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Financial System and Rural Credit
Moyses Kessel

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Coordination:

Economic Department (Depec)

E-mail: depec@bcb.gov.br

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Banco Central do Brasil
Demap/Disud/Subip
SBS - Quadra 3 - Bloco B - Edifício-Sede - 2º Subsolo
Caixa Postal 8670
70074-900 - Brasília (DF)
Telephone (5561) 414-3165
Fax (5561) 414-1359

Statistical conventions:

- ... Data unknown.
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- 0** ou **0,0** figure smaller than half the value of the last digit to the right.
- * preliminary data.

An hyphen (-) between years (1970-1975) indicates the total of years, including the first and the last. A slash (/) between years indicates the yearly average of such years, including the first and the last, or harvest-year or agreement-year, according to the text.

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Banco Central do Brasil Information Center

Address:	Secre/Surel/Dinfo Edifício-Sede, 2º subsolo SBS - Quadra 3, Zona Central 70074-900 - Brasília (DF)	Telephones: (5561) 414 (...) 2401, 2402, 2403, 2404, 2405, 2406 <u>Toll-free:</u> 0800 992345 (just in the country) Fax: (5561) 321 9453
Internet:	http://www.bcb.gov.br	
E-mail:	cap.secre@bcb.gov.br	

Foreword

The institutionalization of the Banco Central do Brasil Technical Notes, conducted by the Economic Department, promotes the dissemination of works featuring economic content, attracting both theoretical and methodological interest, giving a view of the short-term developments of the economy and reflecting the work of the Bank's employees in all areas of action. Besides, other works, though external to the Banco Central, may be included in this series provided the Bank has afforded institutional support to their preparation.

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Financial System and Rural Credit

MOYSES KESSEL¹

1. Introduction

Bank loans to agriculture exhibit specific characteristics among operations performed by the National Financial System. Almost all credits are granted under rules and charges established by the National Monetary Council (CMN); official banks, mainly Banco do Brasil, grant the majority of loans, resorting, in their majority, to mandatory bank deposits or transfers from official funds. In this article, we analyze these characteristics and comment the current problems faced by rural credit.

Agricultural loans represented, at the end of 2000, about 9% of total balance of bank credit operations to the private sector. This share changed significantly since the establishment of the Rural Credit National System (SNCR) in 1965, following successive changes in the Federal Government rural policy. Hence, from the upper limit of 17% of such credits in 1980 (when rural debts came to be indexed), the share declined to 7.7% by the end of the 1st half of 2001, reaching 15.1% for loans granted by public institutions and 4.2% for those granted by private institutions.

Rural credit is different from other types of loans in the source of funds, participation of public and private financial entities and charges paid by borrowers. Essentially, law and subsequent regulations established the SNCR arrangements. Some characteristics were maintained: the main role given to official banks, especially Banco do Brasil (BB), in credits granted, interest rates below the market figures and controlled, that is to say, determined by regulations of the Central Bank and the CMN, and the mandatory source of the main part of funds.

The reasons behind the specific conditions of rural credit are the existence of “market failures” that make unfeasible the granting of credit to farmers under the conditions prevailing in the financial system, considering the unstable returns and the high risk involved in agricultural investments. For this reason, free loans, that is to say, loans granted under conditions and rates freely negotiated between financial institutions and their rural clients, are of small importance: 2% in Banco do Brasil; 5% in other public banks (OBP), mainly Banco do Nordeste; and 6% in private banks.

¹/ Statistician and actuary of the Economic Department/Technical Management of Economic Studies in São Paulo.

2. Source of funds

The main sources of funds for rural credit are of mandatory character: first, the part of the banks' demand deposits that has to be compulsorily channeled to rural credit (50% of loans granted by Banco do Brasil and 75% of those granted by private banks); then, transfers and refinancing, comprising funds coming from Rural Passbook Accounts, Constitutional Funds, part of the National Bank of Economic and Social Development (BNDES), Worker Support Fund (FAT), among others. Such transfers represent 48% of BB credits, 84% of OBP loans and 19% of private balances.

This results, to a large extent, from statutory requirements that transfer of funds from Sectoral Constitutional Funds – Northeast Investment Fund (Finor), Amazon Investment Fund (Finam) and FAT –, financing the National Program for Strengthening Family Agriculture (Pronaf), shall be made by official banks only. Therefore, private banks, with no access to such resources, use mainly mandatory funds.

Another reason for the relatively small participation of private banks is the access by public banks only to the arrangement of interest rate “equalization”, that is to say, reimbursement of differences between charges paid and received in loans granted to family agriculture (Pronaf) and to supporting farm prices – Federal Government Loans (EGF) and Federal Government Acquisitions (AGF). The rebates made by the National Treasury are part of the Federal Government Budget.

Rural credit reaches only a minority of farmers, estimated in about 25% of the total surveyed by the Agricultural Census. Besides, rural credit is concentrated in loans granted to larger farmers, despite the establishment, in 1996, of programs specifically turned to family agriculture (Pronaf). According to a survey among the main private rural credit operating institutions, the 10% larger customers represent about 80% of loans granted; in BB, about 6% are granted 73% of agricultural credit values.

3. Use of funds

In the aggregate of bank balances at the end of 2000, BB had 62% of credits, private banks, 35% and other public banks, 3%; the balances represent loans granted over several years. Lenders' shares in loans granted over the year 2000 are as follows: BB executed 61% of agreements and lent 43% of the value; private banks signed 15% of agreements, with 43% of the value lent; while OBP were responsible for 17% of agreements and 9% of the value. The remaining was to credit cooperatives (7% of agreements and 9% of the value), showing the higher average value of credits granted by private banks.

Rural credit is used in three cases: harvest funding, investment and marketing. These uses vary widely among institutions: BB channeled, in 2000, 79% of credits to funding, 16% to investment and 5% to marketing; OBP channeled 69% to investment, 28% to cost and 3% to marketing. Private banks, in turn, employed 53% in cost, 35% in marketing and 12% in cost.

The greater concentration of marketing loans in private banks may be explained by the fact that such banks prefer to focus their loans in larger customers, especially companies that process and market grain and other exportable crops.

On the other hand, in ranking credits according to their risk level, June 2001 data show that, regarding the Financial System in general, loans bearing higher risks (level H, payments delayed over 180 days) corresponded to 3.8% of the rural credit balance, second only to those of housing (8.8%) and natural persons (5.6%). In the lower risk rank (AA) are 19.4% of rural loans, contrasted to 11.8% of housing and 11.2% of natural person loans; the best behavior relates to loans to industry: 43.2% at level AA and 2.9% at level H. Separately, public institution loans have, in the rural credit, 14.6% ranked at level AA and 5.1% at level H.

The above data define the characteristics of the SNCR: it operates with directed credits and for the benefit of a minority of producers, employing basically official funds and granting loans with interest rates below market rates; for instance, the top yearly interest rate applicable to harvest funding with controlled funds is 8.75%; of Pronaf rates are 5.75%, or lower for small producers and families settled by the Agrarian Reform program.

4. Comments

The National Rural Credit System has been criticized by both Brazilian specialists and international institutions. The criticisms focus on the narrow scope of the program, benefiting a small proportion of borrowers – mainly large farmers –, with subsidized loans, and for making room, in the '70s and '80s, for distortions in the allocation of investment and channeling of funds to different purposes, as well as for encouraging rural migration and concentration of the agricultural structure.

The criticisms, though valid to a certain extent, fail to consider the role of the SNCR in modernizing and increasing the productivity of the Brazilian agriculture, translated into larger crops. Besides, the negative factors have diminished in importance with the monetary stabilization after 1994 and the establishment of programs for small farmers.

The current questions are, in essence:

- 1) how to create non-inflationary funding arrangements, reducing the dependence on controlled funds;
- 2) how to include the majority of farmers in the system;
- 3) how to reduce the poverty of Brazilian farmers, where a large part of families live on subsistence agriculture;
- 4) how to increase the share of private banks in the rural credit.

Several solutions have been suggested for these problems. There is a generalized belief that the current financial system is not appropriate for small farmers given the scattering of target customers, high transaction and management costs, poor information on prospective customers, and difficulties to obtain collaterals and enforce them. In the case of poorer farmers, credit is not the best instrument for improving life conditions: direct disbursements, job creation outside the agricultural sector and investment in human resources seem to be more efficient instruments for this purpose. For those small farmers already integrated to agribusiness, the establishment of non-conventional and decentralized credit institutions, with decisions taken locally, joint collaterals and non-asset guarantees have been successful in other countries.

Corporate agriculture has access to credit other than that provided by banks, such as the Rural Producer Note (CPR), option contracts, advances on exchange contracts and direct loans granted by suppliers of inputs and by marketing and processing corporations. It is therefore necessary to establish instruments to finance investments that are at the margin of agricultural modernization. Under the current conditions, private banks may not operate in rural credit with market interest rates; however, such banks argue that their share could increase if they had access to arrangements such as transfers and equalization, which are available to official banks.