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ACTION MEMORANDUM FOR THE DIRECTOR

THROUGH: DDIR, Paul E. White *[Signature]*
FROM: AC/PDSO, Richard Steelman *[Signature]*
SUBJECT: Authorization of Small Farmer Coffee Improvement
Project, 520-0381

ACTION: Your approval is requested for a grant of Eleven Million Dollars (\$11,000,000) from FAA Section 103 of the Food and Nutrition appropriation for Guatemala for the Small Farmer Coffee Project, 520-0381. It is planned that a total of US\$2.6 million will be obligated during FY 1989.

BACKGROUND: The Project Paper for the Small Farmer Coffee Project was reviewed by the Mission Executive Review Committee on June 21, 1989. As a result of the meeting, the Project Paper was approved subject to the following provisions:

1. Bank of Guatemala's role: The arrangements for the fiduciary fund in the Bank of Guatemala should clearly specify the role of the Bank generally, and that of the Credit Committee, specifically, in such a manner as to preclude the Bank from exercising review and/or approval authority over the project's loans.

The AID team negotiating the trust funds is adhering to this guidance. Furthermore, AID's acceptance of terms for the trust fund and its administrative mechanisms is a CP for disbursement of credit funds under this project.

2. Fiduciary Fund Structure: The project is to: (1) avoid the establishment of a guaranty fund; and, (2) avoid establishing the timing for the use of loan reflows on a schedule that would permit the GOG to reduce its counterpart contribution for the credit component.

Same response as to Action number 1, above.

3. The PP should provide a brief summary of past and current discussions with private banks, describing the banks contacted and their general response to the project. We should stress that, while only BANCAFE is participating currently, other banks have voiced interest.

See pages 5 and 30 of PP.

A statement should be included that no geographic monopolies will be granted to participating banks.

See Pages 5 and 30 of PP.

4. The authorization and ProAg should include the CP for BANDESA, requiring a time-scaled decentralization plan, which parallels the CP for BANDESA under the HADS Project.

Done.

5. The monitoring and evaluation plan of the PP and ProAg should provide for close monitoring of BANDESA's compliance with its decentralization plan. Disbursements to BANDESA should be tied in to continued compliance with the plan.

See page 85 and 87 of the PP

6. The PP should clarify how the private sector bank credit will be structured, in effect, to provide long-term credit to small farmer coffee producers. Explaining that the credit will take the form of annual loans rolled over as needed.

See pages 27, 30 and 35 of the PP.

7. Neither the PP nor the ProAg should limit the source of GOG counterpart to PL-480 Title I.

Done.

8. The PP should present a more balanced conclusion regarding the indigenous farmers' acceptance of new technology.

See page 77.

9. The Clarifications listed in the Issues Paper must all be responded to.

All the clarifications were addressed, clarified or resolved.

DISCUSSION: The proposed project addresses the production of Guatemala's major traditional export crop, coffee. This product brings in an estimated \$500 million annually, an increase in the quantity and quality of coffee produced in Guatemala will have a major impact on this country's economy, and on the income of the roughly 40,000 small farmers who grow it.

The goal of the project is to increase the participation of Guatemala's rural poor in sustained, real economic growth. Its purpose is to increase small coffee farmer income by increasing production, productivity and product quality.

The project seeks to accomplish this objective through the establishment and implementation of a closely-linked technical and financial assistance program for small farm coffee producers. The Association of Coffee growers in Guatemala (ANACAFE) will be the principal project grantee and serve as the central institution for the administration coordination and implementation of project activities. A project management unit in ANACAFE will be responsible for developing and implementing the training and technical assistance program. The project will be formulated to coordinate with participating financial institutions (BANDESA and the private bank[s]) and the Ministry of Finance, the source of local currency resources for the credit fund.

The extension and training plans will be based on the ANACAFE technical assistance program of Grupos de Amistad y Trabajo, and successful USAID projects in Honduras, Costa Rica and Ecuador. Technical Assistance personnel from the two major coffee producer cooperative federations (FEDECOCAGUA and FEDECOVERA) will be trained and utilized and their members will be able to access the projects credit as individuals, however, the federations themselves are not financially sound and will not have access to the credit.

The project's two primary components are: (1) the transfer to small farmers of a technical package and the necessary expertise for the production of high-yielding, export grade coffee; and, (2) the establishment and operation, through the commercial banking system and BANDESA, of a credit fund to finance the production and investment needs of the target group.

An estimated 8,100 small farmers will be assisted by this project's TA and credit: 4,500 on the first round of credit and 3,600 with the reflows. A significant expansion and specialization of ANACAFE's extension project will be financed with \$7.0 million in grant funds; the \$4.0 million balance will support the establishment and partial capitalization of the project credit mechanism. The current Title I agreement has Q4.0 million (US\$1.5 million) identified for this project's credit trust fund; the Quetzal equivalent of US\$10.1 is planned during the eight-year life of project. AID will provide \$1.5 million in bridge financing to assure credit availability until the Title I funds, required for the first year's credit, are in place in BANDESA and the private bank(s).

Initially, it is likely that BANDESA will manage the largest portion of the loan portfolio. However, the participation of commercial banks is expected to increase during the LOP as successful experience in small farmer lending is gained.

Currently, BANCAFE is the only participating private bank though others have voiced interest and active discussions are under way with them at this time.

ANACAFE extension agents will pre-select creditworthy loan applicants before seeking final loan approval from the participating banks. In addition to this pre-selection and loan preparation activity, these same personnel will guide the producers in selecting the most appropriate production technologies needed to optimize yields and financial returns.

The project will also provide limited financing to construct small processing plants and to upgrade existing processing facilities once a needs assessment has been completed. It is assumed that the processing plants will be owned by individual farmers, small farmer groups or local entrepreneurs and will be conveniently located in close proximity to small farm production areas. This will enable producers to market a higher quality and higher value product, and to temporarily store the coffee to hedge for more optimum market conditions.

The project will also undertake a pilot effort to certify and promote specialty coffee for the export market. The activity will develop a promotional campaign directed at U.S. wholesalers to test the acceptability and marketability of an independent certificate that guarantees the quality of Guatemalan coffees.

In the area of project personnel and technical assistance, the project will finance the cost of establishing a management unit in ANACAFE. It is planned that this unit will be sustained by ANACAFE, after the project, with increased income from improved coffee exports as well as the income obtained through ANACAFE's 5% spread on project financed coffee credit. The project will finance three long-term advisors: an extension specialist; an agricultural economist; and a locally hired expert in specialty coffee marketing organization. In addition, 49 person-months of short term TA in a variety of specialties will be financed. Project funds will also purchase equipment and materials for the extension components; long- and short-term participant training and in-country training costs; coffee processing facilities, vehicles and other equipment expenses as well as a management information system for tracking project results and gathering and disseminating project data.

Guatemalan counterpart contributions will be provided from two different sources. The Government will contribute the Quetzal equivalent of \$10.1 million to capitalize the major share of the project's credit fund. ANACAFE's counterpart contribution of \$3.11 million includes the cost of additional personnel and

institutional support not financed with project funds. Project related positions, funded by ANACAFE will include extension workers, extension credit agents and project para-technicians. ANACAFE and the beneficiaries themselves will also finance a portion of the cost related to training (per diem expenses), equipment and logistic support and administrative assistance. It is estimated that from year 4 to 8, inclusive, the private banks will provide \$1.0 million of their own funds for project related credit.

By the end of this project, the following outputs are expected: (1) 8,100 small coffee producers will be trained in modern, appropriate renovation and production technologies; (2) 800 small producers will be trained in improved coffee processing technology; (3) four ANACAFE technicians will have been trained to the M.S. level in modern coffee technology; (4) Sixty ANACAFE extension agents will have been trained in the application of the new technical packages as well as in the operation of processing plants; (5) 300 para-technicians will have been trained to support and complement the extension agents; (6) ANACAFE's project management unit will have been established and operating with required levels of staffing and financial resources; (7) coffee processing facilities (the number to be determined during project implementation) will be constructed and in operation; (8) credit trust funds will be established in BANDESA and at least one private bank; (9) a mechanism for certifying coffee characteristics and quality will have been developed; and, (10) a promotion campaign will be established to promote high quality Guatemalan coffee in export markets.

WAIVERS: The PIO/T for the cooperative agreement with ANACAFE contains a request for a waiver of competition per Handbook 13, Chapter 2, Section 3b, which states that competition is not required for "assistance awards for which one recipient is considered to have exclusive or predominant capability, based on experience, specialized facilities or technical competence, or based on an existing relationship with the cooperating country or beneficiaries.

ANACAFE, under provisions of Guatemala's 1969 Coffee Law, is defined as a non-profit entity constituted by and comprised of the coffee producers of the Republic with full legal and fiscal attributes accorded private companies. This law is the legal instrument that has regulated and controlled the Guatemalan coffee industry since that time. While legally a private institution, the objectives of ANACAFE, as outlined by the Coffee Law, are to cooperate with the government in protection of the interests of the nation's economy in relation to the production and marketing of coffee.

Specifically, ANACAFE carried out technical investigation services, experimentation, demonstration, assistance and extension in the diverse fields of the coffee industry and promotes all the economic and agricultural activities related directly or indirectly with coffee. Consequently, ANACAFE is the prime employer of coffee related experts in these fields. Moreover, the association is charged with resolving problems of small producers with regards to financing cultivation, processing and marketing of their products at just and reasonable prices.

The law also establishes ANACAFE as the only organization authorized to extend coffee export and shipping permits

In view of its unique legal status, relationship to the public and private sectors, impact on the small coffee farmer and extensive experience in extension, production and marketing of coffee the waiver of competition has been requested.

JUSTIFICATION TO THE CONGRESS: This project was notified to Congress on June 26, Per Congressional Notification Transmittal Sheet, the CN expired on July 10. A Budget Allowance was received in State 6122 dated January 28, 1989.

RECOMMENDATION: Per Delegation of Authority 752 you are authorized to approve projects with an initial LOP of up to ten years and up to \$20.0 million. This project falls within your area of authority and, in State 184165 of June 9, you received AID/W approval to authorize this project. Therefore, it is recommended that you sign the attached Project Authorization and Facesheet, authorizing the Small Farmer Coffee Project (520-0381) for an LOP of eight years and of US\$11.0 million.

Drafter: RSteelman RS 7-20

Clearances

ORD, GStraub	<u>[Signature]</u>	Date: <u>7-20</u>
PRM, TKellermann	<u>[Signature]</u>	Date: <u>7/21/89</u>
OEPA, DHoelscher	<u>[Signature]</u>	Date: <u>7/21/89</u>
CONT, JOHill	<u>[Signature]</u>	Date: <u>7/27/89</u>
ADM, LWhitlock	<u>[Signature]</u>	Date: <u>7/27/89</u>
DDIR, PEWhite	<u>[Signature]</u>	Date: <u>7/27/89</u>