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REPORT OF THE WORKSHOP

ON

RURAL FINANCE AND FINANCIAL SECTOR DEVELOPMENT

Sponsored by:

Office of Rural and Institutional Development
Bureau for Science and Technology
U.S. Agency for International Development
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PREFACE

RONCO Consulting Corporation was contracted by the United States Agency for International Development to provide the logistical arrangements and coordination for a two-day workshop on Rural Finance and Financial Systems Development, and to prepare this report on the workshop proceedings.

The report is organized as follows: The Introduction gives a background summary of the A.I.D. experience with developing countries in rural finance, explains the purpose of the workshop, presents abstracts of introductory remarks by two senior officials of A.I.D., and summarizes the main ideas that emerged from the workshop. The following section provides summaries of papers presented during the workshop. The final section contains conclusions of the discussion panels on Financial Policy, Financial Systems, and Financial Institutions and Mechanisms that were held during the final half-day of the workshop.

Full papers presented are not included in this report, but are available by request (use the order form at the back of this report).

RONCO Consulting Corporation
Washington, D.C.
October 15, 1987

I. INTRODUCTION

A. Background

The Rural Finance and Financial Sector Development Workshop was organized under the auspices of the Office of Rural and Institutional Development (S&T/RD) of the Bureau for Science and Technology of the Agency for International Development.

The conceptual groundwork for identifying a sound financial sector as a vital part of a country's development was prepared in the 1960s and 1970s by Raymond Goldsmith, Hugh Gurley, Patrick Shaw and Ronald McKinnon, among others. In the field of rural finance, building on the work of these pioneers, important work has been carried out by a team of Ohio State University (OSU) researchers: Dale Adams, Carlos Cuevas, Douglas Graham, Richard Meyer, Claudio Gonzales-Vega and Robert Vogel. The Ohio State work has extended to Asia, Africa and Latin America through the Bureau's centrally funded "Experimental Approaches to Rural Savings" (EARS) project. In each instance where country level work has been carried out, it has been done in collaboration with and was supported by A.I.D. field missions.

The EARS project became operational in the fall of 1982. By the second year of the project it became apparent that deposit mobilization, the major focus of the project, was not enough to promote financial institution building. OSU and S&T/RD concluded that developing countries require a broader approach to building up their indigenous financial systems. Other factors that significantly influence development of rural financial systems include macroeconomic policy, fiscal and monetary policy, the presence of a private sector, the informal financial system, and the regulatory framework.

A workshop on rural finance and financial sector development was sponsored by A.I.D. on September 21st and 22nd in Washington D.C. to discuss and define issues and opportunities for intervention in financial markets in developing countries. Ninety participants from A.I.D./Washington, A.I.D. missions, international donor agencies, academia, and consulting and banking communities attended.

The Rural Finance and Financial Sector Development Workshop layed out a broad framework for addressing some of the major issues constraining financial sector development. Its themes highlight several areas that development practitioners and policy makers must confront as they promote viable and sustainable financial institutions capable of attracting and channeling indigenous financial resources.

B. Chairman's Comments

The Workshop Chairman, Eric Chetwynd, Acting Director of the Office of Rural and Institutional Development, Science and Technology Bureau, A.I.D., welcomed conference participants and gave special thanks to those who had come from developing countries and overseas Missions to take part in the workshop. He pointed out that, collectively, the group represented a tremendous breadth and depth of knowledge and experience. Participants were invited with that in mind. They included, in addition to U.S.A.I.D. Mission personnel, representatives from international donor agencies, and the academic, consulting and banking communities. He said that the agenda deliberately covered several areas in the realm of finance. The workshop was to cast a broad net in discussing and defining issues and opportunities for improvements in financial markets in developing countries.

The chairman indicated that the plan was to begin the two day discussion with a history of activities and accomplishments to date in rural finance, and then to move on to new knowledge in the major topics, from savings mobilization to equity markets. The intent was to reveal not only what we know, but what we need to know to continue the kind of progress that has been experienced over the two last decades. The ultimate purpose is to emerge with a clear picture of where the Agency should be going in the financial sector and how this breaks down into manageable tasks.

The chairman introduced and thanked Sandra Frydman, who had managed the planning and development of themes for the workshop and the selection of presenters. He then introduced the Counselor to the Agency, Alexander R. Love, and the Deputy Assistant Administrator, Science and Technology Bureau, Dennis Brennan, who officially opened the workshop.

C. Statement by Counselor to the Agency - **Alexander R. Love**

It's a personal pleasure for me to welcome you to this workshop.

The first project I worked on when I was a management intern in this Agency over 25 years ago was helping to set up a private financial institution in the Philippines, the Private Development Corporation. I have had a strong interest in financial institutions since that time. I had an opportunity two years ago to go out and re-evaluate PDC after nearly a quarter century of existence. I was pleased to see that as a private sector institution, it had survived and in fact prospered in the somewhat turbulent waters of the Philippines financial community.

Today's topic is much in the news. In fact, recently the Washington Post featured an article on A.I.D.'s successes in small enterprise and private sector development in the Dominican Republic. The Congress and private volunteer organizations, as most of you know, have also shown renewed interest in the subject in recent years. Because of this interest, the fiscal year 1988 foreign assistance legislation contains strong language directing A.I.D. to increase its programs in targeting financial activities on the poor.

Your discussions in this workshop will undoubtedly feature the rural credit and savings mobilization program. It all started 15 years ago with a simple idea: Is cheap and targeted credit undermining much of rural development? A bold and important question to ask, not an easy one to answer. After years of painstaking survey and research in Brazil, and many other countries, by Ohio State University, it became clear that the answer to the question was yes. Dependency on dominant outside funding combined with subsidized, targeted supply-led credit strategies were counter-productive. They failed to create incentives for domestic savings mobilization, and were also creating a costly, one-sided, delinquency-prone financial institution which offered poor services. These subsidized credit programs rarely achieved their production goals or contributed to any substantial increase in rural incomes.

Important questions remain. What are the credit needs of small enterprise? What will be the impact of proposed legislation for strong credit programs for micro-enterprise? That's an activity I would like you to particularly take a close look at given the rather extensive dialogue that's been going on between A.I.D. and the Congress over the course of the last year. Will we have the same ills that plague small farmer credit programs? Will there be the same high delivery cost for credit? Will financial institutions resist lending to small and micro-enterprises? Will the margins charged by enough to cover the institutional costs? Do the funding arrangements ignore deposit mobilization? Is there a high degree of targeting, and is it having the desired effect? How can the formal and informal sectors be effectively linked?

We hope this conference will stimulate a creative, active discussion of these issues and many others. Collectively, you represent an enormous pool of expertise from the financial sector. I know that with this group, we will have a lively discussion. I wish you the best. Thank you.

D. Statement by Deputy Assistant Administrator, Bureau for Science and Technology - **Dennis Brennan**

A NEED FOR HONESTY

Sometime earlier this year, I had the opportunity to testify before the House Select Committee on Hunger on the question of a bill concerning micro-enterprise. What came through in that discussion and the ensuing debate, that has still not been resolved in the succeeding months, is a large area of fundamental mistrust.

It is clear to me, at any rate, that the members of Congress who were sponsoring this legislation, and a number of the NGOs who were involved in supporting it, took the view that A.I.D. at least, and perhaps other donors as well, had talked a lot about credit and financial support to small enterprise, small farmers, the rural poor--and had done very little about it.

It was equally clear as that discussion evolved, that we had to do more than just tell them they were wrong and we were right.

I noticed in going through the outline of this morning's discussion, this conference on which you are embarked, that the headings cover:

- deposit mobilization and financial sector growth
- A.I.D. and finance
- financial policy
- financial systems development
- financial institutions
- equity markets
- promoting financial sector development in A.I.D. programs.

There is no mention in those of small farmers, small enterprise, subsistence farmers, the rural poor--none of those things we talk about in our legislation, which we are tasked with when we appear on the Hill, which the general community of supporters of aid as an institution think the donors, including the banks and ourselves, are doing.

I don't know what the current figures are, but some years ago the World Bank did a study which indicated five to ten percent of farmers were taking between seventy and eighty percent of the institutional credit available for rural financing in most developing countries. Those figures may have changed, but I suspect they have not changed very much. What they mean is that larger farmers, and the mid-sized farmers, those who have assets, those who have resources, are getting more, or can have access to them.

Those without, stay without.

Now there is some measure of sense in that perhaps..

What it probably means is that most small farmers, most of the rural poor, most subsistence farmers don't borrow unless they have to. Don't borrow unless a flood wipes out stored grain, does something to seed, or drought dries up the crop they planted, or a wedding or a burial or something else imposes a dramatic and an immediate demand on the family. Then where do they go? They probably go to somebody else in the village, somebody else in their own family, somebody else in their own clan, group, or organization.

They don't go to institutions, for many good reasons as most of you know. Not just because they may not be allowed through the door, but it is probably also not a good idea for them. Why should they risk whatever little security they have in the world by signing up in some strange office? An act that may ultimately result in decapitalizing them or depriving them of ownership of the few limited assets they indeed do have.

That's hardly institutional credit - this way of dealing with friends, neighbors, relatives, money lenders, pawn brokers of one form or another, but it's very real, and it is probably the source of most credit for most small farmers.

- Notwithstanding what we say on the Hill.
- Notwithstanding what we say to our constituents.
- Notwithstanding what we say to most people about how effective our rural finance programs are in addressing the needs of the rural poor, the subsistence farmer, those who really have to be lifted up and helped along.

But I think that raises a question--a question I would like this workshop to look to. For the rural poor, the subsistence farmer, the disenfranchised entrepreneur who is so small he doesn't count in the larger picture or in terms of the macro-planners - the question is whether these people are discussed under the headings I've noted from your outline, the outline for the discussion you are going to have over the next two days.

These small farmers are rarely a force for modernization in agriculture. They don't buy irrigation pumps, and they don't buy seed, and they don't buy fertilizer. They don't do a lot of the things that we talk about in the literature, that most development literature talks about - how agriculture is going to change, grow, expand and be the "engine of development" in Africa and Sub-Saharan Africa, in Asia. But there is a whole large body of people out there who aren't even involved.

It's other farmers, those who have the resources and are prepared to take the risks, who want to grow; it is those who get the institutional resources and do something with them. It is not the small farmer who, when he goes into a bank or an institution, takes a risk of losing his basic livelihood and whatever limited independence he has.

Now one can argue in efficiency terms that this is really the right thing to do. Even if the small farmer prospers and uses a loan to do it, he is probably going to do so at the expense of a neighbor. Ultimately, if the rural finance, savings mobilization and lending system is working efficiently, the inefficient farmer gets out, goes to the cities and populates more Calcuttas and Khakas, Jakartas, Nairobis, and cities like those - where they then drop out of the picture.

The small undercapitalized producers are getting out because they don't have the capital and they don't have the efficiency--and they are never going to buy those irrigation pumps or do those things that all the planners expect them to do or expect to see happen as part of a rural finance/savings mobilization "growth in agriculture".

There is no question this is happening - that small farmers are leaving, that the poor are leaving the rural sector - because there are not enough jobs, there is not enough capital, there is a bad crop year, or a flood in Bangladesh, a drought in India, a drought in Sub-Saharan Africa.

What do they do? Well at least you can live in Calcutta, even if you are living on the sidewalk. It is a little better than trying to subsist or exist out there in the middle of the country, where no one pays any attention to you any more - and somebody else is working your land or what was your land.

But to the extent this is happening, to the extent the rural poor are leaving agriculture and going into cities, and cities are growing, this has almost nothing to do with rural finance, rural credit and any of the successes or failures of any A.I.D. or other donor-funded rural finance programs over the last few decades.

They simply don't reach the poor! They don't reach the small farmer or they reach only a fractional number.

So what does rural finance mean to the rural poor? What it does mean probably, what it means to most governments, is some kind of social responsibility or moral imperative--relief even, if you want to call it that.

So that when the waters in Bangladesh rise by that inexorable two more inches or one more foot, every ten or fifteen years, and half the villages in the country are wiped out, that somebody is around to help--to have these farmers set up and give them some money, so that they can buy something and start all over again, even if it means going down and working on some project where they are paid with food, then sell the food so they can buy seed or do something else.

Or farmers in India hit by the drought this year. India has one of the most elaborate systems for relief in the world, dating back to the days of our British cousins.

What this means to governments is that survival is important -- survival is a political, a moral an social imperative in these countries. I'm not sure it's an imperative in terms of rural finance, savings mobilization, lending, institutional development, or all the other things you are going to be talking about for these two days. The survival of the rural poor, of the subsistence farmer, of the small farmer, at some decent level of life is an acceptable, important objective of every aid program and of every LDC government, but that doesn't mean it's rural finance or rural savings.

In this workshop, I think it would be important to test the orthodoxy of what we've been telling ourselves, and telling our constituents, and telling Congress, and telling the banks and telling host governments for the last 20 years--that we really do have a mechanism for reaching the small farmer, the subsistence farmer, the rural poor, that our higher interest rates and our methods of mobilizing savings, that our institutional development and our tie-ins to technology, that our extension systems, and all the other ways which we propose to make agricultural lending and small enterprise lending in the rural sector more efficient, that all of these really reach the poor or that they really can reach the dispossessed, the subsistence farmer, the small farmer.

I think that rhetoric, which continues every year, is something that deserves to be tested in all honesty.

I think to come to terms with what in fact we really do, to recognize the limitations on the ability of the sector we are dealing with--on the ability to address what in human terms is often the most important and most intractable issue for most developing countries and will continue to be until the next century--the needs of the rural poor.

I think honesty about that is a beginning of some reality in this discussion!

I think it's important to recognize the contradictions, the discrepancies--and try to deal with them, to find if there is any way we can deal with them.

Is there any way we can honestly go before any public forum - go back to the Hill for example--and say we know there is a way in which we can realistically predict that the resources you provide, through A.I.D. or through the World Bank or through any other donor, can reach the people out there who need it probably more than anybody else? And that that makes sense in terms of rural finance and rural lending?

That's a question I think we don't have the answer to, but it's a question I think you should look to in each of those headings.

And I wish you luck. Thank you.

E. Executive Summary of Central Ideas Emerging from the Workshop

The central ideas emerging from the workshop are summarized below. They are organized in accordance with the three main themes of the workshop: Financial Policy, Financial Systems, and Financial Institutions.

Financial Policy

1. **A more systematic approach to financial sector work is needed within A.I.D. and among donors. For A.I.D., this means that more financial sector analysis should be done by USAID missions.** It also means that individual initiatives within A.I.D. should be better coordinated, and that conditions in the LDCs should be recognized and relevant to the financial development strategy adopted. In some cases, only modest and preparatory investments are possible because the government concerned is not interested in needed reforms of the financial system.

2. **Certain minimum conditions are necessary (but not always sufficient) for financial development to proceed.** The absence of hyperinflation and its associated instability, positive real rates of interest, and reasonable incentive for various types of savings and investment are all examples of these conditions. Where these conditions are lacking, assistance should be limited.

3. **The use of leverage is often overrated or misunderstood. The best leverage comes from continuous contact and dialogue with LDC decision makers.** As participants in such dialogue gain insight into the advantages of financial reform, they are more likely to adopt a reformist agenda as their own. Using financial assistance to stimulate or force compliance will usually fail if the government is not convinced of the desirability of the policy measures being urged. Provision of educational opportunities, often in conjunction with technical assistance, can be critical.

4. **The provision of funding through equity sources is often not given attention in the formulation of financial policy.** Both equity purchases by local citizens and debt-equity conversions with foreign investors and banks can play an important role in financial sector development. Typically, equity investments are most promising in more advanced developing nations.

Financial Systems

1. **The role played by informal sector institutions in many nations has not been a major area for study.** In many countries, they are the major source of credit in rural areas. No picture of the scope or nature of the financial system is complete if they are excluded. They can extend the reach of the financial system and play an important complementary role to the formal sector. More complete studies about integrating this sector with formal financial markets are needed.

2. **Workable approaches need to be found in order to reach low income groups with "normal" banking services.** Special institutions that charge higher interest rates to cover higher costs, set up to collect savings and make small loans in local areas, and gather knowledge of local people to reduce losses represent one solution. Another is to increase loans to and competition among informal sector institutions so that they can more easily and widely reach the poor, at lower costs. A third is to encourage the growth of credit unions. However, much more needs to to known about all three possible solutions. Subsidizing interest rates for special purpose lending has proven to be a non-solution. This retards development of viable institutions and encourages political or corrupt allocation of funds.

3. **There are major opportunities for technical assistance in auditing and management of financial institutions in many countries, as well as for applied research of transaction costs.** Efficiency of intermediaries needs to be raised. Costs of doing business are often unreasonably high while loan losses are well above acceptable levels. Yet there is seldom a mechanism for uncovering, reporting, and dealing with these problems.

4. **A healthy financial system should have a wide range of instruments available to savers and borrowers.** For savers in particular, variations in term, liquidity, and yield can be crucial. Placing the collection points (branch offices) close to customers can also be a major incentive for savers, as it greatly reduces transaction costs to depositors. (Costs of raising funds must also be considered, of course.) These points have often been overlooked due to the emphasis on interest rates.

5. **Deposits, rather than "soft loans" should be stressed in offering capital assistance to financial institutions.** While technical assistance is likely to be helpful, and some help with buildings and machinery may be in order, the use of "soft" loans to the institution substituting for deposits often undermines commercial lending discipline.

6. **In general, targeting of lending to particular narrow economic groups should not be undertaken. A viable financial institution should diversify its loan portfolio, not concentrate it.** Commercial, not programmatic considerations predominate in the lending decisions of successful financial institutions. (However see #2 in this section for ways to reach the poor with financial services.)

Financial Institutions

1. **A first priority for any financial institution and for its customers is survival and continued operation.** A poorly run institution will stop operating and stop providing services for its customers. This is why institution destroying policies such as low interest spreads and rates, targeting of loans, lax regulation and supervision, and subsidies to poorly-run institutions are bad for the supposed beneficiaries.

2. **Credit unions are one form of institution that have succeeded in some cases in reaching the poor with financial services at a reasonable cost.** The most successful cases have been truly private, not government supported. Nevertheless, many private credit unions have failed. More needs to be known about the reasons for success and failure of credit unions.

3. **A common element found in successful financial intermediaries is active resource mobilization alongside lending.** Because resources are raised from the community, the community often encourages borrowers to repay, so that their savings are safe. In addition, identifying sound potential borrowers is easier when past savings behavior is known. Finally, if lending can continue even in times of budgetary stringency, the reliability of the institutional services to its customers acts as an added incentive for them to pay back existing loans.

A.I.D. Roles

Based on discussions concerning these major ideas and the role that A.I.D. could play, the concluding panels suggested that the following activities would be appropriate for A.I.D. to consider undertaking:

- Increase resources for training in financial sector development, including training of mission as well as local personnel.

- Emphasize technical assistance in the building up of capability for domestic policy analysis, and the support of domestic policy analysis rather than imposing "outside" solutions.

- Support collegial, supportive, and continuing contacts with decision makers over leverage or conditionality. Policy dialogue should be a two-way street.

- Concentrate research on the formulation of generalized guidance to U.S.A.I.D. missions in the research agenda. They should be able to perceive the best type of intervention in a particular situation. Goal setting should be realistic and based on possible developments of the present situation.

- Improve A.I.D. support of the capability of national bodies to conduct audit, supervision, and review of the conditions of financial intermediaries.

- Expedite A.I.D. internal coordination and its coordination with other donors.

- Support A.I.D. research into various forms of institutions, instruments, and techniques for improving the functioning of the financial system and particular institutions. These will include transactions cost analysis, credit unions, informal sector institutions, and conditions for successful equity offerings.

II. SUMMARY OF PAPERS PRESENTED

- INTRODUCTION

- DEPOSIT MOBILIZATION AND FINANCIAL SECTOR GROWTH (Review of the Experimental Approaches to Rural Savings (EARS) Project) (Ohio State Team)--Claudio Gonzales-Vega, Douglas Graham, Richard Meyer

    A.I.D. and Finance (Thomas Tifft)

- FINANCIAL POLICY
    Instruments of Financial Policy (Maxwell Fry)
    A.I.D. and Financial Policy (Neal Zank)
    Implementing Financial Development (David Cole)

- FINANCIAL SYSTEMS DEVELOPMENT
    Formal Financial Systems (J.D. Von Pischke)
    Regulation and Supervision (Vincent Polizatto)
    Informal Financial Markets (Thomas Timberg)

- FINANCIAL INSTITUTIONS AND MECHANISMS
    Role of Credit Unions in Financial Sector Development (Peter Marion)
    Formal Financial Institutions and Mechanisms (Robert Vogel)

- EQUITY MARKETS
    Promoting Private Sector Financial Institutions (George M. Ferris, Jr.)
    Equity Markets: An IFC/World Bank Perspective (Peter Tropper)

    Monetary Policy and the Financial Sector (Courtney Blackman)

INTRODUCTION

This section provides summaries of five presentation/discussion sessions of the two-day Workshop on Rural Finance and Financial Sector Development. The first session provided an overview of A.I.D.'s Experimental Approaches to Rural Savings (EARS) project; the following four sessions focused on related financial sector themes.

The first session set the stage for the subsequent presentations by reviewing the experience and findings of the EARS project. Ohio State University (OSU) is the contractor for EARS under a Cooperative Agreement with the Bureau for Science and Technology, Office of Rural and Institutional Development (S&T/RD). Members of the OSU team, Dale Adams, Carlos Cuevas, Douglas Graham, Richard Meyer, and Claudio Gonzales-Vega collaborated in preparing and making the presentations during this session. Their presentations stressed the major themes of EARS--the role of savings mobilization in increasing capital access and in strengthening financial institutions.

The trend of the work being carried out by OSU was recently assessed by a consultant team as part of the EARS project evaluation. Among other things, the evaluators considered how A.I.D. should build on EARS experience and findings to develop a successor project. Their conclusion was the same as that suggested by much of the finance and credit work being carried out through A.I.D. projects around the world: a broader financial sector approach is needed for future A.I.D. rural finance work.

Specific themes identified in this evaluation, as well as OSU field work were used as the basis for selection of the four themes around which the presentations in the workshop were organized. Because of time limitations, not all the issues identified were covered.

As a further prelude to the four theme sessions, Thomas Tifft, the A.I.D officer who headed the EARS evaluation team, presented some of the major issues for financial sector development in developing countries that emerged from the evaluation.

From the outset of its EARS work, the OSU team stressed the importance of the context for savings mobilization, and therefore of the need to incorporate policy reform dialogue into savings mobilization efforts. The work of the EARS evaluation team reemphasized this point. Thus, the second workshop session was devoted to the topic of the policy framework through which financial innovation is introduced. Maxwell Fry, of the University of California, Irvine, is well known for his work on the role of financial sector conditions and operations in economic development, which he reviewed in his workshop presentation. A.I.D. is increasingly concerned with financial policy reform, and Neal Zank, of A.I.D.'s Bureau for Program and Policy Coordination, discussed this as he reviewed A.I.D.'s draft policy paper on financial market development. David Cole, of the Harvard Institute of International Development, discussed some conclusion from his 20 years experience in promoting financial sector development and policy reform through A.I.D. programs.

The third session dealt with formal and informal financial systems. J.D. Von Pischke, who has conducted extensive research and field work on finance for the World Bank, discussed the role of the formal institutionalized financial system in developing countries. Vincent P. Polizatto, recently with the Controller of the Currency of the U.S. Treasury, is now concerned with the regulation and supervision aspects of financial systems of developing countries at the World Bank. He discussed the regulatory needs of developing countries to revitalize their financial systems. The informal financial system comprises moneylenders, informal savings and loan societies, moneykeepers, and the like; in some developing countries this sector accounts for as much as 85% of the financial market. Thomas Timberg, of Robert R. Nathan Associates, discussed the informal financial sector based in large part on his field work and experience under various A.I.D. projects.

The fourth session of the workshop focused on financial institutions and mechanisms. Peter Marion, of the World Council of Credit Unions, gave a presentation on the role of credit unions and their federations as "middle tier organizations" between the formal and informal financial sectors. Robert Vogel, of the University of Miami, has carried out extensive work in both savings mobilization and formal finance; he discussed the role and problems of public sector financial institutions, and possible reforms to improve their functioning.

The final presentation/discussion session dealt with equity markets as an alternative to debt markets for financial resource allocation. Equity markets are often neglected in workshops and of this type on financial sector development. It was felt equity markets should be taken into account as A.I.D. considers approaches to its future financial market activities in developing countries. George M. Ferris, Jr. is CEO of Ferris and Company, Inc., and also Director of the Capital Markets Project of A.I.D.'s Bureau for Private Enterprise. He discussed the role of private sector financial institutions in promoting equity markets. Peter L. Tropper, of the IFC's Capital Markets Development program, presented the IFC/World Bank's perspective on equity market development.

Following this session, Dr. Courtney Blackman, recently Governor of the Central Bank of Barbados, discussed the role and problems of monetary policy within the financial sector framework.

After the theme sessions, workshop participants divided themselves into discussion panels covering financial policy, financial systems, and financial institutions and mechanisms. The panels were charged with identifying major current issues in financial sector development, and considering what this suggests for future A.I.D. financial sector program and project activity. The findings of these three panels are presented in the third section of this workshop report.

Copies of the four formal papers presented are available by request (see Annex D).

SESSION I

DEPOSIT MOBILIZATION AND FINANCIAL SECTOR GROWTH

Deposit Mobilization and Financial Sector Growth

Claudio Gonzales-Vega, OSU

For almost three decades Ohio State University (faculty and students) have devoted major attention to analysis of rural financial markets in developing countries and design of policies and programs to improve the provenance of rural financial services. From the analysis and field experience the following general conclusions concerning rural financial markets and the financial institutions emerged.

- Deposit mobilization must play a key role.
- Transaction cost on both deposits and loans is a major factor in institutional viability and success.
- Credit subsidies are poor and often perverse instruments for accelerated technological improvement, improvement in equity of income distribution and achievement of sectorial agricultural investment required for a prosperous agricultural sector.

The evidence indicates that a new system-wide approach to rural financial markets should be substituted for the more limited traditional view that has underlain design of past policies and programs. The new approach which OSU has espoused emphasizes overall efficiency and integration of financial markets. It emphasizes a total interlinked market approach rather than a limited public development bank or project approach; total financial services to rural populations rather than loans to target groups; total intermediation margins,competition and minimization of transaction costs over fixation of interest rates.

While the traditional approach has been the supply of loans at low interest rates to a targeted group, recently the new emphasis is on development of broad financial intermediation services which are valued, income augmenting and welfare increasing, not just to selected borrower groups but to <u>depositors</u> and <u>borrowers</u> as a whole. Deposit mobilization is viewed as a critical aspect of the integrated approach. Traditional emphasis on low interest rates which fail to serve either their production or income redistributional objectives are replaced by emphasis on competition, reduction in transaction costs and provision of services for which demand will fully cover all costs of deposit mobilization and lending. Field studies show non-interest costs of small loans frequently are equal to or greater than the explicit interest costs. Total intermediation costs relative to margins obtained from such services are the key to institutional success in serving of the potential depositor and borrower clientele. Non-price rationing in shortage situations usually discriminates against smaller and riskier loans.

Traditional systems have emphasized development of an ideal institution with minimal linkage to financial markets loaning to particular groups; but financial service needs are not homogeneous even within targeted groups. The most pressing need is diverse services provided by interlinked institutions which permit a flow of funds and information while minimizing total costs of resource mobilization and application. A hospitable environment is needed for a variety of interlinked institutions able to serve different needs and ends efficiently.

The real measure of success is overall effectiveness and efficiency in serving the varied financial needs of the rural sector. Impact on agricultural production and/or farmer income is not an adequate criterion. Many conditions are necessary for sustained agricultural growth--favorable price policy, suitable technology and supply of inputs for adoption, farm to market roads, transport, reliable markets, and information. Credit can facilitate development but cannot substitute for lack of other development essentials or other unfavorable policies.

At the rural community levels farmers and others usually are best served at lowest cost by financial intermediaries located in the community, well acquainted with the conditions and needs of families in the community, and appropriately linked with other financial institutions. Outside intermediaries usually incur much higher transaction costs, risks, and reduced profitability. Clearly defined property rights and rules on contract enforcement hold financial costs of operation down. Some regulation and supervision is needed to protect and encourage depositors. Where organizational inadequacies exist costs are increased.

Economic policies which repress rural income and increase its variability reduce both deposits and credit worthiness of borrowers.

Fiscal policies which lead to inflation, expectation of devaluation, financing of fiscal deficits by bank credit, increased reserve requirements, interest rate control and other forms of excessive financial market regulation reduce the efficiency and effectiveness of financial markets in servicing rural needs. Clear financial signals and reliable information are needed for financial planning and development of strong service oriented institutions. With favorable policies providing clear signals and adequate information upon which to act technological improvement in operations becomes increasingly important.

Cost per transaction is particularly important for rural deposit mobilization, which usually involves small individual transactions, and for small size loans. Credit institutions already possessing a substantial network of branches have found it possible to mobilize rural deposits at very low marginal cost after undertaking this new function because excess capacity usually existed at local offices. However, successful addition of deposit mobilization to previously specialized lending institutions based on donor or government resources usually require some changes in attitudes and practices--to greater depositor orientation of practices such as interest rates, liquidity, loan selection, risk reduction, improved information collection and analysis. More flexibility is needed.

Success and Failure Syndromes in Rural Finance: A Conceptual Framework and Lessons Learned

Douglas Graham, OSU

Past experience with financial institutions including development banks, rural banks, credit unions and other development oriented financial institutions reveals a fairly high rate of failure among such institutions, including institutions receiving substantial donor support. At the extreme failure means insolvency and forced bankruptcy, but it also may involve lesser degrees of malfunctioning where costs greatly exceed revenues, capital stock is rapidly depreciated and ability to generate new capital injection is severely limited.

An important characteristic of emerging institutions, especially those heavily donor supported, was the supply lending approach to where credit was offered, usually in advance of clearly measured or demonstrated demand, usually to specifically targeted groups--farm sizes, geographical areas, growers of particular commodities.

As a consequence of targeting on particular clientele and heavy donor or government financing, institutions were borrower rather than saver dominated. Other syndromes in addition to borrower domination and reliance on external or government-provided funds included portfolios concentrated on the target farmers and/or commodity groups which precluded portfolio diversification and spreading of risks, lack of deposit mobilization, non-price rationing of credit often to the disadvantage of smaller and less well connected farmers. Loans frequently were tied to rigorous collateral requirements, political patronage or both. Concessional interest rates contributed to non-price rationing, and a variety of explicit or implicit non-interest, frequently hidden costs, especially on small loans.

Characteristics of successful institutions and programs included:

- Demand following rather than supply leading lending.
- Saver rather than borrower domination resulting in primary concern over safety and greater care in portfolio management.
- Portfolio diversification.
- Primary emphasis on deposit mobilization (rather than concessional donor or public financing).
- Explicit price (re interest) rationing of credit.

Further, the successful institutions commonly are smaller and have frequent contact with potential borrowers, often as depositors. Intimate knowledge of their clientele can substitute for explicit provision of collateral in achieving loan safety. Other important elements for success include:

- Freedom from excessive regulation, particularly of interest rates which may preclude margins sufficient to cover operating and risk costs.

- Regulation restricted to essential depositor protection.

- Judicial systems for contract enforcement with minimal costs.

- Proper balance of funds (primary dependence on depositors but access to other sources).

- Proper systems of accountability for action, e.g., loan approvals.

A.I.D. Priorities in Rural Financial Markets
Richard Meyer, OSU

My objective in this final part of the OSU presentation is to lead into the issue Eric posed at the outset. Where does AID go from here in its work on Rural Financial Markets (RFMs)? This implies two questions: "What are the rural financial market needs," and "What is AID's role and comparative advantage in meeting these needs?" I believe that AID is likely to continue with a strong, though not necessarily exclusive, private sector orientation. It will continue to work also with public agencies such as Ministries of Finance, Central Banks, Ministries of Cooperatives and with credit union organizations and others. AID is likely to continue to be interested in helping to provide financial services for the agricultural sector, where it has a huge investment, and in helping to provide financial services for other disadvantaged groups within LDC societies. Further, I think AID will be involved in development of financial institutions to meet needs where institutions currently don't exist and/or the rehabilitation of already existing but failing institutions. And finally, although AID has made some impressive improvements in staffing in recent years, particularly with the hiring of several economists, ag economists and so on, and therefore has more staff able to engage in some RFM analyses, and to understand and interpret the analyses that others have done, I think AID will still find that it has a shortage of staff. AID undoubtedly will lament the shortage of funds for support of RFM development.

In its RFM activities I think that AID will continue to be heavily involved in policy dialogue in several developing countries. To be successful in this dialogue AID will require careful analysis of financial issues. Our review of past experience suggests that to be successful these should heavily involve local analysts from universities, research institutes, Ministries, Central Banks, the private sector, and so on. Such involvement will not only help create the local capacity to conduct this type of research, but also will develop a local vested interest in the implementation of the results. Conditionality undoubtedly will continue to be introduced into AID's projects and programs. Participatory conduct of analyses will strengthen and support such conditioning. Since AID funds to support this work are severely limited there will be an increasing need for donor coordination, both to increase

AID's leverage in the policy dialogue process and to achieve consistency in the recommendations of the international community to individual countries.

What then are the likely future RFM development directions? AID's needs in providing development assistance to RFMs? Six topics are identified in the area of research:

a) There will continue to be a need for work on the design of cost and risk reducing technologies appropriate for rural financial institutions.

b) There will be a continual need for the analysis of institutional costs and efficiency and the minimum margins necessary to cover intermediation costs at various stages of financial development.

c) The extent to which the minimum conditions for financial reform must be met before undertaking particular projects.

d) More analysis on the responses that have occurred in countries where policy and regulatory reform has taken place, ways to increase levels of response when it has been limited, and the reasons for the limited response.

e) Frequently projects have been designed to minimize or reduce the role of informal financial markets. Analysis is needed on ways to make informal markets more effective and to link formal with informal markets. As a part of this, research is needed on the design and operation of financial institutions that attempt to serve farm and non-farm enterprises in rural areas.

f) We are all aware of the huge problem of loan recovery in many institutions. More research is needed on the question of how to improve loan recovery, monitoring loan recovery, establishing more realistic loan loss reserves and related issues dealing with loan repayment.

In some countries AID, with its very limited resources, has concentrated on providing technical assistance while other donors have provided an increased share of the capital resource transfer for development of financial markets. As AID works to rehabilitate financial institutions, local research capacity should be developed to analyze financial market problems. AID may support the development of this capacity through separate projects or through components of larger financial reform projects. Institutional rehabilitation and improved financial efficiency will require considerable experimentation and close monitoring of such experiments. Effective policy dialogue will require AID's support for both internal and external analysis to do the required analysis and perhaps to participate in the policy dialogue process itself.

Some training would be desirable in dealing with the broad issues of the type that Gonzalez discussed such as relationships between the financial sector and economic development. Training is needed also for personnel responsible for conducting policy analysis, e.g., specific research methodologies in management of financial institutions and design of policy and regulatory reforms.

A much greater exchange of information (call it networking) is needed with Missions, and with agencies in developing countries. Communication amongst ourselves, amongst the contractors, amongst the PVOs, all of us that are working with AID is another weakness. We think that at OSU we have done a fairly good job in the area of communication by our work and by disseminating papers and publications widely. Yet I suspect there are many who know little of our work. Conversely, we hear time and again about the great things that you have done, but it is very difficult for us to learn about your experiences in a systematic way.

There are research and technical assistance requirements and activities in which AID may be involved in the future. There certainly are opportunities for training, networking and information exchange. Which of these AID will choose to emphasize is, of course, yet to be determined. It will be interesting to hear your ideas and to see how much congruence there is between the specific priorities that you've identified and to compare them with the ones that we have developed.

Thank you for the opportunity to share these ideas with you.

A.I.D. and Finance - Thomas Tifft

The experience of the development community in fostering the development of financial institutions and markets may be summarized into two stages:

In Stage I (1950s and 1960s), institutions were created outside existing financial systems: e.g., agricultural development banks and industrial development banks. These were characterized by loans targeted to specific clientele and subsidized interest rates. The well-meaning intent was to provide an incentive to entry into new areas of production, thereby accelerating economic development. These arbitrary allocation systems gave disappointing results.

Stage II (1970s to date) was characterized as a scattered approach to financial sector development, although much has been learned which has helped to strengthen assistance programs of other donors, especially the World Bank and other multilateral agencies, as well as of A.I.D. Research by Ohio State University has broadened our understanding that market rates of interest and deposit mobilization are key,and that financial markets, not institution, are key. Involvement of A.I.D. in financial sector development has been broadened to include policy reform (e.g., Philippines, Bangladesh); improvement of financial systems (e.g., Dominican Republic and Indonesia); improvement of financial institutions (e.g., Egypt, Jamaica); research in financial markets (S&T); assistance to cooperatives and credit unions (FFP); and activities in capital markets and other financial projects (PRE) and in financial policy, systems, and institutions (regional bureaus).

Useful insights into financial sector development have been gained, but the approach needs to be broadened. Workshop participants were challenged to define a third stage of development, to deal with the financial sector in an integrated approach, to include:

- Financial sector policy;
- Financial systems (formal and informal) and regulation; and
- Financial institutions and mechanisms, with a broader range of activities, including banks, coops, non-bank intermediaries, and equity markets.

SESSION II

FINANCIAL POLICY

FINANCIAL POLICY

Instruments of Financial Policy - Maxwell Fry

Over the past three decades, developing country governments have made various changes in the structure and operations of their financial systems under the rubric of financial development, liberalization or reform; the experience of these efforts has been very disappointing. (The driving force behind recent financial innovations and reforms in the developed countries has been market pressures. However,the market is so distrusted in the majority of developing countries that market pressures frequently are virtually non-existent.)

It is increasingly important to assess the potential role of improved financial intermediation in the process of economic development. Furthermore, financial intermediation involves more than just the removal of discriminatory taxes and interest rate distortions, and adjustments to other policies directly affecting the operation of the financial sector. First, macroeconomic stability is essential. Second, a sound regulatory framework and effective bank supervision is imperative. Third, some institutional reforms are urgently needed in many developing countries. In large part, however, institutional reforms must address the overwhelming problem of non-performing assets.

There are at least two prerequisites for successful financial liberalization: macroeconomic stability and adequate bank supervision. (Price stability, fiscal discipline,and policy credibility may well be the three factors explaining Asian successes and Latin American Failures over the past three decades.) A prerequisite for successful financial liberalization is strong bank supervision, to ensure that weak financial institutions are detected early. However, there exists no analytical framework dealing with the relationship between financial liberalization and financial regulation for prudential and monetary control Regulation and supervision are the areas in most urgent need of further research. (Because inappropriate regulations and inadequate supervision have been the norm, a strong current of academic opinion favors minimalist government intervention in a country's financial sector.) Most developing countries do not possess or cannot attract sufficient expertise to staff an effective bank supervision office, even less a securities commission. This may suggest that financial development programs should start with the development of markets for simple short-term financial assets such as treasury bills and certificates of deposit rather than equities. Some form of audit, examination or inspection is essential both for the monetary policy implementation and the evaluation of banks' performance. The dearth of audit skills in most developing countries suggests the possible use of external auditors (e.g., as in the Belgian system) in which each bank must appoint an auditor chosen from a list maintained by the Banking Commission and must follow the rules established by the Commission.

High percentages of non-performing assets constitute one of the most serious problems facing financial systems in developing countries. Finding a solution should be foremost on the list of urgent financial policy reforms. Excessive arrears and default rates indicate inefficiency of one kind or another. Repetition of this problem can be prevented by abandoning directed credit programs.

The second most urgent financial policy reform concerns interest rate policy. Markets in which interest rates are freely determined are few and far between in the developing world. The monetary authority can offer education in and experience with the market determination of interest rates in a few easy stages. To start, central banks could establish an inter-bank money market, if none exists, to enable financial institutions to hold desired reserve levels on a day-to-day basis. Next, they could develop a treasury bill market, which would provide salient competition with the banking system. The central bank might also establish an open market for the resale of treasury bills and foster markets in negotiable certificates of deposit.

In summary, three areas need research:

- The role of management in financial institutions insolvency;
- Effects of alternative macroeconomic settings on the outcomes of financial liberalization and reform programs; and
- Financial system fragility, or instability: the differential effects of government regulation on the financial sector's ability to withstand exogenous shocks.

A.I.D.'s New Financial Market Development Policy - Neal Zank

In response to the critical economic problems confronting developing country financial markets today, A.I.D. has formulated anew official Agency policy which goes into effect in Fall 1987. Government intervention in the economy, high inflation and limited access to capital of target groups have had major impacts on the implementation of many A.I.D. projects, resulting in situations where financial institutions have become decapitalized.

Often little attention is paid to policy and institutional reasons why credit wasn't available and, over the last year, A.I.D. has realized that private enterprise policy guidance is often ineffective because it is isolated from the broad issues affecting the financial sector. Therefore, the new financial market policy paper stresses the linkage of these large issues to project issues. The policy paper has two basic purposes, first to develop a policy framework whereby A.I.D. can help LDCs effectively address financial market problems through policy reform and market-based host-government policy and secondly to guide Missions in the development of financial market projects and programs which lead toward more equitable economic growth.

The A.I.D. paper sets out long- and medium-term problem solving assistance using three categories of policy approach: policy reform, institutional development and guidance, as specific for credit projects. Often A.I.D. provisions are directly tied to policy or institutional reforms by the host government.

Regarding policy reform, A.I.D. has found that policy and institutional design features are often left out of project plans. A.I.D. now recommends that Missions develop a comprehensive financial market development strategy before pursuing financial market projects and that a thorough analysis be carried out with each project. Because financial market development and economic growth require appropriate macroeconomic policies, A.I.D. recommends that reforms be negotiated with host governments to eliminate government-imposed impediments to the free capital market, and that no support be given unless reform action is taken. Sometimes, well-intentioned legal regulatory controls become restrictions which stagnate the financial sector and therefore A.I.D. encourages LDC governments to constantly review and revise the legal and regulatory frameworks. Similarly, tax measures may promote goals contradictory to financial market development and economic growth, and A.I.D. asks Missions to review host government tax structure and urge the LDC government to change inappropriate tax laws, adopting tax policies and incentives that do not discourage development of business and financial sectors.

A.I.D. has found that a major deterrent to the development of an effective financial sector in most LDCs is the lack of strong institutional support. For this reason, A.I.D. stresses the development of private sector financial institutions such as credit financial projects which strengthen the private financial system. A.I.D. funds provided to financial institutions should avoid introducing or expanding the involvement of government ministries or parastatals.

A.I.D. takes an active role in guiding LDCs to eliminate deficiencies in financial institutional structures which impede growth. This role will not allow A.I.D. to take an equity position in private enterprise and permits grants only for direct training and technical assistance. USAID believes that market-based credit is the most effective way to promote development of financial markets. It recommends that funds provided to financial institutions carry interest rates equal to the local cost of capital, be separated into loans and grants and financed as separate components, and that, if it is necessary to adjust interest rates or grace periods, concessionality be related to a realistic determination of the added cost of undertaking the activity. Interest rates and fees charged by intermediate funding institutions should cover all IFI costs of lending where practical, should be at or near the prevailing interest rates and, at minimum, should be positive in real terms to private borrowers. Although directed credit projects are attractive to A.I.D. in terms of effort to assist target groups, they should only be undertaken when policy, institution and cultural constraints have been eliminated, or as policy reform devices. Under proper host government policy and institutional environments, guarantees may be appropriate, but the case for their introduction must be carefully arranged, and their size and duration limited.

Implementing Financial Development - David Cole

Many countries, both developed and developing, are grappling with how to improve the functioning of their financial markets. The general direction is to move toward greater competition by breaking down administrative barriers between markets and freeing up controls over prices. But in many cases, there is reluctance to move from a controlled set of prices to market-determined prices. There is considerable skepticism in many developing countries about the consequences for both growth and equity of relying upon market mechanisms. It is believed that the rich and powerful will dominate them and use them to exploit the poor while serving their own ends rather than the country's broader developmental objectives.

Rates set by some central authority or banker's cartel tend to eliminate competition as a means of attracting customers either as savers or borrowers. Fixed rates often do not take into account differences in risk or administrative cost of handling accounts, so that banks may have to resort to other rationing instruments, such as fees or compensating balances of borrowers, and quality of service for depositors. But the most serious defect of administratively-set interest rates is that they are never "right". Market conditions change, necessitating frequent changes in rates or acceptance of the fact that they are generally "wrong" in terms of market conditions.

Given the limitation of trying to set the "right" interest rates (or of trying to boost financial rations), what can be done? The answer lies in improving the functioning of financial markets: broadening participation in markets to increase competitiveness; curtailing opportunities to exercise monopoly power; improving sources of information about market operations and factors bearing on supply and demand in the market; and trying to improve linkages between markets and reduce market segmentation.

SESSION III

FINANCIAL SYSTEMS DEVELOPMENT

FINANCIAL SYSTEMS DEVELOPMENT

Reflections on an Agenda for U.S. Development Assistance for Financial markets - J.D. Von Pischke

A strategy for U.S. development assistance directed towards the financial markets of less-developed countries could usefully be based on the concept of a financial system. Financial systems are composed of financial centers and of networks that connect these centers to hinterlands and enable them to mobilize resources and to allocate funds efficiently.

This approach highlights the importance of transaction costs as indicators of efficiency, and the opportunities provided by economies of scale and scope through deregulation and indirect controls. The approach also facilitates examination of the importance of personal financial services in development, especially for households of modest means. It illuminates the flows of funds within the network and between the network and the center and the decision-making procedures that determine these flows.

The proposed agenda attempts to promote equity through the center and efficiency through the network. Equity requires accountability to a broad constituency, which requires competition, market rates of interest, independent lending decisions, and good information readily available. Private ownership of financial institutions can contribute to achieving these objectives.

Operating efficiency requires training, innovation, a creative approach to developing markets for specific services and client groups. Promoting efficiency in the network can help to counter the potential for abuse by the center, and can be assisted by tapping the managerial skills of the financial sector in the U.S.

Further research on rural finance, broadly defined, is warranted. Equity market development deserves more attention and is consistent with U.S. institutional strength. The capital structure of enterprises targeted for assistance requires much more professional attention from developers, as do the criteria of success for projects using credit as a means of promoting financial sector development.

* Views expressed in this summary and in the full text are those of the writer. They should not be attributed to the World Bank, its affiliated organizations, or to individuals acting on their behalf.

Regulation and Supervision in Financial Systems Development

Vincent P. Polizatto

Financial systems throughout the developing world are in distress. Much attention has been focused on macroeconomic issues. Certainly, macroeconomic policies are critical. But even when developing countries have implemented the correct macroeconomic measures, reforms have failed. A significant problem, often overlooked, is that the financial intermediaries, i.e., the banks and other lending institutions, are frequently insolvent. Real, but unrecognized losses often approach 80% to 90% of portfolio. Therefore, the allocation of resources by these institutions is distorted. Loans are extended to problem borrowers and inefficient users of credit, rather than firms which can use credit productively. Managers of these institutions are unwilling to face up to problems which may cost them their jobs and they deteriorate into a culture of deception, speculation, and possibly even fraud. Unfortunately, the regulatory and supervisory framework necessary to prevent or correct these problems is often ill-equiped, incapable, or politically unwilling to deal with the situation. The skills necessary for asset portfolio evaluation are lacking and financial information needed to assess credit, when available, is incomplete, unreliable, or out-of-date. Because solvency problems are not dealt with quickly, losses multiply.

The solution to this problem involves first and foremost, the restructuring of the institutions. The restructuring process requires the liquidation, merger, or rehabilitation of the institutions. Under ideal circumstances, a quasi-independent agency of the government, such as a deposit insurance fund, should manage the restructuring process. A quasi-independent agency has the advantages of avoiding many of the political constraints and unnecessary red-tape normally associated with government bureaucracies. The takeover of institutions by such an agency will avoid some of the criticism that the banks are being nationalized. By limiting the amount of deposit insurance, the government's potential liability is reduced, and healthy banks help to pay for the restructuring through their assessments.

In restructuring the banks, existing management and shareholders must lose in order to establish discipline within the system. That means that an appropriate legal system must be put into place to allow government authorities to remove management and directors, force the banks to write off problem assets, place banks into receivership, and wipe out shareholders' investments.

Other measures must be taken in parallel to ensure that continuing health of the institutions once restructuring has been completed. These measures involve prudential regulation and supervision. Prudential regulation establishes the rules of the road. The most important regulatory measures include lending limits, minimum capital ratios, limits on loans to insiders and related companies, enforcement powers (i.e., the ability to remove officers and directors, issue cease and desist orders, levy fines, etc.), rules governing the definition of non-performing assets, provision for losses and write-offs, and discretionary authority to screen access to ownership and management. Since most banks fail due to concentrations of credit and insider or related company abuse, regulatory prohibitions in these areas should be carefully crafted.

Supervision is the means of enforcing regulation. However, supervision involves much more than determining mere compliance with laws and regulations. Bank supervisors should be experts in the art of asset evaluation and should be empowered to require banks to provide for or write-down problem assets. In addition, bank supervisors can, and should, be catalysts for changing the fundamental way in which financial institutions are managed. The auditing and accounting professions and market disclosure are also important components of supervision and should not be overlooked.

Finally, the institutions themselves must move away from seat-of-the-pants management. They must carefully consider and institutionalize their procedures and policies so that more informed decisions are made within the scope of a strategic plan. Activities should attempt to optimize returns but within acceptable tolerances of risk. To accomplish this, executive management must have the ability to make informed decisions and control the activities of the institution. This may be done through developing management systems--systems such as written policies and procedures, formalized planning and budgeting, strategic planning, audit, internal controls, loan review, and management information systems. Bank supervisors can be an integral part of this process of institutional upgrading by encouraging the development of these management systems.

When implemented properly, restructuring, institutional upgrading, prudential regulation, and supervision will lead to a more robust, efficient, and dynamic financial system, thus providing an opportunity for macroeconomic reforms to succeed.

Informal Financial Markets - Thomas Timberg

Informal credit markets encompass financial transactions that are unregulated and sometimes banned by the government. (These are in contrast to formal financial markets which are defined by the fact that they are regulated.) Informal credit markets are of interest because:

- In many developing countries, they account for a good portion of financial activity; understanding them is crucial for understanding the economy. Financial market interventions might otherwise be counter-productive. Attitudes of donors toward financial markets has changed from looking on them as promoting and subsidizing agents for important inputs (fertilizer, etc.) to considering them as crucial if not the critical part of financial infrastructure.

- They service important purposes such as financing otherwise unserved market segments, facilitating otherwise foreclosed transactions, and pioneering new and functional financial instruments. By protecting or promoting these informal markets, or by formal sector institutions studying and mimicking them, these purposes could be served even better.

USAID missions should be more concerned with promoting the positive functions that these informal markets serve. This can be done in one or more of four ways:

1. U.S.A.I.D. could increase their own consciousness and understanding of informal financial markets and their relations with formal financial institutions. This could be done in collaboration with other institutions, and might involve sponsoring surveys and research as well as disseminating research results.

2. U.S.A.I.D could engage in policy dialogue looking to the removal of regulations that forbid or reduce the feasibility of informal market transactions.

3. Frequently, U.S.A.I.D. missions are involved with formal sector savings and lending schemes which mimic or duplicate features of informal financial institutions. For instance, grouped lending schemes lack formal procedures and they require the same kind of personal involvement (lending on character) and the same focus of working capital finance as informal market lending and savings.

4. In rare cases, U.S.A.I.D. missions fund or support transactions with formal sector institutions that indirectly fund informal markets.

SESSION IV

FINANCIAL INSTITUTIONS AND MECHANISMS

FINANCIAL INSTITUTIONS AND MECHANISMS

Peter Marion, World Council of Credit Unions, Inc.

In 1986 there were 20,000 credit unions in 71 developing countries with 7.8 million members and a total of over US $3 billion in total assets. Credit unions frequently are the first step in formal financial market development, especially in rural areas where they bring financial services to groups not previously served by deposit and formal loan services.

Credit unions have demonstrated that ability and willingness to save exists even in very low income areas, that democratic institutions can survive and thrive, that financial intermediation , including small scale lending, can be a viable business even among low income groups. Credit unions have benefited from international donor assistance but have not been dominated by donor supplied concessional financing as have many agricultural development banks and credit institutions. While credit unions make small loans at lower rates than many lenders they are saving rather than borrower dominated, typically have first hand knowledge of their borrowing clientele, and are able to maintain good repayment experience. Credit unions usually are built from the bottom up by volunteers and operate without government subsidies.

Credit unions frequently provide the first formally financial institutions linked to national and international financial markets and for the first time serve the rural community with deposit, lending and, in many cases, life insurance services.

Some credit unions provide non-financial services but evidence indicates these services commonly have been unsuccessful or only partially successful.

Despite notable past progress, credit unions are still in a formative stage in developing countries and a number of important issues affecting unions must be addressed: need to improve the capacity of leadership and membership through training, improved policies and planning and introduction of improved technology; need to improve the economic environment in rural areas and economic conditions of farmers and rural workers by introduction of production increasing technology, improved markets and price policy, better roads, and supply of inputs; need to improve cooperative regulation and supervision, strengthen cooperative ideals and improve access to central bank services.

The key components of the international credit union development strategy include:

- institutional development emphasizing better use of human resources, better tailoring of programs to participant needs, focus of donor support on institution building.

- integrated organizational and financial development strategies emphasizing institutional and human resource development, improved financial stability and savings mobilization, and improvement in asset quality and credit management.

Credit unions have a great deal to offer in developing countries in efficient provision of financial services and also in demonstrating the viability of private enterprise and of grass roots democratic institutions even in situations where democratic concepts and institutions are rare.

Financial Institutions and Adjustments
Impact of Financial Adjustment on Financial Institutions
Robert Vogel

My experience with finance work in developing countries, much of it having little to do with rural finance, leads with great frequency back to work being done in rural finance including that done under the AID/OSU projects.

From past discussions including the OSU presentation yesterday, there appears to be widespread agreement on the kinds of financial reforms needed, e.g., making interest rates more competitive, opening up financial systems to more competition, generally liberalizing financial markets. Financial institutions often are not supporters of reform especially where more competition is expected to result. Low interest rates are fine if they can keep borrowers, who also are owners and savers, happy. Thus, it becomes politically difficult to find a constituency for liberalization and conditioning by donors. As noted yesterday, the IMF attempts to apply a few simple ratios but even these are difficult to police. Then how can you police conditionality on general policies? A great deal of time and effort on policy dialogue is needed with government and also with representatives of financial institutions. For the policy reforms A.I.D. wants to see, the dialogue must build support in the financial community as well as in formal political circles.

There is a role for development banks within the framework of reform, but targeting to specific groups doesn't work well. We can not be optimistic that development banks can differentiate between financial and economic rates of return--through they may think they can. Even with the distinction, where the trade structure has not also been reformed, fungibility takes over and the borrower uses the money where financial return is greatest. Ignoring financial rates of return in favor of economic rates is a virtual act of suicide to development banks. Very limited term lending might be possible.

Many development banks and other institutions were started with the idea that large economies of specialization and scale existed and diversification could be ignored. Now we have learned that economies of scope are really important: short- and long-term lending, a diversified loan portfolio and, particularly, mobilization of deposits. Voluntary deposits help keep institutions honest. Depositors want not only positive returns, but low transaction costs, deposit security, and opportunity to borrow. The idea that informed depositors provide sufficient monitoring is not adequate. Some form of deposit insurance and supporting inspection and regulation are needed to insure prudent institutional behavior.

In loan portfolio examination, the total value of delinquent loans, not just amount due, should be compared with total value of outstanding loans. Interest should not be accrued and shown as income on delinquent loans. In these and many other aspects of portfolio and operation behavior, A.I.D. could contribute. There are a great many sick institutions but a lot of opposition to strong action by governments. Governments prefer to bail out rather than close banks. Provision must be made for restructuring as well as regulation and supervision and this cannot rewarded current owners and managers. Continuing existing management in banks becoming insolvent is an invitation to misuse remaining assets.

Public sector financial institutions are by definition underwritten by the Government, which is responsible for financing debts and thus negative net worth. Hence, they do not become really insolvent; incentives are needed for efficient operation of public institutions. Public institutions often have been favored by donors because it was thought that they would do what was asked of them for good or bad. One position holds that all public banks should be eliminated, but this often is politically unacceptable.

A.I.D. needs to provide more assistance and training in the priority areas identified in the conference but should be careful in providing technical assistance, especially TA directed to a particular institution.

SESSION V

EQUITY MARKETS

EQUITY MARKETS

Financial Markets are Essential to the Well-Being of a Vibrant Economy
George Ferris, Jr.

Financial markets are essential to the development of the well-being of any LDC economy. Financial market development, a misunderstood term in LDCs, leads to capital mobilization which, in turn, leads to increased productivity and raised standards of living. Developing countries are in a unique position to learn from the mistakes of the United States as "good judgements come from experience, and experience comes from bad judgements."

Development occurs not through governments, but thorough people, and people require incentives. However, incentives, especially when given by such agencies as A.I.D., must be used carefully. Raising real income requires raised productivity which requires investments in equipment, or capital development. Giving incentives to those whose basic needs are not met, as the case has been in Indonesia, does not necessarily raise productivity. Thus, incentives often must be given to those that have capital to encourage them to invest in plants, equipment and technology as opposed to real estate or investing abroad. For A.I.D. to supply incentives to those with capital is politically ambiguous as it seems to thwart the Mission goal, but in order for an economy to grow (and attract foreign capital) domestic capital must be invested in domestic industry.

There are four important local industry incentives which developing countries can take advantage of by adaptation of their policies. (A.I.D. should be aware of these.) First, with comparative yields it should be noted that while interest on savings accounts and government bonds goes untaxed, corporate stocks and bonds are taxed. LDCs should give the latter tax breaks to encourage private investment. Secondly, developing countries should eliminate capital gains tax to encourage growth rates, as has happened in Japan, Taiwan, Korea, Singapore and Malaysia. Thirdly, the small investor should be given the same opportunities that are available to the large investor. This means that small investors should have access to professional money management institutions such as mutual funds, investment companies and investment trusts (like the 157 Fund Program in Brazil). Fourthly, the public should be encouraged to invest privately in favorable investment experiences. Privatization of successful companies is the key to bringing about capital mobilization. Privatization of failures, as happened in Indonesia, does nothing for the private sector.

While incentives are given, share supply availability to the public should be increased. In order to accomplish this goal, governments should be guided to allow stock prices to float, rather than attempting to control them. Shares should not be priced too low, as often happens in developing countries. Thirdly, in order to prevent a false sense of demand and profiteering by the middlemen, stock prices should be set by negotiations between underwriters and the issuing country. Giving incentives for companies to go public is complicated and difficult to control, as Indonesia learned in an ineffective attempt.

The middleman can play a key role in developing share markets, promoting and educating the public while bringing buyers and sellers together. However, in order to avoid corruption of the stock market there must be some profitability in the middleman's role. In 1960, there was no way for a broker in Taiwan to be honest and make a living. Quality stockbrokers are the biggest protection to the investing public.

Governments cannot develop countries without assistance from the private sector, and the private sector requires a favorable political and economic climate. Leaders of business and leaders of government must therefore cooperate and develop substantive dialogue.

Although policy dialogue is important, bureaucrats often judge programs by the number of projects rather than the climate improvement. Institution building, project continuity, and good management practices are also key elements to private sector development. When A.I.D. provides funding, they should insure that it is well managed.

Equity Markets: An IFC/World Bank Perspective - Peter Tropper

A major distinction between the World Bank and IFC is that IFC takes an equity position in providing resources as well as making loans for development purposes. IFC also has been active in promotion of equity markets. This has included providing technical assistance to stock exchanges, financial systems, central banks, and commercial banks. IFC now also is investing in developing country funds through an emerging market growth fund which mobilizes resources from developing country investors. Formal stock markets and similar investment arrangements are very much underdeveloped in developing countries. Together, developing countries with stock markets account for about 12% of world GDP but their stock markets account for only about 2% of the capitalization represented by world stock markets. This indicates a major opportunity for growth in stock markets and in the broader equity markets. In general, developing countries have a low ratio of value in stock market capitalization size to GDP compared with most free market developed countries, such as Japan and the U.S. (frequently below 10% compared with over 80% for developed countries). In some developing countries, growth in equity markets in the past few years has been very large. India, Malaysia and Taiwan experienced growth rates in the 300-400% range in the 1977-86 period. This is particularly significant in a country like India which has little foreign financing; and most of the investment came from small farm and city investors. IFC maintains an emerging (country) market database which measures how well markets are doing. Developing countries have shown higher returns though with more risk than developing countries. However, one of the difficulties of countries which have adopted a privatization policy is the narrowness of the equity base, (e.g., Mexico). This is an important factor affecting the speed with which privatization policies can be implemented.

Stock or equity markets often encounter serious obstacles e.g., the requirement that brokers be subject to unlimited liability (incorporation and thereby limitation of liability is not permitted); inadequacy of stock transfer systems resulting in long delays in obtaining possession of certificates; government fixing of new issue prices often at unrealistically low levels; misleading release of corporate information (often to avoid taxes); and lack of regulation, enforcement and inadequate auditing facilities. These are problems that need attention but can be dealt with over time. As a final note: there has been a great deal of interest recently in developing countries, in debt-equity conversion. This development should be followed closely.

Monetary Policy and the Financial Sector - Courtney Blackman

Monetary and fiscal policy are the two major economic policy instruments available to authorities in a market of mixed economy. The Central Bank is the agency through which monetary policy is implemented.

The virtue of monetary policy is its economy of implementation, the fact that it can be incrementally applied and reversed, and the impersonality of its application. Fiscal policy, on the other hand, requires elaborate administrative measures for its implementation, is difficult to reverse, and is usually contentious.

The Central Bank effects its policies through the medium of the financial sector. Adjustment of Central Bank policy on the part of financial units in turn induce adjustments in the behavior of firms and households in the real sector.

The effectiveness of monetary policy depends on the efficiency with which the desired effects can be transmitted throughout the financial sector, and from the financial sector to the real sector. This, in turn, depends on the degree of perfection of the financial and real markets. This process is analogous to the relative conductivity of materials to electricity.

Because of the imperfections and rigidities endemic to both financial and real markets in less developed countries, monetary policy is not as effective in developing countries as in developed countries. For this reason, economic managers in developing countries must place far greater reliance on fiscal policy than on monetary policy. Indeed, runaway fiscal deficits can completely negate the best-intentioned monetary policies.

Concern for the promotion of economic development also conditions the application of monetary policy in developing countries. Economic development requires an increase in the ratio of investment to consumption. A policy objective of monetary policy, then, is the allocation of credit to the productive sectors at the expense of consuming units. In the context of imperfect markets, monetary authorities will be forced to use extra-market techniques (e.g., quantitative credit restrictions and the prescription of loan rates) in order to ration scarce resources.

The policy implication of the above argument is the enhancement of both the efficiency and depth of financial markets. This is an exercise in long-run institution building. The progressive reduction of market imperfections and rigidities would improve the effectiveness of monetary policy and diminish the need for extra-market measures--admittedly a second-best solution.

The ultimate constraint on the efficiency of the financial sector is the efficiency of markets in the real sector. An efficient financial sector promotes economic growth only to the extent that households and firms in the real sector can generate real surpluses for transfer to would-be investors. If the real sector lacks the entrepreneurship, the managerial talent and the skilled labor, no volume of financial savings will suffice.

III. FINDINGS OF WORKSHOP DISCUSSION PANELS

- FINANCIAL POLICY PANEL
- FINANCIAL SYSTEMS PANEL
- FINANCIAL INSTITUTIONS AND MECHANISMS PANEL

FINANCIAL POLICY PANEL

Major Issues

Principal issues discussed by the panel included identification and definition of specific financial policy reforms which would lead to healthier LDC financial markets. These included tactics to reduce transaction costs, reduce financial fragility (vulnerability of the financial system to internal and external shocks or bad management) and to integrate formal and informal markets.

A.I.D., very concerned that policies promote access for the constituencies in which it is interested, supports a logical progression in financial development. Ideally, this would start with simple institutions, build on success and gradually expand market capabilities. Consequently, A.I.D. does not encourage equities markets until deposit services are in place (although the rate of progression may vary from country to country). It does suggest experiments with free pricing on instruments, such as treasury bills, that will not go "haywire" immediately.

The need to identify key reform issues was addressed and a list was drawn up. These included questions about the preconditions for success of specific policy reforms, the relationship between financial sector and other sector reforms, effective instruments for policy dialogue under political and economic constraints and action formulation under such unfavorable conditions as lack of government receptivity. Questions were also brought up about past experience lessons learned about policy reform in LDC; and situations that are so unfavorable that no actions should be taken.

The ensuing discussion focused on this need to carefully examine past experience in specific reform environments. The group concluded that productive efforts can be initiated in any situation, even though they may not have immediate results. In some cases, the only possible roles may be long-term investments such as training programs, or upgrade of audit and regulatory capability. However, five years later these may have a very positive impact.

More questions were voiced about the tradeoffs of promoting free-market private sector dominated financial systems, instead of public/private sector combinations, especially in LDCs with weak private sectors. What is the correct private/public balance under different circumstances? In many situations, it was suggested, a gradual shift into the private sector, or a balanced public/private sector approach, might be the only appropriate choice.

In most cases, all the prerequisites for development of sound financial institutions--appropriate macroeconomic environment and policy, prudential regulation, proper financial supervision--do not exist. Because of the scarcity of sound financial institutions and the variety of issues, it is difficult to identify useful approaches to policy dialogue. This discussion led to the presentation of a key final question: How does one decide where to start and how to proceed?

Suggestions for A.I.D. Actions

The panel recommended that technical assistance, research, dissemination of results, training, and coordination in relation to these policy issues should be addressed bearing in mind the unique situation of each country. They suggested the following general programming guidelines:

1. A.I.D. should put more resources into training in financial sector development than it has up to now. This includes training of mission personnel, as well as local personnel, to give them a better grounding in financial issues.

2. Technical assistance should emphasize domestic policy analysis over experience transfer from elsewhere, and on developing domestic capability for policy analysis to address major issues with locally relevant and acceptable solutions. Although imposition of solutions through conditionality might follow such on-site sector findings, it should never precede them. In other words, policy analysis and a cooperative, intellectual policy dialogue process should always be emphasized over political leverage and resource transfer as conditions of policy reform.

3. The research agenda should include formulation of generalized guidance to U.S.A.I.D. missions as one of its objectives. These should include realistic expectations for a particular set of interventions in a financial market under a given set of developing country conditions.

FINANCIAL SYSTEMS PANEL

Major Issues

The panel felt it was difficult to separate out issues of financial systems without first defining requirements for policies and institutions and/or their reform, because financial systems, policies and institutions are highly interrelated. The panel considered systems to include savings mobilization, credit (loans), and all the stages between these two. Five major issues that the panel identified are list below.

- There is a need to discover how donors can helpfully intervene to bring about needed reform in the financial market system without disrupting or destroying it. Fragile institutions in a young financial system are especially venerable to this damage.

- There is a need to discover ways of reducing transaction costs and introducing other efficiency measures. The panel endorses the work of Ohio State University which explains transactions costs and how they result in a real return on deposits or a real cost of borrowing quite different from that represented by the interest rate offered.

- Regulatory and supervisory apparatus improvement should be given much more attention. The panel recommended research to define the types of regulatory and supervisory systems needed in different settings.

- Donors need to be more coordinated in their efforts. The panel noted that host governments frequently resent donors interacting independent of their supervision. However, without adequate coordination, donors sometimes give conflicting advice and counter-productive assistance. Donor coordination needs to be carried out more effectively, so that proposed interventions reinforce each other in a manner acceptable to host governments.

- More financial system research should be supported. The panel suggested operations research and assistance to local personnel to do field investigations. Informal financial systems, which have not been extensively studied, would be a fertile area for additional research. The panel did not identify specific priorities for A.I.D. in relation to these issues. However, during the discussion, participants stressed the importance of examination of past experience, research, collection of basic data, and development of sound analytical bases for actions.[1]

FINANCIAL INSTITUTIONS AND MECHANISMS PANEL

The panel identified five sets of issues important to the development of financial institutions and mechanisms and made specific recommendations for A.I.D. action in each area.

First, the panel described a need for donor agencies to understand the evolution of financial markets beginning with informal institutions and emergent formal institutions such as credit unions. The principal A.I.D. role suggested is sponsorship of research and analysis with local participation. This research should concentrate on what is happening in financial markets, interfaces between informal financial markets and credit unions, informal market

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1. In addition to the five major issues identified, the panel discussed the following issues, and while considering them to be less crucial than the five selected, believed them none-the-less to be important:

   Influencing ownership and control of financial institution market performance; improvement of integration of markets; development of appropriate procedures and methods for improved loan portfolios; utilization of better methods for choosing clientele groups; identification of the principal components of financial systems; indentification of the functions of the individual components; definition of formal and informal financial markets and their components; identification of the appropriate linkages of rural financial markets and capital markets; identification of expected outputs and measures of performance of a financial system.

formalization, characteristics of the changing balance between formal and informal financial markets, and implications for financial operations when new financial technology (such as computerized systems) is introduced. A.I.D. should support training emphasizing institutionalization of training capability and transfer of appropriate, not overly-sophisticated technology.

Secondly, the panel called for approaches to improve classification of financial institution assets (with efforts of strengthen management of arrears and bad debt) and management of portfolios. They also identified collateral and collateral substitutes which could be brought to LDC government attention. The panel suggested research roles for A.I.D. in this sector in identifying and providing evidence on workable guidelines. The panel suggested that A.I.D. address the questions through research by local investigators, rather than bringing in short-term foreign experts, in order to build a domestic research capability. U.S.A.I.D.'s technical support/training should emphasize portfolio management system design and testing. Asset quality evaluation, risk management and management of financial institutions should be included in any training program.

Thirdly, the panel identified a need to expand policy dialogue to involve financial institutions and policymakers (not just the Ministry of Finance or the Central Bank). Research should include local analysts and local institutions (i.e. banks) participating in the process. The panel recommended that A.I.D. emphasize improved coordination with other donors and avoidance of mis-use of financial institutions for social welfare.

Fourthly, the panel found cost-reducing financial innovations to be an important issue in financial institutions and in their choice of mechanisms. Cost-reducing innovations necessarily involve economics of a broader scope of functions and specialized financial elements in the banking system, market expansion strategies (for both loans and deposits) and improvements in hardware and software (transfer of technology). The principal role recommended for A.I.D. is support of research into innovative methods of cost reduction and provision of technical support/training.

Finally, the panel discussed equity market sources of funds in LDCs. Major issues identified included dimensions of regulation and supervision; tax, fiscal and monetary policies; and private sector approaches. Again, it was suggested that A.I.D. play its traditional role by selectively supporting technical assistance, research and training on operation of equity markets.

ANNEXES

ANNEX A: WORKSHOP AGENDA

RURAL FINANCE AND FINANCIAL
SECTOR DEVELOPMENT WORKSHOP
International Club, Washington, D.C.

September 21-22, 1987
AGENDA

MONDAY, SEPTEMBER 21

8:30-9:00 Registration & Coffee

9:00-9:15 Opening Remarks
Alexander R. Love (A.I.D., Counselor to the Agency)
Dennis Brennan (A.I.D., Deputy Assistant Administrator, Bureau for S&T)

9:15-11:15 Deposit Mobilization and Financial Sector Growth
Chairman: Eric Chetwynd (A.I.D., Acting Director, Office of Rural and Institutional Development)
Richard Meyer (Ohio State University)
Claudio Gonzales Vega (Ohio State University)
Douglas Graham (Ohio State University)

11:15-12:00 A.I.D. and Finance: Thomas Tifft (A.I.D.)

12:00-1:30 Luncheon Speaker: Arturo C. Porzecanski (Vice President, Morgan Guaranty Trust Company)

1:30-3:00 Financial Policy
Chairman: David Dapice (Tufts University)
- Instruments of Financial Policy
  Maxwell Fry (University of California-Irvine)
- A.I.D. and Financial Policy
  Neal Zank (A.I.D., Bureau for Program and Policy Coordination)
- Implementing Financial Policy Reforms
  David Cole (H.I.I.D., Coordinator, Banking & Finance)

3:00-3:30 Break

3:30-5:00 Financial Systems Development
Chairman: David Dapice
- Formal Financial Systems
  J.D. Von Pischke (World Bank)
- Regulation and Supervision
  Vincent P. Polizatto (World Bank)
- Informal Financial Markets
  Thomas Timberg (Robert Nathan Associates

Cash Bar Reception Immediately Following

TUESDAY, SEPTEMBER 22

9:00-10:30 Financial Institutions and Mechanisms
Chairman: David Dapice
- Role of Credit Unions in Financial Sector Development
  Peter Marion (World Council of Credit Unions)
- Formal Financial Institutions and Mechanisms
  Robert Vogel (University of Miami)

10:30-10:45 Break

10:45-12:00 Equity Markets
Chairman: David Dapice
- Promoting Private Sector Financial Institutions
  George M. Ferris, Jr., Chief Executive Officer, Ferris & Company Inc.
- Equity Markets: An IFC/World Bank Perspective
  Peter Tropper (Capital Markets Program, IFC)

12:00-1:15 Luncheon Speaker: Courtney Blackman (Former Governor, Central Bank of Barbados)

1:30-4:00 Promoting Financial Sector Development in A.I.D. Programs: Panel Discussion
Chairman: Eric Chetwynd

1:15-1:30 Chairman's Presentation

1:30-2:45 Panels Meet

2:45-3:00 Break

3:00-4:30 Panel Presentations & General Discussion

4:30-5:00 Summary

ANNEX B: PARTICIPANTS IN THE WORKSHOP

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revised 9/22/87

ANNEX C: BIOGRAPHICAL SKETCHES OF WORKSHOP PARTICIPANTS

Courtney Blackman is an International Business Consultant from Bridgetown, Barbados. He was presented a Gold Crown of Merit for his services as Governor of the Central Bank of Barbados between 1972 and 1987. Dr. Blackman, who currently resides in Florida, earned his Ph.D. while studying under a John Chapman Fellowship in Finance at Columbia University.

Dennis J. Brennan is currently a Deputy Assistant Administrator at the Bureau for Science and Technology of U.S.A.I.D. His department is responsible for the research and development programs that address such areas as tropical diseases, nutrition, family planning, agriculture, forestry and environmental resources. Mr. Brennan has served as Mission Director in Nepal, Director for Projects in the Near East and Asia Bureaus, and in the U.S.A.I.D. missions to Bangladesh, Indonesia, and Thailand.

Eric Chetwynd is a Development Economist who has been with the U.S. Agency for International Development since 1962. His experience in developing countries includes six years overseas with the Agency in Indonesia and Korea and short-term assignments in some forty countries. Presently, he is Acting Director of the Rural and Institutional Development Office in the Bureau for Science and Technology of U.S.A.I.D. Dr. Chetwynd received his Ph.D. in Economics, with a minor in Sociology, from Duke University.

David Cole, a native of Detroit, Michigan, has been the Coordinator of Banking and Financial Studies at Harvard University since 1966. He received his Masters and Ph.D. in Economics at the University of Michigan, Ann Arbor, and has conducted seminars in Financial Development for the World Bank.

David O. Dapice has been Associate Professor of Economics at Tufts University since he received his Ph.D. in the same subject from Harvard in 1973. He served as the Economic Advisor to the Government of Indonesia with the Harvard Development Advisory Services and has completed consultancy work for the World Bank, A.I.D. Credit Schemes, and the Rockefeller Foundation. Presently residing in Concord, MA, he has participated in numerous seminars on Development Economics and has an extensive list of publications regarding the economies of Indonesia and Bolivia.

Maxwell Fry, a British resident of the U.S., is currently a Professor of Economics at the University of California, Irvine. He is a consultant to A.I.D. and USDA in financial sector affairs under a University Cooperative Agreement. A two-time winner of the National Science Foundation Award, Dr. Fry has held advisory positions to the governments of Bangladesh, Turkey, Portugal, Nepal and Afghanistan and has lectured in Turkey, at UCLA, University of Hawaii, and Oxford.

Claudio Gonzales-Vega, currently a professor with Ohio State University, has taught graduate level finance and development and economic development at American University, the World Bank's Economic Development Institute and the University of Costa Rica. His extensive academic background includes a Ph.D. in economics from Stanford, an M.Sc. in Economics from the University of London and degrees in Law and Economics from the University of Costa Rica. He has served as a consultant for U.S.A.I.D., the Central American Common Market Secretariate, the OAS, the World Bank, the IDB, the UN, Arthur D. Little, Inc. and the Rockefeller Foundation. Mr. Gonzales-Vega has written numerous papers in both Spanish and English on such development topics as rural finance, agricultural credit and economic crises in LDCs.

Douglas Graham, Professor of Agricultural Economics, Ohio State University, has a Ph.D. in economics from Harvard University. His most recent long-term overseas assignments were in the Philippines, Niger and Honduras under OSU auspices. From 1969 to 1973, he taught economics and conducted research at the University of Sao Paulo, Brazil.

Alexander R. Love, Counselor to the Agency for International Development, received his MBA from Harvard University School of Business in 1981. He spent his first fourteen years with the Agency as head of the Asia Bureau. From 1979-1982, he was Director if REDSO, based in Niger. From 1982 to 1987, he served as Deputy Assistant Administrator for the Bureau for Africa. During this time, he played a key role of formulating and implementing the President's famine relief program in the Sahel. Mr. Love has received the Agency's Distinguished Honor Award and the President's Meritorious Award.

Peter Marion, a graduate of UCLA's School of Economics, is Latin American Regional Coordinator and Financial Systems Specialist for the World Council of Credit Unions. His work has focused on the development of improved financial systems in Africa, Asia, the Caribbean and Latin America. He began his career in international credit as a Peace Corps Volunteer in Guatemala and later held a variety of consulting positions there including regional coordination for CARE. Mr. Marion is currently enrolled in the Graduate School of Business at the University of Wisconsin.

Richard Meyer, who was awarded Masters and Ph.D.'s in economics from Cornell University, has served as a professor in the Department of Agricultural Economics and Rural Sociology at Ohio State since 1979. His expertise in rural finance and agricultural development have resulted in consultancies with the World Bank (Nigeria, Brazil), Instituto Superior de Agricultura (Portugal), ESALQ (Brazil), the FAO (Rome) and USAID (Philippines, Barbados, Thailand, Brazil, Portugal) among others. Dr. Meyer's monographs appear in numerous books and his articles have been published in American, Portuguese and Brazilian science journals. He has an extensive list of research summary articles and professional meeting presentations focusing on rural finance.

J.D. Von Pischke has been a permanent World Bank staff member for over ten years, serving as Senior Operations Officer of East Asia and Pacific Projects, Senior Financial Analyst for Central Projects Staff and in supervision and design of Europe, Middle East and North Africa Projects. He has also worked overseas for Chase Manhatten Bank in Africa and London, lectured at Haile Sellassie I University in Addis Ababa and co-authored two major publications on rural development.

Vincent P. Polizatto is now a Financial Planning Specialist in the Financial Policy Division of the World Bank. Previously, he served for 14 years in the U.S. Office of the Comptroller of the Currency, most recently as the Senior Advisor within the International Relations and Financial Evaluation Division. Mr. Polizatto has served on the faculties of the Southwestern Graduate School of Banking, the School of Banking of the South, and Columbia University's Executive Development Program. His speaking credits include Yale University's seminar on the LDC Debt Crisis and the Justice Department's Legal Education Institute as well as many workshops sponsored by the OCC.

Arturo C. Porzecanski, who is from Montevideo, Uruguay, is the Vice-President of the International Economics Department of the Morgan Guaranty Trust Company of New York. Presently responsible for Brazil's accounts, he is also the senior author of the magazine World Financial Markets, and has published three books on Latin American Economics. He has also served as an economist in the Center for Latin American Monetary Studies in Mexico City and the International Monetary Fund in Washington, D.C.

Thomas A. Timberg is Project Director for the USAID-supported Assistance to Resource Institutions for Enterprise Support (ARIES) of Robert R. Nathan Associates, Inc. He has completed consultations for A.I.D., the World Bank and commercial consulting firms supporting various private enterprise projects in India, Bangladesh and Africa. He has numerous publications to his credit in small-scale industrial entrepreneurship, financial institutions, rural development, and India and Asian studies.

Peter Tropper works for the International Finance Corporation as the Investment Officer of the Capital Markets Department which provides detailed statistics on LDC stock markets. He has served as Deputy Director of the Northeast-Midwest Institute and as an International Economist for both the United States Trade Representative and the Pharmaceutical Manufacturers' Association.

Robert Vogel is currently the Professor of Economics at the University of Miami. He has served as a Financial Economist for the World Bank and has lectured at American University, Ohio State University, Syracuse University, Southern Illinois University and the University of Florida. His Latin

American expertise has resulted in many consultancies and in grants with the National Science Foundation, A.I.D., the World Bank and the Rockefeller Foundation. His list of publications on money, finance, agricultural credit and developing economies rivals his list of lectures presented worldwide.

Neal S. Zank is the senior policy advisor for private enterprise in A.I.D.'s Bureau for Program and Policy Coordination. He has written A.I.D.'s policies on privatization, trade and financial markets, and monitors the entire range of A.I.D.'s private enterprise activities. Prior to joining A.I.D. in mid-1984, he served on the staff of President Reagan's Task Force on International Private Enterprise.

ANNEX D: ORDER FORM FOR BACKGROUND PAPERS

ORDER FORM

WORKSHOP ON RURAL FINANCE AND FINANCIAL SECTOR DEVELOPMENT BACKGROUND PAPERS

_________ Impact of Financial Adjustment on Financial Institutions, by Robert C. Vogel

_________ Deposit Mobilization and Financial Sector Growth, by Claudio Gonzalez-Vega, Ohio State University

_________ Informal Financial Markets, by Thomas A. Timberg, Robert R. Nathan Associates, Inc.

_________ Instruments of Financial Policy, by Maxwell J. Fry, University of California, Irvine

Make selections on this form, detach and return to:

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1629 K Street, N.W.
Suite 300
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