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POLICY TOOLS FOR RURAL FINANCE**

STUDY OF THE BILL TO REFORM THE FODEA LAW:

FODEA II

by

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Abstract

A bill to amend the section of the FODEA Law that regulates the rescheduling of loans was introduced in the Costa Rican Congress in July, 1988 (FODEA II). The main reforms featured in the bill are outlined in this paper, which also contains an analysis of the effects that the bill may have on the Costa Rican National Banking System and on the nation's farmers, on the basis of an evaluation of the consequences of FODEA I.

The analysis reveals that the FODEA portfolio has been highly concentrated among a small number of farmers, particularly livestock producers of the Guanacaste region. Because of the low interest rates charged on the rescheduled loans, the subsidy granted to agricultural borrowers by the FODEA Law has also become highly concentrated. If implemented, the FODEA II bill would not only increase this concentration of the FODEA portfolio, but it may also contribute to further exacerbate the revenue and liquidity losses that the banks have already experienced as a consequence of the FODEA Law.

STUDY OF THE BILL TO REFORM THE FODEA LAW: FODEA II

Luis Mesalles*

Introduction

In May, 1987, the "Ley de Fomento a la Producción Agropecuaria," better known as the FODEA Law, was approved by Congress. This legislation was aimed mainly at reactivating the agricultural sector, specially the livestock sub-sector, from what was considered to be a major crisis.[1]

In order to assist the agricultural sector, the Law contained, among other things, an authorization for the Ministry of Finance to issue CR$5 billion in bonds, to buy a portion of the portfolio in arrears of the state-owned banks. The loans of small and medium farmers already in arrears before June 1986 qualified for rescheduling, at low interest rates, with a sixteen-year payback period, and four years of grace. Small farmer loans were rescheduled at 8 percent during the first four years and at 10 points below the basic deposit interest rate during the remaining 12 years. Medium farmer loans were rescheduled at 12 percent during the grace period, and at 6 points below the basic deposit interest rate afterwards. This portion of the portfolio was then bought by the Government, in exchange for the bonds.

Large farmer loans were also rescheduled by the banks. In this case, however, the Government did not buy out the loans. Instead, the banks were forced to carry the burden of the rescheduling, according to the terms established by the Law. Specifically, the loans of the large farmers were rescheduled at a 15 percent interest rate during the four-year grace period, and then at a rate equivalent to the basic interest rate, during the remaining 12 years.

Fifteen months after the FODEA Law was approved, in July 1988, a bill to reform part of it was introduced by Congressman Muñoz Bustos. The new initiative is called "Bill to Reform Articles 1, 6, 7, 8, 9, 11, 12, 13, 14, 15, 16, 18, and 21 of Law No. 7064, Ley de Fomento a la Produccion Agropecuaria," and is commonly known as FODEA II.

In supporting FODEA II, Congressman Muñoz Bustos argued that, notwithstanding FODEA's positive role in helping to alleviate some of the problems of the agricultural sector, continued government policies of disincentive to this sector, combined with droughts that affected the country during the past few years, had exacerbated the crisis and, thus, had further discouraged farmers from remaining in the agricultural sector. Congressman Muñoz Bustos argued that FODEA had been inadequate, as well, partly because the final draft of the Law provided an opportunity for the banks not to develop much interest in rescheduling farmer loans. Consequently, he felt that many farmers had not been able to reschedule their loans and had not become creditworthy again. State-owned bank officers claim, on the other hand, that they have done as much as possible to follow the guidelines of the FODEA Law, but that farmers have not come to the banks to complete their paperwork.

The main objective of the bill is to reform a part of the section in the FODEA Law that deals with the rescheduling of loans (Chapter I). It calls for an increase from CR$5 billion to CR$10 billion in the amount of bonds issued by the Government, to be devoted to the purchase of the arrears portfolio of the banks from small and medium farmers. In order to allow for more producers to qualify for the preferential interest rates, so that the rescheduled portfolio financed by the Government becomes larger, the bill raises the maximum level of debt used to classify a farmer as a small or as a medium borrower. At the same time, in order to give more farmers the opportunity to benefit from the rescheduling of loans, the bill includes changes in procedures that would facilitate the paperwork for farmers.

The main reforms introduced by the FODEA II bill are analyzed in this paper. The current status of the bill as well as its political feasibility are examined, in order to assess its chances of approval by Congress. An evaluation of some of the effects that the FODEA Law has had on the banks and on farmers is also provided. The possible effects of the FODEA II bill on the banks and on farmers are then evaluated in the final section of the paper, on the basis of the actual consequences of the first FODEA.

Main Reforms Proposed

The main changes to the FODEA law introduced in the new bill are:

(1) an increase from CR$5 billion to CR$10 billion of the authorization to the Ministry of Finance to issue "Public Sector Rescheduling Bonds," for the purpose of buying the arrears portfolio related to small and medium farmers held by state-owned banks;

(2) an increase in the limits that define a small farmer, from CR$2 million to CR$4 million in original debt, and from CR$2.5 million to CR$4.5 million in agricultural assets;

(3) an increase of the limits that define a medium farmer, from CR$5 million to CR$7 million in original debt, but leaving the limit on agricultural assets at CR$12

million, as stated in the original FODEA Law. As a result, the lower limit on original debt for classification as a large farmer is increased from CR$5 million to CR$7 million;

(4) the state-owned banks are required to accept real estate from farmers in partial or total payment of a loan, while the banks are authorized (but not required) to accept other types of assets as well;[2]

(5) the bill requires that the banks surrender their right to freely negotiate which assets may be accepted as payment for a loan. Instead, the bill creates a "State Inter-Institutional Commission," to be appointed by the Ministry of Agriculture, to coordinate the management and sale of these assets. Preference would have to be given to public institutions that might need the assets for their own programs;

(6) the bill forces the banks to reschedule the loans of those borrowers who had disposed of the assets offered as collateral. The FODEA Law, instead, merely allowed the banks to do so if so desired;

(7) the wording of the Law is changed from reschedule (adecuar), to reschedule and re-reschedule (adecuar y readecuar). In this way, the bill would allow farmers who had already arrived at an agreement with the banks regarding their defaulted loans, before the FODEA Law was enacted, to benefit from the new terms and conditions introduced by the law;[3] and

(8) the bill calls for a moratorium, with respect to principal and interest, of five to ten years, for those farmers who want to remain as agricultural producers, but who cannot meet their borrowing obligations, due to adverse circumstances derived from price or weather factors. The need for a moratorium would be determined on an individual basis by the banks.

Political Feasibility of FODEA II

At present, the FODEA II bill will be the first item on the agenda of the Agricultural Commission in Congress, when it reconvenes on the first week of September for its ordinary period of sessions. During the month of August, Congress was in the midst of an extraordinary period of sessions, during which it can only study bills sent by the Executive. The Agricultural Commission studied, during that period, an environmental bill related to "Green Peace."

The fact that the Executive did not send the FODEA II bill to the extraordinary session of Congress shows the little interest that it has in this bill. The Ministry of Agriculture gave a negative report on the bill to the Commission, and has urged the legislators to be cautious, indicating that the full effects of FODEA are still not known, and focusing on the detrimental impact that FODEA II might have on the loan recovery efforts of the banks. The Ministry of Agriculture is at present preparing an alternative bill, which would replace the FODEA II bill. In it, the emphasis would be on solving the agricultural sector's crisis through institutional changes, rather than on engaging in additional rescheduling of loans.[4]

Meanwhile, most of the Congressmen from both major parties (Liberación and Unidad) who are members of the Agricultural Commission have shown interest in the approval of the bill. Some Congress analysts consider that the chances for the Agricultural Commission to approve the bill when the ordinary sessions of Congress are reconvened in September are very good.

Some Congressmen, however, are attempting to introduce reforms to other chapters of the FODEA law, not related to the rescheduling of loans. Particularly, a motion for the creation of the Ministry of Natural Resources has been introduced. This motion has caused some controversy in the Agricultural Commission, which might prolong the deliberations on the bill, making it more difficult for it to be approved by Congress before the current term expires in April, 1990.[5]

Time is an additional factor against the bill's approval. Even if it is approved by the Agricultural Commission in the very short term, the bill will be placed at about the two hundredth position in the order of the Plenario for Congress, before it can come to the full floor. The bill would need the approval of at least two thirds of Congress to be moved up to a better position in the order of the agenda, which is unlikely to happen, since there are other projects of higher priority for Congress and the Executive. This is the case of the "Structural Adjustment Loan II" bill, better known as PAE II, and of the Central American Parliament bill, which the Executive is urging Congress to approve as soon as possible.

In addition, the month of November is spent in Congress studying the Fiscal Budget. After that, and because of the national elections to be held in February, Congressmen are likely to declare a holiday during the months of December and January, to incorporate themselves into the political campaign.

At the same time, the main groups that would benefit from this bill, which seem to be the cattle and rice producers, as was the case with the first FODEA, have this time not exerted much pressure on Congress for the approval of the bill, compared to their earlier lobbying. Those most interested in the Law have already rescheduled their loans.

The possibilities of the FODEA II bill to be approved, before the term of the present Congress expires in April 1990, are not very good, therefore. As some Congress advisors claimed, however, Congress is like a "Pandora's Box," where anything can happen, specially during an election period. It must also be noted that the FODEA Law was approved by Congress unanimously.

Effects of FODEA on the Farmers

Even though detailed information on the distribution of the FODEA portfolio at the different banks was hard to obtain, it is easily established that there are some differences between the preliminary estimates and the actual rescheduling that took place.[6] Particularly, far less large farmers have rescheduled their loans, than small and medium farmers, as compared to what was expected, as shown in Table 1. Only about 60 percent of the large farmer portfolio that qualified for FODEA in the Banco Nacional de Costa Rica (BNCR), and 25 percent in the Banco de Costa Rica (BCR), was rescheduled. On the other hand, nearly 96 percent of the portfolio of small and medium farmers in the BCR was rescheduled, while in the BNCR more than what was expected from these categories was rescheduled.

As expected, the distribution of the rescheduled portfolio was highly concentrated in the livestock sector. About 65 percent of the rescheduled loans of the entire banking system belong to the livestock sector (Tables 2, 3 and 4).

Rice producers are another group that was highly favored by the FODEA law. It is estimated that around 10 percent of the loans rescheduled by the Banco Nacional belong to this group. In contrast, around 2 percent of these loans were from bean and corn producers.

Table 1

Costa Rica: National Banking System.
FODEA's Estimated and Actual Portfolio Distribution,
by Bank and Farmer's Size, as of June 1989.
(Million colones).

	Small	Medium	Large	Total
BNCR				
Estimated	706.8	788.2	1,165.6	2,660.6
Actual	2168.5		696.5	2,865.0
BCR				
Estimated	1,136.9	545.8	988.5	2,681.3
Actual	970.8	639.5	248.5	1,859.2

BNCR: Banco Nacional de Costa Rica
BCR: Banco de Costa Rica.

Source: Data provided to the author by the Departments of Economic Studies of the Banco Nacional de Costa Rica and the Banco de Costa Rica.

Table 2

Costa Rica: National Banking System.
Portfolio Distribution of Rescheduled Loans under the FODEA Law, by Sector of Productive Activity and Source of Financing.*
June 1989. (Million colones).

	BNCR	BCR	BAC	BCAC	Total
Cartera Propia					
Agriculture	312.8	172.0	87.7	23.5	596.0
Livestock	762.2	323.4	201.1	37.9	1,324.6
Rest	13.9	9.4	5.3	0.0	28.6
	1,088.9	504.8	294.1	61.4	1,949.2
Fideicomiso					
Agriculture	521.7	373.0	275.5	112.8	1,283.0
Livestock	748.2	1,072.6	500.6	76.4	2,397.8
Rest	29.8	44.4	48.4	0.0	122.6
	1,299.7	1,490.0	824.5	189.2	3,803.4
Cartera Propia and Fideicomiso					
Agriculture	834.5	545.0	363.2	136.3	1,879.0
Livestock	1,510.4	1,396.0	701.7	114.3	3,722.4
Rest	43.7	53.8	53.7	0.0	151.2
	2,388.6	1,994.8	1,118.6	250.6	5,752.6

* Cartera Propia consists mainly of large farmer loans, which each bank has to finance with its own funds, while Fideicomiso consists of small and medium farmer loans, financed through Government bonds.

BNCR: Banco Nacional de Costa Rica
BCR : Banco de Costa Rica
BAC : Banco Anglo Costarricence
BCAC: Banco Crédito Agrícola de Costa Rica

Source: Data provided to the author by the Monetary Department of the Central Bank.

Table 3

Costa Rica: National Banking System.
Portfolio Distribution of Rescheduled Loans Under the FODEA Law, by Sector of Productive Activity and Source of Financing.*
June 1989. (Percentages)

	BNCR	BCR	BAC	BCAC	Total
Cartera Propia					
Agriculture	28.7	34.1	29.8	38.3	30.6
Livestock	70.0	64.1	68.4	61.7	68.0
Rest	1.3	1.9	1.8	0.0	1.5
	100.0	100.0	100.0	100.0	100.0
Fideicomiso					
Agriculture	40.1	25.0	33.4	59.6	33.7
Livestock	57.6	72.0	60.7	40.4	63.0
Rest	2.3	3.0	5.9	0.0	3.2
	100.0	100.0	100.0	100.0	100.0
Cartera Propia and Fideicomiso					
Agriculture	34.9	27.3	32.5	54.4	32.7
Livestock	63.2	70.0	62.7	45.6	64.7
Rest	1.8	2.7	4.8	0.0	2.6
	100.0	100.0	100.0	100.0	100.0

* Cartera Propia consists mainly of large farmer loans, which each bank has to finance with its own funds, while Fideicomiso consists of small and medium farmer loans, financed through Government bonds.

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Source: Data provided to the author by the Monetary Department of the Central Bank.

Table 4

Costa Rica: National Banking System.
Portfolio Distribution of Rescheduled Loans Under the FODEA Law, by Source of Financing, and Sector of Productive Activity.*
June 1989. (Percentages)

	BNCR	BCR	BAC	BCAC	Total
Agriculture					
Carter a Propia	37.5	31.5	24.2	17.2	31.7
Fideicomeso	62.5	68.5	75.8	82.8	68.3
	100.0	100.0	100.0	100.0	100.0
Livestock					
Cartera Propia	50.5	23.2	28.7	33.2	35.6
Fidercomeso	49.5	76.8	71.3	66.8	64.4
	100.0	100.0	100.0	100.0	100.0
Rest					
Cartera Propia	31.8	17.5	9.9	0.0	18.9
Fidercomeso	68.2	82.5	90.1	0.0	81.1
	100.0	100.0	100.0	0.0	100.0

* Cartera Propia consists mainly of large farmer loans, which each bank has to finance with its own funds, while Fideicomiso consists of small and medium farmer loans, financed through Government bonds.

BNCR: Banco Nacional de Costa Rica
BCR : Banco de Costa Rica
BAC : Banco Anglo Costarricence
BCAC: Banco Crédito Agrícola de Costa Rica

Source: Data provided to the author by the Monetary Department of the Central Bank.

Since the livestock and rice producers are characteristically larger than farmers in other activities, it is expected that the concentration of loans in those groups will cause the rescheduled portfolio to be highly concentrated in a small group of producers, as well. A as shown in Table 5, in the case of the Banco Nacional, 3,229 cattle producers rescheduled a total of CR$1,676.8 million, while 737 rice producers rescheduled CR$298.8 million. In contrast, 1,855 corn and beans producers rescheduled only CR$59.4 million.

Table 5

Costa Rica: Banco Nacional de Costa Rica
Distribution of the Number of Individuals,
Total Debt and Average Loan in the FODEA Portfolio,
by Products. (Thousand colones)

	Number	Amount	Average Size	Percentages Number	Percentages Amount
Total	8776	2,886,557.7	328.9	100.0	100.0
Livestock	3229	1,676,800.7	519.3	36.8	58.1
Rice	737	298,786.0	405.4	8.4	10.4
Beans	664	21,360.9	32.2	7.6	0.7
Corn	1191	38,065.8	32.0	13.6	1.3
Other Agriculture	2845	760,506.0	267.3	32.4	26.3
Other	110	91,038.4	827.6	1.3	3.2

Source: Data provided to the author by the Department of Economic Studies of the Banco Nacional.

The concentration of the portfolio is highlighted by the difference in average size of loan in each group. Cattle and rice producers rescheduled, on average, CR$519,000 and CR$405,000 per producer, respectively. Corn and beans producers, on the other hand, rescheduled an average loan of CR$32,000. The differences among groups is also shown by the fact that most of the cattle and rice producers that were rescheduled under FODEA were mostly financed through the Commercial Department of the Banco Nacional (50 percent of rice producers and 82 percent of cattle producers), while more than 95 percent of corn and beans producers were financed by the Juntas Rurales.

The concentration of the FODEA portfolio is accentuated when the distribution of the rescheduled loans within the groups is considered. On the one hand, 140 livestock producers, with loans of more than CR$2.5 million each, (4.3 percent of the number of borrowers who rescheduled), accounted for a total of CR$628 million (37.5 percent of the total amount), as shown in Table 6. On the other hand, almost 2,000 producers, with loans of less than CR$250,000, (60 percent of those who rescheduled), accounted for CR$161.7 million (that is, less than 10 percent of the loans rescheduled by cattle producers at the Banco Nacional). Similarly, 25 rice producers, who represented only 3.4 percent of those who rescheduled, accounted for CR$132 million of the rice loans, or 44.3 percent of the amount, while 440 producers (74.6 percent of the number) accounted for only CR$31 million (10.5 percent of the amount).

Since the FODEA loan portfolio is highly concentrated in the livestock and rice sectors, it is expected to be concentrated in the regions where these products are dominant. As shown in Table 7, almost one-half of the FODEA portfolio of the Banco Nacional is from the Guanacaste region, while another one-sixth is from the San Carlos region, the two most important cattle producing regions of the country. Even though the concentration in these two regions is not as noticeable in the Banco de Costa Rica, since its Central Office in San José accounts for 11 percent of the FODEA portfolio, still more than 40 percent of the portfolio is from the Guanacaste and San Carlos regions.

Table 6

Costa Rica: Banco Nacional de Costa Rica.
Distribution of the Number of Individuals,
Total Debt and Average Loan in the FODEA Portfolio,
by Size of the Loans, for Rice and Livestock.
(Thousand colones)

Loan Size	Number	Amount	Average Size	Percentages Number	Percentages Amount
Rice	737	298,786.0	405.4	100.0	100.0
0-250	550	31,308.6	56.9	74.6	10.5
250-1,000	114	61,944.4	543.4	15.5	20.7
1,000-2,500	48	73,065.2	1,522.2	6.5	24.5
More than 2,500	25	132,467.8	5,298.7	3.4	44.3
Livestock	3229	1,676,800.7	519.3	100.0	100.0
0-250	1933	161,655.0	83.6	59.9	9.6
250-1,000	879	440,050.7	500.6	27.2	26.2
1,000-2,500	277	446,456.6	1,611.8	8.6	26.6
More than 2,500	140	628,638.4	4,490.3	4.3	37.5

Source: Data provided to the author by the Department of Economic Studies of the Banco Nacional

Table 7

Costa Rica. Regional distribution of the
FODEA Portfolio of the Banco Nacional de Costa Rica,
and the Banco de Costa Rica.
(Thousand colones)

Region	BNCR Amount	BNCR %	BCR Amount	BCR %
Total	2,515,515	100.0	1,859,082	100.0
Guanacaste	1,176,414	46.8	493,926	26.6
San Carlos	436,772	17.4	277,185	14.9
Atlantic	256,328	10.2	157,800	8.5
South	230,724	9.2	281,531	15.1
Rest	415,279	16.5	648,640	34.9

Source: Data provided to the author by the Departments of Economic Studies of the Banco Nacional de Costa Rica and the Banco de Costa Rica.

Finally, the concentration of the FODEA portfolio is even greater if one considers the number of loans per family nucleus. Large farmers tend to have loans under the name of several family members, while small farmers tend to have one loand per household. This is not taken into account in the data obtained from the Banco Nacional or Banco de Costa Rica, since each operation rescheduled under FODEA, although it may pool several loans, it belongs to one producer, not a family nucleus.

Effects of FODEA on the Banks

An earlier paper analyzing the potential effects of FODEA claimed that there were three possible sources of losses for the banks from the Law: interest revenue, default, and liquidity losses.[7] The liquidity and interest revenue losses were underestimated in that analysis, however, since the author's interpretation of the Law was different from the way in which it was finally implemented.

The state-owned banks received Government bonds in exchange for the small and medium farmer loan portfolio. The banks still remain responsible, however, for the collection of these loans. The Law states that, if at the end of four years, there is any difference between what the bank has collected from the farmers and the bonds owned by the bank, the Government will pay the difference from the fiscal budget. It was assumed that the interest on these bonds (at an annual rate of 8 percent) would be paid annually by the Government to the banks. The interpretation of this legislation, however, has been that banks will not receive any interest on the bonds until the fifth year, when the difference between the amount collected by them and the interest rate on the bonds will be assessed.

In the case of the Banco Nacional, there will be a loss in interest revenue during the first four years of the FODEA Law, of approximately CR$548 million per year, if the totality of the loans in arrears are recovered. This will not only reduce the revenues of the bank, but it will also affect its liquidity position.

It is interesting to note, with the purpose of estimating how much of the arrears portfolio would have been recovered by the banks if the FODEA law would not have been enacted, that approximately 10 percent of the FODEA portfolio of the Banco de Costa Rica had already been declared as non-recoverable (insoluto). Another 10 percent of this portfolio was in process of being collected through the courts, while the remaining 80 percent was classified as overdue.

The early estimates of a loss of CR$1.3 billion in liquidity for the Banco Nacional, as a result of the FODEA Law, under the assumption that the banks would only recover 50 percent of their arrears portfolio in four years, seems a plausible estimate, then. If an estimated CR$270 million per year is added, in terms of interest revenue losses from FODEA, it is clear that the liquidity situation of the banks is greatly affected by this legislation.[8]

Possible Effects of FODEA II

The main effect of the FODEA II bill would come through the change in the classification by size of the arrears portfolio of the banks. First, there would be an increase in the amount of loans in the small farmer category. The Banco Nacional de Costa Rica estimates that the number of borrowers in the small farmer category would increase from 12,289 to 12,481 loans, an increase of about CR$600 million. The medium farmer category would decrease from 234 to 76, a decrease of about CR$400 million, because of the transfer of borrowers to the small farmer category, and from the large farmer class. In other words, the 192 medium farmers transferred to the small farmer category would have an average size of loan of CR$3.1 million. There are also 34 large farmers transferred to the medium farmer category, with an average size of loan of CR$6.7 million.

As a result, the subsidy granted under the FODEA law to farmers, due to the lower interest rate paid on the loans by those who qualify as small farmers, would increase. For the same reason, the banks will lose revenue from the new bill. Since the large farmer category is reduced, and the small and medium categories are enlarged, the banks must accept Government bonds, that pay 8 percent interest rate, instead of the 15 percent thay they might have received from large farmer loans under the previous rescheduling agreement of FODEA.

The Banco Nacional estimates that the interest revenue loss from the change in the distribution of the FODEA portfolio would be of about CR$33.4 million per year, during the first 4 years, and CR$52.4 million per year during the remaining 12 years.

In addition to the additional borrowers shifted to the small farmer category, Congressman Muñoz Bustos argues that the number of farmers who would benefit from the rescheduling of loans, within all categories, would also increase. The increase would come about because of the new norms in the bill regarding the acceptance of collateral by the banks, that would encourage more farmers to approach the banks and sign the rescheduling papers. The effect of the larger number of farmers in the FODEA portfolio would be an increase in the revenue of the banks, since it would bring to the banks some of the clients that are not paying at all at this moment. It is hard to estimate the effect that this may have on the banks, since it is not known how many farmers have not approached the banks.

Actually, the banks argue that most of the farmers that have not signed the rescheduling papers have not done so because they have not wanted, and not because of the paperwork burden. At the Banco Nacional, only about 22 percent of the expected farmers that qualified for FODEA have not signed the paperwork. Most of these are large farmers, as shown in Table 1. Bank officials claim that these farmers are better off by not repaying the loans than by signing a rescheduling agreement. As a result, few additional loans would be rescheduled under the new bill. In many cases, farmers prefer to rely on alternative sources of credit, i.e. private banks, financieras, and cooperatives, than to pay back the old loan to the state-owned bank, and thus risk losing their land, by signing the FODEA papers.

Even if not many new farmers approach the banks, there still is a significant increase in the amount of loans to be financed with Government bonds. The bill calls for an increase of CR$5 billion, but most probably less than that would have to be used. The increase in bonds would not affect the budget deficit, or have any inflationary effects at this moment, since it is just a swap of debt from the state-owned banks to the Ministry of Finance. After the fourth year, however, when the Government must pay the residual that the banks have not collected from the farmers and interest on the bonds, a payment that must go through the fiscal budget, inflationary pressures may increase.

Conclusions

Even though it is hard to estimate the effects of the FODEA II bill on the banks, some losses should be expected. On the one hand, there is the loss in revenue and in liquidity, caused by the decreased interest revenue that the increase of the small farmer category would cause. On the other hand, there is the possible increase of revenue, caused by the rescheduling of farmers who are presently inactive in their payments.

In any case, the most dangerous effect of the bill is the addition of the norm calling for a moratorium of the debt of farmers in trouble. Even though this is not an obligatory moratory, it sends the wrong kind of signal. Farmers would expect the moratorium to take effect almost immediately, at the first sign of trouble. Some other farmers might declare a de facto automatic moratorium themselves, and not repay their loans. Additionally, some groups could use this norm to put pressure on the banks to declare a moratorium of all their loans in the future. As a result, the call for a moratorium not only affects the farmers being rescheduled under the FODEA law, but it also affects the repayment of all the loans of the National Banking System, as the Ministry of Agriculture already warned the Agricultural Commission of Congress.

The final long-term effect on the banks of the approval of the FODEA II bill, therefore, will be a negative one. The possible benefits derived by some farmers, on the other hand, could be substantial. Even though almost half of the FODEA portfolio of the entire banking system is classified as small farmer loans, the concentration of the benefits in a few farmers, particularly livestock producers, mostly in the Guanacaste region, is great. In addition, most of the farmers that have not rescheduled under the

FODEA law are large farmers. As a result, the increase in Government bonds and reclassification of the farmer-size categories proposed by the FODEA II bill may result in an increased concentration of the benefits derived by the farmers.

On the other hand, the changes proposed by the bill to facilitate the paperwork for rescheduling under the FODEA terms are not substantial, while the benefits of not repaying the defaulted loans still outweigh the costs of not doing it for most farmers. It should be expected, therefore, that the number of new farmers that would reschedule under the bill is not that great.

In conclusion, even though not many new farmers may reschedule under the new FODEA II terms, the approval of the bill would result in an increased concentration of the rescheduled agricultural default portfolio of the National Banking System. As a result, the additional subsidy received by the new farmers being rescheduled, and those being reclassified into the preferential interest rate categories, would also be greatly concentrated in a few hands.

Notes:

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1. The FODEA law is analyzed in greater detail in Luis Mesalles, "Costa Rica: The Political Economy of Agricultural Credit," unpublished paper, Agricultural Finance Program, The Ohio State University, March 1988.

2. There is no relationship between this article in the FODEA II bill and the recently enacted "Fideicomiso Agrario" (Agrarian Trust). Even though the banks may assign a given farm to the "Fideicomiso," they are not forced by the bill to do so.

3. The FODEA Law intended to do the same thing, but because of its wording, the banks have interpreted it not to allow this to happen, and some farmers in this position have complained when they have been left out of the rescheduling process.

4. It was not possible to obtain a draft of this bill, since it still is at an initial stage of discussion, during which the Ministry of Agriculture is asking the banks to make suggestions.

5. There are some rumors of an agreement among both major parties to let the deliverations prolong until there is no time for approval of the bill.

6. The banks are not keeping a detailed record of the number of farmers in each of the size categories. Each bank branch maintains a detailed record of the FODEA transactions so that, in order to obtain information about the number of small, medium and large farmers who have rescheduled, the Central Office of each bank must call each branch and ask them to compute it for them.

7. See Annex I of Mesalles (op. cit.)

8. Again, assuming a 50 percent recovery rate on the interest rate payments.