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

BOLIVIA

PROJECT PAPER

MICRO AND SMALL ENTERPRISE DEVELOPMENT

AMENDMENT NUMBER 4

AID/LAC/P-909
CR-452, 666, 724,
824, 902

PROJECT NUMBER: 511-0596

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: C (A = Add, C = Change, D = Delete) — Amendment Number 4

DOCUMENT CODE 3

2. COUNTRY/ENTITY: BOLIVIA

3. PROJECT NUMBER: 511-0596

4. BUREAU/OFFICE: LAC — 05

5. PROJECT TITLE (maximum 40 characters): Micro and Small Enterprise Development Project

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 97

7. ESTIMATED DATE OF OBLIGATION (Under 'B', below, enter 1, 2, 3, or 4)
A. Initial FY 88 B. Quarter C. Final FY 97

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

A. FUNDING SOURCE		FIRST FY B. FX	C. L/C	D. TOTAL	LIFE OF PROJECT E. FX	F. L/C	G. TOTAL
AID Appropriated Total							
(Grant)		(2,040)	( )	(2,040)	(14,350)	( )	(14,350)
(Loan)		( )	( )	( )	( )	( )	( )
Other U.S.	1.						
	2.						
Host Country	GOB					3,350	3,350
Other Donor(s)	P/S FUNDAPRO					2,725	2,725
TOTALS		2,040		2,040	14,350	6,075	20,425

9. SCHEDULE OF AID FUNDING ($000)

	A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH CODE 1. Grant	2. Loan	D. OBLIGATION TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1)	DA	840	840		9,449				11,800	
(2)	ESF	840	840		2,500				2,550	
(3)										
(4)										
TOTALS					11,949	0			14,350	0

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 690 | 810 | 930

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
A. Code: BUW
B. Amount:

13. PROJECT PURPOSE (maximum 480 characters)

To stimulate the long-term, stable growth and development of Bolivia's small scale enterprise sector.

14. SCHEDULED EVALUATIONS
Interim MM 07 YY 95 | MM YY | Final MM 09 YY 97

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

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

A microfinance component has been added to the project which will provide (1) training and technical assistance to microfinance institutions, (2) technical assistance to the Superintendency of Banks and financial institutions and (3) make equity investments in microfinance institutions through a third party. Funding for this new component will be transferred from the WOCCU Stabilization Fund.
The Controller has reviewed the financial procedures described herein and hereby indicates his concurrence.

9/22/94

17. APPROVED BY
Signature: Richard Goughnour, Controller
Title: Carl H. Leonard, Director
Date Signed: MM 10 DD 05 YY 94

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

AID 1330-4 (3-89)

MICRO AND SMALL ENTERPRISE DEVELOPMENT PROJECT 511-0596

Project Paper Amendment No. 4

September 23, 1994

PROJECT AUTHORIZATION

Amendment No. 4

Name of Country:	Bolivia
Name of Project:	Micro and Small Enterprise Development
Number of Project:	511-0596

Pursuant to Sections 103 and 106 of the Foreign Assistance Act of 1961, as amended, the Micro and Small Enterprise Development Project for Bolivia was authorized on August 19, 1988. That authorization was amended on August 9, 1991; March 30, 1993; August 9, 1993; and on August 30, 1994. The authorization is hereby amended further by adding a sub-section (e) to paragraph 2, as follows:

> "(e) Expansion of poor peoples' access to financial services through the provision of funds to NGOs for equity investments and technical assistance to Bolivia's strong microfinance institutions. The component will also include administrative support to the Superintendency of Banks and Financial Institutions."

Except as amended hereby, the authorization remains in full force and effect.

~~Carl Leonard~~ for
Director, USAID/Bolivia

Date: 10/5/94

A/PD&I:PNatiello	(in draft)
DP:ESzepesy	(in draft)
CONT:RGoughnour	(in draft)
RCO:MKidd	(in draft)
A/RLA:SAllen	SA 10/5/94
ECON:KBeasley	(in draft)
DD:LLucke	10/5/94

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MICRO AND SMALL ENTERPRISE DEVELOPMENT PROJECT PAPER
AMENDMENT No. 4

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4. GC Ruling on Equity Investments (8/31/94)

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MICRO AND SMALL ENTERPRISE DEVELOPMENT PROJECT AMENDMENT No. 4

I. SUMMARY

This Project Paper Amendment adds a new microfinance* activity to the project consisting of equity investments and technical assistance for Bolivian's stronger microfinance institutions. The activity will also include administrative support and technical assistance to the Superintendency of Banks and Financial Institutions. The purpose of these activities is to expand poor peoples' access to financial services rapidly and on a sustainable basis by capitalizing strong microfinance institutions.

The amendment will require $2.44 million in funds reprogrammed from the credit union stabilization component, and will serve as an important headstart to the $10 million Microfinance Project (511-0637), expected to begin in FY 1995. The reason for this amendment is to initiate microfinance activities with currently available funding as soon as possible. This will not be a stand alone activity. It will be merged with the Microfinance Project, for which a New Project Description (NPD) has been approved by USAID/Bolivia and in Washington. Therefore, continuity between this component and the new project will be critical.

This amendment will not require either an increase in the $14.350 million Life of Project (LOP) funding nor a change in the September 30, 1997 Project Assistance Completion Date (PACD).

II. OVERVIEW OF MICROENTERPRISE SECTOR AND THE NEW PROJECT COMPONENT STRATEGY

A. Overview of the Microenterprise Project to Date

The project has provided credit, training, technical assistance and policy formulation assistance to Bolivia's credit unions, PRODEM, and the Bolivian Federation of Small Industry (FEBOPI) and its constituent Departmental Small Industry Associations (ADEPIs).

Project components currently include: **(1) Institutional Strengthening:** Acción International/AITEC

*Microfinance activities are financial services for marginal people who do not have access to formal financial intermediation. The use of the term "microfinance," instead of the more usual "microcredit," reflects a conviction that our present challenge goes beyond provision of credit to microbusinesses. Experience in advanced programs shows that the opportunity is much broader: we should be bringing efficient *liquidity management* services to poor households, including their income-producing activities. Exploiting this opportunity fully will require institutions which are true financial intermediaries, providing deposit services to willing savers, and using those deposits to finance loans to willing borrowers.

Institutional Strengthening: Acción International/AITEC technical assistance to PRODEM; World Council of Credit Unions (WOCCU) provides technical assistance to credit unions and FEBOPI. **(2) Credit:** USAID donation of approximately $1,800,000 to PRODEM for micro and small enterprises. **(3) Policy research:** Implemented by FEBOPI, this component includes research concerning micro and small enterprise sector issues, impediments to sector growth and training needs. **(4) Stabilization Fund:** This component provides credit unions with technical assistance and capital support to embark upon an internal reform program. **(5) APPLE Program:** USAID/Washington APPLE funds are matched one to one by outside sources to provide credit for rural and peri-urban microfinance activities.

The first three components above have been completed, two of which have been enormously successful in stimulating the development of the micro and small scale enterprise sector. By 1991, as a result of Acción International's work, PRODEM had developed a highly efficient micro credit operation, with low default rates (less than 3%) and growing demand. In order to try to meet this demand, PRODEM's loan portfolio was transferred to BancoSol, a new private microfinance bank. PRODEM became and still is one of the bank's major shareholders.

The FEBOPI component was disappointing because the institution did not achieve the desired level of self-sufficiency, although it was active during the project component's life in providing production and marketing assistance to small businesses. Several other donors continue to provide assistance to FEBOPI.

After little more than a year since its initiation, the credit union stabilization component is meeting or surpassing planned objectives. USAID has already accomplished the most important goal of this program through policy dialogue. Last year's Bolivian banking law brought all entities that capture savings, including credit unions, under the supervision of the Superintendency of Banks. This produced immediate results in the form of increased deposits in credit unions, over 21 percent in the six month period ending March 31, 1994.

WOCCU will continue to strengthen the credit union sector through technical assistance and the stabilization fund, as well as support to the Superintendency of Banks.

Implementation of the fifth component of the current project began this year. USAID signed in February a Cooperative Agreement with FUNDAPRO for $1.150 million in APPLE monies. About $750,000 of these funds finance credit and operating expenses for PRODEM, one of Bolivia's strongest rural microfinance institutions. FUNDAPRO made the first disbursement to PRODEM during the first semester of FY 1994. The remaining

$400,000 will be used in a similar way for another microfinance institution which has yet to be identified. Finally, in August of 1994 an additional $500,000 in APPLE funding was approved for Pro-Mujer, an NGO providing training and credit services to poor women living in peri-urban areas.

B. Current State of Bolivian Microfinance Institutions

During the past ten years, new finance technologies have been developed in several countries that have been capable of:

1) providing credit in very small amounts to people of minimal economic means and little or no ability to offer collateral guarantees,

2) maintaining high rates of recuperation (client repayment) of these credit resources, and

3) recovering from clients the total cost of delivering credit, including operating costs, loan losses, financing costs (opportunity costs) and inflation, thus allowing for the expansion of services without financial subsidies.

Bolivia is perhaps the most advanced country in Latin America in developing and diffusing these new financial technologies. Although there are dozens of small micro credit programs that are far from reaching financial sustainability, there are a handful of other programs that are close to or past the equilibrium point. The financial indicators of BancoSol, Sartawi, PRODEM, Pro Crédito and FIE indicate their capacity to massively expand client services ("massively," on an order of magnitude, means at least by ten fold) with funds obtained principally from commercial sources. The sources of loan portfolio financing for these institutions is diversified. All five have received either equity donations or soft loans from donors or socially minded individuals, especially during their initial stages of operation. Because such soft funding is limited and cannot be accessed easily or quickly, the majority of microfinance institutions have more recently taken out commercial bank loans (at commercial interest rates up to 16 percent) to finance their expanding loan portfolios. Annex 1 summarizes the institutional and financial information of these five programs.

Currently, there are two important areas of microfinance technology that require significant further development: rural services and savings services. On the rural front, the two principal actors are PRODEM and Sartawi, both demonstrating solid progress in providing credit services. Unlike urban and peri-urban programs, where BancoSol and other institutions have proven that financial services can be provided efficiently and profitably on a large scale basis, rural finance presents unique constraints. These include:

1) Dispersed population,
2) Shallow rural economy based principally on agriculture,
3) Recent history of banks retreating from rural areas,
4) Fragmented financial markets due to subsidized credit. (GEMINI technical report #31, 1992)

The importance of savings services for microfinance clients is seriously underestimated by most financial and development institutions. Experience in other countries demonstrates that families with limited resources have a much greater demand for deposit facilities than credit services. In Bank Rakyat Indonesia (BRI), for example, where savings services were introduced years after the credit program, total customer deposits are now more than double the value of the loan portfolio. For every outstanding loan, BRI has over four savings accounts.

Savings services are also necessary in order to build strong, stable financial institutions. By having control over and making adjustments to the institutions' passive and active interest rates (and hence their "spreads"), financial institutions have greater control over profitability. Furthermore, client deposits, especially liquid accounts (which are generally preferred by the poor), are the most stable, long-term source of loan portfolio financing.

Of the strong microfinance programs in Bolivia, only BancoSol has a license from the Superintendency of Banks and Financial Institutions which permits the provision of client savings services. Pilot savings programs, which began in La Paz and Santa Cruz in 1993, have already shown that significant demand exists for appropriate deposit instruments. BancoSol recently made the decision to extend savings services to all its branches, and expects total savings to reach six to eight million dollars within a year (total savings are currently around $2.0 million).

C. Project Rationale

1. The Predicament

Microfinance in many countries faces a predicament which can be described as follows:

(a) Successful programs in widely scattered countries (e.g., Dominican Republic, Ecuador, Bangladesh, Indonesia, Kenya, South Africa) have shown that we now have at our disposal new financial technologies which are capable of bringing efficient formal financial intermediation within the reach of very large numbers of poor households.

(b) In no country have we yet succeeded in reaching the majority of those poor households; market penetration by microfinance seldom exceeds five percent.

(c) Even the roughest calculations of potential market size reveal a need for microfinance assets far in excess of donor funding available for the purpose.

2. A Typology of Microfinance Programs

The issue of financial self-sufficiency has obvious relevance for the predicament described above. But the predicament calls for an analysis of microfinance that goes beyond self-sufficiency. If we have the technical tools to bring efficient finance to massive numbers of the poor, and we do not have the funds to saturate that market, then leverage has to be the linchpin of our strategy. Thus, the following typology of microfinance programs, and the levels on which they operate, is based on a simple "bottom line" question:

If donors put one dollar into a program today, how much in microfinance assets will that dollar have generated after, say, five years?

Level One. At this level, a microfinance program does not break even on a cash flow basis: i.e., more cash drains out as expenditures than flows in as revenue (even without including any imputed cost for the program's soft funding). The vast majority of microfinance programs fall into this category. The bottom line at this level is that if a donor puts one dollar in today, by year five there will be less than a dollar still available to provide ongoing finance for poor people.

Level Two. A program at this second level has achieved a breakeven in cash flow: revenues are at least equal to expenditures. The program may even have gone on to a fuller self-sufficiency, a state in which income covers all expenses, including non-cash expenses like depreciation, inflation, and the opportunity cost of its funds. But for a program at this second level, most of its microloan portfolio is financed by money the program has borrowed from donors. Thus it has little or no equity. Such a program cannot leverage its donor funds by further borrowing from commercial sources. Because of the absence of an "equity cushion," even a modest loss in the institution's microloan portfolio assets would imperil its ability to honor its debts. Thus, the bottom line for a level two program is that for each dollar donors put in today, the program will continue to have about one dollar available in later years for microfinance.

Level Three. Like a level two program, a program at this third level has reached breakeven or better. But in contrast to the previous level, the program has substantial equity funding, which some development agency has granted, rather than lent, to the program. On the basis of this positive net worth, the program can then finance expansion of its portfolio by borrowing from commercial sources, such as banks. Experience around the world suggests that commercial lenders will not lend much more than $1.00 for each dollar of equity which this kind of program has available to back up the loan. Therefore, at level three a dollar of donor grant money leads to about two dollars of total microfinance resources available for poor clients. (The assumption here is that the program's profits are not high enough to produce a rapid multiplication of its equity capital, even though Bolivia's BancoSol has begun to report impressive profits during the first half of 1994).

Level Four. A program reaches this fourth level when it has, not only a self-sufficient cash flow and a significant equity base, but also a license as a bank or other formal financial institution. Because the program is certified as meeting the requirements of a credible regulatory authority (the Superintendency of Banks and Financial Institutions in Bolivia) which maintains ongoing supervision, outside parties are willing to loan or deposit money into the institution in amounts up to eleven times the institution's equity base. Why eleven? Because this limit is the international standard which more and more countries are adopting. The ratio comes from the "Basel Convention" rule that an institution's equity must be no less than eight percent of its risk weighted assets. The outside sources of funds for level four intermediaries can be diverse: deposits from microclients, deposits from larger commercial investors, interbank loans, or Central Bank credit facilities, to name some. Additional donor funding should not be required for a level four institution.

Level four allows an institution to capture savings. Appropriate voluntary deposit instruments, if offered, will likely be met with significant demand. The resulting increase in customers will require a major expansion and adjustments in all aspects of the financial institutions. This is when the institution is transformed from a loan facility to a true financial intermediary. Eventually, the institution should finance most or all of its loan portfolio with customer deposits, as does BRI in Indonesia.

The bottom line for donors: after several years, a

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level four program will have leveraged each dollar of donated equity into as many as twelve dollars of assets available for continued microfinance.

Level Five. A program arrives at this level when, in addition to meeting the requirements of level four, it is making profits that are so high that investors begin to start their own microfinance institutions, for motives which are not social but purely financial. Indonesia is now arriving at this level. Two banks there, BRI and Bank Dagang Bali, have recorded profits for several uninterrupted years. Recently, a number of other small provincial banks in Indonesia have entered the microfinance business. And as of this year, a few of Indonesia's largest commercial banks have expressed serious interest in offering microfinance services.

We know of no other country where this has occurred, although as stated earlier, BancoSol posted impressive profits for a couple of months in early 1994. But BancoSol is still a fragile institution experiencing rapid growth and undergoing many changes, including the implementation of large scale savings services. It will be several years before we know if BancoSol can consistently make profits.

At Level Five, the donor's original dollar would catalyze an indefinitely large amount of resources going to serve microfinance clientele. Once this level is reached in a number of countries in different parts of the world, the donors' job will have been done and the marketplace will have taken over.

3. Core Strategic Considerations

How large is the potential microcredit market in Bolivia? In making a rough calculation, the following groups should be subtracted:

- those that receive services from traditional commercial banks (approximately 55,000),

- those that receive services from non-bank institutions, including credit unions and savings & loans, although some of the customers from these institutions could jump to microfinance institutions whose services may be more appropriate for them (approximately 350,000),

- those families that live so far from transportation and communication services that it is virtually impossible to offer microfinance services at real prices (approximately 250,000),

- those families that are destitute, who do not need and who could not afford financial services (approximately 250,000).

What remains is a rough estimate of about 500,000 families, or a little more than a third of the Bolivian population. This group represents families with limited resources that do not receive financial services from banks and credit unions, but that could qualify for services provided by intermediaries employing new microfinance technologies.

Again, estimating roughly that the microfinance system would require approximately $500 in assets for each client (or family), the total assets required to provide credit services to 500,000 clients would be about $250 million.

If donors rely on programs below level four, they have little chance to satisfy the demand for poor peoples' finance, which we estimate to be about $250 million. Assuming that donors in Bolivia rely on superb level three programs, and further assuming that donors provide all their funds to these programs as equity (donations) rather than loans, the market can be saturated only if the supply of donor funds is about $125 million. This would be impossible to attain given budget levels for Bolivia and other demands on donor funds.

If donors can structure level four programs, saturating the market is well within reach. A level four program, because it enjoys the credibility stemming from certification and supervision by a capable financial regulatory authority, can borrow up to $11 of commercially sourced funds for every $1 of equity it starts out with.

Level four, as described above, is real. The prospect of massive leveraging of donor microfinance resources, up to eleven to one, is achievable. Nearly all of Bolivian's banks leverage their equity at a ratio of close to eleven to one, as do banks in most countries around the world. Regarding microfinance, BancoSol in Bolivia obtained its banking license in 1991 with about $5 million in equity, provided by USAID, other donor groups and socially motivated investors. Drawing deposits from a wide variety of sources, by mid-1994 it had parlayed that equity into a microloan portfolio of about $30 million. In another year or so, its portfolio grow to about $60 million, representing the maximum legal leverage of its original $5 million in equity capital.

In the Bolivian case, the $250 million in assets needed to respond to the demand for poor people's finance can be raised on an equity base of as little as $21 million. About half of this amount is already lodged in the equity capital of BancoSol and four other sound Bolivian microfinance programs, and the remainder should not strain the budgets of USAID and other potential contributors, such as the Multilateral Investment Fund of the IDB.

D. Relationship to USAID and GOB Strategies

Microenterprise development has been given priority emphasis in the Agency's new "Economic Growth" policy. The "lessons learned" section of the Agency policy paper states that "microenterprise projects focused on the provision of financial services to established enterprises have performed best, particularly in achieving adequate cost recovery and sustainability." The guidelines section of the same paper urges field missions to focus on "building sustainable viable financial intermediaries that provide client responsive savings, credit, and transfer services to large numbers of poor households and small businesses." USAID/Bolivia fully agrees with these conclusions and recommendations. The microfinance sector will be the Mission's Economic Opportunity Office's principal area of interest for at least the next half decade.

Although the Government of Bolivia plays a limited role in microfinance, its policies are fully in support of the sector's expansion. In his inaugural address this year, the Secretary of Agriculture stated that institutions like BancoSol and Sartawi will be the future providers of rural credit in Bolivia. These types of institutions have demonstrated to the GOB that financial services should be delivered to microenterprises and poor farmers in a sustainable manner; this means permanent, profitable institutions without the distortions of subsidies and other forms of directed credit.

The democratization of financial services will also support the GOB's efforts to democratize Bolivia. Access to financial services helps to empower the poor by increasing incomes and by allowing them to participate in the formal economy. The expansion of financial institutions into rural areas will also give municipalities convenient access to financial services as they begin to receive a large portion of the GOB budget under Popular Participation.

E. Inter-agency Coordination

Since USAID/Bolivia initiated a major assistance program to PRODEM in 1987 and 1988, USAID has been among the most active of donors in Bolivia's microenterprise development field. Until recently, most donors, including USAID, supported only their individual projects and affiliate institutions. USAID's current approach, which is embodied in this new project component, emphasizes assistance to the overall microenterprise sector, more specifically the microfinance sector.

In the past 12 months, the Mission has initiated a number of inter-agency programs and policy dialogue activities in an effort to strengthen Bolivian microfinance. These include:

- co-sponsorship with FUNDAPRO and Plan International of international seminars and technical assistance to strengthen Bolivia's microfinance institutions, and

- coordination with NGOs, the World Bank and the IDB to develop a rational regulatory framework for microfinance institutions and to lobby the opening of a licensing window for these institutions with the Superintendency of Banks and Financial Institutions.

Although there are a number of donors supporting microcredit programs in Bolivia, outside of USAID only the IDB and GTZ have been playing a major role. The IDB has provided several NGOs with funds for their credit portfolio, and has millions more in funds that it wants to channel through a second story credit facility (probably the Central Bank) at market interest rates. GTZ has supported the development of Pro Crédito, and also gives technical assistance to the Superintendency.

Because USAID is committed to strengthening the microfinance sector, inter-agency coordination and coordination with the GOB will be of paramount importance over the next few years. In particular, we would like to see other donors join USAID in supporting strong microfinance institutions with equity investments of their own. The Multilateral Investment Fund has already expressed interest in doing so.

III. PROJECT DESCRIPTION

A. Project Goal and Purpose

The goal of the project remains the same: to promote rapid and sustained economic growth in Bolivia and to bring about a more equitable distribution of income.

The purpose of the project is also unchanged: to stimulate long-term, stable growth and development of Bolivia's small-scale enterprise sector. The purpose of the new microfinance component is to expand poor people's access to financial services rapidly and on a sustainable basis by capitalizing strong microfinance institutions.

B. End of Project Status (EOPS)

The $2.44 million transferred from the stabilization component to the new microfinance component will be used to equity investment(s) in microfinance institution(s) and support to the Superintendency of Banks and Financial Institutions. Beginning in FY 1995, funding from the new Microfinance project will become available to support the same activities financed under this project. Although we expect to begin to see quantifiable, attributable project results by FY 1996, the rate of these results will accelerate in the later years. Results for the first three years will also depend on the amounts of funding available under the new project.

Following are preliminary project impact projections through September, 1997:

1) At least two growing microfinance institutions with Superintendency licenses for national coverage, $12 million in equity, and $80 million in loan portfolio,

2) 160,000 Bolivian households receiving financial services, and

3) At least two microfinance institutions offering appropriate voluntary savings services to Bolivia's lower economic classes.

C. Project Components

1. Equity Investments

While many USAID countries are testing the viability of microfinance institutions, Bolivia has already accomplished this step of the process. Several strong microfinance institutions are already in place to serve Bolivia's future demand for microfinance services, provided that adequate capital and appropriate technical assistance are available. PRODEM, BancoSol, Sartawi, Pro-Crédito, and FIE already operate successful microfinance activities, albeit with varying portfolio size. As mentioned above, we estimate Bolivia's microcredit demand at about $250 million. This demand can be met by licensed financial institutions with only about $21 million in equity capital, about half of which is already in the system. Financed by this amendment and the new Microfinance project (511-0637), USAID will provide a major part of the unmet equity requirements.

BancoSol already has proven that microfinance can be done with a regular commercial bank license from the Superintendency of Banks. At this stage, though, the minimum equity requirement for such a license (about $4.5 million) is much too steep for the other sound programs. USAID, with support from other donors including the World Bank and the IDB, is lobbying the Superintendency to open up a separate licensing window for non-bank intermediaries. This regulatory framework would lower the minimum equity requirement and would incorporate minor regulatory adjustments given the unique characteristics of microfinance.

USAID, under this component, will grant funds to an NGO Cooperating Agency ("CA") which, in turn, will buy equity shares in several microfinance intermediaries. The relationship between USAID and the CA will be defined under a cooperative agreement. The CA will be an NGO with considerable interest and experience in microfinance development. Its role will be to purchase shares in the microfinance institution, and then actively provide the institutional strategic and operational guidance needed by the institution to expand microfinance activities.

We know of a few NGO institutions capable of carrying out this CA role effectively. The model has already been successfully tested. Acción International, for example, owns equity in BancoSol. Over the past year Acción has effectively assisted in steering BancoSol in the right direction by providing critical technical assistance and by pressing the bank to implement key changes. WOCCU and FUNDAPRO have played key roles in the credit union stabilization and Apple components or this Project.

Implementation of the equity program will be a three step process, as outlined below:

(a) Strong microfinance intermediaries will be identified (including those already known to USAID) for possible participation based on an evaluation of these criteria (these evaluations will serve as project technical analyses):

- management and institutional structure
- medium and long-term institutional strategy & goals
- institutional track record
- financial policies
- delivery mechanisms
- financial performance
- superintendency license (or prospects to be issued one)
- potential to expand outreach

(b) The evaluation in step one will likely reveal, even in the strongest institutions with solid growth potential, a number of basic weaknesses. At this time the third party institution will enter into discussions with the microfinance institutions to develop concrete strategies for correcting those weaknesses. The implementing institution will offer technical assistance to the microfinance intermediaries willing and able to participate. The eventual decision on whether or not to make an equity investment will depend on the institutions' implementation of measures for improvement.

The next step would be to determine these institutions' specific equity needs. This would require an evaluation of the following factors in each institution:

- current equity position
- current loan portfolio size
- current and future loan management systems capacity
- past, current and future rate of loan portfolio expansion

(c) Completion of the second step of this process will result in a short list of qualified microfinance institutions and their equity needs. To repeat, the execution of an equity investment will depend upon the successful implementation of basic measures by the microfinance institution to improve its program and to demonstrate a commitment to the goal of this project, which is to significantly expand poor peoples' access to financial services, both credit and savings. The more an institution can accomplish before the equity investment, the greater the probability of project success.

The NGO cooperating agency will enter into negotiations with the microfinance institution. Once a preliminary agreement is reached between these institutions, USAID will execute a Cooperative Agreement to the NGO CA, who will in turn execute the equity investment with the microfinance intermediary, after written approval by USAID.

2. Technical Assistance to Microfinance Institutions

Technical assistance to the microfinance institutions will be needed on an ongoing basis throughout the life of this activity, both before and after the execution of equity investments. The purpose of the technical assistance is to help ensure that participating microfinance institutions grow in a sound and secure manner. Once an equity investment is made, the technical assistance will differ from most USAID technical assistance programs in that it will be provided by the NGO CA, as part owner of the microfinance institutions, by the NGO's staff or through contracts with individual experts. The advantage of this implementation arrangement is that the institution giving technical assistance will also be participating on the boards of directors of the microfinance institutions, which will allow it to exert a degree of control. This arrangement strengthens assurances that the microfinance utilize the technical assistance.

Sources for expert technical assistance in this field are scarce. Commercial bankers can provide only a limited portion of the guidance required: their business is different in many respects. The kind of technicians needed for this program must have extensive nuts and bolts experience with microfinance programs, but also must have the financial and systems expertise to translate their experience into the requirements of a successful micro-banking operation.

Most of the microfinance institutions that will participate in this program are NGOs or originated as NGOs, although commercial banks will also be eligible. The transition from a socially oriented organization to an efficient financial intermediary is extremely difficult, psychologically and technically. Therefore, technical assistance will be required at several levels, from loan officer to boards of directors. Here is an illustrative list of the types of technical assistance that will be needed:

- develop and implement growth strategies (business plan development)
- organizational and personnel development
- improve data collection and analysis for monitoring and evaluation
- upgrade management information systems
- assist in accessing financial markets
- develop client deposit services
- develop diversified client services
- develop systems to comply with regulatory (Bank Superintendency) requirements
- improve financial analysis and administration

All the reasonably strong microfinance institutions will be eligible for technical assistance at the beginning of the project. For those that want to participate, the project implementing unit will conduct an evaluation of their programs and determine the first set of steps the institution needs to take to strengthen itself. Technical assistance will be offered to support the institutions in taking these steps. Additional technical assistance will depend on the institutions' successful completion of prior steps.

3. <u>Administrative Support to the Superintendency of Financial Institutions</u>

Under this element, the component will assist the Superintendency of Financial Institutions to design, develop and install specialized regulatory, examination and supervision systems adapted to the needs and capabilities of microfinance institutions. As mentioned below, a separate licensing window for these institutions would be advantageous to the sector, but it is not a requisite for the successful implementation of the project. During the upcoming design of the Microfinance project, USAID will consider the inclusion of a project covenant with the GOB for the creation of this specialized licensing window.

If the Superintendency responds favorably to the development of special regulations for microfinance institutions, USAID will provide administrative support and technical assistance to the Superintendency, probably through a cooperative agreement with the World Council of Credit Unions (WOCCU) or another capable institution. Administrative support will be offered for the first few years of its operation, until the Superintendency can incorporate the unit's operation into its own budget, paid for by GOB treasury resources and/or fees paid by microfinance institutions. If necessary, support will be given for the development and revision of financial regulations and reporting requirements for microfinance institutions.

USAID will also support the establishment of a unit specializing in the regulation, inspection and oversight of microfinance institutions. Assistance will be given for the design of inspection, supervision and monitoring systems, and will provide extensive training and technical advice to the Superintendency unit's staff.

ELEMENTS OF A SEPARATE LICENSING WINDOW:

There are several reasons why the requirements that need to be met in order to acquire a license should be very stringent. Most important of these is the fact that this type of licensing arrangement has no precedent that we know of. The Superintendency would be exploring a new frontier, and therefore should proceed with extra caution.

Here are a few of the key elements proposed for Bolivia:

- a minimum equity requirement of about $2 million.

- a track record of three years of successful operations; a concrete, detailed business plan, and ; organizational chart of the institution.

- under the new window, a microfinance intermediary will not be allowed to leverage at a ratio of 11:1 at the outset. It will be restricted to perhaps five-to-one for the first two or three years, with gradual increases toward 11:1.

- key personnel, at both the executive and board level, will be evaluated for their professional qualities and experience.

- ownership of the microfinance institutions will be limited to non-profit entities. Any of these institutions could convert at a later point in time to for-profit ownership by qualifying for a regular bank license.

- with the exception of the equity requirement, licensed micro-finance institutions will be governed by generally the same reporting and prudential requirements that are imposed on commercial banks.

It is important to note that, while the microfinance intermediary licensing window described above would be advantageous to the system, it is not a necessary prerequisite for the implementation of this project component. Its advantages are that (1) it would allow strong microfinance institutions to get their licenses more quickly and thus accelerate the rate at which financial services are made available to the poor, and (2) it would serve as the first model worldwide where a financial regulatory body creates licensing regulations specifically for microfinance institutions. If successful, there would be potential worldwide applications.

There are two other alternative licensing options, other than the separate window, for the strong microfinance NGOs. First, even without the special licensing window, we believe at least two of the strong microfinance institutions will satisfy the requirements to become commercial banks within the next few years. Second, the current banking law does provide a number of licensing opportunities for non-bank institutions, including NGOs. The conditions under which a license can be obtained are not well defined. Therefore, individual microfinance NGOs may be able to negotiate individual licensing agreements with the Superintendency. Pro Crédito is in the process of doing this now, and expects to be issued a license as a "Caja de Ahorro" shortly.

IV. PROJECT IMPLEMENTATION ARRANGEMENTS

A. Implementation Responsibilities

This project component will be managed by USAID/Bolivia's Economic Opportunity Office. USAID will execute a Cooperative Agreement with an NGO Cooperating Agency which will assist with project implementation, both the equity investments and technical assistance components. This Agency must have a strong track record working with several microfinance intermediaries, and must in particular have demonstrated financial analysis capabilities.

Key functions of the NGO under a Cooperative Agreement will include:

- develop project implementation strategy and policies
- prepare project implementation and disbursement plans for USAID approval
- manage project funds
- evaluate microfinance institutions' capacity for secure, profitable growth
- evaluate and quantify microfinance institutions' future equity needs
- maintain open and frequent lines of communication with the Superintendency of Banks regarding licensing and regulatory requirements and for microfinance institutions
- collaborate with USAID in coordinating with other donors and in engendering other donor participation in project activities
- execute equity investments in microfinance institutions
- actively participate in directing microfinance institutions by providing advice and technical assistance
- establish, monitor and evaluate project impact and performance indicators

B. Implementation Schedule

Below is an illustrative implementation schedule for the Amendment period.

First 6 months (October 1994 - March 1995)

- negotiate and execute institutional cooperative agreements for project implementation unit
- hire project implementation unit personnel and equip office
- continue policy dialogue with Superintendency of Banks for special licensing window
- complete design and authorize new microfinance project

April 1995 - September 1995

- develop project implementation strategy and policies

- prepare one year project implementation and disbursement plan
- develop and begin implementation of monitoring and evaluation plan
- begin comprehensive assessments or at least 2 microfinance institutions
- identify technical assistance and training needs
- provide technical assistance and training to microfinance institutions
- initiate administrative support to Superintendency of Banks and refine regulations for microfinance institutions

October 1995 - March 1996

- continue assessments of microfinance institutions
- provide technical assistance and training to microfinance institutions
- begin to evaluate equity needs of at least 2 microfinance institutions

April 1996 - September 1996

- prepare one year project implementation and disbursement plan
- continue assessments of microfinance institutions
- provide technical assistance and training
- execute at least one equity investment in a microfinance institution(s)
- continue to evaluate equity needs of microfinance institutions

October 1996 - March 1997

- continue assessments of microfinance institutions
- technical assistance and training
- continue to evaluate equity needs and execute equity investment, if appropriate
- provide ongoing advice and technical assistance and participate in major decision making of institutions in which equity investments have been made

April 1997 - September 1997

- prepare one year project implementation and disbursements plan
- continue assessments of microfinance institutions
- provide technical assistance and training
- continue to evaluate equity needs and execute equity investments, if appropriate
- conduct mid-term evaluation of microfinance program which will serve as the final evaluation

of project amendment
- continue to provide support to institutions with equity investments

C. Procurement Plan

USAID/Bolivia will administer funds under cooperative agreements, contracts or similar instruments. Competitive selection procedures will be followed wherever possible. In order to maintain continuity between this component and the new Microfinance Project, it will be important that the same institutions be contracted or sign cooperative agreements under both projects (instead of competing over again when the new project gets underway). This is important because of several reasons. First, one of the critical elements of the program will be the ability of the people in the implementation unit to gain the confidence of the microfinance institutions. The technical assistance program will be based on the implementation unit's continuous review and access to the microfinance institutions' records. A change in implementing institution would require that this confidence is gained all over again. Second, implementation of the technical assistance program will be in successive steps, each step depending on the successful completion of the prior step. Again, the ability to do this effectively will require the involvement of the same implementing institution, from beginning to end.

Regarding the Superintendency support component, the World Council of Credit Unions (WOCCU) is currently implementing a similar program with the Superintendency for credit unions. To date, implementation of this component has been successful. Because of WOCCU's experience and established relationship with the Superintendency, WOCCU would be the most likely candidate to implement this sub-component. This would require an amendment to WOCCU's current cooperative agreement with USAID in order to add these additional duties regarding the Superintendency.

V. MONITORING AND EVALUATION PLAN

A. Monitoring

This project component will be monitored on a day-to-day basis by the chief advisor of the NGO institution under a Cooperative Agreement with USAID/Bolivia. Within three months of signing the Cooperative Agreement, the advisor should develop and submit to USAID a general monitoring plan for the life of the component (through September, 1997), and a detailed monitoring plan for the first year of operations. The annual plan will include concrete benchmarks which will be tracked and reported semi-annually or more frequently, if necessary. The chief advisor should also meet with USAID on a monthly basis to provide status reports on project implementation.

B. Evaluation

This new component will be evaluated together with the upcoming Microfinance Project (511-0637). There will be two evaluations, mid-term and final, conducted for the Microfinance Project. The evaluations are tentatively scheduled for 1997 and 1999, respectively. Funding for the evaluation of this component in 1997 is included in the budget for this amendment.

USAID will work with the institution under Cooperative Agreement to agree on which data and other information will be required to measure project impact. The institution under Cooperative Agreement will be responsible for collecting and reporting this information throughout the life of the project.

It is worth making a few comments here about microfinance evaluation. For many years, donor finance programs were implemented as a means of reaching certain economic sectors that were not being reached as a result of supposed failures in the financial system. The goal of these programs was to channel economic resources to a target group. Therefore, evaluation criteria was often based on measuring the direct impact of individual loans on clients. Examples of indicators that were used include changes in income or enterprise/agricultural growth. More recent research has concluded that it is both prohibitively costly and nearly impossible methodologically to measure the direct effects of financial services on financial clients.

It is a much simpler task to measure the impact of financial services through the institutions that provide financial services. What, after all, is the value of financial services? Finance creates value at both the macroeconomic and client level. At the macro level, finance mobilizes an economy's resources and distributes them efficiently. It also facilitates an economy's transactions. At the client level, finance not only provides important investment capital, but it also allows people to manage liquidity both at the household and business level. Financial services do not create economic opportunities directly. Rather, they help people and enterprises "position themselves to take advantage of opportunities" (Rhyne, The New World of Microenterprise Finance, 1994). Therefore, goals for finance programs should be specified in terms of the institution's ability to perform the functions mentioned above for the economy and for its clients.

This project component will put priority importance on assessing program impact with quantitative indicators. Virtually all the data will be collected by the participating microfinance institutions themselves. The two general categories of indicators to be measured will concern (1) client services, and (2) institutional viability of the microfinance institutions.

Following is a short list of some of the indicators likely to be collected on a portfolio basis:

- number of clients (stratified by loan size)
- range and types of client services
- loan delinquency rate
- loan portfolio ($)
- savings portfolio ($)
- profitability

Once a microfinance institution is under the supervision of the Superintendency of Banks or other regulatory body, it will be required to provide a comprehensive list of financial statements and indicators on a monthly basis. Access to the Superintendent's monthly financial bulletins will be an important source of project data.

VI. FINANCIAL PLAN

A. Modification of the Credit Union Stabilization Fund

Amendment #3 to the Microenterprise Project added a credit union stabilization component budgeted at $5 million ($3.2 million in appropriated dollars and $1.8 million in DIFEM local currency). This component, managed under a Cooperative Agreement by the World Council of Credit Unions (WOCCU), is strengthening the financial viability of participating credit unions by improving their net capital positions and thus their ability to absorb losses without threatening members' savings.

The fund, as it currently operates, earns interest in special accounts held in the names of credit unions that have stabilization loans with WOCCU. Over time, as a credit union complies with the terms of the loan and related stabilization contract, it receives interest (only interest) generated from the fund. Theoretically, this arrangement would allow for the reuse of stabilization funds, over and over again.

The final destination of the $5 million stabilization fund was not decided upon in Amendment #3. Now that the component has been operating for about a year, WOCCU and USAID have together come to the following conclusions:

(1) The stabilization program has been effective in strengthening participating credit unions,

(2) The health of the credit union system in general has improved more quickly than we anticipated, and therefore will not require the assistance of the stabilization fund beyond the FY 1997 project PACD,

(3) Ownership rights of the $5 million of reflows in fund might become a source of significant controversy should it still exist toward the end of the project. Therefore, a resolution should be reached as soon as is reasonably possible.

With the development of this new microfinance amendment, USAID has identified an immediate, preferred use of the unprogrammed part of the stabilization component. This amendment will reprogram $2.44 million for the microfinance activity, leaving what is needed by WOCCU for stabilization loan and contract commitments through FY 1997 (i.e. there will be no change in the original targets of 15 stabilization loans and contracts for approximately $2 million). This will require that stabilization contract disbursements are made with principal from the fund, and will no longer consist solely of with interest generated by the fund.

B. Institutional Analysis

USAID/Bolivia has not yet selected the implementing agency for this project component. If the selected organization has no previous working history with USAID, an institutional analysis, a financial analysis and an analysis of their contracting capabilities will be conducted before the first disbursement is made.

C. Audits

There will be a mandatory financial compliance audit conducted every year by the recipient of the cooperative agreement. These audits will follow the Recipient Contracted Audit Guidelines prepared by the Regional Inspector General for Audit (RIG/A/SJ). Funds have been budgeted for this activity under the Cooperative Agreement as a separate line item.

D. Disbursement Mechanisms

Funds will be advanced quarterly by USAID/Bolivia to the contractor under cooperative agreement based on annual budgets prepared by the recipient and approved in writing by the Technical Office.

E. Revised Life of Project Budget

A "Revised Life of Project Summary of Financial Plan" is attached.

RESUMEN DEL PLAN FINANCIERO PARA LA VIDA DEL PROYECTO
LIFE OF PROJECT SUMMARY OF FINANCIAL PLAN

(US$000)

Agencias Implementadoras Implementing Agencies	Total de la Donación de USAID Total USAID Grant	Cambios en esta Enmienda Changes in this Amendment	Nuevo Total de la Donación de USAID New Total USAID Grant	Contribución del Gobierno Boliviano GOB Contribution	Cambios en la Contribución del Gobierno de Bolivia Changes in GOB Contribution	Nuevo Total de la Contribución del Gobierno de Bolivia New Total of GOB Contribution	Total de la Contribución del Sector Privado Total Private Sector Contribution	Total para la Vida del Proyecto Total Life of Project
1. PRODEM	2,775	0	2,775	1,650	0	1,650	1,525	5,950
2. FENACRE	399	(15)	384	40	0	40	50	474
3. FEBOPI	617	(45)	572	0	0	0	0	572
4. Otros/Others	687	(400)	287	0	0	0	0	287
5. WOCCU	8,222	(1,980)	6,242	1,160	0	1,160	0	7,402
6. APPLE	1,650	0	1,650	500	0	500	1,150	3,300
7. Microfinance	0	2,440	2,440	0	0	0	0	2,440
TOTAL	14,350	0	14,350	3,350	0	3,350	2,725	20,425
Percentage of Contribution			70%	30%				

* Fondos de la PL 480.
PL 480 funding.

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Revised 4 November 1994

MSED PROJECT PAPER AMENDMENT #5
(511–596)
Detailed Budget for Microfinance Component

5% anual inflation rate for salaries and other overhead items

LINE ITEM	Base	(Half Year) FY 95	FY 96	FY 97	LOP
A. Technical Assistance					
1. Salaries					
Microfinance Advisor (Chief of Party)	$115,700				
(Working half time)	$57,850	$28,925	$60,743	$63,780	$153,447
Subtotal Salaries		**$28,925**	**$60,743**	**$63,780**	**$153,447**
2. Fringe Benefits	31% Salary	$8,967	$18,830	$19,772	$47,569
Subtotal Fringe Benefits		**$8,967**	**$18,830**	**$19,772**	**$47,569**
3. Allowances					
Temporary Lodging Arrival	$61 30 days	$1,830	$0	$0	$1,830
Temporary Lodging Departure	$74 5 days	$0	$0	$370	$370
Housing	$21,600 (half)	$5,400	$10,800	$10,800	$27,000
Post Differential	25% Salary	$7,231	$15,186	$15,945	$38,362
Education/Tuition	$4,500 year/child	$4,500	$9,450	$9,450	$23,400
Education/Registration	$1,000 once/child	$2,000	$0	$0	$2,000
Subtotal Allowances		**$20,961**	**$35,436**	**$36,565**	**$92,962**
4. Travel/Relocation					
Airfare	$1,200 enitre family	$4,800	$0	$4,800	$9,600
Excess Baggage	$45 enitre family	$180	$0	$180	$360
Unaccompanied Baggage	$500 enitre family	$2,000	$0	$2,000	$4,000
Shipping Household	$1.25 2,500 lbs.	$3,125	$0	$3,125	$6,250
Storage Household	$0.10 5,000 lbs.	$500	$500	$500	$1,500
R&R Airfare	$1,400 enitre family	$0	$5,600	$0	$5,600
International Travel	$2,500 7 trips	$5,000	$7,500	$5,000	$17,500
Subtotal Travel/Relocation		**$15,605**	**$13,600**	**$15,605**	**$44,810**

MSED PROJECT PAPER AMENDMENT #5

(511–596)

Detailed Budget for Microfinance Component

5% anual inflation rate for salaries and other overhead items

LINE ITEM	Base		(Half Year) FY 95	FY 96	FY 97	LOP
5. Local Office Costs						
a. Personel Costs						
Salaries						
Finance Advisor	$18,000	1 person	$9,000	$18,900	$19,845	$47,745
Secretary	$10,000	1 person	$5,000	$10,500	$11,025	$26,525
Messenger	$3,000	1 person	$1,500	$3,150	$3,308	$7,958
Fringe Benefits	35%	salaries	$5,425	$11,393	$11,962	$28,780
b. Office Expenses						
Rent	$1,000	month	$6,000	$12,600	$13,230	$31,830
Utilities	$200	month	$1,200	$2,520	$2,646	$6,366
Telecommunications	$900	month	$5,400	$11,340	$11,907	$28,647
Supplies	$200	month	$1,200	$2,520	$2,646	$6,366
Miscellaneous	$300	month	$1,800	$3,780	$3,969	$9,549
c. Travel/Transportation						
Airfare (in country)	$100	15 trips	$300	$600	$600	$1,500
Per diem (in country)	$50	120 days	$1,200	$2,400	$2,400	$6,000
Car Rental	$100	60 days	$1,200	$2,400	$2,400	$6,000
Public Transportation	$5	60 days	$60	$120	$120	$300
d. Audits	$10,000	annually	$10,000	$10,500	$11,025	$31,525
Subtotal Local Office Costs			**$49,285**	**$92,723**	**$97,083**	**$239,090**
6. Equipment and Commodities						
a. Computer Hardware	$2,000	3 persons	$5,000	$500	$500	$6,000
b. Computer Software	$300	3 persons	$700	$100	$100	$900
c. Telecommunications	$1,000	2 lines	$2,000	$0	$0	$2,000
d. Office Equipment/Furniture	$500	3 persons	$1,000	$250	$250	$1,500
Subtotal Equipment and Commodities			**$8,700**	**$850**	**$850**	**$10,400**

MSED PROJECT PAPER AMENDMENT #5
(511-596)
Detailed Budget for Microfinance Component

5% anual inflation rate for salaries and other overhead items

LINE ITEM	Base	(Half Year) FY 95	FY 96	FY 97	LOP
7. Overhead					
a. Home Office Backstopping	$18,000 annually	$9,000	$18,900	$19,845	$47,745
b. Overhead	36% salaries&fringe &backstopping	$16,881	$35,450	$37,223	$89,554
Subtotal Overhead		**$25,881**	**$54,350**	**$57,068**	**$137,299**
8. Subagreement with the Superintendency of Banks					
a. Personnel Costs					
Senior Examiner	$15,000 1 person	$7,500	$15,750	$16,538	$39,788
Examiners	$10,000 2 persons	$10,000	$21,000	$22,050	$53,050
Computer Support and Software	$10,000	$7,000	$2,500	$500	$10,000
Training	$4,000 15 days	$1,750	$1,750	$500	$4,000
b. Travel/Transport					
Airfare (in country)	$100 15 trips	$300	$600	$600	$1,500
Per Diem (in country)	$50 120 days	$1,200	$2,400	$2,400	$6,000
Public Transportation	$5 60 days	$60	$120	$120	$300
c. Other Direct Costs	$300 month	$1,800	$3,600	$3,600	$9,000
Subtotal Superintendency of Banks		**$29,610**	**$47,720**	**$46,308**	**$123,638**
9. Other Costs		**$50,000**	**$100,000**	**$100,000**	**$250,000**
Subtotal Technical Assistance		**$237,934**	**$424,251**	**$437,029**	**$1,099,214**
B. Equity Investments		**$0**	**$1,310,786**	**$0**	**$1,310,786**
C. Evaluation		**$0**	**$0**	**$30,000**	**$30,000**
TOTAL		**$237,934**	**$1,735,037**	**$467,029**	**$2,440,000**

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MSED PROJECT PAPER AMENDMENT #5
(511-596)
Detailed Budget for Microfinance Component

5% anual inflation rate for salaries and other overhead items

LINE ITEM	(Half Year) FY 95 $US Costs	(Half Year) FY 95 Local Costs	FY 96 $US Costs	FY 96 Local Costs	FY 97 $US Costs	FY 97 Local Costs	LOP $US Costs	LOP Local Costs
A. Technical Assistance								
1. Salaries	$28,925		$60,743		$63,780		$153,447	
2. Fringe Benefits	$8,967		$18,830		$19,772		$47,569	
3. Allowances	$20,961		$35,436		$36,565		$92,962	
4. Travel/Relocation	$15,605		$13,600		$15,605		$44,810	
5. Local Office Costs		$49,285		$92,723		$97,083		$239,090
6. Equipment and Commodities		$8,700		$850		$850		$10,400
7. Overhead	$25,881		$54,350		$57,068		$137,299	
8. Superintendent of Banks		$29,610		$47,720		$46,308		$123,638
9. Other Costs	$50,000		$100,000		$100,000		$250,000	
Subtotal Technical Assistance	$150,339	$87,595	$282,959	$141,293	$292,790	$144,241	$726,088	$373,129
B. Equity Investments	$0		$1,310,786		$0		$1,310,786	
C. Evaluation	$0		$0		$30,000		$30,000	
TOTAL	$150,339	$87,595	$1,593,745	$141,293	$322,790	$144,241	$2,066,874	$373,129

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Amount ($us)	Date	Grantees	Amount ($us)	Date	Current Clients	Portafolio (US$)	Date	Delinquency	Date	Net Worth ($us)	Date	Savings Deposits ($us)	Branch Operations	Nominal Annual Interest Rate	Operating Costs as % of Portafolio
$500,000.00 $500,000.00 $50,000.00 $100,000.00	8/23/94	GTZ COTESU	$200,000.00 $100,000.00	8/23/94	7500	$1,900,000.00	8/23/94	88%	8/23/94	$1,200,000.00	8/23/94	n/a	El Alto – 2 El Tejar Central Miraflores	36% (Bs) Prod. 42% (Bs) Comm.	22%
$500,000.00 $500,000.00 $130,000.00 $93,000.00 $230,000.00 $10,000.00	1987 1991 1994 1993 1994 1994	DIAKONIA MISEREOR COTESU	$750,000.00 $80,000.00 $110,000.00	1991 1993 1994	7800	$4,000,000.00	8/23/94	4.0%	8/23/94	$1,900,000.00	8/23/94	n/a	San Pedro El Tejar El Alto – 2 Oruro Santa Cruz Cochabamba Potosi	18% ($us) 36% (Bs) Comm.	10%
$50,000.00	1994–95	USAID/B CRS Plan Internacional PL480 II PL480 III RS ONAMFA Pro–Salud	$500,000.00 $80,000.00 $270,000.00 $472,000.00 $834,000.00 $115,000.00 $37,000.00 $117,000.00	11/94 1994 1994–95–96 1994–95 1994–95–96 1994–95 1994 1995–96	1500	$170,000.00	8/23/94	1.0%	8/23/94	$328,853.00	12/31/93	n/a	Urban areas of El Alto	36% (Bs)	24%
$500,000.00 $988,000.00	1992 1994–1995	IDB DIFEM AITEC–CALMEADOW TINKER UNIFEM NRECA USAID/B CAF ACDI/TRIGO USAID/APPLE DIFEM/Cochabamba SAT	$170,000.00 $135,780.00 $438,453.00 $18,000.00 $1,985,000.00 $137,000.00 $2,470,057.00 $276,850.00 $276,850.00 $581,000.00 $208,888.00 $5,900.00	1992 1994 1993 1993 1993 1992 1990 1992 1993 1994–95 1992 1992	12055	$3,105,722.00	6/30/94	88%	6/30/94	$3,205,650.00	12/31/93	n/a	El Alto, Caranavi, Batallas, Achacachi, Potosi, Montero, Minero, Yapacani, Mairana, Quillacollo, Punata, Sacaba, Colcapirhua, Sucre	48% (Bs)	22.7%
$840,000.00 $75,000.00					5189	$830,000.00		.61%		$214,042.00	12/31/92		El Alto, Batallas, Tihuanacu, Villa Remedios, Viacha, Jutucuta, Carabuco	36% (Bs) 24% ($us)	18%
$1,200,000.00 $2,000,000.00 $7,500,000.00	1993–94 1992–93 Short–term loans of 6 months or less	n/a			57948	$28,700,000.00	7/31/94	6.7%	8/24/94	$8,100,000.00	5/30/94	$3,700,000.00	La Paz – 6 Cochabamba – 5 Santa Cruz – 7 Oruro – 2 El Alto – 3	30% ($us) 48% (Bs)	18.5%
$15,777,000.00			$10,188,758.00												

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ANNEX 2

MEMORANDUM

TO: Elizabeth Rhyne, Microenterprise Office, USAID/W

ee

FROM: Steve Smith, Economic Opportunity Office, USAID/Bolivia

SUBJECT: A Justification and Request for a GC Ruling on Equity Donations as an Allowable Use of USAID Funds

THROUGH: Carl Leonard, Director, USAID/Bolivia

DATE: June 8, 1994

As you probably know, we in USAID/Bolivia are developing a new microfinance project. The New Activity Description (NAD) for $10 million, which I have attached, has been approved by the Mission. Unfortunately, due to budget cuts and the many "directives" applicable to USAID appropriated funds, funding for the project may not be available until FY 1996. Therefore, we have decided to amend our current Microenterprise Development project in order to begin implementation of the new activity as soon as possible. We think we can pull together between $2 to $3 million of existing project funds for this activity.

The principal component of this new activity would involve **equity investments** in solid micro finance institutions. In discussions with the Mission RLA and Controller the question arose as to whether or not equity investments are an allowable use of USAID funds. The purpose of this memo is to ask that your Office request a ruling from GC on the allowability of AID donations for equity. We provide below a programmatic justification (*) for doing this, using Bolivia as the prototypical case. The preliminary view of RLA/Bolivia as to the legality of such equity investments is provided as an attachment.

I. The Predicament:

Microfinance today faces a predicament which can be characterized simply and with little risk of controversy:

> (1) Successful programs in widely scattered countries have shown that we now have at our disposal new financial technologies which are capable of bringing efficient formal financial intermediation within the reach of very large numbers of poor households.

* Much of the programmatic justification described herein has been extracted from Richard Rosenberg's "Beyond Self-sufficiency: Licensed Leverage and Microfinance Strategy.

(2) In no country have we yet succeeded in reaching anything like the majority of those poor households; market penetration by microfinance seldom exceeds five percent; indeed, few countries have achieved as much as one percent.

(3) Even the roughest calculations of potential market size reveal a need for microfinance assets far in excess of donor funding available for the purpose.

II. A Typology of Microfinance Programs:

The issue of financial self-sufficiency has obvious relevance for the predicament described above. But the predicament calls for an analysis of microfinance that goes beyond self-sufficiency. If we have the technical tools to bring efficient finance to massive numbers of the poor, and we don't have the funds to saturate that market, then leverage has to be the linchpin of our strategy. Thus, the following typology of microfinance programs is based on a simple "bottom line" question:

If donors put one dollar into a program today, how much in microfinance assets will that dollar have generated after, say, five years?

The five levels of leverage laid out below are not airtight compartments. They don't form an exhaustive taxonomy: some programs fall between the cracks. But these levels do clarify the dynamics of financial leverage, and thus speak directly to a program's ability to respond to our real life predicament.

Level One. At this level, a microfinance program does not break even on a cash flow basis; i.e. more cash drains out as expenditure than flows in as revenue (even without including any imputed cost for the program's soft funding). The vast majority of microfinance programs fall into this category. The bottom line at this level is that if a donor puts one dollar in today, by Year Five there will be less than a dollar still available to provide ongoing finance for poor people.

Level Two. A program at this second level has achieved a breakeven in cash flow: revenues are at least equal to expenditures. The program may even have gone on to a fuller self-sufficiency, a state in which income covers all expenses, including non-cash expenses like depreciation, inflation, and the opportunity cost of its funds. But for a program at this second level, most of its microloan portfolio is financed by money the program has borrowed from donors. Thus it has little or no equity (equity = net worth = assets minus liabilities = the difference between what a program owns and what it owes). Such a program cannot leverage its donor funds by further borrowing from commercial sources. Because of the absence of an "equity cushion", even a modest loss in the institution's microloan portfolio assets would imperil its ability to honor its debts.

Thus, the bottom line for a Level Two program is that for each dollar donors put in today, the program will continue to have about one dollar available in later years for microfinance.

Level Three. Like a Level Two program, a program at this third level has reached breakeven or better. But in contrast to the previous level, the program has substantial equity funding, which some development agency has granted, rather than lent, to the program. On the basis of this positive net worth, the program can then finance expansion of its portfolio by borrowing from commercial sources, such as banks. Experience around the world suggests that commercial lenders will not lend much more than $1.00 or at most $1.50 for each dollar of equity which this kind of program has available to back up the loan. Therefore, at Level Three a dollar of donor's grant money leads to about two dollars of total microfinance resources available for poor clients. (The assumption here is that the program's profits are not high enough to produce a rapid multiplication of its equity capital).

Level Four. A program reaches this fourth level when it has, not only a self-sufficient cash flow and a significant equity base, but also a license as a bank or other formal financial institution. Because the program is certified as meeting the requirements of a credible regulatory authority which maintains ongoing supervision, outside parties are willing to loan or deposit money into the institution in amounts up to eleven times the institution's equity base. Why eleven? Because this limit is the international standard which more and more countries are adopting. More precisely, the ratio comes from the "Basel Convention" rule that an institution's equity must be no less than eight percent of its risk-weighted assets. The outside sources of funds for a Level Four intermediary can be diverse: e.g. deposits from microclients, deposits from larger commercial investors, interbank loans, or Central Bank credit facilities.

The bottom line for donors: after five years, a Level Four program will have leveraged each dollar of equity they have donated into as much as twelve dollars of assets available for continued microfinance.

[Level Five. This level is in brackets because no one has reached it yet, anywhere in the world. A program would arrive at this level when, in addition to meeting all the requirements of the previous levels, it is making profits that are so high that other investors begin to start their own microfinance institutions, for motives which are not social but purely financial. We already know that it is possible to operate a microfinance bank profitably. But we do not yet know whether it is possible to generate profits that are rich enough to attract a lot of purely commercial competition. If this level can be achieved, the donor's original dollar would catalyze an indefinitely large amount of resources going to serve the microfinance clientele. A review of the present state of the art suggests that microfinance is unlikely to reach this level in most countries, over the medium term at least.]

III. Core Strategic Considerations, with Illustrations from the Bolivian Case:

Level Four is Real. The prospect of massive leveraging of donor microfinance resources, up to eleven to one, is not a pipe dream. Nearly all of Bolivia's commercial banks leverage their equity at a ratio of close to eleven to one, as do banks in most countries around the world. Regarding microfinance, Banco Solidario in Bolivia obtained its banking license in 1991 with

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about $5 million in equity, provided by USAID, other donor groups and socially motivated investors. Drawing deposits from a wide variety of sources, by mid-1994 it had parlayed that equity into a microloan portfolio of about $30 million. In another year or so, its portfolio will have grown to about $60 million, representing the maximum legal leverage of its original $5 million equity capital. Bank Rakyat Indonesia's Unit Desa program provides another demonstration of the practicality of this kind of leverage (although the Unit Desa system's status as a department of a state bank complicates the accounting presentation.)

While real, Level Four is not easy. Institutions of this sophistication do not develop spontaneously. Some conditions for building programs at this level are discussed below.

If Donors Rely on Programs Below Level Four, They Have Little Chance to Satisfy the Demand for Poor Peoples' Finance. Taking the Bolivian example, something like $300 million in assets are estimated to be necessary to saturate the market for microfinance. Assuming that donors in Bolivia rely on superb Level Three programs, and further assuming that donors provide all their funds to these programs as equity (donations) rather than loans, the market can be saturated only if the supply of donor funds is about $150 million. This would be impossible to attain given budget levels for Bolivia and other demands on donor funds. The results of similar calculations for other countries are unlikely to be broadly different.

If Donors can Structure Level Four Programs, Saturating the Market is Well Within Reach. A Level Four Program, because it enjoys the credibility stemming from certification and supervision by a capable financial regulatory authority, can borrow up to $11 of commercially sourced (and priced) funds for every $1 of equity it starts out with. In the Bolivian case, the $300 million in assets needed to respond to the demand for poor people's finance can be raised on an equity base of as little as $25 million. This figure is within easy reach for Bolivia's donors. Almost half this amount is already lodged in the equity capital of BancoSol and four other sound Bolivian microfinance programs, and the remainder is unlikely to strain the budgets of USAID and the InterAmerican Development Bank Group over the next three or four years.

Another important difference between a Level Three and a Level Four institution is the ability to provide savings services. Although savings services are not central to the subject here, it is worth mentioning their inseparable role in microfinance. Aside from being a major source of portfolio financing for the institution, savings are critical to liquidity management for the microenterprise or poor household. Savings increase equity by providing increased security and returns for the saver, and encourage client self-financing for investments. They benefit the economy as a whole by increasing funds available for productive investment. Contrary to popular belief, poor people will save if good saving services are available. In Bank Rakyat Indonesia (BRI), for example, where savings services were introduced years after the credit program, total customer deposits are now more than double the value of the loan portfolio. For every outstanding loan, BRI has approximately four savings accounts. BancoSol's pilot savings program has demonstrated that the demand for micro savings in Bolivia is also significant.

Therefore, another important difference between a Level Three and a Level Four institution the ability to provide savings services.

IV. Three Conditions for Market Saturation:

If we accept the proposition that market saturation requires institutions whose ability to leverage commercial funds is at Level Four, then three requirements emerge as conditions for the development of such institutions. These institutions must have a substantial equity base. They must have access to licensing by a credible and competent financial regulatory agency. And, since many if not most of these institutions will have begun life looking more like a socially oriented NGO than a bank, they will usually require heavy **technical input** to support their transformation into a professional and efficient financial intermediary.

V. What Bolivia Needs to Satisfy the Conditions for Market Saturation:

Equity: We estimate that, among Bolivia's microfinance intermediaries that have reached Level Three, there is about $12 million in equity capital. Assuming an eventual leverage ratio of 11:1, the system would require another $13 to $15 million to achieve market saturation. As a side point, only about $5 million of the equity currently in the system is being leveraged at a ratio greater than 1:1 (by Banco Solidario, which is at almost 6:1).

USAID's new Microfinance project (511-0637) proposes to infuse another $8 to $10 million into the system. The InterAmerican Development Bank Group also has expressed considerable interest in contributing equity capital to Bolivian microfinance intermediaries.

Independent Licensing and Supervision: Banco Solidario has already proved that microfinance can be done with a regular commercial bank license. But the minimum equity requirement for such a license (about $5 million) is much too steep for the other sound programs. USAID, with support from the IDB and the World Bank, has convinced the Superintendent of Banks to open up a separate licensing window for non-bank microintermediaries. For a number of reasons, which we will not enter into here, the requirements that need to be met in order to acquire a license must be very stringent. Here are a few of the key elements proposed for Bolivia:

- a minimum equity requirement of about $2 million.
- a track record of three years of successful operations and a concrete, detailed business plan.
- under the new window, a microfinance intermediary will not be allowed to leverage at a ratio of 11:1 at the outset. They will be restricted to perhaps five-to-one for the first two or three years, with later gradual increases toward 11:1.

- ownership of the microfinance institutions will be limited to non-profit entities. Any of these institutions could convert at a later point in time to for-profit ownership by qualifying for a regular bank license.

- with the exception of the equity requirement, licensed microintermediaries will be governed by most of the same reporting and prudential requirements that are imposed on commercial banks.

Technical Support: All of Bolivia's microintermediaries began life as socially oriented NGOs. The transition to an efficient financial intermediary is difficult, psychologically no less than technically.

Banco Solidario already receives considerable outside technical support, mainly from Acción International. All the other institutions will require significant technical support, not as a one-shot affair, but as an ongoing process for the first five years or so. The kind of technicians who are needed are people who not only have extensive nuts-and-bolts experience with real microfinance programs, but also have the financial and systems expertise to translate their experience into the requirements of a successful micro-banking operation.

USAID/Bolivia has begun a program of seminars and technical assistance to assist the microintermediaries. The new Microfinance project will expand this program, including more intensive assistance for the institutions receiving equity contributions.

VI. How the Equity Contribution Would Work:

USAID is generally prohibited from holding equity shares in any institution by Section 635(g)(3) of the Foreign Assistance Act. (The restriction refers only to "loans" made under the FAA, and not to "grants."). Under the new project, we plan to grant funds to a third party which, in turn, would buy equity shares in one or more microintermediaries. USAID's grant to the third party would be made under a cooperative agreement. The third party would be a development agency or NGO with considerable interest and experience in microfinance development. Its role would be to purchase shares, and then actively provide strategic and operational guidance to the microintermediary. It would have access to the technical assistance necessary to achieve this, whether provided with USAID's or its own funding.

We know of several institutions capable of carrying out this third party role effectively. This model has already been successfully tested. Acción International, for example, owns equity in BancoSol. Over the past year Acción has effectively assisted in steering BancoSol in the right direction. Acción has even provided critical technical assistance where it was needed.
Other NGOs and donors have similar relationships with other microfinance institutions in Bolivia and in other countries.

Before any grant is made to the third party, USAID and the third party would have agreed upon the final institutional destination of the equity funds. Obviously, an intensive institutional analysis would be performed on the microintermediary which would, at a minimum, evaluate the following:

- Management and Institutional Structure.
- Institutional Strategy and Goals.
- Financial Policies.
- Delivery Mechanisms.
- Financial Performance.
- Potential to Expand Outreach.

The purchase of equity shares would be negotiated and executed between the third party and the microintermediaries. It would be subject to USAID approval. USAID's monitoring responsibilities would not end once the purchase is executed. Through the Cooperative Agreement with the third party, USAID would regularly monitor the microfinance institution's progress in expanding services to a greater number of poor households. USAID would also monitor the areas listed in the previous paragraph in order to ensure the long-term health of the institution. (Since USAID may not have all the required monitoring capability in-house, the full-time services of an expert in this field would likely be needed.) On the other hand, USAID would not track the use of each dollar donated as it does with traditional grants for loans and operating expenses.

VII. The Argument for Equity instead of Traditional USAID Grants for Loan Portfolios and Operating Costs:

Traditional USAID donations for loans and operating costs have, over recent years, been appropriate for the development of microcredit institutions. The extensive accounting procedures and oversight were necessary as these AID-supported institutions got on their feet. Practically speaking, USAID/Bolivia could carry out the project described above using the same disbursement mechanisms. The problem is that it would be a distant second best alternative. We are no longer concerned as to whether microfinance institutions can deliver credit services on a sustainable basis. Our concern now is that the strong institutions in Bolivia expand their services to significantly greater numbers of poor households. We believe the way to do this is through equity investments. It is not important to us what the microfinance institutions use these funds for, provided they are used for costs and activities normally associated with a financial institution, and provided they are not used in ways prohibited under the FAA. On the other hand, we will closely monitor the institution's progress towards the project's main goal: outreach. We will also monitor the institutional and financial health of the microintermediary, and provide critical technical assistance wherever needed. Below are some of the key reasons why implementation of such a program would be more successful using equity investments than traditional USAID disbursement mechanisms:

(1) Leverage: The potential of the model described above lies in the ability to leverage equity capital. These are the only assets we can be sure the Superintendency will permit to be leveraged. Microintermediary assets provided by USAID or the third party for loan portfolios could not be leveraged until they were returned to the microintermediary from the microclient as reflows. It is possible that an exception to this could be made by qualifying the loan funds as subordinated debenture. Under such an arrangement, the donor or third party makes a long-term loan to the micro finance institution, and agrees that its rights to the repayment of the loan will be subordinated to the rights of the institution's other creditors. But there is no guarantee the Superintendency would be willing to treat this as equity.

(2) Control: With the purchase of shares, the third party would be given management control of the microintermediary equal to its proportion of ownership. We view this as critical to the project's success. Although we believe that an agreement could be reached between the third party and the microintermediary to count funds tied to loan portfolio as ownership equity, the accounting responsibilities of the third party would divert its attention from its critical role, which would be to provide strategic and operational guidance. Furthermore, the third party's percentage of ownership would be constrained by the rate at which loan portfolio funds are disbursed.

(3) Timeliness: With equity donations, strong Bolivian microintermediaries could qualify quickly for licensing and begin to leverage equity capital thereafter. The full technical assistance component could also be implemented right away under the ownership control of the third party. Under a traditional USAID loan portfolio arrangement, funds would be allocated to the microintermediary incrementally, based on a demonstration of loan disbursements. This would slow the rate at which otherwise qualified microintermediaries receive licenses. It would also slow the rate at which the Bolivian poor receive microfinance services.

VIII. Action Requested:

That GC provide a ruling that donations as described above constitute an allowable use of USAID funds, both under the FAA and recent Appropriations Acts, and under the cost principles stated in OMB Circulars applicable to HB 13 Grants and Cooperative Agreements to U.S. and non-U.S. NGOs.

EO:SSmith
Clearances:
RLA:SAllen (in draft)
PDI:PNatiello (in draft)
CONT:RGoughnour (in draft)
A/DD:RGoughnour

ATTACHMENT

PRELIMINARY VIEW OF RLA/BOLIVIA

1. The question of whether the purchase of equity by a Grantee or Recipient of a Cooperative Agreement is an allowable cost under the applicable laws and regulations (under the FAA, recent Appropriations Acts, HB 13, OMB Circular A-122, etc.) is of Agency-wide significance, and should be thoroughly discussed among G, OP, and GC. If this is the best way to expand microfinancing, we should support grants and C.A.s which expressly permit and authorize the grantee/recipient to purchase equity in microfinance institutions. The following are thoughts on whether this is legally permissible.

2. FAA 635(a) gives USAID broad authority to furnish assistance on a grant basis on such terms as are "determined to be best suited to the achievement of the purposes of this Act." FAA 635(b) echoes this broad authority. FAA Sec. 103(b)(1) ("organization of a system of financial institutions which provide both savings and credit services to the poor)" and Sec. 106(d)(5) ("programs of urban development with particular emphasis on small, labor intensive enterprises, marketing systems for small producers, and financial and other institutions which enable the urban poor to participate in the economic and social development of their country") authorize microfinance activities in both urban and rural areas.

3. FAA 635(g)(3) prohibits only acquisition of equity by the USG (by USAID) through USAID-direct loans. It does not forbid the recipient of a grant from USAID from purchasing equity. (Nor does this Section prohibit USAID from directly making equity investments with <u>grant</u> funds, although for policy reasons, including organizational conflicts of interest, USAID would probably never decide to do so.) No other section of the FAA nor of any recent Appropriations Act (e.g. FY 93 and FY 94) bears directly on this subject, nor prohibits grants to NGOs for equity investments to stimulate microfinance. Congress has expressed, however, in recent Appropriations Acts and Committee Reports, a substantial interest in expanding microloans to poor people. (See, e.g. Title II of the FY 94 AA, Sen. Report 102-419 (September 23, 1992), pp. 97-98; Sen. Report 103-142 (September 14, 1993), p. 77.

4. Handbook 13 Grants and Cooperative Agreements generally refer (in a note to the Standard Provision on "Allowable Costs", HB 13, App 4C and 4D) to OMB Circular A-122. The latest version of Circular A-122 available to the RLA is dated July 8, 1980 (45 FR 46022). In Attachment A to the Circular, "General Principles," factors affecting the "allowability" of a cost are its <u>reasonableness</u> and <u>allocability</u> to a particular cost objective. If a grant were written with the express purpose of purchasing equity in microfinance institutions to expand credit available to the poor

through leveraging, these criteria would be satisfied. Attachment B to the Circular are "Selected Items of Cost." The first paragraph provides that, "Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment or principles for similar or related items of cost." Equity investment is not listed in Attachment B. The most similar item listed is No. 13, "Equipment and Other Capital Expenditures, which are generally "unallowable except with the prior approval of the awarding agency." (Emphasis added.) Hence, it appears that equity investments, similar to capital expenditures, may be determined to be an allowable cost by USAID as awarding agency, by so stating in the Schedule of the Grant or Cooperative Agreement.

As a last resort, not needed here, Attachment C to Circular A-122 provides that an awarding agency may negotiate the non-applicability of the Circular to a particular organization.

RLA/Bolivia:SAllen 06-09-94

ANNEX 3

NEW ACTIVITY DESCRIPTION

1. Basic Data

(a)	Project Title:	Microfinance
(b)	Project Number:	511-0637
(c)	Funding Source:	To be determined
(d)	Duration:	Shelf 1995 FY 1996-1997
(e)	LOP Funding:	$10 million

2. Strategic Fit with Agency/Bureau Goal

Micro enterprise development has been given priority emphasis in the Agency's new "Economic Growth" policy. This project is directed at microenterprises and poor households. USAID/Bolivia supports the Agency policy guidance which indicates financial services as the most successful means of assisting microenterprises. The project directly supports two Program Outcomes, (1) increased employment opportunities in non-coca industries, and (2) broadened access to financial markets.

3. Consistency with Mission Strategy

(a) Project Goal: The project's goal is to increase income and employment of the Bolivian poor by significantly broadening access to financial services. This project supports the Mission's "Expanded Economic Access and Opportunity" strategic objective.

(b) Project Purpose: To enhance the capacity of a small group of microfinance institutions to deliver financial services to the poor.

(c) Project Description: In the last decade, new financial technologies developed in various countries have provided efficient financial services (credit and savings) to poor households, including those households' income-producing activities (microenterprise). These technologies have been proven and refined in Bolivia over the last six years. The challenge is to extend these services to the massive numbers of poor households who would find them valuable.

Rough estimates suggest a potential reachable clientele for such services in Bolivia of perhaps 600,000 poor households. Assuming an average loan balance rising over the years to $500 per household, the capital requirement will be around US$300 million. Only 10% of this demand is being served right now ($30-35 million reaching about 60-70,000 poor households), mainly by PRODEM and Banco Solidario, both of which sprang from USAID/Bolivia's Micro and Small Enterprise Development Project.

Donor agencies fund microfinance programs with donations (equity) and loans (debt). Generally donor debt finance in such programs cannot leverage additional commercial-source funding, and equity finance (including guarantee authorities) rarely leverages more than two dollars of total finance for each dollar of donor input. At this rate, $150 million in donor funds would be required for adequate service of Bolivia's market for poor people's finance.

However, once a microfinance program reaches the stage of being able to qualify for a banking license or its equivalent, it can quickly leverage *twelve* dollars in poor peoples' finance for each dollar of equity (i.e., donated) input. Operating on this basis, the required $300 million of microlending can be financed from commercial sources if an equity base of $25 million can be assembled. Banco Solidario is already leveraging its $5 million in equity capital (principally from USAID and other development agency sources). There are several other good Bolivian microfinance programs, who account for approximately another $5 million in equity at their disposal, but none of them has yet been able to get a banking license. Individually they do not have the $5 million required for a full bank license, and the Superintendency of Financial Institutions is reticent to opening a new window to license them on a lower equity capital basis.

Thus, there is a double gap which needs to be filled in order to spread efficient new microfinance technologies to all the poor Bolivians who can practically use them:

Funding: Additional equity of perhaps $15 million, principally from donations, will be needed;

Licensing: Banking licenses, or some equivalent which allows commercial leveraging, must be structured for a few more microfinance programs (in addition to Banco Solidario).

The proposed project could go a long way to filling these gaps. Most of the requested resources would be donated to sound microfinance NGOs, on the condition that they be invested by those NGOs as equity in licensed microfinance intermediaries (including Banco Sol and other intermediaries which would complement it and compete with it). Each dollar so invested will predictably leverage twelve dollars of microlending. We have little doubt that other development agencies would be willing to add equity funds to those provided by the USAID project, based on past successes in attracting such matching funds.

Perhaps 5-10% of the requested resources would be used to finance technical assistance and training to help a very few good NGO programs raise themselves to the level of operations controls necessary to comply with the Superintendency's licensing requirements; and perhaps to subsidize, for a very few years, the Superintendency's supervision costs for microfinance institutions.

The key objective against which the project will be designed and managed is providing a major improvement in the efficiency and cost

qb

ACTION: AID-1
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Rec'd 6/21

File: PRM

DISTRIBUTION: AID
CHARGE: AID

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Reply 6/28

E.O. 12356: N/A
TAGS:
SUBJECT: FY 95-96 ACTION PLAN FOR BOLIVIA

Action tkn VAP

1. THE FY 95-96 ACTION PLAN FOR BOLIVIA WAS REVIEWED ON MAY 25, 1994. THE DAEC WAS CHAIRED BY AA/LAC MARK SCHNEIDER. IN ATTENDANCE WERE REPRESENTATIVES FROM G, M, PPC, LPA, STATE AND ALL APPROPRIATE LAC OFFICES. THE AA/LAC AND DAA COMPLIMENTED THE MISSION ON THE QUALITY OF THE ACTION PLAN. THE USAID DIRECTOR, CARL LEONARD, AND STAFF MEMBERS LEWIS LUCKE AND GENE SZEPESY PRESENTED THE ACTION PLAN. THE ACTION PLAN WAS APPROVED BY THE BUREAU, SUBJECT TO THE GUIDANCE PROVIDED BELOW.

2. POVERTY ALLEVIATION: AA/LAC QUESTIONED THE APPARENT LARGE NUMBER OF USAID/BOLIVIA PROJECTS AIMED AT ECONOMIC GROWTH WHICH SEEM TO WORK ONLY INDIRECTLY TO ALLEVIATE POVERTY. THE MISSION EXPLAINED THAT MANY OF THE PROJECTS WITH AN INDIRECT APPROACH REFLECT AN EARLIER STRATEGY FOCUSSING ON TRADE AND INVESTMENT AND ARE NEARING COMPLETION. USAID/BOLIVIA POINTED OUT THAT ITS ENTIRE PROGRAM EMPHASIZES POVERTY ALLEVIATION DIRECTLY, EVEN THOUGH SOMETIMES ACHIEVEMENT OF THE OBJECTIVES REQUIRES INDIRECT MEASURES.

3. GOB POPULAR PARTICIPATION/DECENTRALIZATION: DAEC REVIEWERS WERE VERY SUPPORTIVE OF MISSION PLANS TO ASSIST THE GOB IN ITS AMBITIOUS POPULAR PARTICIPATION PLAN. PARTICIPANTS WERE, HOWEVER, CONCERNED THAT MANAGEMENT OF THE 20 PERCENT OF GOB RESOURCES TO BE MADE AVAILABLE TO 301 MUNICIPALITIES STARTING IN 1995 MIGHT OVERWHELM MUNICIPALITIES WHICH HAVE LITTLE EXPERIENCE OR EXPERTISE IN DEVELOPING AND MANAGING CAPITAL PROJECTS. THE MISSION

of financial services available to the majority of poor Bolivian households, including their income producing activities. In terms of the quality of services, the principal indicator will be reduction in the cost of financial intermediation.* The higher-level purpose of improvement in financial intermediation is to better the efficiency of poor people's economic activities, thereby raising incomes and reducing poverty. Rigorous measurement of these latter changes and their dependable attribution to project interventions is extremely expensive if not impossible. Whether the project attempts to measure these variables directly will depend on the outcome of current AID/W research on monitoring methodology. In the meantime, we are satisfied with the benefits of a project which accomplishes a massive lowering of costs of financial intermediation for poor people who have formerly been excluded from the formal finance system. The existence of such benefits is attested by the massive numbers of poor people who rush to take advantage of such services when they are offered, even though they are charged the full cost of the services. (Banco Sol's client base is already at 50,000 households, and is doubling every year.)

In addition to measuring the *quality* of the financial services in terms of intermediation costs, we will also measure the *extension* of those services in terms of the percentage of poor Bolivian households which have access to them.

(d) **Anticipated impact on poverty alleviation, access and participation, including gender level impact:** In the economic area, Agency strategies focus on growth and access. The impact of the proposed project on poor people's access to the economic and financial systems of their country is too obvious to require analysis. As to the growth aspect, it should be sufficient to observe that in any country, sector, or economic level that economists have ever studied, growth is always strongly correlated with the efficiency, cost, and volume of financial intermediation.

As of the end of 1993, about 70% of Banco Sol and PRODEM's 60,000 customers were women, thanks to systems which respond well to their particular needs. We would expect the majority of customers served by this project to be women.

(e) **Dialogue Agenda:** Bolivia's macroeconomic framework requires no change to make this project viable. The important policy component will be a dialogue with, and possible support to, the

* For example, before PRODEM/Banco Sol began operations, the cost of intermediation in a typical poor community would be about 500%: the effective annual cost of a loan from an informal moneylender (say, 500%), minus the effective annual return on the usual savings instrument (0% on cash under the mattress). But once the same community has access to a full-service Banco Sol office, loans are available at an effective annual rate of about 35%, while save, liquid savings deposits pay about 10%, for a cost of intermediation which is one twentieth of that which prevailed previously.

Superintendency of Banks to smooth the way for licensing of a few of the better NGO microfinance programs. The availability of significant resources to put these programs on a solid financial footing should be an important factor in convincing the Superintendent.

(f) Donor Coordination: During the pre-design USAID/Bolivia has already coordinated with the World Bank, the German bilateral donor agency, and about a half dozen NGOs. The IDB also will be brought into the process. Other donors and NGOs will be involved throughout the project, either in coordinating roles or direct project participation.

4. <u>Policy and Design Issues</u>

(a) Sustainability of Proposed Activities: Financial self-sufficiency of participating institutions would not be an outcome of this project; on the contrary, it would be a precondition for participation. Bolivia, fortunately, has several microlending NGOs who are already at this stage, in addition to Banco Sol.

(b) Potential Issues: The excessive "directives" assigned to USAID/Bolivia do not permit the flexibility to start this activity in FY95 unless the OYB is increased (possibly from the Administrator's Microenterprise Fund). Therefore, it is submitted as a "shelf" activity for FY95 and firm start in FY96.

(c) Linkages to and Utilization of Global Resources and LAC Regional Programs: Because non-directed Mission resources are severely limited, the Mission may request access to the Microenterprise Fund. USAID/Bolivia has actively participated in the centrally funded GEMINI project. We will continue to do so, especially to access key technical assistance and to keep abreast of new developments in the micro finance field.

(d) Management and Support Requirements: The staff of the Mission's Economic Opportunity office is unusually well-versed in microfinance issues, and already has established close working relationships with several of the best microfinance experts in the world who are applying in Bolivia the lessons learned in hundreds of microfinance programs all over the world. The additional staff time necessary to manage this project will be available through the termination of other projects.

(e) Timetable and Resource Requirements for Developing the Assistance Proposal: We expect to complete the project design during the first quarter of FY 1995, followed by a second quarter authorization and obligation of funds. This requires AID/W to provide an increased OYB for FY95 or relief from the "directives" of USAID's DA OYB and an early FY 95 budget allowance.

(f) Recommendations on Delegation of Authority for Further

Review and Approval: Given the Mission's experience and success in this area, a complete delegation of all subsequent stages of project design and approval is appropriate.

EXPLAINED THAT THE GOB AND MISSION STAFF ARE WELL AWARE OF THE RISKS ASSOCIATED WITH THIS MASSIVE AND COMPLEX UNDERTAKING, AND THAT THIS IS WHY THE MISSION HAS PROPOSED THE FY 95 NEW ACTIVITY ENTITLED DEMOCRATIC DEVELOPMENT AND CITIZEN PARTICIPATION. . THEY WILL ALSO BE COORDINATING CLOSELY WITH OTHER DONORS. THE DAEC RECOMMENDED THAT THE MISSION REVIEW THE EXPERIENCE OF OTHER COUNTRIES IN THE REGION WHICH HAVE DECENTRALIZED GOVERNMENT FUNCTIONS SUCH AS EL SALVADOR AND CHILE.

4. COUNTERNARCOTICS: IN RESPONSE TO A QUERY FROM AA/LAC ON THE DIFFICULTY THE GOB IS HAVING IN MEETING THE COCA ERADICATION TARGETS, THE MISSION EXPLAINED THAT PART OF THE PROBLEM WAS DUE TO LACK OF POLITICAL WILL DURING THE 1993 ELECTIONS, AND THE CHANGE OF ADMINISTRATION IN BOLIVIA, AS WELL AS TO THE INCREASING PRICE OF COCA. THE MISSION POINTED TO THE SUCCESS ALTERNATIVE CROPS ARE HAVING IN THE PRIME COCA GROWING AREAS AND EXPRESSED THE HOPE THAT STEPPED-UP INTERDICTION EFFORTS AND ENHANCED POLITICAL WILL WILL CONTRIBUTE TO REDUCING THE PRICE TO FARMERS FOR ILLICIT COCA AND RENEWING INTEREST IN THE ERADICATION PROGRAM.

5. BUDGET: THE MISSION WAS MADE AWARE OF THE FURTHER STRESS WHICH IS LIKELY TO BE PLACED ON THE ESF BUDGET AND ADVISED TO CONSIDER WHICH ESF-SUPPORTED PROGRAMS ARE MOST CRITICAL TO THE ACHIEVEMENT OF MISSION OBJECTIVES. IN RESPONSE, THE MISSION STATED THAT IN SUPPORTING THE USG'S COUNTERNARCOTICS OBJECTIVES, IT WOULD BE PARTICULARLY IMPORTANT TO ENSURE CONTINUANCE OF SUPPORT TO
AND THE COCHABAMBA
REGIONAL DEVELOPMENT PROJECT (CORDEP). THE MISSION EXPRESSED ITS DEEP CONCERN ABOUT THE CONSTRAINTS PLACED ON THE MISSIONIS FLEXIBILITY BY VARIOUS FUNDING "DIRECTIVES" IT RECEIVES EACH YEAR. THE DAEC NOTED THE LIMITATIONS THESE DIRECTIVES PLACE ON THE MISSION'S ABILITY TO RESPOND CREATIVELY AND EXPEDITIOUSLY TO PROGRAM NEEDS AS THEY ARISE. IN RESPONSE TO THE ACTION PLAN PLEA TO PROVIDE FUNDING ALLOCATIONS IN A MORE TIMELY AND PREDICTABLE MANNER, THE MISSION WAS ADVISED TO TAKE FULL ADVANTAGE OF

LAC/DPPIS ANNUAL OFFER TO MEET URGENT FIRST QUARTER FUNDING NEEDS.

6. TRAINING FOR SUSTAINABLE DEVELOPMENT: THIS PROJECT WAS QUESTIONED ON THE GROUNDS THAT IT DID NOT APPEAR TO HAVE ANY DIRECT LINK TO ACHIEVEMENT OF USAID/BOLIVIA'S PROGRAM OBJECTIVES. THE MISSION CLARIFIED THAT, WHILE INDIVIDUAL PROJECTS DO HAVE THEIR OWN TRAINING ELEMENTS, THERE ARE INEVITABLY GAPS IN THE MISSIONIS ABILITY TO FUND TRAINING

NEEDED TO IMPLEMENT THE OVERALL SUSTAINABLE DEVELOPMENT PORTFOLIO IN BOLIVIA. ALL THE PROJECTIS TRAINING WILL SUPPORT THE STRATEGIC OBJECTIVES.

E.O.
SUBJECT:

7. FEMALE EDUCATION: CONCERN WAS EXPRESSED ABOUT THE EXTENT OF MISSION ACTIVITIES SUPPORTING EDUCATION, ESPECIALLY FEMALE EDUCATION. THE MISSION STATED THAT EDUCATION OF GIRLS, PARTICULARLY AT THE PRIMARY AND SECONDARY LEVELS, IS VITAL TO ACHIEVEMENT OF DEMOCRACY, HEALTH, POPULATION AND ECONOMIC GROWTH OBJECTIVES. HOWEVER, AS AGREED IN USAID/W'S APPROVAL OF USAID/BOLIVIA'S STRATEGY, SUPPORT TO EDUCATION WOULD BE LEFT TO OTHER DONORS WITH USAID/W AND THE MISSION PROMOTING POLICY DIALOGUE INVOLVING THE GOB, OTHER DONORS AND CIVIC ORGANIZATIONS, AND MONITORING PROGRESS OF REFORMS. THE MISSION BELIEVES THAT THE SUBSTANTIAL EDUCATION PROGRAMS PLANNED BY THE GOB WITH OTHER DONOR SUPPORT, ESPECIALLY LED BY THE WORLD BANK, SHOULD DEVOTE PARTICULAR ATTENTION TO FEMALE EDUCATION. REDOUBLED POLICY/PROGRAM DIALOGUE ON KEY ISSUES TO ENSURE ADEQUATE ATTENTION TO FEMALE EDUCATION AND MONITORING EFFORTS AT BOTH THE USAID/W AND USAID/BOLIVIA LEVEL WILL BE NEEDED TO ENSURE THE DESIRED OUTCOME OF INCREASING THE QUANTITY AND QUALITY OF FEMALE EDUCATION AND CLOSING THE GAP BETWEEN BOYS AND GIRLS. AS A FIRST STEP, USAID/W (LAC/DR/EHR) WAS ASKED TO REVIEW THE WORLD BANK PROJECT DOCUMENTATION TO ENSURE THAT THIS ISSUE IS RECEIVING APPROPRIATE ATTENTION. FOR ITS PART, USAID/BOLIVIA WILL DIALOG WITH APPROPRIATE GOB AND LOCAL WORLD BANK EDUCATION PLANNING STAFF ON THE CRITICAL IMPACT OF FEMALE EDUACTION IN ATTAINING SUSTAINABLE ECONOMIC GROWTH AND OTHER KEY STRATEGIC OBJECTIVES.

8 [redacted] ALL MEMBERS OF THE DAEC AGREED THAT THE PROPOSED MICROFINANCE ACTIVITY COULD PLAY A MAJOR ROLE IN POVERTY ALLEVIATION AND ECONOMIC GROWTH. WHILE THE ENVIRONMENT FOR THIS TYPE OF INTERVENTION IS RIGHT FOR AN IMMEDIATE NEW START, THE MISSION EXPLAINED THAT THE SUBSTANTIAL PROPORTION OF ITS PROGRAM WHICH MUST BE DEVOTED TO MEETING NUMEROUS AGENCY "DIRECTIVES", LEAVES IT

VERY LITTLE ROOM TO MANEUVER TO TAKE ADVANTAGE OF EVEN THIS VERY PROMISING OPPORTUNITY. ALTHOUGH THERE ARE CURRENTLY NO CENTRALLY HELD FUNDS FOR MICROENTERPRISE PROMOTION, THE DAA ADVISED THE MISSION TO GO "FULL STEAM AHEAD" WITH DEVELOPMENT OF THE PROGRAM SO THAT IF A

FUNDING SOURCE CAN BE IDENTIFIED, THE MISSION CAN MAKE A PROPOSAL PROMPTLY.

9. PL 480: A. THE MISSION NOTED ITS EXTREME DISAPPOINTMENT WITH USAID/WIS PROPOSED ABRUPT DROP IN THE PL 480 TITLE III LEVEL FROM FY 94 TO FY 95 (DOLS 20 MILLION DOWN TO DOLS 7 MILLION) AND THE POTENTIAL HARM THE LOSS OF LOCAL CURRENCY WILL DO TO COUNTERPART CONTRIBUTIONS FOR ONGOING PROJECTS. THE BUREAU WILL TRY TO OBTAIN ADDITIONAL FUNDS FOR THE PROGRAM. THE MISSION INDICATED THAT IN THE EVENT ADDITIONAL TITLE III RESOURCES DO NOT BECOME AVAILABLE, THE MISSION WILL CONCENTRATE THE RESOURCES THAT ARE AVAILABLE ON ACTIVITIES DESIGNED TO ALLEVIATE POVERTY AND IMPROVE FOOD SECURITY.

NOTE: NOTWITHSTANDING THE ABOVE, MISSION SHOULD BE PREPARED TO ADDRESS ANY DISINCENTIVE ISSUES (BELLMON) CREATED AS A RESULT OF THE RECENTLY SHIPMENT OF BULK WHEAT BEING PROVIDED BY THE EUROPEANS, AND POSSIBLY BY USDAIS EEP IN FY95, BEFORE ANY TITLE II OR III MONETIZATION PROGRAMS CAN BE AUTHORIZED IN FY95.

B. REGARDING USE OF LOCAL CURRENCY NOTE THE RECENT TITLE III GUIDANCE REQUIRES THAT QUOTE MISSION WILL BE EXPECTED TO USE TITLE III RESOURCES TO SUPPORT INTERVENTIONS WITH DIRECT LINKAGES TO INCREASED AGRICULTURAL PRODUCTION AND CONSUMPTION WHICH CAN DEMONSTRATE VISIBLE PROGRESS OVER A THREE TO FIVE-YEAR TIME PERIOD. PROPOSALS SHOULD INCLUDE A PLAN TO ENHANCE FOOD SECURITY THROUGH POLICY REFORMS WHICH ADDRESS SECTORAL ISSUES AFFECTING FOOD PRODUCTION AND CONSUMPTION, INCLUDING NUTRITION, AND LOCAL CURRENCY SUPPORT OF ACTIVITIES ADDRESSING SMALL FARMER AGRICULTURAL PRODUCTION (PARTICULARLY FOOD PRODUCTION) AND CONSUMPTION PROBLEMS IN THAT COUNTRY. UNQUOTE

C. IN ACCORDANCE WITH RECENTLY ISSUED POLICY GUIDANCE, THE TITLE III PROGRAM WILL BE AUTHORIZED IN USAID/W.

D. BHR/FFP RAISED THE QUESTION OF THE DEGREE TO WHICH FOOD FOR DEVELOPMENT RESOURCES ARE INTEGRATED INTO THE MISSIONIS PROGRAM. THE MISSION STATED THAT, ALTHOUGH THE ROLE PL 480 RESOURCES PLAY IN THE MISSIONIS PROGRAM IS NOT TREATED IN EVERY ELEMENT OF THE ACTION PLAN, PL 480 PROGRAMS ARE COMPLETELY INTEGRATED INTO ITS APPROVED STRATEGIC OBJECTIVES. IN A SUPPLEMENTARY DOCUMENT

(DISTRIBUTED TO DR AND BHR/FFP AND WHICH WILL BE INCLUDED IN THE OFFICIAL ACTION PLAN FILE) THE MISSION DETAILED THE INTEGRATION OF THE PL 480 PROGRAM INTO ITS PROGRAM. BHR

EXPRESSED ITS SATISFACTION WITH THIS CLARIFICATION OF THE

PL 480 PROGRAMIS ROLE.

10. RENEWABLE ENERGY: IN THE ACTION PLAN THE MISSION REQUESTED ADDITIONAL RESOURCES SO THAT IT CAN COMPLETE FUNDING OF BOTH THE RENEWABLE ENERGY AND RURAL ELECTRIFICATION PORTIONS OF ITS ENERGY PROJECT. THE BUREAU ADVISED THAT IT HAS NO ADDITIONAL FUNDS TO RESPOND TO THIS REQUEST. SIMILARLY, THE GEF HAS NO MORE FY 94 FUNDING AVAILABLE. G/R&D/E IS FAVORABLY IMPRESSED WITH THE RENEWABLE ENERGY PROJECT, BUT ALSO HAS LIMITED FUNDING AVAILABLE. A G/R&D/E REPRESENTATIVE WILL VISIT BOLIVIA IN JUNE TO REVIEW POSSIBILITIES FOR COLLABORATION.

11. VOTER REGISTRATION AS A MEASURE OF POPULAR PARTICIPATION: GIVEN THE SUCCESS OF THE VOTER REGISTRATION PROGRAM, AND THE GOB'S AND AGENCY'S EMPHASIS ON LOCAL EMPOWERMENT, THE MISSION WILL NOW MOVE TO EMPHASIZE AND MEASURE OTHER ASPECTS OF POPULAR PARTICIPATION. WHILE THE MISSION WILL CONTINUE VOTER REGISTRATION ACTIVITIES FOR THE REMAINING ONE MILLION RURAL UNREGISTERED PEOPLE, VOTER REGISTRATION WILL BE DROPPED AS AN INDICATOR. THE NATIONAL ELECTORAL COURT WILL MONITOR VOTER REGISTRATION.

12. COUNTERNARCOTICS AND ALTERNATIVE DEVELOPMENT: TWO QUESTIONS WERE RAISED: 1) BY RESHAPING ITS STRATEGIC OBJECTIVES, IS USAID SIGNALLING A MOVE AWAY FROM ITS COMMITMENT TO THIS EFFORT? AND 2) IS FOLDING COUNTERNARCOTICS EFFORTS INTO THE ECONOMIC GROWTH OBJECTIVE APPROPRIATE? THE MISSION EXPLAINED THAT IT IS AS COMMITTED AS EVER TO THE SUSTAINABLE ALTERNATIVE DEVELOPMENT APPROACH OF CREATING JOBS AND INCOME THROUGHOUT THE BOLIVIAN ECONOMY AND REDUCING THE OVERALL MACROECONOMIC EFFECT OF COCA PRODUCTION AND TRAFFICKING, BUT THAT THE DRASTIC CUT THE BOLIVIA PROGRAM HAS TAKEN IN ESF RESOURCES MAKES IT IMPOSSIBLE TO CONSIDER THAT TRANSFORMATION OF THE ENTIRE BOLIVIAN ECONOMY IS WITHIN USAIDIS MANAGEABLE INTEREST. THE MISSION STILL HAS A MAJOR CONCENTRATION OF DEVELOPMENT RESOURCES IN ILLICIT COCA PRODUCING AREAS (COCHABAMBA), AND IS FULLY COMMITTED TO FOSTERING SUSTAINABLE DEVELOPMENT IN THE CHAPARE AND ASSOCIATED AREAS.

WITH RESPECT TO THE IMPACT OF ALTERNATIVE DEVELOPMENT EFFORTS ON ECONOMIC GROWTH, THE MISSION ARGUED THAT AN ECONOMY SIGNIFICANTLY RELIANT ON ILLICIT PRODUCTION, CANNOT, BY DEFINITION, BE CONSIDERED SUSTAINABLE. THE

MISSION INTENDS TO CONTINUE ITS PROGRAM IN THIS AREA AND WILL PURSUE THIS SUSTAINABLE ALTERNATIVE DEVELOPMENT COUNTRY WIDE, SUBJECT TO THE AVAILABILITY OF FUNDS. HENCE, IT MAINTAINS A PLACE IN THE OBJECTIVE TREE IN SUPPORT OF THE ECONOMIC GROWTH OBJECTIVE.

13. IMPROVED FAMILY HEALTH STRATEGIC OBJECTIVE: IT WAS POINTED OUT BY DR/HPN THAT THE STATEMENTS OF PROGRAM OUTPUTS UNDER THIS OBJECTIVE DO NOT LEAD DIRECTLY TO ACHIEVEMENT OF THE STRATEGIC OBJECTIVE OF IMPROVED HEALTH. IN CONVERSATIONS BETWEEN LAC/DR/HPN AND USAID/BOLIVIA POPULATION/HEALTH PERSONNEL OUTSIDE THE FORMAL REVIEW MEETINGS, USAID/ BOLIVIA AGREED THAT ACHIEVEMENT OF THE THREE PROGRAM OUTCOMES AS PRESENTLY STATED IN THE ACTION PLAN TOGETHER WILL LEAD TO THE STRATEGIC OBJECTIVE OF "IMPROVED FAMILY HEALTH" THROUGH AN INTERMEDIATE STAGE OF "INCREASED UTILIZATION OF HEALTH AND FAMILY PLANNING INTERVENTIONS". THIS INCREASED UTILIZATION LINKS THE PRESENT PROGRAM OUTCOMES WITH THE PROPOSED STRATEGIC OBJECTIVE. IT WAS AGREED THAT THE FAMILY HEALTH STRATEGIC OBJECTIVE TREE WILL BE REVISED TO REFLECT THIS RELATIONSHIP, AS DESCRIBED IN THE EHMER-DABBS MEMO OF MAY 17, 1994.

14. DECLINE IN NON-TRADITIONAL AGRICULTURAL EXPORTS: THE ACTION PLAN SHOWS A DROP IN EARNINGS FROM NON-TRADITIONAL AGRICULTURAL EXPORTS. THE MISSION EXPLAINED THAT SOME OF THE DROP WAS DUE TO A DETERIORATION IN THE TERMS OF TRADE, AND SOME FROM A CRACK-DOWN BY THE GOB ON OVER-INVOICING WHICH HAD INFLATED REPORTED EXPORT EARNINGS IN EARLIER YEARS. HOWEVER, THE VOLUME OF EXPORTS IS INCREASING AND THIS SHOULD LEAD TO HIGHER EARNINGS AS COMMODITY PRICES RECOVER ON WORLD MARKETS.

15. NEW ACTIVITY DESCRIPTIONS: THE FOLLOWING NEW ACTIVITY DESCRIPTIONS WERE REVIEWED BY THE DAEC.

PROJECT ACTION	PROJECT	LOP AMOUNT	RECOMMENDED
FY94			
511-0568	REPRODUCTIVE HEALTH SERVICES	40,300	APPROVE/DELEGATE
FY95			
511-0594	CBMMUNITY & CHILD HEALTH	26,000	APPROVE/DELEGATE

511-0634	DEMOCRATIC DEV. & CIT.	5,000	APPROVE/DELEGATE
511-0630	BALANCE OF PAYMENTS SUPPORT	18,000	APPROVE/USAID/W
N/A	PL 480 TITLE III	60,000	APPROVE/USAID/W
511-0637	MICRO-FINANCE	10,000	APPROVE/DELEGATE
FY96			
511-0636	TRAINING FOR SUST. DEVELOP.	5,000	APPROVE/DELEGATE
511-0638	INDIGENOUS RESOURCE MANAGEMENT	5,000	APPROVE/DELEGATE
511-0639	BALANCE OF PAYMENTS	30,000	APPROVE/USAID/W
N/A	PL480 TITLE II	20,000	APPROVE/USAID/W

NOTE: ALTHOUGH AUTHORITY TO DEVELOP AND APPROVE THE TRAINING FOR SUSTAINABLE DEVELOPMENT AND THE INDIGENOUS RESOURCE MANAGEMENT PROJECTS IS DELEGATED TO THE MISSION, FUNDING PRIORITIES WILL BE REVIEWED AGAIN NEXT YEAR.

BASED ON CONVERSATIONS BETWEEN LAC/DR/HPN AND MISSION PERSONNEL OUTSIDE THE FORMAL REVIEW PROCESS, THE FOLLOWING CLARIFICATIONS WERE OFFERED: FOR THE REPRODUCTIVE HEALTH PROJECT, CONSIDERATION WILL BE GIVEN TO MAKING THE INDICATORS FOR THE GOAL AND PURPOSE LEVELS PARALLEL TO THE INDICATORS FOR THE STRATEGIC OBJECTIVE AND PROGRAM OUTCOMES OF THE STRATEGY, ESPECIALLY USING CONTRACEPTIVE PREVALENCE AS AN INDICATOR OF THE GOAL, NOT THE PURPOSE LEVEL. FOR THE CHILD AND COMMUNITY HEALTH PROJECT, ACUTE RESPIRATORY INFECTIONS INTERVENTIONS WERE CONFIRMED TO BE A PART OF THE REVISED PROJECT.

16. PROGRAM BUDGET: THE CURRENTLY AVAILABLE DA BUDGET LEVELS FOR USAID/BOLIVIA ARE DOLS 19.598 MILLION IN FY 94 AND DOLS 29.16 MILLION IN FY 95. THESE LEVELS ARE CONSISTENT WITH THOSE REQUESTED IN THE ACTION PLAN, AS AMENDED PRIOR TO THE REVIEW. THE ESF LEVEL CURRENTLY EXPECTED TO BE AVAILABLE IN FY 94 DOLS IS 32 MILLION. DOLS 40.4 MILLION IS REQUESTED FOR FY 95. ANTICIPATED PL 480 TITLE II AVAILABILITY IS 22.055 MILLION IN BOTH FY 94

AND FY 95. THE BUDGETED FY 94 PL 480 TITLE III LEVEL IS
DOLS 20 MILLION. DOLS 7 MILLION OF PL 480 TITLE III IS
PLANNED FOR FY 95, ALTHOUGH AS DISCUSSED IN PARAGRAPH 9
ABOVE, THE BUREAU WILL SEEK ADDITIONAL TITLE III RESOURCES
FOR BOLIVIA.
CHRISTOPHER
BT
#2533

NNNN

To: Stephen Smith@TI.EXE@LAPAZ,James Watson@ETIO@QUITO
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Bcc:
From: Paul Weisenfeld@GC.SA2@AIDW
Subject: Equity for Micro Finance
Date: Wednesday, August 31, 1994 17:02:47 BOL
Attach:
Certify: N
Forwarded by:

Gentlemen -

Rich Rosenberg and Beth Rhyne asked me to respond to an inquiry from USAID/La Paz regarding the use of USAID grant funds to acquire equity in micro finance institutions. As I understand it, the proposal is to extend a grant to an NGO that would, in turn, use the grant funds to purchase shares of a Bolivian micro finance institution. The two concerns we've been asked to address are (1) whether there are any legal prohibitions on a grantee using USAID funds to acquire an equity interest in a financial intermediary, and (2) what tracking requirements apply to the use of the dollar funds.

(1) On the first issue, we agree with the analysis in the legal memoramdum prepared by Steve Allen, the former RLA from La Paz. Although USAID cannot directly acquire equity interests for its own account, there are no legal prohibitions on a grantee using USAID funds to acquire an equity interest in a micro finance institution. As noted in Steve Allen's memorandum, we think it would advisable to indicate clearly in the grant agreement and project documentation that the purpose of the grant is to allow the NGO to capitalize or strengthen the equity of the micro finance institutions.

(2) As long as the purpose of the grant is clearly stated as allowing the NGO to capitalize the financial intermediary, our opinion is that USAID/La Paz need not track the dollars beyond the acquisition of an equity interest in the financial intermediary, for the purpose of ensuring compliance with the host of legal and policy restrictions applicable to USAID funds (e.g., abortion equipment, citrus for export, luxury goods, pesticides, etc.). We've raised this issue with others in GC, and our experience is that IG audits focus on whether the purpose of the grant has been met and do not track dollar funds beyond the achievement of that purpose. If the purpose of the grant were to fund microloans, however, we believe the mission would have to track the dollar funds to each disbursement to a qualified borrower, and arguably to the use by each borrower.

Of course, these types of tracking requirments are entirely different from the monitoring and evaluation of the project's performance that the project manager deems appropriate. For instance, in order obtain data for project-level indicators, the project manager may require the NGO or micro finance institution to supply information on borrowers receiving micro loans.

One last point, its probably a good idea to deal with the issue of dividends and capital gains that will accrue to the NGO by virtue of their shares. We suggest including a provision in the grant agreement that says something along the following lines: consistent with the non-profit status of the NGO dividends accruing to the NGO shall be used for the agreed purposes of the grant.

Hope this is helpful.

Paul