Lessons Learned in Rural Finance

The Experience of the Inter-American Development Bank

Mark D. Wenner

Inter-American Development Bank

Washington, D. C.

Sustainable Development Department
Technical Papers Series

Cataloging-in-Publication provided by
Inter-American Development Bank
Felipe Herrera Library

Lesson learned in rural finance : the experience of the Inter-American Development Bank.

p.cm. (Sustainable Development Department Technical papers series ; RUR-109)
Includes bibliographical references.

1. Rural credit--Latin America. 2. Agricultural credit--Latin America. 3. Inter-American Development Bank. I. Inter-American Development Bank. Sustainable Development Dept. Rural Development Unit. II. Series.

332.71 L282—dc21

This paper presents background research that supports the development of the Bank's formal strategy on rural finance (GN 2123-3). Mark D. Wenner is a financial specialist in the Rural Development Unit of the Sustainable Development Department. The author wishes to acknowledge the comments of Marguerite Berger and Glenn Westley of the Micro, Small and Medium Enterprise Division (SDS/MSM); Dale Adams, retired professor, Ohio State University; and Luis Ruben Zavaleta of the Social Programs Division, Region 2 (RE2/SO2) who served as reviewers. In addition, special recognition goes to Reinaldo Santos and Andrés Baquero of SDS/MSM for their assistance in retrieving data from the IDB operational records.

All errors and omissions are the author's sole responsibility. Note that there are slight differences in the project values reported in the rural finance strategy published in December 2001 and those reported here. The numbers that appear in this report are deemed to be more accurate. No substantive changes in interpretation are implied by the revision in reported project values.

October, 2002

This publication (Reference No. RUR-109) can be obtained from:

Rural Development Unit
Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577
E-mail: sdsinfo@iadb.org
Fax: 202-623-1708
Website: http://www.iadb.org/sds/

Foreword

The Inter-American Development Bank has been one of the major actors in funding rural finance projects over the last four decades in Latin America and the Caribbean. The legacy of the Bank is mixed. Some of the early interventions have been somewhat unsatisfactory. Some of the newer, more recent interventions show promise. This paper attempts to document the flows, chart the changes in thinking, extract lessons, and make recommendations on how to improve project design and monitoring. The focus is not on the impact of access to financial services on individual beneficiaries but more on the efficiency and sustainability of financial services delivery and the transformation of rural financial markets.

After a hiatus of a decade or so, rural finance is receiving more attention. This paper will help policy makers, practitioners, academics, and consultants to better understand the history and types of interventions that the IDB has made in the past. The hope is that new operations will benefit from the lessons of the past and build on existing strengths. As we move into an era of increased market integration and globalization, the importance of well-functioning financial markets cannot be overemphasized. This paper shows how rural financing in Latin America and the Caribbean might be improved in the coming years.

Ruben G. Echeverría
Chief, Rural Development Unit

Contents

Executive Summary
i

I. Introduction
1

II. Overview of Bank Lending Policies and Operations in Rural Finance
3

III. Targeted Rural Credit Operations
9

IV. Sector and Regulatory Reform Operations
16

V. Private Enterprise and Financial Intermediary Development
32

VI. Lessons Learned and Recommendations
45

Conclusions
52

References
53

Annexes
60

Executive Summary

The past 40 years have witnessed an important shift in the Bank's agricultural credit and rural finance policies. During the 1960s, in accordance with the Bank's "Policy Guidance for the Use of the Fund for Special Operations" (GN123-1, issued in September 1965), emphasis was placed on agriculture and rural development through targeted directed credit for rural producers. Norms and polices governing global credit operations issued during the 1970s meant that in the field of rural finance, the predominant intervention was a subsidized line of credit to a state-owned development bank for on-lending to small-scale agricultural producers. Misgivings about directed subsidized credit schemes began to surface in the 1980s and, as a result, the Bank issued an agricultural sector policy (GP106-3) in 1982, which called for a careful review of the sector and a redoubling of efforts to improve the performance of agricultural credit programs. The paradigm shift that occurred in the late 1980s led to the demise of the policy of extending subsidized credit. Since the 1990s, the focus has been on liberalizing financial markets and directing support to selected financial institutions serving rural clients engaged in both farm and nonfarm activities.

Between 1961 and 1998, the Bank approved 462 rural finance operations totalling $9.6 billion. Of that total, $4.4 billion went to targeted agricultural credit for medium- and small-scale agricultural producers; $4.8 billion went to sector and regulatory reform; and $474 million went to private enterprise credit and the development of financial intermediaries.

The paper reviews the Bank's lending experience in rural finance and extracts the lessons learned from that experience. It is based on a review of project documents, evaluation reports, and interviews. A sample of 27 projects were studied in detail. Although the review of IDB projects is far from exhaustive (due to the lack of data on project outcomes in a number of cases), it nevertheless serves to identify some important lessons for the design of future interventions. These lessons are organized in three categories that reflect the broad objectives of the projects reviewed, rather than the project titles *per se*: (1) targeted credit programs that serve to expand the supply of credit to rural producers or small enterprises; (2) policy, legal and regulatory reform programs; and (3) investments to strengthen the retail capacity of financial institutions. In addition, some lessons and conclusions are drawn about the applicability of the various Bank instruments and how the institution monitors and supervises projects once they enter the execution phase. Main conclusions in each of these areas are presented in summary form below:

Targeted Credit

- Targeted, subsidized credit programs distort rural financial markets, undermine the viability of many participating financial intermediaries, discourage the mobilization of savings, and disproportionately benefit higher income borrowers. In general, these types of programs failed due to faulty design assumptions and hostile economic environments in rural areas.

- Unsubsidized wholesale credit projects that are more broadly targeted can play a role in promoting the expansion and deepening of financial services to meet the needs of undeserved producers. However, their role is limited. Although the evidence is not complete, it appears that under some conditions these operations can play a role in expanding and deepening rural financial markets. Those Small and Micro Enterprise Global Credit Loans (MicroGlobals) that succeeded in expanding rural produc-

ers' access to credit were carried out in countries with large agrarian sectors where intermediaries were already present in rural areas.

- To avoid unintended negative effects in wholesale credit projects, final sub-borrowers should be charged market interest rates. The rates charged to intermediary institutions should be set at levels that do not undermine their deposit mobilization activity. The Bank's experience has shown that small-scale borrowers are more sensitive to the nonfinancial costs of transactions (processing fees, travel costs, and income lost due to delays in approval and disbursement) than to the financial costs (interest payments).

- Experience with the Bank's MicroGlobal loans and Small Projects as well as with the Multilateral Investment Fund's projects, shows that a combined household and business model of credit analysis (in which all business and personal income and expenditure flows are considered in calculating repayment capacity), is more appropriate to this market segment, making restrictions on end use of credit impractical and undesirable.

- The role of second tier, wholesale institutions is important in deepening financial markets. However, care should be taken to avoid the negative effects of the arbitrary allocation and pricing of long-term resources.

Sector and Regulatory Reform.

- Laws governing the creation, perfection, and enforcement of security interests and the attendant institutions should be improved. Small borrowers often lack secure title to land or are unwilling to pledge it in a loan transaction; therefore, other formal collateral substitutes are needed, especially moveable property.

- Much also needs to be done in the area of supervision to identify the biases that may impede rural and microfinance intermediation, especially in the areas of licensing, minimum capital requirements, asset risk classification, documentation, and provisioning

- In order for rural financial markets to function effectively, complementary reforms are needed in titling, judicial process, and disclosure that would improve the environment for financial services. However, the Bank's experience in this arena is currently limited.

- In order to promote change in the rural finance environment, operations must focus more specifically on this area. The Bank's experience has shown that rural finance reforms have very low probability of succeeding if included in complicated, multifaceted operations.

- The issues surrounding rural finance are complex and may require more evidence of consensus and political commitment prior to loan approval than there has been in the past.

- Because so many reforms needed in rural finance are of an institutional nature, the gestation period tends to be long and thus the leverage associated with the fast disbursing nature of sector loans is diminished.

- Past experience with sector loans and technical assistance to promote reforms shows that particular attention must be paid to the political economy surrounding their implementation if these types of interventions are to be effective. Vested interests exist that benefit from the status quo and operations must be designed in ways that deal with the threat of opposition to change that is likely to arise.

Institutional Retail Capacity

- The creation of sustainable financial intermediaries requires identifying organizations with strong leadership; a clear mission to assist the rural small- and microenterprise sector; a businesslike approach; a proven microfinance technology; and the creation of a partnership with these organizations to address institutional weaknesses. Therefore, the process of selecting institutions is crucial to success; the Bank's experience shows that broad consideration of alternative institutions and rigorous analysis of their actual and potential performance are essential.
- Innovations are needed in financial service delivery technologies to lower transaction costs and allow financial intermediaries to expand financial services in rural areas. Parallel interventions are needed to reduce the high degree of production and price risk in agriculture. Such parallel efforts should include appropriate investments in physical infrastructure, improved extension services, improved marketing, and an increase in the provision of insurance services.
- Building sustainable financial intermediaries capable of providing access to financial services to small rural producers is a slow process that requires a commitment over a long period (5-10 years). Rules or customary norms that prohibit granting of resources to the same group on multiple occasions need to be reevaluated.

Instrument Selection

- The Bank has at its disposal adequate instruments that can be used to promote and support the development of better functioning rural financial markets.

Project Execution

- Evaluations and staff interviews indicate that a recurrent area of weakness in IDB rural finance operations is lack of adequate technical monitoring and supervision. The incentives in place favor routine administrative monitoring for contract compliance rather than pro-active troubleshooting and assistance in shaping or providing timely remedial interventions. The situation has improved over the span of period covered, but further improvements are still needed. In order to enhance the probability of success in attaining project goals as well as the overall effectiveness of development aid, greater effort and resources will have to be dedicated in the future to pro-active supervision

I. Introduction

This review of the experience of the Inter-American Development Bank in rural finance originated as background research for the development of the institution's rural finance strategy (GN2123-3). It aims to ascertain what worked and what did not work in order to adopt more appropriate lending policies and project models that will contribute to building more complete, efficient, and deep rural financial markets in the region. Much of the experience in rural finance of the last forty years has been extensively documented by others. This paper compares the Bank's efforts to those reported in the existing literature on rural finance to determine how they coincide or differ from those of other institutions. It also serves to inform operational staff and management on how best to use the lending instruments at its disposal to support rural finance.

This paper is part of a larger set of documents and strategies produced by the Sustainable Development Department in recent years to provide conceptual guidance to Bank staff preparing operations in the rural sector. In particular, this paper complements the rural poverty reduction (GN 1995-5) and agricultural development (GN-2069-1) strategies. The increase in the number and volume of rural sector operations in recent years reflects a renewed interest in the rural economy. Between 2000 and 2002 , sixty-two operations of this type with an estimated total value of $3.8 billion were in the process of being approved. Rural finance operations amount to an estimated 2 percent of this total. In addition, the number of operations approved by the Multilateral Investment Fund and Social Entrepreneurship Program (PES, formerly Small Projects) has increased markedly.

This paper shares the insights and lessons of the first four decades of Bank experience in this rural finance.

Background

The IDB has invested over US$9 billion in agricultural credit and rural finance projects since its founding. Despite the large outlay of resources, the challenge of improving access to formal financial services remains. Only a small proportion of the rural population of the region enjoys access to formal financial services such as credit, deposit, insurance, and payment services.[1] The principal source of rural credit continues to be the informal sector; that is, relatives, friends, traders, suppliers, and moneylenders. Other financial services, deposits, payment systems, and insurance, remain very underdeveloped despite high demand.

The litany of potential pitfalls that await financial intermediaries contemplating entry into rural finance is formidable and discourages most. The challenges to the development of sound, competitive, and efficient rural financial markets include: (1) a production and marketing environment characterized by high levels of risk and uncertainty; (2) low population densities that imply substantial outlays on banking infrastructure and high transaction costs; (3) a pervasive lack of real collateral by the majority of potential clients, increasing credit risk; (4) high per unit transaction costs due to the small size of loans and deposits; (5) urban bias in economic and investment policies that results in poor rural infrastructure and limited economic and educational opportuni-

[1] See for example, Chaves and Sanchez (1995). The World Bank (INSERT reference publication year) reports that loan access rates are 2.9 percent in parts of Mexico. It is estimated that only 8.5 percent of Peruvian farm units received formal credit in the early eighties (IDB, 1983). Formal access to rural financial markets in Honduras was estimated at 6.7 percent in 1985 (Gonzalez-Vega and Torrico, 1995). Access to formal rural financial markets in Costa Rica was estimated at 19.9 percent in Costa Rica in 1988 (Gonzalez-Vega, Jimenez and Messalles , 1988).

ties; (6) costly and imperfect information about potential clients due to the heterogeneity of production conditions and managerial ability and absence of formal credit histories; (7) incomplete or poorly functioning complementary markets (land, labor, research and development) that reduce profitable investment opportunities; and (8) inadequate legal, regulatory and contract enforcement frameworks that increase the cost of intermediation and fail to reduce risk exposure.

Efforts to improve access to financial services in rural areas falls within the Bank's mandate to alleviate poverty and promote social equity issued by the Board of Governors in 1994 as part of the Eighth Capital Replenishment. Poverty among medium- and small-scale agricultural producers and farm workers, who make up the great majority of the economically active rural population, is quite high, and while there is no direct relation between access to financial services and poverty alleviation there is a strong correlation between rapid economic growth and financial market development (IDB, 1998; King and Levine, 1993). Thus, efforts to construct well functioning and efficient rural financial markets can be expected to contribute to reducing poverty and promoting social equity.

Methodology

This paper is based on the review of Bank project documents, evaluation reports, and interviews. Several critera were used to determine if a particular operation was successful: (1) improved credit access among the target population; (2) the sustainability and permanence of financial intermediaries; and (3) evidence of financial deepening and financial product innovation. No attempt was made to address issues of impact of credit or additionality given methodological difficulties. The focus is more on the viability of the intermediary institution and the supply side functioning of rural financial markets.

A representative sample of 27 project loan documents were reviewed along with available accompanying midterm evaluations, project performance monitoring reports, project completion reports, and project performance reviews (see Annex 1 for a list of selected projects). To develop further insights and verify details, interviews with knowledgeable Bank staff involved in the design, monitoring and evaluation of these operations were also conducted. Given the extensive gaps in information on impacts and how implementation problems were resolved, the effort should not be interpreted as a rigorous post mortem evaluation but rather as a heuristic assessment.

Organization of Paper

Section 2 provides an overview of the Bank's lending policies and activities in the sector. Section 3 reviews targeted agricultural credit instruments (pre-1990). Section 4 reviews operations promoting sector and regulatory reform. Section 5 assesses the operations designed to improve credit availability for rural small and micro entrepreneurs and to strengthen the capacity of financial intermediaries with a rural presence. Lastly, Section 6 presents the lessons learned and recommendations.

II. Overview of Bank Lending Policies and Operations in Rural Finance

This section reviews the policies that guided rural lending programs and the volume and types of lending that occurred.

LENDING POLICY FOR AGRICULTURAL AND RURAL FINANCE

The Bank's policy on agricultural credit and rural finance has evolved since 1961, when lending operations started. In September 1965, the Board of Executive Directors approved "Policy Guidance for the Use of the Fund for Special Operations" (GN-123-1) which designated agriculture and rural development as the "first field of action." This document stated that the objective of the Bank was to increase agricultural production and improve the socioeconomic well-being of rural residents. In practice the focus was on improving farm incomes, rural employment prospects, and national balance of payment positions. A chief means used to reach these goals was targeted, subsidized lending. State-owned development finance institutions (DFIs) in member countries became the preferred channel for transferring resources and divesting the IDB of the necessity of exercising close supervision over the disbursement of funds to final borrowers (sub-loans). By the early 1970s, the various norms and policies surrounding global credit operations were compiled into three basic documents: Certain Aspects of the Operating Policy of the Bank (GN-625, April 6, 1970); General Guidelines on the Operating Policy of the Bank (GN-750, May 19, 1971), and Operating Policies of the Bank (GN-65-1, December 28, 1970).

In 1982, the agricultural sector policy (GP106-3) reiterated the need to prioritize lending to alleviate agricultural marketing and processing constraints and to increase "credit lines to small holders, especially those participating in priority rural and development programs." Nonetheless, the document raised a cautionary flag, stating that, "A careful review is needed of subsidized agricultural credit (low interest rates, long grace periods, etc.) to determine if credit programs are reaching their intended beneficiaries...". Two reports published in the 1980s attempted to improve small farmer targeting.[2] However, the problem of improving the performance of state development banks, the principal source of rural credit, was not effectively addressed.

Through the mid- to late eighties, the policy of targeted, subsidized credit came under a slow but increasing attack as evidence mounted of the disappointing performance of directed credit programs, especially poor loan recovery, high administrative costs, agricultural development bank insolvency, and accrual of a disproportionate share of the benefits of subsidized credit to larger farmers. The basic tenets underlying the traditional directed credit paradigm (DCP) were debunked and supplanted by a new school of thought alternatively called the "financial systems approach" or the "financial market paradigm" (FMP), which viewed credit not as a productive input necessary for agricultural development but as just one type of financial service that should be freely priced to guarantee its permanent supply and eliminate rationing. The FMP school held that the emphasis on interest rate ceilings and credit subsidies retarded the development of financial intermediaries, discouraged intermediation between savers and investors, and benefited larger scale producers more than small scale, low-income producers.

[2] Report of the Working Group on the Analysis of Agricultural Credit (1982) and Guidelines for Estimating the Demand for Credit in Bank's Global Loans (1987).

As a result, loan proposals adhering to the directed credit paradigm encountered greater difficulties in winning approval in the early to mid-1980s. Subsidized credit components were sometimes removed. In July of 1989, the IDB formed a task force to study small farmer credit to consider alternative instruments for channeling resources to farmers. This group, comprised of staff from various departments, produced a report that was presented to upper management in the Fall of 1989. The report called for (1) free pricing of financial products; (2) moving away from targeting; (3) recognizing the fungibility of credit and modifying norms permitting only productive credit uses; (4) encouraging domestic savings mobilization; (5) emphasizing the soundness of financial intermediaries participating in Bank programs; and (6) encouraging competition among intermediaries (MacDonald et al., 1989). The report and subsequent discussions led to the issuance of a memorandum reflecting the new lending approach; namely, supporting market-driven intermediation (Agricultural Production and the Environment: Case of Credit, RE-192 Evaluation Report, January 10, 1990). In the same year, the Bank was authorized to engage in sector policy reform activities as part of the mandate of the Seventh Capital Replenishment (AB-1378, IDB 1989). In 1990, the Bank began to cofinance operations with the World Bank aimed at liberalizing financial market policies in borrowing member countries. In April of 1991, the Board of Governors authorized the Board of Executive Directors to approve independent sector loans, on a case-by-case basis. As central planning fell out vogue throughout much of the Eastern bloc and developing countries, the directed credit approach was no longer compatible with the market-oriented economic thinking that was taking hold.

LENDING PATTERNS

The Bank's rural finance lending program focuses on targeted agricultural credit for medium- and small-scale agricultural producers, sector and regulatory reform, and private enterprise credit and the development of financial intermediaries. Between 1961 and 1998, total lending in each of these categories totalled $4.4 billion, $4.8 billion and $474 million, respectively (Table 1). This amounts to $9.6 billion in 462 operations for the sector. In comparison, the World Bank approved $3.34 billion for agricultural credit projects in Latin America and Caribbean between 1961 and 1992 (largely directed subsidized credit), and U.S. Agency for International Development (USAID) invested $2.3 billion in the period 1961-1997 (World Bank, 1993; USAID, 1998).

Targeted Agricultural Credit

Between 1961 and 1989, the IDB disbursed over $4.2 billion for agricultural credit through 131 operations. These credit programs channeled resources, either indirectly through rediscount facilities or directly through loans, to state agricultural development banks and other specialized rural lending institutions for on-lending to rural producers at preferential rates of interest for the production and marketing of crops and livestock. In addition, the Bank also made credit available to rural producers through integrated rural development (IRD) operations. These were multifaceted projects that attacked the problems of rural poverty and underdevelopment in a specific region of a country through simultaneous investments in a number of areas, including, for example, agricultural extension, credit, marketing, infrastructure, and training. Thirty-six IRD operations were approved between 1961 and 1996 totaling $1.3 billion.[3] Of these operations, 18 had agricultural credit components, totaling $236 million. According to information available in the Environment Division's database (1998), the approved amounts under these two programs constituted about 40 percent of total Bank lending for rural devel-

[3] These programs were reviewed in other Bank publications and reports and are not addressed in great detail in this document. See Annex 4 of the Bank's Rural Poverty Reduction Strategy (GN-1995-5), July 1998. The focus of this paper is only on credit operations.

opment, agriculture, fisheries, and forestry in the period 1961-90, and 7 to 8 percent of total Bank lending for all sectors during the 1980s, the heyday of agricultural credit project approvals.

The Bank´s substantial involvement in agricultural credit operations was motivated by the perception that the lack of access to formal credit at costs significantly below informal sector costs was a major constraint on agricultural growth and development. The primary goal of these operations was to spur agricultural production and improve the economic welfare of small farmers. These operations focused on credit supply only and virtually nothing was done to support the provision of other financial services such as deposits, insurance, or payment services.[4] One side effect of the directed credit schemes was to discourage savings mobilization. Imposed ceilings on lending interest rates forced participating financial institutions to set rates on deposits at very low and unattractive levels. As a result, many deposit-taking rural institutions came to depend increasingly on access to external lines of credit as the principal source of loanable funds.[5]

Sector Reform Loans

As a result of the evolution in Bank lending policy much of the effort in the late 1980s and early 1990s was devoted to liberalizing markets and improving investment efficiency. Three main instruments—financial sector reform loans (FSLs), investment sector reform loans (ISLs), and agricultural sector loans (ASLs)—were used in a coordinated fashion to this end. FSLs assisted borrowing member countries to move toward market-based interest rates, increased banking competition, and strengthened the prudential and regulatory frameworks. ISLs helped to liberalize trade, investment, and regulations in order to spur private investment. ASLs were used to remove price distortions that reduced the profitability and competitiveness of the agricultural products, thereby making rural producers more bankable. Some of these loans included specific conditionality related to state-owned agricultural development banks and other aspects of rural finance..

Loans to Support Private Enterprise and Financial Intermediary Development

Four other instruments, targeted specifically to improve credit access for private entrepreneurs, were also used: (1) small- and microenterprise global credit loans (MicroGlobals); (2) global multisectoral credit loans (Globals); (3) Multilateral Investment Fund projects (MIF), and (4) small projects.[6]

MicroGlobals were used to provide liquidity and to reduce funding risk as an incentive for participating financial intermediaries in the borrowing countries to serve the small- and microenterprise sector. As of December 1998, 15 microenterprise global loans had been approved for a total of $397 million, and 13 were in execution. The available data on these loans, although limited, suggested that the overwhelming majority of participants in the MicroGlobal programs had been financial institutions in urban settings. The amount reaching rural producers was estimated to be about

[4] Computer searches of the Bank´s operations database for keywords or phrases that included insurance, savings, and deposits mobilization, were unsuccessful in uncovering rural-based projects. A sample of operational staff present during the 1980s and active in rural lending could not recall non-credit projects.

[5] See *Economic and Social Progress Report in Latin America: 1989*. Washington D.C. pp. 236-237. For example, Banco Agrario de Peru (BAP), the state agricultural bank in Peru, changed its liability structure significantly over time. In the early 1960s more than 50 percent of liabilities were deposits from the public. By 1988, less than 2 percent of liabilities were deposits, the rest being transfers from the central bank and external lines of credit with international financial organizations and bilateral donors. BAP was a participant in the IDB's Global Agricultural Credit program.

[6] The Small Projects Program was officially revised and renamed Social Entrepreneurship Projects in December 1998.

$21 million or approximately 10 percent of the amount disbursed.[7]

Global multisectoral credit loans were used to promote longer term financing and thus spur private sector investment. The programs were open to all types of clients. Some agroindustries and rural enterprises benefited, but most clients tended to be located in urban areas and to be involved in manufacturing and services.[8]

Another instrument that has helped rural clients is Window III, The Small and Microenterprise Facility of the Multilateral Investment Fund, which dates back to 1993. Rural finance MIF operations have been few (12) and the amount approved ($21.6 million) is a modest 5.2 percent of total MIF financing as of 1998. Many rural finance MIF projects are still in the early phases of execution and therefore little data exist to evaluate results.

The Social Entrepreneurship Program (SEP), which prior to 1998 was known as the Small Projects Program (SPP) has also benefited rural producers. Fifty-two small projects were directed to rural agricultural producers prior to 1992, but the amount disbursed ($23.7 million) constitutes about 18 percent of cumulative SPP lending as of 1998. In the early 1990s, the SPP was reoriented and some 80 percent of the resources approved since then have been directed to microenterprise development. Although much of that financing went to urban projects, a fair amount reached rural beneficiaries. Due to lack of data on microfinance beneficiaries, it is difficult to determine the exact share reaching rural clients. Nonetheless, the Small Project Programs, in particular, provided a laboratory in which interesting experiments were tried. Several financial intermediaries who received small project loans have now matured and transformed themselves into regulated financial entities. Some of these transformed NGOs are now expanding operations in rural areas.

The section labeled "Private Enterprise and Financial Intermediary Development" in Table 1 includes financing targeted to rural private enterprises as well as financial institutions with a presence in rural areas. Some of the credits in this category benefitted rural producers but the exact amount cannot be determined due to data disaggregation problems. The limited evidence available suggests that the majority of these funds benefited urban business owners. However, the technologies perfected to reach microenterpreneurs and the provision of medium-term financing help to strengthen financial markets overall and may some day benefit rural residents. The second section in Table 1 (Sector and Regulatory Reform) includes lending that helped to liberalize financial policies, strengthen prudential norms and banking supervisory authorities, improve secured transactions frameworks, and promote the creation of agricultural commodity exchanges. These reform actions clearly help create a better environment for efficient and sustainable financial intermediation but do not necessarily translate into immediate and observable improvements in access to rural financial services.

Since 1985, a declining amount of resources has been going to the rural sector in general and to agricultural credit in particular (see Table 2). The change in credit flow patterns is due to a change in Bank lending policy and the ongoing search for appropriate and effective financial technologies for large scale rural intermediation that can be promoted in the midst of a liberalized policy regime.

---

[7] This estimate is based on a review of executing agency reports and conversations with project officers involved in designing and supervising MicroGlobal loans.

[8] Multisectorial Global loan programs will not be discussed in great detail because most of the lending was directed to the industrial sector. See Annex 3 for a brief discussion and summary tables.

Table 1
Estimated Allocation of Agricultural Credit, Rural Enterprise Credit, and Financial Market Reform Loans: 1961-1998

Type of Operation	Number of Operations	Total Approved (US$ millions)
Targeted Agricultural Credit		
Agricultural Credit Loans	131	4,205
Integrated Rural Development Loans (Credit Components Only)	18	236
Subtotal	**149**	**4,441**
Sector and Regulatory Reform		
Financial and Investment Sector Reform Loans	29	4,224
Agricultural Sector Loans	8	602
Multilateral Investment Fund (Regulatory and Legal Reform)	14	13
Subtotal	**51**	**4,839**
Rural Private Enterprise Credit and Intermediary Development		
Small Projects (Agricultural Credit)	52	24
Small Projects (Microenterprise and Other Credit) [1]	182	84
Multilateral Investment Fund (Rural Finance Projects) [2]	12	22
Multisectoral Credit[3]	10	323
Microenterprise Global Credit (Rural Lending) [4]	6	21
Subtotal	**262**	**474**
Total	**462**	**9754**

Notes:

[1]The values represented are the sums of projects classified as microenterprise and global credit programs, multisector and fishing. This sum is an overestimation of rural credit because the classifications include client groups that are wholly urban-focused, wholly rural groups, and urban-based groups that on-lend for rural purposes. Due to limited information on the composition and of portfolios, a rural-urban disaggregation is difficult.

[2]Six of twelve projects involve institutions with an exclusively rural focus. The total value of these six projects is $14.3 million.

[3]Eight percent or so of the total value of multisectorial credit loans ($4.2 b) is estimated to have gone to support rural based industries and producers. However, the loans helped to strengthen many second-tier institutions and develop medium- and long-term credit, contributing to overall financial market development.

[4]An estimated 10 percent of the total amount disbursed as of December 1998 ($211 million). Of the 15 small and MicroGlobals approved, only 6 had intermediaries with rural loan portfolios.

Source: IDB Operational Departments Database.

Table 2
Rural Finance Operations: Estimated Allocations of Direct and Indirect Support by Year and Type of Operation
(US$ millions)

Type of Operation/Year	1961-65	1966-70	1971-75	1976-80	1981-85	1986-90	1991-95	1996-1998	Total
DIRECT SUPPORT									
Global Agricultural Credit	122	151	248	459	1,625	1,600	0	0	4,205
Integrated Rural Development (Agric. Credit)		17	37	161	22	0	0	0	237
Small Projects (Agricultural Credit)				6	9	7	2	0	24
Small Projects (Est. Rural Microenterprise)							10	6	16
MicroGlobals (Est. Rural Allocation)							20	1	21
MIF (Rural Intermediary Support)							15	7	22
Total Direct	122	168	285	626	1656	1,607	47	14	4549
INDIRECT SUPPORT*									
Sector Loans						410	2,880	950	4,240
Multisectoral Credit					39	106	1,587	1,853	3,585
MIF (Regulatory Reform)							4	9	13
Total Indirect					39	516	4,471	2812	7,838
GRAND TOTAL	**122**	**168**	**285**	**626**	**1,696**	**2,123**	**4,517**	**2,826**	**12,387**

Notes:

*Indirect Support: These operations help to create conditions favorable for rural intermediation in general. Sector loans and MIF regulatory operations help to strengthen prudential and supervisory framework. Multisectoral Credit operations help to strengthen second-tier institutions and extend medium- and long-term credit. Although a small percentage of rural clients are believed to have benefited from direct access to medium and long-term credit under Multisector Credit operations, these operations were valuable in strengthening second-tier institutions. Therefore, the total sum is credited as indirect support.

Rounding errors exist.

Sources: IDB Operational Database and Author's Calculations

III. Targeted Rural Credit Operations

This section reviews and analyzes the Bank's experience with targeted rural credit operations. There were two main types of targeted rural credit programs, global agricultural credit loans and integrated rural development loans. Both were directed and targeted to medium- and small-scale farmers.

AGRICULTURAL CREDIT LOANS

Agricultural credit loans were intended to increase the supply of credit available to medium- and small-scale agricultural producers in borrowing member countries. The program's aim was increasingaccess to credit for small and medium sized agricultural producers in order to increase farm productivity through the adoption of modern cultivation techniques, the more intensive use of purchased inputs, and the cultivation of larger areas. The program was also intended to promote the efficient allocation or resources; contribute to the development and strengthening of national capital markets; stimulate the mobilization of internal and external savings; and strengthen intermediary institutions so that they could effectively fulfill their role and foster long-term financial viability.[9]

These operations were made directly to a state-owned financial intermediary specialized in rural lending, the central bank, or a second-tier bank. These institutions, in turn, established a rediscount facility or a line of credit with one or more eligible financial intermediaries active in agricultural or rural lending. The borrowing government guaranteed the loan. The loans issued by the financial intermediaries to agricultural or rural borrowers (called "sub-loans") could be used for both fixed and working capital. The central government generally assumed the foreign exchange risk and loan terms were approximately 20 to 25 years. The interest rate charged to the borrowing government tended to be low (1 to 2.5 percent p.a.), the financial intermediaries paid a slightly higher rate to compensate the central government for the foreign exchange risk and administrative costs, and the final lending rates to clients tended to be capped at 6 to 12 percent in local currency, with no maintenance of value. The terms for sub-loans ranged from 1 to 12 years, depending on end use. Table 3 shows the distribution by country of the 131 agricultural credit operations approved for a total of $4.2 billion.

Outcomes

Overall, the outcomes of the agricultural credit projects were not positive.[10] In some instances, they achieved some of their stated goals; namely, improvements in small farmer access to institutional credit and increases in agricultural output, crop diversification, and small farmer income. However, in one evaluation report after another, the consensus was that directed agricultural credit programs had pronounced negative consequences on resource allocation, income distribution, macroeconomic management, and financial market development. Other studies in the field have come to the same conclusions (Yaron, Benjamin and Piprek, 1997). Due to serious methodological difficulties in assessing the impact of credit (lack of baseline data, fungibility of money, selection bias, attribution) even the favorable reports on positive production and income gains must be interpreted with caution (Vogel and Adams, 1993).

[9] See "Summary of Evaluations of Global Agricultural Credit Programs", IDB GN-1493, February 27, 1984 p.2 plus other agricultural credit program loan proposals cited therein.

[10] The operations reviewed in detail were Ecuador (Loans 521/SF-EC and 339/OC-EC), Panama (Loans 404/SF-PN and 554/SF-PN), and Peru (Loans 355/OC-PE and 589/SF-PE).

TABLE 3
Distribution of Agricultural Credit Globals by Country
1961-1989 (US$)

Country	Amount (US$ millions)	Percent	Operations
Mexico	1,296.0	30.8	14
Chile	722.6	17.2	8
Ecuador	443.4	10.5	10
Argentina	254.9	6.1	7
Peru	220.3	5.2	8
Bolivia	185.8	4.4	4
El Salvador	126.5	3.0	9
Brazil	124.4	3.0	8
Nicaragua	113.3	2.7	5
Colombia	107.0	2.5	2
Panama	97.0	2.3	11
Guatemala	93.5	2.2	8
Costa Rica	79.6	1.9	7
Paraguay	64.5	1.5	6
Venezuela	64.0	1.5	1
Jamaica	43.0	1.0	4
Dominican Republic	39.5	0.9	2
Regional	34.8	0.8	5
Honduras	33.7	0.8	5
Uruguay	33.1	0.8	3
Trinidad & Tobago	27.0	0.6	2
Haiti	0.8	0.02	1
Barbados	0.8	0.02	1
TOTAL	**4,205.0**	**100.0**	**131**

Source: IDB

Three comprehensive evaluations of global agricultural credit programs in Ecuador, Panama, and Peru conducted in 1983 reached the following were common findings:[11]

- *Outreach was generally limited*. Peru's Banco Agrario (BAP), the leading supplier of agricultural credit, accounting for more than 80 percent of the credit disbursed in the sector, only reached at maximum 7 percent of all farmers in Peru. The state agricultural banks of Ecuador and Panama accounted for a lower proportion of the formal credit supplied to the sector in those countries but reached fewer than 10 percent of all the farmers.

- *The distribution of loans tended to be concentrated* among upper income clients, even though the average income for a rural client was below the national average. In Panama, the 4th and 5th income quintiles

[11] See Agricultural Development Bank (BDA) Evaluation of Global Agricultural Credit Programs in Panama (1983); Banco Agrario del Perú: Evaluation of Global agricultural Credit Programs (1983): and Banco Nacional de Fomento: Evaluación de Programas Globales de Crédito Agropecuario (1983).

captured 74.3 percent of the loans. In Peru and Ecuador, similar patterns held.

- *Interest rates charged were generally negative in real terms*. For Ecuador's Banco Nacional de Fomento (BNF) the rates ranged from -6.8 percent in 1970 to -0.1 percent in 1982. In the case of Peru's BAP, real annual interest rates fluctuated between -3.8 percent in 1973 and -36.5 percent in 1982. In 1978, they reached a nadir of -61.7 percent in some months. In Panama, a dollarized economy with generally low inflation rates, the problem was less severe. No subsidies were granted until after 1980 when the passage of a special law (Law 20, Special Fund for Interest Compensation) intended to increase credit access for farmers meant that the Banco de Desarrollo Agropecuario (BDA) charged slightly negative rates for the period 1980-82 (the years for which data were available).

- *Borrower transaction costs were uniformly high in absolute terms*. In relative terms, they were regressive. Smaller borrowers tended to spend a larger percentage of the loan received on transaction costs related to pre-loan approval, disbursement, and repayment compared with larger borrowers. In Panama the estimated transaction cost was 5.7 percent for small short-term loans compared with 2 percent for large short-term loan. In Peru's coastal area (which has high agricultural potential), BAP clients paid an estimated 11.1 percent of total loan value for the smallest loans compared with 1.1 percent for the largest loans. In Ecuador, total borrower transaction costs equaled 5.3 percent in interest rate equivalent on an annualized basis for small loans compared to 0.6 percent for the largest loan.

Arrears tended to be high (ranging from 14.3 percent to 25.8 percent for the operations reviewed). When donors placed contractual clauses limiting arrears in operations, they tended to be circumvented by use of lax definitions of arrears, frequent debt rescheduling, and write-offs financed by transfers from the central bank. For example, the contaminated portfolio of Peru's Banco Agrario (arrears plus rescheduling in the last two years) was 17.8 percent in 1982.[12] In Panama, in the seventies, the definition of delinquency as an installment overdue for more than 90 days, was very lenient.

The administrative costs of placing the targeted credit was high and when combined with high delinquency, resulted in operating losses. The total cost per dollar lent was 8.7 percent for BAP and 9 percent for BNF.

These findings can be generalized to the vast majority of global agricultural credit programs and were even applicable to later operations, based on conversations with staff involved with these operations and later reviews (Zavaleta, 1989).

CREDIT COMPONENTS OF INTEGRATED RURAL DEVELOPMENT LOANS

Prior to 1990, integrated rural development projects addressed constraints in production, marketing, infrastructure, and social services on a coordinated basis. The aim was to promote economic growth in land reform or undeveloped rural areas. The typical project included two or more of the following components: (1) production technology transfer; (2) construction of farm to market roads; (3) irrigation works; (4) electrification; (5) construction of schools, health clinics, and community centers; (6) investments in marketing and/or cooperative organizations; (7) investments in farm equipment and facilities such as grain

[12] According to interviews with staff, by the mid to late 1980s, the contaminated portfolio of several state agricultural banks rose to the range of 40 to 60 percent of the total outstanding portfolio.

dryers and warehouses; (8) agricultural research and extension services; (9) land surveying, titling, and registration, and (10) credit for producers. The common target population tended to be agrarian reform beneficiaries or settlers on an agricultural frontier. Often, the government's objective was to rationalize spontaneous settlement along an agricultural frontier or subdivided estate land (state or private) by installing a modicum of infrastructure and productive support services so that the colonization or the land reform effort could succeed and the full productive potential of the area could be realized.

Since 1990, there has been a change in orientation. The agricultural frontier is largely closed and whereas the general purpose is still the same (i.e., promotion of rapid regional economic development) the means employed to achieve that end are quite different. There is greater emphasis on participatory design and capacity building in the target community, and more reliance on funds mobilized domestically. The emphasis is more on promoting private-public partnerships in pursuing regional development goals. No IRD loans approved since 1990 include credit components.

Before 1990, IRDs tended to involve a large number of government agencies (ministries of agriculture, public works, health, and education, state-owned financial intermediaries, and agrarian reform institutes). The projects were top-down in terms of design and implementation. Often the project was an element in a national development plan. Central planners, with the assistance of donor institutions and consultants, constructed the plans with little input from residents in the affected region. The credit components adhered to the directed, subsidized model and the terms and conditions were similar to those in global agricultural credit programs.

Since 1990, IRDs are much more participatory, the number of governmental actors has been reduced, and externally funded credit components are not present. The focus is on creating the capacity of the target community in order to increase the possibility of long term sustainable development.

Eighteen IRDs with agricultural credit components were approved in the period 1968-1981. The value of the agricultural credit component averaged 40 percent of the IDB's total contribution to the project. In 36 IRDs approved on or before 1981, there were several in which other donors or the borrowing government financed the agricultural credit component. These components were not reviewed for this study.

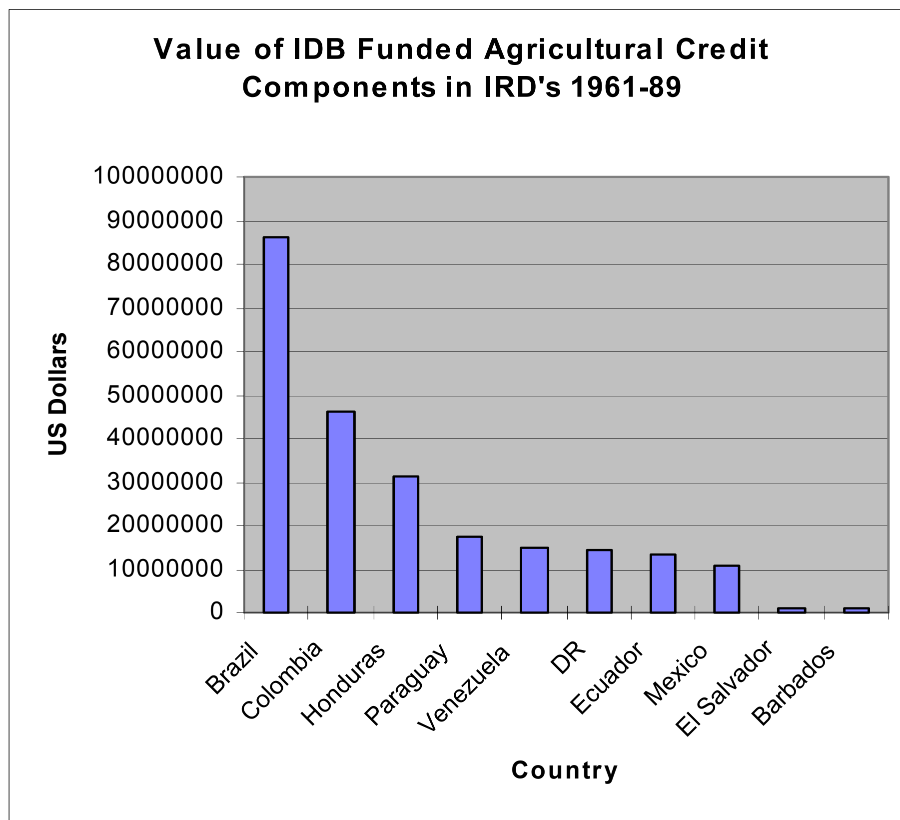
Outcomes

Like the agricultural global credit programs, the outcomes of IRDs were less than desired.[13] The stated goals of increased output and dynamic and sustained growth were not generally achieved due to serious coordination and funding problems experienced during execution. In addition, adverse sectoral and macroeconomic policies and unexpected external shocks hampered goal attainment. The common findings were:

- *Outreach to the target population was successful* and significant investments in physical infrastructure and delivery of services did occur.

- *The productive support programs were not sustainable*. Ex post evaluations reveal that the majority of the support services and installed physical infrastructure ceased to operate or deteriorated dramatically once the disbursements under international loans stopped. There was limited participation and "ownership" on the part of beneficiaries and the institutional framework and organization of program

[13] The IRDs reviewed in detail were Dominican Republic (Loan 350/SF-DR) and Mexico (Loans 293/OC-ME and 443/SF-ME). Also see Echeverría, 1998, Annex 2., [series name]



execution were insufficiently addressed (Echeverría, 1998).

- *Common problems in the credit subcomponents were high delinquency, high processing costs for both borrowers and lenders, and late disbursements*. For example, in the case of an IRD program executed in the Dominican Republic in the 1970s, the Agricultural Bank of the Dominican Republic had recurrent arrears problems (more than 41 percent at one time) (IDB, 1982). The bank's capitalization problems and its limited sustainability and outreach, reduced the impact of the extension and training services provided under the IRD, which were otherwise generally good (IDB, 1982). In the case of a Mexican IRD program, subprograms dealing with promoting fruit cultivation and cattle ranching suffered losses due to late disbursements and high costs of accessing credit from BANRURAL, the Mexican state agricultural bank responsible for supplying credit to the target population in the project area (Monzon et al., 1980).

ANALYSIS OF TARGETED AGRICULTURAL CREDIT PROGRAMS (GACs AND IRDs)

Design Issues

The reasons for the disappointing outcomes are the combination of poor design, weak execution, and unfavorable macroeconomic and sectoral environments. The projects were characterized by common assumptions that proved to be faulty. Some of those assumptions were the following:

- Small farmers are poor because they lack access to modern technology that will allow them to increase productivity and income.

- Small farmers cannot afford to pay commercial rates of interest because of low rates of return on their activities. Therefore, they need subsidized credit as an incentive to adopt modern farming techniques and/or as compensation for biased pricing policies.

- When subsidized loans are offered, small farmers will be able to gain access to credit.

- Small farmers cannot save because their incomes are low and they have a high incidence of poverty. Therefore, they cannot easily self-finance investment projects and have little need for deposit services.

- Small farmers cannot be trusted to manage their own funds. Therefore, they need strict supervision to prevent the diversions of funds to nonproductive activities.

- Private commercial banks are absent from the scene. Therefore, they have to be replaced by state-owned financial intermediaries or forced to lend to small farmers through the imposition of sectoral credit quotas.

- The conceptualization of a coordinated, integrated program of action was logical in theory but ignored the implementation constraints. The main underlying assumption was that the various state agencies had the wherewithal to execute a complicated program in which timely coordination was crucial.

The feasibility studies tended to overestimate the administrative capacity of the executing agencies and discount the adverse price and incentive policy environment facing farmers. Selection criteria and credit regulations tended to depend on static farm budget modeling and ignore the complex nature of peasant household production and consumption decisions.

Execution Issues

Institutional Capacity. The loan documents reviewed show a common pattern of accepting the executing agency' s glaring institutional weaknesses, as evidenced by high delinquency rates and administrative costs. In most cases, little money was allocated for personnel training, policy reform, or technology improvement. The emphasis was on the use of specialized agricultural financial intermediaries as channels for the disbursement of credit and not on investing in strengthening the credit institutions. Despite pledges to take corrective actions or make modifications in future operations, these changes were not forthcoming.

A 1984 report titled "Summary Evaluation of Global Agricultural Credit Programs" documents a series of operational and institutional problems, including: (1) noncompliance with contractual clauses to maintain arrears below specified limits; (2) high levels of rescheduling and write-offs; (3) noncompliance with reserve provisions in contracts; (4) failure to deliver technical assistance services to large percentages (more than 30 percent) of sub-borrowers, especially small scale producers; (5) instances of negative rates of interest charged and no consideration of price indexing to prevent decapitalization; (6) inverse and regressive relations between borrower transaction costs and farm size; and (7) high lender administrative costs. In later reports and evaluations the findings were generally the same

Counterpart Funding. According to interviews with Bank staff involved in these projects, most of the apex organizations and state development banks that participated in agricultural credit operations (GACs and IRDs) had soft budget constraints and therefore did not

generally have counterpart funding problems. In addition, each final borrower typically self-financed, 10 to 20 percent of the total investment cost of the project, and this was counted as counterpart funding (IDB, 1983).

In some specific IRDs, local counterpart funding was often not forthcoming for other non-credit subcomponents. This caused delays and indirectly affected the performance of the credit component. Many of the delays and disruptions in the provision of productive support services and infrastructure, coupled with the late disbursement of loans by state agricultural development banks contributed to lower than expected agricultural yields and farm revenues, which, in turn, raised loans delinquency rates.

Monitoring and Supervision. According to loan officers and managers involved in the design and oversight of agricultural credit programs, few resources were dedicated to the technical aspects of project monitoring. Once a loan was approved, the focus of the credit officer was on designing and winning approval for new proposals. Field office staff focused more on filing administrative reports and processing disbursements than on technical troubleshooting. Interviewed loan officials also claimed that one of the most serious problems was political interference in the executing agencies. Sometimes loan evaluation standards were lowered due to outside political pressures. As a result, loan repayment suffered and a culture of nonpayment was fostered.

External Conditions

For many Latin American and Caribbean countries the macroeconomic environment was not favorable in the early to mid-seventies (1973 oil price shock) and during the decade of the 1980s (foreign debt crisis and declining commodity prices). The economic environment was characterized by high inflation rates; overvalued currencies that reduced the competitiveness of agricultural exports; capital controls that limited foreign investments; administered prices for staple food products (grains, sugar and vegetable oils) that favored urban consumers but adversely affected rural producers; export taxes on principal agricultural exports (coffee, bananas, cocoa, cotton and cattle); poor rural infrastructure that increased marketing costs and limited the flow of information; and limited investments in agricultural research and extension. For the loans reviewed in greater detail (Ecuador (1970-82), Peru (1979-82) and Panama (1977-82)), conditions varied from country to country. Nonetheless, each country exhibited some sign of financial fragility. Over the period reviewed (1970-82), Ecuador's real growth rate slowed, inflation increased, and the fiscal deficit's share of GDP rose. In Panama, growth was strong but a burgeoning fiscal deficit created inflationary pressures. The inflation rate in Peru was the highest of the three countries, eroding the purchasing power of local currency loans and probably contributing to the dampening of savings mobilization. In the Dominican Republic (1972-77), inflation was modest as was the public deficit but multiple exchange rates, fixed agricultural output prices, and fixed interest rates, had a negative impact on rural financial markets. Mexico (1974-80) suffered from high inflation rates, a high fiscal deficit and two sharp devaluations, a drop of 23 percent in 1976 and another drop of 46 percent the following year. These conditions did not favor rural intermediation and exacerbated pre-existing problems of high risk and high transactions costs.

IV. Sector and Regulatory Reform Operations

Macroeconomic, financial, and agricultural policies have affected the development of rural financial markets in the region. Through the 1980s, most Latin American countries experiencedbalance of payment disequilibrium, large public deficits as a share of GDP, repressed financial markets, and weak financial regulatory frameworks. The result was pervasive credit rationing and financial disintermediation. Credit flows to the private sector tended to be low and savings were discouraged in rural areas. In addition, cheap food pricing policies that further reduced producer income, aggravated the situation and increased risk for financial intermediaries.

In the 1990s, the Bank started to use policy-based lending instruments (financial, investment, and agricultural sector loans) to support the creation of a more favorable environment for financial intermediation. In addition, a number of Multilateral Investment Fund operations were approved whose aim was strengthening the capacity of banking superintendencies and improving marketing channels for agricultural commodities. These experiences are reviewed below, first at the general program level and then for specific operations.[14]

FINANCIAL AND INVESTMENT SECTOR REFORM LOANS

Financial Sector Reform Loans (FSLs) and Investment Sector Reform Loans (ISLs) are fast disbursing, tranched loans intended to provide balance of payments support to the borrowing government in exchange for implementation of an agreed upon set of policy reforms. FSLs focus solely on the financial sector, and the overall objective of these programs is to enhance financial intermediation capacity, promote competition, and improve the efficiency, solvency, and soundness of financial systems. ISLs focus on removing obstacles to private investment and efficient resource allocation in a number of interrelated areas that may include the financial sector. The objective is to enhance private sector investment by creating a transparent legal and regulatory framework for business activities and guaranteeing equitable treatment of both foreign and domestic private investors. Common financial sector components of ISLs included reform and strengthening of banking superintendencies and central banks; reform of banking regulations and prudential norms; and redefining the role of state-owned financial intermediaries. ISLs include a number of common nonfinancial components such as trade liberalization and protection of intellectual property.

These loans were financed from the Ordinary Capital of the Bank, carried standard variable rates of interest, and were to be amortized over a 15 to 20 year period. Funds were usually disbursed in three tranches based on compliance with a set of policy conditionalities. Loan funds could be used by the borrowing government to finance the CIF cost of eligible imports. These operations were often carried out in conjunction with macroeconomic stabilization and sectoral policy adjustment programs of the World Bank and the International Monetary Fund. Specific policy conditions commonly included some of the following plus maintenance of a stable macroeconomic environment:

- Moving to a regime of market-determined interest rates.

[14] The specific operations reviewed are Peru FSL (PE-0033), Venezuela FSL (VE-0071), Uruguay FSL (UR-0031), Dominican Republic FSL (DR-0016), Uruguay FSL (UR-0057), and Argentina ISL (AR-0059).

- Strengthening of prudential norms to improve solvency of the entire financial system, particularly, capital adequacy, credit risk exposure, related party lending, asset classification and provisioning, and treatment of distressed and insolvent financial institutions.

- Improving regulatory and legal frameworks to promote competition, efficiency in financial intermediaries, and expansion of financial services by reforming general banking laws to clearly define entry and permit foreign banks to enter the local market, and allowing for financial entities to engage in leasing, factoring, credit cards, etc.

- Strengthening banking, insurance, and securities supervisory authorities.

- Making the central banks more independent of political authorities, eliminating their economic development role and focusing their mission on the maintenance of a stable currency and controlling inflation through judicious use of monetary instruments, including lowering and unifying cash reserve requirements and relying on open market operations and the discount rate as the chief instruments of monetary policy.

- Liquidating, restructuring, and/or privatizing state banks.

- Passing laws that would permit the orderly development of capital markets. ISLs attempted to attack a broad number of impediments to private investment. They typically focused on the following objectives: (1) improving commercial policy (i.e., tariff reduction, removal of quantitative restrictions, establishing countervailing tariff mechanisms, simplification of incorporation, foreign investment, and import and export procedures); (2) protecting intellectual property rights; (3) establishing dispute settlement mechanisms for investors and entrepreneurs; (4) initiating social security pension reform; (5) privatizing public sector enterprises; (6) restructuring and strengthening regulatory agencies (ports, roads, electricity and water); (7) simplifying tax codes and strengthening tax collection; (8) strengthening environmental protection rules; (9) strengthening banking and insurance regulatory authorities; and (10) reforming or liquidating state development banks.

Because ISLs sought to change policies in more areas, the number of conditionalities was high. For example, Uruguay (UR–0057) had to meet 60 conditions, and in the case of Argentina's ISL, the number of conditions were 55. FSLs had fewer conditions, ranging from 22 to 46 for the FSLs studied in the Dominican Republic, Venezuela, and Peru.

Tables 4 and 5 show financial sector and investment sector loans by country and year. Most approvals occurred in the early 1990s. Since then, the number of approvals has declined.

Table 4
Financial Sector Loans
1990-1998
(US$ Millions)

Project	Country	Amount	Year
VE0071	Venezuela	300.0	1990
UR0031	Uruguay	151.7	1991
PE0033	Peru	221.8	1992
DR0016	Dominican Republic	102.0	1993
GU0018	Guatemala	132.0	1993
EC0043	Ecuador	110.0	1994
GY0032	Guyana	38.0	1995
ME0188	Mexico	750.0	1995
VE0101	Venezuela	14.0	1995
PN0056	Panama	130.1	1997
NI0104	Nicaragua	65.0	1998
NI0106	Nicaragua	0.8	1998
Total	**12**	**2,015.4**	

Source: IDB

Table 5
Investment Sector Loans
1990-1998
(US$ Millions)

Project	Country	Amount	Year
AR0059	Argentina	350.0	1992
AR0187	Argentina	750.0	1995
AR0254	Argentina	2.5	1998
BA-0012	Barbados	35.0	1995
CH0044	Chile	150.0	1991
CO0035	Colombia	5.0	1991
CR0032	Costa Rica	100.0	1993
ES0016	El Salvador	90.0	1992
HA0046	Haiti	52.5	1996
JA0019	Jamaica	76.0	1991
PR0003	Paraguay	81.5	1992
NI0012	Nicaragua	132.5	1991
NI0087	Nicaragua	3.5	1995
PR0003	Paraguay	82.0	1992
PE0097	Peru	150.0	1996
TT0012	Trinidad and Tobago	80.0	1993
UR0057	Uruguay	68.8	1992
Total	**17**	**2,209.3**	

Source: IDB

Outcomes

Overall, the FSLs and ISLs contributed to a consolidation of the process of financial reform in Latin America and the Caribbean. Some of these operations helped to liberalize, privatize, and improve supervision of the financial systems of several countries in the region (Bolivia, El Salvador, Peru, Uruguay, Ecuador, Guyana, Dominican Republic, Trinidad and Tobago, Nicaragua, Venezuela, Guatemala, and Paraguay), though many of the operations came late in the process.

During the period 1990-98, 10 countries received FSLs with a total approved value of $2 billion and 14 countries received ISLs with a total approved value of $2.2 billion. Although some countries began the liberalization process before the loans began to disburse, the IDB loans nonetheless helped the borrowing governments to initiate reforms in some cases or to consolidate reform programs in other cases. A study of financial reforms that occurred during the period 1988-1994, concludes that 13 countries achieved major and/or substantial reforms (IDB, 1996; Westley, 1995). Of these, 5 received financial sector loans from the IDB. In only two cases can the changes be clearly attributed to IDB involvement (Uruguay and Venezuela).

Three areas of weaknesses were encountered in the wave of reforms. First, there was improper sequencing of reforms. Rapid dismantling of interest rate controls, targeted credit programs, and lowering of reserve requirements prior to strengthening prudential norms and supervisory authorities seems to have materially contributed to the likelihood of banking crises. The liberalization fueled banking competition and an expansion in financial intermediation that, absent adequate supervision, led to unsound lending practices on a much larger scale in numerous countries. Second, there was limited success in improving the independence of the central banks from the executive and legislative branches of governments. The lack of central bank independence hampered the maintenance of a stable macroeconomic regime in certain countries. Third, components that had a direct bearing on rural finance—secured transactions reform, privatization/reform of state banks, and incentives for the entry of commercial banks in rural areas—generally did not meet expectations in the one country that tried to do something in these areas. These weaknesses, directly and indirectly, made efficient and sustainable rural intermediation more difficult (See Table 7).

A more detailed review of selected sector loans was conducted in order to better understand the operational context. The selected loans were Peru FSL (PE-0033), Venezuela FSL (VE-0071), Uruguay FSL (UR-0031), Dominican Republic FSL (DR-0016); Uruguay ISL (UR-0057), and Argentina ISL (AR-0059).

Not all goals were achieved in all these countries, but significant advances were made in all. Variations resulted from different initial conditions, external shocks, and the effectiveness of implementation. In the sample, the reform programs in the Dominican Republic, Peru, and Argentina tended to be more successful than those implemented in Venezuela and Uruguay. Some of the common findings for the FSLs and the financial components of the ISLs were:

- Financial liberalization was in part responsible for the financial deepening that occurred in two of the four countries. In the Dominican Republic the ratio of M2 to GDP increased from 25.3 percent in 1993 (start of project) to 28 percent in 1997 (end of project). Likewise, in Peru, the ratio rose from 13.2 percent in 1992 (start of the project) to 25.8 percent in 1997(end of project). Financial deepening did not occur in the two other countries. However, in the case of Uruguay the degree of dollarization diminished, the confidence of depositors increased and holdings in national

Table 6
Compliance with Project Goals for Selected FSLs and ISLs

Condition	Peru 1992 (PE0033) FSL	Nicaragua 1998 (NI0104) FSL	Ecuador 1994 (EC0043) FSL	Peru 1996 (PE0097) ISL	Guyana 1995 (GY0032) FSL	Dominican Rep.-1993 (DR0016) FSL	Venezuela 1995 (VE0101) FSL
Banking legislation		Satisfactory		Satisfactory	Satisfactory	Satisfactory	
Central Bank reform and monetary policy	Satisfactory		Satisfactory			Unsatisfactory	
Privatization or restructuring of development banks (industrial-urban)	Satisfactory	Satisfactory	Unsatisfactory		Satisfactory		
Privatization or restructuring of state agricultural bank					Unsatisfactory		
Creation and/strengthening of second tier bank				Satisfactory			
Reaction to systemic banking crisis							Satisfactory
Interest rate liberalization							
Elimination of subsidized credit							
Banking regulations and prudential norms				Satisfactory		Satisfactory	Satisfactory
Strengthening of Superintendency	Satisfactory		Unsatisfactory			Satisfactory	Satisfactory
Reform secured transactions framework (moveable property collateral)					Unsatisfactory		
Linkages/Incentives for commercial bank to enter rural areas					Unsatisfactory		

Source: IDB Note: Blank spaces mean that the project did not have the corresponding conditionality or goal.

Table 7
Agricultural Sector Loans: 1991-1995
(US$ Millions)

Project	Country	Amount	Year
HO0082	Honduras	60	1990
JA0097	Jamaica	50	1990
GY0043	Guyana	30	1991
ME0038	México	200	1991
HO0027	Honduras	50	1992
NI0020	Nicaragua	55	1992
EC0048	Ecuador	93	1994
TT0032	Trinidad and Tobago	65	1995
Total	**8**	**602**	

currency increased over the period of project execution.

- The spread between lending and deposit rates shrank in Peru and the Dominican Republic but increased in Uruguay and Venezuela, countries with greater macroeconomic instability. The shrinking could be due to increasing efficiency in the banking sector.

- The dominance of state-owned financial intermediaries diminished substantially in Peru, the Dominican Republic and Argentina. In these countries, the amount of credit disbursed by private banks rose as well as the amount of savings captured, as state banks were either privatized, liquidated, or lost preferential reserve rate treatment. In the case of Argentina, studies were started in AR-0059 that led to the privatization of 16 provincial state banks in a later IDB/World Bank operation (Loan 865/OC-AR). Likewise, in Peru, four state banks were closed including the state agricultural development bank (Banco Agrario).

- In all countries, significant advances were made in revising prudential norms and strengthening supervisory capacity. Basle standards were adopted, limits were placed on related party lending, and conditions for intervention in failing institutions were clarified. The result was a consolidation process and an improvement in commercial bank solvency. One indicator correlated with solvency is portfolio quality. In Venezuela, the risk index for commercial banks (portfolio in arrears/gross outstanding portfolio) dropped from 11.7 percent in 1995 to 2.9 percent in 1998. Similar declines occurred in Peru where the rate dropped from 10 percent in 1994 to 5 percent in 1997. In the Dominican Republic, the index dropped form 7.9 percent in 1993 to 5.3 percent in 1997.

- In terms of program execution, all the programs experienced coordination problems, some experienced delays in complying with conditionalities, and not all the policy conditions were fully complied with. In the case of the Dominican Republic, the third tranche was not disbursed because the legislature would not enact a code for monetary and financial reform, legitimizing the changes that the monetary and banking control authority had made by decree. In Uruguay, Venezuela, and Argentina, the pace of strengthening the superintendencies lagged behind changes in other areas. In the case of Argentina, some of the studies to privatize the provincial banks were very superficial and had to be redone in later operations. Also, slow ap-

proval and disbursement of technical co-operation funds from non-IDB sources created execution problems. In some instances the level of salaries offered and the number of staff for coordination was less than sufficient given the complexity of the tasks (Uruguay). In all programs the time required for institutional reform tended to be underestimated.[15]

AGRICULTURAL SECTOR LOANS

Agricultural Sector Loans (ASLs) are intended primarily to remove trade, price, and financial market distortions that reduce the efficiency, competitiveness, and profitability of agricultural production. A secondary goal is to improve the legal and institutional framework affecting agricultural activities, namely land tenure, natural resources management, labor, moveable property collateral issues, and the reform of public sector institutions active in the sector. Many of these conditions indirectly affect the ability of small rural producers to access financial services, especially credit.

ASLs have the same term and pricing structure as other sector loans. The negotiated conditions for future disbursement normally included some of the following, depending on the particular country setting:

- removal of price controls and quantitative restrictions on staple food products;
- elimination of export taxes on agricultural commodities;
- compression of tariff ranges;
- reduction in the number of crops subject to guaranteed producer prices or their total elimination and replacement with price bands (variable levies), a more transparent commodity price stabilization scheme;
- elimination of marketing boards;
- reduction or elimination of credit and input subsidies;
- reforming and restructuring of government agencies actively supporting production (Ministries of Agriculture, Agrarian Reform Institutes, crop and livestock research institutes);
- reform, restructuring, or liquidation of state-owned or heavily state dependent rural finance entities (i.e., agricultural development banks and cajas rurales de crédito y ahorros);
- reforming taxation of land and better defining property rights; and
- reform and/or privatization of state-owned agroindustries.

Eight ALSs were approved since 1990. These operations often were co-financed by and carried out in conjunction with World Bank sponsored structural adjustment programs (SAPs) and sectoral adjustment loans (SALs) that started in the late 1980s (Table 8). Each operation was wide-ranging and complex (See Table 9).

Outcomes

ASLs were generally successful in achieving trade and price liberalization but less successful in the reform of state-owned financial institutions, land tenure, natural resource management, restructuring of agricultural research and extension agencies, and promotion of competition.[16] In Nicaragua, Jamaica, and Honduras, attempts to restructure or convert state agricultural banks into viable banks were

[15] See "Preliminary Overview of the IDB's Experience with Sector Lending: First Phase". Office of Evaluation, 1996 and PPR-14/98; PPR-12/98; PPR-12/97; PPR-10/97; PPR-8/98; PPR-16/97; PPR-5/95; PPR-11/97; PPR-14/97.

[16] See corresponding Project Performance Monitoring Reports (PPMRs).

Table 8
Conditionality for Agricultural Sector Loans

Conditionality	Honduras I (HO0082)	Honduras II (HO0027)	Jamaica (JA0097)	Mexico (ME0038)	Guyana (GY0043)	Nicaragua (NI0020)	Trinidad & Tobago (TT0032)
Foreign Trade and Competition							
Tariff, quantitative restrictions, export taxes, etc.	■		■	■	■	■	■
Exchange rate	■						
Price controls and subsidies			■	■	■		
Reform and sale of state-owned agroindustries	■		■		■		■
Promotion of competition							■
Financial Markets							
Credit institutions	■	■	■		■	■	
Credit supply			■			■	
Interest rate structure	■		■				
Land and Other Natural Resources							
Land tenure and titling			■			■	
Sale and/or leasing of public lands		■	■			■	■
Other aspects of land markets		■			■		
Natural resource management					■	■	
Environment, safety & occupational health, other			■	■	■		
Institutional Support and Reform							
Agricultural research and extension services				■	■	■	■
Reform of government agencies	■	■		■			■

Table 9
Regulatory Reform and Institutional Strengthening Projects that Indirectly Improve Rural Intermediation (Dec. 98)

Country	Title	Amount (US$)	Year
El Salvador	Strengthening of the Financial Sector Superintendency	1,832,000	1994
Costa Rica	Strengthening Agricultural Commercialization-Commodity Exchange	322,700	1995
Dominican Republic	Strengthening Agricultural Commercialization-Commodity Exchange	294,790	1995
El Salvador	Strengthening Agricultural Commercialization-Commodity Exchange	685,530	1995
Nicaragua	Strengthening Agricultural Commercialization-Commodity Exchange	374,740	1995
Haiti	Bankable Property Rights Reform Program	650,000	1995
Costa Rica	Program to Support the Reform of the Financial Sector	1,600,000	1997
Paraguay	Institutional Strengthening of the Bank Superindendency	1,200,000	1996
Bolivia	Bank Superintendency-Informal Financial Entities	1,200,000	1998
Peru	Support Program for Banker’s Training Institute	1,300,000	1998
Colombia	Strengthening Supervisory Structure for Confederation of Credit Unions	1,415,000	1998
Trinidad & Tobago	Strengthening Banking Supervision	720,000	1998
Regional	Bank and Securities Markets Supervision Training Program	1,300,000	1998
Regional	Implementation of Basle Core Principles	100,000	1998
TOTAL	**14**	**$12,994,760**	

frustrated by lack of borrower commitment and by political opposition.[17] As a result of conditionalities to reduce transfers from the central government, these agricultural development institutions became unable to lend large amounts of credit because large nonperforming portfolios reduced their capital base.[18] The proactive efforts to improve financial performance did not yield the expected results. Into the void created, few private commercial banks entered. Those that did focused on financing large scale producers and industrial and/or export crops with well established marketing outlets. In Honduras ASL II, attempts to create a special land credit fund (Land Bank), that would permit the landless to finance the purchase of land, and the restructuring of a network of *cajas rurales* (rural savings and loans), have not advanced far.[19]

The success in the trade and price liberalization components of these programs has permitted agricultural producers to face unfettered price systems and enter the global economy. However, there was not sufficient progress to establish an institutional framework conducive to sustained and broad-based agricultural growth.[20] For example, increasing the competitiveness of the exchange rate over time should lead to an increase in exports and import-substitution activities. In the cases of Jamaica, Honduras, Mexico, and Guyana there were upward trends in the agricultural terms of trade and expanding output of tradables as the theory would imply.[21] However, a dramatic drop in public investment in agricultural infrastructure, constrained the agricultural supply response. Undeveloped and distorted rural financial markets also serve to constrain the supply response. Evidence from Nicaragua suggests that the gains realized in agricultural output may have been due to increases in the total area cultivated and not to increases in productivity. This suggests favorable price incentives but inability to access purchased inputs and change technologies.[22] In a more detailed review of two ASLs (Jamaica and Nicaragua), the following findings were common in the rural finance subcomponents:

- Despite the liberalization of interest rates, market-determined interest rates became slightly negative in real terms in both countries, indicating the underlying inability to maintain consistency in the macroeconomic framework (monetary, fiscal, trade and exchange rate policies). This increased demand for credit at a time when the traditional sources of formal credit, state banks, were being restructured and were shackled with a high proportion of nonperforming assets.

- Loan disbursements from the state-owned rural financial entities declined while agriculturaloutput rose, suggesting successful substitution of credit sources.

- The rationale for attempting to reform rather than eliminate the stated-owned specialized credit institutions was based on their extensive network of rural branches (Nicaragua) and in-depth knowledge of the sector (both countries). However, attempts to reform organic charters, professionalize staff, improve collection of

[17]Staff interviews.

[18] See "Evaluación del Programa del Préstamo Sectorial Agrícola a Nicaragua" Project Performance Report 16-67(NI0020), Oct. 1997 and Project Performance Monitoring Reports for ¨Agriculture Sector Reform Program in Trinidad and Tobago¨ (TT0032), Dec. 1998 and communication with Paul Trapido, sectoral specialist, Honduras Country Office., Feb. 1999 who previously worked on the Honduras ASLs.

[19]Staff interviews and "Eligibility for Release of Second Tranche-Honduras Agricultural Sector Reform Program (Loan 737/OC-HO)" Doc. PR-1906-2, June 1995. p.5.

[20] See Annex 2 pp. 3 in "Evaluation of the Policy-Based Lending Portfolio, Phase II", Evaluation Office, Inter-American Development Bank, 1998.

[21] See "Evaluation of the IDB's Agricultural Sector Adjustment Loans: Impact, Implementation Issues and Policy Implications." WP-1/94, Evaluation Office, Inter-American Development Bank, 1994.

[22] PPR 16-67 "Evaluación del Programa del Préstamo Sectorial Agrícola a Nicaragua"

delinquent loans, and increase overall operational efficiency yielded less than desired results.

ANALYSIS OF FINANCIAL, INVESTMENT, AND AGRICULTURAL SECTOR LOANS

Design Issues

Five main assumptions undergird FSLs, ISLs, and ASLs.

First, the analytical framework underlying the policy prescriptions were valid; namely, that trade, pricing, and exchange rate distortions had to be eliminated before sustained economic growth and poverty reduction could be attained. Once the distortions were eliminated there would be a supply response.

Second, government policymakers, technical staff, and key stakeholders in the borrowing country understood the need for the reforms, accepted the trade-off between expected long-term benefits and short-term economic and social costs, and would commit to project goals.

Third, the borrowing country had sufficient political, technical and institutional capacity to execute the reform program within a reasonable period of time.

Fourth, the private sector would respond positively to the liberalization and minimize the social cost of the transition through increased investment and the creation of new jobs. The borrowing government could maintain macroeconomic stability and intersectoral consistency during the period of project execution.

In practice, these assumptions, especially the last four, did not hold in several instances. Empirical evidence in the economic literature exists suggesting that countries that have open, market-oriented economies, do grow faster and are able to reduce poverty more quickly than closed, statist economies (Thomas and Nash, 1991). The timing and intensity of the expected response, however, are affected by other factors, including the quality of the institutional framework, effective demand, competitiveness in world markets, and risk aversion. In the case of the operations studied, there was a pattern of slow first and second tranche disbursements and requests for extensions and waivers for eligibility and disbursement conditionalities that suggest design weaknesses in sector lending overall, and particularly in agricultural and investment sector lending (IDB, 1996; IDB, 1998). Of 25 FSLs, ISLs, and ASLs reviewed, 14 operations experienced a lapse of a year or more between first and second disbursements, beyond the typical norm of 4 to 6 months.[23] The ASLs experienced a high incidence of problems: long delays, waivers, project reformulations, and one project cancellation (Honduras, Trinidad and Tobago, Guyana). According to information from staff interviews, good progress was normally made on the price liberalization front but not in reforming institutions, including state-owned financial intermediaries.

Execution Issues

Institutional Capacity. Project results seemed to be influenced by the combination of degree of "borrower commitment to project goals," human capital, proper institutional incentives, ability to coordinate action across various areas, and property rights definitions.

In some cases the reform package was not "fully owned" by the borrowing country. The stakeholders of the borrowing country may have been divided in support of reform measures but pressed nonetheless to attend contemporaneously to a foreign debt reduction program, a banking crisis, or a current account imbalance and thus acquiesced to the reform

[23] See pages 32-33 and page 35 of "Preliminary Overview of the IDB's Experience with Sector Lending: First Phase". Office of Evaluation, IDB published in 1996 and IDB financial database.

program without full internal support (Nicaragua, Venezuela, Haiti and Guyana). Once the operation was approved, the opposition exerted its influence to slow and thwart the reform package. In the cases where the borrowing government was fully committed and other factors permitted it, compliance was swift (Peru-FSL, ISL, Argentina-FSL, ISL). Attempts were even made to deepen and extend the proposed reforms. In cases where there was strong opposition by the political party out of power or other organized constituencies (Nicaragua-FSL, Uruguay-ISL) or where land tenure issues were unresolved (Nicaragua-ASL, Trinidad-ASL, ISL), the pace of reform was slowed.[24]

Many borrowing countries lacked the technical and institutional capacity to implement and coordinate very ambitious programs involving a large number of co-executing agencies. Often the disbursements did not directly benefit participating government agencies responsible for implementing specific changes, thereby reducing incentives for cooperation. In some cases, the lead government agency did not inform subordinate agencies of the actions that needed to be taken to comply with conditionalities. Other times the subordinate or decentralized agency disagreed with the reform objective and mobilized to resist change.

These factors created quality of implementation problems for the entire operation or for particular components (Jamaica-Superintendency, Trinidad-State Agricultural Bank Reform, Honduras-State Agricultural Bank Reform, Guyana-Public Registry Reform, Nicaragua-State Agricultural Bank Reform). There was more unevenness in the quality of implementation across sectors for the ISLs because of the sheer ambitiousness and complexity of the reforms (e.g., the Uruguay ISL had 60 policy conditionalities, compared with a range of 22 to 46 conditionalities for the FSLs).

In several cases, the Legislative Branch refused to ratify, in a timely fashion, laws negotiated as part of the project's conditionality by the Executive (Dominican Republic-FSL, Costa Rica-ISL, Uruguay-FSL). In the case of ASL II in Honduras and the Trinidad and Tobago ASL, changes in ruling political parties during the course of execution limited progress because the successor administration either did not share the same enthusiasm for the reform program or lost momentum due to transition and staff changes. The program coordinating unit may also have lacked the breadth of technical talent needed to effectively troubleshoot, and the line agencies may not have had sufficient budget support to fully implement the reforms in a number of sector loans.

Technical Assistance and Counterpart Funding. Reports from those involved in design and supervision claim that in those projects in which there was an associated technical assistance component attached, the TC component provided a valuable contribution to implementation. They were particularly important in projects involving institutional restructuring.[25] Counterpart funding was not reported as a problem.

Monitoring and Supervision. For sector loans, the headquarters technical staff took responsibility for approving conditionalities and waivers, while the periodic monitoring of operations and contact with national program coordinators was the responsibility of the country offices. The degree and quality of interaction between the headquarters and country office seem to have been adequate, especially after the reorganization of 1994 that reduced reporting dichotomies. The flexibility granted project teams in reviewing compliance with the contractual conditions and maintaining dialogue with the borrowing government helped

[24] See corresponding Project Performance Monitoring Reports (PPMRs) and interviews with staff involved in operations.

[25] Ibid.

resolve problems and make appropriate course corrections. Nonetheless, the number of different technical areas and the large number of reforms included in the typical financial, investment, and agricultural sector reform operation may have exceeded the installed technical expertise in the country office. In the countries where there was substantial reform (Peru, Bolivia, Argentina, Dominican Republic, and El Salvador), there were strong cadres of technical expertise in the counterpart government agencies.

Overall attention was focused on compliance in key sectors (macroeconomic stability, exchange rate, trade, and price reform) and positive movement in the right direction was accepted in other areas. According to interviews with staff, compliance waivers were sometimes issued where resistance was strong in order to maintain momentum in other areas where there was less resistance.

External Conditions

Some governments experienced shocks that adversely affected the implementation of the sector loans in question (Mexico, Venezuela, and Jamaica—banking crises; Mexico, Ecuador, Venezuela, and Guyana—decline in principal export commodity prices). In general, however, the external environment in the 1990s was favorable for the majority of countries receiving sector loans. The period was marked by abating inflation rates, low and stable energy prices, increased capital inflows, and positive real GDP growth rates. Thus, the external environment, except for a small number of countries, was better for the implementation of sector loans compared with the implementation of agricultural global credit and integrated rural development programs in previous decades.

MULTILATERAL INVESTMENT FUND: REGULATORY AND LEGAL REFORM PROJECTS

The Multilateral Investment Fund (MIF) was established in 1993 as a special fund administered by the IDB to accelerate private sector development and help improve the climate for private investment in Latin America and the Caribbean. MIF has focused on strengthening the policy and regulatory framework for the private sector, increasing worker skills and mobility, broadening the participation of micro and small enterprises through the use of loans, grants, guarantees, quasi-equity, and equity investments. MIF's philosophy is to support private sector activities that are innovative and catalytic yet financially sustainable. In the regulatory and policy area, MIF's goal is to assist regional governments to improve the investment climate. Many activities undertaken reinforce and extend reform actions started in previous FSLs and ISLs or address remaining weaknesses in the regulatory framework.

MIF regulatory and legal projects tend to use nonreimbursable technical assistance to improve institutional service delivery capacity. The client institution can be public or private sector—a banking superintendency, a commodity stock exchange, a securities exchange, or a federation of credit unions.

As of December 1998, MIF had approved 221 projects worth US$414 million. Fourteen projects summing to $12.9 million or 3.1% of total value approved serve to improve and strengthen the environment for rural financial intermediation. Fifty-four percent of these projects (seven) were approved in the 1996-98 period and preclude in-depth review. Table 10 lists the 14 legal, regulatory, and commodity exchange projects that provided indirect support to enhance rural intermediation (see Table 10).

Table 10
Global Credit Loans for Small and Micro Enterprise Development as of December 1998
(US Dollars)

Loan No.	Borrower	Year	Amount Approved (IDB Resources Only)	Disbursed	Rating	Estimated Rural Lending	% Rural
CO0086	Colombia	1990	$14,000,000	$14,000,000	S	$0	
EC0110	Ecuador	1990	$15,254,771	$15,254,771	S	$726,000	4.7
UR0033	Uruguay	1990	$7,000,000	$7,000,000	S	N/A	
AR0213	Argentina	1991	$45,000,000	$44,173,500	S	$0	
CR0016	Costa Rica	1992	$10,000,000	$4,628,408	US	$3,425,022	74.0
GU0072	Guatemala	1992	$10,000,000	$640,000	S	$0	
PR0013	Paraguay	1992	$10,000,000	$10,000,000	HS	$0	
CO0037	Colombia	1993	$30,000,000	$30,000,000	S	$0	
ES0037	El Salvador	1993	$23,990,100	$23,990,100	HS	$4,954,574	20.7
NI0035	Nicaragua	1993	$22,903,186	$22,903,186	S	$8,447,600	36.8
PE0035	Peru	1995	$25,000,000	$25,000,000	HS	$2,673,710	10.6
PR0094	Paraguay	1997	$18,545,330	$8,070,225	S	$827,796	10.3
BO0171	Bolivia	1998	$35,000,000	$0	N/A	N/A	
AR02	Argentina	1998	$100,000,000	$0	N/A	N/A	
PE0189	Peru	1998	$30,000,000	$6,000,000	HS	N/A	
TOTAL	**15**		**$396,693,387**	**$211,660,190**		**$21,054,702**	**9.9**

Notes:
S=Satisfactory Implementation; US=Unsatisfactory; HS=Highly satisfactory; N/A Not applicable or data not available.
Rural Lending Estimation Methodology:
Peru: Total program disbursements of 3 participating *cajas rurales* plus the agricultural portfolios of Banco Wiese ($572,000), Norbank ($3,710), and Banco Orion ($138,000). Rural commerce lending is acknowledged to be underestimated. August 1998. **Paraguay**: Report from Program Executing Unit within Central Bank. December 1998. **Nicaragua**: All disbursements outside the four largest urban areas (Managua, Masaya, Granada, Leon) are considered to be rural. 39.4% Financiera Nicaraguense de Inversiones. December 1998. **El Salvador**: Financiera Calpia has 24% of portfolio in rural areas and accounted for approximately 60% of the disbursements of the MicroGlobal or $3.454 m. Another participant, Banco Agrícola, is estimated to have disbursed $1,500,000. **Costa Rica**: According to Midterm Evaluation Report (Examen de Ejecucion: Programa Global de Credito para la Micro y Pequeña Empresa, 1997), 74% of the credit is rural. That percentage was applied to the current disbursements, yielding the reported volume. **Ecuador**: Amount reported by the Corporación Financiera Nacional, the project executor, via Edgar Carvajal (Microenterprise Specialist in Country Office) for the period 1997-1999. According to Bill Gheen (EVO) who participated in the evaluation of said program there is controversy regarding the exact amount. Banco Nacional de Fomento, a state agricultural bank, participated in an early phase of the program but was disqualified for violating borrower eligibility requirements. BNF had reported disbursing US$5 million in agricultural credit. Here the revised smaller number is reported.

Source: Operational Departments database, Project Performance Monitoring Reports, and Progress Reports from Executing Agencies.

Outcomes

Three MIF projects were reviewed in detail: Bankable Property Rights Reform Program in Haiti; Banking Superintendency Strengthening in Paraguay; and Strengthening of an Agricultural Commodity Exchange in El Salvador. There were three major findings:

- In the project to reform the secured transactions framework, objectives were not met due to failure by the Legislative branch to promulgate the necessary changes in the law. A draft law on secured transactions was presented but not adopted. The design for a new public registry and training of staff could not be initiated.

- The project to reform and strengthen the Paraguayan banking superintendency is helping to improve supervision capacity but has not specifically addressed issues that have a direct and pertinent relationship to rural intermediation. The regulatory framework was examined, bank examiners trained, and computer equipment purchased.

- The project to establish a commodity exchange for agricultural products has succeeded in El Salvador. A law to establish the exchange (Ley de Bolsas de Productos y Servicios Agropecuarias) was drafted and approved in June of 1997. In addition, internal rules and regulations governing operations were presented and accepted by the Superinentendency of Mercantile Business. The most significant project result was the reform of the commercial code that recognized non-possessionary legal ownership of commodities. This facilitates the trading of paper conveying ownership rights and allows for ancillary uses: rediscounting, securitization, futures, and pledging as collateral. Other significant achievements include the bonding and certification of warehouses and quality control laboratories. At the end of 1997, traded volume was US$10.3 million covering 13 commodities; the exchange posted a profit of $75,552 and had no outstanding debts.

Analysis of MIF Regulatory and Legal Projects

Design Issues

The key assumptions behind MIF interventions are that there are legal and regulatory impediments or weaknesses and that once these are removed, private intermediaries will respond positively to perceived profit-making opportunities and extend financial services to the target group of small scale rural producers.

These assumptions are largely valid but may be subject to time lags and degrees of risk aversion. If private agents are extremely risk averse, the desired action may not occur. In addition, low-risk, lower cost intermediation opportunities will tend to be exploited before high-risk, high cost intermediation opportunities. For example, in our sample, few Paraguayan commercial banks provided services in rural areas despite an improving regulatory framework. This was due to a combination of factors: (1) the increased costs of complying with a more rigorous and professional system of supervision; (2) the presence of a subsidized government farm credit program that would tend to undercut a high interest rate policy; (3) high and unmitigated levels of production and price risk; and (4) high transactions costs involved in small lending programs. More important, in a situation of flux in the financial markets and unsettling macroeconomic conditions, few managers would risk moving into a new niche if it could be avoided.

Execution Issues

Institutional Capacity. In two of the three cases reviewed in depth, project execution was not problematic. The executing agencies were

solid institutions and their hired consultants performed admirably. In Haiti, the executing agency, an ad hoc interagency coordinating body called the Presidential Commission, had no control over the legislative branch, which had to approve the laws and regulations developed by the project. Therefore, an external agent foiled project completion.

Counterpart Funding. In none of the reviewed projects was counterpart funding identified as a problem.

Monitoring and Supervision. The coordination between headquarters and field staff was adequate.

External Conditions

The conditions in Haiti were not favorable to the implementation of the project. Political differences prevented the collaboration between the Legislative and Executive branches of Government that was needed for passage of a law establishing new types of security interests. In El Salvador, macroeconomic stability and period of sustained growth and investment helped the commodity exchange get established. In Paraguay, a mounting banking crisis has served to focus attention and speed up implementation of the project. However, much of the attention has been on controlling a systemic crisis and not on the microeconomic imperfections in the existing framework of prudential norms and how these may hamper rural intermediation, especially small and micro loans. Thus, external conditions mattered in all cases. Interestingly, in the case of Paraguay, a negative environment provided a stimulus for change.

V. Private Enterprise and Financial Intermediary Development

Many of the financial sector reforms of the early 1990s made possible the more effective use of instruments to promote private enterprise development and to create and strengthen private financial intermediaries. For example, the wider use of MicroGlobal loans was possible only after interest rate ceilings were removed and rules were changed to allow greater banking competition. Hitherto microlending resulted in low profitability and even losses. Similarly, the strengthening of specific financial intermediaries with MIF resources has yielded positive results in some cases due to improved prudential norms, more liberal banking laws, better supervision, the absence of interest rate ceilings, and macroeconomic stability. Even a relatively old instrument targeting the low-income population, such as the Social Entrepreneurship Program (formerly Small Projects), has evolved to reflect changes in thinking that now place a greater emphasis on financial sustainability. The goal of sustainability, albeit difficult to achieve for nonbanks, is facilitated by the lack of financial repression.

SMALL- AND MICROENTERPRISE GLOBAL LOANS (MICROGLOBALS)

MicroGlobal credit programs primarily seek to increase the access of a target group, small- and microentrepreneurs, to formal credit on a permanent basis.[26] This goal is to be achieved through the combination of an increased supply of credit (external line of credit) to the financial system; the transfer of appropriate microcredit delivery technologies to participating financial intermediaries; the training of microentrepreneurs in nonfinancial areas; the adoption of environmental protection measures; and a dialogue to effect changes in government regulatory and legal practices in order to more fully integrate the small- and microentrepreneurs into the national economy and the formal financial system.

MicroGlobals usually include both a loan and a technical assistance component. In the credit component, there are three possible fund allocation mechanisms: (1) the central bank or a second-tier institution (apex institution) lends to regulated, first-tier financial institutions that then on-lend the resources to microentrepreneurs; (2) the apex institution lends to regulated financial entities who then on-lend to nonregulated financial intermediaries (NGOs) who in turn on-lend to entrepreneurs; or (3) the apex institution lends directly to nonregulated financial entities that on-lend to target entrepreneurs. For the projects in execution the most common mechanism is the first. In the case of Nicaragua, Argentina, Peru, and Costa Rica, the second option is allowed. In the case of Colombia all three are permitted.

In the technical assistance component, a grant is usually provided for one or both of the following purposes depending on existing conditions: (1) to strengthen the capacity of the executing agency— normally a second tier bank—in program administration and information management; (2) to train the staff of participating retail financial institutions in microfinance technology.

The terms and conditions for these loans resemble the multisectoral loan: amortization periods of 20 years, commitment periods of 3 years, disbursement periods of 4 years, and variable interest rates and commissions on both undisbursed and outstanding balances.

Between 1990 and 1998, the IDB approved US$397 million in 15 MicroGlobal operations for on-lending purposes and disbursed US$211 million. The resources provided by

[26] Out of the thirteen MicroGlobal loans in execution, eight target microentreprenerus while five target both small and micro entrepreneurs.

the MicroGlobals have penetrated into rural areas in a limited way. Only in Peru, Costa Rica, Nicaragua, and El Salvador are there participating intermediaries with appreciable rural finance portfolios. In Paraguay and Ecuador, one intermediary each is reported to have a rural presence, albeit a small one. The estimated amount of total rural credit provided is US$21 million or 10 percent of the total amount disbursed as of December 1998. Most of the programs have been implemented in a satisfactory manner, two are above average (highly satisfactory), and two have underperformed.

Outcomes

Most MicroGlobals have been successful in reaching a large number of small and urban microentrepreneurs. Client outreach goals have been exceeded in several operations, and the actual average loan size has been lower in many cases than that stipulated in credit regulations or fixed as *ex ante* goals (Peru, Nicaragua, Paraguay, Ecuador, El Salvador), indicating delivery of service to a lower income stratum.[27] Despite the success in coverage, the overall number of participating commercial banks has been limited in a number of countries and the number of intermediaries focusing on rural lending has been even lower. For example, in Peru 27 financial intermediaries are qualified to participate but only 16 actively disburse IDB funds. Of that 16 only 3 are based in rural areas. Also, the majority of credit disbursed has been for commerce, even in rural areas, indicating that nonfarm activities are quite bankable and a less risky activity for lenders.

When conditions are right, MicroGlobals can reach rural areas. Three countries have significant shares of total disbursements going to rural areas, Costa Rica (74%), Nicaragua (40%), and Peru(20%).[28] The first two countries are largely agrarian and all three have a fair density of regulated financial institutions located in rural areas. In the case of Costa Rica, the leading participating private commercial bank, Banco del Comercio, bought the portfolio of an existing rural NGO and retained its staff. It also opened, in quick succession, a number of rural branches partly in response to a government targeting decree and partly because of leadership commitment to microenterprise. Thus, it began rural microenterprise lending with a crucial base of clients and trained staff. In Nicaragua, the two leading participating intermediaries in the MicroGlobal program, BANCAFE (44% share of total disbursed) and INTERFIN (34% share of total disbursed), each have an extensive network of branches in provincial cities from which they do substantial rural lending (Financiera Nicaragüense de Inversiones, 1998). Also, the Nicaraguan program has an innovative design element that permits participating regulated financial entities to lend to nonconventional entities (agricultural suppliers, agroindustries, agricultural cooperatives) who then on-lend to rural entrepreneurs. The amount disbursed through this last channel has been modest but allows greater penetration and improved management of risks in the case agricultural processors use marketing contracts to ensure repayment.

Analysis of MicroGlobal Loans

Design Issues

The MicroGlobals adhere to a set of explicit and implicit assumptions. The following apply to the vast majority of programs in execution and clearly affect the likelihood of project success:

- Effective demand for credit exists on the part of small- and microentrepreneurs.

[27] See Evaluation Reports(Paraguay, Ecuador, El Salvador), Executing Agency Periodic Progress Reports, PPMRs. PCRs.

[28] Data are not available for Uruguay.

- Regulated intermediary financial institutions (IFIs) are interested in serving the microenterprise sector and will adopt the appropriate financial technology to lend effectively to the sector.

- Executing agencies are capable of managing the credit, technical assistance, and environmental oversight components.

- Macroeconomic stability is sufficient and the costs of financial intermediation in the borrowing countries are within reasonable bounds so as to allow for successful program implementation.

- Banking regulation and supervision are adequate.

- Participating financial intermediaries can reach rural sectors. No intrinsic program impediments exist that would inhibit rural penetration.

In practice, these assumptions have not held true in several instances. First, regulated financial institutions cannot be persuaded to provide services to the microenterprise sector just with the existence of a line of credit that reduces funding risk. In country after country, the amount of commercial bank interest has been tepid. In Peru, El Salvador, Nicaragua, Costa Rica, Paraguay, only a few commercial banks and finance companies have accounted for the vast share of disbursements. In order to penetrate the sector, IFIs have to be motivated by profit, and they must also make a commitment to mastering new credit delivery technologies and making other necessary changes. These tasks are daunting and will be assumed only by institutions with highly motivated leadership (see Wenner and Campos, 1998). The participating intermediaries who accounted for the largest share of disbursed funds tended to be transformed NGOs (Financiera Calpia in El Salvador, Financiera Familiar in Paraguay); entities already expert in consumer finance who migrated to microenterprise lending (Banco de Orion-Peru, Banco del Trabajo-Peru, Financiera Visión-Paraguay), or recently created specialized microfinance institutions (*cajas municipales* and *cajas rurales* in Peru).

Second, the asset quality of participating intermediaries, in particular, those with a rural concentration, tends to be poor. In Costa Rica and Nicaragua, the two leading program participants have experienced problems with delinquency, which has barred them from accessing the line of credit for periods of time. In Peru, the principal intermediaries serving rural clients, the *cajas rurales* (CRACs), have been plagued with delinquency and governance problems. Of fifteen CRACs, only three have qualified to participate in the MicroGlobal program (see Nunura and Portocarrero, 1998). In addition, a commercial bank-NGO linkage scheme, pioneered by Banco Weise, one of the strongest and oldest banks participating in the MicroGlobal program, has not worked as planned (see Nunura and Portocarrero, 1998). The organizational weaknesses of the NGOs have affected the maintenance of asset quality.

Third, in a number of loan programs the executing agencies encountered difficulties in coordinating all elements, especially the technical assistance component and the hiring of consultants (Costa Rica, Argentina, and Peru). In some instances, insufficient technical assistance resources and scheduling delays did not allow the environmental components to mesh with the lending activities. Didactic materials and training sessions were not completed in time for the first disbursements of credits and there were limited funds for ample extension outreach to microentrepreneur clients. Moreover, participating banks generally saw the environmental controls as cumbersome and ineffective.

Fourth, excess liquidity dampened interest in some of the countries (El Salvador and Nicaragua). Banking crises in other countries precipitated a sharp rise in interest rates, lowering loan demand for a time (Paraguay and Costa

Rica). In Guatemala, failure to come to agreement on a suitable second tier institution as the executor, delayed the declaration of eligibility and disbursement of funds for years.

Fifth, the property rights and banking regulatory frameworks in two of the countries, Nicaragua and Costa Rica, are not yet fully conducive to rural microfinance operations. In Nicaragua, the unresolved issue of land tenure creates investment uncertainty. Over 80 percent of the land area is under a titling cloud. In addition, the Nicaraguan regulatory authorities have yet to decide whether to create a narrow bank figure such as the Bolivian Fondos Financieras Privados (FFP) that may encourage greater discipline and consolidation in a market overcrowded with unsustainable, credit granting NGOs. In Costa Rica, the banking supervisory authorities have shown flexibility in provisioning rules for small loans (<$22,000) that permits profitable entry into this market segment. Nevertheless, the entire framework related to secured transactions needs to be improved. At present, delinquency control is difficult for every lender, but especially so for rural lenders that operated in a riskier environment.

Sixth, most eligible IFIs are based in urban areas and do not have the necessary branch infrastructure, staff with knowledge of rural productive activities, nor the inclination to enter a market segment that is even more risky than urban microenterprise. In three countries where significant rural lending occurred (Nicaragua, Costa Rica, and Peru) the leading participating entities had a rural presence. In the other countries, mostly regulated urban-based financial intermediaries participated. Since few private commercial banks are present in rural areas, the design implicitly precluded rural penetration.

Execution Issues

Institutional Capacity. Many MicroGlobal loan programs experienced start-up delays, problems with functioning of technical assistance programs for microentrepreneurs, enforcement of cumbersome subloan procurement requirements, and enforcement of environmental oversight requirements.[29] The latter two issues make lending even more costly than it otherwise would be. Except for Guatemala, there were no major problems with the functioning of the second-tier execution agencies. In the case of Peru, COFIDE consistently earned high marks for professionalism and efficiency.

Counterpart Funding. Only in the case of Costa Rica was there a known problem with pledged counterpart funding. The shortfalls and delays affected the technical assistance components, primarily programs to directly assist microentrepreneurs.

Monitoring and Supervision. Monitoring and supervision by the field offices were generally adequate. Bank staff made strong efforts to resolve problems in the two under performing projects—Guatemala and Costa Rica. In the case of Guatemala a successful resolution was achieved and the program is now performing satisfactorily.

External Conditions

For the countries in which participating intermediaries had a rural finance presence (Ecuador, Costa Rica, Peru, Nicaragua, and Paraguay), macroeconomic and sectoral conditions were much improved compared to a decade ago. However, in the cases of Nicaragua and Paraguay, the weak external conditions may have impaired the execution of MicroGlobals. In the cases of Ecuador, Peru, and Costa Rica, for example, lower inflation rates may have contributed to greater confidence to make real, productive investments as opposed to speculative ones.

[29] Project Performance Monitoring Reports.

Table 11
Financial Indicators of Participating Intermediaries with Rural Portfolios Selected MicroGlobal Credit Programs

Country	Financial Intermediary with Rural Portfolios	Estimated Size of Total Rural Portfolio	Avg. Loan Size	Annual Interest Rate	Most Common Term	30 Day Delinquency Rate
Costa Rica (Feb. 1997)	Banco del Comercio	$3.9m	$949	36-41%	6 months	9.2%
El Salvador (Mar. 1998)	Financiera Calpia	$3.075m	$450	30%	10 months	3.1%
Nicaragua (Aug. 1998)	BANCAFE	$16.9m	$5823	30-39% Cordobas 15-21% US$	13-24 months	na
Paraguay (Jan. 1998)	Financiera EFISA	$8 m	$8,998	42%	6 months	0%
Peru (Mar. 1998)	CRAC Selva Central	$6.1m	$4,066	63% Soles 27% US$	13-24 months	3.2%

MULTILATERAL INVESTMENT FUND: SUPPORT TO INTERMEDIARIES

The Multilateral Investment Fund was established in 1993 as a special fund administered by the IDB to accelerate private sector development and help improve the climate for private investment in Latin America and the Caribbean. The MIF's philosophy is to support private sector activities that are innovative and catalytic, yet financially sustainable. In the intermediary support area, MIF's goal is to assist promising financial institutions expand and consolidate themselves.

MIF projects can combine a financing component with a nonreimbursable technical assistance component aimed to improve the ability of an institution to deliver a particular service. The financing components (loans, equity, quasi-equity, and guarantees) generally generate market-based rates (6-20% depending on instrument and risk exposure). The range of project terms is two to eight years. The most common for programs that directly affect the provision of rural finance services is four years. There are two categories of projects that indirectly support rural intermediation: (i) equity investments in institutions that engage in rural microfinance or finance agroindustries or (ii) technical assistance grants to strengthen particular intermediary institutions or assist in the formulation and implementation of more appropriate and rational policies.

Between 1993 and 1998, the Fund approved 221 projects totaling US$414 million. Twelve projects, totaling US$21.6 million or 5.2% of total value approved, affect rural intermediation directly.[30] A third of the projects were approved in the 1998.

[30] Three regional projects—environmental NGO venture fund ($5 million), equity investment in Accion Gateway ($2.7 million) and , and guarantee fund LACIF ($3.75 million)—may have an impact on rural areas depending on how many rural focused groups are financed.

Table 12
Rural Finance Projects Supported by the Multilateral Investment Fund
Dec. 1998
(US Dollars)

Country	Title	Amount	Year
Bolivia	Strengthening Rural Credit Unions to Serve Microenterprise	800,000	1993
Bolivia	Equity Investment in Banco Caja de los Andes	2,000,000	1994
El Salvador	Equity Investment for Financiera Calpia S.A.	800,000	1994
Jamaica	Institutional Strengthening of Jamaican Coop. Credit League	1,900,000	1994
Mexico	Fund for the Development of Productive Projects in Rural Areas	6,200,000	1994
Dominican Republic	Strengthening of Rural Financial Intermediaries AIRAC	1,530,000	1995
Trinidad and Tobago	Institutional Strengthening of the Credit Union System	1,283,460	1995
Dominican Republic	Equity Investment in the Small Enterprise Bank (FONDOMICRO)	675,000	1996
Bahamas	Strengthening the Cooperative Credit Union	660,000	1998
Mexico	Equity Investment in Venture Capital Fund for Agroindustry	3,000,000	1998
El Salvador	Support to Organic Fruit and Vegetable Microenterprises	1,300,000	1998
Uruguay	Quasi-Equity Investment in FUCAC	1,500,000	1998
TOTAL	**12**	**21,648,460**	

Outcomes

In general, early MIF programs have performed satisfactorily, although several experienced start-up delays. Over time the number of annual project approvals has increased as would be expected. However, many recently approved projects are in early stages of execution, contract signing, complying with prior conditions, contracting consultant services, so that there are few tangible outputs to analyze. Two MIF projects supporting intermediary capacity building whose approval pre-date 1997 and have had time to yield results were selected for review (Institutional Strengthening of the Jamaican Cooperative Credit League and Equity Investment in Financiera Calpía-El Salvador).

Jamaica: The restructuring and strengthening operations for a second tier institution (federation office) in the Jamaican Cooperative Credit League progressed much slower than expected. When the project was conceived in 1993, the League had extensive coverage, especially in rural areas, but poor performance indicators. It suffered from fixed interest policies, low operational efficiency, and poor investment policies. The project sought to improve prudential norms, formalize a relationship with banking supervisory authorities, revise the legislation governing credit unions, standardize accounting procedures, help with mergers and liquidations, and develop five credit unions into models of excellence. Start-up delays and personnel turnover have plagued the project. Major achievements include drafting new prudential norms, eliminating mandatory credit union deposits with the League office; redrafting the League Charter, and revising procedures for the Central Finance Facility. The slower pace of execution can be attributed to institutional inertia and personnel issues. The reforms challenged the position and power of existing groups.

El Salvador: An equity investment to increase the capital base of a nongovernmental agency, AMPES/SC, and transform it into a regulated finance company, renamed Financiera Calpía, S.A., succeeded. The new entity has performed well and has extended microfinance operations from an urban base into the rural areas. In 1997, some 24 percent of its net outstanding loans of US$18.4 million was rural. Tremendous portfolio growth and diversification of products over the years has been matched with gains in operational efficiency, maintenance of asset quality, and high profitability. The success can be attributed to the combination of capable staff and management, access to external lines of funding, and a favorable economic climate.

Analysis of MIF Financial Intermediary Projects

Design Issues

The assumptions underlying MIF projects are not expressed explicitly but can be surmised from various project documents. MIF projects assume that effective demand exists for the financial, marketing, or training services offered. The executing private sector agency is committed, competent, and capable of achieving project goals. Moreover, the agent is not overly risk averse. The macroeconomic and political environment is not overly hostile and unfavorable to the attainment of project goals. In the two projects reviewed, not all the assumptions hold. However, it should be noted that the types of projects approved by the MIF tend to be generally riskier and more innovative than typical Bank operations. Whereas the first assumption clearly held, the others did not, in one case, creating problems. Institutional capacity and external risks were clearly identified but mitigating elements were few.

Execution Issues

Institutional Capacity. In the sample, the issue of "ownership" of the reform process was important in several instances. In the case of the Jamaican Credit Union League, the complexity of engineering the institutional reform slowed progress.

*Counterpart Funding.*No counterpart funding problems were reported.

Monitoring and Supervision. Supervision and monitoring seemed adequate in the reviewed sample of projects. The country office and headquarters staff discharged their duties well.

External Conditions

The Jamaican financial system has been under significant stress since 1995. In 1998, several large banks failed, prompting government intervention. One of the contributing factors to the crisis was a weak regulatory framework that did not adequately assess financial risk and address issues of regulatory arbitrage within financial holding companies. However, El Salvador's economy has exhibited strong growth and maintained macroeconomic stability during the execution period (1994 to present). On the regulatory front, however, there is some uncertainty. In December 1998, a new banking law was presented to the Legislature, seeking to raise the minimum capital requirements to US$12 million, up from US$2 million. The intent was to reduce the number of weak financial institutions in the system. A special exemption was given to Financiera Calpía, granting it 10 years to raise the additional capital in recognition of its strength and important role in serving the informal sector.

SMALL PROJECTS PROGRAM

The Small Projects Program (SPP) was established to benefit low-income and marginalized groups who lacked conventional access to credit by providing grants and concessional loans for the financing of productive, income-generating projects and strengthening local intermediary institutions.[31] The policy governing the program was revised in 1998 and the program's name was changed to Social Entrepreneurship Program (SEP). The purpose remained very similar but the terms and conditions as well as the types of eligible intermediary organizations changed.

Between 1980-1990, the typical small project consisted of a loan up to a maximum of $500,000 on highly concessional terms. The maximum term for amortization was up to 40 years, with a grace period of up to 10 years, an annual interest rate of 1 percent, a 1 percent commission on outstanding balances, no maintenance of value, and no government guarantee. Disbursement tended to occur in less than 30 months and payments of amortization were generally in local currency.[32] Parallel, nonreimbursable technical cooperation grants up to a maximum of $250,000 often accompanied the loan and could be used to finance fixed investments, equipment or services to improve the institutional capacity of the executing agency. The typical rural signatory was a nonprofit foundation, cooperative, or community association engaged in multipurpose development activities. The vast share of the loan was used for on-lending to sub-borrowers who used the loans to finance fixed and working capital needs at rates of interest not superior to prevailing development bank preferential rates for small scale farmers. The ultimate beneficiaries tended to be low-income, medium and small farmers who satisfied income and asset tests appropriate for that particular country and region as stipulated in the credit regulations (GN-1373-1, 1985). They tended to reside in areas underserved by private commercial and state development banks.

Since 1990, the Small Projects Program has become increasingly specialized in credit programs for microenterprises. More than 80 percent of the funds in a given year have supported NGOs engaged in microfinance. Like the earlier SPPs, the typical project involves a

[31] See Operational Policy for Small Projects Financing Program (OP-706) of 1982.

[32] See Evaluation of the Program for the Financing of Small Projects (GN-1373-2). Operations Evaluation Office, August 1995.

loan to help establish a revolving loan fund accompanied by a technical assistance grant to help the intermediaries to develop appropriate microfinance technologies, improve management, purchase equipment and vehicles and/or make fixed investments. But the difference now is that many recipients are engaged in nonfarm activities, particularly commerce, handicraft production, and small-scale industry. The main differences in the SPPs approved in the 1990s compared with the late 1970s and 1980s was a tendency to move to stricter terms.[33]

General Trends

Fifty-two small projects were approved between 1978 and 1992 that had a strictly agricultural credit focus.[34] Unlike the Agricultural Credit Globals and the Integrated Rural Development projects there was a more even distribution of these resources across countries with, twenty different countries receiving funding. Bolivia and the Dominican Republic were granted to greatest amount of financing. Together, they received 25 percent of total small project agricultural credit. Over time, the number of projects of this nature trended downward. The narrow focus on agricultural financing was replaced by an emphasis on financing intermediaries with more diversified portfolios and with strong indicators of financial health.

Beginning in 1990, the number SPP operations increased, peaking in 1993 and then declining in later years due to the limited availability of funding (Table 21). Over time, the percent of SPPs that are credit-oriented has shown an upward trend. Of the 168 SPPs focused on microcredit that were approved between 1990 and December 1998, an estimated 36 (or 21 percent) had rural credit components.[35]

As can be gleaned from Table 14, the estimated amount of the credit-oriented SPPs, not specifically designated as "agricultural credit," that benefits rural producers (farmer or nonfarmer), is estimated to be about 21 percent.

Outcomes

The results of the 1985 evaluation of the Small Projects Program was generally positive. It commended the program for successful outreach to the target population, maintenance of tolerable loan delinquency, and institutional strengthening. The report found that the number of low-income beneficiaries, especially women and youths, exceeded the ex ante projections by 29 percent for the 22 projects sampled. In approximately half the cases, the average income level of borrowers was below the low-income benchmark set for the country, in 9 cases the benchmark was met, and in only 3 cases the beneficiaries reported income greater than the benchmark. As for loan delinquency, in 13 of 18 cases with available data, the delinquency rate was less than 10 percent. Intermediaries increased loan portfolios, improved relations with other public and private entities, and began to mobilize additional resources to undertake more complicated projects, indicating growth in institutional capacity.[36]

[33] The newer post 1990 terms and conditions are: (1) Shorter amortization periods (10 -25 years as opposed to 40); (2) Market-based rates of interest (not pegged to subsidized state development rates); (3) Stipulations for cessation of disbursements if arrears were high (>5% or >10%); and (4) Emphasis on adopting new microfinance technologies and improved management information systems.

[34] Starting in 1990, many of the SPPs began to be classified as OT-CRE in the Bank's operational database even if they had an agricultural or rural focus. After 1992, no SPPs have been classified as AGR-CRE(agricultural credit), representing the change in philosophy of promoting sustainable microcredit without emphasizing the destination of the credit.

[35] Note, that these figures do not include SPPs that were classified as agricultural credit operations. Note further, that this estimate is base on the word "rural", "campesino" or "agricultural" appearing in the name of the beneficiary group or reports from the project officer. The reported amount is believed to be underestimated.

[36] See Evaluation of the Small Projects Program, GN-1373-2 p. 7.

Table 13
Distribution of Agricultural Credit Small Projects
(US$)

Country	Amount	Percent	Operations
Bolivia	3,499,244	14.7	8
Dominican Rep.	2,475,000	10.4	6
Uruguay	1,500,000	6.3	3
Panama	1,500,000	6.3	3
Nicaragua	1,500,000	6.3	3
El Salvador	1,500,000	6.3	3
Costa Rica	1,500,000	6.3	3
Argentina	1,500,000	6.3	3
Honduras	1,300,000	5.5	3
Paraguay	1,000,000	4.2	2
Jamaica	1,000,000	4.2	2
Brazil	1,000,000	4.2	2
Peru	900,000	3.8	2
Haiti	840,000	3.5	2
Venezuela	500,000	2.1	1
Trinidad & Tobago	500,000	2.1	1
Mexico	500,000	2.1	1
Colombia	500,000	2.1	1
Guatemala	400,000	1.7	2
Guyana	330,000	1.4	1
Total	**$23,744,244**	**100.0**	**52**

Source: IDB

Table 14
Small Projects Approvals 1990-1998

Credit Operations Approvals			Estimated Rural Credit		Total SPP Approvals		
Year	**Amount (US$)**	**Number**	**Amount (US$)**	**No.**	**Amount (US$)**	**Credit %**	**Rural Credit %**
1990	500,000	1	0	0	7,700,000	6.5	0.0
1991	7,050,000	15	1,250,000	3	26,000,000	27.1	4.8
1992	14,800,000	32	1,000,000	2	29,200,000	50.7	3.4
1993	19,300,000	39	5,000,000	10	32,600,000	59.2	15.3
1994	9,000,000	18	1,000,000	2	14,300,000	62.9	6.9
1995	9,980,000	22	1,950,000	4	20,400,000	48.9	9.5
1996	2,900,000	6	0	0	4,000,000	72.5	0.0
1997	9,655,000	20	1,655,000	4	12,000,000	80.5	13.8
1998	5,753,000	15	4,733,400	11	7,149,900	80.0	66.2
Total	**78,938,000**	**168**	**16,588,400**	**36**			

The areas of weaknesses included high administrative costs in loan preparation and processing for the IDB, coordination and timing problems in the implementation of the technical assistance components, and most significantly, the inappropriate pricing of the subloans by the executing institution. In the vast majority of projects reviewed in the evaluation reports and in the sample below, the final lending rate to sub-borrowers was pegged to the interest rates charged by the state development banks and not indexed to account for inflation. Since the reference rate was subsidized and often negative in real terms, this pricing policy by organizations receiving SPP funds, contributed to the decapitalization of their revolving credit funds over time. Because of this lack of institutional viability, there was an urgency to seek fresh concessional funds constantly, creating a dependency on donor agencies.

Later evaluations were not so favorable. In 1991 the External Review and Evaluation Office conducted a study entitled, "IDB and Microenterprise: A Development Strategy for the 1990s." This study reviewed four SPPs, one of which had a rural focus. This latter project, located in Mexico, was found to have experienced a series of problems that threatened program viability and limited the beneficial impacts for sub-borrowers. Arrears were high in the 1984-90 period, averaging 37 percent, interest rates were negative in real terms, late disbursement were common, and amounts lent were insufficient to allow artisans to change production technologies. At the time of the evaluation the same dependence on middlemen for inputs and marketing outlets continued. In 1994, Interdisziplinäre Projekt Consult GmbH (IPC) conducted another, more extensive evaluation of 16 SPPs that financed revolving funds. Out of the total, five were wholly rural and three had portfolios in both rural and urban areas. The financial performance of the rural group was generally worse than the rest, and was marked by lower staff productivity and lower effective rates of interest, resulting in higher levels of decapitalization.

Two SPPs were examined in greater detail (Nicaragua SP/TF-79-10-NI and Costa Rica SP/SF-91-11-CR) for this study. The patterns found were similar to those found in the two larger evaluations. The projects involved a coffee cooperative in Nicaragua and a canton

level farmers association in Costa Rica (Centro Agrícola Cantonal, CAC). The two projects disbursed without problems and reportedly had a positive income impact on sub-borrowers. Both projects also had technical assistance components designed to strengthen administrative capacity. The main difference was in pricing policy. The Nicaraguan cooperative charged an interest rate of 13 percent (real negative >100% in 1982-85 period), while the Costa Rican CAC charged interest rates greater than 35 percent (in the 1990-94 period). The Nicaraguan cooperative did not report delinquency data. Arrears for the Costa Rican CAC were less than 10 percent.

Analysis of Small Projects

Design Issues

The small projects studied had several common design assumptions , among them were the following: (i) nongovernmental intermediary organizations can reach a targeted low-income clientele effectively; (ii) the revolving fund can be capitalized and protected from loss of purchasing power through appropriate pricing; (iii) the managerial capacity of the intermediary institution can be improved through consultancy services of short duration (less than 36 months); (iv) effective demand exists for the credit services provided; and (v) external conditions will be favorable or neutral to project execution.

For the most part, the assumptions were valid in the cases examined. Clearly there was a strong credit demand and the nongovernmental organizations based in rural areas effectively reached the targeted clientele. In the sampled projects, disbursements to small borrowers were made within the stipulated period. The attempts to maintain the value and even capitalize the revolving funds succeeded in Costa Rica but not in Nicaragua. The provision of technical assistance also seemed effective.

The question, however, is what is the proper role of the SPP in relation to other instruments at the disposal of the Bank and whether selection criteria should be more rigorous given the limited availability of funding. The cost effectiveness of the SPP as a stand-alone instrument is limited and other follow-on operations are likely to be needed. NGOs tend to have informational and mission focus advantages compared to formal financial intermediaries. Private commercial banks are often too distant, bound by different strategic objectives, and subject to regulations that make serving clients who demand low volumes of services relatively more expensive Consequently, they do not deliver an appreciable amount of services to poor rural producers. NGOs, nonetheless, have some serious weaknesses, including limited managerial and technical talent, poor support infrastructure, small capital bases, highly concentrated loan portfolios, and a social as opposed to a business-like approach to intermediation. Technical assistance grants were used to correct some of the weaknesses, but fixed limits on the amounts available could have been a constraint in certain cases. The question becomes: How much support will be necessary to convert a few of the most promising NGOs into permanent viable intermediaries?

The early SPPs focused on agricultural credit, the “need for a credit subsidy” and other fallacious assumptions of the directed credit paradigm (DCP), wich helped undermine the long-run sustainability of the various credit programs financed. Another mistaken assumption was the belief that SPP sub-borrowers would “graduate” to commercial and development banks. In hindsight, small borrowers, even those with a good repayment record, have other problems. They cannot transmit information about their creditworthiness to distant formal lenders, because there are either no credit bureaus in the country or none that track NGO lending. Traditional banks are bound by documentation and provisioning norms that penalize borrowers without secure collateral. Traditional banking technologies are too costly to process small transactions. Despite these problems, there was a reluctance to fund

organizations more than once. Over time, the credit granting nongovernmental organizations supported by the IDB became decapitalized and clamored for more concessional funding, justifying their worthiness by excellent outreach and the failure of formal banks to respond. Successful low-income SPP sub-borrowers were still largely excluded from conventional sources of credit for lack of real collateral and the small size of their loans, despite good repayment histories. In the later credit-oriented SPPs, in general, the sustainability and quality of management assumptions seem to be questionable in several instances.

Execution Issues

Institutional Capacity. The institutional capacity of the intermediaries varied. The groups tended to perform administrative and operational functions generally well, but were uniformly weak on financial management (inadequate provisioning for bad debt, and insufficient interest rate differential that would cover all operational costs, that is, permit capitalization of the loan fund). Outreach to the target group was excellent and loan recovery was superior compared with Agricultural Credit Globals, wherein the disproportionate share went to larger farmers. Nevertheless, few of the organizations were viable and efficient intermediaries.

Counterpart Funding. For the pre-1990 project reviewed, no counterpart funding was required, so it was not an issue. In the post-1990 sample, no problems were reported.

Monitoring and Supervision. According to the 1985 OEO report, the degree and quality of supervision provided by the country offices was uneven. The small projects tended to increase the work burden of sectoral specialists, especially in countries with a large number of SPPs. Some staff fully identified with the program and others considered the amounts involved too small to merit the large investment in time needed, given the institutional weaknesses of most of the beneficiary groups. In later evaluations, the work load associated with monitoring SPPs was not reported as problematic.

External Conditions

Through the 1980s, the macroeconomic environment in most of the countries in the region was not favorable. For the countries in the sample, Nicaragua and Costa Rica, project settings were opposite. Nicaragua experienced hyperinflation, large deficits, and civil unrest in the 1980s. The year the project was approved coincided with a political revolution and an open counterrevolution started in 1981-1982, the early years of project execution. In contrast, Costa Rica, in the early 1990s, had a generally more favorable environment.

VI. Lessons Learned and Recommendations

The IDB has had extensive experience with a variety of project types and instruments designed to promote the expansion and deepening of rural financial services in Latin America and the Caribbean. Although the review of IDB projects included in this report is far from exhaustive due to the lack of data on project outcomes in a number of cases, it nevertheless serves to identify some very important lessons for the design of future programs. These lessons are organized in three categories that reflect the broad objectives of the projects reviewed: (i) targeted credit programs that serve to expand the supply of credit to rural producers or small enterprises (both rural and urban); (ii) policy, legal and regulatory reform programs, through technical cooperation, loan conditionality and sector loans; and (iii) investments in institution-building for financial institutions with capacity to provide services to rural producers on a sustainable basis.

EXPANDING THE SUPPLY OF RURALCREDIT: THE ROLE OF TARGETED CREDIT PROGRAMS

The directed agricultural credit schemes financed by the Bank before 1989 produced disappointing results. Intended to expand access to credit for small farmers by channeling loans through agricultural banks and other financial institutions at low interest rates, these operations served instead to distort rural financial markets, undermine the viability of many participating financial intermediaries, discourage savings mobilization, and disproportionately benefit higher income borrowers.

Although the Bank has not approved an agricultural credit loan in the past ten years, it continues to finance two other types of targeted credit programs: Multisector Credit Programs and Micro and Small Enterprise Global Loans. These operations provide financing for businesses of a specific size (micro and small business) in one case, and for a specific purpose in the other case (medium- to long-term financing for investment purposes). In contrast to the agricultural credit programs, however, these more recent instruments do not permit interest rate subsidies. They include mechanisms designed to avoid some of the problems of the earlier targeted credit programs in terms of decapitalization, high arrears, disincentives to savings mobilization, and rationing of credit to higher income or politically connected borrowers.

In the 1990s, the use of non-subsidized but size-targeted lines of credit (average loan size limits that favor use by small- and microentrepreneurs) succeeded to some extent in improving outreach in urban markets without undermining financial market development, but penetration in rural markets has been limited to date, reaching a modest number of rural producers in six countries. MicroGlobals and their lines of credit do not seem efficacious as a lure to get regulated financial intermediaries to serve the rural sector, but rather a facilitator that allows a financial entity with a preexisting strategic commitment and profit motive to expand service to the rural microenterprise market. Examples include the CRACs in Peru, Banco del Comercio in Costa Rica, BANCAFE in Nicaragua, and Financiera Calpía in El Salvador. The share of financial intermediaries participating out of the total number of potentially eligible intermediaries in MicroGlobal loans has been small, except in the case of Argentina where the original intention was to emphasize service to small urban entrepreneurs. In short, the Bank's experience with these operations has shown that simply injecting liquidity into the financial system will not achieve massive outreach to small-scale borrowers, urban or rural.

Credit Pricing

The assumption that low-income producers, including farmers, could not afford to pay the high, market-based rates of interest that often accompanied Global Credit programs has been proven incorrect in program after program. Research both inside and outside the Bank has shown that small scale borrowers are more sensitive to the non-financial costs of the transaction (processing fees, travel costs, and income lost due to delays in approval and disbursement) than to the financial costs (interest payments). In the sample of participating intermediaries in MicroGlobal loans with rural portfolios, positive real interest rates are being charged and demand for the service continues to be high as indicated by growing portfolios. The sector most commonly financed is commerce, however. The high rates of capital turnover that are possible in commerce permit the servicing of a short-term, high interest rate loan. Productive projects in agriculture and industry have longer gestation periods and therefore lower capital turnover ratios, creating a need for long-term loans and a higher sensitivity to debt service loads. The longer the term the greater the risk due to price uncertainties and external shocks. Therefore, greater intermediary competition, cost saving innovations in financial service delivery, greater domestic savings, and better macroeconomic management are needed to reduce intermediation spreads and lower the opportunity cost of capital in the economy.

Credit Evaluation and End Use

In the period 1960-90, the Bank restricted the use of loans provided under the global credit operations to investment in fixed assets in so-called productive sectors (agriculture and manufacturing). The innovative and non-traditional Small Projects Program paved the way for a change in thinking. . By the early 1990s, lending for commerce had become the basis of microenterprise lending in this program.

The MicroGlobals also allowed for lending to any economic sector, including services and retail trade. In modest and low-income households, rural or urban, the separation between business activities and household consumption activities is blurred. Thus, microcredit often combines the features of both commercial and consumer lending. In conducting loan evaluations, a household model of analysis in which all business and personal incomes and expenditure flows are included in the calculation of repayment capacity may be more appropriate. Similarly, stipulations about the end use of the funds are often unenforceable. Farm budget and demand estimation models developed in the heyday of the directed credit paradigm were methodologically unsound since they ignored the fungibility of credit and oversimplified household decision-making processes.

In the future, the challenge will be to understand better the dynamics of intra-household decision-making. The assumption of one, all powerful and benevolent decisionmaker may not be appropriate for all circumstances. Gender issues, internal distribution of power and command of productive resources complicate the loan evaluation process and can affect both willingness and ability to repay. As the new rural intermediaries, who use the household approach, mature and expand, we will learn more about the implications of this method of evaluation.

Second Tier Institutions and Wholesalers

The IDB's experience with MicroGlobals and Multisector Credit operations shows the importance of appropriate action by second tier (ST) or wholesale credit institutions. Properly designed and functioning wholesalers can channel funds to privately-owned institutions in a transparent manner (credit auctions) that does not undermine deposit mobilization efforts yet assures a stable source of funding and promotes deepening and innovation. The Bank's Multisectoral Global Credit programs helped to strengthen a number of public sector ST institutions including, for example, those

in El Salvador, Bolivia, and Peru. However, strengthening these institutions can be risky because it may end up creating a stronger constituency for state intervention in financial service delivery. An attempt to create a private second tier institution in the Guatemala MicroGlobal did not succeed and the project was delayed for three years, and ultimately reformulated. In any case, the apex role is not likely to be very effective without a competitive and efficient first tier system that will assume the risks and adequately discharge project evaluation and monitoring tasks. Furthermore, the Bank's MicroGlobal and Multisector credit experience shows that great care must be taken to avoid arbitrary allocation and pricing of long-term resources that can lead to rent-seeking behavior on the part of first tier intermediaries, welfare losses, and an unhealthy dependency on the apex institution for long-term funding (See Annex 3).

CREATING THE CONDITIONS FOR THE EXPANSION AND DEEPENING OF RURAL FINANCE: POLICY, LEGAL, AND REGULATORY REFORM PROGRAMS

Laws governing property and individual rights, and regulations governing businesses and financial intermediation should be comprehensive, consistent, comprehensible, and fair. Of particular importance for financial intermediation is the ability to create, perfect, and enforce security interests; a clear delineation of the powers of and limitations of financial institutions; a clear definition of rights and responsibilities associated with a variety of financial instruments; and the rights of government to supervise and intervene when necessary in the affairs of financial institutions and/or circumscribe the use of specific instruments and transactions when they are deemed unsafe and imprudently managed.

Over the 37 years of the review, the IDB's rural finance activities have evolved from placing a heavy emphasis on expanding the supply of rural credit to placing more attention on making sure the financial architecture is right, i.e. on improving the regulatory framework that facilitates the development of rural financial services (452 credit projects compared with 57 policy reform and regulatory projects). The projects that addressed financial policy, legal, and regulatory issues were approved in the 1990s and have focused on first order problems (elimination of fixed interest rates, modernizing banking laws to permit greater competition, applying the norms of the Basle Committee, and strengthening and professionalizing the superintendencies). Despite substantial success, much still needs to be done to consolidate the gains from the first round of reform and to extend reform efforts to reduce other imperfections. Some second generation interventions that specifically tried to improve the framework for secured transactions, an area that would greatly help collateral constrained clients gain access to formal intermediaries, such as the Haiti Bankable Property Rights project and the Guyana ISL (Bankable Service Component), were well conceived but encountered implementation problems due to political instability and institutional inertia.

The lesson to be learned is that these types of interventions should be promoted but particular attention must be paid to the political economy surrounding their implementation. Vested interests exist that benefit from the status quo and opposition to change is likely. The reform process will have to either convinced or overcome opposing interests. In addition, these innovative projects may be best attempted first in countries with greater political stability or where advocates for microenterprise interests are better organized and more powerful, to serve as a counterweight in the political arena.

In the area of prudential regulation and supervision, much also needs to be done to identify the biases that may impede rural and microfinance intermediation, especially in the areas of licensing, minimum capital requirements, asset risk classification, documentation, and

provisioning. To date there is little evidence on how the projects that strengthen supervision have improved rural intermediation. Further research and analysis are needed in this area. There are many complementary reforms needed in titling, judicial reform, and disclosure laws that would improve the conditions for lending and its supervision.

The Bank's financial, investment, and agricultural sector loans played a significant role in liberalizing trade, pricing, and financial markets in Latin America and the Caribbean. They helped increase returns to agriculture and other productive activities in rural areas, though the supply response may have been constrained by sharp reductions in public investment in rural infrastructures. Nonetheless, less progress was noted in rural finance, especially in reforming and restructuring state-owned financial institutions, the predominant suppliers of rural credit until the start of reform programs. The principal problem was lack of borrower commitment and a political interest in maintaining formal institutions in rural areas since commercial banks are reluctant to serve them

IDB-supported attempts to reform and restructure state agricultural development banks in the early 1990s (BANADES-Nicaragua, BANDESA-Honduras, Banco Agropecuario de Fomento-El Salvador, Agricultural Credit Bank-Jamaica, and Agricultural State Bank-Trinidad and Tobago) did not yield positive results, probably due largely to lack of borrower commitment. The Peruvian experience, however, did yield significant results–the liquidation and closing of a loss producing state owned agricultural bank–but left a void in the rural financial landscape that has yet to be satisfactorily filled. This review of IDB sector lending shows that change in rural finance happened if there was a prior strong commitment to reform. The balance of payment support provided by IDB loans generally served to reinforce this commitment, but was not the main determinant of reform efforts.

Often, rural finance was recognized a priori as a difficult area and expectations for major changes were low. Other times, the achievement of substantial reforms in other areas, deemed of high importance in restoring sustainable economic growth, was accepted and compensated for slower progress in the rural finance area. Sometimes the lack of macroeconomic consistency undermined and limited the performance of sector loans, for example, in the case of the Jamaican ASAL. In other cases, such as Nicaragua (ASAL) and Trinidad and Tobago (ISL), the political value of maintaining a weak state-owned intermediary seemed to have outweighed the financial losses incurred, and attempts at radiccal reform were undermined.

The lessons that stems from this experience is that the issues surrounding rural finance are complex and may require more focused and narrow operations, preceded by thorough diagnostic work, careful consensus building, and political commitment prior to loan approval. Because so much of the reforms needed in rural finance are of an institutional nature, the gestation period tends to be long and the leverage from fast disbursing sector loans is greatly diminished.

SUSTAINABLE AND PERMANENT PROVISION OF SERVICES

Institution Building

The belief that the provision of lines of credit to private formal intermediaries would be sufficient and succeed in assuring a permanent and stable supply of financial services to the target low-income and collateral constrained clientele is often incorrect. The provision of technical assistance may be more important. Evidence suggests that the creation of sustainable financial intermediaries requires identifying organizations with strong leadership; a clear mission to assist the rural small- and microenterprise sector; a business-like approach; a proven microfinance technology; and the

creation of a partnership with these organization to address institutional weaknesses.

Although the MicroGlobals have succeeded in serving a significant number of rural producers in six countries, the experience with these loans has also shown that injecting liquidity into financial systems will not achieve massive outreach to small-scale borrowers, urban or rural. The key to success in motivating existing commercial banks to serve rural borrowers seems to rest in helping them to overcome barriers to entry into this market. Technical assistance in the global loans and other operations has therefore focused on making the proposition of lending to the poor more profitable and less risky by transferring appropriate technology. Both the technical assistance and the line of credit that may be afforded by a global loan serve more to facilitate the entrance of already interested institutions into this market, rather than inducing those that have no prior interest to discover microfinance for the first time, and this seems even more pronounced in rural markets.

The Bank has had some promising experiences with support to individual institutions, both in the Small Projects Program and in MIF operations. The Bank's relatively short history of such institution building is greater in urban microfinance, but some experiences in rural markets as well as general lessons from all these programs can provide guidance for future operations.

For example, the IDB has engaged in successful institution building with the transformation of several NGOs into regulated financial intermediaries. The best-known NGOs in the region, supported over the last decade by both the Small Projects Program and the MIF, are: Prodem-Banco Sol (Bolivia), ADEMI-BancoAdemi (Dominican Republic), Caja los Andes (Bolivia), AMPES/SC-Financiera Calpía (El Salvador), and FondoMicro-Banco de la Pequeña Empresa (Dominican Republic). It should be noted that each of these transformed NGOs was the recipient of multiple Bank operations, suggesting that longevity in the relationship is important. Some of these institutions have also obtained access to IDB-funded global microenterprise programs, which have allowed them to grow at a faster rate than they otherwise would have. Of these institutions, the last three have both a presence in rural areas and good current financial performance. Two more NGO conversions are under the way—AgroCapital and Prodem—both in Bolivia and both with a pronounced rural orientation. The success of these transformed NGOs should reduce segmentation in financial markets and allow better portfolio diversification.

Instrument Selection

In promoting policy reform, intermediary development, and expansion of financial services to medium and small scale rural entrepreneurs, the Bank has several instruments that have varying degrees of effectiveness depending on the circumstances. Existing Bank instruments can be refined and better coordinated to meet the challenges of rural finance in the region.

Wholesale credit operations (Multisectoral Globals and MicroGlobals)

Wholesale credit operations can reach rural producers, but their role is limited. They work best in serving rural clients when there is a pre-existing density of financial intermediaries active in rural areas and when agrarian production accounts for a large percentage of domestic output and employment. Depending on the circumstances in a given country, these operations can include policy conditionality to improve the environment for financial intermediation, technical assistance to build institutions, and measures that reinforce the effects of the expansion of the supply of credit.

Sector Loans

In pursuing legal, regulatory, and institutional reform, the sector loans seemed effective at resolving only a certain type of problem.

Gross distortions (interest rate ceilings, etc.) have been corrected in many countries but narrower and more focused operations seem to be needed to remove remaining imperfections (lack of credit bureaus, more efficient public registries and poorly functioning legal systems, etc.). Unless there is a strong pre-existing commitment to reform and develop rural finance markets, member governments may not be inclined to accept the conditionalities to borrow for these types of operations that have long gestation periods and are dependent on the actions of multiple and independent agents for compliance with the conditionality (e.g., cooperation between an executive branch agency, a legislature, the court system, and the legal profession). Moreover, extensive prior economic and legal diagnostic studies may be necessary to understand the constraints and interrelationships. Therefore, these imperfections may be better addressed with individual MIF or technical cooperation operations.

Multilateral Investment Fund

MIF operations lend themselves well to both surgical interventions in the policy reform area (Window I) and to institution building of specific financial intermediaries (Window III). In the future, the demand for this instrument should be high. The challenges will be good screening, effective coordination with other programs, and effective monitoring and supervision to increase the chances of success. In order to have sustainable financial institutions, bankable clients, and a variety of complementary investments to reduce risk and increase rural productivity are needed.

Small Projects or Social Entrepreneurship Projects

The future role of the Small Projects Program (renamed Social Entrepreneurship Program (SEP) in December 1998) in promoting rural financial market development is limited. It can serve as seed capital for a selected number of rural intermediaries and support business development services and productive investments in rural areas that will complement the development of the rural financial system. At present, the trend of approvals for small projects emphasizing rural credit is upward. It seems to be serving as a stop-gap measure to provide credit to low-income rural groups excluded from formal markets. Nonetheless, sustainability, scale of operations, and funding availability issues remain. An important question will be whether to follow a first-come, first served selection policy depending on availability of funding or to be quite selective and try to support the most promising institutions in terms of transformation potential.

PROGRAM EXECUTION: MONITORING AND SUPERVISION

As with all projects, the critical elements to successful execution of rural finance operations are clear and realistic goals, competent and committed management, honored counterpart funding, adequate and timely supervision, and a generally favorable external environment. The Bank's project design and preparation process generally succeeds in clearly identifying the constraints and developing a feasible solution to the problem on hand. Three areas of recurrent weaknesses emerged in the review of projects in rural finance.

First, the time, resources, and appropriate conditions needed for the herculean task of reforming financial institutions can be easily underestimated. The consensus-building and leadership skills needed to engineer a change sometimes did not coincide with the fast disbursing tranche design of sector loans.

Second, timely technical interventions by Bank personnel in difficult operations, especially those involving complex policy and institutional reforms, were sometimes lacking. Given the nature of these operations, the technical capacity of the field office can become overextended. Often, the need to identify with the project protagonists and play the role of ombudsman and advisor conflict with the need

to comply with strictly administrative duties. As a result, delays occur and project progress slows. Similarly, headquarters staff involved in the design of the operation often cannot pay close attention to projects in execution due to pressures to approve new projects. In short, the structure of incentives in place within the Bank emphasizes approvals and not high-quality follow through and successful execution.

In rural finance, the real problem is not lack of liquidity in financial systems, but the lack of an appropriate legal and regulatory environment that will lower intermediation risk, the lack of institutional commitment and capacity, and the lack of appropriate technology. The investments needed are not high-priced but rather human intensive. Many critical reforms needed to lower the cost of rural intermediation involve consensus-building, restructuring existing institutions, changing governance incentives, training staff, computerization, and passage of new laws and regulations. Therefore the technical assistance components are relatively more important than other components and may require more intensive participation by Bank technical staff in the monitoring and supervision of execution. Also, greater flexibility to adjust the program to changing conditions may be needed in order to increase the chances of success of individual projects and create models for dissemination and replication in other countries.

Third, there is a paucity of verifiable project risk mitigating elements. Many project documents pinpoint the external factors that could impede project goal accomplishment such as: (i) macroeconomic stability, (ii) dependence on the legislative branch to pass a law; (iii) commitment by key stakeholders to support reform efforts; (iv) buoyant demand conditions, (v) availability of counterpart funding, etc. However, few projects have been explicitly structured to cope with these threats. If conditional probabilities for a set of risks, ranked by likelihood of occurrence and severity of consequences given occurrence, were developed, then contingent plans could be developed for the most probable, adverse events. Some slowness in project progress and disbursement may, in this way, be eliminated. There is no clear cut fall-back position in the cases where the level of commitment and the necessary coordination is not forthcoming as planned. A possible suggestion would be to contemplate adaptable operations that are not so rigid and would allow rethinking and redesign based on commitment, the level of technical competency of the executing agency, and the unfolding of external developments.

Conclusions

In summary, from past experience, the Bank has learned much more about what does not work and less about what does work in operations that aim to improve rural finance. What seems to explain project success is the rare confluence of good design, talented and committed people, a proper alignment of political and economic interests, institutional capacity, and favorable external conditions. Looking to the future, redoubled efforts seem to be needed to create an environment conducive to rural financial intermediation through improvements in the legal/regulatory/policy framework. At the same time, more work is needed to build strong financial institutions. Both activities can occur simultaneously, but some minimum level of stability and consistency in the overarching framework is necessary to have success in building institutions.

While the arsenal of available instruments seems more than adequate, refinement may be needed in the design, approval, and monitoring processes. Areas of possible improvements may include continuing to make operations more flexible and adaptable to changing conditions during implementation and devoting more resources to monitoring and supervision. The possibility for quick redesign and/or phasing during execution and performance driven disbursements seem to be key features to consider in new operations. The main lesson, is that the problem of rural finance is not one so much of limited supply, but of policy and institutional constraints that need time and dedication to resolve.

References

Besley, Timothy. 1994. How Do Market Failures Justify Interventions in Rural Credit Markets? In *The World Bank Research Observer* 9: 27-47.

Besley, Timothy and Kanbur, F. 1990. *The Principles of Targeting.* Policy, Research and External Affairs Working Paper No. 385. The World Bank, Washington, D.C.

Chaves, Rodrigo, and González-Vega, C. 1994. Principles of Regulation and Prudential Supervision and their Relevance for Microenterprise Finance Organizations in *The New World of Microenterprise Finance*, edited by Maria Otero and Elisabeth Rhyne, West Hartford, CT:Kumarian Press.

____________, and Sanchez, S. 1995. 1995. *Mexico: Rural Financial Markets*. Report No. 14599-ME. Natural Resources and Rural Poverty Division and Country Department II-Latin American and the Caribbean Regional Office, The World Bank, Washington, D.C.

Buttari, Juan J. 1995. Subsidized Credit Programs: The Theory, the Record, the Alternatives. USAID Evaluation Special Study No. 75, Center for Development Information and Evaluation, U.S. Agency for International Development, Washington, D.C.

Clemens, Harry and Wattel, C. 1998. Financiamiento Rural por Proyectos: ¿Otro Ciclo de Interveniones No Sostenibles en los Mercados de Crédito? Un Análisis de Casos en Centroamérica. Conferencia Electronica Latinoamericana sobre Servicios Financieros para los Pobres Rurales. May 5-July 25, FIDAMERICA.

Conrow, James. 1989. Remarks of the Executive Vice President of the Inter-American Development Bank Before the 13th Annual Conference on Investment, Trade, and Development in the Caribbean Basin. Miami, FL (November 29).

Echeverría, Rubén G. 1998. Strategic Elements for the Reduction of Rural Poverty in Latin America and the Caribbean. Policy Research Paper, Sustainable Development Department, Environment Division. Inter-American Development Bank.

Fernández, José, 1994. An Evaluation of the IDB´s Agricultural Sector Adjustment Loans: Impact, Implementation Issues and Policy Implications. WP 1/94, Evaluation Office, Washington, D.C.

Fleisig, Heywood and de la Peña, N. 1996. Creating a Legal and Regulatory Framework to Promote Access to Rural Credit. Center for the Economic Analysis of Law, Washington D.C.

Inter-American Development Bank. 2000. Strategy for Agricultural Development in Latin America and the Caribbean. Rural Development Unit, Washington, D.C.

______________________________. 1998. Rural Poverty Reduction Strategy. Sustainable Development Department, Environment Division. Washington, D.C.

______________________________. 1998. Estudio de Caso: Programa Global de Crédito a la

Microempresa (GMC): Ecuador (Préstamos 851/SF-EC and ATN/SF-3602). Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Estudio de Caso: Programa Global de Crédito a la Microempresa (GMC): Paraguay (Préstamos 707/OC-PR and ATN/SF-4107-PR y ATN/ SD-4107--PR).” Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Estudio de Caso: Programa Global de Crédito a la Microempresa (GMC): El Salvador (Préstamos 915/SF-ES and 780/OC-ES). Oficina de Evaluación, Washington, D.C.

_______________________________. 1998. Basic Soico-Economic Data. Statistics and Quantitative Analysis Unit, Integration and Regional Programs Department, Washington, D.C. (November 18).

______________________________. 1998. Evaluación del Préstamo de Reforma del Sector Financiero del BID a República Dominicana (DR 0016). PPR 12/98, Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Evaluation of the Policy-Based Lending Portfolio-Phase II. Report RE-228, Evaluation Office, Washington, D.C.

______________________________. 1998. Evaluación del Préstamo para el Sector de Inversiones de Argentina (AR-0059). PPR-14/98, Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Review of the Project for Institutional Strengthening of the Jamaica Cooperative Credit Union League. Kingston, Jamaica.

_____________________________. 1998. Programa Sectorial para la Privatización de Bancos Provinciales de Argentina (AR-0187). PPR 10/98, Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Evaluación del Préstamo para Ajuste del Sector Financiero a Venezuela (VE-0071). PPR 8/98, Oficina de Evaluación, Washington, D.C.

______________________________. 1998. Informe de Ejecución del Programa de Apoyo a la Micro y Pequeña Empresa, Financiera Nicaragüense de Inversiones.

______________________________. 1997. Programa de Crédito y Apoyo Técnico para Pequeños Productores Agropecuarios del Noreste Argentino. PPR 18/97, Oficina de Evaluación, Washington, D.C.

______________________________. 1997. Evaluación del Programa del Préstamo Sectorial Agrícola a Nicaragua (NI-0020). PPR 16/97, Oficina de Evaluación. Washington, D.C.

______________________________. 1997. Programa Global de Crédito Agropecuario con el Banco de la Republica Oriental del Uruguay (UR-0060). Informe de Terminación de Operaciones. Representación del BID, Montevideo, Uruguay.

___________________________. 1997. Evaluación del Préstamo Sectorial de Comercio y Finanzas a Nicaragua (NI-0012). PPR-14/97, Oficina de Evaluación, Washington, D.C.

___________________________. 1997. Evaluación del Préstamo de Promoción del Sector Financiero a Perú (PE-0033). PPR-12/97, Oficina de Evaluación, Washington, D.C.

___________________________. 1997. Evaluación del Programa de Reformas del Sector de Inversiones de del Uruguay (UR-0057). PPR-11/97, Oficina de Evaluación, Washington, D.C.

___________________________. 1997. Evaluación del Programa de Ajuste del Sector Financiero del Uruguay (UR-0031). PPR 10/97, Oficina de Evaluación, Washington, D.C.

____________________________. 1996. *Economic and Social Progress in Latin America: 1996 Report* Office of the Chief Economist. Washington, D.C.

____________________________. 1996. Programa Global de Crédito Multisectorial I con el Banco Central de Reserva de El Salvador (612-OC/ES y 850/SF'ES). Informe de Terminación de Operaciones: Representación del BID, San Salvador, El Salvador

____________________________. 1996. Preliminary Overview of the IDB's Experience with Sector Lending: First Phase. RE-213. Evaluation Office, Washington, D.C.

___________________________. 1995. Evaluation of the Program for the Financing of Small Projects (GN-1373-2). Operations Evaluation Office, Washington, D.C.

___________________________. 1995. The Reform of Development Banks in IDB Financial Sector Loans. RE-203/95. Evaluation Office, Washington, D.C.

___________________________. 1995. Préstamo de Reforma del Sector Financiero—Venezuela (590/OC-VE)."PPR 5/95, Oficina de Evaluación, Washington, D.C.

___________________________. 1994. *Fondos Rotatorios de Crédito para Microempresas: Un Estudio Empírico*. Division de Microempresas. Washington, D.C.

_________________________________. 1994. Evaluation of the IDB's Agricultural Sector Adjustment Loans: Impact, Implementation Issues and Policy Implications. WP-1/94, Evaluation Office, Washington, D.C.

__________________________. 1994. "Report on the Eighth General Increase in the Resources of the Inter-American Development Bank." Document No. AB-1683, Washington, D.C.

__________________________. 1991. IDB and Microenterprise: A Development Strategy for the 90's. RE-179. External Review and Evaluation Office. Washington, D.C.

__________________________. 1990. Proceso al Crédito Protegido y la Paradoja del Crédito Subvencionado en El BID. (Boletín Mensual de Noticias del Banco). Ediciones de enero-febrero-marzo.

__________________________. 1989. *Economic and Social Progress in Latin America: 1989 Report.* Economic and Social Development Department. Washington, D.C.

_________________________. 1988. Technical Cooperation for Institutional Strengthening an Evaluation of the Bank's Experience." Project Performance Report-37/88, Operations Evaluation Office, Office of the Controller. Washington, D.C.

_________________________. 1987. Guidelines for Estimating the Demand for Credit in the Bank's Global Loans. Internal Memorandum, Project Analysis Department. Washington D.C., (March 27).

_________________________.1985. Evaluation of the Small Projects Program GN-1373-2, Operations Evaluation Office, Washington, D.C.

_________________________. 1984. Evaluation Report on the Beneficiaries of IDB Agricultural Credit Projects. External Review and Evaluation Office, Washington, D.C.

_________________________. 1984. Analisis de Ejecución de Proyectos: Programa de Pequeños Proyectos-- Nicaragua (SP/TF-79-11-NI; SP/TF-79-12-NI; SP/SF-80-08-NI). Oficina de Evaluación de Operaciones, Oficina del Contralor. Washington, D.C.

__________________________. 1984. Summary of Evaluations of Global Agricultural Credit Programs, Document # GN-1493, Washington, D.C.

_________________________.1983. *Agricultural Development Bank (BDA) Evaluation of Global Agricultural Credit Programs in Panama (Loans 404/SF-PN and 554/SF-PN)*. Operations Evaluation Office. Office of the Controller. Washington, D.C.

________________________. 1983. *Banco Agrario del Perú: Evaluation of Global Agricultural Credit Programs (Loans 355/OC-PE and 589/SF-PE).* OER-31/83. Operations Evaluation Office, Office of the Controller.

_______________________. 1983. *Banco Nacional de Fomento: Evaluación de Programas Globales de Crédito Agropecuario (Préstamos 521/SF-EC y 339/OC-EC)*. OER-29-83. Oficina de Evaluación de Operaciones, Oficina del Contralor. Washington, D.C.

________________________. 1982. *Program for Regional Development of the Northwest of Minas Gerais, Brazil (Loans 252/SF-BR and ATP/SF-1017-BR)*. Project Performance Review-1/82. Operations Evaluation Office, Office of the Controller. Washington, D.C.

________________________. 1982. *First Integrated Agricultural Development Program Dominican Republic (Loan 350/SF-DR).* Project Performance Review 01/82. Operations Evaluations, Office of the Controller. Washington, DC.

________________________. 1982. Agricultural Sector Policy (OP-706). GP-106-3. Washington, D.C.

________________________. 1982. Operational Policy for Small Projects Financing Program (OP-706).GP-75-7, Washington, D.C.

________________________. 1973. Fund for Special Operations: Financing of Farms" GP-2, Washington, D.C.

________________________. 1973. Evaluation Study of Global Loans to Development Finance Institutions. RE-29, The Group of Controllers.

________________________. 1960-98. Assorted Project Proposal Documents and Project Performance, Monitoring Documents, (over 200).

International Monetary Fund. *International Financial Statistics*. Washington D.C. various editions.

González Vega, Claudio and Torrico, J. 1995. ¨Honduras: Mercados Financieros Rurales No Formales.¨ Proyecto para el Desarrollo de Políticas Agrícolas de Honduras, USAID.

____________, Jimenez, R. and Mesalles, L. 1988. Fuentes de Crédito para los Agricultores. Academia de Centroamerica por USAID, San José, Costa Rica.

___________ and Graham, D. 1995. State-owned Agricultural Development Banks: Lessons and Opportunities for Microfinance. Occasional paper No. 2245. Economics and Sociology. Ohio State University, Columbus, Ohio.

Hoff, Karla, Braverman, A. and Stiglitz, J. eds. 1993. *The Economics of Rural Organization: Theory, Practice, and Policy*. New York: Oxford University Press.

King, Robert, and Levine, R. 1993. Finance and Growth: Schumpeter Might be Right in *Quarterly Journal of Economics* 108 (3): 717-37.

Ledgerwood, Joanna. 1999. *Microfinance Handbook: An Institutional and Financial Perspective*. The World Bank. Washington, D.C.

Ladman, J. 1984. "Loan Transactions Costs, Credit Rationing, and Market Structure: The Case of Bolivia." in *Undermining Rural Development with Cheap Credit*, edited by Dale Adams et. al., Boulder, CO:Westview Press.

Luna, Julio. 1989. "Prospects for the Development of Agriculture, Forestry, and Fisheries in Latin America. " Agricultural and Forestry Development Division. Washington, D.C.

MacDonald, C., Eleanor Howard, Ana Maria Rodriguez-Ortiz. 1989. Alternatives for Increasing the Access of Small Rural Producers to Credit. Report of Task Force on Small Farm Credit. Inter-American Development Bank, Washington, D.C.

Mathieu, Nicolas. 1998. Financial Sector Reform: A Review of World Bank Assistance. The World Bank, Washington, D.C.

Meliza, A. and Daly, J. 1996. "An Alternative Approach to Rural Financial Intermediation: The Philippine Experience." Chemonics Occasional Paper, Chemonics International, Washington, D.C.

Miño, Hilda and Pieper, P. 1998. ¨Evaluación del Programa de Apoyo a las Bolsas de Productos Báscios de El Salvador, Nicaragua, Costa Rica, y República Dominicana.¨ International Management and Communications Corporation (IMCC). Miami. FL.

Monzón. M, Gómez, A., Lima, J., Vargas, R., y Nieva, I. 1980. "Revision de la Operación: Programa Integral de Desarrollo Rural (PIDER). Oficina del BID-Mexico.

Nunura, Juan y Portocarrero J. 1998. "Programa de Crédito Global a la Microempresa: Evaluación de la I Fase y Preparación de la II.¨ Informe de Consultoría. Oficina de BID, Lima, Perú.

Proenza, Francisco. 1998. Rural Finance in International Development: Progress Report and Possible Strategy for FAO Intervention. Food and Agriculture Organization, United Nations. Rome, Italy.

Rice, E.B. 1973. History of A.I.D. Programs in Agricultural Credit, 1950-1972 in *Spring Review of Small Farmer Credit*, Volume 8. Washington D.C.:A.I.D.

Robinson, Marguerite S. 1994. "Savings Mobilization and Microenterprise Finance: The Indonesian Experience" in The New World of Microenterprise Finance, edited by Maria Otero and Elisabeth Rhyne, West Hartford, CT:Kumarian Press.

Stiglitz, Joseph. 1994. The Role of the State in Financial Markets. The World Bank, Washington, D.C.

____________ and Weiss. A. 1981. Credit Rationing in Markets with Imperfect Information. *American Economic Review* 7(3) pp. 393-410.

Thomas, Vinod, and Nash, J. 1991. *Best Practices in Trade Policy Reform*. New York: Oxford University Press.

U.S. Agency for International Development. 1998. Development Experience Clearinghouse (formerly Center for Dissemination of Development Information), Washington, D.C.

___________________________________. 1988. Financial Markets Development. USAID Policy Paper, Bureau for Program and Policy Coordination, Washington, D.C.

Vives, Antonio and Staking, K. 1997. Financial Intermediation and Policy-Based Lending: Policy Recommendations for Latin American and the Caribbean" in *Policy-Based Finance and Market Alternatives: East Asian Lessons for Latin America and the Caribbean,* edited by Kim Staking. Inter-American Development Bank. Washington, D.C.

Virmani, Arvind. 1982. *The Nature of Credit Markets in Developing Countries: A Framework for Policy Analysis*. Staff Working Paper No. 524. The World Bank, Washington, DC

Vogel, Robert C. 1984. Savings Mobilization: The Forgotten Half of Rural Finance. *Undermining Rural Development with Cheap Credit*, edited by Dale Adams et.al., Boulder, Colorado: Westview Press, pp. 248-265.

Vogel, Robert C. 1984. "The Effect of Subsidized Agricultural Credit on Income Distribution in Costa Rica." in *Undermining Rural Development with Cheap Credit*, edited by Dale Adams et. al., Boulder, Colorado: Westview Press.

Vogel, Robert C. and Adams, D. 1996. "Old and New Paradigms in Development Finance: Should Directed Credit be Resurrected?" CAER Paper. Miami, FL: IMCC.

Von Pischke, J.D. and Dale Adams. 1980. "Fungibility and the Design and Evaluation of Agricultural Credit Projects." *American Journal of Agricultural Economics* 62: 719-726.

Wenner, Mark and Campos, S. 1998. *Lesson in Microfinance Downscaling: Case of Banco de la Empresa* S.A. Microenterprise Unit, Sustainable Development Department, Inter-American Development Bank, Washington, D.C.

Westley, Glenn. 1995. *Financial Reforms in Latin America: Where have We Been, Where Are We Going?* Office of the Chief Economist, Working Paper (January). Inter-American Development Bank, Washington D.C.

World Bank. 1993. *Review of Bank Lending for Agricultural Credit and Rural Finance (1948-1992)*. Report No. 12143. Operations Evaluation Department. Washington, D.C.

_________. 1989. *World Development Report 1989: Financial Systems and Development*. New York: Oxford University Press.

_________. 1989. "Report of the Task Force on Financial Sector Operations.", Washington, D.C.

Yaron, Jacob, Benjamin, M., and Piprek, G. 1997. *Rural Finance: Issues, Design, and Best Practices.* World Bank, Washington D.C.

___________. 1992. *Rural Finance in Developing Countries*. Policy Research Working Paper WPS 875. The World Bank, Washington, D.C.

ANNEX 1:
List of Projects Reviewed

Type	Loan Number/ Title	Country	Date	Amount (US$)
Agricultural Global Credit	521/SF-EC and 339/OC-EC	Ecuador	1978	19,900,000
Agricultural Global Credit	404/SF-PN and 554/SF-PN	Panama	1974 1977	12,080,000 21,000,000
Agricultural Global Credit	335/OC-PE and 589/SF-PE	Peru	1979	11,500,000
Integrated Rural Development	350/SF-DR	Dominican Republic	1972	24,800,000
Integrated Rural Development	293/OC-ME and 443/SF-ME	Mexico	1974	60,000,000
Investment Sector Loan	773/OC-AR	Argentina	1992	350,000,000
Investment Sector Loan	UR-0057	Uruguay	1992	68,800,000
Financial Sector Loan	773/OC-DR	Dominican Republic	1993	102,000,000
Financial Sector Loan	677/OC-PE and 678/OC-PE	Peru	1992	221,825,000
Investment Sector Loan	730/OC-UR and 704/OC-UR	Uruguay	1991	68,800,000
Financial Sector Loan	626/OC-UR and 664/OC-UR	Uruguay	1991	151,700,000
Financial Sector Loan	595/OC-VE	Venezuela	1990	300,000,000
Agricultural Sector Loan	JA0097	Jamaica	1990	50,000,000
Agricultural Sector Loan	20/IF-NI, 724/OC-NI, 725/OC-NI, and 897/SF-NI	Nicaragua	1992	54,850,000
MIF	ATN/MT 5078/ MIF/AT-67 Bankable Property Rights Reform Program	Haiti	1995	650,000
MIF	ATN/MT-5479-PR Institutional Strengthening of the Banking Superintendency	Paraguay	1997	1,200,000
MIF	ATN/MT-5063-ES Strengthening Agricultural Commodity Exchange	El Salvador	1995	685,530
MicroGlobal	CR0016	Costa Rica	1992	10,000,000
MicroGlobal	NI0035	Nicaragua	1993	23,600,000
MicroGlobal	PE0035 958/SF-PE	Peru	1995	20,000,000
MIF	MIF/AT-32 Institutional Strengthening of the Jamaican Cooperative Credit League	Jamaica	1994	1,900,000
MIF	MIF/AT-6 Equity Investment in Financiera Calpía	El Salvador	1994	800,000
Multisectoral Global	BO-0167	Bolivia	1990	51,200,000
Multisectoral Globall	CH-0108	Chile	1989	358,458,000
Multisectoral Global	612/OC-ES and 850/SF-ES	El Salvador	1992	60,000,000
Small Project	SP/TF-79-10-NI	Nicaragua	1979	500,000
Small Project	SP/SF-91-11-CR	Costa Rica	1991	500,000

Annex 2:
Persons Interviewed or Contacted by Email
(Spring 1999)

Name	Title	Department
George Alexandrou	Sr. Financial Specialist	RE2/EN2
Sarah Almonte	Sr. Financial Specialist	COF/CNI
Guillermo Arrivillaga	Financial Specialist	COF/CPE
Edgar Carvajal	Local Sectoral Specialist	COF/CES
Hugo Cohan	Sr. Natural Resources Agriculture Specialist	RE3/EN3
Dora Currea	Advisor (Currently Representative EC)	EVP
Sandra Darville	Investment Officer	MIF
Ruben Echeverría	Principal Agricultural Specialist	SDS/ENV (Currently Chief, SDS/RUR)
Rudolf Faller	Evaluation Officer	EVO
Eduardo Feliciangeli	National Financial Specialist	COF/CPR
Mark Flaming	Financial Specialist	RE2/FI2
Kurt Focke	Sr. Financial Special	RE2/RE2
William Gheen	Senior Evaluation Officer	EVO (retired)
Kathryn Hewlett-Jobes	Investment Officer	MIF
John Horton	Natural Resources Agriculture Specialist	RE2/EN2(Currently COF/CUR)
Hunt Howell	Principal Financial Specialist	FI/RE3
Miguel Linares	Administrative Officer II	COF/CDR
Julio Luna	Former Agriculture Division Chief	Private Consultant
Charles MacDonald	Former IDB Employee	Private Consultant
Fredrich Mack	Operational. Specialist Co-financing	RE1/CEP
José Marciel	Chief, Project Executing Unit	Banking Superintendency of Paraguay
George Montalvan	Junior Management Analyst	CON/OMS
Gabriel Montes	Principal Natural Resources Agriculture Specialist	RE3/EN3

(continued)

Annex 2: (Cont.)
Persons Interviewed or Contacted by Email
(Spring 1999)

Name	Title	Department
Michael O´Donnell	Operational Specialist	COF/CTT
Terry Powers	Deputy Manager	RE2/RE2 (retired)
Jeff Poyo	Senior Development Specialist	DAI
Renato Puch	Principal Operational Specialist-Microenterprise	RE1/FI1
Stefan Queck	Operational Specialist-Microenterprise	RE3/OD6
Fernando Rees	Records Assistant	RE2/RE2
Rafael Riveria	Local Sectoral Specialist	COF/CES
Anna María Rodríguez-Ortiz	Sr. Financial Specialist.	RE2/RE2
José Andrés Rosales	Junior Evaluation Officer	EVO
Miguel Rosales	National Sectoral Specialist	COF/CCR
Paul Trapido	Sr. Social Development Mod. of State Specialist	COF/CHO (currently RE2/EN2)
Bibiana Vásquez	Investment Officer	MIF
Roberto Vellutini	Senior Advisor	PRI
Waldo Vergara	Principal Financial Specialist	RE1/FI1
Fernando Villimizar	Economist	RE2/EN2
Jesse Wright	Financial Specialist	RE2/FI2 (currently COF/CNI)
Luis Ruben Zavaleta	Natural Resource Specialist	RE2/RE2

Annex 3 :
List of Multisector Programs (1980-1998) US '000s

Country	Project Name	Code	Approval Date	Amount
Argentina	Global Multisector Credit Program	AR-0055	1993	300,000
Bahamas	Multisector Credit Program	BH-0015	1992	7,837
Bolivia	Global Multisector Credit Program II	BO-0034	1994	70,000
Brazil	Global Multisector Credit Program I	BR-0172	1990	250,000
Brazil	Global Multisectoral Credit Program II	BR-0155	1995	300,000
Brazil	Global Multisectoral III	BR0277	1998	1,100,000
Chile	Global Multisectoral Credit	CH0108	1989	358,458
Ecuador	Multisectoral Global Credit Program	EC-0089	1992	60,000
El Salvador	Multisector Global Credit	ES-0086	1990	60,000
El Salvador	Multisector Global Credit II	ES-0057	1995	100,000
Honduras	Multisector Global Credit	HO-0034	1992	60,000
Mexico	Consolidation of Financial Institutions	ME0126	1995	250,000
Panama	Multisector Credit Program	PN-0085	1984	8,339
Peru	Multisector Credit Program	PE-0113	1994	100,000
Peru	Multisector Credit Program	PE-0191	1998	200,000
Uruguay	Multisetoral Global Credit	UR-0063	1992	90,000
Uruguay	Global Multisector Financing Program	UR-0021	1998	155,000
Regional: Caribbean Development Bank	Multisector Loan Program	RG-0036	1984	22,572
Regional: Seed Capital	Multisectoral Loan Program	RG-0051	1998	3,000
Regional: Latin America	IIC Multisector Global Credit Program	RG-0014	1997	300,000
Regional: Central America	CABEI Institutional Support and Multisector Credit Pro-gram	CA-0008	1 997	100,000
Regional: Andean	CAF Multisector Institutional Support Program	RG-0010	1993	200,000
TOTAL	**22**			**4,095,206**

Global Multisectoral Credit Loans

Purpose

Global Multisectoral Credit Loans are intended to improve the continued supply of medium and longer term financing for productive projects by the private sector. Due to the structure and functioning of many financial systems in the region and ongoing structural adjustment policies, the availability of longer term financing is problematic. Factors that explain the difficulties are high interest rates due to the need to control inflation; overall low domestic savings rates; intermediary dependence, and economic instability that make long term investment planning very uncertain and investment returns highly variable. Consequently, to avoid maturity mismatches and adverse selection risk, financial institutions tend to lend short.

Main Features

The loans usually had three components. First, the establishment of an auction or a rediscount facility as the fund allocation mechanism at a cost not inferior to the average deposit rate of interest in the financial system marked up by the reserve requirement in order not to undercut deposit mobilization. The apex or second tier institution lends funds to eligible first tier financial institutions who then on-lend to private firms with eligible productive investment projects in a number of different sectors. Second, the strengthening and/or creation of a second tier institution to manage the program. Third, the adoption of environmental standards in credit appraisal procedures. The terms and conditions of financing tended to use Ordinary Capital with of standard variable rates and commissions with an amortization period of 10 years, a commitment period of 3 years and a disbursement period of four year. To prevent weak institutions from participating, capital adequacy, operational capacity, and asset quality benchmarks were preestablished as well as full compliance with the rules and regulations of the Banking Superintendent. Steps were also be taken to limit the amounts going to related individuals and firms.

Actual Outcomes

The projects in Chile, Ecuador, El Salvador, and Bolivia mentioned in previous table served as the sample. Partial evidence suggests that most of the funds were used to finance industrial projects in urban areas.[37] The typical use was for fixed investments in plant and equipment in the industrial sector. The exception seems to have been Bolivia (BO0167). The Project Completion Reports states that 54.59% of the loan disbursements went to agriculture and agroindustry. In all, 10 operations were estimated to were believed to have reached rural industries. The value is estimated as nine percent of the total amount approved(staff estimates). Common findings related to rural finance included:

I. 1. The projects did not seem to directly benefit small rural entrepreneurs but could have had an indirect effect. Except for the Bolivia I program, no disaggregated data are available but it can be reasoned that modernizing food processing plants and tourism related industries, if successful in use of loan funds, could be expected to increase demand for primary and handicraft products from rural areas.

II.

[37] In the Ecuador Project Performance Monitoring Report evidence suggest that the average loan sizes were large >$100,000 and that most of the funds were used in financing the industrial sector (est. 80%). In the Chile program the average loan size was US$149,149 with sectorial use unspecified. In El Salvador the average loan size was US$203,439 again with sectorial end use unspecified.

2. Multisectoral loan operations contributed to a strengthened banking system which indirectly helps rural finance. The Multisectorial loans helped transfer of developmental banking activities from the Central Bank to newly created second tier banks. This allowed Central Banks to focus on monetary policy and being lenders of last resort. NAFIBO in Bolivia, Corporación Financiera Nacional (CFN) in Ecuador, BMI in El Salvador, and CORFO in Chile were all strengthened. In the case of Chile, one clear innovation was the inclusion of leasing companies. Leasing companies disbursed US$697.4 million out of a total of US$999.3 million or 68%. Leasing companies can serve the collateral constrained medium and small entrepreneurs, because unlike banks, the typical guarantee is the leased equipment itself, not properly titled real property which smaller firms may not have. Unfortunately, no data were available that would permit a reliable estimate of how many of these leases benefited rural producers.