

From Urban to Rural: Lessons for Microfinance from Argentina

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The recent success of microfinance for the urban self-employed contrasts with decades of failure on the part of public development banks for small farmers. This article describes the ways in which rural microfinance organisations have tried to adapt the lessons of urban microfinance to manage the risks and control the costs of the supply of financial services in rural areas. It then asks whether the lessons of urban microfinance are likely to apply in the poorest rural areas of Argentina. The article concludes that microfinance is unlikely to improve access to small loans and small deposits for many of the rural poor in Argentina; distances are too great, farmers too specialised, and wages too high. Improved access depends not on targeting loans by government decree but on strengthening institutions that support financial markets.

Microfinance can be defined as the attempt to improve access to small deposits and small loans for poor households neglected by banks. Access to deposits implies savings contracts that, for the bank, cost less than funds from other sources and that, for the saver, are safe, liquid, and convenient. Access to loans means the ability and willingness to borrow and to repay at a price that covers the long-run costs of an efficient lender. It is thus the nexus of demand, based on ability and willingness to repay, and of supply, based on low-cost ways of judging risk and enforcing repayment.

The poor pay more for financial services because the poor cost more to serve. They demand small loans for short terms, but they are unable to signal and guarantee creditworthiness with constant income from a salaried job or with physical collateral. Similarly, poor savers cost a lot to serve because they hold low balances and make frequent deposits and withdrawals.

Public development banks, NGOs, and microfinance

For decades, governments and donors worldwide sponsored development banks in an attempt to improve access for the rural poor (Yaron et al., 1997). They saw the problem of rural microfinance not as the profitability of a niche, given standard bank technology, but rather as the willingness of banks to enter a profitable niche (Gonzalez-Vega, 1998a). Unfortunately, the attempt backfired (Braverman and Guasch, 1986; Von Pischke, 1991). Subsidised loans, ostensibly targeted to small farmers, led to excess

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demand and thus rationed supply. The rich captured most of the subsidies because they were better able than the poor to post land as collateral and to lobby. The rich also often defaulted, certain that the government lacked the political muscle to seize their land. Bail-outs for development banks drained the public budget and, in time, led to their downfall. In most countries, the paradigm of supply-driven, top-down, subsidised, directed credit was scrapped, having done the rural poor more harm than good (Adams et al., 1984; Krahn and Schmidt, 1994).

What governments could not do by decree, non-governmental organisations (NGOs) have tried to do with technology. Although most NGOs are inefficient and no NGOs can take deposits, a few have found ways to judge the risk of the poor, to accept their signals of creditworthiness, and to monitor and enforce repayment at a price that covers costs (Schmidt and Zeitinger, 1996a, 1996b). The promise of microfinance rests on new loan technologies based on joint-liability groups, chattel mortgages on household assets, and the linkage of access to future loans to good repayment.

A microfinance movement seeks more than \$20 billion to supply microfinance to 100 million of the poorest households in the world by 2005 (Microcredit Summit, 1996). Outside Latin America, the biggest successes are in rural areas of Bangladesh (Khandker, 1998), Indonesia (Chaves and Gonzalez-Vega, 1996; Yaron, 1994), and Thailand (Muraki et al., 1998). Successful microfinance in Latin America has been largely confined to urban areas in Bolivia (Gonzalez-Vega et al., 1997), the Dominican Republic (Benjamin, 1994), and Peru (Lepp, 1996).

Microfinance in rural Argentina

As in Mexico, Brazil, China, India and South Africa, microfinance in Argentina presents a puzzle. Despite huge populations and/or mid-range per capita incomes, microfinance in these nations lags behind such unlikely places as Bangladesh and Bolivia. Two factors help explain this. First, the old paradigm still reigns in these countries, and public development banks can sometimes be the smotherers of invention. Second, high wages and sparse populations in South Africa and Argentina raise the costs of small rural loans. Much of the success of rural microfinance in Asia depends on low wages and dense populations (Rhyne and Rotblatt, 1994). For example, it costs much less to get college graduates in Bangladesh or Java to walk or to cycle between villages than to get anyone in South Africa or Argentina to drive between rural homesteads.

Microfinance in rural Argentina matters for four reasons. First, academics, the government, and donors all believe that constraints on access for the rural poor might affect how well the country can sustain rapid growth and share the fruits of growth (Sawers, 1998; Secretaría de Agricultura, 1996; World Bank, 1996). Second, agriculture is the biggest source of foreign exchange. To compete in the new open economy, farmers may need loans because current cash outflows for investments are not matched by current cash inflows. Third, access to finance can fill in for absent insurance markets and help to buffer consumption for the poorest families, especially outside the Pampa in the rural Northwest and Northeast provinces bordering on Brazil, Paraguay, Bolivia, and Chile (Zeller and Sharma, 2000). Fourth, access matters for fairness. To escape from poverty means to build wealth. If access helps to build wealth but also requires wealth in the first place, then unequal access may perpetuate unequal wealth. Standard

bank finance requires assets that the poor do not have, such as land or new cars. In contrast, microfinance uses assets that the poor do have, such as reputation or household goods.

Will microfinance work in rural Argentina? The material conditions there imply that it will not, at least as practised at present. Small farmers are too undiversified, and wages and transaction costs are too high. The niche of non-farm businesses is too small, and farm workers can borrow at lower costs from their employers or from retailers of consumer durables.

Given this, efforts to improve access to small loans and small deposits for the rural poor should probably focus on institutions that support financial markets. The most important example is continued rigorous prudential regulation and supervision and the privatisation of development banks. The government might also strengthen the framework for security interests, support a comprehensive national credit bureau, and establish a registry for all kinds of movable goods. These interventions improve access inasmuch as they help lenders to judge the risk of rural borrowers at lower cost.

The material conditions of rural microfinance

The classic work of Binswanger and Rosenzweig (1986) describes the material conditions of rural production. Dunn et al. (1998) and Gonzalez-Vega (1998a, 1998b) discuss the use of the new microfinance technologies in rural areas. Here, these concepts are synthesised and then applied to rural Argentina.

Transaction costs and risk In rural areas, sparse populations and long distances combine with the conditions of agricultural production to produce a lack of infrastructure, high transaction costs, and high risk. Rural infrastructure is poor because the cost of extending electric lines or surfaced roads over long distances cannot be spread over sparse populations. Long distances and poor infrastructure increase the costs of transport. High transaction costs lead to imperfect information and thus weaken markets for loans and insurance.

In agriculture, subtle differences across distant fields and pastures also lead to agency problems: households cannot always watch hired workers to make sure they do a good job. Agricultural production also exposes households to price risk and to yield risk from pests and weather. Furthermore, the covariance of agricultural risk across households is high. The main stylised facts of small farms – the use of family labour and the consumption of at least some of their own produce – can be seen as ways of skirting price risk, avoiding transaction costs, and reducing agency problems.

Rural households have less access to financial services because rural material conditions increase the cost of supply. With long distances, suppliers cannot dilute the fixed costs of small, frequent transactions. With sparse populations, banks cannot dilute the fixed cost of branches. Employees ask for higher wages to accept posts distant from urban amenities. Far from police or neighbours, bandits can waylay cash transported along rural roads.

Information is the life blood of finance because it feeds the judgement of the risk of promises to transfer command over resources in the future in exchange for command over resources now. Rural distances and agricultural production, however, increase the cost of information.

On the supply side, rural loan officers need to make a special trip to visit the homes or workplaces of their clients, whereas urban loan officers, in contrast, often pass by their clients as they go about other business. With diverse farms dispersed in space, lenders cannot easily monitor the risk of moral hazard nor discern which farmers possess the skill and other assets needed to succeed. On the demand side, small farmers are loath to mortgage their land because it constitutes their livelihood, and their livestock and machines are imperfect guarantees. Small farmers are unable to provide other standard signals of risk because they mix the affairs of the household and the firm, and also because they do not have written records of their income streams.

Neither banks nor borrowers can control agricultural risk well. This risk is high for individual households, and it is also highly correlated across households. For example, drought or floods can affect whole regions. If a household diversifies and/or consumes what it produces to insure itself against risk, then it also decreases the cash inflows that could be saved or used for debt service. If a household specialises in one or two cash crops, then it earns more but faces greater risk.

Finally, agricultural production prompts high demand for loans and savings services because cash inflows and outflows are mismatched in time. Constant outflows for consumption and lumpy outflows for investment in land, machines, and labour precede cash inflows from the sale of produce. The seasonal cycles of hoe and harvest for crops and birth and butcher for livestock sharpen the mismatch. They also exacerbate the liquidity risk faced by banks because many farms demand the same financial services at the same time.

Urban lessons for rural microfinance Urban microfinance does not deal with many of the costs pertaining to the material conditions of rural areas. The best urban microfinance technologies are ways of making loans and collecting them at a price that covers the cost of serving clients without a constant source of income and who cannot or will not post standard physical collateral to signal and guarantee creditworthiness. These new technologies are webs of policies, practices, and contract designs that reduce the cost of judging the risk of potential borrowers, processing their signals of creditworthiness, and monitoring and enforcing repayment (Gonzalez-Vega, 1998a; Murdoch, 1999).

Common elements of the new technologies are group-liability contracts that tie access to future loans for all members to good repayment by each member, chattel mortgages on household goods that inflict shame and replacement costs on defaulters even though the salvage value is less than the cost of seizure and sale, and access to future loans for individuals who repay debts as promised. Loan officers monitor borrowers only when they miss one of the frequent instalments.

Given the fluidity of funds between the household and the firm, lenders evaluate the risk not of the single project listed by the borrower on the loan application but rather of all the diverse cash flows of all household members. Over time and through repeated contact, loan officers grow to know the characters and cash flows of borrowers and so can judge their risk better. Simple procedures and branches placed near dense settlements or markets help to hold down the transaction costs of small, short loans.

Technological development has been slower for deposits than for loans. The chief advance has been the recognition that the poor do save and that they value safety, liquidity, and convenience more than returns (Robinson, 1994). Other advances include

efforts to revive post-office savings in Africa, raffles for depositors, and the use of roving savings collectors (Rutherford, 2000).

To cope with the heterogeneity, seasonality, and risk of agriculture, the best rural microlenders tailor loans to the production cycles of each borrower and check that the household can repay with non-farm income even if crops fail or livestock die. They accept chattel mortgages on equipment, livestock, and household goods, even though the cost of seizure exceeds the salvage value (Churchill, 1999). Loan officers are also often agronomists who are familiar with local farm practices.

To cope with systemic risk, rural lenders diversify into non-farm sectors. To control transaction costs, they use motorcycles instead of trucks, open branches only on market days, evaluate borrowers in one visit with portable computers, and streamline procedures. Branches are small and of inexpensive design.

Material conditions in rural Argentina The material conditions of rural Argentina are such that the new microfinance technologies are unlikely to help the rural poor. The two main constraints are the public development banks and the relative development of the country as a whole. Unlike Bolivia and Indonesia where village leaders scold defaulters, rural Argentina has a weak culture of repayment. The social capital that would gird joint-liability contracts is largely absent. Much of this is due to habits learned when public development banks dispensed loans as rewards for political support and as *ex-post* crop insurance for rich farmers. The rents that accrued to borrowers during hyperinflation also led to the view that loans are gifts.

Rural microfinance in Argentina is also affected by the economic development of Buenos Aires, of the provincial capitals, and of the modern mechanised agriculture in the Pampa. High average incomes increase the opportunity costs – and thus the wages – of loan officers, the main expense of all microfinance organisations. Few white-collar workers are willing to ride motorcycles and live in small towns. Agronomists, on the other hand, learn not about the smallholder agriculture of the hinterland but rather the modern agriculture of the Pampa. Banks use agronomists not to evaluate projects but to value land offered as collateral (Colombet, 1997).

Furthermore, rural Argentines live not in villages but in isolated homesteads. Also, shops are open every day, so rural people do not converge on small towns on the same day each week. Thus effective distances in Argentina are greater – and populations less dense – than in the places where rural microfinance has done well.

Microfinance is also unlikely to reach the rural non-farm self-employed or rural wage labourers. Non-farm small businesses are scarce in rural Argentina because, as in South Africa, small rural manufacturers or retailers cannot compete with mass-produced goods sold through town-based shops and retail chains. For labourers, microfinance organisations cannot compete with the information and enforcement advantages of employers on tobacco, citrus, and grape farms.

Microfinance is also unlikely to reach small farmers. Suppliers of inputs and buyers of outputs have information and enforcement advantages. Furthermore, small farmers in Argentina are poorly diversified. Unlike small farmers in Bolivia and Bangladesh, rural men do not weave baskets or work as blacksmiths on the side, and rural women do not work in town or brew beer or run small stores from the homestead. The lack of non-farm activities makes the small farmers in Argentina who till a few hectares with old tractors too risky for current microfinance technologies.

The innovations of microfinance up to now are not enough for small commercial farmers and poor rural households with undiversified incomes. 'These groups will have to wait for other innovations, possibly linked to the development of the institutions that govern guarantees, property rights, contract enforcement, and legal and judicial processes' (Gonzalez-Vega, 1998a: 17). The rest of this article discusses ways of supporting the development of such institutions. It attempts not only to prescribe improvement in the financial system but also to suggest ways in which that improvement might be accomplished.

Prudential regulation and supervision

Financial markets fail when private choices do not lead to outcomes that are the best for all (Besley, 1994). One response to market failure is prudential regulation and supervision. A supervisor reins in the risk caused by the fact that the owners and employees of banks obtain much of the gains of success but bear few of the costs of failure. Argentine depositors distrust banks; in the 1995 Tequila crisis, runs drained 16% (\$8 billion) of deposits from the system (Calomiris, 1999; World Bank, 1995). Depositors ran from unsupervised co-operatives and provincial banks to supervised banks (Martinez Peria and Schmukler, 1998).

Market failure is necessary but not sufficient to justify invention. Because flawed interventions do not fix themselves, they often fail more quickly than markets. The government not only has to diagnose market failures but also design technically and politically feasible policies whose expected benefits exceed expected costs (Gonzalez-Vega, 1998b). After Tequila, the regulatory framework of the Banco Central de la República de Argentina (BCRA) was strengthened and extended to cover co-operatives and provincial banks (Schumacher, 2000). The new regime has increased trust, improved efficiency, and led to larger and longer deposits.

Increased deposits For most people and especially for the rural poor, savings matter more than loans. After all, depositworthiness exceeds creditworthiness; all Argentines qualify for savings services and have a use for them, but not all qualify for loans and have a use for them. The choice by Argentine officials to embrace a strict regulatory framework and to eschew directed-credit programmes was meant to strengthen and consolidate the banking system for the long-term gain of all Argentines rather than for the short-term gain of only those few who could get hold of subsidised loans. Safe deposits for all come first; once that is in place, policy can start to look to loans for the rural poor.

Trust in the reformed regulatory framework has made deposits larger and longer. The hope is that, in time, greater access to deposits for all will lead to greater access to loans for the rural poor. At first, the new framework constricted the supply of loans (Cañonero, 1997), but this was mostly because of a lack of deposits to fund loans (Carrizosa et al., 1996). If deposits are small, short, and scarce, then loans will be too.

Still, the recent shift in the supply of loanable funds has yet to affect the rural poor. The new funds have been gobbled up by salaried urban households whose pent-up demand was unleashed by the recent economic recovery (López Murphy and Navajas, 1998). The rural poor cannot compete against those willing and able to pay high prices, to prove constant income streams, and to post real estate as collateral. If banks remain

safe for savings, however, then time should loosen the constraints on loans. Meanwhile, access to savings services should help households to cope with a lack of loans.

Greater efficiency Before the regulatory reforms, the inefficiency of the Argentine banking system meant high costs and therefore low access. Financial markets were shallow, intermediation costs high, and margins wide (World Bank, 1994). In developed countries, the ratio of non-interest expense to assets is about 60% of the deposit rate. In Argentina, it was almost 100%. The ratio of non-interest expense to assets was less than 2.5% in developed countries, 3.5% in several developing countries, and 6.5% in most of Latin America. In Argentina in the first quarter of 1996, the ratio was about 6.3%. Entities without effective owners – co-operatives and provincial banks – were the least efficient. Private Argentine banks were more efficient, and private foreign banks were the most efficient.

Inefficiency in the presence of high profits suggests weak competition. The return on assets for banks in OECD countries is about 0.7%. Banks in Argentina earned triple that, even though many public development banks posted losses (World Bank, 1994). The return on equity for the biggest private banks exceeded 20%, even though leverage and inflation were low.

Weak competition allowed inefficient banks to survive. The market was fragmented and shallow; only about 20% of households had a bank account. The number of banks was high, but many had only a few branches, and even the relatively big banks were absolutely small. It seems that Argentina had too many banks but not enough banking.

There were five main causes for the inefficiency. First, many of the smallest banks were family owned and operated. These banks have been slow to innovate and inefficient because banking skills are not always passed on from parents to children. Second, labour was not very productive (World Bank, 1996). Wages made up 62% of the spread (World Bank, 1994). Narrowed spreads since 1995 came from a 30% cut in the payroll thanks to massive lay-offs (BCRA, 1996), often of sinecures sloughed from public development banks. Third, outdated technology bloated payrolls. The problems of the computerisation of the biggest bank, the Banco Nacional de Argentina (BNA), are legendary; in 1996, the rotunda of its biggest branch in downtown Buenos Aires had hundreds of teller windows but not one computer screen in sight. Fourth, loan officers did not know how to analyse character and cash flow because, under the old paradigm, they simply matched borrowers with pre-set lines of credit (Larroy, 1996). In 1995-6 for example, the BNA lent more than \$1.1 billion to big farmers against mortgages of land without any analysis at all. Even if a branch was willing and able to analyse character and cash flows, most lending decisions took place in a central office where nothing was visible but collateral.

Fifth, hyperinflation caused analysis skills to atrophy. Hyperinflation made cash-flow analysis useless because slight changes in what amounted to arbitrary assumptions drove the results. Project analysis is now less arbitrary, but the skill and the practice have been lost. Under hyperinflation banks were set up to lend to the government and to manage accounts, not to serve clients (Berger, 1996). Banks forgot how to mediate between depositors with surplus funds and borrowers with surplus opportunities. Finally, hyperinflation allowed inefficiency to persist because it numbed borrowers to interest rates. After the rates common in hyperinflation, a real interest rate of 20% per annum seemed low to consumers.

Inefficiency also restricted access to deposits. Banks set high minimum balances and high maintenance fees to offset the high fixed costs per account and per transaction. Passbook accounts lost value in real terms unless the average balance exceeded \$1,000 to \$3,000. Most of the rural poor, with low amounts available for savings and high transaction costs just to get to the bank branch, stayed out of the market.

Reforms The reformed regulatory framework has increased efficiency through competition and consolidation, mainly by mergers and the privatisation of provincial development banks. The results were swift. The average intermediation margin – the lending rate minus the deposit rate – fell from 40% in 1991 to about 4% in 1996 (BCRA, 1996; World Bank, 1995, 1994). The 4% margin is still wide, and if fees were converted to interest equivalents, then the margin would almost double.

Competition has started to push some banks downmarket. For example, foreign banks in low-income countries commonly skim the best prime-rate borrowers and do not have a strong retail presence. In Argentina, foreign banks do compete on a retail level, and this, along with the fact that some prime-rate customers are able to place their own paper abroad, has forced all banks to compete more fiercely at the retail level.

Competition has started to disrupt the ‘quiet life’ (Berger and Hannan, 1998) of banks open only five hours a day, five days a week. Convenience matters most to depositors. Banco de Galicia, the biggest retail deposit-taker in Argentina, arranged in 1998 to set up mini-branches in post offices. This technological and organisational innovation cut transaction costs and thus increased access to deposits. Another private bank has also embarked on an ambitious programme to build new branches.

The deeper financial system produced by larger, longer deposits has made loans cheaper and longer. This has prompted some banks to start to lend for agriculture, once the sole domain of the BNA. For example, some banks formed from the mergers of co-operatives have started to explore small farmers as their own market niche.

The banking system of Argentina, though still weak, has improved. The reformed regulatory framework, especially its extension to provincial banks, has led to constant improvements in confidence, strength, competition, and efficiency. In the long term, this should improve access for the rural poor, first to deposits, and then to loans.

The legal framework for secured transactions

Weaknesses in the legal framework for secured transactions in Argentina increase the cost of loans backed not by real estate or new cars but by reputation or chattel mortgages on movable assets. This section describes the constraints and reports on recent attempts at reform. It also suggests two further reforms. The first – a comprehensive pledge registry – would reduce the cost of chattel mortgages. The second – a comprehensive credit bureau – would increase repayment on uncollateralised loans by making a good reputation portable among lenders and thus more valuable.

Weaknesses A *security interest* is a right of satisfaction held by a lender against an asset of a debtor. Examples include mortgages on real estate or liens against movable goods such as motor vehicles, livestock, household furniture, accounts receivable, or stored grain. Most lenders in Argentina do not accept movable property other than new cars because of the high cost of establishing a security interest, getting priority over

other creditors, and seizing and selling the asset after default. This is due to the structure of Argentine law, to problems with pledge registries, and to a slow legal system.

Based on the Napoleonic Code, Argentine law prohibits everything that it does not expressly allow. The law expressly allows just a few types of lenders to accept just a few types of movable property as security in just a few types of contracts. The ostensible purpose is to protect debtors from predatory lenders, but the effect has been to restrict loans only to those who can mortgage real estate or new cars.

In principle, Argentina allows pledges of movable goods. In practice, chattel mortgages are uncommon because of the high costs of registration. These costs have five sources. First, each geographic area has its own pledge registry. Without a single national registry, lenders cannot check in one place whether a movable asset has already been pledged. Second, movable assets must be re-registered each time they cross a registry boundary. This discourages the use of cattle as chattel. Third, each local registry is a monopoly, and this has led to inefficiency and exploitative prices (Bacchiocchi et al., 1995). Fourth, the databases are set up in such a way that a lender can check whether a particular movable asset has been pledged but not whether a potential debtor has ever pledged a movable asset. Fifth, registration data cannot be transmitted by phone or fax. Because the process lasts more than one day and because registries are dispersed, the rural poor face high costs for food, transport, lodging, and lost time.

The execution of guarantees of movable goods is lengthy and cumbersome because it is treated as a trial (de la Peña and Muguillo, 1995). On average, the full process takes two to three years, so almost all cases are dropped or settled out of court. The creditor cannot seize and sell the pledge even if seizure would not disturb the peace.

Real estate and new cars The combination of Napoleonic law, fragmented registries, and slow courts has led lenders to prefer mortgages on real estate and new cars. These types of collateral have effective legal frameworks and comprehensive, national, efficient registries. The rural poor do not possess new cars, however, and most are landless (Maletta, 1996). Often those who do own land are unwilling or unable to mortgage it. Even among farmers, 25% do not own land, and another 50% own less than 100 hectares, the minimum commonly required by lenders.

Furthermore, many smallholders lack secure title. Some have squatted on public land or live in indigenous communal arrangements. Others cannot mortgage land that they received as part of land reform. The most common source of precarious tenancy is informal divisions of land among heirs. No single plot can be mortgaged because the legal title encompasses all the plots. Policy induces informal splits in two other ways. First, the government has failed to regulate the fees charged by the unions of surveyors who measure and register land. Second, some provinces do not allow land to be split into parcels below the size considered necessary for the efficient production of a given crop.

In contrast to land, many poor rural households do own old tractors, livestock, stored grain, and sundry household durables. Although chattel mortgages may not help a lender to recoup losses from default, they can increase incentives for borrowers to repay. Urban microfinance relies on such pledges and on the incentives created by the promise of future access to loans. The pledge system and incomplete credit bureaux in rural Argentina, however, decrease the usefulness of these strategies.

Recent and further reforms

Recent reforms are based on the belief that better institutional support could reduce the costs of the use of guarantees other than real estate and new cars. Argentina has made two recent attempts at reform. The first brought all motor vehicles under the law that had previously governed only cars. The second attempted to implement, by decree, the recommendations of Fleisig and de la Peña (1996).

Cars work as pledges in Argentina because they have an effective legal framework and their own national registry. A 1996 law brought all motor vehicles – including pick-ups, trucks, buses, tractors, and combine harvesters – into this system. The hope is to decrease the cost of loans guaranteed by used tractors and other motorised implements. A reform is also under way to graft a pledge registry onto the system that already tracks cattle for public health purposes.

In late 1995, a presidential decree attempted to remove most of the constraints on rural credit in one fell swoop. Unlike the rest of Argentine law, the decree allows anything that it does not specifically prohibit. In particular, it allows pledges with any type of movable property, for any type of loan to be backed by pledges, and for anyone to make or to accept pledges. The decree also provides for criminal punishment of some of the abuses that the old law tried to outlaw. Finally, it attempts to reduce the need to use the legal system. In most cases, the loan contract takes precedence over the decree. ‘Harmless’ repossessions are allowed if they do not disturb the peace. The decree also attempts to speed those cases that do end up in court.

The decree and the reforms of the vehicle registry should improve access, but they do not solve all problems. Without the force of a law passed by Congress, the decree of the President may not be enforced. Also, the reforms do not strengthen some other institutions that support access to loans for the rural poor, such as a registry for all types of movable goods and a comprehensive credit bureau.

A pledge registry for all kinds of movable assets would reduce transaction costs for borrowers and lenders and help the rural poor to secure loans with chattel. The present registries, already licensed by government, could be required to use computers linked in a national network, to track the identity both of the borrower and of the asset pledged, and to charge reasonable fees. Data could be sent by phone or fax.

Like pledge registries, the credit bureaux in Argentina are fragmented and incomplete, but they have begun to expand and consolidate. Although the BCRA does track all borrowers in arrears or in default, it has recently begun to track those who have repaid on time. Private credit bureaux which recently serviced only a few lenders and, like the BCRA, recorded only negative information, now serve an ever-increasing number of lenders. Perhaps most importantly, a lender can use the credit bureaux to check whether a potential borrower has ever defaulted and also whether s/he has ever repaid a loan from another lender on time. The addition of this positive information greatly increases the value of a clean credit record.

A single source for both positive and negative data for all borrowers would decrease the cost of small, uncollateralised loans. Borrowers repay these loans in the hope of access to future loans. If a good reputation vanishes when a borrower switches lenders, however, then the incentive to preserve a clean record diminishes.

To support credit-bureau reform, the government might force all formal lenders to report in a digital format all repayments, arrears, and defaults for all borrowers to any credit bureau on request. In return, all credit bureaux would supply digital data for any potential borrower to any lender. Such a bureau would be inexpensive, little more than a big computer and a few employees. It would charge lenders a fee for each request, and fees would be regulated. Work has started on just such a project.

Privatisation of public development banks

Many of the flaws in the banking system in Argentina can be traced to weaknesses in the development banks owned by provincial governments. An important part of the reform has been their privatisation. The provincial banks had a mission to serve rural areas, to promote agriculture, to lend to those rejected by private banks, and to serve remote towns. Rural microfinance has a similar mission, except that it aims not to lend to bad risks but rather to decrease the cost of judging and managing risk. This section addresses the concern that privatisation will leave the rural poor stranded without financial services.

In one sense, privatisation can hardly decrease access; the provincial banks had already been moribund for a long time. For example, the Banco de Salta made no loans in the year before its sale, and 98% of its portfolio was delinquent. Likewise, 60% of the portfolio of the provincial bank of Santa Fe was in default. Similarly, the two banks that traditionally lent the most to agriculture, the Banco Nacional de Argentina and the Banco de la Provincia de Buenos Aires, have virtually stopped making new loans and now do little more than refinance old loans which are already in default and probably will never be collected. In the short term, the rural poor probably have little access to lose from privatisation. In the long term, privatisation may increase access if improved confidence deepens the financial system and if competition pushes banks down-market in search of new niches. Indeed, several of the new, consolidated private banks with an urban history – Banco BISEL and el Banco de Santa Fe – have begun to lend successfully to small and medium farmers (although none provide what could be called microcredit to very small farmers).

The provincial banks were privatised because poor management, inefficiency, and politicised loans caused them to swallow bail-outs like black holes. The government wanted the development banks not only to mediate between savers and borrowers but also to finance public deficits, to lend to high risks, to lend at subsidised rates, to collect taxes without remuneration, and to create employment (World Bank, 1994). Even efficient banks cannot do all these jobs. The only way the provincial banks could survive was with public help in the form of free deposits from the government, relaxed reserve requirements, tax exemptions, government guarantees on deposits and loans, and protection from bankruptcy. Chartered under provincial law, the banks could not be closed by the BCRA for insolvency or illiquidity. With time, however, the power of the BCRA was extended, the provincial budgets ran dry, and privatisation followed.

The dangers of privatisation

Most provincial banks have been bought by urban banks. In principle, the sale could decrease access to rural financial services if it destroys intangible assets such as a

mission for agriculture, knowledge of the characters and cash flows of good borrowers who seem uncreditworthy when judged by the availability of collateral, and a rural focus, as well as a network of rural branches (Gonzalez-Vega and Graham, 1995).

The two types of banks closest to agriculture – co-operatives and provincial banks – were also those most affected by bank reform. With regard to co-operatives, consolidation will probably not affect the agricultural portfolio because they already lent to agriculture before consolidation, not for political reasons but for profits. For provincial banks, privatisation will probably shrink the agricultural portfolio for three reasons. First, much of the old agricultural portfolio was delinquent. Privatised banks will avoid bad risks. Second, provincial banks made risky loans in the name of development and used public funds to cover losses. Privatised banks cannot ask taxpayers to pay for their mistakes. Third, provincial banks often ran directed-credit programmes for agriculture. These will cease.

In principle, privatisation could erase informal knowledge of the character of borrowers or special knowledge of agricultural cash flows. In practice, however, provincial banks usually lent on the basis of collateral, not of character or cash flows. The new owners may move lending decisions from the provincial capital to Buenos Aires, but, for most small borrowers, either capital is too distant.

The loss of rural branches may affect access to deposits for the rural poor. Carrizosa et al. (1996) state that Argentina has too many bank branches and that the new owners should be allowed to close the unprofitable branches of provincial banks, many of which were built for political reasons or to capture the inflation tax. In fact, more branches closed before privatisation than after. For example, public banks lost 102 branches (6% of their total) in the first six months of 1995, while private banks added 33 branches. Most of the new owners are bound by covenants to keep all branches open for a few years, with or without profits. This could increase access in the long term if, in an effort to cut losses, they experiment with technology in the unprofitable branches. Thus privatisation is both a threat and an opportunity. Without new technology, many rural branches will close in a few years. The current moratorium, however, gives the new owners a selfish reason to experiment with new technology.

Rozenwurcel and Bleger (1998) argue that privatisation has not closed many branches. In fact, a kind of branch war erupted after the entry of two private Spanish banks (Banco Bilbao Vizcaya and Banco Santander) and this has resulted in a modernisation of branches overall, a shift in the share of branches from public to private banks, and no net change in the number of branches.

The new owners are often second-tier wholesale banks which, it is feared, might fund urban loans with rural savings. Perhaps they do not care to learn how to make retail loans, or perhaps urban returns are higher. Even if rural deposits do fund urban loans, at least the rural poor will have some access to deposits.

Overall, privatisation saved the public purse billions of dollars and has slowly increased credit to the private sector (Clarke and Cull, 1999). Efficiency has improved, arrears have decreased, deposits are larger and longer, and the number of branches has remained constant. Lending for agricultural production and to small farmers has, however, not yet increased.

Argentina is not the first country to worry about the loss of local ownership of rural banks. In the United States since 1979, 2,500 small rural banks have been involved in mergers, usually with large urban banks. Like Argentina, the United States was

concerned that urban banks would not salvage the comparative advantages of rural banks. As expressed by Neff and Ellinger (1996: 721), 'Smaller locally owned banks typically have developed strong relationships with borrowers and have more expertise in local agricultural production processes than do larger regional banks. They are often better able to identify the needs and problems of local-market, small-business participants.' Urban banks also tend to focus not on loans for agriculture but on fee products.

It turns out that mergers have not affected access to rural financial services in the United States, at least not much and not yet (Berger and Udell, 1998; Featherstone, 1996; Neff and Ellinger, 1996). In fact, mergers may have created economies of scale and helped to spread risks. In Argentina as in the United States, it seems likely that 'following some amount of short-run adjustment, total rural credit availability should be little affected by bank consolidation' (Lovonian, 1996: 735).

Conclusion

The new microfinance technologies that have proved successful in urban areas are unlikely to improve access to small deposits and small loans for the poor in rural Argentina. Microfinance works best for households with diverse sources of income and who can therefore repay their loans even if a project fails. Most small farmers in Argentina are not very diversified. Few rural households have non-farm employment. Furthermore, the effects on costs of sparse populations and long distances are more severe in rural Argentina than in other places where rural microfinance has had some success.

This does not mean that government and donors have to abandon their hopes of improving access to financial services for the rural poor. It does mean, however, that they should probably stop the use of public development banks to address the issue. This old approach undermined rural development. The rich got the loans and did not repay them, and this reduced access for all.

Public entities might instead try to strengthen the market institutions that support a stable banking system. High transaction costs, imperfect information, and high risk are reduced not by decree but by the provision of infrastructure and experiments in technology. With time, greater deposits might lead to greater access to loans for the rural poor.

One way to strengthen the institutional infrastructure of rural financial markets is to strengthen the regulatory authority. Strict supervision and the privatisation of the provincial banks have already produced greater confidence in the banking system and more competition. Trust and strength also protect against runs on deposits and thus improve access to savings services, the most important financial product for the rural poor. Constraints on loans may loosen as deposits increase. In time, competition may increase access without adverse side-effects, as it prompts banks to search for virgin niches and nudges them towards poorer, smaller, and more rural clients.

A second set of interventions would attempt to decrease the cost of the use of the types of guarantees that the poor can offer. The decree of the President to reform the framework for security interests could be made law. Likewise, public support for a national pledge registry for all kinds of movable assets would decrease the cost of loans backed by chattel. The government could also mandate the use of a national credit

bureau for all borrowers, whether in arrears or in good standing. This would increase the worth of a clean credit record and thus spur better repayment.

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