícolas privadas, específicamente de la Federación Nacional de Cooperativas Agrícolas Regionales (FENCOAR), de la Federación Nacional de Cooperativas Agrícolas de Crédito (FENACOAC), las que recibirían hasta una suma equivalente a US$4.0 millones, y la Fundación del Centavo, a la que se le ha asignado una suma equivalente a medio millón de dólares. El Estado, que sería el Prestatario, canalizaría los fondos del préstamo a través del BANDESA, el que no sólo aportaría los elementos administrativos del programa, sino supervisaría y controlaría el buen uso de dichos fondos. El Estado, a su vez, contribuiría aportando los servicios de sus instituciones que, como la Superintendecia de Bancos y los departamentos técnicos del Ministerio de Agricultura, velarían por la correcta y eficiente aplicación de los fondos del Préstamo.

Este Despacho espera que el préstamo solicitado pueda ser incluído dentro de los objetivos de la Alianza Para el Progreso y que la Misión a su digno cargo dé a esta solicitud su más pronta y favorable acogida, permitiéndome agregar que tanto los funcionarios de este Ministerio como los del Ministerio de Agricultura, gustosamente aclararemos cualesquiera dudas o consultas que, en relación con el programa descrito, pudieran tener los miembros de esa Misión.

Al agradecer a usted la atención que la presente le merezca, me es grato aprovechar la oportunidad para suscribirme su muy atento y seguro servidor.

LIC. JORGE LAMPORT RODIL
MINISTRO DE FINANZAS

MINISTERIO DE FINANZAS PUBLICAS GUATEMALA, C. A. AMERICA CENTRAL

JLS/mnn

OFFICE TRANSLATION

Penny Foundation
January 31, 1973
S. G. 58-1-73

AID Mission
Cruz Azul Building
Guatemala City

Attention: Mr. Daniel A. Chaij
Office of Rural
Development

Gentlemen:

In response to your letter of January 30, 1973, and in compliance with your request for a response by the first of February, I am quoting to you the text of the conditions that the Penny Foundation has accepted as per Points Four and Ten of Minutes No. 128 of the session held on January 30, 1973, pending reading and approval during the next session (of the Executive Committee).

"FOURTH: A discussion began concerning the development of a new loan with AID, stating that there had been steps taken during the past year to obtain a million Quetzal loan; and that there presently exists an authorization to pursue negotiations for credit of an unspecified amount, but that according to AID Officials the amount is approximately Q500,000.00.

"It was concluded that it was in the interest of the Foundation to obtain an AID Loan and consequently the President and the General Manager are authorized to pursue a line of credit the general terms of which are the following:

Amount of Loan	Q500,000.00 - Q1,000,000.00
Loan Period:	Twenty-five to forty years
Interest rate:	Three to four percent
Purpose:	Sub-loans to marginal rural groups
For projects as:	Fertilization and purchase of agricultural production inputs; marketing; crop maintenance; seed improvement; small stores and businesses; irrigation; transportation; agricultural machinery; community construction projects; land purchase; installation of medical posts; handicrafts, and others.
Method of Operation :	The Loan will be utilized through the system previously used with the Q200,000 AID-BANDESA loan, or under such a system as may be agreed to.

"TENTH: With the state of negotiations with the AID Mission being known from the letter dated today from Mr. Daniel Chaij, Director of the Office of Rural Development of the USAID Mission to Guatemala, and as an extension of Point Four of this minutes, the following preliminary conditions are accepted for the loan being negotiated:

a) to stabilize the income and expenses of the Foundation it will be necessary to increase the interest rate to a level that will allow for self-sufficiency in accordance with a technical study now being prepared;

b) the Foundation will establish a reserve fund of 5% of each loan made to cover losses against bad debts. This reserve fund can be placed in investments that are both safe and liquid, such as Government Bonds, FHA bonds, and documents redeemable at sight;

c) the Foundation agrees that together with the financial analyst of AID there will be established a maximum percentage of retained earnings that can be invested in fixed assets, thus avoiding the freezing of capital;

d) the Foundation agrees not to contract for external debt that would create greater than an eight to one debt/equity ratio, unless AID otherwise agrees in writing;

e) the Foundation will prepare a plan showing how it proposes to reduce its net operating expenses to guarantee its economic viability within the interest rate that is used for sub-loans. The collaboration of AID is asked for the preparation of this plan"

With nothing more at present, and hoping that with this we have satisfactorily met your concerns, I remain,

Sincerely yours,

Rodolfo Martínez Ferraté
General Manager

FUNDACION DEL CENTAVO
FUNDACION GUATEMALTECA PARA EL DESARROLLO
6a. AVENIDA 7-19, ZONA 9. CIUDAD DE GUATEMALA
DIRECCION CABLEGRAFICA: FUNDACEN TELEFONO: 62-4-04

31 de enero de 1973
S. G. 58-1-73

Señores
Misión AID
Edificio Cruz Azul
Ciudad

At. Sr. Daniel A. Chaij
Oficina de Desarrollo Rural

En respuesta a su carta de fecha 30 de enero de 1973 y cumpliendo con su solicitud de una respuesta para el día lo. de febrero, le transcribo a continuación las condiciones que la Fundación del Centavo ha aceptado, según consta en punto cuarto y décimo del Acta número ciento veintiocho, (pendiente de lectura y aprobación en próxima sesión), de la Sesión realizada el día 30 de enero de 1973.

"CUARTO: Se inició la discusión del nuevo préstamo en trámite con la Agencia Internacional para el Desarrollo, informándose que se habían hecho gestiones el año anterior para obtener un millón de quetzales de acuerdo a datos y resumen que se leyó y que actualmente existe la autorización de negociación de un crédito por una cantidad no especificada, pero que en términos de funcionarios de AID es de alrededor de Quinientos Mil Quetzales.

Se convino en que era conveniente para la Fundación de obtener un préstamo de AID por consiguiente se autoriza al Presidente y Gerente para que gestionen un crédito cuyas características mas recomendables serían que se ajusten a lo siguiente:

Monto del préstamo	Quinientos Mil a Un Millón de Quetzales
Plazo	Veinticinco a Cuarenta años
Tasa de Interés	Tres a Cuatro por ciento
Destino	Sub-préstamos a campesinos marginales
Para proyectos de:	Fertilización y compra de insumos
	Comercialización
	Mantenimiento de Cultivos
	Mejoramiento de semillas
	Tiendas de insumos y comercialización

Irrigación
Transporte
Maquinaria Agrícola
Construcción de obras comunales a nivel de aldea
Compra de tierra
Instalación de Clínicas Médicas
Artesanía
Otros

Modus Operandi: El préstamo deberá obtenerse por el sistema utilizado en el préstamo anterior de Doscientos mil quetzales a través de BANDESA que lo recibe en fideicomiso del Gobierno de Guatemala y éste de la AID, u otro sistema que se acuerde.

DECIMO: Conocido el estado de la negociación de un préstamo por la Misión AID, teniendo a la vista la carta del señor Daniel A. Chaij, Director de la Oficina de Desarrollo Rural de la Misión AID de Guatemala el día de hoy, y en ampliación al punto cuarto de ésta Acta se aceptan las siguientes condiciones preliminares para el préstamo que actualmente está siendo programado:

A) Para equilibrar los gastos e ingresos de la Fundación será necesario aumentar la tasa de interés a un porcentaje que la lleve a su auto-suficiencia de acuerdo a un estudio técnico que para el efecto se está realizando.

B) La Fundación establecerá una reserva para préstamos incobrables del cinco por ciento de cada préstamo. Esta reserva será efectiva en inversiones de alta liquidez y seguridad, tales como bienes del estado, cédulas FHA y otros documentos redimibles a la vista.

C) La Fundación acepta que con el Analista Financiero de AID se establecerá el porcentaje máximo del fondo social que podrá ser invertido en activos fijos para evitar el congelamiento de capital.

D) La Fundación del Centavo se compromete a no contraer deuda externa en exceso de una relación deuda-capital de ocho a uno, sin previa autorización escrita de AID.

E) La Fundación preparará un plan demostrando como se propone reducir un porcentaje de sus gastos netos de operaciones para garantizar su viabilidad económica dentro de la tasa de interés que se fije a los subpréstamos. Se solicta la colaboración de AID para la preparación de este plan.

Sin otro particular de momento, y esperando que con esto hayamos cumplido con sus deseos, me es grato suscribir, atentamente,

Ing. Rodolfo Martínez Ferraté
Gerente

RMF/mug

P E N N Y   F O U N D A T I O N

Status of AID-BANDESA Loan Program

Monthly Report as of December 31, 1972

No.	P R O J E C T S	Families Benefited	Loan Amount	Repayments	Balance Due
1	Com. Agric. El Divisadero	25	Q. 347.88	Q. 75.15	Q. 272.[illegible]
2	Com. Agric. Altupe	117	4,406.48	951.94	3,454.[illegible]
3	Com. Agric. El Porvenir	100	5,744.48	1,240.99	4,503.49
4	Com. Agric. Palo Verde	87	1,098.68	435.40	663.28
5	Com. Agric. Los Izotes	57	914.76	180.31	734.45
6	Com. Agric. San Yuyo	87	2,318.36	456.97	1,861.39
7	Com. Agric. El Durazno	47	667.92	210.23	457.69
8	Com. Agric. Laguna del Pito	53	1,142.24	225.14	917.10
9	Com. Agric. El Carrizal	33	513.04	101.12	411.92
10	Com. Agric. El Rodeo	72	1,994.08	1,060.50	933.58
11	Com. Agric. La Laguneta	78	2,112.96	1,062.42	1,050.54
12	Com. Agric. La Fuente	77	1,645.60	324.36	1,321.24
13	Com. Agric. San Francisco	21	542.08	106.85	435.23
14	Com. Agric. Llano Grande	47	1,462.88	1,437.04	25.84
15	Com. Agric. La Reforma	32	892.00	558.07	333.93
16	Com. Agric. La Ceibita	12	625.04	523.09	101.95
17	Asoc. Agric. Saquitacaj	24	1,779.39	337.40	1,441.99
18	Asoc. Agric. Chuinimachincaj	39	1,462.05	565.62	896.
19	Asoc. Agric. Pahuit	34	1,471.03	560.19	910.84
20	Asoc. Agric. San Antonio Sija lo.	20	1,419.00	129.52	1,289.48
21	Asoc. Agric. Sta. Catar. Ixtahuacán	50	1,099.80	285.11	814.69
22	Cooperativa Guitón	19	1,240.87	131.05	1.109.82

23	Asoc. Agric. Chivarreto	24	1,310.21	496.07	814.14
24	Asoc. Agric. Choantonio	15	1,266.64	436.90	829.74
25	Asoc. Agric. Patzalá	23	1,620.48	269.99	1,350.49
26	Asoc. Agric. Coj Samaj Junán	47	2,235.65	1,038.81	1,196.84
27	Liga Campesina Chicalquix	27	1,521.48	244.76	1,276.72
28	Asoc. Agric. San Antonio Sija 2o.	19	1,006.20	195.22	810.98
29	Comité Agric. El Jícaro	47	1,733.98	820.97	913.01
30	Comité Pro-Mej. El Potrerillo	60	2,569.56	555.56	2,014.
31	Asoc. Agric. de Chiaj	40	3,347.81	748.57	2,599.24
32	Comité Agric. San Matías	15	469.42	---	469.42
33	Comité Agric. El Chaguite	31	1,220.10	221.54	998.56
34	Asoc. Agric. Cucabaj	48	881.34	264.49	616.85
35	Asoc. Agric. San José Poaquil	22	1,497.30	135.07	1,362.23
36	Asoc. Agric. Xecoxol	66	1,540.77	238.29	1,302.48
37	Asoc. Agric. Saquilla	37	1,352.40	274.91	1,077.49
38	Asoc. Agric. La Garrucha	38	1,289.61	396.75	892.86
39	Asoc. Agric. El Rosario	14	547.56	106.24	441.32
40	Asoc. Agric. Las Lomas Scalá	41	1,298.25	241.26	1,056.99
41	Asoc. Agric. El Rincón	31	1,645.80	1,220.44	425.36
42	Asoc. Agric. Las Camelias	51	2,686.90	501.54	2,185.36
43	Comité Pro-Mej. El Jocote	84	1,335.62	250.53	1,085.09
44	Asoc. Bonanza	8	1,507.43	38.76	1,468.67
45	Asoc. Agric. Don Tomás	27	1,226.01	117.60	1,108.41
46	Comité Agric. Tatasirire	74	1,369.50	248.67	1,120.87
47	Asoc. Agric. Chipiacul	43	1,953.90	858.33	1,095.[illegible]
48	Cooperativa El Dulce Nombre	20	4,924.34	---	4,924.34
49	Comité Agric. El Maestrillo	36	1,159.15	216.00	943.15
50	Consorcio Coop. de El Petén	13	1,500.00	---	1,500.00
51	Comité Pro-Mej. Suj y Canzela	86	1,204.80	211.30	993.50
52	Asoc. Agric. El Rosario	22	9,160.00	453.82	8,706.18
53	Cantón Jujujil	4	1,000.00	209.20	790.80
54	Asoc. Agric. La Pedrera Xejuyú	26	1,141.92	596.85	545.07
55	Comité Agric. de Huitán	60	1,664.36	---	1,664.36

56	Comité Agric. 4o. Centro Choacamán	20	839.05	234.80	604.25
57	Asoc. Agric. El Terreno	19	525.00	---	525.00
58	Luis Antonio Zacarías Morales	1	500.00	40.00	460.00
59	Sandoval y Franco	2	4,462.45	---	4,462.45
60	Cooperativa Alianza Campesina	15	1,000.00	45.15	954.85
61	Cooperativa La Curbina	16	3,258.20	---	3,258.20
62	Coop. Unión Central Ojeteca	30	2,000.00	---	2,000.00
63	Carlos Mollinedo Herrera	1	500.00	---	500.00
64	Carlos R. Amenábar	1	3,125.00	---	3,125.00
65	Alfredo Oliva Véliz	1	2,400.00	416.00	1,984.00
66	Mario H. Oliva Véliz	1	3,000.00	---	3,000.00
67	José Victor Vásquez	1	160.00	76.18	83.82
68	Carlos Humberto Tobar	1	2,000.00	550.00	1,450.00
69	Asoc. Agric. Cucabaj	12	1,396.00	345.26	1,050.74
70	Israel del Socorro Martínez	1	201.00	---	201.00
	T O T A L E S	2,452	Q120,455.81	Q24,274.30	Q96,181.51

UNCLASSIFIED
Annex III
Exhibit C

(Conformed Translation)

PROPOSED LENDING POLICY FOR COOPERATIVES FEDERATIONS

NATIONAL AGRICULTURAL DEVELOPMENT BANK

(BANDESA)

Guatemala, C. A.

INTRODUCTION

Article 1. The present policy establishes the guidelines, requisites and conditions required to effectively administer funds provided in the Cooperatives Federations Loan, and thereby increase the income and productivity of Guatemala's small farmers and strengthen the Federations which serve them.

OBJECTIVES

Article 2. The resources of this loan will be used to finance the following cooperative activities:

A. Production, processing, marketing, and storage of agricultural products; purchase of facilities and equipment and financing of complementary services which are considered necessary to the strengthening of the cooperative movement;

B. Small livestock operations;

C. Small rural industry and business activities; and

D. Social improvements in rural areas, such as farm and have improvements, education of farmers and their families, etc. All such credits will be made only to farmers who are already receiving productive credit and have, therefore, the ability to repay social improvement loans. A maximum of 10% of total loan funds may be used for this purpose.

E. Strengthening the image and financial integrity of the cooperative Federations.

TECHNICAL ASSISTANCE

Article 3. Technical assistance will be provided by personnel of the borrowing cooperative institutions, its sub-borrowers and by the technical staff of DIGESA, and INDECA. 1/

1/ DIGESA: Directorate General of Agricultural Services (Ministry of Agriculture)
INDECA: National Marketing Institute (a decentralized agency of the Ministry of Agriculture)

CREDIT SUBJECTS

Article 4. Credit subjects for the Loan regulated by this Policy are the National Federation of Regional Agricultural Cooperatives (FENCOAR) and the National Federation of Savings and Credit Cooperatives (FENACOAC) and the Penny Foundation.

Loans made to the three organizations may be used by them for investments to their own account or for sub-loans to affiliated cooperatives.

ELIGIBILITY OF THE SUBJECTS OF CREDIT

Article 5. In order to be eligible for credit, each Federation must comply with the following conditions:

a. Be legally chartered;

b. Maintain efficient administrative procedures and an up-to-date accounting system;

c. Present an acceptable feasibility study and an adequate Investment Plan;

d. Have access to technical assistance in agriculture, industrial, administrative, and cooperative matters;

e. Handle their funds through BANDESA;

f. Maintain fidelity bonds for those who control or handle funds and inventories;

g. Possess adequate means for safeguarding documents and funds;

h. Commit themselves to capitalize not less than 50% of their annual net profits;

i. Allow officials of BANDESA and the Cooperatives Dept. of DIGESA to have free access to the accounting records and proceedings as well as the General Assemblies and Meetings of the Board of Directors when it is deemed necessary in the judgment of DIGESA or BANDESA;

j. Accept the technical assistance of the specialized departments of DIGESA and INDECA in the planning and execution of projects;

k. Adopt the recommendations which BANDESA may propose to correct administrative deficiencies, increase reserves, and avoid borrowers' and sub-borrowers' delinquency.

ELIGIBILITY OF THE SUB-BORROWERS

Article 6. (1) In order to be eligible for sub-loans from the Cooperative Federations which have qualified in accordance with Article 4, their affiliate cooperatives will have to satisfy the following pre-requisites:

a. Have a legal charter;

b. Maintain efficient administrative procedures and an up-to-date accounting system;

c. Present an acceptable feasibility study and Investment Plan.

d. Have access to technical assistance in agricultural, industrial, administrative and cooperative matters;

e. Handle their funds through BANDESA;

f. Maintain fidelity bonds for those who handle funds and inventories;

g. Abstain from initiating other credit negotiations without prior approval from the Federation;

h. Maintain a loan delinquency rate of not more than 10% of their total portfolio;

i. Possess adequate means for safeguarding documents and funds;

j. Commit themselves to capitalize not less than 50% of their annual net profits;

k. Allow officials of BANDESA and the Cooperatives Department of DIGESA, to have free access to the accounting records and proceedings as well as the General Assemblies and meetings of the Board of Directors when it is deemed necessary by BANDESA or DIGESA;

l. Accept the technical assistance of the specialized departments of DIGESA and INDECA in the planning and execution of project plans; and

m. Adopt the recommendations which BANDESA and the Cooperatives Department of DIGESA may propose to correct administrative deficiencies, increase reserves, and avoid loan delinquency.

(2) Any legally responsible pre-cooperative group of more than 10 members, with or without an official charter, upon satisfying the program's objectives may be eligible for sub-loans from the Penny Foundation, which has qualified in accordance with Article 4. Expressly excluded are individual loans or loans to groups of less than 10 members.

A group is considered to be legally responsible when its members have designated a legal representative before a public notary or competent authority, and have established joint debtor responsibility of the individuals. In special cases the names of all debtors will be accepted in the loan document.

INTEREST RATES

Article 7. BANDESA will charge interest at the rate of 3% for the first 10 years of each loan and 4% during the remaining 30 years.

AMOUNT OF LOAN & REPAYMENT SCHEDULES

Article 8.

a. The amount of the loan to be granted to the National Federation of Credit Unions will be $2,000,000; to the National Federation of Regional Agricultural Cooperatives will be $2,000,000; and to the Penny Foundation will be $500,000. The maximum term will be of forty (40) years. During the first ten (10) years the borrowing institutions will pay only interest to BANDESA, and during the following thirty (30) years they will pay interest and capital in semi-annual installments.

b. The amount of any sub-loan made by the borrowing institution will not exceed the total obtained by multiplying the number of members to be benefitted by Q.5,000.00, amount considered as the maximum for individual loans to members from resources of this fund.

The aforementioned disposition will not apply to funds which the Federations use directly for fixed investments and equipment necessary to achieve the viability of the Program's objectives.

c. Repayment schedules for sub-loans will be determined according to the cooperatives income as projected in their Investment Plan.

GUARANTEES

Article 9.

a. The borrowing institutions will offer in guarantee their present assets, assets acquired with proceeds from the Loan, and the assignment of their loan portfolio. All loan contracts may be kept in the safe of the federation, or at BANDESA if so requested.

b. Sub-loans will have sufficient collateral such as crop, industrial or cattle leins, and in some cases, they may be supplemented by equipment and real estate mortgages, if the sub-borrower can provide such additional guarantees.

c. Sub-loans will be granted in the following proportion to the collateral offered: Mortgages 85%, leins 75%, and when leins and mortgages are both offered, 80% of the aggregate value.

d. Cooperatives may also offer a blanket guarantee of all their assets as collateral for a sub-loan.

e. All sub-loans granted by the federations will have supporting contracts written in accordance with all legal requirements.

RESTRICTIONS

Article 10.

a. The federations may grant additional subloans to cooperatives that have not fulfilled previous credit obligations, when inability to pay has been caused by adverse circumstances and calamities, such as: drought, floods, earthquakes, hurricanes, crop disease and other acts of nature which are considered unforeseen or unavoidable in the opinion of BANDESA.

b. Funds from this loan may not be used for:

1. Cattle operations.
2. Acquisition of land and used buildings.
3. Payment of interest.
4. Payment of salaries to the Federations', Foundation's and Cooperatives' personnel.
5. Payment of dues to the Federations or Foundation.
6. Granting of credit by Federations to other organizations or non-members.
7. Purposes other than those requested in the sub-loan application.

8. Individual member loans exceeding Q.5,000.00.

9. Financing activities relating to coffee, cotton, sugar or other crops or commodities unacceptable to AID.

10. Distribution of net income or patronate refund to members; and

11. Payment of debts.

c. The sub-borrowing cooperatives may not obtain any other loans, or assume new indebtedness through contracting of services, and buying or selling of property, without prior approval from the lending federation.

d. The federations must submit to BANDESA a list of their affiliates borrowers, so BANDESA may consult the federations in cases where cooperatives and their members are submitting loan applications directly to the Bank while having outstanding indebtedness with the federations. The Foundation will submit a similar list of its borrowers under this Loan.

LEGALIZING OF CONTRACTS

Article 11. All contracts must be legalized according to the Law.

GENERAL PROVISIONS

Article 12. The sub-borrowing institutions may grant loans to individuals with outstanding indebtedness at BANDESA, if such outstanding balance plus the new loan does not exceed the amount of Q.5,000.00, as referred to in Article 8, clause B, of these Regulations and providing the individual is current with his obligation to BANDESA.

Article 13. The Federations will obtain approval from BANDESA and AID prior to any investment exceeding $1,000 from any source in fixed assets. Cooperatives affiliated will submit for approval to its Federations a cost/benefit analysis on any proposed fixed investment project exceeding $1,000. Fixed investments proposed by the affiliates and exceeding $5,000 will require prior BANDESA/AID approval.

Article 14. The Federations will establish a Crop Disaster Fund equivalent to 2% of cash sub-loan granted. This amount will flow through to the final user and will be deducted off the top of subloans and invested by the Federations in Government securities or similar investments of the highest safety and liquidity. The Penny Foundation will establish and maintain a bad-debt reserve equivalent to 5% of the Loan. Pay-in to the reserve will begin with the first drawdown of Loan funds.

Article 15. All borrowing cooperatives will capitalize 5% of the value of each loan in their federation. Likewise, each borrowing cooperative member will capitalize 5% of the value of each loan he receives in his cooperative.

Article 16. The maximum debt/equity ratio in sub-loans to members will be 5:1.

Article 17. Local and regional cooperatives will capitalize at least 50% of all their net profits. The Federations will capitalize all their profits until their debt/equity ratio is not higher than 5:1.

Article 18. Any conditions, covenants and regulations of AID Loan 520-L-024 and its Implementation Letters will apply to this Lending Policy even if not mentioned or defined herein.

GROWTH PROJECTIONS AND ACTUAL ACHIEVEMENTS

		FENACOAC 1971	FENACOAC 1972	FENCOAR 1971	FENCOAR 1972
AFFILIATED COOPERATIVES	P	75	80	2	3
	A	75	80	2	3
COMMUNITIES AFFECTED	P	75	80	40	80
	A	87	117	80	150
TOTAL MEMBER FAMILIES	P	20,000	25,000	1,500	3,000
	A	23,122	32,400	1,600	3,100
TOTAL NET WORTH (System Wide)	P	$ 890,000	$ 1,350,000	$ 35,000	$ 60,000
	A	924,291	1,550,000	19,000	251,200
CREDIT OUTSTANDING (Federation Level)	P	$ 435,000	$ 731,000	$ 250,000	$ 500,000
	A	144,042	485,000	255,000	477,000
BAD DEBT RATE (Federations	P	1%	1%	-	1%
	A	0%	0%	0%	0%
FERTILIZER PURCHASED (Cwts)	P	--	--	30,000	60,000
	A	55,000	100,000	35,000	91,000
PRODUCT MARKETED (Cwts.)	P	--	--	40,000	80,000
	A	--	5,000	65,000	130,000

P = Projected

A = Achieved

GROWTH PROJECTIONS

As of December 31 of each year (1)

		1975	1980	1985
Affiliated Cooperatives	R(2)	6	6	6
	C(2)	95	120	120
Communities Affected	R	240	270	300
	C	225	300	375
Total member families	R	15,000	22,000	25,000
	C	65,000	100,000	105,000
Total Equity Capital (system wide,000's)	R	750	3,100	7,500
	C	4,700	13,500	25,000
Credit Outstanding (Federation level,$000)	R	2,500	6,760	8,600
	C	2,842	9,121	10,900
Fertilizer sales (thousand cwts)	R	403	820	1,025
	C	250	350	475
Product Marketed	R	4,000	8,150	10,180
	C(3)	--	--	--

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(1) Projections shown on this sheet are end of year figures, whereas projections used in financial analysis are often first or mid-year figures. In some cases, more conservative projections were used in financial analysis.

(2) R = FENCOAR; C = FENACOAC.

(3) As a formal policy has not been adopted by FENACOAC for this activity, no projections have been included.

CHIMALTENANGO

In the area of the Chimaltenango regional agricultural cooperative, located some 50 miles west of Guatemala City, a sample of 20 representative farmers growing corn and wheat with inputs acquired on credit from the cooperative were investigated through the field staff interviews (2 agronomists) and base line member data from accounting records. Although there was high variability in the sample due to differences in planting techniques and the effect of the drought, a satisfactory cost-benefit ratio was observed of 1:3.01 thanks, in part, to the increased price of corn over the previous years' experience of the farmers before joining the cooperative. The average price of corn nearly doubled, from $2.75 per cwt. in 1972, to $4.30 at the time of the current harvest which was short due to the drought. Fertilized crops suffered much loss due to the drought than unfertilized proving the validity of the "stress" theory of plant development.

Recommended formulas of fertilizers were financed mainly for corn production by the cooperative during its first year of credit experience due to the high incidence (84%) of applications for planting corn. Native varieties have a proven genetic potential of at least 8 times traditional yields with the addition of chemical nutrients.

A small amount of Tobary, Nariño and Rijatzul wheat seed was also financed. The limitations of the credit policy did not permit more than $5 of cooperative credit for every $1 of paid-in capital. This had the effect of restricting the extension of credit to the farmers especially in wheat in which the levels of off-the-farm inputs per hectare are much higher than for corn.

Another effect of the conservative credit policy was that the sample of farmers planted about 40% of their land area using fertilizer obtained on credit. None of the farmers in the sample has a second wheat crop to be harvested in January - February, 1973. Observance of these crops in the field, however, indicates that, in many cases, farmers will not have enough yield to even pay their fertilizer and seed bill. The inclusion of this drought-caused wheat failure in the calculation of cost-benefit for the entire membership for the complete season, would possibly reduce the ratio to about 1:2.70.

CHIMALTENANGO - EASTERN HIGHLANDS

	Member Name	Previous Production Experience: Production cwt.	Previous Production Experience: Value $	Loan 018 Cooperative Fertilizer & Seed Credit	Current Production Exper.: Prod. cwt	Current Production Exper.: Value $
1.	Felipe Chirich	92	308	85.00	90	630
2.	Rigoberto Miza	85	238	105.30	127	585
3.	José Miguel Velasco	50	200	131.85	80	448
4.	Alejandro Atz Capir	40	148	66.15	72	540
5.	Francisco Perén	72	286	54.40	92	112
6.	Santos Coroy	688	1,708	152.25	1,285	2,225
7.	Francisco Curruchich	21	74	47.25	19	125
8.	Inés Simón	78	534	116.65	175	945
9.	Prudencio Tubac	10	30	51.90	19	155
10.	Adán Pichiyá	328	758	147.00	220	1,112
11.	Apolinario Patzón	42	136	31.60	74	390
12.	Santos Chile S.	164	484	244.44	203	1,285
13.	Basilio Perén	62	244	78.75	104	552
14.	Esteban Perén	47	183	52.50	56	312
15.	Carlos Tun Chalí	42	168	47.40	37	275
16.	Manuel Cumatzul	32	110	26.05	27	137
17.	Simeón Hernández	201	450	111.40	373	815
18.	Faustino Velasco Sutuc	56	224	73.15	44	460
19.	Valerio Yool	32	152	44.40	35	325
20.	Juan Morales Sajbochol	45	240	53.20	44	420
	Totals	2,187 cwt.	6,675	1,720.64	3,176 cwt.	11,848
	$\bar{x}$	109 cwt.	$ 333.75	$ 86.03	158 cwt.	$ 592.40

Cost:Benefit $\frac{\$ 11,848 - \$6,675}{\$1,720} = 1:3.01$

UNCLASSIFIED
ANNEX III
Exhibit E.1.

SAN MARCOS

Twenty farmers of the membership of the San Marcos regional agricultural cooperative were investigated, through the field staff (2 agronomists) and accounting records and membership data compiled at the time they joined the cooperative for the purposes of receiving services for the 1972 crop year. Due to the remoteness of the area in the highlands near the Mexican border, few services of the GOG had reached the farmers before the cooperative was formed. (To give an example, the loan portfolio of the BANDESA agency in San Marcos was slightly over $50,000 in 1971--all of which was loaned to larger, commercial farmers.) The cooperative followed fairly conservative recruitment and credit policies during the first year. Members were required to pay at least $10 in capital shares of the cooperative before receiving any credit. Fertilizers (Urea and 12-24-12) and soil insecticide (Valexon) were financed only to the maximum extent of 5 times the amount of the member's paid-in capital. Twenty-nine percent of the credits were extended for corn and 71% to wheat in the sample of farmers.

Comparative data for the cost-benefit ratio were obtained from the sample of farmers based on the production of their own farms in years previous to joining the cooperative. Yields of both corn and wheat more than doubled with improved practices and the use of fertilizers and insecticide. Traditional varieties of corn were used and farmers obtained principally Nareño and Xelajú varieties of wheat from their own resources. The growing season was somewhat below normal due to shortage of rain but probably did not reduce crops by more than 20%. The validity of the "stress" theory was evident in that well fertilized crops withstood the adversity of drought much better than the unfertilized plantings. Wheat prices were stable (a controlled market) and corn prices increased from an average of \$2.60 per cwt. to \$3.40. A cost-benefit ratio of 1:2.9 was found in the sample with the use of fertilizers and insecticide. Higher ratios should be obtained in normal growing seasons and in the future as the cooperative finances a larger "package" of improvements--certified seed, mechanization and more wheat instead of corn.

-- SAN MARCOS - WESTERN HIGHLANDS

	Member Name	Previous Production Experience: Production cwt.	Previous Production Experience: Value $	Loan 018 Cooperative Fertilizer & Insecticide: Credit	Current Production Experience: Production cwt.	Current Production Experience: Value $
1.	David Silvestre Paz Barrios	26	83	48.75	61	326
2.	Manuel de Jesús López Bonilla	35	114	49.40	75	372
3.	Jorge Antolín García	37	129	74.80	102	510
4.	Ovidio Javier Pérez	66	238	114.90	161	855
5.	Fausto de Jesús Ventura	26	86	85.05	78	370
6.	Timoteo Candelario de León	83	299	175.40	238	1,218
7.	Ciriaco Ramírez y Ramírez	92	328	145.90	226	1,058
8.	Arturo Francisco López Pérez	28	91	65.50	77	403
9.	José Luis Godínez	14	44	27.00	38	183
10.	Antonio Ramírez Baltazar	67	218	117.95	160	783
11.	Luis Francisco Angel de León	23	74	42.85	63	322
12.	Justo Rufino de León	43	142	92.45	120	625
13.	Francisco Luis Godínez	23	98	48.30	64	331
14.	Teófilo Valentín Villancinda	31	127	49.90	60	298
15.	Félix Camel	19	71	42.85	51	247
16.	Julio Luciano Rodríguez	23	97	48.90	51	259
17.	Angel González Muñoz	59	194	98.70	117	568
18.	Amado Clodoveo Soto	82	285	174.45	195	991
19.	Gavino Ernesto Mazariegos	30	108	52.25	79	384
20.	Dolores Francisco Barrios	18	61	49.90	49	240
	Totals	1,275 cwt.	5,587	$ 1,605.20	2,065 cwt.	10,243
	$\bar{x}$	63.7 cwt.	279	$ 80.26	103 cwt.	$ 512

Cost:Benefit $\frac{\$10,243 - \$5,587.00}{\$1,605.20} = 1:2.90$

SAN ANDRES

In San Andrés Semetabaj, located north of Lake Atitlán in the Central Highlands, information from 35 representative member-farmers of the regional agricultural cooperative was obtained through the extension staff (2 agronomists) and accounting records of each member. This cooperative has been operating for 11 years and in the majority of the cases of the farmers investigated, the men have nearly "graduated" from subsistence corn production to commercial wheat and intensive corn production for consumption. The average loan was $353.62. A cost-benefit ratio of 1:3.64 was observed utilizing data of the 1972-73 crop cycle without considering the late second crop wheat which is not harvested until January-February. Due to very poor growing conditions, the inclusion of the late crop for the sample of farmers would probably bring down the benefits to about 1:2.5 judging from the appearance of the crops still standing in the field. Native (criollo) varieties of corn were used and improved varieties of wheat were planted by all of the sample farmers. These varieties, of Mexican heritage are Rijatzul, Tobary, San Andrés Nariño and Xelajú.

Current base line data of production without inputs was not available from the sample farmers because they do not plant control plots on their farms. In order to get a base from which to calculate the benefits of inputs, calculations were made on plantings of non-members who still use traditional methods. Average yields in the Dept. of Sololá this year without using fertilizers and related improved practices are 23 cwt. per hectare in corn and 18 cwt. per hectare in wheat. Depending somewhat on variables of location, improved yields this year averaged 57 cwt. per hectare in corn and 59 cwt. per hectare in the first crop of wheat. Top yields of 119 cwt. per hectare in corn and 76 cwt. per hectare in wheat were also observed in the area this year, although these particular farms were not in the sample. The price of wheat has been stable and the price of corn has gone up from an average of about $3.20/cwt. in previous years to a current price of $4.10 due to country-wide shortages as a result of the drought of late 1972. The San Andrés Portfolio of credits to the member-farmers in the sample in 1972 was 68% dedicated to wheat and 32% to corn.

Member Name	Previous Production Experience		Loan 018 Cooperative Fertilizer & Seed	Current Production Experience	
	Production cwt.	Value $	Credit	Production cwt.	Value$
1. Mariano Cuy Cay	126	459	458.33	339	1,648
2. Francisco Espantay Serech	52	184	102.20	111	550
3. Gregorio Chumil Ben	92	329	206.84	257	1,318
4. Sebastián Zapeta Morales	42	150	156.23	103	499
5. Domingo Serech Morales	146	516	377.86	376	1,696
6. Fidel García Muj	100	353	167.84	258	1,202
7. Pascual Pérez Díaz	123	439	228.17	302	1,550
8. Juan Juárez Cortés	324	1,344	512.55	832	3,430
9. Victor Fernando Ovalle Letona	387	1,533	594.75	993	4,098
10. Catarino Cuy Ben	111	405	186.76	273	1,357
11. Feliciano Saloj Julajuj	370	1,343	817.10	1,028	5,473
12. Ricardo Espantay Lares	87	380	128.82	224	1,024
13. Francisco Güarcas Raxcún	85	331	156.90	204	1,045
14. Celestino Matzar García	133	961	243.60	278	1,433
15. Lorenzo Güitz Tuy	88	223	169.75	191	1,004
16. Guillermo Cian Bocel	89	346	151.04	176	921
17. Pedro Saguach Yos	157	725	276.91	382	1,876
18. Santiago Güitz Par	91	393	131.76	191	891
19. Miguel Vargas Morales	231	954	321.98	436	2,246
20. Felipe de León Mota	106	422	173.87	174	934
21. Genaro de León Juárez	244	1,048	408.64	520	2,733
22. Juan Chumil Pablo	86	344	222.74	247	1,265
23. Juan Xet Rabinal	91	386	242.92	217	1,185
24. José Gustavo Turcios	171	726	391.97	452	2,306
25. Casimiro Par Jocop	331	1,493	586.92	788	3,926
26. Nicolás García Serech	47	191	106.74	130	676
27. Luciano Saquic Chox	874	3,086	954.25	1,296	6,964
28. Mazario Muj Nicolás	404	1,545	879.05	861	4,482
29. Mariano Saloj	84	321	219.91	196	919
30. Manuel Chumil Quino	41	143	172.92	107	533
31. Ramón García Xobín	38	139	116.10	91	465
32. René Anleu Calderón	490	2,081	1,400.06	1,066	5,320
33. Sebastián Quino Calel	264	977	469.41	519	2,438
34. Felipe Cuy Mota	42	138	100.34	83	387
35. Porfirio Ajcalón	166	714	542.58	486	2,493
Totals	6,313 cwt.	$25,122	$12,376.81	14,187 cwt.	70,287
$\bar{x}$	180 cwt.	717.77	$ 353.62	405 cwt.	2,008

Cost:Benefit $\frac{\$70,287 - \$25,1:}{\$12,376} = 1:3.64$

RESPONSE TO FERTILIZER IN THE GUATEMALAN HIGHLANDS

The question has been asked, "Will Guatemalan Highland crops respond economically to fertilizer applications without the use of other improved practices?"

My opinion is negative. Fertilizers alone will not create economic responses if other improved practices are omitted.

Had the question been, "Will crops in the Guatemalan Highlands respond economically to fertilizer applications with present levels of applied technology?" then my opinion would be positive.

Why?

The first question assumes that low yields are equally associated with all production practices and that these same practices are totally omitted.

The second question also recognizes the importance of technology--the use of a package of practices--but asks, "Where are fertilizer practices relative to the other practices being employed?"

Soil fertility probably is the factor most limiting crop production in the Hignland region. This is not surprising; the Mayans have cultivated this region for centuries. Their practice of fertilization was and practically is nil. In 1965, Guatemala had approximately 6.21 million acres in production,and fertilizer imported that year would correspond to 3.0, 2.1, and 1.0 pounds per acre for nitrogen, phosphorus, and potash, respectively. Of this, it has been estimated that coffee received fifty percent, cotton twenty-five percent and sugarcane and other cash crops twelve to fifteen percent. Little remains for application to the traditional crops.

Varieties of the crops grown in this region come from varied sources. The wheat varieties originated from CIMMYT. The potato varieties are improved Mexican materials. This region is either a primary or secondary center of the origin of corn. The corn variety San Marceño is a selection from this gene pool.

Do these varieties have the genetic potential to produce?

Average wheat yields in Guatemala are only twenty-five percent less than in the United States; the potato varieties are producing 35.8 metric tons per hectare in the experiment stations, and the corn variety San Marceño has produced 150 Bu/Ac, or more than any "improved or introduced" variety.

Plant populations are a very limiting factor in crop production in this region. The reason is simply that the local Indian has found that his land will not support a higher population. Working with corn in this same geographical region, Oscar Ortiz obtained an increase from 910 to 7345 Kg/Ha when plant population was increased from 12,500 to 43,000 plants per hectare and adequately fertilized. Unpublished data of Dr. Noble Usherwood of the American Potash Institute showed striking yield responses could be obtained with higher populations in potatoes if soil fertility or applied fertilizers were adequate to furnish the required nutrients.

Weed control in crops is accomplished mainly through shading. Pre-emergence herbicides or early season mechanical control serve only until the crop "covers over" and shades out the weeds. Higher plant populations of more vigorously growing plants cover the soil more quickly and aid in weed control.

Similarly, higher populations of more vigorous plants are also able to better withstand insect depredations, not only through a dilution effect, but also because they are growing more rapidly and the damage caused by the insects is "percentagewise" less.

Fertilizer trials data of various crops from the several experiment stations show very good responses to fertilizer applications; however, this data was all obtained under conditions of non-limiting or minimum-limiting factors.

More appropriate to the question at hand are the results of the on-the-farm FAO fertilizer response trials performed in this region during the years of 1963, 1964 and 1965. These trials were a demonstration type to show the small traditional farmer the value of fertilizers. The following table shows yield response of corn to applied fertilizers under conditions of existing technology. Similar data for wheat and potatoes exist.

C O R N

Location	Number of Trials	Yield in Kg/Ha.			
		Check	"N"	"NP"	"NPK"
Western Highlands	112	2277	4079	4933	5196
Central Highlands	69	1922	3438	3964	4493

In these tests, FAO furnished the fertilizer and through extension agents showed the farmer how to apply it. All other practices were those currently being used by the farmer.

Undoubtedly, the crops are responding to fertilizer applications. This indicates that under the conditions of these 181 farms, fertilizer was, on the average, one of the more limiting factors.

Were these responses economic? The following table shows the increases in yield obtained from the fertilizer applications.

C O R N

Area	Trials	Increased Yields Obtained by Fertilizing (Kg/Ha) "N"	"NP"	"NPK"
Western Highlands	112	1802	2656	2912
Central Highlands	69	1516	2042	2571

From these data FAO calculated the most economic application to be:

Area	No. Trials	Best Comb.	Increase over Control Kg/Ha	%	Benefit: Cost	Profit $/Ha.
Western Highlands	112	"NPK"	2919	128	3.1	131.87
Central Highlands	69	"NPK"	2571	134	2.7	108.56

From a point of view of profit per hectare, the FAO data is correct, but from a point of view of return per unit invested, nitrogen was by far the better general recommendation.

The design of these trials did not permit the partitioning of yield response by nutrient elements applied and obtaining specific benefit:cost ratios. Nevertheless, it can be generalized that the B:C ratios would be much higher for nitrogen alone.

When FAO terminated this project, all field data was turned over to my office. A study of these data showed:

(1) Applications of nitrogen (within quantity limits) almost always resulted in economic yield responses.

(2) Applications of phosphorus (within quantity limits) usually resulted in economic yield responses.

(3) Applications of potassium (within quantity limits) were very variable with respect to both yield increases and profitability.

(4) Yield increases from applications of "N", "P", and "K" came about from more ears produced per hectare, more grain per ear, and heavier weight per grain, respectively. These data indicate that the local Indian is probably correct to maintain a lower population if fertilizers aren't available, but that he should be able to increase his yields markedly through fertilization, especially with increased plant populations.

In summary, it is my opinion that the Guatemalan Highlands farmer is using a set of practices (not the ideal), but nevertheless "Improved") and that the use of fertilizer is the weakest part of the existing package. For this reason, fertilizer applications should give and have given economic responses within the framework of presently used crop production practices.

by: Dr. Albert N. Plant
Basic Grains Specialist
Mississippi State University

FENCOAR

Assumptions - Financial Projections

1. The financial projections in Exhibits G.2 through G.4 utilize the following growth assumptions:

	1972	1975	1980	1985
No. of Regional Cooperatives	3	6	6	6
Members (a)	1,500	10,000	20,000	25,000
Cwts. Fertilizer Consumption/Member (b)	25	31	41	41
Credit Demand*(c)	$267	$2,210	$5,845	$7,400
Total Product Value*	$801	$6,600	$17,500	$22,200
Minimum Capital Accumulation in Regionals Excluding Retained Earnings*	$55	$440	$1,170	$1,480

*: In 000's of Dollars

(a) Number of Members Served

These figures are the result of calculating the yearly growth in members served by each of the six regional cooperatives, and then adding them together. Growth is projected to level off when membership approaches 3000 per cooperative (in the fourth or fifth year of operations). These forecasts are considered conservative.

(b) Increased Fertilizer Usage

Farmers in the highlands use less than the recommended amounts of fertilizer when first beginning application. This is due both to the limited credit availability and to conservative farmer practices. When credit becomes available, along with agricultural training, fertilizer usage increases. The projected increases are equivalent to a 1972 usage of 4.55 cwt/hectare and a 1980 usage of 7.45 cwt/hectare. These averages are below present recommendations of 8.02 cwt/hectare in the area served by the cooperatives, made by Dr. James Walker, North Carolina State University Soil Fertility Specialist on contract with the GOG Ministry of Agriculture. Dr. Walker's recommendations are for optimizing return to farmer rather than maximizing production, and are based upon extensive field trials in the area. The 8.02 figure is a weighed average of the requirements for corn, wheat and potatoes and includes nine different formulas of fertilizer. If additional weight is given in the future to potatoes or other vegetables, this average would greatly increase. It is assumed that the average farm size will remain constant during the seven years projected. This is considered reasonable as almost no additional land is available in the area served.

(c) Seed and Other Inputs

Average value of fertilizer, seeds, and other inputs has been held constant throughout projections. If prices increase considerably, either additional external financing must be contracted, or the cooperatives will not be able to serve all farmers requiring services.

Presently, farmers use one bag of seed for each four bags of fertilizer. The value of purchases of herbicides, insecticides, fungicides, and other inputs are equal to about 50% of the value of seed sales. The relation of seeds to fertilizer may go down, but the use of other inputs will probably increase. In making the projections these relations have been held constant, as we lack valid information regarding degree of changes.

2. Total value of produce is projected at three times the value of inputs, based upon the experienced cost/benefit ratio of 3:1. Presently, only one half of the members' produce is marketed through the cooperative. The balance is either kept for home consumption, or marketed locally by the members themselves. These ratios are maintained throughout the projections.

3. FENCOAR purchased fertilizer in October 1972 to take advantage of low off-season prices. This type of operation may be repeated in the future, but only if funds are available, and if the margin covers costs of storage, transportation, and interest. It is not possible to anticipate when these transactions might be undertaken, and therefore no income or expense has been included in the projections.

4. At least 95% of loans receivable at year end will be collected during following year and bad debts will not exceed 1%. This is the experience of FENACOAC, but realistically no overdue loans or bad debts should be expected in FENCOAR. It has only six borrowers, and each of these is expected to finance collection lags with its own resources. Major crop losses are provided for by the contingency reserve.

5. Notes receivable representing loans made to member cooperatives for construction and major equipment purchases will earn a minimum 5% return.

6. Additional long-term debt up to $1.8 million, with a 2% spread, can be arranged to satisfy

credit demands between 1977 and 1980.

7. The staff to be assembled in 1973, consisting of four operations people, a secretary and an accountant, will be able to effectively administer the greatly increased program in 1980 without additional personnel.

8. Any excess capital generated during the period forecasted would go toward expanding the loan portfolio or debt retirement and no patronage dividends will be paid.

9. The Crop Disaster Reserve will be fully funded in the form of investments earning a minimum return of 8%, the present interest rate available on government guaranteed bonds in Guatemala.

F E N C O A R

Projected Balance Sheets
1973-1980 and 1985
(000s Dollars)

	Assumed at 12/31/72	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Debt	
		1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Assets												
Cash	1	3	23	28	28	8	15	18	5	5	11	5
Loan Portfolio	252	625	1,395	2,506	3,506	4,442	5,314	6,090	6,760	8,600	4,525	6,405
Less - Reserve for Doubtful Accounts	---	---	(6)	(20)	(39)	(60)	(80)	(100)	(115)	(160)	(77)	(115)
Total Current Assets	253	628	1,412	2,514	3,495	4,390	5,249	6,008	6,650	8,445	4,459	6,295
Construction Notes Receivable - 5%	115	115	235	295	278	261	227	193	151	---	151	---
Crop Disaster Fund - 3% Bonds	---	12	36	80	140	217	310	415	530	1,205	410	900
Fixed Assets (net)	60	53	45	37	33	23	11	51	41	55	41	55
Total Assets	428	808	1,728	2,926	3,946	4,891	5,797	6,667	7,372	9,705	5,061	7,250

Liabilities and Capital	Assumed at 12/31/72	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Deb	
		1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Accounts Payable	---	12	20	17	31	40	40	40	110	225	60	195
Interest Payable	---	6	17	33	50	72	90	110	125	175	70	115
Total Current Liab.	---	18	37	50	81	112	130	150	235	400	130	310
Long-term Debt:												
BANDESA	252	580	1,400	2,450	3,000	3,000	3,000	3,000	3,000	2,700	3,000	2,700
Other	---	---	---	---	200	800	1,300	1,700	1,800	1,200	---	---
Total Long-term Debt	252	580	1,400	2,450	3,200	3,800	4,300	4,700	4,800	3,900	3,000	2,700
Total Liabilities	252	598	1,437	2,500	3,281	3,912	4,430	4,850	5,035	4,300	3,130	3,010
Accumulated Earnings	176	198	228	259	330	417	522	637	782	1,595	706	1,405
Accumulated Capital-ization	---	---	27	87	195	345	535	765	1,025	2,605	815	1,935
Reserve for Crop Disaster	---	12	36	80	140	217	310	415	530	1,205	410	900
Total Capital	176	210	291	426	665	979	1,367	1,817	2,337	5,405	1,931	4,240
Total Liabilities & Capital	428	808	1,728	2,926	3,946	4,891	5,797	6,667	7,372	9,705	5,061	7,250

	Assumed at 12/31/72	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Debt	
		1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Total Debt to Equity Ratio		2.85	4.94	5.87	4.93	4.00	3.24	2.67	2.15	0.80	1.62	0.71
Loan Portfolio as % of Assets		77.4%	80.4%	85.0%	87.9%	90.0%	90.3%	90.0%	90.1%	87.0%	87.9%	86.8%
Average Cost of Funds (year end)		2.2%	2.6%	2.8%	3.0%	3.3%	3.5%	3.7%	3.6%	3.6%	2.8%	3.2%

NOTE: The assumptions in Exhibit G.1 are an integral part of this statement.

F E N C O A R

Projected Income Statements
1973-1980 and 1985
(000s Dollars)

	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Debt	
	1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Revenue											
Accrued Interest Income	36	91	167	243	313	380	440	500	670	340	500
Marketing Operations	--	14	24	41	50	60	70	80	105	80	105
USAID Grant	49	40	4	--	--	--	--	--	--	--	--
Total Revenue	85	145	195	284	363	440	510	580	775	420	605
Expense											
Interest	12	33	67	100	144	185	225	250	340	135	225
Provision for Bad Debts	--	6	14	25	35	45	55	60	80	40	60
Salaries and Benefits	28	44	48	50	54	60	65	70	100	70	100
Office Supplies and Expense	9	13	14	16	18	20	20	25	30	25	30
Depreciation	7	8	8	9	10	10	10	10	15	10	15
Travel, Maint. and Other	7	11	13	13	15	15	20	20	25	20	2[illegible]
Total Expense	63	115	164	213	276	335	395	435	590	300	455
Net Income	22	30	31	71	87	105	115	145	185	120	150

Note: The assumptions in Exhibit G.1 are an integral part of this statement.

F E N C O A R

Projected Source and Application of Funds Statements
1973-1980 and 1985
(000s Dollars)

	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Debt	
	1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Sources of Funds											
BANDESA	328	820	1,050	550	---	---	---	---	---	---	---
Other Long-term Debt	---	---	---	200	600	500	400	100	---	---	---
Collections	---	621	1,385	2,506	3,499	4,445	5,313	6,087	8,097	4,024	6,022
Net Income	22	30	31	71	87	105	115	145	185	120	150
Non-Cash Expenses	13	31	55	84	117	147	175	195	270	120	190
Cash/Accounts Payable	10	---	---	---	---	---	---	---	---	96	---
Total Sources	373	1,502	2,521	3,411	4,303	5,197	6,003	6,527	8,552	4,360	6,362
Applications of Funds -											
New Loans	325	1,360	2,270	3,060	3,865	4,615	5,280	5,845	7,400	3,900	5,500
Crop Disaster Fund	12	24	44	60	77	93	105	115	150	80	110
Non-Cash Revenues	36	100	182	267	340	410	475	540	720	380	550
Fixed Assets	---	---	---	5	---	---	50	---	---		
Retiremend of Debt	---	---	---	---	---	---	---	---	200		100
Cash/Accounts Payable		18	25	19	21	79	93	27	82		102
Total Applications	373	1,502	2,521	3,411	4,303	5,197	6,003	6,527	8,552	4,360	6,362

NOTE: The assumptions in Exhibit G.1 are an integral part of this statement

FENACOAC

Assumptions - Financial Projections

Financial projections presented in Exhibits H.2 through H.4 are based upon the following growth assumptions:

	1972	1975	1980	1985
No. of Affiliated Cooperatives	79	95	120	120
Total Members (a)	32,865	65,000	100,000	105,000
Total Credit Demand*(b)	$1,620	$5,725	$16,410	$23,825
Credit Demand in Excess of Funds Available* (c)	$645	$2,440	$7,800	$8,950

*: In 000's of Dollars.

(a) Increase in Movement's Membership

Over the last five years, total membership in savings and credit cooperatives affiliated to FENACOAC has increased on the average of 2.5% monthly. This growth results primarily from the multiplier effect of new member promotion by current members. Each member is encouraged by the cooperative to discuss the benefits of the institution to potential new members. This is the primary force leading to overall growth. Also, it is considered that the savings and credit cooperative movement has reached the "take-off" period, where it has proven itself to rural citizens as an effective deliverer of services.

At the same time, if this average growth rate is projected out to 1985, total membership would be over 1,540,000. It is reasonable to expect that the growth rate will level off in the future, especially considering that limits exist on the institutional capabilities to provide increased services.

For these reasons the membership growth rate has been gradually reduced to provide only a slight yearly growth in members after 1980. These projections are considered conservative based on experience.

(b) Credit Demand

Projections indicate a yearly average loan size increase of only $10 per year. On this basis, by 1985, the average loan would still be only $285, or 25% of the average BANDESA loan during 1972. Since one of the objectives of this project is to increase the technical inputs to the farmer, this projection is considered quite conservative. In fact, this assumption does not consider the possibility of increases in the costs of technical inputs.

In 1972, approximately 40% of savings and credit cooperative members had loans outstanding at any one time. This is caused by the fact that until very recently, the lending capacity of the cooperatives was limited to the total savings of members. The prime function of these cooperatives was to serve as a community bank that could mobilize savings normally kept in a tin can in the farmer's dirt floor, and to introduce a savings habit to rural dwellers.

The new membership, however, will be attracted more by the possibility of receiving a loan, although he too will begin saving. For this reason a gradual increase in the percentage of members with outstanding loans has been included, reaching 80% of members by 1985. This percentage will probably increase as rapidly as funds are available for loans.

(c) External Credit Demand

The requirement for external financing equals the difference between credit demand and funds available for loans in member cooperatives. Over the last five years, total shares have grown at an average monthly rate of 3.5%. However, if continued growth through 1985 is calculated at this rate, total shares would surpass $330,000,000. Consideration must be given to the assumption made that membership growth will probably not maintain its historical monthly rate of 2.5% (see a. above).

Growth in shares is obviously integrally related to the accumulated growth of members. Considering this factor, we have adjusted the yearly increase in shares in keeping with the adjusted increase in members. The yearly increase in shares up to 1972 has been slightly over 50%, while the percentage increases used in the projections decline to just over 10% in 1985.

It may be argued that a 10% increase in shares for one year is too high for 1985, considering that membership increase has been limited to about 1%. However, given that external credit demand is determined by substracting funds available for loans at the local cooperative level from total projected demand, a high estimate of shares results in a low estimate of external demand. As the profitability of FENACOAC depends on the volume of its loan portfolio, it is more conservative to have a low estimate of demand from the cooperatives.

17.5% of the $1,520,000 of share capital in 1972 was tied up in other assets such as cash, shares in the Federation, overdue loans and fixed assets. This is considered reasonably constant as 5% will always be held in shares in the Federations, roughly another 5% is tied up in overdue loan refinancing, and due to the lack of banking facilities in rural areas, roughly 5% of shares will be tied up in liquidity requirements. The remainder of 2.5% is considered sufficient for investment in fixed assets given the low cost of facilities in rural areas, and the limited requirement for facilities for this type of cooperative.

2. Fertilizer Sales

Sales of fertilizer during 1972 were 100,000 cwts. for the entire system. This activity is considered a side line to FENACOAC's present activities, and no study has been made upon which future growth in fertilizer sales could be projected. Assuming that 75% of members are farmers and that each could use the same amount of fertilizer as the members of FENCOAR, demand for 1972 would have been over 616,000 cwts, and demand for 1985 would surpass 3,200,000 cwts. Due to the lack of reliable projection bases, however, conservative increases of 25,000 cwts. per year have been included in our figures, reaching a total demand of 475,000 cwts. for 1985.

3. Other Income

Income from other sources such as marketing activities, net income from sales of office supplies and equipment, gross income from the Materials Production Center and from sales of educational materials have been increased at a constant rate of $10,000 per year to a total of $155,000 by 1985. Total sales from the Materials Production Center alone are expected to reach $125,000 at full volume with present equipment. Income from marketing operations has been estimated very conservatively as a long-term policy has not been developed concerning this activity.

4. Bad Debt Rate

A bad debt rate of 1% and a collection lag of 5% has been assumed in the projections. To date, FENACOAC has not lost a loan, and delinquency stands at only 2.34%. The above percentages are based up on the experience of other savings and credit cooperatives Federations in Latin America. The member cooperatives will have fairly high diversity in their loan portfolios due to the traditional activity of credit union lending for education, home improvements, family emergencies, etc. Also, the Federation will be working with member cooperatives to maintain their financial strength, and Federation services such as bonding and life insurance will further strengthen the affiliates. Major crop losses would be at least partially handled by the Crop Disaster Fund established for that purpose.

5. The Crop Disaster Reserve will be fully funded in the form of investments returning a minimum of 3%, the present interest rate available on government guaranteed bonds.

6. Additional long-term debt up to $3,950,000, with a 2% spread, can be arranged to satisfy credit demands between 1977 and 1980.

7. Excess funds generated during the period forecasted will go toward expanding the loan portfolio or debt retirement and no patronage dividends will be paid.

F E N A C O A C
PROJECTED BALANCE SHEETS
1973-1980 and 1985
(000's of Dollars

	ACTUAL	*	PROJECTED -ASSUMING ADDITIONAL DEBT TO MEET FULL CREDIT DEMAND									ASSUMING NO ADDITIONAL DEBT	
	12-31-71	12-31-72	1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
- A S S E T S -													
Cash	$ 26	518	$ 37	$ 54	$ 65	$ 23	$ 29	$ 39	$ 35	$ 8	$ 10	12	$ 10
Loan Portfolio	156	539	1139	1845	2842	4002	5279	6529	7872	9121	10900	5279	7325
Less: Reserve for Doubtful Accounts.	--	--	(5)	(16)	(29)	(46)	(67)	(90)	(115)	(141)	(205)	(92)	(125)
Other Current Assets	10	17	15	20	20	20	16	11	15	15	20	10	10
TOTAL CURRENT ASSETS	$ 192	$ 1074	$1186	$ 1903	$ 2898	$ 3999	$ 5257	$ 6489	$ 7807	$ 9003	$ 10725	$ 5209	$7220
Crop Disaster Fund - 8% Bonds	--	--	19	50	99	168	259	371	506	662	1545	484	1015
Fixed Assets (Net)	67	106	91	109	90	75	60	45	22	108	110	108	110
Other Assets	--	32	35	35	35	40	35	30	30	30	40	22	20
TOTAL ASSETS	$ 259	$ 1212	$1331	$ 2097	$ 3122	$ 4282	$ 5611	$ 6935	$ 8365	$ 9803	$ 12420	$ 5823	$8365
- LIABILITIES AND CAPITAL -													
Accounts Payable	$ 5	$ 12	$ 8	$ 10	$ 15	$ 65	$ 72	$ 71	$ 77	$ 96	$ 70	$ 127	$ 90
Interest Payable	--	--	21	30	43	63	92	125	160	194	255	93	150
Member Savings	1	13	18	24	31	39	47	55	63	71	100	71	100
TOTAL CURRENT LIABILITIES	$ 6	$ 25	$ 47	$ 64	$ 89	$ 167	$ 211	$ 251	$ 300	$ 361	$ 425	$ 291	$ 340

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Long-Term Debt	ACTUAL 12-31-71	12-31-72	PROJECTED - ASSUMING ADDITIONAL DEBT TO MEET FULL CREDIT DEMAND 1973	1974	1975	1976	1977	1978	1979	1980	1985	ASSUMING NO ADDITIONAL DEBT 1980	1985
BANDESA - 3%	$	$ 800	$ 800	$ 1350	$ 2150	$ 2800	$ 2800	$ 2800	$ 2800	$ 2800	$ 2495	$ 2800	$ 2495
Other - 6%	109	150	150	200	200	350	1250	2050	2850	3550	2100	200	20[illegible]
Total Long-Term Debt	$ 109	$ 950	$ 950	$ 1550	$ 2350	$ 3150	$ 4050	$ 4850	$ 5650	$ 6350	$ 4595	$ 3000	$ 269[illegible]
TOTAL LIABILITIES	$ 115	$ 975	$ 997	$ 1614	$ 2439	$ 3317	$ 4261	$ 5101	$ 5950	$ 6711	$ 5020	$ 3291	$ 3035
Accumulated Earnings	$ 90	$ 128	$ 147	$ 169	$ 190	$ 218	$ 267	$ 330	$ 405	$ 498	$ 1145	$ 414	$ 840
Restricted Earnings	8	15	20	25	30	37	49	65	84	107	265	86	190
Capitalization Accumulated	46	94	148	239	364	542	775	1068	1420	1825	4445	1548	3285
Reserve for Crop Disaster	-	-	19	50	99	168	259	371	506	662	1545	484	1015
TOTAL CAPITAL	$ 144	$ 237	$ 334	$ 483	$ 683	$ 965	$ 1350	$ 1834	$ 2415	$ 3092	$ 7400	$ 2532	$ 5330
TOTAL LIABILITIES AND CAPITAL	$ 259	$1212	$ 1331	$ 2097	$ 3122	$ 4282	$ 5611	$ 6935	$ 8365	$ 9803	$ 12420	$ 5823	$ 8365
AVERAGE COST OF FUNDS EMPLOYED (Year End)	3.6%	3.3%	3.3%	3.3%	3.2%	3.3%	3.8%	4.1%	4.2%	4.3%	4.0%	3.4%	3.5%
TOTAL DEBT TO EQUITY	0.8	4.1	3.0	3.3	3.6	3.4	3.2	2.8	2.5	2.2	0.7	1.3	0.[illegible]

* Unaudited

NOTE: The assumptions on Exhibit H-1 are an integral part of this statement

FENACOAC

PROJECTED INCOME STATEMENTS

1973-1980 and 1985
(000's of Dollars)

	ACTUAL*		PROJECTED - ASSUMING ADDITIONAL DEBT TO MEET FULL CREDIT DEMAND									ASSUMING NO ADDITIONAL DEBT	
	12-31-71	12-31-72	1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
REVENUE													
Accrued Interest Income	$ 4	$ 33	$ 65	$ 111	$ 175	$ 256	$ 348	$ 444	$ 544	$ 642	$ 835	$ 384	$ 540
Market Activities & Sales	26	50	75	85	100	115	130	145	160	175	250	175	250
Membership Dues	4	10	27	40	55	63	77	91	108	125	190	110	170
USAID Grant	101	119	88	62	27								
Gross Income	$ 135	$ 212	$ 255	$ 298	$ 357	$ 434	$ 555	$ 680	$ 812	$ 942	$1275	$ 669	$ 960
EXPENSE													
Interest	$ 4	$ 14	$ 42	$ 59	$ 86	$ 126	$ 184	$ 251	$ 319	$ 387	$ 515	$ 186	$ 305
Provision for Bad Debts	-	-	5	11	18	28	39	51	64	77	105	48	65
Salaries and Benefits	48	92	111	121	133	146	161	177	195	214	280	214	280
Depreciation	1	7	14	14	19	15	15	15	23	16	25	16	20
Travel and Transport	20	22	23	26	28	31	34	38	41	46	60	46	60
Office, Materials, Other	47	36	36	40	47	53	61	69	76	86	100	86	105
Total Expense	120	171	231	271	331	399	494	601	718	826	1085	596	835
NET INCOME	$ 15	$ 41	$ 24	$ 27	$ 26	$ 35	$ 61	$ 79	$ 94	$ 116	$ 190	$ 73	$ 125

NOTE: The assumptions on Exhibit H-1 are an integral part of this statement

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F E N A C O A C

Projected Source and Application of Funds Statements
1973-1980 and 1985
(000's of Dollars)

	Projected - Assuming Additional Debt to Meet Full Credit Demand									Assuming No Additional Debt	
	1973	1974	1975	1976	1977	1978	1979	1980	1985	1980	1985
Sources of Funds											
BANDESA	--	550	800	650	--	--	--	--	--	--	--
Other Long-Term Debt	--	50	--	150	900	800	800	700		--	--
Collections	572	1,183	1,889	2,895	4,055	5,334	6,587	7,922	10,596	5,027	6,715
Net Income	24	27	26	35	61	79	94	116	190	73	125
Non-Cash Expenses	40	55	80	106	146	191	247	287	384	157	235
Cash/Accounts Payable	478	--	--	44	--	--	--	--	--	57	
Total Sources	1,114	1,865	2,795	3,880	5,162	6,404	7,728	9,025	11,170	5,257	7,075
Applications of Funds											
New Loans	955	1,565	2,440	3,440	4,540	5,610	6,770	7,807	9,050	4,450	5,93[illegible]
Crop Disaster Fund	19	31	49	69	91	112	135	156	179	89	115
Non-Cash Revenues	140	196	220	371	478	589	704	817	1,083	559	790
Fixed Assets	--	32	--	--	--	--	--	102	--	102	--
Retirement of Debt	--	--	--	--	--	--	--	--	593	--	93
Cash/Accounts Payable	--	41	36	--	53	93	119	143	265	57	142
Total Applications	1,114	1,865	2,795	3,880	5,162	6,404	7,728	9,025	11,170	5,257	7,075

NOTE: The assumptions on Exhibit H.1 are an integral part of this statement.

FUNDACION DEL CENTAVO
INCOME & EXPENSE STATEMENTS
(PRESENT FINANCING & PROGRAMMING LEVELS)
1971 - 1976

	Actual 1971	Pro Forma (1) 1972	1973	1974	1975	1976
Revenue						
Donations	Q165,090	Q 80,000	Q 55,000	Q 30,000	Q 40,000	Q 40,000
Income from Loan Portfolio	15,265	24,100	26,900	21,900	16,300	9,820
Net Income/(Loss) Cattle Sharing	(71,484)	(14,600) (2)	16,100	8,700	10,000	(7,700)
Net Income - Material Resources	4,795	3,000	3,000	3,000	3,000	3,000
Other	1,946	5,700	5,500	5,500	5,500	5,500
Total Revenues	Q115,612	Q 90,200	Q106,500	Q 69,100	Q 74,800	Q [illegible]
Expense						
Administration Salaries & Expenses	Q 42,308	Q 51,400	Q 53,900	Q 56,500	Q 59,300	Q 62,300
Interest & Commission on Debt	9,360	11,700	14,000	13,500	13,000	13,000
Publicity & Donation Collection Expense	10,661	15,700	14,800	11,700	14,800	14,800
Professional Expenses	8,335	7,000	7,000	7,500	8,000	8,500
Vehicle Maintenance & Subsidy	3,766	7,000	7,200	7,200	7,200	7,200
Bad Debts	3,000 (3)	10,100 (3)	14,500	11,600	7,300	3,700
Utilities, Rent & Office Supplies	3,895	3,200	4,000	4,200	4,400	4,600
Depreciation	2,679	1,900	1,600	1,600	1,600	1,600
VITA	53	5,500	5,500	5,500	-o-	-o-
Other (4)	5,778	7,200	7,300	5,700	5,900	7,000
Total Expenses	Q 89,835	Q120,700	Q129,800	Q125,000	Q121,500	Q122,[illegible]
Net Income/(Loss)	Q 25,777	(Q22,500)	(Q23,300)	(Q55,900)	(Q46,700)	(Q72,100)

(1) Assumptions:
  a. No new loans or grants.
  b. Loan portfolio turnover, interest earnings, and bad debts will remain substantially equal to 1970 and 1971 experience.
  c. BANDESA funds of Q200,000 will be fully disbursed by 12/31/72.
  d. One new Credit Supervisor and a Controller will be employed in the last quarter of 1972.

(2) Excludes a Q26,000 overvaluation of cattle herd which may be taken in 1972.

(3) The large increase between 1971 and 1972 is due to two factors: first, the beginning balance of the loan portfolio is much greater in 1972; second, an unusually small amount of loans were written-off in 1971.

(4) This account includes Q9,400 for the avocado project over the five-year projection period. This estimate was made by the Program Manager but the avocado project presentation to the Executive Committee contemplated an expenditure in excess of Q58,000 for the first four-years of the project.

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Exhibit I.1

FUNDACION DEL CENTAVO
BALANCE SHEETS
(PRESENT FINANCING & PROGRAMMING LEVELS)
1972 - 1976

	1972	1973	1974	1975	1976
			Pro Forma		
Assets					
Cash	Q 28,200	Q 21,600	Q 3,900	Q 4,600	Q 900
Loan Portfolio (net of reserve)	334,500	275,500	219,700	139,700	70,700
Cattle (1)	82,700	103,700	130,400	154,300	163,100
Land	53,300	53,300	53,300	53,300	53,300
Fixed Assets (net) and Other	51,300	38,300	31,700	30,100	28,500
Total Assets	Q550,000	Q492,400	Q439,000	Q382,000	Q316,500
Liabilities & Equity					
Accounts Payable	Q 50,000	Q 30,000	Q 40,000	Q 40,000	Q 55,000
Deferred Gain on Cattle	-0-	-0-	8,700	14,600	23,400
Bank Loans	53,000	38,700	29,600	20,500	10,400
Long-Term Debt	309,300	309,300	302,200	295,100	288,000
Total Liabilities	Q412,300	Q378,000	Q380,500	Q370,200	Q376,800
Social Fund (Retained Earnings)	137,700	114,400	58,500	11,800	(60,300)
Total Liabilities & Equity	Q550,000	Q492,400	Q439,000	Q382,000	Q316,500

(1) Value of herd includes a Q26,000 overvaluation which may be adjusted in 1972.

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Exhibit I.2
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FUNDACION DEL CENTAVO
INCOME & EXPENSE STATEMENTS
(ASSUMING Q1,000,000 ADDITIONAL FINANCING)
1972 - 1976

	Assuming Q1,000,000 - 3% Loan (1)				
	1972	1973	1974	1975	1976
Revenue					
Donations	Q 80,000	Q 55,000	Q 30,000	Q 40,000	Q 40,000
Income from Portfolio	24,100	51,400	89,400	95,800	92,300
Net Income/(Loss) - Cattle & Materials	(11,600)	19,100	11,700	13,000	(4,700)
Other	5,700	10,700	15,500	15,500	15,500
Total Revenue	Q 98,200	Q136,200	Q145,600	Q164,300	Q143,100
Expense					
Administration Salaries & Expenses	Q 51,400	Q 67,000	Q103,700	Q122,400	Q130,300
Interest & Commission on Debt	11,700	21,500	36,000	43,000	43,000
Publicity & Donation Collection Expense	15,700	14,800	11,700	14,800	14,800
Professional Fees	7,000	8,000	9,500	10,000	10,500
Vehicle Maintenance & Subsidy	7,000	13,200	25,200	31,200	31,200
Bad Debts	10,100	40,700	62,100	53,800	46,500
Utilities, Rent & Office Supplies	3,200	5,800	7,800	8,000	8,200
Depreciation	1,900	1,700	1,700	1,700	1,700
VITA	5,500	5,500	5,500	-0-	-0-
Other	7,200	8,300	6,700	6,900	8,000
Total Expense	Q120,700	Q186,500	Q269,900	Q291,800	Q294,200
Net Income/(Loss)	(Q22,500)	(Q50,300)	(Q124,300)	(Q127,500)	(Q151,100)

(1) Additional Assumptions:

a. Foundation would be able to fully utilize all funds in first two years - 1973 and 1974.

b. Loan portfolio turnover, interest earnings and bad debts will remain substantially the same as 1970 and 1971 experience.

c. Sufficient credit supervisors will have to be added gradually as the new loan is disbursed in order to maintain the ratio of one supervisor for each Q60,000 in new loans.

d. The following additional personnel will also be added gradually as the loan is disbursed - two accounting or clerical and two deputy project directors.

FUNDACION DEL CENTAVO
INCOME & EXPENSE STATEMENTS
(ASSUMING ADDITIONAL FINANCING, REDUCED EXPENSES, INCREASED INTEREST)
1972 - 1981

	Assuming Q1,000,000 Loan, 25% Reduct. in Admin. Expenses & 2% Increase in Interest Rate (1)									
	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Revenue										
Donations	Q 80,000	Q 55,000	Q 30,000	Q 40,000	Q 40,000	Q 40,000	Q 40,000	Q 40,000	Q 40,000	Q 40,000
Income from Portfolio	24,100	62,800	110,300	123,600	113,300	103,300	92,200	80,200	67,300	53,400
Net - Cattle & Materials	(11,600)	19,100	11,700	13,000	(4,700)	(5,000)	(4,000)	(3,000)	(2,000)	(1,000)
Other	5,700	10,700	15,500	15,500	15,500	16,000	16,000	16,000	16,000	16,000
Total Revenue	Q 98,200	Q147,600	Q167,500	Q192,100	Q164,100	Q154,300	Q144,200	Q133,200	Q121,300	Q108,400
Expense										
Admin. Salaries & Exp.	Q 38,500	Q 50,200	Q 77,800	Q 91,800	Q 97,700	Q100,000	Q104,000	Q108,000	Q112,000	Q117,000
Interest & Comm. on Debt	11,700	21,500	36,000	43,000	43,000	42,500	42,000	41,500	41,000	40,500
Publicity & Donation Exp.	15,700	14,800	11,700	14,800	14,800	15,000	15,000	15,000	15,000	15,000
Professional Fees	7,000	8,000	9,500	10,000	10,500	11,000	11,000	11,000	11,000	11,000
Vehicle Maint. & Subsidy	5,300	9,900	18,900	23,400	23,400	24,000	24,000	24,000	24,000	24,000
Bad Debts	10,100	42,800	65,500	59,500	54,900	49,600	43,800	37,600	30,900	23,700
Util., Rent & Supplies	2,400	4,300	5,800	6,000	6,200	6,000	6,000	6,000	6,000	6,000
Depreciation	1,900	1,700	1,700	1,700	1,700	2,000	2,000	2,000	2,000	2,000
VITA	5,500	5,500	5,500	-o-	-o-	-o-	-o-	-o-	-o-	-o-
Other	5,400	6,200	5,000	5,200	6,000	6,000	6,000	6,000	6,000	6,000
Total Expense	Q103,500	Q164,900	Q237,400	Q255,400	Q258,200	Q256,100	Q253,800	Q251,100	Q247,900	Q245,200
Net Income/(Loss)	(Q 5,300)	(Q17,300)	(Q69,900)	(Q63,300)	(Q94,100)	(Q101,800)	(Q109,600)	(Q117,900)	(Q126,600)	(Q136,800)

(1) Additional Assumptions:
a. Foundation would be able to fully utilize all funds in first two years - 1973 and 1974.
b. Loan portfolio turnover, interest earnings and bad debts will remain substantially the same as 1970 and 1971 experience.
c. Credit Supervisors would be able to service Q100,000 in loan portfolio and no additional clerical or managerial personnel would be required.

RESPONSE TO DAEC COMMENTS

The DAEC reviewed this proposal on January 16 and approved an Intensive Review to address the following eight points:

1. The relationship and particularly the possible duplication of effort between FENACOAC and FENCOAR (raised in the IRR as an issue) should be explored and the issue in all its aspects resolved during intensive review.

Response: The analysis of this issue by the Project Committee has resulted in a USAID policy position supporting the development of two separate Federations. This policy decision, as well as the alternative relationships available, is discussed in detail in Section II.E.

2. The nature of the technical assistance inputs and how they are to be provided for production credit to cooperative members should be described in detail in the Loan Paper. The technical capacity of the coops to pursue "full service" operations should also be described..

Response: The technical assistance inputs required by the cooperative members and the corresponding technical assistance capacity of each recipient institution is discussed in Section II.B. of the Loan Paper. Included in this section is a description of present capabilities and plans for improving those capabilities as anticipated demand for member services increases.

3. A proforma financial analysis of the cooperatives should be prepared (for a ten-year period). Intensive Review should focus on the circumstances under which cooperatives can attract private sector credit with particular reference to the underlying

interest rate assumptions. In this connection, future growth assumptions of the cooperatives without further concessional lending should be discussed in detail.

Response: 10-year financial projections for the Federations are found in Annex III, Exhibits G and H. Four-year projections for the Penny Foundation are contained in Annex III, Exhibit I. The Foundation is presently working on a detailed 10-year financial plan, which will be a condition precedent to the signing of the Loan Agreement between BANDESA and the Foundation.

Section II.D. of the Loan Paper discusses in length the recipient institutions' capital structure, profitability, need for additional debt, interest spreads, and future growth without further concessional lending.

4. The Penny Foundation is receiving credits now from BANDESA under Loan 520-L-018. The possible inclusion of the Foundation in this cooperative project should be explored. In that event, an analysis for the Foundation similar to that required for the cooperatives, including particularly the requirements of paragraph 3 above, should be included.

Response: The inclusion of the Penny Foundation in this Loan Project has been explored. It has been determined that, as described in various sections of this Paper, the Foundation activities to be financed under this Loan are within the scope of the project's purpose. The question still remaining is how the Foundation will make the necessary financial and administrative changes in order to meet AID's conditions of viability. The Foundation has stated in a letter of intent to AID its willingness to take the necessary steps toward financial viability and is presently working on a detailed financial plan which will support the interest rate and administrative levels required for Loan implementation. USAID recommends that the submission of an acceptable financial plan be a condition precedent to the signing of the Loan Agreement between BANDESA and the Penny Foundation.

5. The target group under the Loan should be identified with greater precision and in relationship to the credit recipients under the BANDESA program.

Response: The Project Committee has addressed this question in Section I.A.2.

6. The Loan Paper should include an evaluation of the uses of credit made available to the cooperatives under Loan 018 in cost/benefit format.

Response: A cost/benefit analysis has been made of the uses of credit available to the cooperatives under Loan 520-L-018. The evaluation was done on the basis of a random sampling of farmer production in the Highlands. The results of this Study are discussed in Section II.C.2 and are detailed in Annex III, Exhibits E.1, E.2, and E.3.

7. The self-help aspects of the project should be discussed in the Loan Paper, including the GOG as well as cooperatives' contribution.

Response: The self-help aspects of the project, including GOG and Cooperatives' contributions have been discussed in Sections I.A.1, I.A.4, and II.B. The GOG will be contributing services in the areas of auditing, legislative monitoring, and agricultural training. The Cooperatives' contribution will be of an in-kind nature, including volunteer time in the approval and supervision of member loans, and through its system of required capital investment.

8. The assumptions underlying credit demand of the cooperatives over the project period should be elucidated in detail in the Loan Paper.

Response: The assumptions underlying all financial projections for the Federations are described in Annex III, Exhibits G.1 and H.1. The assumptions underlying the Foundation's four-year projections are attached to each chart in exhibits I.1-4, Annex III.

DRAFT LOAN AUTHORIZATION

Provided from: Alliance for Progress Funds

GUATEMALA: RURAL CREDIT AND COOPERATIVE DEVELOPMENT

Pursuant to the authority vested in the Deputy U.S. Coordinator, Alliance for Progress, Agency for International Development ("A.I.D."), by the Foreign Assistance Act of 1961, as amended, and the delegations of authority issued thereunder, I hereby authorize the establishment of a loan ("Loan") pursuant to Part I, Chapter 2, Title VI of said Act to the Government of Guatemala ("Borrower") of not to exceed FOUR MILLION FIVE HUNDRED THOUSAND United States Dollars ($4,500,000) for the local currency costs of a project to assist in increasing the rural productivity and incomes of small farmers; complete the formation of viable, effective and autonomous cooperative federations and stimulate economic activity among small farmer groups in a pre-cooperative stage; and contribute to the development of a rural financial infrastructure in Guatemala. The Loan shall be subject to the following terms and conditions:

1. Interest and Terms of Repayment:

Borrower shall repay the Loan to AID in United States dollars within forty (40) years from the date of the first disbursement under the Loan, including a grace period of not to exceed ten (10) years. Borrower shall pay to AID in United States dollars on the disbursed balance of the loan interest at the rate of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter.

2. Source and Origin:

Goods, services (excluding ocean shipping) and marine insurance financed under the Loan shall have their source and origin in countries which are members of the Central American Common Market or in countries included in Code 941 of the AID Geographic Code Book. Marine Insurance may be financed under the Loan only if it is obtained on a competitive basis and any claims thereunder are payable in freely convertible currencies. Ocean shipping financed under the Loan shall be procured in any country included in Code 941 of the AID Geographic Code Book, excluding countries which are members of the Central American Common Market.

3. Local Currency:

United States dollars utilized under the Loan to finance authorized local currency costs shall be made available pursuant to procedures satisfactory to AID.

4. Other Terms and Conditions:

a. Prior to initial commitment documents or separate disbursements for each of the recipients under the Loan, the Borrower shall submit to AID, in form and substance satisfactory to AID:

(1) Borrower's lending policy with respect to the funds made available pursuant to the Loan.

(2) Executed separate loan agreements with each of the three loan fund recipients, requiring:

(a) General

(i) The Federations and the Foundation may not borrow from other sources any amount of money which would result in a debt/equity ratio for each institution in excess of a ratio to be established in the Loan Agreement.

(ii) Unless AID and Borrower otherwise agree in writing, Loan funds will be used throughout the repayment period of the Loan for activities as may be approved in writing by AID and as further defined by each institution's lending policy. In no event will loan funds be used to finance activities directly relating to coffee, cotton, sugar or other crops or commodities unacceptable to AID.

(iii) The recipient institutions may not incur any indebtedness which would take a senior position to the AID Loan.

(iv) Unless AID and Borrower otherwise agree in writing, the approved lending policies of the recipient institutions will be adhered to througout the repayment period of the Loan.

(v) Net fixed assets of the recipient institutions, such as land, buildings, and equipment, as a percentage of equity capital will be reduced during the disbursement period of the Loan to not more than 15% a shall not exceed such percentage during the repayment peri of the Loan.

(vi) Annual interest rates on all subloans to farmers will not fall below the rates established by mutual agreement between each recipient, Borrower, and AID.

(b) <u>Cooperative Federations (FENACOAC and FENCOAR)</u>

(i) The Federations will maintain a uniform interest rate on all subloans to cooperative affiliates not lower than the prevailing commercial bank interest rates.

(ii) The Federations will establish a Crop Disaster Fund equivalent to 2% of each sub-loan granted. This amount will flow through to the final user and will be deducted off the top of subloans and invested by the Federations in Government securities or similar investments of the highest safety and liquidity.

(iii) The Federations will obtain approval from Borrower and AID prior to any investment exceeding $10,000 from any source in fixed assets.

(iv) Until the Federations maintain a debt-equity ratio acceptable to AID, dividends, when declared, must be invested in shares of the Federations, and no shares can be redeemed except upon disaffiliation from the Federations.

(c) <u>Penny Foundation</u>

(i) The Foundation will not enter into activities outside of the development loan program which would adversely affect the implementation loan program.

(ii) The Foundation may not make loans to individuals.

(iii) The Foundation will establish and maintain a bad-debt reserve equivalent to 5% of the subloans committed. Pay-in the reserve will begin with the first drawdown of subloan funds.

(iv) Prior to the signing of the loan agreement between the Borrower and the Penny Foundation, the Foundation shall submit in form and substance satisfactory to Borrower and AID a detailed financial plan of its operations for ten years.

b. The Loan shall be subject to such other terms and conditions as AID may deem advisable.