

Latin American Association of Development Financing Institutions



TECHNICAL DOCUMENT

**FINANCING AND NON-FINANCIAL SERVICES IN THE
AGRICULTURAL DEVELOPMENT BANKING**

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FINANCING AND NON-FINANCIAL SERVICES IN THE AGRICULTURAL DEVELOPMENT BANKING

INTRODUCTION

In the group of productive and social sectors which require with more attention the support of the development banking, maybe the agricultural and rural scopes, is one of the most dedicated and complex. In the first place, because of the social aspect, as always the rural areas have the highest levels of poverty; in second place, the political connotation that the problems associated to rural places (country) always have and that it is very sensitive to political decisions which lead to interferences in the agricultural development financing institutions. A third aspect, has something to do with the own nature of the agricultural activity, its high risk makes the banks not to pay great attention to it, even more when this are small producers.

In this document, are discussed a series of elements related to the characteristics of the agricultural financing, the operative modalities, ways of acting, provision of non-financial services, and finally some suggestions and recommendations which can help as references to the agricultural development financial institutions and to the organizations related to negotiations and supervision of the same.

1. GENERAL VIEW AND CHARACTERISTICS OF THE LATIN-AMERICAN AGRICULTURAL FINANCING

The rural financial system has gradually walked into a new financial model. This new model of rural financial markets focuses on the development of the sustainability of the rural financial institutions and in the promotion of financial intermediation, based both in the provision of services guided by the demand, which includes deposits and credit facilities for agricultural activities as well as for the non agricultural rural companies. The model also recognizes that the provision of financial services is not necessarily the fastest and more efficient way to improve the incomes or to reduce the poverty levels of the rural populations, so it must be complemented with other important governmental measures.

The instruments through which the new model operates are: a) market interest rates, or preferential interest rates to specific segments, always allowing the financial intermediaries a sufficient margin to cover all their costs; b) rural savings mobilization; c) proper prudential regulation and supervision of the non banking or quasi banking rural financing intermediaries; d) support for the institutional training and promotion; e) provision of refinancing facilities, in particular for medium and long term credits, for the rural financial intermediaries who qualify; f) provision of subsidies clearly delimited and with an approach on temporality; g) productive chain promotion to achieve credits with lower risks; h) development of new non banking rural financial intermediaries.

Even though the experienced in Latin America indicates us that the modernization of the financial systems for the agriculture and the rural areas has developed in some countries more than others, this process has yet a lot to cover, even more in the actual circumstances, especially in those countries that suffered important institutional empties with the retire of the State from this function, without the private sector having replaced it completely, because the agriculture still is a risky business for commercial banking, the problems of lack of guarantees persists, and because the small producer is not the interest of the private commercial banking, and instead, are the no banking financial intermediaries together with the development banking the ones who deal with this producers.

It is precise to point out, that a FAO and GTZ study on the agricultural development financing function reveals that given the singular characteristics of the agricultural financing and the high percentage of rural population existing in the developing countries, it results real that the State supports the agricultural and rural development establishing a proper politics framework so the agricultural and rural financing markets work efficiently and at a reasonable cost.

With the withdraw of the State as a financing provider, in first instance an important drop on the assignment of credit resources for the agriculture was produced. That encouraged the discussion about the importance of counting again with the presence of properly conceived developing banks and with financial institutions of micro finances, for their decided contribution towards the financing productive activities, especially the ones in the agricultural sector and those of the small and medium business. As a result to all this it was initiated an agricultural institutionally

recomposition process, which included among other aspects, the restructuring and modernization of the agricultural and rural development financial institutions; the support towards the development of non banking financial intermediaries; a bigger coordination of the development banking with all the financial intermediaries related to the agricultural and rural sector, in such way to take advantage of the infrastructure and to the knowledge that each one of these institutions had in their respective scope of operations; the conformation of strategic alliances with services providers (technical assistance and others); and enterprises that buy the agricultural production.

It is also important to point out that the non financial services that the agricultural development banks provide direct or indirectly, represents the fundamental characteristic which differences them from other financial intermediaries, and answers precisely to the roll and the mission they were created for, which is to support and promote the development of the medium and small producers of the rural areas and to contribute to overcome the conditions of poverty of the rural zone populations.

Despite the changes in the agricultural and rural financing, some countries still have political interferences which oblige the development financial institutions (DFI's) to perform different functions from promoting and restructuring, releases of debts which seriously affect the institution's financial viability.

2. OPERATIVE MODALITY OF THE LATIN AMERICAN AGRICULTURAL BANKING

In Latin America there isn't a development banking uniform model. On the contrary, the generic denomination of "development banking", "promoting banking" or "financial development institution", covers a variety of entities and mechanisms that include banks properly said, financial corporations, development financing funds , etc., being diverse the level in which these institutions constitute financial intermediaries in the strict sense, although the majority participates of this condition, in a non exclusive way.

The physiognomy adopted by the development banking varies, depending on the level of relative development of the countries, markets size, as well as the level of aperture and integration in the international financing and trade currents. Like this, in several countries, in a given time, there was the predominance of the criteria according

to which the development banking had to act in a preferential way for “merchant banking” operations, canalizing credits through rediscount modalities through the commercial banking and other financial intermediaries. That, was believed, not only will avoid entering an unnecessary competition with the commercial banking, but it will make it easier to foster their shares, having the infrastructure and operation networks that these financial intermediaries have. However, in the few last years, this approach has been losing importance each time the private commercial banking did not show enough willingness to pay attention to segments of the market, such as the agricultural and the rural, objective of the development banking. From that, the DIF that had changed to operate only in the merchant banking modality, is returning gradually to grant financings in a direct way.

When the development banking acts in a branch banking modality, the possibilities of loss are increased because of the lack of viability of the credit's collection, reflected in violations that are translated into a high cost for the society. However, given the conditions of certain regions and sectors, it is only possible to move the resources to the rural areas through the branch development banking, directly or through micro financial institutions, trying to avoid a low recovering rate, because the producers associate this resources with governmental help, so it is vital to project an effective capacity image to recover the credits.

As shown in the previous point, to operate through banking or non banking financial intermediaries, doesn't matter if they are institutions regulated or not regulated by the Banks and Financial Entities Superintendency, reduces their risks, leads to lower operation costs and its possible that their reach and scope grows caused by more resources placing windows.

Nevertheless, when we operate only under that modality, some basic questions arise: With what kind of financial intermediaries we count? What is the situation of those intermediaries? What risks can be assumed?

The risk under that modality is that it depends too much of the intermediaries disposition to use their resources. So it is of vital importance to promote the development of a wide range of financial intermediaries, generate the proper stimulation, indentify and develop new financial products, and avoid the agglomeration of the resources in some few intermediaries.

Even though, it has been proved the importance of the merchant banking financial institutions, that achieved the task of going deeper into the financial markets, canalizing successfully resources from multilateral sources or from the internal and external capital market. However, the credit programs of these institutions must be designed very carefully to avoid the arbitrary assignation of long term resources and the fixation, arbitrary as well, of interest rates, because these measures can weaken the efforts to mobilize resources, of the savings acquiring and turn slow the development of secondary markets.

In this general framework, the goal to reach is to promote the formation or growth of financial institutions in the rural areas that have as a guiding principle the criteria of sustainability, efficiency and productivity, improving the access of small scale producers to the banking services. To achieve that, the governmental spheres must apply policies that look for the following points: a) connect the formal and informal financial intermediaries; b) promote the interest of the commercial banks in acting on the rural areas; c) contribute to the restructuring and fortification of the existing public and private financial institutions; d) upgrade the semi formal financial institutions to the classification of regulated financial institutions; e) create new financial institutions in the rural areas.

Besides the well known roll of financial intermediation, the development banking is providing services that point directly to the private sector in the lines of advice and information, technical assistance and training; and for this purpose it has been making alliances with public and private institutions, because there is a clear interest in making the smallest business sectors have better managements standards, because of the importance these have in the national economy. It is recommended that these efforts have as main characters the private sector, not just because it involves them more but because the business sectors are well prepared to take that kind of task, remaining for the development entities the roll of promotion and support (public-private partnership).

The experience of the merchant banks, in the time passed from its creation has already left some lessons. One of them is that the model of merchant banking "is less risky", other, is that the supply and demand of the resources isn't always a "result" of the market, a third one is that the intermediary institutions require "incentives" to take

care of certain sectors. Other lesson is that the management of the interest rates or the lower interest rates not necessarily dynamize the economies.

Independently from the operational modality chosen by an agricultural development bank, it has its advantages and disadvantages to evaluate. For example, in its initial conception, the simple model of merchant banking that attracted funds of the Central Reserve Bank, the State and of the international organizations that later on were transferred to the financial intermediaries through rediscount operations, where the final user of the credit wasn't supposed to have any relation with the development bank, the market was expected to choose wisely the financing necessities to be covered and the banks were supposed to take care of the market according to its demand. However, to the extent that the banking has to determine where to guide the credit, what really happened was that it preferred to guide it towards big credits, because simply it was more profitable. When the time came to choose weather to place long or short term funds, the most obvious decision was to place short ones, because it would be more profitable to perform the operation ten times a year that to perform a operation once every ten years. Therefore the long term credits to small businesses were penalized.

The above is just part of the merchant banking problem. Other problem arises when commercial banks are their principal intermediaries, meaning, there is too much dependency on them to canalize the financial resources. There have been many paradoxical situations with lack of financing and excess of liquidity in the merchant public banks. To avoid these situations, they have worked in two big areas: 1) creation and fortification of new distribution channels; and 2) development of new financial instruments.

As a complement for the existing distribution channels, the agricultural development banking must encourage the emergence and incorporation of new financial intermediaries (banking and non banking) in the rural markets, accompanying all this process until the achievement of their fortification with financial incentives, transference and adoption of new credit technologies; consultancy in their financial management; development of operative and informative systems, among others. These supports, as well as all the participation of the development banking, must be temporal, establishing gradual retirement mechanisms and adjustment of intermediaries and borrowers.

For the creation and fortification of new distribution channels for their credits the development banks have worked in the design of laws and guidelines for leasing companies, entitling societies, reciprocal guarantee companies, factoring companies, risk capital funds, cooperatives, credit reunions. With the creation of those legal frameworks it was hoped to use these companies to intermediate the bank's credit operations.

However, the single creation of these laws for each type of institutions wasn't enough; it just gave support through more specific instruments for things to happen. For example, the Multisectorial Investment Bank (BMI, Spanish acronym), from El Salvador, in the case of the leasing companies and entitling societies, worked with the World Bank to create and develop these businesses. In the case of reciprocal guarantee societies it has worked together with the banks and big companies, in the construction of the first guarantee society. It has also worked actively with several multilateral organisms in the creation of risk capital funds and factoring companies.

Other important element that we need to consider is what is the importance of the long term financing business for investment projects to the commercial banking? We have to be very realistic on this. The previous experience indicates -and the numbers confirm it- that for banks this is more like a marginal business. The commercial banking doesn't have too much long term vocation or culture and prefers the short term financing which usually reports higher margins of profitability. It prefers as well the consumer loan and the mortgage loan.

On the other hand, the executives of the commercial banks tend to give privilege to their most regular and massive products, with the consequence that the merchant banking products (in particular, the ones directed to investment), tend to dilute in the big mass of products that in the actual time have to place an executive, generally, applying pressure to achieve very exigent goals imposed by their institution.

The above oblige to have a permanent dialog with the banks and at the same time demands a very intense work of diffusion. It is essential that in every intermediary exists a little unit -or, maybe, it can be enough with a good professional level single person- who is a specialist in merchant banking products directed to the investment

and that can guide and support the commercial executives for the materialization of these financings.

It is also needed that parallel existence of a permanent diffusion for the potential users through the trade union organizations or other diffusion channels. This work of diffusion and promotion must be a permanent task, basic for the success of the development banking financings through the branch banking.

When the time comes to define the operative modality a development financial institution in our concept must evaluate risk versus coverage in the objective segment. In the branch banking, there are more risks but the financings to the bank's objective clients can be guided more securely. In the merchant banking it is probable that having more points of service the reach will be bigger but there is no guarantee that the clients will be those the merchant bank considers, but those ones resulting more profitable to the financial intermediary and above all with short term credits.

The advantage, for banks, of working with these financial intermediaries is that they expand their reach, reduce risk, reduce costs, avoid complex and expensive structures, and besides there is the advantage that these institutions are the ones who know customers better and reach groups that a bank would find too hard to reach, above all to the micro producers.

Because of all the previously exposed advantages and because the positive experience of the development financial institutions show it, it is recommended that an agricultural and rural development bank takes advantage of the infrastructure and knowledge of the non banking financial intermediaries to take care of the rural sector.

In the rural and agricultural sector one of the limitations for the development of the financial markets also constitutes the geographical dispersion of clients, every time it demands to count with a bigger infrastructure of service, which makes the costs more expensive. In several cases, the universe of customers does not justify the operations volume to support an agency or open branch through the whole year.

That's why, the development banks, especially the agricultural banks have different ways to operate. Among them, the following:

- Through its own agencies or branches in cases that the operations volume and the universe of clients to be helped justifies it.
- Renting spaces in other financial entities that already operate in the zone but are not directed towards the agricultural financing.
- Operating with merchant banking entities through financial entities that already operate in the zone and have in their credit portfolios the agricultural sector: banks, cooperatives, credit unions, rural banks.
- Sending from time to time a executives team to the rural areas to take care of the credit solicitations, using the installations of the producers associations and area's unions in general.
- Sending executives equipped with technology (for example: palm pilot) that takes "the office to the client". A typical aspect of the micro finances is the visits to the land (to the client) and for that the systems are important. Now it is very much used a technology that works with a cell phone or house telephone to send and receive information to the Bank's systems, therefore it is possible to work as if one would be in the bank. This technology allows having customer's information to take better advantage of the opportunities and do a more efficient managing of times. These technologies elevate the executive's productivity and shorten the credit approval periods and reduce risks.
- For the withdraws, the ATMs (automatic teller machine) with the proper educational level and language for the rural clients are resulting very important. There is the experienced in Mexico where the ATMs of the rural areas with native languages are the ones that show in average a higher quantity of transactions.

The development banks use a mix up of all of these possibilities to operate, because the final point is to achieve great banking penetration and even to include socially a bigger number of people who doesn't have access to the financing through the financial system.

In general there isn't a unique approach in all the countries of the region, some have a integrated financing system for the agricultural sector constituted by a combination of specialized merchant and branch banks, others have only development merchant banks specialized in the agro or multisectorals, in others there are specialized agricultural banks and, finally certain number of countries have multisectoral public banks with a important agricultural portfolio.

The evidence shows that in Latin America and the Caribbean practically all the countries or either have a specialized bank in the agricultural and rural sector or a multisectoral bank with an important agricultural portfolio. The exception to this fact is Bolivia, but despite that it created a multisectoral development branch bank that considers the agricultural and rural sectors for financing.

As diverse as the type of institutional profile under which the financial services for the agricultural sector are offered, the DFIs also use a wide spectrum of schemes and operative modalities to perform their financing development activities, which goes according with the particular characteristics of the agricultural sector in each and every one of the countries and the specific necessities presented by the agricultural productive units.

It is important to point out, as a general appreciation of character, that in the countries where there are specialized agricultural banks, the agricultural GDP (gross domestic product) is high, as well as the population economically active dedicated to the agriculture. This correlation explains, if not justifies, that the country's governments see the necessity of a specialized banking approach in the rural sector. That is even more fortified by the acknowledgment that the poverty in our countries is located, usually, in the rural areas.

On the other hand, it is also important to say that the changes observed by the development banks in the last years have defined a new profile for these institutions, consisting in the fortification of the banking character, in replacement of an orientation that in the past would have been exclusively for the attention of their developments ends. The development banks actions are framed inside a new conception of promotion which is not associated to interest rates of insufficient levels to cover the costs, but to the efficient and appropriate provision of financial non financial services for the micro, small and medium businesses, of the rural and urban scope,

manufacturing and services, which traditionally haven't had access to the commercial banking credits. Also, the support of the development banks is not conceived anymore as indiscriminated for all types of projects and clients, but takes care selectively of the social profitability as well as of the project's private profitability, helps with the fixed cost's coverage and variables of banks and, as a matter of fact, helps with the creation of a reasonable utility for the financial institution.

In those institutions in which the provision of subsidies maintains as a part of their promotion politics, such resources are canalized in a direct and fortified way, under co-financing schemes, in such way that the business man compromises his own resources in the achievement of the competitive improvement objectives that the State is willing to support. In the same way, the assistance for the clients is posed as an attention to the demand, with objectives and clearly pre-defined periods, to avoid paternalistic relationships with the companies.

3. PURPOSE AND MAIN OBJECTIVES OF THE AGRICULTURAL DFI'S

In general the public banks promote and lead promoting actions for the economical and social development supporting the governmental and private initiatives in their acting field through the planning and technical, institutional and long and short term credit support.

In general terms, the main objective of the agricultural DFI's is to provide short, medium, and long term financings, training, information and technical assistance for the producers and companies related to the agricultural sector. Every country according to its particular reality, determines the activities or products as well as the type of producers (small, medium or big) inside the sector with priority for the support. A common characteristic is that the small producer is prioritized, because in Latin America the poverty is generally higher in the rural areas, the agriculture competitive level is low, and the supply of financing is too limited, or even nonexistent in most cases.

These primary objects can have as a ultimate purpose, a range of priorities to be established considering their impact on: (a) the creation of employment, (b) the alimentary safety, (c) the protection of the natural resources, (d) currencies generation and saving, (e) the raw material production for the industry, (f) the sector's

capitalization, (g) the sector's modernization through the long term financing for technology investments; (h) the country's balanced development with a geographical development dispersion. The priority can also be the impact that such actions have in reducing the migration from the countryside to the city.

4. LOANS PORTFOLIO STRUCTURE FROM THE AGRICULTURAL DEVELOPMENT BANKS

The evidence shows that in the case of the specialized banks in the agricultural and rural sector, the 100% of their portfolio is placed in the agricultural and rural sectors. In the commercial branch banks with an important portfolio this percentage goes from the 15% (Banco de la Republica Oriental de Uruguay) to 32.3% ¹(case of the Banco do Brasil). In the development merchant banks that usually are multisectoral ones it's generally under the 10%.

About the percentage of the portfolio for the agricultural and forestall sectors, this obeys more to the internal planning of each institution. There are very few countries where there were established limits of minimum portfolio a priori for this sector. About this, maybe there is pertinent to say that in Brazil there has been for four decades now a National System of Rural Credit, which works with two types of resources: controlled and non controlled ones. The controlled ones are a) the ones coming from the financial institutions, with an obligatory character, and the contribution is made according to the deposits that every entity can see; b) the assigned by the Treasury Department coming from the public budget, from the Workers Retirement Fund and from the Extra-market Investment Fund, and others applied by the National Monetary Board CMN (Consejo Monetario Nacional). The non controlled ones are the freely provided by the financial entities.

Also, in Venezuela the Credit Law for the Agricultural Sector of September the 7th, 1999, stipulates in the article 2 that the National Executive, by the agency of the Production and Trade Ministry; will agree with the commercial and universal banks and other financing institutions, on the first month of every year, the minimum percentage of the credit portfolio for the agricultural sector, taking in consideration the production and

¹ The 58% of the credit granted by the National System of Rural Credit from Brazil is granted by the Banco do Brasil.

marketing cycles. In the case that such agreement wouldn't be achieved, the President of the Republic, in the Council of Ministers, will set given percentage, which in any case will be higher than the twenty five percent (25%) of the loan placements. On this percentage of credit portfolio devoted for the agricultural sector must be included the medium and long term credits.

5. FINANCING TYPES AND CREDIT CONDITIONS

Despite the institutional specifications, the financing modalities used by the agricultural DFIs are grouped into three major categories:

The working capital loans or working capital support loans, used for the acquisition of supplies, labor payments and other compromised services inside the direct costs. The same way, some DFIs offer special working capital loans programs that have as a purpose to promote the development of certain cultivations and livestock products, as well as according to their location in developing zones or poles.

The fixed asset loans or investment loans are destined to the acquisition of machinery, equipment, installation and other capital goods needed for the development of productive agricultural and livestock activities, as well as for the prevention projects financing, guided towards the improvement of competitiveness, sustainability, and reduction of risks caused by climatic and seasonal effects. In this last case, the credit programs are directed towards the financing of activities such as: lands suitability, technological advance, productive reconversion and rural capitalization.

The commercialization loans are characterized for the use of different financing schemes to support the stocking, selection, packing, storing and external and internal distributing face of agricultural products. These schemes can be granted under the working capital or fixed asset modality, according to its life cycle. A different kind of this type of financing is the collateral credit, which has as a purpose to facilitate the commercialization the farmer's products in the time resulting more convenient.

As a complement of the credit, the DFIs offer a number of **technical assistance, training, product organization, guarantee funds, and risk coverage services** that have as a purpose to improve the production of the agricultural exploitations. The technical assistance services include feasibility studies which can

support the technical and financial viability of the investment projects that require credit support, as well as professional consultancy for the determination of modifications about extensions, reprogramming and changes in the supervision calendars, according to the project's necessities. Such services are provided through technicians hired by the DFI, the commercial banking or by request of specialized professionals.

The interest rates applied by the DFIs, reflects in a big way, the client acquisition cost, as well as those inherent towards the financial intermediation process. In this sense, the DFIs have reduced the use of the interest rates as a sector promoting instrument, that according to the past experience, were guided to favor the impulse of economically more efficient activities. However, in some cases there still are preferential interest rates for specific segments –case of the small producers- who have viable projects but can't get to the credit for the lack of guarantees; or for products considered a priority.

On the other hand, with the purpose of getting closer to the interest rates used in the international markets, the DFIs have established interest rates preferential policies for the export activities.

The terms granted by the DFIs depend on the type of credit and the activity that will be financed. Like that, in the case of the working capital loans the term varies between 180 and 360 days. For the fixed asset loans or investment credits, the term varies between 2 to 7 years, with the exception of forestall products or big agroindustrial projects which can get to 25 years; and the commercialization credits with terms that range between 90 and 360 days. For emergency situations the DFIs have established an extension and debt restructuring systems which provide additional time for the fulfilling of the credit obligations.

What is important to stand out here is that more of the 50% of the placing of loans of the development banks are medium and long term financings, and together with investments in securities and businesses capital represent almost two thirds of the total actives, which are directed completely towards financings with much more longer terms, and that confirm one of the main functions and give meaning to the development banks, which is to be a institution provider of medium and long term financings.

The DFIs use the proportion or financing coverage, measure like the percentage of the project's total cost sensitive to receiving credit, as a preferential mechanism to boot the development of determined type of livestock productive activities, or producer scope. The same happened with the Banco Estado (State Bank) and the Chilean Agricultural Development Institute, which finance close to the 90% of the investment necessities for the temporal agricultural or forestall activities, particularly if those are performed by small producers. In the past, it was very common to find that the FDIs were assuming 100% of the investments financing, however this have been changing because now the common thing is to demand that the producer to assume a bigger part of the business risk.

6. OBJECTIVES OF TRANSFORMATION AND MODERNIZATION OF THE AGRICULTURAL DEVELOPMENT BANKS

The objectives of transformation and modernization have three levels or categories:

The first category is referred to the positive repercussions hoped with the change in the financial institution: (a) Achieve having a profitable financial and sustainable institution in the long term; (b) To place the Bank as a efficient entity which doesn't depends on the public sector resources and provider of short and long term financings; and (c) To be the financial institution which gives solutions for the financial problem of the agricultural and rural sectors.

The second category is composed by the objectives that have to do with the development of an agricultural and rural financing system. Regarding that we have the following:

- In the real productive field, the provision of the indispensable productive, organizational and business technical assistance for the agricultural and rural products through the establishing of mechanisms suitable for the formation of credit subjects, mainly in the sectors with less incomes.
- In the financial field, the attention and induction of the demand and the fortification of the supply of financial services, through the establishing of proper attention, promotion and foment mechanisms to take care of the agricultural and rural producers and to mobilize the existing and close to be created financial agents in the rural sector; expanding the penetration of

financial services through the opening of new offices, sharing the infrastructure of the existing financial institutions or operating under the modality of merchant banking through the financial institutions oriented to the rural sector.

- The wide and massive mobilization of the resources of complementary financial internal deposits and savings, to finance the productive activities of the agricultural and rural populations inside the country.
- The gradual and organized achievement of a financial development policy characterized by a growing diversification which will mean real access to banking services and spatial penetration of services of mobilization of deposits and savings, credits and other services in favor of such populations.
- The adaptation of the financial services to the requirement of the different areas and socioeconomic levels of the agricultural and rural producers inside the country.

A third category is composed from the last objectives that a country would hope for as an action of a sustainable and efficient agricultural bank: (a) The employment creation to fight the poverty and the high levels of unemployment in the rural areas; (b) Contribute to achieve the country's population alimentary safety; (c) Contribute to the non-renewable natural resources' protection; (d) To boost the exports and the local production to achieve the currencies' creation and saving; (e) To ensure the sufficient supply of raw material production for the national industry; (f) Encourage the rural sector capitalization; (g) The sector's modernization, through the long term financing to invest in technology; (h) The country's balanced development because of the geographical dispersion of the development; and (i) The reduction of the migration from the country to the city.

7. NON FINANCIAL SERVICES FOR THE AGRICULTURAL SECTOR²

In an economy the Services sector is something well understood and is about the group of activities that, without the necessity of producing tangible goods, allows the generation of wellness, increase of efficiency and in general makes modern life possible. Between the ones oriented to the companies, the range is way bigger. In the case of the agricultural company the services include at least six categories. In the scope of the services for the productive sector, we can refer to services such as the non tangible components of the production-transformation-commercialization process, which gives additional add values to the products. This additional added value is obtained through quality, adequacy, presentation, image development and the relocation of the product. From another point of view, the services allow us to develop the productive activity of transformation and marketing with the help of the knowledge and support that makes the processes viable in a more effective way than if we wouldn't turn to them.

It's hard to even think in the possibility of dedicating to the agriculture if there isn't access to the services. Now we hope the State acts more like a market promoter, turning in some cases towards the subsidies and measures which allow lowering the transaction costs. On the side of the farming men interested in dedicating themselves to new products or interested in increasing their productivity, the added value and the profitability of what they really produce, is evident the necessity of being able to have access to the services which allow them to make the changes in the desired direction. The services are required to be informed of what is happening in the market; to analyze the options and to define viable projects; to learn how to do things better, using new techniques; to improve the company's management and to contract such activities they don't have technology or equipments for. The services are also necessary to learn how to produce without toxic wastes and to certify the quality. Besides, it's necessary to recognize that as the business develops higher levels of vertical integration, to generate final products with brand and to get closer of the consumer; their demand for services will be bigger.

² Carlos Pomareda (2002) "Services and competitiveness in the agriculture". Lecture presented in the seminar about the Latin American Agricultural Financing, conducted by ALIDE. Lima, Peru, July 1st and 2nd.

Even though there are several ways of grouping the non financial services for the agricultural sector, these can be grouped into five big categories:

- The **Productive services** are those of direct support to the productive process and that almost always need some kind of machinery or equipment. This last aspect is what makes them a particular category. In this scope the necessities are bigger, specially for the most capital limited farmer, who can't afford equipments or machinery to use them just a few times every year. The situation could be different if the machinery and equipments would be produced in sizes and capacities right for the necessities of the small agricultural business, in which case it would be the agriculture's property, not requiring the contracting of these services.
- The **professional services for the production** have been separated in a special category, because they are necessary to solve the technological limitations. They can be offered by technicians, professionals, companies and or institutions. In this category it has been centered an important part of the direct action of the public sector, supported by the idea of technological change as it is and of the phytosanitary inspection, and the direct participation of the State to support the small producers.
- The **professional services for management** have been defined as a different category because they deserve special attention. These services have been generally put aside. The reason for that is the prevailing vision that agriculture is just terrains or cultivations, but not businesses. In the extent that the competitiveness demands are for the people and businesses, every time it would be more and more indispensable the contracting of these services, to achieve viable businesses in the agriculture.
- The **services for the creation of technological innovations** have been differentiated from the common investigation services' category. Given distinguishing used to leave to a limited interpretation of the agricultural investigation as an activity that only generates public goods. Today, with the development of the investigation as a business, in the extent that the developed goods can be patented, the investigation concept requires to be widened in the context of the market economy.

- The **services for commercialization** have been and will be one of the areas which attracts more attention in the agriculture. The flaws in the market are in this case, almost always responsible for the extreme commercialization margins between the product and the consumer and for the post harvest losses. The existence of these flaws was taken care of by the State, in almost all countries, through the path of direct intervention in the commercialization, resolving only partially the symptoms of the problem and creating other ones. Today there is the need to look for much more sensible solutions through market development, using services such as the information, the cattle bidding sessions, the bags of agricultural products, the refrigerated storing, etc. These are offered by private actors. Just like a service of growing importance for the international commerce now there is the quality certification, which can include the environmental certification.

From this small description can be concluded that the range of required services in the modern agriculture is too wide. Even more, it is easy to see that the demand for services will grow more and more every time between the farmers interested in acquiring a higher competitive capacity. There is also evidence that the services' requirements are bigger between the businesses dedicated to export.

8. STRATEGIC ORIENTATIONS

¿What perspective do we have for the future? When we talk about the access to financial services for the rural population, we must have in count the economical framework in which the financial institutions looking to provide this service act and answer the following question: can it be successful financial institutions in our actual rural economies? This is the main challenge that we need to take care of, when we formulate schemes and financing mechanisms in the rural sector, where poverty is almost absolute and the economy is more like a survival economy.

From the operative point of view, between the main obstacles referred to the demand and supply of financial services that the rural financial markets that limit access to the rural sector financing have to fight, the following can be mentioned:

The demand for financial services in the rural areas is restricted, between other motives, because: a) elevated transaction costs for the debtors and depositors; b) elevated risks for the debtors and depositors; c) lack of indebtedness capacity of the rural homes-businesses; d) lack of financial and non financial products right for the necessities of the final beneficiary; and e) lack of adequate information about the credit services and of available deposits.

From the supply side, the rural financial transactions encounter serious difficulties as a consequence of: a) poor information, which makes it difficult to evaluate the loan risk; b) debtors incentives and creditors which aren't necessarily compatibles, what creates the moral risk; c) difficulties to make the contracts valid, what makes higher the possibilities of lose by the lack of the loans' recovery; d) difficulties to diversify the risks; and e) difficulties to dilute the fixed costs of the financial infrastructure.

Therefore, before organizing durable rural financial markets, three fundamental elements must be present. The first consists in some **favorable macroeconomic conditions**, which need to have proper levels of inflation and change rates, the liberation of the import and export regulations which affect the agricultural products, the maintenance of predictable economic policies, and a high margin of legal stability, of safety and order.

The second fundamental element is the **right mix of financial market policies**, meaning, that the banks need to be allowed to apply interest rates which cover their costs and loan risks and allows them to maintain the purchasing power of their loans portfolio. On the other hand, the government procedures must avoid the imposition of excessive transaction costs over the rural financial markets, the taxpaying of the deposits through an elevated number of reserve and the rural financial system's exposition to politic incursions.

The third fundamental element is the **incentive for the rural financial markets** to make them competitive. To do this it is possible to turn to the creation of new banks and other financial institutions that are willing to give services in the rural areas, as the case of the microfinance entities. The policies must also offer the possibility of implanting new procedures, technologies and financial products.

As have been pointed in several studies and international forums, the rural financial market is affected by three fundamental factors: the implicit risk of the agriculture, a imperfect information, and elevated transaction costs.

The risk sources in the rural sector are bigger and different from other sectors and have relation with the uncertainty about the potential performance of the agricultural lands, the variation of the products ´prices (depends on variable markets), and the loss or damage of the cultivations by natural causes.

Regarding the imperfect information, the restricting factors are the lack of data and the information problems caused by the physic distance, the isolation of the product and the absence of communication systems in the rural sector. The data transfer about the production and market is expensive and before the absence of credit history, the evaluation of the producers´ indebtedness and the credits monitoring activities becomes difficult and complicated.

The third factor to be considered is the transaction cost, which faces several limitations in the physic environment (lack of proper infrastructure); in the legal and regulatory framework (lack of ownership titles and proper regulation and supervision); and In the institutional scope, where the lack of governmental incentives is obvious, lack of management capacity, poor investigation, lack of appropriate mechanisms to fulfill the contracts, etc.

With this view, the new approaches of the rural financing and the state´s participation. Follow the objective of increasing the small producers´ incomes and shortening the poverty in the rural areas. To increase the farmers´ incomes it is important to consider the combination of macroeconomic and efficient sector policies, create rapidly a proper legal and regulatory framework and correct the market´s malfunctions. To reduce the poverty isn´t enough to elevate the medium rural income if the level of opportunities of progress doesn´t get equally to the people, what can justify a series of directed interventions programs.

In the past decades, in virtue of the financial liberalization policies, the role of the property and state administration financial institutions was reduced, though they still are the main suppliers of credits for the small scale rural producers in several countries of the region, and besides in the last years there has been a recomposition project of

the rural financial markets with development promotion of non banking financial intermediaries oriented to the rural area. Between the most common problems that the public banking has to deal with are the high debt rates, structures with elevated administrative costs, frequent managers and high level officers' rotation, political interference in the approval process of loans and in the debts relief, and slow operational procedures caused by its state entity condition, what elevates the transaction costs for the loans.

9. RECOMMENDATIONS

- To guarantee a bigger volume of resources to satisfy the credit demand of the sector, supported in a new agenda for the rural development financing, which transcends the fundamentalists schemes bases exclusively in the market and reinforces the financial complementation schemes, making it possible for the development banking and rural microfinance institutions to access directly to new sources of resources and that way to achieve a more diverse and stable funds structure. For that it will be important to elevate the capitacion levels and the mobilization of internal saving, together with bigger acquisition of exterior resources in competitive conditions, considering terms which facilitate the rural modernization process.
- To elevate the access to the financial sector credit, because traditionally the commercial banking has focused its attention on the demands of higher relative development sectors, like the commerce, the industry, the primary exports, leaving without important attention sectors built by rural producers, small and medium businesses, independent businessman, small business female owners, etc. which require the design of adequate schemes and financing modalities to take care of their needs for work capital, promote their productive investments and help with the capitalization of their business units.
- Achieve a higher efficiency in the canalization of financial resources, and to do so it will be needed to reduce and eliminate all kind of political interferences or of other character, to impede that the development banks provide services and credits that aren't viable or competitive. The development banks will have to establish interest rates policies that besides

assuring a healthy financial management like banks, allow them to have an efficient resources assignment. In those specific realities where the subsidies are justified, it will be needed that those subsidies not to be assumed by the financial intermediaries, but to use transparent mechanisms like the direct transfers of the national budget or other instruments which won't affect the profitability of the development banks.

- Promote and boost the restructuring and modernization of the agricultural development banks which involves, as was pointed in this document, a redefinition of their role and transformation into agile institutions that count with a self-governing management, supported by a diversification of its resources' source and the canalization to viable projects, together with a particular vocation to help the rural population. This new development banking must be constituted as a mixed business, with the participation of the State as shareholder, of the agricultural products and civil society involved with the rural sector.
- The fundamental role of the development bank consists in promote and favor the emerging and development of rural financial markets which provide efficient and sustainable financial services and are reachable by the low resources populations of the rural areas. That involves addressing their actions to make it possible for the financial markets to work every time better and to be substituted, using the advantage of the transactions that happen through the markets and, in any case, distortion the market causing these advantages not to manifest.
- The direct treatment of the development banks towards the final borrower, meaning, the branch banking modality, have meant, through history, big risks of patrimony loses for the institution and for the public sector, caused by political interferences and economic power groups for orientations and recovery of loans. That does not invalids, in some cases, the presence of the government, through properly conceived institutions, justified because all the results that the market offers are economically and socially acceptable, as shown in the low interest of the commercial banks in costs and risks considerations.

- When the canalization of resources through the commercial private banking isn't achieved with the market mechanisms or with the action of induction of the merchant banking, it results convenient to evaluate the incorporation of supports or incentives for the private commercial banking to compensate the operation costs which means to take care of the market's segments for which there is development interest or, in that case, encourage the participation of non banking financial intermediaries that are obtaining their funding principally in the free market or with the private commercial banking, because only like that there will be a decentralized evaluation and supervision of their value.
- The participation of the development banking as a merchant banking entity will have to turn to market mechanisms taking advantage of the existing competitive financial agents, which can act as a counterpart of the public administration. Because of that, the canalization of their resources must be performed preferably through the private commercial banking or through the non banking financial intermediaries that in most cases is the best way to achieve an efficient distribution and an acceptable system for the administration of the financing risks.
- As a complement for the existing distribution channels, the development banking must encourage the emerging and incorporation of new financial intermediaries (banking and non banking) in the rural markets, accompanying this process till its fortification with financial incentives, transfer and credit technologies adoption is made; consultancy in its financial management; development of operative and informative systems, among others. These supports, like all the development banking participation, must be temporal, establishing gradual retirement mechanisms and mechanisms of adjustment of intermediaries and borrowers.
- The clear advances watched in several rural development banks, are framed into a new notion of foment not associated to interest rates of sufficient levels to cover costs, but to the efficient and timely provision of financial and promoting services for socio-economic groups that haven't been helped by the commercial banking. The support of the development banks is no longer conceived as indiscriminate for all type of projects and

clients, but deals selectively with the social profitability and also with the private profitability of the projects, with the coverage of the fixed costs and banks' variables and with the creation of a reasonable utility for the financial institution. Also, the assistance of the clients is considered like attention to the demand with a time limit horizon, at the end of which the clients will be in conditions of accessing the commercial banking credit. In short, is the quality of the policies and the management of a bank what besides a proper capital base allows to achieve a successful performance.

- For that, it will be vital to maintain a right transparency in the relations between the developments banks and the government, to avoid political interferences and to assure the proper autonomy in the management of development banks, through a legal and statutory regiment that allows their authorities and representatives to act with judgment independency, who must be designated on a basis of professional and not political criterions.

APPENDIX

FINANCIAL CRISIS: ACTIONS IN FAVOR OF THE AGRICULTURAL SECTOR

ARGENTINA	BRAZIL	CHILE
<p>The Argentinean government created a "contingency plan" that will be based on loans of the Investment and Foreign Trade Bank (Banco de Inversion y Comercio Exterior, BICE) and the auction of credits for businesses with a 11% rate. The package will be instrumented through different lines of credit and contemplates an income of \$13.200 million (US\$3,900 million) to go ahead with a plan for production, investment, work, employment and consumption, to compensate the effects of the international crisis. From this fund, 495 US million dollars will be destined for the agricultural sector.</p>	<p>Support of 300 millions, with an advance of resources by the Banco do Brasil of US\$2,150 millions.</p> <p>Increase of US\$2,350 millions for the resources that the banks must destine to the agricultural sector.</p> <p>Increase of 65% to 70% for the aliquot of the rural obligatory deposit, meaning US\$1,100 millions.</p> <p>Use of the changing reserves for the financing of the rural sector through the "trading companies".</p> <p>Use of the constitutional funds resources of US\$215 millions;</p> <p>Help for the agricultural cooperatives of US\$435 millions; and assignation of resources from the fund for the protection of worker (Fondo para el Amparo de trabajador, FAT) to the agricultural family of US\$150 millions.</p>	<p>The government looks to give support for the producers through the activation of a series of measures destined to create liquidity for supplies and agricultural distributors in such way that they can act like credit agents. Like that, the main measures are:</p> <ul style="list-style-type: none"> - From March 2009 the distributors of supplies and agricultural industry will be able to obtain resources using the mutual guarantee agreements. - The MINAGRI has been informing to several cooperatives the advantages of using the financing line available at Corfo. This allows granting the credit to an intermediary, in this case to the distributor of supplies or agro industry, supporting directly the agriculture allowing him to finance his requirements of working capital. - Possibility of get working capital through the stocks financing. For that, the agricultural products exchange (Bolsa de Productos Agrícolas, BPA) and the banking play a very important role. The Banking for example uses the usual warrants granting credits for equally amounts, in average to the 80% of the stock's value. - The support goes on the direction of making reprogramming and buying debt portfolios. From March 2009 it will be operating the line of reprogramming with Corfo warranty. This measure will make it possible for the beneficiaries to access little more long term loans and with lower fees.

		<ul style="list-style-type: none"> - On the side of BANCOESTADO it has promoted two initiatives: (i) liabilities refinancing, buying from the supplies' distributor the debt portfolio of the producers and (ii) establishing strategic alliances with the supplies' suppliers to finance the short and long term farmer's operations.
EL SALVADOR	HONDURAS	MEXICO
<p>In the agricultural sector is intended to reinforce the improved seed program and give the farm men fertilizers for their cultivations.</p> <p>Creation of a strategic reservation of corn and beans to guarantee the provisions.</p>	<p>The National Bank of Agricultural Development (BANADESA) has \$200 million (US\$11 million), to fight the recovering of the financial crisis in the agricultural sector, these resources that are part of a special fund, will allow the Bank to fortify the projects of micro and small areas of risk which will make possible the annual production.</p> <p>Also, the Bank will be able to count with resources from the Venezuelan's National Bank of Economic and Social Development that signed an agreement of US \$30 million, and additionally the funds from Petrocaribe for production and risk.</p>	<p>The credit for the rural sector, through Rural Financial Institution (Financiera Rural) and the designated trusts in relation with the agriculture (Fideicomisos Instituidos en Relación con la Agricultura, FIRA), will increase a 10%, reaching theUS\$6,430 millions.</p>

PARAGUAY	PERU	URUGUAY
<p>Development of a support policy for the agricultural sector to reduce the impact of the drought and assure the crop 2009/2010; this includes credits, technical assistance and seeds' distributing.</p> <p>The financial Development Agency counts with US\$50 million. To finance the harvest and the exports</p>	<p>Established the creation of Agro-Peru, a fund of s/. 200 million (US\$61,5 millions) which will make possible to grant a state guarantee for the agricultures who invest in cultivating new crops.</p>	<p>Credit Measures and dirty products support: The Banks of the Republic will place new products before the new current clients and new credit subjects and The National Development Corporation (Corporacion Nacional del Desarrollo, CND) will open credit lines through the milk institutions and emergency products with industry's participation. The credits for the acquisition of forage, which will require the active participation of the producers' unions, will be implemented by the Agricultural Emergency Fund (Fondo</p>

		<p>Agropecuaria de Emergencia) directed by the Minister of Agriculture, livestock and fishery.</p> <p>Besides the Ministry of Housing will increment the support towards the small productive units which participate in the system and the National Institute of Colonization (Instituto Nacional de Colonizacion) will evaluate the milk colons and the re-breeding fields.</p> <p>To promote the fabrication of equipment for the production of renewable energy and agricultural machinery through the exoneration from taxes. There will be exonerated 100% of the IRAE* for the fabrication of energy equipments, from the year 2009 until the year 2014, and then it will start to reduce gradually until the 50% of the IRAE in the year 2018. Also, the IVA (value added tax) will be returned for the purchases of supplies in other countries to fabricate the equipments and the ones who buy such national equipment will be exonerated from the IVA. As for the agricultural machinery, the exoneration from the IVA will be elevated from the 75% to the 100%, for the purchasing of supplies for its fabrication and a similar regime of exoneration from the IRAE will be added.</p> <p>*/ From its acronyms in Spanish: Income Tax on Business Activities (IRAE).</p>
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