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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

PERU

PROJECT PAPER

PRIVATE SECTOR AGRICULTURAL
INVESTMANT PROMOTION

AID/LAC/P-126

Project Number: 527-0265
Loan Number: 527-T-081

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: ____ — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: PERU

3. PROJECT NUMBER: 527-0265

4. BUREAU/OFFICE: LA

5. PROJECT TITLE (maximum 40 characters): Private Sector Ag. Investment Promotion

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY — 12 31 86

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)

A. Initial FY 83 — B. Quarter 2 — C. Final FY 87

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 83 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total		10,000	10,000		10,000	10,000
(Grant)	( )	( )	( )	( )	( )	( )
(Loan)	( )	(10,000)	(10,000)	( )	(10,000)	(10,000)
Other U.S. 1. U.S. Bank		10,000	10,000		10,000	10,000
Other U.S. 2.						
Host Country		5,000	5,000		5,000	5,000
Other ~~XXXXXX~~ PERU		1,050	1,050		10,500	10,500
TOTALS		26,050	26,050		35,500	35,500

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) ARDN	220		040			-0-	10,000	-0-	10,000
(2)									
(3)									
(4)									
TOTALS							10,000		10,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 044 | 840 | 260

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BR	BL					
B. Amount							

13. PROJECT PURPOSE (maximum 480 characters)

To increase the availability of medium-term agricultural credit in Peru by strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans.

14. SCHEDULED EVALUATIONS: Interim MM YY 09 84 | MM YY | Final MM YY 10 86

15. SOURCE/ORIGIN OF GOODS AND SERVICES: ☐ 000 ☒ 941 ☐ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY — Signature: George A. Hill *George A. Hill* — Title: Acting Director — Date Signed: MM DD YY 12 30 82

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (8-79)

PROJECT AUTHORIZATION

Name of Country:	Peru
Name of Project:	Private Sector Agricultural Investment Promotion
Number of Project:	527-0265
Loan Number:	527-T-081

1. Pursuant to Section 103 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Private Sector Agricultural Investment Promotion project for Peru involving planned obligations of not to exceed Ten Million United States Dollars ($10,000,000) in loan funds ("Loan") over a five (5) year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project.

2. The project ("Project") consists of the establishment and operation of a facility within the State Development Finance Corporation (COFIDE) for rediscounting eligible loans made to sub-borrowers for medium-term agricultural credit and strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Interest Rate and Terms of Repayment

The Borrower shall repay the Loan to A.I.D. in U.S. Dollars within twenty five (25) years from the date of first disbursement of the Loan, including a grace period of not to exceed ten (10) years. The Borrower shall pay to A.I.D. in U.S. Dollars interest from the date of first disbursement of the Loan at the rate of (i) two percent (2%) per annum during the first ten (10) years, and (ii) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

b. Source and Origin of Goods and Services

Goods and services, except for ocean shipping, financed by A.I.D. under the Loan shall have their source and origin in Peru or in countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Loan shall be financed only on flag vessels of Peru or countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing.

c. Condition Precedent to Initial Disbursement

Prior to any disbursement, or to the issuance of any commitment documents under the Project Agreement, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D., a signed loan agreement between COFIDE and a U.S. commercial bank to provide $10,000,000 for the Project Agricultural Investment Fund for sublending under the Project.

d. Conditions Precedent to Disbursement to Finance Lending Activities

Prior to any disbursement, or to the issuance of any commitment documents under the Project Agreement to finance lending activities, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D.:

(1) a technical assistance plan for training appropriate personnel of the participating intermediate credit institutions (ICIs) in the technical aspects of the lending program (including indexation of subloans) and in the promotional aspects of such program.

(2) a plan for distributing the sub-borrower Technical Assistance Fund among participating ICIs for technical assistance and training to sub-borrowers before and during sub-project execution.

(3) a COFIDE credit operations manual for the Project.

e. Covenants

The Borrower shall covenant that, unless A.I.D. otherwise agrees in writing, it will:

(1) deposit to the Agricultural Investment Fund all reflows of principal and interest received (less commission and fees) from all subloans for relending consistent with the purpose of the Project.

(2) maintain the value of the Agricultural Investment Fund at an amount of Peruvian Soles Oro equivalent to the dollar value of the Fund upon initiation of lending activities, and to make annual capital contributions to the Fund to compensate for any losses in value during the previous year.

(3) insure that participating ICIs establish a technical assistance fund for sub-borrowers using Project funds and that ICIs maintain that fund with the fees charged to sub-borrowers receiving technical assistance.

(4) insure that rediscounted subloans conform to the eligibility criteria specified in the Credit Manual.

(5) maintain interest rates charged to sub-borrowers of the Fund in line with commercial bank terms available in Peru for this purpose and to adjust interest rates under the Fund whenever necessary to maintain such comparability.

(6) obtain A.I.D. approval prior to authorizing any subloan under the Agricultural Investment Fund in excess of $50,000.

(7) insure that subloans will not be approved for the production, processing or marketing of sugar, palm oil or citrus for export, or for any A.I.D. restricted agricultural commodity.

George A. Hill

Mission Director

12/30/82

Date

Clearances:
CD:MLikar: (in draft)
DR:GWachtenheim: (in draft)
PROG:DCruz: (in draft)
RD:DChiriboga: (in draft)
OARD:DBathrick: (in draft)
CONT:MRogal: (in draft)

DRAFTING INFO:RLA:DAAdams:pdc

PRIVATE SECTOR AGRICULTURAL INVESTMENT PROMOTION
PROJECT NUMBER: 527-0265

PROJECT ANNEXES:

Annex I - Legal Exhibits
A. PID Approval Cable
B. Statutory Checklist
C. Mission Director's 611(e) Certification
D. Borrower's Application Letter
E. Draft Authorization
F. Environmental Determination

Annex II - Technical Exhibits
A. Logical Framework Matrix
B. Cash-Flow Projections
C. COFIDE Organizational Charts and Background Data
D. Cross-Default Clause

Annex III - Unattached Exhibits (Available in USAID/Peru DR and AID/W, LAC/DR)
A. Arthur D. Little, Inc., Report: Peru Private Sector Agricultural Investment Promotion Project.
B. Peru's Financial System

I. SUMMARY AND RECOMMENDATIONS

A. Recommendations

The Project Development Committee recommends that a concessional Loan be authorized to the Government of Peru (GOP) for $10 million to assist in financing an agricultural investment fund to be established in COFIDE.

B. Borrower and Implementing Agency

The Borrower will be the Ministry of Economy, Finance and Commerce, representing the GOP. As the implementing agency, COFIDE will administer the rediscount fund; sub-loans will be made by participating intermediate credit institutions (ICIs).

C. Summary Rationale and Strategy

The Presidential Agricultural Task Force to Peru analyzed constraints to increasing agricultural production in Peru as well as private sector participation in agriculture and stated that the lack of medium-term credit was a serious constraint to private sector involvement in increased agricultural production. The Task Force recommended that the GOP and USAID explore ways of increasing the availability of private sector financing for this purpose.

The proposed Project responds to this recommendation and builds upon the market-oriented policy environment created by the Belaunde administration. The Project has been developed with the explicit intention of changing GOP agricultural lending and interest rate policies by reintroducing private sector financial institutions to the agricultural sector after fifteen years of declining lending levels. At present, the Peruvian commercial banking sector's primary involvement in agriculture is to provide limited financing for agroindustries. The objective of the Project is to stimulate private sector lending for agricultural investment. Private banks have been reluctant to re-enter the agricultural lending market after more than a decade of relative inactivity in the sector due to serious policy constraints. The Belaunde Administration has implemented a number of policies to promote private sector lending and, although private banks are interested in lending once again to agriculture, it is necessary to provide an incentive to private banks to generate the long-run involvement in agricultural lending of a risk-conscious banking community. The AID loan subsidy will encourage banks to extend credit at market rates to a new sector--small and medium-sized farmers--for a new type of lending--medium-term investment--and will serve as a catalyst to increase private lending to agriculture in years to come.

Thus, the Project will promote the institutionalization of two basic policy objectives. First is the revitalization of medium-term agricultural lending by the Peruvian private financial sector through tl introduction of the commercial banking system, which now general provides credit mostly to larger commercial or industrial clients, t small and medium-sized agricultural borrowers. Second, the Project wil support changes in the GOP's interest rate policy so that market interes rates are used in agricultural lending. The Project will achieve thes objectives by working through COFIDE, an autonomous state enterprise rather than with any individual private bank or group of banks. In thi way, participation is open to any ICI and, thus, the Project will cover greater geographic area and will reach a more diverse target group. I addition, the Project offers the AgBank participation in the lendin program, thereby giving AID some policy leverage over the AgBank in th effort to encourage the Bank to modify its current interest rate polic away from subsidized rates and toward market rates.

As mentioned in a recent AID draft policy paper o co-financing, the proposed Project is the Agency's first to offer co-financing arrangement with a U.S. commercial bank. Implementatio arrangements for this type of financing will be tested during the life o the Project, and the results will be used to guide future AID projects AID's $10.0 million loan combined with the private bank financing, GO counterpart, and ICI and sub-borrower contributions will result in $35.0 million investment in medium-term credit in Peru with only a $10.(million contribution from AID. This is a greater than 2:1 ratio an provides a very cost-effective investment of AID's limited developmen resources. But even more important is the stimulus to future privat sector lending which the Project will provide.

D. Project Description

1. Project Goal, Purpose, and End-of-Project Status

The goal of the Project is to increase rural incomes in Peru by increasing agricultural productivity. The purpose of the Project is to increase the availability of medium-term agricultural credit in Peru by strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans. Under the Project, COFIDE, the State Development Finance Corporation, will create a facility for rediscounting eligible loans made to sub-borrowers for medium-term agricultural credit of up to seven years for on-farm improvements. The Project will also provide technical assistance and will support promotional activities for the participating financial entities. Sub-borrowers will receive technical assistance from the ICIs to help them submit loan applications, undertake cash flow analyses, and carry out other activities related to the development of farm plans.

By the end of the Project, COFIDE's medium-term agricultural credit fund will be operating using reflows from loans made during the life of the Project. Approximately nine to twelve private sector lending institutions will have gained experience in rediscounting medium-term agricultural investment loans for a representative variety of lending activities and will be channeling their own resources to term lending in agriculture.

2. Project Activities

Under the proposed Project, medium-term agricultural credit will finance on-farm improvements (e.g., land leveling, water storage structures, small-scale irrigation systems, farm machinery, among other activities) to increase the agricultural productivity of small to medium-sized commercial farms. Financial institutions in the private banking sector as well as the public sector's AgBank are eligible to participate in this Project as long as they adhere to COFIDE's lending criteria. Interest rates charged by the intermediary credit institutions (ICIs) will be at positive effective rates.

a. Agricultural Investment Fund

The Agricultural Investment Fund established in COFIDE will be capitalized at $24.7 million, of which $9.7 million will be AID loan funds, $10.0 million will be co-financed by a US commercial bank, and $5.0 million will be contributed by COFIDE as GOP counterpart to the Project. Participating Peruvian intermediate credit institutions (ICIs) and sub-borrowers will contribute $10.5 million in resources. COFIDE will rediscount 70% of the loan and the ICIs and sub-borrowers will finance the remaining 30%. COFIDE will require that the ICI and the sub-borrower each finance a minimum of 10%. Thus, the Project will mobilize $35.2 million for agricultural credit activities.

COFIDE will establish the selection and screening criteria as well as lending and operating procedures and will incorporate these into a credit manual to be used by the ICIs to screen sub-loan applications. The credit manual will specify sub-lending parameters which will include interest rates, terms, percentage of rediscountability, sub-loan uses, sub-borrower equity contribution, sub-loan size restrictions, and guarantees.

b. Technical Assistance

The Project will provide two levels of technical assistance: (a) COFIDE assistance to the participating ICIs to build and/or strengthen the ICIs' capacity to promote and carry out the proposed lending program ($300,000); and (b) ICI assistance to the sub-borrower to help him submit a loan application and use his subloan more efficiently for on-farm capital improvements ($500,000).

c. Co-financing

Discussions held with representatives of several US commercial banks indicate that the US banks, and in particular the Union Bank and the BOA, appear interested in co-financing this Project with AID. COFIDE is currently exploring these possibilities. Prior to the signing of the AID-GOP Project Agreement, COFIDE will have received a letter of intent from a prospective co-financing institution Before AID funds for the Project are disbursed, a loan agreement between COFIDE and the US bank will have been signed. Once the AID Project Agreement and the commercial bank loan contract are signed, the funds from both sources will be co-mingled in the credit fund and no special disbursement mechanisms are envisioned beyond the normal AID procedures for ICI loans of this type.

3. Project Inputs

The total cost of the proposed four-year Project is estimated at $35.5 million of which $10.0 million will be an AID loan, $5.0 million the counterpart contribution of the GOP (COFIDE), $10.0 million in co-financing from a U.S.bank, and $10.5 million from the ICIs and sub-borrowers.

E. Summary Cost Estimates and Financial Plan (US $000)

Application	AID	US Bank	GOP (COFIDE)	ICIs	Sub-Borrowers	Total
	SOURCES					
Ag Investment Fund	9,700	10,000	5,000	5,250	5,250	35,200
- Credit for on-farm improvements	(9,200)	(10,000)	(5,000)	(5,250)	(5,250)	(34,700)
- Local TA for sub-borrowers	(500)	-	-	-	-	(500)
Technical Assistance	300	-	-	-	-	300
- ST training	(125)	-	-	-	-	(125)
- Local TA for ICIs	(125)	-	-	-	-	(125)
- Evaluation	(50)	-	-	-	-	(50)
	10,000	10,000	5,000	5,250	5,250	35,500
	28%	28%	14%	15%	15%	100%

F. Summary Findings

The Project Development Committee has reviewed all aspects of the proposed Private Sector Agricultural Investment Promotion Project and finds that it is financially, economically, and socially sound and consistent with the development objectives of the GOP and with Mission strategy and objectives. It also finds that COFIDE is institutionally capable of administering the rediscount fund and that ICIs in Peru are capable of carrying out the sublending activities described within the four-year life of the Project.

G. Project Development Committee

Loan Officers:	Mary Likar Cesar Espino Edward Kadunc George Wachtenheim
Rural Development:	Douglas Chiriboga
Program Officer:	Danilo Cruz-De Paula
Regional Legal Advisor:	Annette Adams
Controller:	Michael Rogal Douglas Arnold
TDY Assistance:	Rafael Samper, A.D. Little Inc. Harold Carey, A.D. Little Inc.

II. BACKGROUND

A. Country Setting

Peru's total land area covers 128.5 million hectares, of which 6% are suitable for agriculture and another 14% are suitable for pasture. The remainder is suitable for forestry (38%) and protection (42%).

The coastal strip is accessible by road, and about half the agricultural land of the coast is presently cultivated, almost exclusively under irrigation since rainfall is almost nil. Most of it is under the management of collective-ownership entities, primarily agricultural production cooperatives (CAPs), created by the agrarian reform. A quarter to a third of the 800,000 hectares of irrigated coastal crop land suffers from drainage and salinity problems. Major industrial crops, predominantly sugar cane and cotton, account for 33% of the harvested area; another 30% produces grains, mostly rice and corn; 9% is cultivated pasture; 28% is in pulses, vegetables, potatoes and fodder crops. The coast accounts for about 43% of the gross value of agricultural production.

The sierra region is characterized by generally poor and eroding soils, recurrent drought, and frost. Nevertheless, this area has some valleys with deep fertile soil. Almost all of the wheat that Peru grows, 90% of the potatoes, and a third of the corn are produced in this region, largely by small farmholders. The sierra accounts for approximately 80% of the national cattle production, almost all of its sheep, over 60% of the pigs, 70% of the goats, and all of the 3.2 million alpacas and 1.5 million llamas. The area is noted for its large collectively held farms and ranches, which are mainly in natural pasture. They are operated under management schemes instituted during the agrarian reform but reflect traditional land-holding patterns. The large associative enterprises exist side by side with small farmers. Virtually all sierra land suitable for agriculture (and much that is not) is presently occupied; about 250,000 hectares are irrigated, of which 150,000 hectares need rehabilitation. Increased crop yield and reduced erosion are feasible through more appropriate land use, application of available technology, and improved irrigation in the sierra.

Only 10% of the agricultural land is presently farmed in the selva region and the area accounts for about 15% of total agricultural production. The area, generally divided into "high jungle" (ceja de selva) and "low jungle" (selva baja), is characterized generally by fragile acid soils, pest problems, and sporadic torrential rainfall, and is isolated by the Andes from the coastal markets. Climate, rainfall patterns, and soil vary considerably from north to south, generally becoming less favorable. Many selva products are at a competitive disadvantage because of high freight rates resulting from difficult ground transportation and the rudimentary market structure. Beef and other livestock are raised, as well as a variety of crops including upland and paddy rice, coffee, rubber, cacao, citrus, pineapple, corn, bananas, yuca, and other food crops. Some

30,000 hectares are under irrigation, but most of these systems are poorly designed and constructed, and perhaps 20,000 hectares require rehabilitation. No reliable data exist for realistic estimate of irrigation potential in the selva. Technology for successfully exploiting the region on a sustained yield basis is far from completely known, and is not always readily transferable without local adaptive research, although a body of knowledge is slowly growing with accumulating farmer experience and results of scientific research.

Of the principal sub-sectors, forestry represents a major unexploited physical resource. An estimated 60 million hectares of tropical and sub-tropical forest of industrial potential exist, almost all in the selva; and an additional 10 million hectares of sierra land are appropriate for reforestation. Serious erosion of sierra soil and irregularity of the hydrological regimen in the sierra and coast have been caused by overcutting of forests (without replanting) both for land clearing and to meet basic energy needs.

B. Historical Overview

In 1968, a military government was established which carried out a large-scale, fundamental agrarian reform and socialized much of the economy. High public sector deficits, savings-investment gaps, and heavy external borrowing were the norm. Many private enterprises were replaced by state enterprises, and regulations and controls on the private sector, including banking, were increased. As a result, large numbers of professionals emigrated, and agricultural education, research, and extension institutions were severely weakened as priority was given to the agrarian reform. In the course of this socio-economic transformation, the power base of the large landholders was broken. However, this political/economic goal of the government was accomplished at the expense of productivity and agricultural production, and per capita food production was negative during most of the 1970s.

President Fernando Belaunde Terry took office in July 1980, and his inauguration marked the return to an open political system and to an economic development model in which the private sector and market forces play predominant roles in promoting economic development. The new GOP policy makers have taken bold steps to restore free-market conditions, including liberalized international trade, reduction or abolition of producer price supports for all but a few commodities, establishment of interest rates which reflect the cost of capital, and initiation of legislative reforms in mining, oil, banking, and industry. In this development model, the state is a rule-maker for the private sector and a provider of essential public services and development infrastructure. The private sector--domestic and foreign--however, has been given the role of predominant economic actor. The state lends strong support to the private sector, but will not subsidize or compete with it. As a result. Peru now displays a positive climate for private sector investment in economic growth and development.

The Belaunde administration is trying to create truly competitive environment--even for state companies--that will stimulate private investment through the market place. Accelerating efforts begun during the last few years, the GOP has also declared its intention to sell state enterprises to private groups which can make them more productive. Implicit in policy statements in this regard is the belief that a number of activities more recently in the domain of the government in Peru can be carried out more effectively and efficiently by the private sector. Enterprises which remain in government hands will be given greater managerial autonomy and will be expected to be economically viable enterprises and not dependent on government subsidies.

The agricultural sector, whose revitalization is a key GOP goal, is illustrative of how GOP policy themes have been translated into action. The government is committed to increasing incentives for production as the basic policy. President Belaunde, Prime Minister Ulloa, and other prominent administration officials have stated in major speeches that food consumption in industrial and urban centers will no longer be subsidized at the expense of agricultural production and the rural areas.

In April 1981, the government lowered duties on agricultural inputs and capital goods and opened an expanded line of credit for short-term agricultural loans. Regulations for the 1980 Agricultural Promotion Law were promulgated in October 1981 and established significant incentives for new investment in agricultural production and agro-industry as well as more binding quality standards, a price support system for agricultural commodities, and an advisory committee of government and private interests to develop agricultural policy recommendations. The GOP has followed a policy of gradual elimination of price controls on foodstuffs which has spurred an increase in production. As of March 1, 1982, price controls were dropped for most agricultural commodities, with the exception of rice, sugar, low-cost bread and noodles, and evaporated and recombined milk. Many parastatal entities created under the previous government are to be dismantled with responsibilities returning to the private sector.

Resource productivity is also being increased. Already lower tariffs for capital goods and other agricultural inputs such as fertilizers and improved seed have increased their use and have boosted production and productivity. Credit to the agricultural sector is increasing although most of it is still short-term. The new Agricultural Law provides for private sector participation in technical assistance, fertilizer and seed distribution, and other services. In addition, the GOP is also permitting Agrarian Reform Cooperatives which presently work under communal organizational structures to revamp the form of land ownership. GOP state entities involved in agriculture are being streamlined and reorganized to be more responsive to farmers' needs.

C. Agricultural Sector Constraints

As outlined by the Presidential Agricultural Task Force Report among other documents, the principal constraints to increased agricultural production in Peru include: government policy, lack of credit, the extremely limited quantity and quality of cultivable land resources, as well as inadequate input availability, support infrastructure, management, and marketing.

1. GOP Policy

Government policy intervention in the market place was the legacy of the previous Peruvian government. Recognizing that many of these policies produced disincentives to increased agricultural production, the Belaunde administration has undertaken a series of measures designed to reduce government intervention and to support the private sector. These include a gradual elimination of price controls on foodstuffs and agricultural inputs; liberalization of import restrictions affecting machinery, fertilizers, and other inputs; and passage of the Agricultural Promotion Law, which provides a series of incentives for investment in agriculture and agroindustry. However, in order to continue to strengthen the agricultural sector and develop and implement the policies necessary to do so, the GOP requires an effective system for information gathering and policy analysis.

The Task Force identified current agricultural policy as a major problem. While much of the public sector orientation of the military in its policies has already been blunted or reversed by the current administration with the intention of relying more on market forces in the allocation of resources, further policy changes are required. To assist in this effort, AID is currently developing a $14,500,000 Agricultural Policy Planning and Manpower Development Project.

2. Credit

Sources of medium- and long-term agricultural credit, including those for short-term relending, have virtually disappeared in recent years, with the exception of Agrarian Bank lending. In 1979, AgBank credits covered only 19.7% of Peru's cultivated land; producers of cotton, rice, corn, and coffee accounted for 72% of this total. Associative enterprises received 56% of total AgBank lending in 1980, although this amount was down 10-15% from the average during the middle and late 1970s.

For small and medium-sized individual farmers to increase their productivity and production, they must have access to credit. The AgBank is dedicated to meeting the credit needs of Peruvian agriculture, but cannot accomplish the task alone. According to the Presidential Task Report, thousands of Peruvian farmers are either obtaining credit from informal sources, such as wholesalers, or doing without. To correct this situation, commercial banks must be provided the incentives and opportunities to once again play an important role in the development of the agricultural sector through medium-term lending programs.

3. Resource Management

The high proportions of long-term fallow land in the sierra and inefficient water management throughout the country are major constraints to expanding agricultural production. Major agricultural production areas of the country are also plagued with frequent droughts (e.g. a costly three-year drought on the northern coast and sierra ended in late 1980). Production in the sierra is further affected by frosts and by severe erosion and flooding caused by deforestation, overgrazing, and inappropriate land use.

Peru is dependent upon irrigation to remedy its severe water deficiency. Thirty-five percent of the agricultural land in Peru is under irrigation, while for the rest of Latin America the corresponding figure is only 6.5%. Salinization problems currently affect 250,000 hectares of the 750,000 hectares under irrigation on the coast, and approximately 100,000 additional hectares require rehabilitation. In the sierra and jungle, the problem of salinization is even more acute. Of the 250,000 hectares under irrigation in the sierra, 150,000 hectares require rehabilitation works, and of the 30,000 hectares under irrigation in the jungle, two-thirds require rehabilitation. It is estimated that at least an additional 100,000 hectares in the jungle could be incorporated through the construction of new irrigation works. The recent Presidential Agricultural Task Force stated that, aside from Government policies, the most important single deterrent to accelerated agricultural development in Peru is the distribution, management, and use of water in much of the sierra and the coastal valleys.

4. High-Yielding Seed Varieties, Fertilizer, and Mechanization

The use of improved seed and fertilizers outside the more modern, commercial agriculture of the coast has been minimal. Use of fertilizer, for example, increased from 69,000 metric tons in 1968 to 143,000 metric tons in 1977, but fell back to an estimated 132,000 tons in 1980.

With regard to mechanization, it is estimated that the stock of 8,000 tractors in use during 1968 had declined to 6,500 by the late 1970's, of which only 55% were in operating condition. Up-dated figures are unavailable, but the situation is thought to have deteriorated even further.

5. Research, Extension, and Education

Weak and ill-conceived or mismanaged support services in the sector have hindered agricultural development in a variety of ways. The politicization of research and extension services during the military governments, along with reduced budgets for research, extension and education, resulted in a loss of significant numbers of qualified personnel from the agricultural sector--as well as a steady decline in operating standards and equipment maintenance. The current government has significantly increased investments in agricultural support services. With the creation of INIPA, the GOP is focusing on increasing the efficiency of agricultural production through applied research, technology transfer, and strengthened extension services with re-trained personnel. AID is assisting this effort with its Research, Extension and Education Project.

6. Management of Agricultural Enterprises

The Agrarian Reform program carried out by the military government confiscated the large, relatively modern farms of the coast and transferred ownership to large numbers of inexperienced laborers on the former haciendas. As a result, the management of these agricultural enterprises has been adversely affected by the transfer. Many of the new organizations have now hired managers to oversee operations, but conflicts between workers and hired management frequently have had negative effects on production.

7. Marketing

Marketing of agricultural and livestock products has been disrupted by pervasive and often inconsistent government intervention through price controls, regulations, subsidies, and actual takeover by the state of numerous marketing functions, several on a monopoly basis. The outcome has been a lack of adequate organization of market participants and a lack of competition within the marketing sector.

GOP organizations involved in procurement, storage, and sale of Peruvian agricultural products are not performing satisfactorily. The tendency in the past has been for both producers and consumers to become dependent on these government marketing boards such as ENCI for the acquisition and sale of fertilizer, importation of corn and the control of critical agricultural commodities; ECASA for the purchase and distribution of rice; and EPSA for government ownership of retail marketing. Thus, producer and consumer dependency on these agencies has inhibited needed private initiative and creativity in production and marketing. The GOP, however, is taking some positive steps to return such activities to the private sector. When this is accomplished, basic economic forces will play a stronger hand in the agricultural sector.

D. Financial Sector Overview

The Peruvian financial system is dominated by the banking system which has historically held around 88% of the total assets of the financial system. Besides the Central Bank (Banco Central de Reserva del Peru), the banking system comprises Banco de la Nacion (the central Government's bank and tax receiver), other specialized banks including one cooperative bank, and eleven commercial banks. The non-banking system includes the government's development finance institution, COFIDE (Corporacion Financiera de Desarrollo), as well as 12 finance companies, 17 savings and loan associations, 20 insurance companies, many small savings cooperatives, and hundreds of credit unions. Peru also has a small but growing securities exchange which has become increasingly active during the past two years.

During the early 1970s, the military government introduced several reforms aimed at strengthening government control of financial institutions, channelling credit to "strategic" sectors, and improving access to credit of state enterprises, beneficiaries of the agrarian reform, and enterprises located outside the Lima region. The major reform measures included the nationalization of three commercial banks, the establishment of a Council for Monetary Policy, the creation of COFIDE and strengthening of the development banks, a new law regulating the operations of the finance companies, and the channelling of commercial bank credit to priority sectors and regions.

Beginning in 1978, some of these measures were relaxed. The Belaunde administration has considerably reduced government guidance of financial institutions and policies. Most importantly, the administration has returned responsibility for monetary policy to the Central Bank, and has phased out the direct channelling of credit to priority sectors. The interest rate law passed in December 1980 returned full autonomy in setting interest rates to the Central Bank. In recent years, the Central Bank has also operated several special lines of credit (FONEX, FRAI, and FONCAP) through which it channeled funds to priority areas via banking and non-banking institutions. These lines of credit have more recently been transferred to COFIDE as the Central Bank returned to its more traditional role of regulating monetary policy. Nonetheless, the Government continues to exercise much influence in the financial system through the policies of the Central Bank and the Government-owned financial institutions.

Early in 1982, the MEFC and the Central Bank instituted two new measures designed to promote competition in the banking sector: interest rates were partially freed and cash reserve requirements were lowered. Another GOP effort to open up the banking system to more foreign and local competition is the Banking Law, introduced in Congress in May 1982, but not yet enacted. The purpose of the law is to: authorize the establishment of new commercial banks; establish a 33.3% ceiling on foreign ownership of banks (up from 20%) and finance corporations (down from 49%); and permit foreign banks to set up new branches in Peru. According to the Central Bank, the proposed law contains the most urgent provisions of a wider, more detailed banking reform measure to be presented to Congress in 1983.

1. Banking System

The banking system includes several specialized banks and eleven commercial banks. The specialized banks are The National Bank (Banco de la Nación), six regional banks, two construction industry banks, a savings bank, and five Government-owned development banks. The regional banks operate as commercial banks with a particular focus on promoting economic development within their respective regions. The Central Reserve Bank regulates money supply, credit, and the operations of all financial intermediaries, and manages international reserves. All of these institutions are permitted to accept deposits from the public and all except for the development banks rely to an important extent on deposits as a major source of funds.

The commercial banks carry out short-term (i.e. less than one year) banking operations. Currently, these banks maintain a total of 690 offices, two-thirds of which are located in the Lima area. Except for indexed credits, commercial banks are prohibited from extending credits that exceed one year in maturity. As a consequence, all but one of the domestic commercial banks have created finance company subsidiaries (financieras) as vehicles for providing medium-term financing to their clients.

The six regional banks operate as commercial banks with special emphasis on regional development, and are permitted to make medium and long-term loans. They are relatively small, with total assets of less than 11% of those of the commercial banks.

Five state development banks (Banco Industrial, Banco Minero, Banco Agrario, Banco Nacional de la Vivienda, and Banco Central Hipotecario) operate as specialized financial intermediaries through which the Government channels foreign borrowings and resources mobilized through the banking system to priority sectors, (i.e. industry, agriculture, mining, and housing.) With the exception of the Central Mortgage Bank these banks have been authorized to accept deposits, but they have only recently become active in mobilizing funds from the public with less dependence on Central Bank funding and foreign borrowings.

2. Non-banking System

COFIDE was established in 1971 as a state-owned industrial development finance institution. COFIDE's principal focus has been the financing of medium- and large-scale industrial projects, in particular those of state-owned enterprises. Acting as an agent for the decentralized agencies of the government, COFIDE negotiates foreign credits, provides credit guarantees, and raises local resources through the issue of bonds which, because of special tax benefits, are among the most attractive savings instruments in the country.

COFIDE's role has been changed by the Belaunde administration, and is indicative of the supportive policies for private sector investment that the GOP pursues. The bulk of COFIDE's credit had traditionally gone to large state enterprises. However, COFIDE is planning to divest itself of many of its investments in nationalized industries and will now concentrate on development banking functions. A major objective of COFIDE is to expand its lending operations to the private sector and to increase the financial coverage of that sector by channeling increasing amounts of term capital, including foreign resources, through private financial intermediaries.

Private finance companies (financieras) were established primarily to provide medium-term financial services which, under the banking law, cannot be offered by the commercial banks and were not being fully met by the specialized development banks. In 1981, a law was passed bringing the financieras under the control of the Central Bank and establishing minimum capital requirements.

3. Savings Mobilization

Mobilization of domestic financial savings in Peru is done mainly by the banking sector, which at the end of 1979 held 85% of all financial obligations with the private sector. Non-bank methods for savings include deposits of the savings and loan associations, and time deposits and bonds issued by COFIDE and the financieras. Insurance policies are also an important form of financial savings. In addition, a limited number of non-financial institutions place financial instruments, principally stocks and bonds. All financial institutions operating in Peru (except insurance companies) may take time deposits in local currency. The regional banks and financieras also issue negotiable certificates of deposit. Bonds have not been used to any large extent by Peruvian financial institutions with the exception of COFIDE. All deposit-taking institutions, except the savings banks, are authorized to take deposits in foreign currency (demand deposits as well as negotiable certificates of deposit) as part of the government's efforts to repatriate savings invested abroad.

4. Interest Rates

Prior to 1978, interest rates in Peru were regulated by the Monetary Council, and since December 1980 by the Central Bank, which established a very complex structure of rates differentiated by financial instrument, by type of intermediary, and by sector of destination. As a result of the very high rates of inflation, all deposit and lending interest rates in local currency were negative in real terms from the early 1970s until this year. Increases in the structure of interest rates took place from mid-1978 to early 1979, but the further acceleration of inflation quickly eroded the improvements. Between 1979 and 1980, lending rates were for the most part unified at 32.5% for short-term loans and 37.5% of medium-term loans in local currency, plus commission fees of 1% to 3% p.a. and a 17% tax on interest payments.

In December 1980, a new law was passed eliminating the 17% tax on interest payments and giving the Central Bank full responsibility for establishing interest rates. Simultaneously, the Central Bank approved comprehensive changes which resulted in the simplification of the interest rate structure, including an average increase of 20 percentage points for most deposit and lending rates effective on January 5, 1981. Under the new structure, medium- and long-term loans in local currency carry an interest rate of 56.5% p.a., plus annual commissions of 1.5% to 3%. As interest is paid in advance on a quarterly basis, the corresponding effective rates range from 71.9% to 84% p.a. Short-term effective interest rates are well in excess of 100% in many institutions. As the Government's fiscal and monetary policy measures begin to bring inflation down, the current high interest rates can be lowered. The GOP policy, however, remains that of permitting the market place to set positive effective rates of interest.

5. Agricultural Credit

During the 1970s, the supply of short-, medium-, and long-term agricultural credit was handled almost exclusively by the AgBank. In 1968, agricultural credit (mostly short-term) was 25% of the commercial banks' portfolio, but it consistently declined thereafter and reached 7% toward the end of the 1970s. There is no evidence that other sources within the financial sector contributed any significant amount of credit to compensate for this decline. The reduction in agricultural credit financing from commercial banks following the Agrarian Reform is attributed to the following factors:

a. The institutional changes caused by the Agrarian Reform of the 1970s created an atmosphere of uncertainty which redirected loans toward the industrial, commercial, and public sectors at the expense of agriculture;

b. GOP subsidies to the AgBank made it impossible for private banks to compete.

c. Since agricultural land could no longer be mortgaged, private banks had no acceptable collateral.

d. Through the 1970s, agricultural credit was directed toward associative enterprises.

As a result of these factors, a discussion of agricultural lending in Peru during the past five years is reduced to an analysis of the activities in this sector by the AgBank, as illustrated in the following table.

AgBank Lending
(Millions of 1976 Soles and Millions of US$) 1/

Year	(1) Total Credits Soles	(1) Total Credits US$	(2) Investment Credits 2/ Soles	(2) Investment Credits 2/ US$	Percent of total Credits for Investment
1976	20,820	367	1,082	19	5.2%
1977	20,802	343	728	13	3.6%
1978	19,522	272	1,288	18	6.6%
1979	24,291	396	1,652	27	6.8%
1980	30,074	493	2,736	45	9.1%

1/Deflated CPI Lima-Callao. Source: Agrarian Bank.
2/Medium- and long-term credits.

As indicated above, lending by the AgBank decreased in constant Soles between 1976 and 1978, while credit for investment purposes decreased in dollar terms. This tendency was reversed in 1979 and 1980. Long-term credit also increased significantly during those two years. Nevertheless, the low level of capitalization of Peruvian agriculture remains a cause for concern since it is estimated that on the coast, agricultural enterprises function with between 25% to 40% of the investments required to operate efficiently. In addition, credits authorized by the bank in 1980 covered only about 20% of the land under cultivation in Peru.

With regard to the beneficiaries, the statistics reflect the previous regime's priorities--between 60% to 65% of the AgBank's credit during 1976-79 went to associative enterprises. During 1980, the percentage had decreased somewhat to 56%. The regional distribution of agricultural credit during 1979 was as follows: 63% went to the coast, 24% to the jungle and high jungle, and 13% to the sierra.

The GOP has dictated clear and well defined policies for the creation of a more favorable environment which should channel increased resources to the agricultural sector, thereby contributing to its development. GOP officials believe, however, that despite significant IDB lines of credit having recently been disbursed to the sector through the AgBank, additional resources are still required to satisfy the large demand for fixed farm investments so that farmers have sufficient financing available to address full production potential.

In May 1981, the AgBank Board of Directors put into effect new interest rates for agricultural credits. The ordinary interest rate was set at 47.5% plus a 2% commission. Preferential rates applicable to the entire country are as follows: for production credit 44.5% + 2% commission; for capitalization (i.e. irrigation, land leveling, drainage, desalinization, etc.) 44.5% + 2% commission; for "Special Loans", (i.e. FDA, reforestation loans, IDB loan 497 subprogram B, new or rollover loans to farmers affected by rains and floods, IBRD loan 1812-PE for the development of Juliaca, Puno, and FIDA loan 38-PE) the rate of interest is 30.5% + 2% commission. The interest rates set for the jungle and high jungle are as follows: production credit 30.5% + 2% commission; credits for agro-industry 44.5% + 2% commission; and credits for capitalization 30.5% + 2%. The difference between the ordinary and preferential rates imply additional subsidies by the GOP.

E. Problem Statement

Most indicators of the performance of the Peruvian agricultural sector demonstrate that it has gone through a severe crisis. Since 1950, the sector has been characterized by a decline in per capita agricultural production. The long-term rate of decline between 1950-1979 was 0.6%. The situation worsened during the decade of the 1970s when the per capita aggregate value declined more than 2% per year.

The recent Presidential Agricultural Task Force to Peru emphasized the great potential that exists in the agricultural sector and it analyzed the problems which must be overcome to take advantage of the opportunities that are available to the Peruvian farmer. The Task Force stated in its report that agricultural policy in Peru constituted a classic case of objectives and policies in conflict. Although the current government recognizes the fundamental importance of agriculture to the sustained development of the economy and has given highest priority to the development of the agricultural sector, the economic risk of agricultural production in Peru falls mainly on the farmer who is subject both to the uncertainties of nature and of government policy.

A major problem in the agricultural sector identified by the Task Force is credit. During the 1970s, structural changes in the agricultural sector caused the demand for investment capital in the sector to contract. At the same time, the supply of financial resources for the sector, which declined rapidly as economic conditions worsened, was channelled almost exclusively through the AgBank, principally for short-term production credit. However, the Bank had many "incentive" rates for borrowing, all below the rate of inflation, and as a result of these rates, slow repayments, and defaults, the bank's resources were decapitalized. By the end of the decade, credit for agricultural production was in extremely short supply. Public inability and private unwillingness to loan to agriculture resulted in very little investment and thus little increase in agricultural production or productivity.

Capital is necessary in order to improve Peru's food system from producer to processor, wholesaler, retailer, and eventually to the consumer. The Task Force identified both the inadequate supply of credit and the lack of competition in the agricultural financial sector as significant constraints to the improvement of food production. The AgBank lending programs, for example, currently cover only 20% of land under cultivation and an estimated 5% of farmers. Additionally, the Task Force indicated that lenders perceive agriculture to be a high risk enterprise. Finally, they found that the AgBank alone did not address the broad credit needs of Peru's agricultural sector and recommended that more financial entities participate in agriculture financing.

Thus, new policies undertaken by the Belaunde government have produced demand for agricultural investment credit in excess of presently available resources. Demand is expected to continue to increase as the expansion in the agricultural sector takes hold due to the new incentives as well as the opening of new land, particularly in the high jungle, to agricultural and forestry production. Besides the expected expansion in agricultural production, additional factors indicate an increasing demand for agricultural investment credit: (a) the current decapitalization of the sector, particularly for individual producers; (b) import liberalization of capital goods, which also affects goods utilized in agricultural production and the consequent need for financial resources for their acquisition; (c) the 11% increase in the number of loans and 67% increase in the value of loans financed by the AgBank between 1979 and 1980; and (d) the faster-than-expected disbursement of IDB loans demonstrating a pent-up demand for agricultural credit.

F. <u>Project Rationale and Strategy</u>

The Presidential Agricultural Task Force analyzed the constraints to increasing agricultural production in Peru as well as private sector participation in agriculture, and stated that the lack of medium-term credit was a serious constraint to private sector involvement in increased agricultural production. The Task Force recommended that the GOP and USAID explore ways of increasing the availability of private sector financing for this purpose.

The proposed Project responds to this recommendation and builds upon the market-oriented policy environment created by the Belaunde administration. The Project has been developed with the explicit intention of reintroducing private sector financial institutions to the agricultural sector after fifteen years of declining lending levels. At present, the Peruvian commercial banking sector's primary involvement in agriculture is to provide limited financing for agroindustries. The objective of the Project is to stimulate private sector lending for agricultural investment. Private banks have so far been reluctant to re-enter the agricultural lending market. To stimulate the type of long-term commitment to agricultural lending that will generate increased investment in the sector, it is necessary to provide an incentive to private banks so that they will target a portion of their lending for this purpose. AID has limited resources and thus is not interested in a mere resource transfer of a subsidized credit line to private sector ICIs. Rather, the AID loan subsidy will encourage banks to extend credit to a new sector--small and medium-sized farmers--for a new type of lending--medium-term investment. But the sub-loans themselves will be at non-subsidized positive interest rates. Once ICIs start lending for agricultural investment and realize that such lending is profitable, they will continue to lend for agricultural investments with their own funds in addition to reflows from the rediscounted loans.

Thus, the Project will promote the institutionalization of two basic policy objectives: (1) revitalization of medium-term agricultural lending by the Peruvian private financial sector through the introduction of the commercial banking system, which now provides credit mostly to larger commercial or industrial clients, to the small to medium-sized agricultural borrower, and (2) changes in the GOP's interest rate policy, establishing market rates for agricultural lending. The Project will achieve these objectives by working through COFIDE, an autonomous state enterprise, rather than with any individual private bank or group of banks. In this way, participation is open to any ICI and, thus, the Project will cover a greater geographic area and will reach a more diverse target group. In addition, the Project offers the AgBank participation in the lending program, thereby giving AID some policy leverage over the AgBank in the effort to encourage the Bank to modify its current interest rate policy away from subsidized rates and toward market rates.

The Project's focus on lack of medium-term credit for the private sector addresses one of the major constraints to increased production in the agricultural sector today. Such credit has virtually disappeared in recent years; the AgBank has been the major lender in the sector and has concentrated its lending on short-term production credit. With the anticipated decline in GOP resources available for agricultural lending, the AgBank has also reduced its lending coverage geographically, and focused on four major crops and on the associative enterprises as areas of prime interest. At present, the only line of credit available for medium-term lending to the agricultural sector is a $15 million local currency fund established in July 1981, which is channeled through the Central Reserve Bank. Almost half of this amount (47%) had been disbursed by July 1982 using the Central Bank's indexation system. This credit line was channeled through private sector ICIs, such as Banco Internacional, Popular, Comercial, Sur Medio, among others.

While helping to relieve the medium-term credit constraint facing Peru today, the proposed AID Project also promotes policy change in agricultural lending. Only market rates will be charged by the Fund. The general policy change of increasing the cost of money to reflect its relative scarcity will support GOP efforts to encourage an efficient allocation of resources throughout the financial sector, to promote savings, and to increase the availability of credit to borrowers now outside the reach of the financial intermediaries. Furthermore, this line of credit will provide an incentive to encourage the AgBank to change its interest rate policy. The Bank has been lending at highly subsidized rates of interest: real rates average a negative 12%-22%, depending on the particular line of credit. In connection with a major World Bank credit, the AgBank has agreed in principle to rationalize its interest rate policy.

The Project also supports a basic rural development goal--increased agricultural productivity. The Project will have a favorable impact on AID's traditional target group, particularly by increasing employment opportunities. External disincentives--in particular, Peruvian labor laws which make it difficult to dismiss employees--discourage the use of labor and thus favor capital-intensive activities. AID will attempt to deal with this broader policy issue through other efforts. The GOP has recognized this problem as a serious constraint to investment in Peru and the Congress is currently debating a new industrial law that would alleviate the problems caused by current labor legislation. Additional disincentives to labor-intensiveness were, until recently, an overvalued sol and subsidized interest rates, both of which favored capital investment in imported equipment. Now, however, a realistic exchange rate and market interest rates ensure that investments in capital-intensive activities, such as machinery purchases, are made only if they are profitable. Rational, economic decisions will govern Project lending activities. A market-oriented policy framework should guarantee that market forces come into play in the selection of capital or labor for a particular activity. Given Peru's labor surplus, it is expected that investment in the agricultural sector will promote labor absorption. In addition, it is anticipated that a number of Project sub-loans will open up new lands to development on the coast through irrigation or in the jungle through land clearing, thereby also creating significant new employment opportunities.

As mentioned in a recent AID draft policy paper on co-financing, the proposed Project is the Agency's first to offer a co-financing arrangement with a U.S. commercial bank. Implementation arrangements for this type of financing will be tested during the life of the project, and the results will be used to guide future AID projects. AID's $10.0 million loan combined with the commercial bank financing, GOP counterpart, and ICI and sub-borrower contributions will result in a $35.0 million investment in medium-term credit in Peru with only a $10.0 million contribution from AID. This ratio is greater than 2:1 and provides a very cost-effective investment of AID's limited development resources. And as private banks undertake new loans to agriculture in the future, this ratio will increase even more.

In summary, the proposed Project will: a) promote and support significant policy changes both for the public and private sectors; b) have a positive impact on the level of productivity in the agricultural sector; c) use both the domestic and foreign private sectors, as the principal agents for meeting Project objectives; d) restore the confidence of the Peruvian commercial banking sector in investments in agriculture; and e) restore confidence on the part of the small- and medium-sized farmer that investments in on-farm improvements are once again desireable and possible.

G. Relationship to USAID Program

1. Relationship to Mission Strategy

The proposed Project supports A.I.D.'s development strategy in Peru in two ways. First, the Project will promote increased agricultural productivity which is one of the major objectives of USAID/Peru's development program. To date, approximately 80% of the Mission's development assistance portfolio has been dedicated to agricultural and rural development, and this sector will continue to be the highest priority in the Mission's program. Mission projects in the sector have focused on two inter-related objectives: increasing agricultural production and developing policies and programs to promote the rational use of Peru's natural resources. The proposed Project is in line with both of these objectives. Second, USAID/Peru has the cross-sector objectives of increasing private sector participation in development and of increasing domestic financial resource mobilization through positive rates of interest. By working through private sector ICIs and requiring that positive interest rates be charged, the Project will support these objectives.

a. Sector Objectives

The findings of the Presidential Agricultural Task Force are central to the development of Mission agricultural strategy. The Project addresses two important constraints to agricultural growth identified in the Task Force Report: inadequate supply of credit and a lack of competition in the agricultural financial sector which has been dominated by the Agrarian Bank during the last decade. As described above, the low level of capitalization of Peruvian agriculture is a detriment to future growth. By increasing financial competition, the Project aims to revitalize the sector--a necessary element to increasing production and productivity over the long run.

Given the productivity of coastal agriculture relative to that of the sierra and high jungle, a large percentage of Project funds will likely be lent to farmers on the coast. Past USAID strategy has concentrated Mission resources on the promotion of sierra and high jungle economic growth, particularly agricultural and rural development. The proposed Project will provide credit for viable sub-projects which emerge from ongoing Mission activities in the high jungle and the sierra. At the same time, Project design recognizes that about 70% of value-added in agricultural is from coastal production. For this reason, we expect that much of the resource lending made possible by this Project will be used to expand coastal agriculture.

In addition, the Mission does not limit its efforts to influence sector-wide constraints to one geographic area. For example, the ongoing Agricultural Research, Extension and Education Project encompasses activities on the coast, as well as in the sierra and high jungle. Under the proposed Project, we will encourage the use of funds in all three geographical areas in order to institutionalize the program country-wide. However, economic realities will require that most subloans be made to the country's productive areas. The result will, in any case, be consistent with the Mission's strategy of encouraging private sector participation and with the Project objective of re-introducing commercial bank term lending to agriculture, as discussed below and elsewhere in the Project Paper. Rather than shifting fundamentally, Mission strategy is evolving as a result of changes in country conditions, programmatic considerations, and the requirements of implementing the newer themes in U.S. development assistance.

b. Cross-Sector Objectives

The Project also supports the implementation of USAID strategy themes: active encouragement of private sector solutions to development problems, institutional strengthening, and improved productivity through continuing economic policy reform. The private sector will play a pivotal role in several ways. It will increase access to term credit and improve the efficiency of credit delivery to Peruvian farmers. Technical assistance to participating ICIs will strengthen the ability of these institutions to participate once again in agricultural sector lending.

Private sector co-financing of the Project, including contributions fro participating ICIs, maximizes the impact that a relatively small amount o A.I.D. resources will have. Finally, the Project supports the GOP (and AID policy of establishing market lending in all sectors of the economy particularly agriculture.

2. Relationship to Other Mission Projects

Other Mission projects in the agricultural sector complement the proposed Project by dealing with important, non-credit constraints identified above. For example, the Agricultural Research, Extension, and Education Project (527-0192) is addressing the lack of adequate research and extension in Peru. An FY 83 project, Agricultural Policy Planning and Manpower Development (527-0238), will strengthen Peru's agricultural statistics and information system and improve the GOP capacity to formulate and implement sound, coherent agricultural sector policies.

The proposed Project complements other Mission activities aimed at reinforcing the critical GOP policy initiative in the financial sector: that of positive interest rates. In the past, subsidized credit, particularly in the agricultural and housing sectors, has been the rule in Peru. In agriculture, credit subsidies have resulted in the almost total absence of term lending. The AID Urban Small Enterprises Development loan as well as two major AID integrated rural development projects--Upper Huallaga Area Development and Central Selva Resource Management--are promoting increased term lending at positive interest rates, including the use of indexed loans. The proposed Project will support this effort in other regions of the country.

In addition, the Mission successfully implemented an earlier loan, Rural Agribusiness Rediscount Fund (FRAI--Loan 527-T-060), through the Central Bank and COFIDE. Experience gained under the FRAI loan has been important in the design of the proposed Project. Also influential in the design has been the Mission's experience under the Agricultural Cooperative Federations Loan, 527-T-058, implemented by the AgBank. A substantial portion of that loan was deobligated because the Bank failed to disburse those AID funds earmarked for agroindustrial development by the centrales, despite the extensions granted by AID. Thus, for the Mission, a critical factor is the implementing agency's ability to move funds to the target group rapidly and efficiently.

h. Relationship to Other Donor Activities

By encouraging commercial banks to participate in agricultural sector lending, the proposed Project complements IBRD and IDB efforts to increase the supply of agricultural investment credit in Peru. Both the IBRD and IDB have channelled their assistance to the AgBank which, as mentioned elsewhere in this paper, has been the major source of agricultural credit in recent years. The Bank is currently in the early stages of negotiating a new loan package with the IBRD.

Of the two recent IDB loans, the first was fully disbursed at the rapid rate of \$6-\$8 million/month, largely due to the subsidized interest rates used (32% to 49.5%). The second IDB loan, which is for cooperatives, has disbursed only \$16 million of the \$31 million available.

The IBRD lent \$30 million to the AgBank in 1973. The latter required six years to move those funds at commercial rates, in part because the agrarian reform and its numerous regulations made lending in that period a rather precarious proposition. The IBRD project currently under consideration would total \$128 million, of which \$65 million would be provided by the IBRD and \$63 million would be GOP counterpart. The IBRD is requiring that the AgBank show its resolve to implement commercial interest rates before the IBRD funds will be lent.

Both AID and the IBRD are concerned about IDB's willingness to make funds available for subsidized credit programs and are working to bring IDB policies in line with their own. Recent meetings have been held in Washington with representatives of AID, the Department of Treasury, and the IDB to discuss the interest rate policy issue. AID/W will continue to work to resolve this issue.

III. PROJECT DESCRIPTION

A. Project Goal, Purpose, and End-of-Project Status

The goal of the Project is to increase rural incomes in Peru by increasing agricultural productivity. The purpose of the Project is to increase the availability of medium-term agricultural credit in Peru by strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans. Under the Project, COFIDE, the State Development Finance Corporation, will create a facility for rediscounting eligible loans made to sub-borrowers for medium-term agricultural credit of up to seven years for on-farm improvements. The Project will also provide technical assistance and will support promotional activities for the participating financial entities. Sub-borrowers will receive technical assistance from the ICIs to help them submit loan applications, undertake cash flow analyses, and carry out other activities related to the development of farm plans.

By the end of the Project, COFIDE's medium-term agricultural credit fund will be operating using reflows from loans made during the life of the Project. Approximately nine to twelve private sector lending institutions will have gained experience in rediscounting medium-term agricultural investment loans for a representative variety of lending activities and will be channeling their own resources to term lending in agriculture. Small and medium-sized farmers will actively seek medium-term investment loans from private banks.

B. Project Activities

Under the proposed Project, medium-term agricultural credit will finance such on-farm improvements as land leveling, canals, water storage structures, small-scale irrigation systems, permanent plantings, fruit storage, dairy machinery, farm machinery, livestock, silos, stables, fencing and posts, and other activities to increase the agricultural productivity of small- to medium-sized commercial farms. Any financial institution in the private banking sector--e.g., commercial banks, regional banks, financieras, as well as the public sector's AgBank--is eligible to participate in this Project as long as it adheres to COFIDE's lending criteria. All interest rates charged by the intermediary credit institutions (ICIs) will be at market rates.

The fund will make available $35.2 million for on-farm capital improvements. It will contribute to increased agricultural productivity of commercial farms by promoting production efficiency and bringing additional land under cultivation. Availability of medium-term agricultural credit will help alleviate sector-wide credit constraints in agriculture. By the end of the Project, the fund will have a proven capacity to maintain its level of refinancing and to operate as an effective mechanism for promoting medium-term agricultural credit.

During PID development, it was planned that the Project would seek to change public sector lending policies by offering the AgBank participation in the rediscount fund, providing that market rates of interest be used. Currently the World Bank is also working to convince the AgBank to change its subsidized interest rate policy. If the AgBank adopts positive rates, the Project's credit line could help to expand the AgBank's credit coverage of land under cultivation and move the AgBank into medium-term lending activities on a permanent basis.

By involving private sector financial intermediaries, the Project will reintroduce these institutions to agricultural sector lending, an activity which they have not promoted since the late 1960s. By the end of the Project, these ICIs will begin to use their own resources to finance medium-term credit in agriculture, as well as drawing on the resources of the Fund.

The implementing agency for this Project will be COFIDE. Established in 1971, COFIDE is an autonomous state enterprise whose purpose is to stimulate and promote Peruvian entrepreneurial activity, coordinate and guarantee the financing of state enterprises, mobilize resources for priority projects of state, private, and social property enterprises, and expand the domestic capital market. During the last three years, however, COFIDE has made significant changes in its orientation and has substantially increased lending to the private sector (see Institutional Analysis).

In November 1980, COFIDE assumed the management of the AID-funded Agribusiness Rediscount Fund (FRAI), when the Central Bank divested itself of all its rediscount lines. In order to implement this program, COFIDE established a new Financial Intermediaries Division, and the Special Unit operating the FRAI in the Central Bank moved intact to the Division. This Special Unit--statred with a Director (Economist), Assistant Director (Economist), Promotion Specialist (Agricultural Engineer), Financial Analyst, Administrative Officer, and support staff--will manage the Agricultural Investment Fund.

1. <u>Agricultural Investment Fund</u>

a. <u>Magnitude and Scope</u>

The Project will mobilize $35.2 million for agricultural credit activities: $9.7 million in AID loan funds, $10.0 million co-financed by a US private bank, $5.0 million from COFIDE as GOP counterpart, and $10.5 million from participating Peruvian intermediate credit institutions (ICIs)and sub-borrowers. COFIDE will rediscount 70% of the loan and the ICIs and sub-borrowers will finance the remaining 30%. COFIDE will require that the ICI and the sub-borrower each finance a minimum of 10%.

b. Operating Procedures

The new credit system will function in the following manner. COFIDE will prepare an operations manual which will advise financial institutions of the procedures and criteria for lending under the program. Simultaneously, COFIDE will carry out a promotional campaign to familiarize ICIs and potential sub-borrowers with the Fund and its objectives. A sub-borrower wishing to develop or expand on-farm improvements will present an application to the intermediate bank of choice. The application will include a farm plan and a cash flow analysis to establish the sub-borrower's ability to repay the loan and to assure that adequate complementary, short-term production credit will be available. Technical assistance will be available to assist the farmer in the preparation of a farm plan. The ICI will screen the initial application to determine that it conforms to approved lending criteria; it will then make the credit judgment, establish the lending terms, and assume the credit risk. If the sub-loan is within the established limits for ICI autonomy ($50,000), the ICI will disburse the sub-loan and then ask COFIDE for automatic reimbursement. COFIDE will automatically rediscount those sub-loans which do not surpass the $50,000 limit. For a sub-loan which exceeds this limit, prior COFIDE authorization will be necessary. Before authorizing a sub-loan over $50,000, COFIDE and AID will evaluate the project based on information provided by the ICI.

Once the ICI has made the sub-loan disbursement and presented COFIDE with evidence of the disbursement, COFIDE will arrange to reimburse the ICI. All sub-loan supervision and collection responsibilities will rest with the ICI.

COFIDE will establish the selection and screening criteria as well as lending and operating procedures and will incorporate these into a credit manual as a condition precedent to AID disbursement. AID anticipates that all individually owned farms as well as cooperatives and associative enterprises will be eligible for Project lending. Selection criteria might require that farms be operated by owners, members of the immediate household, or tenant operator, if the operator is protected by lease agreement of sufficient term or if the owner will assume joint liability for repayments. No sub-loans will be provided for the purchase of homes or land.

The credit manual will specify sub-lending parameters which will include those identified below:

(1) Interest Rates: Interest rates and point spreads are discussed in more detail in the Financial Analysis. Point spreads for COFIDE and the ICIs will be reviewed shortly after Project implementation begins to ensure that adequate incentives are provided to the ICIs while still providing competitive rates to sub-borrowers. If it is found that the

ICI point spread is insufficient to induce ICI sub-lending, then the COFIDE point spread will be reduced and the ICI spread increased.

Sub-loan terms will specify the use of one of the following:

- Fixed rates in Soles as set by the Central Reserve Bank. Maximum nominal rate permissible by law will be used to assure that decapitalization does not occur.

- Dollar-denominated fixed rates.

- Indexation system. The interest rate for an indexed loan consists of two parts: (1) the nominal fixed rate of interest (17%) applied to the principal, and (2) the adjustment factor (currently 40%) which is determined by the Central Reserve Bank based on the interest rates which must be paid to attract savings, i.e., the cost of mobilizing resources.

Under the indexed system, the borrower eventually pays the same amount in interest (except as modified by the savings index) as paid under the fixed system with advanced interest payments. The key difference is that the borrower under the indexed system may only have to pay nominal interest rates of about 40-50% during the first year or two, before paying as much as 90% rates in the last years to compensate for the lower earlier payments. Thus, this system is attractive to borrowers because their loan repayments are lower in initial years before their improved operations become profitable. Key to the success of the indexed system is educating farmers as to these delayed-payment benefits. Banks have been reluctant to promote indexation because, while the system solves the borrower's cash flow problem, it creates a similar one for the lender. However, by assuming 70% of the delayed payment, COFIDE will take most of the burden of short-term cash-flow complications from the ICIs.

(2) Terms: The maximum term for sub-loans will be seven years including a grace period not to exceed two years. Sub-loans will not be made for a term of less than one year. Within these limitations, sub-lending terms will be set on a case-by-case basis by the participating ICI.

(3) Percentage of Rediscountability: COFIDE will refinance 70% of ICI sub-loans meeting eligibility criteria; 30% will be contributed from the resources of the ICI and the sub-borrower. A minimum of 10% will be required from each of these two parties.

(4) Sub-loan Uses: Eligible uses of Project resources will include farm and dairy machinery, other major pieces of equipment and accessories, land leveling, terracing, fencing, permanent plantings, drainage systems, small-scale drip irrigation systems, canal lining, herd improvement (artificial insemination, and semen), silos, and stables. We

expect that sub-loans will reflect a representative distribution of these activities. During Project implementation, the sub-loan distribution will be monitored to ensure that ICIs gain experience in a variety of lending activities.

Subloans will not finance investments on farms producing sugar, palm oil, or citrus for export, or for any AID-restricted agricultural commodity. A covenant to this effect is included in the Project Areement.

To encourage lending which makes optimal use of labor, preference will be given to those sub-loans which are labor-intensive.

(5) Sub-borrower Equity Contribution: A minimum of 10% contribution from the sub-borrower will be required by the ICIs. This can in some cases be as much as 20%, depending on the type of on farm improvement financed. For example, for a land clearing operation in the high jungle, the ICI may request a 20% cash or in-kind contribution from the sub-borrowers as a normal ICI debt/equity requirement. For purposes of the financial plan, an average of 15% contribution from the sub-borrower has been used.

(6) Sub-loan Size Restrictions: The maximum sub-loan size and maximum amount to be outstanding to any one sub-borrower will be $50,000, unless otherwise agreed by AID.

(7) Guarantees: Under the relatively new Agricultural Promotion law, land may now be mortgaged for agricultural capital investments. Land had been commonly cited as the "missing link" needed to inspire commercial lending. However, the banks are more disposed now to use the capital equipment financed as collateral than the newly mortgageable land. As in the US, banks are more interested in a borrower's repayment potential than the guarantees provided. "Character," earning capacity, and credit history are most important. These are indicated by his business practices, balance sheets, credit records, as well as the investment's effect on the borrower's cash generation. Creditworthy borrowers will also have houses, equipment, or machines to offer as collateral. If the capital financed cannot be easily liquidated, as in irrigation processes, then the guarantee problem would be more significant. It appears that the main reason commercial banks and financieras have not made agricultural capital equipment loans in recent years has had little to do with guarantees "per se," and more to do with the poor financial health of the agricultural sector and the concessional rates offered by the AgBank.

2. Technical Assistance

The Project will provide two levels of technical assistance: (a) COFIDE assistance to the participating ICIs to build and/or strengthen the ICIs' capacity to promote and carry out the proposed lending program; and (b) ICI assistance to the sub-borrower to help him submit a loan application and use his subloan more efficiently for on-farm capital improvements.

a. Technical Assistance to the ICIs

Since most ICIs have not been lending for agricultural investment recently, they may not have the capacity to analyze and evaluate agricultural investment projects. Therefore, $300,000 of the AID loan will be channeled to the ICIs to provide technical assistance and training. Approximately $250,000 will be used to fund both in-country and foreign training for ICI and COFIDE personnel, as necessary. Short courses in agricultural finance and project evaluation at US universities or perhaps in-house training by the co-financing bank will be eligible for funding.

Specific training and technical assistance requirements will be determined by COFIDE and a plan submitted to AID as a Condition Precedent to disbursement. The following estimates of requirements are provided for information. It is anticipated that COFIDE will send one or two employees to the United States for short-term training in project feasibility analysis and financial management of agricultural projects at a cost of $10,000 each, or $20,000 total. The twelve participating ICIs will each train an officer to carry out agricultural project feasibility studies at an estimated cost of $6,000 each for a six-week training course in the U.S. ($72,000 total). In addition, each ICI will provide in-country training, as available through ESAN (Superior School of Business Administration) or other programs, for two additional persons in accounting and financial management of agricultural projects at a cost of $1,300 each, or $32,000 total. Thus, the total amount required for COFIDE/ICI training is approximately $125,000.

In addition to this training, the Project will finance up to five months local technical assistance for participating ICIs at $2,000/month, for a total of approximately $125,000. These local consultants will work directly with participating ICIs to improve their project analysis and evaluation capacity; to promote the lending program and the various interest rate schemes, especially indexation, to be used in the lending program; and to address additional problems, such as procurement, identified during Project implementation. As part of the promotional activities, Project technical assistance will analyze individual model sub-projects to demonstrate to potential sub-borrowers the profitability of particular investments on farms of various sizes. An additional $50,000 will finance periodic evaluations of the AID-COFIDE Project.

b. Technical Assistance to the Sub-Borrowers

A technical assistance fund of $500,000 will be established as part of the cost of the subloan from the credit fund. This fund will be made available to participating ICIs to provide technical assistance to their sub-borrowers. Areas of assistance will include preparation of farm plans and subloan applications, cash flow analyses, bookkeeping, and equipment procurement, installation, and maintenance. Since many of the subloans will be for sophisticated on-farm improvements, we anticipate that a significant level of short-term assistance will be necessary. At an average cost of $2,000/month including expenses, the Project T.A. fund will provide each participating ICI with approximately 20 months of technical assistance for an estimated 166 borrowers on the average. Divided among an estimated total of 2,000 Project sub-borrowers, individual technical assistance costs will average $250. Once sub-borrowers' repayments for technical assistance begin, additional funds will become available for technical assistance for new sub-borrowers. COFIDE will initially disburse to the ICIs for the establishment of these individual T.A. funds which will be managed by each ICI and maintained by sub-borrower repayments.

One area which will receive specific emphasis is indexation. The Central Bank is actively promoting indexation and indications are that the AgBank will also be adopting the indexed system. Project technical assistance and promotional campaigns will be aimed at informing the borrower of the advantages for him of the system. COFIDE's promotional campaign directed at ICIs will emphasize the cash-flow advantages for the lending ICIs since COFIDE will be rediscounting 70% of indexed loans made by the ICIs.

3. Co-financing

Discussions have been held with representatives of several US commercial banks, including the Union Bank of California and the local branch of Bank of America (BOA) in Lima, concerning the possibilities of co-financing this Project with COFIDE. Generally, the US banks, and in particular the Union Bank and the BOA, appear interested in co-financing this Project with AID. The BOA made an initial proposal on lending terms of somewhere between five and seven years at approximately 1 1/2 points over LIBOR or 1 3/8 over prime. In addition, BOA would charge a 1% management fee and a 1/2% commitment fee and would require both a GOP guaranty and a cross default clause in the AID loan agreement. This clause would be similar to the one used in the BANEX loan agreement in Costa Rica (see Annex II Exhibit D) or to clauses used in World Bank co-financed loan agreements.

If BOA is selected as the co-financing institution (a COFIDE decision subject to Mission approval), the branch in Lima has the authority to authorize the loan in-country without prior consultation with headquarters, and has in fact expressed a strong interest to Mission representatives in joining with AID to finance this Project. Preliminary discussions concluded that once the AID loan was near to being authorized, BOA would put its loan package together so that both loans could be signed with the GOP concurrently or together as one loan agreement.

Once the AID Project agreement and the private bank loan contract are signed, the funds from both sources would be co-mingled in the credit fund and no special disbursement mechanisms are envisioned beyond the normal AID procedures for ICI loans of this type.

C. Project Inputs

The total cost of the proposed four-year Project is estimated at $35.5 million of which $10.0 million will be an AID loan, $5.0 million the counterpart contribution of the GOP (COFIDE), $10.0 million in co-financing from a U.S. bank, and $10.5 million from the ICIs and sub-borrowers.

IV. PROJECT ANALYSES

A. Financial Analysis

1. Project Financial Plan

The total cost of this four-year Project is estimated at US$35,500,000. AID will provide US$10,000,000 in loan funds, and a US private bank will provide co-financing in the amount of $10,000,000. COFIDE will provide $5,000,000 and the participating ICIs and sub-borrowers will contribute $10,500,000.

As shown in Table 1, Summary Cost Estimates and Financial Plan, $35,200,000 will be used to capitalize the agricultural investment fund, of which $500,000 will finance local technical assistance for sub-borrowers. The remaining $300,000 will finance short-term training, local technical assistance for the ICIs, and Project evaluation. Table 2 shows expected disbursements by year.

TABLE 1
Summary Cost Estimates and Financial Plan
(US $000)

	SOURCES					
Application	AID	US Bank	GOP (COFIDE)	ICIs	Sub-Borrowers	Total
Ag Investment Fund	9,700	10,000	5,000	5,250	5,250	35,200
- Credit for on-farm improvements	(9,200)	(10,000)	(5,000)	(5,250)	(5,250)	(34,700)
- Local TA for sub-borrowers	(500)	-	-	-	-	(500)
Technical Assistance	300	-	-	-	-	300
- ST training	(125)	-	-	-	-	(125)
- Local TA for ICIs	(125)	-	-	-	-	(125)
- Evaluation	(50)	-	-	-	-	(50)
	10,000	10,000	5,000	5,250	5,250	35,500
	28%	28%	14%	15%	15%	100%

TABLE 2
Expected Disbursements by Calendar Year
(US$000)

Source/Application	YEAR I	II	III	IV	Total
AID	1,040	3,030	3,000	2,930	10,000
Ag /Investment Fund					
- Credit for on-farm improvements	920	2,760	2,760	2,760	9,200
- Local TA for sub-borrowers	50	150	150	150	500
Technical Assistance					
- ST training	40	50	35	-	125
- Local TA for ICIs	30	60	35	-	125
- Evaluation	-	10	20	20	50
US Bank	1,000	3,000	3,000	3,000	10,000
COFIDE	500	1,500	1,500	1,500	5,000
ICIs	525	1,575	1,575	1,575	5,250
Sub-Borrowers	525	1,575	1,575	1,575	5,250
TOTAL	3,590	10,680	10,650	10,580	35,500
Annual disbursement (%)	10%	30%	30%	30%	100%
Cummulative disbursement (%)	10%	40%	70%	100%	

2. Summary Financial Analysis of the Investment Fund

Three projected cash flow forecasts have been prepared to assess the financial viability of the proposed Project:

Annex II, Exhibit B-1 shows the result that would be obtained if a private bank loan could be negotiated at 13% for a five-year term. It assumes that COFIDE will lend its proceeds to ICIs for a seven year term at 13%.

Annex II, Exhibit B-2 shows the result that would be obtained if a private bank loan were negotiated at 15% for a five-year term.

In this case, we have assumed that ICIs could not cover their costs unless the rediscount rate were 13%.

Annex II, Exhibit B-3 shows the result that would be obtained if private U.S. bank money were available at 17% for ten years. In this case, ICI borrowing is assumed at 15%.

Although Exhibit B-1 most closely approximates the outcome with interest rates at current market levels (December 1982), the volatile nature of money markets over the last few years makes it impossible to determine which of the attached exhibits most closely represents what will actually occur in the Project.

Three general conclusions can be drawn from this analysis:

a. As conceived the Project is financially viable over a wide range of possibilities. This viability is the result of three basic elements built into the Project design. A maintenance-of-value clause incorporated into the Project authorization requiring the GOP to cover any foreign exchange losses protects COFIDE from Soles devaluation. The structuring of the discount facility to obligate ICIs to make payments on loans in default or disqualify themselves from additional participation in the fund eliminates the need to make a provision for bad debts. Additionally, AID's concessional loan rate when combined with a near-equal amount of private resources from a US bank drastically reduces the real debt service costs. Thus, even after covering its costs, COFIDE may lend to the ICIs with a sufficient spread to cover the ICIs' costs and risk of loss while still enabling the ICIs to be competitive in the market place.

b. Under the most difficult of circumstances, the greatest obstacle to viability will be the length of the term of the US bank loan. The minimum acceptable term with interest rates at 15% or below is five years and with interest between 15% and 17%, the minimum acceptable term is ten years.

c. Regardless of the actual interest rates and terms, an aggressive cash management policy consisting of the annual preparation of numerous possible cash-flow projections will be necessary during the first five to seven years of the Project to insure that COFIDE's contribution to the credit fund and use of reflows are properly timed to avoid net outflow deficits. Exhibits B-2 and B-3 were reworked several times before it was possible to determine what action would be necessary to overcome outflow deficits during the first five to seven years of the life of the Project. To ensure that the Project is a success, the Project Agreement will require that at the start of each year COFIDE present to AID three cash-flow projections for the next five-year period.

B. Effective Demand Analysis

1. Summary

The central issue in the analysis of demand for agricultural investment credit is the amount of medium-term credit desired by individual farmers and cooperatives in Peru. This analysis, supported by World Bank demand analyses carried out earlier, indicates that overall demand for investment credit in agriculture in 1983 will be at least $82 million. The COFIDE agricultural investment fund ($35.2 million) will increase total credit resources available for agriculture investment, rather than displace current credit levels available from either the private or public sector sources. The analysis also concludes that an additional $40-60 million over a three-year period for the AgBank from the IBRD and an equal amount of GOP counterpart funding (currently being negotiated by the IBRD and the GOP) will not cause an excess supply of financing for agricultural investment credit, even with the AID financing to COFIDE.

From the expected IBRD loan and GOP counterpart, the AgBank anticipates that it will have approximately $40 million at its disposal during the next year. Current private agricultural medium-term lending is an estimated $10 million per year. The remaining demand of $32 million could be supplied by the ICIs, in addition to their current lending. The ICIs will be in a much more competitive position vis-a-vis the AgBank since we anticipate that the latter will also be charging positive interest rates.

Analysis of the trends in the demand for agricultural equipment and products indicates that credit demand for the purchase or production of those commodities has increased markedly in the past two years, due to declining import duties, increased rainfall, and freer agricultural prices. Absence of credit for investment in equipment or expansion of production has fed a growing demand for capital.

Recent increases in interest rates appear to have had little or no impact on the demand for credit. For example, the only available line of credit for term agricultural investment--the Central Bank's indexed credits--has disbursed rapidly at market rates, channeled through private sector ICIs.

The amount of unsubsidized funds available to the Ag Bank will not affect the viability of the proposed AID Project. Commercial banks have the institutional capacity to move funds more quickly and efficiently and this ability will compensate [illegible] lack of experience in agricultural sector lending. Project technical assistance is aimed at helping ICIs overcome any constraints posed by their lack of experience.

2. Methodology

Given the lack of comprehensive market data, the demand for agricultural credit in Peru can be calculated in two ways. One method, the supply approach, is to examine past disbursements of credit to discern trends that are indicative of future needs. The second approach focuses directly on demand and calculates the amount of capital sought by the farming sector in order to increase its production. Greater emphasis is placed here on the supply approach because comprehensive data on past lending are readily available. The demand approach is used to validate the estimate initially derived from the supply analysis.

3. Supply Approach

This approach looks at past lending trends and makes projections into the future. Several Ag Bank data sources exist which indicate that past agricultural lending for investment/capitalization has been constrained by lack of funds. In 1981, the Ag Bank made capitalization loans to individual farmers worth US$26.3 million (See Table 3). (The AgBank did not have detailed information on loans to cooperatives.) This amount represents lending over an eight-month period, since during the months of May, June, August, and September, the bank had no capital. Had capital been available during those months, an additional $13.1 million would have been disbursed, based on the average disbursement rate during the other eight months.

Given the expected life of these investments, it is doubtful that the borrowing followed an agricultural investment cycle. Rather, it appears that the funds were used up more rapidly towards the end possibly because of information on the rapidly diminishing amount of funds available for lending. The total amount lent in 1981 was substantially below 1980 levels, in large part due to this supply constraint. The average size of loans in 1981, however, increased by 53%, while the number of loans made per month was slightly below those of 1980. Only a fraction (1%) of Peru's farmers even applied for credit.

TABLE 3

Ag Bank Loans for Capitalization to Individual Farmers
(US$ millions current dollars)

1979 1/		1980 2/		1981 3/		1982 4/	
No.	$	No.	$	No.	$	No.	$
2016	9.67	4630	33.37	1936	26.3	1848	29.3

Notes
1. 1979 exchange rate S/.225 to US$1. The average loan was $4796. Average amount loaned per month $805,833.
2. 1980 exchange rate S/.300 to US$1. The average loan was $7207. Average amount loaned per month $2,780,833.
3. 1981 exchange rate 420 Soles to US$1. The average loan was $13,584. The average amount loaned per month $3,287,500, over the eight months during which the AgBank was lending.
4. 1982 exchange rate 550 Soles to US$1. The average loan made per borrower was $15,871. The average amount loaned per month was $5,860,000, over five months.

The situation for 1982 has been similar. Once again, the Ag Bank exhausted the funds it had available for capitalization loans to individual farmers (IDB loan-411) and some GOP funds in the first five months of the year. The AgBank had no funds for capitalization loans after May 15, 1982. The average size of loans made increased to US$15,871, a modest 17% increase over 1981. The average monthly number of loans averaged during the five-month period was 369, a significant 53% increase over 1981. If we project this five-month $29.3 million total over a 12-month period, then we see that appoximately $70 million could have been lent in 1982, had funds been available. Thus, the deficit of funds for capitalization loans to individual farmers in 1982 would be approximately $41 million, compared to US$13.1 million in 1981.

The demand forecast is made from these "deficit projections" of Ag Bank lending ("pent-up" demand). The accumulated deficit for capitalization loans to individual farmers over 1981-82--that is, the amount that would have been lent but was not available--was US$54 million. The sector, therefore, could have absorbed an estimated US$70 million during 1982 ($41 million deficit plus $29 million actually lent). If the average loan size in 1983 were 17% larger than in 1982--a modest increase compared to the 53% increase registered from 1980 to 1981 following the return of civilian government--and the same number of farmers requested loans as in 1982, then the 1983 demand for credit would be approximately US$82 million.

Table 4 shows the distribution of farm units and agricultural lands, based on the 1972 census. As can be observed, most agricultural units (86%) are concentrated on less than 10 hectares, comprising over half the productive land. The combined size grouping of 10-50 and 50-150 hectares have 13% of farm units and 35% of productive land. Table 5 shows the distribution of IDB loan-411 over farm size groups and areas of activities, as disbursed during the period of July 1981 to May 1982. About 45% of the total value of the most recent capitalization loans were disbursed to the farms of 10-50 hectares, while 22% went to farms under 10 hectares and 33% went to farms over 50 hectares.

TABLE 4

Distribution of Farm Units and Agricultural Land by Land Size Grouping, based on 1972 Ag Census and Percent Distribution of IDB Capitalization Loan ı 411 in 1981/82.

Size Grouping(hectares)	Farm Units No.	%	Agricultural Land (000)has. No.	%	IDB Loan ı 411 %
Under 10	952,893	86	1907	52	42
10-50	125,347	11	940	25	45
50-150	19,978	2	381	10	8
Over 150	8,170	1	463	13	5
Total	1,106,325	100	3691	100	100

TABLE 5
Disbursement of IDB Loan 411 (US$37m IDB and US$5m GOP)
By Size of Farm and Activity - July 81 to May 82 1/

Size of Farm Has.	Number of Loans	Total Value	Infra-structure	Permanent Crops	Equip. Machin. Vehicles	Livestock	Other
		Total Value of Loans Made by Area of Activity (Millions Soles)					
Under 5	358	1606	297	168	393	689	57
5-10	546	2544	552	236	549	1064	141
10-15	251	1709	430	151	661	399	66
15-20	168	1289	277	178	544	215	72
20-30	218	2288	402	564	842	381	98
30-40	135	1842	253	367	775	369	76
40-50	100	1169	214	238	421	244	49
50-70	117	1685	241	444	598	334	66
70-90	48	863	183	196	321	129	31
90-110	63	901	213	150	254	252	29
110-150	48	895	322	129	226	178	38
150-2000	96	1731	234	213	483	718	71
TOTAL	2148	18530	3626	3041	6075	4980	805

1/ For the IDB credit line (No. 411) of $42 million available during 1981-82, the interest rate charged on 17% of the funds was 49.5%, on 62% of funds was 46.5%, and on 21% of funds was 32.5%.

Commercial bank lending in 1968 covered about 25% of agricultural production. By 1978, it had decreased to 7% and probably declined until 1980. The AgBank, the chief source of agricultural production investment credit, also experienced declines in lending in the late 1970's. By 1981, AgBank lending went to 112,189 farm units, or about 10% of farm units as recorded in the 1972 census. Investment/capitalization loans from AgBank have over the period 1979-82 gone to some 10,430 individual farmers, which represents 9% of all borrowers in 1981, and 1% of all farm units. These figures indicate that the market for investment lending has been barely tapped, leaving ample room for both AgBank and the commercial banking sector to increase their presence. In addition, unless the AgBank offers subsidized loans, its customers are likely to start borrowing from commercial banks which offer quicker service.

The size of investment loans approved by the Ag Bank has almost doubled since 1980 while the number of borrowers has decreased, due principally, it is assumed, to limited available funds. This increase may be in part attributable to the liberalization of import duties, which favored larger capital purchases particularly machinery. Table 6 supports this view, indicating that 33% of the average loan went for machinery, equipment, and vehicles. Table 6 also shows that investment loans have reached the small farmers (those with less than 10 hectares), representing 86% of farm units, and 42% of loans received. Medium-sized farmers, (those with 10-50 hectares) represent 11% of farm units and received 41% of loans. Twenty percent of AgBank investment loans have gone for infrastructure, and 53% of loans have been to the coastal region.

More Ag Bank investment credit has flowed to the coastal region (Table 7), despite the AgBank's policy to seek equal lending levels to all three regions. Considering the economic situation in the other regions--sierra, depressed; selva, developing--the AgBank probably offers more loans to the sierra and the selva than would the commercial banks. As shown in Table 8, the highest percentage in number of capitalization loans went to the coast, but the greatest amount in value went to the selva.

Table 6

Average Size of Loan in US Dollars by Land Size Grouping for 1981/82 and % Distribution by Activity of Use

Size of Farm (Hectares)	Average Size Loan-$	% of All Loans	% Distribution: Infra	Permanent Crops	Equip., Mach., Vehicle	Livestock	Other
Under 10	8,346	42	20	10	23	42	5
10-50	17,299	41	19	18	39	2	4
50-150	28,616	3	22	21	32	21	4
Over 150	32,840	13	14	12	38	41	4
TOTAL	15,684	100	20	16	33	27	4

Table 7

Distribution of BAP Borrowers & Value of Loans for both Production & Capitalization Loans by Region

BAP Region	1981 No.	%	Soles Millones	%	1980 No.	%	Soles Millones	%	1979 No.	%	Soles Millones	%
Coast	37,041	33	137,201	66	37,110	35	100,933	60	36,213	38	58,146	64
Sierra	42,320	38	39,071	19	37,225	35	24,227	14	30,827	32	10,570	12
Selva	33,820	29	30,235	15	33,072	30	43,264	26	28,184	30	22,384	35
TOTAL	112,189	100	206,508	100	107,407	100	168,424	100	95,224	100	91,100	100

Table 8

Distribution of Farm Units and Agricultural land by BAP regions (1982) Based on 1972 Ag Census Information and Percent Distribution of BAP Capitalization Loans made in 1981/82

	Farm Units		(000)has	Agr.Land	% Dist.AgBank Cap. Loans	
	No.	%		%	No.	$
Coast	425,032	31	1363	37	53	44
Sierra	787,331	57	1708	47	7	9
Selva	170,542	12	593	16	40	47
TOTAL	1,382,905	100	3668	100	100	100

Given a distribution similar to that of IDB Loan-411, AID's proposed $35.2 million Agricultural Investment Credit Fund will benefit more than 2000 farmers with average loans of $17,600. Using the existing major groups of activities, we estimate that $7.04m would go for infrastructure such as irrigation, $6.68m would go for permanent crops, $13.02m would go for equipment and machinery, $ 7.04m would go for livestock, and $1.4m would go for other uses. Assuming that commercial banks have branch office distributed in similar proportion to AgBank regional offices, the regional distribution of the AID project would be distributed $15.5 million to the coast, $3.2 million to the sierra and $ 16.5 million to the selva. However, it is likely that the coast will receive a higher percentage of commercial lending, and the selva less.

The four major banks interviewed for the purposes of this analysis (Credito, Internacional, Popular, and Surmeban) are well suited to provide agricultural investment credits because of the extensive coverage of rural areas through their branch banks. They made agricultural investment loans of approximately $10-20 million in 1981. The Banco de Credito, the largest of these banks, made agricultural loans in 1981 totaling US$40 million; roughly 5% ($2 million) was for investment loans to individual farmers. Data on investment lending by the commercial banking sector were not available for inclusion in the estimates of demand for credit which have been made here.

4. Demand Approach

The demand approach to estimating demand, as used in this analysis, examines trends in the demand for farm equipment and products, the purchase or production of which would affect agricultural credit demand.

Evidence indicates that credit demand has increased markedly in the past two years. The combination of declining import duties, increased rainfall, and freer agricultural prices have allowed farmers greater profits and growth potential and, thus, greater investment resources. Freer markets, for both revenues and costs, increase the incentives for improved agricultural management, and consequently the demand for investment credit. Absence of available credit has magnified these economic impacts, releasing a retroactive, as well as growing, demand for capital.

a. Prices and Production

Farm prices have been increasing slightly faster than inflation. Farmers are generally no worse off than the rest of Peru's economy in terms of revenues. The real increase in farm income reflects increased demand for agricultural products, not decreased supplies. In order to increase production, however, capital is needed and must be financed. The increase in demand for agricultural products should thus lead to increased agricultural credit demand.

Available forecasts on total agricultural production appears generally optimistic with a 4% national increase expected for 1983, according to the Ministry of Agriculture. After years of negative growth, the latest statistics from the Ministry of Agriculture on wheat, milk, oats, feed, vegetable oil, and margarine show annual and monthly increases (though the increases were identical for all of these normally seasonally variable products). Figures for meat and chicken appear more reliable. The supply of meat has increased, for example, 11.7% from 1981 to 1982.1/ This is faster than the approximate 2.9% average annual population increase. For livestock, an overall 4.9% increase in value is estimated, with a 1.6% increase in output expected. Particularly promising are fowl (12.1% increase in value with 1.2% increase in output) and beef (12.1% and .1%, respectively). Only pork has negative values (-1.8% and 0%, respectively).

Every category of agricultural commodities shows projected increases in 1982 over 1981 for both output and value. Quantity of output is expected to increase 4.2% and its value 6.2%. This projected increase in value over output is another positive indicator. The higher values resulting from higher prices and quantities should provide the cash needed to finance new capital (unless water or fertilizer becomes relatively scarce or even more expensive). For agricultural consumer products, the increase in real value is also higher than the projected increase in output in 1982 over 1981; a 17.4% increase is expected with only a 3.7% increase in output. Greater cash flows from output can be expected for rice (40% real increase in value with 1.5% increase in output), corn (26% and .5%, respectively), potatoes (11.4% and 1.6%, respectively), and wheat (6.6% and .1%, respectively). These trends should continue as the decontrol of agricultural prices is further implemented.

1/ Informativo de la Produccion Pecuaria, Ministerio de Agricultura, June 1982.

No evidence of overproduction exists, except possibly in cotton (whose prices are decreasing) and in potatoes (due to cyclical nature of years of high prices followed by years of overproduction). As long as credit prices reflect the real cost of money, then increased capital investment should respond to the market's signal that demand has shifted outward to increase the real price of all major consumer agricultural products. Farmers are thus receiving greater net revenues than they did in the past and a greater share of the redistributed national income caused by inflation than most other sectors. Floating, free market prices should produce sufficient revenues with normal average capital investment rates to enable farmers to increase output through financed mechanization, land improvement, and the like.

b. <u>Reduced Debt</u>

Inordinate debts that were accumulated during the drought years of 1978-80 would presumably be the only basis for insufficient savings for downpayment and future net cash flow needs for repayment. Nevertheless, the government through the AgBank has absorbed much of the defaulted accumulated debt or rolled it over at 32% interest rates. Therefore, drought-related debt is unlikely to inhibit major investment. If the drought does not return to Peru, production should continue to grow robustly.

c. <u>Investment Needs</u>

Table 6 shows that one-third of the investment credit recently available went for agricultural equipment including tractors. Tractors are probably one of the most likely products to be underwritten by the ICIs. Industry sources suggest that 4500 tractors currently exist in Peru. With average expected lives of 10 to 11 years each and an average of 50 horsepower, their use over Peru's 3.6 million hectares of farmland (Table 2), yields a current average of 0.06 horsepower per hectare. Given the FAO's minimum acceptable range for agricultural mechanization of .2 to .25 horsepower/hectare, Peru is quite undermechanized with a deficit of some 10,080 to 13,680 tractors. Total annual sales of tractors in Peru in 1981 were about $26.4 milion. The number of tractors sold was 880, an increase of 76% in annual sales of roughly 500 for previous years. At this rate, this deficit in tractors would be satisfied after a period of 11 to 15 years.

Tractors are attractive as self-collateral. Assuming that the average price of a tractor is $30,000 (1981) and that 1982 sales are at least as strong as in 1981, then total 1982 sales of tractors would be $26.4 million. If all tractor sales were based on credit and represent 33% of investment using credit, then total demand (three times tractor demand) for credit in 1982 would be about U.S.$80.0 million. This is about $10.0 million greater than the supply approach estimate using AgBank data. The $80.0 million figure is inflated for several reasons: all tractor purchases do not require credit; all credit for equipment did not go for tractors; and all credit for tractors did not come from AgBank since ICIs presently are financing equipment purchases. The magnitude of tractor sales per year nevertheless corroborates the magnitude of annual demand estimated above.

In addition, these tractor sales figures suggest there is little risk that the COFIDE Investment funds would saturate the market, especially if disbursed over a three-year period. If, of the $35.2m, 33% or $13.02 were to go for equipment purchases over a three-year period, this would represent $4.34 million annually or 16% of total annual tractor sales. Using the average price of a tractor ($30,000), only 144 tractors would be ICI financed each year, a conservative figure even for the depressed conditions previously experienced by Peru.

Other demand-approach evidence substantiates the supply approach estimate of $82 million in effective demand for 1983. A rule of thumb for Peruvian capital investment, according to sources in the commercial banking sector, is that 10% of total production is spent on capital investment. In 1981, total final agricultural production was about $2 billion (not including sectoral linkages). Therefore, capital investment would have been $200 million, a large percentage of which would have been financed through borrowing. The actual agricultural capital demand would be less because Peruvian agricultural credit markets are still constrained by entry barriers (AgBank subsidies) and limited returns (price controls).

5. Interest Rates

Interest rates modify the cost of credit funds and thus modify total demand. As shown in Table 9, AgBank interest rates have been essentially negative (below the inflation rate which has been over 60% during recent years). For the IDB Credit line (No. 411) of $42 million during 1981-82, the interest rate charged on 17% of the funds was 49.5%, on 62% of funds was 46.5%, and on 21% of funds only 32.5%. Table 3 shows that total lending decreased from 1980 to 1981; nevertheless, the lack of AgBank resources, not interest rate increases, seems to have been the reason. The average loan size increased (See Notes, Table 3) from 1980 to 1981, despite the nominal increases in interest rates. The borrower's perception of the impact of inflation on the "real" interest rate is unknown. Nevertheless, no negative impact on demand has been apparent.

In spite of the 1981 increases, AgBank interest rates remained concessionary. It is possible that the demand for credit might decrease when positive interest rates are charged by the AgBank. Since demand obviously has not shifted downwards, any decrease in demand would be a function of the price elasticity of demand for credit. The latter is usually relatively inelastic in the short run, as it appears to have been in 1981. (In 1981, the decrease in demand from the previous year reflected a backward shift in the supply of credit.) If interest rates were to rise from 50% to 75% (a 50% increase) and the price elasticity of demand is assumed to be 80% (moderately inelastic), then credit demand would decrease by 40% (80% x 50%) over the short term. This means that the $82 million in credit estimated for 1983 would be reduced to about $50 million.

Responsiveness to interest rate increases in Peru is probably much less than unity (quite inelastic), perhaps 25%. In that case, the decrease in demand due to the AgBank charging commercial rates would only be 12.5% (25% X 50%) or $10.3 million. Then, estimated demand for credit funds for 1983 would be reduced to $71.9 million. Particularly given the recent scarcity of funds for term lending, it is unlikely that increased interest rates will reduce demand significantly.

This scarcity of funds for investment lending has recently prompted the AgBank to attract more savings by paying nominal 55% (effectively 65%) on deposits, competitive with commercial banks. Pressure from the GOP is being placed on the AgBank to forego GOP subsidies to cover the AgBank's bad loans and concessional interest charges. While savings deposits should increase AgBank resources significantly, interest rates on lending will have to increase far more than the savings rate of 55% to avoid GOP subsidies. The AgBank is also currently authorized to raise up to $100 million from the private financial markets, but only at free market credit costs. Discussions indicate a preliminary willingness by AgBank to increase interest charges on lending to levels above current inflation rates. In part, this results from IBRD preconditions on future credit lines to the AgBank. The Ministry of Agriculture has recently completed an interest rate study which suggests that the AgBank could effectively reach commercial interest rates by charging borrowers for interest from one to four months in advance as the commercial banks now do for one-year loans. The effective interest rates (Table 10) would then be as high as 75.6% if charged four months in advance.

Farmers now are more willing to pay the higher interest rates for credit than they were several years ago when economic conditions were bleak. All the GOP officials, bankers, and businessmen interviewed believe that significant demand for agricultural credit now exists even at real market terms. The IBRD officials reported seeing piles of unprocessed loan applications in the AgBank field offices that they visited in October 1982. Even AgBank officials, who for years argued publicly that Peruvian farmers could never afford market rates, now concede that they can. The farmers most able to repay their loans will have credit records and/or savings accounts with the commercial banks with offices in the farming districts. Borrowers prepared and able to pay commercial rates will be more likely to opt for commercial lending options which have a reputation for faster service.

Similarly, no significant declines in lending activity were manifested by the FRAI and the AgBank when higher interest was charged. Farmers apparently are becoming used to repayment at such high rates. For example, the Central Bank's line of indexed credits for medium-term agricultural lending, established in July 1981, had disbursed 47% of its funds after one year. These credits--$15 million in local currency--are being channeled through private sector ICIs. It is expected that the impact of charging commercial rates on demand will be minimal. Farmers understand that high inflation rates have necessitated higher interest rates because farm prices have risen faster than the general price rise in the economy. Low price elasticities of demand should mean small changes in borrowing levels. Since past concessionary rates were available during a drought, the improved weather conditions, higher prices, and increased outputs should easily compensate for the difference in the cost of money as interest rates increase.

Table 9

Ag Bank Interest Rates in Effect 1980 to Present in Percentages

Type of Loan	Coast & Sierra 1980	Coast & Sierra 1981 1/ To present	Jungle 1980	Jungle 1981 1/ To present
Production 2/	%	%	%	%
Food	29	48.5	22	44.5
Non-food	32	49.5	28	49.5
Livestock	29	46.5	14	30.5
Capitalization				
Agricultural	31	49.5	22	32.5
Reforestation	18	32.5	18	32.5
Livestock	31	46.5	14	32.5

1/ In effect as of January 1, 1981.
2/ Not competitive with COFIDE Plan.

Table 10

Interest Rate Structure Proposed for BAP Loans as of January 1983

	Present Nominal Interest Rate + Commission	Effective Rate Per Months in Advance that Interest is Charged 1	2	3	4
Coast & Sierra-Equipment	47.5 + 2	65.8	67.6	69.6	75.6
Coast & Sierra-Permanent crops, Infrastructure and Livestock	44.5 + 2	60.6	62.3	63.9	69.8
Selva	30.5 + 2	39.0	39.7	40.3	42.6

C. Institutional Analy:

1. Summary

COFIDE was selected to implement this Project in order to provide an alternative to the Agrarian Bank as a means of channeling investment credit to the agricultural sector. AID views the private banking system as a major potential conduit for stimulating agricultural development. By working through COFIDE, the Project can mobilize the resources of a larger number of ICIs with a very extensive network of branches throughout Peru. COFIDE has had ample experience in the management of similar credit funds and has performed consistently and efficiently in carrying out its administrative and promotional functions. Finally, the Mission selected COFIDE, a GOP corporation, as implementing agency because the co-financing aspect is an important element of the Project and would not have been possible through a loan directly to a private commercial bank.

Conversations with commercial bank executives indicate that a substantial number of banks would be interested in participating in the COFIDE-rediscounted lending program, These include the four largest commercial banks, the regional banks, BANCOOP, and the CCC, all of which have numberous branch offices. The major factor constraining private sector participation in agricultural lending in recent years has been the prohibition on term lending. Fixed rate credits under the COFIDE program as well as all indexed credits are exempt from the restriction. The new banking law, now under consideration in Congress, would eliminate this restriction across the board.

Thus, the proposed Project is very timely in that it will lay the groundwork for re-introducing private sector lending in agriculture in anticipation of the new banking law. By providing technical assistance, the Project will help to overcome the remaining constraint to private sector lending: lack of expertise in the evaluation and financial management of agricultural projects.

2. Implementing Agency--COFIDE

a. Rationale for Selection

This Project will be implemented through COFIDE (Corporacion Financiera de Desarrollo, S.A.) and various private sector intermediate credit institutions (ICIs). The aim of the Project is to expand and strengthen the institutional channels capable of delivering benefits to the rural poor, a common thread within many of USAID's ongoing and proposed programs in the rural sector. Concern for adequate institutional mechanisms is of foremost importance in AID's efforts to facilitate the flow of benefits to the rural poor. Now that other donors, particularly the World Bank and IDB, have increased their lending for

Peruvian agriculture, AID hopes to avoid overloading the traditional institutions which serve the sector and views the private banking system in Peru as a major potential conduit for stimulating agricultural development.

AID can help to create the conditions for this development by ensuring: (i) that the existing physical infrastructure and human resources are oriented toward solutions to the problems facing the rural poor; (ii) that resources for longer-term lending, promotional activities, and technical assistance are made available and that the proper incentives for their use are established; and (iii) that the GOP continues to analyze the implications of overall credit policies. In order to achieve these objectives, the Mission has chosen to work with COFIDE, an autonomous state enterprise, rather than with any one private bank. In this way, a larger number of ICIs can participate in the Project, thus expanding the institutionalization of the concept of medium-term lending for on-farm improvements to a large segment of the financial community. The Project can at the same time offer the AgBank participation in the proposed investment fund, thereby achieving a measure of policy leverage over the AgBank, particularly with reference to interest rates.

Section II.D, Financial Sector Overview, describes Peru's financial system. The universe of potential ICIs includes the commercial banks, regional banks, the state development bank, the financieras, and the cooperative banks. Based on discussions with these entities, we expect nine to twelve of them to participate in medium-term agricultural investment lending under the Project by the third year. Neither upper nor lower limits for ICI participation will be set nor will the type of lending be restricted beyond the lending criteria discussed above.

COFIDE has had experience in ICI lending through other similar programs for agroindustry and small enterprise. A basic objective of COFIDE is to promote credit availability in the agricultural sector so as to ensure economic growth, increasing incomes, and a high level of employment. This objective is key in the GOP sector strategy of promoting private sector activity in agriculture in order to increase agricultural production, decrease food imports, improve agricultural marketing, and stimulate regional development and decentralization. COFIDE can play an important role in this effort by encouraging and promoting banking system allocations of credit to private sector farmers interested in making on-farm investments.

The Project is administratively attractive in that, in addition to its experience with other rediscounting operations, COFIDE maintains ongoing relationships with the banking system. Commercial banks, regional banks, and financieras have all participated in COFIDE rediscounting programs including AID's FRAI (Fondo de Redescuento para Agro-Industrias) as well as FIRE (Fondo de Inversiones Regionales), PROPEM (Programa de Crédito Multisectorial para la Peque;a Empresa), among others.

COFIDE is a prestigious institution that consistently attracts experienced, high caliber, well trained, and versatile personnel. Moreover, USAID has had previous favorable experience with COFIDE under the FRAI, and COFIDE is familiar with AID loan implementation requirements. COFIDE is also experienced in organizing the delivery of technical assistance and training to ICIs in project evaluation techniques. As an intermediary, COFIDE does not carry out direct lending and its imparcial reputation should facilitate its promotional and technical assistance activities among private banks and potential borrowers.

The GOP is keenly aware of the absence of term lending for agricultural investment. In an effort to improve this situation, the Central Bank is promoting a program of indexed credits for medium-term investments in the agricultural sector. In addition to making fixed-rate credit available, the proposed Project will support and expand that effort. By lending AID support as well as that of the US commercial bank co-financer to the indexation program, the Project will be very important in the success of that program.

The proposed Project will assist COFIDE to institutionalize the rediscounting mechanism as its standard method of financial intermediation. Except for PROPEM, a World Bank program, most of COFIDE's activities have been conducted as credit lines. Under PROPEM, the ICIs cover 12-15% of the costs, and COFIDE rediscounts most of the remainder. The other COFIDE programs, such as the FRAI, FIRE, and FONCAP, were all credit lines which required the ICI branch offices to gain approval both from the banks' main offices and from COFIDE. This process is more time-consuming than a system for automatically rediscounting commercial paper to COFIDE. To require the latter's approval, particularly when the sub-borrowers are far from Lima, would frustate the flexibility of the profit-motivated ICIs. Therefore, the proposed Project will operate as a rediscount window. Autonomy at the ICI and regional branch level will encourage ICI lending, and fast turnaround time of ICIs will permit them to be competitive with the AgBank.

Under the proposed Project, COFIDE will support private bank participation, speed of credit delivery, and a wide variety of project types. The objective of the COFIDE program is to stimulate private bank re-entry into agricultural lending. Because it is probable that the ICIs will be more interested in lending for moveable equipment whose value can be collateralized and more easily linked to future earnings capability, COFIDE will provide technical assistance and will support promotional activities in order to encourage ICIs to diversify their lending and include riskier projects such as land-clearing in the jungle, irrigation, or land development.

These guidelines proposed by AID will assist COFIDE to achieve the program objectives. Since private banking institutions have generally not been predisposed toward the agricultural capital market, they cannot be forced to finance complex projects in the sierra or the selva.

Rather, COFIDE officials will work with the ICIs and provide technical assistance to facilitate the ICIs entry into this new market. AID/COFIDE objectives under the rediscount model include a variety of participating ICIs, diversity of projects supported, feasibility studies required, regional distribution of sub-loans, among others.

b. Background and Institutional Changes

COFIDE was established in 1971, as an autonomous state enterprise principally to stimulate and promote Peruvian entrepreneurial activity; to coordinate and guarantee the financing of state enterprises; to mobilize resources for priority projects of state, reformed private, private and social property enterprises; and to expand the domestic capital market. Initially, COFIDE was also designated to own the Government's shares in all state enterprises, but when this proved unworkable, legislation was enacted reducing COFIDE's responsibility to that of holding the shares in custody. However, between 1973 and 1979, several private sector firms nationalized by the Government were allocated to COFIDE to be held on its own account.

On June 12, 1981, the GOP enacted Legislative Decree No. 206, known as the Law of Promotion and Financial Support for Entrepreneurial Development in Peru whereby COFIDE was to be reshaped organizationally and financially. This decree created the Corporacion Nacional de Desarrollo (CONADE); converted COFIDE to Corporacion Financiera de Desarrollo - Sociedad Anonima (COFIDE S.A.), a stock company of CONADE; and established INVERSIONES COFIDE S.A., a stock company of CONADE.

CONADE is a public entity wholly owned by the GOP, with authorized capital of US$562.5 million, established to serve as the GOP promotor and financial agent of entrepreneurial activities in Peru, within the context of the plans and policies of the State. The stock companies COFIDE S.A. and INVERSIONES COFIDE S.A. have authorized capitals of US$375 million and US$50 million respectively, to be fully paid by CONADE. The distinguishing feature of both companies is that, in spite of being public enterprises, their operations are regulated by private law and practices.

With Decree No. 206, COFIDE's two basic functions--supplier of medium- and long-term credit and holding company for the State--have been institutionally divided and shifted, the first function to COFIDE S.A. and the second to INVERSIONES COFIDE S.A. By December 1982, the financial statements will reflect this new organizational pattern.

As defined by law, the objective of COFIDE S.A. is to contribute to the development of the country by mobilizing savings and by performing financial intermediation to promote investment projects and to support the financing of new and existing enterprises in accordance with GOP policies and plans. COFIDE S.A. is a stock company of CONADE, subject to the legal regime of private enterprises in the fiscal, administrative, contractual, and labor aspects. COFIDE has economic and administrative autonomy, as well as the capacity to open domestic and off-shore branches.

The authorized capital of COFIDE S.A. is US$375 million, of which US$94 million has already been paid up by CONADE, the parent company.

c. Organization and Management

COFIDE S.A. is managed by the Board of Stockholders, the Board of Directors, and the General Manager, whose duties and responsibilities are described in detail in Annex II Exhibit C. The Board of Stockholders, the top managerial body, comprises three members appointed by CONADE in coordination with the Minister of Economy, Finance and Commerce; the President and Vice-president being elected by the Board itself. Stockholders hold one ordinary meeting during the first quarter of each year, and extraordinary meetings whenever requested by CONADE or the Board of Directors.

The second management level is constituted by the nine-member Board of Directors, elected by the Board of Stockholders in coordination with the Minister of Economy, Finance and Commerce. Directors are appointed for one-year terms but can be indefinitely re-elected.

The executive management and administration of COFIDE S.A. have been conferred to the General Manager, Division Managers and other officers designated by the Board of Directors. Under the General Manager, who is mainly responsible for day-to-day operations, operational responsibilities have functionally been assigned to the Resources, Operations, and Financial Intermediaries Divisions. This structure contrasts sharply with the previous organization in which operating responsibilities were vested in four operating divisions, Finance, International, Credits, and Investments, with many overlapping functions and responsibilities and little coordination among them. The Investments Division, in charge of managing COFIDE's investment portfolio and recommending new promotional investments, acted independently of, and with little coordinacion with the Credits Division. Each division had subsector specialized project analysts that often duplicated work in the same subsector, and which have now been merged under the new Operations Division. Each division had its own legal department; this function has now been consolidated under the General Manager.

The second-level management and professional staff are competent and experienced. The Resources, Financial Intermediaries, and Operations Division Managers recently joined COFIDE and brought with them considerable commercial and development banking experience. About two thirds of the Corporation's, 261 professionals, out of a total staff of 547, have been with the institution five or more years. The number of staff members appears somewhat high considering the current level of clients and operations, but should facilitate handling of an increase in activities, particularly that expected from the new Financial Intermediaries Division.

COFIDE S.A. appraises all projects submitted to it for financing, with emphasis on financial, technical, marketing, and increasingly economic aspects. Overall, appraisals and the appraisal reports are of good quality. COFIDE S.A. is increasingly including the calculation of economic rate of return among the criteria it uses in selecting projects for financing. It has also improved its supervision activities and capabilities, and pays greater attention to the project implementation capacity of investment enterprises. In part these improvements have been aided by the growing experience of its loan officers, and by their being organized along sectoral and subsectoral lines which allows them greater specialization and knowledge of their clients' activities. On balance, the appraisal and supervision capacity is sufficiently strong to entrust COFIDE S.A. with allocating the proceeds of the proposed loan.

COFIDE S.A. has been giving increasing attention to procurement decisions, particularly those of its larger clients. Also, it assists their clients by preparing financial packages which blend export financing from supplier countries with resources provided by other donors. COFIDE S.A. requires several alternative quotations for all procurement in its lending to the private sector, and national or international bidding is the standard procedure for public sector enterprises under Peruvian law. For all procurement COFIDE S.A. requires that the goods and services purchased are suitable for the investment project and are reasonably priced, and it provides the rationale for procurement in all subloan appraisals. Disbursement procedures are adequate to ensure that funds are used for their intended purpose. Loan collection procedures and follow-up on arrears are also satisfactory.

d. COFIDE's Lending Experience

Until recently COFIDE's operations and management attention were heavily concentrated in activities related to its mandate to coordinate and guarantee the financing of state enterprises, including the holding of shares of certain of these companies. In addition, COFIDE has had since its establishment the added responsibility for coordinating all state enterprise financing as well as guaranteeing their financing when and as required. In support of the latter, COFIDE could lend to state enterprises from its own resources, arrange and participate in the financing of state enterprises, other than State banks, either on its own account or on behalf of the Government, and issue guarantees on behalf of these enterprises, either on its own account or acting as agent for the Government. Until very recently, these activities, together with its ownership of basic industries have dominated COFIDE's operations. The effect of the institution's emphasis on public sector financing is still reflected in its portfolio. Although during the last three years lending to the private sector has increased substantially, as of December 1980, 50% of the loans outstanding and 56% of the guarantees issued on COFIDE's own account were to State enterprises. Together they represented 35% of COFIDE's total assets.

Between 1973 and 1979, the Government decreed that

COFIDE hold for its own account some of the private companies operating in "basic industries" that were nationalized during the period. Until June 1981, when Legislative Decree No. 206 was enacted, it held twelve such companies in its portfolio: five cement companies, three paper firms, two in chemicals, one is a combined paper and chemicals concern, and one is in metalmechanics. Most of these equity holdings exceeded COFIDE's single client exposure limits, and have diverted from its originally intended purpose and frozen a large proportion of COFIDE's resources. As of December 1980, the equity held by COFIDE in the twelve companies accounted for 89% of its investments portfolio, and represented 85% of COFIDE's own equity. Including loans and guarantees, COFIDE had 36% of its total assets tied up in these companies. (INVERSIONES COFIDE S.A. has replaced COFIDE as a holding company for the GOP.)

In 1980, as part of the GOP realignment of public sector financial institutions channelling term resources, COFIDE reassessed its role and reoriented its objectives and priorities. COFIDE started to divest itself of its frozen investments in industries nationalized through 1979 in order to concentrate on development banking functions. A major objective of COFIDE was to expand its lending operations to the private sector, and to increase the coverage of that sector by channeling increasing amounts of term capital, particularly foreign resources, through financial intermediaries. Although COFIDE began lending through intermediaries in 1978, it did not initially actively promote this method of lending, because it lacked the organizational capability to do so. COFIDE's Board of Directors remedied this situation in 1980 with organizational changes which included the creation of a new Financial Intermediaries Division. The new division has been partly staffed with personnel experienced in dealing with financial intermediaries as a result of the transfer to COFIDE on November 13, 1980, of the four funds: FRAI, FONCAP, FIRE and FONEX--previously operated by the Central Reserve Bank. COFIDE has proved efficient in the management of these funds, and has strengthened the financial intermediaries, both institutionally and financially.

The recent expansion of COFIDE's lending operations through financial intermediaries required a comprehensive set of policies to govern these activities. These policies were approved by COFIDE's Board in June 1981, and have already been adopted by COFIDE S.A. COFIDE is looking closely at these procedures in order to make any necessary adjustments to allow a more efficient use of scarce financial resources.

At year-end 1981, COFIDE had total assets of $638 million. Long-term borrowings amounted to $409 million and total equity stood at $ 194 million. The $160 million in paid-in capital is fully owned by the Government. Since mid-1978, COFIDE's operations have grown substantially in line with Peru's overall economic recovery, and geographically, operations have been reasonably well distributed.

By maturity, 75% of COFIDE's loans and guarantees during the same period were for more than five years and 18% were for two to five years.

COFIDE's exposure reached $627 million at year-end 1981. On the whole, the quality and management of COFIDE's portfolio are quite good. Arrears over 90 days affected only 6.2% of the loan portfolio, and exposure to companies in arrears constituted only 5% of COFIDE's overall exposure. Provisions for bad debts and losses in value of the investment portfolio are also adequate.

COFIDE has a satisfactory financial structure (with a long-term debt to equity ratio of 2.1 to 1 in 1981) as well as a satisfactory liquidity situation (with a current ratio of 1.7 to 1 in 1981). However, COFIDE's profitability, although improving during recent years, has remained low. In 1981, net profits after taxes were equivalent to 5.8% of equity--well below the opportunity cost of capital in Peru. In line with Government policy to raise interest rates to positive levels in real terms, COFIDE's management approved in January 1981 a new structure of interest rates and guarantee fees that will allow a more adequate return on equity. With the new structure of interest rates and the divestiture of equity investments in nationalized basic industries, COFIDE's financial position will remain adequate and its return on equity will gradually increase.

3. Institutional Feasibility

This section analyzes the capability of the private banking sector in Peru to lend for agricultural production. It explains why private banks have not loaned for agricultural capitalization; the extent to which they now are capable of actively returning; and the need for COFIDE financial and technical support to encourage that participation.

The analysis concludes that the ICIs are equipped to loan the $35.2 million over the next two to three years, whether or not the AgBank is lending. The ICIs are not able to meet the entire projected $82 million in annual capitalization demand by themselves, but under the AID-COFIDE program, their participation in agricultural term lending will increase substantially.

A decade of distortions--from the changes in land tenure imposed by the land reform to agriculture price controls--have created systematic market failures. The limited private and commercial agricultural investment lending suggests policy and institutional shortcomings. One method for correcting these market imperfections is to use public financial incentives to induce private banks to return to agricultural lending. Following sufficient experience with agricultural capital loans, the ICIs should have the independent capability to exploit lending opportunities in this market. However, because commercial lending to farms has been insignificant for over a decade, the willingness and capability of the ICIs to lend effectively to this sector over the short and long run requires assessment. Moreover, farmers must develop private banking relationships based on traditional commercial practices, including payment of real interest rates and provision of downpayments and collateral.

a. Background

Agricultural policies during the GOP's Agrarian Reform of the 1970s heavily discouraged private financial institutions from participating in agricultural sector lending. Many of these policies have been reformed while others remain intact. Private banks have been resuming limited lending to this sector to an estimated level of roughly $10 million in 1981, far less than the pre-agrarian reform levels of 25% of their portfolios.

Because of the various investment and lending disincentives, the ICIs need counterbalancing incentives to stimulate their return to agricultural sector lending. COFIDE's institutional ability to promote ICI lending was illustrated in the related field of agroindustry under the FRAI program. COFIDE provided both technical expertise and rediscounted loans, as the ICIs gained practical experience.

Various distortionary public policies limit private lending for agricultural capitalization. First, legal restrictions on term lending by commercial banks have had an important impact. Second, the AgBank has continued to offer concessionary terms of credit whenever such terms have been available. Third, changes in land tenure imposed by the Agrarian Reform reduced the cost of land ownership as well as the penalty for poor farm management. Fourth, Peru's general economic conditions, particularly the high inflation rates, have greatly increased the lending risks, despite indexation of interest rates. Repayments may result in negative effective interest rates if inflation increases above the interest rate which was set for the loan originally. Fifth, serious agricultural economic shortcomings remain, including a marketing system but still substantially government-dominated, the lack of nationally coordinated soil, water, and forestry development planning and coordination, and badly conducted irrigation systems. Finally, commercial banks in Peru have been very profitable in recent years and have seen no need for expanding their lending to agriculture. While Peru's agricultural sector is growing as never before in recent years, risk-averse bankers are still somewhat reluctant to commit large resources to this market.

Estimates of the extent of private financing in agriculture vary. A World Bank report ("An Economic Review of the Agricultural Sector in Peru", June 30, 1981, p.ii) estimates that perhaps 5% comes from commercial banks. Because of the laws limiting commercial banks from lending for terms to maturity exceeding one year, virtually all of this commercial credit has been disbursed for production. Medium-term lending is permitted by regional banks and for all commercial lending for imported equipment. The COFIDE program will have a "special funds" exemption for medium-term lending from the Central Reserve Bank. Therefore, it will open the door to the large commercial banks to lend for capital investments other than imported equipment. This special funds exemption is a temporary measure; a new banking law currently under Congressional consideration would permit commercial banks to lend over the medium and long term.

b. Agrarian Bank Lending

The Agrarian Bank has been the main supplier of agricultural capitalization credit in Peru (see Effective Demand Analysis Part IV.B.). The Bank generally serves a small percentage (about 5% over the last five years) of farmers (concentrated in cotton and rice). Usually, only the more sophisticated farmers can get AgBank loans. Since the AgBank could potentially serve a broader proportion of Peruvian agriculture, the World Bank is considering support to the AgBank provided that the Bank readjust its currently subsidized interest rate policy to market rates. The AgBank is considering raising its rates toward commercial rates. It also has the option to use indexed loans and is committed to doing so.

The AgBank default rate of 10% is calculated on the basis of its total portfolio, not on the amount of loans still outstanding (the "normal" practice). The default rate on the latter would be substantially higher. The AgBank hopes to create a guarantee fund from commission charges, as well as profits from technical assistance.

The AgBank receives funds from the Central Reserve Bank at a charge of only 29%, which covers 30-35% of AgBank lending. However, Central Reserve Bank transfers have virtually ceased, leaving the AgBank in a serious liquidity crisis. It also receives government subsidies for foreign exchange risk and capital shortfall from decapitalization. Most importantly, the Government protects the AgBank from its own defaults, such as those caused by loan defaults. These subsidies from the GOP, as well as those from the IDB, have permitted the AgBank to continue its poor record of bad loans. However, the GOP has already begun to reduce its subsidies, and there is pressure on the IDB not to permit concessional lending by the AgBank since both the IBRD and AID are making positive rates a precondition to their lending.

c. Commercial Bank Lending to the Agricultural Sector

As discussed above, the AgBank has monopolized agricultural sector lending in recent years for a number of reasons. However, changes in several of these factors provide encouraging signs that private bank lending to the agricultural sector will increase. First, special exemptions and the proposed banking law remove legal restrictions to term lending. Second, the AgBank has lacked funds during several months in each of the past two years. GOP and IDB subsidies of the AgBank are unlikely to continue and AgBank will be required to attract funds and lend at market rates. Third, the improved outlook for agriculture is encouraging new investments to increase production and productivity. All these factors favor the participation of commercial banks in agricultural lending.

Commercial banks will have several advantages in their competition with the AgBank. First is their relative administrative efficiency. The banks report that they can approve loan applications with 48 hours for established customers, and within a week for new ones. This is far shorter than the time the AgBank normally requires. In addition, the banks expected to participate in the Project all have numerous regional offices so their coverage will be as extensive as that of the AgBank. Since they charge market rates, none of these institutions have any liquidity constraints to lending in the sector.

The Project is designed to overcome the two major constraints to term lending by commercial banks identified during intensive review. The first is the legal restriction on term lending which, as mentioned above, has been resolved in the short term by COFIDE's exemption for its credit line. AID will continue to encourage GOP efforts to change the banking law to lift these restrictions on a permanent basis.

The second constraint is the commercial banks' lack of experience and technical expertise in agricultural lending. In interviews during intensive review, commercial bank officials often cited this lack of experience--particularly in feasibility analysis of agricultural projects--although all of them stated that this constraint could be readily overcome with appropriate training and technical assistance. A number of these officials indicated that their institutions had previously lent to the agricultural sector and were now lending albeit on a very limited basis.

Peruvian private banks make approximately 200 capital loans each year to farmers, most often for machinery, but also for irrigation systems. For collateral, the banks require either "prendas" (each year's crops) or "inmuebles" (houses, cars, etc.), not land. The largest portfolio in agriculture is that of Banco Sur Medio Callao (Surmeban). Surmeban is the largest Peruvian regional bank and is the seventh in Peru overall. It has 4% of Peruvian commercial banking deposits, 5.3% of deposits in the private commercial banking system, and 29.1% of deposits in regional banks. In 1974, Surmeban was lending a quarter of its portfolio into agriculture; before that year, it allocated as much as a half of its resources there, according to Surmeban officials. Surmeban is currently making agricultural investment and production loans (6.1% of its portfolio) with its own funds and indirectly through the FRAI-related agroindustrial fund. Surmeban made FRAI loans of 6.7 million soles in 1981 and 10.1 million soles in 1980. In 1981, the bank's agrarian loans based on credit received from the Central Reserve Bank totaled 872 million soles for a maximum term of one year. It also made agricultural development loans, many of which were medium- and long-term, of 614.4 million soles in 1981, at a maximum interest charge of 10% and an average of only 5%, based on a Central Reserve Bank discount program. These loans were based on credit extended from the Central Reserve Bank. Surmeban has expressed its desire to participate in the Project.

Banco de Credito and Banco Popular, who have also expressed interest in participating, are currently making about 2% of their loans for agricultural activities. A portion is for capital, usually tractors and other machines for the largest farmers and cooperatives. Though it has the most regional offices, Banco de Credito appears to have a small agricultural investment lending portfolio. Banco Popular was the first bank to develop dollar-denominated lending to exporters of cash crops that derive foreign exchange, after utilizing a dollar credit line of $18 million from the US Export-Import Bank. Though that program has been since cancelled by the USG, Banco Popular has retained these customers and has made new ones for 1982 lending of $8 million to date.

Loan applications are normally approved by standing agricultural committees at all of Surmeban's locations or by lending committees of Banco Popular and Banco de Credito. Typically, prefeasibility studies and the like are not required of a borrower.

The four banks most likely to be active initially under the COFIDE program would be: Banco Comercial, Banco Internacional, Banco Popular, and Banco de Credito, all of which have many regional offices. The regional banks--del Norte, Nor-Peru, Sur Medio y Callao, Amazonico, and Sur del Peru--are also probable initial participants. A few larger banks like the Wiese and Continental have also expressed interest, although they do less agricultural lending now than the other banks mentioned. As the Project gains experience and exposure, other commercial banks would presumably become interested in this lending activity.

d. Other Potential ICIs

Other potential ICIs include BANCOOP (Banco Nacional de Cooperativas), the CCC (Cooperativa Central de Crédito), and the AgBank. These organizations are disposed toward participating in the COFIDE program using commercial loan terms.

BANCOOP and the CCC are two potential participants in the proposed COFIDE project. BANCOOP has been charging commercial rates and its experience to date has been limited to production lending. It will, however, be offering medium-term credits for the AID Upper Huallaga project, using indexation. The CCC is now permitted to lend to various types of cooperatives, including agricultural ones. CCC and BANCOOP participation in the COFIDE rediscount program will encourage the two entities to increase their medium-term lending because they will be reimbursed for 70% of their capital, plus the 10-20% from the sub-borrowers, downpayments. BANCOOP has written to AID expressing its interest in participating in the COFIDE program.

As discussed earlier, another possible participant the AgBank. It is currently the bank best equipped to finance more complex agricultural projects; however, its participation is contingent upon interest rate policy reform.

D. Social Analysis

1. Background

Poverty in Peru, while not exclusively confined to rural areas, can nevertheless be considered a phenomenon of rural origin. Urban poverty is linked to a high rural outmigration rate of 5.9% per year which is in turn the result of a limited agricultural land base, inadequate mobility in rural areas, and the poor performance of the traditional agricultural sector. Geographic income distribution patterns, based on a 1971-1972 national food consumption survey, indicate an extremely skewed distribution favoring the coastal region where Peru's principal cities are located. While metropolitan Lima comprised only 20.1% of the country's total population, its residents earned 46.2% of the national income. Rural areas acount for 54.4% of all families, but receive only 23.5% of all family income.

Proposed Project activities will form part of the enormous GOP effort that is necessary to revive the dynamism of the agricultural sector. Among the goals of this effort are. self-sufficiency in food production (at least of basic staples), stabilization of agricultural commodity prices; promotion of export agriculture (particularly of cash crops); and job creation in rural areas. The Project is aimed at relieving one of the chief constraints to increasing agricultural productivy--lack of medium-term investment credit needed by farmers to make on-farm improvements in order to expand their production.

Because it will make medium-term credit for agricultural investments available to farmers, the proposed Project is an important link in a series of GOP and other donor activities in the sector. These activities are designed to increase agricultural productivity and farmers' real incomes; attract much-needed new capital to the sector; and create new jobs, both on-farm and off-farm.

Reasons for shortages of medium-term agricultural credit in recent years are discussed in the Background Section and Demand Analysis of this paper. The commodity prices enforced by the government so as to benefit the urban poor perpetuated the dependence of the agricultural sector on subsidized credit: with inadequate prices for the crops, farmers were unable to pay market rates for credit, particularly for the medium- or long-term credit in machinery needed to finance investments in machinery or farm improvements. In turn, subsidized credit became the monopoly of public sector credit institutions since private sector banks which must pay market rates for their funds have to make a profit and cannot compete with the subsidies available to the AgBank. However, rather than stimulating agricultural investments, subsidized interest rates for agricultural credit severely limited the amount of funds available for lending in the sector. In particular, medium- and long-term credit has been nearly non-existent in recent years.

Given its foreign debt situation, the GOP is unable to continue subsidizing agricultural credit. The Demand Analysis above indicates that there is substantial demand in the sector for credit at market interest rates and that there exist projects capable of providing a positive financial return on the investment. Thus, the timing seems opportune for the emphasis of this Project: to involve the private sector once again in agricultural lending.

2. Target Group

Because the private lending activities under the proposed Project are commercially motivated, the Project cannot specifically target the poorest segment of the rural population. Rather, it will promote the more general objective of growth in the agricultural sector, still the largest in Peru. With many backward and forward linkages to other industries, the dynamic development of this sector will help diversify the Peruvian economy in general. To the extent that Project lending makes farming more efficient, prices of agricultural goods will tend to decrease (unless export crops receive most of the ICI support) and in this way the Project credit line will help to reduce rural and urban poverty in general.

The Project will directly benefit the small and medium-sized farmers of the rural high jungle, sierra, and coast who will have access to credit under the Project. Individual farmers regardless of farm size as well as those who are members of associated enterprises and cooperatives will be eligible to participate in the lending program. To the extent that the Project funds can overcome ICI reluctance to lend in this sector, restrictions designed to benefit farms of particular sizes would undermine that goal. Banks will avoid lending to risky clientele and might not participate if forced to do so. The incentives to encourage them back into this sector would be strongest if they are permitted to lend to the farmers who have the best earning potential. However, Peru's poor population will benefit indirectly by policies that best support agricultural growth, as the proposed Project intends.

Farmers will benefit both from direct credits and from employment opportunities provided by those sub-loans which are made to larger farming operations. The importance of job creation cannot be underestimated since over 60% of those employed in agriculture are underemployed, according to recent Ministry of Labor figures. Improved irrigation operations in coastal areas will permit more intensive cultivation of those lands and will provide jobs for currently underemployed farm laborers. In the jungle, land-clearing operations financed by the Project will increase the availability of agricultural lands for production and will provide jobs for migrants from the sierra and other rural areas. In the sierra, credits for small-scale irrigation, storage facilities, livestock improvement, fencing, dairy machinery, and other on-farm improvements will provide additional jobs for laborers and will increase the production and productivity of sierran farmers, thereby increasing farm incomes and promoting economic recovery in the sector. Indeed, recovery in the agricultural sector is critical to the GOP's economic strategy since world prices of metal are down and export earnings from Peru's oil production have stabilized. Self-sufficiency in basic foodstuffs is an important step for improving the country's balance of trade situation--for several years, Peru has imported a substantial proportion of its food requirements.

The PID guidance cable raised the issue of the labor-intensiveness of the Project and concern that Projects funds might be used to fund labor-saving investments despite the high levels of unemployment and underemployment in rural areas. As discussed above in Section II.F, external disincentives discourage the use of labor and favor capital-intensive activities. For example, Peruvian labor laws make it difficult to dismiss employees who have been working longer than six months. And until recently, both an overvalued sol and subsidized interest rates favored capital investment in imported equipment. Now, however, a realistic exchange and market interest rates ensure that investments in capital-intensive activities, such as machinery purchase, are made only if they are profitable. Project sub-loans will undoubtedly be made for the purchase of machinery and equipment. In some cases, the new equipment may replace labor but in many cases, we expect that the new lending will generate sufficient revenues to finance the same number of jobs or more jobs than would exist without the lending. Some equipment will create jobs since more people will be hired to operate it. Moreover, to the extent that these purchases of machinery and equipment will make farm operations more efficient, agricultural production will increase and, as a result, additional jobs will be created--both for on-farm laborers and in processing and marketing. With regard to the disincentive to labor absorption provided by Peruvian labor laws, AID will attempt to deal with this broader policy issue through other efforts. The GOP is aware of the problem and the Congress is currently debating a new industrial law which would alleviate this serious constraint to investment in Peru.

The GOP's market-oriented policy framework should guarantee that market forces come into play in the selection of capital or labor for a particular activity. Given Peru's labor surplus, new investment in the agricultural sector will promote labor absorption. In fact, employment generation both in the agricultural sector and in the economy as a whole will be one of the most important benefits of the Project. Employment opportunities in rural areas have traditionally been few; the additional farming activities financed by the Project will provide a stimulus to rural employment generation for farm laborers as described above. Additional rural and market town employment will also be generated in the agricultural supply and service sectors and, in urban areas, in the manufacturing sector which produces seeds, tractors, inputs, and other manufactured or processed goods for farming. Forward linkages would also generate employment in transportation, agroindustrial processing, and marketing activities which would receive the increased agricultural production and make it available to intermediate and final local or foreign markets.

3. Risk Aversion and Economic Behavior

At the present time, perhaps the key sociological factor affecting small farmer economic behavior is avoidance of risk. Generally, farmers are too small and too undercapitalized to operate with any significant economic of scale or to create, or even manipulate, the forward and backward linkages to their own production. They buy inputs at the prices dictated by commercial firms or marketing intermediaries, and sell their produce on the same basis. Over time, within a given region, farmers come to know more or less what the market for a few specific crops will be, and having determined this, they are reluctant to shift production patterns into "unknown" crops or to expand their operations with on-farm improvements. Thus, low cash crops with correspondingly low risk become the stable production pattern within a specific region.

To break with the present production pattern requires not only incentives such as increased availability of credit and technical assistance, but a lowering of the risk associated with the expansion of farm operations or the introduction of new crops. Small farmers currently have little incentive to diversify production or to shift productive patterns from traditional cash crops which have stable markets, but frequently provide little income, to higher-priced crops which are generally marketed through non-traditional channels, since they require either further processing or refinement prior to reaching final consumer markets. At the same time, inadequate marketing and processing facilities, scarcity of medium-term credit to allow for investment in production shifts, and lack of technical assistance to the farmer combine to increase the risks associated with production change.

Thus far, the GOP has had limited success in trying to convince small farmers to expand their operations to shift from traditional crops (root crops and easily marketed grains) into higher income crops such as soya or those crops which would serve as basic inputs into vegetable oil manufacturing or other industrial ventures. Such attempts have had disappointing results, as farmers claim that they have received neither the financial resources nor the technical know-how to effect the production shifts, and that the marketing mechanisms for eventual disposal of the new crops have not been made known to them or simply do not presently exist. Farmers listen patiently as the virtues of new cropping patterns are explained to them by Ministry technicians; then they return to their farms to perpetuate cropping conditions which they know will yield a certain year-end return.

The typical Peruvian farmer, while conservative from the point of view of risk aversion, is nonetheless a rational actor in the market economy in which he deals. If he can be convinced that a given investment will increase his income (even though that return may be more than a year into the future), he will invest if credit is available and accessible to him.

One specific aim of the proposed Project is to provide farmers with technical assistance in project feasibility analysis. In addition, COFIDE and the ICIs will carry out promotional campaigns to increase farmers' information about and access to credit.

A primary objective of the T.A. and promotion campaigns will be to inform farmers about the relatively new system of indexed credit. Indexation was introduced by the Central Bank more than a year ago, but so far, farmers' lack of comprehension as to its benefits, has inhibited its use as a means of providing medium-term credit to farmers. Because of inadequate explanations as to how indexation works, farmers do not see the benefits of the improved cash flow indexation affords them; rather, they see only the greatly increased, readjusted principal that they must eventually pay back. Moreover, banks have not aggressively promoted indexation, perhaps because of the cash flow problem it presents for the bank or perhaps simply because indexation is a "new" concept for the banks and promotional activities for it have not yet been established. The proposed Project will provide both TA and support for promotional campaigns to ensure that farmers understand and use the indexed system.

IMPLEMENTATION ARRANGEMENTS

A. Administrative Arrangements

1. COFIDE

The Financial Intermediaries Division of COFIDE will be responsible for monitoring the Project credit fund.

After the Project Agreement is signed, COFIDE will draft the credit fund operations manual and the technical assistance plan, will train the staff required to implement the Project and will begin the development and distribution of promotional materials in target areas.

Once the Conditions Precedent have been met, implementation will focus on the identification, appraisal, approval, and execution of sub-projects financed by the fund as well as the monitoring and collection of outstanding credits.

2. AID

a. Monitoring

The Project will not involve unusual administrative features for AID or additional AID staff. AID personnel will work closely with the COFIDE implementation unit to assist in meeting the Conditions Precedent. During Project implementation, AID will assist COFIDE to monitor Project performance to ensure that: (1) loan size restrictions are adhered to, so as to encourage the largest feasible number of beneficiaries; (2) a wide variety of lending activities are encouraged; and (3) sub-loans discounted under the program are additional to current ICI agricultural lending.

Monitoring will be exercised by the USAID Project Committee with the following responsibilities.

i. A Project Manager will be assigned from Mission's Office of Development Resources to monitor Project implementation, to ensure that the provisions of the AID Loan Agreement and Implementation Letters are met, and to approve all vouchers for disbursement.

ii. The Mission Controller will review disbursement requests for conformity with AID Regulations, and will ensure that adequate financial controls are exercised.

iii. Other Mission offices may be called upon to review sub-loan requests above the authorized amount, and to assist with sub-project inspections.

b. Reporting

COFIDE records on sub-projects and sub-borrowers will be open to AID. COFIDE will submit the following reports:

i. A Quarterly Progress Report showing by source the investments in the credit fund and the commitments, disbursements, and recuperations, detailed by region and sub-project. The report will include an analysis of sub-borrowers' effective interest rate structure to ensure that it is in accordance with the Central Bank's annual inflation estimate for the previous six months. It will also include technical assistance activities and overall Project status.

ii. Quarterly Shipping Reports (to be required only in the event of, and after the initiation of, ocean shipping).

iii. An annual audit report on the credit fund prepared by an independent auditor acceptable to AID.

c. Disbursement Procedures

No deviation from established AID disbursement procedures is anticipated. AID will make an initial advance to COFIDE to fund the planned lending for the first 90 days. Additional advances will be made every thirty days as needed, subject to the presentation of regular liquidation vouchers.

d. Procurement Procedures

The source and origin of goods and services procured under the Loan and the procurement procedures followed under sub-loans will be in accordance with AID requirements applicable to intermediate credit institutions projects (see AID Handbook 1, Supplement B, Chapter 19). Procurement of goods and services by COFIDE for its own account will be in accordance with host country contracting rules and will be carried out by COFIDE.

B. Implementation Plan

The $10 million Project Agreement will be executed by the Ministry of Economy, Finance and Commerce. COFIDE will be designated as implementing agency under the Project, and the Financial Intermediaries Division of COFIDE will have overall responsibility for Project planning, credit administration, evaluations, and coordination of other inputs such as technical assistance and training.

The implementation schedule allows for a six-month start-up period following signature of the Project Agreement to fulfill all Conditions Precedent, and a three and one-half year disbursement period to fully commit and disburse the Credit Fund to eligible sub-projects:

1. Loan Authorized	December 30, 1982
2. Project Agreement signed	February 28, 1983
3. Conditions Precedent met	August 31, 1983
4. Disbursement of Credit Fund begin	September 1983
5. First Project Evaluation	September 1984
6. Final Project Evaluation	October 1986

C. Evaluation Plan

The Project will be continually monitored by COFIDE and USAID, and regular joint USAID/COFIDE reviews will be held.

In addition to the periodic reviews, two major Project evaluations are planned. The first evaluation will be made approximately 12 months after the first Loan disbursement to permit early identification and solution of implementation problems. Following the PACD, a second in-depth evaluation will be undertaken to assess the impact of the Project at both the sub-borrower and institutional levels. Topics to be reviewed will include:

1. Sub-borrowers

- variety of lending activities
- average loan size
- income and assets generated
- employment generated
- value added
- productivity
- socio-economic groups benefitted
- technological change
- effects of optional interest rate policy

2. COFIDE

- integration of Project concept within COFIDE
- increase in ICIs' agricultural lending portfolios
- cost of credit
- cost and effectiveness of technical assistance
- bad debt management
- implementation of optional interest rate policy

D. Conditions, Covenants, and Negotiating Status

See the Draft Authorization (Annex I, Exhibit E) for Conditions Precedent and Covenants.

This Project proposal has been prepared in close collaboration with COFIDE management and staff, and with the endorsement of the Minister of Economy, Finance and Commerce and the President of the Republic. Given

COFIDE familiarity with the previous AID-financed Rural Development Agribusiness Fund project, and its similarity to this proposal, negotiation and execution of the Project Agreement should proceed rapidly.

E. Environmental Considerations

The USAID/Peru Project Committee has determined that the Project does not require an Initial Environmental Examination because its activities are included within the classes not subject to the AID Environmental Procedures. See Annex I Exhibit F for Environmental Determination.

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E.O. 12356: N/A
TAGS:
SUBJECT: PRIVATE SECTOR AGRICULTURE INVESTMENT PROMOTION PID REVIEW

1. SUBJECT PID WAS REVIEWED AND APPROVED BY THE DAEC ON AUGUST 24, 1982, WITH THE FOLLOWING ISSUES TO BE ADDRESSED DURING INTENSIVE REVIEW. AA/LAC HEREBY AUTHORIZES MISSION DIRECTOR, USAID/PERU TO APPROVE PROJECT PAPER AND AUTHORIZE PROJECT UP TO AN AMOUNT NOT TO EXCEED DOLS 10 MILLION. THIS AUTHORITY REDELEGATED BY THIS CABLE IS EFFECTIVE UNTIL AUGUST 24, 1983. WHEN PROJECT IS READY FOR AUTHORIZATION, WE REQUEST YOU CABLE AID/W A DESCRIPTION OF THE CO-FINANCING ARRANGEMENTS AND DATE BY WHICH U.S. PRIVATE BANK WILL SIGN LOAN AGREEMENT WITH GOP. WE URGE MISSION TO CONSIDER FIRST QUARTER FY 83 AUTHORIZATION AND OBLIGATION BECAUSE FY 82 FUNDING IS HIGHLY UNLIKELY.

Cable Peru 12758
sent 12/15/82

2. RELATIONSHIP TO REVISED CDSS STRATEGY: BECAUSE THE PP WILL PROBABLY PRECEDE THE SUBMISSION OF THE MISSION'S REVISED CDSS, THE PP SHOULD BRIEFLY DESCRIBE THE MISSION'S REVISED DEVELOPMENT ASSISTANCE STRATEGY, ESPECIALLY THE NEW FOCUS ON COASTAL AGRICULTURE, AND HOW THE PROJECT RELATES TO THAT STRATEGY.

See Section II G

3. PROJECT DESIGN:
--A. PARTICIPATION OF THE AGRARIAN BANK: WE ENCOURAGE THE MISSION TO DESIGN THE PROJECT SO THAT TECHNICAL ASSISTANCE TO THE AGRARIAN BANK TO CARRY OUT AN INTEREST RATE POLICY STUDY IS MADE AVAILABLE EARLY DURING PROJECT IMPLEMENTATION. WE ARE INTERESTED THAT THIS PROJECT, IN CONJUNCTION WITH THE PROPOSED DOLS 40 MILLION IBRD LOAN, PROMOTE A POLICY CHANGE WITHIN THE AGRARIAN BANK SO IT CAN BE AN ACTIVE RECIPIENT OF THE AG INVESTMENT FUND IN COFIDE AT THE EARLIEST POSSIBLE OPPORTUNITY.

See Sections II F, III B, and IV C2.

[illegible]. PRIVATE SECTOR LENDING INSTITUTIONS: IN THE PP THE REASONS WHY THE PRIVATE SECTOR CEASED LENDING FOR AGRICULTURE SHOULD BE DESCRIBED. THE PP SHOULD ALSO EXPLAIN WHY WE THINK THIS PROJECT WILL INDUCE THE PRIVATE FINANCIAL INSTITUTIONS TO RESUME AGRICULTURAL LENDING, GIVEN THE PERCEPTION BY PRIVATE LENDERS THAT AGRICULTURE IS A HIGH RISK ENTERPRISE, AND THE FACT THAT EXISTING BANKING LAWS ALLOW COMMERCIAL BANKS TO LEND FOR MORE THAN ONE YEAR ONLY IF THEY USE THE INDEXATION SYSTEM. AS PART OF THAT INDUCEMENT, WE RECOMMEND THAT A MINIMUM FINANCIAL RATE OF RETURN BE CONSIDERED AS A LENDING CRITERIA BY THE ICIS, AS WELL AS A MINIMUM INTEREST RATE SPREAD REQUIRED BY ICIS TO MAKE IT ATTRACTIVE TO LEND TO HIGH RISK AGRICULTURE CLIENTELE. IN ADDITION, DURING INTENSIVE REVIEW THE MISSION SHOULD EXAMINE THE RESOURCES THE PERUVIAN ICIS HAVE AVAILABLE, OR CAN POTENTIALLY MOBILIZE FOR LENDING TO THE SECTOR, SO THAT THE END OF PROJECT STATUS OF INCREASING THE ALLOCATION OF INDIGENOUS PERUVIAN RESOURCES FOR MEDIUM TERM AGRICULTURE LENDING CAN BE ACHIEVED.

See Sections II C, D, and E

C. LABOR INTENSIVENESS: DURING PROJECT REVIEW, CONCERN WAS EXPRESSED ABOUT THE POSSIBILITY THAT PROJECT FUNDS WOULD BE USED TO FUND LABOR SAVING INVESTMENTS DESPITE THE HIGH LEVEL OF UNEMPLOYMENT AND UNDEREMPLOYMENT IN RURAL AREAS. THE PROJECT PAPER SHOULD EXAMINE THE INCENTIVES EXISTING IN THE CURRENT PERUVIAN CONTEXT FOR LABOR SAVING AND LABOR USING INVESTMENTS AND SHOULD ATTEMPT TO QUANTIFY ANY DISTORTIONS WHICH TEND TO PROMOTE THE FORMER OVER THE LATTER. IF NECESSARY, SUB-LOAN LENDING CRITERIA SHOULD BE PROPOSED TO PREVENT FINANCING OF INAPPROPRIATE LABOR SAVING INVESTMENTS. HOWEVER, WE RECOGNIZE CERTAIN FARMING ACTIVITIES WILL LEGITIMATELY REQUIRE SUB-LOANS WHICH WOULD FINANCE LABOR SAVING EQUIPMENT AND WE DO NOT MEAN TO PRECLUDE LENDING IN THESE INSTANCES.

See Sections IV D 2 and II F.

4. EFFECTIVE DEMAND ANALYSIS: THE EFFECTIVE DEMAND STUDY IS CRITICAL TO DETERMINE THE FINAL PROJECT DESIGN AND TO ESTABLISH LENDING TERMS AND CRITERIA. THE STUDY SHOULD INCLUDE THE OVERALL DEMAND IN PERU FOR BOTH MEDIUM AND SHORT TERM CREDIT AND PROVIDE INFORMATION ON THE VARIOUS CLASSES OF SUB-BORROWERS AND MAXIMUM SIZE OF SUB-LOANS. IT IS DESIRABLE THAT THERE BE AS LARGE A NUMBER OF SUB LOANS AS POSSIBLE UNDER THIS PROJECT IN ORDER TO GIVE THE PRIVATE SECTOR FINANCIAL ENTITIES EXPERIENCE IN AGRICULTURE LENDING, AS WELL AS TO REACH THE MAXIMUM NUMBER OF BENEFICIARIES. FURTHERMORE, THE DEMAND STUDY SHOULD FOCUS NOT ONLY ON THE PROFITABILITY OF POTENTIAL INVESTMENTS, BUT ALSO ON THE WILLINGNESS OF FARMERS TO BORROW LONG TERM FOR THESE PURPOSES.

See Section IV B

5. PROJECT BENEFICIARIES: IT IS ENCUMBENT ON THE PROJECT THAT IT SERVE THE BASIC HUMAN NEEDS INTENT OF THE FAA. WE RECOGNIZE THAT SMALL FARMERS WILL PARTICIPATE IN THIS PROJECT VIA THEIR MEMBERSHIP IN ASSOCIATED ENTERPRISES AND COOPERATIVES. HOWEVER, THE PP SHOULD SPECIFY HOW MAKING CREDIT AVAILABLE TO MEDIUM
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#3933

See Section IV D

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SIZED FARMERS WILL IMPACT FAVORABLY ON SMALL FARMERS. THIS ANALYSIS COULD BE DONE IN SEVERAL WAYS. FOR EXAMPLE, THE PP COULD DEMONSTRATE THAT THERE ARE DIRECT EMPLOYMENT EFFECTS ON THE SMALL FARMER BY INCREASING EMPLOYMENT ON MEDIUM SIZED FARMS ON THE COAST BY MORE INTENSIVE CULTIVATION OF EXISTING HOLDINGS THROUGH IRRIGATION. OR THE PP COULD DESCRIBE THE INCREASED EMPLOYMENT EFFECTS IN THE HIGH JUNGLE BY BRINGING MORE LAND UNDER CULTIVATION IN A LABOR SHORT REGION, I.E. JOBS FOR MIGRANTS. PERHAPS, AS A RESULT OF THE IMPROVED ON FARM STORAGE CAPACITY, SEASONAL FOOD PRICES WOULD STABLIZE, THEREBY IMPACTING FAVORABLY ON THE URBAN POOR. OUR REVIEW OF THE EXISTING LITERATURE INDICATES THAT BHN OBJECTIVES CAN BE ACHIEVED BY A VARIETY OF ACTIVITIES OTHER THAN THE DIRECT PROVISION OF GOODS AND SERVICES TO THE POOR. IN FACT A KEY CHALLENGE FOR MEETING BHN OBJECTIVES IN THE POOREST COUNTRIES IS TO ACHIEVE BROAD-BASED ECONOMIC GROWTH WHICH IS DEPENDENT ON POLICIES IMPLEMENTED BY THESE COUNTRIES. IT SEEMS TO US A CASE CAN BE MADE FOR THIS PROJECT THAT WILL CLEARLY DEMONSTRATE THAT THE POOR, AS WELL AS THE RELATIVELY WELL OFF MEDIUM SIZE FARMERS, ARE BENEFICIARIES.

6. PD-71 AND FINANCING OF POTENTIALLY SENSITIVE PRODUCTS: POLICY DETERMINATION 71 STATES AID'S CONCERNS ABOUT FINANCING THE PRODUCTION OF POTENTIALLY SENSITIVE PRODUCTS SUCH AS PALM OIL, SUGAR, AND CITRUS WHEN PRODUCTION IS FOR EXPORT AND WHERE SUCH EXPORTS ARE LIKELY TO BE IN SURPLUS ON THE WORLD MARKET AND ARE LIKELY TO CAUSE SUBSTANTIAL INJURY TO U.S. PRODUCERS OF THE SAME OR SIMILAR PRODUCTS. AID HANDBOOK ONE DESCRIBES FINANCING RESTRICTIONS FOR TOBACCO AND OTHER NON-FOOD CROPS. IF IT IS DETERMINED DURING INTENSIVE REVIEW THAT A SIGNIFICANT LEVEL OF FINANCING FOR ANY RESTRICTED OR SENSITIVE CROP IS DESIRABLE AND EXPECTED TO OCCUR UNDER THE PROJECT, THESE FACTS SHOULD BE CONVEYED TO AID/W FOR ITS REVIEW IN LIGHT OF PD-71 (PPC/EA AND PPC/PDPR ARE RESPONSIBLE FOR REVIEW OF PD-71 ISSUES). MISSION'S SUBMISSION SHOULD INCLUDE THE NECESSARY JUSTIFICATION AND ANALYTICAL BASIS WHICH UNDERLIES THE PROPOSED PROJECT'S SUPPORT OF THESE ACTIVITIES. THE PROJECT PAPER SHOULD INCORPORATE THIS ANALYSIS AND JUSTIFICATION, AND THE PROJECT AGREEMENT SHOULD ALSO LIST THE FULL RANGE OF CROPS WHICH CAN NOT BE FINANCED BY AID IN CONJUNCTION WITH THE PROJECT.

See Covenants in Project Authorization and Section III A 1.

7. THE ISSUES OF LABOR INTENSITY (PARA. 3C) AND THE NECESSITY OF MEETING BHN REQUIREMENTS (PARA. 5) SHOULD BE RESOLVED IF POSSIBLE WITHOUT ENCUMBERING LOAN IMPLEMENTATION AND CO-FINANCING WITH DIFFICULT SELECTION CRITERIA AND ADMINISTRATIVE PROCEDURES WHICH WILL COMPLICATE IMPLEMENTATION AND INHIBIT FULL PRIVATE SECTOR PARTICIPATION. MISSION'S ATTENTION IS DRAWN TO [illegible] "THE [illegible] OF THE BASIC [illegible] APPROACH TO CURRENT AID POLICY" AS WELL AS A RECENT ARTICLE IN WORLD DEVELOPMENT BY MARCELO SELOWSKY OF THE IBRD ENTITLED "INCOME DISTRIBUTION, BASIC NEEDS, AND COUNTRIES." BOTH STUDIES SUGGEST THAT THERE IS NO NECESSARY CONFLICT BETWEEN BHN AND GROWTH OBJECTIVES IN AN APPROPRIATE POLICY ENVIRONMENT. IN THE CASE OF PERU AND THE PRESENT PROJECT, IF INTENSIVE REVIEW DEMONSTRATES THAT THE EXISTING POLICY ENVIRONMENT (EXCHANGE RATE, TARIFFS, TAX STRUCTURE, ETC.) ARE NOT CONDUCIVE TO THE ACHIEVEMENT OF THESE OBJECTIVES, MISSION SHOULD SEEK APPROPRIATE CHANGES IN THE POLICY ENVIRONMENT. [illegible] IF THIS IS NOT SUCCESSFUL SHOULD [illegible] WITH SPECIFIC [illegible]

STATUTORY CHECKLIST FOR FY 82

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELEGIBILITY

1.	FAA Sec. 481. Has it been determined that the government of the recipient country has failed to take adequate steps to prevent narcotic drugs and other controlled substance (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 being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?	No
2.	FAA Sec.620(c). If assistance is to a 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) the debt is not denied or contested by such government?	No
3.	FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisons) 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?	No
4.	FAA Sec. 532(c), 620(a), 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?	No
5.	ISDCA of 1981 Secs. 724, 727, 728 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727, 728 and 730 of the IS[illegible] of 1981	Not applicable

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

No

7. FAA Sec. 620(k). Does the program furnish assistance in excess of $100,000,000 for the construction of a productive enterprise, except for productive enterprises in Egypt that were described in the Congressional Presentation materials?

No

8. FAA Sec. 620(1). Has the country failed to enter into an agreement with OPIC?

No

9. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?

(a) No

(b) If so, has any deduction required by the Fishermen's Protective Act been made?

(b) No

10. FAA Sec. 620(g); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?

(a) No

(b) No

11. FAA Sec. 620(s). If contemplated assistance is development loan or from Economic Support Func, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? Reference may be made to the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.

Yes, the Administrator has take such into account in the FY 83 Taking Into Consideration Memorandum

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

No

13. FAA Sec. 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 AID Administrator in determining the current AID Operational Year Budget?

Peru is not in arrears in payment of its UN obligations

14. FAA Sec. 620A; FY 1982 Appropriation Act Sec. 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?

No

15. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No

16. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or denoted a nuclear explosive device, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

No

17. FAA Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of

No

Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken into account?

18. FAA Sec. 762. See special requirements for assistance to Haiti.	Not applicable

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

a. FAA Sec. 116. Has the Department of state determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the	No such determination has been made

2. Economic Support Fund Country Criteria.

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?	Not applicable
b. FAA Sec. 620B. If ESF is to be furnished to Argentina, ha the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?	Not applicable
c. ISDCA of 1981, Sec. 726(b). If ESF	Not applicable

assistance is to be furnished to Chile, has the President certified that (1) the Govt. of Chile has made significant progress in human rights; (2) it is in the national interest of the U.S.; and (3) the Govt. of Chile is not aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier?

PROJECT CHECKLIST

A. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).	
(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?	(a) A Congressional Notification for the Project was sent on October 15, 1982 and expired on October 30, 1982. (b) Yes
2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,00, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?	(a) Yes (b) Yes
3. FAA Sec. 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 purpose of the assistance?	No further legislative action is required.
4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973?	The Project is not a water, or water-related land resource construction project.

5. <u>FAA Sec. 611(e).</u> If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has the Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

A 611(e) certification is included in the project paper and has determined that Peru has the ability to maintain and utilize the project.

6. <u>FAA Sec. 209.</u> Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

The Project is not susceptible to execution as part of a regional or multilateral project.

7. <u>FAA Sec. 601(a).</u> Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and 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.

By providing credit to individual farmers to increase their production, the Project (a) will increase the flow of international trade insofar as the production is for export; (b) will foster private initiative and competition; (c) cooperative banks, credit unions and S&Ls are encouraged to participate as ICIs; (d) wide participation by ICIs is encouraged and expected; (e) on-farm improvements financed under the Project will improve the technical efficiency of agriculture.

8. <u>FAA Sec. 601(b).</u> Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

The project will affect US trade to the extent that machinery or technical assistance may be procured from US sources. A private U.S. Bank will participate directly in the Project as co-financier.

9. <u>FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507.</u> Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	The GOP will contribute the equivalent of US$5 million to the investment fund. The US owns no Peruvian currency.
10. <u>FAA Sec. 612(d).</u> Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No
11. <u>FAA Sec. 601(e).</u> Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes
12. <u>FY 1982 Appropriation Act Sec. 521.</u> If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	No
13. <u>FAA 118(c) and (d).</u> Does the project take into account the impact on the environment and natural resources? If the project or program will significantly affect the global commons or the U.S. environment, has an environmental impact statement been prepared? If the project or program will significantly affect the	Initial Environmental Examination is not required.

environment of a foreign country, has an environmental assessment been prepared? Does the project or program take into consideration the problem of the destruction of tropical forests?

14. FAA 121(d). If Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?

Not applicable

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better

(a) The project will involve the poor in development by increasing access to credit in the agricultural sector and by creating jobs for farm laborers. To the extent possible, labor-intensive projects using appropriate technologies will be given preference in financing.

(b) Cooperatives are eligible to receive credits under the project.

life, and otherwise encourage democratic private and local governmental institutions; (c) support the selfhelp efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

Yes

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

To the extent feasible, projects using appropriate technologies will be financed.

d. FAA Sec. 110a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory

No grant funds for capital assistance will be available under the Project.

to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"?

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

g. FAA Sec. 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 civil education and training in skills required for effective participation in governmental processes essential to self-government.

The project recognizes the needs of the country to increase agricultural production to better meet its food requirements and to increase incomes and create job opportunities for the rural poor.

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b). Information and conclusions on capacity of the country to repay the loan, at a reasonable rate of interest.

Peru has always repaid AID loans on a timely basis.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an

Not applicable.

agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

ISDCA of 1981, Sec. 724(c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?

Not applicable.

3. Project Criteria Solely for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?

Not applicable.

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

Not applicable.

c. FAA Sec. 534. Will ESF funds be used to financed the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?

Not applicable.

d. <u>FAA Sec. 609.</u> If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Not applicable.

ANNEX I

Exhibit C

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

I, George A. Hill, the principal officer of the Agency for International Development in Peru, having taken into account, among other factors, the maintenance and utilization of projects in Peru previously financed or assisted by the United States, do hereby certify that in my judgment Peru has both the financial capability and human resources capability to effectively maintain and utilize the proposed Project: PRIVATE SECTOR AGRICULTURAL INVESTMENT PROMOTION.

12/30/82

Date

George A. Hill

George A. Hill

Acting Director

USAID/Peru

CORPORACION FINANCIERA DE DESARROLLO S.A.-COFIDE

GERENCIA GENERAL

CF-10071//82-15

Lima, 29 de diciembre de 1982

Señor
John A. Sanbrailo
Director
Agencia para el Desarrollo Internacional
Ciudad.-

Tenemos el agrado de dirigirnos a usted con la finalidad de comunicar nuestro interés en la implementación de un Programa para la Capitalización del Sector Agropecuario, mediante un préstamo de la AID de US$ 10,000,000.

El presente programa constituiría un fondo de US$ 35,000,000 y operaría bajo el sistema de Intermediación Financiera, sistema en el cual tenemos una exitosa experiencia.

El propósito del programa es la canalización de recursos financieros a través de créditos de mediano y largo plazo, para mejoramiento de tierras, adquisición de activos fijos y el necesario capital de trabajo para este fin.

El monto total del programa tendría la siguiente conformación:

Préstamo AID	US$	10,000,000
Préstamo de un Banco Privado de USA		10,000,000
Aporte del Gobierno del Perú		5,000,000
Aporte de Intermediarios Financieros más Beneficiarios		10,000,000
RECURSOS TOTALES	US$	35,000,000

Finalmente, señalamos que si bien expresamos nuestro interés mediante la presente, previo a la firma del Convenio, deberá cumplirse con lo dispuesto en el Decreto Legislativo N° 5.

Hacemos propicia la oportunidad para expresarle las seguridades de nuestra mayor consideración.

Atentamente,

Carlos J. Klinge
Gerente Central

Carlos Neuhaus Tudela
Gerente General

PROJECT AUTHORIZATION

Name of Country: Peru

Name of Project: Private Sector Agricultural Investment Promotion

Number of Project: 527-0265

Loan Number:

1. Pursuant to Section 103 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Private Sector Agricultural Investment Promotion project for Peru involving planned obligations of not to exceed Ten Million United States Dollars ($10,000,000) in loan funds ("Loan") over a five (5) year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project.

2. The project ("Project") consists of the establishment and operation of a facility within the State Development Finance Corporation (COFIDE) for rediscounting eligible loans made to sub-borrowers for medium-term agricultural credit and strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Interest Rate and Terms of Repayment

The Borrower shall repay the Loan to A.I.D. in U.S. Dollars within twenty five (25) years from the date of first disbursement of the Loan, including a grace period of not to exceed ten (10) years. The Borrower shall pay to A.I.D. in U.S. Dollars interest from the date of first disbursement of the Loan at the rate of (i) two percent (2%) per annum during the first ten (10) years, and (ii) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

b. Source and Origin of Goods and Services

Goods and services, except for ocean shipping, financed by A.I.D. under the Loan shall have their source and origin in Peru or in countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Loan shall be financed only on flag vessels of Peru or countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing.

c. Condition Precedent to Initial Disbursement

Prior to any disbursement, or to the issuance of any commitment documents under the Project Agreement, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D., a signed loan agreement between COFIDE and a U.S. commercial bank to provide $10,000,000 for the Project Agricultural Investment Fund for sublending under the Project.

d. Conditions Precedent to Disbursement to Finance Lending Activities

Prior to any disbursement, or to the issuance of any commitment documents under the Project Agreement to finance lending activities, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D.:

(1) a technical assistance plan for training appropriate personnel of the participating intermediate credit institutions (ICIs) in the technical aspects of the lending program (including indexation of subloans) and in the promotional aspects of such program.

(2) a plan for distributing the sub-borrower Technical Assistance Fund among participating ICIs for technical assistance and training to sub-borrowers before and during sub-project execution.

(3) a COFIDE credit operations manual for the Project.

e. Covenants

The Borrower shall covenant that, unless A.I.D. otherwise agrees in writing, it will:

(1) deposit to the Agricultural Investment Fund all reflows of principal and interest received (less commission and fees) from all subloans for relending consistent with the purpose of the Project.

(2) maintain the value of the Agricultural Investment Fund at an amount of Peruvian Soles Oro equivalent to the dollar value of the Fund upon initiation of lending activities, and to make annual capital contributions to the Fund to compensate for any losses in value during the previous year.

(3) insure that participating ICIs establish a technical assistance fund for sub-borrowers using Project funds and that ICIs maintain that fund with the fees charged to sub-borrowers receiving technical assistance.

(4) insure that rediscounted subloans conform to the eligibility criteria specified in the Credit Manual.

(5) maintain interest rates charged to sub-borrowers of the Fund in line with commercial bank terms available in Peru for this purpose and to adjust interest rates under the Fund whenever necessary to maintain such comparability.

(6) obtain A.I.D. approval prior to authorizing any subloan under the Agricultural Investment Fund in excess of $50,000.

(7) insure that subloans will not be approved for the production, processing or marketing of sugar, palm oil or citrus for export, or for any A.I.D. restricted agricultural commodity.

Mission Director

Date

Clearances:
CD:MLikar: (in draft)
DR:GWachtenheim: (in draft)
PROG:DCruz: (in draft)
RD:DChiriboga: (in draft)
OARD:DBathrick: (in draft)
CONT:MRogal: (in draft)

DRAFTING INFO:RLA:DAAdams:pdc

ENVIRONMENTAL DETERMINATION

Project Location:	Peru
Project Title and Number:	Private Sector Agriculture Credit Promotion 527-0265
Funding:	FY-82 $10,000,000
Project Description:	To increase the availability of medium-term agriculture credit in Peru by strengthening the capacity of private sector intermediate credit institutions to finance medium-term loans. The Project will utilize a re-discount facility to be established in COFIDE. The medium-term credit will finance improvements on individually owned, medium-size (10 to 70 hectares) commercial farms, and cooperatives or associative enterprises of up to 150 hectares.

STATEMENT FOR CATEGORICAL EXCLUSION

It is the opinion of the USAID/Peru Project Committee that the Project does not required an Initial Environmental Examination, because its activities are within the classes of actions described in Section 216.5, Paragraph (c)(2) "Categorical Exclusions" of 22CFR Part 216.

"Section 216.2 (c) (2) (x)"

"Support for intermediate credit institutions when the objective is to assist in the capitalization of the institution or part thereof and when such support does not involve reservation of the right to review and approve individual loans made by the Institution".

Concurrence of Mission Director

I have reviewed the above statement and concur in the determination that the Project "Private Sector Agriculture Credit Promotion" does not require an Initial Environmental Examination.

August 11, 1982
Date

Malcolm Butler
Director USAID/Peru

ANNEX II
Exhibit A

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: 4 years
From FY 83 to FY 86
Total US Funding $10,000,000
Date Prepared: December 82

Project Title & Number: Private Sector Agricultural Investment Promotion, Project 527-0265

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Important Assumptions
To increase rural incomes in Peru by increasing agriculture productivity.	Farm incomes increased Agricultural productivity increased.	USAID evaluations. (Baseline: credit applications)	Demonstration effects of Project and donor lending programs will stimulate medium-term agricultutal lending.
Project Purpose: To increase the availability of medium-term ag credit by strengthening the capacity of private sector financial institutions to finance medium-term agricultural loans.	End-of-Project Status: 1. Medium-term ag investment fund established in COFIDE. 2. 9-12 private sector lending institutions channeling own resources for medium-term ag credit as well as using resources available through discount facility. 3. Sub-borrowers receiving TA on a regular basis.	GOP records. USAID project evaluations. Quarterly Project Report On-site field trips.	- GOP maintains positive interest rate policy. - Agricultural output prices are not prices are not administered to the detriment of farmers. - International donors will not undermine GOP policies of sound financial management.
Outputs 1. On-farm investments financed by medium-term investment fund in COFIDE. 2. ICIs participating in lending program. 3. Sublending directives issued. 4. COFIDE staff trained in promotion of fund and project interest rate scheme. 5. ICI staff trained in promotion of fund and interest rate scheme. 6. Sub-borrowers provided with TA for preparation of farm budgets, loan application, etc.	1. At least $35.0 million invested and about 1000 sub-loans made. 2. 9-12 private sector ICIs participating. 3. One Credit Manual developed. 4. 2 members of COFIDE staff trained. 5. 36 members of ICI staff trained. 6. Approximately 1000 farmers receive TA.	USAID and COFIDE records.	- Demand for credit and technical assistance exists among farmers.
Inputs: (See Financial Table)	Implementation Target (Type and quantity)	USAID and COFIDE records.	- U.S. commercial bank willing to co-finance project. - AID and COFIDE inputs provided on a timely basis.

Annex II
Exhibit B-1.

Private Sector Agricultural Investment Promotion 1/
Projected Cash Flow Statement
($000)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Inflows										
AID TA Funds	70	120	90	20						
AID Credit Funds	970	2910	2910	2910						
Private US Bank	1000	3000	3000	3000						
COFIDE Counterpart	500	1500	1500	1500						
Increment to Fund	-	81.3	1140.5	1842.5	11487.7	2564.1	2384.9	1694.2	898.7	0.7
Sub-Total	2470	7491.3	8590.5	9252.5	11487.7	2564.1	2384.9	1694.2	898.7	0.7
Reflows										
Year 1	139.6	558.4	558.4	558.4	558.4	558.4	558.4	418.8	-	-
Year 2	-	846.9	1693.8	1693.8	1693.8	1693.8	1693.8	1693.8	846.9	-
Year 3	-	-	971.2	1942.4	1942.4	1942.4	1942.4	1942.4	1942.4	971.2
Year 4	-	-	-	1046.0	2092.0	2092.0	2092.0	2092.0	2092.0	2092.0
Year 5	-	-	-	-	1298.7	2597.4	2597.4	2597.4	2597.4	2597.4
Year 6	-	-	-	-	-	1069.9	2139.8	2139.8	2139.8	2139.8
Year 7	-	-	-	-	-	-	1246.3	2492.6	2492.6	2492.6
Year 8	-	-	-	-	-	-	-	1512.3	3024.6	3024.6
Year 9	-	-	-	-	-	-	-	-	1683.2	3366.5
Year 10	-	-	-	-	-	-	-	-	-	1901.4
Total Inflows	2609.6	8896.6	11813.9	23745.6	19073.0	12158.9	14655.0	16583.3	17717.6	18586.2

ANNEX II
Exhibit B-1, 2

Outflows

Debt Servicing										
AID (Principal)	–	–	–	–	–	–	–	–	–	–
(Interest)	17.6	66.3	126.4	185.4	200	200	200	200	200	200
Private US Bank										
1	284.3	284.3	284.3	284.3	284.3	–	–	–	–	–
2	–	1008.5	1008.5	1008.5	1008.5	–	–	–	–	–
3	–	–	1270.5	1270.5	1270.5	–	–	–	–	–
4	–	–	–	1798.5	1798.5	–	–	–	–	–
Subloans	2068.9	5993.0	6912.4	7402.0	11487.7	9463.7	12270.1	14889.1	16818.9	14868.4
Administrative Expenses 1.5% of Subloans	37.5	133.4	129.6	138.7	172.3	176.0	184.0	223.3	277.6	223.0
Technical Assistance 2.5%	120.0	270.0	240.0	170.0	287.1	293.4	306.7	372.2	420.4	371.7
Total Outflows	2528.3	7755.5	9971.7	12257.9	16508.9	10133.1	12960.8	15684.6	17716.9	15663.1
Increment to the Fund	81.3	1140.5	1842.5	11487.7	2564.1	2384.9	1694.2	898.7	0.7	2923.1

1/ With Private Bank Money at 13% all due and payable in 5 years and ICI financing at 13 %, financial viability will require that 20% of the subtotal of credit funds available be retained until year 5 before being used for subloans.

ANNEX II
Exhibit B-2.1

Private Sector Agricultural Investment Promotion 1/
Projected Cash Flow Statement
($000)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Inflows										
AID TA Funds	70	120	90	20	-	-	-	-	-	-
AID Credit Funds	970	2910	2910	2910	-	-	-	-	-	-
Private US Bank	1000	3000	3000	3000	-	-	-	-	-	-
COFIDE counterpart	500	1500	1500	1500	-	-	-	-	-	-
Increment to fund	-	216.0	1175.5	2097.3	2451.0	504.5	476.3	282.1	691.2	804.2
Sub Total Credit Funds	2470	7616.0	8585.5	9507.3	2451.0	504.5	476.3	282.1	691.2	804.2
Reflows 13% 7 years										
Year 1	111.4	445.4	445.4	445.4	445.4	445.4	445.4	334.0	-	-
Year 2	-	668.1	1336.3	1336.3	1336.3	1336.3	1336.3	1336.3	668.1	-
Year 3	-	-	668.1	1336.3	1336.3	1336.3	1336.3	1336.3	1336.3	668.0
Year 4	-	-	-	668.1	1336.3	1336.3	1336.3	1336.3	1336.3	1336.3
Year 5	-	-	-	-	780.6	1561.3	1561.3	1561.3	1561.3	1561.3
Year 6	-	-	-	-	-	737.1	1474.2	1474.2	1474.2	1474.2
Year 7	-	-	-	-	-	-	900.6	1801.2	1801.2	1801.2
Year 8	-	-	-	-	-	-	-	1069.6	2139.3	2139.3
Year 9	-	-	-	-	-	-	-	-	1244.5	2489.0
Year 10	-	-	-	-	-	-	-	-	-	1387.6
Total Inflows	2651.4	8859.5	11125.3	13313.4	7685.9	7257.2	8566.7	10531.3	12252.4	13661.3

ANNEX II
Exhibit B-2 2

Outflows

Debt servicing	–	–	–	–	–	–	–		–	–
AID (Principal)										
(Interest)	17.6	66.3	126.4	185.4	–	–	–	–	–	–
Private U.S. Bank										
15% due in 5 years 1	298.3	298.3	298.3	298.3	–	–	–	–	–	–
2	–	1050.8	1050.8	–	–	–	–	–	–	–
3	–	–	1313.9	1313.9	–	–	–	–	–	–
4	–	–	–	1845.4	–	–	–	–	–	–
Subloans	1970	5910.0	5910.0	5910.0	6905.3	6520.1	7966.1	9461.7	11007.9	12273.7
Administrative Exp. 1.5% of Subloans	29.5	88.6	88.6	88.6	103.5	97.8	119.4	141.9	165.1	184.1
Technical Assistance Estimated for years 1-4, 2.5% of Portfolio thereafter	120	270	240	170	172.6	163.0	199.1	236.5	275.2	306.8
Total Outflows	2435.4	7684.0	9028.0	10862.4	7181.4	6780.9	8284.6	9840.1	11448.2	12764.6
Increment to fund	216	1175.5	2097.3	2451.0	504.5	476.3	282.1	691.2	804.2	896.7

1/ With Private Bank money at 15% all due and payable in 5 years and ICI financing at 13%, financial viability will require all reflows and COFIDE counterpart to be accumulated until year 6.

ANNEX II
Exhibit B-3.1

Projected Cash Flow Statement 1/

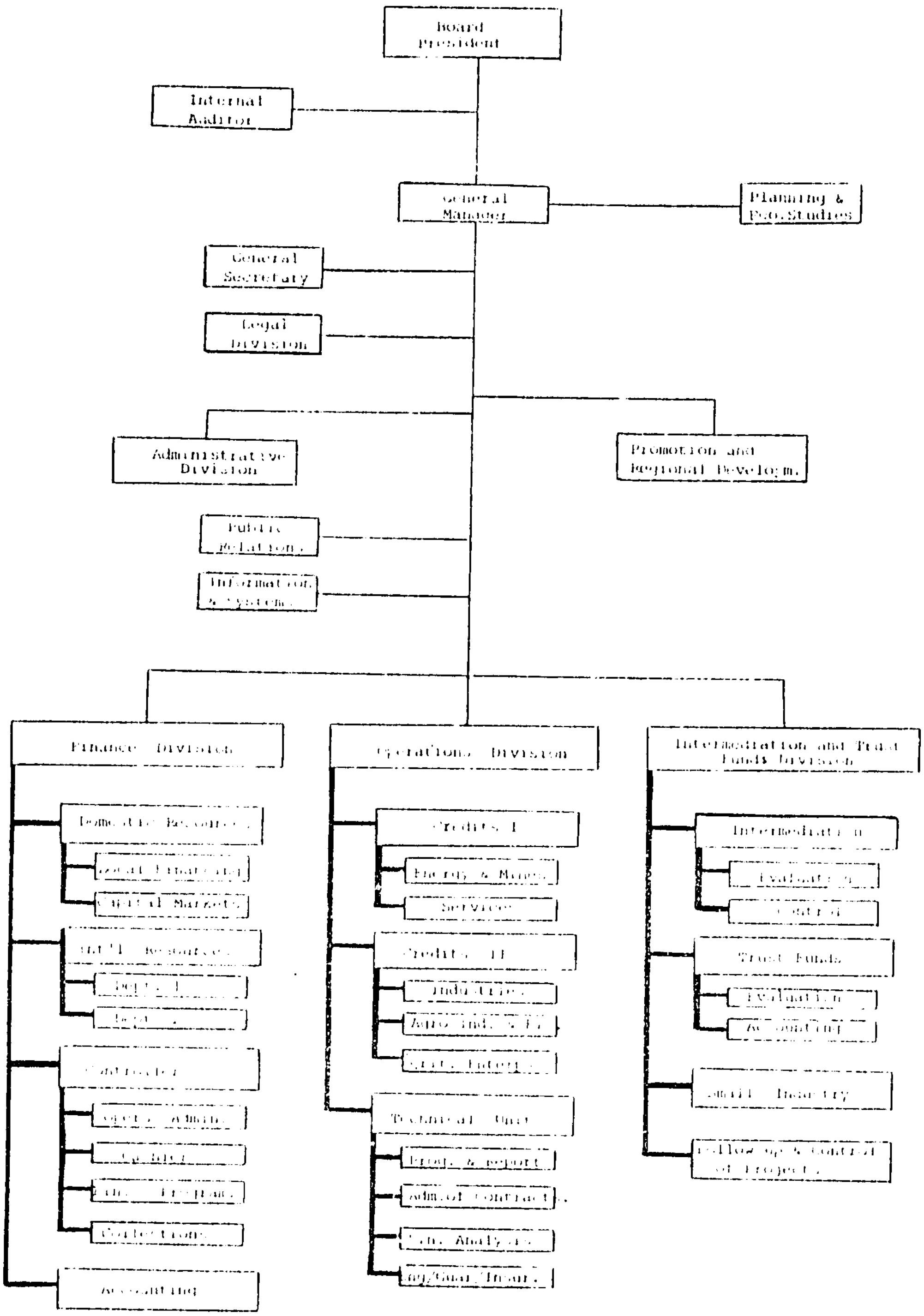
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Inflows										
AID TA Funds	70	120	90	20	–	–	–	–	–	–
Credit Funds										
AID funds	970	2910	2910	2910	–	–	–	–	–	–
Private US Bank	1000	3000	3000	3000	–	–	–	–	–	–
COFIDE counterpart	500	1500	1500	1500	–	–	–	–	–	–
Increment to fund	–	306.5	1560.5	3006.6	5814.2	2620.0	846.3	220.7	683.8	1310.9
Subtotal Credit funds	2470	7716.5	8970.5	10416.6	5814.2	2620.0	846.3	220.7	683.8	1310.9
Reflows 15% 7 years										
Year 1	118.3	473.5	473.5	473.5	473.5	473.5	473.5	335.2	–	–
Year 2	–	747.1	1494.2	1494.2	1494.2	1494.2	1494.2	1494.2	747.1	–
Year 3	–	–	710.0	1420.5	1420.5	1420.5	1420.5	1420.5	1420.5	710.0
Year 4	–	–	–	710.0	1420.5	1420.5	1420.5	1420.5	1420.5	1420.5
Year 5	–	–	–	–	710.0	1420.5	1420.5	1420.5	1420.5	1420.5
Year 6	–	–	–	–	–	710.0	1420.5	1420.5	1420.5	1420.5
Year 7	–	–	–	–	–	–	745.7	1491.5	1491.5	1491.5
Year 8	–	–	–	–	–	–	–	783.1	1566.1	1566.1
Year 9	–	–	–	–	–	–	–	–	822.2	1644.5
Year 10	–	–	–	–	–	–	–	–	–	863.3
Total Inflows	2658.3	9057.1	11738.2	14534.8	11332.9	9559.2	9241.7	10026.7	10992.7	11847.8

ANNEX II
Exhibit B-3

<u>Outflows</u>

Debt servicing										
AID (Principal) Interest	17.6	66.3	126.4	185.4	200	200	200	200	200	200
Private U.S. Bank										
17% due in 10 years 1	214.6	214.6	214.6	214.6	214.6	214.6	241.6	214.6	214.6	214.6
2	–	674.1	674.1	674.1	674.1	674.1	674.1	674.1	674.1	674.1
3	–	–	713.1	713.1	713.1	713.1	713.1	713.1	713.1	713.1
4	–	–	764.8	764.8	764.8	764.8	764.8	764.8	764.8	764.8
Subloans	1970.0	6216.5	5910	5910	5910	5910	6205.5	6515.8	6841.6	7183.7
Administrative Expenses 1.5% of Subloans	29.6	55.1	88.6	88.6	88.6	88.6	93.8	97.7	102.6	107.7
Technical Assistance Estimated for years 1-4, 2.5% thereafter	120	270	240	170	147.7	147.7	155.1	162.8	171.0	179.6
Total Outflows	2351.8	7496.6	8731.6	8720.6	8712.9	8712.9	9021	9342.9	9681.8	10037.6
Increment to fund	306.5	1560.5	3006.6	5814.2	2620.0	846.3	220.7	683.8	1310.9	1810.2

1/ Assumes Private Bank Financing at 17% for 10 years with subloans to ICI at 15% for 7 years. To make the project viable at these rates, amount of subloans in years 3 through 6 must be limited to $5,910,000.


Board
President
Internal
Auditor
General
Manager
Planning &
General
Secretary
Legal
Division
Administrative
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Promotion and
Regional Develop m.
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Collections
Accounting
Operations Division
Credits I
Energy & Mines
Services
Credits II
Industries
Technical Unit
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Intermediation and Trust
Funds Division
Intermediation
Evaluation
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Trust Funds
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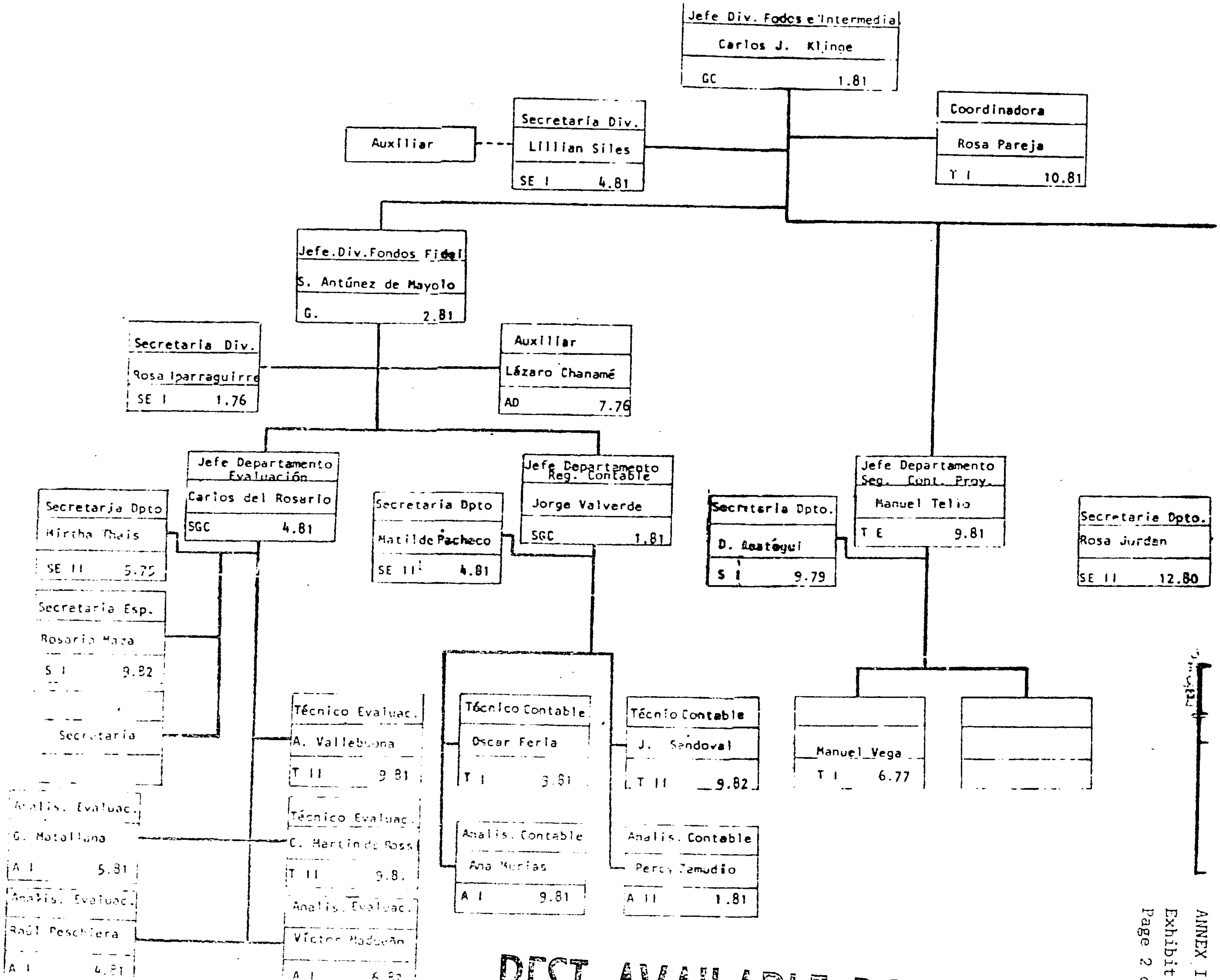
Accounting
Small Industry
Follow up & Control
of Projects



ANNEX II
Exhibit C-1
Page 2 of 2

A. Functions of CONADE:

1. to establish and coordinate the policies related to the promotion, investment, procurement, allocation and mobilization of the financial resources of its enterprises;

2. to orient and coordinate the GOP actions in relation to entrepreneurial investments, by establishing general policies;

3. to grant state guarantees on behalf of enterprises partially or wholly owned by the State. Such guarantees will constitute public debt; and

4. to act as a holding company for the State.

B. Operations and functions of COFIDE:

1. To promote the investment of capitals, savings and credit in the country and abroad.

2. To execute on its own account or by contractual arrangements with third parties, the execution of studies to identify investment opportunities.

3. To obtain financial resources in domestic currency or in foreign exchange on short- medium- and long-term from the following sources:

a. The GOP Monetary Program.

b. Trust funds of the GOP or of any other entity, domestic or foreign.

c. Domestic or foreign credit lines for its own use or for relending through the financial system, on short- medium- and long-term.

d. Issuance of bonds and other financial assets in the country and abroad.

e. The Central Reserve Bank of Peru or from any other financial institution through rediscount operations.

4. To carry out lending programs, provide advances of funds, and discounts of financial assets.

5. To grant surety bonds, endorsements and other guarantees.

6. To buy, keep, administer and sell stocks, bonds and other debentures issued by firms based in Peru.

7. To act as intermediary and/or trustee in the Stock Exchange.

8. To issue letters of credit and accept promissory notes as a result of import-export operations and domestic negotiations of goods.

9. To own machinery, equipment and vehicles to implement leasing operations.

10. To act as Financial Agent of Public Enterprises and of enterprises where the State is the major stock owner, except banks and financial entities, for the negotiation and contracting of credit - from domestic and foreign sources - with repayment periods of over one year.

11. To make deposits in local currency or in foreign exchange in domestic and foreign banks and financial companies.

12. To make direct purchases of goods and services including the contracting of studies and consultants.

13. To form enterprises of any juridical nature, and participate in the paid-in capital.

14. To carry out all types of acts and operations conducive to the attainment of its objectives.

C. Responsibilities of COFIDE's Board of Stockholders:

1. To appoint members of the Board of Directors in coordination with the Minister of Economy, Finance and Commerce.

2. To approve or reject the Financial Statements and other annual reports.

3. To approve or reject the proposals of the Board of Directors in relation to dividends, constitution of reserve funds, and application of profits.

4. To select external auditors.

5. To sell the assets of the company or to provide the legal power for that purpose.

6. To approve the issuance of debentures.

7. To approve increases or decreases of capital.

D. Duties of the Board of Directors:

1. To formulate and approve the general organizational plan of COFIDE S.A. and the functions of each administrative unit.

2. To authorize the contracting of credit, in local currency or foreign exchange; and to provide the necessary guarantees on behalf of public and private enterprises.

3. To approve the granting of credits.

4. To establish policies of management and control for the Corporation's businesses and activities.

5. To appoint the General Manager.

6. To provide legal powers for the representation of COFIDE S.A.

7. To establish branches and other offices in the country and abroad.

8. To convoke Ordinary and Extraordinary Meetings of Stockholders.

E. Functions of the General Manager:

1. To direct and organize the operations and the services of the Corporation in accord with its Statutes and other functional policies approved by the Board of Directors.

2. To control the activities and supervise and inspect the offices, accounts, books and systems of the Corporation.

3. To guard for the compliance of legal obligations of the Corporation, the payment of taxes, the upkeeping of registers and the timely and up-to-date publication of financial reports.

4. To comply with and cause the compliance with the directives and resolutions of the Board of Directors and of the Board of Stockholders.

5. To approve operations on terms fixed by the Board of Directors.

6. To act on behalf of the Corporation before the State Powers, international agencies, foreign governments and institutions, diplomatic missions, Board of Directors of public and private enterprises, and others as agreed by the Board of Directors.

7. To attend to the meetings of the Board of Directors, with voice only.

8. To propose to the Board of Directors the appointment of Division Managers.

9. To contract consultants.

10. To organize committees to review and approve specific operations of the Corporation.

11. To approve the execution of the operational budget of the Corporation, required to meet its functions.

12. To approve and sign contracts for the acquisition of goods and services in accordance with the norms established by the Board of Directors.

13. To exercise other functions assigned by the Statutes or delegated by the Board of Directors.

ANNEX II
Exhibit D

CROSS DEFAULT CLAUSE

(Illustrative)

Events of Default; Acceleration:

It will be an "Event of Default" if:

(a) the Borrower shall have failed to pay when due any interest or installment of Principal required under this Agreement; or

(b) the Borrower shall have failed to comply with any other provision of this Agreement; or

(c) the Borrower shall have failed to pay when due any interest or installment of Principal or other payment required under any other loan, guaranty or other agreement between the Borrower or any of its agencies and A.I.D. or any of its predecessor agencies. If an Event of Default shall have occurred, then A.I.D. may give the Borrower notice that all or any part of the unrepaid Principal will be due and payable sixty (60) days thereafter, and, unless such Event of Default is cured within that time:

(i) such unrepaid Principal and accrued interest hereunder will be due and payable immediately; and

(ii) the amount of any further disbursements made pursuant to then outstanding commitments to third parties or otherwise will become due and payable as soon as made: or

(d) the Borrower is in default under its obligations to other lender(s) with whom A.I.D. has co-financing relationship(s).