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AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROJECT PAPER

JORDAN: Loan Guarantee for Small Enterprise Development (278-0255)

August 18, 1988

UNCLASSIFIED

JORDAN
LOAN GUARANTEE
FOR SMALL ENTERPRISE DEVELOPMENT
PROJECT PAPER
(278-0255)

USAID/JORDAN

August 1988

ACTION MEMORANDUM FOR THE DIRECTOR, USAID/JORDAN

FROM: Jim Dempsey, PD/PE

SUBJECT: Loan Guarantee for Small Enterprise Development Project (278-0255)

Action: You are requested to approve the authorization of a grant of $10.0 million for the subject project.

Background and Discussion: The Loan Guarantee for Small Enterprise Development Project (LGP) was designed in mid June and the Project Paper (attached) was reviewed by the Mission Project Review Committee on June 30, 1988. The Committee recommended authorization of the four year project with ESF grant funding of $10,000,000. This amount is in line with the revised PID which increased project funding from $5.0 million to $10.0 million and was approved by the ANPAC per PID revalidation cable - 1988 State 176205.

The project fully conforms with USAID/Jordan's CDSS of 1986, which identifies private enterprise growth and financing as a priority. The PP demonstrates that the project is technically, socially, and economically sound and administratively feasible. The environmental analysis resulted in a categorical exclusion. The technical design and cost estimates are reasonable and adequately planned, thereby satisfying the requirements of all parts of Section 611 of the Foreign Assistance Act (FAA), as amended. The timing and funding of project activities are appropriately scheduled. The implementation plan is realistic and establishes a reasonable time frame for carrying out the project. Adequate provision has been made for evaluation and audits. The needed conditions precedent and convenants have been identified and will be included in the grant agreement.

Recommendation: Per Delegation of Authority 654, you approve the attached authorization for the Loan Guarantee for Small Enterprise Development Project.

Attachments: a/s

Clearances:

RLA, DRobertson		Date	8-16-88
CONT, BRudec		Date	8-17-88
PRM, KJohnson		Date	8/16/88
PD/PE, SRiley	S. Riley	Date	8-16-88

b

PROJECT AUTHORIZATION

Name of Country: Hashemite Kingdom of Jordan

Name of Project: Loan Guarantee For Small Enterprise Development Project

Number of Project: 278-0255

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Loan Guarantee For Small Enterprise Development Project for Jordan involving planned obligations of not to exceet $10,000,000 in grant funds over a four year period, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is four years from the date of initial obligation.

2. The project consists of helping local financial institutions to increase their lending to small businesses, thus improving the ability of local entrepreneurs to establish and expand their productive enterprises.

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

   (A) Source and Origin of Commodities, Nationality of Services

   Commodities financed under the AID grant shall have their source and origin in Jordan or in the United States except as AID may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services financed under the AID grant shall have Jordan or the United States as their place of nationality, except as AID may otherwise agree in writing. Ocean shipping financed under the AID grant shall, except as AID may otherwise agree in writing, be financed on flag vessel only of the United States.

18 August 1988
Date

Director, USAID

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)

Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: USAID/Jordan

3. PROJECT NUMBER: 278-0255

4. BUREAU/OFFICE: ASIA AND NEAR EAST (ANE) 03

5. PROJECT TITLE (maximum 40 characters): LOAN GUARANTEE FOR SMALL ENTERPRISE DEV.

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 92

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

A. Initial FY 88 B. Quarter 4 C. Final FY 91

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

A. FUNDING SOURCE	FIRST FY 88 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	1375	1125	2500	1375	8625	10000
(Grant)	(1375)	(1125)	(2500)	(1375)	(8625)	(10000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
GOJ/IDB						
Other Donor(s) Private Banks					1763	1763
TOTALS					12919	12919
				1375	23307	24682

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) ESF	701	840		- 0 -	- 0 -	2500		10,000	
(2)									
(3)									
(4)									
TOTALS									

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 111 | 650 | 810

11. SECONDARY PURPOSE CODE

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

A. Code	BU	BR
B. Amount	7500	2500

13. PROJECT PURPOSE (maximum 480 characters)

Increase the ability of local entrepreneurs to establish and expand enterprises, to improve the efficiency of the enterprises, and to produce and sell goods and services in the local and export markets.

14. SCHEDULED EVALUATIONS

Interim MM 05 YY 91 | MM YY | Final MM 08 YY 92

15. SOURCE/ORIGIN OF GOODS AND SERVICES: [X] 000 [ ] 941 [X] Local [ ] Other (Specify)

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

17. APPROVED BY

Signature: [signature]

Title: Director USAID/Jordan

Date Signed: MM 08 DD 18 YY 88

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

AID 1330-4 (8-79)

LOAN GUARANTEE FOR SMALL ENTERPRISE DEVELOPMENT
PROJECT PAPER
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LOAN GUARANTEE
FOR SMALL ENTERPRISE DEVELOPMENT

I SUMMARY

This project will provide a grant to assist in establishing a program to guarantee commercial banks and non-bank financial institutions against a portion of the losses they might incur in making loans to micro and small enterprises (MSE). The project will include technical assistance, training and other support as well as financing for a Loan Guarantee Fund (LGF) to provide the needed financial banking for MSE defaults. The Loan Guarantee Program (LGP) will be administered by an office established specifically for that purpose within the Industrial Development Bank (IDB).

The Loan Guarantee For Small Enterprise Development Project represents one of several efforts of the USAID to promote development of private enterprise in Jordan, but it is the first to promote the finance of micro and small businesses on a national scale through commercial banking channels. The goals of the project are highly consistent with both the priorities of the GOJ and the USAID's development strategy in that the ultimate objective is to create jobs by encouraging and supporting the formation of new, and the expansion of existing businesses. The project builds upon strong evidence from developed and developing countries alike that small businesses contribute a disproportionately large share of jobs to the employment base relative to larger enterprises.

Current conditions in Jordan suggest that the timing of the project, in terms of the positive impact that it is likely to have on contributing to an expansion of employment, is excellent. Following the rapid expansion of the economy in the early 80's, recent years have seen a leveling off and entry into a period of modest growth. Projections of the number of new workers entering the work force, and the return of large numbers of Gulf workers, indicate that unemployment is likely to increase in the absence of any further increase in the business and industrial base.

There are an estimated 11,000 micro and small productive enterprises in Jordan, approximately 60% of which are located in Amman. Very few of these firms have benefitted from financing from commercial banks. Based on a sample of 50 firms, an AID review found that 70% of these small scale entrepreneurs did not receive credit from the banking sector. The only substantial existing finance for MSEs is the Industrial Development Bank Program for Small Scale Industries and Handicrafts which made only 77 loans in 1987. Further, loans provided by this program are limited to a maximum of JD 4000 (JD1.0 equals $2.8) and a five-year term. The overwhelming majority of applications are for amounts at or close to the maximum, which suggests that there is considerable pent-up demand for larger loans. At present, commercial banks are the only potential source of loans in the range of JD4,000 to JD10,000, but virtually none of the banks are offering loans to small businesses.

To measure very roughly the potential demand for MSE lending, the design team surveyed 9 of the 17 financial institutions in Jordan that conduct approximately 85% of the banking business and found that their estimated demand for guaranteed lending for the first twelve month period of the program totalled $3,200,000. Although this is only an estimate, it does reflect that adequate borrower demand and sufficient banking institutional support exist to achieve target project loan objectives.

The goal of this project is to increase the levels of employment and income of micro and small enterprises in Jordan. In so doing, the micro and small industries should earn or save foreign exchange to help ease the foreign exchange constraints. The project purpose is to increase the ability of local entrepreneurs to establish and expand enterprises, to improve the efficiency of the enterprises, and to produce and sell goods and services in the local and export markets.

In the development of the Project Paper, the need for MSE financing and improved bank channels and practices for credit extension were recognized as a key problem in the sector. Thus, during the process of PP design, the plan was adjusted to increase the size of the loan guarantee program and to emphasize and assist more directly improvements in bank credit practices and procedures (See Project Revalidation Cable in Annex A). Accordingly, the Project also has the objective to help local financial institutions to increase MSE lending and to improve their understanding and management of the risks.

The project will pursue two operational objectives in seeking to achieve its goal and purpose. The first is to increase the supply of credit from commercial sources to micro and small enterprises. This will be accomplished by sharing the risk of small business lending between the participating financial institutions and the guarantee fund. Risk will be shared at a 50% or 75% with the higher guarantee applied to smaller loans (JD 5,000 or under) and those made in the rural areas and to women-owned businesses. At the proposed level of grant funding, it is estimated that the LGP will generate upwards of 1,600 loans and support approximately $13.0 million in loans outstanding at any one time.

A second, but closely related, objective of the project is to increase the capacity and the confidence of commercial banks and other financial institutions in making loans to small businesses in a self-sustaining and profitable manner. This will be accomplished by providing intensive training in cash flow and other small business lending techniques to loan officers at the participating institutions.

Over the four year life of the project, it is expected to achieve: (1) an improved capacity on the part of MSEs to obtain and apply credit for productive activities; (2) a self-sustaining credit guarantee program; (3) an increased capacity on the part of commercial banks to analyze MSE lending; (4) an improved understanding of the policy environment resulting from a series of policy studies.

A summary budget follows in Table 1 and provides a listing of all direct project contributions.

Table 1

Loan Guarantee Project
Summary Cost Estimates
Life of Project
($000)

Source	AID		IDB/GOJ		Private Banks		TOTAL
Use	FX	LC	FX	LC	FX	LC	
A. Technical Assistance	695	-	-	-	-	-	695
B. Training	215	-	-	-	-	-	215
C. Research	200	-	-	-	-	-	200
D. Office Operation	-	-	-	472	-	-	472
E. Commodities	15	25	-	-	-	-	40
F. Evaluation	105	-	-	-	-	-	105
G. LG Fund	-	8600	-	1291	-	-	9891
H. Funds Lent	-	-	-	-	-	12919	12919
Contingency (A to F)	60	-	-	-	-	-	60
Inflation (A to F)	85	-	-	-	-	-	85
TOTALS	1375	8625	-	1763	-	12919	24685

Background assessments and analyses conducted over the past year have concluded that the elements of the Loan Guarantee Project are economically and technically sound, and financially and administratively attractive. The project works directly through the private sector and benefits individual private enterprises, including women-owned businesses. Project beneficiaries will be small entrepreneurs who have generally been excluded from commercial bank lending. The expansion of their firms will bring much needed employment to the Jordanian economy.

In addition to the normal conditions precedent on legal opinion and the specification of a government grant officer, two special conditions will relate to the Loan Guarantee Fund. Prior to disbursement under the Grant for LGF, the Grantee will, except as the Parties may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

(1) Evidence that the Loan Guarantee Fund has been duly established as a trust held by the Industrial Development Bank and that adequate mechanisms and operating procedures have been developed to utilize and administer the Fund, and

(2) Evidence that the Industrial Development Bank has been given the requisite authority to make disbursements from the fund for prompt payment of claims against the approved loan guarantees and to meet operating expenses not covered by fees collected from participating financial institutions.

In addition to these CPs, there will be covenants related to project evaluation, policy studies, suspension of commercial bank participation in the Loan Guarantee Program and termination of the LGF. These are presented in detail in Section VII of this paper.

A competitive procurement will be conducted to select an institutional contractor which will be responsible for assignment of a long-term advisor to the IDB for a period of two and a half years, and for development and delivery of training courses to be provided to the staff of commercial banks and other financial institutions as a condition to their participation in the credit guarantee program.

Many Jordanians contributed guidance and assistance in preparing this paper. USAID enjoyed and appreciated the close cooperation provided by Jordanian colleagues throughout the period of project planning and design. The General Manager of the Industrial Development Bank and his staff contributed considerable time and effort to the project and have a keen interest in expanding upon the assistance that has been provided to small businesses in Jordan under the IDB's direction. The commercial banking community of Jordan was also very helpful in the design of the project, as well very supportive of the project objectives.

II. BACKGROUND PROBLEMS AND RATIONALE

A. The Banking Sector

An understanding of the Jordan banking sector, especially its size and relative sophistication, is presented here to give the background and setting for the Loan Guarantee For Small Enterprise Development Project. Participants in the the Jordan banking sector may be broken down into three major categories of institutions: (1) commercial banks, (2) specialized credit institutions and (3) savings and financial intermediaries (finance companies). Table 2 provides a listing of all financial institutions by category and their 1986 level of operation.

The commercial banks are allowed to engage in normal banking operations such as accepting demand deposits, providing short term lending and trade financing. These banks are privately owned and about half are branches of foreign owned banks. The Arab Bank Ltd. is by far the largest bank in terms of total assets, being in fact eight times larger than the next largest institution, the Housing Bank. No bank failures have occurred in Jordan, but in at least two cases, one as recently as the early eighties, the Central Bank has stepped in to prop up ailing banks. There is a general feeling within the banking community that the Central Bank will act to ensure that no financial institution, including finance companies, will fail.

Presently commercial banks may be categorized as being very liquid. Reasons for such high liquidity include low levels of private investment which has resulted in depressed demand for credit facilities and reluctance on the part of banks to expand credit facilities under the prevailing recessionary conditions.

The savings and financial intermediaries, often referred to as finance companies, were established in the early 80's primarily to enhance trading on the Amman Financial Market (the local stock exchange). They generally function as merchant banks and are authorized to underwrite new issues, deal in foreign exchange and to trade in all securities listed in the Amman Financial Market (AFM). In recent years, the distinction between the finance companies and the commercial banks has begun to blur as the finance companies expand their scope of operation. They are now involved in money market activities and trade in treasury bills and government bonds issued in Jordan Dinars. These entities are not entitled to accept demand deposits but do provide services similar in nature. One method used by the finance companies for a depositor who wants to write a check to another party, is for the finance company to make out its own check to the party. This obviously would not work for small personal accounts but seems to be quite effective for firms with fewer but larger transactions. Institutions in this category are generally less liquid than the commercial banks.

Specialized Credit Institutions have typically been created by law to fulfill specific purposes. For example, the Industrial Development Bank (IDB) Law of 1972 established the IDB for the purpose of encouraging the development of industrial projects. The law itself specifies the bank regulations but generally these institutions follow the usual banking laws and regulations.

TABLE 2

JORDAN BANKING SYSTEM

CENTRAL BANK OF JORDAN

COMMERCIAL BANKS

NATIONAL BANKS

YEAR ESTABLISHED		TOTAL ASSETS (MILLIONS JD)	BANKING (MILLIONS JD)	1986 PROFIT	# OF BRANCHES
1950	ARAB BANK LTD	665	1	26.5	24
1951	JORDAN NATIONAL BANK	134	7	2	27
1960	BANK OF JORDAN	127	8	1.9	24
1960	CAIRO AMMAN BANK	149	5	1.3	15
1977	JORDAN - KUWAIT BANK	137	6	1.1	13
1978	JORDAN AND GULF BANK	107	9	0.5	20
1978	PETRA BANK	267	3	1.4	22
1978	ARAB JORDAN INVESTMENT BANK	109	10	1.3	1
1979	JORDAN ISLAMIC BANK	167	4	0.8	11
1980	SYRIAN - JORDAN BANK	N/A	N/A	N/A	-

FOREIGN BANKS

YEAR ESTABLISHED		TOTAL ASSETS (MILLIONS JD)	BANKING (MILLIONS JD)	1986 RESULTS (MILLIONS JD)	# OF BRANCHES
1947	THE BRITISH BANK OF THE MIDDLE EAST (U.K.)	72	11	0.4	3
1951	ARAB LAND BANK (EGYPT)	35	16	0.2	8
1957	RAFIDAIN BANK (IRAQ)	13	17	0.2	3
1967	BARCLAYS BANK (U.K.)	53	13	0.01	11
1972	BANK AL MASHREQ (LEBANON)	34	15	0.2	3
1974	CITIBANK (U.S.A.)	44	14	0.2	-
1975	BANK OF CREDIT AND COMMERCE INTERNATIONAL (LUXEMBERG)	60	12	0.7	2

NON BANKING FINANCIAL INSTITUTIONS

SPECIALIZED CREDIT INSTITUTIONS

JOINT OWNERSHIP

1955	INDUSTRIAL DEVELOPMENT BANK	60	N/A	0.5	
1974	HOUSING BANK	427	2	2.8	77

PUBLIC OWNERSHIP

1959	AGRICULTURE CREDIT CORP.	N/A			
1966	CITIES AND VILLAGES DEV. BANK	49		1.4	
1968	JORDAN CO-OPERATIVE ORG.	N/A			

SAVING & FINANCIAL INTERMEDIARIES

1979	ARAB FINANCE CORP. (JORDAN)	19	0.2
1980	JORDAN SECURITIES CORP.	22	0.2
1981	NATIONAL GENERAL INVESTMENT CO.	35	0.3
1981	JORDAN FINANCE HOUSE	10	0.2
1981	ISLAMIC FINANCE HOUSE	N/A	N/A
1982	FINANCE AND CREDIT CORP.	47	0.6
1982	JORDAN INVESTMENT & FINANCE CO.	45	1.0

REAL ESTATE SAVINGS

1960	REAL ESTATE FINANCE CORP.	21	0.07
1982	DAFCO	2	0.09
1984	NATIONAL DEVELOP. & FINANCE CO.	2	0.07
1984	PETTONA	3	0.20

FOREIGN BANKS REPRESENTATIVE OFFICES

MANUFACTURERS HANOVER TRUST CO.	HABIB BANK
BANK NATIONALE DE PARIS	SOCIETE GENERAL
AUSTRIAN LAENDER BANK	ARAB AFRICAN BANK
PETRA INTERNATIONAL-WASHINGTON	AMERICAN EXPRESS
CREDIT LYONNAIS BANK	JORDAN FINANCE CONSORTIUM

MONEY EXCHANGE COMPANIES

AL-MASHREQ MONEY EXCHANGE
ARAB EAGLE EXCHANGE COMPANY
MIDDLE EAST EXCHANGE COMPANY

PLUS OTHER 70 COMPANIES

The Government owns one third of the IDB and about 10% of the Housing Bank. All of the other specialized credit institutions are 100% publicly owned. These institutions are exempt from taxes fees, duties etc., or have favorable grace periods on payment. Specialized credit institutions are forbidden from accepting demand deposits (a low cost source of funds), but they have an additional source of funds which commercial banks do not have: foreign aid funds at concessionary rates (2-5%) often with no associated foreign exchange risk.

Banks in Jordan tend to lend primarily on the basis of collateral, sometimes requiring 100% cash collateral or up to 200% property collateral. They also look at the "character" of the borrower which generally refers to his standing in the community and his reputation or more often than not, his net worth. Approximately 55% of the commercial lending is through overdrafts many of which remain "overgreen". The usual types of financial analysis concerning risk, liquidity, leverage and cash flow are generally not emphasized.

The government has maintained ceilings on deposit and lending interests rates that have kept the lending rate in the 10% range. In early June, however, the Central Bank eliminated the ceiling on commission charges for lending, effectively allowing the banks to charge higher interest rates. The effect on lending is not clear at this early stage. The issue and recent changes are discussed in detail in the Economic Analysis of the Paper.

To improve earnings with the lending ceiling in place, the banks have shown a preference for clients with high fees (primarily L/C) and turnover banking business (to earn initial lending fees). Government bonds are also a preferred investments because they are low risk with reasonably high yield and often tax exempt status. Nearly all development bonds provide an after tax yield that is higher than business lending. The ceiling on interest rates had compressed the spread between the cost and use of funds such that banks found little room to make a profit on a high cost or riskier loan. It is too early to determine the impact on lending of the liberalized interest policy but the effect will obviously be to improve bank return on lending. Whether riskier or more costly loans, such as small enterprise lending, will become part of the regular portfolio of the commercial banks remains to be seen.

B. Micro and Small Enterprises (MSE)

Data from the 1984 Industrial Census and a survey of the Jordanian MSE sector conducted in the same year provide the basis for the information contained in this section. Though insufficient for a detailed view of the sector, the data allow the following observations to be made.

Private business establishments total approximately 55,000. Of this number, approximately 87 percent are micro enterprises (under 5 employees) with the remainder being small enterprises (under 25 employees). Tables 3 provides a breakdown of the various enterprises by location and type.

Table 3

Breakdown of Enterprise by Industrial Classification

	Micro Enterprises (1-5 workers)			Small Enterprises (6-25 workers)		
	Industry	Services	Trade	Industry	Services	Trade
1. Total number of enterprises	6,811	11,410	25,858	1,720	2,858	6,463
2. Number of enterprises by governates						
Amman	3,841	7,597	9,937	961	1,899	2,484
Zarka	897	1,030	6,000	240	257	1,500
Irbid	1,190	1,378	5,564	300	344	1,391
Mafraq	188	204	793	47	51	198
Balqa	308	388	1,355	77	97	338
Karak	141	197	869	35	49	217
Tafila	30	28	280	7	14	70
Maan	216	588	1,060	54	147	265

Trade and service establishments dominate both small and micro enterprises, accounting for 59 percent and 26 percent of all units respectively. Industrial units number only 8,531. We estimate based on a review of the nature of the service firms, that only one in six would be a target enterprise for the LGP. Thus, for this paper we are using a conservative figure of 11,000 target MSEs nation-wide.

At least 50 percent, if not 70 percent, of all enterprises are located in Amman and account for a significant portion of the value added in the sector. This reflects the overall geographic distribution of productive units in the Jordanian economy.

Enterprises cover a range of disparate activities. The Census, which provides a breakdown of micro-enterprises by industrial activity, indicates that 43 percent of the enterprises are involved in industrial services, 15 percent in the production of non-electrical machinery, 14 percent in furniture and wood products, and the rest in a variety of activities ranging from clothing to pharmaceutical production.

Workers in micro enterprises seem to be evenly distributed between those who are paid and those who are unpaid apprentices or family members. The average number of workers per enterprise appears to be 2.2. The total number of workers in micro businesses is approximately 95,974. The number of workers employed in small enterprise sector is estimated to be 206,384, of which approximately 56,000 are unpaid workers. It is not clear whether these unpaid workers were counted in the official labor force figures. The estimated total number of workers also includes foreign workers who are not considered to be part of the Jordanian labor force. It is not known how many of the foreign workers are registered or unregistered.

As is the case throughout the developing world, management capacity, especially in relation to financial matters, is relatively weak. Jordan businessmen are, however, better educated and more knowledgeable than in most LDC about business systems and financial controls. Because of the high cost of operating a business in Jordan, a small business is much larger than in most AID assisted countries. Assets of $25,000 - $50,000 would not be unusual for a micro business with only 2-4 employees. The average size loan in 1987 for the Industrial Development Bank's Small Scale Industries and Handicraft Fund (SSIH) was approximately $9,000. No loan was made to any firm with more than 5 employees.

From 1975 to 1987 under the SSIH Fund only a very small percent of the loans of a total of 2360 were made to women. Culturally women entrepreneurs are discouraged and those that do borrow do so with the guarantee or under the auspices of their husband or a male relative.

C. Problems and Constraints

1. Economic Downturn

Since the early 1980's, depressed economic conditions in the region coupled with continued low world commodity prices for Jordan's mineral exports adversely affected the performance of Jordan's external sector which represents 38% of GNP.

In the past several years, government spending has provided a key boost to growth, offsetting to some extent the stagnation in exports and lagging workers' remittances. As a result of slowing remittances and poor export performance, GDP annual rate of growth has remained at less than 3% since 1983.

Lower world oil prices, reduced private consumption, lowered investment, and consumer expectations of continued hard times have all led to a compression in imports. Preliminary balance of payments results for 1987 reveal a sharp deterioration in Jordan's external position. Worker's remittances, the mainstay of Jordan's balance of payments, fell by USD 247 million to Dols 938 million, their lowest level since 1978. Official unrequited transfers, predominantly arab AID, fell by nearly Dols 100 million to Dols 588 million, their lowest level since 1978. While exports showed healthy growth, the trade cap windened by USD 70 million to USD 1.7 billion, as imports expanded sharply reversing a four year downward trend. The net result of these trends was a sharp increase in the current account deficit from Dols 46 million in 1986 to Dols 349 million in 1987. This level in the current account deficit, equivalent to 6.3 percent of GNP, marks a return to levels registered in the early 1980's. The USD 303 million increase in the current account deficit was mirrored by a USD 240 million drop in the foreign exchange position of the Central Bank, an estimated USD 28 million sale from official gold holdings, and a USD 180 million increase in non-military external public debt. With foreign exchange reserves at dangerously low levels, Jordan cannot sustain further current account deficits of this magnitude without expanded external borrowing or adjustment measures. In the face of the dwindling foreign exchange reserves, Jordan has abandoned its official peg to the SDR and allowed the dinar to depreciate some 18 - 20% against the SDR since December 1986. Jordan's debt service ratio rose from a level of 7% of goods and services exports (including workers' remittances) in the early 1980's to 12.9% in 1986.

With the reduced job opportunities in the Gulf States and continued high labor force growth - estimated at 4-5% per annum - Jordan faces a growing employment problem. Jordan's new Five Year Plan for 1986-1990 targets annual GDP growth of 5%, but most doubt that the external resources will be available in the amounts needed to support this growth level. Slower economic growth will limit the pace at which new jobs will be created, aggravating Jordan's employment problem.

In the past, government services absorbed a large portion of additions to Jordan's labor force. Government and community services account for some 21% of GDP, but their share of total employment is nearly 50%. With budgetary stringencies, government ability to provide jobs will be reduced. Agriculture, which contributes 8% of GDP and a similar portion of total employment, is unlikely to provide many new job opportunities, given the large reliance on Egyptians for unskilled agricultural labor. Construction, which now comprises 10% of GDP and provides 11% of employment, is suffering from the Jordanian economic downturn and is also unlikely to be a major future source of employment growth. Mining and manufacturing, which contribute 18% of GDP, employ only 11% of Jordan's workforce. Services other than government represent some 43% of GDP and 22% of total employment.

It is in these sectors - private services and mining and manufacturing - that employment growth will have to accelerate. Expanded export earnings from these sectors, as well as from agriculture, will also be important if Jordan's structural trade imbalance is to be redressed.

2. Credit to Micro and Small Enterprises

Because of the small size and informal nature of the business, MSEs don't generally have strong links into the banking sector through credit or savings.

These small operators rely upon informal channels which in Jordan are almost exclusively family and friends. Money lenders are not an important source of credit to any sector in the economy. Suppliers do, however, provide credit for the small shopkeepers and some financing for equipment and inputs into small industries.

Although these informal sources of funds are adequate in a strong and expanding economy, they do not provide for full expansion of the MSE sector. In times such as these in Jordan today (slow growth and rising unemployment), the informal credit sector is inadequate to promote the growth of small enterprises.

To open formal credit channels to the small and micro industries requires above all else a change in the banking practices in Jordan. From the Small Scale Industries and Handicraft Loan Program at the IDB (described in detail in Section II F) and the experiences, although limited, of commercial banks, small and micro industries have an understanding of the formal lending sector and are more knowledgeable of credit and business than MSE in other parts of the world. This is not to say that training of the entrepreneur and close loan supervision is not important or beneficial. Rather it points to the constraints within the financial institutions as those that should be addressed first.

The most important of the banking constraints is the extensive use of collateral based lending. Very little investment analysis is completed even for large projects or loans. Cash flow lending is just now being discussed in the country and only a handful of loan officers in the entire banking community have even basic skills in cash flow lending. The lack of analytical skills does not reflect the full extent of the constraint. Collateral based or "name" lending can be completed within the comforts of the bank office. At present, few loan officers have experience or familiarity with business operations, especially production. Cash flow lending with a complete and accurate set of books and financial tables is a straight forward application of standard ratios and investment analysis. But with small businesses, the task becomes one of establishing and verifying the records as well as completing the analysis. Development of the analytical skills as well as the practice of lending to small business is necessary to expand MSE lending.

Although the task of training loan officers is complex, there is a strong foundation upon which to build in the banking structure of the country. The banking community in Jordan is relatively large both in terms of branch offices that are out in the community and the number of loan officers in total.

Branch bank officers have a reasonably good knowledge of the local business scene which is a prerequisite for cash flow lending. The time consuming nature of small business lending is a problem if there are only a handful of loan offices. It is less of a burden on the system or the individual when many financial institution are participating in the program and all loan officers are seeking to extend MSE loans. Returning to the need for upgrading the skills of the entrepreneurs themselves, proper cash flow lending (loan supervision) with site visits and financial and operational reviews provide a basic business knowledge and training to the businessman.

A second set of structural problems in the banking sector is the preponderance of overdraft lending and the fact that this lending remains in the U.S. banking terms "evergreen". Approximately 55% of all lending in the Jordan is through overdrafts. Although there is a Central Bank requirement that the balance for overdrafts go to zero at least once during a calander year, in practice this is not followed. Overdrafts are used for a wide range of business and personal needs by the borrowers with little or no supervision by the lending institution. Not surprisingly, financial institutions are reluctant to give this freedom to a small businessman. Overdrafts are the logical instrument for collateral based or "name" lending.

On the positive side, the Central Bank has recently issued orders to the banks to cut the percentage of overdrafts in the portfolio down to 20%. This will increase the number of term loans which are more appropriate for the needed supervision of small business lending. A record of timely payment of short term loans is an excellent indication of a small entrepreneur's ability to handle a medium or long term loan. Use of the overdraft lending is a constraint to MSE lending, but the recent decision of the Central Bank to move the banks away from such lending is, however, a very positive sign.

A corollary problem to overdrafts is the limited use of medium and long term lending. In Jordan, amortization of capital equipment over its medium or long term useful life is necessary for an accelerated pace of business expansion. This is especially true for MSEs which have not had access to the "evergreen" overdrafts that have substituted for long term lending.

D. Rationale and Strategy

Expansion of the the micro and small business sector will lead to economic growth with the corresponding expansion of employment and incomes. Given the high priority of the government and USAID/Jordan of employment generation in this period of rising unemployment, the provision of capital funds into the MSE sector is highly attractive. Around the world, it has been shown that the greatest potential for job creation is in small enterprises and that the capital cost per job created is low. In the Small Scale Industrial and Handicraft loan scheme at the Industrial Development Bank, a new job was created for every $6,000 invested under the program. The relative neglect of the MSE sector by the banking community and lack of a clear strategy and support programs by the government itself indicates that there is likely to be much potential for expansion to help address the concerns of employment and slow economic growth.

The increasingly serious problem of foreign exchange constraint can also be helped by an expansion of the MSE sector. A project objective will be to assist industries that earn or save foreign exchange. Since foreign exchange is becoming a constraint, opportunities exist to expand local production of products that Jordan may no longer be able to afford to buy outside the country.

The program is designed to build upon the existing banks and their normal lending structures, albeit with new cash flow lending analysis. No new institutions will be established. A special institution for MSE development with the resultant high overhead costs is avoided.

Project and GOJ funds will be used to leverage existing liquidity within the banking system to lend commercially. The use of market, commercial lending is at the core of the strategy. Although there are guarantees, there are no subsidies to the banks or the MSEs and both groups should be able to earn reasonable returns. The approach is a private sector one that once fully implemented should be self-financing and, thus, self-sustaining.

E. Conformity with GOJ Priorities

The Third Development Plan, 1986-1990, of the GOJ recognizes that the development of the private sector offers the most viable opportunity for sustainable growth. In the five year plan, Jordan has targeted the small enterprises in industry, services and trade as areas for encouragement of development. Industrial sector goals include employment generation, foreign exchange earnings and savings as well as expandion of investment. The Government is establishing new policies and regulations to encourage the growth of the private sector. These include extension of the investment incentives to smaller firms, a simplification of the custom procedures and a review of tariff protection to find and eliminate biases against small business. Although not discussed in the Five Year Plan, the Central Bank now has the stated objective of increasing small business lending and increasing the use of cash flow and term lending.

A series of bank reforms, most notably the liberalization of interest rate controls, is setting the stage for MSE lending by giving the banks the opportunity to earn reasonable returns on such lending. Specific to this project the GOJ is establishing the loan guarantee program and is committed to its implementation and continuation after this particular AID project. Support exists within all areas of the Government.

The Government also has the objective of promoting economic growth in the regions outside of Amman. Although there is a recognition that certain economies of scale and infrastructure support make Amman a more attractive locale for some businesses, equity and the goal of balanced national growth make regional development important. In line with this GOJ policy, the program is designed to give a higher level of guarantee to firms operating outside of the greater Amman region.

Finally, government continues to support the development of the necessary infrastructure and human resources needed for private sector growth, and that of the smaller enterprises in particular.

F. Conformity with the Country Development Strategy Statement (CDSS)

The USAID/Jordan CDSS was set out specifically to address the increasing unemployment and balance of payments/foreign exchange problems facing the country.

This strategy seeks to work directly with private sector manufacturing and service industries to empower them to be the main engines of growth in income, employment and exports. This will be accomplished directly through AID resources, and indirectly, through policy dialogue. The strategy calls for increased USAID assistance to small enterprises, which tend to be the most efficient users of capital and generate more employment opportunities.

The USAID/Jordan strategy for small and micro enterprises is as follows:

1. To improve access of small and micro enterprises to formal sources of credit on a direct or indirect basis.

2. To provide technical assistance and training.

3. To promote availability of capital through the establishment of a business development center and/or a venture capital fund.

To meet USAID/Jordan's CDSS objectives and plans for enterprise development, the Mission has implemented a series of projects that are helping the private sector in general and working to provide some assistance to the MSE subsector. Existing and new projects are or will be providing assistance in supporting areas such as policy dialogue, improved capital access to small and medium sized entrepreneurs, improved marketing orientation and skills in industrial and agri-business, as well as increase exports of products and services. The Private Enterprise Technical Resources Assistance does provide small enterprise lending, export promotion and venture capital assistance but its scope is limited. However, no other project directly supports the MSEs. The Loan Guarantee For Small Enterprise Development Project fills an obvious need to assist this important subsector of the private sector.

F. MSE Lending: The Record and the Demand

1. The Lending Record

The record of small enterprise lending throughout the world varies considerably and must be seen as a function of the program design and the business conditions that exist in the specific country or locale. USAID/Jordan is undertaking small enterprise lending as one part of its Private Enterprise Technical Resources and Assistance (PETRA) Project. However, the number of MSE loans made under the program to date is very small and none have come due.

The most important and by far the largest MSE lending program in Jordan is the Industrial Development Bank's Small Scale Industries and Handicraft (SSIH) Fund which has been in operation since 1975. Summary of its loans by year, size, location and type of business is set out in Annex F.

The program grew through the period to reach a point of approximately 225 loans per year with an average size loan being in the $8,000 to $9,000 range. The staff included only 5 loan officers in 1984 and repayment rates were good through 1983 (93.5% in 1983). With Arab donor assistance, the SSIH lending doubled in size in 1985 and 1986 to over 400 loans per year with a total value of $3.75 million. However in 1986 and 1987, repayments on the loans dropped dramatically. Essentially the problem was the inability of the small staff to deal with such a large number of loans, especially given the economic slowdown that hit the country. In 1985 and 1986, the loan officers' attention became focused on extending new credit rather than supervising existing loans. This problem was identified and the IDB drastically cut back new lending and devoted loan officer time to collection and supervision of existing loans. The SSIH loans extended in 1987 were just 77. The SSIH lending has not yet returned to its previous high levels of collection and questions remain about appropriate size and scope of the program.

2. MSE Loan Demand

Review of the SSIH program gives a good idea of the potential demand for MSE lending in Jordan by considering the amount of money lent and the number of loans made in its peak years of 1985 and 1986. The IDB with its small staff lent in each of these years approximately $3.75 million to over 400 MSEs.

The record is also clear that demand must be evaluated with consideration to institutional capacity. The question of demand for the lending is dealt with in detail in the economic analysis but suffice it to say that the demand analysis is best made on the "wholesale" level by receiving from commercial banks an estimate of how much MSE lending they could move. The institutional capacities are estimated by the banks themselves. As part of the design exercise, we contacted and solicit a response from 9 financial institutions that conduct approximately 85% of the commercial business in Jordan. As a group they estimated that $3,200,000 of MSE credit could be extended in the initial year of Loan Guarantee Project.

III. PROJECT DESCRIPTION

A. Goal, Purpose and End of Project Status

The goal of this project is to increase the levels of employment and income of micro and small enterprises in Jordan. In so doing, the micro and small industries should earn or save foreign exchange to help ease the foreign exchange constraints. The Project purpose is to increase the ability of local entrepreneurs to establish and expand enterprises, to improve the efficiency of the enterprises, and to produce and sell goods and services in the local and export markets.

In the development of the Project Paper, the need for MSE financing and improved bank channels and practices for credit extension were recognized as a key problem in the sector. Thus, the project was adjusted to increase the size of the loan guarantee program and to emphasize and assist more directly improvements in bank credit practices and procedures (Ref in Annex A - Project Revalidation Cable). Thus, the Project also has the objective to help local financial institutions to increase MSE lending and to improve their understanding and management of the risks.

At the end of the four year life of the project the following accomplishments are expected:

(1) There will be an improved capacity on the part of micro and small businesses to obtain credit and apply it to productive activities. We expect a fifteen percent participation by micro and small enterprises producing in the target areas of industry and non-trade services (present estimates of this group are 11,000).

(2) A self-sustaining credit guarantee program to provide partial credit guarantees for loans to micro and small enterprises will be established. To achieve this end, there will be

- Program participation by approximately six financial institutions which conduct a significant proportion of the country's banking, and

- Country-wide coverage for small entrepreneurs through the branches of participating banks.

(3) The Industrial Development Bank will have the capacity and systems in place to operate a credit guarantee program, and to monitor loan performance and issue guarantee payments promptly when necessary.

(4) The capacity of the banking sector to analyze micro and small business lending needs will be improved. To achieve this end, a series of specialized courses on MSE lending will be provided to loan officers to improve their ability to diagnose MSE credit needs and related problems, and to conduct financial reviews and cash flow analyses. Technical assistance to to help the loan officers apply these new ideas will also be needed.

(5) An improved understanding of the policy environment will result from the studies carried out under the project. It is expected that these studies will produce recommendations and ultimately revision of policies and regulations affecting the banking sector.

B. Project Structure and Elements

1. Project Components

The project will provide, over its four year life, an ESF grant of $10,000,000, of which $1,400,000 will be used to finance part of the costs of administration, bank credit training and other program support activities. The balance of the $8,600,000 of the AID grant will be used to reimburse the GOJ for the establishment of a Loan Guarantee Fund to be held in trust by the Industrial Development Bank. The LGF will be available to guarantee micro and small business loans made by financial institutions that choose to participate in the Loan Guarantee Program (LGP). The income generated by the LGF investments will be available to cover payments on defaulted loans and the operating expense of the LGP. The project will be incrementally funded by USAID with an initial obligation of $2,500,000 in FY 1988.

2. Operation of the Loan Guarantee Program

For the LGP, two important administration functions will be required. Both will be performed by the IDB. The first and simplest will be the administration of the LGF held for the GOJ by the IDB. The Bank's Finance Department will have responsibility to manage the Fund, but will be limited to investments in the GOJ bonds and bills and Certificates of Deposit (CD) at local banks. Priority in placement of the CDs will be given to those banks participating in the program. All investments are very low risk and should earn an average of 7% annually for the LGF. The IDB will be required to establish a schedule for investment maturities that matches the expenditures (guarantee payments and office operations) of the LGP.

Secondly, a new office will be established in the Industrial Development Bank to administer and monitor the guarantee program itself. The LGP Office will have two Jordanian professionals, the Office Director and a Loan Program Monitor/Officer, as well as a expatriate Loan Guarantee Advisor who will work with the staff for two and a half years. Job descriptions for all of these individuals appears in Annex G.

Generally, the advisor will be expected to help establish program procedures and to oversee and participate in development of the Office staff to assure a smooth transition to self-sufficient operation upon his departure. The Loan Guarantee Advisor will have considerable experience and knowledge of small business lending as well as be experienced in training to increase skills in lending to small businesses. The individual will report to the General Manager of the Industrial Development Bank and to the USAID Project Officer.

The Office Director will be a senior individual with extensive experience in bank lending to small and medium enterprises as well as be familiar with risk analysis, cash flow lending and banker training. The Loan Program Monitor will monitor participating banks' lending and performance and be responsible for development and operation of a computerized system for generating reports from information provided by the participating banks.

More specifically in relation to the loan guarantee, the Office would receive and review applications from financial institutions who want to participate in the program. The Office will then prepare recommendations to the IDB's Board of Directors which will make the decision on bank participation in the program, subject to the concurrence of the Central Bank and USAID. The IDB Board of Directors include the Deputy Governor of the Central Bank, the Minister of Industry and Trade, and the Secretary General of the Ministry of Planning. A loan guarantee agreement will be signed between the IDB and the participating financial institution.

In implementation of the program, the Office will monitor the performance of the participating banks in accord with program criteria and the participation agreement signed with IDB. This monitoring would be achieved primary by reviews of quarterly reports submitted by the banks and audits completed by independent accounting firm. Based on the reports and the procedures established, the Office Director or the Managing Director of the IDB would be responsible for payments to the banks for non-performing loans that are classified as a bad debt. The guarantee criteria and the bad debt collection procedures are described in more detail in later parts of this section of the PP.

Finally, the LG Advisor will direct the development, delivery and evaluation of training of local bank participants provided by an institutional contractor selected under the technical assistance component of the project. For training of the staffs of participating banks, there will be much activity initially but the requirements will be relatively small after two to three years of program implementation. The office will monitor the training programs to assure they deliver to the participants practical and effective small business lending techniques. The office will also oversee the selection of auditors, and review audit findings to determine the need for corrective actions.

3. Target Loans

Lending will be limited to micro (under 5 employees) and small (under 25 employees) enterprises that are productive in nature, i.e., in the manufacturing, maintenance or non-trade services sectors. It has been established that small businesses have contributed to increased employment at lower capital investment than large businesses in most countries and it is generally agreed by the bankers interviewed that the same is true in Jordan. For that reason, the Loan Guarantee Program will emphasize productive activities in the selection of loan recipients, and will exclude retail operations that rely on imports or do not generate additional foreign exchange. Financing for trading, consumer sales or consumer purchases will generally not be provided. The economic objective of the program is to create employment and generate foreign exchange earnings or savings.

An exception to this policy will be made for isolated rural areas where basic retail shops do not exist. In these areas traders will be financed in order to cut back on the high and uneconomic transport costs incurred by the local residents.

A qualifying sub-borrower is an individual, partnership, association, cooperative or corporation that is a private, Jordanian owned business operating in the Kingdom. Loans will not be made to firms or subsidiaries of firms with equity participation by the GOJ, including the Pension and Social Security Funds. The program is national in scope but preference through a higher guarantee will be given to those businesses outside the greater Amman area. Special efforts were extended to interest banks with branches in areas outside of Amman. The Housing Bank, which maintains 83 branch offices is particularly well represented in the outlying areas. However, there are at least four commercial banks with branch offices in major towns throughout the Kingdom.

No loans will qualify for the guarantee from the existing portfolios of the banks. The principal objective of the Loan Guarantee Program is to extend credit to businesses which have not previously had access to bank credit. Only new enterprises or clearly defined expansions or upgradings of existing businesses will be eligible for the guarantee. Credit to previous borrowers for expansion of existing business will be included subject to a statement to that effect from the participating lending bank. Renewals or extensions of pre-existing debts will be strictly prohibited.

4. Criteria for Commercial Bank Participation

The principal criteria that will be applied in selecting participating financial institutions will be the estimated capacity of the institution to issue small business loans at the levels proposed. The terms and conditions of bank participation may need to be reviewed on a periodic basis to ensure that the desired lending is being made. Adjustment of the terms as presented below may be required, but they provide what is presently considered an attractive package to financial institutions in Jordan.

Before allocating a portion of the guarantee to a specific institution it must commit to sending personnel to the training program that will be provided through the LGP. Participating banks will also be required to pay an annual fee of 2% on the guarantee extended. For the initial year of the LGP, this fee will be payable in advance based upon an estimate of the size of the portfolio that will be guaranteed.

a. Loan Conditions

The following loan conditions will apply to the lending program.

(1) A guarantee of 75% will be given for loans of under JD 5000. However, if the production facilities are located outside of the greater Amman region, the upper limit for a 75% guarantee will be raised to JD 10,000. For loans in the greater Amman area between JD 5000 and 10,000, a 50% guarantee will be provided by the program. All women owned and operated business loans will be guaranteed at the 75% level.

No loan of more than JD 10,000 will be guaranteed under the program. Blending of a guaranteed loan with regular commercial lending will not be permitted. Borrowing will be for discrete business activities within the loan guarantee limits.

(2) At least half the number of loans in individual bank programs must be under JD 5,000.

(3) The guarantee will cover principal and interest (including six months accrued interest). Loan payments or collections received after a guarantee payment is made will be shared by the bank and the LGP on a pari passu basis.

(4) Banks may draw down on the guarantee on loans that have had no payment on interest or principal for over a six month period. The banks will be required to describe their collection procedures and have them approved at the time of application to the Loan Guarantee Program. Steps for collection must be followed in order for the loan to qualify for reimbursement under the guarantee.

(5) There will be a 2% annual fee charged on the amount of the guarantee provided under the program.

(6) The program will be for term lending for discrete business activities or working capital loans. Overdrafts will be excluded.

(7) The program will also address the difficulty encountered by new business in meeting loan repayments before the business has begun to generate adequate revenue, by providing appropriate grace periods.

(8) Jordanian and American law relating to the prohibitions of lending for certain items such as pesticides, luxury goods, police or gambling equipment, alchoholic beverages, firearms and explosives will be applicable. Also the source and origin of the goods and services financed cannot be from Communist Bloc countries.

The guarantee could also be used for supplier credit to individual businesses that receive funds in line with the previously listed loan criteria. One possible approach would be that in exchange for the purchase of eligible goods, the entrepreneur would give to the supplier a bill which is an agreement to pay for the items purchased per specified terms. The supplier may then present the bill to the participating bank which will discount the bill to the supplier. The discounted amount would then be eligible for inclusion in the Loan Guaranteed Program.

b. Loan Review and Supervision

In order for a financial institution to participate in the program, it will agree to include in the credit file for each loan a full or constructed balance sheet and income statement showing the present position of the proposed borrower together with a budget or cash flow analysis which will support the proposed source of repayment of the specific loan. An estimate will be made of future sales, cash receipts, cost of inventory purchases, salary expenses and overhead costs in order to convert the forecasted sales into cash for the repayment of the loan.

If the borrower has insufficient experience to prepare a formal financial statement, it will be required that the financial institution, in cooperation with the proposed borrower, draft a statement which will list the assets and liabilities of the business to be financed. These estimates, signed by the borrower, must be in the files of the financial institution for possible evaluation and audit by the LGP Office or its auditor. Using cash flow lending techniques, we expect that collateral requirements will drop sharply in the lending under the LGP. However, it is not expected that collateral requirement will be eliminated. Collateral plays an important role in securing the loan repayment on the part of the borrower and security to the lender in the case of unforseen problems.

5. Guarantee Mechanism

Experience has shown that the success of guarantee programs is highly dependent upon the clarity of conditions and rapidity with which guarantee claims are settled and paid. Therefore, to assure success, the financial institutions must have confidence that funds will be available and that draws under the guarantee will be effected smoothly. A number of features have been built into the project to assure that this requirement is met.

a. Funding Mechanism

Project grant funds will be used to reimburse the GOJ for payments into the Loan Gaurantee Fund that is held in "trust" and managed by the IDB. The Fund portfolio will be held in Government of Jordan bonds or bills or certificates of deposit at local banks. These securities will be held as a guaranty fund for loans made under the program. The GOJ will purchase and be reimbursed for the securities over the life of the project on an incremental basis, as loans are made under the LGP up to a total of Project funding of $8.6 million. The interest proceeds from the bonds and CDs will be used to defray the operating cost of the guarantee program (payments against bad debts and administration costs) and to increase the size of the guarantee fund. A projection of Fund balances over the life of the Project appears in the Financial Analysis Section of the PP.

b. Agreements with Commercial Banks

These agreements will define the types of loans to be made, commit for the required training in small business lending and credit management, and specify the reporting formats to be completed by the participating banks, so that compliance with the objectives of the project can be monitored.

c. Draw Down Procedures

While the agreement for payments on defaults with the participating institutions will not be a standby letter of credit, it should operate as easily as such an instrument with the participating institutions. The availability of the proceeds of the guarantee should be straightforward.

If the institution is in compliance and its loan is delinquent under the terms of the agreement, funds must be immediately available on the approval of the Loan Guarantee Program without the need for additional review.

A definition of a bad debt or standard practice on write-offs for non-performing loans does not exist in Jordan. Each bank has its own rules. Generally, Jordanian banks do not consider a loan as seriously in arrears until payments are delinquent at least a year. Although this time frame seems appropriate in the Jordan context, unfortunately the follow-up on delinquent loans appears very weak in a number of banks. Good banking practices require that the lender maintain close working relationship with the borrower and should check missed payments promptly and review repayment prospects on a monthly basis thereafter. This project will consider a loan as qualified for a guarantee payment when the loan is delinquent on all payments for a period of six months. Consistent with this judgement, the Central Bank has promulgated a more stringent regulation which prohibit the banks from accruing interest on loans that are six months delinquent. For the Loan Guarantee Program, the participating bank will be required to visit and review the borrowers situation and show that efforts had been made to collect the funds. In addition, the lending institution will be required to show that it has taken all legally possible steps to effect payment once the loan is past due. This will include demand letters, legal repossession procedures on machinery and equipment collateral, notices to guarantors and any other legal steps that prudent banking in Jordan requires on delinquent loans. Claims under the guarantee will include a copy of the debt instrument, with payments of principal and interest noted thereon, copies of the original cash flow analysis undertaken when the loan was approved and copies of the memos of the contacts with the borrower and copies of legal steps taken in the collection efforts.

6. Potential Bank Programs

All but two of the nine banks contacted expressed interest in participating. Thus, it is anticipated that a substantial number of local financial institutions will participate in the program and establish or expand small business lending. The final number of participants will depend on the amount of lending of the participating institutions themselves, but our objective is to have approximately six participating banks. A large program and much lending by the Housing Bank or the Arab Bank (the two largest banks in Jordan) would limited the availability of funds for other financial institutions. Since an objective of the Project is to help change the lending practices in the entire banking sector, the participation of a good cross section of banks will be sought.

The program is expected to have a significant impact on increased lending to enterprises in outlying areas because of the higher guarantee level provided for rural businesses. An additional benefit of the program is anticipated to be an increase in the availability of credit to women-owned businesses. This is likely to occur principally in Amman where more women are included among the owners of small businesses.

While participation in the Loan Guarantee Program is open to all financial institutions, there will be a review of the financial position of the bank and recommended action on the application submitted for consideration by the IDB Board of Directors.

Participation in the program will also be subject to the concurrence of the Central Bank and AID. The initial allocation may be limited to assure that there are at least four banks or financial institutions participating. Close monitoring of loan reports from the lending institutions will be followed to be sure that loans are to qualified businesses, under the terms specified in the program and that delinquencies are being followed-up.

7. Percentage Guarantee

The decision to provide 50% and 75% guarantees is based on experiences worldwide that show that sharing of a significant level of the risk by the lending institution and the guarantor is necessary for a successful program. As an incentive for the bank to expand its lending into new areas, a risk sharing of a significant portion of the new lending is strong encouragement. On the other hand, too high a guarantee (90% and up) leaves the bank with insignificant risk and thus little incentive to extend good credit and supervise it. The 50-75% guarantee range has been found to be appropriate and successful in the expansion of small enterprise lending. A more detailed discussion of the incentives to increase small business lending is presented in the Technical Analysis.

8. Size of Program

AID will provide grant funding of $8.6 million over the life of the project to back the loan guarantees with an equivalent amount deposited in the Loan Guarantee Fund. Thus, the guarantee will be a 100% backed by AID funds. This level ensures confidence on the part of the banks for this new program. The total value of loans supported by the guarantee at any one time will depend upon the relative sizes of the 75% guarantee compared to the 50% guarantee loans within the banks' portfolios. For example, if all loans issued are eligible for a 75% guarantee, the size of the portfolio would be approximately $11.3 Million. If only 50% of the value of the loans issued are guaranteed, the program would leverage $17.2 million for loans for small businesses.

A conservative approach was taken in estimating the value of loans generated: It assumed that the requirement that half the loans be less than JD 5000 would be filled with loans eligible for 75% guarantee. Larger size loans are more likely to be made in Amman, and a mix of 70% Amman-originated and 30% outlying area-originated was assumed for large (JD 5000 to JD 10,000) loans carrying guarantee coverage of 50% and 75%, respectively. This approach produced a weighted average guarantee coverage of 64%, and estimated total loan value generated of approximately $13.0 million.

This level of AID backing is attractive not only from the standpoint of confidence building, but also in that it is a level that can be self-sustaining in the sense of creating a Fund that can earn enough to pay for the cost of the Loan Guarantee Program.

As the program matures and default rates drop, the earnings from the fund should be adequate to increase the level of leverage without drawing down the Fund's capital.

9. Bank and MSE Capacities

In the present environment, the financial institutions are hesitant to enter the small business market. Based upon evaluations of the previous experience of lending officers with small business lending, it is easy to understand their caution. To overcome the limited skills of lending officers in small business lending, each participating institution must agree to send the personnel who will be making the small business loans to an extended training program. Only when the individuals have satisfactorily completed initial training will the institution be allocated a guarantee line. Follow-up advisory assistance will be provided to help the loan officers apply their skills.

The small lending program administered by the bank will provide considerable assistance to the potential borrower. As part of the lending service, loan officer will work with applicants in helping them develop and describe their financial position and gain a good understanding of the revenue and cost targets they must achieve to meet their loan objectives. As part of routine visits to borrowers, lending officers will also review the current financial position of the entrepreneur and suggest corrective actions when appropriate.

10. GOJ Contributions for Expansion

Any contributions to the Loan Guarantee Fund by the GOJ will, of course, increase the level of lending that can be supported by the program. It is reasonable to expect that the amount of the fund would be increased at the conclusion of AID participation in year 4 when the program has achieved self-financing status.

In addition to GOJ support, the participating banks might be willing to supplement the guarantee by making payments into a risk pool to be used for that purpose.

C. Project Inputs

1. Technical Assistance

In addition to the long term Loan Guarantee Advisor at the IDB, twelve person months of short term TA will be provided primarily to direct banks, and loan officers in particular, in the application of their new skills in risk analysis and cash flow lending. Technical Assistance in the amount of $680,000 over the life of the project will be provided through an institutional contractor hired directly by AID.

2. Training

Through the TA contract, training services will be provided for:

- training of participating bank personnel in cash flow lending and small business financial analysis,

- brief training programs for senior bank management, and
- periodic follow-up and technical assistance to participating banks and the LGP Administrative Office as required.

To generate adequate support and understanding of the program among senior bank management, orientation and workshop sessions of 1-2 days will be conducted for these personnel. This will help to assure that senior management will be familiar with and will support the new lending techniques that will be introduced into the bank's operations as a result of the training provided to lending officers.

The training of participating bank operational personnel is expected to be accomplished through a series of sessions involving personnel from participating banks. An intensive program of approximately three weeks will be provided for the lending officers and branch managers. Previous experience with this type of training suggests that it will be necessary to review accounting principles and to provide practice in construction of balance sheets and income and expense statements, as well as considerable hands on experience in analyzing operating costs and cash flow analyses.

The follow-up technical assistance that has been included in the project will provide for supplemental training and on-site assistance over the first two years of implementation of the program.

Because of the lack of experience with cash flow and small business lending in Jordan, it will be necessary to contract with a U.S.-based firm to obtain the training and technical assistance services. Training of the type proposed is provided on a regular basis to U.S. bank personnel, and no difficulty is anticipated in contracting with a competent firm through a competitive procurement. While the materials that have been developed for these training programs are in English, the contractor would be expected to recruit bi-lingual personnel in Jordan to assist in training delivery. The Industrial Development Bank's training arm, the Jordan Institute of Management (JIM), will be used to give the courses and provide staff as appropriate. It already has experience in banker training and its institutional capacity is being strengthen by USAID/Jordan in other projects.

3. Policy Analysis

Although the policy environment for small enterprise operation and development is sufficient to enable small business to expand in Jordan, there are a number of biases within the system that are a constraint to faster MSE growth. The encouragement of investment law provides incentives to medium and large firms who establish industries in priority locations and "economic" projects. Generally, production by micro and small enterprises does not receive any special incentive from the government. There is a potential to help the MSE through concessions in the area of income tax, tariff adjustments and expedited custom procedures.

A second major for analysis area will be the effect of the program on employment generation. Significant new employment is expected, but

research on the type (laborer, semi-skilled, manager), level of training (uneducated, primary education, vocational, degree holding) and source of education would be useful to plan additional enterprise development programs. In relation to decreasing Jordanian unemployment the issue of increasing Egyptian migrant worker employment in the MSE sector will be addressed.

Another area to study will be the operations of the Loan Guarantee Program itself, especially in light of the recent liberalization of interest rates in Jordan. Given the need for these policy studies, the Loan Guarantee Project will set aside $200,000 for studies and policy seminars in areas related to micro and small enterprises development and credit extension.

This analysis component will be included in the training and technical assistance contract, and is expected to generate 4-6 major studies related to the formation and growth of small businesses, and especially the financing and operating characteristics of these enterprises.

IV FINANCIAL ANALYSIS AND PLAN

A. Project Budgets

Direct contributions to the project over its four year life are estimated to be just under $24.7 million of which the AID contribution will be $10.0 million while the lending institutions will contribute as loans to small businesses approximately $12.9 million. There will also be interest earnings from the Loan Guarantee Fund and Guarantee fee earnings which are estimated to be $1.8 million.

There will also be a number of contributions that are derivative or indirect in nature. If we assume 1:1 debt equity ratio for the participating business borrowers, then their contribution would total the same as the banks at $12.9 million. Finally, interest earnings on the bank loans will total approximately $3.6 million. Thus, the total expenditures of the LGP and minimum value of the resulting productive activities would be approximately $41.2 million.

AID funds will be obligated on an incremental basis, with an initial obligation in FY 1988 of $2,500,000. Specific to the Loan Guarantee Fund, AID will provide a grant to the government to reimburse the GOJ for its contributions to the Loan Guarantee Fund that will be held in trust at IDB. Disbursements of the $8,600,000 of AID grant funds for the Loan Guarantee Fund will be made based on quarterly projections of guaranteed amounts of small business lending by participating banks. The IDB Loan Guarantee Office will consolidate the estimates of all participating banks and submit the information to AID. Adjustments will be made to reconcile actual and estimated loan disbursements.

A summary project budget appears in Table 4 while a detailed yearly budget appears in Table 5. Table 6 is a budget for the Loan Guarantee Office in the IDB which will be finance by the earning from the LGF and the 2% guarantee fee. Table 7 provides projections on the sources and uses of funds for the Loan Guarantee Fund and thus provides a projection of the its self-sustainability.

For the budget tables, a contingency of 5% and annual inflation of 5% are applied to the technical assistance and training portion of the grant. No inflation or contingency is applied for the funds used to back the loan guarantee since the funds will be drawn down as needed. Long term technical assistance is budgeted at $200,000 per year, all costs included, while short term technical assistance is estimated to cost $15,000 per month. To complete an analysis of the source and use of funds, a 10% default rate was estimated for the first three years of the program and then moves to 8% in the fourth year.

B. Sources and Uses of Funds

The size of the program in terms of total value of outstanding loans

generated by the guarantees is a function of risk sharing (percentage of guarantee), default rates and Fund self-sustainability.

The income earned on investments and the guarantee fees collected from participating banks provide sources of funds that are additive to the funding provided by the AID Grant. The funds available to the guarantee are reduced by the expense of operating the Loan Guarantee Program Office and by claims against the guarantee, of which the latter is the most significant.

The guarantee fees collected from banks are sufficient to cover estimated operating expenses and provide a small surplus. As a result, the ability of the fund to achieve self-financing is determined by the relationship between the investment income earned by the fund and the amount paid out to cover loan defaults. Somewhat pessimistically, the default rate is estimated at 10% on the average outstanding balance of loans for each of the first three years. The rate is assumed to drop to 8% in the fourth year of the program as the banks gain more experience with small business lending. To assume a lower default rate would not be in line with the risks involved and experiences at the IDB and other LDC small enterprise development programs. Based upon this default rate, the fund will be marginally decapitalized through its first three years of operation, but will become nearly self-financing in the fourth year if the defaults stay at 8% or less. A review of Table 7 on LGF and LGP Source and Use of Funds provides the specifics on this finding.

C. Methods of Payments

The following chart presents a summary of the contracting and payment methods for all components of the project:

AID Grant: Contract and Funding Methods

Element and Contracting Method	Payment Method	Amount
Technical Assistance and Training Contract - Direct AID Contract	Direct Payment - Reimbursement	$1,110,000
Evaluation and Audit - Direct Contract	Direct Payment - Reimbursement	$105,000
Guarantee Loan Fund	Host Country - Reimbursement	$8,600,000
Commodities - AID Purchase Orders	AID Direct Payment	$40,000

Table 4

Loan Guarantee Project
Summary Cost Estimates
Life of Project
($000)

Source	AID		IDB/GOJ		Private Banks		TOTAL
	FX	LC	FX	LC	FX	LC	
Use							
A. Technical Assistance	695	-	-	-	-	-	695
B. Training	215	-	-	-	-	-	215
C. Research	200	-	-	-	-	-	200
D. Office Operation	-	-	-	472	-	-	472
E. Commodities	15	25	-	-	-	-	40
F. Evaluation	105	-	-	-	-	-	105
G. LG Fund	-	8600	-	1291	-	-	9891
H. Funds Lent	-	-	-	-	-	12919	12919
Contingency (A to F)	60	-	-	-	-	-	60
Inflation (A to F)	85	-	-	-	-	-	85
TOTALS	1375	8625	-	1763	-	12919	24685

Table 5

DETAILED EXPENDITURE PLAN
LOAN GUARANTEE PROJECT ($000)

I. AID CONTRIBUTION	FY 1989	FY 1990	FY 1991	FY 1992	TOTAL
A. LOAN GUARANTEE FUND	2,100	3,000	3,500	-	8,600
B. TECHNICAL ASSISTANCE					
1. LONG TERM IG ADVISER (30 MONTHS)	150	200	150	-	500
2. SHORT TERM ADVISER (12 MONTHS)	45	75	45	30	195
C. TRAINING					
1. MSE LENDING (AT $ 25,000/COURSE)	50	50	50	25	175
2. OTHER TRAINING (SHORT TERM)	20	20	-	-	40
D. RESEARCH FUND	-	50	125	25	200
E. COMMODITIES					
1. OFFICE EQUIPMENT (INCLUDES PC)	25	-	-	-	25
2. OFFICE SPACE	15	-	-	-	15
F. EVALUATION / AUDIT	-	15	75	15	105
B TO E SUB TOTAL	305	410	445	95	1,255
G. CONTINGENCY (5%)	15	20	21	4	60
H. INFLATION (5% / YR)	-	22	48	16	85
AID TOTAL	2,420	3,452	4,014	115	10,000
II. OTHER CONTRIBUTION					
A. BANK CONTRIBUTIONS : NET NEW LENDING	3,188	4,529	5,267	(65)	12,919
B. FUND EARNING (7% /YR)	74	248	468	582	1,371
C. GUARANTEE FEE (2%)	21	71	134	166	392
OTHER CONTRIBUTION TOTAL	3,283	4,848	5,869	683	14,682
GRAND TOTAL	5,703	8,300	9,883	798	24,682

Table 6

IDB LOAN GUARANTEE OFFICE
EXPENDITURE PLAN

	FY 1989	FY 1990	FY 1991	FY 1992	TOTAL
ADMINISTRATIVE COSTS					
OFFICE DIRECTOR	41	54	56	56	207
DATA MANAGER	21	28	30	30	109
SECRETARY AND DRIVER	8	11	12	12	43
RENT	14	18	18	18	68
OFFICE OPERATIONS / EXPENSES	4	5	5	5	19
VEHICLE TAX OPERS/MAINT.	15	4	4	4	27
TOTAL ADMIN. COSTS	102	120	125	125	472

Table 7

LOAN GUARANTEE FUND & PROGRAM OPERATIONS
SOURCE AND USE OF FUNDS
(END OF YEAR STATUS)

	FY 1989 ENDG BALANCE	FY 1990 ENDG BALANCE	FY 1991 ENDG BALANCE	FY 1992 ENDG BALANCE	TOTAL
SOURCE OF FUNDS :					
AID GRANT	2,100	3,000	3,500	-	8,600
LGF INCOME (7% /YR)	74	248	468	582	1,371
GUARANTEE FEES (2% / YR)	21	71	134	166	392
TOTAL SOURCE OF FUNDS	2,195	3,319	4,102	748	10,363
APPLICATION OF FUNDS :					
GUARANTEE PAYOUTS	53	300	606	665	1,623
ADMINISTRATIVE COSTS	102	120	125	125	472
TOTAL APPLICATIONS OF FUNDS	155	420	731	790	2,095
BALANCE	2,040	2,899	3,371	(42)	8,268
LOAN GUARANTEE FUND	2,040	4,939	8,310	8,268	
INCREASED LOAN LEVEL SUPPORTED	3,188	4,529	5,267	(65)	12,918
EST LOANS OUTSTANDING	3,188	7,717	12,984	12,918	

V IMPLEMENTATION AND PROCUREMENT ARRANGEMENTS

A. Responsibilities

1. GOJ and IDB

For the GOJ, the IDB will be the implementing agency and have direct responsibility for management of the Loan Guarantee Fund and the administration of the guarantee program itself. The Central Bank, as the monitor and regulator of the banking system, will have oversight responsibility for the Loan Guarantee Program. The GOJ will establish the Loan Guarantee Fund held by the IDB, with AID grant monies used to reimburse the GOJ for its purchase of bonds, treasury bills or certificates of deposit. The Department of Finance within the IDB will manage the fund to ensure maximum return and appropriate flexibility to pay guarantee liabilities and the operational expenses of the LGP Office. It will be a line office under the bank's General Manager with major decisions going to the Board of Directors as appropriate. IDB will budget and draw from the Loan Guarantee Fund monies to operate this office. An estimated budget for office operations appears in the Financial Plan.

The office staff will have day-to-day responsibilities for dealing with the commercial banks to ensure effective use of, and compliance with, the Loan Guarantee Program objectives. The office responsibilities generally fall under three areas: First, the office will review, evaluate and recommend to IDB Board of Directors or possibly a subcommittee to include representatives from the Central Bank and the Ministry of Planning the approval of the commercial bank applications for the program. Second, the Office will be responsible for monitoring and evaluating performance of the commercial banks guaranteed lending. This responsibility will include training needs assessment and training delivery. During the first two years of operation the Advisor will be in the lead in training but will be developing the skills of the staff to handle this responsibility upon his departure. Finally, the office will review and recommend decisions on payments under the Loan Guarantee Fund. Since the success of loan guarantee programs around the world has often turned on the ease and fairness of the payment on default, the process of review of the payments on the bad debts application must be timely and criteria clear and easy to apply.

2. Commercial Banks

In order to participate in the Loan Guarantee Project, the financial institution will be required to sign a master agreement with the IDB. This agreement will be based upon an application by participating commercial banks. The agreement will specify the terms and conditions of and the maximum amount of small business loans that will be made within specific period. The bank will be required to provide quarterly reports on loans outstanding and make projections on loans to be extended during the next quarter. USAID/Jordan and the IDB will have full access to all loan records for lending which is covered under the program. It is expected that if the delinquencies on loans reach 25% of either the total value or of the total number of loans outstanding, guarantees for new lending will be stopped to give the participating bank time to improve its collections.

B. Procurement

1. Contractor (TA, Training and Analysis)

A direct USAID contract will be awarded for technical assistance, training and the analysis components of the project. After reviewing the responses to the Commerce Business Daily solicitation of interest in the program by Grey Amendment contractors, the Mission will decide on the appropriate contracting mechanism. Full and open competition or a small business set-aside will be selected depending on the nature of the responding Grey Amendment contractors. Even assuming that full and open competition, the longest of the contracting processes, is followed, a contract should be awarded by the end of December, 1988. The long-term advisor should be in Jordan to assist the IDB establish its new office by February 1989.

2. Commodities

AID will procure only $40,000 of commodities under this project. Procurement will be made through AID purchase orders prepared by the Project Officer in the Private Enterprise Office and issued by the Mission. Purchase Orders will be completed for an office car of U.S. source and origin, the local procurement of office equipment and a two workstation office computer. Local procurement will be made for the personal computer, because of the need to have appropriate service and backup capability.

C. Schedule

The project schedule is presented below in detail for the first year of implementation and thereafter, only the major activities are listed through the remainder of the project life. The responsible entities for implementation as listed on the Schedule include the Area Contract Office (ACO), the USAID Mission to Jordan (USAID/J), the Ministry of Planning (MOP), the USAID Private Enterprise Officer (PEO), the Industrial Development Bank (IDB), the Jordan Institute of Management (JIM), Commercial Banks (Comm Banks), the IDB's Loan Guarantee Office (LG Office)

Project Schedule

Date	Responsible Entity	Action
1988		
7/7	-ACO	- CBD Request - Gray Amendment Firm Interest in TA Contract
8/1	-USAID/J	- Review of Gray Amendment Firm Qualification
8/15	-MOP & USAID/J	- Sign Grant Agreement
	-ACO	-- Solicitations for TA Contract
8/29	-PEO/CMO	- Issue PO for Vehicle
9/1-11/1	-PEO/IDB	- Planning for LGP Office
9/15	-MOP	- Initial CPs met
10/15	-MOP/IDB	- LGP CPs met

Date	Responsible Entity	Action
11/1	-ACO	- All Proposals for TA Contract Received
11/1-12/15	-ACO/IDB/ USAID/J	- Review and Selection of TA Contractor
12/29	-USAID/ Contractor	- Contract signed.
1989		
1/15	-USAID/J & IDB	- Procure Office Equipment & Materials - Car Arrives
2/15	-Contractor -IDB	- Arrival of LG Specialist - Office Opened
2/15-3/15	IDB/USAID/J Contractor	- Recruit and Hire Staff for LG Office
4/1-5/15	-LG Office/ IDB Board	- Review and Approve 3-5 Banks for LGP.
5/15	-Contractor & JIM	- First Training Course
6/15	-Comm Banks	- First Guaranteed Loans made.
8/15	-LG Office/ Contractor	- Audit firm contract awarded - First ST Advisor Arrives to Help Apply Cash Flow Lending
10/1	-Comm Banks	- Quarterly Reports
10/15	-LG Office & JIM -LG Office	- Beginning of Regular Cycle of Training and TA - Audit Firm Begins Regular Reviews
1990		
1/1	-IDB -Contractor	- System for Payments on Bad Debts Operational - Initial Research Task Completed
6/1-6/30	-USAID/J & IDB	- Internal evaluation of project
1991		
5/1-5/31	USAID/J & IDB	- Major Project Evaluation
6/30	Contractor	- LT Advisor departs
1992		
6/30		- Project Assistance Completion Date

D. Monitoring, Evaluation and Audits

In addition to AID project management, review and control of the LGP will be provided through three distinct functions: monitoring of participating bank performance, evaluation of project impact; and auditing of financial records and program compliance.

1. AID Project Management

The USAID/Jordan Office of Project Development and Private Enterprise will be responsible for management and monitoring of the project. With the assistance of Mission and regional staff as well as Mission senior management, the Office will:

- Review disbursements of grant funds for reimbursement of securities purchased by the GOJ;

- Select through competitive procurement training and technical assistance services;

- Monitor project activity, including contractor performance and GOJ compliance with conditions and covenants of Project Agreement, and take management action, as needed;

- Supervise project evaluation activities conducted by the institutional contractor;

- Help designate topics and evaluate results of policy analyses and other studies;

- Review performance and financial reports prepared by the LG Administrative Office;

- Conduct periodic visits to participating banks;

- Review LGP audits of participating banks prepared and take appropriate actions; and

- Report on project progress to Mission management and AID/W, as appropriate.

2. Monitoring of Participant Bank Performance

Participating bank performance will be monitored by the LGP Office in the Industrial Development Bank. Monitoring of participating bank activity is particularly important to assure that the banks are applying reasonable and consistent standards in the review of loan applications, and that they are vigorously pursuing debt collection prior to submitting claims against the guarantee. The activities of the participating banks will be monitored in two ways. Quarterly reports will be submitted by each bank and then to supplement this reporting, reviews will be conducted at six month intervals based upon the anniversary date of the entry of the bank into the LGP. Spot reviews, or a more frequent schedule of reviews will be conducted if the program experience dictates or if specific banks appear to be having difficulty.

The reviews will have two purposes: (1) to determine the level of small business lending activity carried out by the bank during the period; and (2) to assess the quality of the small business loan portfolio and the overall soundness of the loan management practices being followed by the participating bank.

The review of lending activity will include compilation of the following performance statistics:

- number of LGP loans made during the period;
- distribution of loans by
  - subsector
  - size of loan
  - gender
  - size of firm
- repayment and arrearage statistics

The LGP Office will compile this data in quarterly reports for management review and for submission to USAID and the Central Bank. The data collected will be analyzed to determine the effectiveness of the LGP in reaching the target groups, and the need for additional training or other corrective actions at individual banks.

3. Evaluation

The LGP will be evaluated twice. First, an internal evaluation will be conducted one year into full implementation of the Project and then a full evaluation will be conducted a year later to occur approximately at month 30 of the Project. This second evaluation will be concerned primarily with measuring the performance and impact of the two key elements of the project: (1) the credit needs of small and micro businesses; and (2) the development of small business lending skills and an increase in lending to small businesses by commercial banks.

a. Impact on Credit Needs of Small Businesses

The evaluations will measure the following effects:

- number of businesses assisted by the LGP
  - size and number of loans per enterprise
  - subsector distribution of loans
  - distribution of loans by gender of owner
  - size of firm at application and currently
  - urban/rural location of primary business operations
- profile of non-recipients
  - estimated number of applicants denied
  - subsector distribution
  - distribution by gender of applicant
  - years of business experience
  - reasons for loan denial
  - rural/urban distribution of loan denials
- quality of service
  - length of time required from application to approval
  - competitiveness of interest/fees
  - type and level of assistance provided by loan officer

This and other data will be collected from a stratified random sample of borrowers in both urban and rural areas. The results of the analysis of the data from the evaluation will be used to identify the actions or other adjustments that are required to improve the effectiveness of the guarantee program over its remaining life.

b. Impact on Small Business Lending Practices

The second component of the evaluation will address the effects of the program in establishing self-sustaining capabilities and in institutionalizing financial services to micro and small businesses. It will focus on identifying the services that have been added by commercial banks to meet the needs of small business, and the quality and cost of the services provided.

The evaluation will rely on a survey of all the banks that participated in the program, and a sample of non-participating banks. There will be some overlap, but a natural complementarity, between those items needed to evaluate credit impact and those required to evaluate lending practices. Measures of the impact of the LGP will include the following:

- Number and average size of loans made by each bank
    - participating and non-participating banks
    - rural/urban mix
    - average loan term and rate
    - amount of collateral required
    - average processing time
- Loan applications rejected
    - distribution by size of firm and subsector
    - size of loan requested
    - reasons for rejection
- Number of loans defaulted
    - loan amount
    - distribution by firm size and subsector
    - months in arrears at foreclosure
    - amount of claim on guarantee
    - length of time to settle claim
- Number of personnel assigned to small business lending
    - average time per borrower
    - typical services provided
    - processing cost per loan

The analysis of the data collected in this portion of the evaluation will be shared with the participating banks and used to identify additional training requirements or other adjustments that might be required by the program.

While the results of the evaluation will be important in the first instance in identifying the progress achieved and the actions required to increase program impact, they will also serve to increase understanding of the role of the LGP in expanding the "risk frontier."

The credit experiences around the world has led to reliance on guarantee extension to promote growth of small enterprise. Experience to date with credit guarantee schemes has been too limited to produce conclusive evidence of the effectiveness of this approach in Jordan. For that reason, the evaluation of the LG project can make a significant contribution to the understanding of the issues and program parameters. In this regard, the Loan Guarantee Project is quite consistent with the AID approach in encouraging the use of innovative projects as a field laboratory for expanding understanding of the development process, particularly these efforts leading to market-led growth.

The evaluation of the Loan Guarantee Project will provide additional insight into several of the key issues surrounding credit guarantee programs, such as:

- additionality - in view of the very small number of loans made by commercial banks in Jordan, the LGP will provide considerable evidence of the effects of a guarantee in drawing out additional credit.

- bank participation - the participation of the banks, particularly privately owned commercial banks, is critical to the success of a guarantee program. the LGP will provide very useful information on the success of guarantees in encouraging bank participation, and on the effectiveness of a two-tiered approach to achieving an equitable or targeted distribution of loans.

- default rates - for a variety of reasons, there is very little commonality of default rate experience that can be relied upon in project design. In addition to providing another default rate statistics, the LGP should provide useful date for comparison with the experience of the IDB in administering its small business lending program.

In summary, the evaluation of the LG Program can be a potential source of considerable information of use to AID personnel and others involved in the design of credit guarantee programs.

4. Audits

Audits of participating banks will be conducted by Independent Public Accountants (IPA) contracted through the LG Office using LG Funds. This eliminates the need for assignment of AID personnel to conduct the audit, although $30,000 is provided in the budget to meet AID audit requirements that are not satisfied by the work of the IPA. The financial records related to the guarantee program for each bank holding guarantee loans in its portfolio during the period will be reviewed and audited at least annually. In addition to verifying the completeness and accuracy of the financial records maintained by the bank for its guarantee loans, the IPA will also verify that the bank is in compliance with the guarantee program requirements.

The review of program compliance will verify that:

- loans included in the guarantee portfolio were entered into during the period covered by the agreement between the IGP and the participating bank;

- multiple loans have not been extended to one firm in excess of loan guarantee limits;

- the total value of claims for recovery under the guarantee has not exceeded the limit established for individual banks;

- officers of the bank and their immediate families have not received guarantee loans.

The results of audits of participating banks will be submitted to the Industrial Development Bank and A.I.D. on a periodic basis.

VI PROJECT ANALYSES

A. Technical Feasibility

The technical feasibility of the LGP is strongly supported by the characteristics of the current economic environment in Jordan, and by the relative simplicity of the approach that the project takes to provide term loans to encourage the growth of small enterprises. The analyses of the technical feasibility of the project focuses on an examination of the economic and market conditions supporting the demand for small business loans, and on the conditions that would need to be addressed by the project to overcome traditional limitations on the supply of credit to this segment of the private sector.

Analysis of the flow of funds for the project indicates that even at the modest level of funding proposed, and using conservative estimates of the default rate, the LGP will generate nearly $13.0 million in loans to micro and small businesses over the four year life of the project.

The principal sources of the estimates and assessments of conditions in the small business and banking sectors are a report prepared by Robert R. Nathan Associates under the ARIES project in October 1987, and an informal survey of senior personnel in the Amman and branch offices of 9 major banks conducted in June 1988.

1. Economic and Market Conditions

The economic environment in which the LGP must operate has been described in detail in previous sections of this Project Paper. Briefly restating that assessment, the Jordanian economy has leveled off and entered a period of slow growth following the rapid expansion of the early 1980's. Under present conditions, the current rate of growth is insufficient to offset the effects of the projected birth rate or the effects of the large number of workers that are returning to Jordan from the Gulf. This project addresses the need to expand the employment base in Jordan in two ways. By providing credit to small businesses, the project will assist growth of the sector of the economy that accounts for a disproportionately large proportion of the employment base and employment growth. Increasing the availability of credit will also provide opportunities for workers returning from the Gulf to establish businesses and generate additional employment. The returning workers represent an experienced work force, many of whom have managed to accumulate modest savings. In making credit available to these workers, the project is in essence creating an opportunity for returning workers to invest these savings in their own businesses, rather than just drawing them down through a long period of unemployment.

a. Small Business Credit Demand

Very little information is available on the composition and financing characteristics of micro and small businesses. Statistics prepared by the Ministry of Industry and Trade rely on an

industrial classification system that requires grouping firms into only 23 categories; too highly aggregated a level to be useful in identifying the areas in which small businesses dominate. A survey of small businesses was proposed under the ARIES project, but it was not possible to collect data for other than a pilot test sample of 50 entrepreneurs because of difficulties encountered in obtaining the necessary survey clearances.

The best source of information on the demand for credit by small businesses is the Industrial Development Bank. The bank has operated a Small Scale Industries and Handicraft program to provide loans up to a maximum of JD 4000 for thirteen years. During this period the IDB extended nearly 2,400 loans with an average term of slightly more than 3 years. There had been a steady increase in the number of loans issued each year until 1984-1985 when the number of loans issued jumped sharply to 400. The sizeable increase overburdened the small staff of 6 loan officers assigned to the program. Because of the amount of time that the staff has had to devote to loan management activities and a larger number of problem loans than had been encountered in the past, the number of loans issued in 1986 dropped to 77 (see Annex F for summary details).

Bank data indicates that the vast majority of loans are for JD 3000 or more which suggests that there is considerable pent-up demand for loans in excess of JD 4000 that are generally only available from banks.

Demand for credit in the rural areas seems to be more a function of access to bank offices than a reliable indicator of the interest in these areas in obtaining loans to finance business activities. Several of the commercial banks are represented in the outlying areas, but branch managers generally must seek approval of the Amman office before making loans. The Housing Bank, however, is well represented in the populated areas outside of Amman. The Housing Bank program does not currently include loans for micro and small businesses, but it has indicated a strong interest in participating in the LGF. From the very limited information that was collected through the ARIES project effort, it would appear that business start-ups and expansion are financed primarily through family members.

b. Hindrances to Increased Access to Credit

Term lending to micro and small business entrepreneurs by commercial banks is virtually nonexistent in Jordan. The only formal source of small business loans is the Industrial Development Bank, which as mentioned previously, has had to reduce significantly the number of loans that it makes annually. As in the case of many other countries, credit is generally only extended by commercial banks on highly collateralized terms to a small group of favored clients. Typically, these loans are in the form of overdrafts, and are "evergreen", i.e., are renewed every year and, therefore, constitute a constant line of credit equal to the overdraft limit approved for the borrower.

Previous studies of the banking sector and the interviews conducted in preparation for this project paper indicate that Jordanian bankers are

very risk adverse. Most regard small business lending under present conditions as carrying too high a risk and too costly to administer to warrant much attention. Not surprisingly, most banks are quite liquid and, therefore, could extend credit if they regarded the degree of risk as acceptable.

The project addresses the adversity of commercial bankers to provide credit to micro and small businesses, and thereby the need to increase the supply of credit to this segment of the private sector in two ways: by providing training in lending techniques appropriate to small businesses; and by establishing a guarantee level for small business loans that reduces the risk sufficiently to attract commercial banks to small business lending.

2. Need to Improve Small Business Lending Skills

Interviews of commercial bank personnel in Amman and outlying areas indicated that they had little experience in making loans to small enterprises. While the overall quality of personnel seemed quite high, their experience has not prepared them for the detailed cash flow analysis and level of assistance to the entrepreneur that is characteristic of small business lending. Because of the current emphasis in the banking sector on highly collateralized lending and previous experience with the borrower, it will be necessary to train commercial bank personnel in lending techniques that are applicable to analysis of the credit worthiness of small enterprises if they are to participate actively in the LGP. While the lending analysis techniques to be presented in the training are quite different from the methods applied currently, they rely upon the basic accounting and analytical skills that are already possessed by lending officers.

As indicated in the description of the project components, two training programs are proposed. An intensive program of approximately three weeks will be provided to lending officers and branch managers. The Jordan Institute for Management (JIM) has facilities that would be appropriate for conducting the training. Faculty at the Institute will be invited to participate in the training programs both to introduce them to cash flow lending, and to establish a potential source of future training in the subject. The training program does not require any special equipment, and can be conducted entirely with the use of basic audio-visual equipment such as an overhead projector. Participants would be required to have access to adding machines or calculators, but most would be expected to supply their own.

3. Incentives Required to Increase Supply of Credit

Given the highly risk adverse nature of lending practices in Jordan, and the limited experience of commercial bankers in small business lending, training in lending techniques alone cannot be expected to increase the supply of credit to small enterprises in any significant amounts. The analysis of current conditions indicated that it would be necessary to reduce the risk of lending to small businesses if commercial bankers were to be expected to participate in this activity in any significant numbers.

Loan guarantee programs have proven to be highly successful in both developed and developing countries in increasing the supply of credit to small enterprises. Discussions with bankers in Jordan confirmed their willingness to participate in small business lending if the risk of loss could be reduced. At issue in assessing the technical feasibility of the LGP is: (1) the distribution of risk between the lending institutions and the guarantee fund that would be required to increase the supply of credit to the small business sector, particularly in outlying areas and nontraditional enterprises; (2) whether the banks would have sufficient confidence in the guarantee fund to participate; and (3) would the program overload the capacity of commercial banks to handle an increased volume of loans.

a. Distribution of Risk

Experience in 27 developed and developing countries reviewed by the World Bank (Jacob Levitsky and Ranga N. Prasad, Credit Guarantee Schemes for Small and Medium Enterprise, World Bank Technical Paper Number 58, 1987, Washington, D.C.) indicates that the appropriate balance of risk sharing between the lending institution and the guarantee fund lies between 20% and 50%. When the risk to the banks is less than 20%, there is a danger that it will issue too many risky loans because it has little to lose. Discussions with commercial bankers, representatives of the Industrial Development Bank, and others in various ministries led to the conclusion that a 50% guarantee would be regarded as adequate coverage for loans originated in the Amman area. Considerable skepticism was expressed as to the adequacy of this coverage to encourage lending in outlying areas or to women-owned enterprises. The final project design and the agreements that will be entered into with participating banks will provide a 50% guarantee to loans originated in Amman, and a 75% guarantee for loans originating outside of Amman or extended to women-owned businesses.

b. Bank Confidence

Experience with credit guarantee programs in other countries indicates that next to the guarantee percentage, bank participation is most highly influenced by the level of confidence banks place in their ability to recover claims against the guarantee fund. Reasonable assurance must be provided that: (1) claims will be paid; and (2) that the length of time and administrative burden of recovering a claim will not represent an additional cost of participation.

Several features have been built into the design of the LG project to provide as more assurance as possible to banks considering participation, that their claims in the event of loan default will be paid promptly. For one, ready accessibility to the funds that will be paid to a bank in the event of an eligible claim is assured by the fact that guarantee fund, in the form of securities and investment income, will be managed by the Department of Finance within the IDB, and, therefore, will be readily accessible the LG Administrative Office without the need to seek other than IDB General Manager approval of disbursements from the fund. A covenant will be included in the Project Agreement to that effect.

The project also assigns responsibility to the LG Program Office to establish, with the assistance of a long term advisor, a clear set of regulations governing payment of claims. This will be prepared and distributed to the banks prior to accepting applications for participation. Procedures and approvals associated with claims payment will be kept to a minimum, but these also will be published in advance so that the banks know exactly what steps they must take to settle a claim. The LGP Office will be committed to settling claims quickly, but will reserve the right to re-open the case in the event that there is further information forthcoming suggesting negligence or misrepresentation on the part of the bank.

Prior to accepting its first application, the Loan Guarantee Program Office will also establish the procedures and responsibilities for recovering from the borrower any portion of the unpaid debt, even after settlement of the claim. The agreement between the IDB and the participating lender and the IDB will also spell out clearly the division of repayments, amounts recovered and losses between the guarantee fund and the lending institution.

c. Implications for Bank Work Load

The total amount and number of loans that might be generated under the guarantee were calculated to determine the impact on the existing loan activities of participating banks. Using a value of $13.0 million for the total loan amount supported by the guarantee fund, the banks might issue as many as 1,600 loans over the life of the project, but would have only around 800 in their portfolios at any one time. This estimate assumes an average value of JD 3000 for 50% of the loans and an average value of JD 8000 for the other 50% of the loans. Short-term loans are expected to turn over 2-3 times and long-term loans would turn over once. These estimates would apply at the time of full implementation of the project. As can be seen from Table 7, incremental funding of the project results in a gradual buildup in the value and number of outstanding loans.

If 6 lending institutions are participating when the program is fully operational, each bank would be carrying an average of about 135 loans each and a total guaranteed loan portfolio valued at approximately $2,000,000. This is well under the loan management workload typically handled by the banks considered to be strong candidates for participation in the program, and, therefore, does not represent an excessive burden on the banks.

B. Institutional Analysis

The analysis of the capacity of the institutions that will participate in the LG program was limited to the Industrial Development Bank. Prior to receipt of applications, it is not possible to identify the commercial banks or Non-Bank Financial Institutions that might take part in the program. Applicants, however, will be subjected to an Intermediate Credit Institution (ICI) review as part of the selection process.

1. Considerations in the Selection of the Industrial Development Bank

Three alternatives were considered in the deciding where the organization that would have responsibility for administration and oversight of the Loan Guarantee Fund would be located. The alternatives considered included the Central Bank of Jordan, the Industrial Development Bank (IDB), and an independent entity. After due consideration and discussion, it was determined that the IDB provided the most appropriate location for the following reasons:

- The IDB has thirteen years of experience in operating a small business lending program comparable to the program proposed;
- It has a competent staff experienced in lending to small businesses that are a potential source of technical assistance to commercial banks participating in the program;
- The IDB is 30% owned by the GOJ, but is managed on a profit and loss basis under very competent senior management that has established an effective private sector-oriented organization;
- The bank is centrally located in close proximity to most of commercial banks that it would be responsible for monitoring;

The existing Board of Directors of the IDB include senior representatives of the Central Bank and the Ministries that would provide GOJ oversight of the LGP, as well as key representatives of the business community, which eliminates the need to establish a separate committee for this purpose.

2. Capacity of the IDB

The activities of the bank include loans to industrial activities, equity investments in projects, participation in syndicated loans, underwriting, brokerage services, management of the Jordan Institute for Management (JIM), and management of the Small Scale Industries and Handicraft Fund. In 1987 the IDB approved 58 loans totalling JD 7.7 million with an average value of JD 130,000. It currently holds equity investments totalling JD 4.8 million in 30 projects. Total assets of the bank are in excess of JD 61 million. In addition, to being an active and effective instrument in promoting market-led growth, the bank has a well-founded reputation for being well managed.

The Small Scale Industries and Handicraft Fund managed by the bank is both an example of the success of micro and small business lending in Jordan, and an important source of experience for development of adequate loan management procedures to be followed by commercial banks participating in the LG program.

The investments of the IDB are managed by an existing Department of Finance with the requisite skills and experience for management of the investments of the Guarantee Fund. Access to this existing capacity

simplifies the investment management requirements of the program, and should contribute to rapid processing of repayments to the banks, when necessary.

C. Economic Analysis

1. Macroeconomic Conditions

Changing economic conditions in the region have rapidly shifted the focus of the employment problem in Jordan from labor shortages to excess labor. The economic boom of the seventies and early eighties resulted in a shortfall of labor supply that necessitated the inflow of a substantial number of guest workers. With the onset of a slack in the economies of neighboring Arab countries, increasing number of Jordanians are seeking domestic employment. High population growth rate-3.7%- and the ensuing increase in the labor force, further aggravates the unemployment situation.

The labor force in 1986 was put at 535,000 up 6.5% from the previous year, whereas the labor force actively employed stood at almost 493,000 up 4.2% from its 1985 level. Rough estimates by the Ministry of Labor indicate that some 350,000 Jordanians worked abroad in 1986 largely in the Gulf States— an amount equivalent to 45% of total Jordanian workforce comprising both domestic and foreign employment. The rate of recorded unemployment, based on the number of Jordanians registered as unemployed at the Civil Service Commission was estimated by the Ministry of Labor at 8% in 1986, compared with 3.9% in 1981. The actual rate of unemployment is believed to be currently in excess of 10%. A World Bank report, projects the rate of unemployment to reach 30% by 1990, should manpower imbalances remain unchecked. The overall labor participation rate is a low 19.4%. A young Jordanian population (more than 50% are less than 15 years of age) together with a low female participation rate of 12.5% and more than 32% of the total population enrolled in schools, account for this low participation rate.

Jordan's balance of payments has been characterized by a persistent though narrowing deficit in the trade balance which has been financed in part by a surplus on the services account, namely a net inflow of remittances, and unrequited transfers. The trade deficit narrowed from $2488 million in 1982 to $1692 in 1986. Lower world oil prices, reduced private consumption, lower investment, and a depreciation in the exchange rate have all led to a compression in imports. From a peak of $3.0 billion in 1982, net merchandise imports (total imports less re-exports) have fallen by an estimated 16.6% to $2.5 billion. Even with import contraction, there is a major structural imbalance in Jordan's external account: exports of domestic goods cover only 25% of Jordan's merchandise import bill (excluding re-exports). Import compressibility is low for Jordan as foodstuffs and petroleum products accounted for 33.2% of total merchandise imports in 1986.

Remittance inflow from the some 350,000 Jordanians working abroad dropped from a peak of $1237 million registered in 1982 to $1185 million in 1986. Unrequited transfers, which comprise Arab grant aid, the largest component, grants from other donors and private donations, fell 15% in

1986 from its 1985 level to $680 million. Declining remittance inflows, plus lower levels of Arab aid are likely to characterize balance of payments performance over the next few years. Further import compression coupled with some expansion in exports are necessary to offset the decline in the flow of foreign exchange funds, thus forcing the Jordanian policy makers to adopt measures to generate and or save foreign exchange.

2. Small Scale Enterprises

Interest in small scale enterprises in developing countries generally stems from the greater labor intensity of small firms and therefore the proportionately higher effect that the expansion of this segment of the private sector has on job creation. Although there is some ambiguity as to whether small firms are more labor intensive than large firms within narrowly defined sectors, on average the smaller firms are concentrated in the labor intensive industrial sectors. Financing programs geared towards investing in small firms implicitly aim at reducing the capital intensity of firms overall, they also support job creation by fostering start-up of new firms and expansion of existing activities.

The 1984 Industrial Survey Data disaggrigated by firm size: micro (0-5 employees) small scale enterprise (5-25 employees) and large scale enterprises (over 25 employees) clearly reveals that Jordan's small industrial base is dominated by a few large firms in phosphates, potash, cement, petroleum refining and electricity generation. Large firms in these industries account for 37% of total employment, JD 887 million in investment or 80% of total industrial investment and 61% of value added generated by industry. Nonetheless, firms employing 0-25 employees account for nearly 50% of total employment and 17% of value added. Micro and small enterprises provide more than half of value added in clothing, furniture and wood products, rubber and rubber products, nonelectrical equipment machinery, and miscellaneous industries as well as in industrial services.

Comparing micro and small enterprises with large enterprises one would expect less capital per employee, not only because of the differences in technology used to make the same product but also because of the differences in the types of products manufactured by micro and small enterprises as compared to large scale enterprises in any industrial sub-sector. Fixed assets per employee are consistently less for micros and SSEs. LSEs utilize nearly 8 times as much capital per employee as SSEs and 53 times that of micros. Furthermore both micro and SSE tend to utilize less capital per unit of output than LSEs. The ratio of fixed assets to value added averaged 0.47 for micros and 1.87 for SSEs as compared to 4.36 for LSEs. Lower labor productivity is observed in both micros and SSEs. On average value added per employee is JD 1,424 in micros, JD 2,413 for SSEs vs JD8,083 in LSEs. However, capital is utilized more efficiently in micros and SSEs than in LSEs. On average output per unit of capital is 2.13 for micros, and 0.54 for SSEs as compared to 0.23 for LSEs.

3. Interest Rates

Up until June 6, 1988 a ceiling on lending rates prevailed in Jordan making financial institutions lend only to the most established of clients on a collateral basis. This has not triggered sufficient need by the financial institutions to develop strong project appraisal and loan supervision skills that are prerequisite to the establishment of a modern investment banking sector. Lack of flexibility to charge higher interest rates for more risky ventures has been detrimental to the development by financial institutions of a whole array of innovative forms of finance: venture capital programs, project financing and cash flow lending. The rigidity in interest rates hampers optimal resource allocation as interest rates are not market determined. A key requirement for continued expansion of private sector participation is the availability of credit at a market determined price. However, the small entrepreneur in Jordan with no collateral to offer faces difficulties in obtaining credit on the merits of their investment proposals alone.

The interest rate policy followed by the Central Bank of Jordan until recently, has affected the spreads between borrowing and lending rates and thus profitability of the financial sector. The financial sector operated under a fairly detailed interest rate structure where ceilings on both lending and deposits rates by instruments and institutions were fixed by the Government. Competition for deposits within the sector between the banks coupled with the theoretical restrictions on transfer of funds abroad pushed the effective deposit rate close to the ceiling. Together with the ceiling on lending rates, the spread between lending and borrowing rates were reduced, thus curtailing the profitability of the financial system.

On June 6, 1988, the Central Bank of Jordan issued new regulations pertaining to interest rates. Whereas the ceiling on lending rates remained the same, all financial institutions are now at liberty to charge any rate of commission they deem necessary, in effect liberalizing lending rates. As far as deposits are concerned, the ceiling on certificates of deposits of JD 1000 or more and of duration of three months or more were removed. However and for purpose of information the Central Bank of Jordan requires the banks to submit, at the end of each week, the maximum rate of interest paid on certificates of deposit, and the maximum commission rate taken on direct credit. With those recent changes, banks may now charge more for riskier or costlier lending. The removal of interest rate ceilings can constitute a step toward ensuring that interest rates for all borrowers approximate the opportunity cost of capital. An essential precondition for expanded bank finance to small enterprise has been met.

4. Demand Analysis

Since both fixed and working capital are indispensible elements in any business activity, the issue according to World Bank Staff Working Paper -Small Industry in Developing Countries- is not whether the demand for finance "exists" but what are the most efficient channels of supply. All but a small minority are excluded from access to institutional finance. While informal sources may be ideal for small borrowings of short

maturity, they cannot be expected to meet the demand for term-loans in this sector. For example in the cloth and garments industries the demands are greater for working than for fixed capital and are more frequently met through supplier credit.

The World Bank report on small and medium scale manufacturing industries concluded that the policies followed by the Government of Jordan, together with the low profitability of banks has had two negative implications for lending policies. Because of the narrow spread due to interest rate ceilings the banks were not able to differentiate between customers by risk. They, preferred to invest in low risk loans to prefered clients. In 1985, 58% of credit outstanding of the commercial banks to the industrial sector were in the form of syndicated loans. Financial institutions also prefer to lend in the form of certain instruments over others. Since the interest rate charged on overdrafts was higher than on other forms of lending, banks relied extensively on those forms of lending. In short, the ceilings on interest rates and Government policies reduced the availability of funds for the small entrepreneur thus curtailing a source of growth in the economy. With the recent liberalization of lending rates a precondition has been met for higher levels of bank credit to small enterprises.

The traditional source for equity finance for small business in Jordan is family and friends. Many business owners are not aware of the availability of financing. According to the Aries report on Small Business Development in Jordan, financing extended to small business by the banks is conservatively estimated at more than US$ 50. Moreover, many firms have needs that are smaller than the minimum loans that the banking system can handle efficiently. Because of lack of efficient credit information banks are cautious about widening their credit base. The report estimates that the market for lending to micro and small businesses currently outside the system is roughly $300 million. This estimate is derived from guesswork as no reliable data is available. Based on a quick sample of 50 or so small enterprises, over 70% of those responding said that they did not receive a loan to assist them in starting a business. Some 15% of those interviewed said that they did not have a bank account.

Small businesses usually deal with a large number of suppliers. More than 60% of the small businesses indicated that they received credit or were allowed deferred payments from suppliers. The normal repayment period ranged from three days to one year with the mean being 72 days.

The bias in lending by the financial sector towards large firms and the comparative underfinancing of smaller firms is demonstrated by marked differences in the ratios of outstanding loans to enterprise sales. From the Industrial Survey 1984 figures for sales and interest payments can be dissaggregated by firm size. Sales and interest payments for firms employing less than 25 persons amounted to roughly JD95 million and JD1.2 million respectively. For the larger firms, that is, those employing more than 25 persons sales totalled almost JD815 million and interest payments stood at JD35.2 million. Using an interest rate of 11% -interest rate and commissions that prevailed during 1984-the value of outstanding loans amounted to JD11 million of the small enterprises and JD320 million for the large enterprises. The loan/sales ratio averages 11.7% for small enterprises compared with 39.3% for large enterprises, an indication of the bias of the financial sector of extending loans to larger firms, and suggesting that small firms are comparatively underfinanced.

Overall market conditions indicate continued growth in demand for the products of small enterprises. Most small scale enterprises are in the business of producing goods consumed by households (clothing, furniture, foodstuff, light consumer goods etc.). Demand for the items is linked most directly to the rate of population growth and household formation. These are very high in Jordan as the population growth rate is 3.7%. Another source of demand for micro and small enterprise products is the production linkages with other sectors of the domestic economy. In addition, with the depreciation in the Jordanian Dinar imported products have become increasingly more expensive, hence demand is shifting toward substituting domestically produced goods for foreign goods, forcing already existing enterprises to expand and new ones to get started.

5. Economic Justification

In economic terms the justification for financing programs for small scale enterprises is that without such programs small firms are restricted to self finance and high cost borrowing from the informal sector. Projects with rates of return above the marginal cost of capital to sources in the formal sector remain unfinanced. With the Loan Guarantee Project, the economic benefits would include a savings in the cost of finance for those activities that would otherwise use high cost alternatives, and additional economic output from those projects that alternatively would not be undertaken. Relaxation of administrative controls on lending rates is a necessary but not sufficient condition to direct an efficient flow of finance to small-scale enterprises. Even with the liberalization of lending rates, institutional short-comings still prevail. Financial institutions will still not lend to small scale activities-including efficient and financially sound projects- because these financial institutions have acquired neither the capacity nor the information needed to be able to screen projects on a cash flow basis.

In addition, the legal framework that is necessary to maintain a loan repayment discipline is rather weak, as there are no set standards regarding default.

Costs of ascertaining risk could be high as information and knowhow is not widespread. Therefore, even with no effective ceilings on lending rates, the cost initially to the financial sector of extending credit to the small borrower is high. The Loan Guarantee in sharing the risk reduces the loss and therefore the cost of lending.

In addition, the technical assistance component will train credit officers of participating banks in risk lending. There are economies associated with learning by doing that arise from the accumulation of information and experience within the institution as lending takes place. The effect is to improve screening procedures and reduce both the risk and administrative costs of subsequent loans. Economies of scale stem from the fixed costs of processing a loan, which are incurred regardless of the size of the loan, and from the expected gradual increase in the size of the loan.

Assuming that "long term" loan amounts to half the total loans leveraged by the project, then the "long term" loan averages JD 6250. The return to fixed asset investment and entrepreneurship are exceedingly high. From the 1984 Industrial Survey, operating surplus and depreciation for the 8316 small firms (<25 employees) totalled roughly JD 29.3 million. Fixed asset per enterprise averaged JD 7,854. For every one JD worth of fixed asset investment the entrepreneur gets a return of 449 fils comprising of operating surplus and depreciation. Assuming that the useful life of a machine is 7 years, the stream of costs and benefits translates into an internal rate of return of 40.7% (Table 8).

The other half of the loans leveraged under the project are of a "short term" nature i.e. 3-6 months which will be used for working capital finance. It is generally believed that working capital loans increase profits due to the fact that the principal source of increased profits is the ability to buy in larger quantities, thus taking advantage of supplier discounts. Working capital finance is less risky to supply as there are less uncertainties about the investment for it relates to current and more proven operations of the business. The borrower generally requires working capital regularly which enables him to enter into a familiar relationship with the bank personnel.

D. Social Analysis

1. Summary

The Social Soundness Analysis shows that the Loan Guarantee Project to be feasible and in fact small business lending is desiable within the socio-cultural context of Jordan. The guarantee itself will act as a catalyst to expand MSE lending. The social impact of the lending will be to increase employment and provide economic benefits to improve welfare. The Project is socially sound.

LOAN GUARANTEE PROGRAM

CALCULATION OF INTERNAL RATE OF RETURN

TABLE 8

SIZE OF FIRM	0-5 EMPLOYEES	5-25 EMPLOYEES	TOTAL
NUMBER OF ENTERPRISES	6,847	1,469	8,316
FIXED ASSETS (JD)	10,025,905	55,291,224	65,317,129
OPERATING SURPLUS (JD)	12,949,641	11,494,097	24,443,738
DEPRECIATION	957,597	3,901,232	4,858,829
TOTAL	13,907,238	15,395,329	29,302,567
AVERAGE FIXED ASSET/ENTERPRISE	1,464	37,639	7,854
OPERATING SURPLUS PER JD OF FIXED ASSETS	1.292	0.208	0.374
OPERATING SURPLUS + DEPRECIATION PER JD OF FIXED ASSETS	1.387	0.278	0.449
AVERAGE LONG TERM LOAN (JD)	6,250		

ANNUAL AMOUNT OF LOANS FOR FIXED ASSETS: JD 630,000

ASSUMED FIXED ASSET ECONOMIC LIFE OF SEVEN YEARS

YEAR	FIXED ASSET LOANS AND ANNUAL RETURNS				NET BENEFITS		
1	(630,000)				(630,000)	IRR:	40.77%
2	282,631	(630,000)			(347,369)		
3	282,631	282,631	(630,000)		(64,739)		
4	282,631	282,631	282,631	(630,000)	217,892		
5	282,631	282,631	282,631	282,631	1,130,522		
6	282,631	282,631	282,631	282,631	1,130,522		
7	282,631	282,631	282,631	282,631	1,130,522		
8	282,631	282,631	282,631	282,631	1,130,522		
9		282,631	282,631	282,631	847,892		
10			282,631	282,631	565,261		
11				282,631	282,631		

SOURCE: DEPARTMENT OF STATISTICS, 1984 INDUSTRIAL CENSUS

2. Socio-Cultural Context and Feasibility

Bank lending for enterprise development is an accepted practice in Jordan. Although the Moslem religion places restrictions on interest payments that can be applied to lending, commercial banks have operated, until the recent reforms, with only the legal constraints of interest rate ceilings. Moslem banking does exist through the Islamic Bank, but its size and importance in the market is relatively small. This project is not designed to deal with Islamic banking.

In a general context, banks in Jordan have been rather conservative with regards to their lending practices extending loans only to the more established clients on a collateral basis. Commercial banks are reluctant to extend term loans to small and micro enterprises, as they lack the skills required to evaluate such loan applications and make appropriate decisions as far as risk and cash flow is concerned. When treated as commercial loans, repayment is taken seriously. However, if the government is involved, say through specialized credit institutions, then attitude of the debtor differs, and repayment becomes unreliable. The LGP is designed to go through commercial channels with the guarantee being an internal banking matter of which the client is not informed. If the guarantee is perceived by the small entrepreneur as a grant from the United States Government, then repayment may be erratic. By keeping AID and GOJ roles in the program in the background, the project builds on the strong reputations for requiring loan repayment and arrearage collections by the participating commercial banks.

In relation to collateral requirements, the improved credit analysis will reduce the requirement for high collateral. However, it is expected that some collateral will remain necessary to ensure a good repayment record. Over the life of the project collateral requirements are expected to be further reduced.

3. Beneficiaries and Replicability

The Loan Guarantee Project targets a population, namely the small scale entrepreneur, with little or no previous access to credit from the formal financial sector. The project introduces a poorer segment of the population to financial institutions which have been closed to them. It directly benefits smaller enterprises, including women owned businesses. The project aims at encouraging female entrpreneurs by providing 75% guarantee to all loans extended to women. Banks will be encouraged to broaden their lending base to clients that would otherwise be turned down without the Loan Guarantee Project, thus changing their attitudes towards MSE lending. The motivation for both the banks and businessmen is commercial, that is increased opportunities for profit.

As estimated in a previous section almost 1,600 opportunities are opened to micro and small enterprises under this project, supporting approximately $13.0 million in outstanding loans at any time during the life of the project. Direct beneficiaries could include Jordanian expatriates returning from the Gulf who may have some capital but need additional financing to set up a new business. Also benefiting from the

project are existing enterpreneurs who need additional financing to expand. New employment opportunities are thus created. Since women and rural enterprises are offered higher guarantees than others then employment in those categories are encouraged. Small and micro enterprise development is one strategy, seemingly quite effective in addressing the unemployment problem in developing countries. The project by targeting this sector helps increase income and standards of living of the project participants, creates new jobs and reaches a population that may not have had access to the formal financial sector.

4. Impact

The Loan Guarantee Project through its guarantee mechanism encourages commercial banks to extend loans to micro and small firms that otherwise could not obtain credit from the formal financial sector. Since commercial banks have extended little credit to small and micro enterprises, the project would encourage such loans. During the life of the project a record of repayment would be established that instills trust and confidence by the banking officials in micro and small enterprises lending. We can reasonably expect a substantial spread effect as the banking community becomes more comfortable with such loans.

The small entrepreneur would establish a credit history for future reference and be compelled to develop viable feasibility analysis to secure credit. These entrepreneurs would no longer find the formal financial sector intimidating, and the banks would develop skills to make small loans profitable thus making the whole project sustainable.

E. Environmental

The project will fund a combination of technical assistance, training and policy research as well as reimburse the government for contributions to its Loan Guarantee Fund. This Fund will provide a partial guarantee on a wide range of long and short term loans for operating capital, raw materials and capital equipment. The loans will be made through intermediate credit institutions and AID will not be involved in the selection and approval of the lending. AID will have no direct involvement in the actual implementation in the micro and small enterprises benefiting from the project.

In the Initial Environment Examination, the project activities were found to fall within the categorical exclusions of 22 CFR 216.2(C)(2) as a technical assistance and intermediate credit institution project. The Mission Environmental Officer, therefore, determined that the project qualifies for a categorical exclusion from formal environmental review procedures and that no further environmental impact assessment is required.

VII LEGAL STATUS

A. Project Agreements

There are two levels of project agreements that need to be negotiated and approved for the Loan Guarantee for Small Enterprise Development. First, a Draft Project Grant Agreement with the Government of Jordan will be submitted to the Ministry of Planning for its review and recommendation to the Cabinet for its approval. In the development of the project, the Minister of Finance and various officials of Ministry of Planning and the Central Bank have participated in the design. Because of this collaboration and cooperation as well as the project's very positive development impact, we expect timely endorsement of project by the Cabinet.

As one of the initial steps of project implementation, commercial banks will sign a Guarantee Agreement with the IDB. The program must be attractive to the commercial banks to ensure their participation. The terms and conditions described for the guarantee are the result of discussions of a selection of leading financial institutions in the country. We believe that the terms are reasonable and attractive to the commercial banks.

B. Conditions Precedent

In addition to the normal conditions precedent on legal opinion and the specification of a government grant officer, two special conditions will relate to the Loan Guarantee Fund. Prior to disbursement under the Grant for LGF, the Grantee will, except as the Parties may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

(1) Evidence that the Loan Guarantee Fund has been duly established as a trust held by the Industrial Development Bank and that adequate mechanisms and operating procedures have been developed to utilize and administer the Fund, and

(2) Evidence that the Industrial Development Bank has been given the requisite authority to make disbursements from the fund for prompt payment of claims against the approved loan guarantees and to meet operating expenses not covered by fees collected from participating financial institutions.

C. Covenants

Covenants in the following three areas will be included in the Grant Agreement.

1. Project Evaluation

The Parties agree to establish and Evaluation Program as a part of this Project. Except as the Parties may otherwise agree in writing, the program will include, during the implementation of the Project:

(a) Evaluation of progress toward attainment of the objectives set forth in the Project Paper for the Project;

(b) Identification and evaluation of problem areas or constraints which may inhibit attainment of Project objectives;

(c) Assessment of how such information may be used to help overcome identified problems and constraints; and

(d) Evaluation, to the degree feasible, of the overall development impact of the Project.

2. Policies and Procedures

The Grantee agrees to study and to review certain policies and procedures that are important to the encouragement of development of micro and small enterprises. Lending policy and practices will be a prime area for review. These policies and procedures will be examined by, and recommendations will be provided by, the prime technical advisory contractor for consideration and appropriate action by the government.

3. Suspension of Bank Participation in Loan Guarantee

The grantee agrees to ensure prompt suspension or termination of the Guarantee Agreement between the IDB and a participating financial institution in the event that IDB determines that the said financial institution is not in compliance with the terms and conditions of the Agreement.

4. Loan Guarantee Fund Termination

If the Loan Guarantee Program is terminated, the GOJ agrees to use all funds remaining in the Loan Guarantee Fund to support directly micro and small private enterprise development.

ANNEX A
PID APPROVAL CABLES

A.1 Original ANPAC PID Review Cable - 1987 State 144329

A.2 USAID/Jordan PID Revalidation Cable - 1988 Amman 5029

A.3 ANPAC Revised PID Approval Cable - 1988 State 176205

ACTION AID-2 INFO AMB DCM

ANNEX A.1

VZCZCAJ0000
PP RUEHAM
DE RUEHC #4329/01 1321908
ZNR UUUUU ZZH
P 121906Z MAY 87
FM SECSTATE WASHDC
TO AMEMBASSY AMMAN PRIORITY 0548
BT
UNCLAS SECTION 01 OF 02 STATE 144329

LOC: 115/16 626
13 MAY 87 0525
CN: 23646
CHRG: AID
DIST: AID

ACTION COPY
13 MAY 1987
PEO

AIDAC

E.O. 12356: N/A
TAGS: N/A
SUBJECT: ANPAC: SMALL ENTERPRISE DEVELOPMENT PROJECT (278-0255)

1. ANPAC ON SUBJECT PROJECT WAS HELD MAY 4 WITH ANE/PD DIRECTOR PETER BLOOM CHAIRING. DEPUTY DIRECTOR JOHNSON ATTENDED ON BEHALF OF THE MISSION. SUBJECT PID WAS APPROVED FOR AN ACTIVITY OF AT LEAST FIVE YEARS DURATION (SEE PARA 2C BELOW), AND MISSION MAY PROCEED TO DEVELOP PP FOR FIELD APPROVAL UNDER EXISTING DELEGATION.

2. DURING ANPAC REVIEW SEVERAL ISSUES WERE DISCUSSED AS FOLLOWS:

A) POLICY CHANGE; ANPAC NOTED THAT THE PID DOES NOT DIRECTLY ADDRESS POLICY CHANGES IN QUOTE MACRO UNQUOTE AREAS SUCH AS TAXATION AND INTEREST RATE REFORM AS BEING ESSENTIAL TO PROJECT SUCCESS. PROJECT'S HYPOTHESIS IS THAT LACK OF INSTITUTIONAL CREDIT CHANNEL IS PRIMARY CONSTRAINT TO INCREASED PRODUCTION OF GOODS AND SERVICES BY LOCAL SMALL-SCALE ENTREPRENEURS. THE MISSION REPRESENTATIVE DISCUSSED THE VIEW THAT BANKERS' ATTITUDES TOWARD LENDING SOME OF THE SURPLUS LIQUIDITY IN THE SYSTEM TO THE SMALL ENTERPRISE SECTOR WILL BE CRITICAL TO PROJECT SUCCESS; HOWEVER, IMPROVEMENT IN MACRO-LEVEL AND INDUSTRY-SPECIFIC POLICIES WILL HEIGHTEN THE LEVEL OF SUCCESS WHICH MAY BE ACHIEVED. ANPAC RECOMMENDED THAT PP ADDRESS WHAT MACRO AND SECTOR/INDUSTRY SPECIFIC POLICY CHANGES ARE NECESSARY TO INCREASE THE LIKELIHOOD OF LONG-TERM INSTITUTIONALIZATION OF A GUARANTEED LENDING FACILITY FOR SMALL-SCALE ENTREPRENEURS, AND THE APPROPRIATE POLICY ENVIRONMENT NECESSARY TO PERMIT SMALL PRODUCERS TO UTILIZE BETTER CREDIT ACCESS TO INCREASE PRODUCTION. THE PP MAY IDENTIFY POLICY AREAS WHERE THE MISSION CAN DIRECT FUNDING EITHER ON ITS OWN OR THROUGH THE PROPOSED SMALL BUSINESS FOUNDATION.

B) PUBLIC VS. PRIVATE BANK SUPPORT: ANPAC AGREED WITH DEPUTY DIRECTOR JOHNSON THAT IT MAKES MORE SENSE FOR GUARANTY FACILITY TO LEVERAGE LIQUIDITY IN PRIVATE BANKS

(I.G., PETRA BANK, JORDAN BANK, ETC.) THAN TO LEVERAGE GOJ REGIONAL DEVELOPMENT FUND DEPOSITS IN THE CVDB. ANPAC BELIEVES THE MISSION SHOULD INSIST ON LIMITING USE OF GUARANTY FUND TO PRIVATE BANK LENDING UNLESS THERE IS COMPELLING JUSTIFICATION TO USE THE GUARANTY FUND FOR PUBLIC FINANCIAL INSTITUTIONS (E.G., CVDB).

C) ROLE OF SMALL BUSINESS FOUNDATION (SBF); LENGTH OF PROJECT: ANPAC EXPRESSED SERIOUS RESERVATIONS ABOUT THE VIABILITY OF CREATING A SMALL BUSINESS FOUNDATION WHICH COULD FUNCTION AS THE PROJECT'S COORDINATING ENTITY. ANPAC WAS NOT CERTAIN SBF WOULD BE ABLE TO MAINTAIN A STRONG DEGREE OF AUTONOMY IN THE EYES OF ITS CONSTITUENCY (SMALL ENTREPRENEURS), HAVE THE DEGREE OF IMPLICIT AUTHORITY REGARDING THE USE OF THE GUARANTY MECHANISM, AND BE VIEWED AS THE PROJECT'S IMPLEMENTING ARM ON BEHALF OF AID AND/OR THE GOJ. IT IS ALSO NOT CLEAR HOW THE ORGANIZATION WILL BE CREATED AND BECOME OPERATIONAL QUICKLY ENOUGH TO DO WHAT IS EXPECTED OF IT GIVEN THE PROJECT'S THREE-YEAR IMPLEMENTATION TIMEFRAME. ANPAC FELT THAT IT WILL LIKELY BE IMPOSSIBLE TO QUOTE WHOLESALE UNQUOTE PROJECT MANAGEMENT RELATING TO TA, TRAINING, RESEARCH AND MONITORING OF GUARANTY FUND TO AN ORGANIZATION THAT DOES NOT YET EXIST. IN FACT, IT MAY BE A SUFFICIENT ACCOMPLISHMENT FOR THE PROJECT TO PROPOSE FOR THE SBF AN ADVOCACY ROLE FOR THE SMALL ENTREPRENEUR AND LIMIT ITS FUNCTION TO THAT. IN ANY EVENT, ROLE FOR SBF MUST BE CAREFULLY DEFINED. ANPAC FELT STRONGLY THAT PID REFLECTED A PROJECT WHICH WOULD NOT LIKELY SHOW SIGNIFICANT RESULTS IN TERMS OF

INCREASED PRODUCTION OF GOODS AND SERVICES FROM A CREDIT GUARANTY MECHANISM IN A THREE-YEAR PERIOD, AND RECOMMENDED DESIGNING A PROJECT WITH A LIFE OF AT LEAST FIVE YEARS.

D) GOJ CONTRIBUTION: PID DOES NOT DISCUSS GOJ CONTRIBUTION TO PROJECT, ALTHOUGH IT IS ACKNOWLEDGED THAT THE REGIONAL DEVELOPMENT FUND WILL BE A SUBSTANTIAL RESOURCE DEVOTED TO PROJECT OBJECTIVES. ANPAC FELT PP SHOULD MORE FULLY ADDRESS THE RELATIONSHIP OF THE PROJECT TO THE GOJ REGIONAL DEVELOPMENT FUND AND DISCUSS THE OVERALL ANTICIPATED ROLE OF THE GOVERNMENT IN THE PROJECT AS IT RELATES TO THE CREDIT OPERATIONS.

E) DIFFERENTIAL LOAN GUARANTY RATES FOR WOMEN: ANPAC RECOMENDED THAT SOCIAL SOUNDNESS ANALAYSIS IN PP SHOULD JUSTIFY WHY THERE SHOULD BE DIFFERENTIAL LOAN GUARANTY RATES FOR MEN AND WOMEN, AND ESTABLISH A WAY TO MONITOR PERFORMANCE OF BANKS IN MAKING LOANS TO MALE AND FEMALE ENTREPRENEURS TO DETERMINE IF THE GUARANTY RATES SHOULD BE ALTERED.

F) ESTABLISHMENT OF CREDIT GUARANTY FUND: ANPAC WAS UNDECIDED ON THE BEST WAY TO ESTABLISH THE PROPOSED GUARANTY FUND/MECHANISM. SPECIFICALLY, SHOULD AID FULLY CAPITALIZE A GUARANTY FUND INITIALLY WITH A DOLS 2.5 MILLION DISBURSEMENT, OR HOLD DOLLARS FOR REIMBURSING THE FUND FOR LOSSES AS THEY ARE INCURRED? IN THE LATTER CASE, A MEASURE OF SUCCESS WILL BE HOW LITTLE AID FUNDS ARE USED. ON THE OTHER HAND, DOES AID HAVE SUCH DEFINABLE INTERESTS IN THE GUARANTY FUND (E.G., ESTABLISHING AN INTERMEDIATE CREDIT MECHANISM) TO ADVANCE ITS CAPITAL REQUIREMENTS? IF AID WERE TO HOLD BACK ITS DISBURSEMENT UNTIL GUARANTY FUNDS ARE NEEDED, WILL WE BE REIMBURSING THE GOJ FOR DINARS IT MAY LEND TO THE GUARANTY FUND, OR WILL REIMBURSEMENT BE DIRECT TO BANKS? FUNDAMENTAL TO THIS SET OF QUESTIONS IS UNDERSTANDING WHAT TYPE OF ENTITY/WINDOW WE ADVOCATE ESTABLISHING, WHAT THE GOJ'S ROLE WILL BE IN FINANCING AND MANAGING IT, AND WHETHER THE GUARANTY SCHEME IS A DISTINCT MECHANISM OR SIMPLY A LENDING WINDOW THAT EACH BANK WILL USE AS APPROPRIATE. IN EITHER CASE, WHAT WILL BE AID'S ROLE IN MONITORING THE USE OF THE GUARANTY SCHEME'S RESOURCES? ANPAC CONCLUDED THAT BUREAU COULD OFFER LITTLE MORE THAN SUGGESTIONS REGARDING DESIGN, AND OFFERED TO CONSULT WITH S AND T AND PRE ON VARIOUS OPTIONS FOR DESIGNING A GUARANTY MECHANISM. WILL ADVISE OUTCOME OF THAT DISCUSSION SEPTEL. DEPUTY DIRECTOR JOHNSON HAS ALSO HANDCARRIED COPY OF THAILAND RURAL

INDUSTRIES AND EMPLOYMENT PROJECT.

F) CONCERNS: THE ANPAC IDENTIFIED THE FOLLOWING CONCERNS WHICH THE MISSION SHOULD CONSIDER IN DESIGNING THE PP:

1) THE MISSION MAY WANT TO CONSIDER FEASIBILITY OF PROVIDING CREDIT GUARANTIES TO LARGER WHOLESALE PURCHASERS OF SMALL ENTERPRISE PRODUCTS IN ADDITION TO SUPPLIER CREDIT.

2) THE MISSION SHOULD CONSIDER DISAGGREGATING ITS DATA COLLECTION UNDER THE PROJECT'S MONITORING AND EVALUATION SYSTEM BY SEX.

3) THE PP SHOULD MAKE CLEAR WHAT THE LONG-TERM REQUIREMENTS ARE FOR THE PROJECT AND WITH WHOM THE RESIDENT TA PERSONNEL WILL INTERACT.

4) OPPORTUNITIES FOR GRAY AMENDMENT CONTRACTING MUST BE IDENTIFIED IN THE PP. SHULTZ
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ANNEX A.2

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DE RUEHAM #5029/01 117 **
ZNR UUUUU ZZH
R 260813Z APR 88
FM AMEMBASSY AMMAN
TO SECSTATE WASHDC PRIORITY 8751
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UNCLAS SECTION 01 OF * AMMAN 05029

CLASS: UNCLASSIFIED
CHRGE: AID 4/11/1988
APPRV: DIR:LP:EADE
DRFTD: PE/PD:JDEMPSEY:LL
CLEAR: 1.PRM:WMCKINNEY; 2. D:DJOHNSON; 3.PEC:S ILEY
DISTR: AID-2 AMB DCM

AIDAC

FOR ANE/PD

E.O. 12356:N/A
SUBJECT: LOAN GUARANTEE PROJECT FOR SMALL ENTERPRISE DEVELOPMENT - 278-0255

REF: A) STATE 144329 (1987) B) AMMAN 8953 (1987)
C) AMMAN 4820

1. SUMMARY: USAID/JORDAN HAS MADE SUBSTANTIAL PROGRESS WITH THE GOJ IN THE DEVELOPMENT OF THE SUBJECT PROJECT. OUR PLANS ARE TO COMPLETE THE PROJECT PAPER IN JUNE WITH GRANT OBLIGATION IN JULY. THE PP WILL BE SIMPLIFIED BY DROPPING SOME COMPONENTS PRESENTED IN THE PID BUT WITH THE EXPANSION OF THE LOAN GUARANTEE FROM DOLS 2.5 TO 8.5 MILLION. NO NEW COMPONENTS WILL BE ADDED. REQUIRED FINANCING IS NOW IN THE RANGE OF DOLS 10 MILLION. ALTHOUGH THE PROJECT APPROACH IS ESSENTIALLY UNCHANGED SINCE ORIGINAL ANPAC, MISSION SEEKS REVALIDATION OF THE PID AT THE DOLS 10.0 MILLION LEVEL WITH FIELD APPROVAL OF THE PROJECT PAPER. BACKGROUND INFORMATION AND PLANS FOR PROJECT DESIGN ARE PRESENTED IN THE FOLLOWING PARAGRAPHS. A REQUEST FOR AID/W HELP IN IDENTIFYING AND POSSIBLY CONTRACTING THE NEEDED DESIGN ASSISTANCE WAS SENT IN REF C.

2. BACKGROUND: ON MAY 4, 1987 ANPAC WAS HELD ON SUBJECT PROJECT WHICH WAS THEN TITLED THE SMALL ENTERPRISE DEVELOPMENT PROJECT. PER REF A SUBJECT PID WAS APPROVED AT DOLS 5.0 MILLION FOR A PERIOD OF AT LEAST FIVE YEARS AND MISSION WAS AUTHORIZED TO DEVELOP PP FOR FIELD APPROVAL UNDER EXISTING DELEGATION. ON JULY 27, REF B ADVISED AID/W ON MISSION'S DECISION TO POSTPONE OBLIGATION OF THE PROJECT UNTIL FY 1988 DUE TO AN INABILITY TO COME TO TERMS WITH THE GOJ ON SOME ASPECTS OF THE PROJECT. AFTER ADDITIONAL DISCUSSIONS AND THE SUBMISSION OF A RECAST CONCEPT PAPER (CHANGES DISCUSSED BELOW) TO THE GOJ, MISSION IS NOW CONFIDENT THAT A MUTUALLY ACCEPTABLE PROJECT CAN BE DESIGNED WHICH WILL NOT BE ASSOCIATED WITH THE GOJ'S REGIONAL DEVELOPMENT FUND. ACCORDINGLY, MISSION PLANS TO COMPLETE THE PP AND TO OBLIGATE THE LOAN GUARANTEE PROJECT FOR AN AMOUNT UP TO DOLS 10.0 MILLION IN JULY.

3. PROJECT DESIGN AND THE PID: THE CONCEPT OF THE

PROJECT REMAIN UNCHANGED AND ALL COMPONENTS IN THE PROJECT WERE PART OF THE PID. THE GUARANTEE FUND FOR SMALL ENTERPRISE LENDING WILL BE EXPANDED FROM DOLS 2.5 TO 8.5 MILLION. THE PROJECT GOAL, PURPOSE AND END OF PROJECT STATUS ARE UNCHANGED. THERE WILL HOWEVER BE SOME ADJUSTMENTS IN THE OUTPUTS. ON THE INSTITUTIONAL SIDE, WE WILL BE DEPENDING ON COMMERCIAL BANK CHANNELS AND EXPECT THEM TO EXPAND THEIR LENDING TO MICRO AND SMALL FIRMS. THE CENTRAL BANK OR THE INDUSTRIAL DEVELOPMENT BANK WILL MOST LIKELY ADMINISTER THE LOAN GUARANTEE FUND. BUT COMMERCIAL BANKS WILL DESIGN AND IMPLEMENT THEIR OWN SMALL ENTERPRISE LOAN PROGRAMS. USING PROJECT CRITERIA, A GOJ BANK COMMITTEE (ITS MEMBERSHIP TO BE DETERMINED) WILL APPROVE A LOAN GUARANTEE "LINE OF CREDIT" TO THE APPLICANT BANK. THE BANK WILL BE EXPECTED TO CARRY A SUBSTANTIAL PORTION OF THE LOAN RISK WITH THE BALANCE COVERED BY THE AID SUPPORTED GOJ GUARANTEE. LOANS TO INDIVIDUAL FIRMS WILL NEED ONLY THE APPROVAL OF THE PARTICIPATING BANK IN LINE WITH THE PROCEDURE THAT THEY SET OUT IN THEIR APPLICATION TO THE GOJ COMMITTEE.

WE HAVE DROPPED THE IDEA OF A SMALL BUSINESS FOUNDATION OR NGO TO SUPPORT THE PROGRAM. NO DIRECT LOANS WILL BE MADE BY AID. WE ALSO EXPECT TO GIVE MUCH LESS DIRECT ASSISTANCE TO SMALL ENTREPRENEURS THAN WAS ENVISAGED IN THE PID. THE TA AND TRAINING WILL BE PROVIDED TO INDIVIDUAL FINANCIAL INSTITUTIONS TO IMPROVE THEIR CREDIT RISK EVALUATION AND LOAN APPROVAL AND MONITORING CAPACITY. ASSISTANCE TO INDIVIDUAL FIRMS WILL COME PRIMARILY THROUGH THE COMMERCIAL BANKS AS LOAN SUPERVISION.

4. FUNDING: BECAUSE OF THE NEED TO HAVE A LOAN GUARANTEE PROGRAM LARGE ENOUGH TO ATTRACT A NUMBER OF COMMERCIAL BANKS, WE PLAN TO INCREASE THE GUARANTEE FUND SUBSTANTIALLY.

A REVISED ESTIMATED PROJECT BUDGET IS AS FOLLOWS:

PID	REVISED BUDGET	ORIGINAL BUDGET
TA & TRAINING	$ 1,150,000	$ 1,775,000

RESEARCH	-	300,000	200,000
LOAN GUARANTEE	-	8,500,000	2,500,000
DIRECT LOAN FUNDS	-	- 0 -	300,000
EVALUATIONS	-	50,000	225,000
TOTALS	-	$10,000,000	$ 5,000,000

5. PRE IMPORT SUPPORT FACILITY (UP TO DOLS 5.0 MILLION): WE ARE WORKING WITH PRE TO DEVELOP LOAN GUARANTEE FACILITIES TO TWO OR MORE FINANCIAL INSTITUTIONS TO FINANCE PRODUCTIVE IMPORTS BY SMALL AND MEDIUM SIZED BUSINESSES. AS A COMPLEMENT TO THE BILATERAL PROJECT, THE PRE FINANCED PROGRAM WILL PROVIDE DOLLAR FINANCING TO LARGER SIZED FIRMS IN THE SMALL AND MEDIUM RANGE WITH IMPORT REQUIREMENTS.

6. ANPAC REVIEW: TO HELP AID/W UNDERSTAND WHERE THE MISSION IS IN THE DESIGN OF THE PROJECT, WE ARE GIVING THE PRESENT STATUS OF THE ISSUES RAISED IN THE ANPAC REVIEW AND REPORTED IN REF A. WE NOTE THAT THESE ARE PROJECT PAPER ISSUES; SOME WILL BE RESOLVED ONLY WITH THE COMPLETION OF THE PP.

A. POLICY CHANGES: IN LINE WITH ANPAC GUIDANCE WE WILL INVESTIGATE MACRO-LEVEL POLICIES NEEDED TO "LEVEL THE PLAYING FIELD" AS WELL AS INDUSTRY SPECIFIC AND MICRO CHANGES. MONEY FOR RESEARCH AND POLICY STUDIES WILL CONTINUE TO BE AVAILABLE WITHIN THE PROJECT.

B. PUBLIC VS. PRIVATE BANK SUPPORT: THIS ISSUE HAS BEEN RESOLVED. ALL FUNDS WILL BE GOING TO COMMERCIAL BANKS FOR PRIVATE SECTOR SMALL ENTERPRISE LENDING.

C. ROLE OF SMALL BUSINESS FOUNDATION: WE HAVE ELIMINATED THIS COMPONENT OF THE PROJECT.

D. GOJ CONTRIBUTION: SINCE LOCAL BANKS WILL USE THEIR OWN FUNDS LEVERAGED AT LEAST TWO TO ONE BY THE LOAN FACILITY, THE LOCAL CONTRIBUTION WILL BE AT LEAST DOUBLE AID'S. THE INITIAL LEVERAGE LEVEL IS EXPECTED TO BE 2:1 BUT SHOULD GO UP FROM THERE ONCE MORE EXPERIENCE IS GAINED. THE ISSUES RAISED IN ANPAC IN RELATION TO THE REGIONAL DEVELOPMENT FUND ARE NO LONGER RELEVANT.

E. DIFFERENTIAL LOAN GUARANTY RATES FOR WOMEN: THE POINTS RAISED UNDER THIS ISSUE WILL BE ADDRESSED IN THE DESIGN WITH THE HELP OF A LOCAL SOCIOLOGIST.

F. ESTABLISHMENT OF THE CREDIT GUARANTEE PROGRAM: THE PROJECT OBJECTIVE IS TO ESTABLISH A LOAN GUARANTEE PROGRAM THAT IS SELF-SUSTAINING AND WILL CONTINUE AND EXPAND AFTER THE AID PROJECT IS COMPLETE. TO ACHIEVE THIS END, THE PROGRAM NEEDS TO BE ESTABLISHED AND OPERATED BY A LOCAL ENTITY WITH AID PLAYING ONLY A SUPPORTING ROLE THROUGH THE PROJECT. THUS, FOR THE GUARANTEE FUND WE SEE AID FUNDS BEING USED TO REIMBURSE THE LOCAL ENTITY FOR THE PURCHASE OF GOVERNMENT SECURITIES AND BILLS HELD TO BACK THE GUARANTEE. THE

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DRAWDOWN OF THE GRANT WILL BE OVER THE LIFE OF THE PROJECT TO COVER THE AGREED UPON PERCENTAGE OF THE LOANS MADE BY THE PARTICIPATING BANKS. GIVEN THE COMMERCIAL BANKS PRESENTLY PERCEIVED HIGH RISK OF THE SMALL ENTERPRISE LENDING AND THEIR BAD EXPERIENCE WITH LOCAL GUARANTEES THAT ARE NOT BACKED BY A SECURITY FUND, THE GUARANTEE FUND IS ESSENTIAL.

WE EXPECT THAT OVER TIME THE EXPERIENCE GAINED WILL ENABLE US TO REFINE THE RISK REQUIREMENTS AND LOWER THE ACTUAL AMOUNT NEEDED TO COVER LOSSES FROM BAD LOANS. ALSO WE PLAN TO SEEK INCREASED LOCAL CONTRIBUTIONS TO THE FUND ONCE ITS VALUE IS CLEARLY UNDERSTOOD.
(DRAFTED: PD/PE:JDEMPSEY; APPROVED: DIR:LPREADE)
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ANNEX A.3

ACTION AID-2 INFO AMB DCM ECON

LOC: 21/02 343
22 JUN 88 0429
CN: 32278
CHRG:
DIST: AIDLY

ACTION COPY
02 JUN 1988
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YZCZCA30301
OO RUEHAM
DE RUEHC #6205/01 1530107
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FM SECSTATE WASHDC
TO AMEMBASSY AMMAN IMMEDIATE 8381
BT
UNCLAS SECTION 01 OF 02 STATE 176205

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E.O. 12356: N/A
TAGS:
SUBJECT: LOAN GUARANTEE PROGRAM FOR SMALL ENTERPRISE DEVELOPMENT - 278-0255

REFS: A) AMMAN 5029; B) AMMAN 4820

1. PROJECT COMMITTEE, CHAIRED BY ANE/PD DIRECTOR VENEZIA, REVIEWED REFTEL A REQUEST FOR REVALIDATION OF PID APPROVAL AT THE DOLS 10 MILLION LEVEL ON MAY 11. BASED ON PRC REVIEW, AA/ANE HEREBY CONFIRMS PID APPROVAL WITH FIELD APPROVAL OF THE PP. DISCUSSION POINTS FOLLOW.

2. INCREASE IN GUARANTEE FUND: REF TEL PROPOSES TO INCREASE THE GUARANTEE FUND FROM DOLS. 2.5 MILLION TO DOLS. 8.5 MILLION, WHICH AT 2:1 LEVERAGE ASSUMES DEMAND FOR LOANS TO SMALL ENTERPRISES TOTALLING DOLS. 17 MILLION. WHILE THIS IS SMALL AMOUNT RELATIVE TO JORDAN'S ECONOMY, IT MAY REPRESENT AS MUCH AS ONE PERCENT OF CREDIT, A SUBSTANTIAL AMOUNT AT THE MARGIN. ACCORDINGLY, PRC REQUESTED THAT PP INCLUDE A DEMAND ANALYSIS DEMONSTRATING NEED FOR THIS LEVEL OF SMALL ENTERPRISE FUNDING. WHILE AUTHORIZATION OF REQUESTED LOP AMOUNT OF DOLS 10 MILLION WOULD APPEAR APPROPRIATE

IF DEMAND CAN BE ESTABLISHED, BUREAU REQUESTS THAT OBLIGATION RATE OF PROJECT FUNDS BE COMMENSURATE WITH EXPECTED RATE OF USE.

3. CASH MANAGEMENT PROCEDURES: AS IN OTHER GUARANTEE PROPOSALS, DISBURSEMENT PROCEDURES SHOULD ASSURE THAT DISBURSEMENTS NOT BE MADE IN ADVANCE OF NEED. IN THIS CASE AID FUNDS WILL REIMBURSE THE IMPLEMENTING ENTITY FOR THE PURCHASE OF SECURITIES WHICH BACK THE GUARANTEE, AND ARE DISBURSED ONLY AS SECURITIES ARE PURCHASED TO COVER QUALIFIYING LOANS AS THEY ARE MADE BY PARTICIPATING BANKS. CAPITALIZATION OF THE FUND IS THE OBJECTIVE AND THE BASIS FOR DISBURSEMENT. PRC AGREED THAT THIS WOULD BE AN APPROPRIATE PROCEDURE WHICH ADEQUATELY PROTECTS AGAINST PREMATURE DISBURSEMENT.

4. ACCESS TO THE GUARANTEE: PRC DISCUSSED NEED FOR BALANCE IN THE DEGREE TO WHICH THE GUARANTEE IS

ACCESSIBLE. THERE SHOULD BE FULL INCENTIVE FOR THE PARTICIPATING BANKS TO FOLLOW GOOD BUSINESS PRACTICES IN THEIR LENDING AND LOAN SUPERVISION PROCEDURES, AND TO MAKE ALL REASONABLE EFFORTS AT COLLECTION PRIOR TO RESORT TO THE GUARANTEE; AT THE SAME TIME, THE PROJECT'S OBJECTIVE IS TO DEMONSTRATE TO THESE LENDING INSTITUTIONS THAT REACHING DOWN TO SMALL ENTERPRISES WITHOUT REQUIRING QUOTE EXCESSIVE UNQUOTE COLLATERAL CAN BE AN ACCEPTABLE RISK. TO ACCOMPLISH LATTER OBJECTIVE, BANKS HAVE TO BE CONVINCED THAT THE GUARANTEE WILL BE ACCESSIBLE IN THE EVENT OF EXTRAORDINARY LOSSES ON PROJECT LOANS. THE PROJECT DESIGN WILL NEED TO EXPLORE APPROACHES AND DEFINE A SET OF PROCEDURES WHICH PROTECT LENDERS' CAPITAL WITHOUT ENCOURAGING THEM TO REDUCE SUPERVISORY DILIGENCE REGARDING INDIVIDUAL BORROWERS. WITH REGARD TO COLLATERAL, WE ASSUME THAT THERE IS NO INTENTION HERE FOR AID ITSELF (AS OPPOSED TO GUARANTOR) TO TAKE TITLE OR POSSESSION OF COLLATERAL IN THE EVENT OF DEFAULT.

5. POLICY CHANGE: THE PROJECT COMMITTEE DISCUSSED THE EXTENT TO WHICH CURRENT INTEREST RATE CEILINGS ARE A MAJOR CONSTRAINT TO SMALL FIRMS' ACCESS TO CREDIT. IF INTEREST RATES CHARGED TO VARIOUS CLASSES OF BORROWERS REFLECTED THE UNDERLYING PURE CREDIT RISK, ONE WOULD EXPECT THE GUARANTEE TO PROVIDE A USEFUL INDUCEMENT TO LEND WHERE THE BUSINESS RISK IS OVERESTIMATED BY THE BANKS. (THE TA AND TRAINING IN RISK ANALYSIS AND LOAN APPROVAL/MONITORING CAPACITY WHICH WILL BE AVAILABLE TO THE PARTICIPATING FINANCIAL INSTITUTIONS THROUGH THE PROJECT MAY PROVE AS IMPORTANT AS THE GUARANTEE ITSELF IN IMPROVING THE ACCESS TO CREDIT OF SMALL AND MICRO ENTERPRISES.)

IF THE INTEREST RATE STRUCTURE IS DISTORTED, HOWEVER, IT IS NOT CLEAR THAT THE INTRODUCTION OF THE GUARANTEE WILL RESULT IN THE DESIRED MARKET CORRECTION. PRC NOTED THAT THE MISSION PLANS TO INVESTIGATE NEEDED MACRO-LEVEL POLICIES AS WELL AS INDUSTRY-SPECIFIC AND MICRO CHANGES, THROUGH RESEARCH AND POLICY STUDIES (REF A PARA 5A), AND RECOMMENDED THAT THE PP ANALYSIS INCLUDE DISCUSSION OF MAJOR CONSTRAINTS TO SMALL ENTERPRISE LENDING, INCLUDING INTEREST RATE POLICY AND COLLATERAL REQUIREMENTS, AND THEIR POTENTIAL IMPACT ON THE PROJECT. REQUEST MISSION'S VIEWS ON POSSIBILITY OF OBTAINING GOJ POLICY CHANGE AS CONDITION TO THE PROJECT.

6. LENDING PROCEDURES AND CRITERIA: PRC REQUESTED THAT PROJECT PAPER SPELL OUT HOW THE GUARANTEE FUND WILL OPERATE, INCLUDING LENDING CRITERIA TO ASSURE THAT LOANS SUPPORT PROJECT OBJECTIVES, AS WELL AS AID'S RIGHTS TO

APPROVE AND REVIEW PERIODICALLY SUCH LENDING AND GUARANTEE CRITERIA. IT WAS ALSO REQUESTED THAT PROJECT BENCHMARKS BE ESTABLISHED, SUCH AS PROGRESS TOWARDS REDUCING COLLATERAL REQUIREMENTS NOT BACKED BY THE GUARANTEE PROGRAM.

7. GOJ CONTRIBUTION: IF AID FUNDS WILL BE APPLIED TO PURCHASE OF GOJ SECURITIES TO BACK THE GUARANTEE FUND, AID WILL BE PROVIDING FREE FOREIGN EXCHANGE AND BUDGET SUPPORT TO THE GOJ. PRC REQUESTS THESE MACRO BENEFITS BE DISCUSSED IN THE PP. IN LIGHT OF THESE DIRECT BENEFITS, PRC FELT THERE WAS A STRONG PRESUMPTION IN FAVOR OF A GOJ REPEAT GOJ FINANCIAL CONTRIBUTION TO THE PROJECT TO JUSTIFY USE OF GOJ SECURITIES FOR THIS PURPOSE RATHER THAN OTHER INSTRUMENTS, SUCH AS U.S. T-BILLS. REQUEST MISSION'S VIEWS ON FEASIBILITY OF OBTAINING SUCH A CONTRIBUTION OR HOLDING FUNDS IN U.S. SECURITIES. PLEASE ADVISE.ADDITIONAL CLEARANCES:
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June 1988

JORDAN LOAN GUARANTEE FOR SMALL ENTERPRISE DEVELOPMENT
LOGICAL FRAMEWORK

NARRATIVE SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
Program Goal:	Measures of Goal Achievement		
To increase levels of employment and income of small and micro enterprises in Jordan	Increased private sector employment and income at the small and micro level	National statistical data. Analysis of relevant industrial sector/subsectors	Feasibility of restructuring the Jordanian economy.
Project Purposes:	End of Project Status:		
To increase the ability of local enterprises, to increase the efficiency of their enterprises, and to increase production and sales of goods and services in the local and export oriented markets.	(1) There will be an improved capacity on the part of micro and small businesses to obtain credit and apply it to productive	National statistical data. Analysis of relevant industrial sector/subsectors	Availability of viable business opportunities. Availability of appropriate training and TA resources
	(2) A self-sustaining credit guarantee program to provide partial credit	National statistical data. Interim and Post project evaluations.	Guarantee terms attractive to banks in changing economic conditions
	(3) The Industrial Development Bank and systems in place to operate a credit guarantee program, and to monitor loan performance and issue guarantee payments promptly when necessary.		
	(4) The capacity of the banking sector to analyze micro and small business lending needs will be improved.		
	(5) An improved understanding of the policy environment will result from the studies carried out under project.		

NARRATIVE SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
Outputs:	Magnitude of Outputs		
(1) A bank credit guarantee program for MSEs	1600 small enterprises receiving partial guarantees for loans.	Quarterly and annual reports submitted by the coordinating agency. Project records	Willingness of commercial banks to cooperate and support project objectives and activities. Demand for credit from appropriate enterprises
(2) Loans to women	25% increase over SSTH		
(3) Policy studies	4-6 studies		
(4) MSE Lending manuals	In 6-9 participating banks		
Inputs	Magnitude of Inputs		
(1) Technical Assist	42 pm		
(2) Training	7 courses 4 study tours		
(3) Guarantee Fund	$8.6 million		

STATUTORY CHECKLIST
JORDAN LOAN GUARANTEE FOR
SMALL ENTERPRISE DEVELOPMENT PROJECT (278-0255)

A. GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is bought to obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?	Regular CN Notification Procedure.
2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?	a. Yes. b. Yes.
3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?	None required.

4.	FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)	N/A
5.	FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?	N/A
6.	FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	Not so susceptible.
7.	FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	(a) Yes, but only in a limited way. A few small enterprises mig export same products. (b) Yes, through small enterprises developme (c) No impact. (d) No impact. (e) Yes. (f) No impact.
8.	FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	Some small enterprises ma purchase inputs exported from the U.S.A.
9.	FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	The local banks will contribute nearly $13.0 million in loans to small enterprises. The U.S. owns no local currency in Jordan.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

Jordan is not an excess currency country.

11. FY 1988 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

N/A

12. FY 1988 Continuing Resolution Sec. 553. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

No.

13. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

N/A

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

15. FY 1988 Continuing Resolution. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? N/A

16. FY Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? N/A

17. FY 1988 Continuing Resolution Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained? N/A

18. FY Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified? N/A

19. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision). It will be sent when date is confirmed.

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?	Yes.
b. FAA Sec. 531(e). Will this assistance be used for military or paramilitary purposes?	No.
c. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	N/A

THE HASHEMITE KINGDOM
OF JORDAN
MINISTRY OF PLANNING
AMMAN
Tel. 644466 - 644470
644381 - 644385
Tlx. 21319 - P.O.Box 555
Teleg. NPC - Amman

المملكة الأردنية الهاشمية
وزارة التخطيط
عمان
هاتف ٦٤٤٤٦٦ - ٦٤٤٤٧٠
٦٤٤٣٨١ - ٦٤٤٣٨٥
تلكس ٢١٣١٩ - ص.ب ٥٥٥

NO. 5/4/1/4676
DATE 2/8/1988
REF.

الرقم
التاريخ
الموافق

ANNEX D

Mr L.P. Reade
Director
USAID/Jordan
Amman.

Dear Mr. Reade,

I would appreciate it if the initial contribution of US $2,500,000 can be allocated for the Loan Guarantee for Small Enterprise Development Project under USAID Technical Assistance Program.

Sincerely yours,

Minister of Planning

ANNEX E

Draft
PROJECT AUTHORIZATION

Name of Country: Hashemite Kingdom of Jordan

Name of Project: Loan Guarantee Project For Small Enterprise Development Project

Number of Project: 278-0255

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Loan Guarantee For Small Enterprise Development Project for Jordan involving planned obligations of not to exceet $10,000,000 in grant funds over a four year period, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is four years from the date of initial obligation.

2. The project consists of helping local financial institutions to increase their lending to small businesses, thus improving the ability of local entrepreneurs to establish and expand their productive enterprises.

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

   (A) Source and Origin of Commodities, Nationality of Services

   Commodities financed under the AID grant shall have their source and origin in Jordan or in the United States except as AID may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services financed under the AID grant shall have Jordan or the United States as their place of nationality, except as AID may otherwise agree in writing. Ocean shipping financed under the AID grant shall, except as AID may otherwise agree in writing, be financed on flag vessel only of the United States.

_____ Date

_____ Director, USAID

INDUSTRIAL DEVELOPMENT BANK

AMMAN - JORDAN

ANNEX F
page 1

SMALL SCALE INDUSTRIES & HANDICRAFT DEPARTMENT
ANALYSIS OF APPROVED LOANS

NATURE OF PROJECT	1975 - 1979		1980		1981		1982		1983		1984		1985		1986		1987		First Quarter 1988		198			
	No.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	No	AMOUNT	NO.	AMOUNT	NO.	AMOUNT	NO.	AMOUNT
New Projects	246	520360	63	214100	90	316000	134	494900	154	506700	101	339200	253	781600	258	883500	54	155200	5	17800				
Expansion Projects	254	397620	39	79900	94	253200	93	204400	107	267400	87	171200	164	492300	146	355800	23	61000	1	4000				
Total	500	917980	102	294000	184	569200	227	699300	261	774100	188	491400	417	1273900	404	1239300	77	216200	6	21800				
SECTORAL DISTRIBUTION:-																								
Carpentry	173	315900	21	55200	39	107300	47	126700	50	133800	31	81900	64	181300	49	137100	10	37200	1	3500				
Construction Material	87	162160	21	58700	51	171900	42	128700	44	141900	30	70300	51	151000	47	122000	5	10500	-	-				
Metal Works	74	149300	19	52900	33	99200	36	114300	40	114700	39	92800	57	178200	63	199200	7	15500	-	-				
Knitting & Tailoring	74	99720	5	13700	12	34100	20	69700	33	103100	11	30100	49	158100	48	140700	6	9800	-	-				
Leather & Shoes	10	18550	-	-	2	[illegible]	3	6600	4	2900	3	9000	4	10000	5	14500	-	-	-	-				
Maintenance	24	55200	13	39900	16	52800	35	125000	37	113800	31	89700	63	191200	66	202300	14	39300	2	7200				
Printing & Photography	25	55000	5	16700	11	41400	9	33600	7	22000	12	32100	20	72300	21	74700	2	5000	-	-				
Plastic Bags	2	4500	-	-		-	1	1000	1	4000	-	-	-	-	1	4000	-	-	-	-				
Tourism & Others	4	4800	3	6500	6	16500	13	33900	9	19000	12	35[illegible]0	24	60500	18	53400	6	16100	1	4000				
Confectionery & Food	29	57850	15	50400	14	40000	21	59000	36	102900	19	50200	85	270800	86	291400	27	82800	2	7100				
Total	500	917980	102	294000	184	569200	227	699300	261	774100	188	491400	417	1273900	404	1239300	77	216200	6	21800				
Geographical Distribution:-																								
Amman	251	477470	53	145300	97	311400	108	338000	137	417600	93	243900	228	698900	190	591900	21	64300	1	4000				
Salt	34	52750	14	45600	29	83800	20	64700	26	70700	19	55400	27	85800	31	87200	13	36400	-	-				
Irbed	70	127050	16	55800	22	62000	34	98800	28	82300	30	80600	49	146600	64	205600	11	29100	3	10300				
Karak	16	23200	5	13500	11	35900	20	67800	10	26300	14	33900	16	47200	19	52100	2	7000	-	-				
Zarka	46	95700	8	18800	12	34500	20	63200	25	69600	15	42400	34	99100	51	150900	6	16300	-	-				
Mafrak	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4	9500	8	18700	1	3500				
Tafila and Ma'an	13	25900	1	2600	2	5000	3	5700	8	22500	2	10200	4	10500	4	12500	2	5600	-	-				
Madaba	15	25600	4	11800	5	18500	15	46900	5	15100	10	15400	14	38100	11	31900	6	19400	-	-				
Jerash and Ajlun	15	27950	1	600	5	14600	1	4000	3	9200	3	7600	10	28300	9	26900	3	7900	-	-				
Jordan Valley & other	40	62360	-	-	1	3500	6	10200	19	59800	1	2000	35	119400	21	70800	5	11500	1	4000				
Total	500	917980	102	294000	184	569200	227	699300	261	774100	188	299800	417	1273900	404	1239300	77	216200	6	21800				
Size :-																								
Below JD 500	40	17155	2	1000	1	500	6	3000	4	2000	3	1500	1	500	-	-	1	500	-	-				
JD. 501 - 1000	65	55375	14	13200	21	20800	25	24500	33	32000	41	39800	66	63600	55	54500	7	6700	-	-				
JD. 1001 - 1500	71	92600	5	6600	8	12000	10	13900	11	15500	11	15000	15	21200	15	20500	10	14100	-	-				
JD. 1501 - 2000	213	406850	9	17300	10	24500	15	27300	24	46600	21	40300	22	42500	30	56700	10	18900	-	-				
JD. 2001 - 2500	29	66900	8	18500	13	37200	11	27000	30	75400	16	38200	26	63200	27	65300	4	9800	-	-				
JD. 2501 - 3000	39	114700	9	25300	22	61000	26	76100	25	74000	17	49400	40	117300	43	127300	10	29300	-	-				
JD 3001 - 3500	12	40700	10	34100	12	41200	12	43800	12	40800	12	41300	27	92400	38	130300	3	10200	3	9800				
JD. 3501 - 4000	31	123700	45	178000	97	372000	122	483700	122	487800	67	265900	220	872200	196	782600	32	126700	3	12000				
Total	500	9179800	102	294000	184	569200	227	699300	261	774100	188	491400	417	1273900	404	1239300	77	216200	6	218000				
Duration :-																								
Up To 3 Years	114	101330	27	32700	47	71500	50	57100	57	66700	59	63500	91	102000	79	93000	23	30200	-	-				
3 To 4 Years	306	576150	17	40900	30	81100	24	58700	50	116100	40	90700	51	122200	55	125500	11	25100	-	-				
4 To 5 Years	80	240500	58	220400	107	416600	153	583500	154	591300	89	337200	275	1049200	270	1020800	43	160900	6	21800				
Total	500	917980	102	294000	184	569200	227	699300	261	774100	188	491400	417	1273900	404	1239300	77	216200	6	21800				

RB/BS

RB/AM.

INDUSTRIAL DEVEOPMENT BANK
AMMAN - JORDAN

SMALL SCALE INDUSTRIES & HANDICRAFT DEPARTMENT
SUMMARY OF OPERATIONS

	1975-1979	1980	1981	1982	1983	1984	1985	1986	1987	1.1.87-31.3.88
Approvals :-										
Loans:-										
For domestic purchases	848777	278000	553200	676300	758100	475400	1238100	1199800	216200	238000
For foreign purchases	69203	16000	16000	23000	16000	16000	30800	39500	-	-
TOTAL	917980	294000	569200	699300	774100	491400	1273900	1239300	216200	238000
Cancellation :-										
Loans:-										
For domestic purchases	95589	25550	17300	11000	37260	32400	33429	91378	32800	59843
For foreign purchases	2000	4000	4000	-	-	-	2500	3000	-	-
Total Cancellations	97589	29550	21300	11000	37260	32400	35929	94378	32800	59843
Committments:-										
Loans:-										
For domestic purchases	753188	252450	535900	665300	720840	443000	1204671	1108422	183400	178157
For foreign purchases	67203	12000	12000	23000	16000	16000	28300	36500	-	-
Total Committments	820391	264450	547900	688300	736840	459000	1232970	1144922	183400	178157
Disbursements:-										
For domestic purchases	733943	264150	488600	601250	671216	426001	1198194	1113565,950	252506	410621
For foreign pruchases	65248	9000	21000	10625	16000	13000	38795	25308,550	9250	9250
TOTAL	799191	273150	509600	611875	777216	439001	1236989	1139774,500	261756	419871
Approvals :-										
Loans for purchasing :-										
Machinery and tools	249129	251080	471790	572087	616743	376908	1035914	1035426	194564	215814
Raw materials	21321	42920	97410	127213	157357	114492	237986	203874	21636	22186
TOTAL	270450	294000	569200	699300	774100	491400	1273900	1239300	216200	238000

RB/AJ.

LOAN GUARANTEE PROGRAM OFFICE
LONG-TERM BANKING ADVISORY POSITION

I. BACKGROUND

The Loan Guarantee Project (LGP) is being planned by USAID/Jordan to increase the availability of credit to small and micro enterprises in Jordan. The project is one of several efforts being assisted by A.I.D. to expand the employment base in Jordan by encouraging the formation and expansion of firms and productive activities.

It is proposed that the Loan Guarantee Project be administered by the Industrial Development Bank (IDB). An Administrative Office will be established to provide the management, training, and monitoring functions associated with operation of the LGP.

II. SCOPE OF SERVICES

The services to be provided by the LGP Advisor shall include, as a minimum:

- Assist in the organization of office operations and assign staff responsibilities and authorities necessary to carry out the LGP in an effective manner;

- Help establish procedures, and review and make recommendations on applications received from participating bank candidates;

- Help establish and manage operations of an information system to monitor participating bank performance, and the status of loans included in the guarantee portfolio;

- Identify training requirements among participating bank staff, and manage development of training programs to improve skills in small lending practices;

- Help conduct periodic reviews of participating bank performance and recommend corrective actions to improve lending or collection practices;

- Develop educational and other advertising campaigns to promote participation by enterprises in rural or priority subsectors;

- Help establish procedures for review of claims against guarantee and prompt payment of valid claims;

- Organize career development and training programs to assure orderly transition to a self-sufficient LGP Administrative Office staff by the conclusion of the advisor assignment.

III. QUALIFICATIONS

The long-term advisor should possess the following qualifications, as a minimum:

- A minimum of 10 years experience in commercial banking, preferably in small business lending or retail banking;
- Experience in organization or delivery of loan officer training, preferably small business/cash flow lending;
- Experience with small business operations and management through banking or related financial services;
- Ability to communicate and operate effectively with senior host government managers, business persons, and A.I.D. officials;
- Experience in analyzing the quality of loan portfolios;
- Previous experience in managing staff and directing loan management activities; and
- Some knowledge of banking and business practices in the Middle East and of Islamic culture;

Loan Guarantee Program Office Director

Responsibilities:

The Loan Guarantee Program Office Director will have overall management responsibility for all aspects of the Loan Guarantee Program (LGP). In this position he will be directly responsible to the General Manager of the Industrial Development Bank.

His specific responsibilities include:

1. Acts as the major contact at IDB for the banks participating in the LGP.

2. Accepts and reviews bank applications for participation in the LGP.

3. Supervises the Information Manager and other staff in the Office.

4. With the Information Manager, monitors performance of participating financial institutions in the LGP.

5. Reviews and determines acceptability of bank requests for bad debt payments under the loan guarantee.

6. Is a lead IDB Officer in the selection of an auditing firm for the LGP.

7. Supervises audit contract for LGP.

8. Budgets and controls office expenditures.

9. Provides estimates of Office expenditures and payments for bad debts to the manager of the Loan Guarantee Fund held in trust.

Qualifications:

In order to accomplish the above assigned tasks, the individual must be a proven banker with experience in small business lending and be able to deal tactfully with government officials and senior bankers faced with a material change in the way they have been doing business for many years. Completion of the above tasks will require that this individual be a high ranking senior member of the IDB with at least ten years experience in the Jordan banking community. Since training to promote cash flow lending will be important, preference should be given to individual who has experience in application of such techniques to lending.