

PDKAG 512

file

PROJECT PAPER  
FOR A  
PRODUCTIVE CREDIT GUARANTY PROJECT  
IN  
THE REPUBLIC OF COSTA RICA  
UNDER THE  
PRODUCTIVE CREDIT GUARANTY PROGRAM  
(PCGP)  
OF THE  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
(A.I.D.)

REVISED

**NON COPY**

## TABLE OF CONTENTS

	<u>Page</u>
I. <u>PROJECT SUMMARY AND RECOMMENDATIONS</u>	1
A. PP Facesheet	1
B. Recommendations	2
C. Description of the Project	2
D. Summary of Findings	4
II. <u>PROJECT BACKGROUND AND DETAILED DESCRIPTION</u>	4
A. Background	4
B. Description	5
C. Borrower, Subproject, and Loan Eligibility	8
D. Administration	10
E. Operation of the System	14
F. Project Issues	16
III. <u>PROJECT ANALYSES</u>	18
A. Technical Analysis	18
B. Financial Analysis	20
C. Credit Demand Analysis	29
D. Social Analysis	32
E. Economic Analysis	34
IV. <u>IMPLEMENTATION ARRANGEMENTS</u>	35
A. Administrative Arrangements	35
B. Implementation Timetable	36
C. Evaluation Plan	36

## ANNEXES

- I. Legislation
- II. Guaranty Authorization
- III. Director's Certificate
- IV. Letter from the Central Bank
- V. Statutory Criteria
- VI. Logical Framework
- VII. Credit Demand Analysis
- VIII. Environmental Impact Determination

I. PROJECT SUMMARY AND RECOMMENDATIONS

AGENCY FOR INTERNATIONAL DEVELOPMENT  <b>PROJECT PAPER FACESHEET</b>		1. TRANSACTION CODE <div style="display: flex; align-items: center;"> <div style="border: 1px solid black; padding: 2px 5px; margin-right: 5px;">A</div> <div style="font-size: small;">                     A ADD                      C CHANGE                      D DELETE                 </div> </div>		PP  2. DOCUMENT CODE <b>3</b>
3. COUNTRY/ENTITY  Costa Rica		4. DOCUMENT REVISION NUMBER  <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">0</div>		
5. PROJECT NUMBER (7 digits)  <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">515-0156</div>	6. BUREAU/OFFICE A. SYMBOL LA	B. CODE <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">05</div>	7. PROJECT TITLE (Maximum 40 characters)  <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">PRODUCTIVE CREDIT GUARANTY PROJECT</div>	
8. ESTIMATED FY OF PROJECT COMPLETION  FY <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">83</div>		9. ESTIMATED DATE OF OBLIGATION A. INITIAL FY <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">78</div> B. QUARTER <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">4</div> C. FINAL FY <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">78</div> (Enter 1, 2, 3, or 4)		

10. ESTIMATED COSTS (\$000 OR EQUIVALENT \$1 - )						
A. FUNDING SOURCE	FIRST FY			LIFE OF PROJECT		
	B. PA	C. L/C	D. TOTAL	E. PA	F. L/C	G. TOTAL
AID APPROPRIATED TOTAL						
(GRANT)	( )	( )	( )	( )	( )	( )
(LOAN)	( )	( )	( )	( )	( )	( )
OTHER U.S.						
1. Guaranty		3,000	3,000		3,000	3,000
2.						
HOST COUNTRY		1,500	1,500		1,500	1,500
OTHER DONOR(S)						
<b>TOTALS</b>		<b>4,500</b>	<b>4,500</b>		<b>4,500</b>	<b>4,500</b>

11. PROPOSED BUDGET APPROPRIATED FUNDS (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE		E. 1ST FY		H. 2ND FY		K. 3RD FY	
		C. GRANT	D. LOAN	F. GRANT	G. LOAN	I. GRANT	J. LOAN	L. GRANT	M. LOAN
(1)	900	840							
(2)									
(3)									
(4)									
<b>TOTALS</b>									

A. APPROPRIATION	N. 4TH FY		O. 5TH FY		LIFE OF PROJECT		12. IN-DEPTH EVALUATION SCHEDULED
	P. GRANT	Q. LOAN	R. GRANT	S. LOAN	T. GRANT	U. LOAN	
(1)							<div style="border: 1px solid black; padding: 5px; display: inline-block;">                     MM YY                      12 79                 </div>
(2)							
(3)							
(4)							
<b>TOTALS</b>							

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.

2

 1 = NO  
 2 = YES

14. ORIGINATING OFFICE CLEARANCE SIGNATURE		15. DATE DOCUMENT RECEIVED IN AID/W OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION  MM DD YY <div style="border: 1px solid black; padding: 2px 5px; display: inline-block;">07 28 78</div>
TITLE  DIRECTOR, USAID/COSTA RICA		

## B. Recommendations

It is recommended that A.I.D. enter into a Trust Agreement with the Banco Central de Costa Rica ("Trustee") for the development, implementation and administration of a credit guaranty project under the Productive Credit Guaranty Program ("PCGP") that A.I.D. supports under the provisions of Section 222A of the FAA of 1974 (See Annex I). The credit guaranty system will have a capacity to guaranty a total portfolio of loans equal to \$6.0 million equivalent; the assistance from A.I.D. will consist of a guaranty of \$3.0 million and technical direction and assistance by the regional technical unit in charge of the technical direction of the PCGP. (See Annex II)

It is also recommended that AID/W initiate as early as possible the necessary action to obtain extension of the congressional authority expiring on September 30, 1978, to at least September 30, 1978, to provide an opportunity for project expansion if necessary.

## C. Description of the Project

The project purpose is to develop a self-sustaining credit guaranty mechanism which will use a guaranty fund to stimulate the credit operations of local financial institutions (the "Beneficiaries") to increase economic activity in potentially productive under-privileged socio-economic sectors of Costa Rica. By self-sustaining it is meant that the credit guaranty system will be capable of generating enough income to cover losses and administrative expenses within a reasonable time after implementation. (See financial projections in Part III.B. Financial Analysis). The projected output is therefore a commercially viable credit guaranty mechanism.

The proposed guaranty mechanism will facilitate the operations of commercial lenders with small farmers and small business operators, individually or in groups, who have insufficient collateral to obtain credit under normal circumstances. Hence, the goal to which the Project contributes is to increase opportunities for productive and profitable investment by incorporating into the credit system the above mentioned small entrepreneurs who because of their relative poverty, have not been able to obtain such credit heretofore.

The principal inputs for the realization of the Project will be made by the Trustee, A.I.D. and the Beneficiaries of the fund in trust. The Trustee will provide office space and equipment,

professional staff, support services, and administrative budget support before the Project becomes self-sustaining. A.I.D. will establish the Guaranty Fund with a guaranty of \$3.0 million, and will provide training seminars and assistance in system design, implementation, and operations.

The guaranty of A.I.D. through the Fund will be of 75% of each loan but, because of the statutory limit, A.I.D. will not pay under its obligation more than 50% of the outstanding amount of all loans made by each participating lender during the year of each defaulted loan. However, to benefit from the guaranty of A.I.D., and make possible the payment by the Fund of all guaranteed loans defaulted, the Beneficiaries have agreed jointly and severally to deposit into the Fund the necessary financial resources to pay defaulted loans, if there are not sufficient financial resources in the Fund and A.I.D. has reached the 50% limit of its guaranty.

Thus, the Guaranty Fund will be the backbone of the guaranty system. With the inputs from A.I.D. the Trustee and the Beneficiaries, the Fund will be able to offer a guaranty of 75 percent of every eligible loan made by the participating lenders. Under the arrangement of an A.I.D. Fund in Trust capitalized with adequate guaranty commissions and other income, the Fund will serve as a cushion to prevent payments by A.I.D. and the Beneficiaries. However, at the outset, before the Fund develops its strength, the immediate risk in each lender's portfolio of loans will be shared as follows:

	<u>Percent of Risk</u>
1. Lender	25
2. A.I.D.	50
3. Banks, collectively	<u>25</u>
Total Risk Coverage	<u><u>100</u></u>

Operationally, the guaranty will apply automatically to those projects found eligible and feasible by the lenders and qualified participating technicians. Upon approval of this Project, the system design will be completed and its implementation will be carried out; guaranty operations will begin on or about January, 1979.

67

#### D. Summary of Findings

The basic concept for a POGP guaranty system has been found appropriate for Costa Rica. Conversations with Central Bank officers and potential participating lenders, and analyses of their institutional strengths have indicated that there are adequate physical and intellectual infrastructure and sufficient resources to achieve the project purpose and contribute toward the project goal (See Annex III). The proposed utilization of existing resources to design and operate a guaranty system that will work within the banking system, enhancing without disrupting normal credit operations, constitutes a vital condition for the acceptance of the Project and the prompt achievement of self-sufficiency (See Technical and Financial Analyses in Part III). Moreover, the probable socio-economic impact of the Project is quite significant if viewed in relation to projects that require foreign debt or monetization to stimulate credit internally. This feature and the principle of cost-effectiveness at all system levels are perhaps the principal reasons for the support of the GOOCR, the banking system, and the private sector in general (See Economic Analysis in Part III). Lastly, the satisfaction of the need for stimulation of credit for "grass roots" development is quite timely to support other GOOCR efforts, where A.I.D. also participates. The Mission is currently also proposing financial assistance for some \$16.8 million in the Urban Employment and Community Improvement Project. There are other approved and proposed projects for the rural sector where A.I.D. inputs will reach some \$14.0 million. All these projects have a credit component that will be enhanced by the guaranty system.

## II. Project Background and Detailed Description

### A. Background

The idea of developing a credit guaranty mechanism was proposed by the Mission as the Urban Employment and Community Improvement Project was in the conceptualization stage in early 1978. Although that project has a soft term loan component for sub-lending operations through the banking system, it was evident that the lenders would not participate in these operations without a mechanism to help neutralize the risk of the proposed sub-lending operations that were new to them.

The Mission had knowledge of the POGP and requested assistance from AID/W to assess the viability of a credit guaranty system in Costa Rica. The Technical Director of the POGP visited Costa Rica in the Spring of 1978, and explained the technical details

of said system to government officials and technicians from the Central Bank and OFIPLAN. At the same time it was established that there were many conditions that were favorable for the development of the system, and that \$3.0 million of guaranty authority, previously allocated to Honduras, were available for a POGP project in Costa Rica.

Finally, a formal offer of the POGP was made to the GOCR through the Central Bank, which was accepted by the office of the President of the Republic in June of 1978. At the request of the Mission, the Technical Director-POGP traveled to San José to assist the Mission and officials of the Central Bank and of the banking system in the conceptualization of the Project for the presentation of this paper.

Prior to the formulation of the project for Costa Rica, the A.I.D. technical staff assisted in the formulation of projects for Bolivia, Colombia, Honduras and Nicaragua. Some flaws in the implementation arrangements and changing conditions did not permit the completion of the system in Honduras and have delayed implemen- tation in Colombia and Bolivia. The projects in Nicaragua and Paraguay have been implemented and lending is taking place in those countries in both the urban and rural areas. The significant success of the Paraguayan project has been partly the result of the Mission's early recognition of the need to assist the Central Bank in system implementation, which has been provided by assistance from Washington. The same approach is being proposed for Costa Rica with technical assistance from the recently created Regional Technical Office for the POGP. A new and improved model for the Project Agreement is being proposed where the lenders are counter guarantors of the obligations of the guaranty fund. This relieves the Central Bank from this obligation, which was a major negative factor in Honduras and caused considerable delay in other countries. Generally, Central Banks do not have the authority to incur this kind of obligation, as is the case in Costa Rica.

## B. Description

The goal to which the Project contributes is to increase opportunities for profitable and productive investment by incorporating into the institutionalized credit system small entrepreneurs who have not previously been able to obtain such credit. Typically, the alternatives available to such individuals are not to use credit, or to use non-institutional credit sources that, because of onerous conditions, impede economic gain and any capitalization for economic growth.

The intention of the legislators, reflected in the guaranty authority (Annex I), is to develop commercially viable loan guaranty mechanisms. If this is possible, their demonstrated merits will hopefully lead to their institutionalization to provide continuously the necessary incentive to credit institutions to fund projects proposed by socially and economically deprived individuals. These projects have not been "bankable" because of a high degree of uncertainty about their potential success. The purpose of the Project is therefore to develop an effective, self-sustaining credit guaranty system that will neutralize the real or imagined risk of the projects proposed by potentially productive individuals, normally outside of the bonafide credit system. Economically, these

men and women constitute an invaluable resource to foster socio-economic development at "grass roots" levels of society. These people are existing or new small farmers, small business operators in food production and commercialization, and small businessmen in the production, manufacture, or service industries, whose profitable activities will have a direct impact on the quality of life and economic opportunity in their communities.

The output of the Project will be a tested guaranty system with a record that could justify its strengthening as considered proper and necessary by the banking system of Costa Rica.

The inputs required of A.I.D. will be a guaranty of collection to the participating lenders through the Guaranty Fund, which will be established and administered by the Central Bank under a trust agreement, and technical support for project design, implementation and operation of the necessary operating system. The guaranty of A.I.D. will be 75 percent of each loan in default for up to 180 days, and will cost the borrower up to 5% of the guaranteed loan. However, payments by A.I.D. will cease when the total of all payments made after the Fund is exhausted, reaches fifty percent of the loans outstanding from the year of each loan paid. Since the guaranty of the Fund is of 75 percent of the outstanding balance in each loan, after A.I.D. reaches its limit the banks of the system will jointly absorb the loss until the full 75 percent of total lending is covered. As stated above, the payments by A.I.D. will only take place after the resources of the Fund, mainly from guaranty fees, are exhausted. This feature will reduce the probability of these payments and will also protect the banks.

In other words, in matters of risk coverage, A.I.D. and the banks of the system will be counter-guarantors of the obligations of the Fund. However, to protect the interest of A.I.D., assure equity and enhance the liquidity of the Fund, the lenders, under the terms of the Trust Agreement, to benefit from the guaranty system will be required to make best efforts to collect loans and to establish legal proceedings to recuperate delinquent guaranteed loans, before the guaranties are paid by the Fund. After payment by the Fund, the lender will continue to seek payment of the delinquent loan and, in the event of recovery, will pay back to the Fund 75 percent of the amount recovered, after deducting recuperation expenses.

As to the technical assistance support, A.I.D. will pay for periodic training seminars sponsored by the Technical Unit in charge of the technical direction of the PCGP. These seminars will be available to the staff assigned to administer the guaranty system. The training will cover the basic technical principles of guaranty mechanisms and their design, organization and operations, financial management and analytical techniques to evaluate project progress. A.I.D. through the Technical Unit will also pay for the services of an expert in banking and risk management to assist for a period of 18 months in the final design, implementation, and start of operations of the guaranty system.

Lastly, if after the system is in operation A.I.D. and/or the Trustee decides to terminate the Project, the capital of the Fund at the time of the decision will be used to discharge all the outstanding obligations of the Fund. The remaining balance, if any, will be the property of A.I.D. to be used in any other development project approved by the Government of Costa Rica.

Development of the Project will entail the organization and adaptation of several existing institutions into future components or subsystems of the guaranty system. These institutions have been and will continue to operate as independent entities in their respective functions. However, for the coordination of their activities under the POGP system they will follow the specific guidelines established to facilitate the achievement of the Project's operational objectives. The institutions that will form the system for the POGP in Costa Rica, and their functions are:

1. The Trustee - will develop and implement the guaranty system with the technical assistance of A.I.D., will coordinate the activities of the other three subsystems, and will administer the Guaranty Fund. Within its capacity, this subsystem will also provide liquidity for lending under the POGP through the regular procedures of rediscount or through improved procedures, as necessary, to provide incentives for the desired credit expansion. It is contemplated that over 50% of the guaranteed loans will be discountable at the Central Bank. There are assurances from the Central Bank that there will be sufficient resources within the banking system to sustain the credit volume forecast in the Financial Analysis section of this paper.
2. A.I.D. - will provide the Fund with a guaranty of collection of up to \$3.0 million, and the necessary guidance and technical assistance for the development, implementation, and operation of the system. Sufficient guaranties will be made available on a yearly basis to support expected lending activities under the Urban Employment and Community Services Loan.
3. Participating Credit Institutions - there are in Costa Rica 4 commercial banks operating through over 70 offices in the country. These institutions, as participating lenders under the system, will screen potential private borrowers and will grant credit for the implementation of eligible subprojects. The proposed participating lenders are acceptable to participate in the POGP because they are institutions with an acceptable record of success in their credit operations and because over 60% of their total capitalization comes from the private sector. The

institutions have requested admittance to the system, and will agree as parties to the trust agreement to operate in accordance with its policies and procedures; as established by the Administrator and A.I.D.

There are also some 28 finance companies that could join the system after its merits are demonstrated with the initial collaboration of the National Banking System.

4. Participating Technicians - there are available for the first year of operations sufficient technicians to generate at least 45 subprojects. For projects in agriculture there are over 51 extension agencies from the Ministry of Agriculture dispersed throughout the country. For projects in the urban areas, the Ministry of Economy's Office of Small Industry and Artisanry (DGATPIA) has been in existence for approximately two years. Under the proposed Urban Environment Project, DGATPIA's institutional capacity will be boosted in 36 months by adding 36 field analysts to their present staff. Among many other things, the institution will have the capacity to prepare more than 35 financial and technical feasibility reports and assist up to 970 firms obtain credit. Moreover, independent technicians will be invited to join the System to develop projects and provide follow-up assistance under contracts with the borrowers. It is expected that independent consultants will join the system as the Project proves to be a good source of income. Lastly, all the technicians currently in the payroll of the participating lenders will begin to focus their attention on those projects proposed by target group applicants.

The principal activities of all the participating technicians will be the conceptualization of subprojects and the formulation of financial proposals. The interested professionals and para-professionals will be classified in accordance with their practical experience. Those qualified and interested in participating will be trained in the use of the Project's handbooks of policy and procedures, which will be prepared to guide and maintain minimum standards of quality. The technicians' recommendations will be based on the technical, economic, and financial viability of the subproject. The technicians' services will be free to the borrower, or included as part of each subproject cost.

In cases where the cost of technical assistance is charged to the subproject, the cost is retained by the lender from the proceeds of the loan. Ten percent is then credited to the technical assistance account of the guaranty fund and ninety percent is paid to the participating technician. The ten percent is accumulated to finance the cost of studies of proposed subprojects where financial assistance is not recommended. As it is shown on page 26, the cost of pre-investment technical assistance is expected to average 5% of the credit: 90% of this amount will be disbursed for technical assistance and 10% for lost technical assistance.

#### C. Borrower, Subproject and Loan Eligibility

Because recipients of sub-loans under the Urban Employment loan will also have access to guaranties under the PCGP, these firms must meet eligibility criteria specified in the Urban Employment and Community Improvement Project Paper, i.e., they must have:

- (a) fixed capital assets of less than \$30,000;
- (b) capital per job ratios of less than \$4,000;
- (c) no access to other institutional credit;
- (d) technically and financially sound use for the credit; and
- (e) an owner who works full time in its operations.

The maximum loans to an individual firm will be \$15,000.

Eligibility criteria for the remainder of the Guaranty Fund is broader. It has been established for owners or groups who:

- (a) are capable of managing and devoting all their time to a subproject;
- (b) in the case of farmers, individually or in group, own and work less than 20 has. of land per person and proposed total subproject capitalization is no more than \$5,000 equivalent per worker.
- (c) in the case of small industry and commercial enterprises the proposed total capitalization of the project is less than \$10,000 equivalent per worker, including owners.
- (d) are willing and able to contract debt; and
- (e) are unable to obtain institutional credit on reasonable terms.

Criteria (a) through (c) are meant to focus the project assistance on individuals and groups who previously had been largely excluded from convenient institutional credit, frequently because of lack of sufficient collateral. They, along with their employees, are believed to be included in the poorest two-thirds of the population. They generally do not understand how they can use credit, and if they do, they typically obtain it from money lenders who often also buy the commodities the borrowers produce at prices the money lenders themselves establish. Interest rates on loans from private money lenders are typically several times the 6 to 14 percent the eligible borrowers will be paying under this Project. This group of borrowers is also composed of people who have had little or no access to technical assistance and are generally in need of it.

Subproject eligibility has been established in accordance with known principles of risk management to enhance the potential impact of the Project through broad risk diversification.

Eligible subprojects will be those,

- (f) found technically, financially, and economically feasible by participating technicians;

121

- (g) providing more than 50 percent of the borrower's income; and
- (h) located in rural areas or in depressed urban areas.

Loans eligible for the guaranty of the Project will be those made:

- (i) not exceeding \$25,000 equivalent for subprojects owned by one individual person and not exceeding \$50,000 equivalent for subprojects owned by groups of individuals (\$15,000 for the Fund component covering small industry loans in the San Jose Metropolitan area);
- (j) for a one-time guaranty fee that shall not exceed five percent of the subloan;
- (k) at terms no longer than ten years, at a legal interest rate;
- (l) to finance fixed and/or current assets; and
- (m) to refinance debt only in cases justified technically and financially and if that debt was previously under the guaranty or was contracted in harsh terms not considered beneficial to the subproject.

The eligibility criteria are expected to conform with the return on investment necessary to secure an income that will assure improvement in the socioeconomic status of subproject sponsor(s). Subprojects with net returns of 30 percent or more are quite possible in Costa Rica. Such returns will be attractive enough to motivate the use of credit.

The five percent limit to the guaranty commission is intended to prevent an inordinate burden on the subproject and to pose a challenge in the administration of the Project. If the capitalization of the Fund can be easily achieved with the initial guaranty commission, the commission can be lowered to favor the borrower but without putting in jeopardy the financial soundness and effectiveness of the guaranty system.

Changes and exceptions to the above criteria will be made by the Administrator and A.I.D. as the Project progresses, to reflect better the intent of the legislation, to assure the positive impact of the Project, or when the merits of specific subprojects require such action.

#### D. Administration

To achieve the purpose of the Project, the Central Bank will create an administrative unit. The unit will be staffed with a project director, a financial-administrative analyst with

training in finance and economics, and a secretary. The unit will function at the Central Bank under an administrative board where all the banks and the Central Bank will be represented. The work content of each position will be defined based on the policies and procedures established to carry out the administration of the Project. These will encompass the following activities:

1. Research and Planning
  - a. Periodic analyses to determine:
    - i. priorities of satisfaction of credit needs;
    - ii. availability of physical and human resources;
    - iii. legal framework for utilization of resources;
    - iv. applicability of current monetary policy and/or need for modifications; and
    - v. availability, or need for creation or modification of systems to mobilize financial resources.
  - b. Periodic review of project objectives and achievements and definition of measurable criteria for:
    - i. total volume of loans by lending institution;
    - ii. distribution of credit through rural and urban areas;
    - iii. geographic distribution of project coverage;
    - iv. number and capacity of participating lending institutions;
    - v. resource mobilization goals through rediscounts and other sources;
    - vi. levels of capitalization of the Guaranty Fund;
    - vii. number and capacity of available sources of technical assistance;
    - viii. operations plan for the guaranty system;
    - ix. operating budget for the guaranty system;
    - x. pricing policy and guaranty commission; and
    - xi. technical assistance fees.

With respect to ii above, the yearly planning exercise will take into consideration the lending programs of the participating banks in the urban and rural areas, and will place particular attention to lending programs planned under the Urban Employment and Community Services Project for the allocation of the guarantying capacity of the Fund in the forthcoming year.

- c. Studies of special system features and recommendations to improve their effectiveness and efficiency with emphasis on:
  - i. policy;
  - ii. organizational structures;
  - iii. methods and procedures; and
  - vi. combinations of the above.

2. Design and Implementation

- a. Development and updating of:
  - i. communications and information systems;
  - ii. administrative and financial models; and
  - iii. handbooks containing operating policy and procedures approved by the Administrator and A.I.D.
- b. Selection, incorporation, training, and coordination of:
  - i. technical assistance entities;
  - ii. financial institutions; and
  - iii. support subsystems within and without the Central Bank.

3. Operations and Control

- a. Maintenance of the central register of:
  - i. loans granted and borrowers;
  - ii. technical assistance operations;
  - iii. arrearages, delinquency periods, and defaults;
  - iv. doubtful recuperations;
  - v. audits;

- vi. payments of guaranties and of technical assistance;
- vii. other borrower's assets encumbered;
- viii. participating institutions; and
- ix. accounting and administrative data.

b. Execution and preparation of:

- i. payments;
- ii. collections;
- iii. inspections;
- iv. audits;
- v. corrective actions;
- vi. financial statements of the Fund; and
- vii. operations reports.

c. Monitoring of:

- i. trends in approvals and disbursements;
- ii. utilization of the resources of guarantied loans;
- iii. actual performance of subprojects per their original projections;
- iv. loan amortizations and delinquencies;
- v. management of assets received after payment of guaranties; and
- vi. lenders' operations and portfolio status reports.

4. Evaluation and Information

a. Statistical analyses of:

- i. credit volumes;
- ii. productivity of borrowers;
- iii. profitability of borrowers, lenders, technicians, and other participants in the system;
- iv. benefits to the national government;

110

- v. borrower's incomes;
- vi. living standards; and
- vii. any other identifiable effect of the guaranty system.

b. Editing and dissemination of information through:

- i. publication of special studies; and
- ii. publication of the YEAR BOOK - POGP

E. Operation of the System

The administrative unit will guide the system's operations through established means of communications: operations handbooks, training sessions, and field evaluations. The system's operations can be synthesized in three major functions:

1. Credit and Technical Assistance - the system will support credit for productive activities in agriculture, agribusiness, and small industry and commercial activities providing economic opportunity and needed services for community development. The thrust of the project will be to stimulate productive activities. Lenders and technicians will screen potential borrowers. Identification of a potential borrower by a lender will result in a referral of the applicant to a participating technician paid by the Administrator or the Borrower, as explained below. The technician will study the technical and financial merits of the project in accordance with established eligibility criteria and will recommend for or against funding.

The technical and financial studies of a subproject will establish the minimum required capitalization. With a positive recommendation, the lender will be free to grant the credit under the guaranty, within the established portfolio limit of the lender, after verification of the eligibility of applicant and subproject. It must be stressed, however, that the lender is not obligated to grant the credit even with a positive recommendation from a participating technician. The loans made will be eligible for rediscount at the Central Bank at favorable loan percentage terms, and interest rates.

Borrowers will also be entitled to follow-up technical assistance during the first year of a subproject, which may be charged to the loan. Such follow-up technical assistance may be made a condition of the loan agreement when it is deemed necessary by technicians carrying out the preinvestment analysis and/or by

the commercial bank extending the loan. After the first year of operation, it is assumed that a subproject will generate sufficient cash flow to allow the firm to pay for its own technical assistance.

Both preinvestment and follow up technical assistance will be financed by the lender as part the loan when the assistance is not available without charge. In case the loan is not approved after a preinvestment survey, the cost of making the survey will be paid by the Administrator out of a 10% differential between the cost of the services paid to the technicians making the survey and the price charged to the subproject. The Lender's operations handbook will list all the available technicians by specialization, location, and fees. This directory will be expanded as the project develops.

2. Guarantied Loan Amortization and Performance Information - the granting of a guarantied loan by any participating lender will immediately be reported to the Administrator. A new file will be opened on each loan, and information will be updated monthly, mainly after delinquency reports. In this way the Administrator will gather current information about the total portfolio under the guaranty and about the magnitude of the balances in arrears. This will also facilitate the monitoring of the lender's operations, the determination of loan eligibility for the guaranty, the needs for subproject and/or portfolio audits, and the lender's eligibility for payment of any guarantied loan.

The main purpose of the information system is the proper functioning of the portfolio control mechanism. Inordinate increases of arrearages must be promptly identified to slow or suspend the lending operations of those lenders likely to show losses close to the guaranty commission (to be initially established at 5 percent). In addition to the lender's reports, the Central Bank will also receive technicians' reports as they provide assistance to the subproject during operations. A lender's deviation from the Project's procedural guidelines in granting any loan will render the guaranty invalid and the obligation of the Fund terminated.

Under this function it has been established that the Administrator shall submit to USAID a quarterly report with information about the operations of the Project, the financial situation of the Fund, total A.I.D. exposure under the guaranty, and lenders', borrowers', and technicians' performance as reflected in the portfolio status at the end of the quarter.

3. Guaranty Payments and Other Payments - the last important function covers the actual payments of the obligations contracted by the subsystems that constitute the loan

guaranty system. In order of importance, the first obligation is contracted by the Fund which agrees to pay 75 percent of the outstanding balance of a loan made by a participating lender in accordance with the guidelines given to the lender by the Central Bank. Payment by the Fund will take place after no more than 180 days of delinquency, if the lender has initiated legal action against the delinquent borrower. In the event that the Fund's resources are not sufficient A.I.D. will start its payments as explained earlier. If A.I.D.'s payments reach the limit of 50 percent of a lender's portfolio, the participating credit institutions will continue to pay until the entire portfolio is covered.

The guaranty commission will be paid once by the borrower to the lender, who will credit it to the account of the Administrator. The commission will be 5 percent of the credit, which is expected to be sufficient to cover losses and administrative expenses (see financial projections in Part III below). Adequacy of the guaranty commission will be related to the competence of the staff managing the guaranty system. Specifically, they must accurately assess the risk of the lending operations, organize a reliable technical assistance system, and monitor portfolio delinquency rates to take timely corrective action and to insure prudence by the participating lenders.

Lastly, the participating lenders who received guaranty payments from the Fund will continue to seek payment of the defaulted loans, and in the event of recuperation, will pay back to the Fund 75 percent of the amount recovered less the cost of recuperating.

All the activities under the above four functions will be monitored by the Administrator to assure the effectiveness and reliability of the system. Monitoring of the project by USAID will be carried out by the Capital Development Office with the assistance of the regional technical unit in charge of the technical direction of the PCGP.

#### F. Project Issues

Project success depends upon crucial interrelated elements:

1. Efficient and effective administration of the Project, in accordance with the administrative cycle outlined under "Administration", to be able to, a) develop a reliable risk neutralization system to instill confidence and obtain lenders' participation; b) develop an effective technical assistance sub-system to identify a sufficient number of bankable investment

opportunities, and develop subproject proposals.

The experience gained so far in the design and implementation of other guaranty systems was useful in the conceptualization of the system for Costa Rica. The Mission expects that the utilization of the trust concept with the participation of the trust beneficiaries, with their own interest at risk, in the administration of the fund, will enhance the quality of the management and maintain their interest in continuous improvement of the system. Specifically, with the Central Bank as the trustee but with the lenders bearing an increasing financial burden, in the case of poor management, we expect a generally stronger interest in the quality of the administration of the system. The technical assistance subsystem will also have many incentives to perform well. Increasing incomes and professional pride are the two principal possible motivators.

2. Lenders with sufficient recognition of the potential profitability of their banking operations with the guaranty system, and sufficient interest and commitment to seek the success of the project through utilization of the guaranty system.

The participation and assistance of the technical unit staff will be a positive factor in the dissemination of information from other projects under the POGP and in the continuous motivation and training of all the participants in the operations of the Costa Rican system.

USAID does not believe there are any serious issues *per se* in this Project but presents the above thoughts to focus attention on the areas of possible weakness if the necessary technical direction and support from the technical unit are not available in a timely and efficient fashion.

7/7

### III. Project Analyses

#### A. Technical Analysis

The Project's purpose becomes the primary technical goal of the Project which is to implement, operate and refine the Costa Rican POGP model. In general, the model is intended to neutralize economically the risk inherent in the operations of the participating lenders. The need for this system arises from the lenders' belief that the appropriate interest rate for loans to individuals outside the credit system becomes prohibitive or cannot be ascertained because of the uncertainty about the success of the subproject. In other words, the high degree of uncertainty usually translates into infinite risk in the mind of the lender. To illustrate,

$$\text{COST} + \text{RISK} = \text{PRICE}$$

Where,

COST is the opportunity cost, the administrative cost, and the price the lender must pay for funds, either to the Central Bank or to the depositors.

RISK is the probability of losing the loan. With the general tendency of the commercial banker to cover 100 percent of the risk through the requirement of sufficient collateral, in operations with new borrowers, the lack of sufficient mortgageable assets makes the operation impossible.

PRICE is the interest rate plus commissions paid by the borrower. This becomes a major constraint because the interest rate cannot exceed legal limits and anything above the return of the subproject after covering production expenses and salaries, is not acceptable by the borrower.

Therefore, the role of the guaranty system is to minimize the "infinite" or indeterminate risk of the lender and provide a profit incentive within the terms of existing rediscount rates and legal interest rate structure. This is intended to allow the lender a net return equal to his opportunity cost. As to the self-sufficiency of the Guaranty Fund, it will depend on the accuracy with which the potential risk is quantified adequately to price the guaranty, and on the reliability of the technical assistance sub-system in the development and selection of profitable subprojects. For example, assuming no overhead cost, the Fund will be self-sufficient if the losses can be controlled and stabi-

lized below the accumulated income to the fund, primarily from the five percent guaranty commission planned. Examination of the past performances of the probable participating lenders indicates that they have sustained losses below one percent of their portfolio and that the planned guaranty commission is reasonable to defend the fund. Since the new lending will take place with different types of borrowers and projects, a guaranty commission of five percent should safely cover losses and administrative expenses.

While the risk of the lender is thus neutralized by the Fund, the management of the guaranty system must find ways to neutralize the risk assumed by the Fund. This will be achieved through several measures designed into the guaranty system. One is the requirement of preinvestment technical assistance. This will tend to homogenize the quality of the subprojects by establishing their technical and financial feasibility, and operationally reduce the eligibility criteria to simple foreseeable debt-service indexes of, say, 4 to 1 (i.e., the net cash generating capacity, before financial expenses, must be equal to four times the amount required to service the debt). Second, the preinvestment technical study of a subproject will focus on its viability as an economic unit and will assess total capital requirements. Thus, a subproject will represent a fully conceptualized, self-help economic unit for which a financial proposal is formulated. This will prevent the common cursory analyses of working capital needs to "put out a fire" without full assessment of total short and long-term capital requirements. Third, "follow-up" technical assistance during the first year of a loan will assure that the borrower makes effective use of the credit. Fourth, because of the required self-help type of economic unit, strong emphasis will be on determining the individual borrower's motivation and potential as a productive new credit user within the bonafide credit system. Finally, the monitoring system will continuously provide information on portfolio management, to be able to identify unacceptable arrearages and stop lending operations before conditions deteriorate beyond bearable limits.

The procedure described above will assist in the development of reliable actuarial data to expand the guaranty system operations. This will require a high degree of competence of the administrative unit which must maintain the balance of the financial equation explained in the next section.

In the long run, self-sufficiency hopefully will result in capitalization of the Fund. With this and greater availability of actuarial data, the liability incurred by the Fund could be expanded

prudently. For example, with the probability of 3 percent losses established at 80 percent, \$4 million equivalent in Fund resources could safely guaranty a portfolio as high as \$12 million equivalent, because the Fund's resource level will be over ten-times the maximum amount required to cover probable losses.

The Project requires the application of risk management principles to a loan guaranty system. This application is new in Costa Rica, but the technology exists within the banking system to carry it out. In terms of cost-effectiveness, the guaranty system is expected to develop into one of the best ways to economically stimulate credit for productive activities at the lowest socioeconomic levels. A.I.D. will provide a fund and a guaranty of \$3.0 million, which will not require foreign debt to support a portfolio of \$6.0 million equivalent. The financial projections show that A.I.D. may never have to pay any losses if the system management achieves the planned operational objectives.

The technical support from A.I.D. and the subsidy of the Central Bank are relatively small expenditures compared with those of others projects designed to achieve comparable sub-lending at similar socioeconomic levels.

Finally, the interest of the Central Bank (Annex IV) and of the lenders indicates that the Project is desirable from the political standpoint. The Mission has thus concluded that the Project has been conceived and planned well, and that the socio-political environment is favorable for prompt implementation (Annex III).

## B. Financial Analysis

Intimately related to the eventual financial success of the Project is the ability and speed with which the project management, with adequate support from the technical unit of A.I.D., gains control of the variables in the following financial equation for the Guaranty Fund.

$$\text{Losses} + \text{Administration} + \text{Capitalization} = \text{Commission} \times \frac{\text{Possible Lending}}{\text{Absorptive Capacity}}$$

Where,

- |                |   |  |
|----------------|---|--|
| Losses         | = | The aggregate of all the guaranty payments on defaulted loans.   |
| Administration | = | The cost of salaries, overhead, and support services.  |
| Capitalization | = | An operating surplus.  |
| Commission     | = | The fee paid by the borrower. It is established in accordance with expected rates of default and administrative costs. |

TABLE J

PORTFOLIO GROWTH OF COMMERCIAL BANKS  
IN CREDIT FOR AGRICULTURE, CATTLE,  
INDUSTRY, SERVICES AND HOUSING,  
IN  
COSTA RICA  
FROM 1974 TO 1977  
(IN MILLIONS OF U.S.\$) 1/  
AS AT DECEMBER 31

	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u> <u>2/</u>	<u>Average Comp. Growth</u>
Agriculture	93.5	136.0	172.0	187.0	0.260
Cattle	123.4	140.6	164.9	190.4	0.155
Industry	114.1	155.1	182.8	236.4	0.275
Services	25.9	39.9	52.4	65.2	0.361
Housing	<u>38.8</u>	<u>54.7</u>	<u>70.0</u>	<u>89.0</u>	<u>0.319</u>
	<u>395.7</u>	<u>526.3</u>	<u>642.9</u>	<u>768.0</u>	<u>0.247</u>

SOURCE: Banco Central de Costa Rica.

1/ US\$1.00 = C.R. ₡8.54.

2/ Estimated based on December 1975 and 1976 figures.

- Possible Lending = The total lending volume permitted by the available liquidity and installed capacity of the lenders.
- Absorptive Capacity = A restrictive factor determined by the relative availability of acceptable projects generated by participating technicians.

For an estimate of the possible effect of the guaranty system and its probable financial success, a forecast is possible using available information on the banking system's portfolio growth over the past several years. Table I shows that the banks' portfolio of short, medium, and long-term credit grew from \$395.7 million equivalent in 1974 to \$768.0 million equivalent in 1977. The yearly average compound rate of growth is 24.7 percent. This trend is extrapolated to show in Table II that the portfolio of those lenders may grow from \$963.0 million in 1978 to over \$3.0 billion equivalent by 1983.

The stimulative effect on total credit of the availability of loan guaranties through the POGP can be estimated using as a base the expected new yearly credit granted without the guaranty system by the private lenders. The relative magnitude of the effect will depend on the aggressiveness and imagination shown by the Central Bank staff in organizing the required group of technicians for subproject generation and in implementing operating plans that will satisfy and generate demand for credit for production. Based on USAID's assessment of initial availability of technicians, liquidity of the banking system, and installed capacity of the banks, stimulations of from 1/4 of 1 percent (0.25%) in 1978, to 1 and 1/2 percent (1.50%) in 1983, can be expected above the basic trend (See Table III), or new credit growth from the equivalent of \$488,000 in 1978 to \$9.9 million in 1983. The total new credit generation in this five years is expected to reach over \$34 million equivalent.

Based on a survey of small industry and agricultural loans, USAID estimates that the average loan to individuals under the Project will be \$5,000 and the average to groups (cooperatives and community groups) about \$20,000, for a combined average of about \$10,000 equivalent. Therefore, the POGP will be generating from at least 45 subprojects per year in 1978 to over 986 subprojects in 1983. This is a quite sustainable assumption if we look at the current availability of technicians, their expected growth in the country, and their motivation to increase their income and status through participation in the POGP. Assuming that the average loan will be for 36 months, the total portfolio guarantied by the Fund will be over \$16.0 million equivalent by 1983 -- slightly under

TABLE II

FORECAST OF THE PORTFOLIO OF COMMERCIAL BANKS  
IN CREDIT FOR AGRICULTURE, CATTLE, INDUSTRY,  
SERVICES AND HOUSING IN  
COSTA RICA  
(IN MILLIONS OF U.S.\$)  
1979 TO 1983

	<u>Agriculture</u>	<u>Cattle</u>	<u>Industry</u>	<u>Services</u>	<u>Housing</u>		<u>New</u>
Growth	0.260	0.155	0.275	0.361	0.319	0.262	-
1977	187.0	190.4	236.4	65.2	89.0	768.0	-
1978	235.6	219.9	301.4	88.7	117.4	963.0	195.0
1979	296.9	254.0	384.3	120.8	154.8	1,210.8	247.0
1980	374.1	293.4	490.0	164.4	204.2	1,526.1	315.3
1981	471.3	338.8	624.7	223.7	269.4	1,927.9	401.8
1982	593.9	391.4	796.5	304.5	355.3	2,441.6	513.7
1983	748.3	452.0	1,015.6	414.4	468.7	3,099.0	657.4

SOURCE: Table I.

212

1.0 percent of the total expected portfolio of the banks, not under the guaranty of the Fund. (See Tables II and III).

The results expected are reasonable if we consider the responsiveness of the banking system to the demands of the Costa Rican economy. It has been observed that the contribution of Agriculture and Forestry to the GDP has been above the contribution of Industry and Mining and that it increased steadily between 1970 and 1973. After two years, the growth of Agriculture ceased and became a static contribution, while the contribution of Industry and Mining maintained a faster growth since 1970, and surpassed the contribution of Agriculture and Forestry in 1975.

To support this steady growth the banks placed a strong emphasis on their operations in term deposits, which unstable growth changed significantly in 1974 and 1975, and grew less impressively in 1976. As of this writing the banks of the system have sufficient liquidity to recover from a slight decline in the growth of their credit operations since 1976, and have the capacity to generate sufficient resources, if necessary.

Assuming only the conservative projection of the portfolio growth shown in Table I is achieved, and assuming that administrative expenses and losses are held constant, the capitalization of the Fund will progress as shown in Table IV. It can be seen here that although the guaranty commission may be adequate at 5 percent, there is the danger of a "run" of claims that will exhaust the Fund's resources faster than they are being generated. Therefore, to enhance the probability of adequate liquidity at any one time, the borrower will continue to pledge the assets of each subproject as security, even though the loan may also be secured under the PCGP. Moreover, to prevent lengthy legal proceedings and assure prompt recoveries of the amounts disbursed by the Fund, the borrower will waive the right to protest any legal action by the lender in the event of default and all loans will be registered to shorten the liquidation of the assets used as security.

It cannot be sufficiently emphasized that the credit projections of Tables II and III and the financial projections in Table IV constitute only a forecast and cannot alone be interpreted as achievable operating plans. Nevertheless, in view of the economic resources and institutional dynamism identified, the assumptions for the forecast are quite conservative. The parameters of possible success presented in the forecast will be accepted by the project management and USAID as desirable minimal operating objectives that should be achieved, if not surpassed, through well-thought out operating plans.

TABLE III

TOTAL CREDIT UNDER THE PCGP  
A FORECAST FOR 1978 TO 1983  
(IN MILLIONS OF U.S.\$)

<u>Year</u>	<u>New Credit</u>	<u>P C G P</u>		
		<u>Stimulation Factor 1/</u>	<u>Credit</u>	<u>Portfolio 2/</u>
1978	195.0	.0025	0.488	0.488
1979	247.0	.0050	1.235	1.723
1980	315.3	.0075	2.365	3.600
1981	401.8	.0100	4.018	6.383
1982	513.7	.0125	6.425	10.439
1983	<u>657.4</u>	<u>.0150</u>	<u>9.861</u>	<u>16.282</u>
TOTAL	2.987.6		34.249	
Average		.00875	5.708	6.485

SOURCE: Table II.

1/ Based on expected project generating capacity

2/ Assuming average term of 36 months.

265

TABLE IV

PRODUCTIVE CREDIT GUARANTY FUND  
ESTIMATE OF INCOME AND EXPENSES, AND FINANCIAL STRENGTH 1/  
1978 - 1983  
(In Thousands of Dollars)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
1. Credit	<u>488</u>	<u>1,235</u>	<u>2,365</u>	<u>4,018</u>	<u>6,421</u>	<u>9,861</u>
<b>A. INCOME</b>						
2. Guaranty Commission (.05x#1)	24.4	61.8	118.3	200.9	321.1	493.1
3. Sales & Rediscount Commission (.005x#1)	2.4	6.2	11.8	20.1	32.1	49.3
4. Interest (12%)	1.5	7.0	14.0	23.6	44.7	80.3
5. Recuperations (.30x# - 1yr.)	-	-	6.0	14.8	28.4	48.2
6. Technical Assistance (.05 x #1)	24.4	61.8	118.3	200.9	321.1	493.1
7. Guaranty Payments AID & Banks	-	-	-	-	-	-
8. Guaranty by Central Bank	<u>39.0</u>	-	-	-	-	-
TOTAL	<u>91.7</u>	<u>136.8</u>	<u>268.4</u>	<u>460.3</u>	<u>747.4</u>	<u>1,164.0</u>
<b>B. EXPENSES</b>						
9. Salaries and Fringes	28.0	28.0	28.0	28.0	28.0	28.0
10. Technical Assistance (.9 x #6)	22.0	55.6	106.5	180.8	289.0	443.8
11. Lost Technical Assistance (.1 x #6)	2.4	6.2	11.8	20.1	32.1	49.3
12. Payments of Guaranties (.04 x #1 - 1 yr.)	-	19.5	49.4	94.6	160.7	256.8
13. Administrative Expenses	<u>11.0</u>	<u>11.0</u>	<u>11.0</u>	<u>11.0</u>	<u>11.0</u>	<u>11.0</u>
TOTAL	<u>63.4</u>	<u>120.3</u>	<u>206.7</u>	<u>334.5</u>	<u>520.8</u>	<u>788.9</u>
<b>A-B TO THE FUND</b>						
	<u>28.3</u>	<u>16.5</u>	<u>61.7</u>	<u>125.8</u>	<u>226.6</u>	<u>813.6</u>
14. A.I.D. Fund	<u>28.3</u>	<u>44.8</u>	<u>106.5</u>	<u>232.3</u>	<u>458.9</u>	<u>1,272.5</u>
15. A.I.D. Exposure	366.0	1,292.3	2,700	4,787.3	7,829.3	12,211.5
16. Bankers Exposure	122.0	430.7	900	1,595.7	2,609.7	4,070.5
17. Portfolio	488.0	1,723.0	3,600	6,383	10,439	16,282

1/ See explanation of Accounts in next pages.

It has been shown that the Fund could break even before the second year of operations and that the accumulated surpluses will grow from \$28.3 thousand equivalent in the first year to \$1.3 million equivalent by the sixth year of operations. The desirable reliability of the administrative system should result in achievement of these objectives and in the development of the needed actuarial base to leverage the Fund resources beyond the 1 to 1 ratio of liabilities/capital. If this is achieved, A.I.D. may not have to increase or prolong its support beyond 1983, and the Banking System of Costa Rica alone could sustain the Project.

#### Explanation of Items on Table IV

##### 1. Credit

From credit operations in Table III.

##### 2. Guaranty Commission

A commission of five percent to capitalize the Fund. With effective control of losses at four percent (4%), the fund could support losses and prevent payments by A.I.D. and the Bankers.

##### 3. Sale and Rediscount Commssion

A commission of one half percent (1/2 of 1%) is established for coverage of the administrative cost of rediscounting the paper generated by the program. As with Guaranty Commission, it will be refined as the Project develops.

##### 4. Interests

Half of the year's income and the accumulated profits will yield twelve percent (12%) per year, if invested in prime paper like coffee bonds.

##### 5. Recuperations

One-fourth of the Guaranty Payments made the previous year will be recuperated by the Fund.

##### 6. Technical Assistance

Up to five percent (5%) of the credit granted by the participating lenders will go for payment of technical assistance. The administrator of the Project will receive these payments and will pay the technicians as explained in numbers 10 and 11, below.

137

7. Guaranty Payments by A.I.D.

The Payments made by A.I.D., under its obligations to pay seventy-five percent (75%) of each loan, in the event the Fund's resources are exhausted.

8. Subsidy by Central Bank

Before the Fund becomes self-sustaining, the Bank will pay for the salaries and fringe benefits of the personnel assigned to administer the Project as follows:

Monthly Salaries and Fringes

Project Manager	\$ 1,500
Senior Analyst	900
Secretary	<u>400</u>
Sub-Total	\$ 2,800

Overhead and Support

It is estimated that the Central Bank will spend 15% of salaries and fringes to implement, promote and operate the system.

	<u>\$ 420</u>
Total Monthly Expenses	<u>\$ 3,220</u>
Yearly Expense	<u>\$38,640</u>

9. Salaries and Fringes

The yearly expenditure and funds reserved as computed under #8, above.

10. Technical Assistance

Payments to participating technicians for the elaboration of feasibility studies and financial proposals, in accordance with the schedule negotiated with the Project Administrator, plus payments to technicians for follow-up assistance during the first year of the sub-

projects. It is estimated that 90 percent of the revenues under #6 will be used for payments of preinvestment studies that will result in subproject financing.

11. Lost Technical Assistance

Payment to the participating technicians for subproject studies that resulted in negative recommendations for funding. It is estimated at 10 percent of revenues under #6, above.

12. Payments of Guaranties

It is estimated that each year the Fund will have to pay guaranties of the order of four percent of the credit guaranteed the year before.

13. Administrative Expenses

The payment for the overhead and support services of the Central Bank in its administrative and promoting activities.

14. Fund

The accumulated yearly operating surplus.

15. A.I.D. Exposure

Fifty percent of the outstanding credit. The Fund will be able to support the burden of guaranty claims with the expected income but the support of A.I.D. will continue to be necessary.

16. Banker's Exposure

Twenty-five percent of the portfolio. As with the A.I.D. guaranty, the Banker's support will be necessary for the foreseeable future.

17. Portfolio

Total portfolio under the PCGP.

C. Estimated Demand to be Generated

1. Agricultural Sector

Based on the 1973 Agricultural Census, there were 81,562 total farms in Costa Rica of which 44,728 had less than ten hectares of land. Sixty percent, or 26,837 of the farmers who worked these small plots, had per capita incomes of less than \$150 in 1969 prices. An

evaluation of the Census prepared by the Consulting Firm Academia, called Profile of Poverty in Costa Rica, shows that the number of poor farm families may vary between 19,750 and 44,000 depending on the methodologies used. If the 1973 Census data figure is rounded down, an average of 25,000 families seems a reasonable and even conservative estimate of our target population, especially given Academia's lowest estimate of approximately 20,000. It should also be noted that there has been no significant change in the number of poor farms between 1973 and 1978.

Two other elements must be included in our estimate: collateral requirements and small farmers interest in credit. Government Policy since 1975 permits uncollateralized loans, guaranteed exclusively by a co-signer, only if the loan amount is less than 15,000 colones. While data from rural branches of the national bank of Costa Rica show that for these 25,000 poor farmers co-signing is the common form of guarantee, it is difficult for this category of borrower to obtain a co-signer. Information generated from an agricultural model developed by SIECA for Costa Rica indicates that poor farmers currently without access to credit would use credit to change their crop mix to include more profitable crops. Related research at CATIE indicates that once credit is available, the average loan, in 1979 dollars, would be approximately \$2,142. The SIECA model indicates that Costa Rican small farmers are especially receptive to changing crop mix when increased profits are clearly obtainable.

As a result, we estimate that from the 25,000 poor farmers, 4,000 with neither collateral nor co-signer will request credit over the next five years with PCGP coverage. This is an extremely conservative figure, representing an average of only 800 loan requests per year over the life of the project, or 200 for each of the four nationalized banks. It does not take into account poor farmers returning for more than one loan. It does not include any of the 17,891 non-poor families farming under ten hectares who also might be eligible for guarantee coverage, nor the approximately 21,000 poor families who probably need varying degrees of PCGP coverage. The 4,000 represents only 15 percent of all poor farms under 10 hectares, and 5 percent of all farms. Given the improvement in information on prices for non-traditional, high-valued, crops currently resulting from GOCR promotion and an A.I.D. loan, the estimate of 4,000 poor farmers without collateral seeking to change their crop mixes appears very reasonable, if not overly conservative.

Assuming an annual eight percent rate of inflation, the average loan size for poor farmers would be:

1979	\$2,142
1980	2,313
1981	2,498
1982	2,698
1983	2,914

Matching these average loan sizes with 800 loans per year for five years gives a potential demand of \$10.052 million for this one category of small farmers seeking to change crop mixes. Additional demand will come from farmers seeking to expand their production, from farmers starting new farms under the Land Colonization Institute (ITCO) program, and from small farmer cooperative groups wanting to expand operations through the National Cooperative Institute (INFOCOOP).

ITCO expects to locate 2,000 of the landless poor per year on unsettled land. The average settlement cost of these individuals is \$9,000. Because ITCO subsidizes 80 percent of the settlement costs in the form of grubstakes, some construction materials, certain farm inputs, basic farm infrastructures and technical assistance services, the average loan size is about \$1,800. Total annual credit demand for ITCO settlers--all eligible for the PCGP--is \$3.6 million, or \$18 million over the five years.

The lending operations of INFOCOOP have shown that small farmer cooperatives cannot normally obtain guarantees from the national banking system. Experience of INFOCOOP with A.I.D. Loan 025 has demonstrated that 65 percent of the sub-loans (\$1.75 million) to poor cooperatives has been made with no guarantee. INFOCOOP does not have the financial capacity to satisfy the total cooperative demand for production credit. The guaranty program will allow the national banking system to respond to some of the excess demand. We, therefore, estimate that the demand from agricultural cooperatives for guaranteed credit will be at least \$3 million over the life of the PCGP. While the \$3 million estimate from INFOCOOP may include some double counting of the 4,000 poor farmers already described, it is clear that the agricultural sector will provide substantial demand for the credit availability generated by the PCGP.

## 2. Small Industrial Firm Credit Demand in San Jose

The credit demand analysis conducted for the Urban Employment Community Improvement project paper (pp. 72-75) indicates that there will be some 970 new small industrial loans, totalling \$6.0 million, generated by the project over the 1979-81 three year period (See Annex VIII). Approval of the PCGP project is a condition precedent

2/1/8

to the disbursement of credit monies under the "Urban" loan. Since the PCGP project will extend to 1983, the final industrial demand in San Jose should be greater than the \$6.0 million figure. In addition, there may be some agricultural industry subprojects generated.

3. Summary of Total Demand and Supply for Credit Resulting from the PCGP

The amount of loan demand from both sectors to be generated as a result of the \$6 million PCGP program (\$3 million from USG and \$3 million from GOCR) is conservatively expected to reach some \$31 million: \$25 million from the agricultural sector and \$6 million from the small industrial sector. The supply and demand estimates are quite similar (34 vs 31). Even at half these anticipated values, the figures indicate that the PCGP should generate more than enough loan activity to justify the cost of establishing the administrative machinery to test the PCGP concept in Costa Rica.

D. Social Analysis

1. Target Group

This PCGP Project is directed to the small entrepreneur who can be a poor farmer or a poor artisan, businessman, food processor, or merchant. These can be long established, recently self-employed, or able to be self-employed because of the availability of the PCGP guaranty. In the rural areas, given the diversity of conditions and personalities within the target group, the success of the Project will depend on the understanding of those conditions and characteristics that from the social landscape, and of the differences among the groups involved.

2. Small Farmers

The average farmer within the target group has had 2 - 3 years of education and is a member of a family of six persons. Depending on employment opportunities and because of lack of capital to work the full year, about half of them seek seasonal employment away from their farms. In this endeavors there has been some migration and trans-migration in the surrounding areas, but most farmers have been in residence for a long time in Costa Rica and constitute a stable population.

The Costa Rican farmer usually lives in a dispersed community settlement and his social organization has its foundation in family-friendship groups. The success of the PCGP will depend on the acceptance of the concept of "working with borrowed money" and on the effectiveness of lenders and technicians in identifying and financing eligible subproject which requires some sophistication from the borrower as he must perceive the benefits of financial leverage.

Social interaction tends to take place within a social strata rather than among strata which limits the flow of the necessary information for progressive mobility. Small farmers owning their land,

2,5

generally less than 20 hectares, are at one social stratum, landless laborers at another, and large farm owners at still another. Intelligent utilization of financial tools, however, could provide a catalyst to improve their utilization of economic resources and enhance the possibilities of upward mobility through ownership and higher productivity.

As a favorable condition, the farmers have been found to be quick to accept change - if they are confident that profits will be possible or will increase. The lending institutions have been successful with small farmers also because, properly handled and assisted their response to financial obligations has been excellent. The lack of a tool like the POGP, however, has obstructed a greater penetration by the institutional lenders, and the satisfaction of a need for credit, already felt by a relatively large group of the poor rural population.

### 3. The Urban Producers

These are the poor entrepreneurs with somewhat better education that try to survive in the tugurio areas. Depending on their relative success in stabilizing their satisfaction of basic necessities, this population moves from unstable Pocket-type tugurios, to dispersed tugurios, to concentrated tugurios. It has been established that goods and services from the well-established slum areas satisfy many of the needs of the urban population.

Within these areas, the success of the POGP will also depend on the relative sophistication of the entrepreneur to accept credit, and in the aggressiveness and effectiveness of credit institutions in penetrating these areas. Several surveys have been made of these areas to ascertain the responsiveness of those in business to the concept of credit. The results have been encouraging because it has been established that a meaningful number of entrepreneurs have expressed a desire to use credit. It has also been established that the lack of sufficient guaranties has prevented the flow of institutional credit to these areas.

The POGP comes at a time of awareness of the needs of the rural and urban poor entrepreneurs, and of the constraints to the operations of the institutional lenders. The Project acceptance will depend on the effectiveness of the administration system to make the POGP benefits available to all participants. These benefits must flow to the target group but not without making possible an acceptable profit to the lender, and an attractive compensation to the technician. A spread effect is expected as the Project proves successful. Additional lenders in pursuit of profits are expected to seek the target group market; additional technicians are also expected to join the system as good remunerations become visible; and more farmers, producers and communities will seek credit as they learn about its benefits.

For certain cultural and economic reasons, women make up over 50% of the economically active population. Historically, women have been active in government, businesses and industry. The project will encourage the development and funding of those subprojects sponsored by women. Women will also be able to participate on an equal basis with men in the management of the Project and as technicians.

### E. Economic Analysis

The POGP will seek to develop a commercially viable solution to the pervasive problem of lack of adequate collateral to secure credit for production at the "grass roots" level. This problem acts as a serious constraint to increases of real income and profitability of the productive activities of the majority of the economically active population. This group is made up of small producers in the agricultural, industrial, and service sectors. The assistance provided by the guaranty system is designed in accordance with the existing monetary policies of the Government of Costa Rica, to increase economic output by seeking optimization in the utilization of existing resources, within the socio-cultural environment.

Although GDP has grown during the last ten years its rate of growth began to decline in 1974, when a sharp drop of the output of Agriculture was registered. From this year on the GDP showed a slower rate of growth and the agricultural output ceased to grow. The output of Industry and Mining has continued to grow, but from the same year it showed a slower pace also. In 1976 the output of Industry and Mining surpassed the output of Agriculture, but no significant improvement of the GDP growth was observed. The GOCR has reacted to increase the rate of economic growth by placing a strong emphasis on small industry and small farming.

The POGP comes at an appropriate time to help in the effort to raise the rural and urban poor incomes by providing the necessary incentive to stimulate the flow of private financial resources to their productive enterprises. The financial and technical assistance envisioned under the POGP is urgently needed to enable the introduction of higher value (and more labor-intensive) crops in the activities of poor small farmers.

The POGP will also satisfy the need for financial and technical assistance of the small urban producers to increase their output and productivity. Both in the rural and urban areas the Project expected immediate effects are in the creation of new employment and ownership opportunities for the benefit of landless and small enterprise families and groups with under-utilized labor and land.

If current social and political conditions remain favorable and the management of the Project achieves promptly the necessary competence, the probability of achieving the results envisioned in the forecasts presented in previous sections is high. Sufficient resources have been identified to assure the success of the Project. These resources are represented in the physical

capacity of the banks throughout the country, the banking system liquidity to fund subprojects under the guaranty, technical personnel to generate subprojects for funding and to help initiate them, and potentially productive small borrowers who could profitably use credit to improve their socio-economic conditions.

It is felt that the Project will not be successful if tangible benefits are not made possible to all the above participants. Most important, if through the concerted efforts of bankers, technicians, and the Central Bank, the financial benefits to the Fund are not sufficient to cover costs, the Project will not meet the statutory requirement of self-sufficiency. Therefore, the key to the success of the Project will be the competence of the human resources dedicated to manage the guaranty system at the Central Bank and to provide technical assistance to borrowers. Through the technical assistance provided by A.I.D., the trustee is expected to develop promptly the capability to make possible the expected economic benefits.

These benefits can be measured in terms of revenues to the Fund (which will strengthen the guaranty system), employment through the subprojects funded, interest income to the lenders, operating revenues to the subproject sponsors and to the participating technicians, and new tax revenues to the local and national governments. These benefits will have a direct impact on the quality of life at the community level and will add dynamism to the process of integrating into the economy previously neglected productive sectors that represent a majority of the active labor force (largely the poor majority) in agriculture, industry, and commerce. Thus, the Project clearly qualifies under the criteria of A.I.D.'s Congressional Mandate.

Based on the forecast of operating results, the guaranty system is expected to stimulate new lending of some \$34.2 million equivalent from 1978 to 1983. Without going beyond the direct beneficiaries of the Project, the participating lenders will gross over \$1.0 million equivalent taking into consideration an average spread of 2 percent between their cost of money and their interest rate, and estimating an average term of three years. The spread will result from a rediscount interest rate of 6 percent of the loan and 8 percent interest to the borrower. The maximum cost of the bank's own resources, the portion of the loan not rediscountable, is 8 percent if obtained through certificates of deposit at 6 to 12 months. This can be lowered by deposits in current account where the bank does not pay any interest. These earnings will be possible without an increase of the lenders' installed capacity, which will also have a direct impact on their profitability.

The above new lending for subprojects under the PCGP will generate directly some 7,000 new jobs and will generate gross profits to the borrowers of \$41 million equivalent during the average term of 3 years per loan, estimating \$5,000 equivalent to create a new job and an average of 40 percent return on investment. From the standpoint of the borrower, the PCGP will give him the opportunity to use institutional credit. This will be enjoyed by new borrowers who never used credit and by those who have been using credit obtained at usurious interest rates from money lenders outside of the bonafide credit system. While the benefits to the former will solely be in terms of the profitability of the subprojects, the latter will also benefit from greater availability of credit for fixed and current assets and from the savings possible as they move from the money lender to the banking system. With some 34,200 productive economic units being created or expanded, during the next five years, there will therefore be a series of future indirect benefits to the macroeconomy which together with direct benefits will contribute to raising municipal and national tax revenues.

One of the important indirect benefits is the encouragement of savings through bank deposits of small farmers and businessmen who have not previously had bank accounts but will be encouraged to do so after receiving a loan for the first time from a commercial bank. During discussions with USAID, commercial bankers were quick to recognize this as an important potential benefit to them, while the Central Bank officials considered this to be significant from the viewpoint of encouraging domestic savings. Another important indirect benefit will be to increase the number of able entrepreneurs and managers as small scale firms gradually grow into medium scale enterprises with the assistance of PCGP. The direct increase in real income resulting from the program may also be expected to have a multiplicative effect on aggregate income that is at least 2 to 3 times the initial increase.

One other economic benefit is that after the self-sustaining capability of the guaranty system is established, it can be viewed as a generator of excellent investment opportunities for those individuals seeking alternatives to the savings account. It is known fact that the limited success of the concepts of underwriting stock issues and investment banking in countries where these concepts are least known is caused by the reluctance of investors to acquire paper when the profit is guaranteed only by the often dubious potential success of the management of the enterprise funded. Therefore, for those seeking safe and profitable investment opportunities, PCGP paper will be attractive because it will be 75 percent guaranteed by the Fund and 25 percent by the seller.

Examples of the need for this type of investment alternative can be seen in the unexpected success of the Savings and Loan Systems created for housing, which have captured savings many times beyond the most optimistic estimates in countries where they have been established, Colombia, Guatemala, Paraguay, etc.

Lastly, development of the anticipated number of subprojects will result in approximately \$500,000 in revenues to the technicians providing pre-investment and follow-on technical assistance. It is difficult to quantify all the economic benefits from the Project, such as indirect employment created, new taxes to the local and national government (from credit users, lenders, and technicians), and strengthening of the communities of the beneficiaries. However, given the modest magnitude of the inputs from A.I.D. and the National Banking System, the Project appears highly desirable from an economic viewpoint.

#### IV. Implementation Arrangements

The implementation arrangements have been made in accordance with the existing strength and capabilities of the proposed subsystems. The initiation of eligible lenders and technicians is expected to be slow but relatively easy. The most difficult task, because of the thoroughness required, will likely be the training of the administrative staff and organization of the administrative unit at the Central Bank.

##### A. Administrative Arrangements

1. Conduit - Under a Trust Agreement with A.I.D., the Central Bank will be the Administrator of the guaranty system and of the A.I.D. guaranty that shall flow through the Guaranty Fund created by A.I.D. to the participating lenders. The technical strength of the Banking System and its authority in monetary matters make it the most feasible institution in the country to implement and operate the Project. The administrative unit will be staffed in accordance with the perceived needs of the Project, by two full-time professionals and a secretary. As discussed earlier, they will receive from A.I.D. the necessary training and assistance to carry out effectively the development, implementation, and operation of the guaranty system. Development of operating handbooks will be an essential part of the training.

2. Lenders - All commercial banks will participate as lenders and all other financial institutions will be invited to participate. All participants will receive training on how to operate in accordance with Project policies and procedures, and portfolio quotas will be assigned in accordance with their relative strength before they are authorized to start lending operations under the system.

3. Technicians - All qualified technicians available in Costa Rica will also be invited to participate. Fees will be negotiated with those interested, on the basis of reasonable rates plus direct and indirect expenses. Training sessions will also be held to familiarize them with the contents of the operating handbooks before they are authorized to start operations under the system.

4. A.I.D. - USAID will have the capacity to monitor the Project after participating in the early design and implementation of the guaranty system. The officer assigned to maintain contact with the Central Bank will receive a thorough briefing on project objectives, operating policies and procedures, and desirable results. He/she will maintain close communications with the regional technical unit in charge of the technical direction of the PCGP.

### B. Implementation Timetable

The following calendar of events applies to the implementation of the Project. It has been established by USAID with the cooperation of the Central Bank.

	<u>Date</u>
1. Approval by DAEC	August 31, 1978
2. Guaranty Authorization	September 8, 1978
3. Negotiation of Trust Agreement	September 15, 1978
4. Signature of Trust Agreement	September 29, 1978
5. Technical Advisor on board	October 31, 1978
6. Training of Central Bank Staff	November 30, 1978
7. System promotion with lenders and technicians	November 30, 1978
8. Analysis and classification of lenders	November 30, 1978
9. Analysis and classification of technicians	November 30, 1978
10. Training of lenders and technicians	December 15, 1978
11. Start of operations	January 2, 1979
12. Project completion	September 30, 1983

C. Evaluation Plan

The flow of information from the Central Bank to USAID will permit a quarterly review of the Project's operations. The review will cover statistics on borrowers, subprojects, geographic coverage, economic activities supported, technical assistance services, credit volumes, loan amounts, lenders' activities, portfolio status, delinquencies, financial condition of the Fund, and other information. This information will not only facilitate A.I.D.'s monitoring of

operations but will permit a quarterly assessment of progress toward achieving the purpose and contributing toward the goal of the Project. A formal evaluation of progress toward these objectives will be held annually, as a result of which the fiduciary of the trust, the Central Bank, will publish an annual PCGP report.

UNCLASSIFIED

ANNEX I  
Page 1 of 2

Section 222A - Agricultural and Productive Credit and Self-Help  
Community Development Programs

(a) It is the sense of the Congress that in order to stimulate the participation of the private sector in the economic development of less developed countries in Latin America, the authority conferred by this section should be used to establish pilot programs in not more than five Latin American countries to encourage private banks, credit institutions, similar private lending organizations, cooperatives, and private nonprofit development organizations to make loans on reasonable terms to organized groups and individuals residing in a community for the purpose of enabling such groups and individuals to carry out agricultural credit and self-help community development projects for which they are unable to obtain financial assistance on reasonable terms. Agricultural credit and assistance for self-help community development projects should include, but not be limited to, material and such projects as wells, pumps, farm machinery, improved seed, fertilizer, pesticides, vocational training, food industry development, nutrition projects, improved breeding stock for farm animals, sanitation facilities, and looms and other handicraft aids.

(b) To carry out the purposes of Subsection (a), the agency primarily responsible for administering Part I is authorized to issue guaranties, on such terms and conditions as it shall determine, to private lending institutions, cooperatives, and private nonprofit development organizations in not more than five Latin American countries assuring against loss of not to exceed 50 percent of the portfolio of such loans made by any lender to organized groups or individuals residing, in a community to enable such groups or individuals carry out agricultural credit and self-help community development projects for which they are unable to obtain financial assistance on reasonable terms. In no event shall the liability of the United States exceed 75 percent of any one loan.

(c) The total face amount of guaranties issued under this section outstanding at any one time shall not exceed \$15,000,000. Not more than ten percent of such sum shall be provided for any one institution, cooperative, or organization.

UNCLASSIFIED

45

(d) The Inter-American Foundation shall be consulted in developing criteria for making loans eligible for guaranty coverage in Latin America under this section.

(e) Not to exceed \$3,000,000 of the guaranty reserve established under Section 223(b) shall be available to make such payment as may be necessary to discharge liabilities under guaranties issued under this section or any guaranties previously issued under Section 240 of this Act.

(f) Funds held by the Overseas Private Investment Corporation pursuant to Section 236 may be available for meeting necessary administrative and operating expenses for carrying out the provisions of this section through June 30, 1976.

(g) The Overseas Private Investment Corporation shall, upon enactment of this subsection, transfer to the agency primarily responsible for administering Part I all obligations, assets and related rights and responsibilities arising out of, or related to, the predecessor program provided for in Section 240 of this Act.

(h) The authority of this section shall continue until December 31, 1977.

(i) Notwithstanding the limitations in Subsection (c) of this section, foreign currencies owned by the United States and determined by the Secretary of the Treasury to be excess to the needs of the United States may be utilized to carry out the purposes of this section, including the discharge of liabilities under this subsection. The authority conferred by this subsection shall be in addition to authority conferred by any other provision of law to implement guaranty programs utilizing excess local currency.

(j) The President shall, on or before January 15, 1976, make a detailed report to the Congress on the results of the program established under this section, together with such recommendations as he may deem appropriate.

#### Section 223 - General Provisions

(a) A fee shall be charged for each guaranty issued under Section 221, 222, or 222A in an amount to be determined by the President. In the event the fee to be charged for such type guaranty is reduced, fees to be paid under existing contracts for the same type of guaranty may be similarly reduced.

## GUARANTY AUTHORIZATION

Provided From: FAA Section 222A  
Costa Rica: Productive Credit  
Guaranty Program

Pursuant to the authority vested in me as Assistant Administrator, Bureau for Latin America and the Caribbean, by the Foreign Assistance Act of 1961, as amended ("the Act"), and the delegations of authority issued thereunder, I hereby authorize the issuance of a guaranty in an amount not to exceed three million United States dollars (\$3,000,000) ("Guaranty") to benefit eligible lenders in Costa Rica ("Fideicommissaries") pursuant to Section 222A of the Act and in furtherance of the Alliance for Progress. The Agency for International Development ("Fideicommissor") will enter into a trust agreement with the Banco Central de Costa Rica or other appropriate financial institution ("Fiduciary") which will administer a pilot credit guaranty project ("Project") within the Productive Credit Guaranty Program. The Fideicommissor shall establish a Productive Credit Guaranty Fund ("Fund") pursuant to the Project for the purpose of repaying eligible loans ("Loans") made by any Fideicommissary on which Loans a default has occurred. The Guaranty shall be subject to the following terms and conditions:

I. Period of Eligibility

In the absence of a written objection by A.I.D. to the Trustee with respect to any proposed Fideicommissary, the Guaranty authorized herein shall be applicable to Loans made by any Fideicommissary subsequent to the date which is five (5) business days after the date on which the Fiduciary notifies the Fideicommissor that the Fideicommissary has satisfied all applicable conditions precedent with respect to the Project ("Commencement Date"), but shall not be applicable to Loans made after September 30, 1978, or a later date notified in writing by the Fideicommissor.

II. Amount of Guaranty

Upon a showing by the Fiduciary that the resources of the Fund have been totally depleted pursuant to the Project, the Fideicommissor shall pay to each fideicommissary pursuant to the Guaranty an amount equal to seventy-five percent (75%) of the sum of the outstanding

principal balance of each Loan made by such Fideicommissary on which a default has occurred plus the normal interest accrued thereon during no more than the first one hundred eighty (180) calendar days following the date on which the default occurred; provided, however, that with respect to defaulted loans made in each discrete calendar year by an fideicommissary, the aggregate of the payments made by the Fideicommissor shall not exceed fifty percent (50%) of the outstanding principal amount of all Loans made during such year by such Fideicommissary calculated as of the last day of each applicable default period. Anything contained herein to the contrary notwithstanding, the aggregate liability of the Fideicommissor under the Guaranty shall in no event exceed three million United States dollars (\$3,000,000).

III. Commission and Fees

Each borrower shall pay to the Fideicommissary making a Loan to such borrower under the Project a guaranty commission in an amount not to exceed five percent (5%) of the amount of such Loan, which guaranty commission shall be promptly paid into the Fund by such Fideicommissary.

IV. Term of a Loan

The term of Loan shall not exceed ten (10) years.

V. Conditions Precedent

A. Prior to the guarantying of the first Loan under the Project, the Fiduciary shall submit to the Fideicommissor in form and substance satisfactory to the latter:

- (1) a roster of the Fiduciary's personnel responsible for the administration of the Project;
- (2) a standard Guaranty Contract form to be executed by and between the Fiduciary and each Fideicommissary that was not

- a party to the Trust Agreement;
- (3) a participation agreement between the Administrator and the entities or individuals providing technical assistance under the Project;
  - (4) the operating handbook for the Fideicommissaries, the handbook for the individuals providing technical assistance, and the handbook for the Fiduciary; and
  - (5) evidence that the programs for training the personnel of the Fiduciary, of the Fideicommissaries, and the personnel providing technical assistance have been established.
- B. Prior to the commencement date for each Fideicommissary, the Fiduciary shall have in its records, in form and substance specified by the Fideicommissor:
- (1) an executed original of the Guaranty Contract, if the Fideicommissary was not a party to the Trust Agreement;
  - (2) evidence that all personnel to be involved in the Fideicommissary's Project operations have satisfactorily completed the required training pursuant to the Project.

VI. Covenants

The Fideicommissaries shall jointly and severally covenant and agree to:

Pay to each Fideicommissary an amount equal to seventy-five percent (75%) of the sum of the outstanding principal balance of each defaulted loan made by such Fideicommissary plus the interest accrued thereon during no more than the first one hundred eighty (180) calendar days following the date on which the default occurred less the aggregate of the amounts paid to such eligible lender

by the Fund and/or by the Fideicommissor pursuant to the Guaranty;

The Fiduciary shall covenant and agree to:

- A. Pay the administrative expenses associated with the guaranty system until such time as the Project shall become self-sufficient as demonstrated by the Fund achieving a level predetermined by the Fiduciary and the Fideicommissor;
- B. Negotiate agreements with the Fideicommissaries for the purpose of rediscounting loans made by such Fideicommissaries under the Project;
- C. Obtain the Fideicommissor's approval of any change in plans, procedures, policies and handbooks previously approved by the Fideicommissor and the Fiduciary.

VII. Amount of Guaranty

The Trust Agreement between A.I.D. and the Administrator shall include formulae to facilitate the increase or decrease of the maximum amount of the Guaranty necessary to support the growth of the total portfolio of loans under the Project. In no event shall the Fideicommissor agree to increase the maximum amount of the Guaranty if such increase would result in the violation of Section 222A of the Act.

VIII. Other Conditions

The Project shall be subject to such other terms and conditions as the Fideicommissor may deem advisable.

\_\_\_\_\_  
Assistant Administrator

\_\_\_\_\_  
Date

Clearance:

GC/LA, JKessler \_\_\_\_\_ Date \_\_\_\_\_  
 LA/SA, \_\_\_\_\_ Date \_\_\_\_\_  
 LA/DR, MBrown \_\_\_\_\_ Date \_\_\_\_\_  
 LA/DR, HBassford \_\_\_\_\_ Date \_\_\_\_\_

PHC/DPR, EHogan \_\_\_\_\_ Date \_\_\_\_\_  
 SFR/PM/C, TBlacka \_\_\_\_\_ Date \_\_\_\_\_  
 GC/LA, GWinter:lb  
 Revised: LA/LR, AVelásquez:rm

CERTIFICATION PURSUANT TO SECTION 611 (e) OF THE  
FOREIGN ASSISTANCE ACT

1. Stephen P. Knaebel, the Principal officer of the Agency for International Development in Costa Rica, having taken into account among other factors the maintenance and utilization of projects in Costa Rica previously financed or assisted by the United States, do hereby certify that in my judgement Costa Rica has the technical capability and physical and human resources to develop and maintain the administrative system required to utilize the proposed \$3,000,000 of loan guaranty authority under the Productive Credit Guaranty Program, Section 222A, FAA of 1974.



---

Stephen P. Knaebel  
USAID Mission Director

July 28, 1978

**BANCO CENTRAL DE COSTA RICA**  
SAN JOSE, COSTA RICA

ANNEX IV  
Page 1 of 1

9 de agosto de 1978  
PE-262-78

Señor  
Stephen Knaebel, Director  
Agencia para el Desarrollo Internacional  
Embajada Americana  
San José

Señor Director:

Tenemos el agrado de dirigirnos a usted con respecto al Programa de Garantías de Créditos Productivos ( P.G.C.P. ) que esa Misión a su digno cargo ofreció al Gobierno de Costa Rica por conducto de la Casa Presidencial, y a las conversaciones que sobre el particular se han llevado a cabo al nivel técnico.

Deseamos comunicarle que estas conversaciones han culminado en la formulación de un proyecto bajo el PGCP para la creación de un sistema de garantías de crédito en Costa Rica, y que, encontrándolo beneficioso para la economía del país, en nombre del Gobierno Nacional, este Banco acepta la oferta de asistencia económica a través del PGCP en los términos del Documento de Fideicomiso que oportunamente se apruebe por parte de esa Misión de la Agencia para el Desarrollo Internacional como fideicomitente, de este Banco como fiduciario y de las instituciones financieras del sistema de crédito del país como fideicomisarios.

Agregamos que los fideicomisarios estarían dispuestos a asumir el riesgo cubierto por el Fondo de Garantías si en cualquier momento se agotaran los recursos del fondo y la A.I.D. hubiera cubierto el cincuenta por ciento ( 50% ) del monto de cartera vigente de préstamos otorgados en cualquier año de operaciones dentro del sistema P.G.C.P. de cualquiera de los fideicomisarios.

Para coordinar la instauración del sistema de garantías esta Institución ha designado a la licenciada Cecilia Uconitrillo.

Sin otro particular, aprovechamos la oportunidad para saludarle con nuestra consideración más distinguida.

Atentamente,

  
Guillermo González Truque  
Presidente Ejecutivo

56

PROJECT CHECKLIST  
FOR  
PRODUCTIVE CREDIT GUARANTY PROJECT

1. Section 222A(a): Will the Project encourage the mobilization of private Sector resources through banks, credit institutions, similar private lending organizations, cooperatives or nonprofit development organizations to make loans for agricultural credit and self-help community development projects?

Yes. The Project is specifically designed to achieve this objective. See statement of goal and purpose for the Project.

2. Section 222A(a): Will the Project loans be made on reasonable terms to organized groups or individuals to enable them to carry out agricultural and industrial self-help production projects for which they are unable to obtain financial assistance on reasonable terms?

Yes. Project loans will be made only to such individuals and groups, and only for their self-help development projects for which they are unable to obtain credit on reasonable terms. Loan terms will be those prevailing in the financial market for all traditional credit customers of the participating financial institutions, plus a charge for the loan guaranty.

3. Section 222A(a): Will the agricultural credit and self-help community development projects include fixed and current assets such as wells, pumps, farm machinery, improved seed, fertilizer, pesticides, vocational training, food processing facilities, food distribution projects, improved breeding stock for farm animals, sanitation facilities and looms and other handicraft aids?

Yes. All such assets are fair examples of asset to be financed with credit under this program.

4. Section 222A(c): Will the total face amount of guaranties, including the one for this Project, exceed \$15,000.000?

UNCLASSIFIED

ANNEX V  
Page 2 of 3

No. If this Project is approved at the level of guaranty requested (\$3.0 million), a total face amount of \$15.0 million in guaranties will have been approved. (The others are Bolivia \$2.5 million, Colombia \$5.0 million, Nicaragua \$3.0 million and Paraguay \$1.5 million.)

5. Section 222(b): Will the total number of Latin American countries receiving guaranties under Section 222A, including the one for this project exceed five?

No. With approval of this Project, five countries will have received this guaranty program.

6. Section 222A(b): Will the guaranty assure against the loss of more than 50 percent of the portfolio of eligible loans made by any lender?

No. The Guaranty Section of the Trust Agreement shall so state.

7. Section 222A(b): Will the liability of the United States exceed 75 percent of any one loan?

No. The Guaranty Section of the Trust Agreement shall so state.

8. Section 222A(c): Will more than \$1,500,000 in face amount of guaranties be provided for any one institution, cooperative or organization?

No. The total amount requested is only \$3,000,000, and the total number of lending institutions exceeds ten (10).

9. Section 222A(d): Has the Inter-American Foundation been consulted in developing criteria for making loans eligible for guaranty coverage?

Yes. The official guidelines for borrower and project eligibility established by AID/W for Section 222A programs were developed in consultation with the Inter-American Foundation. Those guidelines will be incorporated into the official operating manual for this program.

10. Section 222A(b): Do the participating institutions understand that A.I.D. cannot issue any guaranties after September 30, 1978?

UNCLASSIFIED

Discussions on this topic have been carried on with the Banks and the Central Bank, the trustee and in-country administrator for the Project. After the trust agreement is signed, eligible participating institutions will be incorporated into the program and informed of this fact as well as all other operating regulations.

11. Section 223 (a): Will a fee be charged for each guaranty issued under Section 222A in an amount to be determined by the President?

Yes. A one time guaranty fee of no more than 0.05 (five percent) of each loan has been established for this Project. This fee will be paid to A.I.D.'s Fund for the guaranty.

12. Section 223 (h): Will appropriate steps be taken to assure that no payment will be made under the guaranty for any loss arising out of fraud or misrepresentation for which the party seeking payment is responsible?

Yes. The Guaranty Section of the Trust Agreement will so provide.

ANNEX VI  
PROJECT DESIGN SUMMARY  
LOGICAL FRAMEWORK

Life of Project  
From 1981 to 1983  
Total U.S. Funding Qty:  
Qty of \$ 3,000,000  
Date Prepared: Aug. 7, 1981

Project Title & Number: PROSPECTIVE CREDIT GUARANTY PROJECT

NARRATIVE SUMMARY	OBJECTIVELY MEASURABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS																					
<p>Program or Sector Goal: The broader objective to which this project contributes: (A-1)</p> <p>Increase opportunities for profitable and productive investment by incorporating into the institutional credit system small entrepreneurs who have not previously been able to obtain such credit.</p>	<p>Measures of Goal Achievement: (A-2)</p> <table border="1"> <tr> <td></td> <td>'78</td> <td>'79</td> <td>'80</td> <td>'81</td> <td>'82</td> <td>'83</td> </tr> <tr> <td>Credit Approved (mln)</td> <td>.5</td> <td>1.2</td> <td>2.0</td> <td>4.0</td> <td>6.0</td> <td>9.0</td> </tr> <tr> <td>Services introduced to credit system (\$10,000 av. proj. size)</td> <td>49.0</td> <td>123.0</td> <td>237.0</td> <td>401.0</td> <td>647.0</td> <td>946.0</td> </tr> </table>		'78	'79	'80	'81	'82	'83	Credit Approved (mln)	.5	1.2	2.0	4.0	6.0	9.0	Services introduced to credit system (\$10,000 av. proj. size)	49.0	123.0	237.0	401.0	647.0	946.0	<p>(A-3)</p> <p>POCF Annual Report, based on Central Bank records. A system will be established in which the Central Bank will receive information on every loan made.</p>	<p>Assumptions for achieving goal targets: (A4)</p> <p>Effective demand for credit among target group can be generated using this Project's unique method of providing and controlling technique: assistance for subproject investment analysis and implementation.</p>
	'78	'79	'80	'81	'82	'83																		
Credit Approved (mln)	.5	1.2	2.0	4.0	6.0	9.0																		
Services introduced to credit system (\$10,000 av. proj. size)	49.0	123.0	237.0	401.0	647.0	946.0																		
<p>Project Purpose: (B-1)</p> <p>Develop a self-sustaining credit guaranty mechanism that will neutralize the real or imagined risk in the subproject proposed by potentially productive individuals outside of the bonafide credit system.</p>	<p>Conditions that will indicate purpose has been achieved: End-of-Project status. (B-2)</p> <ol style="list-style-type: none"> <li>Net capital in Fund from guaranty fees exceeds claims on Fund from defaults and operating expenses.</li> <li>COOR adopts system and continues it beyond life of Project.</li> </ol>	<p>(B-3)</p> <p>Central Bank records.</p>	<p>Assumption for achieving purpose: (B-4)</p> <p>Loan default rates will not exceed levels of 4 percent of portfolio.</p>																					
<p>Project Output: (C-1)</p> <p>A viable, self-supporting Credit Guaranty Fund.</p>	<p>Magnitude of Outputs: (C-2)</p> <table border="1"> <tr> <td></td> <td>'78</td> <td>'79</td> <td>'80</td> <td>'81</td> <td>'82</td> <td>'83</td> </tr> <tr> <td>Net capital-lation of Fund (mln)</td> <td>70.3</td> <td>66.0</td> <td>106.5</td> <td>232.3</td> <td>416.9</td> <td>1,772.5</td> </tr> </table>		'78	'79	'80	'81	'82	'83	Net capital-lation of Fund (mln)	70.3	66.0	106.5	232.3	416.9	1,772.5	<p>(C-3)</p> <p>Central Bank records.</p>	<p>Assumptions for achieving outputs: (C-4)</p> <p>There will be adequate support for Project from Central Bank and lenders.</p>							
	'78	'79	'80	'81	'82	'83																		
Net capital-lation of Fund (mln)	70.3	66.0	106.5	232.3	416.9	1,772.5																		
<p>Project Inputs: (D-1)</p> <ol style="list-style-type: none"> <li><u>A.I.D.</u> A guaranty of not to exceed \$3,000,000.</li> <li><u>Banking System</u> a. A guaranty of not to exceed \$1,500,000.</li> <li><u>Central Bank</u> Budget support for administration of the Guaranty Fund of no less than \$40,000</li> </ol>	<p>Implementation Target (Type and Quantity) (D-2)</p> <ol style="list-style-type: none"> <li>A.I.D. technical support unit will fund training program for Central Bank staff through advisor to Central Bank for 28 months.</li> <li>Central Bank support will pay for staff and other expenses of Fund for first year until it is self-supporting.</li> </ol>	<p>(D-3)</p> <p>A.I.D. records.</p> <p>Central Bank records.</p>	<p>Assumptions for providing inputs: (D-4)</p> <p>Trust Agreement signed and Effective Project Management.</p>																					

## INITIAL ENVIRONMENTAL EXAMINATION

### 1. Examination of Nature, Scope and Magnitude of Environmental Impacts

#### A. Description of Project

The proposed Project will enable loans to be made to small borrowers (individuals and groups) without access to traditional sources of credit because they lack sufficient collateral for agricultural credit and self-help community development projects. Examples of assets to be financed include wells, pumps, farm machinery, improved seed, fertilizer, pesticides, food processing and distribution facilities, improved breeding stock for farm animals, sanitation facilities, looms, other handicraft aids, and machinery for small industries in rural and peripheral urban areas. A guaranty of collection of 75 percent of each loan will be offered to all eligible lenders as an incentive to make loans under the proposed guaranty system.

#### B. Identification and Evaluation of Environmental Impacts

The proposed Project will establish a guaranty fund which will be the source of guaranties to encourage banks and other lending organizations to utilize private sector financial resources to make loans for agricultural and self-help community development projects. The loans will be made on legal commercial terms to organized groups or individuals to enable them to carry out these projects for which they are unable to obtain other financial assistance on reasonable terms. Eligible loans made are eligible to be rediscounted by the Central Bank. In these and other respects, the proposed Project can be considered an instrument to stimulate intermediate credit institution activity.

It is possible to identify the general nature of the loans which will be made under the Project. Investments will be partened in agricultural production, agro-industry and small industry and artisan activities. It is expected that no significant negative environmental impact will result from these activities. Small rural and peripheral urban enterprises will primarily include commercial and service activities. The negative environmental impact of these activities is expected also to be negligible. Agribusiness activities are expected to include small-scale industries established for the assembly, processing, marketing and distribution of small farmer-produced agricultural products, or for the production and distribution of factor inputs. Some of the

small industries established in this category may have minor environmental implications, but they are likely to be negligible. Finally, perhaps a majority of the projects will be small-scale agricultural activities involving more intensive cultivation of existing lands, expansion of land areas being cultivated, or the undertaking of new agricultural or livestock activities, all on a small scale by farmers working less than 20 hectares of land. The environmental effects are also expected to be negligible. The above activities fall into the general class of activities which will not normally require the filing of an Environmental Impact Statement or the preparation of an Environmental Assessment, according to Section (f) of Appendix B of Handbook 3, entitled, Environmental Procedures. Since a guaranty project is not for the purpose of carrying out a specifically identifiable subproject.

In addition, the essentially intermediate-credit-institution nature of the Project would appear to qualify it to the third category for which a Negative Declaration is recommended by the IIE Guidelines. In this regard, the proposed activities represent a programmatic approach which includes a variety of activities, and which have been, and will continue to be, applied by the Agency on a national basis in Latin/American countries under the experimental program of small loan guaranties authorized by Section 222A of the IAA of 1974.

## II. Recommendation for Environmental Action

A Negative Determination is recommended.

# BEST AVAILABLE DOCUMENT

AMERICAN  
Page 2 of 4

## DEPARTMENT OF THE ARMY AND NAVY

Impact  
Identification  
and  
Evaluation 2/

### Impact Areas and Sub-areas 1/

#### A. LAND USE

- 1. Changing the character of the land through:
  - a. Increasing the population----- H
  - b. Extracting natural resources----- H
  - c. Land clearing----- L
  - d. Changing soil character----- H
- 2. Altering natural defenses----- L
- 3. Foreclosing important uses----- H
- 4. Jeopardizing man or his works----- H
- 5. Other factors

#### B. WATER QUALITY

- 1. Physical state of water----- H

1/ See Explanatory Notes for this form.

2/ Use the following symbols: H - High environmental impact  
 L - Little environmental impact  
 M - Moderate environmental impact  
 H - High environmental impact  
 U - Unknown environmental impact

57x

- 2. Chemical and biological states-----   H
- 3. Ecological balance-----   H
- 4. Other factors
- \_\_\_\_\_
- \_\_\_\_\_

C. ATMOSPHERIC

- 1. Air additives-----   N
- 2. Air pollution-----   H
- 3. Noise pollution-----   H
- 4. Other factors
- \_\_\_\_\_   N
- \_\_\_\_\_

D. NATURAL RESOURCES

- 1. Inversion, altered use of water-----   H
- 2. Irreversible, inefficient commitments-----   N
- 3. Other factors
- \_\_\_\_\_   H
- \_\_\_\_\_

E. CULTURAL

- 1. Altering physical symbols-----   H
- 2. Dilution of cultural traditions-----   N
- 3. Other factors
- \_\_\_\_\_   H
- \_\_\_\_\_



ENVIRONMENTAL ASSESSMENT

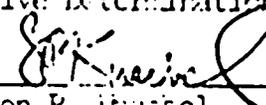
Project Location: Costa Rica  
Project Title: Productive Credit Guaranty Program  
Funding: \$3.0 million guaranty  
Life of Project: Guaranties may be issued under current authority until September 30, 1978. Guaranties will cover loans of varying terms; issued guaranties will run for the life of each loan.

Prepared by: Antonio M. Velásquez

Date: July 28, 1978

Environmental Action Recommended: Negative Determination

Concurrence:

  
\_\_\_\_\_  
Stephen P. Knebel  
Director

Date: August , 1978

Assistant Administrator's  
Decision:

Approved \_\_\_\_\_

Disapproved \_\_\_\_\_

\_\_\_\_\_  
Signature Date:

Credit Demand Analysis for Small Industry<sup>1/</sup>

1. Summary

An analysis carried out in April 1978 derived the expected incremental demand for small industry credit for the three-year period 1979-1981 by calculating the gap between the total credit demanded and the total supply of small industry credit funds.

The study estimates a 21% increase in the number of small industrial firms applying for credit as a result of activities to be carried out under the Urban Employment and Community Improvement Project--bank reforms, credit promotion, technical assistance and training activities. It also predicts an 18 percent increase in bank approved loan applications because of an increased interest rate spread to the National Banking System (SBN) on loans made to small industries, and the existence of a risk-neutralizing Guaranty Fund. Of the 3,500 small industrial firms in San Jose, the study estimates that 2,100 will receive credit by the third year of the Project, an increase of 970 firms over the number which received credit in 1977. The final conclusions of the study are that over the life of the Project, the total amount of new, small industry loans to be granted will be \$15.5 million, or \$5.8 million more than the SBN will be able to lend.

The ability of the SEM to lend is dictated by the Central Bank, which allocates credit funds on the basis of a tope (limit) system. It establishes ceilings on the total allowable portfolio the SEM can maintain for each sector of the economy, and imposes penalties on SEM members if they exceed any of these limits. Only the artisan and small-industry sectors have minimum topes, or portfolios which they are expected to reach and surpass.

In 1977 small-industry and artisan lending in the San José Metropolitan Area (230.0 million colones) exceeded the minimum tope for the entire country (226.8 million colones) and additional resources to meet this credit demand had to be drawn from the Small Farmer Credit allocation (Annex II.B, pg. 19 and Annex II.H). The Central Bank increased the combined tope for the small-industry and artisan sectors (for the entire country) to 250.0 million colones in 1978, because of this increased demand and pressure for progress in this economic sector. However these additional funds, plus recuperations, will not be enough to meet projected credit demand, and the Central Bank cannot increase the tope without straining the supply of funds in other sectors of the

<sup>1/</sup> Except for the last page this is excerpted from page 72-74A of the Urban Employment and Community Improvement Project Paper AID/LAC/P-002, Project Number 515-0130.

61x

economy (for which credit demand already exceeds the available supply).

The critical role of AID and GOCR counterpart funds is, therefore, to raise the small-industry portfolio to meet increased demand resulting from this Project.

## 2. Calculations

Assuming that new firms entering the institutional credit market will require financing for both working and fixed capital, and that old firms will return every year for loans in order to maintain their working capital balances, the study produced the following projections:

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
<u>Fixed Capital</u>						
New Firms	320	850	280	310	340	320
<u>Working Capital</u>						
New Firms	320	850	290	310	340	320
Old Firms	0	320	1,170	1,450	1,760	1,790
Number of Firms in the Portfolio	320	1,170	1,450	1,760	2,100	2,100

Estimating a ratio for the use of credit funds of 40% for working and 60% for fixed capital, the study developed the following equation to determine the total amount of credit demanded each year:

$$\text{Total annual credit} = \frac{.6}{.4} (O)(X) + (N)(X) + .75(O)X$$

Where: X = average size of working capital loan

N = number of new firms

O = number of old firms

It then solved for X using the known 1977 amount of small industrial credit provided in the metropolitan area (\$3,546,485), the number of new firms requesting credit (850) and number of old firms returning for credit (320). The results for 1977 are as follows:

	<u>Fixed Capital</u>	<u>Working Capital</u> <u>New Firms</u>	<u>Working Capital</u> <u>Old Firms</u>
1977	\$ 2,250	\$ 1,500	\$ 1,125

The study incorporated an inflation rate of 3% and the expected increased use of bank credit by small industrialists into coefficients for each year of the Project. They are: 1978 - 1.08; 1979 - 1.15; 1980 - 1.3; 1981 - 1.45.

Applying these coefficients to the above 1977 average figures produced the following:

	<u>Fixed Capital</u>	<u>Working Capital</u> <u>New Firms</u>	<u>Working Capital</u> <u>Old Firms</u>
1977	\$ 2,250	\$ 1,500	\$ 1,125
1978	2,430	1,620	1,215
1979	3,018	2,012	1,509
1980	3,685	2,456	1,242
1981	4,439	2,959	2,219

The estimated average loan size multiplied by the number of firms requiring credit gives the total credit demand for each year.

UNCLASSIFIED

63x

	<u>Fixed Capital</u>	<u>Working Capital</u> <u>New Firms</u>	<u>Working Capital</u> <u>Old Firms</u>	<u>Total</u>
1977	1,912,500	1,275,000	360,000	3,547,500
1978	680,400	453,600	1,421,559	2,555,550
1979	935,580	623,720	2,188,050	3,747,350
1980	1,252,900	835,040	3,241,920	5,329,862
1981	1,420,480	<u>946,880</u>	<u>3,949,820</u>	<u>6,317,180</u>
Program Total	3,608,960	2,405,640	9,389,790	15,394,392

The program total does not equal the amount required for the Project because the banks will be able to recuperate some of the amounts loaned in previous years. The projected recuperations were calculated based on the assumption that the banks will recuperate two thirds of working capital loans in the second year and the final third in the third year; that the banks will recuperate one fifth of fixed capital loans every year after a 2-year grace period for loans made before 1979, and recuperate one-eighth of fixed capital loans after a 2-year grace period for loans made after 1979; and that all loans will be made at mid-year. The projected recuperations are:

1977	239,503
1978	1,263,315
1979	2,093,535
1980	3,053,175
1981	<u>4,337,241</u>
Total Program Recuperation (1979-1981)	9,483,952

UNCLASSIFIED

1.24

The estimated total loan demand for new firms is derived by adding together the fixed and working capital average figures for each year and multiplying by the corresponding number of new firms seeking credit:

	<u>Avg. Fixed &amp; Working Cap. New Firms</u>	<u>Number of Firms</u>	<u>TOTAL Credit Demand by New Firms</u>
1979	\$5,030	310	\$1,559,300
1980	6,141	340	2,087,940
1981	7,398	320	<u>2,367,360</u>
		TOTAL -	\$6,014,600

605'