PD-AAR-542

TRADE & DEVELOPMENT INTERNATIONAL CORP.

99

Report on Design and Negotiation of a New Private Sector Productive Credit Guarantee Program

(Final Report)

Bruce A. Tippett

002942

00005

S

Prepared for the Office of Private Sector

USAID-Mission Bolivia

November 16, 1984

Contract Number 511-0000-C-00-5001-01

16 EATON SQUARE, NEEDHAM, MA 02192 - TELEPHONE 617-444-4326

PROPOSAL TO BUREAU FOR PRIVATE ENTERPRISE FOR A NEW PRODUCTIVE CREDIT GUARANTEE FACILITY TO THE UNION OF BOLIVIAN BANKS - AN INVESTMENT (GUARANTEE) PROPOSAL

Submitted by
USAID Mission - BOLIVIA
November 16, 1984

TABLE OF CONTENTS

Annexes I.

List of Abbreviations II.

Executive Summary III.

A. Historical Overview 1

1. Description OF Original PCGP 2

B. Analysis of PCGP Program and Portfolio 79-7/84 2

1. General Portfolio 2
2. Target Groups 3
3. Geographic Coverage 3
4. Participation of Lending Institutions-The ICI's 4
5. Barriers to ICI Use of PCGP 5
6. Loan Recuperation Experience 6
7. AID Outstanding Obligations 6
8. The C.B.B. as PCGP Administrator 8
9. General Recommendations for continuing the PCGP 11

C. Rationale for a New PCGP Program 11

1. Major Factors - The Need 11
2. Bankers' Interest in the PCGP - Their motives 12
3. Relation of New PCGP to Mission Objectives 14

D. Structure and Administration of New Program 14

1. Structure and Ownership of the Program Administrator 14
2. Objectives and Functions of the Administrator 15
3. Staffing needs of the Administrator 17
4. External Technical Assistance 18
5. Portfolio Management Strategies, Policies, and Controls 19
6. Criteria for Selection of Intermediary Credit Institutions (ICI's) 19
7. Guarantee Structure and Policies 20
8. Capitalization and Management of the Guarantee Fund 21
9. Projected Financial Requirements and Sources for Program 22
10. Target Sub-borrower Groups and Loan Terms 24
11. Reporting System and Requirements 24
12. AID PRE and Bolivia Mission Relationship and Monitoring Role with New PCGP 26

E. Risk Analysis 28

F. Schedule and Tasks for Approval and Implementation 30

1. AID/PRE Washington 30
2. USAID/Bolivian Mission 31
3. U.B.B./New Administrator 31

ANNEXES

Annex I	-	PCGP Portfolio Information (79-7/84)	1
Annex II	-	Breakdown of Portfolio by Sector (1979-82)	2
Annex III	-	PCGP Program Functions, Participants, and Work Flow	3
Annex IV	-	Portfolio Projections-Notes and Assumptions	4
Annex V	-	Estimated First Year Administrative Operating Budget	9
Annex VI	-	Estimated Operating Expenses and Income Scenarios; Notes and Assumptions	10
Annex VII	-	Bank Compulsory deposit Requirements	18
Annex VIII	-	Information on AGEDESA, U.B.B. and Bolivian Banks	19
Annex IX	-	List of Banks Interviewed	25
Annex X	-	U.B.B. Letter Requesting Program and Translation	26
Annex XI	-	List of Probable Stockholders	28
Annex XII	-	Sample of Field Intermediaries	29
Annex XIII	-	Bolivia Money and Credit - Interest Rate Information	30

LIST OF ABBREVIATIONS

List

ADMINISTRATOR -	Under former PCGP, it was the CBB. Under proposed new PCGP, it will first be the UBB as interim Administrator, which will be replaced during early 1985 by a new specialized entity to be formed by a private banking consortium to administer the guaranty program.
AGEDESA -	Almacenes Generales de Deposito S.A.
CBB -	Central Bank of Bolivia
ICI's -	Intermediary Credit Institutions
PCGP -	Productive Credit Guarantee Program
UBB -	Union of Bolivian Banks

Executive Summary

Recommendations

At the request of USAID/Bolivia, this recommends that PRE take the following actions:

1. Approve a new private sector admininstered PCGP faciility for Bolivia to start in January, 1985.

2. Allocate $2,000,000 in guarantee authority for four years to cover 50% of the contingent liability of the Bolivian administrating entity, to be matched by the Administrator's stockholders (private banks) with a 25% contingent guarantee, provided to eligible private lenders for loans to small productive borrowers. The contingent guarantees will be protected by a locally-funded Guarantee Fund, established and capitalized by the Administrator at the rate of 5% of projected portfolios.

3. Agree with the Union of Bolivian Banks (UBB) for them to act as organizer and interim Administrator of the program. This agreement will transfer to the new independent administering entity to be formed by up to ten private Bolivian banks as stockholders. The Mission proposes to provide financial and technical assistance to the UBB to assist during the start-up phase, and will continue assisting them during the present planning and preparation phase.

4. Negotiate with the UBB in concert with the Mission, during early December, 1984 (the Mission could negotiate on PRE's behalf) to supplant the former PCGP, and meet with both local lender and Mission operating objectives' and schedules.

5. Analyze the additional operational recommendations contained on pages 8 through 11, concurring or offering suggestions.

Findings

We base these recommendations on an evaluation of the former Central Bank administered PCGP, which USAID terminated as of September 30, 1984,and intensive preparation and design work by Mission staff and consultant. We executed the work with key past and proposed local participants, under the guidance of PRE.

- The former PCGP provided experience and clear lessons on how to administer and operate the program (and how not to) which have been incorporated in the design at all levels of the new program.

- The former PCGP demonstrated that:

  1. the credit risk, even during the recent economic crisis, has been low;

  2. the loan volume depends on the Administrator taking an active role in program promotion and development;

  3. the Administrator must have qualified full-time professionals devoted to program financial and operating management and control;

  4. Lender management must be involved and committed to program to achieve significant results; and

  5. the limited size and geographic penetration of Bolivian private banks requires that various lenders participate to achieve meaningful and economic program scale.

- The preparation and design work clearly demonstrated that:

  1. Current economic and political conditions have motivated many private bankers to seriously approach the small productive borrower market. The bankers want the support of a guarantee for this market;

  2. Bolivian private bankers prefer a private guarantee Administrator, owned and operated by a consortium of interested banks (rather than one bank), for the benefit of various accredited banks;

  3. These banks-members of the UBB - have eight years of successful experience as owner-managers of a specialized service company with functions and characteristics similar to a guarantee program Administrator, so they are confident in their capacity to act as Administrators' of this program; and

4. Participating bankers are: devoting top management and technical time to carefully plan a workable program, providing initial capital to form the new Administrator, participating as co-contingent guarantor with AID, as well as providing part of guarantee as lenders.

This proposed project offers and opportunity for the Mission and PRE to collaborate effectively on a private sector program which significantly assists the realization of both AID and Bolivian private sector objectives. In the Mission's opinion it has an excellent potential for success.

A. Historical Overview

1. Description of the Original Project - The Productive Credit Guarantee Program (PCGP)

In July 1978 USAID signed an agreement with the Bolivian government initiating the Productive Credit Guarantee Program. The project's objective was to stimulate private lenders to provide medium and long-term credit, formerly unavailable, to small individual and group borrowers for agricultural, artisan, small business and community group productive purposes, low cost rural housing.

The Central Bank of Bolivia (CBB) was designated as the Administrator of the PCGP program. Under this agreement USAID's exposure was limited to US$, 2,500,000 equivalent to 50% of potential defaults, in accordance with the limits of Section 222A of the Foreign Assistance Act of 1961 as ammended. For this coverage AID received a fee of 1/4 of 1% on the original principal of each eligible loan. The Central Bank of Bolivia took 25% of the remaining exposure. The Administrator then provided a 75% guarantee against default to participating Intermediary Credit Institutions (ICI's) whose own exposure was thus limited to 25% on loans to eligible sub-borrowers.

The AID/CBB 75% exposure was protected by the establishment of a local multi-purpose Guarantee Fund to be managed by the Administrator, which was capitalized by guarantee commissions charged to sub-borrowers on the principal of each loan.

The objective of this fund was to cover 75% of defaults by sub-borrowers, and only upon complete depletion of this fund, would the AID/CBB contingent guarantee be utilized. It was later planned that a successful local guarantee fund sufficiently capitalized, could cover the administrative-operating expenses of the project, in addition to defaults.

Under this project a second fund, the "Technical Assistance Fund", was established and managed by the Administrator to cover costs related to providing pre-investment and implementation assistance to sub-borrowers and technical assistance to the ICI's. This Fund was capitalized by a technical assistance commission charged to sub-borrowers, initially set at 2% of loan principal. Technical assistance was to be provided both by the Administrator and a roster of accredited external technicians and consultants.

With the assistance of AID, the CBB developed and subsequently revised a set of operations manuals and forms for the Administrator, the lenders (ICIs), and technical assistance entities to guide program operations.

Over the years of the project 15 ICI's entered into Guarantee Contracts with the Administrator, received technical assistance to prepare for lending under the program, and made loans to sub-borrowers.

Two sources of funds have been used for sub-borrower loans. The primary source has been the Central Bank rediscount facility, which includes various specialized lines of credit for agricultural and artisan lending, providing 80% to 90% of loan total, depending on the type of loan. The ICI has provided the remainder from its' own resources.

The following section briefly analyzes the development of the PCGP project and portfolio and recommends the changes considered appropriate for the next stage of the project based upon the visiting consultant's experience, consultation with local participants and both USAID/Bolivia staff and AID/PRE in Washington.

B. Analysis of PCGP Program and Portfolio 1979-7/84

1. General Portfolio

From 1979 through July 1984, 2430 loans were made under the PCGP Program with loans averaging US$ 4,595. The PCGP Portfolio has averaged approximately 450 new loans per year, with a high of 822 in 1981, followed by declines over the past three years. The economic crisis seems to be the primary factor halting growth of the program from 1982. By late 1981, the portfolio's outstanding balance reached a high of nearly US$ 4,000,000, figured at official exchange rates. Due to the rapid devaluation of the Bolivian peso, the dollar value of the outstanding portfolio has declined (while the nominal peso value increased) so that by the end of 1983 it stood at US$ 2,091,814 figured at the year end exchange rate, then fell in July of 1984 to US$ 662,629. As of October 1984, the portfolio is estimated to be approximately US$ 1,200,000 due to recent agricultural lending. (See Annex I for Portfolio review).

2. Target Groups

The PCGP envisioned reaching a broad range of target groups including small farmers, small agrobusiness, cattle farmers,

artisans, small business, rural housing (low income), and rural community projects. Annex II shows the breakdown of program activity. Approximately half of total loans went to small farmers, evenly spread over the years of the project. Since 1982 agribusiness has received an increasing share. Artisans received a major share of loans until 1981, and since have received little attention. Both rural housing and cattle farms received only a small percentage of loans early in the program, then practically no loans were made to these groups after 1981 as the crisis grew. Small business as a category appears to have received no attention. Because of the broad definition of artisan activity in Bolivia, many micro-enterprises have been included in that reporting category.

According to the Central Bank, 75% to 80% of program beneficiaries formerly had no access to Bolivian Banks. Prior to the worst stages of the crisis, all target groups were receiving attention by the new program, although the total number of loans under this program has been small, for reasons to be discussed later.

3. Geographic Coverage of Programs

Of the nine provinces, six have received only slight coverage, with less than 40 loans each, over the years of the program. The provinces of La Paz and Santa Cruz, have benefited with 88% of the loans, followed by Cochabamba as a distant third with only 6% of loans.

4. Participation of Lending Institutions - The ICI's

Fifteen different institutions have utilized the PCGP guarantee over the years. They include 13 private commercial banks, a housing bank, and a private industrial finance bank. Most of these financial institutions had little or no previous experience with the small borrower target groups of this program, nor did the commercial banks have much experience with development, and/or medium and long-term loans. Furthermore, the rediscount facilities at the Central Bank from which most PCGP loans were made were first established shortly before the PCGP got underway. Therefore, the banks were largely unprepared to deal with the Central Bank as well, in its new role as a rediscount facility for development loans.

With the new development-oriented rediscount lines and the PCGP, the Central Bank has tried to move the commercial banks toward development lending. As part of this strategy banks have been urged to establish "development departments".

Over the past few years some of the banks formed such departments, and recently most of the other banks have begun to form them also. The level of activity of each bank under the PCGP reflects the extent to which they have developed such departments, coupled with their predisposition to small-borrower lending. USAID/Bolivia is currently providing technical assistance to the development departments of the commercial banks, in order to establish and strengthen them. This assistance should significantly increase the use of Central Bank rediscount lines, many of which are funded by AID for specific development sectors.

The participation of the 15 lenders in the PCGP has been very uneven. One commercial bank, the Bank of Cochabamba, had made over 500 loans by end 1982 (over 25% of total) and continues the leader. Three additional banks have made between 200 and 400 loans, thus four banks have been moderately active. Interestingly, they are all "regional banks" with strong ties to specific interior areas of the country. A second group of four banks, including the housing and industrial development bank, each made approximately 100 loans thru 1982. A third group of seven banks had made less than 40 loans each thru 1982. These included some of the larger La Paz banks. All but one of the lenders are Bolivian banks - the international banks have shown little interest in target groups of this program.

5. Barriers to ICI Use of PCGP

In summary, the PCGP has been used by practically all of the Bolivian Banks, but by only four on a reasonable scale. Reasons for not using the guarantee include perceived Central Bank bureaucracy and delays which are a major disincentive to commercial banks and borrowers, lack of bank interest in and preparation for this type of lending, and since 1982, the general slowdown and chaos accompanying the economic crisis. This crisis has involved spiraling inflation reaching 200, then 300, and now over 1000 percent; Bolivian peso devaluations, accompanied by ever widening differentials between official and black market dollar values, resulting in short term speculation, rather than productive investment (objective of PCGP).

Over the past two years, an increasingly uncomfortable political climate has arisen between the private banking system and the government, due to a combination of inhibiting Central Bank measures, and leftist-inspired strikes and operational delaying tactics at the Central Bank, which have literally closed down operations for weeks

at a time, and delayed operations, fostering a general lack of confidence in the Central Bank. The inhibiting measures have included substantial increases in compulsory bank deposits at the Central Bank; from 40% on demand deposits in 1982, to 60% in 1983, followed by a recent 1984 decree increasing the rate to 100% on certain deposits (as yet not implemented). What is particularly disturbing to private bankers and other experts is that these resources are being used to cover the rapidly increasing government debt, rather than being channelled back to banks and borrowers. The net effect has been significantly reduced liquidity in the private banking system with expectations for further reductions. (See Annex VII - Legal Reserve Requirements for Peso Deposits).

Under these conditions, it is no wonder that the growing interest and participation of private bankers in the PCGP through 1981 sharply declined starting in 1982. Since 1982, only those few banks which already had made the investment in organizing a "development department" and had developed an initial "critical mass" of PCGP clients, continued, albeit less agressively, to utilize the PCGP program.

6. Loan Recuperation Experience

Generally speaking both arrears and default rates have been low under the PCGP covered portfolio, and presently (July/84) are extremely low (1/2% arrears rate). The lowest (1/2 to 7%) arrears rates are among the most active banks with the largest portfolios and better organized development loan departments. The only high arrearages were among a few banks with small PCGP portfolios, receiving little attention, which in 1982 ranged from 11% to 60%. These banks had combined portfolios totalling only 2.5% of the total PCGP portfolio.

Few loan arrearages have become defaults under the PCGP. Only five claims have been paid by the Central Bank on over 2000 loans. The near zero official default rate stems from the following factors:

- in general, small borrowers in Bolivia do pay their obligations;

- the spiraling inflation has made payment easier for medium, and long term loans for borrowers;

- banks have required substantial collateral to cover their 25% exposure under the PCGP, which has spurred repayment

of delinquent loans, and in a limited number of cases, provided the bank with an option for direct collection, rather than going through the process of claims with the Central Bank under the PCGP;

- a limited number of claims to the Central Bank have been rejected because the CBB/PCGP procedures for establishing default were not met by lenders.

As a result, the Central Bank administered Guarantee Fund has had no problem absorbing the low rate of default claims (in spite of poor financial management of that fund).

7. AID Outstanding Obligations

To date, neither the CBB nor AID has had any claims against their contingent guarantee authorities. No claims should arise in the future on loans made while AID's authority was in force through September 1984 with the CBB. The arrears rate as of July/84 on the PCGP portfolio was only approximately 1/2 %, and the total portfolio as of July/84 had a value of only US$ 265,051 at the most recent exchange rate ($b 5000/US$ 1.00), on which AID's obligation cannot exceed 50%, or US$ 132,525.

As of September 30, 1984 the estimated outstanding portfolio had increased to approximately US$ 1,200,000, or a maximum AID exposure of $600,000 at the current exchange rate. USAID/Bolivia is currently requesting the CBB for an exact outstanding portfolio balance as of September 30, 1984, the official date for termination of the CBB administered PCGP. This balance, and AID's exact exposure will be transmitted to AID/Washington (LAC, PRE, and FM) as soon as available.

Prior to making claims on either AID or CBB contingent obligations, the PCGP guarantee fund resources must be utilized. As of July-1984, that fund contained approximately $b 85.000.000 or 6.4% of the value of the outstanding portfolio, a sufficient amount to cover claims at present rates of arrears and default.

8. The CBB as PCGP Administrator

The Central Bank's management of the PCGP has had some positive and many negative aspects. On the positive side, they have helped keep arrears relatively low and defaults at near zero, resulting in few claims on the local guarantee fund under CBB management, and no claims on AID's authority or CBB contingent obligation.

The CBB's Development Department, which manages both the CBB's rediscount lines and the PCGP, has provided some training for commercial banks and sets of procedures for those banks to follow, as well as a central directory and funding for technical and consulting assistance to loan projects. The CBB covered administrative and operating expenses for the PCGP through 1982, theoretically in order for the Guarantee Fund to capitalize. Starting in 1983 administrative expenses have been paid from the PCGP Fund.

On the negative side, the fund has not been held in an interest-generating account. Therefore the fund has not been strengthened as a means of alleviating the effects of inflation.

The CBB has not been aggressive in promoting the PCGP program, seeing its function more in a monitoring role. This partly accounts for the relatively small portfolio generated under the PCGP.

The CBB is often criticized for focusing on procedures and for excessive requirements, and bureaucratic delays, which are roundly disliked by commercial bankers. Over the past few years political considerations have become more evident in CBB operations, and the general climate between the CBB and private banks has deteriorated, negatively affecting the PCGP, and the CBB's capability to effectively administer the program.

One of the most important factors in guarantee programs is the lenders' confidence that claims will be paid, and promptly. Apparently the CBB has found procedural justifications to both delay and reject most of the few claims, undermining the confidence of bankers in the program, thus creating a disincentive for lenders to take on new target groups.

Given the CBB's general monitoring functions of the banking system, it is apparent that private banks are reluctant to provide information to them - particularly if it denotes poor performance, and when the amount and type of information in the private lenders eyes are excessive for the type and small size of loan operations under the PCGP.

In the opinion of most participant lenders and the USAID/Mission staff, the CBB has been overly conservative in its management of the PCGP fund and the loan portfolio, which has resulted in less use of the guarantee program than could be expected. The CBB's lack of aggressive promotion

of the program, coupled with their primary focus on control of rather than incentives to private lenders (aggravated by the deteriorating GOB-private banking sector relationships) have constrained this program. Most programs that have successfully incorporated private lenders into small rural and artisan lending have used multiple incentives and allowed the lenders to operate more freely in a non-bureaucratic, low cost fashion to reach these new client segments. Many facets of the CBB-administered PCGP project have, on the contrary, acted as disincentives to lenders and borrowers.

9. General Recommendations for the Next Stage of the PCGP

a. Move PCGP project administration to the private sector

Based upon general reviews of PCGP performance in various Latin countries, including Bolivia, AID/Washington and the PRE Bureau have concluded that the Central Banks should be replaced by private sector Administrators. USAID/Bolivia staff have reached a similar conclusion with which the visiting consultant fully agreed, regarding the Bolivian PCGP. Meetings held with private lenders during mid-1984 confirmed their preference for a privately-administered guarantee program.

b. Select a private sector Administrator capable of mobilizing and successfully interacting with private sector lenders (ICI's)

Initial discussions with private bankers at the technical and managerial level identified some general options for a private sector Administrator; an insurance company, a single private bank, or a banking association. During further discussions, including individual meetings with bank owners and top management, these and other options were evaluated, with the following conclusions:

- An Insurance Co. - At present no insurance companies offer "credit default insurance", only insurance for natural disasters, nor do they offer other incentives needed for expansion of the PCGP, as decribed below. This option was discarded.

- A single Private Bank - Bankers generally were against the idea of one bank's administering the program. Particularly important, the most active banks under the former program were against this option. They

- unanimously agreed that a consortium of banks would generate the unity, confidence, and administrative capacity required for the Administrator of the PCGP program. Furthermore, because the Bolivian banks are small, with limited national coverage, a number of intermediary lenders are necessary to achieve a significant volume of loans under the program. Therefore, a single bank as both Administrator and lender would not fit Bolivian realities, nor complement mission objectives and initiatives.

- Bankers Association - The Association of Banks which includes all foreign and national banks was ruled out as administratively incapable of handling the PCGP, and functionally focused exclusively on "lobby" and representational functions. A second association, the Union of Bolivian Banks (UBB), which includes only Bolivian banks, was recommended by all participant banks as more qualified both administratively and technically to act as the official organizer of a specialized independent agency to administer the PCGP, and as an interim Administrator until such a new agency was established.

- An independent specialized Administrator owned by a Consortium of interested banks - This option was selected and agreed upon by bankers, the UBB, the USAID mission, and the visiting consultant, as the most acceptable and viable option to supply the range of necessary inputs and meet program goals. The details of the structure and operation of this independent specialized Administrator are outlined in Section D.

c. Expand the functions of the Guarantee Administrator to assist lenders in the development of larger, economically viable portfolios

Evaluation of the former PCGP program indicated the need for aggressive promotion of available credit lines and technical assistance among target client groups, field organizations that serve and deal with such client groups, and operating personnel at lenders (ICI's). Other successful guarantee schemes have taken an active role with these functions until lender portfolios and experience have reached "critical mass" and grow automatically.

d. Redesign the Guarantee Program operating mechanisms and reporting procedures in functional non-bureaucratic terms which stress ICI responsibility and employ dynamic (rather than passive) portfolio management and supervision methods

The guarantee Administrator should establish annual total program portfolios with each acredited ICI, and the form and timing of reporting which fits with the ICI's operating mode. ICI's should have the freedom to approve and disperse portfolio loans, to make claims and receive payments on guarantees, and generally operate portfolios according to pre-established plans and criteria, without case by case, or less than annual, external approvals by the guarantee Administrator or AID.

Portfolio risk management by the Administrator should first be based upon annual plans and annual post-audits of each ICI, supplemented by constant interaction of the guarantee Administrator's field staff with ICI's operating staff (focused primarily upon portfolio development, but also on-going field monitoring). This system should also include the Administrator's option to cut off new loan activity by any ICI at any time, if the Administrator considers that program criteria are being grossly misused, or if default claims exceed an established limit.

Portfolio risk management should first involve limiting the total portfolio of each participating ICI, and increasing (or decreasing or eliminating) each portfolio annually based upon performance. Second, both risk management and leverage should be accomplished by setting a percentage of overall exposure on the ICIs' portfolios. For example, starting with coverage of up to 50% of the total portfolio, reduce coverage to 20% as lenders gain confidence. Under this system, individual portfolio loans carry, for example, a 75% guarantee against default, but up to maximum portfolio wide exposure of 50% or 20%. This results in a growth of leverage from 2 to 1, to 5 to 1 in this case with total maximum exposure declining from 50% to 20% of total outstanding portfolio balances.

e. Utilize an expanded private PCGP program as a key component to catalyze and/or support USAID/Bolivia overall program thrust to stimulate private sector lending to target small productive enterprises

Private banking sector management of the PCGP provides a unique opportunity to lodge full committment and responsibility for both Mission and AID/Washington goals under this PCGP program directly with the owners and executives of ICIs, who in the final analysis, are the key actors governing success or failure of not only the PCGP, but a total of nine mission programs, including five rediscount credit lines, technical assistance programs, and several Title III funded bank managed fidecomisos and the Chapare coca control project. Using a consortium of private bankers as the owner-Administrators of the PCGP not only creates a healthy set of checks and balances for the PCGP program, proved effective and successful in other countries, but it also provides AID with a direct, effective, and on-going avenue of dialogue with the collective private banking leadership, that should impact all related AID initiatives.

Finally, the PCGP, under banker consortium administration, with a broader package of functions (i.e. 9c x d) as incentives, should dramatically impact the ICI's willingness and capability to loan to small borrowers, thus achieving both Mission and AID/Washington basic goals.

C. Rationale for a New PCGP Program

1. Major Factors - The Need

Various important factors have combined to convince private lenders, the Mission, and the visiting consultant that a new PCGP should be implemented in Bolivia; in spite of the present economic crisis and the weaknesses of the previous PCGP.

The unmet demand for credit by small productive borrowers continues to be high in today's inflationary economy and is increasing due to the lack of import options. This is occuring at a time when liquidity in the banking system has been severely reduced. Present economic and political factors confronting the private banking system have now created strong incentives (described below) for them to undertake lending to small productive enterprises, which requires investment in small loan departments, relaxation of traditional collateral requirements, and liquidity.

The legacy of the past PCGP program enters squarely into this present-day context. Both previously active and some relatively inactive lenders now want to aggressively lend to these target groups. Enough experience (positive and negative) has been amassed by them from the past PCGP, so that private bankers consider themselves at least partly prepared to lend to these new target groups, but they unanimously want the support of the guarantee and related assistance to develop these still-new markets. Furthermore, the generally negative experience with the Central Bank as PCGP Administrator has convinced them to jointly undertake responsibility themselves for administration of the guarantee program, and to redesign it to facilitate expanded operations.

Given the limited financial capacity, coverage (geographic and borrower type), and specialization of Bolivian banks, in relation to demand, they share AID's opinion that various active ICI's will be necessary to utilize a significant portion of available rediscount and new resources, and achieve the overall objective of the PCGP, and related Mission programs.

2. Bankers' Interest in the PCGP - Their Motives

Given the present negative economic climate, why are private bankers now seriously interested in continuing and expanding the PCGP program in the midst of the present crisis. The bankers have the following compelling reasons:

- Liquidity - Due to greatly reduced liquidity, bankers now see the CBB rediscount lines as one of the few sources of funds available. Very recent normalization of CBB operations, under strong pressure from many groups using their leverage, including the AID Mission, have increased expectations that the rediscount line flows will grow, providing approximately US$ 20 million of underutilized funds for lending to PCGP target groups. In addition, the USAID Mission is presently negotiating direct loans to various private lenders to cover a percentage of new portfolios for specialized lending, part of which is targeted to PCGP borrowers. Finally, bankers are convinced that they must now aggressively mobilize small client savings to increase their own liquidity, because larger savers have increasingly turned to offshore or unofficial dollar savings.

- Urgent motive (political, social and economic) to stimulate local production of basic food and consumer

products - Lack of foreign exchange, plus the high costs of imported inputs, have severely restricted imports of basic food, clothing, and consumer products, as well as sophisticated local production based on imports, resulting in severe shortages felt by everyone. As a result, bankers (and the general public) see an urgent need to support local production to fill this demand. But few large public or private projects are being initiated and demand for large loans is down. That leaves the majority of Bolivian producers, which are small farms and small enterprises.

In sum, an immediate social-economic motive for small productive loans has emerged at a time when private bankers are under political pressure from leftist elements in Bolivia, and in a position with the PCGP and some liquidity to make a contribution to solving the crisis, while creating badly needed positive public relations. New linkages with small borrowers and intermediary organizations (Co-ops, etc.) will improve relations with the Left and the general public.

- Strong interest in moving away from Central Bank controls - Private bankers want to become as independent as possible of Central Bank controls, due to the political climate, bureaucracy and delays (particularly harmful and costly for working with small borrowers). They have a strong emerging interest in finding agile private sector instruments and solutions in which they have confidence. The intention of moving the PCGP program to the private sector is seen by them as an important step in that direction; which when successfully implemented, will lead to other private programs supporting bank activities (i.e. generally applicable insurance schemes, direct international credit lines, etc.).

- USAID/Mission support perceived as serious - Private bankers are reacting favorably and seriously to the Ambassador's and USAID Mission's aggressive program of promoting direct private-sector action in various development sectors. They see this as a real shift in traditional AID policy of working mainly through government, and one which is coming at a critical time in Bolivia for the private sector, with strong economic survival and political implications. AID's program of technical assistance to the development departments of private banks, its attempt to leverage existing AID-funded rediscount lines already in the central bank, new direct fidecomiso credit lines under negotiations

with private banks, and plans for a privately-run agile PCGP guarantee system supported by AID, have created a strong package of incentives for banks to aggressively develop small productive loan portfolios on a meaningful and economic scale.

Given the initial favorable experience with the PCGP through 1981, and the strong present incentives described above, the key private banking leadership, both individually and collectively, have strongly recommended continuing the PCGP, administered by them in the private sector.

3. Relation of New PCGP to Mission Objectives

A new PCGP, administered by the private banking sector, will promote and support important global and specific mission objectives and program. The mission is making every effort to help the overall private sector survive and continue in the midst of the governmental chaos that affects Bolivia. A vital part of this effort is to support the private banking system in order that critically-necessary resources reach the productive sector - including the small-scale producers-generating production and employment, which will help stabilize the country.

The new PCGP will play an important catalyst role in moving existing underutilized AID-financed rediscount lines to target groups and support new credit facilities under negotiation with the private banking sector. By working with private banking leadership in a consortium, as the new PCGP Administrator, AID will not only effectively capitalize on the experience gained under the previous PCGP, but create an important working relationship and model which will directly impact on other mission programs with the banking sector.

D. Structure and Administration of New Program

1. Structure and Ownership of the Program Administrator

The program Administrator will be owned and operated by a consortium of 7 to 10 interested Bolivian banks. This consortium will form an independent, specialized for-profit Administrator, with each bank holding equal share capital in the Administrator.

All of the banks to become stockholders are members of the Union of Bolivian Banks (UBB), a non-profit bank membership organization, which has chaired the preliminary negotiations regarding this program. In order to proceed immediately with

the program, the UBB - which has the legal capabilities necessary for program administration-will act as interim Administrator, and coordinate the formation of the new specialized Administrator. Agreements signed between UBB and AID/Washington, and the Bolivia Mission will be so structured that they are transfered automatically to the new Administrator as soon as it is legally constituted and able to carry out the specific functions of the agreements. Legal constitution and necessary authorizations are estimated to take from 90 to 180 days.

In 1976, the UBB assisted its bank members to create a similar for-profit specialized agency called AGEDESA, which provides a range of warehousing services countrywide and issues warrents and certifications to the banking system as collateral for various financing operations. This successful experience has convinced the bankers that a for-profit specialized Administrator, owned by them and well-managed, is the best alternative for managing the guarantee program. They concluded that even though the UBB has extensive experience in sindicating bank loans, providing general training to banks, and in representational functions, it is nevertheless a non-profit multi-purpose association; and therefore not well suited to the specialized and aggressive tasks required for a successful PCGP, yet capable of playing the "bridge role" described above.

Under the proposed structure of the new Administrator, the bank stockholders will elect a board of directors, composed of bank executives, to set policy and supervise the administration. In order to provide needed continuity at the board level, the majority of directors will remain at least three years on the board. They have also proposed that a small, well qualified professional management and operations team be recruited and trained for permanent service to this Administrator, rather than rotating bank personnel in and out of this Administrator.

2. Objectives and Functions of the Administrator

The overall objective of the Administrator will be to profitably promote and support (through guarantees, etc.) credit and technical assistance services to small productive individual and group borrowers, including agricultural, artisan, and small business activities throughout rural and urban Bolivia. To accomplish this objective the Administrator will provide the following specific and inter-related functions or services, in order to achieve the

critical mass of clients needed to make the program both economically viable for lenders and Administrator, as well as have the broad development impact desired.

a. Planning and Provision of Guarantee for Program Portfolio - A guarantee will be provided to the ICI's covering 75% to 100% of loans within their PCGP portfolio. The amount of the guarantee on individual ICI loans is under study by the organizing commission. It may vary according to loan size. The maximum size of the portfolio will be determined annually for each bank, based on performance, and the guarantee will cover individual defaults up to a certain percentage of the overall portfolio (i.e. 20%-50%). Under this system, the guarantor can leverage portfolios to increasing size, based upon demand and performance, while limiting and controling risk.

b. Promotion and Facilitation - The Administrator will actively promote the credit lines of participating banks during the early years of the new PCGP, in order to help them build the critical mass of target clients required for economic viability. The entity's trained field staff will mobilize and orient local non-political field institutions with access to potential clients (and interest in their development) so that these field intermediaries pre-screen, orient, and channel clients to participating lenders. Field intermediaries include PVO's, certain companies, technical assistance and development organizations, local committees, religious organizations, and Co-ops. (See Annex XII).

c. Technical Assistance to Borrowers - The Administrator entity will establish a roster of qualified people to provide technical assistance to borrowers for preparation of loan applications and followup technical assistance. This roster will be available through bank and field intermediaries. To the greatest extent possible, field intermediaries will be trained to provide basic assistance in preparing loan applications, and techniques for loan supervision. Approximately 25% of the administrative costs budgeted are for sub-contracted key technical and training services, managed by the Administrator to supplement sub-borrower contracting of direct TA services.

d. Orientation and Monitoring of ICI Credit Operations The Administrator entity will interact constantly with lenders at executive and operating levels during the early years of the program. With the exception of

initial formal training, orientation and monitoring will be done on-the-job at lender, field intermediary and client offices. The objective of the Administrators field team will be get credit officers into close working contact with field intermediaries and client groups to build business relationships, and simultaneously to monitor loan activity, performance, and a well-designed follow-up system for loan arrearage, defaults, and loss recuperations.

e. Administration of the Guarantee Fund and Other Administrator Resources - A primary function and concern of the new Administrator will be to effectively manage and protect its financial resources to maintain (and where possible increase) real value, in the highly inflationary Bolivian economy. The banker members of the Administrators' board are well equipped to understand and operate the mechanisms necessary in the local context to achieve this goal. Income, primarily from guarantee commissions, will be divided into two major accounts - operating expenses, and the Guarantee Fund (for essential coverage of defaults) - and will be held in the best alternative instruments to protect value and earn interest. A second administrative function will be the timely payment of default claims, and standard followup procedures to generate recuperations on claims paid out.

3. Staffing Needs of the Administrator

Based upon the functions described above and estimates of portfolio scenarios for the first four years, the following staffing requirements have been indentified and agreed upon.

- General Manager: A dynamic individual capable of working with the Administrator board, bank executives and managers, who knows the market (small borrowers and field intermediaries) and financial and field management. During the organizational period, it has been suggested that the assistant manager of the AGEDESA organization, who fills this description, could occupy this position.

- Accountant and Financial Manager: To handle day-to-day financial transactions including constant flow of commissions to income generating accounts, claims payments, financial statements, payroll, etc.

- Information Officer: To systematically collect and monitor operating information from the ICI's, field intermediaries, and field staff; to prepare operating reports, and communicate needed actions to other staff.

- Head Office Secretary: For secretarial services.

- Field Representatives: Three representatives located in La Paz, Santa Cruz, and Cochabamba will have operational responsibility for area provinces. These representatives will identify and train intermediary organizations, identify client groups, channel technical assistance sources, and train bank credit officers as part of their promotional and linking functions. In addition, they will monitor ICI portfolios and follow-up systems for arrears and defaults. The field representatives outside La Paz will use AGEDESA and bank branch facilities for office and administrative support in Santa Cruz, Cochabamba and other provinces of the country.

- As a result of the major promotional and orientation efforts planned for the first few years in order to build a critical mass of ICI clients and train ICI's, it is projected that no additional Administrator field staff will be necessary as the portfolios grow, because ICI personnel will assume the field representatives promotional functions.

4. External Technical Assistance

The UBB and stockholders have requested external short-term technical assistance during the period of Administrator formation and operation. This technical assistance should focus on the following key areas during the first quarter of 1985:

- Orientation of the Stockholders and Board, including policy and procedural experience from other countries;

- Final definition of program mechanisms and portfolio management methods;

- Orientation of General Manager (on-the job);

- Design of functional monitoring, claims, and reporting procedures;

- Planning of field representative functions;

- Training of field representatives; and

An annual external audit is recommended by a team composed of an auditor and consultant, specialized in small productive loan programs.

5. Portfolio Management Strategies, Policies, and Controls

The Board and general management will be responsable for portfolio management policies. The general strategy, which contrasts sharply with the Central Bank's approach, includes both careful selection of intermediary lenders, according to standard criteria (described below), and intensive work with them on the planning, development, and supervision - monitoring of annual portfolios. Then portfolio allocations will be made according to performance, which will be pegged to a combination of the number and volume of loans, the recuperation rate on loans, and their progress in-house with portfolio development and management. This strategy focuses aggressively on a balanced combination of growth and quality portfolios.

By setting annual portfolio levels based upon performance, a strong incentive exists to comply and grow, and a system is in place to reduce or eliminate ICI portfolios which are of poor quality or too small to be economically viable. This system puts the Administrator in a strong and active, rather than passive position, to manage risk while promoting growth.

6. Criteria for Selection of Intermediary Credit Institutions

Because the Administrator will provide a series of services to the ICI's, it will be able to set and enforce initial selection criteria, and more importantly, the criteria for continuing to use program services, as described above. Initial selection criteria will include:

a. A commitment according to annual plans to lend an established minimum to maximum number and volume of loans to target groups;

b. Designation of a minimal team (department) responsible for Program promotion, loans, and portfolio management;

c. Acceptance of on-the-job training for designated personnel, and on-going working relationship with program field representatives;

d. Agreement, under contract, with program operating, monitoring, and reporting procedures, including guarantee levels, guarantee commissions, and followup procedures for arrears and default cases; and

e. Agreement that new loans will be suspended if program criteria and portfolio quality are not met.

The selection criteria will allow the Administrator to work only with those lenders which are ready to make and continue a serious committment and the necessary investment for building viable portfolios. The fact that bank executives, on the board of the Administrator, set these initial selection criteria, and subsequent performance criteria, is expected to favorably influence lender performance.

7. Guarantee Structure and Policies

a. Contingent Guarantees: It is proposed that AID/PRE provide US$ 2,000,000 of contingent guarantees under contract for four years with the UBB - to be transferred to the newly-formed Administrator-to cover 50% of contingent liabilities under this new program. The remaining 25-50% of the contingent liability up to US$ 2,000,000 will be assumed as follows:

The UBB, replaced by the new Administrator, will assume 25% with the backing of its stockholders in equal proportion to their stock. The 25% assumed by the new Administrator, may increase if they decide to provide guarantees to ICI's in excess, on the average, of 75%. The level of the guarantee to ICI's is presently being analyzed.

b. First Level Guarantees: The UBB, replaced by the new Administrator, will provide guarantees averaging 75% of losses including principal and interest (or higher, if they so decide) on individual eligible loans of each ICI portfolio. This guarantee will cover 75%, or the agreed amount, of losses on individual loans, but up to a maximum percentage of each ICI's overall portfolio. The UBB is considering an initial portfolio wide exposure of 50%, reduced to 20%, as soon as experience and ICI confidence permit.

The remaining first level guarantee coverage of 25% (or less, if decided by Administrator for certain loan segments) will be directly absorbed by the ICI's on each individual portfolio loan. In addition, each ICI will

absorb an aggregate exposure on their total portfolio in the amount set by the Administrator, which in the case described in the paragraph above would start at 50% and increase to 80% of their portfolio.

Recuperations on defaulted loans, where the Administrator had paid claims to the ICI, will be shared between ICI and Administrator, in accordance with the proportion of loss covered by lender and Administrator.

c. Sharing of Contingent Liabilities: In the event that the Administrators' Guarantee Fund reserve is completely depleted, then AID and the Administrator will share the contingent obligations on a 2 to 1 basis (if 75% guarantee or on one-to-one basis if 100% guarantee) up to the maximum exposure allowed, under the Administrators contract with ICI, i.e. 50% or 20% of their portfolios.

d. Leveraging of Contingent and First Level Guarantees: Under the system described above, whereby 50% or 20% of ICI portfolios are the maximum level of Administrator exposure, the contingent Guarantee amount (ex. US$ 3,000,000 total) can be leveraged 2 to 1 initially, then 5 to 1 at 20%, in the relation total portfolio to contingent guarantee. This is accomplished without exceeding a 1 to 1 ratio between contingent guarantee and legal obligation or exposure, which stays within AID authority limitations.

8. Capitalization and Management of the Guarantee Fund

The Administrator's guarantee will be backed by a Guarantee Fund, established and managed by the Administrator. It will initially be capitalized at the rate of 5% of the projected total first year portfolio. Initial capitalization will be in the form of obligations, subject to immediate draw down, provided by the stockholders in equal proportions.

The Guarantee Fund will be continually fed by the deposit of a minimum of one-half (averaging 5%) of all guarantee commissions received by the Administrator. The Guarantee Fund will be maintained in the highest-earning instruments available for value protection and growth. The percentage of guarantee commissions allocated to the Guarantee Fund will be adjusted annually according to prudent reserve requirement levels based on arrears and default, established by the Administrators board in consultation with AID.

Payments of default claims will be deducted from the Guarantee Fund, and subsequent recuperations will be returned to the Fund. Because of the importance of maintaining the value of the Fund under present inflationary conditions, part or all of the Fund may be maintained in instruments that are not immediately negotiable, therefore default payments will be made from either a mini-reserve, or short-term credit-lines established with stockholders' banks.

9. Projected Financial Requirements and Sources for Program

Two major categories of resources are required: (a) lending funds for the ICI's; and (b) operating resources for the Administrator.

a. Sources of ICI Lending Funds

As previously stated relevant CBB rediscount lines presently contain over US$ 20 million in resources which can be drawn by participating ICI's, and supplemented with 10% to 20% of ICI resources. The CBB is presently also studying the possibility of private banks using a percentage of high compulsory deposit requirements for development lending of this type. USAID/Bolivia is currently negotiating Fidecomiso credit lines with private banks for similar target client groups. These options are in addition to present and new bank resources which may flow to a dynamic privately-run program.

Our conclusion is that sufficient lending resources can be leveraged to develop a total portfolio equivalent to US$ 20 to US$ 35 million over four years, with average portfolio balances equivalent to US$ 12 to US$ 20 million by the fourth year. Refer to Annex IV (Portfolio Projections Notes and Assumptions) for details.

b. Operating Resources for the Administrator

The Administrator primarily requires resources to cover: (1) personnel and administrative costs, and (2) portfolio costs which include fees paid to contingent guarantors (AID and Administrator stockholders) and default claims from ICI portfolios. Small investments in fixed assets and external technical assistance are also programmed for the first year of operation. Personnel, administrative costs, fixed assets, and external T.A. are projected at about US$ 100,000 per year, while portfolio costs are variable in relation to portfolio size and default rate.

Therefore, the operating costs fall dramatically as a percentage of total costs as the portfolio grows. Annexes V and VI contain detailed projections of operating and portfolio costs under conservative, moderate, and optimistic conditions, expressed in dollars at the official exchange rate. Default rates are calculated at the high rate of 5% on annual portfolio, in spite of near zero past default rates, to cover unexpected occurrences under the new program. The high default calculation also covers potential impacts of inflation on dafault claims including high nominal interest rates, and unexpected erosion in income from guarantee commissions. These projections are being refined by the UBB commission preparing the program.

Under the most conservative projection (See Annex VI) the Administrator would incur a deficit of US$ 27,500 during the first year of operations, followed by increasing annual surpluses, using an average guarantee commission of 10% (the same as presently used under the old PCGP). Therefore, it is recommended that the program use an average commission of 10% to start, which should cover contingencies and capitalize the Guarantee Fund, then reduce (or if necessary increase) the commission based upon experience with cost and income factors. The commission amount will vary according to key risk factors, such as duration of loan.

c. Sources of Operating Funds

In addition to the projected income flow from commissions, which occurs when loans are disbursed, the UBB planning commission, USAID/Bolivia, and the visiting consultant developed the following strategy to assume coverage of organizational and first semester start up expenses (including initial capitalization of the Guarantee Fund at US$ 50,000) which total an estimated US$ 120,000. Stockholders will put up the equivalent of US$ 70,000 in cash and drawdown obligations, and USAID/Bolivia will grant US$ 50,000 to UBB (a non-profit organization) for project-related expenses, including purchase of fixed assets (equipment, second-hand vechicles), external technical assistance, and training.

Stockholders will continue to be responsable for covering operating expenses after the first semester, although projections indicate that operating income will cover them from that point on.

10. Target Sub-Borrower Groups and Loan Terms

The target borrowers of the new PCGP program include those under the former program as described in section A and B, but also will include micro and small business individual or group activities, urban or rural, that involve production or services as part of the business. Similar credit access, asset and owner-operator eligibility requirements will be used. Adjustments of the eligibility requirements and loan ceilings and terms by loan type are under study by the organizing commission.

The maximum loan size under the program will be the equivalent of US$ 35,000 at official exchange rates (now equivalent to US$ 12,000 at parrallel market rates). Loan terms may range from short-term for working capital, to medium and long term for fixed asset and working capital financing. Interest rates will be the maximum allowed by the Central Bank, which controls both rediscount rates, and private bank resources lending rates. (See Annex XIII p. 29 for further discussion of Bolivian interest rate policy and private lender method to minimize impact of negative interest rates policies of Central Bank).

Collateral requirements are presently under study by the UBB organizing commission and USAID/Bolivia, with preliminary agreement that no land and buildings will be required as collateral, that small loans (under US$ 5,000 equivalent) will require only personal signature and co-signers. For larger loans, co-signers, and when readily available, receivables plus equipment (tractors, machines) purchased with loan, will be allowed as collateral.

Normal client status at banks for new borrowers is expected to take three years of multiple short-term loans, or the duration of a longer term loan, before graduation from the program guarantee.

11. Reporting System and Requirements

Under this project, the reporting system will include three levels: Sub-borrower to ICI, ICI to Administrator, and Administrator to USAID/Bolivia and AID/Washington.

The general approach recommended, based upon experience with small borrowers and commercial banks, is to (a) limit reporting requirements generally to realistic levels and periods, (b) tailor the reporting system to the extent possible to the normal procedures of participating

institutions, and (c) where additional reporting/evaluation is necessary for AID requirements, to have the Administrator prepare special reports using its staff capability, financed with its own resources, or AID assistance (e.g. cost deducted from fees paid to AID for contingent guarantee). Reporting requirements perceived as unncessary, burdensome, and costly by borrowers and lenders will create a negative incentive and stunt program growth.

a. Sub-borrowers' reporting to ICI: Sub-borrowers will provide an initial personal, company, and project profile in loan applications, documented to the extent that the borrower is capable of providing. This will contain information necessary to establish eligibility under program. Sub-borrowers will be urged to maintain periodic informal contact with ICI credit officers, and to report any situation which requires late payment, informal or formal loan rescheduling, or impending default. ICI's will be required to make periodic contacts with sub-borrowers, scheduled as considered necessary, or when arrears have reached over 60 days and borrowers have not contacted ICI's. Simple visit reports will be maintained by the ICI's, as well as records of loan terms, dispersements and payments, to which the Administrator will have constant access. No sub-borrower written progress reports will be required during the term of a loan except as normally required by ICI's. Updated profiles will be required with applications for new loans. Any special reports on borrower progress will be undertaken directly by the Administrator.

b. ICI Reporting to Administrator: ICI's will be required to submit the following annual plans and reports:

- A report identifying the number and volume of new loans under the program portfolio, the outstanding balance of accumulated portfolio, arrearage rates by age, defaulted loan payments received, default recuperations, and commissions plus recuperations paid to Administrator.

- An annual estimate of new loan volume under the program, for Administrator approval.

- The ICI's annual report containing general financial statements.

The Administrators' field team will monitor each ICI on a monthly basis, informally gathering sufficient portfolio information necessary for administrator management information and operation decisions, including on-going orientation to ICI managers and credit officials.

Under this system no formal monthly or quarterly reports will be required of the ICI's. Claims for payment under the guarantee will be made periodically, as they occur, and in accordance with the Administrator's established procedures.

c. Administrator Reporting to USAID Mission and AID/Washington: The Administrator will submit annual reports to the USAID Mission and AID/Washington including the following information:

- Statistical consolidation of ICI reports described in 11.b (new and accumulated portfolio, arrearage and defaults, etc).

- Approved annual portfolios for each ICI with observations on portfolio management and development of each ICI.

- The Administrator's annual descriptive report with complete financial statements, including income and expenses (with default payments), and Guarantee Fund movement and balances.

- A demonstration of AID and Administrator's outstanding contingent liabilities under the guarantee.

- Other reports or evaluations, specifically requested by USAID mission or PRE including external audit and specialized consultants report.

- Annual payment of fee on Guarantee (1/4% on total new loans) to AID account. (Rather than quarterly as under former PCGP program).

The annual reporting cycle will be supplemented by informal quarterly presentations, made by Administrator to the USAID/Bolivia which in turn will prepare short quarterly progress reports for Mission and PRE staff.

12. AID/PRE and Bolivia Mission Relationship and Monitoring Roles with the New PCGP

Given the joint interest and objectives of the Mission and PRE related to this project, it is recommended that each play complementary and mutually supporting roles in this project.

AID/PRE - PRE as Administrator of the PCGP authority is requested to provide a US$ 2,000,000 Guarantee for four years, under an agreement with the UBB, transferable to the new Administrator.

USAID/Bolivia - The Mission is considering providing a grant (or local currency long-term loan) of approximately US$ 50,000 equivalent to the UBB for identified project organizational and first year expenses, including minimal fixed assets, external technical assistance, and training/orientation expenses, not to exceed 50% of budgeted first year expenses.

Project Preparation and Negotiation - It is recommended that the Mission, with PRE guidance, take the necessary steps with the UBB organizing commission to finalize preparation of this project, including refinement of the operating procedures and organizational steps. It is further recommended that PRE and the Mission jointly carry out the final negotiation with UBB and identified stockholders of the Administrator during December 1984, resulting in signed agreements by both PRE and the mission with the UBB for their respective inputs, and project initiation in January 1985.

Project Monitoring - It is recommended that the Mission take primary responsability for monitoring the Administrator and program, through designation of a project officer who should maintain monthly contact with the program, prepare quarterly progress reports, and channel annual (as well as quarterly) reports to PRE. In cases where major substantive changes in program content affecting PRE risk are under consideration, PRE will be consulted by the Mission prior to making recommendations, or when required, issuing approvals to the program Administrator.

This important program will be an excellent demonstration and model of PRE and Mission cooperation, each providing its unique capabilities, to achieve the overall objective of successfully promoting direct private sector participation in the development of AID target groups.

E. Risk Analysis

AID's risk under this program is divided into two parts: the credit risk and the likelihood of successful implementation of the program.

1. The Credit Risk

This program is not new. It follows from six years of experience gained under the former PCGP, years equally divided among normal and crisis economic conditions. During both those economic periods, and under weak, passive management by the Central Bank, the program incurred negligible losses, and moderate to low loan arrearage performance. The proposed new program will reach essentially same target clients, using the most capable ICI's for credit delivery, under an aggressive private Administrator, governed by bankers whose survival depends upon effective financial and risk management in an economic crisis period.

The new Administrator of the program - a for-profit Administrator owned by participating banks - will be modelled after and organized by the owners and present management of AGEDESA, the eight year old warehousing and warrent issuing Administrator, that has successfully served the banking system, farmers, and manufactures nationwide. With a small, well managed staff AGEDESA has effectively executed its mission and generated net profits every year, except its first, that average 37% per annum on capital through September 1984. See Annex VIII for details.

The capabilities and sound management practices applied through AGEDESA will be the yardstick for owners of the new Administrator. They include past experience with issuing warrents and certifications, aggressively selling services nationwide to farms and manufacturers, liasion and day-to-day transactions with all private banks; assisting with Central bank rediscounting; subcontracting warehousing facilities all over the country; and arranging and monitoring transport, storage, quality, aging, and sale of a diverse range of agricultural products and manufactured goods through well trained representatives in each province of Bolivia.

In addition to the experience AGEDESA brings to the new Administrator, the planned portfolio management and risk control policies, coupled with banker ownership of Administrator, substantially limit credit risk. These

policies include exclusion of poorly performing ICI credit portfolios, combined with minimum size portfolio requirements supported by adequate small loan departments - which proved successful in the former PCGP program-and the fact that banker-owners of the Administrator are responsible for absorbing losses both through their ICI and as contingent guarantors. Finally, program financial performance is planned around a default rate projection of 5% - set intentionally high - and a Guarantee Fund with sufficient resources to absorb that default projection.

The general economic crisis has weakened banks and resulted in spiraling inflation. This program has been designed to help assist the economic recovery, and to contend with the inflationary factors that impact on loans, repayment, and defaults (i e. a high commission to offset payment of both principal and high nominal interest on defaults).

Under very bad circumstances, some bank failures might occur but should not cripple the program, due to multiple lenders and the probability that the survivors would buy up portfolios. Under the worst circumstances, the private banks could be nationalized, which would immediately result in program suspension by the Administrator and AID, including covering past obligations assumed by government.

In spite of the general economic and political crisis in Bolivia the key risk factors described above are not excessive, and are the subject of thorough program planning.

2. Likelihood of Successful Program Implementation

The probability of successful implemenation depends upon the strength of key private bankers' committment to lend to target clients, effectively manage the Guarantee Administrator, access rediscount and other external resources for lending, and fill unmet credit demand in the current economic-political environment.

The current strong interest of most private bankers is based upon vital economic and political motives and incentives, explained in Section C.2, and substantial decline in traditional client business (large private and government borrowers), not expected to recuperate for years. Therefore, the prognosis - thus far substantiated in preparatory phases - for committment to be translated into effective action as lenders and guarantee Administrators, is very promising. Given the strong committment of

the USAID Mission and its leverage, coupled with the ICI's real need for rediscount and external resources, the problem of availability of lending resources is minimized, yet may be partly constrained by the agility of the Central Bank.

Under the increasing pressure for local production, demand for local currency loans by small borrowers is expected to grow rather than decline. Their capability to repay loans taken at controlled negative real interest rates will be strong, as long as inflation continues, and under current government policies.

A key factor in transforming potential demand into actual loan volume is whether the banks and borrowers will get together and bridge the gap. Some lenders under the former PCGP have partly learned how to do this. The program design invests heavily - with bankers unanimous support - in a system to bridge the gap between banks and potential borrowers.

The Bolivian banks, the former PCGP, and small enterprise have continued to function and survive through three years of economic and political crisis. It is realistic to expect that they will continue to survive through the next stages of this crisis. AID's support will make a substantial contribution to that effort.

Given the risks described above, and based upon past experience, the recent preparations, and future expectations - in spite of the current Bolivian climate - the Mission and visiting consultant firmly believe that the important program goals, and probability for substantial success far outweigh the limited risks inherent in this program.

F. Schedule and Tasks for Approval and Implementation

1. AID/PRE-Washington - Proposed schedule

Task	Dates
a) Receive/review Draft Concept Paper/P.P.	November 12-16
b) Consultant presentation of Project at AID/W	" 16-21
c) PRE finalize draft	" 19-23
d) PRE formal Project Review	" 26-30
e) PRE formal negotiation of Agreement in Bolivia, either through Mission or joint PRE/Mission negotiation.	December 3-7
f) Formal signature of Agreement - Mission on behalf of PRE.	December 5-14

Task	Dates
2. USAID-Bolivia Mission - Proposed Schedule	
a) Assist UBB to name Organizing Commission President and General Manager.	November 5-9
b) USAID designate Mission staff to work with Commission President and General Manager.	November 5-9
c) Implement steps agreed with PRE to cancel Guarantee at Central Bank (refer to S. Carlson suggestions) and remit information to PRE/LAC/FM/Washington.	November/December
d) Respond to PRE requests for additional pre-approval requirements.	November
e) Assist Commission to complete detailed program design.	November
f) Prepare budget detail and agreement for USAID grant to UBB; negotiate and disperse.	November/December
g) Assist UBB to recruit and select highly qualified program manager.	November/December
h) Assist PRE in final negotiation (in Bolivia) and signature of Guarantee Agreement.	December 3-14
i) Arrange external technical assistance for new program management, starting in Jan-Feb.	December
3. UBB/New Administrator - Proposed Schedule	
a) Designate Organizing Commission President and General Manager.	November 5-9
b) Complete commission work with USAID Reps. on Program design details.	November
c) Prepare budget and formal request for USAID/ Bolivia grant for startup expenses; negotiate sign.	November/December
d) Start legal preparation for new Administrator.	November
e) Recruit and select (with USAID assistance) highly qualified General Manager for new Administrator.	November/December

Task	Dates
f) Negotiate, finalize, and sign agreement for Guarantee with PRE, assisted by Mission.	December 3-14
g) Arrange for external assistance for short-term orientation/planning assistance to UBB/New Administrator Board, General Manager, and staff during Jan-Feb 85.	December

ANNEX I

PCGP PORTFOLIO INFORMATION
(1979-7/84)

	79	80	81	82	83	84 7/31/84	Totals
No. Loans	322	382	822	466	232	206	2430
Total Amt. $b.1.000	16,871	43,924	84,777	438,389	620,229	653,932	1,858,122
Average loan Size $b 1.000	52	115	103	941	2,673	3,174	—
Total Amt. $US 1.00	674,879	1,756,972	3,391,105	2,077,675	2,939,473 3/	326,966	11,167,070
Average loan 1/	2,095	4,599	4,125	4,458	12,678 2/	1,587	4,595
Loan Portfolio Delinquency rate —	N.A.	N.A.	8.07%	1.46% 4/	N.A.	0.5%	
Loan Portfolio Balance end of year $b.1.000	N.A.	N.A.	97,107	418,764	1,045,907	1,069,679	—
Dollar value of Portfolio Balance	N.A.	N.A.	3,884,280	1,984,663	4,956,905 3/	662,629 5/	—

* Source - Central Bank of Bolivia; Reports on PCGP.
N.A. = Not available

Rounded estimates by CBB

Notes: 1/ Exchange rate used 79-81=25;82=211;83=211;84=2,000
2/ 1983 - Using exchange of 500, average loan is $5,346.00.
3/ 1983 - Using exchange of 500, total new portfolio is $1,240,458, and the year end Portfolio Balance is $2,091,814.
4/ The total amount delinquent decreased from 7.8 million to 6.1 million pesos from end 81 to 82, while nominal size of portfolio increased from 97 to 418 million.
5/ At present exchange rate of $b 5,000 total Portfolio balance as of July 31, 1984 drops to $265,051.

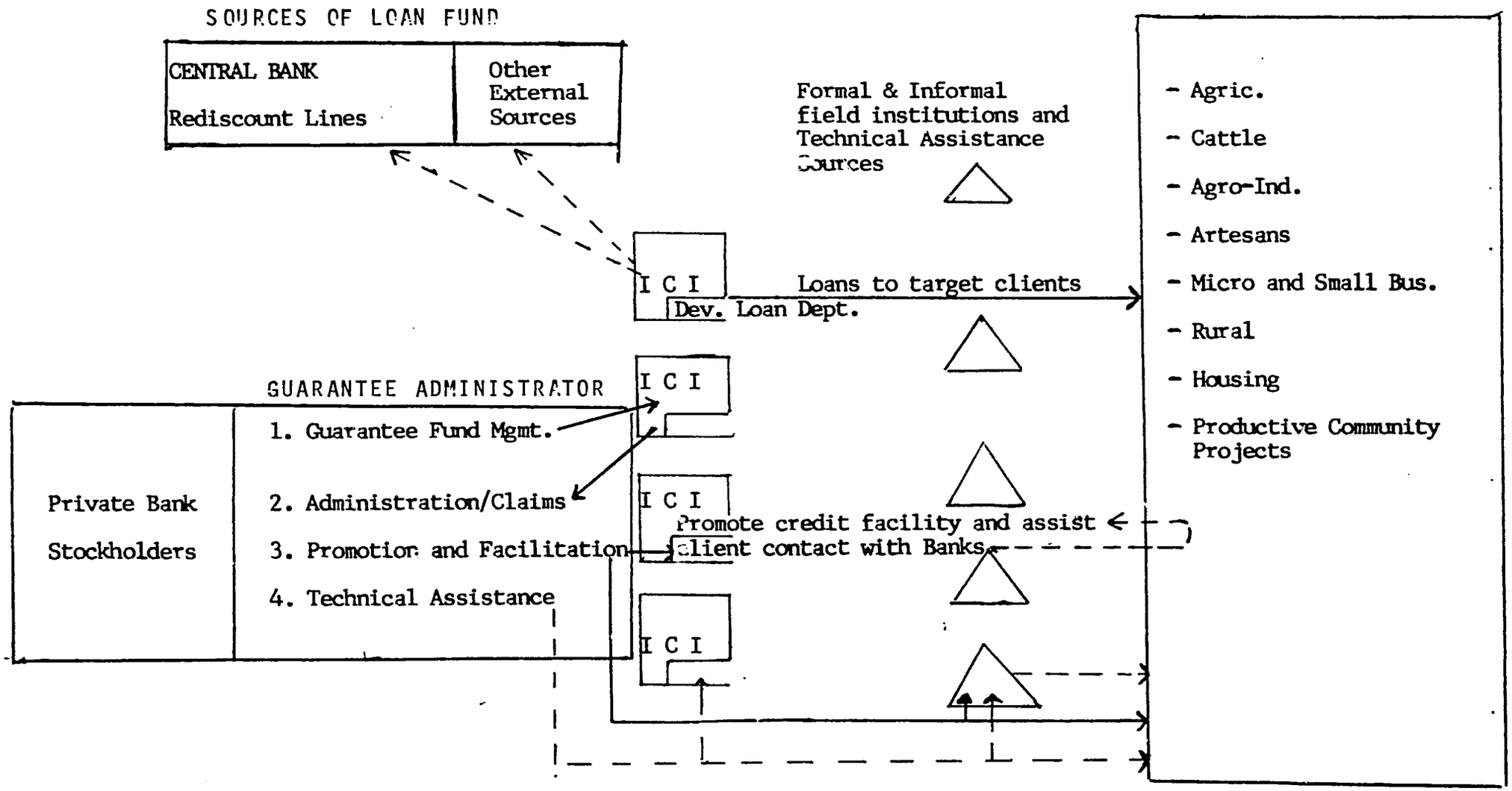
ANNEX II

BREAKDOWN OF PORTFOLIO BY SECTOR (1979-1982)

Type of Loan	Number Loans 79-82	% Total Loans	Loan Volume ($b 1.000)	Average Loan Size ($b1,000)	Observations
1. Small Agriculture	985	49.6	145,000	147	Continued activity over period.
2. Agro Industry	326	16.3	373,000	1,144	Most loans made in 1982
3. Artezan	524	26.3	53,000	101	Few new loans after 1981
4. Rural Housing	95	4.7	3,800	40	Housing loans stopped after 81
5. Small Enterprise	8	.4	2,800	350	Loans only made in 1981
6. Cattle Farming	54	2.7	6,200	115	Few loans after 1980
TOTALS	1,992	100.00	583,800	—	

ANNEX III

PCGP PROGRAM FUNCTIONS, PARTICIPANTS AND WORKFLOW



ANNEX IV

Portfolio Projections
(In US$)

YEAR	I	II	III	IV	Total
I. Projection I. (Conservative)					
No. Loans	300	450	675	1000	2425
Average Loan	3000	3500	4000	4,500	(3,750)
Total Portfolio	900,000	1,575,000	2,700,000	4,500,000	9,675,000
Guarantee Fee Income					
At 10%	90,000	157,500	270,000	450,000	967,500
At 5%	45,000	78,750	130,000	225,000	478,750
Port. Bal. Yr End	787,500	1,940,625	3,684,375	6,328,125	6,328,125
II. Projection II (Moderate)					
No. Loans	600	900	1350	2025	4875
Average Loan	3,000	3,500	4,000	4,500	(3,750)
Total Port.	1,800,000	3,150,000	5,400,000	9,112,500	19,462,500
Guarantee Fee Income					
At 10%	180,000	315,000	540,000	911,250	1,946,250
At 5%	90,000	157,500	270,000	455,625	973,125
Port. Bal. Yr. End	1,575,000	3,881,250	7,368,750	12,754,688	12,754,688

ANNEX IV (cont'd)

Portfolio Projections
(In US$)

YEAR	I	II	III	IV	Total
III. Projection III (Optimistic)					
No. Loans	1000	1500	2250	3375	8125
Average Loan	5,000	4,700	4,500	4,000	(4550)
Total Port.	5,000,000	7,050,000	10,125,000	13,500,000	35,675,000
Guarantee Fee Income					
At 10%	500,000	705,000	1,012,500	1,350,000	3,567,500
At 5%	250,000	352,500	506,250	675,000	1,783,750
Portf. Bal Yr. End	4,375,000	9,293,750	15,140,625	21,409,375	21,409,375

Portfolio Projections-Notes and Assumptions

I. General Assumptions for all three projected scenarios:

1. No. Loans - 50% per annum increase in number of loans over four year period.

   - Assume minimum 5 and maximum 10 active ICI's in program, starting with average of 60/30, 120/60, 200/100 the first year of each scenario.

   - Assume that new clients under guarantee remain under guarantee for 3 years if they take multiple loans of 1 yr. each, and new clients that take longer term loans (3yr+), remain under guarantee for duration of loan.

   - Present PCGP program has averaged approximately 400 loans per year over last three crisis years, and reached 822 in 1981. This supports viability of conservative and moderate scenarios.

   - Bankers contend that small productive borrower demand for credit has increased with growth in inflation.

2. Average Loan Size - The dollar value of average loans are affected by the makeup of the portfolio in terms of target groups, with Artisan and small farmers in the $US 2,000-$US 4,000 range, while agro-business/industry loans average in the $US 10,000-$US 20,000 range. Over the past few years the overall average loan has been in the $US 4,000 to $US 5,000 range. We have assumed that the average loan will stay in the $US 3,000-$US 5,000. Given the uncertainty of past and future exchange policy, the best estimates are ballpark figures within the ranges mentioned above.

   - Under the first two scenarios we have assumed that a smaller number of traditionally active banks will increase their PCGP portfolios with relatively smaller borrowers resulting in a lower average loan ($US 3,000), but that measures decreasing inflation and exchange policy will increase the dollar value of loans over the next few years from the $US 3,000 average, by around 15% per year.

   - Under the third scenario, we project that a larger number of banks participate, and that the newer participants will favor fewer larger agro and small business loans, pushing the average loan up to

approximately $US 5,000, then as their portfolios grow they will also include smaller loans, bringing the average loan slowly down in dollar terms.

3. Total Annual Portfolio - Total number of loans x average loan size.

4. Guarantee Fee Income - This fee is charged on the full principal of each loan and deducted upon dispersement, and placed in the Guarantors account immediately. Therefore it is a straight percentage of the total new annual portfolio. Figures are given at 10% (the present and recommended average PCGP commission) and 5%, which is under consideration as the amount to automatically go into the Guarantee Fund.

5. Portfolio Balance at Year End - This is the outstanding portfolio at the end of each year. It is calculated by taking the average new portfolio for each year (50% of total new portfolio), and subtracting a percentage of principal based upon the average maturity. In these projections, average maturity was set at 4 years, with 25%/yr. principal reduction assumed on the average new portfolio, plus accumulated portfolio. The portfolio balances shown here have not been reduced by default payments or percentage of terminated loans. Also, the portfolio balance only includes principal, not interest. The assumption that the average loan maturity is four years may be revised upon further analysis of the projected portfolio. The end of year portfolio balance is used to establish liability limits and/or leverage ratios for the Guarantee Fund and contingent liabilities of Guarantors.

6. General Conditions - We assume that the financial system and a significant percentage of participating banks won't collapse.

II. Assumptions related to Alternative Scenarios

I. Projection I - Conservative

(a) -Central Bank continues their PCGP program, in addition to new private PCGP program, reducing the number of loans covered by new program, with delays on rediscount of loans.

(b) -A minimum number of banks, but at least 3 to 4, utilize program during first 2 years.

(c) -Average loan size in dollars starts low ($US 3,000) due to high percentage of smaller loans from traditional PCGP bank participants, but loan size increases in dollars over years due to exchange policy and reduced inflation.

(d) -Little or no direct external funds provided to participant banks; use only CBB rediscount lines and Bank resources.

2. Projection II Moderate

(a) -Central Bank discontinues its PCGP program, or banks shift largely to new private guarantee program, and Central Bank doesn't delay request for rediscount lines, and banks utilize automatic rediscount facility more agressively.

(b) -Minimum number of banks (5) use program aggressively and/or larger number (10) become moderately active.

(c) -See I.(C)., except that majority of portfolio (65-75%) generated by traditional PCGP participants, rather than even activity among all banks.

(d) -Some external funding provided to participating banks ($US 1,500,000 to $US 3,000,000) from years 2 to 4 of program, in addition to CBB rediscount lines available.

3. Projection III-Optimistic

(a) -Central Bank discontinues its PCGP program, and encourages new private program through legal recognition, facilitation of rediscount lines, and use of compulsory deposit funds.

(b) -4 or 5 banks aggressively use program, the Central Bank automatic rediscount facility, and another 5 or so banks become active participants.

(c) -Average loan size is higher due to new (group 2) participant banks making larger loans early in program.

(d) -Substantial external funding ($US 3,000,000 - $US 5,000,000) channeled directly to participants, starting in year I of program, accompanied by aggressive use of CBB rediscount lines.

ANNEX V

ESTIMATED FIRST YEAR ADMINISTRATIVE/OPERATING BUDGET

	No.	$b.1.000.000 Month	$b.1.000.000 Year	US$ 1.00 Month	US$ 1.00 Year
I. Personnel					
- Mgr.	1	2.5m	40.0m	500	8,000
- Acct.	1	1.2m	19.2m	240	3,840
- Inform. Coor.	1	1.2m	19.2m	240	3,840
- Sec.	1	.625	10.0m	125	2,000
- Messenger	1	.40	6.4m	80	1,280
- Field Tecn.	3	4.5	72.0	900	14,400
Sub-total	8	10.425	166.8	2,085	33,360
II. Adm/Oper					
- Rent		1.0m	12.0m	200	2,400
- Communications		1.0m	12.0m	200	2,400
- Materials/Supplies		.50	6.0	100	1,200
- Travel/Perdiems		1.25	15.0	250	3,000
- Gasoline/Repairs		2.50	30.0	500	6,000
- Mis Exp/Publicity		.50	6.0	100	600
Sub-total		6.75	81.	1,350	15,600
III. T. Asst./Training		—	100.0	—	20,000
IV. Equipment (Capital Exp.)					
- Vehicles	3	—	100.0	—	20,000
- Furniture		—	25.0	—	5,000
- Office Machines		—	10.0	—	2,000
- Telephones		—	5.0	—	1,000
Sub-total		—	140.0	—	28,000
V. T O T A L		$b.17.1	$b.487.8	$3,435	$96,960

Annex VI

PROJECTION I - CONSERVATIVE

I. Operating Expenses Yr.	I	II	III	IV	TOTAL
1. Administrative Costs					
- Personnel	33,300	36,630	40,293	44,322	154,545
- Adm/Oper	15,600	17,160	18,876	20,763	72,399
- External TA/TR	20,000	22,000	24,200	26,620	92,820
- Equipment	28,000	6,000	6,000	6,000	46,000
Sub-total	96,900	81,790	89,369	97,705	365,764
2. Portfolio Costs					
- AID Guarantee 1/4%	2,250	3,937	6,750	11,250	24,187
- Stockholder G. 1/8%	1,125	1,968	3,375	5,625	12,093
- Default Paym. 5%-2yr	16,875	46,406	80,156	135,000	278,437
Sub-Total	20,250	52,311	90,281	151,875	314,717
3. Total Costs	117,150	134,101	179,650	249,580	680,481
II. Operating Income					
1. Guarantee Comm. 10%	90,000	157,500	270,000	450,000	967,500
2. Rec. on losses 25%	—	11,250	19,687	33,750	64,687
3. Int. Inc. on Guar. Fund. Balance	—	—	—	—	—
Total Income	90,000	168,750	289,687	483,750	1,032,187
III. Operating surplus (Deficit)	(27,150)	34,649	110,037	234,170	351,706
IV. Accummulated Surplus (Deficit)	(27,150)	7,499	117,536	351,706	351,706

PROJECTION II - MODERATE

I. Operating Expenses/Yr.	I	II	III	IV	TOTALS
1. Administrative Costs					
- Personnel	33,300	36,630	40,293	44,322	154,545
- Adm/Oper	15,600	17,160	18,876	20,763	72,399
- External TA/TR	20,000	22,000	24,200	26,620	92,820
- Equipment	28,000	6,000	6,000	6,000	46,000
Sub-total	96,900	81,790	89,369	97,705	365,764
2. Portfolio Costs					
- AID Guarantee Fee	4,500	7,875	13,500	22,781	48,656
- Stockholder Guara.Fee	2,250	3,937	6,750	11,390	24,327
- Default Payments	33,750	92,812	160,312	272,109	558,983
Sub-total	40,500	104,624	180,562	306,280	631,966
3. Total Costs	137,400	186,414	269,931	403,985	997,730
II. Operating Income					
1. Guarantee Commission 10%	180,000	315,000	540,000	911,250	1,946,250
2. Recuperations	—	22,500	39,375	67,500	129,375
3. Interest Income	—	—	—	—	—
Total Income	180,000	337,500	579,375	978,750	2,075,625
III. Operating Surplus (Deficit)	42,600	151,086	309,444	574,765	1,077,895
IV. Accumulated Surplus (Deficit)	42,600	193,686	503,130	1,077,895	1,077,895

PROJECTION III-OPTIMISTIC

I. Operating Expenses/Yr.	I	II	III	IV	TOTALS
1. Administrative Costs					
- Personnel	33,300	36,630	40,293	44,322	154,545
- Adm/Oper	15,600	17,160	18,876	20,763	72,399
- External TA/TR	20,000	22,000	24,200	26,620	92,820
- Equipment	28,000	6,000	6,000	6,000	46,000
Sub-total	96,900	81,790	89,369	97,705	365,764
2. Portfolio Costs					
-AID Guarntee Fee	12,500	17,6255	25,312	33,750	89,187
-Stockholder Guaran. Fee	6,250	8,812	12,656	16,875	44,593
-Default Payments	93,750	225,937	322,030	442,968	1,084,685
Sub-total	122,500	252,374	359,998	493,593	1,218,465
3. Total Costs	209,400	334,164	449,367	591,298	1,584,229
II. Operating Income					
1. Guarantee Comm.	500,000	705,000	1,012,500	1,350,000	3,567,500
2. Recup. on losses	—	62,500	88,125	126,562	277,187
3. Interest on Fund Balances	—	—	—	—	—
Total Income	500,000	767,500	1,100,625	1,476,562	3,844,687
III. Operating Surplus (Deficit)	290,600	433,336	651,258	885,264	2,260,458
IV. Accummulated Surplus/Deficit	290,600	723,936	1,375,194	2,260,458	2,260,458

Operating Expenses and Income-Notes and Assumptions

I. Operating Expenses

1. Administration Costs - The same size Administration/ Operation staff will manage portfolios under all three projections without significant increase in Administration costs.

   - A dynamic Bolivian manager will found who can effectively relate to bank executive and development department personnel, and manage aggressive field promotion program.

   - The dollar equivalents of peso salaries, figured at the present official exchange rate, will not vary substantially on average-over the next few years. Current peso salaries levels, based on 16 x monthly salary for annual totals were used as basis, then converted to dollars at $b 5.000 to the dollar. Ten percent increase on dollar figures per year are budgeted.

   - External technical assistance to the Administrator of the program will not exceed 75% of first year projections for external TA/TR, or 25% of subsequent years, unless it is absorbed by additional external fund sources (AID, etc).

   - Only technical assistance in preparation of loan applications when necessary will be provided or paid by the Administrator. Additional T.A. to borrowers will be provided either by voluntary T.A. sources, or be paid directly by borrowers, (when necessary included in principle of loan) rather than from the Administrators' operating budget.

   - Three full time field technicians located in La Paz, Santa Cruz and Cochabamba, supported by the manager, logistics and subcontractors for T.A., will be sufficient to mobilize and train field organizations and bank credit officers to generate and monitor-supervise the projected volume and number of loans under all three scenarios.

   - Three small vehicles will be purchased, maintained, and utilized for the amounts budgeted. Free office facilities will be arranged in participant banks, or similar facilities, for the field technicians posted in Santa Cruz and Cochabamba.

2. Portfolio Costs

- AID's 50% Contingent Guarantee Fee: Will cost the Administrator 1/4 of 1% on the full principle of all new portfolio loans-a one time charge-as in the former PCGP program. It is recommended that this fee be paid annually, rather than quarterly, to facilitate program administration.

- Administrator Stockholders 25% Contingent Guarantee Fee: Will cost the Administrator 1/8 of 1% on the full principle of all new portfolio loans-a one time charge-which is proportional to AID's fee. It is recommended that payment be made annually.

- Default Payment: Although payments of defaults under the PCGP program administered by the Central Bank were negligible, given the present uncertain economic climate, and difficulty in projecting the future, we are projecting a 5% default payment rate, in order to be exceptionally cautious.

The recommended operating structure for the new program emphasizes simple rapid decision and dispersement procedures for lenders, reduction or elimination of real property guarantee requirements for many small borrowers, and simple, fast claims procedures to collect on defaulted loans (principal and accrued interest at rates now between 100% and 200% p.a.). The formal monitoring and auditing system will be based upon post-approval and audit, annually, to cut down on program bureaucracy and delays. Dynamic informal supervision and monitoring will occur continuously (on day to day or week to week basis) with lenders and field intermediaries, focused on portfolio development, but also to offset laxity on the part of lenders or borrowers.

Greatly increased agility, coupled with significant growth of lenders new portfolios, are expected to result in moderate increases in arrears rates and default rates, with partial recuperation of defaults to follow.

The projected 5% default payment rate is divided as follows: 2 1/2% each year over two years, for each years' total portfolio of new loans. The cost to the Administrator (in default payments) is 75% of that default rate per year. This calculation assumes that the average loan is only for two years and/or that bad loans occur in the first two years of a loan with a longer maturity. Given that loans are made throughout the year, and defaults require a minimum of 90 to 120 day arrearage prior to making claims, the amount budgeted per year

under default payments is, in reality, quite high (5%-10% range) in cash-flow terms for the early years of the program. Unused funds, budgeted for default payments, will be retained in income generating accounts as part of the Guarantee Fund.

3. Total Operating Expenses - The sum of Administrative (including fixed assets, equipment) and portfolio costs. Not included in this total are Administrator income taxes and other taxes potentially applicable, depending on the juridical form (for-profit; non-profit, etc.) of the Administrator, and levies on its functions (i e. Guarantees). Under each of the three projected scenarios, administrative costs are equal, rising by only 10% per year. The portfolio costs rise significantly and become the major cost item by the third year with Scenario I, and earlier in the other scenarios with larger loan volumes. Therefore, one of the important functions of the Administrator is to monitor lenders arrearage and default performance, and in concert with lenders, to aggressively pursue borrowers in arrears or default status to pay off their loans.

1. Guarantee Commission.- Under all projections an average of a 10% flat fee on the principle of each loan is charged to borrowers. This commission-the same used by the CBB's PCGP-is charged in place of traditional real guarantee requirements which are impossible for many small borrowers to provide, and/or are extremely costly both financially and in procedural delays for borrower and lender in relation to loan size. Risk is reduced instead by requiring co-signers and loan supervision. Risk is spread considerably by a large number of small loans, rather than a few highly collateralized large loans.

   The guarantee commission is the main income source for the Administrator. It is deducted from the first loan dispersement, and immediately transferred or credited to the Administrators Guarantee Fund account and starts generating interest. In this manner, a part of the commission is immediately available to cover on-going administrative costs and eventual portfolio fees. The volume of the portfolio (new loans) is the vital factor in commission income, as shown under the three scenarios.

2. Recuperations on Defaults: Experience has shown both under the Central Bank PCGP, and more convincingly in other countries, that (with or without real guarantees as collateral) a reasonable percentage 25-50% of defaulted loans can be recuperated. Recuperation occurs through

effective direct pressure, on borrower and co-signers, threat of legal action, or when absolutely necessary (and worthwhile financially or for demonstration purposes), formal legal action. Recuperations occur because of immediate action-pressure, granting reasonable delays for payments, or formal rescheduling of loans. As a last resort, formal judicial takeover and sale of assets. This should seldom be necessary or advised, for recuperation of small loan defaults.

The projected level of recuperations will occur when lenders and/or Administrator (preferably joint action), act decisively and quickly first on arrearage beyond a reasonable age (30-60 days), then on defaults (90 to 120 days, or at the time the loan supervisors considers necessary), with a pre-established set of measures, that are designed as carrot or very tough stick.

The recuperations are an important receivables account in these projections, because the default payments in each projection are set high to cover both unexpectedly high default levels and/or a system of covering claims for "temporary or transitory default" which are expected to be rescheduled.

The calculation is based upon recuperating 33 1/3% of total default for which claims were paid. Of that 33 1/3%, 8 1/3% would remain with the lender, and 25% would pass through to the guarantee Administrator, representing the 25-75% split in default coverage. The recuperations are projected to occur during the year after which the loan was made.

3. Interest Income on Guarantee Fund and Operating Balance: The figures are not included in these projections, but will be an important income/loss item. The Guarantee Fund will be kept in the highest interest bearing accounts, or other instruments (hard or local currency) to protect and increase operating balances and capitalize the Guarantee Fund. Given high Bolivian inflation and present negative rates of return on local currency saving accounts, the financial management of the Administrators' resources will be a critically important aspect of this program, to which the commercial bankers-stockholders of the Administering agency-must put their best creative efforts. Under present and projected conditions, interest income is not projected to be an important item under operating income, but maintenance of real value of both Guarantee Fund and operating balances is clearly a most critically important factor for the financial health of the program and system.

4. Total Operating Income: The sum of commissions, recuperations, and interest income not used to capitalize the Guarantee Fund. Only in the first year under Projection I is operating income less than operating expenses. This favorable projection depends most on the maintenance of value of peso income received.

III. Operating Surplus or Deficit:- Under each projection an operating surplus, and accumulated surplus grows steadily from the first year (exception Proj. I-yr. I deficit). These surpluses grow respectively to $US 351,706, $US. 1,077,895, and $US 2,260,458 under the three scenarios over a four year period. The surpluses will be used to capitalize the Guarantee Fund, expand program operations, and pay dividends to stockholders.

factor which has helped maintain term deposit levels is the requirement of most commercial banks that borrowers hold compensating balances equal to at least 10 percent of the value of their outstanding borrowings.

An important consequence of high inflation and negative interest rates has been a rising velocity of circulation of money. The IMF has calculated that M1 (currency plus demand deposits) as a proportion of GDP declined from 9 to 7 percent between 1979 and 1983. At the same time M2 (M1 plus term deposits) fell from 15 to 12.1 percent of GDP. This indicates that a higher transactions level is being sustained by a given quantity of money. This observation is consistent with the widespread public perception that maintaining funds immobilized, even for short periods of time, is extremely costly.

Faced with a declining GDP, [illegible]dly accelerating inflation and a rise in the velocity of monetary circulation, the Bolivian Government has taken a series of measures to reduce excess demand in the economy. The most important of these has been the continual raising of legal reserve requirements. Average required reserves as a percentage of total bank deposits rose from 27 percent in December 1982 to 42 percent in December 1983. In 1982 the government also ordered the brief suspension of private lending and prohibited U.S. dollar-denominated transactions between Bolivians. These measures were not effective in controlling inflation. However they did reduce the amount of credit potentially available to the private sector.

TABLE III-9 -
LEGAL RESERVE REQUIREMENTS FOR PESO DEPOSITS
(in percent)

	March 1981	Nov. 1982	July 1983	May 1984
Domestic Banks				
Demand Deposits	44.5%	40.0%	60.0%	60.0%
Savings Deposits	14.5%	15.0%	30.0%	25.0%
Time Deposits	10.0%	13.0%	30.0%	25.0%
Other Deposits	10.75%	40.0%	60.0%	60.0%
Foreign Banks				
Demand Deposits	49.5%	45.0%	67.5%	67.5%
Savings Deposits	14.5%	15.0%	30.0%	25.0%
Time Deposits	10.0%	15.0%	32.0%	30.0%
Other Deposits	45.0%	45.0%	67.5%	67.5%

Source: Central Bank of Bolivia. IMF: Bolivia Recent Economic Developments, Table 41.

AGEDESA

ALMACENES GENERALES DE DEPOSITO S.A.

LA PAZ – BOLIVIA

ESTADOS FINANCIEROS ANUALES COMPARATIVOS

RUBROS	GEST. 1977	GEST. 1978	GEST. 1979	GEST. 1980
ACTIVOS				
Disponible	50.164.58	64.378.27	478.094.51	1.095.879.55
Circulante	66.566.18	755.977.21	686.561.26	46.674.81
Fijo	633.494.00	812.156.00	783.203.50	3.304.090.00
Transitorio	143.980.00	107.980.00	124.426.00	113.584.43
Otros	2.545.210.00	2.603.504.50	2.595.780.00	170.188.00
Pérdidas y Ganan.	8.819.18	- . -	- . -	- . -
PASIVOS				
Exigible	1.670.233.94	1.362.905.67	1.303.630.48	272.900.00
Capital	1.770.000.00	2.650.000.00	2.846.000.00	3.613.300.00
Reservas	8.000.00	18.000.00	63.837.31	144.032.55
Pérdidas Y Ganan.	- .- -	313.090.31	454.597.48	720.184.24
TOTAL ACT.=PASV.	3.448.233.44	4.343.955.98	4.668.065.27	4.730.416.79
RESULTADOS				
Comis. Ord.	82.908.29	378.051.33	403.168.96	497.124.28
Comis. Particip.	- . -	578.499.35	1.295.989.38	2.053.906.69
Ingresos	82.908.29	956.550.68	1.699.158.34	2.551.030.97
Egresos	91.727.47	643.460.37	1.244.560.86	1.830.846.73
Util.(perd.)Neta	(8.819.18)	313.090.31	454.597.48	720.184.24

EDIF. LITORAL, PISO 14 • CABLES Y TELEGRAMAS: "AGEDESA" • CASILLA CORREO 6753 • TELFS. 361703 - 376164

ANNEX VIII-A

ALMACENES GENERALES DE DEPOSITO S.A.

LA PAZ – BOLIVIA

ESTADOS FINANCIEROS ANUALES COMPARATIVOS

RUBROS	GEST. 1981	GEST. 1982	GEST. 1983	SEPT. 30- 1984
ACTIVOS				
Disponible	2.582.677.48	1.382.033.03	17.839.369.23	119.780.413.09
Exigible	- . -	2.603.767.93	5.346.850.04	464.892.650.49
Circulante	139.736.68	- . -	- . -	- . -
Fijo	3.792.418.00	16.782.976.23	439.989.779.00	441.965.022.25
Transitotio	162.071.43	- . -	- . -	- . -
Otros	153.375.00	471.725.00	156.300.00	4.764.896.22
Pérdidas y Ganan.	- . -	- . -	- . -	- . -
PASIVOS				
Exigible	4.405.200.00	1.138.188.26	39.716.344.37	242.909.877.49
Capital	4.505.900.00	15.544.800.00	412.940.212.70	447.894.512.70
Reservas	329.254.87	1.526.130.63	3.438.873.93	26.651.942.29
Pérdidas y Ganan.	1.995.123.72	3.031.383.30	7.236.867.27	313.946.649.57
TOTAL ACT.=PASIV.	6.830.278.59	21.240.502.19	463.332.298.27	1.031.402.982.05
RESULTADOS				
Otros ingresos	- . -	638.258.01	2.624.725.19	8.242.890.67
Comis. Ordi.	682.721.70	4.939.656.31	31.531.936.87	124.728.098.27
Comis. Particip.	4.434.948.17	11.148.993.56	54.352.750.99	668.136.433.76
Ingresos	5.117.699.87	16.726.907.88	88.509.413.05	801.107.422.70
Egresos	3.122.546.00	12.021.887.62	77.532.913.48	487.160.773.13
Util. (perd.)Neta	1.995.123.87	4.705.020.26	10.976.499.57	313.946.649.57

La Paz, Octubre de 1984

Miguel Ballivián Arduyo
Sub-Gerente General
"AGEDESA"

EDIF. LITORAL, PISO 14 • CABLES Y TELEGRAMAS: "AGEDESA" • CASILLA CORREO 6753 • TELFS. 361703 - 376164

ANNEX VIII-B

- 30 -

TABLE III-4
CHANGE IN BANK LIABILITIES IN CONSTANT PESOS

COMMERCIAL BANKS	6/30/1982 MILLION $b*	9/30/1983 MILLION $b*	PERCENT CHANGE
Banco del Estado (State)	101,358.2	37,894.9	-62.6%
Banco Boliviano Americano	40,295.7	19,488.6	-51.6%
Banco de Cochabamba	19,747.3	9,882.1	-50.0%
Banco de Crédito Oruro	15,166.1	6,987.0	-53.9%
Banco de Santa Cruz	46,200.9	23,527.5	-49.1%
Banco Hipotecario Nacional	13,130.2	8,231.8	-37.3%
Banco Mercantil	20,118.7	12,553.2	-37.6%
Banco Nacional de Bolivia	30,313.0	17,015.9	-43.9%
Banco Big Beni	16,815.8	6,266.2	-62.7%
Banco de Potosi	6,623.9	3,384.0	-48.9%
Banco de La Paz	7,470.1	3,838.2	-48.6%
Banco del Progreso	1,013.3	663.0	-34.6%
Banco de la Unión	497.7	3,215.2	+546.0%
Banco Popular del Perú	28,337.8	14,171.2	-50.0%
TOTAL	347,088.7	167,118.8	-51.9%
FOREIGN BANKS			
Banco de la Nación Argentina	9,514.6	2,686.4	-71.8%
Banco do Brasil	11,429.2	3,076.8	-73.1%
First National City Bank	3,819.9	1,211.2	-68.3%
Bank of America	4,428.9	1,924.1	-56.6%
Banco de Boston	9,688.6	3,545.3	-63.4%
Banco Real S.A.	7,969.6	3,238.2	-59.4%
TOTAL	46,850.8	15,682.0	-66.5%
SPECIALIZED BANKS			
Banco Minero de Bolivia (State)	29,586.3	19,057.9	-35.6%
Banco Agrícola (State)	44,501.1	14,509.3	-67.4%
Banco de la Vivienda (mixed)	6,648.7	1,663.1	-75.0%
Banco Industrial	22,284.0	7,248.8	-67.5%
Banco Hipotecario Nacional	5,718.3	1,392.7	-75.6%
Banco de Financ. Industrial	8,830.0	3,832.0	-56.6%
Banco de la Inversión Boliviana	4,115.7	1,729.2	-58.0%
Banco Real de Inversiones	3,199.6	950.1	-70.3%
TOTAL	124,883.7	50,383.1	-59.7%
GRAND TOTAL	518,823.2	233,183.9	-55.1%

Note: Liabilities include owners' equity.

* Figures are in terms of September 1983 constant pesos. The deflator used is from the General Consumer Price Index which rose 519% during the period.
Source: Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia.

TABLE III-5
CHANGE IN BANK LIABILITIES MEASURED AT OFFICIAL EXCHANGE RATES

COMMERCIAL BANKS	6/30/1982 THOUSAND $US AT $b43.22/US$	9/30/1983 THOUSAND $US AT $b196.29/US$	PERCENT CHANGE
Banco del Estado (State)	378.86	193.06	-49.0%
Banco Boliviano Americano	150.62	99.28	-34.1%
Banco de Cochabamba	73.81	50.34	-31.8%
Banco de Crédito Oruro	56.69	35.60	-37.2%
Banco de Santa Cruz	172.69	119.86	-30.6%
Banco Hipotecario Nacional	49.08	41.94	-14.5%
Banco Mercantil	75.20	63.95	-15.0%
Banco Nacional de Bolivia	113.31	86.69	-23.5%
Banco Big Beni	62.86	31.92	-49.2%
Banco de Potosi	24.76	17.24	-30.4%
Banco de La Paz	27.92	19.55	-30.0%
Banco del Progreso	3.79	3.38	-10.8%
Banco de la Unión	1.86	16.38	+780.6%
Banco Popular del Perú	105.92	72.20	-31.8%
TOTAL	1,297.37	851.39	-34.4%
FOREIGN BANKS			
Banco de la Nación Argentina	35.56	13.69	-61.5%
Banco do Brasil	42.72	15.67	-63.3%
First National City Bank	14.28	6.17	-56.8%
Bank of America	16.55	9.80	-40.8%
Banco de Boston	36.21	18.06	-50.1%
Banco Real S.A.	29.79	16.50	-44.6%
TOTAL	175.12	79.89	-54.4%
SPECIALIZED BANKS			
Banco Minero de Bolivia (State)	110.59	97.09	-12.2%
Banco Agrícola (State)	166.34	73.92	-55.6%
Banco de la Vivienda (mixed)	24.85	8.47	-65.9%
Banco Industrial	83.29	36.93	-55.7%
Banco Hipotecario Nacional	21.37	7.10	-66.8%
Banco de Financ. Industrial	33.01	19.52	-40.9%
Banco de la Inversión Boliviana	15.38	8.81	-42.7%
Banco Real de Inversiones	11.96	4.84	-59.5%
TOTAL	466.80	256.68	-45.0%
GRAND TOTAL	1,939.30	1,187.96	-38.7%

Note: Liabilities include owners' equity.
Source: Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia.

TABLE III-6

BANK LIABILITIES MEASURED AT PARALLEL MARKET EXCHANGE RATES*

COMMERCIAL BANKS	6/30/1982 THOUSAND $US*	9/30/1983 THOUSAND $US*	PERCENT CHANGE
Banco del Estado (State)	163,745	47,369	-71.1%
Banco Boliviano Americano	65,098	24,361	-62.6%
Banco de Cochabamba	31,902	12,353	-61.3%
Banco de Crédito Oruro	24,501	8,734	-64.4%
Banco de Santa Cruz	74,638	29,409	-60.6%
Banco Hipotecario Nacional	21,212	10,290	-51.5%
Banco Mercantil	32,502	15,691	-51.7%
Banco Nacional de Bolivia	48,971	21,270	-56.6%
Banco Big Beni	27,166	7,833	-71.2%
Banco de Potosi	10,701	4,230	-60.5%
Banco de La Paz	12,068	4,798	-60.2%
Banco del Progreso	1,637	829	-49.4%
Banco de la Unión	804	4,019	+399.9%
Banco Popular del Perú	45,780	17,714	-61.3%
TOTAL	560,725	208,900	-62.7%
FOREIGN BANKS			
Banco de la Nación Argentina	15,371	3,358	-78.2%
Banco do Brasil	18,464	3,846	-79.2%
First National City Bank	6,171	1,514	-75.5%
Bank of America	7,155	2,405	-66.4%
Banco de Boston	15,652	4,432	-71.7%
Banco Real S.A.	12,875	4,048	-68.6%
TOTAL	75,688	19,603	-74.1%
SPECIALIZED BANKS			
Banco Minero de Bolivia (State)	47,797	23,822	-50.2%
Banco Agrícola (State)	71,892	18,137	-74.8%
Banco de la Vivienda (mixed)	10,741	2,079	-80.6%
Banco Industrial	36,000	9,061	-74.8%
Banco Hipotecario Nacional	9,238	1,741	-81.1%
Banco de Financ. Industrial	14,265	4,790	-66.4%
Banco de la Inversión Boliviana	6,649	2,162	-67.5%
Banco Real de Inversiones	5,169	1,900	-63.2%
TOTAL	201,751	63,692	-68.4%
GRAND TOTAL OF ASSETS	838,164	292,095	-65.2%

*Values are converted to U.S. dollars using the parallel market.
For 6/30/82 US$1= 100 $b. for 9/30/83 US$1 = 800 $b. approximately.
Source: Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia.

TABLE III-7
CHANGE IN NOMINAL BANK LIABILITIES

COMMERCIAL BANKS	6/30/1982 MILLION $b*	9/30/1983 MILLION $b*	PERCENT CHANGE
Banco del Estado (State)	16,374.5	37,894.9	+131.4%
Banco Boliviano Americano	6,509.8	19,488.6	+199.4%
Banco de Cochabamba	3,190.2	9,882.1	+209.8%
Banco de Crédito Oruro	2,450.1	6,987.0	+185.2%
Banco de Santa Cruz	7,463.8	23,527.5	+215.2%
Banco Hipotecario Nacional	2,121.2	8,231.8	+288.1%
Banco Mercantil	3,250.2	12,553.2	+286.2%
Banco Nacional de Bolivia	4,897.1	17,015.9	+247.5%
Banco Big Beni	2,716.6	6,266.2	+130.7%
Banco de Potosi	1,070.1	3,384.0	+216.2%
Banco de La Paz	1,206.8	3,838.2	+218.0%
Banco del Progreso	163.7	663.0	+305.0%
Banco de la Unión	80.4	3,215.2	+3,899.0%
Banco Popular del Perú	4,578.0	14,171.2	+209.6%
TOTAL	56,072.5	167,118.8	+198.0%
FOREIGN BANKS			
Banco de la Nación Argentina	1,537.1	2,686.4	+74.8%
Banco do Brasil	1,846.4	3,076.8	+66.6%
First National City Bank	617.1	1,211.2	+96.3%
Bank of America	715.5	1,924.1	+168.9%
Banco de Boston	1,565.2	3,545.3	+126.5%
Banco Real S.A.	1,287.5	3,238.2	+151.5%
TOTAL	7,568.8	15,682.0	+107.2%
SPECIALIZED BANKS			
Banco Minero de Bolivia (State)	4,779.7	19,057.9	+298.7%
Banco Agrícola (State)	7,189.2	14,509.3	+101.8%
Banco de la Vivienda (mixed)	1,074.1	1,663.1	+54.8%
Banco Industrial	3,600.0	7,248.8	+101.4%
Banco Hipotecario Nacional	923.8	1,392.7	+50.8%
Banco de Financ. Industrial	1,426.5	3,832.0	+168.6%
Banco de la Inversión Boliviana	664.9	1,729.2	+160.1%
Banco Real de Inversiones	516.9	950.1	+83.8%
TOTAL	20,175.1	50,383.1	+149.7%
GRAND TOTAL	83,816.4	233,183.9	+178.2%

Note: Liabilities include owners' equity.
*Current pesos unadjusted for inflation.
Source: Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia.

ANNEX IX

List Banks Interviewed

BANK	Person	Position	Observations
1. Banco Central	- Carlos Bustamante	Jefe Tec. Depto Des.	
	- Ernesto Solano	Encargado PGCP	
2. Banco de La Paz	- Guido Hinojosa	Presidente	
3. Banco Cochabamba	- Guido Quiroga	Presidente	
	- Jaime Gutierrez	Gerente General	
	- Miguel Hoyos	Gerente Depto. Des.	
4. Banco Mercantil	- Alberto Valdes	Director	
	- Jorge Mac Lean	Oficial de Créditos	
	- Emilio Ruiz T.	Evaluación de Proyec.	
5. Banco Boliviano Americano	- Luis E. Siles	Presidente	
	- Jorge Martinic R.	Gerente Desarrollo	
6. Banco de Potosí	- Jaime Buitrago	Presidente	
	- Walter Bellido	Gerente General	
7. Banco Nacional	- Fernando Bedoya	Presidente	
	- Miguel A. Fabbri	Gerente General	
	- Jorge Gonzales Quint	Jefe de Desarrollo	
8. Banco Industrial S.A.	- Fernando Maldonado	Gerente Operaciones	
	- M. Amparo Ballivian	Asistente Financiero	
	- Felipe Sillerico B.	Sub-Gerente Operaciones	
9. Banco Industrial y Ganadero Beni	- Jorge Jordan	Presidente	
	- Fernando Garrón del Barco	Gerente La Paz	
10. Banco Hipotecario Nacional	- David Blanco	Gerente Generl	
	- Edward Derksen	Director Ejecutivo	
	- Enrique Blanco de La Fuente	Sub-Gerente Fomento	
	- Ricardo Vargas	Gerente La Paz	
11. Banco de Crédito Oruro	- Ruben Romero	Gerente General	
	- Ivan Arce	Gte. Depto. Desarrollo	
	- Mario Galleguillos	Gte. Nal. Operciones	
12. Unión de Bancos	- Guido Hinojosa	Presidente	
	- Luis Torrejón	Secretario Ejecutivo	
	- Wenseslaw Alba	Ex-Sec Ejecutivo	
13. AGEDESA	- Fernando Mustfa	Gerente General	
	- Miguel Alba A.	Sub-Gerente General	
14. ASOBANC	- Fernando Bedoya	Presidente	
	- Luis A. Ballesteros	Gerente Administrativo	
	- Miguel Zalles	Asesor Económico	

- ANNEX X

UNION DE BANCOS BOLIVIANOS

LA PAZ — BOLIVIA

RECEIVED USAID - 1 NOV. 1984 LA PAZ

COPY TO CENTRAL FILES

La Paz, 31 de octubre de 1984

Señor
Henry E. Bassford
Director de la Misión de USAID/Bolivia
Presente

Señor Director:

Tenemos el agrado de comunicarle que, como consecuencia de las conversaciones con personeros de esa Misión y el Sr. Bruce A. Tippett, la Unión de Bancos Bolivianos estaría de acuerdo con el manejo del P.G.C.P., para lo cual le hacemos conocer lo siguiente:

1.- Inicialmente el manejo y coordinación del Programa estaría a cargo de la Unión de Bancos Bolivianos mientras se conforme una Institución especializada, con personería jurídica que podría ser una sociedad anónima.

2.- La U.B.B. estaría en condiciones de firmar un convenio con AID-Washington, sobre las garantías contingentes, en sentido de que la U.B.B. aportaría la parte no cubierta por AID y las ICI's.
Una vez conformada la sociedad este convenio, con todas las cláusulas, pasaría a la nueva institución.

3.- Este Programa estaría manejado en la forma más ágil y adecuada, de tal manera que tenga alcance a mayor número de prestatarios dentro de los diferentes sectores determinados en el mismo Programa.

4.- Como es de su conocimiento, la U.B.B. ha conformado dos comisiones compuestas por ejecutivos y técnicos de sus bancos miembros, las que continuarán trabajando en la preparación e implementación del Programa, conjuntamente con los representantes de USAID/B.

Es propósito de la U.B.B. que entre en marcha el Programa a la mayor brevedad posible, para lo cual suplimos a su autoridad prestar la colaboración necesaria, tanto a través de USAID/B. como de AID-Washington.

Con este motivo, saludamos a usted con nuestra mayor atención.

UNION DE BANCOS BOLIVIANOS

Lic. Luis Torrejón Vera
Sctrio. Ejecutivo

Lic. Guido E. Hinojosa S.
Presidente

LT/Esr.

E	PDSI	
	ACTION	INFO
		✓
		✓
		✓
		✓
A	11/16	

Av. Mariscal Santa Cruz Edif. Cámara de Comercio Piso 15.- Cables y Telegramas: "unionbancos" Casilla Correo 6753 Teléfonos 361703 — 376164

ANNEX X-A

Translation

La Paz - October 31, 1984

Mr. Henry H. Bassford
Mission Director
USAID/La Paz,
Bolivia

Dear Mr. Bassford:

Based upon the results of meetings with representatives of your mission and Mr. Bruce A. Tippett, the Union of Bolivian Banks has the pleasure of communicating to you that we are in agreement on our administering the Productive Credit Guarantee Program, which prompts us to inform you of the following points:

1. Initially program coordination and management will be the responsibility of the Union of Bolivian Banks, during the period while an independent legally chartered specialized company, which will probably be a for-profit corporation, is being constituted.

2. The UBB has the legal authority to sign a contract or agreement with AID/W covering the contingent guarantees, and will take responsibility for the portion of the quarantees not covered by AID and the ICI's (intermediary credit institution's). Once the new quarantee entity is chartered, the AID/UBB agreement, with all its clauses, will be transferred to the new entity.

3. This program will be managed in the agile and adequate manner so that it reaches the largest possible number of program target clients.

4. As you know, the UBB has nominated two working commissions, composed of member bank executives and technicians. They will continue to work on preparation and implementation of the program with the assistance of USAID/Bolivia representatives.

It is UBB's objective to start this program very soon and therefore we request that USAID/Bolivia and AID/W provide the collaboration necessary toward that objective.

With this motive, we appreciate your attention and interest.

Union of Bolivian Banks

Lic. Luis Torrejon Vera
Executive Secretary

Lic. Guido E. Hinojosa C.
President

ANNEX XI

List of Probable Stockholders of New Company to be Guarantee Administrator

1. Banco de Cochabamba
2. Banco Industrial y Ganadero del Beni
3. Banco Potosi, S.A.
4. Banco de Santa Cruz
5. Banco Mercantil
6. Banco Industrial, S.A.
7. Banco Boliviano Americano
8. Banco de La Paz
9. Banco Nacional de Bolivia
10. Banco Hipotecario Nacional

ANNEX XII

Sample List of Field Intermediary Organization Types

1. PVO's - International

Project Concern International
Foster Parents Plan
World Relief Corporation
CARE
International Voluntary Service
Heifer Project International
CLUSA
Lutheran World Relief
CODEL
Adventist Development and Relief

2. Local Institutions - Private and/or Specialized Public Companies and Agencies

Central de Cooperativas Agropecuarias
FENACRE - Federation of Credit Unions - 160 member Credit Unions.
Centro de Mujeres Rurales
Associacion de Artesanos Q'antati'
Esperanca
CORDECH
Provincial Development Corporations (each Province)
Jiwaki International - Artesan Exports
AGEDESA - National Agric. Product Warehousing System
INOPE - National Institute for Small Business Assistance
Camara Nacional de Industrias
DESEC - Rural Development Organization
Hambirf - Housing and Urban Development Program
Caja Central - Sistema Ahorro y Prestamo - 13 local mutual associations.
Comites Vecinales
Machinery and Input Distributors

3. Technicians - Individuals and Consulting Firms

- 185 accredited technicians and consultants under former PCGP program, spread across country provinces.

III. MONEY AND CREDIT

A. TRENDS IN MONEY AND BANK LIABILITIES*

Beginning in January, 1982, the Bolivian Central Bank permitted virtually uncontrolled growth in the money supply. In the 24 months between 31 December 1981 and 31 December 1983 M1 (Currency plus demand deposits) grew 940 percent while M2 (M1 plus term deposits) grew 795 percent. These rates of growth dwarf those under the pre-Torrelio governments and in fact are roughly equal in proportion to the total monetary expansion between 1971 and 1981.

TABLE III-1
GROWTH OF MONEY SUPPLY
(in million Bolivian Pesos)

	Dec. 31 1980	Dec. 31 1981	Dec. 31 1982	Dec. 31 1983
M1 Total	14,321.4	17,064.5	57,321.1	177,465.2
Currency	9,460.5	10,755.6	39,573.6	126,299.6
Demand Deposits	4,860.9	6,308.9	17,747.5	51,165.6
M2 Total	22,841.8	29,539.5	94,649.2	264,311.2
Savings Deposits	4,323.4	6,742.9	18,680.3	51,315.5
Term Deposits (C.D.'s)	874.9	1,346.5	12,274.1	25,048.6
Other Liabilities	690.8	1,215.4	4,548.1	9,551.9
Foreign Currency Deposits	2,631.3	3,170.2	5,860.6	930.0
Currency & Demand Deposits	14,321.4	17,064.5	57,321.1	177,465.2

Percentage Change from Previous Year
(End of Year Basis)

	1980-1981	1981-1982	1982-1983
M1 Total	19.2%	235.9%	209.6%
Currency	13.7%	267.9%	219.2%
Demand Deposits	29.8%	181.3%	188.3%
M2 Total	29.3%	234.1%	167.8%
Savings Deposits	56.0%	177.0%	174.7%
Term Deposits (C.D.'s)	53.9%	811.6%	104.1%
Other Liabilities	75.9%	274.2%	110.0%
Foreign Currency Deposits	20.5%	84.9%	-84.1%

Source: IMF: Bolivia Recent Economic Developments, Table 14 and 39; Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia.

* Liabilities include deposits in checking and savings accounts, certificates of deposit, deposits from other banks, borrowings of capital, and retained earnings and shareholders' equity.

Monetary growth has not been used as a tool to stimulate production and loosen credit, rather it is a direct outcome of the government's inability to control its chronic deficits. Because of the absence of a sufficiently developed internal capital market which would permit borrowing privately and the unavailability of foreign loans, the government has had to force the Central Bank to issue new pesos at an unprecedented rate. This tendency to rely upon the Central Bank as a lender of last resort has a history in Bolivia, but it has traditionally been maintained at much lower levels. In the 1970s, the government was able to cover about 75 percent of its expenditures out of business and personal taxes, customs duties, and gas and mineral royalties. Even as late as 1982, 53 percent of expenditures were funded from revenues. (Table III-2) Beginning with the Siles presidency, the situation changed. In 1983 government income rose nearly 162 percent, however expenditures rose almost fivefold. As a consequence less than 29 percent of total expenditures could be funded by revenues.

TABLE III-2
CENTRAL GOVERNMENT REVENUE AND EXPENDITURE

YEAR	REVENUE MILLIONS $b	EXPENDITURE MILLIONS $b	REVENUES AS PERCENTAGE OF EXPENDITURES
1972	1,330.1	2,068.3	64.3%
1973	2,469.5	2,882.0	85.7%
1974	5,069.7	5,524.7	91.8%
1975	5,688.8	6,395.4	89.0%
1976	6,840.9	8,239.8	83.0%
1977	7,641.2	10,954.1	69.8%
1978	8,540.1	11,542.0	74.0%
1979	9,188.1	15,163.0	60.6%
1980	12,558.0	21,876.5	57.4%
1981	18,008.1	29,382.2	61.3%
1982	28,208.6	53,630.4	52.6%
1983	73,831.2	262,027.9	28.2%

Source: For 1972 to 1978: Boletin Estadistico No. 248 & No. 247, Banco Central de Bolivia. For 1979 to 1983 IMF: Bolivia Recent Economic Developments, Table 36.

A major result of these large deficits is hyperinflation and the consequent collapse of the peso. Alone between January 1983 and April 1984 the general index of consumer prices rose 1,040 percent. At the same time the Bolivian peso fell from about 300 to 3300 per U.S. dollar on the parallel market and from 196 to 2,000 per U.S. dollar at the official rate. Recently inflation appears to have accelerated: prices are up 240 percent in the first five months of 1984, and the Central Bank has projected a rate of 600 percent for the year.

Financial markets have been among the areas hardest hit by inflation and the depreciating peso. This is due both to an absence of flexible financial

instruments and an excess of official regulation. Government financial legislation has redistributed income in a capricious fashion. For example, in spite of an official inflation rate in excess of 300 percent per annum, existing regulations have placed a low ceiling on the interest banks can pay or charge. In 1982 the highest interest rate payable on savings accounts was 32 percent per annum. Even by late 1983, the rate had only risen to 45 percent, and that only for holders of long-term certificates of deposit. Owners of checking accounts fared worse since they received no interest. Consequently, a quantity of pesos placed in a checking account in June 1982 and withdrawn one year later would have lost 75 percent of its 1982 present value, assuming a 300 percent annual inflation rate. A similar investment in a long-term savings account would have lost about two-thirds.

The obverse side of this situation is the enormous benefits which accrue to anyone fortunate enough to borrow at the legal lending rates. In 1983 loans from the specialized industrial and development banks carried interest rates of between 12 and 20.9 percent. Thus again assuming an inflation rate of 300 percent per annum, a borrower might theoretically pay back as little as 28 percent of the present value of a loan with a maturity of only one year. This is equivalent to a negative cost of capital of 72 percent per annum.

The table below presents the real and nominal average interest rates which prevailed from 1979 to June 1984. Real interest rates on savings accounts and certificates of deposit were positive briefly in 1981 and increasingly negative thereafter. Similarly, the legal maximum lending rates were positive in 1980 but fell rapidly afterwards.

TABLE III-3
REAL AND NOMINAL INTEREST RATES 1979-1984

	1979	1980	1981	1982	1983	1984
Annual Change in Consumer Prices	45.4%	23.9%	25.6%	296.5%	328.5%	600.0%(est.)
Nominal Int.Rates*						
Savings Accounts	11.8%	16.2%	27.8%	30.0%	37.1%	110.0%
Term Deposits	12.1%	17.2%	28.0%	30.3%	39.0%	140.0%
Commercial Loans**	34.7%	33.3%	11.9%	20.2%	66.3%	160.0%
Industrial Loans**	24.3%	28.1%	11.4%	19.0%	63.1%	160.0%
Real Interest Rates						
Savings Accounts	-23.1%	-6.2%	+2.1%	-67.2%	-68.0%	-70.0%
Term Deposits	-22.9%	-5.4%	+2.3%	-67.2%	-67.5%	-65.7%
Commercial Loans	-7.4%	+7.6%	-10.5%	-69.5%	-61.2%	-62.9%
Industrial Loans	-14.5%	+3.9%	-11.0%	-70.0%	-62.0%	-62.9%

*Nominal interest rates are the weighted average for the year.
**Loan rates include taxes and surcharges.

Source: Central Bank of Bolivia. IMF: Bolivia Recent Economic Developments, Table 41.

In actuality, the preceding table understates the effective interest rates which commercial banks are able to charge borrowers. This is because commercial banks have been extremely creative in interpreting interest rate laws. For example, it is not unusual to require a borrower to deposit 10 percent of the principal of a loan as a compensatory balance, and also to deduct initial interest payments (say, an additional 10 percent) from the amount disbursed. At the same time interest can be compounded daily or monthly rather than at the annual rate implied by government regulations. Using all of the above would permit a bank to stretch the official 160 percent rate prevailing in June 1984 to over 500 percent, or something very close to a positive interest rate.

It should be mentioned that this degree of manipulation was not possible until recently. Due to the exponential nature of compounding interest rates daily, a rise in the legally permitted annual rate results in a more than proportional increase in interest charges. For example, 72 percent (the highest legal rate prior to May 12) compounded daily is equivalent to about 105 percent per annum, while 160 percent (the current rate) compounded daily approaches 400 percent per annum. Of course these benefits do not reach depositors who continue to receive only the legal interest rate.

Distortions in the real cost of capital interfere with rational output and investment decisions by Bolivian firms. For example, companies are encouraged to invest in unprofitable ventures[1] as long as the present value of the future income stream of the investment exceeds the present value of future repayments to the bank. Thus a project which results in a net loss of 10 percent of the real value of the amount invested would make sense if the cost of capital were sufficiently negative, or in this case anything less than minus 10 percent.

Interest rate distortions are also highly inequitable since they result in a transfer of real resources from depositors (usually individuals of modest means) to borrowers (large companies or wealthier individuals with access to credit). In response to the constant erosion of the purchasing power of their savings, Bolivian investors have reduced the level of their deposits whenever possible and converted their liquid assets into dollars or nonperishable real assets. This flight of capital from the organized financial sector has depleted the financial base of the banking system.

Whether measured in constant pesos adjusted for inflation, U.S. dollars at the official rate, or U.S. dollars at the parallel rate, the liabilities of commercial and state banks have diminished dramatically (see Tables III-4 to III-7). Even when converted at official exchange rates, bank liabilities declined nearly 40 percent between June 1982 and September 1983. If one uses

[1] Actual investment in a development project is often a condition for receiving a loan, especially from the specialized industrial and development banks. Where this is not the case firms are tempted to invest in dollar-denominated financial instruments which at least guarantee a positive risk-free rate of return.

the more meaningful[1] conversion of pesos at the parallel market rate, total bank liabilities dropped from US$ 838 million in June 1982 to only US$ 292 million in September 1983, or 65 percent. A third measure of the decline is provided by the conversion of bank liabilities to inflation-adjusted constant pesos which would indicate a fall of 55 percent in the real value of bank resources. Only when measured in inflated nominal pesos as in Table III-7, do the banks show growth.

A study by the Bolivian Ministry of Finance using more recent base periods found even greater rates of decline for various categories of bank liabilities. According to the study, between January 1983 and March 1984 savings deposits declined 75.6 percent when measured in constant pesos . At the same time term deposits and total savings fell 59.4 percent and 66.6 percent respectively.

The decapitalization of the banking sector has not been evenly distributed and foreign commercial banks have suffered more than domestic Bolivian banks. The Banco do Brasil and Banco de Argentina, for example, each lost nearly 80 percent of their liabilities (capital and deposits) when measured in U.S. dollars at the parallel rate, and this only in the fifteen months to September 1983. The only Bolivian banks to have fared this badly are the Banco de la Vivienda and the housing division of the Banco Hipotecario Nacional, both of which are engaged in mortgage lending and offered a less favorable 25 percent rate on deposits.

Since September 1983 the value of bank liabilities has continued to decline fairly steadily. Many domestic commercial banks can no longer fund even relatively small scale projects independently but must seek partners to share the risk. Of the 19 private commercial banks operating in Bolivia, ten now have less than US$5 million in liabilities versus only two in mid-1982. Thus the time may have arrived when some consolidation of the system may be in order.

Because of the absence of generally accepted accounting standards in Bolivia, it is difficult to quantify the effects the drop in liabilities and the depreciation of the peso have had on bank earnings. To begin with, inflation affects both sides of the balance sheet equally, leaving the proportional distribution of assets and liabilities unchanged. However, shareholders would suffer a loss in the real value of their stock through the general depreciation of bank loans and investments.

[1]Conversion at the parallel rate is the best indication of the amount an investor would actually pay or charge to acquire the assets or liabilities of a given bank. For example, a bank thinking of selling off a private loan in exchange for dollars would be forced to use the parallel rate of the peso since investors, with the possible exception of the Central Bank, would be unwilling to part with their dollars at the official exchange rate.

In the second place the accounting conventions regarding foreign exchange losses are arbitrary and do not require banks to reduce their shareholders' equity. When a Bolivian bank with U.S. dollar-denominated debts registers the foreign exchange loss resulting from an official devaluation, it simply adjusts upwards the value of its fixed assets such as buildings and equipment. In this way it maintains equilibrium on the two sides of the balance sheet. Under U.S. accounting procedures, the devaluation of the peso would register as a foreign exchange loss on debts owed abroad and would be subtracted from the shareholders' equity on the balance sheet[1].

Finally, Bolivian banks make no provision for non-performing loans, which at the moment must constitute a considerable percentage of their portfolios. Consequently investors have no objective means of determining the relative security of one bank versus another or even its profitability.

[1]Foreign exchange losses would be far greater if it were not for the February 1984 Bolivian Supreme Court decision which required the Central Bank to sell U.S. dollars at the official rate of exchange for the private banks' foreign currency liabilities. The ruling stemmed from the Bolivian Government's November 1982 "de-dollarization" decree which in effect forced banks to accept repayment in pesos at 145.5 per U.S. dollar for their foreign currency-denominated domestic loans. At the same time the banks were theoretically required to service these foreign liabilities at 196.6 pesos to the U.S. dollar, the official exchange rate at the time. In actuality, the Central Bank never accepted the obligation to provide hard currency to the banks. However, in early 1984 the Central Bank was forced to accept US$28 million (at 196.6/US$) and US$16 million (at 500/US$) in peso deposits from the private banks. In return the Central Bank acquired the corresponding external liabilities.