INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS

of the

PRESIDENT

to the

EXECUTIVE DIRECTORS

on the

PROPOSED LOAN

to the

BANCO DE FOMENTO AGROPECUARIO DEL PERU

TO FINANCE THE IMPORT OF AGRICULTURAL GOODS INTO PERU

November 5, 1954
1. I submit herewith a report and recommendations on a proposed loan of $5 million to finance the importation of agricultural equipment, livestock, and storage and processing plants to be distributed in Peru by the Banco de Fomento Agropecuario del Peru (hereinafter called the "Banco").

**PART I - HISTORICAL**

2. On March 25 of this year the Banco, with the concurrence of the Peruvian Government, submitted a proposal to the Bank for a series of five annual loans, totaling $24 million, to enable it to undertake an expanded five-year program of medium and long-term lending. The proceeds of the loans were to be used to finance the import of agricultural materials and equipment and livestock, which would be purchased by farmers with the help of loans granted by the Banco.

3. A Bank representative visited Peru in April and May of this year to assess the demand for agricultural credit. Another staff member and consultant in agricultural credit were in Peru in June and July to investigate the Banco, its organization and credit program.

**PART II - DESCRIPTION OF THE PROPOSED LOAN**

**Borrower**

4. The Borrower would be the Banco, an autonomous credit institution of the Peruvian Government. The Banco is administered by the general manager under a Board of Directors whose members are appointed by the Government, the Central Reserve Bank, the Commercial Banks of Lima, the National Agrarian Society and the Rural Association of Peru. With headquarters in Lima, it operates throughout the country by means of 76 local offices. Its main activity to date has been the provision of short-term credit to farmers. Though it has expanded its medium- and long-term lending in recent years, these operations are still on a relatively small scale. The proposed loan would be used by the Banco to finance medium- and long-term loans covering imported goods. As a consequence the Banco would be able to devote more of its own available resources to medium- and long-term loans related to expenditures in local currency.
5. Accordingly, the Bank and the Banco have thought it appropriate to agree upon a two-year program of medium- and long-term loans to be made not only with the proceeds of the proposed loan but also from the Banco's own available resources. This program sets out categories of agricultural goods to be financed and the amounts to be devoted to each category and is incorporated in a draft letter which is attached hereto as Appendix IV. The period of two years was chosen because a minimum of two years is considered necessary to enable the Banco to put into effect a comprehensive program of medium- and long-term loans. It would be difficult to plan realistically for a longer period.

Guarantor

6. The Guarantor will be the Republic of Peru, a member of the Bank.

Amount

7. The amount of the Loan would be $5 million or its equivalent in other currencies.

Purpose

8. The purpose of the Loan is to enable Peru to import agricultural machinery and equipment, irrigation pumps and equipment, fencing, livestock and parts and materials for small processing and storage plants. These goods will be distributed in Peru with the help of medium- and long-term loans granted by the Banco.

Interest, Commission and Commitment Charges

9. The loan would bear an interest rate of 4-1/4% per annum, including the statutory commission of 1%. The commitment charge would be 3/4 of 1% per annum and would accrue from the effective date of the Loan Agreement or sixty days after the date of the Loan Agreement, whichever is earlier.

Amortization

10. The loan would be for a period of eight years. It would be amortized by semi-annual payments of principal beginning August 1, 1957 and ending February 1, 1963, as set out in Schedule I of the proposed Loan Agreement.
Legal Instruments and Legal Authority

11. Drafts of the Loan Agreement and Guarantee Agreement are attached as Appendix I and Appendix II, respectively. Attention is drawn to the following special provisions in the Loan Agreement. Section 2.02(b) provides that no withdrawals are to be made for goods to be incorporated in processing or storage plants until the particular project has been approved by the Bank. The total amount allocated for this purpose is $500,000. In Section 5.03 the Banco obligates itself not to incur debt of one year or more maturity until it has received the consent of the Bank. Section 5.08 provides that the Banco will make arrangements satisfactory to the Bank to assure that purchases of agricultural equipment are made only through dealers who have adequate service and repair facilities. The report of the Committee provided for in Article III Section l(iii) of the Articles of Agreement is attached as Appendix V.

PART III - APPRAISAL OF THE PROPOSED LOAN

12. A detailed appraisal of the Project (TO 67) is attached as Appendix III.

Justification of the Project

13. Peruvian agricultural production has increased in recent years but has failed to keep up with consumption. Imports of foodstuffs continue to grow year by year. There is thus an urgent need to increase the production of foodstuffs and other crops to meet the needs of a growing population and an expanding economy.

14. The Banco represents the only source of medium- and long-term credit available to agriculturalists. Medium-term loans are particularly required for the purchase of agricultural machinery and equipment and breeding stock, and for the construction of small drainage and irrigation works. Longer term loans are required particularly for processing and storage facilities. About half of the proposed loan would be used for the purchase of machines and implements, mostly tractors and tractor-drawn equipment. Due to shortage of labor, increased mechanization is essential in the coastal regions where the principal crops are cotton, sugar and rice. The introduction of machines is necessary in the high mountain valleys if production of wheat, barley and potatoes (the main crops of this region) is to be expanded. Machinery will also be required if the extensive jungle areas of Peru are to be cleared and colonized. The imports of tractors contemplated in the two-year program of the Banco will hardly suffice to make good the obsolescence on tractors now in use in Peru. About one-quarter of the loan would be used for the purchase of pumps and irrigation equipment. Shortage of water, particularly in the coastal region, makes expansion of irrigation works a basic requirement for increasing production.
15. The proposed loan would complement the two SCIPA loans (PE 67 & 98). Machinery pools of light tillage and threshing equipment have demonstrated the effectiveness of mechanized farming. As a consequence, demand for this kind of equipment has been stimulated but credit terms are needed to enable farmers to make these purchases. As a general rule, it would not be economic for farmers to own the kind of heavy equipment which the SCIPA pools use for land rehabilitation, but the farmer requires credit to enable him to rent such equipment from SCIPA. The Banco will be in a better position to supply this kind of credit from its own resources if the loan proposed herein is approved.

16. The benefits to be derived from the proposed loan would be extensive. It is estimated that the cost of tractors and other agricultural machinery can be paid for out of one or two crops even allowing for all current expenditures such as fuel, repairs and labor. As a consequence, the net benefits to the farmer, if the machinery has a life, of, say, six years, would be four or five times the value of the original purchase. A well with pumping equipment would on the average cost $20,000, but it would increase the production of the 50 hectares it would serve by the equivalent of $5,000 per annum.

17. It is more difficult to assess the benefits to be derived from the import of livestock and of machinery and materials for storage and processing facilities. Peru still has insufficient high quality breeding stock of both cattle and sheep and must continue imports for some time to come. The ultimate effect of such imports on the production of milk, meat and wool should far outweigh the original investment. Storage and processing facilities will stimulate production, promote orderly marketing, reduce waste and spoilage, and thus result not only in better returns to the farmer but in lower prices to the consumer.

The Economic Situation

18. The economic background against which the proposed loan can be considered is contained in the Economic Report (WH 22a) presented to the Board of Executive Directors on April 8, 1954. This report was prepared shortly after the Peruvian Government had taken several steps to remedy an exchange crisis which had resulted in a 30% decline in the value of the sol during 1953. The events of the last six months show that the policies of the Peruvian Government have borne fruit and the situation has improved appreciably.

19. The period 1949-52 had been one of steady economic expansion. Devaluation, a free exchange market and favorable terms of trade stimulated export activities. During the War imports had been restricted but rose rapidly thereafter under the impact of higher incomes; in 1949 their dollar value was three times and in 1952 five times that of the annual average for the years 1937-1939. As a consequence, important changes took place in the balance of payments. Traditionally, a surplus on trade account covered a deficit on other balance of payment items; since 1949 Peru has registered a current account deficit financed by heavy capital inflows.
20. In 1952 the terms of trade turned against Peru and external stability was threatened. Export earnings fell from the peak of $252 million in 1951 to $238 million in 1952 and $220 million in 1953. Budget deficits were incurred and money supply increased; consequently, the demand for imports continued to rise. Imports grew from $272 million in 1951 to $287 million in 1952 and $290 million in 1953. The pressure thus brought upon the balance of payments weakened the sol, which fell from less than 16 soles per dollar in March 1953 to almost 18 in September and 22 in January 1954.

21. The year 1954 must be considered as one of adjustment to the lower level of foreign exchange receipts. The government reiterated its adherence to a policy of free trade and free exchange, choosing to make the necessary adjustments by means of financial policy rather than by maintaining the exchange rate through the use of direct trade and exchange controls. At the beginning of 1954 the President announced the government's determination to reduce its expenditures and curtail credit expansion. A new Minister of Finance was appointed and stabilization credits totalling U.S. $30 million were obtained from the International Monetary Fund (U.S. $12.5 million), the U.S. Treasury (U.S. $12.5 million) and the Chase National Bank (U.S. $5.0 million), their declared purpose being to help support the sol and avoid the necessity for restrictions on trade and payments. It was also announced that there was no intention of maintaining a rigid exchange rate; fluctuations would be allowed although there would be the possibility of official intervention in the exchange market in order to prevent wide swings in daily quotations.

22. These assurances, together with the availability of the stabilization credits, quickly restored confidence. The sol rose from a level of 22 soles per U. S. dollar in January to 19.70 in February. Since then the rate has remained very stable and in the last three months has fluctuated between 19.20 and 19.50 soles per dollar in the certificate market. As of September 30 the sol strengthened to 19.20 soles per U.S. dollar. None of the stabilization credits has been used. There has simultaneously been a remarkable recovery of the balance of trade. In the first six months of 1954 the value of exports increased 10% due both to an expansion in volume and to a firming of prices, particularly of minerals. Imports declined 15% in value under the impact of higher sol rate for the dollar, a reduction in domestic investment and a tighter commercial bank credit policy. As a result the period closed with an adverse trade balance of U.S. $15.3 million as compared with a deficit of U.S. $53.7 million for the same period of 1953.

23. As far as can be seen at the present time measures to adjust the balance of payments have not had a serious effect on the internal growth of the economy. Agricultural and mining exports have increased in volume. It is not yet known to what extent private and public investment
in productive activities has been affected. Because of the large local currency expenditures involved, the government did postpone starting the second stage of the Quiroz-Piura irrigation works, despite the fact that the Bank had indicated its readiness to undertake negotiations for an $18 million loan on the project.

24. The basic position of the Peruvian economy is unchanged from that described in the above-mentioned report. Long run prospects remain sound and the progress of the Peruvian Government towards curbing inflation and stabilizing the currency has been highly encouraging. Exploration for new oil resources has been disappointing to date and the American Smelting and Refining Company has not yet decided to embark upon the Toquepala copper development, but these factors were not relied upon in the last economic report when assessing Peru’s creditworthiness. According to the conclusions of that report the proposed loan would be well within Peru's payment capacity. This conclusion has been strengthened by the general developments in the Peruvian economic and financial situation during the last six months. As stated when the last loan was made to Peru (PE 98, April 12, 1954), the Republic of Peru has negotiated settlements and made offers based on these settlements for resuming service on all government or government-guaranteed debt which has been in default. Payments have been resumed under the settlement made with the dollar bondholders. No payment has yet been made under the settlement reached with sterling bondholders, but we understand that satisfactory progress is being made in this respect.

Method of Procurement

25. With the exception of livestock, the goods to be purchased under the Loan will be imported and distributed through normal trade channels. The Banco itself will import livestock for distribution to farmers since it is in a better position to arrange for shipments and select the breeds best suited for Peruvian conditions.

Prospect of Fulfillment of Obligations

26. From small beginnings, the Banco has in its twenty-three years of existence played an increasingly important role in the development of Peru's agriculture. The management, staff, and organization of the Banco are competent and it now has sufficient experienced personnel for the expanded program which is contemplated. The credit policy of the Banco is generally satisfactory. Careful analysis is made of applications and loans are adequately secured and supervised.

27. The Government has advised the Banco that it will assume the foreign exchange risk in regard to the service of the proposed Loan.

PART IV - COMPLIANCE WITH ARTICLES OF AGREEMENT

28. I am satisfied that the proposed loan will comply with the requirements of the Articles of Agreement of the Bank.
PART V - RECOMMENDATIONS

29. I recommend that the Bank make a loan of 5 million to the Banco de Fomento Agropecuario del Peru on such terms and at such rates as specified in the attached draft Loan Agreement.

Eugene R. Black

Washington
November 5, 1954