527-157

5270159 (2)

UNCLASSIFIED

PD-AAB-415-B1

1921

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

PROJECT PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

PERU - RURAL DEVELOPMENT AGRIBUSINESS FUND

AID-DLC/P-2243

UNCLASSIFIED

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

UNCLASSIFIED

AID-DLC/P-2243

September 2, 1977

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Peru - Rural Development Agribusiness Fund

Attached for your review are recommendations for authorization of a loan to the Republic of Peru acting through the Central Reserve Bank of Peru ("Borrower") in an amount not to exceed Fifteen Million United States Dollars ($15,000,000) to assist in financing certain foreign exchange and local currency costs of goods and services required for the Rural Development Agribusiness Fund (the "Fund") consisting of a special rediscount facility within the Central Reserve Bank of Peru (the "Central Bank") for financing agribusiness loans (the "Project").

This loan is scheduled for consideration by the Development Loan Staff Committee on Friday, September 9, 1977, at 2:30 p.m., in Room 3886 New State. If you are a voting member a poll sheet has been enclosed for your response.

Development Loan Committee
Office of Development Program Review
and Evaluation

Attachments:
Summary and Recommendations
Project Analysis
Annexes I - XI

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT PAPER FACESHEET

1. TRANSACTION CODE: A (A = ADD, C = CHANGE, D = DELETE)

PP

2. DOCUMENT CODE: 3

3. COUNTRY ENTITY: PERU

4. DOCUMENT REVISION NUMBER:

5. PROJECT NUMBER (7 digits): 527-0159

6. BUREAU/OFFICE: A. SYMBOL: LA; B. CODE: 05

7. PROJECT TITLE (Maximum 40 characters): Rural Development Agribusiness Fund

8. ESTIMATED FY OF PROJECT COMPLETION: 81

9. ESTIMATED DATE OF OBLIGATION: A. INITIAL FY 77; B. QUARTER 4; C. FINAL FY 77 (Enter 1, 2, 3, or 4)

10. ESTIMATED COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY B. FX	FIRST FY C. L/C	FIRST FY D. TOTAL	LIFE OF PROJECT E. FX	LIFE OF PROJECT F. L/C	LIFE OF PROJECT G. TOTAL
AID APPROPRIATED TOTAL	4,600	10,400	15,000	4,600	10,400	15,000
(GRANT)	( )	( )	( )	( )	( )	( )
(LOAN)	(4,600)	(10,400)	(15,000)	(4,600)	(10,400)	(15,000)
OTHER U.S. 1.						
OTHER U.S. 2.						
HOST COUNTRY		11,000	11,000		11,000	11,000
OTHER DONOR(S)						
TOTALS	4,600	21,400	26,000		21,400	26,000

11. PROPOSED BUDGET APPROPRIATED FUNDS ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE C. GRANT	PRIMARY TECH. CODE D. LOAN	E. 1ST FY ___ F. GRANT	E. 1ST FY ___ G. LOAN	H. 2ND FY ___ I. GRANT	H. 2ND FY ___ J. LOAN	K. 3RD FY ___ L. GRANT	K. 3RD FY ___ M. LOAN
(1) FN	130		010		15,000				
(2)									
(3)									
(4)									
TOTALS					15,000				

A. APPROPRIATION	N. 4TH FY ___ O. GRANT	N. 4TH FY ___ P. LOAN	Q. 5TH FY ___ R. GRANT	Q. 5TH FY ___ S. LOAN	LIFE OF PROJECT T. GRANT	LIFE OF PROJECT U. LOAN
(1)						15,000
(2)						
(3)						
(4)						
TOTALS						15,000

12. IN-DEPTH EVALUATION SCHEDULED: MM 01 YY 79

13. DATA CHANGE INDICATOR. WERE CHANGES MADE IN THE PID FACESHEET DATA, BLOCKS 12, 13, 14, OR 15 OR IN PRP FACESHEET DATA, BLOCK 12? IF YES, ATTACH CHANGED PID FACESHEET.

1 (1 = NO, 2 = YES)

14. ORIGINATING OFFICE CLEARANCE

SIGNATURE: Leonard Yaeger

TITLE: Mission Director

DATE SIGNED: MM DD YY

15. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM 08 DD 08 YY 77

AID 1330-4 (3-76)

RURAL DEVELOPMENT AGRIBUSINESS FUND

PROJECT PAPER

TABLE OF CONTENTS

Page

ANEXES

I. Application Letter
II. Draft Authorization
III. Director's 611 (e) Certification
IV. Statutory Checklist
V. Logical Framework
VI. Description of Financial System
VII. Screening Criteria

Exhibit A: Initial Impact Determination
Exhibit B: Project Impact Assessment

VIII. Peruvian Consulting Firms
IX. Demand Study
X. Three Model Sub-projects Demonstrating Benefits to Small Farmers
XI. Synopsis of Additional Sub-projects Currently Requiring Investment.

I. SUMMARY AND RECOMMENDATIONS

1. Borrower

The Borrower will be the Central Reserve Bank of Peru. Implementation of the Project will be carried out by a Special Unit within the Bank charged with promotion and execution of the Rural Development Agribusiness Fund.

2. Amount and Terms of Loan

The loan will not exceed $15.0 million, to be disbursed over a four and one half year period from the date of signature of the loan agreement. Authorization of the loan is requested for a 20-year amortization period including a 7-year grace period, with interest at 2% during the grace period and at 3% thereafter.

3. Goals and Purposes of the Project

The goal of the Project is to increase food production, employment and incomes of the rural poor, and improve nutrition.

To further this goal, the purposes of the Project are:

i) To establish in the Central Bank a facility for rediscounting loans made by financial institutions to sub-borrowers which process or market agricultural products or provide complementary goods and services to the agricultural sector;

ii) To establish a program of promotion and development of such agribusiness, including appropriate technical assistance, which will maximize benefits to small farmers and the rural poor.

The Project will be directed towards stimulating the role of intermediate credit institutions in the development of a viable agribusiness sector. The development of agribusiness is seen as an effective way of alleviating four basic constraints to increased employment and income levels in the agricultural sector. The four major constraints identified by USAID and the Bank are: (i) inadequate marketing facilities; (ii) inadequate processing facilities; (iii) inadequate goods and services input industries, and (iv) incomplete agribusiness system linkages.

Potential sub-projects will be reviewed to determine the linkages between the proposed activity and these constraints. Sub-project eligibility criteria have also been developed to ensure benefit incidence upon AID's target group.

4. Background of the Project

The Agrarian Reform process in Peru has substantially modified the structure of the agricultural sector, by dissolving the latifundista system and adjudicating land to associative enterprises, while at the same time preserving the integrity of small farms. The first years of the Agrarian Reform were disruptive of the traditional agricultural system, and were accompanied by decreases in production and severe decapitalization of the rural sector. In recent years productivity has recovered, but the sector still is insufficiently capitalized to allow farmers to reach their productive potential.

The lack of medium to long term capital has hampered the growth of agribusiness linkages which would provide incentives to increase production and effect shifts into higher value crops. As presently constituted, the commercial banking system is not able to provide medium and long term credits for financing agribusiness activities. Through the establishment of a Rural Development Agribusiness Fund rediscount mechanism in the Central Bank, the Project will be directed toward eliminating a major bottleneck to increased rural employment and income.

A.I.D. has financed rural development projects in Peru in the past and is currently implementing several projects directed towards specific rural area problems, all of which strive toward the attainment of the common sectoral goal of increased production, incomes, and employment opportunities for the rural poor. The bulk of the Mission's programs are oriented toward alleviating technological and management constraints faced by small farmers and associative enterprises in the production process. These projects include Sierra Water and Land Use, Corn and Soy Production on Small Farms, Agricultural Cooperative Federations Development, Treated Sewerage, Fresh Water Fisheries, the CENCIRA training project, and the proposed FY 78 Small Farmer Production Technology and Sub-Tropical Lands Development loans. The Project will complement these activities by focusing on other elements within the agribusiness system, addressing the constraints of inadequate facilities for the processing and marketing of agricultural production. Such constraints are already severe and likely to worsen once GOP production programs including those supported by A.I.D. as well as the other donors' on-farm agricultural credit programs begin to result in an increased production pay-off. The Project committee therefore feels that the proposed Rural Development Agribusiness Fund can provide important complementary linkages to other on-going A.I.D. financed programs.

5. Project Description

The strategy of the proposed Project is to alleviate major barriers, including the availability of medium-to long-term credit, technical assistance and promotion, to the development of agribusiness enterprises in Peru which have a direct linkage to small farmers and associative enterprises created under the Peruvian Agrarian Reform. In selecting an agribusiness strategy, the Mission has been influenced by the following three factors: i) the present gap between need and GOP and other donor activity oriented toward this critical area; ii) the existence of conditions faced by A.I.D.'s target group that could be alleviated through agribusiness development; and iii) the Project's propitious timing, given recent policy changes which have reduced constraints to agribusiness development in Peru.

The Project will establish a rediscount mechanism, the Rural Development Agribusiness Fund, to finance agribusiness sub-projects meeting eligibility criteria through the banking system. The Project's target group of small farmers and associative enterprises created under the Agrarian Reform will benefit as a result of sub-loans made to agri-businesses providing marketing, processing, or goods and services to the target group. The Project aims at increasing target group income, institutionalizing a new credit channel, stimulating bank participation in agribusiness development lending, and achieving a greater out-reach to rural areas by incorporating existing banking infrastructure as suppliers of credit for rural development.

The capitalization of the Rural Development Agribusiness Fund will/be $19.6 million. A Special Unit staffed with a full-time professional staff will be charged with implementation and $0.3 million of loan funds will be available for technical assistance to the Unit.

Credits from the Fund will be rediscounted through the Peruvian banking system (commercial banks, regional and state development banks and private financieras) at an initial 90:10 ratio for financing sub-projects which are designed to alleviate one or more of the four basic identified constraints to increased agricultural productivity, and which demonstrate through an Initial Impact Determination a direct and quantifiable impact on A.I.D.'s target group of rural poor.

The following outputs are anticipated under the Project: i) at least $19.6 million of investments financed by the Rural Development Agribusiness Fund over the Project's life; ii) approximately 9-12 ICIs participating in agribusiness lending under the program; iii) sub-lending directives (the Credit Manual) distributed and periodically revised; iv) promotional seminars held in all of Peru's departments reaching ICI branch office managers; and iv) a project promotion and evaluation system established. Such outputs are necessary to achieve the Project's purpose of establishing an effective, permanent rediscounting facility and a program of promotion and development of agribusinesses which benefit the rural poor. At the end of the Project we would expect that all Project funds will have been placed in sub-projects meeting eligibility criteria, the Fund will be institutionalized with a demonstrated capacity to maintain its level of refinancing, the real capital value of the Fund will be equal to at least $19.6 million, and the Fund will continue as an effective and functioning system to identify, promote, and finance eligible sub-projects.

6. Financial Plan

The estimated total cost of the program is $26.0 million, of which $15.0 million will be provided by the A.I.D. loan. The A.I.D. contribution includes $14.7 million which will be utilized for the capitalization of the Rural Development Agribusiness Fund, and $0.3 million for technical assistance to the Special Unit of the Central Bank. The Central Bank will contribute $4.9 million to the Fund's capitalization, and $0.1 million for start-up administrative expenses of the Special Unit. In addition, participating intermediate credit institutions will provide an estimated $2.2 million, and sub-borrowers will contribute approximately $3.8 million.

7. Alternative Sources of Financing

The Ex-Im Bank, IBRD and IDB have expressed no interest in financing this Project.

8. Statutory Criteria

All Statutory Criteria have been fulfilled (See Annex IV).

9. Issue: Justification of Loan Amount

The PRP and Interim Report recommended a loan in the amount of $10.0 million, of which $200,000 would be utilized for technical assistance. It was anticipated that the Fund would be disbursed over a three and one half year period (including a six month start up period).

The demand study, carried out by USAID, GAMCO and the Bank, for sub-loan financing showed a far higher demand than was originally anticipated. Due to the lack of medium and long term capital currently available to potential agribusiness sub-borrowers, a backlog of unfinanced projects exists. The "ready-to-go" category in Annex IX, Exhibit A, shows up to $6.4 million in projects which could be implemented in the near future, and since the demand study covered a very limited geographic area, it is expected that once the Bank begins its promotion campaign the "ready-to-go" category could be significantly increased.

Exhibits B and C of Annex IX give preliminary estimates of potential sub-project demand in categories requiring further study to determine whether the proposed enterprises would meet eligibility criteria. Total amount projected in these categories is approximately $28.0 million. The demand study, on a limited sample basis, has thus identified over $34.0 million of funding requirements for potential sub-projects. In the view of the Project Committee, this justifies the revised funding level for the program.

Moreover, the additional funding will contribute to the institutionalization of the Fund, and the Fund's ability to meet a higher percentage of agribusiness demand beyond the disbursement period of the A.I.D. loan. Because of the existence of grace periods on Fund sub-loans, reflows to the Fund under the original assumptions would have been low immediately following full disbursement of the program's resources, particularly in the fourth year of operations. The added injection of capital in the fourth year will permit much greater sub-lending activity in that year, and by year five the magnitude of reflows will be adequate to carry-on a meaningful sub-lending program. The additional resources should thus contribute to the maintenance of the Fund's momentum and to the probabilities that the Fund will have its desired, long-range institutional impact.

10. Recommendations

Based on the analysis contained in the Project Paper, the Project Committee has concluded that the Project is technically, financially, socially, and economically sound, and recommends authorization of a loan in an amount not to exceed $15.0 million.

11. Project Committee:

Chairman	:	Carl H. Leonard, USAID/Peru - ODR
Loan Officer	:	Edward L. Howard, USAID/Peru - CAP
Financial Analysts	:	Harold W. Collamer, USAID/Peru - CON Cesar Espino, USAID/Peru - CON Aurelio Tasso, USAID/Peru - CON
Economists	:	Janet C. Ballantyne, LA/DR Robert Adler - ECON
Legal Advisor	:	Charles Costello - RLA
USAID Approval	:	Leonard Yaeger, USAID/Peru - D

II. Project Background and Detailed Description

A. Background

1. Introduction

In the FY 1978 Annual Budget Submission, the Mission submitted a PID for a proposed A.I.D. loan-financed project to establish in the Central Bank of Peru a facility for rediscounting loans made by financial institutions to sub-borrowers which produce, process or market agricultural products or provide complementary services to the agricultural sector. The PID was approved in August 1976 and the PRP was submitted in October 1976. In reviewing the PRP, the DAEC raised a series of questions pertaining to the project design and asked that these be treated in an interim report. In the course of analyzing the DAEC issues, particularly with regard to the effective demand for project sub-loans by various groups and the credit supply situation including other donor initiatives, the Mission and GOP reevaluated project components identified in the PRP and concluded that some redesign was required in order for the Project to respond best to unsatisfied effective demand. Basically, it was concluded that the Project would fill a needed gap through an agri-business focus -- that is, a sub-lending program to industries processing and marketing the output of the sector. Accordingly, one of the categories of sub-lending contemplated in the PRP -- credits to small farmers for on-farm improvements for crop production -- was dropped from the program. The interim report was submitted and approved by Washington in May 1977.

The following background sections provide an overview of the agricultural sector, constraints faced by the target group, the rationale for the agribusiness strategy, a summary of the studies undertaken in developing the Project, and a discussion of the relationship of the Project to A.I.D. priorities and other Mission programs.

2. Agricultural Sector Overview

a. Recent Growth

In recent years the performance of the agricultural sector has been poor; in 1975, the sector grew at the rate of only 0.6%, compared to 2.3% and 2.4% in 1974 and 1973 respectively. While the sector still employs about 42% of the country's labor force, its contribution to total GDP has been decreasing, from 20% in 1960, to 15% in 1969, to 12.7% in 1975. The average annual sectoral growth rate of 1.8% for the 1973-1975 period contrasts with an overall GDP growth rate of 5.3% for the same period and a population growth rate of 3.1%. Domestic production of basic food items has failed to keep pace with the high population growth. This situation, combined with growing demand for food resulting from increasing disposable incomes among the low economic class in cities, has forced Peru to import increasing amounts of food, thus adding to an already deteriorated balance-of-payments position.

b. GOP Agrarian Reform Program

During the past eight years, the GOP has implemented one of the most extensive agrarian reform programs ever undertaken in South America. The program is an attempt to implement broad structural changes in the agricultural sector of Peru, changing the traditional land ownership patterns and thereby incorporating previously landless peasants into the economic and social life of the country.

Prior to 1969 one percent of the landowners in Peru controlled approximately 85% of the scarce agricultural land. These large landholders used their collective economic influence to gain a substantial degree of political power which influenced previous political regimes against enacting any sort of effective reform in the agrarian sector. The rural population remained landless and thereby isolated from any real economic and social participation in society under this system. The Agrarian Reform Law of 1969 has profoundly altered the former system, and seeks to effect a new distribution of power to those who work the land while, at the same time, bringing about increases in agricultural production over the medium to long-run.

Under the Agrarian Reform program, owner-operated holdings on irrigated coastal cultivable land must not exceed 50 hectares in size, and in the highlands 30 irrigated hectares. 1/ Holdings of natural pastures are restricted to units sufficient to support 3,000 head of sheep or the equivalent. Farms in excess of these maximum limits are being expropriated, and primarily distributed to previously landless farm workers.

The Peruvian Agrarian Reform has been designed to encompass more than just redistribution of land to workers; it is also conceived as a long-range process in which the rural population will be accommodated in the socio-economic life of the country. A major problem facing Latin America is the assimilation of the rural poor

---

1/ Per the 1969 Law, the original limits were 150 hectares on the coast and 55 hectares in the sierra. These were reduced by Decree Law 21333 of December 1975.

whose condition has traditionally been one of economic insecurity. The Agrarian Reform seeks to provide security on the land by incorporating previously landless workers into the ownership structure of productive enterprises, and providing mechanisms for the building up of equity in such enterprises.

Redistribution of land and the creation of worker-based associative enterprises has now largely been completed. As of December 1976, 8.7 million hectares representing 13,493 farms had been expropriated and taken over from the prior owners. Of this amount at that date, 7.04 million hectares had already been formally transferred from the State to approximately 295,000 farm families or roughly 1.5 million people. 98% of the land transferred has been assigned to 275,000 farm families organized into 1,377 associative enterprises, and 2% has been transferred to approximately 20,000 individual farmers. Land distribution is scheduled for completion this year on the remaining 200 coastal farms and 2,800 sierra and high jungle farms that exceed the maximum established limits. An additional 100,000 families (0.5 million people) are expected to benefit from these transfers. The GOP has also recently begun to assure the land titles to those not affected by the land reform and has begun the process of consolidation and development of the agricultural sector to raise production, especially of food products, and employment.

c. Constraints

The general disruptive atmosphere which can normally be expected to accompany massive land transfers and prior price policies which acted as a disincentive to domestic production may be cited as two factors which contributed to poor production performance in recent years. The practice of keeping the prices of basic food products relatively low has been eliminated, and, recognizing the need to stimulate production of staple commodities, the GOP has consistently raised support prices, Major upward price adjustments of foodstuffs occurred in July 1975, January 1976, June 1976, and March 1977, thereby restoring production incentives. Concerning the Agrarian Reform, the latifundia -- which impeded the economic utilization of available agricultural resources and labor -- have now been eliminated. Since the distributive phase of the reform is nearly completed, the disruption and uncertainties generated by the reform also have been reduced.

Nevertheless, serious constraints remain. A fundamental problem is the poor quality of land resources manifested in an extreme scarcity of cultivable land. Of the country's total land area of approximately 128.5 million hectares, only about 3% or 3.7 million hectares is under cultivation (including fallow lands), while 12%, or 15.1 million hectares represents natural pasture. The rest of the land area includes forests, jungle, mountains and desert. As a result only about 0.38 hectares of farmland are available per rural person and 0.18 hectares per inhabitant, the lowest ratios in all of Latin America. Harsh topographic and climatic conditions inhibit the expansion of the amount of arable land. While vast amounts of unutilized land are available in the jungle and high jungle, efforts to develop these areas must await the completion of land transportation routes, and, in addition, great differences in agro-economic potential exist among jungle regions. Expansion of land on the coast is very expensive, although the GOP is supporting the development of a number of large scale coastal irrigation projects. Some marginal increases in cultivable land in the sierra can be obtained through improvements in irrigation facilities and technological developments to reduce the time that land must lie idle.

Further constraints to increased production and income are imposed by low levels of technology, the low average level of farm management skills, and scarcity of physical infrastructure. Farm families, particularly in the sierra and high jungle, use primitive agricultural techniques with the result that very little surplus is available for sale after immediate family requirements are met. Factors of production in current use by most Peruvian farmers are minimal: unimproved seed from year to year, a depleted soil which must be fallowed regularly to restore a minimum fertility, and hand labor and animal power. Dependence on traditional farming methods is both a function of limited technical knowledge and an unreliable and fragmented system of delivering agricultural inputs to the end-user.

Difficult communications -- e.g., scarcity of all-weather roads, limitations of mountainous roads whose use is often interrupted by landslides, and the great distances that separate the widely scattered productive valleys -- contribute to a continued, low level of production technology. Government efforts to provide technical assistance to these farmers have been greatly reduced in efficiency in recent years as the extension service has been utilized heavily for agrarian reform activities. High operating costs due to communications difficulties for extension services and a general scarcity of trained extension personnel due to low salaries and budget constraints have led to a dearth of technical assistance for farmers.

The supply of short-term production credit provided by the Agrarian Bank has increased significantly in recent years (at an estimated real rate of 23% in 1973, 21% in 1974, and 34% in 1975) and the Bank is making concerted efforts to improve the timeliness of its delivery. However, a basic constraint to increasing production (and improving marketing) is the inadequate Prob supply of medium-to-long term credit for on-farm improvement, equipment, storage facilities, etc. The needs for such credit are large in light of the heavy decapitalization which occurred in the sector due to the agrarian reform; former landowners, in anticipation of expropriation, sold fixed assets and deferred ordinary maintenance. Pent-up demand exists due to the fact that the expropriation process is virtually completed and land titles have been validated for many eligible independent farmers, enabling them to now plan their production activities and invest in on-farm improvements. Moreover, the new associative enterprises have completed their formation stage, and are now entering a phase of consolidation and development, including the implementation of longer-term investment programs.

Final constraints are incomplete linkages within agribusiness systems and the absence of adequate physical infrastructure for the processing and marketing of agricultural production. Rural collection centers are almost totally inadequate, making it necessary for producers to seek out itinerant truckers who serve the areas as outlets for surplus production, or to sell in small lots to hundreds of small, part-time buyers. The present system is costly, owing largely to high spoilage losses and transport cost, Inadequate market information and lack of competition among local buyers contribute to pricing inefficiencies which operate to the disadvantage of the small producer and raise consumer prices as well. The lack of processing capacity for many commodities has prevented the expanded production of profitable crops and has resulted in foregone off-farm employment opportunities for Peru's rural population. Storage facilities that would reduce losses and eliminate peaks and valleys in the supply of various commodities are also lacking and represent a serious constraint to production and efficiency. For other commodities, inadequate agribusiness linkages inhibit the flow of quality produce from small farmers to existing agro-industries. Since the Agrarian Reform, agro-industries no longer engage in the cultivation process but rather entirely rely on receipt of appropriate raw materials from the rural sector. In some agro-industries, existing plant capacity is underutilized due to an inability to obtain sufficient quantities and proper qualities of raw materials. Financing constraints have precluded these agribusinesses from establishing contractual relationships with producers that would benefit small producers by stabilizing markets and offering credit and technical assistance and processors by stabilizing the raw material supply and improving quality.

A major consequence of all of the above constraints is the high rate of rural underemployment and consequent low income levels in the agricultural sector. The inability of the agricultural sector to absorb natural population increases, the extremely high inhabitant/land ratios, and the few off-farm employment opportunities are factors which have contributed to the heavy outmigration from rural areas to secondary and primary cities. Migration, on the other hand, has been accompanied by a dichotomous problem: (i) on the one hand outmigration from rural areas has not proceeded rapidly enough to alleviate population pressures on the land, and despite the heavy flow into urban areas the high natural growth rate of the population has had the effect of stabilizing the actual numbers of rural dwellers; (ii) on the other hand, the receptive capacity of urban areas has reached the saturation point in the majority of Peru's cities, and further increases in population as a result of inmigration, at this point, only exacerbate urban unemployment, the growth of satellite pueblos jovenes and consequent social unrest.

GEAR, a special study unit created in the Ministry of Industry and Tourism to study and implement measures to generate employment in rural areas, has estimated that two-thirds of the agricultural labor force in Peru is underemployed. Table I shows the income consequences of this high level of underemployment.

TABLE I

FAMILY INCOME LEVELS BY GEOGRAPHIC REGION, URBAN AND RURAL
(in U.S. dollars)

Region \ Area	Urban	Rural	Weighted Average
Lima Metro.	$1815	-	$1815
Coast	1061	584	876
Sierra	753	261	370
Jungle	1015	523	
Total Area	861	340	785

SOURCE: Preliminary Report "Agricultura y Alimentación"

Income disparities are most notable between urban and rural areas, the total average urban income being over two and a half times that in rural areas. Among rural areas, the sierra is by far the most economically depressed, with average incomes registering less than half of those in rural jungle and coastal areas.

d. Agricultural Policy and GOP Actions

In the past year, a series of incentives has been implemented by the GOP to stimulate agricultural production. The increase in farm prices and the new pricing policy have previously been mentioned. In addition, the major exchange devaluations (78% since June 1976) have caused significant price increases for imported grains, thereby providing a relative price advantage to local producers.

In support of the Ministry of Food's extension efforts, a new National Production System has been established by law. Briefly, it seeks to revitalize the extension system and unite producer groups and technicians of the Ministry of Food in a series of production committees from the local to the national level. The system is developing a national production plan which will influence the allocation of resources, including credit and technical assistance.

GOP development policy places highest priority on improving income distribution and integrating the country's rural population into the national economy through various programs designed to support and stimulate economic activities in rural areas. Consolidation of the agrarian reform, industrial decentralization, provision of basic social services and economic infrastructure, the development of natural resources in rural areas, the promotion of rural industries and tourism all aimed at reducing unemployment are among priority activities articulated in recent planning documents oriented toward the rural areas.

The GOP's 1975-78 Agricultural Plan further specifies priorities for agricultural development as follows: (i) consolidation of the Agrarian Reform with the view of improving the organization and administration of the established associative enterprises; (ii) establishment of the national production system, vertically integrated from national to regional to local levels, with the view of better channeling available inputs to meet specific crop production targets; (iii) the incorporation of new lands for agricultural uses through colonization and irrigation projects; and (iv) the improvement of the marketing system by facilitating the establishment of rural collection centers, silos, warehouses, and processing facilities to assure regular production flows and more stable prices. Recent pronouncements also stress the need to maintain adequate production incentives and to give priority to projects with a short-term production pay-off, to projects which will produce basic inputs and needed staples (foodstuffs), and projects which will integrate the production structure.

e. <u>Other Donor Activity</u>

Indicative of its commitment to agricultural and rural development, the GOP has invested substantial sums of internal and externally borrowed funds in rural infrastructure, particularly roads and irrigation. Other donor support for these activities has included loans from the IDB, IBRD, Germany, England, and Yugoslavia.

In the field of agricultural credit, both the IDB and IBRD have on-going and new programs to assist in the recapitalization of farm production units. The IDB's Loan No. 322 for agricultural credit, which was executed in June 1972 in the amount of

$12.0 million, is now nearly fully disbursed. To continue its support, the IDB has just authorized a new loan for agricultural credit in the amount of $30.0 million. $20.0 million of the new IDB loan would be relent by the Agrarian Bank to an estimated 75 associative enterprises for the following purposes: (i) on-farm installations for increasing production; (ii) the planting of perennials; (iii) land preparation and on-farm irrigation; (iv) livestock acquisition; and (v) the purchase of agricultural machinery. $10.0 million would be utilized for supervised agricultural credit for production purposes to the beneficiaries of the 12 irrigation zones developed with the assistance of the IDB's linea global (loan No. 277).

The IBRD also is providing credit to the agricultural sector. IBRD Loan No. 933, in the amount of $25 million, was initiated in September 1973 for financing medium and long-term credits through the Agrarian Bank to associative enterprises and individual farmers. The loan is expected to be fully disbursed by the end of 1977, and the World Bank is now appraising a new loan for similar purposes to help meet the large projected needs for longer-term agricultural credit through 1980. The new loan would be on the order of $30.0 million, with a portion earmarked for use by the coastal sugar estates.

3. Strategy of the Project

a. Strategy Statement

The strategy of the proposed Project is to alleviate major barriers, including the availability of medium-to long-term credit, technical assistance and promotion, to the development of agribusiness enterprises in Peru which have a direct linkage to small farmers and associative enterprises created under the Peruvian Agrarian Reform.

b. Target Group Definition

Through the development of agribusinesses, the Project is designed to benefit a target group of individual small farmers and members of associative enterprises created under the Agrarian Reform. The more profitable, export - oriented farmers and associative enterprises producing cotton and sugar are excluded from the target group, and agribusinesses serving this sub-sector will not be financed. A developed agribusiness sector is expected to create linkages which will benefit the target group by providing services and inputs required for increased production.

By specifically excluding the handful of "large" farms which exceed the maximum limits established by the Agrarian

Reform, the limited number of "medium -sized" farms (generally those consisting of 20 - 50 hectares of cultivable land), and the more profitable and commercially oriented sugar and cotton producers, the project will focus on the small farmer sector in Peru which includes some 900,000 farm families. Of these, approximately 240,000 are members of associative enterprises created under the Agrarian Reform. These farmers are distributed throughout both the coast and sierra of Peru, with the Agrarian Production Cooperative (CAP) mode of organization predominating on the coast and the Sociedades Agricolas de Interes Social (SAIS) common in the sierra. Holdings of cultivable land per member of these associative enterprises ranges from two to ten hectares. In addition, the sierra enterprises usually possess large expanses of marginal land suitable only for livestock grazing. Per capita incomes of members of the associative enterprises range from roughly \$70 to \$200.

Concerning independent small farmers, the vast majority (approximately 500,000), are located in the sierra. The bulk of these are minifundistas, owning and cultivating less than 5 hectares. Per capita incomes average only \$50. An additional 100,000 small independent farmers are found on the coast, and approximately 60,000 have settled in the high jungle area to the east of the Peruvian Andes. Per capita incomes of the coastal and high jungle small farmers are higher than their sierra counterparts, averaging approximately \$100.

In addition to low incomes, small farmers in Peru face difficult living conditions and the quality of life is generally low. Infrastructure works such as electricity, potable water, and sewage system exist only in urban centers, and rural housing consists of one or two room units, with adobe walls and earthen floors. Dietary patterns of the small farmers are closely allied to their family practices. Food staples include tubers and cereals - items such as meat and animal by-products are less frequently eaten, because of the tendency to market animal foodstuffs. Health status is low, due to substandard diet and poor environmental conditions.

The lack of efficient agribusiness enterprises in Peru (e.g., agricultural marketing, processing and service industries) has been identified as one of the constraints to increased small farmer production. Without adequate transportation, processing, packing, storage, etc. and appropriate agricultural inputs, the market for small producers is unstable and insecure. By assisting with agribusiness development, potential benefits which could be derived from the Project include: provision of a convenient and orderly market for small farm production; greater stability in prices; reduced spoilage, wastage and loss associated with unprocessed produce; reduction in bulk, thus facilitating distribution and contribution of added value; conservation and concentration of nutritional values; and increased supplies, lower costs, and improved delivery of agricultural inputs. Taken together these benefits are expected to create the incentives necessary to increase small farmer production and, therefore, profitability and income. In addition, agribusiness can also generate off-farm employment opportunities since many processing activities are labor intensive.

c. Rationale for Agribusiness Focus

In selecting an agribusiness strategy, the Mission has been influenced by the following three factors: (i) the present gap between need and GOP and other donor activity oriented toward this critical area; (ii) the existence of conditions faced by A.I.D's target group that could be alleviated through agribusiness development; and (iii) the Project's propitious timing, given recent policy changes which have reduced constraints to agribusiness development in Peru.

The amount of credit channeled toward rural areas and activities associated with agriculture in Peru at the present time is severely limited. The scarcity of credit available for such activities represents a serious barrier to the improvement of incomes of the rural poor. The needs for such credit are large, particularly in light of the decapitalization which has occurred throughout the agricultural sector since the late 1960's as a result of the Agrarian Reform. Former land-holders severely decapitalized their holdings, and the new associative enterprises created as a result of the Agrarian Reform generally did not have sufficient resources to recapitalize. Recently, external resources such as the previously mentioned IBD and IBRD loans for on-farm improvements have helped to alleviate some of the problems this has created. There are, however, additional critical areas and linkages to the sector which must be developed if productivity on Peru's limited land base and rural incomes are to improve. The other donors' credit programs are oriented toward on-farm investment programs to restore and improve the production potential of Peruvian farms, leaving the important gap of inadequate credit for agribusinesses (industries providing goods and services to the sector and processing or marketing output of the sector) to be filled.

Secondly, improvements in the marketing of products produced by A.I.D's target group clearly are needed. Wastage, losses and spoilage of raw material foods grown by small farmers occur due to lack of adequate facilities for storage and processing. Because of transport costs and perishability, marketing of produce is sometimes feasible only in processed form. Agro-industry is seen as an important mechanism to raise incomes and promote development in rural areas given the ability of agro-industries to provide a stable outlet and thereby reduce marketing uncertainties for raw materials. The promotion of investments in industries which have direct linkages with the agricultural sector may also provide new opportunities to increase rural incomes by promoting the integration of the rural sector with key sectors of the economy. Opportunities for increasing rural incomes are likely to remain limited until stronger economic linkages are achieved between the rural and urban sector and among complementary components of the rural sector.

Concerning the Project's timing, the GOP has largely completed implementation of the basic changes in the pattern of economic development which have been designed to link economic growth with a broader participation of the population in the country's economic, social and political life. Understandably, such basic structural changes as the Agrarian Reform have resulted in uncertainty. For industrial establishments serving the sector this uncertainty, manifested in a hesitancy to invest in modernization programs and new ventures, has been compounded by industrial structural reforms promulgated in recent years such as the industrial community (1970) and social property (1974) legislation. Recently, the GOP has gone a long way toward countering the negative features of previous policies. At present, priority is given to increasing efficiency in the productive systems, and extensive efforts to restore confidence and dynamism in the private sector are being made. The industrial community legislation was greatly modified in early 1977, with the result that the present owners will be guaranteed managerial control of their enterprises. 1/ Social property development is still supported but no more as the foremost priority sector, and it is to

---

1/ The original industrial community legislation provided for the transfer of a specified portion of annual profits of private companies to their workers in the form of shares until the workers acquired 50% of the firm's capital, and a corresponding number of seats on the Board of Directors. Workers also received an additional 10% of profits in cash. The effect of the new law is to limit distribution of profits to one-third of the share capital in the form of special stocks which would still allow for Board representation but would leave managerial control to the common stockholders.

TABLE II

Constraints to Increased Agricultural Sector Productivity and Rural Prosperity

Constraints	Manifestation	Consequences	Type of Sub-Projects Envisioned
1. Inadequate Marketing Facilities	Lack of storage facilities; inadequate farm to market transportation; lack of packing, sorting, grading, equipment, and refrigeration facilities, etc.	Lack of incentives to increase production of perishables (e.g. meat and milk) in most areas outside of area of influence of major markets; uneven product flows and market instability.	Rural collection centers (packing, sorting, refrigeration units); output warehouses; transportation facilities; slaughter houses; etc.
2. Inadequate Processing Available	Lack of processing facilities for agricultural production and raw materials produced in rural sector.	Low level of value added to agricultural sector; insecurity of markets during harvest season; spoilage high; low unit prices to producers; loss of by-products; lack of incentives to expand land under production.	Canning industries; creameries; freeze-drying facilities; oil extraction plants; soap factories, etc.
3. Inadequate Goods and Services Input Industries	Lack of input warehouses, transport facilities, machinery pools, local manufacturers of agricultural tools and appropriate equipment, suppliers of improved seeds, pesticides, and balanced feeds.	Low productivity especially in remote areas; inability to achieve economies of scale through service centers designed to serve specific geographic areas; reliance on traditional technologies.	Small transport cooperatives or companies; machinery pools; local manufacture of implements and distribution of agricultural inputs, etc.
4. Incomplete Agribusiness System Linkages	Lack of proper quality and quantities of raw materials for certain agro-industries; breakdown in product flows from producer to processor dating from Agrarian Reform.	Bottlenecks to agro-industrial expansion and foregone rural income and employment opportunities.	Manufactures of inputs (crates, sacks) for agro-industry; contractual arrangements between processors and small producers to deliver technical assistance and improve product quality and assure sufficient quantities.

compete with the private sector on equal terms. With the elimination of these basic policy constraints to agro-industrial development, a development strategy with an agribusiness element is considered timely and appropriate.

d. Constraints to be Addressed

Table II lists four major constraints which have been created or aggravated by agriculture sector decapitalization, along with the situations which have resulted from the various constraints. The major constraints are: (i) inadequate marketing facilities; (ii) lack of agro-industrial processing facilities; (iii) unrealiable goods and service input industries; and (iv) incomplete linkages within agribusiness systems.

4. Studies Undertaken to Develop Project

The evolution of the Project through the PID, PRP, and interim report stages has previously been cited. Since the approval of the interim report, the principal studies undertaken have included completion of the administrative, economic, financial, and social feasibility analyses by the USAID and Central Bank (see Part III) and completion of a special report on the Rural Development Agribusiness Fund by GAMCO, Inc., a U.S. consulting firm.

GAMCO provided eleven work/weeks of technical services principally in the following fields: (i) demand for project funds; (ii) availability of credit for agribusiness purposes; and (iii) promotional and technical assistance requirements for the Project. The consultants worked closely with a team from the Central Bank and conducted extensive meetings and interviews with government agencies, individual entrepreneurs, banking institutions, manufacturers associations, chambers of industry and commerce, regional development councils, and local consulting firms and universities.

The consultants confirmed the existence of significant demand for Project funds, in the form of agribusiness sub-projects which would alleviate constraints faced by individual small farmers and cooperative members. Enthusiasm for the Project and interest in participating was expressed by many intermediate credit institutions (ICIs). The consultants, through a survey of ICIs, verified the dearth of medium and long-term credit for agribusiness development. Recommendations regarding promotion and technical assistance were made, and are reflected in subsequent sections of the Project Paper.

5. Relationship to A.I.D. Priorities and Mission Programs

a. A.I.D. Priorities

The proposed Project falls within the USAID's priorities for development assistance as most recently articulated in the narrative strategy statement transmitted with the FY 79 Annual Budget Submission. USAID's development assistance strategy contains three thrusts: (i) to improve the quality of life of the sierra poor through on and off-farm employment; (ii) to accommodate rural migration by supporting the orderly, economic development of new agricultural lands in the high jungle and the provision of basic services and job opportunities to the urban poor, and (iii) to stimulate and strengthen innovation and reform within institutions whose programs have particular relevance to the Peruvian poor. The Rural Development Agribusiness Fund, as an effort to establish a new credit system capable of alleviating identified constraints and reinvolving the banking community more actively in meeting the unmet credit needs for rural development, falls squarely within the third key element of USAID's strategy. It also will directly complement other Mission programs falling within the first two priorities, as discussed in section 5.b below.

The Project fits well within AID's general priorities as well, for the agribusiness aspects of food and nutrition programs recently have received great attention and emphasis. Agribusiness activities are being stressed, for it is recognized that if the well-being of lower income families is to improve, each element in the entire L.D.C. food chain and agricultural system must be healthy and capable of flexible growth. Small farmers need to be assured of ready markets and attractive prices for increased production, and system bottlenecks need to be eliminated in order to insure market demand and a consequent profit-stimulated supply. Reflecting this agribusiness priority emphasis, the proposed Project is similar in design to several recent A.I.D. loan programs, including the following: (i) Latin American Agribusiness Development, Central America (1971); (ii) Latin American Agribusiness Development, Caribbean Area (1975); (iii) Rural Enterprises Development, Paraguay (1976); and (iv) Regional Rural Agribusiness, Central America (1976). Analysis supporting these projects has indicated that sub-project activities which demonstrate strong linkages to rural economies based on agriculture can serve as efficient channels for the delivery of significant benefits to target groups of small farmers and the rural poor. The strategy of benefiting the rural poor through the development of agribusiness projects is particularly tenable for Peru where, because of the Agrarian Reform and virtual elimination of the latifundia, there is little danger of the benefits for agribusiness development indirectly accruing to an unintended recipient -- the large individual landowner.

b. Mission Programs

The Project will complement both on-going and planned Mission programs supporting Peruvian agricultural development, all of which strive toward the attainment of the common sectoral goal of increased production, incomes, and employment opportunities for the rural poor. The bulk of the Mission's programs are oriented toward alleviating technological and management constraints faced by small farmers and associative enterprises in the production process. These projects include Sierra Water and Land Use, Corn and Soy Production on Small Farms, Treated Sewerage, Fresh Water Fisheries, the CENCIRA training project, and the proposed FY 78 Small Farmer Production Technology loan. The proposed Project will complement these activities by (focusing on other elements within the agribusiness system, addressing the constraints of inadequate facilities for the processing and marketing of agricultural production.) Such constraints are already severe and likely to worsen once GOP production programs including those supported by A.I.D. as well as the other donors' credit programs begin to result in an increased production pay-off.

The Project will be particularly supportive of two proposed FY 78 projects, Appropriate Rural Technologies and Sub-Tropical Lands Development. The former is envisaged as a grant pilot program to develop institutional arrangements for carrying-out appropriate technology programs and to develop and field test a limited number of specific rural technologies suited to A.I.D's target group. The credit system established under the Project could serve as an important financing source for the widespread manufacture of technologies (e.g. simple tools and agricultural implements) which are proven to be feasible under the grant program. Similarly, agro-industrial investment opportunities have been identified in the Tarapoto region, the principal center of the Sub-Tropical Lands Development project area. These potential sub-projects appear as logical candidates for financing under the Rural Development Agribusiness Fund and, if realized, could serve as an important stimulus to regional development in concert with the Sub-Tropical Lands project components.

One on-going Mission program which provides limited funding for activities similar in nature to those contemplated under the proposed Project is A.I.D. Loan 527-T-058, Agricultural Cooperative Federations (Centrals) Development. The thrust of that program will be strengthening the organizational, financial, and institutional bases of up to 20 Centrals, and improving the integration of member associative enterprises into the second level federations and the services offered by the Centrals. USAID views the two projects as complementary rather than duplicative for the following reasons:

(i) The universe of small farmers and associative enterprises in Peru is much greater than that to be benefited under loan 058. The 20 participating Centrals will represent approximately 160 associative enterprises or roughly 50,000 farm families as compared to an estimated 1,000,000 small farm families in Peru;

(ii) While Centrals can offer important scale economies to member associative enterprises enabling them to purchase inputs in bulk and engage in primary processing activities, they should not be considered a substitute for all elements in the agribusiness system. Sophisticated processing activities as well as the manufacture of inputs are not likely to be feasible for implementation by Centrals, and the backward and forward linkages to and from the Central clearly need to be strengthened; and

(iii) Additionally, it is already apparent that the agro-industrial primary processing sub-projects to be identified in development plans for the 20 participating Centrals under loan 058 will require financing far in excess of funding availabilities under that program. The development plans will have to prioritize agro-industrial sub-projects and loan 058 will be able to fund only the most needy and profitable sub-projects for each Central. There is no reason why other feasible and bankable sub-projects identified in the development plans could not be funded under the Rural Development Agribusiness Fund.

The proposed Project will also complement the Industrial Bank's Rural Enterprises Fund supported by A.I.D. Loan 527-W-057. The rural enterprises project is designed to facilitate the availability of credit and technical assistance in selected regions to those enterprises and organizations which have not previously received or had normal access to credit on reasonable terms and conditions. It provides funding for sub-projects in industry, services, and commerce with an emphasis on employment generation, value added, and consistency with regional development programs. The Rural Enterprises Fund is not specifically linked to agriculture, and the vast majority of sub-loans extended to date have been relatively small (i.e. less than $25,000).

The Rural Enterprises Fund and proposed Rural Development Agribusiness Fund thus differ with regard to philosophy and target sub-borrowers. The Agribusiness Fund will stress linkages to and from the agricultural sector, and in this manner seek to benefit the rural poor. Individual sub-projects will be relatively large, averaging on the order of $250,000. Technical assistance to sub-borrowers will be less critical than in direct lending to small entrepreneurs. The Rural Enterprises Fund will continue its orientation, on the other hand, of providing credit to small sub-borrowers in deprived geographic regions who have not qualified and been able to receive credit from alternative sources.

In the course of promoting the Rural Enterprises Fund, the Industrial Bank has identified numerous agro-industrial investment opportunities and financed under the Fund a limited number of agribusiness activities. USAID, the Central Bank, and Industrial Bank have discussed at length the question of potential overlap and have concluded that no duplication of effort exists. Once the Agribusiness Fund becomes operational, the Industrial Bank will channel the larger agribusiness projects it develops to the Central Bank for refinancing. This will allow the Rural Enterprises Fund to concentrate on the requirements of small rural industries and trade which are not directly linked to agriculture, but which will generate jobs as a partial solution to the limited employment opportunities for sierra inhabitants.

B. Detailed Description

A logical framework for the Project is attached as Annex V.

1. Project Goal/Purposes

The goal of the Project is: to increase food production, employment and incomes of the rural poor, and improve nutrition. The Project will contribute to this goal by promoting investments in agribusinesses in such a manner as to maximize their impact on the rural poor. These investments will help to alleviate such constraints to increased small farmer income as limited product markets, the general lack of markets for agricultural inputs, and the dearth of agricultural-related service enterprises. A sub-goal has been added to the log frame as follows: to alleviate identified typical farm level constraints to increased small farm income through the expansion of markets for small farmer products and the provision of agricultural goods and services.

The purpose of the Project is twofold: (i) to establish in the Central Bank an effective facility for rediscounting loans made by financial institutions to sub-borrowers which process or market agricultural products or provide complementary goods and services to the agricultural sector; and (ii) to establish a program of promotion and development of such agribusinesses, including appropriate technical assistance, which will maximize benefits to small farmers and the rural poor.

2. Project Elements

The Borrower and Executing Agency will be the Central Reserve Bank of Peru. The Project will establish a rediscount mechanism to finance agribusiness sub-projects meeting eligibility criteria through the banking system. The Project's target group of small farmers and associative enterprises created under the Agrarian Reform will benefit as a result of sub-loans made to agribusinesses providing marketing, processing; or goods and services to the target group. The Project aims at increasing target group income, institutionalizing a new credit channel, stimulating bank participation in agribusiness development lending, and achieving a greater outreach to rural areas by incorporating existing banking infrastructure as suppliers of credit for rural development.

The proposed Project will thus involve the development of: (i) a rediscount mechanism within the Central Bank of Peru for refinancing loans made by participating financial intermediaries to eligible agribusinesses; and (ii) a program for the identification, promotion, financing and provision of technical assistance to such eligible enterprises.

a. Rediscount Fund

(1) Magnitude and Scope

The Rediscount Fund will consist of a total initial capitalization of $19,600,000, of which $14,700,000 will be A.I.D. loan funds and $4,900,000 will be provided by the Central Bank. These financial resources will support the development of industries which demonstrate significant direct backward of forward linkages to the target group of individual small farmers and members of associative enterprises through the provision of goods and services and the expansion of markets. Additional resources from Peruvian sources to support these agribusinesses will be provided by participating financial institutions ($2,200,000) and sub-borrowers ($3,800,000).

Agribusiness activities which may be financed under the program can be divided into four categories, all of which will contribute to eliminating identified constraints which exist in the flow of produce from farm to market:

i) Agribusinesses (including fruit and vegetable processing plants, balanced feed plants, canneries, freeze-drying facilities, etc.) which process raw materials grown by small producers and associative enterprises;

ii) Agribusinesses (such as refrigerated storage facilities, warehouses, transportation, etc.) which assist in the marketing of small farmer and associative enterprise agricultural products;

iii) Agribusinesses which provide goods and services which contribute to improved small farm and associative enterprise agricultural production, for instance suppliers of inputs and improved technologies (tools, farm machinery, pumps, vegetable crates, pesticides, improved seeds) as well as complementary services. Service enterprises would include distributors and/or repair facilities for the above-listed inputs, input marketing services, construction services for low-cost silos and irrigation facilities, and rental services for farm machinery and land-clearing equipment; and

iv) Agribusinesses which create linkages to the target group, through the provision of technical assistance, credit, and contractual arrangements for the direct purchase of products from the target group.

Briefly, the new credit system will function in the following manner. Through an operations manual directed to the banking system, the Central Bank will advise financial institutions of the procedures and criteria for lending under the program with particular reference to impact identification requirements (see Section 2.a.2) below), and other eligibility conditions. Simultaneously, the Central Bank will carry out an active promotion campaign to familiarize intermediate credit institutions (ICIs) and potential sub-borrowers with the Fund and its objectives. A sub-borrower wishing to develop or expand an eligible agribusiness activity would present an application to the intermediate bank of his or her choice. The ICI, with the advice of the Central Bank if necessary, would screen the initial application to determine its likely impact on the target group. Based on this preliminary analysis, a decision would be reached whether to undertake a more detailed study of the sub-project. Upon completion of feasibility study, the ICI would appraise the sub-project, make the credit judgment, and assume the credit risk. Upon acceptance by the ICI, the sub-loan would be presented to the Central Bank for refinancing. The Central Bank would check the proposal for conformity with the established criteria, and would authorize the transfer of funds to the ICI for approved sub-projects. All collection responsibilities will rest with the intermediate banks.

(2) Selection and Screening Criteria

In order for a sub-project to be eligible for financing, potential sub-borrowers must demonstrate not only the financial feasibility of the project, but in addition the link between the proposed activity and the designated agricultural sector target group. Selection criteria and a sub-project screening system have been developed to ensure that the sub-projects chosen for Rural Development Agribusiness Fund financing not only conform to normal feasibility creiteria, but also respond to A.I.D's priority concern of maximizing benefits to the rural poor.

The first step in the screening of sub-projects will be the completion of an Initial Impact Determination (IID) form. Annex VII Exhibit A contains a model IID form, and as a condition precedent to the disbursement of sub-loan funds, the Central Bank will develop as part of its Credit Manual a finalized format and will determine a cut-off score below which sub-projects will be automatically rejected even though there may be demonstrable financial feasibility. 1/ The IID will be designed to provide basic information on the nature of the proposed activity and its anticipated impact on target group farmers. It will allow the ICI and the Bank to make a preliminary assessment of sub-project impact on alleviating one or more of the constraints which currently inhibit the income and productive potential or rural producers. While certain basic information on the expected financing will be contained in the IID, its major role will be to provide a basis upon which a "go" or "no-go" decision is made with regard to subsequent sub-project appraisal by the ICI, including financial and economic feasibility.

Ten different factors will be taken into consideration in the Initial Impact Determination. The major ones are summarized below.

First, sub-projects will only be considered if they alleviate one of the four previously identified constraints to improving rural incomes (marketing of produce, processing of production, provision of input goods and services, and provision of agribusiness linkages).

Second, sub-projects will be expected to provide benefits to the target group of small farmers and associative enterprises through at least one of the following means:

1/ The model IID format (Annex VII) contains a maximum point score of 100. While it would be theoretically possible for a sub-project to reach 100, it is extremely unlikely since the proposed activity would have to be one in which both forward and backward linkages were anticipated and high impact registered in every category. The Mission simulated IID applications on a number of the identified sub-projects, and found that the majority of seemingly attractive agribusinesses received total point scores between 55 and 75. While further analysis on the weighting of variables will be necessary, it appears probable that a minimum cut-off score on the order of 55 would ensure that sub-projects meet AID and GOP target group impact criteria.

(a) Provide a market outlet and more stable prices for agricultural products;

(b) Increase productivity of farm laborers and provide more on-farm jobs;

(c) Provide incentives to produce higher value crops;

(d) Provide incentives to expand land under cultivation;

(e) Expand availability of agricultural inputs at reasonable costs;

(f) Introduce new, more productive technology;

(g) Reduce on-farm spoilage of production;

(h) Provide management and technical assistance services and/or credit to the target group.

The expected impact of the sub-project on small farmer income as a result of the above will be estimated and recorded.

Third, the location of the plant or operation will be taken into consideration in judging rural development impact. The location of the operation should be in an area where substantial members of the small farmer target group are located. If not, it should be very clear to the participating bank, that for other reasons, the sub-project will benefit such areas regardless of the location of its installations. On the presumption that rural sector linkages are likely to be stronger in smaller market towns and to support the GOP's goal of industrial decentralization, added weight will be given to feasible sub-projects located in smaller urban settings. However, no cities will necessarily be excluded, since agribusinesses will tend to flourish in larger urban areas which provide adequate infrastructure for power and transportation logistical requirements, labor pool availability and entrepreneurial talent.

Fourth, the average size of the participating farmer (in terms of cultivable hectares for individual landowners and cultivable hectares/member for associative enterprises) and the total number of participating farmers will be recorded. Added weight will be assigned to those sub-projects benefiting the smallest of Peru's small farmers and those which benefit the largest number of small farm families.

Fifth, employment generation will be an important factor to be evaluated, both with regard to off-farm and on-farm job creation. The investment cost to create these jobs will be judged, with added weights and priority for labor intensive sub-projects.

Finally, additional measures of a sub-project's importance will be its ability to contribute to the overall economic improvement of the country or region. Both the value added effect of sub-projects (through processing of locally-produced raw materials) and foreign exchange impact of sub-projects (either through stimulation of exports or import substitution) will be estimated at the time of IID preparation.

If the IID is approved and the decision made to proceed to the second step, the subsequent feasibility study will be required to contain documentation that the data submitted in the IID is indeed correct. The Central Bank will provide guidelines for carrying out feasibility studies to be followed by ICIs and technical assistance consulting firms. In addition to technical, economic, and financial feasibility, a section of the feasibility studies will be devoted to beneficiary impact. A Project Impact Assessment (PIA) form, a model for which is attached in Annex VII, Exhibit B, will be completed for all sub-projects prior to approval and disbursement of funds by the Rural Development Agribusiness Fund. The PIA will be prepared by either the ICI, contracted consultants performing feasibility studies, or by the Central Bank's Special Unit by extracting information from the ICI's request for financing and supporting data. The PIA will document actual conditions of the target group to be served or benefited by the sub-project, and make projections of anticipated changes. It will serve to fulfill the Central Bank's reporting requirement to A.I.D., and will provide a basis for subsequent evaluation of the sub-project's progress in meeting projected conditions.

The Project Committee believes the design of the above screening system will ensure maximum practical flow of benefits to the target group and is responsive to DAEC guidance on development of impact criteria in the following ways:

i) The guidelines are sufficiently precise with regard to types of benefits desired to enable all concerned entities (the Central Bank, ICIs and investors) to determine eligibility.

ii) The criteria are believed sufficiently rigorous to ensure that only those proposals which generate substantive flows of benefits to the target group through linkages with agribusiness will be found eligible for Fund financing.

iii) The methodology provides for the recording of anticipated impact to facilitate subsequent evaluations and verification of the extent to which benefit linkages are being maintained.

The above screening system and eligibility criteria appear to be adequate for the objectives set forth. The system will be evaluated during the course of Project implementation to determine whether modifications in the system and criteria are necessary.

(3) Sub-lending Terms and Conditions

In addition to impact determination guidelines, the Credit Manual to be prepared by the Central Bank and distributed to potential ICI's will specify sub-lending parameters. These are summarized below:

- Interest Rates. Rates charged to end users will initially be set at 16%, the current average rate for comparable credit from alternative sources. The rediscount rate charged ICI's will be 9%. Periodic adjustments in the interest rate and spread will be permitted depending on inflationary trends and changes in overall Central Bank interest rate policy.

- Terms. The maximum term for sub-loans will be 10 years with grace periods of not to exceed 2 years. Sub-loans will not be made for a term of less than one year. Within these limitations, sub-lending terms will be set on a case-by-case basis.

- Percentage of Rediscountability. The Central Bank will refinance 90% of ICI sub-loans meeting eligibility criteria, with 10% to be contributed from the ICI's own resources.

- Commodity Restrictions. Agribusinesses connected with sugar or cotton production will be excluded for reasons of desired target group impact.

- Sub-loan Uses. Eligible uses of Fund resources will include construction, the acquisition of capital goods, working capital requirements, and technical assistance. If a sub-loan is to be utilized strictly for working capital purposes -- as in the case of a company's making loans to farmers to induce cropping pattern shifts into crops which will be processed at the enterprise level -- then it must be shown that the needs are for more than one year 1/ and therefore not eligible for conventional commercial bank financing. No more than 25% of the Fund will be utilized for such medium-term working capital sub-loans. The Fund also will finance feasibility

---

1/ See model sub-project Cadenas San Fernando, Annex X for a description of the type of working capital which could be financed. In this case the company will make working capital loans to farmers to induce production of asparagus, a production shift which requires medium-term financing.

studies for sub-projects meeting initial impact determination requirements. The costs of such studies will be repaid by the investor, regardless of whether the sub-project is approved for subsequent financing.

- Sub-Borrower Equity Contributions. The Credit Manual will not require specific equity contributions by the end-use sub-borrowers, as the participating ICIs all impose similar standards which will apply. In the case of expansions or sub-loans to existing enterprises, the ICI determination is based on the debt bearing capacity of the sub-borrower. For new sub-projects, the ICIs stated that they will generally require a minimum 30% contribution of investors.

- Sub-loan Size Restrictions. The maximum sub-loan size and maximum amount to be outstanding to any one sub-borrower will be $750,000. The demand analysis revealed that several sub-projects will require financing at that order of magnitude.

b. Promotion

The Central Bank recognizes that promotional activities to publicize the program and actively involve ICIs will be critical elements for the successful implementation of the Project. To be sure, the design, coordination, and follow-up of promotional campaigns will be the most important tasks of the Special Unit which will be created within the Central Bank to administer the Fund. The major components of the promotional efforts can be divided into three categories: media release, publications and direct contacts.

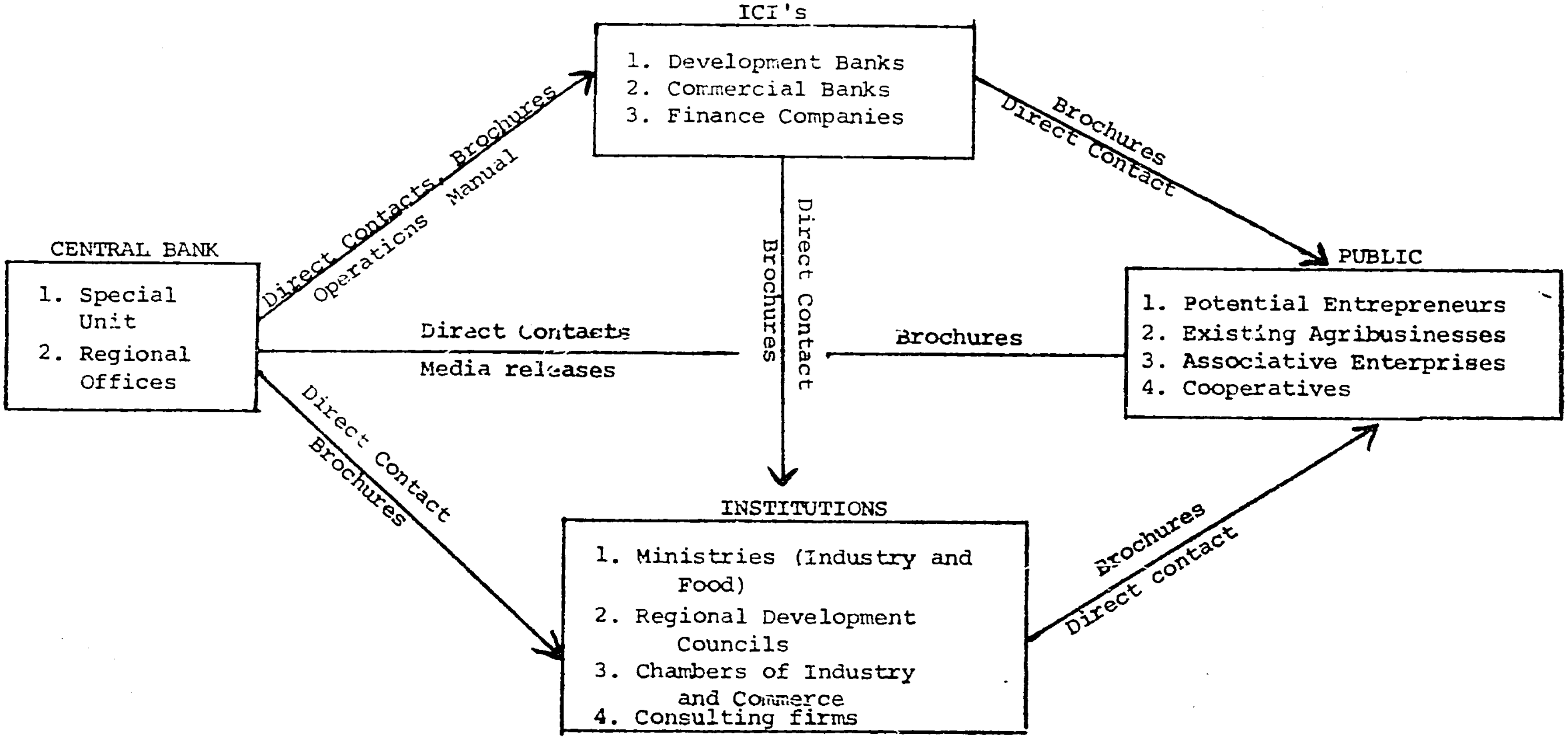
1. Mechanics of Promotion Campaign

Once the Loan Agreement has been signed, an immediate campaign of media releases (radio, TV, and newsprint) will be undertaken by the Central Bank to announce the objectives of the program and availability of financial resources. This will be followed by the publication of pamphlets, brochures, and a Credit Manual which will be ready for USAID's review and approval as a condition precedent to disbursement shortly following the signing of the Agreement. (The Central Bank will be responsible for the preparation and publication of these documents). Figure No. 1 illustrates the major flows of information contemplated among the relevant sectors.

The media release campaign will be initiated from the Central Bank's office in Lima as well as its various regional branches, so as to obtain as much geographic coverage as possible. The Credit Manual will be the basic working tool between the Central Bank and the ICIs. As noted, it will specify the eligibility criteria

FIGURE No. 1

FLOW OF PROMOTIONAL INPUTS



and impact determination guidelines that must accompany sub-loan applications. In addition, brochures and pamphlets will be published by the Central Bank to notify the public of program specifics and will be widely disseminated to existing agribusinesses, known potential investors, Regional Development Councils, local Chambers of Industry and Commerce, consulting firms, and such concerned Ministries as the Ministry of Industry and Tourism and the Ministry of Food. The Central Bank will also make the pamphlets and brochures available to ICI's for further distribution. Their contents will specify the major features of the new credit line with special emphasis on spelling out program objectives, types of eligible enterprises, sub-loan terms and conditions, and impact requirements. The names of participating ICIs will also be included.

The media release and publication activities will be followed by direct contacts by the Central Bank with the ICIs and potential entrepreneurs. The mechanics of these direct contacts will be patterned after the methodology employed by the Central Bank in assessing the demand for Project sub-loans - round table seminars in selected geographic regions with the simultaneous attendance of ICI's, concerned public sector entities, industry associations, and agribusiness representatives. These seminars will be undertaken by the Central Bank with the goal of reaching at least the branch manager level of all ICIs which are likely to participate. Follow-up seminars will undoubtedly be necessary as operational experience is obtained and will serve as a means of disseminating the results of Project evaluation.

2. <u>Promotion by ICIs</u>

Most of the principal ICIs likely to participate under the Project already have departments which promote their credit lines and other banking services available to the public, and the additional promotion efforts required by the Project can be incorporated easily into their responsibilities. ICI promotion efforts with potential sub-borrowers will begin once the Central Bank's promotional seminars have been completed and the brochures and pamphlets have been distributed. Promotion by word of mouth is likely to be a common technique employed by the ICIs. A helpful start in this respect will be the joint participation of the ICIs and potential sub-borrowers at the Central Bank's promotion seminars.

3. <u>Sources of Funds for Promotion Campaigns</u>

The promotional efforts as now conceived will place a major emphasis on direct contacts among the Central Bank's Special Unit, its regional offices, participating ICIs, relevant institutions, and the public. The heavy initial promotion requirements will require a specific Central Bank counterpart allocation, and the Central Bank has agreed to finance these promotion activities with their own funds. The source of promotion funds, once Fund sub-lending is institutionalized, will be a portion of the interest spread accruing to the Central Bank. Similarly, the ICIs will have to cover their promotional costs from the interest spread which they retain. Project analysis and discussions with ICIs indicate that the spread contemplated will be adequate to cover such costs and still provide incentives for ICI participation.

c. Technical Assistance

A project of this nature calls for techn al assistance at various levels as described below.

(1) Central Bank Level

The Special Unit to be established within the Central Bank is expected to consist of five individuals, supported by existing bank infrastructure including the five regional branches of the Central Bank.

The creation of a Special Unit at the Central Bank level will require some technical assistance inputs including short term advisory services related to administering the Rural Development Agribusiness Fund, promotional techniques, training of personnel, and evaluation. A total of 16 work months of U. S. or other Code 941 professional expertise is expected to be required over a four year period. Such advisors will assist the Special Unit institutionalize the Fund's operations and will assist in establishing the evaluation methodology. The evaluation system will include a methodology for periodic data gathering and reporting on use of sub-loan funds as well as sampling to determine end-of-sub-project status. This system will provide information on the degree to which sub-projects alleviate constraints faced by the rural poor, improve incomes, and create employment opportunities.

The Code 941 technical assistance will be supplmented by approximately 8 work months of technical services from Peruvian sources. Advisors will assist in carrying-out the evaluation methodology, i.e. sampling at the sub-project level, and other day-to-day implementation matters such as design of promotional materials.

Also, to aid in the institutionalization of the Rural Development Agribusiness Fund, limited funding will be provided for short-term training of Special Unit personnel in agribusiness and rediscount operation topics. A total of 10 work months of training in the U.S. or other Latin American countries with similar programs is anticipated.

Finally, limited funding will be provided for vehicles to assist the Special Unit in its promotional activities and sub-project analysis functions. The vehicles will be attached to Central Bank Regional Offices for purposes of sub-project identification, promotion, development, and inspection.

Total A.I.D. financing for the above inputs to aid the Central Bank establish the Fund and Special Unit is an estimated $200,000. The Central Bank has requested this assistance and no problems are foreseen which would impede the effective utilization of the proposed technical assistance. Firm sources, apart from the likely breakdown between Code 941 and Peruvian sources, for the technical services have not been identified. However, no difficulties are anticipated in locating qualified individuals or firms to provide the required assistance, and the contracting of professional services will be effected in accordance with standard A.I.D. procurement procedures.

(2) <u>ICIs Level</u>

Technical assistance to participating ICIs will be necessary since agribusiness financing will be a relatively new activity for some of the institutions and the data collection effort with regard to beneficiary impact will be greater than what is normally required for project analysis. The ICIs surveyed are strong in financial analysis, and this capability should be readily transferable to the analysis of agribusiness sub-projects. However, assistance will be necessary in the areas of longer-term project economic analysis and the Project's specific impact analysis requirements to demonstrate the benefits which will accrue to the rural poor.

Project design will provide for this assistance through special courses which will be organized by the Central Bank with the assistance of contracted consultants to train ICI loan officers and branch managers in project evaluation techniques and impact analysis requirements. The philosophy of the Rural Development Agribusiness Fund and the utilization of the Initial Impact Determination and Project Impact Assessment forms will be explained at these seminars. The goal will be to conduct seminars in each of Peru's 23 departments and thereby reach the branch manager level of all participating ICI's. Short-term advisors probably from local universities or consulting firms will assist the Central Bank in carrying-out these training programs. The cost of contracting consultants to assist the Bank will be financed by the A.I.D. Loan in an amount not to exceed $100,000. Total A.I.D. financed technical assistance is therefore an estimated $300,000.

In addition, ICIs may need to contract special expertise on occasion to assist in evaluating technological feasibility and overall merits of sub-loan applications. ICIs will absorb the costs of such technical assistance with a portion of the interest spread retained by the ICI.

(3) <u>Sub-borrowers</u>

For sub-borrowers, technical assistance will be required for the preparation of studies to support sub-loan applications. The Central Bank's Special Unit will maintain a listing of qualified local consulting firms with the capacity to undertake feasibility studies and impact justification analyses. Upon approval of the Initial Impact Determination, the Central Bank will advise the ICI and sub-borrowers of the data requirements of the Project Impact Assessment, and make available the listing of qualified consultants. Sub-borrowers will have the necessary studies completed, and may choose to borrow funds from the Rural Development Agribusiness Fund for this purpose. Up to 4% of the Rural Development Agribusiness Fund's resources or approximately $800,000, will be available for such technical assistance. the cost of which will be passed on to benefited sub-borrowers.

There are a large number of functioning private consultant firms in Peru with various degrees of experience and technical capability. Annex VIII lists over 100 firms, all of which are maintained on COFIDE's registry of quality, professional, and experienced consulting firms. The firms included in Annex VIII are those with experience in agricultural and industrial topics. Potential investors wishing to undertake agribusiness sub-projects will thus have an ample selection of firms from which to choose for the elaboration of feasibility and impact studies, and possible continuing consultation after the establishment and initial operation of their sub-projects. While all of the private consulting firms have their main office in Lima, this centralization is not expected to create major difficulties. All of the firms have the capability of moving teams out to sub-project areas to collect data and do all preliminary work prior to the actual preparation of the feasibility studies.

Apart from feasibility studies and impact analyses, the other technical assistance needs of sub-borrowers will be assessed by the participating ICI in the course of its review of an application for a sub-loan. In many instances, the ICI will have been an active participant in the sub-project development process and will have identified such needs at that stage, thus assuring that sub-loan design will cover them. With the sub-borrower, the ICI will also assess the possible sources of such assistance.

It is not possible to determine with any degree of accuracy how much technical assistance sub-borrowers will require. In the case of the less sophisticated entrepreneurs, particularly cooperatives, technical assistance in administrative, management and production matters will be important. Based on the limited experience of those banks (Industrial Bank, COFIDE, Agrarian Bank) that have worked with these entities, an estimated 15% of total sub-project cost may be needed for technical assistance. Such assistance should be considered supervisory in nature and its delivery should be a risk reduction element from the point of view of the participating ICI. On the other hand, in the case of existing agribusiness which develop sub-projects serving the rural poor, technical assistance requirements of the agri-businesses will be of lesser importance. Some assistance is likely in production and technology fields. Technical assistance to sub-borrowers will be included as part of total sub-project cost and will be sub-mitted in that form to the Central Bank when financing is requested.

A final technical assistance need for sub-borrowers relates to the lack of awareness of many potential investors of all of the complex procedures and bureaucratic approvals required to initiate a new enterprise and obtain financing. Many documents of control and registration have to be completed, with appropriate clearances from several GOP Ministries. To sub-borrowers located in smaller market towns and cities, such procedures are cumbersome and time-consuming. Two solutions to this bottleneck are proposed. First, the Central Bank's Special Unit will maintain a checklist of required procedures with a description of necessary steps and clearances. Secondly, the Lima-based Sociedad de Industrias maintains a special department dedicated to this type of activity, and the Bank's Special Unit will be able to direct Fund applicants facing difficulties to this department.

3. Anticipated Results - End-of-Project Status

By providing the above Project elements the following outputs are anticipated: i) at least $19.6 million of investments financed by the Rural Development Agribusiness Fund over the Project's life; ii) approximately 9 - 12 ICI's participating in agribusiness lending under the program; iii) sub-lending directives (the Credit Manual) distributed and periodically revised; iv) promotional seminars held in all of Peru's departments reaching ICI branch office managers; and v) a project promotion and evaluation system established. Such outputs are necessary to achieve the Project's purpose of establishing an effective permanent rediscounting facility and a program of promotion and development of agribusinesses which benefit the rural poor. At the end of the Project we would expect that all Project funds will have been placed in sub-projects meeting eligibility criteria, the Fund will be institutionalized with a demonstrated capacity to maintain its level of refinancing, the real capital value of the Fund will be equal to at least $19.6 million, and the Fund will continue as an effective and functioning system to identify, promote, and finance eligible sub-projects.

III. PROJECT ANALYSIS

A. Administrative Feasibility

1. Implementing Agency - Central Bank

a. Rationale for Selection

The proposed Borrower and Implementing Agency for the Project is the Central Bank of Peru. The primary reason for selecting the Central Bank is the Mission's conviction that within Peru institutional channels capable of delivering benefits to the rural poor need to be established and/or strengthened. This is a common thread within many of USAID's on-going and proposed programs in the rural sector. Concern for adequate institutional mechanisms must be of foremost importance in A.I.D.'s efforts to facilitate the flow of benefits to the rural poor. Now that other donors have increased their lending for Peruvian agriculture, A.I.D. should not overlook the potential adverse effects of overloading the handful of traditional institutions which presently serve the sector. The Central Bank views the vast network of the Peruvian banking system as a major potential conduit for stimulating agricultural development. A.I.D. can serve as a catalyst behind this concept and create an atmosphere for development by: i) seeing that the existing physical infrastructure and human resources are oriented toward solutions to problems faced by the rural poor; ii) seeing that resources including funds for longer-term lending, promotion and technical assistance are made available and that the proper incentives for their utilization are established; and iii) seeing that the GOP analyzes on a continuous basis the implications of overall credit policies affecting both the magnitude and sectoral allocations of credit.

The universe of potential ICI's which might participate under the Project includes 26 financial institutions consisting of two state development banks, eleven commercial banks including foreign banks, six regional banks, the state development corporation, and six empresas financieras. (See Annex VI for a complete description of Peru's financial system.) These will be the targets of the Central Bank's promotion campaign. Based on Central Bank and Mission discussions with these entities, we believe we can reasonably expect nine to twelve of these to participate in agribusiness lending under the Project by the third year (this is reflected as an output in the Logical Framework, Annex V). In our view, the participation of as many as nine intermediaries would fully justify the Project's design along the lines of a rediscount or refinancing facility. Indeed, one could argue that as few as three or four ICIs participating and developing agribusiness projects which benefit the rural poor would indicate success in opening new channels and spreading the administrative workload among institutions. In any event, the Project Committee has concluded that a refinancing facility which utilizes existing infrastructure as an outreach mechanism has validity for agribusiness sub-lending. The Central Bank is the only institution in Peru which is geared-up for and has experience in rediscount operations; it therefore is the logical implementing agent for the Project.

An argument advanced against involving LDC Central Banks in development is that special credit lines are outside their expertise and that such banks should concern themselves only with implementing overall monetary policy. The Central Bank of Peru refutes the view that the Rural Development Agribusiness Fund is beyond their purview. They cite as one of their basic objectives to promote credit availability and sectoral allocations of credit to insure economic growth, income increases, and a high level of employment. They are very interested in financing development and in seeing that the sectoral allocations of credit are supportive of the GOP's overall development strategy. At present, that strategy, as articulated in recent planning documents, gives priority attention to consolidating the gains of the Agrarian Reform, to increasing production, to arresting the growth of food imports, to integrating the production and marketing systems, and to stimulating regional development and decentralization. The Central Bank therefore believes it has a key role to play in influencing banking system allocations of credit toward priority sectors, and they are enthusiastic over the prospects of participating in a program to encourage agribusiness development.

The Central Bank also points out that it is already involved with activities similar to those contemplated under the Project. The Project is administratively attractive in that the Central Bank has ample applicable experience with other rediscount operations and long-established relationships with the banking system. For example, the administrative feasibility of the rediscounting mechanism has been demonstrated in the successful operations of the Central Bank's on-going Selective Credit Program. The program was established in the Central Bank in 1971 in an effort to promote credit decentralization and regional development by refinancing projects approved by the state associated and regional development banks. The program is for short-term loans only (generally 180 days). The establishment of the Rural Development Agribusiness Fund is thus consistent with present Central Bank activity and the Bank's self-view of its role and responsibility toward Peruvian development.

Furthermore, the Central Bank is a prestigious institution that consistently attracts experienced, high caliber, well-trained and versatile personnel. This, coupled with the important role the Bank plays in overall GOP policy formulation and the strong interest in the Project by the Bank's highest officials, lead us to believe that the Bank will be able to successfully assimilate the activities of the Rural Development Agribusiness Fund within its organization. A.I.D. has had previous favorable experience with the Central Bank, and the Bank is familiar with A.I.D. loan implementation requirements. For example, the Bank acquired such experience in serving as the fiduciary for the CRECE Fund established under A.I.D. Loan No.527-L-053 which was designed to assist small enterprises located in the Earthquake Disaster Area. The Central Bank capably fulfilled its responsibilities under the program.

The Central Bank is also the logical implementing agency because of its unique position at the center of the financial system, with responsibilities for strengthening banking institutions. It is therefore the best vehicle for organizing the delivery of technical assistance and training to ICIs in project evaluation and impact analysis techniques. The Central Bank does not carry out direct lending, and its impartial reputation should facilitate its promotional and technical assistance activities among state and private banks and potential entrepreneurs.

The Central Bank is keenly aware of the absence of agribusiness development programs of the type proposed and the critical need for such programs. While new GOP planning documents are stressing the need for agribusiness development 1/, such development has been impeded by the ill-defined responsibilities for promoting and administering agribusiness activities. Agribusiness falls under various sectors' jurisdiction, and there has been a tendency for numerous institutions to separately investigate and develop agro-industrial projects with little or no coordination. The Ministry of Industry and Tourism, Ministry of Food, and Ministry of Agriculture are all somewhat involved in agribusiness sub-project study and development, but many sub-projects with completed feasibility studies tend to die because longer-term credit is not available for financing. The Rural Development Agribusiness Fund could become the focal point for the GOP's new agribusiness emphasis. The promotional activities of the Central Bank could serve to tie together the activities and unify the strategies of diverse entities concerned with agribusiness development.

1/ The GOP's draft plan "Tupac Amaru" for the period 1977-1980 gives particular importance to agro-industrial development and metal working industries supporting agriculture.

b. Description, Organization, and Staffing

From its position as the center of the Peruvian banking system, the Central Bank makes and implements GOP monetary policy, promotes credit availability and allocations to insure economic growth, and regulates operations of all banks in Peru. It has at its disposal a wide array of monetary policy instruments to control credit expansion and to channel commercial bank credit toward specific economic sectors. These instruments include rediscount operations, legal reserve requirements, the power to set interest rate ceilings on loans and deposits, and selective credit controls. Section III.B. discusses the utilization of these instruments in recent years. The Bank's Organic Law provides for the contracting of external debt and the establishment of special promotion funds for administration by the Bank.

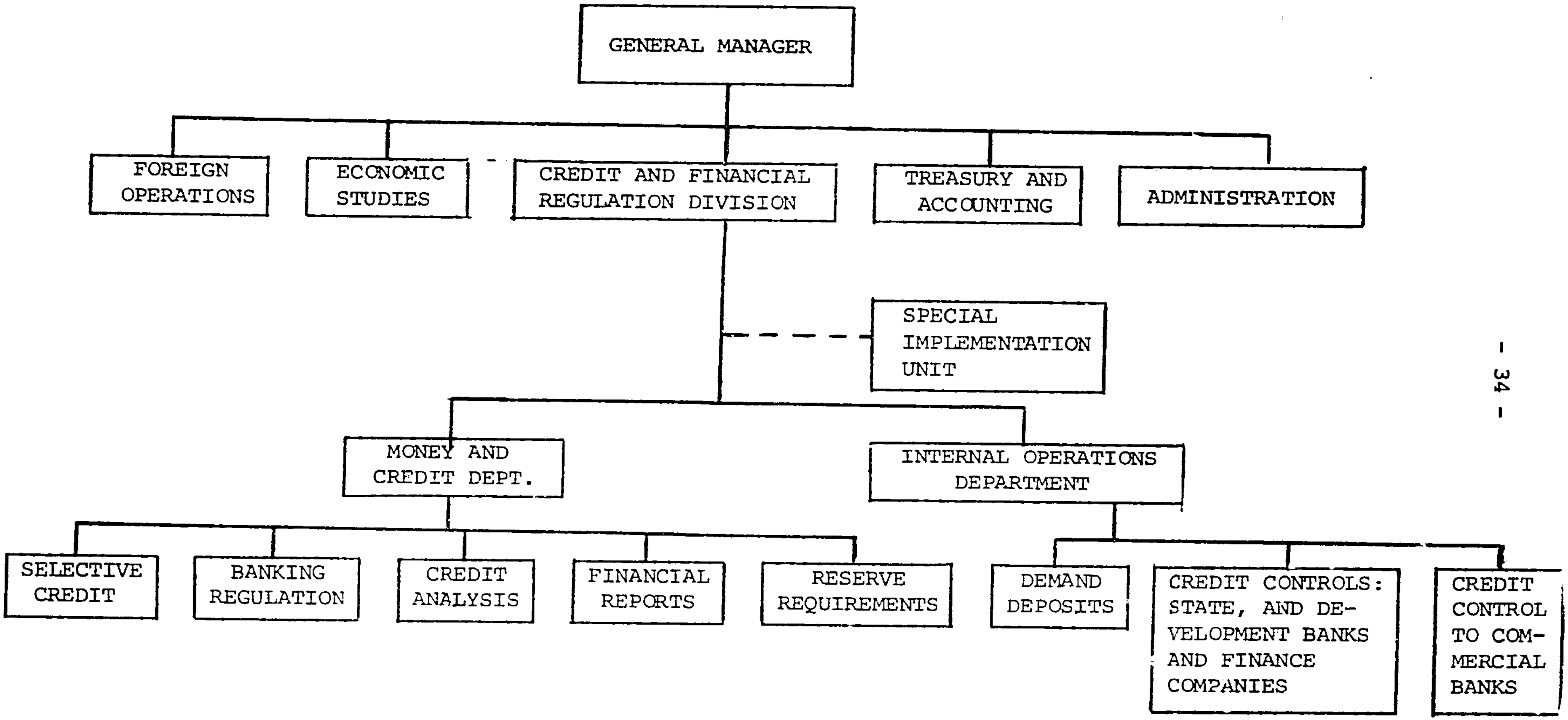
The chief official of the Central Bank is the President of the Board, but the policy making power rests with the full membership of the Board of Directors, composed of high-ranking officials of the Ministry of Economy and Finance and representatives from the major state-managed banks and the private sector. Responsibility for implementing Bank policy rests with the General Manager, five Managers, and three Deputy Managers, all highly-qualified professionals having considerable banking experience.

Organizationally the Central Bank is divided into the following five major divisions: i) Credit and Financial Regulation; ii) Treasury and Accounting; iii) Administration; iv) Economic Studies; and v) Foreign Operations. The principal office is located in Lima, with branches in Piura, Trujillo, Arequipa, Cuzco, and Iquitos. As the Credit and Financial Regulation Division is responsible for administering the Bank's other credit lines and rediscount activities, the Central Bank has indicated its intention to create a special office with full-time personnel within this Division for the purpose of carrying out the Project. Figure 2 depicts the Central Bank's organization, with an emphasis on the Credit and Financial Regulation Division.

This Division is further divided at present into two departments - Money and Credit and Internal Operations. The Money and Credit Department is responsible for programming and analyzing the credit programs of the Central Bank and the activities of the financial system, and is staffed with an efficient team of economists, financial analysts, and banking specialists. The Internal Operations Department administers and accounts for the flow of funds from the Central Bank to financial institutions under the Central Bank's various credit activities. The department is capably staffed with professionals with much experience in credit operations.

FIGURE No.2

ORGANIZATION OF THE CENTRAL BANK



In total, the Credit and Financial Regulations Division contains 51 professional employees, allocated as follows:

Department	Economists	Lawyers	Accountants	Administrators	Economic Technicians	Technicians
Directorate	1	1	-	-	-	-
Money and Credit	13	-	2	-	7	8
Internal Operations	3	1	1	1	2	11
	17	2	3	1	9	19

The existing capacity of this Division will provide support to the Special Implementation Unit charged with carrying out the Project.

c. Special Implementation Unit

The Central Bank recognizes that the Project will require capable full-time personnel assigned to promote and implement the program. The new unit will report directly to the manager of the Credit and Financial Regulation Division, to assure that the Project receives the necessary attention from the Central Bank's top officials. The Special Unit most likely will consist of a multi-disciplinary group of five professionals and one secretary with the following areas of expertise: i) Director-Economist; ii) Assistant Director-Economist; iii) Promotion Specialist-Agricultural Engineer; iv) Financial Analyst; v) Administrative Officer; and vi) Clerical-Secretarial. In addition, there will be a Central Bank official serving as the Fund's promotor in each of the Bank's five regional offices, to serve as a link between the regions and the Special Unit. The principal functions of the Special Unit will include the following:

i) Promotion. As previously described, the Unit will actively publicize the program through the design and development of pamphlets and brochures and the use of mass media. Travel to all areas in Peru will be undertaken on a regular basis to initiate and maintain contact with existing agribusinesses, interested investors, and ICIs.

ii) Service. The Unit will provide assistance to potential users of the Fund, particularly to explain to applicants the necessary steps to be completed for obtaining a sub-loan. The Unit will advise investors of possible sources of technical assistance, particularly for the preparation of feasibility studies.

iii) Training Sponsorship. The Unit will be responsible for organizing seminars for ICI branch managers. Topics to be addressed at these seminars will include sub-project eligibility requirements, impact identification formats, and sub-project promotion techniques.

iv) Control. Control will be exercised by the Unit to check impact identification formats, to analyze, where necessary, applications and feasibility studies, to check on the progress of outstanding applications pending ICI approval, and to evaluate sub-project results. Enterprises financed under the Project will be visited roughly one year following sub-project approval to verify the impact of the sub-projects.

v) Administrative. The Unit will maintain records on expected sub-project impacts, in the form of the Project Impact Assessment, as well as account for sub-project disbursements, commitments, and Fund availabilities. Administrative functions will also include personnel control, scheduling of trips, management of the budget of the Special Unit as well as keeping the Central Bank and the Mission informed of the activities and progress of the Fund.

The Special Unit's greatest responsibility will be to serve as a liaison between the various project participants, linking investors to public sector promotion activities, linking investors to consultants, and linking investors to financial institutions. Clearly, the Unit's success will largely depend on the quality of personnel assigned to the program and the support for the program by Bank executives. On both counts there is no basis for concern as the Bank personnel are of high caliber, well trained, and versatile. Top officials of the Bank place high priority on the Project, and throughout the phase of Project development the Central Bank has assigned highly qualified and competent staff to work on Project design and analysis. Continued support and the staffing of the Special Unit with dedicated and qualified staff is anticipated.

d. Conclusions Regarding Central Bank's Administrative Capacity

In conclusion, the Mission believes the Central Bank possesses the capacity to successfully execute the Project. It has carried out development credit activities with no noticeable impairment to or erosion of the performance of its traditional functions. The addition of the Rural Development Agribusiness Fund to its activities will not create a major resource drain away from the Central Bank's financial and economic management duties. The Bank has a keen interest in financing agribusiness development in support of the GOP's overall development strategy. A.I.D.'s support of the Agribusiness Fund will help create an atmosphere for development not likely to otherwise exist by establishing a new institutional channel capable of benefiting the rural poor. A.I.D., which has financed similar programs elsewhere, can orient the Central Bank toward building eligibility criteria and impact analysis requirements into the operations of the Agribusiness Fund so that selected sub-projects genuinely alleviate constraints faced by the rural poor.

2. Secondary Agencies - Participating Intermediate Credit Institutions (ICIs)

a. Description and Expected Participation

Annex VI provides a complete description of Peru's financial system. The potential ICIs which may participate under the Project may be categorized as follows: i) the state development banks; ii) the commercial banks; and iii) non-bank financial intermediaries including financieras (investment companies) and the state development corporation (COFIDE).

There are five state development banks in Peru of which only two are expected to participate under the Project: the Agrarian Bank and the Industrial Bank. The Agrarian Bank is the largest supplier of credit to the agricultural sector, offering lines of credit to farmers for the purchase of annual production inputs , the expansion and improvement of farming and livestock enterprises, the purchase of on-farm capital equipment, forestry development, and the marketing or processing of agricultural products. Its authorized clientele include the associative enterprises (service and production cooperatives, SAIS, Centrals, etc.) and individual landowners. The Agrarian Bank's Organic Law permits it to lend for agribusiness activities (i.e. agro-industrial processing or services) only when such activities are being undertaken by the producers or associative enterprises, including Centrals, the agricultural cooperative federations. Agro-industry sub-lending to these groups accounts for less than one percent of Agrarian Bank annual lending activity. The Agrarian Bank is likely to develop some agro-industrial or service sub-projects meeting eligibility criteria. As noted, potential sub-projects are being identified and studied under A.I.D. Loan 527-T-058 for Centrals far in excess of fundings availabilities under that program. However, apart from potential Centrals sub-projects, the Project Committee does not foresee the Agrarian Bank participating to a major degree under the Rural Development Agribusiness Fund in the near term. This view is held given the Agrarian Bank's almost exclusive concentration on providing production credit and on-farm credit related to the production process and the fact that the Agrarian Bank will be heavily occupied developing, analyzing and effectively implementing the following: i) A.I.D. loan 527-T-058, Central Development, in the amount of $7.0 million with an equivalent counterpart contribution; ii) the new IDB loan in the amount of $30.0 million with an additional $20.0 million counterpart contribution; iii) the credit fund under A.I.D. loan 527-T-059, Sierra Irrigation, in the amount of $3.0 million ($1.0 million A.I.D. loan and $2.0 million counterpart); iv) completing IBRD loan 933, in the amount of $25.0 million; v) a probable new IBRD loan on the order of $30.0 million, with additional counterpart requirements; and vi) a credit fund to be established under the proposed A.I.D. Sub-Tropical Lands Development Project.

The Industrial Bank offers credit to a wide range of industrial borrowers, including agribusinesses involved in the marketing, conservation, and processing of agricultural products. The bank lends to individuals, cooperatives, reformed private sector enterprises (i.e. those with industrial communities), small and medium private sector industries, and social property enterprises. The Industrial Bank has experienced and competent staff capable of promoting and appraising development credits for industry and is expected to be a major participant under the Rural Development Agribusiness Fund.

The commercial banks when considered as a whole constitute the most important financial intermediary in Peru, and the main institutional source of industrial finance. The commercial banking system includes seven banks which have their main office in the Lima/ Callao area (three of which are the so-called "associated banks"), six regional banks which have a separate legal basis, two private development banks, one savings bank, and the branches of four foreign banks. Of these twenty ICIs ten are likely Project participants - the three associated banks, the six regional banks, and the Banco de Credito, the largest private commercial bank in Peru. The associated banks are those in which the GOP has acquired a majority interest and are the Banco Popular del Peru, Banco Internacional del Peru, and the Banco Continental del Peru. There is no distinction between the private national commercial banks and the associated banks in regard to legal reserve requirements and credit regulations. The regional banks include the Banco Regional del Norte, Banco Nor-Peru, Banco de los Andes, the Banco-Sur Medio, the Banco Sur del Peru, and the Banco Amazonico. In an effort to promote balanced growth throughout the different regions of the country, the regional banks receive tax benefits and other incentives to stimulate investment in the regions where they are authorized to operate.

Banking policies of the commercial banks are similar. In general, they extend credit to all economic sectors and to borrowers who may be individuals or groups, reformed or traditional. Historically, the commercial banks have tended to make loans and credits of a relatively short-term nature. Industrialists also frequently have financed their longer-term investment requirements by rolling over short-term commercial bank credit. Lending to industrial clients has grown significantly over the years from 27% of their outstanding portfolio in 1968 to 38% in 1975. Their credits are all in local currency and their liabilities are composed of various types of deposits, e.g., demand deposits, savings deposits, and term deposits. The ten commercial banks cited above all have expressed enthusiasm for participating under the Rural Development Agribusiness Fund.

Finally, the Central Bank will also attempt to promote utilization of the Fund by the seven *financieras* and COFIDE, which are non-banking financial intermediaries. While the *financieras* do provide medium and long-term credit for investment purposes, they have not as yet engaged in significant developmental operations, i.e. identifying projects, undertaking the related studies, and fomenting the development of new enterprises. Little credit has been extended to the agro-industrial field. While *financieras* are potential users of the Rural Development Agribusiness Fund, the Project Committee does not anticipate significant participation in the near-term.

COFIDE, the state development corporation, was established in 1971 to stimulate and promote Peruvian entrepreneurial activity, coordinate and guarantee the financing of state enterprises, mobilize resources for priority investment projects, and expand the domestic capital market. From the time it began operations in 1971 through 1976, COFIDE financed forty agro-industrial projects which in monetary terms represented 1.6% of their total credit operations over the period. Large scale basic industries such as petroleum, mining, and energy have received the bulk of COFIDE's financing. Also, roughly 60% of COFIDE's loans have been directed to state enterprises. With this orientation likely to continue, COFIDE should not be viewed as a major conduit for the financing of agribusinesses which must show direct linkages and benefits for the rural poor. However, COFIDE's Technical Division does have a limited number of agro-industrial sub-projects under study which could qualify for Rural Development Agribusiness Fund financing. The Central Bank's Special Unit will maintain close contact with COFIDE to encourage the financing of eligible sub-projects, either by COFIDE or another financial intermediary.

b. Coverage

The potential participating ICIs maintain a vast network of branch offices throughout the country, as demonstrated in Table III. In total, there are 688 branch offices of which 333 are located outside of Lima. All 23 of Peru's departments are served by this banking infrastructure. The Banco de Credito has the largest number of offices (203), followed by the Banco Popular (161), Internacional (105), Continental (66), Agrarian Bank (59) and Industrial

Table III : Distribution of Potential ICIs offices by Department
(as of December 31, 1976)

ICI	Amazonas	Ancash	Apurimac	Arequipa	Ayacucho	Cajamarca	Cuzco	Huancavelica	Huanuco	Ica	Junin	La Libertad	Lambayeque	Lima	Loreto	Madre de Dios	Moquegua	Pasco	Piura	Puno	San Martin	Tacna	Tumbes	TOTAL
State Development Banks																								
Agrarian Bank	2	3	1	5	1	3	3	-	4	4	4	2	1	5	8	2	1	1	4	2	1	1	1	59
Industrial Bank	-	2	1	1	1	1	1	1	1	1	1	1	1	1	2	-	1	-	1	1	-	1	1	21
Commercial Banks																								
Popular	1	3	2	9	1	1	4	1	2	6	7	8	6	89	3	-	3	1	8	2	2	1	1	161
Internacional	2	4	-	6	1	2	3	2	1	5	10	8	2	48	2	-	2	-	4	2	-	1	-	105
Continental	-	-	-	1	-	-	-	-	-	-	-	-	-	63	2	-	-	-	-	-	-	-	-	66
Credito	2	7	2	11	3	4	5	2	2	10	7	7	4	110	3	1	4	2	7	3	3	3	1	203
Regional del Norte	-	-	-	-	-	-	-	-	-	-	-	-	-	2	-	-	-	-	5	-	-	-	-	7
Nor-Peru	-	2	-	-	-	1	-	-	-	-	-	8	4	1	-	-	-	-	-	-	-	-	-	16
De los Andes	-	-	-	-	-	-	2	-	-	-	-	-	-	1	-	-	1	-	-	2	-	1	-	7
Sur-Medio	-	-	-	-	-	-	-	-	-	11	-	-	-	6	-	-	-	-	-	-	-	-	-	17
Sur del Peru	-	-	-	6	-	-	-	-	-	-	-	-	-	1	-	-	-	-	-	1	-	-	-	8
Amazonico	1	-	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-	-	-	-	5	-	-	10
Other Intermediaries																								
Financieras	-	-	-	-	-	-	-	-	-	-	-	-	-	7	-	-	-	-	-	-	-	-	-	7
COFIDE	-	-	-	-	-	-	-	-	-	-	-	-	-	1	-	-	-	-	-	-	-	-	-	1
TOTAL	8	21	6	39	7	12	18	6	10	37	29	34	18	335	24	3	12	4	29	13	11	8	4	688

Bank (21). The coverage of the financial system is considered adequate to assure that agribusiness applicants will have little difficulty in establishing initial contact with the financial institutions of their choice. The autonomy of the ICI branch offices to approve sub-loans varies greatly from case to case. For some ICIs, the branch offices will only serve to identify sub-project possibilities, and to discuss Fund criteria with interested investors. In these cases, the subsequent appraisal and approval of sub-projects will be exercised by the ICI central offices. Given the manageable number of sub-projects expected to be financed by any one ICI, this is not expected to be a deterent to the timely utilization of Project funds. The Central Bank's Special Unit, however, will need to keep abreast of the status of the processing of sub-projects which have met initial impact criteria with the aim of minimizing delays in the ICIs review of applications.

c. Staffing Implications

A review of the potential ICIs indicated that they all possess the necessary installed capacity to analyze sub-borrowers' credit worthiness, to assess financial viability of sub-projects, to draft legal documents pertaining to the sub-lending process, and to disburse, account for, and recuperate sub-loan funds. However, with the exception of the larger banks, most of the ICIs do not maintain technical staff (e.g. engineers, industrial specialists) to assist with the evaluation of sub-project proposals. In discussing this issue with the ICIs, it was concluded that the full-time contracting of personnel to fulfill this function would not be warranted. Rather, the ICIs believed that this gap could be best filled by the contracting of technical personnel on a short-term, as needed basis. The ICIs would seek an outside technical opinion regarding technical feasibility upon the presentation of a feasibility study by an investor. Most of the ICIs surveyed have utilized this system previously. An ample supply of consultants capable of providing this service to the ICIs is indicated in Annex VIII.

The costs to the ICI of obtaining such opinions will be small, and easily absorbed within the interest spread retained by the ICI. Indeed the marginal costs to the ICIs to participate under the program will be negligible, when compared with the magnitude of administrative costs necessary to manage their current operations. Since each participating ICI will be handling a limited number of sub-projects, the Project is not expected to create further demands on ICI staff and resources which could not be accommodated by existing installed capacity.

d. Conclusions Regarding Capacity

Of Peru's total financial system, sufficient institutions have been found to possess the necessary interest in agribusiness lending, in terms of willingness and ability to promote and finance subprojects which are consistent with the Project's purpose. The geographic distribution of these institutions is widespread. The ICIs generally will be able to rely on existing capacity to participate under the program, and, as described elsewhere, the financial incentives necessary to induce utilization of this capacity are considered to be adequate. The Project Committee concludes that the designated ICIs will be able to capably carry out their role in implementing the Project.

B. GOP Policy Analysis and Implications for the Project

1. An Overview

The monetary policy instruments in Peru which have the most impact upon the supply of money and volume of credit are legal reserve requirements and the volume of Central Bank credits, i.e., rediscounts and direct credits. Selective credit controls and statutory interest rate maximums are policy instruments of lesser importance in controlling the supply of money and volume of credit, but they are important in determining the allocation as well as the cost of credit.

The period 1962-1969 was one of relative inactivity in the use of monetary policy instruments. Although the Central Bank regulated all interest rates and imposed legal reserve requirements on domestic and foreign deposits, they were changed infrequently. There were no portfolio requirements on commercial banks or other financial intermediaries. The supply of money was controlled mainly by movements in the Central Bank's credit to the public sector and its rediscounts with the banking system.

Beginning in 1969 governmental policies in the area of credit allocation became more explicit and refined. Up to 1969 there were few specific policies apart from those which defined the scope of various financial intermediaries and, in particular, the credit activities of the state development banks. In regard to commercial banks, in the period 1969-1976 legal reserve requirements were employed simultaneously as an instrument of control over the supply of money and as an instrument to channel funds to other financial institutions. In addition, specific loan portfolio requirements were applied to commercial banks.

During the period 1962-1975, interest rates remained relatively rigid in regard to credits and savings deposits. On the lending side, from 1968 on there was a tendency toward increasing diversity in the rates applied to credits of particular types and purposes, particularly by the state development banks. Since mid-1976 there have been two increases in the structure of interest rates. These increases affected the liabilities and assets of all financial intermediaries.

The following sections summarize current GOP credit policies and implications for the Project. In some cases, the Project Committee has concluded that some policy changes should be considered in order to facilitate the attainment of the Project purposes.

2. Legal Restrictions

Presently, commercial banks in Peru are prohibited by law from lending at terms in excess of one year. While commercial banks can circumvent this by rolling over credits to effect medium-term financing, the restrictions have discouraged commercial banks from attempting developmental lending and appraisal of longer-term projects. The decree establishing the Rural Development Agribusiness Fund will specifically authorize all participating ICIs to engage in medium and long-term lending for agribusiness sub-projects.

3. Reserve Requirements

Until November 1976, legal reserve requirements applied to commercial banks were relatively complicated, consisting in minimum, basic, and marginal requirements on deposit liabilities without regard to the type of liability and a complicated set of regulations whereby a sizeable portion of reserves could be invested in securities of the state development banks. The GOP made sweeping changes in commercial banks legal reserve requirements in the period November 1976 - March 1977. The effect of these changes was to redirect the flow of reserves from commercial banks to the Central Bank rather than to the state development banks. The new system (see Annex VI) is less complex and more in accord with the use of reserve requirements as an instrument of effective monetary policy to control the volume of money. The Central Bank does not appear to be anxious at present to experiment further with reserve requirements, and further changes in the policy area are not considered desirable at this time.

4. Interest Rate Policy

As noted, from 1962-1975 interest rates remained relatively rigid in Peru with regard to credits and savings deposits. Throughout this period the maximum interest charge allowed to commercial banks on loans and overdrafts was 12 percent per annum plus a 1 percent commission. Interest rates on savings deposits (typically 5 percent) and time deposits (typically 7 percent) remained fixed throughout the 1962-1975 period.

Important changes were made in interest rate levels in 1976 and 1977. The Central Bank was empowered to make changes in a broad array of interest rates on loans and deposits by means of Decree Law 21504 (May 25, 1976).1/ Annex VI, Table IV indicates the basic interest rates paid on the major types of deposits and fixed-yield securities issued by Peruvian financial intermediaries as of June 30, 1976, as of July 1, 1976 and as of March 1, 1977, and Annex VI, Table V indicates the basic interest charges on the major types of credits extended by Peruvian financial intermediaries at these same dates.

The basic interest charge on short-term credits was raised from 12.0 percent per annum to 17.5 percent per annum. The basic charges for medium and long-term credits were also increased, but the magnitude of increase and absolute rates of interest vary greatly depending upon the financial institution, upon the purpose of the credit and, in some instances, upon borrower characteristics.

The relative rigidity in the structure of interest rates during the period 1962-1975 was maintained in the face of substantial fluctuations in the rate of inflation, and furthermore interest rates were low in comparison with an average annual inflation rate of approximately 10 percent. Low real interest rates could exist because

---

1/ Decree Law 21504 modified Article 59 of the basic charter of the Central Bank giving that institution the power to increase interest rates up to maximum set by the Executive Power by means of a Supreme Decree emitted by the Ministry of Economy and Finance. Previously the charter stated that the Central Bank could not authorize interest rates which exceeded the maximum established by general and specific laws.

profits relate principally to the spread on the funds loaned by financial intermediaries rather than to absolute interest rates, which may be positive or negative in real terms (i.e. the interest rate less the rate of inflation).

In any event, the Government of Peru has become convinced that higher interest rates are necessary to prevent large-scale disintermediation and has increased interest rates twice in the past year. While it would not be realistic to expect the Government to enact positive interest rates in real terms immediately, the recent changes mark a major shift in policy. The Government has indicated that it does have the longer-range goal of moving toward positive real interest rates, a goal that may be obtained by successive reductions in the rate of inflation and/or further increases in institutional interest rates.

The Mission believes that the Loan could be utilized to reinforce the Central Bank's demonstrated concern for an adequate interest rate structure through the negotiation (and inclusion within the Loan Agreement) of the following:

a. A confirmation of the GOP's longer term goal of moving to positive interest rate levels in real terms;

b. An agreement to establish for the Rural Development Agribusiness Fund interest rates in line with the rates available in Peru for comparable types of credit; and

c. An agreement to adjust interest rates for the Rural Development Agribusiness Fund whenever necessary to maintain parity with comparable credit lines.

Based on the above, the Project Committee foresees an initial interest rate level for Project sub-loans greater than the rates originally contemplated in the PID and PRP. Interest rates are further discussed in section III.C., Financial Analysis.

5. Indexing

The indexing of interest rates on medium-term loans to a rate of inflation is at present a practice that is not employed or permitted on any credits made by Peruvian financial intermediaries. The GOP has adopted strong measures to contain inflation and wishes to avoid any formal indexing which could institutionalize or perpetuate inflation. However, the lack of indexing does not signify that interest rates have been stable. As noted, above, during the past year two significant upward adjustments were made in interest rates on all types of deposits and credits. It is significant that interest charges on outstanding loans (including medium-term loans) were increased as well as the interest changes applicable to new or potential loans. (There are some exceptions to this rule, e.g. some outstanding credits of the Housing Bank). Apart from a possible theoretical basis for indexing we see no reason in favor of indexing the principal and interest charges on one credit line when all the other credit lines are not so indexed and compelling reasons why indexing should not be applied to one credit line in isolation from all others. However, interest charges on loans from the Rural Development Agribusiness Fund should be adjusted (both in regard to outstanding and potential loans) when there is a generalized increase or decrease in interest charges. These adjustments should be relatively automatic and triggered by general re-adjustments of interest charges on the assets and liabilities of Peruvian financial intermediaries. By applying interest rate changes to outstanding loans, a variant of inflation correction is built into the program.

6. Portfolio Coefficients

Loan portfolio requirements for commercial banks were instituted in 1969 and the present requirement is that the Lima-based commercial banks must allocate at least 60 percent of the total increase in credit (over a 1969 base) to first-priority and second-priority industries, or alternatively, must purchase Public Investment Bonds by the amount of the total deficiency. First priority industries are basic industries such as steel, non ferrous metals, chemicals, fertilizers, cement, paper, and essential capital goods; second priority industries are manufacturers of essential consumer goods for use in productive activities. Agribusinesses fall within the first and second categories and are thus an eligible recipient for the purposes of meeting the 60 percent requirement. The previously cited increase in industrial lending by commercial banks appears to have been partially due to the effect of the portfolio guidelines.

As a stimulus to ICI participation under the Project, the following policy measure will be incorporated in the Loan Agreement to facilitate the attainment of the Project's purpose.

Projects developed by commercial banks under the Rural Development Agribusiness Fund will be counted toward meeting the loan portfolio requirements even though the project financing will not be principally based on utilization of commercial bank resources.

7. <u>ICI Counterpart</u>

The Central Bank accepts the principle that, from the point of view of making more resources available, it is desirable for ICIs having access to the Fund to provide counterpart funds to the sub-projects they submit to the Central Bank for Fund financing. This can be accomplished by limiting the percentage of a sub-loan eligible for rediscount to some percentage less than 100 percent of the amount lent. However, the Central Bank points out that currently the lending system faces severe liquidity problems and that an overly stringent contribution requirement would be counterproductive to achieving the Project's purpose if ICIs refrain from participating for lack of resources. Since agribusiness lending will be a new activity for many ICIs and given the present liquidity problem, the Central Bank prefers to initiate the program with a high rediscount rate - 90%, with 10% to be contributed by the participating ICI. This represents a change from the 100% refinancing proposed by the Central Bank during PRP preparation. Based on discussions with ICIs and the Bank's knowledge and analysis of overall liquidity, the Central Bank is convinced that 10% is the maximum contribution that can be expected of ICIs at the present time. The rediscount percentage is further discussed in the Financial Analysis section.

In establishing the Rural Development Agribusiness Fund the Central Bank will need to continuously analyze the adequacy of the various incentives available, including rediscount percentage and interest rate spreads, to achieve the desired level of ICI participation. Through Project evaluations, a framework will be established for periodically assessing these variables. Such evaluations may lead to recommendations for upward or downward adjustments in the ICI counterpart contribution requirements.

C. FINANCIAL ANALYSIS

1. Financial Plan

In the following Table, we have summarized the sources and applications of all cash resources that will be mobilized by the establishment of the Rural Development Agribusiness Fund.

TABLE IV

Sources and Applications of Resources Generated by the Project
(Million of US$)

	SOURCES					
	AID		Central Bank	ICI	Sub-Borrower	
Applications	Foreign Exchange	Local Currency	Local Currency	Local Currency	Local Currency	Total
Resources generated for sub-loans	4.4	10.3	4.9	2.2	3.8	25.6
Technical assistance	.2	.1	-	-	-	.3
Administration, promotion & evaluation	-	-	.1	-	-	.1
	4.6	10.4	5.0	2.2	3.8	26.0

The first line of the above table shows that the first round of rediscounted loans will result in the financing of various agri-business enterprises with a combined value of $25.6 million. Of this amount, the sub-borrowers may be expected to put up a minimum 15% or $3.8 million of their own funds. We have used 15% for this paper on the assumption that approximately 50% of the sub-projects will be new ventures requiring a 30% cash or in-kind investment by the sub-borrower (i.e. normal ICI debt/equity requirements) and the remaining sub-projects will be expansions where the existing equity will meet the ICIs requirements. The remaining portion of the agribusiness sub-projects, $21.8 million ($25.6 million - $3.8 million), will be financed by the Fund and the participating ICIs on a ratio of 90:10. (The basis of the 90:10 ratio is discussed later in this section.) Thus the Rural Development Agribusiness Fund will provide \$19.6 million and the ICIs will put up the local currency equivalent of \$2.2 million. It is estimated that 30% of the A.I.D. Loan contribution to the Fund will be required to cover the foreign exchange costs of imported commodities.

The technical assistance component will cost an estimated \$0.3 million of which \$0.2 million will be used to cover the foreign exchange costs of short-term consultants, seminars, publications, etc. The Central Bank will provide during the initial 12-18 months of the Project the local currency equivalent of \$0.1 million to cover administration, promotion and evaluation costs of the Special Unit set up within the Central Bank. By the time these funds are exhausted, the Rural Development Agribusiness Fund will be generating sufficient cash flows to cover these costs.

AID and the Central Bank will maintain sufficient funds in the Agribusiness Fund to cover estimated disbursements for a 90-day period. All deposits to the Fund will include disbursements from both AID and the Central Bank on a ratio of 3:1 respectively.

The mechanics of disbursements by the Central Bank from the Fund are as follows:

1) The ICI completes and submits to the Central Bank documentation for 100% of sub-project costs for previously approved sub-projects.

2) The Central Bank approves or rejects the documentation. If it accepts, the Central Bank will disburse to the ICI 90% of those sub-project costs requiring financing.

3) Subsequently, the Central Bank will submit to AID evidence of disbursements to the ICIs and AID will reimburse the Rural Development Agribusiness Fund concurrently with the Central Bank on the predetermined 3:1 ratio.

2. <u>Budget Analysis for Special Unit</u>

Table V summarizes the annual costs of administration, promotion and evaluation for the Central Bank's Special Unit. We consider the budgeted costs of the Special Unit to be minimum costs since the Unit will operate within the existing Central Bank organizational structure. The Central Bank presently handles rediscount operations and the Fund consequently represents something which can be easily absorbed by the Bank.

TABLE V

RURAL DEVELOPMENT AGRIBUSINESS FUND

Condensed Proposed Operation Budget - Central Bank
(US$ 000)

	Cost Categories	1	2	3	4	5	6	7	8	9	10
1.	Salaries	28	30	33	37	41	44	49	54	59	65
2.	Operating Expenses	8	8	9	10	11	12	13	15	16	18
3.	Fixed one time expenses	9	-	-	-	-	-	-	-	-	-
4.	Travel Costs	9	10	11	12	14	15	17	18	20	22
5.	Promotion	15	15	-	-	-	-	-	-	-	-
6.	Evaluation	-	-	40	-	-	-	-	-	-	60
7.	Representation expenses	1	2	2	2	2	2	2	3	3	3
8.	Unforeseen expenses	2	2	2	2	2	3	3	3	4	4
	TOTAL	72	67	97	63	70	76	84	93	102	172

Note: All cost categories through years two to ten are assumed to increase by 10% per year for inflation.

The Special Unit appears to be adequately staffed by the following personnel: Director - Economist; Assistant Director - Economist; Secretary; Promotion Specialist - Agricultural Engineer; Financial Analyst; Administrative Officer; and Drivers (2).

The budget provides the local currency equivalent of $15,000 per year for promotional activities during the first two years of operation of the Fund. At the end of the third year, a provision for the local currency equivalent of $40,000 will cover the cost of an extensive evaluation of sub-projects. Additionally, the Central Bank has set aside another $60,000 for a second evaluation during the tenth year of the Fund's operation.

As mentioned previously, the Central Bank will provide the equivalent of $0.1 million to cover the costs listed in Table V. This will be sufficient for approximately 12-18 months. As these funds are exhausted, cash generations from the reflows will be utilized to cover the expenses of administering the Rural Devebpment Agribusiness Fund. Should there be any delay in the receipt of adequate reflows under the Fund, the Central Bank would continue to make available from other sources adequate funds and resources to administer the Project.

3. Cash Flow Analysis and Fund Projections

A ten-year cash flow projection of the Agribusiness Fund is shown in Table VI. The various assumptions used to prepare this projection are explained as footnotes in the Table. The projection is denominated in dollars since the Central Bank will be required to maintain the local currency equivalent of the dollar value of the Fund.

The projection shows that by using a six-year maturity for sub-loans the Fund will be able to maintain the high level of sub-loan activity even after the original injection of funds from AID and the Central Bank have been disbursed. In addition, the Fund will be self sustaining by generating sufficient interest income each year to cover all debt servicing (interest and principal repayments) of the AID Loan as well as the Fund's overhead costs. Since the ICIs will assume the credit risk on all sub-loans no decapitalization of the Fund is anticipated. It is interesting to note that the projection anticipates 18 sub-loans in the first year of operation and then for the next nine years the annual number of new sub-loans fluctuates between 30 and 37, except for the fifth year when the number drops to 26. The reason for the drop in the fifth year is that this is the first year that the fund must operate solely on reflows and the reflows in the fifth year are not adequate to maintain such a high level of activity. It can also be noted that there is a slight drop in the level of new sub-loans in the eighth year, the first year that the Fund will begin to cover principal repayments to AID.

The lending targets projected appear reasonable given the extent of potential demand for such financing already identified and the use of the ICIs with their numeous offices as the outreach system for stimulating additional sub-project demand and assuming effective implementation of the promotional element of the program by the Central Bank.

4. Interest Rate and Rediscount Mechanisms Analysis

The maximum interest rate charged on funds loaned by participating financial institutions will be 16%, with no additional commission charges. The rediscount rate charged ICIs by the Central Bank will be 9% on the total amount rediscounted. However, eligible sub-loans will be rediscounted by the Central Bank for only 90% of the sub-loan amount, and the remaining 10% will come from the ICIs loanable funds. The interest earned on the sub-loans will be divided in such a manner as to result in an effective interest rate earned by the Central Bank and the ICIs of 8.1% and 7.9% respectively. Table VII illustrates the effective interest rates accruing to the ICI and the Central Bank:

TABLE VI

RURAL DEVELOPMENT AGRIBUSINESS FUND
CASH FLOW PROJECTION AND ESTIMATED FUNDING LEVEL
(U.S. $000)

	1	2	3	4	5	6	7	8	9	10
Beginning Balance	-	104	94	101	102	206	40	221	222	143
I. Receipts										
- Sub-loans										
A.I.D. Loan	3000	4500	4500	2700						
Central Bank	1000	1500	1500	900						
- Technical Assistance A.I.D. Loan	100	100	50	50						
- Administration, Promotion and Evaluation by Central Bank	72	28								
- Collections										
a) Principal	-	400	1340	2670	4250	5711	6607	7212	7527	7462
b) Interest	135	558	1114	1694	2034	2124	2258	2419	2413	2490
Total Receipts	4307	7086	8504	8014	6284	7835	8865	9631	9940	9952
II. Disbursements										
- Sub-loans made	4000	6800	8100	7600	5810	7625	8300	7950	8350	8350
- Interest on A.I.D. Loan	31	129	250	300	300	300	300	433	413	394
- A.I.D. Tech. Assist.Expend.	100	100	50	50						
- Central Bank Administration, Promotion and Eva.Exp.	72	67	97	63	70	76	84	93	102	172
- Principal Amortz. A.I.D.Loan								1154	1154	1154
Total Disbursements	4203	7096	8497	8013	6180	8001	8684	9630	10019	10070
III. Cash Balance	104	94	101	102	206	40	221	222	143	25
Outstanding Portfolio	4000	10400	17160	22090	23650	25564	27257	27995	28818	29706
Annual Sub-Loans Extended	18	30	36	34	26	34	37	35	37	37

TABLE VI (Cont'd)

ASSUMPTIONS:

1) Total resources provided by AID $14.7 million and Central Bank $4.9 million = $19.6 million.

2) Average sub-loan size $250,000. Amount rediscounted $225,000.

3) Average terms: 6 years, 1 year grace period.

4) Interest rate: 16% to end-user, 8.1% return to Central Bank and 7.9% to ICIs.

5) Slow payment: 20% of the sub-borrowers will make principal repayments one year after due date. Since ICIs will assume the credit risk, they will be required to make good all repayments more than one year delinquent.

6) Interest rate paid to AID: 2% during 7 years of grace period and 3% thereafter.

7) Reflows from original disbursements rechannelled to new sub-loans and to cover operational costs and debt service on AID Loan.

8) Sub-borrowers' repayment schedules computed on the basis of equal annual principal payments.

TABLE VII

EFFECTIVE INTEREST EARNINGS ON LOAN AMOUNT

	Amount	Effective Rate of Interest Earned on Loan Amount
Sub-Loan Amount	$ 1,000	
Portion of Sub-Loan Amount provided by ICI - 10%	100	
Portion of Sub-Loan Amount provided by Fund - 90%	900	
Interest Payable during first year by end user (16% x $1,000)	160	16.0%
Interest Earned by Central Bank ($900 x 9%)	81	8.1%
Interest Earned by ICI on its own funds ($100 x 16%)	16	1.6%
Interest Earned by ICI on rediscounted portion ($900 x 7%)	63	6.3%
Total Interest Earned by ICI	79	7.9%

It is clear from the above example that the ICI earns the full 16% on the 10% of the sub-loan which it provides from its own loanable funds. At the same time the ICI will charge 16% on the portion of the sub-loan to be rediscounted by the Fund, and of this 16% the Central Bank will receive 9% or an effective rate of return of 8.1% (900 x 9%) on the full amount of the sub-loan. The balance (900 x 7%) will be retained by the ICI.

It should be noted that the 16% charged the end-user is somewhat lower than the short-term credit rate of 17.5% (with an additional 2% commission) currently being charged by commercial banks. However, the 16% annual rate to end-users is reasonable when compared to the basic interest charges on medium and long-term credits granted for developmental purposes by the Industrial Bank, COFIDE, the Agrarian Bank and the Housing Bank.

Regarding the allocation of interest between the ICIs and the Central Bank, it is critical to the success of the Project that the ICIs receive an adequate financial incentive to ensure their full support. On the one hand, we look to the vast nationwide network of ICI offices, which are already in place, to locate potential sub-borrowers and work with them to put together rediscountable loans, and accordingly we must not underestimate the importance of the ICI's support. On the other hand, we cannot forget that this represents a newer, more risky area of operations for the ICIs than they have traditionally been involved with in Peru. Considering these factors and an analysis of the current earnings of selected Lima-based ICIs and regional ICIs, we have concluded that the interest rate structure outlined above will provide adequate and reasonable incentives, without windfall profits.

As shown in Table VIII, the Lima-based ICIs have an average before tax net earnings of 2.8%. Banco Popular with 4.5% has the highest before tax net earnings, and Banco Comercial and Banco de Lima have the lowest rate at 1.6%. In order to arrive at a figure for earnings from the Fund's sub-loans which can be compared to the 2.8%, we have made the following calculation:

Effective gross rate of interest earned by ICI on the full sub-loan	7.9%
Less:	
Cost of capital on portion of funds provided by ICI (10% x 4.1%)*	.4
Administrative costs (estimate provided USAID by Central Bank)	.5
Effective Before Tax Net Earnings	7.0%

From the above calculation, we find that the Lima-based ICIs under the Fund will be earning about 2.5 times (7% ÷ 2.8%) their average before tax net earnings on regular operations, although this ranges from a low of 1.5 times for Banco Popular (7% ÷ 4.5%) to a high of 4.4 for Banco Comercial and Banco Lima (7% ÷ 1.6%).

A similar calculation for those regional ICIs listed in Table IX reveals that the average net earnings before taxes are 3.6% compared to an average before tax net earnings of 6.5% on Agribusiness Fund loans. (The difference between the 7% Fund return for Lima-based ICIs and the 6.5% for regional banks is due to higher costs of capital and overhead experienced by the regional banks.) This results in the regional banks earning about 1.8 times (6.5% ÷ 3.6%) their average before tax net earnings on the Fund's sub-loans.

* 4.1% represents the average cost of capital shown in Table VIII.

RURAL DEVELOPMENT AGRIBUSINESS FUND

DETERMINATION OF COST OF CAPITAL AND NET EARNINGS OF LIMA-BASED COMMERCIAL BANKS

(Absolute Figures in Billion Soles)

		Banco de Crédito	Banco Internacional	Banco Popular	Banco Wiese	Banco Comercial	Banco Continental	Banco de Lima	Total	
Deposits										
1) Demand Deposits		12.24	5.32	10.87	3.77	2.14	5.86	2.09	42.29	
2) Time Deposits		2.54	0.91	1.34	0.45	0.23	0.49	0.62	6.58	
3) Savings Deposits		5.98	1.48	2.29	1.17	1.20	1.46	0.63	14.21	
Total Deposits	(A)	20.76	7.71	14.50	5.39	3.57	7.81	3.34	63.08	
Interest Payments										
1) Demand Deposits										
2) Time Deposits (14.5%)		0.36	0.13	0.19	0.07	0.03	0.07	0.09	0.94	
3) Savings Deposits (11.5%)		0.69	0.17	0.26	0.14	0.14	0.17	0.07	1.64	
Total Interest Payments	(B)	1.05	0.30	0.45	0.21	0.17	0.24	0.16	2.58	
Cost of Capital	(B÷A)	5.1%	3.9%	3.1%	3.9%	4.8%	3.1%	4.8%	4.1%	($\bar{X}$)
Loanable Funds	(C)	12.40	4.50	9.40	3.20	2.00	4.50	1.90	37.90	
Interest on Loanable Funds (19.5% x C)		2.42	0.88	1.83	0.62	0.39	0.88	0.37	7.39	
Interest Earned on Reserves (5.5%)		0.38	0.15	0.23	0.10	0.07	0.15	0.06	1.14	
Total Interest Earned	(D)	2.80	1.03	2.06	0.72	0.46	1.03	0.43	8.53	
Net Interest Earned	(D-B)=(E)	1.75	0.73	1.61	0.51	0.29	0.79	0.27	5.95	
Gross Earnings	(E÷A)=(F)	8.4%	9.4%	11.1%	9.4%	8.3%	10.0%	8.4%	9.3%	($\bar{X}$)
Net Earnings	(F less operational costs)	1.7%	2.7%	4.5%	2.7%	1.6%	3.4%	1.6%	2.8%	($\bar{X}W$)

Note: Compiled from data as of November 1976 submitted by Superintendency of Banks and Insurance Companies - Bulletin, February 1977.

Reserve Requirements:

Demand Deposits	46%
Time Deposits	31%
Savings Deposits	31%
Reserves in Vault	17%

($\bar{X}$) = Simple average

($\bar{X}W$) = Weighted average using total deposits as weights.

RURAL DEVELOPMENT AGRIBUSINESS FUND

DETERMINATION OF COST OF CAPITAL AND NET EARNINGS OF REGIONAL BANKS

(Absolute Figures in Million Soles)

		Banco Regional del Norte	Banco Nor Perú	Banco Sur Medio y Callao	Banco Los Andes	Banco Amazónico	Banco Sur del Perú	Total	
Deposits									
1) Demand Deposits		425	542	586	354	345	493	2,745	
2) Time Deposits		256	189	481	433	263	222	1,844	
3) Savings		79	156	180	73	160	92	740	
Total Deposits	(A)	760	887	1,247	860	768	807	5,329	
Interest Payments									
1) Demand Deposits									
2) Time Deposits (15%)		28	28	72	65	39	33	265	
3) Savings (11.5%)		9	18	21	8	18	11	85	
Total Interest Payments	(B)	37	46	93	73	57	44	350	
Cost of Capital	(B)÷(A)	4.9%	5.2%	7.4%	8.5%	7.4%	5.4%	6.5%	($\bar{x}$)
Loanable Funds	(C)	641	741	1,072	748	663	674	4,539	
Interest Earned on Loanable Funds (19.5%)		124	144	209	146	149	131	903	
Interest Earned on Reserves (12%)		12	14	17	11	10	13	77	
Total Interest Earned	(D)	136	158	226	157	159	144	980	
Net Interest Earned	(D-B)=(E)	99	112	133	84	102	100	630	
Gross Earnings	(E)÷(A)=(F)	12.9%	12.6%	10.7%	9.7%	13.2%	12.4%	11.9%	($\bar{x}$)
Net Earnings	(F less operational costs)	4.7%	4.4%	2.5%	1.3%	5.0%	4.2%	3.6%	($\bar{x}W$)

Note: Compiled from data as of November 1976 submitted by Superintendency of Banks and Insurance Companies - Bulletin, February 1977.

Reserve Requirements:

Demand Deposits	23%
Time Deposits and Savings	6%
Reserves in Vault	17.5%

($\bar{x}$) = imple Average

($\bar{x}W$) = W ighted average using total deposits as weights.

Within the individual regional banks shown in Table IX Banco Amazónico will earn only 1.3 times (6.5% ÷ 5%) their average before tax net earnings whereas Banco de Los Andes would earn 4.3 times (6.5% ÷ 1.5%) their average net earnings.

Based on the analysis in the preceding paragraphs, it is clear that the ICIs will receive a higher rate of return from sub-loan funds than their rate of net earnings (before taxes) for 1976. However, it must be remembered that the projected effective before-tax net earnings of 7.0% and 6.5% represent earnings without considering any write-offs for bad debts. Since long and medium term financing does represent a more risky area of banking operations for Peruvian banks, only experience will be able to guide us in projecting write-offs. At the same time, long and medium term financing will require a shift from the traditional conservative Peruvian banking patterns of short-term loans to a more innovative and imaginative banking mentality. Not all ICIs will be willing or able to make this shift and those that do will require an adequate financial incentive. For these reasons we do not consider the proposed interest rates too high.

One final point that should be discussed in regard to interest rates is the differential between what Lima-based ICIs would earn and what the regional ICIs would earn. As mentioned previously, the seven Lima-based ICIs listed in Table VIII would receive an estimated effective before tax net earnings rate of 7.0% which is 2.5 times their average before tax net earnings. This compares to the six regional ICIs listed in Table IX that would receive an estimated effective before tax net earnings rate of 6.5%, which is 1.8 times their average before tax net earnings.

In regard to these differences, our first observation is that they are not significant enough to warrant implementing a separate interest rate structure for the Lima based and regional ICIs. Both the Mission and the Central Bank believe that the difference is small enough so that it will not have a negative impact on the project. Secondly, we are not concerned that the Lima-based ICIs appear to make out slightly better than the regional ICIs since, by virtue of their size, the Lima-based ICIs are in a position to have a more important impact on the success or failure of the project. As can be seen in Table VIII, the seven Lima-based ICIs have total deposits of S/. 63.08 billion or an average of about S/. 9 billion per bank compared to the six regional banks with total deposits of S/. 5.33 billion, an average of S/.0.9 billion. This example is indicative of the comparative resources, both financial and organizational, that the two types of ICIs will be able to mobilize for implementing the project. Thirdly, it is interesting to compare, in absolute terms, the potential earnings from Fund sub-loans to the ICIs.

The maximum potential earnings Lima-based ICIs would realize from Fund sub-loans amounts to only an estimated 7.4% of their 1976 earnings, as shown in the following calculation:

(000 millions of Soles)

Actual 1976 net earnings before-tax for 7 Lima-based ICIs	1,100*
Total funds from ICIs and Fund available for sub-loans ($21.8 million x 80.88)	1,763
Net maximum potential before-tax earnings (7% x 1,763)	123
Assume that Lima-based ICIs make 2/3 of sub-loans from Fund	82
Percentage of Fund earnings compared to actual earnings (82 ÷ 1,100)	7.4%

On the other hand, the regional banks could earn an estimated maximum of 41 million soles (123 million - 82 million), assuming their utilization of one-third of the Fund's resources. This represents a significant 76% of the 1976 net before-tax earnings of the six regional banks. Thus although the incentive is less for regional banks on an individual loan basis, since they are much smaller than the average Lima-based ICI, the Fund sub-loans could have a very significant positive impact on their total earnings, making Agribusiness Fund participation an attractive banking possibility.

In summary, we consider the suggested interest rate structure adequate to elicit the support of Peruvian ICIs for this new and more risky type of bank operation. At the same time we do not believe that the suggested interest rates will provide the ICIs with windfall profits. While the Lima-based ICIs appear to earn more on sub-loans than do the regional ICIs, the difference is not considered significant.

In reviewing the Cash Flow Projections in Table VI, it is clear that any revenues in excess of the Special Unit costs and the debt servicing to AID would accrue to the Fund for recapitalization purposes and to aid in maintaining the Fund's value. Future changes in the interest rate charged to end-users would trigger a corresponding adjustment in the percentage available for recapitalization. However, the key element in maintaining the value of the Fund will be a clause in the Loan Agreement requiring the Central Bank to make an annual contribution of soles to the Fund to maintain the total value of the Fund in terms of U.S. dollars. This would be accomplished

---

* Information provided by Superintendency of Banks and Insurance Companies - Bulletin - March 1977.

through an additional Central Bank contribution to the Fund, on an annual basis, for at least the grace period of the AID Loan. The Central Bank's commitment to maintain the Fund's dollar value is a significant indication of their degree of support for the institutionalization of a funding channel for agribusiness development.

5. Rationale for 90% Rediscount

The Project calls for Central Bank rediscounting of 90% of total sub-loan amounts, with 10% coming from the ICI through which the sub-loan is made.

As a result of the high and sustained inflation affecting the Peruvian economy during the last four years (a minimum of 24% annually as recognized by official GOP entities) as well as an unrealistically low interest rate structure which existed during the period from 1970 to 1975, Peru underwent a crisis period of financial disintermediation and corresponding liquidity crisis. Low interest rates combined with high inflation led to a sharp reduction in savings. GOP statistics indicate that domestic family savings, in nominal terms, dropped from a level of S/. 6.2 billion in 1970 to minus S/. 1.9 billion in 1974. The 1974 figure indicates that Peruvian families decapitalized by this amount during the year, making it more difficult to bridge the gap between domestic investment and savings, a gap which in 1975 amounted to S/.65.6 billion, or 11.5% of GDP.

Financial disintermediation has been an additional catalyst to inflation, since investors have had to compete for scarce funds. Table X shows real banking financial resources in Peru for the period 1971 to 1975.

TABLE X

REAL BANKING FINANCIAL RESOURCES IN PERU 1/
(billions of Soles in terms of 1968 Soles)

	1971	1972	1973	1974	1975
1) Currency & Demand Deposits	27.7	30.2	31.5	33.2	33.6
2) Time Deposits & Savings	12.1	12.7	12.9	11.7	10.9
3) Near Monies	7.7	9.6	10.7	11.3	11.2
TOTAL LIQUIDITY	47.5	52.5	55.1	56.2	55.7
% = Total Liquidity / Gross Domestic Product (GDP) x 100	21.8	22.8	22.7	21.7	20.7

1/ Monthly averages in real terms using the deflator index implicit in the GDP.

Real banking liquidity as a percentage of gross domestic product shows a negative trend since 1973 when the inflation rate reached unusual levels in Peru. There are indications that this negative trend has continued in 1976 and 1977. Commercial banks have had to meet domestic demand for sub-loans basically with sale of foreign exchange and with additional external obligations. The Government of Peru has recognized the need to stop financial disintermediation and important changes were made in interest rate levels in May 1976 and February 1977. The objective of the new interest rate policy of the GOP is to move toward positive real interest rates in the near future. First steps have been made in adjusting interest rates to more realistic rates.

The present situation in Peru has led to a pronounced lack of liquidity on the part of the ICIs. The Mission and the Central Bank feel that under present circumstances 10% is the maximum amount which the ICIs could currently handle. To require a higher percentage could seriously jeopardize the movement of sub-loan funds.

During the first evaluation, six months after initial Fund disbursement, the Mission will review the liquidity position of the ICIs, to determine whether 10% continues to be an appropriate amount. The current economic situation in Peru is sufficiently unclear to warrant conjecture as to whether it will improve significantly in the next year, in which case ICI contribution to sub-lending could be increased, or whether the tight money situation will deteriorate even further, in which case the ICI 10% requirement would be dropped altogether until the situation improves.

D. ECONOMIC ANALYSIS

1. Economic Overview: The Impact of Agribusiness

In Peru, as in a large proportion of the world, the economic linkages among agricultural production, industrialization and consumption have not been developed to the point where the interdependence of the three has reached even a moderate degree of efficiency. This has been primarily because the first phases of industrialization have been heavily concentrated on the production of consumer durables. In the case of Peru, the first stage of import substitution industrialization began early in the decade of the 1950's, when there was heavy investment in such areas as textiles, iron and steel, cement, electrical appliances, and first stage processing of mineral production; given the limited overall financial resource base, the development of agribusinesses serving as forward and backward linkages to the actual production process fell far behind industrial capacity in other areas. For example, over 95% of Peru's mineral production is now exported in some sort of processed form (concentrates, refined or metal products), whereas it is estimated that less than 10% of agricultural production (other than export crops such as sugar, cotton, and coffee) receives any additional processing or treatment between farm and consumer. What has emerged, on the other hand, is a complicated series of intermediate interventions, comprising commercial and financial transactions, which add little, if any, actual value to the final product. These have, rather, increased inefficiencies in the system, by distorting prices both to farmer and consumer, manipulating supply and demand conditions, and in many cases have created disincentives to additional on-farm production.

The importance of developing and reinforcing agribusiness structures in countries such as Peru stems from their value as a link between production and consumption of foods. Whereas population increase as well as a generally improving standard of living puts tremendous pressure on the agricultural sector to increase production, the sector has not responded sufficiently, thus increasing demand for imports and adding to the already heavy pressure on the balance of payments current account.

In general, small farmers in Peru make their economic (including planting, harvesting and marketing) decisions within an overall system characterized by a high degree of uncertainty, largely occasioned by inadequate knowledge of markets. In the majority of cases, not knowing actual market conditions for a variety of produce, the farmer will produce what the commercial intermediaries tell him is his optimal production; at the moment of harvest, whether by foresight or chance, the market conditions may be far less favorable than the farmer was originally led to believe. Especially in the case of perishables, the farmer has no alternative but to sell at whatever price he is offered, frequently at a less or such a minimal profit that there is no incentive to increase production (or the quality of production) during the next planting season.

While the individual farmer frequently does not have the technical or economic know-how to determine market conditions, the agribusiness enterprise --whether it be a private company, cooperative or other form of associative enterprise-- must have this information, since it is the fundamental factor for financial success. Armed with such information, the enterprise is a logical and effective way of translating consumer preferences and demands to the farmer. Because the enterprise depends upon the farmer to provide it with inputs --or purchase its services or market his production-- it must operate in such a way that the farmer receives real and measurable benefits as a result of dealing with this particular enterprise rather than another or simply returning to dealing with the traditional commercial intermediary.

Once the basis of mutual dependence is established, the atmosphere of uncertainty in which the majority of farmers currently operate is reduced; there are incentives to produce more and higher quality crops, to diversify production according to consumer preferences as passed down through the enterprise, and, as economic benefits are felt, to bring new or marginal lands into production. As the enterprise reaches new markets and expands production, it must simultaneously pass on benefits to the farmers it serves in order to stimulate increased production at the farm level and/or increased participation of new farm units.

Theoretically, the enterprise will operate at optimal equilibrium when demand for its output exceeds supply capacity and all possible farm units capable of participating are thus engaged. While this would be the ideal, any point on the continuum between the present situation and optimal equilibrium would represent an economic improvement to participating farmers.

The proposed Project will promote a structural integration between producer and agribusiness activities, designed not only to bring about change in the agricultural production system, but to increase the value added at each stage throughout the system, providing on-farm incentives, production economies of scale, reduction of spoilage, and finally producing an end product which presents a higher quality product at lower cost to consumers.

2. Demand

The following techniques have been utilized to verify the existence of demand for Project funds; (i) a survey of potential participating ICIs; (ii) field survey work by a team from the Central Bank; (iii) a review of potential sub-projects being promoted by sectorial insitutions (Ministry of Industry and Tourism, Ministry of Food); and (iv) field survey work by the USAID and contracted consultants (GAMCO) to confirm the Central Bank's demand projections.

The discussions with potential ICIs and the Central Bank resulted in the decision to orient the Project's focus toward an agribusiness emphasis. Most ICIs visited were enthusiastic over prospects for developing and financing agribusiness sub-projects, and all agreed that such financing was sorely needed. However, the ICIs were more hesitant to commit themselves to participating in direct sub-lending to small farmers and the rural poor. Most concluded that the nature of the two types of lending --direct lending to small farmers for capitalization to expand production and lending to agribusiness serving small farmers-- differed greatly with regard to necessary financial incentives, guarantees, and sub-borrower technical assistance to off-set risk. USAID concluded that the original Project design contemplated in the PRP was overly ambitious in attempting to benefit small producers both directly as sub-borrowers and indirectly as ultimate beneficiaries. When it became apparent that other donors were actively addressing the problems of on-farm capitalization credit, USAID and the Central Bank chose to direct the Project toward agribusiness sub-lending.

Following these discussions, a Central Bank study group was organized to undertake field surveys to assess potential demand. The group focussed its efforts on identifying sub-projects which would alleviate at least one of the following constraints: inadequate marketing facilities, insufficient processing facilities, inadequate goods and service industries serving rural areas, and incomplete agribusiness system linkages. These conditions were chosen for study as they are contributors to the following sectoral problems: (i) a slowdown in the rate of growth of agriculture sector productivity; (ii) scarce employment opportunities; and (iii) low income levels among small farmers working individually-owned plots and associative enterprises created as a result of the Agrarian Reform.

The Central Bank team and GAMCO travelled to selected areas (including Cuzco, Puno, Arequipa, Trujillo, Piura) to investigate investment possibilities. Contacts were made with local banking institutions, public sector entities such as the Ministry of Industry, Ministry of Food, and Ministry of Agriculture, local development committees, and local industrialists. Round table seminars were held with representatives from these entities to discuss the objectives and principles of the Rural Development Agribusiness Fund, operational requirements for its utilization, and area sub-projects now under study which would meet the Fund's eligibility criteria. From these sessions, 90 potential sub-projects were identified.

The 90 identified sub-projects represent a projected demand of over $34,000,000 in agribusiness activities which meet the criteria of alleviating one or more of the four constraints identified by the study group. From these initial contacts, demand appears to be generally high, with the strongest projected demand in the category of processing facilities. Approximately 30% of the total amount corresponds to associative enterprise agribusiness sub-projects, with the balance being developed by private sector groups or entities.

The Central Bank - GAMCO demand surveys are based on a very limited sample of prospective clients and areas and should therefore not be considered an all-inclusive list of potential agribusiness sub-projects. However, the sub-projects identified, in conjunction with the enthusiasm shown for the program in the areas visited, convinced the Central Bank and USAID that the Rural Development Agribusiness Fund could play an important role in stimulating sector development benefiting small farmers and insure that the proposed resources for the Fund will be utilized within a reasonable time period.

A breakdown of sub-projects according to degree of readiness for implementation purposes is shown in Annex IX, Exhibits A, B, and C. Exhibit A lists 22 sub-projects (totalling $6.4 million in investment funds) which are currently ready for implementation and which could be financed during the first year of Fund operations. All of these sub-projects have completed feasibility studies, firm credit worthy entrepreneurs, but, as yet, no assured source of financing. About 60% of these sub-projects are for expansion of existing agribusiness which serve the target group and thus qualify for Fund financing.

Exhibit B presents 26 sub-projects requiring about $8.7 million in investment. These sub-projects are at a pre-feasibility stage and have been identified in conversations with entrepreneurs. While most of the Exhibit B sub-projects would not be implemented in the first year of the Fund, since they lack full feasibility studies, it is probable that they could be financed within two years of the Fund's initiation if further study shows them to be within the purview of Project purposes.

Finally, Exhibit C of the Annex lists 42 projects representing investment of over $19.0 million. These sub-projects are being promoted and developed at the pre-feasibility stage by private entrepreneurs, various public entities such as the Ministries of Food, Agriculture, and Industry, COFIDE as well as cooperatives and social property enterprises. The financing of third category sub-projects is likely to occur during the second to third year after funds are available. In both categories B and C sub-loans for final feasibility studies could be made in the early stages of Loan implementation.

The 90 identified sub-projects were also analyzed from the point of view of projected impact on each of the four constraints which were identified as major causes of low agriculture sector productivity and income. Table XI presents a breakdown of results. The bulk of identified projects (57%) relate to agribusiness processing, with 21% responding to marketing constraints and 18% to alleviating the current inadequacy of inputs to the agricultural sector. Two potential investments, totalling $1.5 million (4%), were identified as sub-projects primarily directed towards improving agribusiness linkages.

The Project Committee believes that the field surveys of sub-projects have identified only a fraction of available agribusiness sub-projects which have potential for improving small farmer income. It is expected that as the Special Unit and Regional Offices of the Central Bank begin active promotion of agribusiness sub-lending, many more sub-projects meeting eligibility criteria will be identified and developed. The lists in Annex IX, however, provide points of reference and a basis for conclusion that the proposed magnitude of the Rural Development Agribusiness Fund is reasonable, and that the AID loan and Central Bank counterpart resources will be disbursed in a timely manner to eligible sub-projects.

3. Economic Impact Analysis

a) Impact on Investments

The proposed loan of $15.0 million plus a Central Bank counterpart contribution of $5.0 million less: (i) $300,000 for technical assistance under the AID Loan and (ii) $100,000 for administration, promotion and evaluation under the Central Bank counterpart funding, will yield a capital resource fund for rediscounting loans of $19.6 million. The Fund will be rediscounted to the commercial banks at the rate of 90 %, yielding a total loan amount of Fund plus commercial bank input of $21.8 million. Assuming that on the average sub-borrowers contribute an additional 15%, private investor participation would be approximately $3.8 million, yielding a total of $25.6 million of capital directed toward the small farm agro-industrial sector on first disbursement of the Fund. Assuming that the Fund will roll over 3.6 times in the first 10 years of the Project, the total investment directed toward the sector over the next ten years would be $92.0 million ($25.6 million x 3.6).

b) Impact on Gross Domestic Product (GDP)

Agricultural sector contribution to GDP has demonstrated a declining trend over the past decade, dropping from approximately 16% in 1966 to an estimated 12% in 1976 (based on preliminary figures). Further disaggregation of productivity trends indicates that while there have been moderate increases registered in production of export crops (sugar, cotton, coffee, etc.) as a result of favorable external markets,

TABLE XI

Potential Agribusiness Projects in Selected Regions

Constraints and Location	Type	Number of Sub-Projects	Amount
I. Inadequate Marketing Facilities			
A. Southern Sierra	Storage Mobile Fruit Collection	2	$ 317,000
B. Cajamarca	Storage, Transport	2	555,000
C. Cuzco	Storage, Transport	3	760,000
D. Satipo and Tarapoto	Fruit Canning, Collection Center	3	1,570,000
E. Tarma and Cañete	Collection Center	2	1,500,000
F. Junin	Collection Center	1	500,000
G. North Coast	Collection Center, Canning	2	1,250,000
H. Iquitos	Collection Center	1	700,000
	Sub-Total	16	$ 7,152,000
II. Insufficient Processing Facilities			
A. North Coast	Poultry, Fruit Processing	10	3,435,000
B. Cuzco and Madre de Dios	Quinua, Flour, Swine, Poultry, Grain, Fruits, Cocoa	18	5,584,000
C. Puno	Meat, Quinua, Flour	6	2,640,000
D. Arequipa and Ica	Cheese, Fruits, Cereals	8	3,413,000
E. Cajamarca	Grain	1	25,000
F. Tarapoto and Satipo	Manioc, Fruit, Swine	9	3,450,000
G. Cañete	Lupino (oil and Protein)	1	300,000
H. Tacna	Fruit Paste and Puree	1	750,000
	Sub-Total	54	$19,597,000
III. Inadequate Input (Goods and Services)			
A. Arequipa	Irrigation Equipment Feed Mill	2	1,290,000
B. North Coast	Wind Mill Manufacturing Feed Mill	7	2,191,000
C. Cuzco and Puno	Crop Service Centers, Feed Mills	5	1,080,000
D. Junin and Cajamarca	Farm Implements, Feed Mill	2	520,000
E. Chimbote	Farm Machinery	1	500,000
F. Tarapoto	Feed Mill	1	510,000
	Sub-Total	18	$ 6,091,000
IV. Inadequate Agribusiness Linkages			
A. North Coast	Asparagus	1	750,000
B. Junin	Fruit Juice	1	800,000
	Sub-Total	2	$ 1,550,000
	TOTALS	90	$34,390,000

the overall production of food crops has actually decreased. The reasons for declining food crop production include a combination of factors: (i) unfavorable climatic conditions, such as drought in the central sierra and flooding on the north coast; (ii) a sporadic, and frequently contradictory, pricing/subsidy policy on the part of the GOP which, until recently, offered few guarantees or incentives to small producers and created disequilibria between input requirements and expected financial return; (iii) a lack of medium-term credit to small and medium producers for the purchase of necessary equipment or financing of basic infrastructure improvement (e.g. replacement of worn-out pumps or relining of tertiary irrigation canals); and (iv) lack of stable markets for production.

The development of a viable agribusiness sector, which would provide a more complete system of forward and backward linkages to the actual production stage of agriculture, will serve as a stimulus to increased on-farm production by offering financial incentives to farmers. While any estimate of the magnitude of production increases which could be attained as a result of the Project would be purely conjectural at this stage, the effect of the Fund's activities should contribute significantly towards reversing actual productivity declines, thereby stemming the diminishing contribution of the agriculture sector to GDP.

While there are no reliable estimates on marginal capital output ratios for the small farmer oriented agribusiness sector in Peru, experience in Latin America has shown this ratio to be generally on the magnitude of 1.5:1 (.67)* Applying this to the present Project, we arrive at an aggregate figure of $61.0 million, over a ten-year period, which represents incremental output at the level of the agribusiness activity alone (92.0 million x .67).

If we further assume that there is a ratio of 2:1 between incremental output at the agribusiness level and the value of farm level production,** nearly $125 million in incremental farm output would be added to GDP over ten years.

c) Impact on Balance of Payments

The impact of the Project on Peru's balance of payments situation will be two-fold: (i) an absolute increase in the value of agricultural exports; and (ii) a slowdown in the rising percentage of imports going towards food products.

The combined effect is expected to result in some improvement in the

---

* See, for example, the Project Papers for LAAD, Regional Agribusiness Development (AID-DLC/P-2127) and Paraguay, Rural Enterprises (AID-DLC/P-2180).

** 2:1 is an extremely low ratio, based on the projected impact of sub-projects analyzed.

negative current account balance of payments situation which has plagued Peru in recent years. In 1976 the deficit on the agricultural trade account was $33 million, a figure which is expected to rise substantially over the next few years unless agricultural sector stagnation can be reversed.

d) Employment Generation

The Project is expected to have moderate impact on employment generation at the agribusiness sector level or factory site. The financial analysis section demonstrates that there will be approximately 144 sub-projects implemented during the first five years of the Project (Cash Flow Projections, Table VI). It is expected that there will be an average of 40 to 60 persons directly employed at each of these sub-projects, resulting in about 7,200 new jobs at the enterprise level.

The major impact, however, of employment generation will be accomplished at the farm level where on-farm laborers will gain employment as a result of the demand for increased agricultural production. This will be a result from both the greater overall agricultural input demand stimulation and crop specific demand stimulation for such crops as tomatoes and asparagus which require intensive cultivation. If a conservative factor of two to one is chosen as the ratio of farm to factory laborers required by the identified sub-projects then the increase in on-farm laborers will be approximately 14,400 persons. This gives a total potential of over 20,000 new employment possibilities as a result of the Project.

4. Model Sub-Projects

Annex X presents analysis of three model sub-projects, to demonstrate the impact that agribusiness projects are capable of having on the agricultural sector. In each case, the sub-project was also analyzed by USAID using the formula set out in the Initial Impact Determination (results are given in Section E on each sub-project profile).

The three sub-projects presented are considered to be representative of those which are likely to be financed under the Rural Development Agribusiness Fund. They are thus illustrative of the types of benefits expected to accrue to both the small farmer target group as well as agribusiness enterpreneurs.

The three sub projects are: (i) Frutas del País S. A.: sub-project for financing mobile fruit processing plants in the sierra; (ii) Cadenas San Fernando: sub-project for financing working capital to asparagus producers on the north coast; and (iii) Rural Marketing Center: an integrated marketing complex located in the sierra and high jungle.

E. Social Analysis

1. Risk Aversion and Economic Behavior

The proposed Project is seen as an essential link in a series of GOP and other donor interventions in the agricultural sector designed to: (i) improve falling rates of productivity; (ii) attract much-needed new capital to the sector; (iii) create new jobs (both on-farm and off-farm) with linkages to the sector; and (iv) increase real income at the level of the Peruvian small farmer.

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

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

GOP experiences in trying to convince small farmers to shift from traditional crops (root crops and easily marketed grains) into higher income crops such as soya or those crops which would serve as basic inputs into vegetable oil manufacturing or other industrial ventures have met with little success. Official production plans prepared at the regional offices of the Ministries of Agriculture and Food have had disappointing results, as farmers claim that there has not been made available either the financial or the technical know-how resources to effect the production shifts, and that either the marketing mechanisms

Expected Impact of Sub-Project:

a. The sub-project will allow for an immediate 15% expansion of the rice production in the zone.

b. Assuming that the second grade rice production is reduced by half, the economic benefit per farm unit (10 hectares) would be S/.75,075 ($938 US) per year.

3. Chocolate Confectionaries Plant

Entity : Chocolates La Iberica - Arequipa

Investment : $400,000

Objective : To double the present production of chocolate based confectionaries (266,000 kg/year).

Background : La Iberica is a well established firm marketing its products all over Peru. La Iberica products are known for their superior quality, and demand currently greatly exceeds supply.

Expected Impact of Sub-Project: The expected impact of this sub-project would be to double the present number of small farmers that provide raw materials for the factory. This translates into an additional 200 small farmers receiving an additional US$280,000 in gross sales for their agricultural products.

4. Fruit Preserves Processing Plant

Entity : Alimentos Cerro Colorado - Arequipa

Investment : $160,000

Objective : To increase the production of peaches, papaya and damascus preserved in syrup, and to increase the production of jellies derived from the same three products.

Background : Alimentos Cerro Colorado is a small successful firm managed by a single entrepreneur and his family.

Expected Impact of Sub-Project: The sub-project proposes to double the present volume of raw materials purchased from fruit farmers and would return about US$42,000 to the local agricultural sector.

5. Balance Feed Mill

Entity : Fongalsur Association - Arequipa

Investment : $540,000

Objective : To install two feed mills to serve FONGALSUR members in two different locations. This would be the first stage of a sub-project that aims at putting four feed mills into operation within the next three years.

Background : FONGALSUR (Fondo de Fomento para Ganaderia Lechera del Sur) is a service cooperative with 5.782 members. About 85% of the members are small farmers with two or three milk cows producing an average of 30 liters per day.

Expected Impact of Sub-Project:

a. As cattle feed presently comes from Lima and other areas, the installation of these feed mills would result in a reduction of up to 15% in feed prices to FONGALSUR member farmers.

b. These same FONGALSUR members would be providing over fifty percent of the raw materials needed by the mills.

c. The quality of the feed would be uniform and controlled by FONGALSUR technicians, and should result in increased milk production. Feed represents 53% of the cost of producing milk by the farmers. A large percentage of the milk consumed in Peru is presently imported.

6. Processing of Quinua Flour and Chocolate paste

Entity : Industrias Alimenticias Cuzco S.A. - Cuzco

Investment : $400,000

Objective : To increase the production of four different types of Quinua Flour and chocolate paste products.

Background : The firm is presently the only one in Peru that processes quinua, a native cereal that has more protein than wheat. Peru presently imports large quantities of wheat, and quinua, which is grown by small sierra farmers, represents an attractive partial substitute.

Expected Impact of Sub-Project:

a. The expansion would mean that an additional 100 small farmers would be brought into supply relationships with the firm.

b. Presently the firm purchases raw materials from intermediaries. Under the expansion the firm plans to deal directly with small farmers or cooperatives, thereby eliminating the interdiaries' 15% margin.

7. Chocolate Confectionaries Plant

Entity : Ismael Moscoso - Cuzco

Investment : $187,000

Objective : To produce chocolate paste with production rising from 13,800 Kg to 41,400 Kg in four years.

Background : Mr. Moscoso is an experienced small businessman familiar with all phases of the operation.

Expected Impact of Sub-Project:

a. It is expected that an additional 45 small farm units will be involved in supplying the plant.

b. The 45 sierra and high jungle small farmers are located in the Valle de Quillabamba and Mr. Moscoso plans to pay at least 5% over present prices to the farmers in order to ensure a stable supply and encourage increased production.

8. Cocoa Products Processing Plant

Entity : Mr. Efrain Vergara - Cuzco

Investment : $107,000 to diversify present chocolate paste production to cocoa butter and chocolate candy.

Background : Mr. Vergara's firm is a small processing plant that has had three years of experience in processing cocoa beans.

Expected Impact of Sub-Project: The planned expansion would process an additional 20,700 kilos of cocoa beans which would require production from about 25 additional small farmers.

9. Pork Processing Plant

Entity : Mr. Jose W. Rozas - Cuzco

Investment : First stage $180,000

Objective : To develop the first stage of a pork processing complex which includes the establishment of a breeding center and facilities for the fattening of sows.

Background : Mr. Rozas has considerable experience with pork processing and presently has sufficient collateral for the proposed investment. The firm would sell the small pigs to farmers for fattening and during the second stage (2 to 3 years later) it would repurchase the pigs and process them into sausage and other products.

Expected Impact of Sub-Project:

a. The sub-project will provide additional sources of on-farm income to local sierra small farmers.

b. During the sub-project's first stage, the firm would purchase a minimum of 600 tons of corn to feed the sows. This would require the production inputs of approximately 75 to 80 small corn farmers in the highlands.

10. Balanced Feed Mill

Entity : Cooperative Santa Elena - Trujillo

Investment : $105,000

Objective : To prepare balanced feed for poultry, swine and dairy cattle. The feed would be purchased by the cooperative's members.

Background : The cooperative has 90 regular members and 64 associated members.

Expected Impact of Sub-Project: The feed mill will stimulate demand for local farmers to provide the raw inputs necessary for the balanced feed.

11. Balanced Feed Mill

Entity : Mr. Gaston Tweddle - Trujillo

Investment : $135,000

Objective : To prepare balanced feed for poultry, swine and dairy cattle. The feed would be purchased by cooperative members.

Background : This new firm would be located 50 Km from the city of Trujillo where there is a high concentration of small farms. The plant would produce feed for poultry and swine at a rate of 180 tons per month.

Expected Impact of Sub-Project:

a. Small farmers in the area will provide corn to the factory and it is expected that the sub-project would affect approximately 65 small farm units per year.

b. It is expected that farmers would receive a 5% price increase for the corn due to the logistical advantage of the plant location, allowing it to pay higher prices.

12. Poultry Balanced Feed Mill

Entity : Mr. Jose Felix de la Fuente - Trujillo

Investment : $455,000

Objective : To construct and operate a plant which would produce 50 tons of feed per day for area poultry production.

Background : The plant would utilize raw inputs from local area small farmers (e.g., corn and alfalfa) to market balanced feed to local chicken producers.

Expected Impact of Sub-Project: The raw inputs required by the mill would necessitate purchasing corn and alfalfa from approximately 480 local small farmers.

13. Feed Mill

Entity : Mr. Fernando Schroeder - Pacasmayo

Investment : $300,000

Objective : To construct and operate a plant which would produce 70 tons of feed per day for area poultry production.

Background : The nearest feed mill plant for poultry is located about 500 Km from Pacasmayo. This plant would provide at least 80% of the feed required by farmers in the area.

Expected Impact of Sub-Project:

a. The daily corn input requirements of the plant would consume the corn production of about 730 small farms per year.

b. The logistical advantage of the plant would probably result in a reduction of up to 15% in the price of the feed.

14. Poultry Processing Plants

Entity : Mr. Jose B. Jugo - Trujillo

Investment : $40,000

Objective : To process 1,200 chickens per hour

Expected Impact of Sub-Project: Probable increases in prices paid to farmers for chicken production (up to 15%) due to the cost reduction in shipping processed versus live chickens to the main market in Lima.

15. Sheep Skins Tannery

Entity : Mr. Carlos Villanueva - Trujillo

Investment : $70,000

Objective : To process 1500 hides per week.

Background : Mr. Villanueva has made shoe soles out of cowhides for several years. His market has been decreasing because of the competition from synthethic materials. However, there is still a large market for sheep hides.

Expected Impact of Sub-Project: The firm would purchase the sheep hides from sierra cooperatives. Presently these cooperatives can only sell wool at good prices because no one has yet industrialized the use of the hides. The firm therefore would be providing a new market for the skins, allowing the cooperatives comprised of small farmers to increase their gross value and income.

16. Fruit Juice Processing Plant

Entity : INDALSA - Junin

Investment : $800,000

Objective : To provide medium-term working capital ($500,000) and technical assistance for the purpose of increasing fruit production by small farmers. In addition, INDALSA plans to invest in cold storage units ($300,000) in the production areas to reduce spoilage.

Background : INDALSA is a well established firm that is presently operating at 35% of installed capacity due to the lack of available raw materials. Lack of credit, spoilage, and transport problems have caused this inadequate raw materials supply problem.

Expected Impact of Sub-Project:

a. The sub-project is likely to stimulate demand for increased raw fruit production by local small farmers.

b. Spoilage and waste should be reduced due to the investment in the cold storage units.

c. The technical assistance program should increase fruit yield and quality, thereby benefiting both the entrepreneur and small fruit farmers.

17. Manioc Flour Mill

Entity : Mr. Carlos Mantero - Tingo Maria

Investment : $60,000

Objective : To increase present production capacity of manioc to 550 tons per month.

Background : Mr. Mantero is presently processing 110 tons of manioc per month.

Expected Impact of Sub-Project: The incremental 440 tons of manioc required by the expansion will consume the production of approximately 85 small farmers (average size of 4 hectares).

18. Production of Farm Implements

Entity : TAPROLAM - Junin

Investment : $500,000

Objective : To manufacture and market minor agricultural equipment and tools.

Background : TAPROLAM presently produces heavy equipment used in agricultural and mining sectors. The sub-project would be an expansion of their product lines into minor agricultural implements for small farmers.

Expected Impact of Sub-project:

a. The sub-project will increase the availability and reduce the cost of minor agricultural implements to small farmers.

b. The use of minor agricultural implements by small farmers will increase their agricultural production.

19. <u>Mobile Fruit Processing</u>

<u>Entity</u> : Frutos del País, S.A.

This sub-project is discussed in further detail in the Model Sub-Projects Section.

20. <u>Asparagus Production</u>

<u>Entity</u> : Cadenas San Fernando, S.A.

This sub-project is discussed in further detail in the Model Sub-Projects Section.

21. <u>Balanced Feed Mill</u>

<u>Entity</u> : Agricultural Production Cooperative, Ramon Castilla - Cuzco

<u>Investment</u> : $135,000

While a feasibility study has been completed, it was not available at USAID at the time this was written.

22. <u>Balanced Feed Mill</u>

<u>Entity</u> : Agricultural Production Cooperative -Lambayeque

<u>Investment</u> : $121,000

While a feasibility study has been completed, it was not available at USAID at the time this was written.