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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON THE

PROPOSED LOAN

TO

BANCO DE FOMENTO AGROPECUARIO DEL PERU

IN LIMA, PERU

May 23, 1960

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS ON A
PROPOSED LOAN TO BANCO DE FOMENTO AGROPECUARIO DEL PERU
IN LIMA, PERU

1. I submit the following report and recommendations on a proposed loan, of an amount in various currencies equivalent to \$5 million, to the Banco de Fomento Agropecuario del Peru (hereinafter called the "Banco") to finance the import requirements of its agricultural credit program.

PART I: HISTORICAL

2. The Bank has already made two loans to the Banco to enable it to finance a program of medium and long-term credits to farmers in Peru for agricultural development: \$5 million in November 1954 (105-PE), and \$5 million in March, 1957 (162-PE). By the end of 1958, the second loan was fully committed and the Banco requested a third loan, again of \$5 million. Consideration of this third request was postponed pending completion of a reorganization of the Banco's structure and system of accounts, which it had found necessary, in order to cope adequately with the increased scale of its activities.

3. A Bank mission visited Peru in November, 1959 and the Banco was invited for loan negotiations in April, 1960. Negotiations for the loan began in Washington on May 5. Mr. Emilio Foley, General Manager of the Banco, and Mr. Cesar Cardenas, legal adviser, represented the borrower and Mr. Carlos Gibson, Financial Counselor of the Peruvian Embassy in Washington, represented the Government of Peru.

4. The proposed loan would increase the Bank's lending to Peru from \$47.5 million to \$52.5 million equivalent, net of cancellations and terminations. The Bank has already made the following loans to Peru:

<u>Year</u>	<u>Project</u>	<u>Amount of Loan (net of cancellations and terminations)</u>
1952	Port development	\$2,410,528
1952	Agricultural development	1,300,000
1954	Agricultural development	1,700,000
1954	Agricultural credit	4,999,771
1955	Irrigation	18,000,000
1955	Construction of cement plant	2,497,082
1955	Highway maintenance	4,994,887
1957	Agricultural credit	5,000,000
1958	Port development	<u>6,575,000</u>
Total (net of cancellations)		47,477,268
of which has been repaid		<u>8,758,099</u>
Total now outstanding		38,718,969 *
Amount Sold	\$5,515,250	
of which has been repaid	<u>4,348,250</u>	<u>1,167,000</u>
Net amount held by Bank on April 30, 1960		<u><u>\$37,551,969</u></u> *

* Includes \$5,072,454 million not yet disbursed

5. At present, work is well advanced on loans for two other projects in Peru. Negotiations are under way for a loan of about \$24 million to assist in financing a hydroelectric project in the Lima area. Preliminary negotiations for a loan of about \$6 million for highway development in the central part of Peru were completed earlier this year and the Bank is now awaiting the passage of enabling legislation to conclude negotiations. A chart showing the effect of these loans together with the proposed loan, on the net investments and commitments of the Bank in Peru is attached (No.1).

PART II: DESCRIPTION OF THE PROPOSED LOAN

6. The loan would have the following characteristics:

<u>Borrower:</u>	Banco de Fomento Agropecuario del Peru
<u>Guarantor:</u>	The Republic of Peru
<u>Amount:</u>	The equivalent, in various currencies, of \$5 million
<u>Purpose:</u>	To provide foreign exchange for the importation of livestock, machinery, equipment and materials for the Banco's program of development credits for agriculture

Amortization: 11 semi-annual instalments from February 1, 1963 to February 1, 1968

Interest Rate: 6% per annum

Commitment Charge: 3/4 of 1%

Payment Dates: February 1 and August 1

PART III: LEGAL INSTRUMENTS AND LEGAL AUTHORITY

7. A draft Loan Agreement between the Bank and the Banco (No.2) and a draft Guarantee Agreement between the Bank and the Government of Peru (No.3) are attached. Both agreements are substantially similar to those for the previous loan to the Banco (162-PE).
8. Law 11691 of the Republic of Peru, dated January 3, 1952, authorizes the Banco to contract loans of this nature and the Government of Peru to guarantee such loans without further Congressional authorization.
9. The report of the Committee provided for in Article 3, Section 4 (iii) of the Articles of Agreement is attached (No.4).

PART IV: APPRAISAL OF THE PROPOSED LOAN

10. A detailed appraisal of the project (TO-240a) is attached. (No.5)

Justification of the Project:

11. The 1958 FAO/Bank Agricultural Survey Mission concluded that agricultural production in Peru should be expanded by about 50% during the next decade to meet the food needs of a growing population and to add to export earnings. Important to the expansion of agricultural production is the ability of farmers to obtain long-term credits to assist in financing the purchase of equipment, breeding stock and improvements in basic productive facilities.
12. The results obtained with the two loans already made to the Banco are good. While it is impossible to measure precisely their impact upon agricultural production, the benefits have been widespread and important. In physical terms, the loans have helped finance the improvement or development of 50,000 hectares of irrigated land; the importation of 1,100 farm tractors, 6,500 breeding stock and material for 2,000 kilometers of fences; the development of 12,000 hectares of permanent plantations; and the establishment of important agricultural processing plants.
13. If limited to its own financial resources, the Banco would have to restrict its lending largely to providing short-term agricultural credit of which it is the principal supplier in Peru. By enabling the Banco to continue to provide medium and long-term credit, the proposed loan makes an important contribution to Peru's agricultural development and economic strength.

The Borrower:

14. As in the case of Loans 105-PE and 162-PE, the borrower would be the Banco, an autonomous credit institution of the Peruvian Government. The Banco plays a unique and increasingly important role in agricultural development. It is the principal source of credit for Peruvian agriculture and also provides important agricultural extension services.

15. The Banco is administered by a General Manager under a Board of eleven Directors. Except for two brief absences while he was Minister of Agriculture, the present General Manager has been continuously in charge since 1954. He has proved to be an able manager and is assisted by an experienced staff. Credit policies and procedures of the Banco are satisfactory, and its financial position is sound.

16. The proportion of delinquent loans in the Banco's portfolio is high, largely because of poor crop markets in recent years. But loans are well secured, losses have been insignificant, and reserves appear adequate. Though no rapid improvement of the delinquent debt situation can be expected, the Banco's financial situation is not jeopardized.

17. To enable the Banco to deal more adequately with its increased scale of operations, a reorganization of its administrative structure, procedures and accounting system was begun in 1958. This reorganization is proceeding satisfactorily.

Terms of Lending:

18. On May 1, 1960, the Banco raised its charges on new loans to medium and large borrowers from 9% to 11% (interest plus 2% commission). Income from loan charges should accordingly increase and improve the Banco's earnings position.

19. In the program financed under the two previous Bank loans, the foreign exchange risks incident to Banco loans made for the production of export crops was assumed by the farmers; the risks incident to loans for production for domestic markets was assumed by the Government. The Government lifted price controls on the principal food products in July, 1959 and is no longer willing to assume this risk; the Banco therefore will require that the exchange risk be assumed by all borrowers under the program. While the higher interest rate and the necessity of assuming this risk will deter some farmers from borrowing, these factors are not expected to reduce the beneficial effects of the program.

Economic Situation:

20. Since the report on the "Current Economic Position and Prospects of Peru" (WH-89a) was distributed to the Executive Directors on November 4, 1959, Peru's financial position has strengthened. This has been due principally to the program followed by the new Cabinet, which took office in mid-1959, and the substantial increase in export earnings which has taken place.

21. The first task to which the new Minister of Finance addressed himself was to end Central Bank financing of Government expenditures. This first task has been accomplished, principally by increasing revenues. If amortization of debts is taken out of expenditure, the 1960 budget is expected to be in surplus. Government borrowing from the Central Bank to finance seasonal shortages of cash has also stopped. With the return of confidence which the successful financial stabilization policy has brought about, the Government was able in March, 1960 to sell six and nine month bonds to private investors. Strict monetary policies are complementing efforts on the fiscal front. To prevent further additions to the liquidity of the commercial banks, which has been increasing because of the accumulation by the Central Bank of foreign exchange in recent months, stringent new marginal reserve requirements were recently imposed. The banks now have to maintain a cash reserve of 100% against all deposits additional to those held on April 22, 1960.

22. In March, the International Monetary Fund renewed its standby credit for \$27.5 million for one year. Since December, 1959 Peru repaid in advance to the Fund and the Export-Import Bank \$30 million drawn earlier for balance of payments purposes. As of May 13, 1960 the net international reserves of the Central Bank were \$50.4 million, (or \$32 million if the "untouchable" gold is not counted) \$43 million more than in mid-1959. Since October, 1959 the exchange rate has remained stable. The cost of living has also remained virtually unchanged since the Fall of 1959.

23. Export values will approximate \$400 million in 1960 compared with the \$300 million level in recent years. Still rapidly rising exports of fish products, particularly fish meal, and new shipments of iron ore and copper from mines recently opened represent new sources of foreign exchange for Peru.

24. Peru's external public debt was \$195 million at the end of 1959. Service payments on this debt amount to \$32 to \$33 million in 1960 and 1961 and will absorb 8% of expected export earnings. But as two-thirds of these payments are for medium-term debts which are being amortized rapidly, service payments on existing debt decline rapidly. Service payments on the proposed loan and the two other loans referred to in paragraph 5 of this report would raise service payments on existing debt to \$26 million by 1963, equivalent to 6% expected export earnings. By 1965, when amortization payments would have begun on all three of the proposed IBRD loans, this proportion would have fallen to 3%.

Procurement:

25. As in the two previous loans, goods to be purchased under the loan will generally be imported and distributed through commercial channels. Credits to farmers for machinery will be given only for purchases from dealers which are able to provide adequate service and spare parts. Most of the livestock will, as in the past, be imported and distributed directly by the Banco.

Prospect of Fulfilment of Obligations:

26. The management of the Banco is competent. It has experience with Loans 105-PE and 162-PE, and should have no difficulty in continuing effectively its program of development credit for agriculture to be financed by the proposed loan. With the recent increase in the Banco's loan charges, earnings should be adequate to cover the cost of administering the program and to provide funds to purchase the exchange needed to service the proposed loan. The Peruvian economy should be able to provide the foreign exchange needed to service the loan.

PART V: COMPLIANCE WITH ARTICLES OF AGREEMENT

27. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VI: RECOMMENDATIONS

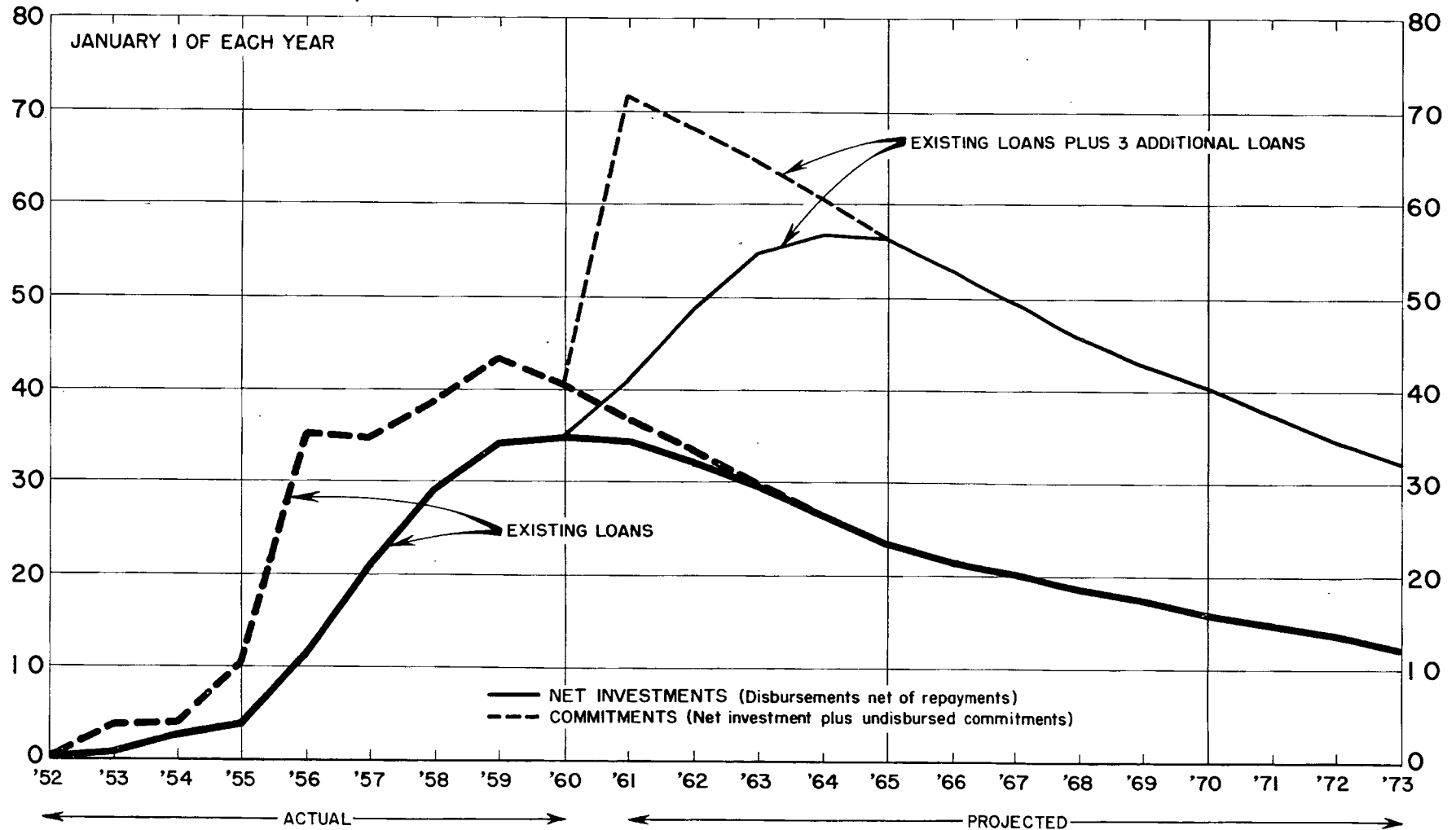
28. I recommend that the Bank at this time make a loan to the Banco de Fomento Agropecuario del Peru in an amount in currencies equivalent to \$5 million for a total term of eight years with interest (including commission) at 6 per cent per annum and on such terms as are specified in the form of the Loan and Guarantee Agreements and that the Executive Directors adopt a Resolution to that effect in the form attached (No.6).

Washington, D.C.
May 23, 1960

W.A.B. Iliff, Vice President
for Eugene R. Black
President

BANK LOANS TO PERU: NET INVESTMENTS AND COMMITMENTS

INCLUDING PARTICIPATIONS AND SALES FROM PORTFOLIO
(MILLIONS OF DOLLARS)



NOTE: Does not include Loan # 190 PE which was cancelled. Additional loans are: \$5,000,000 3rd Agricultural Credit Project, \$24,000,000 Huinco Hydro-electric Project and \$6,000,000 Highway Reconstruction Project (Aguaytia-Pucallpa)