CONCLUSIONS AND RECOMMENDATIONS

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INTRODUCTION

Rural financial markets do not function efficiently in most developing economies. This is also the case in Latin America and the Caribbean. Despite improvements in macroeconomic performance and liberalization of general financial markets in recent years, limited access and a narrow range of financial products continue to be the norm in rural financial markets. This book presents a conceptual framework to better understand the problem and detailed information on policy, organizational and technological environments as well as developments that affect the functioning of rural financial markets in five selected Latin American and Caribbean countries: Bolivia, Costa Rica, Chile, El Salvador and Peru. In addition, seven case studies are included, describing rural financial organizations and promising new approaches to lending in Bolivia, Costa Rica, El Salvador, Jamaica and Peru.

Rationale for the Book

The motivation for undertaking to produce this book is that by examining the context and specifics of some promising examples of sustainable rural finance, we can improve our understanding and draw lessons as to how best to promote and construct broad-based, more competitive, more complete and more efficient rural financial markets in Latin America and the Caribbean.

MAIN FINDINGS

The central conclusion of the book is that policymakers and practitioners in the region need to go beyond economic liberalization and the maintenance of stable macroeconomic environments, which are necessary but not sufficient conditions to tackle microeconomic imperfections, namely how to improve the design and management of intermediary institutions, legal frameworks and information environments and how to introduce new products that are well-suited for middle- and low-income residents. The message is essentially to get institutions and technologies right, not just prices. The task will be difficult and will require coordinated and sustained efforts.

The specific findings and lessons learnt from this undertaking are as follows:

1. A clear and accurate conceptualization of how financial markets operate is critical to the design of appropriate policy interventions and the building of a financial architecture, particularly in rural areas.

The view that runs through the entire book is that a financial obligation is an intertemporal promissory contract. Assets are transferred today with the promise of repayment or return of the assets in the future with interest payments. To fulfill the contract, three challenges must be addressed and resolved. First, how to gather sufficient information on client ability and willingness to repay loans, to save, to honor insurance contracts and on the intermediary's capability to manage fiduciary responsibilities well, in a cost-effective manner, in order to assess risks adequately. Second, how to put a price on and control risk. Third, how to minimize transaction costs so contracts are profitable.

In the case of rural financial intermediation these same challenges apply but are more severe, largely because of the setting. In rural areas, the clientele tends to be lower-income, less educated and more dispersed than the urban population. The production and marketing environments tend to be more heterogeneous and agricultural production, the base of most rural economies, is subject to uncontrollable external weather and market shocks.

At the same time there are fewer and less robust means to mitigate the high level of risk present, for example, lesser availability of insurance and hedging instruments. The generally poorer state of the physical infrastructure (telecommunications, electricity, roads, etc) compared to urban areas increases the cost of travel and communication for both clients and intermediaries. Also, weak public institutions, such as ill-functioning property registries and expensive and time consuming, forced contract compliance mechanisms increase the cost of intermediation and discourage intermediaries from serving all but the most preferred segment of clients. Lastly, the lack of a tradition of reliable record keeping and the limited presence and scope of credit bureaus increases the cost of gathering information.

In this book, credit is not viewed as an input or a social entitlement as in the past. Though concern is shared about how to broaden access, especially in the low-income strata and underserved communities, the approach is to systematically attack the constraints and impediments that prevent clients from being bankable or creditworthy, and to enable intermediaries through regulatory reform, adoption of appropriate technologies and the introduction of innovative new products to attend to the demands of moderate and low-income rural residents. Because of varying circumstances, both semiformal and formal intermediaries have a role to play. As the economy becomes more developed and financial markets more integrated, formal intermediaries are bound to dominate. The traditional approach of relying on directed subsidies as compensation for urban biases in policies and heavy reliance on state-owned institutions as the principal intermediaries has been dismissed.

The factors affecting rural financial intermediation are numerous, complex, and related. In order to move ahead, concerted action is needed to enhance (1) client effective demand, (2) intermediary retail capacity and product innovation; and (3) the effectiveness of the policy, legal and regulatory framework within which clients and intermediaries operate. Isolated attempts to widen access at all cost may yield short-term results, but serve to distort and delay financial market development in the long run.

First, clients must have a sufficient number of attractive and viable investment options available, in order to earn rates of return high enough to honor financial obligations and have surpluses to save. The aggregate demand for financial services depends on income levels, accumulated wealth, human capital, profitability of investment activities, and attitude toward risk and individual clients' vulnerability to external shocks. Clearly, the more income, the more wealth, the more education and the more technical skills clients have, the more likely they are to be productive in their economic activity, all else remaining equal. At the same time, the starting point is important. A country with favorable natural attributes, such as large extensions of arable land and abundant fresh water resources, and equitable distribution of assets, will have an advantage over another country with less favorable land and water resources and more unequal distribution of production assets.

Second, the internal characteristics of intermediaries, such as organizational design, good-governance incentives, management and human resources skills, the technology employed and funding sources help to determine strategic focus, cost structure, ability to management risk and to penetrate and target particular market segments. Whether an institution is constituted as a regulated for-profit company, as an unregulated, non-profit organization or as a mutualist financial intermediary owned by its members, its organizational design has implications for governance incentives, cost structure and the speed with which sustainability may be achieved.

Third, how client and intermediary characteristics combine is affected by the external environment and policy regime within which clients and intermediaries interact. Natural endowments, market size, income distribution, level of development, public policy, and assignment of property rights all come together and play a role in determining the number of clients with an effective demand, what type of financial intermediaries will predominate in a given economy and how capable will these intermediaries be in meeting legitimate client demand for financial services. Below the influences of the external environment and the policy regime are discussed in greater detail.

2. Factor attributes and policy setting are very important but not all determining of individual retail financial institution success

In Chapter 3, factor attributes of the rural sector,and the policy framework were examined in five countries: Bolivia, Costa Rica, Chile, El Salvador and Peru. It was found that the policy environment is highly significant in determining the number of clients that may be eligible to financial services and the level of effective demand for such services, but not their success in terms of financial sustainability and client outreach, nor the efficiency of financial intermediaries that provide services in rural areas. Below is a table with the summarized effects of various natural attributes and economic policies per country.

Characteristics of External Environment		Bolivia	Costa Rica	Chile	El Salvador	Peru
Physical attributes	Arable Land	*Favorable*	*Favorable*	*Favorable*	Unfavorable	*Favorable*
	Irrigation potential achieved	Unfavorable	*Favorable*	*Favorable*	Unfavorable	*Favorable*
	Size of economically active population	Unfavorable	Unfavorable	*Favorable*	Unfavorable	*Favorable*
	Rural population density	Unfavorable	Unfavorable	*Favorable*	*Favorable*	Unfavorable
Structure of the economy	Per capita income	Low	*Middle Income*	*Middle Income*	Low	Low
	Agricultural share of GDP	*Fair*	*Fair*	*Fair*	Low	*Fair*
	Agricultural exports as share of total exports	*High*	*High*	*High*	Low	*High*
	Share of rural income that is nonagricultural	Low	*High*	*High*	*High*	High
	Rural poverty incidence	Unfavorable	*Favorable*	*Favorable*	Unfavorable	Unfavorable
Access to production assets	Land distribution	Unfavorable	*Favorable*	*Favorable*	Unfavorable	*Favorable*
	Water availability	*Favorable in lowlands*	*Favorable*	*Favorable*	*Favorable*	*Favorable in coastal lowlands*
	Human capital	Unfavorable	*Favorable*	*Favorable*	Unfavorable	Unfavorable
	Access to modern agricultural and agro business technology	Unfavorable	*Favorable only for a few export-oriented sectors*	*Favorable only for a few export-oriented sectors*	Unfavorable	Unfavorable
Quality of infrastructure and support services	Roads	Unfavorable	Unfavorable	*Favorable*	*Favorable*	Unfavorable
	Electrical power	Unfavorable	*Favorable*	*Favorable*	*Favorable*	Unfavorable
	Telecommunications	Unfavorable	*Favorable*	*Favorable*	*Favorable*	Unfavorable
	Agricultural research & training services	Unfavorable	Unfavorable	*Favorable*	Unfavorable	Unfavorable
	Marketing In formation	Unfavorable	*Favorable*	*Favorable*	Unfavorable	Unfavorable
Economic policies	Fiscal and monetary polices	Unfavorable	Unfavorable	*Favorable*	Unfavorable	*Favorable*
	Trade policies	*Favorable*	*Favorable*	*Favorable*	*Favorable*	*Favorable*
	Effective exchange rate policies	*Favorable*	Unfavorable	*Favorable*	Unfavorable	*Favorable*
	Price stability (last decade)	*Favorable*	*Favorable*	*Favorable*	*Favorable*	*Favorable*
Financial regulatory framework	Prudential norms	*Favorable*	Unfavorable	*Favorable*	Unfavorable	*Favorable*
	Quality of supervision	*Favorable*	Unfavorable	*Favorable*	Unfavorable	Unfavorable

(cont.)

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Property Rights	Recognition of a variety of fixed and moveable property as collateral	Unfavorable	Unfavorable	Unfavorable	Unfavorable	Unfavorable
	Public registries	Unfavorable	Unfavorable	Unfavorable	Unfavorable	Unfavorable
	Cost of enforcing security claims	Unfavorable	Unfavorable	Unfavorable	Unfavorable	Unfavorable
Social Inclusion	Social distance between majority culture and Indigenous populations	High	N.A.	Moderate	N.A.	High

N.A.: not available.
Author's conclusions based on information presented in Chapter 3.

The two economies that have environments and policy frameworks most favorable for rural financial intermediation are Costa Rica and Chile. These two countries are characterized by higher *per capita* incomes, high levels of education, low rural poverty rates, extensive rural electrification, high rural telephone density, less concentration of land ownership, vibrant and growing agricultural exports sub sectors, significant nonagricultural rural employment, adequate training services on a number of export commercial crops and price stability. These attributes contribute significantly to legitimate demand for financial services. Many people in the rural economy have viable investment opportunities and sufficient income to demand credit and to save. Where the two countries differ significantly is in quality of macroeconomic management and the adequacy of financial regulation. Costa Rica is beset with high fiscal deficits (six percent of GDP in 1997) that lead to high real interest rates and crowding out of private investments.

In addition, the regulatory framework of Costa Rica until recently explicitly favored state-owned banks by not allowing the deposits to be received by other institutions and still makes no allowances for specialized, privately owned banks that could serve to improve the quality of services to rural clients. This makes for a rural financial market essentially dominated by three state-banks. By contrast, Chile maintains low deficits, attracts significant foreign investment and has lower real lending interest rates. The Chilean regulatory framework favors larger well-capitalized private financial institutions, with no provisions for specialized institutions outside of state-owned development agencies (Banco del Estado and the Instituto de Desarrollo Agropecuario, INDAP, an agency within the Ministry of Agriculture). The quality of supervision is quite high and the Chilean financial system is stable and has smaller intermediation spreads and lesser problems with non-performing loan assets than other countries.

In both countries, state-owned development banks and informal moneylenders are the main providers of financial services to the rural population. In Costa Rica,

state-owned banks are not particularly efficient (long delays in processing and disbursing) nor sustainable (high delinquency rates), but do have an extensive branch network and help to contribute to high access rates (approximately 40 percent). In Chile, the state-owned bank and INDAP focus on financing commercial agriculture in the large and medium agricultural sector, but much of rural finance also takes place through inter-linked contracts (vertical integration and credit suppliers).[1,2]

What is most telling is that very successful, albeit small-scale, rural finance intermediaries do operate in countries with less than auspicious environments, as Financiera Calpiá in El Salvador, ANED and Agrocapital in Bolivia, and Critecnia in Peru. In the case of El Salvador, the high rates of rural poverty, less dynamic agricultural sector and low education levels are offset by the high population density, the high proportion of nonagricultural activities and the flow of family remittances. The density lowers the transition costs of making small loans, while the extensive settlements in the periphery of cities and regular flow of family remittances from abroad reduce the risk of default. Many Salvadoran rural households have predictable and virtually constant cash flows over the year, which is atypical for rural areas, but which has not been the base of Calpiá's success, an institution that lends to small farmers who do not have predictable and constant cash flows. In Bolivia and Peru, the general environments are less favorable, but special allowances in the regulatory framework allow for the creation of specialized regulated financial institutions with lower capital minimum requirements, aimed at urban and rural microfinance (Fondos Financieros Privados, FFPs, and Entidades de Desarrollo para la Pequeña Empresa y la Microempresa, EDPYMEs). Thus, while the demand for financial services is not as robust as in Chile and Costa Rica, the supply-side incentives are slightly better in Bolivia and Peru and allow for a high number of privately held intermediaries interested and active in microfinance and rural finance. Nonetheless, financial regulations need to be adapted to the emerging promising rural finance technologies and the quality of supervision needs to be improved.

3. The key to intermediary organizational success is the correct alignment of mission, governance incentives, human resources capacity, internal controls, risk management techniques and service delivery technology, so that the goals of profits, increasing client, outreach and steady portfolio and capital growth may be achieved

No one type of financial institution or model is clearly dominant in the provision of high-quality and sustainable rural financial services. In Latin American and the Caribbean, the general types of rural intermediary institutions are:

1 In spite of being a state-owned bank, the Banco del Estado has been operating as a private commercial bank since 1982.

2 State-owned agencies in charge of financing Chilean small farming are the INDAP and the Programa Nacional de Apoyo a la Pequeña y Microempresa (PYME) of the Corporación de Fomento de la Producción (CORFO). In both cases, the mission of the agencies goes beyond mere financial activities.

(i) Informal lenders such as relatives, friends, suppliers, traders, moneylenders.

(ii) Mutual organizations, such as credit unions, cooperatives, village banks, producers' associations, community development associations, rotating credit and savings associations (ROSCAs), in which members from a particular community join to fund an organization initially or partially from periodic dues and savings and then extend credit largely to themselves or to finance collective projects.

(iii) Non-profit, nongovernment organizations (NGOs).

(iv) Non-bank regulated institutions, such as finance companies, trust companies, building societies, savings and loan associations.

(v) Specialized microfinance lending institutions, such as private finance funds (FFPs in Bolivia, cajas rurales and EDPYMEs in Peru and uniones de crédito in Mexico).

(vi) Private commercial banks.

(vii) State-owned banks.

In rural areas, the most common intermediaries, ranked in order, are informal ones, mutual organizations and nongovernmental organizations. In some countries, a few specialized institutions are making inroads (Bolivia, Dominican Republic, El Salvador and Peru). In others, state-owned banks are still quite active (Brazil, Costa Rica, Chile, Ecuador, Mexico, Paraguay, and Uruguay). Private commercial banks, with some exceptions (Guyana, El Salvador and Costa Rica), continue to be largely absent from rural areas. When present they tend to finance export-oriented agriculture, particularly commodities with well-established marketing and distribution outlets, food processing companies and agricultural input suppliers. Nonagricultural, small businesses and other agricultural commodities, especially those produced by medium- and small-scale producers are not generally financed.

In the case studies presented, the selected intermediary institutions (finance companies, NGOs, banks and private businesses) seem to have some common "virtues" that individually do not seem to make much of a difference, but together have a synergistic effect. In short, they create mutually reinforcing dynamics. The characteristics they tend to share are as follows:

(i) They have clear missions and shared outlooks.

(ii) They hire and retain very competent managers.

(iii) They attract a fair number of Board Directors that have professional expertise in finance and business management and share the view of building a sustainable, high-quality institution. The argument that "the poor cannot pay high interest rates and need charity" has been rejected and replaced

with a belief that providing permanent access to financial services is more important, although this view is not shared thoroughly in agricultural credit.

(iv) They recruit staff with local knowledge and basic technical capacity and then engage in extensive training to develop appropriate skills.

(v) They use performance incentives to motivate staff.

(vi) They use management information systems extensively for decision-making purposes and not only for report writing to donors.

(vii) They have decentralized decision-making.

(viii) They value market research and constant refinement of products and procedures.

(ix) They engage in relationship banking, as opposed to fee-based or transaction banking: openness to listen to clients and to build customer loyalty through maintaining good personal relationships, tailoring repayment schedules to the realities of household cash flows, timely service.

(x) They attempt to manage liquidity judiciously and reduce risk exposure.

The institutions reviewed are not perfect and each one has areas were improvements can and should be made. However, they generally obtain good marks in the above-mentioned areas and do achieve good financial results. Areas of common concern are good-governance incentives; the constitution of guarantees especially in larger sized loans; liability structure; risk management; maintenance of and improvements in management information systems, especially introduction of cost accounting so that the profitability of different lines of activity can be easily assessed; how to introduce new and enhanced financial products for low-income target populations, especially long-term credit and savings instruments; and how to retain high-quality personnel.

4. Current credit appraisal methodologies tend to be "expert-dependent," that is, a local loan officer makes a subjective evaluation more or less based on the 5 C's: (i) character, (ii) capital, (iii) ability (capacity) for repayment, (iv) collateral and (v) prevailing economic conditions. Consistency and comparability are often compromised despite layering of approval authority. Modern techniques, such as credit scoring and option pricing models that are consistent and more standardized, are not being used due to lack of sufficient and reliable data, the high level of informality of client businesses and the ongoing dynamic changes that rural populations are undergoing.

The credit technologies currently used by the surveyed intermediaries depend heavily on a "termination threat" and less on fixed collateral or the "foreclosure threat." Traditionally, lenders have demanded collateral equal or superior to the loan amount as a means of reducing default risk. However, most rural residents are poor and lack adequate stocks of fixed collateral to pledge. In addition, the legal forced compliance systems are so cumbersome that the actual costs of carrying out a collateral seizure can be prohibitive, especially in the case of small loans.

As a result, many of the better lenders rely on information about reputation and technical/managerial ability and use "termination threats." Since access to credit is limited, successful lenders seek to maintain high repayment rates by promising permanent and sustained access through time, and high-quality service. If clients fail to repay, future access to credit is denied. If clients have doubts about the sustainability of the institution, then strategic defaults may occur. This implicit contracting scheme, however, works well up to a certain loan size limit. Thus, microfinance is feasible in rural areas, as in the cases of ANED and Financiera Calpiá. Nonetheless, once the loans become too large, more traditional forms of collateral are required to reduce default risk, as in the example of Agrocapital, which relies on land titles. These three cases, as the others presented in this book, are clear examples demonstrating that rural finance is possible on a profitable basis, provided that the risks affecting credit transactions in rural areas are adequately managed.

For example, the commonplace microfinance technology of group credit may fail when loans exceed the capacity to provide mutual guarantees or the group decides that a strategic default will have few negative consequences. Individual loan contracts with close monitoring, another commonplace microcredit technology, may also fail when the project financed is subject to an external shock that overwhelms the reserves of the household.[3] Thus, microfinance has succeeded and been proven to work in rural areas, but larger-size and longer-term loans for perennial agriculture or the acquisition of fixed assets, such as land, machinery and equipment, remain scarce. They exist for those with sufficient fixed collateral, namely titled land, but technologies have not yet been developed for clients with limited collateral. The implication is that more risk management techniques, broader forms of collateral and more cost-effective execution of claims are needed, as well as stable sources of long-term funding in order to expand longer-term lending.

5. The pricing of loan products in rural areas is high and typical interest rates are above 25 percent per annum in the cases studies. Many prospective clients complain about the high cost of credit and

3 Perhaps it might be useful to mention, that, as in urban microfinance, rural microfinance shows a trend toward individual lending technologies.

the low returns of many rural activities, both on- and off-farm. It appears that the financing of commercial sector activities is inelastic to interest rates, while agricultural and manufacturing activities are elastic to them.[4]

In order to lower the cost of credit, several improvements will be needed. First, the operating efficiency of intermediaries will have to be improved, greater domestic savings mobilization will have to take place, and better management of macroeconomic policy will be needed, especially maintenance of low or zero deficits. The internal driving factors of efficiency are increased staff productivity and lower delinquency rates. The external driving factors of reduced spreads would be public sector policies that lead to lower cost of funds in the entire financial system and an increased willingness on the part of citizens to save in local currency. Too often high fiscal deficits may force monetary authorities to use high reserve requirements, which increases lending rates and depresses deposit rates of interest. Furthermore, problems with misaligned exchange rates raise the country-risk rating, due to fears of impending currency devaluation. Negative country-risk ratings create further pressure for the maintenance of high intermediation spreads.

6. Product innovations hold the promise of significantly reducing transaction costs and better managing risk, thus allowing intermediaries to penetrate hitherto unreachable or underserved markets. However, the innovations seem to work best when they are evolutionary in nature, meaning that the intermediary has had significant experience in a closely related field and has a proven reputation in the geographic area of operation. In addition, certain infrastructure and legal barriers have to be surmountable or favorable from the start of the innovation.

In the cases of Workers Bank of Jamaica, Financiera Trisán of Costa Rica, ANED of Bolivia, and Financiera Calpiá of El Salvador, each institution expanded gradually into a new product. Workers Bank copied a contractual savings-and-loan product that existed as an informal sector, the ROSCA. The Bank even called the product, "Partners," using the same colloquial terminology as in the informal ROSCA sector. Clients were familiar with the technology and saw all the old benefits plus the added advantage of security against fraud, by having a formal bank operate the ROSCA-like product. On the other hand, Financiera Trisán introduced a credit card

4 For a long time, agricultural interest rates have been at the heart of political discussions. Complaints are perhaps more of a legacy from those discussions than actually related to agriculture, as some examples of very high informal interest rates show. As demonstrated in the cases of the CES Solidaridad and Critecnia (Peru), and ANED and Agrocapital (Bolivia), if it is true that lending interest rates are high compared to the average lending interest in the respective financial systems, two important issues follow: (1) rural dwellers, and particularly farmers, may pay high interest rates, which contradicts the common wisdom that farmers are not able to pay cost-covering interest rates; and (2) in most cases, the relevant opportunity cost is not that of the formal financial system, but that of the informal market, where interest rates are usually higher.

that was essentially an enhanced form of supplier credit. The parent company was an agricultural input importer and wholesaler, and for many years had extended supplier credit to retail distributors. The credit card in the first stage was a replacement for supplier credit and later evolved into a true credit card, used by individuals and accepted by a number of different merchants. Overall, the credit card lowered transaction costs for clients and merchants and represented a significant improvement for them. ANED, similarly, has had many years of experience in lending to urban and rural micro business and entered into leasing as a means of helping to provide long-term credit to preferred clients. Clients who have tried out the service appreciate the new product and are exerting pressure to expand the program.

On the supply side, there have been a number of difficulties in responding to added demands for new products. In the case of Workers Bank, the Partner Savings Plan was successful, but the Bank was shut down in the midst of a financial crisis in Jamaica and the portfolio was transferred to building societies. In the case of Trisán, expansion has been slow, due to concerns about asset quality stemming from weak economic conditions in the rural sector, over the past three years, deficiencies in the legal forced contract compliance system and issues relating to equipment and telecommunication costs. ANED has also been slow to expand due to weak economic conditions, difficulties in recruiting equipment suppliers to participate in its program, inability to properly train potential clients in how to use the equipment properly, and uncertainties about how leasing portfolios are regulated.

RECOMMENDATIONS

In summary, some promising and interesting developments have been taking place in the field, and provide the basis for renewed hope. These innovations and promising institutions, however, need to be consolidated and expanded, so that rural financial markets can be improved and transformed. Much needs to be done.

Below is a list of some recommendations that national governments, international donors and financial intermediary organizations can pursue jointly to improve the operations of rural financial markets.

(i) Improving the profitability of rural economic activities through appropriate economic policies and public sector investments. Without strong effective demand for financial services and a favorable business climate (creditworthy clients, for instance), financial intermediaries will continue to be reluctant to expand into rural markets and very averse to serve middle- and low-income segments, who make up the vast majority of the rural population. The approach to rural development and rural finance must be comprehensive.

(ii) Removing biases in financial regulatory and supervisory practices that do not allow profitable rural intermediation. The most common bias in regulatory frameworks is the reliance on particular types of fixed collateral and

documents that make rural finance unattractive, because the majority of potential clients lack the preferred type of collateral that corresponds to low provisions for intermediaries. In addition, transaction costs to document a small loan can be prohibitive. Expanding the type of acceptable collateral (equipment, inventories, appliances, etc.) and enhancing the enforced contract compliance system will be critical in ensuring broadened access. If more types of moveable collateral are accepted and compliance with security claims is more easily and cheaply conducted, then the risk and cost of lending to rural clients will be reduced and a supply-side constraint, removed.

(iii) Opposing political interference, such as interest rate ceilings, mandatory credit rescheduling or large-scale debt write-off programs of state-owned or private intermediaries, which deter the delivery of private financial services in rural areas.[5]

(iv) On one hand the cost of rural credit will have to be reduced through policies and initiatives to lower the cost of funds in the entire financial system, and on the other hand, attempts made to reduce the intermediation spread. Some of the ways the spread may be reduced would be to improve operating efficiency to better control risk and to stimulate competition among financial intermediaries in rural areas. The overall cost of funds can be lowered through more effective deficit control policies. Operational efficiency can be improved through cost cutting processes and product innovations. A lower operating cost per unit lent or financed should translate into better interest rates for clients, as long as there is competition. Better risk management techniques, such as wider use of insurance, portfolio securitization and hedging instruments, can transfer some of the risk from parties less able to bear it to those more able to do so and, thus, result in lower interest rates.

(v) The most common risk management techniques used in the case studies are portfolio diversification and reliance on households with multiple sources of income. These techniques work but need to be complemented with more modern risk management techniques (insurance, futures markets, securitization, etc.), in order to broaden and deepen the financial market. For these newer instruments to become more widely used, more functioning commodity exchanges, adequate legal and regulatory frameworks, and improved information environments will be necessary.

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5 A clear example of political intervention took place in Peru, in 2000. According to Emergency Decree 031-2000, the government ordered the rescheduling of loans contracted as of May 18th, 2000, amounting to about US$ 21,000, including capital, interest and recovery expenses. This represented an obvious interference in the borrower-lender private relationship. In the same fashion, the Asamblea Legislativa (Legislative Assembly) of El Salvador forgave the debts of borrowers of the Banco de Fomento Agropecuario, BFA (Agricultural Development Bank) in 2000.

UNRESOLVED ISSUES

No book on rural finance is comprehensive since the topic is a complex and multifaceted one. Two issues require further study: how to improve the supply of long-term credit to the rural sector, and what is the appropriate role of state-owned financial intermediaries. Many of the lending institutions active in rural areas are not deposit-taking institutions and are not assured of access to long-term funds. Even in the case of the few deposit-taking institutions studied, most savings are short-term and volatile. Thus, the supply of medium- and long-term credit is restricted, due to issues of simultaneous loan maturity and risk associated to interest rates.

No state-owned banks were studied in the book, but, in the case of case of Costa Rica, the size and dominance of state-owned banks has had an influence on the structure of rural financial intermediation. Commercial banks largely view rural areas of Costa Rica as the domain of state banks and are not present. In other countries (El Salvador, Peru and Bolivia), agricultural state banks either have been liquidated or have a very limited presence. Private commercial banks in these countries likewise have reduced rural outreach.

The question of whether state-owned banks can be reformed and made to function more efficiently or whether they are too prone to political interference and serve to crowd out private sector initiatives and therefore should be restricted to second-tier lending needs to be studied empirically. Theory and past experience, however, would seem to suggest that the role of state-owned institutions should be limited and that they should not distort the market by excluding or limiting private service providers.

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MOST USED ABBREVIATIONS AND ACRONYMS

AMPES	Servicio Crediticio de la Asociación de la Mediana y Pequeña Empresa (Credit Service of the Medium and Small Business Association), El Salvador
ANED	Asociación Nacional Ecuménica de Desarrollo (National Ecumenical Development Association), Bolivia
BASIS	"Broadening Access and Strengthening Input Market Systems" Project, sponsored by USAID
BCIE	Banco Centroamericano de Integración Económica (Central American Bank for Economic Integration)
BFA	Banco de Fomento Agropecuario (Agricultural Development Bank), El Salvador
BMI	(Banco Multisectorial de Inversiones), El Salvador
BNCR	Banco Nacional de Costa Rica (National Bank of Costa Rica)
CAM/ FINCA	Centro para el Apoyo a la Microempresa/Fundación Integral Campesina (Micro Business Support Center/Comprehensive Farming Foundation), El Salvador (NGO)
CENTA	Centro Nacional de Tecnología Agropecuaria y Forestal (National Agricultural and Forestry Technology Center), El Salvador
CEPAL	Comisión Económica para América Latina y el Caribe (Economic Comission for Latin America and the Caribbean)
CEPES	Centro Peruano de Estudios Sociales (NGO)
CES	Centro de Estudios Sociales "Solidaridad", Peru (NGO)
CMAC	Caja Municipal de Ahorro y Crédito (Municipal Savings and Loans Fund), Peru

COFIDE	Corporación Financiera de Desarrollo (Financial Corporation for Development), Peru
CONASSIF	Consejo Nacional de Supervisión del Sistema Financiero (National Supervision Council of the Financial System), Costa Rica
CRAC	Caja Rural de Ahorro y Crédito (Rural Savings and Loans Fund), Peru
EDPYME	Entidad para el Desarrollo de la Pequeña y Microempresa (Entity for Small and Micro Enterprise Development), Peru
FEDECRÉDITO	Federación de Cajas de Crédito y Bancos de los Trabajadores (Federation of Credit Funds and Workers' Banks), El Salvador
FEDECASES	Federation of Savings and Credit Cooperatives of El Salvador
FEPCMAC	Federation of CMACs, Peru
FFP	Private Financial Fund (Fondo Financiero Privado), Bolivia
FINSAC	Financial Sector Adjustment Company, Jamaica
FUSADES	Fundación Salvadoreña para el Desarrollo Económico y Social (Salvadoran Foundation for Economic and Social Development)
GDP	Gross Domestic Product
GTZ	German Technical Cooperation Agency
INDAP	Instituto Nacional de Desarrollo Agropecuario (National Agricultural Development Institute), Chile
INEC	Instituto Nacional de Estadísticas y Censos (National Institute of Statistics and Census), Costa Rica
IPC	Internationale Projekt Consult GmbH
M2	Quasi money in domestic currency
MFO	Microfinance Organization
MIF	Multilateral Investment Fund, Washington
OSU	Ohio State University
ROA	Return on Assets
ROC	Return on Portfolio
ROE	Return on Equity
ROSCA	Rotating Saving and Credit Association
SBEF	Superintendencia de Bancos y Entidades Financieras (Superintendency of Banks and Financial Entities), Bolivia
SBIF	Superintendencia de Bancos e Instituciones Financieras (Superintendency of Banks and Financial Institutions), Chile
SBS	Superintendencia de Banca y Seguros (Superintendency of Banks and Insurance Companies), Peru
SDI	Subsidy Dependence Index
SSF	Superintendencia del Sistema Financiero (Superintendency of the Financial System), El Salvador
SUGEF	Superintendencia General de Entidades Financieras (General Superintendency of Financial Entities), Costa Rica

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