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Project no: PIO/T 657-0021-3-20015  
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PN-ABZ-810

## EVALUATION OF CARLOS AQUINO PAPER: STUDY ON THE IMPACT OF CREDIT ON INVESTMENTS

STAHIS S. PANAGIDES

MAY 1994  
GUINEA-BISSAU

TIPS REPORT No.25 E

WP/TC/10/2-e

Approved by TIPS  
March 28, 1996

Submitted to USAID  
April 11, 1996

Stahis S. Panagides

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May 14, 1994

TO: John Blacken, Coordinator IPC/TIPS/USAID Copy: Jim LeFleur/Carlos Aquino

FROM: Stahis Panagides, Senior Associate, MSI

RE: Carlos Aquino's paper **Study of Impact of Credit on Investment**

As per your request I reviewed this TIPS-funded paper. I have discussed my observations with Mr. Aquino and Mr. LeFleur.

The paper is a substantial contribution on a complex and delegate subject. As I mentioned to Mr. Aquino if the World Bank was doing this analysis it would have mounted a three-person mission with a renown credit specialist as a consultant!

- My concern is that in attempting to cover too much, the analysis remains shallow and a number of the conclusions unconvincing or wrong. One area that needs more careful review is the section on the structural adjustment and its contribution. As I participated in the formulation and the write-up of that strategy, I focuse my comments (contribution) on this. If the credit paper reaches different conclusions on the contribution of the structural adjustment programs and its effect in opening the economy than generally accepted, then the IPC/TIPS strategy must be questioned. We must therefore treat this aspect of the paper carefully.

I went back to my old files and my work with the World Bank in GB in the mid-80s and share below a few paragraphs of my DRAFT report on the Agricultural Incentives Program. With no substantial changes these became key element of the Bank lending in GB at the time. I share it with you ( and reflect on it myself) for the immediate objective to contribute to Mr Aquino's credit paper to capture first hand the strategic thinking in the context of the time and the dismal prevailing conditions then. Also in order to make a more realistic assessment of the "before and after" for a more insightful assessment of the contribution that the Program has made. I believe, there is no doubt that the IMF/WB program was decisive in "opening up" the economy. The credit paper should not be ambivalent on this point.

In this respect, the paper should distinguish between the contribution of the structural adjustment program in opening up the economy and providing incentive to economic activity ( the liberalization compared where we started from) and the long term development needs of the country. The paper must reflect the difference between necessary conditions and sufficient conditions to development and growth in GB. The structural adjustment helped open the way for development but it is not in itself sufficient. The logic of the strategy as explained in the following paragraphs was simple: In exchange of offering the government short term balance of payments support to bring about a series of reforms to lead the economy to a more price responsive, decentralized, market driven structure. This to a great extend has been achieved. It was understood from the outset that that was only the beginning. It is instructive in this respect to see that though the Program was successful in helping to "open" the economy and bring a significant initial production response, the entrenched development constraints of the

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political environment, political and legal institutions, the needed policy-making institutional development, education, health " estado e não so governo", [ the objectives of IPC/TIPS/USAID], remain very much the same as I have seen them at the time.

I could not help smile and agree with my observations on "risks" expressed in paragraph 89 below. The inevitable lesson is not that structural adjustment did not work, but that GB ( with our modest support) must keep at it and that we (IPC/TIPS/USAID) are on the right track and that the process takes time.

- The paper gives the impression that credit is the panacea for the country's development. Most development literature shows that though credit is a significant instrument to foster development, it needs to go together with a number of other "condicionantes". In the case of GB it probably ranks relatively low to other priorities needed to make credit function effectively. If this is the case, then TIPS support to a credit program should investigate in much greater depth the working of credit in experiences that worked in GB and draw lessons learned from such experiences, of which there are many. In this respect

- One or two cases of credit ( presented in the paper under **Programas relevantes de crédito**) should be reviewed in some depth to identify what worked (or not) and how and especially why ( mechanisms of credit, guarantees, recovery rates, banking functions, type of beneficiario, role of women, marketing and context considerations, incentives to save, administration of credit program at the local level, in-kind credit, etc).

- I would guess that more than half, of the productive activity of GB is generated in the informal sector ( not captured by official statistics and only indirectly influenced by public policy). We cannot understand credit without looking at the informal sector that seems to be the most dynamic element of the economy and where a credit system ( especially in the absence adequate institutional credit) must be thriving.

- Mr. Aquino shared with me a nineteen page Executive Summary. The paper will benefit from a much more focused summary **not to exceed two pages** focusing on "lessons learned" and where we go from here. The paper makes about 25 to 30 recommendations. These should be prioritized and **reduced to three or four**. In that respect, I would urge that

- If there is a follow-up to the TIPS credit work the priority be given to: a) what worked, how and why - what have we learned from concrete examples in GB about credit, and b) the study of the credit in the informal sector.. We should find out what worked and why and build on it.

- The paper gives disproportionate attention to inflation. Undoubtedly inflation distorts all price relations including interest rates. Nevertheless, a number of other factors, such as savings rates and the absence of access to credit including the lack of credibility in the system and trust by the community, are probably more limiting and determining factors.

[The following conceived and written in late 1986 - selected paragraphs from Draft prepared by SPanagides for "President's Report" to the Board of the WB for the approval of the credit]

DRAFT:WB/Stahis Panagides/87

12. Overall, the adjustment measures had a noticeable positive impact on real GDP, which grew 2.7 percent in 1984 and 4.0 percent in 1985 (estimated), compared to a decline of 3.9 percent in 1983. Production of rice, the major food crop, is estimated to have increased 15 percent over 1984 levels. Output growth and price stability improved in 1985, due principally to increased agricultural production because of favorable weather conditions and improved producer prices. Inflation declined sharply from 65 percent to 34.6 percent.

13. The performance of agriculture during the last decades followed the phases the country has gone through in its transition from a colonial state to independent country in 1974. In the fifties Guinea-Bissau had about 460,000 ha under cultivation, against a little over 300,000 ha in 1984, was self-sufficient in food staples and produced a variety of export crops. During the struggle for independence, agricultural production declined as a result of damages of the infrastructure (including irrigation systems for rice, Guinea-Bissau's main crop) and displacement and migration of population. With independence the Government tried to establish a model of economic development based on central planning and state ownership and control of key sectors in an effort to cope with the enormous task of reconstruction and development. During the last decade, however, the Guinea-Bissau economy has been facing increasing internal and external imbalances arising mainly from the inability of the administration to handle a centrally planned economy while ignoring market forces. Lack of manpower and a weak institutional base led to ill-conceived projects that, while contributing to large budgetary deficits, did not solve the problem of reconstructing and developing the productive infrastructure required to support an increased agricultural production. Inadequate pricing policies, enforced through the marketing operations of inefficient state-owned companies, and overvaluation of the currency, grossly discriminated against agriculture, leading to food shortages and depressed recorded exports. The largely peasant-based rural economy, faced with the adverse terms of trade and lack of incentives, reacted reverting to subsistence-type of activities, re-orienting the sales of agricultural products towards neighboring countries, and migrating out of the rural sector. Recurrent droughts in the region aggravated the economic situation.

14. The declining production of the main staple, rice, which accounts for about one-third of total agricultural production, was a consequence of this adverse policy environment. In the fifties about 150,000 ha were cultivated with rice as compared to only about 110,000 in 1984. Rice production at the beginning of the sixties was estimated at 176,000 tons; by 1984 it had declined to 105,000 tons. Other cereals (corn, sorghum and millet) that covered an area of about 190,000 ha in the fifties, declined to about 130,000

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Besides in GB the index of inflation as defined is probably relevant to a small sub-sector of the economy. The paper should explain how the inflation is calculated ( what basket of goods and in what locations, how often data is collected, etc).

Attached is also a timely note on agricultural credit prepared by Mr. Rui Fonseca of GAPLA/MDRA. It offers an insightful analysis and ~~a~~ some useful guidelines for the direction of policy in this area.

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ha in 1984. Production of groundnuts, which accounts for about one fourth of total exports, was in 1984 below the levels of 1961 (40,000 tons and 42,000 tons respectively).

26. **Agriculture Sector Planning and Management.** The Ministry of Rural Development and Fisheries (MRDF) does not have adequate capabilities in the areas of agricultural planning, project preparation and implementation. It is difficult to identify long-term strategy for agricultural development, on the basis of which meaningful sectorial priorities could be established, a coherent investment program defined and projects assessed. The problems originate in: (a) a dearth of adequately trained personnel; (b) a data base which is neither sufficient nor reliable; (c) unclear delineation of planning and project responsibilities within the MRDF, and between MRDF and the Ministries of Planning and Commerce; and (d) a severe limitation on the ability to implement policies and projects. Management, human resource and counterpart funds are not available. International aid-supported projects which rely on the weak and over-burdened public sector for their design and implementation are seldom sustainable. The government relies heavily on foreign assistance to select, program and implement projects, and foreign donors are generally apportioned certain areas of the country to promote their own development approaches. While overall resources allocated to agriculture may still not be commensurate with the sector's contribution to production and employment, the type of projects, their foreign exchange and management demands, are more important problems in resource allocation for agriculture. Some operations such as mangrove rice development are redundant, others such as policy analysis, research, extension, information gathering, and training need to be strengthened. In some critical areas, such as swamp development, no investments are underway. Local skilled human resources are inordinately stretched and a critical constraint for the preparation and execution of agricultural projects. Financial resources allocated to recurrent expenditures are generally inadequate.

33. **Main objectives of the Agricultural Incentives Program (AIP) consist of:**

(a) improvement in the agricultural prices and incentives framework to encourage production;

(b) the decentralization and liberalization of marketing to reduce public sector dominance and encourage private sector participation;

(c) improvement in investment policy through restructuring of sector investment and improved coordination of external aid; and

(d) short-term compensation through food aid of those adversely affected by the Program.

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34. The Program consists of two principal strategy elements:

(a) price incentives to the producer for production, and

(b) the availability and access of essential goods to the rural people as an incentive to increased output.

35. A US\$ 9 million import credit for<sup>7</sup> goods is provided by the Program for this purpose. The import of essential goods would provide the basis for farmer short-term response to the price and marketing incentives. Financing of agricultural inputs and intermediate consumer goods imports would further ensure that the country's short-term balance of payments difficulties do not reduce the availability of items essential to stimulate increased agricultural production. The program strategy is endorsed by the Government and supported by the donor community. Technical assistance and training will facilitate Program implementation and monitoring.

36. By improving agricultural incentives and marketing, the project is expected to trigger an important production response, which would both improve incomes and employment conditions and have a positive impact on the balance of payments. The successful implementation of the incentives and marketing reforms of the AIP is expected to make the country self-sufficient in rice by 1990. The timely compensation of those adversely affected by the Program will help assure its political viability, allowing time for the production response to the incentives to take place. The analysis of the production response to the Program shows that land and labor resource requirements are adequate. Thus the Program relies on the relatively most abundant resources for its objectives, relying on the country's comparative advantage. With the subsequent liberalization of the economy and more realistic exchange rate, factor and sector allocation will continue to be improved in line with the country's long-term comparative advantage.

37. Strengthening agricultural planning capability and rationalizing the public agricultural investment program would lay the basis for developing a coherent long-term agricultural strategy, redirecting and strengthening agriculture support services, mobilizing and coordinating external support, and improving the allocation and impact of scarce financial and human resources in agriculture.

38. The parallel and complementary project for agricultural services (ASP) would finance selected interventions in decertification control/deforestation and swampland development, monitoring and controlling offshore fishing, and stimulating production of non-traditional fruit tree crops, while strengthening planning management, information gathering and implementation capabilities in the sector. The AIP and ASP would complement the activities of other external donors in Guinea-Bissau, who are for the most part engaged in more conventional agricultural project financing, by pressing forward a well defined sectoral policy, planning and institutional development, which are of crucial importance to the success of agricultural development efforts in the country.

44. Rural imports and their availability in the countryside form an essential complement to price incentives for the Program's production strategy. The availability of goods in the countryside will provide a critical incentive for production beyond subsistence and for the revival of increased marketed surpluses of both food and export crops. This will support the government's economic recovery program while reforms are implemented.

The proposed credit would finance the importation and distribution of:

- (a) Fertilizers, pesticides and other agricultural inputs
- (b) Seeds
- (c) Material and equipment for agriculture and fisheries
- (d) Essential consumer goods

48. The marketing chain will be strengthened under the project through the availability of goods, credit and technical assistance. Government is presenting before negotiations a detailed plan of further marketing reforms assuring proper importation, pricing and distribution of the goods imported by the credit and their effective and timely distribution to the countryside. The Government agrees to incorporate the lessons from the experience with the first Reconstruction Import Credit (RIC I, P-3901-GUB), to ensure that the goods will be imported according to proper procedures and will reach the target population. The Government elaborated its proposal in this area, including among others:

- (i) a calendar for complete liberalization of marketing and elimination of margins for most products, with interim price/margins adjustments of the yet controlled products by a factor higher than the inflation;
- (ii) definition of the responsibilities of government agencies which will handle the imports and the proposed mechanisms for implementation;
- (iii) definition of the role of the private sector in the marketing chain and its participation in designing and monitoring this component;
- (iv) support of the private sector capabilities with emphasis at the retail level;
- (v) availability of short-term commercial credit to the participants in the marketing system; and
- (vi) development of a distribution system which ensures timely arrival/delivery of the goods.

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54. Table 1 below compares the production levels of the main crops in 1984 with the projected levels expected with the Program.

Table 1. Supply Response (Tons)

	1984	Program at full development (1990)	
		Max.	Min.
Rice	105,000	169,700	125,600
Groundnuts	39,800	55,700	46,100
Cashew-nuts <sup>a/</sup>	2,960	6,000	4,800
Palm Kernels <sup>a/</sup>	6,880	14,200	11,300

a/ Export levels

[check my projections and be sympathetic! My econometric skills had already rusted -not to mention that a lot of guessing was also applied in view of the scarcity of data]

82. **Risks.** Agriculture production and marketing in recent years have been at such low levels compared to past performance and potential that further deterioration is unlikely. Downward risks are small as the agricultural production, marketing and export situation is at such a deficient state that it is difficult to see how it can become worse. The main risk is that Program implementation will not proceed as fast as expected, and the timely compensation of those adversely affected not take place, endangering the Program's political viability. The deficiencies of public administration, transport infrastructure and most of the preconditions to reasonable policy formulation and implementation will not change soon. Credibility in public policy has been eroded, and to reestablish confidence will be a gradual process requiring consistent policy for a number of years. External risks remain high. The program deals with policy and structural improvements in the domestic economy. The country will still remain vulnerable to external conditions, especially the international prices for its traditional exports.

83. When comparing benefits and risks, however, the agricultural incentives program is justified. The focus of the project on policy reform and agricultural production incentives is a significant impulse to subsequent production and investment. The Program helps consolidate reforms and policy commitments, and provides compensation without which these needed reforms might not be sustained. The support provided through training and technical assistance will enhance the ability to implement and sustain the agreed upon reforms.

## CONTRIBUIÇÃO PARA O DOCUMENTO "VIAS PARA A IMPLEMENTAÇÃO DA ESTRATÉGIA DO SECTOR AGRÁRIO".

Preparado por Rui Fonseca, GAPLA/MDRA, 14 de maio de 1994

### 1. Crédito Agrícola

Na Guiné-Bissau parecer não existir nenhum sistema financeiro formal, onde é possível para a população rural depositar e pedir crédito. As Caixas Postais Económicas dos Correios mostram que há um potencial e também uma vontade por parte da população rural em fazer depósitos. No entanto, neste momento não um sistema de garantia legal em funcionamento e a taxa de inflação é insustentável para operações eficientes numa instituição financeira formal.

Um eventual sistema precisa de ter em conta a elevada taxa de inflação, a falta de garantias formais, a desconfiança da população rural aos depósitos formais e quanto à moeda e as necessidades de liquidez da população rural. Além mais, deve se ter em termos de organização social e sistemas de produção. Um sistema deve principalmente apoiar as estratégias financeiras existentes dos participantes, oferecendo serviços procurados pela população rural, para que seja bem sucedido.

Neste momento existe 3 instituições financeiras formais na Guiné-Bissau. O Banco Central da Guiné-Bissau (BCGB) funciona como um banco central, responsável pela política monetária, Banco Internacional da Guiné-Bissau (BIGB) e Banco Totta & Açores que funcionam com bancos comerciais. As possibilidades pela parte da população rural utilizarem serviços bancários do sector formal parece ter sido virtualmente não-existent.

No entanto enúmeras e importantes acções de crédito a agricultura camponesa garantidos por diferentes projectos ligados a acção de vulgarização agrícola, ONG's nacionais e internacionais.

Há uma diversidade enorme nos critérios e condições de atribuição desses créditos, não havendo até ao momento da parte do MDRA a capacidade de os articular e coordenar.

Tal situação, se bem que não toque directamente a agricultura privada, tem logicamente reflexos indirectos nela quer pelo impacto na problemática comercial, da mão-de-obra e na provável procura de serviços.

Pode-se concluir que as infraestruturas financeiras da Guiné-Bissau tem sido fraca, especialmente no sector agrícola e rural. A taxa de inflação elevada, uma fraca infra-estrutura económica e uma limitada cobertura pelas instituições financeiras formais do país, tem dificultado uma mobilização eficiente de depósitos. A ter em conta numa eventual introdução dum sistema de depósitos e créditos é a grande desconfiança estabelecida pela população rural, assim como a inexperiência da mesma em participar em sistemas financeiros.

Segundo o estudo sobre os ponteiros, o desempenho da carteira da ex-DESECO em finais de 1989, dado aqui apresentado apenas com o intuito de dar uma imagem qualitativa da utilização do crédito agrícola, era de 5,1 % em situação de mora 25 % em contencioso,

situação menos grave que nos outros sectores (pescas, indústria, transporte e certos serviços), consumidores de maiores montantes de crédito.

Os fins a que se destinaram os créditos agrícolas centraram-se basicamente na aquisição de equipamentos e materiais agrícolas, acções de destronca/limpeza de terrenos, furos/poços de água, e em muito pequeno grau na aquisição de inputs.

Este tipo de procura de investimento é demonstrativo da falta de equilíbrio na concepção dos projectos agrícolas beneficiados, tendo permitido a afectação de meios e por vezes mesmo especulativas.

Analisando vários relatórios ressaltaram algumas conclusões: o crédito foi insuficientemente canalizado para o investimento nos sectores prioritários, como a agricultura.

A utilização do crédito agrícola concentrou-se bastante nos anos 87-90, período de arranque da liberalização económica do país, daí o natural surgimento de muitas novas acções de iniciativa privada na agricultura. A situação da existência de mais de 1/3 dos créditos concedidos estarem em situação de mora ou em contencioso, pode levar a deprender, por um lado uma enorme fragilidade na análise da concessão dos créditos, e por outro lado uma certa incapacidade técnica e organizativa da entidade bancária no acompanhamento dos mutuários.

O crédito mal parado na agricultura, apesar de representar menos 10% do total do crédito a economia nessa situação, não deve deixar de constituir uma grande preocupação, dado o carácter específico da agricultura relativamente a outros sectores, essencialmente no tocante a maior velocidade de reprodução dos investimentos, e conseqüentemente da recuperação dos empréstimos.

A Guiné-Bissau, um país que não herdou nenhuma experiência significativa neste domínio, era inevitável a ocorrência de desvios e erros significativos na montagem e implantação de acções de crédito agrícola.

Após a evolução por demais conhecida da ex-DESECO até ao ex-Banco de Crédito Nacional), desde logo uma solução temporal provisória para ir gerindo o portfolio dos créditos em curso concedidos pela ex-DESECO, chegou-se a conclusão actual onde, desde há mais de dois anos nenhuma instituição creditícia no apoio ao agricultor guineense.

Algumas questões já foram levantadas sobre a organização

Qual o vínculo a estabelecer entre o MDRA, a ANAG e a CCIA e o operador bancário para que as linhas de crédito apoiem de facto as acções de investimento considerados prioritárias e viáveis, de acordo com a política agrícola?

Não pode ser os Bancos Comerciais a definir a política de utilização dos fundos de crédito agrícola, tem que haver uma filosofia global de utilização dos créditos, consubstanciada em sistemas de produção agrária tecnicamente bem desenhadas, que determinem a sua correcta aplicação pela instituição bancária, limitando-se a analisar e a acompanhar os mutuários com

base em regras claramente definidas e sempre na óptica da rentabilidade de técnico-económica.

Sem haver um mercado abastecedor dos materiais e inputs básicos para a produção agrícola, sem haver onde recorrer em termos de assistência técnica, sem haver facilidades e enquadramento na comercialização dos seus excedentes, e muitas outras questões, nenhuma acção de crédito por si só irá desenvolver o agricultor. Por isso, o crédito para além de visar o agricultor em si mesmo, deverá também visar a promoção desses mesmos mecanismos e serviços.

Quais as condições creditícias a utilizar ? Com a situação inflacionista prevalecente, como conciliar estes dois aspectos tão contraditórios: aplicação de taxas de juro reais positivas versus crescimento do agricultor?

Com base em vários materiais pode-se chegar as seguintes conclusões:

- . a mobilização do capital interno na Guiné-Bissau é insuficiente em particular no sector agrícola. Isto implica uma dependência do capital externo;

- . não existe um sistema formal de depósitos e créditos orientada para o sector agrícola, nem parece que existem sistemas formais, como Associações de Crédito e Depósitos Rotativos;

- . as condições económicas e estruturais na Guiné-Bissau neste momento, como alta taxa da inflação, a ausência duma base legal de garantias e uma fraca infra-estrutura económica, dificultam uma operação eficiente duma instituição financeira;

- . as populações rurais têm consciência da desvalorização corrente do peso, pois a maioria tem ligação com o mercado, e a maioria parte das transações feitas são realizadas em pesos. Para captar uma parte deste capital, é necessário oferecer uma taxa de juro dos depósitos atrativos, sem desencorajar os investimentos. Há um interesse de fazer depósitos fora de casa, motivado principalmente pela protecção dos rendimentos do consumo involuntário. Acesso ao crédito com base em depósitos poderia constituir um importante incentivo para depositar.

Duas características devem, em geral orientar a distribuição de crédito:

1. A eficiência deste i.e. o capital deve ser dirigido às actividades económicas que gerem melhores rendimentos, 2. Um nível aceitável de recuperação dos créditos.

Em ambos os casos, os instrumentos normais numa economia, como taxa de juro e um sistema de garantia, dificilmente podem ser usados no ambiente económico da Guiné-Bissau. No caso da taxa de juro, a taxa de inflação dificulta a utilização das taxas de juro de crédito e de depósitos como um mecanismo de afectação eficiente do capital. O problema da distribuição eficiente não pode ser resolvido quando a economia tem uma taxa de inflação de 60-70 %. Por isso é necessário criar um sistema "second-best" até que os pré-requisitos externos, i.e. a taxa de inflação, se alterem favoravelmente. No caso de garantia, a falta

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duma base legal para as garantias, e, também, o comportamento tradicional impedem, por exemplo a utilização de propriedades como garantias.

Uma das preocupações do PIR (projecto terminou em Dezembro de 1993) foi de identificar uma instituição de carácter privado e independente do MDRA que poderia ser a instância intermediária para canalizar os créditos e para recuperá-los, assim também para manejar o Fundo Rotativo.

Esta instituição poderá ser:

- Um Banco comercial que tenha suficiente experiência em administração de créditos para pequenos produtores e comerciantes no meio rural, seja associados seja individuais;
- Uma ONG existente que tenha experiência no manejo de crédito com empresas associativas e pequenos produtores;
- Uma ONG que se constitui para este fim e a quem se dá capacitação necessária;
- Uma sociedade financeira de carácter privado a ser criada a nível nacional;
- Uma cooperativa de serviços de segundo grau que reune várias cooperativas ou associações.
- Uma associação financeira a nível da tabanca, fora do circuito institucional, a ser criada pela própria comunidade.

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