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COSTA RICA
POLICY TOOLS FOR RURAL FINANCE

# COSTA RICA:
# THE POLITICAL ECONOMY OF AGRICULTURAL CREDIT

by

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## I. Introduction

Costa Rica experienced a major economic crisis during the late 1970s and early 1980s. In order to overcome this crisis, a stabilization program was adopted by the authorities which, among other things, attempted to restructure the policies and operations of the Nationalized Banking System (NBS).

The NBS had virtually become an obstacle to the reactivation of the economy. This reflected, in part, an increasing number of restrictions on its operations, imposed by the Central Bank and by special legislation. After the appointment of Dr. Eduardo Lizano as Executive President of the Central Bank, however, a process of liberalization of the financial system was attempted. This process has mainly consisted of a gradual reduction in the use of quantitative restrictions on credit (topes de cartera), until their virtual disappearance in 1987. Liberalization has also been aimed at giving greater independence to the commercial banks in the setting of their interest-rate structure. The scope of subsidies through the credit channels has also been specifically defined and limited.

The Central Bank's strategy has been, therefore, to let the state-owned banks operate with less restrictions than before and to let them simulate more what a private financial institution would do; that is, to efficiently transfer resources from surplus to deficit economic units, thus promoting the most profitable use of those resources.

As a result of the new strategy, however, certain groups in the economy, which had been heavily subsidized under the earlier regime, reacted alarmed. They saw their possibilities to obtain low interest rates and large loans (via topes and avios) greatly diminished. They feared that the state-owned banks would reduce their lending to the high-risk, low-profitability activities which were being subsidized.

For several reasons, from both the demand and the supply side, the volume of agricultural credit, specially for small farmers, had recently declined. This situation, coupled with the drought experienced in the Guanacaste region during four of the past five years, as well as the decline of the international and domestic price of meat, aggravated the crisis of the agricultural sector, in general, and specially that of the cattle raisers and rice producers of the Guanacaste region.

In an attempt to restore the benefits and priviledges that they had acquired before the crisis, such as interest-rate subsidies and easy access to the limited loanable funds available, cattle raisers and rice producers, with the help of small farmers and the rest of the agricultural sector, started to lobby for laws that would protect their entitlements to be approved by Congress.[1/] The major achievements of this lobbying was the FODEA law. By this legislation, agricultural producers obtained a series of benefits, including the rescheduling of delinquent loans and new credit subsidies.

## II. The Political Economy of Agricultural Credit Legislation in Congress

In addition to the FODEA law, several bills, under consideration in Congress in early 1988, will be analyzed in this paper. These bills have reflected the attempts by representatives of the agricultural sector to reverse the financial liberalization process undertaken by the Central Bank. Most of the proposals aspire to go back to the old system of topes and interest-rate subsidies, from which some members of the agricultural sector had greatly benefited in the past.

### 1- FODEA

On april 9, 1987, the Ley de Fomento y Desarrollo Agropecuario, popularly known as the "FODEA" law, was approved by Congress. The main purpose of this legislation was to provide incentives to the agricultural sector. Its mandates can be divided into five major components:

(a) Debt relief to delinquent agricultural borrowers.

This authorized the Ministry of Finance to issue 5 billion colones in bonds, at an interest rate of 8 percent, and maturing in 16 years. These bonds will be used to buy from the state-owned banks those loans from small and medium farmers granted before December 31, 1985 which were delinquent by June 30, 1986.

The small-farmer loans are being rescheduled for up to 16 years, with a grace period of 4 years, at an interest rate of 8 percent during the grace period, and at a rate 10 points below the basic deposit rate afterwards. Loans of medium-sized borrowers are being rescheduled for the same period of time, but at a 10 percent interest rate during the first four years, and a rate 6 points below the basic deposit rate afterwards.

Large-borrower loans will not be rescheduled automatically, as in the case of small and medium borrowers. They are being studied on a case by case basis, since these loans will not be bought by the Government. For those large farmers whose loan projects are still viable, the rescheduling will be for 12 years, with a 4-year grace period, at an interest rate of 15 percent during 4 years, and at a rate equivalent to the basic deposit rate for the remaining 8 years. If the farmers cannot meet these terms, they must surrender part of their property as partial payment, until the bank considers that the project is feasible again.

With the 5 billion colones in bonds, the Government will only be able to buy the small and medium farmers' delinquent portfolio from the state-owned banks. The estimated distribution of the portfolio among these banks and by farmer's size can be seen in Table 1.

Table 1. National Banking System. FODEA's Portfolio Distribution, by Banks and Farmer's Size. Amounts in millions of colones.

| | Small | | | Medium | | | Large | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number | Amount | % | Number | Amount | % | Number | Amount | % | Number | Amount |
| BNCR | 10,461 | 706.8 | 26.5 | 1,508 | 788.2 | 29.6 | 624 | 1,165.6 | 43.8 | 12,593 | 2,660.6 |
| BCR | 5,344 | 1,136.9 | 42.4 | 574 | 545.8 | 20.3 | 383 | 988.5 | 37.2 | 6,301 | 2,681.3 |
| BACR | n.a. | 907.3 | 41.4 | n.a. | 571.5 | 26.1 | n.a. | 713.2 | 32.5 | n.a. | 2,192.0 |
| BCAC | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 296.5 |

Notes: BNCR- Banco Nacional de Costa Rica
BCR- Banco de Costa Rica
BACR- Banco Anglo Costarricense
BCAC- Banco Crédito Agrícola de Cartago
Small: Up to 1.5 million colones in total debt.
Medium: From 1.5 up to 5 million colones in total debt.
Large: Over 5 million colones in total debt.

(b) Preferential tax treatment.

This dimension of FODEA is designed to match the incentives available to the industrial sector. These provisions will primarily allow farmers to use the accelerated depreciation of new fixed assets and to enjoy income-tax credits when reinvesting in the same firm, property-tax relief for farm machinery, and exemption of import duties on light farm machinery.

(c) Creation of the Sector Agropecuario de Recursos Naturales Renovables.

(d) Legislation concernig the Ministry of Agriculture and Livestock (MAG).

(e) A subsidized interest-rate (i.e, 12 percent) for those products classified as agricultura de cambio.

(f) An exemption for the state-owned banks to pay the tax from the Ley para el Equilibrio Financiero del Sector Público, which was set at 60 million colones for 1987, and had reached 150 million colones in previous years.

The FODEA law was enacted unanimously, and it encountered no opposition whatsoever in Congress. The discussion was mainly related to procedure, especially the way in which the rescheduling of the loans was to be arranged.

The project originated from an earlier proposal presented by the MAG, heavily promoted by the Cámara Nacional de Agricultura, in which fiscal incentives were the main instrument used to balance agricultural protection against that for industry. The rationale behind FODEA was that the agricultural sector had been heavily taxed and used to subsidize other sectors of the economy. Government policy had increased the wages of urban workers and had lowered food prices, in order to keep urban consumers and voters happy, at the expense of rural producers. Thus, it was felt necessary to offer the agricultural sector a compensating set of incentives. In addition, it was believed that the reactivation of the agricultural sector could not take place without giving farmers a fresh start. The rescheduling of the loans was included in the project as a way to allow farmers to become creditworthy again. Due to the bad shape in which farmers found themselves, especially cattle and rice producers, who had just gone through two consecutive years of drought, the rescheduling terms were made easy, in order to allow them a chance to recover.

It was also argued that the debt relief chapter of the law was necessary, since the huge amount of delinquent loans in the banks' portfolio was no longer manageable. If the state-owned banks were to send all of those farmers to court, in order to foreclose or get repayment, either the courts would be overrun with these cases indefinitely, or the banks would end up with many farms which they would be unable to sell, except at unremunerative prices. At the same time, agricultural production would dramatically decline, creating an enormous economic problem for the country. FODEA, thus, was needed as a socio-political solution, in order to clean up the banks' delinquent agricultural portfolio, and avoid wholesome foreclosures.

The bill was studied by the Agricultural Commission in Congress, chaired by Congressman Jorge Rossi (PLN). Two other Commission members were Congressmen representing the Guanacaste region, cattle raisers who qualified for the rescheduling of loans themselves. Another Congressman who fought hard for this project, but outside the Commission, was a former president of the Banco Nacional and currently Vice-President of the Federación de Cámaras de Ganaderos.

The role of Congressman Rossi was crucial in getting the bill approved quickly, even though he did not completely agree with the final version of the law. He viewed FODEA as a good start in an effort to solve the short-term problems of the agricultural sector, but believed that more was needed to solve the long-term problems. Actually, almost all Congressmen agreed on this point, but Rossi was the leader who emphasized it the most.

Rossi did not agree on all parts of the project. For example, he was dissatisfied with the granting of subsidized credit at 12 percent to the items of agricultura de cambio. He felt that this was not the way to give incentives to an activity. He also recognized the problems and inequity in the generality of the rescheduling program, by which some individuals who would had been able to but have nevertheless avoided the repaying of their loans, through their political connections, were to benefit. He argued that this problem came from the extreme politization of the state-owned banks, which originated with the "4-3" law of the early 1970s, which created a system for the distribution of the political pie (power shares) among the parties and ended with the autonomy of the banks.

Congressman Muñoz Bustos, former President of the Cámara de Ganaderos de Guanacaste, claimed that the current condition of the farmers (especially cattle raisers) demanded a political solution. The social problem of having a lot of bankrupt farmers losing their land was considered to be far more important than the economic effects that FODEA might have on the banks. He also argued, very forcefully, that the cost of credit is too high for farmers, due to the high levels of transaction costs for loans from the state-owned banks. He felt that farmers cannot absorb the present high levels of interest rates.

Two other large cattle raisers in Congress, Román and Avila, pushed hard for the law to include all farmers, including large farmers, in order to avoid any "discrimination." Avila (PUSC), an influential Congressman in bank-related matters, blamed the state-owned banks for the crisis affecting cattle raisers. He argued that if the banks had carried out the decrees enacted by former President Monge, related to the rescheduling of loans, then the problem would have been solved. At this moment, he claimed, the cattle industry cannot support interest rates any higher than 12 percent, and therefore he proposed lower interest rates for the rescheduled loans.

Two Congressmen from Liberación Nacional, who are not on the Agricultural Commission, but who are still very influential in bank-related matters, are Congressmen Carvajal Herrera and Fait Lizano. The former proposed higher interest rates during the grace period, and rates tied to the basic deposit rate afterwards, in order to penalize the banks less. The last part of his proposal was approved, but at the lower rate than had been initially proposed. Carvajal Herrera had proposed an interest-rate scheme tied to the deposit rate, especially for large farmers, since he argued that the 15 percent rate for the large farmers was a big subsidy, and would actually increase land concentration in the country. He also felt that the law was too general, since it was going to help many people who did not deserve these benefits, namely those who had not been paying their loans on time, but just waited for this law to be enacted.

During the discussion of FODEA, the representative of the

Federación de Cámaras de Ganaderos, Alberto Amador, and representatives of the small-farmers associations, Union de Agricultores, UPAGRA, UPANACIONAL, were present in the public stands of Congress most of the time, lobbying for its approval.2/ The cattle raisers, under the leadership of Amador, have become a very powerful group. They campaigned hard for the debt relief provisions, arguing that it had to be the first step of any successful incentive program for the agricultural sector. The rescheduling exercise was considered necessary because of the negative impact of bad weather, low international prices, high input prices, and excessive indebtness on the cattle industry.

The small-farmer groups campaigned mostly for the lowering of interest rates and for an increased availability of credit. They also asked that the loan approval process be streamlined, since they had to become eligible for credit as soon as possible, before the next crop season. On the other hand, the Cámara de Agricultura, which consists mainly of large farmers, campaigned on the basis of an equality of incentives with the industrial sector and the need for compensatory policies, to offset previous measures that had penalized the sector in the past.

Within the Government, the MAG gave total support to this law. Minister Esquivel was one of the main lobbyist. Although the Central Bank formally disagreed with the bill, it did not actively oppose its approval, contrary to what would have been expected. President Lizano declared in Congress that there were too many producers in trouble, and that there was, therefore, a need for a social solution, i.e., a massive rescheduling (adecuación al por mayor), in order to put the banks' portfolio in order. The banks are partly at fault, he argued, having given too much credit to farmers in the first place. Thus, they should absorb part of the losses of the debt relief scheme, because the Ministry of Finance, at this moment, cannot support much more of a fiscal burden.

The only virtual opposition to FODEA came from the state-owned banks. They argued that the losses from prolonged rescheduled repayments at low interest rates will greatly affect their liquidity and financial strength and endanger the nationalized banks. An analysis of the possible financial effects of FODEA for the case of the Banco Nacional (BNCR) is presented in Annex 1. It shows the possible interest-revenue losses (or gains), the gain from recovering the totality of the loans, and the liquidity losses of not recovering any loans during the first four years.

Since the banks did not present any actual figures on the possible effects of this law, when they defended their possition at the Congress' hearings, their arguments were not taken much into account by the Congressmen. Actually, the bank officers' attitude became, after a while, one of abdication. Since they knew that the law would be approved, they lobbied for higher interest rates and shorter maturity terms, in order to minimize their losses.

In the aftermath of FODEA, the banks also attempted to minimize their losses, through the selling to the Government of the worst-quality loans in their portfolio. These were the loans that had already been transferred to their lost-loans account. They hoped to keep the best-quality loans for rescheduling purposes. The banks also tried to assure the collection of the rescheduled loans by asking for additional collateral on each loan to the farmers, slowing down the rescheduling process in the meantime. Cattle producers protested angrily for these actions. They even stopped the supply of meat for about a week in January, until the Government, through the MAG, pressured the banks to accept small and medium farmers without asking for any papers, just their identification card. Large cattle raisers did not obtain much from this negotiation, except for a statement from the banks that they would expedite the process.

Small-farmer organizations have also had some confrontations with the banks in the aftermath of FODEA, especially regarding the interpretation of some provisions of the law that affect small farmers. For example, the banks interpreted the grace period to begin at the time when that the law was enacted, while the small farmers argued that it should start after the loan is rescheduled. The small farmers threatened to block roads and the supply of products to the cities, if the banks did not stop putting obstacles to the implementation of the law. The banks, on the other hand, argued that they had done as much as possible to speed up the process, and that if roughly one-half of the outstanding loans had not been rescheduled, this was due to the lack of interest on the part of the farmers. Indeed, some farmers have been waiting for the full pardon of their debt.

Some opposition to the FODEA law came from the small-farmer groups, specially their sponsor in Congress, Congressman Brenes Castillo, regarding the concentration of the loan portfolio that qualified under the debt relief program. The arguments were that with this law large farmers benefited much more than the smaller ones, because of the great proportion of the loan portfolio that they represented.

As can be seen in Table 1, around 83 percent of the number of operations that qualified for rescheduling in the BNCR were those of small farmers, while they only accounted for 27 percent of the total amount. At the other end, large farmers represented 5 percent of the total number of operations, but 44 percent of the total amount. If only the Juntas Rurales, which included 6,859 operations for 222 million colones, are considered, "true" small farmers would account for only 8.4 percent of the total amount and 55 percent of the total number of operations. Actually, according to the Central Bank, the definition of a small farmer, in order to qualify for the subsidized rate of the Juntas Rurales differs from that used in the FODEA law. The definition of the Central Bank considers as a small farmer an operator who has no more than 800,000 colones in debt, while FODEA has an upper limit of 1.5 million colones. The concentration figures seem to be more significant if one takes into account that larger farmers tend to have more than one operation, while smaller farmers usually have only one operation with the bank.

Given this concentration, the benefits that each individual will get would be much larger if he is large farmer than a small one. For instance, a large farmer from the Banco Nacional would receive, on average, an interest subsidy of about 121.040 colones, while small farmers would receive, on average, 7,222 colones.[3/]

2- Reformas a la Ley Orgánica del Banco Central y del Sistema Bancario Nacional.

This project contained three distinct parts. The first one included reforms to the Banking System Law, the second one reformed the Central Bank Law, and the last part gave more powers to the Auditoría General de Bancos. The Bill was expected to allow the state-owned banks to compete more effectively with the private commercial banks. The bill recognized that, in order to achieve economic growth, a modern and efficient financial system is necessary. This bill primarily exempted banks from the laws about the Autoridad Presupuestaria and Equilibrio Financiero del Sector Público. The bill was presented to Congress by the Executive branch of Government, with the support of the Central Bank and the Banco Nacional.

The bill was approved by the Economics Commission and was waiting to be studied by the floor of Congress (Plenario). In early March, however, the Government presented an alternative project, with basically the same ideas, but much narrower in scope, in order to expedite the enactment of the law, needed to stabilize the financial system, in view of the recent bankruptcy of several private financieras.

3- Law to Establish Appropiate Interest Rates for Agricultural Loans.

This bill was presented by Congressman Muñoz Bustos. It proposed that the interest rate for agricultural loans be established during a period of five years at the Libor rate plus three percentage points. The argument given was that the cost of money is too high in Costa Rica at this moment, and that the agricultural sector cannot survive such high interest rates.

The state-owned banks expressed their opposition to this project, arguing that the establishment of the interest rates is a matter for the Central Bank, and that the cost of money should reflect the cost of funds and intermediation costs. The bill, they argued, also violated the autonomy of bank administration.

Dr. Miguel A. Rodríguez, now a candidate for the primary elections for President in the PUSC, was invited to comment on the project. He gave a lengthy explanation on how the cost of money is determined on the basis of intermediation costs, the inflation rate, and the demand for resources by the Government, in order to cover the fiscal deficit. Even though Congressman Muñoz Bustos was convinced by the technical arguments of Dr. Rodríguez, he insisted that the agricultural sector needs low interest rates to survive. He then proposed to change the bill in order to tie the interest rate to the deposit rate charged by banks.

In order to alleviate the burden of bills to be examined by the Agricultural Commission and speed up the process, this project was approved in committe, but without the vote of the Commission's President, Jorge Rossi, who did not consider it a solution to the problem. It has little chances of approval by the floor (Plenario) in its present form.

4- Law for the Financing of the Small Farmer.

This bill was proposed by Congressman Avila Solé. Due to the decline of small-farmer credit volumes, and given the importance of small farmers to the democratic life of Costa Rica, this bill attempted to reverse this decline by forcing the state-owned banks to lend at least 10 percent of their portfolio to small farmers.

Opposition to this project came from the state-owned banks, as well as from some Congressmen, who argued that this was not a solution to the problem. The banks do not have an incentive to lend to small farmers, and forcing them to do so will not make them lend more. In any case, bank directors are responsible for their actions at the bank, by law. Forcing them to lend too much to risky enterprises that makes them lose money will put them in an impossible situation.

This bill was also approved by the Agricultural Commission, without much discussion, just to speed up the process. Again, it is unlikely that it will be approved by the Plenario.

5- Ley de Fideicomiso Agrario.

This bill is the initiative of Congressman Jorge Rossi, with the help of the Banco Nacional. It was presented to Congress by Rossi together with Congressmen Corrales Bolaños and Arias Angulo. The bill gives support to the Land Reform Institute of Costa Rica (IDA) in its land distribution efforts. It states that it wants to take advantage of the good will of some landowners to sell their land, so that the state-owned banks may distribute this land among small and medium farmers. The banks, at the same time, would grant loans to help the new owners start production, and be able to pay the loan to purchase the land.

The program is based on the design of the Fideicomiso de Vivienda, which has been in place at the Banco Nacional since 1979. This bill authorizes the state-owned banks to take possession of the land given as collateral by its defaulting clients, and then sell this foreclosed land to small and medium farmers. These will receive, in turn, credit to pay for the land, which is also pledged as collateral for the loan.

The president of the Agricultural Commission, Congressman Rossi, is very interested in this bill. He even had some preliminary conversations with IDA's executive president, Sergio Quiros, who agreed with the purpose of the bill and promised to help. When Congress asked IDA for its evaluation of the bill, however, IDA's Board of Directors, in absence of its President, gave a negative report on the bill and argued that the banks did not have the capacity to undertake land distributions, which was, in any case, a task assigned to IDA. Further talks between Rossi and IDA's president induced this institution to reverse its initial negative report. The new position indicated that IDA would be willing to cooperate with the banks with technical assistance on the distribution of land.

6- Creation of a Small-Farmer Credit Department.

Given the importance of small farmers to the democratic life of Costa Rica, the positive experience of the Juntas Rurales at the Banco Nacional, and the previous experience of institutions that were created through the Banco Nacional, such as the Central Bank, the Consejo Nacional de Producción, and INFOCOOP, the MAG considered it desirable to present a project that would create a more specialized and independent department than the present Departamento de Crédito Rural, to be called Departamento del Pequeño Productor Agropecuario.

This department would have complete administrative and functional autonomy from the BNCR, with its own accounting system and Board of Directors. The Banco Nacional's executive president, the department's manager, and one member appointed by the executive and elected from the national organizations of small farmers, will form the Board of Directors.

The state-owned banks would sell their entire small-farmer credit portfolios to this department, in exchange for certificates of deposit at an interest rate of 8 percent. The Ministry of Finance would also give the department one billion colones in bonds, which would be used to finance its operations, in addition to any foreign loans and certificates of deposit that it may obtain.

The main supporter of this bill in Congress is Congressman Rossi, but not with the same interest as the previously discussed bill. Some of the other Congressmen on the Agricultural Commission, however, do not know much about it, and did not see the need for it, since they consider that the Juntas Rurales will lose a lot of economies of scale and of scope if they are separated from the BNCR.

7- Other.

There were two additional projects related to agricultural credit under study in Congress, but with little or no chance of been approved. One was a bill presented by the left-wing Congressman Solís Herrera, called Ley de Emergencia Agraria. It stated that due to the extreme dependence of the Costa Rican economy on international financial organizations, and the deep crisis that the country is in, the agricultural sector should be protected and promoted.

The bill would force landowners to use their land in production, or otherwise the IDA would be authorized to rent that land to small-farmers who will work it. It would also require the MAG to establish quantitative limits (<u>topes</u>) on agricultural credit every year. It would create, as well, the <u>Consejo Nacional Campesino</u>, composed of 13 members of small-farmer organizations, from which the nation's President should choose at least three members to belong to the state-owned banks' Boards of Directors.

This bill received several negative reports from the banks, which argued that the intrusion that this law would create in the functions of the banks is excessive, and that it would increase the politization of the Board of Directors.

The last one was a bill presented by Congressman Corrales Bolaños, as <u>Ley de Emisión de Bonos para el Desarrollo Agrario</u>. This project was designed to give financial support to IDA, by authorizing it to issue 7 billion colones in public debt bonds, with a maturity of 20 years and at an interest rate equal to the deposit rate of the banking system. The bill generated negative reactions from all banks, and even from IDA, which considered that the issue of bonds is a function of the banks. The bill has little or no chance of been approved, since it was in the Agricultural Commission for more than a year, without having been studied.

## III. <u>Political Pressure on the Banks</u>

Besides the political pressure exerted by interest groups on Congress to pass laws that allow them to obtain additional benefits from the Nationalized Banking System, there are added pressures on the banks themselves by these groups and by influential politicians, either directly, or through the Central Bank and the Executive branch of Government.

For instance, some individuals, because of their political power, may obtain credit with special conditions, such as low interest rates, long maturity terms, high debt-to-assets ratios, and a fast loan processing time. This does not apply only to influential politicians, but also to friends of any Board Director, or large clients of the bank.

This type of influence, however, is not too widespread, according to most of the bank-related people who were interviewed. This may be because, on the one hand, individuals may not have enough political clout, by themselves, to control the Board of Directors and top management of a bank. On the other hand, banks have instruments to avoid some undesired political clients, such as delaying the disbursement of the loan, or by asking for additional requirements that make approval of the loan difficult.

One of the interviewees, however, expressed the feeling that the political clout of small groups of very influential politicians might be very strong in the banking system. These small groups, which act inside the political parties, are formed mainly around former presidents and presidential candidates. In order to further investigate this hypothesis, the concentration of the credit portfolio of the state-owned banks could be studied, not operation by operation, but by individuals and related firms. For instance, it was determined, after a more thorough examination of the arrears portfolio of the BNCR that qualified for the FODEA law, that among the about 640 operations that conformed the large agricultural loans, there were only about 200 different names of individuals or firms. Some of these, moreover, may be closely related (e.g., husband and wife).

Individuals may not have enough power to influence the banks by themselves, but when organized in groups with a common cause, their ability to exert pressure is increased greatly. In Costa Rica, pressure groups organized by product, i.e. coffee, cattle, sugar cane, grains, and so on, seem to be more efficient than individuals in obtaining special conditions from the state-owned banks.

These groups may exert direct pressure on the Board of Directors in order to obtain special conditions, but this may not be effective unless there is at least one member of the group in the Board, to represent their interests. For this reason, groups attempt to influence, instead, the Consejo de Gobierno (Cabinet), which appoints the members of the state owned banks' Boards. Since there is the equivalent of an employee relationship between the Consejo and the banks, the later are used many times as a socio-political instrument of the Government. For instance, many bank employees admitted that the banks lend as little as they can to small-farmers at subsidized rates (Juntas Rurales), except when they feel that the dissatisfaction among small-farmers against the Government is mounting and getting to be too high. Then, they open the line of credit for this group, as a escape valve, to alleviate the pressure.

In exerting this kind of pressure, the groups that belong to producers of seasonal crops, such as grains, will have more clout, since all the members of the group will need credit at the same time. Producers of coffee, bananas, or cattle will not be as efficient in exerting pressure, in this case, since their needs for credit are not as seasonal as for grains.

Groups may also exert pressure through the Executive branch, in order to obtain a decree that favors their particular interests. An example of this is the series of decrees issued by former president Monge during the last year of his mandate, by which cattle production was declared under a state of emergency, and a rescheduling of the loans for this activity was ordered. The effect of this decrees, however, was minimal, since the banks never rescheduled the loans as ordered. This may have led, in the end, to the serach for legislative action and the passage of the FODEA law.

Notes:

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1/ See Tomás Miller, "Costa Rica: El Debate Político en el Sector Agropecuario," in this collection of papers, for a description of several groups and associations created to lobby for the farmers' interests.

2/ These small-farmer associations are now grouped, with the Cámara de Granos Básicos, into the Union Nacional del Sector Agropecuario (UNSA), and are represented in Congress by an independent Congressman, Brenes Castillo. See Tomás Miller's paper in this collection.

3/ Given that the average loan size for large farmers is 1,868,-000 colones, and the average interest rate is 21.48 percent, large farmers receive a subsidy in interest rate of:
1,868,000 * (0.2148 - 0.15 ).
The average loan size of small farmers is 67562 colones and the average interest rate is 18.69 percent.

## ANNEX 1

### Approximate Financial Effects of FODEA on the Banco Nacional

1- Annual interest revenue losses.

The bank loses some interest revenue from having to forego the contractual interest on small and medium loans, which on the average is at present 19.9 percent, and instead receive only 8 percent of interest from the Government bonds. Additionaly, the bank has to reschedule large-farmer loans at 15 percent, while it had expected to receive an average of 21.5 percent of interest. On the other hand, the bank will be receiving for sure the interest from the bonds, while part of the interest revenues from the delinquent loans would have not been received.

The annual interest revenue, during the first four years, from the Government bonds and the rescheduling of large-farmer loans would be (in millions of colones):

| | |
|---|---|
| Small and medium farmers: | 1,494.9 * 0.08 = 119.6 |
| Large farmers: | 1,165.6 * 0.15 = 174.8 |
| Total Interest from FODEA | 294.4 |

The total interest revenue that the banks would have received, if they would had collected the totallity of the interest from the loans that were on arrears, would have been 548 million colones. As a result, the annual loss would be 253.6 million colones. If the banks would have received 75 percent of that interest, then the loss would be 116.6 million colones, while with a 50 percent recovery rate, the bank would gain, instead, 20.4 million colones.

2- Default Losses:

There are gains from collecting the totallity of the loans in sixteen years, against the possibility of not collecting all of it without FODEA. The bank, by selling the small and medium farmer loan portfolio to the Government, is receiving an "assurance" that it will recover 100 percent of this portfolio. If, instead, the bank had to attempt to recover these loans under the normal bank guidelines, part of that would have never been collected. Because of the lack of information at the bank, it was not possible to find out a good estimate of how much of the portfolio would have been recovered. Some bank officers estimated that the recovery rate would be around 50-60 percent, while other estimated it to be much lower than that.

Table A.1. Net Gains from Selling the BNCR's Small and Medium Farmer Portfolio.

| If the bank would have collected (Percentages) | It would have received (Million colones) | Net Gains from FODEA (Million colones) |
|---|---|---|
| 100 | 1,494.9 | 0 |
| 75 | 1,121.2 | 353.7 |
| 50 | 747.5 | 747.4 |
| 30 | 439.5 | 1,055.4 |
| 20 | 299.0 | 1,195.9 |

Source: Computed by the author from unpublished BNCR data.

The gains are inflated, however, by the inflation effect. If the bank would have been able to recover at least part of the portfolio in four or five years, the present value of what the bank receives would not have lost as much value as the Government bonds, from which the bank does not receive anything until the fifth year, and it does not receive the totallity of it until the sixteenth year. In real terms, therefore, the bank will lose part of the purchasing power of the principal. Moreover, the interest rate on the rescheduled loans is lower than the expected rate of inflation, so the bank cannot use interest payments to avoid this erosion of its portfolio.

3- Liquidity losses.

There is a loss for the bank for not receiving any amortization on the bonds until the fourth year, as compared to what the bank would have been able to collect directly from the borrowers, including the large farmers. This lack of loanable funds will strain the liquidity position of the bank. For instance, the bank might have collected 100 percent of the total portfolio during the first four years, while with FODEA it will fail to receive those 2,660.6 million colones in funds, because of the grace period. The assumption of the bank being able to collect the totality of the portfolio in four years is not realistic, however.

Table A.2 BNCR. Liquidity Losses During Fodea's Grace Period.

| If the bank would have collected (Percentages) | It would have received (Million colones) | Net Loss of Liquidity with FODEA (Million colones) |
|---|---|---|
| 100 | 2,660.6 | 2,660.6 |
| 75 | 1,995.5 | 1,995.5 |
| 50 | 1,330.3 | 1,330.3 |
| 30 | 798.2 | 798.2 |
| 20 | 532.1 | 532.1 |

Source: Computed by the author from unpublished BNCR data.