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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED

TECHNICAL ASSISTANCE GRANT

TO THE

REGIONAL UNIT FOR TECHNICAL ASSISTANCE (RUTA)

FOR THE

**RURAL FINANCIAL SERVICES SUPPORT PROGRAMME (SERFIRURAL) IN
BELIZE, COSTA RICA, EL SALVADOR, GUATEMALA, HONDURAS, MEXICO,
NICARAGUA AND PANAMA**



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ABBREVIATIONS AND ACRONYMS

AWP/B	Annual Work Plan and Budget
FASA	Financial Advisory Services Agency
FI	Financial Intermediary
GTZ	German Agency for Technical Cooperation
RUTA	Regional Unit for Technical Assistance
TAG	Technical Assistance Grant



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I submit the following Report and Recommendation on a proposed technical assistance grant (TAG) to the Regional Unit for Technical Assistance (RUTA), for the Rural Financial Services Support Programme (SERFIRURAL) in Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua and Panama, in the amount of USD 750 000 for a three-year period.

I. BACKGROUND

1. IFAD is currently implementing 20 rural development projects in the Central American subregion (Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama). All these projects include a credit component. In all, funding for credit schemes amounts to approximately USD 90 million. There is ample consensus among government and funding agencies that the performance of financial services providers can be improved. This has been shown by the numerous requests for technical assistance that require the adoption of a comprehensive implementation strategy to address the need for sound advice, enhanced training and the subregional exchange of information.

2. Macroeconomic policies being implemented in the subregion have revealed a profound crisis in state development banks, traditionally the only source of rural credit, and serious problems associated with the provision of direct agricultural credit, including the dependency of borrowers on subsidies and the insolvency of financial intermediaries.

3. Since 1997 IFAD, the Free University of Amsterdam and a project funded by the United Nations Development Programme (UNDP) have provided training and technical assistance and fostered the exchange of experience among several IFAD-funded projects. This initiative has allowed for development of a methodology for the selection and assessment of financial intermediaries (FIs) and the elaboration and testing of computer software to improve portfolio management by FIs. There is now a need to consolidate and expand this initial effort. For that purpose it is proposed to provide RUTA with a TAG for the implementation of a Rural Financial Services Support Programme.

II. RATIONALE AND RELEVANCE TO IFAD

4. Studies on rural financial markets in the subregion show that less than 20% of small farmers have access to some kind of informal or formal savings and credit schemes, with the resultant negative effects on agricultural growth, poverty alleviation and the management of natural resources. Faced with this situation, national governments and bilateral and multilateral funding agencies are taking steps to expand the provision of rural financial services. However, for this strategy to succeed,



it will be necessary to: (i) overcome certain legal and regulatory barriers at the policy level; and (ii) influence the way in which financial intermediaries operate, promoting the adoption of financial technologies that will enable financial intermediaries to widen their coverage and achieve financial sustainability.

5. Development projects are challenged to facilitate access by the rural poor to financial services and to strengthen sustainable financial institutions within the context of subregional macroeconomic policy changes that eliminate direct agricultural credit and reform the state development banking system.

6. Small farmers and entrepreneurs in the subregion have increased their demand for rural financial services, which makes it necessary to develop better and more efficient providers of services. At the same time IFAD's projects and partners, the FIs, demand financial technology and advice that can assist them in the construction of rural financial systems. IFAD should systematize its own and others' accumulated experience to improve its strategy and operations.

III. THE PROPOSED PROGRAMME

Goal and Objectives

7. The goal of this grant is to make financial services more easily accessible to the rural poor by helping improve the quality and coverage of the services provided by FIs. To achieve this, the programme will promote the knowledge of financial technologies that contribute to the consolidation of efficient financial discipline by FIs; it will also place a stronger emphasis on linking support to FIs to the improved performance of their portfolios as shown by periodic impact assessment of their operations. In addition, the programme will strengthen the development of subregional and national capacities for the provision of technical assistance and training services, and strengthen IFAD's policy dialogue with governments, especially regarding decisions that might improve the enabling legal and regulatory framework for rural financial services.

Key Programme Activities

8. Programme implementation will include the following:

- (a) **Provision of advisory services.** Advisory services will be provided on a wide range of topics that will be identified on the basis of a technical diagnostic study and needs assessments in each of the beneficiary countries. Specific requests will be evaluated in order to design appropriate solutions to identified problems. Some of the possible areas of support are: portfolio assessment tools, assessment of credit risk, evaluation and qualification tools of FIs; and strategic and business planning.
- (b) **Design and implementation of training programmes.** Training programmes will be elaborated in collaboration with existing regional and national institutions. The approach will be to hold regional seminars, combined with local course modules that will ensure proper follow-up on the practical application of new tools. Courses will cover general topics including an introduction to microfinance and more specific areas such as those mentioned under (a) to improve the skills and abilities of FIs and project staff.
- (c) **Strengthening subregional information systems and portfolio performance.** This will focus mainly on strengthening the monitoring of the operations through a specialized monitoring and evaluation system. This involves developing and adapting performance



indicators and other instruments needed for portfolio assessments. These indicators will be used in periodic impact assessments by external rating agencies – of a selected group of FIs to measure their overall performance – and in impact studies of financial services at the client level. These activities will be directed to the staff of rural financial services, component implementation units, second-tier banking institutions and FIs.

- (d) **Systematization of experience, best practices and knowledge-sharing, and policy dialogue.** Lessons learned will be systematized and shared among development projects, FIs and regional institutions. The best practices of various agencies such as the World Bank, Inter-American Development Bank (IDB), German Agency for Technical Cooperation (GTZ) and Consultative Group to Assist the Poorest (CGAP) will be studied and discussed in regional workshops in order to compare results and provide feedback. The results of these activities will also be used to improve IFAD's policy dialogue with the governments concerned. Specific attention will be given to creating a clearer legal and regulatory framework that will enhance and promote the coverage of rural financial services.

IV. EXPECTED OUTPUTS AND BENEFITS

9. The following outputs are foreseen as a result of grant funding:

- (a) **Improved TA services responsive to specific demands of FIs and utilized by them.** The programme will: (i) transfer financial services technologies; (ii) train human resources in key areas that will strengthen FI performance; and (iii) promote and foster exchanges of local experience and best practices. The programme of TA and training services will strengthen national and subregional service providers, among which a newly established non-profit organization, the Financial Advisory Services Agency (FASA).
- (b) **Financial technology instruments and methodologies validated and disseminated to FIs and projects.** Information on tried methodologies will be gathered, processed and disseminated. Different instruments will be tested in local conditions and validated for wider dissemination. Some of these instruments will improve linkages between projects, FIs and commercial banks that intend to expand their services in rural areas.
- (c) **Monitoring, performance and evaluation tools, with improved impact assessment and portfolio performance assessment by FIs and projects.** Projects and FIs will be trained and equipped with tools that enable them to select FIs; evaluate their performance and future sustainability; and monitor their financial performance. Performance evaluation and impact assessment studies of national and subregional financial intermediaries will result in greater transparency in the allocation of credit resources, and help donors decide with whom to place on-lending resources.
- (d) **Knowledge and best practices systematized and incorporated into the strategy and policy dialogue with governments.** Relevant experiences of IFAD and others in the region will be gathered and analysed to constitute a knowledge base that will feed back into design and strategy. A mechanism for dialogue will be established involving multi- and bilateral agencies (the World Bank, IDB, the Food and Agriculture Organization of the United Nations, GTZ, etc.) and policy dialogue with governments, academic centres, several FIs in the region and commercial banks. Some in-depth analytical studies will provide inputs for strategy and design.



V. IMPLEMENTATION ARRANGEMENTS

10. The programme will be administered by RUTA. A programme coordinator will be contracted through a competitive selection process. He or she will be responsible for the overall management of the programme. An annual work plan and budget (AWP/B) will be submitted no later than July of each year. AWP/Bs will be elaborated on the basis of initial diagnostic study of project staff and FI requirements. They will include a strategy and priorities for each country and will strengthen the local existing capacity to provide TA and training to FIs.

11. Substantive guidance in TAG implementation will be provided by a Programme Advisory Committee (PAC), to be composed of representatives of RUTA, GTZ, UNDP and two representatives each from IFAD and FIs (such as the *Asociación de instituciones financieras para el desarrollo rural* (FINRURAL) from Bolivia). PAC will meet on an annual basis in order to exchange experience and propose new strategic approaches. Consultants on rural financial services could be invited to participate in order to address specific areas of interest.

12. The programme will contract local, regional and international consultants for the in-depth analytical studies, systematization of experience and elaboration of practical tools on best practices. The programme coordinator will prepare agreements with the Free University of Amsterdam (located in San Jose, Costa Rica) and GTZ regarding their collaboration in training courses and the provision of technical assistance. Other agreements might be formed with academic institutions or FIs with particular expertise.

13. At the request of FIs and projects, FASA will provide advisory services and training in areas such as the evaluation and selection of FIs and an information system for portfolio management. The programme coordinator will identify additional service in order to achieve quality provision of essential services in financial technology for projects and FIs. The TAG resources will finance experiments with new technologies and facilitate access to advisory services financed directly from project loan resources, where appropriate.

14. A Programme Executive Committee (PEC) will be established to ensure direction and overall programme supervision. PEC will be composed of the director of IFAD's Latin America and the Caribbean Division, who will chair it, the country portfolio manager (CPM) responsible for the TAG, and the programme coordinator. PEC will meet annually in order to approve the programme's AWP/B. Collaboration with other regional programmes will be established, especially with FIDAMERICA¹, the Rural Microenterprise Support Programme in Latin America and the Caribbean and RUTA.

15. A mid-term review will be conducted before the end of the second year of implementation in order to determine the effectiveness of FASA in responding to requests for advisory services and training from IFAD-funded and other projects and to review overall progress and achievements. An external evaluation will be undertaken at the end of the third year to review the achievements of the programme.

VI. INDICATIVE PROGRAMME COSTS AND FINANCING

16. IFAD will provide a TAG that amounts to USD 750 000, UNDP will contribute USD 90 000, and IFAD projects in Central America will cofinance activities for a total of USD 625 000. Other donors such as GTZ have demonstrated interest in participating in this TAG, but the type of collaboration and their contribution need to be defined over the next few months.

¹ An Internet-based system of information exchange for IFAD programmes throughout Latin America.



(USD)

Cost Category	IFAD	UNDP	IFAD Projects	TOTAL
Staff experts	200 000			200 000
Training	200 000		150 000	350 000
TA and studies	150 000		400 000	550 000
Equipment and publications	50 000	90 000		140 000
Operating costs	100 000		75 000	175 000
Administrative costs	50 000			50 000
Total	750 000	90 000	625 000	1 465 000

VII. RECOMMENDATION

17. I recommend that the Executive Board approve the proposed technical assistance grant in terms of the following resolution:

RESOLVED: that the Fund, in order to finance, in part, the Rural Financial Services Support Programme (SERFIRURAL) in Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua and Panama, for three years, commencing in July 2001, shall make a grant not exceeding seven hundred and fifty thousand United States dollars (USD 750 000) to the Regional Unit for Technical Assistance (RUTA) upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Lennart Båge
President