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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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REPORT ON THE REQUEST FOR A SECOND LOAN  
BY THE  
BANCO DE FOMENTO AGROPECUARIO DEL PERU

March 1, 1957

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Department of Technical Operations

### TABLE OF EQUIVALENTS

Peru has a fluctuating exchange rate with no official parity. Since September, 1954 this rate has been stable at 19 Soles to the dollar.

US \$1.00	=	19.00 Soles
S/1.00	=	5.26 cents
S/1 million	=	US \$52,600

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I. Introduction

1. In March, 1954 the Banco de Fomento Agropecuario (the Banco) applied for a series of five agricultural loans totalling \$24 million, to be made in five consecutive years. The Bank felt at that time that it would be impracticable to consider more than a two-year program. The Bank further felt that the Banco could not absorb more than US\$5 million over two years. A loan of this amount (Loan 105-PE) was made on November 12, 1954 to cover the foreign exchange expenditures of a long-term agricultural credit program for the period October, 1954 - September, 1956. The Bank decided that future lending would be considered at the completion of this program.

2. On September 30, 1956 the Banco had committed the entire amount of loan 105-PE and has now requested the Bank to consider a second loan of US\$5 million to cover the foreign exchange costs of a continuation of this program until September 30, 1958.

3. The purpose of this report is to evaluate the merits of the new loan request in the light of the results of the first loan. There is attached as Annex A a brief summary of the Banco's organization and operations. More detailed information is contained in the report (T.O. 67a of October 29, 1954) which was circulated to the Board at time of consideration of loan 105-PE.

II. The Agricultural Credit Loan of 1954 (Loan 105-PE)

4. This loan was justified on the basis of the large and growing unsatisfied demand for agricultural credit in Peru. As a result of inadequate credit facilities, farmers could not purchase sufficient quantities of imported equipment and breeding stock necessary to raise the level of productivity.

5. During the two years October, 1954 - September, 1956, in carrying out the Bank-financed program, the Banco made medium and long-term credits totalling S/181 million, S/95 million (US\$5 million) of which with loan funds. This is more than twice the volume of loans made for similar purposes during the preceding two years. There is attached as Appendix I a detailed statement showing the purposes for which these credits were made.

6. During recent years, there has been a marked expansion in the economic development of Peru in the fields of farming and stock-raising. This increase has been due to a number of factors, such as improved irrigation, better equipment, relaxed price controls, more effective extension work, but there is no question that the increased availability of farm credits for farm development work, as a result of the Banco's activity has contributed to the result.

### III. The Banco de Fomento Agropecuario

7. The Banco was created in 1931 to assist the agriculture and stock-raising of Peru which were in serious straits as a result of the depression. It has now a subscribed capital of S/400 million, of which S/244 million is paid in. Because of the increased volume of business possible as a result of the Bank's loan, it has been able to follow a policy of decentralization by re-organizing its system of branches and agencies and granting them greater autonomy. For instance, agencies are now authorized to grant substantial loans without reference to Lima, the amount authorized varying from agency to agency, depending on their size and competence.

8. The system of reviewing and approving short-term credit applications at the Lima headquarters has also been streamlined. Three credit committees have been organized, one each for the Coast, the Sierra and the Selva, with authority to approve loans of up to S/500,000 each without need for Board action.

9. Plans are now nearing completion for the organization of a Southern Zone which would include the branches of Cuzco, Puno and Arequipa and their respective agencies. This Zone, where the bulk of the population lives on small subsistence farms, would be granted a considerable degree of autonomy. As a means of reaching more of these small farms, the Banco is organizing special "penetration centers" in the Department of Cuzco. These centers bring together extension services and credit facilities in areas not heretofore reached.

10. The management has remained effective and the organization of the Banco has been strengthened.

11. The Board of Directors of the Banco was, with the exception of two carry-overs, renewed at the onset of the new Administration in Peru in the early fall of 1956. The new members of the Board have been selected with care and include men of broad experience.

12. The financial position of the Banco has improved since the first loan was granted. Attached as Appendices II and III respectively are a current balance sheet of the Banco and an analysis of this balance sheet from the point of view of liquidity.

13. The Banco has been operating at a profit for the past seven years as indicated by the following summary of profit and loss statements:-

(in million Soles)

	<u>1949/50</u>	<u>1950/51</u>	<u>1951/52</u>	<u>1952/53</u>	<u>1953/54</u>	<u>1954/55</u>	<u>1955/56</u>
Operating Receipts	9.1	12.4	24.1	33.1	41.6	50.5	60.8
Operating Costs	<u>7.9</u>	<u>10.4</u>	<u>16.3</u>	<u>24.6</u>	<u>31.8</u>	<u>38.2</u>	<u>46.7</u>
Balance	1.2	2.0	7.8	8.5	9.8	12.3	14.1
To depreciation	0.2	0.3	0.5	2.7	3.4	3.4	4.5
To reserve for bad debt	.9	0.9	5.4	4.2	5.1	7.6	9.3
Profit to Capital	0.1	0.8	1.9	1.6	1.3	1.3	0.3

14. Receipts of the Banco have kept well ahead of operating costs, and operating costs per loan have gone down. This is significant since the Banco has reached the point where an expansion of its lending program is dependent largely on relatively costly long-term borrowing. Consequently its ability to continue operating at a profit will depend on further reduction in operating cost per loan, while maintaining the quality of its loan portfolio.

15. There has been an absolute increase in the portfolio of loans in arrears following the series of poor crops in many parts of Peru during the past agricultural crop season. Being by statute a no profit-no loss organization, the Banco has used most of its surplus of receipts over expenditures to increase materially its reserve for bad debts rather than paying a dividend. At September 30, 1955 S/46.1 million, or 16% of the loan portfolio, were in arrears. At September 30, 1956 this amount had increased to S/55.4 million, but percentagewise it had decreased to 14.9%. The Banco expects the great bulk of these arrears - 82% of which are of short-term loans - to be repaid over the next three years. Unless there are more disastrous droughts, this expectation should be realized. In the meantime, the relatively large delinquent portfolio presents a serious burden to the Banco. Present reserves are S/41.4 million, of which S/24.9 million are reserves for bad debts, which should be adequate.

16. The portfolio of the Banco increased from S/207 million to S/225.1 million during the fiscal year 1953/54. It increased to S/289 million during 1954/55 and to S/371 million during 1955/56. The bulk of the increase during this last year was due to long-term loans, as can be seen from the following table:-

Loan Portfolio of the Banco

	<u>Sept. 30, 1955</u>	<u>Sept. 30, 1956</u>
	(in million Soles)	
<u>Short-term Loans</u>		
To large farms for crops	76.5	88.9
For cattle	8.1	10.0
To small farms for crops	31.8	37.5
Rubber & tropical products	6.0	8.5
Advances on existing crops	20.9	23.8
	<u>143.3</u>	<u>168.7</u>
<u>Long-term Loans</u>		
To large farms	15.6	23.0
For cattle	58.9	74.3
To small farms	11.0	12.7
Chattel & real estate	47.0	74.7
Wool and advances	13.2	17.6
	<u>145.7</u>	<u>202.3</u>

17. During 1954/55 and 1955/56 the Banco made the following long-term loans under the Bank-financed program:-

	1954/1955		1955/1956	
	<u># of Loans</u>	<u>Value</u> (in S/mill.)	<u># of Loans</u>	<u>Value</u> (in S/mill.)
Irrigation	43	9.2	125	14.7
Agric. machinery	190	18.2	260	29.5
Land improvement	14	2.2	32	10.2
Livestock	205	33.5	271	32.9
Plantations	107	7.6	135	13.6
Fencing material	-	-	12	2.2
Processing & storage	<u>10</u>	<u>2.1</u>	<u>13</u>	<u>5.8</u>
Total	569	72.8	848	108.9

These totals compare with S/56 million during 1952/53. The details of the goods financed under Loan 105-PE appear in Appendix IV.

#### IV. The Proposed Program for 1956/57 and 1957/58

18. On September 30, 1956 all the funds from Loan 105-PE had been committed. The Banco, therefore, in order to be able to continue to meet the demand for long-term credits has requested a new loan of US\$5 million to carry out its program for the years 1956/57 and 1957/58.

19. Machinery set up to operate the program is working satisfactorily. Farmers and stock raisers are now familiar with the mechanics of credit operations and the demand for credits is steadily increasing. The Banco, in anticipation of negotiations of a new loan approved during October and November credit applications amounting to S/12 million to finance imports and will soon have to make a decision with regard to applications under negotiation amounting to S/18 million. These applications result from the fact that there are no other long-term agricultural credit facilities in Peru. For example, according to distributors of farm machinery, 75% of wheel and 45% of crawler tractors are now sold through loans granted by the Banco. The tractor fleet of Peru has been increasing at the rate of 500 to 600 a year and is expected to continue to increase at this rate for the next several years if credits continue to be available. In the same way demand for credits for small irrigation projects and for land improvement work has now become very active. There are in Peru some 30 to 40 small projects of a few thousand hectares each which need to be carried out, possibly with a higher degree of priority than some of the larger projects which have been under consideration by the Government for some time already. The Banco should be the source of financing for many of these smaller projects. Acceleration in the financing of such projects would require greater resources, particularly in local currency, than the Banco presently possesses, if this is to take place. The Government will have to make some decision with regard to priorities of large versus smaller irrigation projects.

20. The Banco, using the experience accumulated during the past two years, has developed a lending program for the next two years which is presented in overall figures in the next table and in more detail in par.21.

	Actual 1954/1955		Actual 1955/1956		Forecast 1956/1957		Forecast 1957/1958	
	Local Curr.	Foreign Exch.	Local Curr.	Foreign Exch.	Local Curr.	Foreign Exch.	Local Curr.	Foreign Exch.
	------(in million Soles)-----							
Short-term loans	281.1	-	269.8	-	325.0	-	350.0	-
Long-term loans	<u>37.0</u>	<u>35.7</u>	<u>49.2</u>	<u>59.6</u>	<u>49.7</u>	<u>47.5</u>	<u>75.9</u>	<u>47.5</u>
	255.1	35.7	319.0	59.6	374.7	47.5	425.9	47.5

The resources of the Banco to meet this program would accrue from the following sources:-

	<u>1954/55</u> <u>Actual</u>	<u>1955/56</u> <u>Actual</u>	<u>1956/57</u> <u>Forecast</u>	<u>1957/58</u> <u>Forecast</u>
	------(in million Soles)-----			
Repayment of short-term loans				
Own funds	37.3	38.8	60.8	107.5
Borrowings from Central Bank	149.6	199.5	250.0	250.0*)
Repayment of long-term loans	40.1	51.7	40.4	52.4
Capital increments	27.1	28.4	30.0	30.0
Profits (to capital)	1.0	0.1	0.5	0.5
IBRD loans	<u>35.7</u>	<u>59.6</u>	<u>47.5</u>	<u>47.5</u>
	Total	290.8	378.6	429.2
Less amortization Loan 105-PE		-	-	7.0
Net amount available		290.8	378.6	422.2
				473.4

\*) For short-term operations the Banco borrows from the Central Reserve Bank of Peru against its short-term portfolio up to an amount determined by means of yearly contracts drawn up at the beginning of each agricultural season. The contract is now for S/250,000,000 at 3%.

21. The funds from the proposed loan are allocated evenly over the two years of the new program, and the amount for each category is based on the average demand during the past two years. As in the case of loan 105-PE, however, it will be necessary to review the allocation periodically in the light of changing circumstances in order to ensure a continued balance between the various elements of the program.



Long-Term Program

(in million Soles)

	Realization		Proposed				Program		
	1954/55 & 1955/56		1956/1957		1957/1958		Total		
	IBRD	Banco	IBRD	Banco	IBRD	Banco	Soles	\$Equiv.	Banco
	Loan	Funds	Loan	Funds	Loan	Funds		S/19.-	Funds
	105PE								
1. Irrigation									
a) Pumps & motors	16.5	-	8.0	-	8.0	-	16.0	0.84	-
Wells & Inst.exp.	-	0.8	-	1.0	-	1.0	-	-	2.0
b) Reservoirs, dams, ditches, etc.	1.3	5.0	0.7	2.5	0.7	21.5(2)	1.4	0.07	24.0
2. Machines & implements	47.2	0.3	24.0	-	24.0	-	48.0	2.53(3)	-
3. Land improvements	-	12.4	-	15.0(1)	-	18.0(1)	-	-	33.0
4. Livestock	21.4	45.0	11.0	19.2	11.0	22.5	22.0	1.16	41.7
5. Permanent crops & plantations	-	21.2	-	11.0	-	11.0	-	-	22.0
6. Fencing materials	2.2	-	2.0	-	2.0	-	4.0	0.21	-
7. Miscellaneous	6.4	1.5	1.8	1.0	1.8	1.9	3.6	0.19	2.9
Total	95.0	86.2	47.5	49.7	47.5	75.9	95.0	5.00	125.6

(1) This proposed program includes estimates of the extraordinary demand for credits attendant on the start of farming on the Quiroz Irrigation Project. This demand will amount over the next six years to S/126.9 million at short-term and S/92.9 million at long-term. The estimated long-term foreign exchange demand for 1956/57 and 1957/58 will amount to S/2.5 and S/6.4 million respectively for farm machinery, while the long-term local currency demand is estimated at S/11 and S/12 mill. for land preparation on the assumption that not more than 50% of the lands brought under irrigation will require credits from the Banco.

(2) Includes funds to finance small irrigation projects.

(3) Includes up to \$300,000 for fisheries equipment.

22. The proposed program would be operated in the manner and using the same techniques which proved satisfactory under the first program.

23. The only change from the previous program is the inclusion under Machines and Implements of equipment for fisheries. Peru is now engaged in a campaign to develop her fisheries and as a result there is a demand for credits by fishermen to purchase engines and nets. This type of operation would be in the nature of a pilot project, while more detailed studies of this sphere of Peru's food producing activities are being made. The amount allocated would not exceed \$300,000.

V. Justification of the Loan Request

24. The proposed loan should have a beneficial effect on agriculture, which is reasonable with respect to the investment involved.

25. Peru is already importing large quantities of meat and wheat. Consumption of these products is increasing because of the trend toward urbanization. The same move results also in certain regions in a scarcity of labor. This makes it profitable for the mixed farms to increase production while avoiding an increase in labor requirements. Hence there is a growing demand for the construction of small irrigation works, for irrigation pumps, tilling and harvesting equipment and for disease-control equipment. Much of this demand has been stirred up by the demonstrative work of SCIPA's machinery pools.

26. The general public in the larger cities is becoming increasingly aware of the nutritional values of good milk. A rapidly growing demand for fresh milk can be expected. The importation of a certain number of herd-book cows and bulls is necessary to increase production rapidly and economically, so that the demand can be satisfied at a reasonable price level.

27. The Peruvian Government and the Banco have now for some years been working to improve wool production in the Andean regions. Keeping sheep is one of the very few things that can be done successfully in large areas in the mountains. A great amount of interest in better breeders and producers has been stirred up among the Andean sheep farmers, and also improvement of pastures. It has been demonstrated that the effect of such work is an increase in wool production from  $1\frac{1}{2}$  lb. to 4 to 5 lbs. and more per animal.

28. The Banco, mainly through its Department for the Amazon region, is doing pioneer work in the jungle region where areas suitable for the production of tropical crops and for cattle can be opened up. The settlers in these regions need equipment and breeding animals.

29. There will be a strong demand for equipment in the region of the Quiroz-Piura project where in the next few years land will gradually be made available. The same is true, although to a smaller extent, in other regions where irrigation works are being finished or are under construction, such as the Chotano, Pampa de Anta, Pampa de Noco and Asillo irrigation projects.

30. In general it can be said that Peruvian agriculture is now in a period of expansion and modernization, which will result in a larger and better production at reduced costs. The Banco has a central place and function in this process and it is very desirable that it maintains its activities at a rate commensurate with agricultural expansion. A reduction in the scale of its development operations would do serious and lasting harm to the economy, whereas a continuation of present activities will bring the modernization process nearer to fruition.

VI. Conclusions and Recommendations

31. The operation of the first loan to the Banco has been generally successful. Demand by farmers for long-term credits, which was unsatisfied in the past, has been met during the past two years. This demand, however, continues at a high level and the Banco is unable to meet it from its own resources without a further loan.

32. The Banco is the only institution in Peru making agricultural credits on reasonable terms. It operates efficiently and reaches all the sectors in need of its services.

33. The Banco is a suitable borrower for a second loan of US\$5 million to cover the foreign exchange expenditures for its program for the years 1956/57 and 1957/58 on the same general basis as the first loan.

34. This loan should be for eight years, including two years' grace on capital repayments during the disbursement period.

ORGANIZATION AND OPERATION OF THE  
BANCO DE FOMENTO AGROPECUARIO

A Summary

Organization

The Banco de Fomento Agropecuario, formerly called the Bank of Agriculture of Peru, was created in 1931 to operate in the field of agricultural credit where commercial banks and private houses had been unable to operate without losses.

According to its organic law, the Banco could make short, medium, and long-term loans but its lending was restricted by the limitation of its capital which was at that time S/10 million, a figure not compatible with the actual demand for farm credit in Peru. It was not until 1949 when special sources of capital were created for it that the Banco was able to begin materially to increase its lending.

To minimize the risks inherent to agricultural lending, the Banco developed a system of supervised credits. Because a large number of Peru's farms are very small and therefore very poor credit risks, they received little attention. In 1942, the Banco's organic law was amended to provide that 20% of its capital should be loaned to small farmers. In 1951, the Banco absorbed the Corporacion Peruana de Amazonas and the Junta Nacional de la Industria Lanar, whose fields of activity were mainly developmental. Since then, these institutions have adapted their work to the Banco's functions and are now forming an integral part of its combined activities.

In order to reach all parts of Peru, the Banco operates through seven branch offices which in turn operate through approximately 75 local offices. These branches and offices enjoy varying amounts of autonomy in granting short-term credits. The Arequipa branch further has the authority to make long-term loans of up to S/200,000 each and up to a limit of S/6 million a year. All other long-term credit requests are forwarded for consideration to the Banco's headquarters in Lima.

Operations

The Banco makes short-term loans of up to one year for crops at an interest of 9%, including commission. These loans are usually financed from short-term borrowings from the Central Bank at 3% against the guarantee of the credits themselves. The Banco also makes long-term loans of up to 10 years at 9% for investment purposes in agriculture and processing industries. These credits are financed either from the Banco's own capital resources or from long-term borrowings so far limited to Loan 105-PE.

The foreign exchange risk has been assumed by the Government.

The Banco also carries out a number of operations on behalf of the Government such as loans made to farmers under the Ministry of Agriculture plan for development of food production and the buying of wool, rubber, and rice to support their price. These activities are financed from special Government advances. It also carries out non-banking operations such as river transportation on the upper reaches of the Amazon river, a function it took over from the Corporacion Peruana de Amazonas and, in Southern Peru, sheep breeding stations with high pedigree rams imported from New Zealand under Loan 105-PE.

These non-banking operations are mainly of a developmental nature and will lead eventually to credit operations.

LONG-TERM CREDIT PROGRAM UNDER LOAN 105-PE

(in million Soles)

	Financed by		<u>TOTAL</u>
	<u>IBRD</u> Loan*)	<u>Banco</u> Funds	
1. Irrigation			
a) Pumps & motors	16.6	0.8	17.4
b) Reservoirs, dams, diversion ditches, etc.	1.3	5.0	6.3
2. Machinery & implements	47.4	0.3	47.7
3. Land improvement	-	12.4	12.4
4. Livestock	21.4	45.0	66.4
5. Coffee, tea, cocoa, fruit and other plantations	-	21.2	21.2
6. Fencing materials	2.2	-	2.2
7. Processing & storage	6.4	1.5	7.9
	<u>95.3</u>	<u>86.2</u>	<u>181.5</u>

\*) Calculated at \$1 = Soles 19

BANCO DE FOMENTO AGROPECUARIO DEL PERU

Balance Sheet as at September 30, 1956  
(in Soles)

Assets

Cash & Deposits in The Central Reserve Bank	30,030,249	
Deposits in domestic banks	18,011,598	
Deposits in foreign banks	<u>2,104,132</u>	50,145,979

Short-term Loans

For agriculture (large farms)	88,896,806	
For cattle	9,998,843	
To small farms	37,455,320	
Produce & Selva products (rubber)	8,513,540	
Advances & miscellaneous debtors (existing crops)	<u>23,836,049</u>	168,700,558

Long-term Loans

For agriculture (large farms)	23,016,832	
For cattle	74,262,308	
To small farms	12,660,042	
Chattel and real estate	74,750,436	
Wool and advances	<u>17,565,466</u>	202,255,084

Fixed assets, equipment & materials	10,859,440	
Rubber on hand	7,996,073	
Cattle and merchandise	7,502,737	
Plantations and various crops	2,562,172	
Branches and agencies	1,044,049	
Miscellaneous assets	39,056,260	
Interest due	5,243,103	
Operations on behalf of the Government*)	<u>297,106,966</u>	371,370,800

TOTAL 792,472,421  
=====

Liabilities

Capital authorized	400,000,000	
Not yet paid in	<u>156,557,157</u>	243,442,843
Special reserve		983,163
Reserves		41,403,338
Current liabilities		72,373,060
Domestic banks	317,173	
Central Reserve Bank	<u>91,600,000</u>	91,917,173
Operations on behalf of Government*)		259,035,352
Other liabilities		35,096,780
Long-term debt (World Bank)		47,909,520

Profit 311,192

TOTAL 792,472,421  
=====

\*) Rice and other commodity purchases on behalf and with funds from the Government.

ANALYSIS OF THE BANCO DE FOMENTO AGROPECUARIO'S BALANCE SHEET

<u>ASSETS</u>	<u>9/30/55</u>	<u>9/30/56</u>
<u>Disposables &amp; Short-Term Operations</u>		
Cash and Banks	50.2	50.1
Short-term loans	134.5	151.2
Less short-term loans in arrears	<u>39.7</u>	<u>44.5</u>
Operations on behalf of Govt.(rice purchases)	268.7	255.9
Various debtors	104.6	29.5
IB-loan - Amount reimbursable	3.8	18.1
	<u>522.1</u>	<u>460.3</u>
<u>Investments and Long-term Operations</u>		
Short-term loans in arrears	39.7	44.5
Long-term loans	141.0	202.3
Loans for development program	13.8	13.9
Investments (fixed assets)	27.9	29.0
Various debtors	7.8	15.2
	<u>230.2</u>	<u>304.9</u>
Deferred assets	27.7	27.2
	<u>780.0</u>	<u>792.4</u>
Total Assets	=====	=====
<u>LIABILITIES</u>		
<u>Payable on Short-term</u>		
Deposits and current accounts	104.8	57.4
Various creditors	6.6	16.2
Central Bank & Correspondents	82.8	91.9
Operations on behalf of Govt.(rice purchases)	<u>301.3</u>	<u>245.5</u>
	<u>495.5</u>	<u>411.0</u>
<u>Payable on Long-term</u>		
Capital	215.0	244.4
Reserves	30.1	41.4
Development program	14.1	13.0
Government	1.0	1.0
IB-loan - disbursed	6.3	47.9
IB-loan - committed	<u>3.8</u>	<u>18.1</u>
	<u>270.3</u>	<u>365.8</u>
Deferred liabilities	12.9	15.3
Profits	1.3	0.3
	<u>780.0</u>	<u>792.4</u>
Total Liabilities	=====	=====
<u>SUMMARY</u>		
<u>Short-Term</u>		
Disposables	522.1	460.3
Obligations	<u>495.5</u>	<u>411.0</u>
Difference	26.6	49.3
<u>Long-Term</u>		
Obligations	270.3	365.8
Investments & long-term operations	<u>230.2</u>	<u>304.9</u>
Difference	40.1	60.9



EQUIPMENT FINANCED OUT OF THE PROCEEDS OF LOAN 105-PE

	1954/1955		1955/1956	
	# of Units	Value (in \$000)	# of Units	Value (in \$000)
Pumps & Motors	-	247	-	696
Tractors Implements	186 )	943	229 )	1,537
Cattle				
Bulls	9 )		3 )	
Cows	471 )	617	430 )	
Sheep	311 )		1,106 )	510
Fencing Materials	-	-	-	115
Processing plants, incl:				
Coffee cleaning plant	)			
4 Kenaf cleaning plants	)			
Rice Mill	)	68		267
Milk sterilizing plant in Lima	)			
		1,875		3,125
		=====		=====