





## DONOR PROGRAM REVIEW

### *Sharing insights, lessons and experience in rural finance*

By the early 1970s, it became apparent that the design of many agricultural credit programs were flawed; program outcomes were characterized by low rates of loan recovery, high transaction costs and heavy dependency on outside funding.<sup>3</sup> USAID's 1973 *Spring Review of Small-Farmer Credit* concluded that most conventional agricultural credit programs undermined the sustainability and efficiency of financial institutions; discouraged savings mobilization; and prevented the development of competitive, demand-driven rural financial services. Those programs that were successful were distinguished by the use of flexible interest rates and an emphasis on traditional rural institutions that operated on a scale consistent with the routine transactions of rural populations.<sup>4</sup>

The conclusions of the Spring Review significantly impacted the Agency's approach to rural finance and resulted in the development of associated new guidelines and policies. For example, USAID's *Guidelines on Project and Program Planning for Small Farmer Credit*, issued in 1974, highlighted several new program design criteria, including the development of favorable government policies, the use of market-determined interest rates; the strengthening of institutional administration; and the linking of rural savings and credit programs.

In 1981, USAID and the World Bank co-sponsored the Colloquium on Rural Finance in Low-Income Countries. Discussion at the Colloquium centered on the importance of government financial market policy liberalization, greater domestic private savings mobilization, financial institutional sustainability and efficiency, and flexible credit collateral requirements. The findings of the colloquium were incorporated into Agency agriculture and financial market development policies. The findings of the Colloquium were also incorporated into USAID's *Policy Initiative on Financial Market Development*, issued in 1988. While the policy initiative formalized a significant shift in the Agency's approach to financial market development, it did not discuss the challenges and constraints specific to rural finance and markets.

### **Microenterprise Programs**

Through its early experiences and failures in agriculture credit, USAID learned hard lessons about sustainable financial services to rural populations as well as financial market development in general. In the early 1980s, the Agency shifted its programming focus from agricultural credit to microenterprise development as a means of supporting the economic growth of poor populations. USAID's earliest microenterprise programs focused on providing enterprise-related small loans to poor households and businesses traditionally excluded from access to formal finance. USAID's microenterprise efforts were formalized in the *USAID Microenterprise Development Policy Statement*, issued in 1988 and the Agency's Microenterprise Initiative was launched in 1994. Priorities included lending to women and targeting low-income households, while the programming principles focused on institutional sustainability, outreach expansion, and local partnerships.

While the Agency's microenterprise development programs have increased the economic opportunities for poor populations in developing countries, their effectiveness has been more limited in rural and agriculture enterprise applications. Most USAID-supported microfinance institutions have had a greater proportion of their clients in urban and peri-urban areas with more regular cash incomes and access to developed infrastructures and commodity markets.<sup>5</sup> In addition, most microfinance institutions that do operate in rural areas do not provide the broader

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<sup>3</sup> Adams

<sup>4</sup> McClelland, page 16

<sup>5</sup> USAID (2001), page 34





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USAID's newest credit financing tool, the Development Credit Authority (DCA) mobilizes private capital to support its development assistance activities throughout USAID-assisted countries around the world. DCA guarantees cover up to 50 percent of a lender's net loss on the principal amount of loans extended on commercial terms.

DCA's partial guarantees are designed to demonstrate the financial viability of lending to new areas or sectors and will continue to encourage agricultural lending in rural areas thus directing credit to an underserved market. Guarantees allow banks to gain valuable experience in lending to such higher-risk (real or perceived) borrowers and provide the basis for further outreach of their lending activities by building relationships between banks and businesses, increasing the pool of borrowers, and potentially lowering financing requirements.

#### Warehouse Receipt Financing

Warehouse receipt financing, or inventory credit, has also emerged as an increasingly valuable tool in expanding financial services to rural populations, especially small farmers. By storing a product in a licensed warehouse, a small producer can use the warehouse receipt as portable collateral to secure a loan. In addition, warehouse receipt programs help small farmers gain an advantage on the playing field by storing their goods in a reliable warehouse until the market price for their product increases. In Bulgaria, USAID along with USDA, and EBRD, collaborated to create a nationwide warehouse receipt system. Program implementers worked to create the legal, regulatory and institutional infrastructure required to make a warehouse receipt system successful including creating enabling legislation, regulatory bodies and consistency in warehouse performance. Warehouse receipt programs have also been implemented in Ghana, Kazakhstan, Poland, the Ukraine, Uganda and Croatia.

#### Broader Agricultural Development Projects

Rural financial services are often promoted through a number of broader market linkages and agriculture enterprise development projects. Producer associations developed to help members market their goods, often provide a mechanism for access to financial capital. Business development services help producers and rural enterprises gain critical skills in business plan development, management, marketing, and accounting—all of which improve their viability and bankability.

Supplier credit or vendor financing has been successful in expanding the capacity of processors or vendors and creating market based systems of productions. In Moldova, a USAID agribusiness development project helped a Moldovan company establish a nursery for the production of virus free seedlings, which are then sold to area farmers on credit. Improved raw material, proper farmer training and a higher quality final product will result in greater sales for the company and higher incomes for farmers.

In Afghanistan, USAID funds a project that incorporates the country's existing transport and input suppliers in distributing fertilizers to farmers. Afghan farmers were provided vouchers which could be exchanged for fertilizer from local distributors. Farmers were asked to repay the advance on fertilizer with in-kind payments at harvest time. By using this and other creative variations on supplier credit, USAID is able to support improvement in agriculture output while also strengthening the local input distribution mechanisms.

#### Conclusion

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Unlike rural and agricultural programming of earlier eras, the interventions discussed above strive to develop the institutions, human capacity and policy framework that are so often absent or



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inadequate in developing countries. By intervening in these ways, USAID helps to create an environment more suitable and more attractive for private sector activity and investment.

Building on this brief review of USAID's rural finance programs and policies, the USAID sponsored conference *Paving the Way Forward* will provide an opportunity to further discuss the challenges the Agency faces in rural policy intervention and provide a forum to discuss the current and possible future innovations in institutions and technology that are helping meet the demand for rural financial services.

### **Rural Finance Implementation and Contact Information**

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Strategy and programming relevant to the development of rural finance cuts across many Agency bureaus and offices, both in Washington and local missions. Taking the lead in organizing the conference, *Paving the Way Forward on Rural Finance*, are the Office of Agriculture and the Office of Poverty Reduction, Microenterprise Development Team in the Bureau of Economic Growth, Agriculture and Trade.

Bureau of Economic Growth, Agriculture and Trade

Office of Agriculture

Lena Heron

202-712-0391

[lheron@usaid.gov](mailto:lheron@usaid.gov)

Office of Poverty Reduction

Martin Hanratty

202-712-1412

[mhanratty@usaid.gov](mailto:mhanratty@usaid.gov)

Barry Lennon

202-712-1598

[blennon@usaid.gov](mailto:blennon@usaid.gov)