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Lead Theme Paper

Theme: Legal Policy and Ramifications for Rural Finance

Legal and Regulatory Requirements for Effective Rural Financial Markets

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Executive Summary

Many rural finance and rural development projects, otherwise well-designed, fail because they call for non-legal behavior - behavior that is not sanctioned by law. Sometimes this behavior is extra-legal -- not envisioned by the law; sometimes this behavior is illegal -- prohibited by law. This paper sets out examples of such legal problems, discusses their consequences for rural finance, and discusses best practice remedies. Its main recommendations are these:

* Promote microcredit viability by changing laws to permit portfolios of unsecured loans to serve as collateral for refinancing loans from the formal sector.

* Refocus land titling projects away from "title", a land-use right that does violence to traditions in transitional and customary economies; instead codify all economically important land-use rights.

* Broaden such land-use rights projects to include a clear and simple legal mechanism for transferring land-use rights and using them as collateral.

* Reform laws relating to borrowing status of the poor: age of majority, homestead, literacy, and civil registration. Facilitate the poor, illiterate, and young heads of households in legally conducting business with the formal sector, including signing contracts, opening businesses, and borrowing.

* Reform laws related to the status of farmers, so that farmers can pursue commercial enterprise and participate in commercial transactions.

* Reform laws related to cooperatives and non-governmental organizations, so that they can perform functions like lending and borrowing on behalf of their members and undertake commercial activities with members as beneficiaries.

* Simplify and reduce the cost of bankruptcy procedures, so that a simple and cheap exit mechanism exists for paying unsecured debt and returning the balance to the borrower.

* Limit regulation of rural financial institutions to those taking deposits; do not subject non-financial lenders and financers (dealers, brokers, and farmers) to financial regulation.

* Expand the use of collateral for loans: Permit the use of movable property (1/3 of the capital stock) and immovable property (2/3 of the capital stock) as collateral for loans by improving legal systems for creating, setting the priority, publicizing and enforcing such security interests.

* Expand the use of immovable property (2/3 of the capital stock) as collateral for loans by linking the immovable property security interest system to the broad system of land-use rights, not just titled land. Use a broader concept of security interest than the traditional "mortgage"; use inexpensive systems that do not penalize small rural land-use rights.

* Reform commercial codes that govern rural business, remove economically unsound provisions, and introduce the minimal set of rules needed to run a modern business.

* Pass simple and effective laws governing intellectual property rights so that rural areas can fully participate in the biotechnology revaluation and get the financing needed to do so

* For all relevant legal institutions - write governing legislation that permits competing, and where possible, private, systems civil and commercial registration systems; provide for a notice filing system for security interests property and for land-use rights in immovable property.

I. Introduction and Background

In every country, rural financial markets rest partly on a foundation of law and partly on a non-legal foundation of extra-legal and, sometimes, illegal, customs and usage. These legal and non-legal foundations directly affect the operation of rural financial institutions. They also affect the status of other rural economic agents - individuals, farmers, and businesses. Sometimes these are clients of financial institutions, sometimes in the key case of non-bank financial intermediaries they are competitors, and sometimes they are both.

Box 1. A Bangladesh Dealer in the Informal Sector

One fertilizer dealer in Bangladesh sold fertilizer on credit to about one thousand farmers for a total amount of credit of $200,000 to $500,000. This entire portfolio was backed by a handshake and the knowledge of farmers that if they didn't pay, they would never again get credit from the dealer or from his few competitors. Nor did this dealer look to the legal system for backup. When pressed on whether he would take a (hypothetical) non-paying client to court, he replied, "What? I have enough trouble. He didn't pay me. Why would I go to court"?

Non-legal institutions can work well (see box). However, non-legal institutions work better when they have the backing of an effective legal system. The successful fertilizer dealer (see Box 1) himself had no access to credit, because his enormous portfolio of loans with nearly a 100% repayment rate could not serve as collateral for a loan under Bangladesh law. Even if this portfolio could, he himself, as an individual proprietor, could not use Bangladesh's secured transactions system, which was limited to corporations (the "company charge"). Nor could he expand territory easily because for clients he did not know personally he could not take their future crop as collateral for a loan. He could, in principle, take a mortgage on their land but in most cases they were renting or did not have proper title. However, even where they had proper title, the high costs mandated under the mortgage law made such small properties worthless as collateral. These same barriers to expansion, however, prevented competing fertilizer dealers from entering his market. Therefore, he had market power over both the implicit interest rate on his loans and the price charged for fertilizer. The result? Narrow, fragmented, and uncompetitive rural financial markets.

Non-legal solutions have power in local situations where personal relationships can replace formal law and enforcement. Their weakness lies in their collapse outside that local orbit. These geographic and associational limits on non-legal solutions undermine the central function of the rural financial market - bringing those with savings together with those with the best investments. Those with the best investments may not always be the saver's neighbors, relatives, or members of the same religious sect, caste, or tribe.

This paper discusses analogous legal problems in several areas that affect rural financial markets - bank, non-bank, and non-financial lenders and their clients. The paper first discusses the legal framework for secured transactions that governs taking collateral, covering laws of mortgage, pledge, and, for common law countries, the charge and hire purchase. It discusses briefly some issues in the regulation of rural financial institutions. Then it turns to contract enforcement, entry and exist of institutions from financial markets, issues in land rights, land titling, cadasters, and access to credit. It ends its examination of laws with a discussion of intellectual property rights and proper provision of labor and debtor protection. It concludes with recommendations and a review of donor practice.

All these issues are presented in an abbreviated survey but even that abbreviated summary misses many important areas for rural development that have implications for rural

finance. Law has a broad and deep bearing on rural development.

Implications for Donors and Policy Makers

What do findings mean for effective policy? Most rural finance and rural development projects would do considerably better - and in some cases succeed instead of fail - if economically-relevant laws were revised in ways relevant to the needs of rural finance. The executive summary contains a list; the body of the text contains the detail.

Are most donors already doing this? No. Simply looking at the donor statements for this project shows that only two donors even mention reforming the laws that govern the environment for their projects - the Inter-American Development Bank and the World Bank. However, while these statements reflect sensible views of the role of legal reform, these principles do not reflect the real practices of these donors. For example, in no major financial crisis country - Mexico, Brazil, Argentina, Russia, Indonesia, Korea, Thailand, and Uruguay - has the BID or the IBRD made a reform of the legal framework governing debt collection a condition of a rescue operation.

USAID, which had not at this writing submitted its donor statement, represents a more interesting case. USAID has supported many legal reforms in developing countries. While a full review has not been undertaken and is beyond the possible scope of this paper, those projects have typically underinvested in analyzing the economic fundamentals of modern laws and seeing how to apply them effectively in a developing country context. Nor has there been a clear vision about connecting legal problems to sectoral programs. For example, extensive support for microfinance by USAID and the World Bank has included no analysis of the legal barriers that make microfinance so much more difficult in developing countries than in industrial countries. The result? Even in countries where these donors support legal reforms, these reforms leave the needs of microfinance untouched. Microfinance struggles on in its hostile legal environment. In another case, USAID and World Bank land titling projects focus on title and leave the other land-use rights and mortgage laws untouched; typically they fail to support reform of the laws governing land-use rights as collateral. The result? Multi-billion dollar land titling projects produce no improvement in access to credit secured by land.

These attitudes seem to change at glacial speed. In a competent 1995 study of the role of collateral in microfinance undertaken by the International Labor Organization, the donors were polled to see if they thought revision of the laws governing collateral were important to microfinance. All donors polled said no, except for the representatives of USAID and the World Bank. This 2003 survey of donors can add the BID to the list that expresses concern.

II. The Legal Framework for Secured Transactions

A. Private Finance in Rural Finance

In 2001, developing country GDP amounted to about $6 trillion. On the basis of past performance, just keeping pace with industrial country per capital incomes requires that these countries invest about $1.2 trillion annually. Where will that money come from? Multilateral development banks and the IMF supplied, net, about $18 billion in 2001; aid agencies less. Donors represent less than the rounding error on developing country investment needs. What about the public development banks in developing countries? MDBs have spent the past ten years putting these banks out of business, after their long history of making uncollectible and often unproductive loans. Financing this investment will require private funds. If financed

privately, will it be in equities or debt? That is hard to judge given the primitive state of developing country equity markets. However, the United States has one of the most advanced systems in the world for organizing equity markets. There, in 2000, new equity issues amounted to less than 5% of new lending.

Financing rural investment will require private funds, therefore, and private funds mean debt. For private lending to play the necessary role, private lenders need a fundamental assurance about one thing: that the borrower will pay. A country's legal framework for debt collection provides that assurance.

B. The Economic Gain from Secured Lending

A legal framework that permits offering property as collateral for a loan offers broad benefits in reducing debt collection risk. In systems where borrowers can offer a broad range of property as collateral, they get larger loans, at lower interest rates, repayable over longer periods of time.

The theory behind this is complex1, but examples abound. The credit unions of the World Bank, the Inter-American Development Bank, the International Monetary Fund and the Federal Reserve all offer much better loans terms when a borrower offers collateral. Compared to a loan backed only by a signature, a borrower offering real estate as collateral could expect to get a loan nine times larger, repayable over a period of time eleven times longer, at an interest rate about 50% lower than if the borrower. For a loan secured by movable property, the borrower would get loan terms somewhere between those for unsecured loans and those secured by real estate. Washington commercial lenders follow the same practice.

When the law permits effective use of collateral, the risk from lending falls. Lenders react by offering more credit at the same or better terms. More credit at lower interest rates permits higher rates of investment and more capital per worker, leading to much higher incomes. Seventy percent of bank loans in the United States are secured; at the same time, credit relative to GNP in the United States is about ten times higher than in most developing countries. Farmers and business operators borrow routinely at interest rates about 600 basis points higher than the government-borrowing rate, a fraction of the spread facing their counterparts in most developing countries.

C. Experience in Developing Countries

With few exceptions, farmers and business operators in developing countries get little advantage from offering property as collateral for loans. Why does this experience in developing countries differ so much from that of industrial countries? This section of the paper discusses how poor laws and legal institutions in developing countries provide no economic incentives for lenders in developing countries to give better loan terms when borrowers offer most property -- both movable and real estate -- as collateral for loans. This chapter sets out those features.

1. Basic Elements of a Secured Transactions Legal Framework

The fundamental economic feature of collateral and the distinguishing trait of a secured lending system (a lending system that uses collateral) lies in granting priority to a lender or credit seller in collecting against some property of the debtor. A security interest is "a right of satisfaction" from the property - the "collateral" -- to which the security interest is attached. If the debtor defaults, the collateral can be sold or exchanged, and the security interest of the secured creditor will be satisfied (paid) ahead of the general claims of unsecured creditors.2 In

modern credit systems, such as those of the United States, Canada, New Zealand, or Romania, unsecured and secured lending coexist in a fruitful and mutually reinforcing manner. However, when a legal system supports only unsecured lending, creditors will lend less to any given borrower, for shorter periods of time, and at higher interest rates.[3]

Moreover, the logical possibility under the law of such a security interest cannot alone secure the economic benefits of a secured lending system. Rather, the legal system must meet some key requirements:[4]

* Creation: the process by which the creditor establishes a security interest in property (the collateral) -- must cover all economically important property, transactions, and agents; the law must permit creation at a low cost relative to the value of the transaction.

* Priority: the process by which the lender establishes the priority of the security interest against all other claims in property -- must provide for unambiguous ranking of priority rules; must protect the secured party from hidden claims of third parties, including other secured creditors, unsecured creditors, a trustee in bankruptcy, some purchasers of the collateral, labor claims, and government tax claims.

* Publicity (Registration): the legal process that makes public the ranking of priority of the security interest -- must permit a potential lender to establish a ranking of priority in collateral by filing a notice of the security interest in a publicly available archive (registry), and must also permit a potential lender to easily search the archive to determine quickly and inexpensively whether other claims exist against a borrower's property.

* Enforcement: the process by which, upon the debtor's default, the creditor will seize collateral or evict tenants from real estate serving as collateral, and sell the collateral to satisfy the secured claim -- must take place quickly relative to the economic life of the property, and cost little relative to the value of the transaction secured with such property.

The legal frameworks for secured transactions in most developing countries do not pass these key economic tests.[5]

D. Creation: Problems

Several problems arise in creating security interests in developing countries. These features increase risk, raise transactions costs, and reduce the value of property as collateral:

Unreformed countries usually have a fragmented system for creating security interests -- several different laws govern secured transactions. In Civil Code countries[6], typically the law(s) on pledge will govern creation of the pledge (security interests in movable property), a mortgage law will govern the creation of the mortgage (security interests in titled real estate). Nearly all Civil Code and Common law countries will have a law on mortgage. Civil Code countries often also have a law on pledge for property that remains in the hands of the creditor (the "possessory" pledge used, for example, by a pawnshop or a warehouse), a law on pledge for property that remains in the hands of the borrower (the non-possessory pledge). They may further divide pledges into those that apply to commercial entities, and set out in the Commercial Code (the Commercial Pledge) and those applying to non-commercial entities and set out in the Civil Code (the Civil Pledge). Other laws may apply to particular commodities or goods: examples include ships, airplanes, fishing boats, cattle, or industrial property. Common Law developing countries (all former British colonies) will typically have the company Charge, from the different versions of the British Companies Act, applying to security interests in the property of corporations.

They will normally have a version of a Hire Purchase Act, a device similar to a financial lease or a conditional sale.

Gaps in coverage. Taken together, these laws might superficially indicate that much property might serve as an object of security. However, the opposite is true. Gaps in coverage of transactors and transactions limit using secured transactions in rural credit. (See Box [7,8]). Nor can more laws "fill" these gaps. Just logical prevents naming all numbers between 1 and 2, so logic prevents fragmented laws, each listing only a set of transactions and property, from covering cover all possible transactions and all property that can serve as collateral for loans.

Box 2. Gaps in Coverage

Under the Nicaraguan commercial pledge, movable property cannot secure a loan unless the property is being purchased on credit. This effectively rules out third party financing or the refinancing of equipment already owned.

Mexican law often limits who can use a certain security device. An equipment dealer in Puebla could not use financial leasing to sell equipment on credit. Mexican law permits leasing only by authorized leasing companies. In 1999 in India, the company charge was the only floating non-possessory security interest. A "company", however, refers only to a corporation, not to individual or non-corporate borrowers. At a single stroke, Indian law deprives all small farmers, businesses, and microenterprises of the ability to use their equipment and inventory of movable property as collateral for loans

Limits to Inventory Financing. Moreover, many laws on secured transactions laws, such as pledge laws, restrict the use of general descriptions of collateral (see Box 3).[9] Sometimes this will not matter, as when a lender does want such a detailed description of the collateral - for example, a rare painting or a prize breeding bull. But sometimes a lender will want a general or generic description of the collateral (for example, "100 head of cattle", "all inventory in a store", "all crops in a field"). When the law demands specific descriptions, it can make collection more difficult. Sometimes specific descriptions present more difficulties for the lenders and supervisors if the borrower defaults. Counting 100 head of cattle is easier than inspecting the tattoos on each cow; counting twenty refrigerators on the floor of the store is easier than checking the serial numbers on every refrigerator. Seizing "any inventory" available is easier than identifying specific pieces of inventory. In rural finance, requirements for specific description can cripple transactions. Even when the law permits using the future crop as collateral for loans, for example, most farmers cannot state, in advance, how much they will harvest or exactly describe future crop quality[10] Whether the law effectively permits a general description requires careful checking. Sometimes the law itself will permit a general description needed for inventory collateral. However, this concept is then not present in the other laws that govern registration and enforcement (see box).[11]

Box 3. Other Restrictions on General Description:

In Argentina and Guatemala, the registry law requires a specific description for filing the security interest. In Indonesia, the law requires that the judge state specifically what the lender will seize in a collateral recovery action. Therefore, the provision of the pledge law concerning "general description" cannot be used. These restrictions on general descriptions limit the use of floating security interests for financing inventory, future crop, and securitizing portfolios. They make it impossible to draft security agreements secured by the inventory of a store AND by its accounts receivables. They limit account receivable financing to fund microlenders. These limits have no obvious justification in public policy.

Weak Continuation of the Security Interest. The legal provisions for creation also determine the strength of the security interest and the ease of its enforcement -- crucial issues for creditors. For example, if the debtor sells a crop given as collateral, will the law provide that the security interest continue in proceeds in whatever form those proceeds take? Would those proceeds include those derived from future accounts receivable contracts on the sale of such crop? Does the creditor also get a claim in subsequent dispositions? Suppose the contracts are further assigned. For example, suppose the debtor sells the crop to another purchaser and then buys a tractor with the funds. Does the creditor's security interest automatically continue in the tractor as proceeds of the crop offered originally as collateral? Or must the debtor return to court for a court lien? Moreover, if the debtor returns to court, will the court lien have the same priority as the first security interest? Suppose a bank files a lien on all of the debtor's property. Will the original creditor still collect against the tractor with the original ranking of priority the creditor had in the crop? Unreformed law typically specifies none of these principles and makes no provision for the continuation of the security interests in proceeds of collateral.[12] These rights are crucial practical considerations for prospective lenders and credit sellers.

Best Practice Reform:

A well-drafted system for creating security interests lies at the heart of an effective law. The best reforms integrate all functionally identical security devices (leasing, trust, pledges, mortgages, hire purchase, and assignment of rights) into one comprehensive legal framework and filing registry system. This broader concept - a functional approach -- organizes security interests along the lines of what actually serves as an instrument of security. That permits including broad coverage of all property, transactions and lenders. The law should not restrict descriptions of collateral. To permit and facilitate inventory financing, the law should permit parties to choose a security interest against "generally described" collateral and not require that the security agreement, or later, the court order for seizure, specifically identify the collateral. The law should permit continuation in proceeds and set out clear rules for tracing proceeds; these should supercede old narrow constructs of "fruits and products".[13]

E. Priority: Problems

Priority plays a key role in a secured transactions system: it establishes the order in which the enforcement procedure will satisfy claims against the property serving as collateral. The creditor with the first priority will have its claim satisfied, on sale of the collateral, before a creditor with second priority. Unsecured systems have no system of priority.

For lenders, establishing their priority against the collateral is crucial: even valuable property cannot serve as collateral if a lender cannot determine the value of other claims secured by that property that have a higher priority than the claim that the lender contemplates. For example, a future wheat crop with a minimum value of $10,000 may be excellent collateral for a $6000 loan if no prior claims exist. However, the same crop will be less adequate collateral for a smaller $5000 loan if a prior claim for $7,000 exists.

Priority problems attack the heart of a legal system for secured transaction because they present insurmountable difficulties in determining the value of the property as collateral. Where conflicts of priority exist, secured financing will not take place at all.[14]

The law specifies how priority is established. Two basic systems have evolved: one establishes priority by possession, used only for movable property; the other establishes priority

by publicity or registration, used for both movable property and real estate.[15] Most unreformed legal frameworks for taking collateral do not establish this priority structure in a clear and logical way. Rather, they set out ineffective systems or present unresolved inconsistencies. For example, the law may not state that the time of registration sets the time of priority, but rather use another less verifiable standard, such as date of creation. The law may be ambiguous about what priority system applies to what goods, permitting different pledge laws to apply to different products with no clear distinctions between these products.[16] The result? Searching the registry filing mandated in the law on pledge or the Company Registry, a creditor would still not learn about other major senior rights against collateral. A registry reform alone cannot solve this problem.

Best Practice Reform

Technical excellence in a registry system cannot compensate for inconsistent logic in priority rules. To assure a uniform ranking of priority and eliminate the risk of hidden creditors, priority rules should appear in one law and apply to any and all other interests in property, regardless of their form, entered into for purposes of security. Such a priority structure would cover all present types of security interests, including financial leases, consignments, and sales with retention of title, among others. It would also cover any future hybrid secured transactions that business and finance operators in the reforming country might develop in the future. This framework would not replace the existing special instruments. However, it would operate above them and impose a common system of priority. This would minimize the risk of hidden creditors that could be granted priority rights under a separate law.

F. Publicity (Registries): Problems

If the law follows the best practice system of setting priority by making a public filing, that first-to-file publicity system requires that the law designate the place in which to file the security interest. How well that system works determines, as a practical matter, whether the lender can discover prior security interests or claims against the property in question, as well as ascertain its own ranking of priority versus that of other creditors.

a) Registry versus notice filing archive

Within a framework of making public a security interest, however, sharp differences exist between an approach that uses a registry of the entire security agreement with a broad government guarantee and one that uses a notice filing archive. In a registration system, a lender registers the entire security agreement or a lengthy abstract of it. Typically, registry staff also undertakes some check of legal correctness of the security agreement. In system of notice filing, the lender files only a "notice" of the existence of the security interest. The notice filing archive takes responsibility only for correctly entering the information provided by the lender in the notice and for maintaining the database and public access to it.

A registration system costs more: the costs of filing the entire agreement are greater and are not standard; checking is complex and time consuming. At the same time, the state guarantee has little value because the state does not guarantee against error. Moreover, because so much information is filed, both filers and administrators have incentives to restrict public access. This defeats the purpose of the filing system: making public such data.

The much less costly,[17] notice-filing system requires only that creditors file a notice of the existence of the security agreement. This notice contains the smallest amount of information

necessary to permit third parties to learn that the creditor has created a security interest in certain property. Such a notice might include the names and domiciles of the parties, and a description of the collateral. Because the law requires simple and standardized information, simple databases can readily store it and make it public over the Web. Potential lenders can check existing security interests and other encumbrances on property by searching the filing system themselves.18

Best Practice Reform

A quick review of MDB and USAID project databases shows that registry reform projects pay little attention to the underlying legal requirements of what type of registry or notice system is in place. They make no mention of such substantive laws that need to be changed to accommodate less extensive registration requirements.

For example, most real estate registry reform projects presume that there is nothing wrong with a country's laws if they require that a copy of the entire mortgage deed be filed in the registry. They then proceed to support a real estate registry that will file these entire security agreements.19 Differences in costs and sustainability are enormous: the Internet based Romania notice filing archive supported by the World Bank cost under $500 thousand. Using rented servers and web-based programs, its monthly operating costs are about $150, a cost easily sustainable by its private NGO operators. A real estate registry that files and verifies entire documents could cost millions. Private operators cannot sustain such costs. Indeed, even for the governments themselves, once donor funding ends, these systems typically collapse again in endless backlog and out-of-date computer equipment. The real estate registry of Santa Cruz, Bolivia presents a clear example of these problems.

Box 4. Backward Systems: State-operated Paper-based Systems

Donor funded projects in Indonesia and Vietnam actually introduced state-operated paper-based systems for their secured transactions filing archives. It is difficult to imagine what possible excuse could justify such backward systems in such large countries when Internet-based systems are available.

b) Private versus public operation

Box 5. Registries: Private or Public Operation

Across the world, filing systems operate in very different ways. In most of the United States, state governments operate the filing systems. They file notices and often authorize private persons, such as attorneys and banks, to file notices on their own. In some Canadian territories, provincial registries subcontract essential activities in building up and operating filing systems to private companies. In Argentina, the government licenses private persons to operate the pledge filing system; the state gives these people exclusive rights to certain territories, but also regulates them. In Romania, the new Law on Security Interest grants the right to administer the filing system to a Consortium of private persons that compete among themselves. In Colombia, chambers of commerce, sanctioned by the government but run by their business-operator members, operate the filing systems for businesses and for the commercial pledge.

In Ecuador, Jamaica, Peru, Bolivia, or Romania (pre-reform), as one approaches a registry street address, finding the entrance is easy: just follow the long line of people outside on the sidewalk. These lines are the unsurprising consequences of government-run monopolistic registries. Even where filing fees could cover operations, public officials face constant temptation to divert these funds to other purposes and leave the registry starved for funds. They face strong political pressure to hire politically connected staff; equipment budgets suffer. A consortium of private operators can run filing archives. Where private operators

compete, or represent broad based interest groups, such archives can run very well (see Box).[20]

Best Practice Reform

Based on economic logic and experience, we would expect better performance from private competitive supply than from state owned monopolist supply; we would expect competitive state supply and private monopolistic supply to providing service somewhere in between. Changing a monopolistic state-run system to a competitive registry service requires changing the substantive registry law and drafting extensive regulations. Training, computer software, and equipment for these registries - familiar donor nostrums -- will not improve this poor service.[21] . A brief review of registry projects underway at major MDBs and donors reveals no substantial change in this economically inefficient approach to these registry institutions.

Box 6. The Low Costs of Notice Filing in Internet-based Archives

CEAL's Romanian filing archive, designed for a World Bank project, is operated by a consortium of commercially oriented NGOs. They compete for filings, avoiding monopolistic constraints even while it provides a single filing archive supervised by the government. Because the planning of the archive was integrated early into the legal drafting, the most modern systems techniques could be used under the law. The entire project – including diagnostic paper, law, filing registry archive, and training – was complete for under $700,000. This is 30%-50% of the cost of similar donor supported program. Operating costs for the entire system are under $200/per month, making the system readily sustainable for the team of NGOs operating it. Privatizing the archive bypassed the extensive problems in the state-run registry system. Having competitive private operators operating under indirect government supervision gave Romanians access to competitive prices and service. This privatization approach avoided the private monopolies and poor and expensive service on many poorly designed privatizations of government services.

c) Filing Security Interests and other Interests in Land

The most advanced laws on secured transactions could provide for filing in the notice filing archive notices of both security interests and notices for any other interests in land, including land-use rights and real estate fee-simple title. That expanded filing archive would encompass an "archive of security interests and rights in property." Such an approach circumvents delays arising from slow, expensive, and politically contentious land titling and real estate property registration systems. Rather, it would provide a quick filing system for security interests and other interests in real estate.[22]This strategy, which permits accepting a broad range of land rights as collateral, will accelerate the development of land rights as collateral with commensurate social gain. Titling projects can continue focusing on granting titles while other land rights can be filed where the government prefers. Possessors of such rights will file a notice of such a land right in the security interest filing archive. That will perfect the land use right, including the title, vis-a-vis all subsequent security interests or interests of other subsequent claimants.

G. Enforcement: Problems

Can the creditor, in the event of default by the debtor, repossess or evict and then sell the property that the debtor gave as collateral? Any rational lender or credit seller will focus on the value of collateral after the costs of sale and seizure, not its nominal market value. Lenders who face slow and expensive enforcement will simply adjust downward the size of the loan relative to the value of collateral realized after the costs of sale and seizure, not its market value before these actions are taken.

Box 7. The Economic Impact of Swift Enforcement

In the United States and Canada, a borrower or credit buyer could reasonably expect to finance 80%-95% of the value of a car, machinery, or real estate. In such a system, the lender or credit seller expects enforcement of the loan at a cost ranging between 1% and 5% of the value of collateral, and in a period of time ranging between five days to two months. Such a lender expects to have the full value of the loan covered by the collateral at the end of the enforcement process.

Few lenders or credit sellers in developing countries, with the exception of sellers of cars, and some goods crops produced in monopolistic or monopsonistic contexts, such as sugar in Central America, fertilizer dealers in Bangladesh, or dairy dealers in Uruguay, believed such a condition was met. Rather, they believed that costs of enforcement would absorb up to half the value of the collateral. They believed that collection would take a long time, during which the collateral would deteriorate and that interest would not accumulate during the enforcement period. As a result, the loan plus accumulated interest would greatly exceed the value of the collateral.

For movable property, such as crops and account receivables, the problem of rapid enforcement can be crucial. Movable property typically depreciates more rapidly than real estate: a period of collection and sale of one to three years makes most movable property useless as collateral. Inventories of bread, fruit or vegetables last a few days; dry pasta and accounts receivable might last 30 to 60 days. Even storable agricultural commodities will depreciate rapidly without proper care. But proper care may be a difficult task under court supervision and unrealistic to expect of the defaulting debtor. For other equipment, one to three years may represent a substantial fraction of its economic life -- a computer loses about one-half of its street value in three years. Only rarely can movable collateral withstand one to three years of collection time and emerge at the end of the process with enough value to make a difference to a lender.

Enforcement has two steps: repossession (for movable property) or eviction (for real estate), and sale.

1. Limits to repossession of movable property

Laws in unreformed countries typically require court permission for repossession of collateral. Some poorly drafted reforms appear to give broad leeway to private parties, permitting voluntary agreement an inexpensive means of repossessing collateral.[23] Such laws might state that only if such a private agreement does not exist will the slower traditional rules for repossession apply, rules that require repossession according to the decision of the court, arbitration court or action of a notary. However, often such voluntary rapid repossession agreements only apply when the debtor and creditor both agree at the time of enforcement. Lenders will consider such a possibility of trivial importance. Lenders don't worry about debtors who voluntarily surrender their collateral. Lenders worry about debtors who refuse to surrender their collateral. Under most unreformed laws, should the debtor dispute collection, repossession would require a full and lengthy judicial process. Why? Because unreformed laws do not grant creditors a right of self-help repossession; do not permit speedy use of state-controlled force; and require numerous steps in taking possession of collateral.

2. Limits to eviction from real estate

Repossessing real estate collateral involves evicting the occupants, who upon default become automatically tenants, typically non-paying. Evicting the occupants of real estate taken as collateral usually requires several lengthy and expensive steps.[24]

3. Limits to the Sale of Collateral

Once the collateral is repossessed, it must be sold. Most unreformed laws provide for a complex sale procedure. This might include an appraisal of the property, a court administered auction, a provision for revaluation of the property if it fails to sell at the appraised value. Each of these steps costs money, requires additional trips to court for each step, and takes time.[25]

Box 8. Time for Repossession

In El Salvador, lawsuits to repossess and sell collateral take anywhere from one to ten years. Lenders take movable property as collateral only from borrowers that own real estate or are otherwise demonstrably wealthy.

Each day for a year, an Uruguayan bank lawyer drove past a piece of her bank's leased equipment, sitting abandoned in an open field, slowly turning to rust. The debtor had fled to Brazil. However, the court required a year to rule that the debtor had disappeared and issue a court order for seizure and sale.

In Peru, lawyers interviewed reported no eviction process faster than one year under the mortgage law. Recently enacted trust laws left the crucial eviction process unreformed in the procedural codes. Now, even under the recently-enacted trust law, lawyers estimated a minimum of 8 months to evict a debtor.

4. Legal strategy in enforcement

The key legal elements for improving enforcement in secured rural credit lies in laws that permit non-judicial repossession (when possible without disturbing the peace[26]). They specify rapid "ex-parte" court orders for forcible repossession. They have in place private and public agents who can carry out those orders. They provide procedures for accelerated evictions from real estate. These court-administered methods should retain only those key steps required by most constitutions to use force for breaking and entering. Provisions for sale of collateral, crucially, should permit creditor-administered sales conducted under commercially reasonable standards.[27] These features could be part of a special law of security interests. Such a comprehensive statute will assure close consistency among the four stages: creation, priority, publicity and enforcement.

III. Regulation of Rural Financial Institutions

This section briefly discusses some regulatory issues concerning rural financial institutions. As a technical matter, laws authorize regulations and are superior to regulations. A law could modify a regulation but a regulation could not modify a law. Broadly speaking, this paper takes the view that the major problems affecting rural finance arise from laws, not from regulations.[28] In general, CEAL's own field investigations have indicated that regulations tend to follow laws fairly closely, as they should, and that regulators do not have much leeway to change things without a change in the law. Here we raise some points related to regulation, though in most cases even these issues are determined not by regulators but by the text of the banking law or the financial institutions law in the country.

1. Who should be regulated: "deposit-taking institutions" or "those engaged in financial activities"?

What institutions should be regulated? Two broad strategies have been followed in

deciding which institutions should be regulated. One strategy calls for regulating only deposit-taking institutions, on the grounds that banking panics arise when small and uninformed depositors place funds in unsound institutions. Another strategy calls for regulating all financial institutions on the grounds that any financial institution can contribute to systemic risk. Donors and MDBs have followed both strategies with no apparent consistency.

The equity and distribution case for protecting small depositors is strong. Small depositors are often in no position to judge the soundness of institutions and are often the victims of swindles.

However, regulating non-deposit-taking institutions seems questionable and highly costly in both supervision resources and limiting access to rural credit. It stretches credulity that the credit sales of a fertilizer dealer or a tractor dealer could present a systemic risk to the financial sector of the country. Occasionally a finance company might grow large enough to represent such a risk, but size requirements for regulation could easily handle that eventuality. Otherwise, the operators of the lending and crediting institutions are risking their own capital. If they lend unwisely and lose their money, what is the bad consequence for the financial system? Why is it worse for the financial system than if they went out of business for some other reason? Regulating lenders and credit sellers who do not require regulation limits the growth of such transactions. Why should developing central banks and bank supervisors, already struggling to do their jobs, undertake the preposterous step of bringing fertilizer dealers under their regulation. Non-bank institutions represent 60 percent of US credit; in developing countries such institutions represent no more than 5 percent.

2. Who should regulate deposit-taking non-banks?

For deposit-taking banks, a huge international infrastructure dictates that deposit taking institutions be supervised by a superintendent of banks and that national banking regulations comply, in broad terms, with Bank for International Settlements (Basle) rules.

However, non-bank deposit-taking institutions operate in something of a vacuum. In some countries the Superintendent of Banks nominally regulates them, but rarely do they supervise such institutions effectively. Solidarity group lenders and credit cooperatives have different internal microeconomic logic from banks and need regulation suited to those environments. Supervising and regulating such institutions is as complicated as supervising and regulating banks. However, since such institutions have smaller economic presence in the country, the net result is often not to regulate them. Rather, regulation impedes their development by forcing them to remain in defiance of a lawful system because the lawful system is not well defined.

One possible exit from this problem could lie in using internationally recognized NGOs as the supervisory agency. Clearly this requires some institution building, but why couldn't an organization like WOCCU develop supervisory capability and contract with foreign Central Banks to supervise credit unions? Indeed, credit unions could contract privately with WOCCU for such services. Similar arrangements could be developed for the supervision and regulation of other types of microcredit agencies. This would represent an enormous global economy of resources, bringing first-rate supervision and regulation to countries that could not otherwise afford it.

IV. Contract Enforcement

Well-developed legal systems have several ways to enforce contracts. The earlier section on secured transactions discussed one system -- enforcement of a loan contract secured by collateral. This procedure permits fast repossession and sale because an underlying voluntary agreement exists between parties to use these procedures. Other systems of contract enforcement must operate when no prior agreement exists for using property to guarantee contracts.

A. Enforcing Secured Contracts

Secured contract enforcement follows the steps laid out in the framework for secured lending. Many obligations or contracts may be secured, not just a loan. These could include obligations such as future sale of crop or the timely delivery of shipments, or the performance of a service. Parties cannot use secured enforcement when a poorly drafted law on secured transactions limits the obligations (transactions) that may be secured. A well-drafted secured transactions law has a scope of application that encompasses all transactions, lenders, borrowers, and assets.

B. Enforcing Unsecured Contracts and Non-consensual Claims

Many contracts, however, are not secured with property. What procedures can an injured party follow to enforce such a contract? Or a claim that does not arise from an agreement at all? .

A further distinction matters for contract enforcement and claim resolution. Consensual claims rest on a voluntary agreement. That agreement can provide for arbitration and other alternative dispute resolution systems. This, in turn, permits bypassing problematic judicial systems. Reform should then focus on arbitration and these other systems. However, when no agreement exists, the claim is non-consensual. Suppose you run over my sheep with your truck. Parties to such disputes cannot be forced to use alternative arbitration mechanisms. Reform efforts must focus on the court system.

1. Enforcing Unsecured Contracts

Disputes involving parties to a contract could specify within the contract that disputes be settled outside the court, possibly by arbitration. For example, if a farmer purchases a patented plant and then replicates it, the manufacturer's claim, under intellectual property law, could arise from the licensor-licensee agreement that was part of the sale agreement. Such a license agreement could provide for alternative dispute resolution, such as arbitration.

Arbitration and other Alternative Dispute Resolution Mechanisms. Many donors support the sound strategy of establishing arbitration systems as a partial solution to inefficient courts. However, these efforts often proceed without a full analysis of the laws that limited to the use of arbitration in the first place. For example, sometimes the Code of Civil Procedure permits the loser to appeal an arbitral award before the judicial courts. Potential winning parties, knowing that appeal means an additional long judicial enforcement process, avoid arbitration and go directly to litigation. Not surprisingly, many arbitration centers and training programs, often established at great donor expense, have few cases (e.g., El Salvador). Inadequate basic legal and economic research meant that a basically sound reform had little economic impact on investment and growth in the country. Businesses continue to complain about the lack of a system for dispute resolution.

2. Enforcing Non-consensual Claims

However, suppose that instead of being party to a licensing agreement, the farmer replicated the plant from stolen material. Then no underlying agreement would exist between the farmer and the manufacturer. Rather, the manufacturer's claim will relate to an infringement of an intellectual property right by a third party. Since the farmer and the manufacturer have no agreement, no opportunity exists for applying alternative dispute resolution mechanisms. Non-consensual claims will always require resolution in the courts. Parties could agree to arbitration once the case is filed. However, the party with the weakest case may have the strongest incentive in leaving the matters in the slower court system rather than in agreeing to a more expeditious arbitration process. Parties rarely institute arbitration that state. Rather, the court system applies to most non-consensual disputes.

Judicial Reform

A complete discussion of reform of the court system lies well beyond the scope of this paper. However, several important aspects of court reform emerge from the extensive literature on the subject and from the points raised elsewhere in this paper.

Courts in developing countries have a lot more work than in industrial countries. As an Argentine judge discussed in the introduction of a recently published book, judicial systems are overwhelmed with cases because the underlying legal system makes many standard administrative activities go through the court system.[29] In Latin America, for example, collecting secured loans requires many judicial steps. So does settling an inheritance with an uncontested will. However, the law could assign these uncontroversial activities to the private sector, sparing the scarce resources of the government and reducing governance problems. The judicial system should focus its scarce resources on those activities where the private sector cannot satisfy the public interest.

Judicial systems in developing countries must often follow old procedural laws. None have received economic analysis and most appear to have no economic logic. For example, many Civil Code jurisdictions set out faster track procedures in the code for small claims. However, they indirectly refer back to the more expansive rules of larger trial processes to provide evidence. This undercuts most of the purpose of small claims court by imposing large costs in time and money for evidence gathering.

Best Practice Reform

Traditional judicial reform projects are long on training and computerization and short on changing the laws that produce inefficiency in the first place. For arbitration, the law must permit binding arbitration, competing arbitrators, and insulation from the court system. For judicial reform, a good reform should change all legal provisions in existing laws that directly or indirectly call for unnecessary judicial resolution. Particular focus should be placed on judicial resolution that appear to have no ground in public policy or economic benefit -- such as successory proceedings, and judicial sales of property. Furthermore, a reform should revise the code civil procedure laws that raise the costs of litigation. Often neglected aspects of judicial reform can assure minimalist and well-designed interventions with excellent results: examples include small claims courts, private prosecution, class action law suits, and streamlined procedures for dismissing non-performing judges from their positions.

V. Entry/Exit of Institutions from Financial Markets

A healthy rural financial sector has many institutions providing financial services besides banks. Most developing countries have non-bank credit amounting to no more than five percent of total credit. In the United States, non-bank credit amounts to sixty percent of total credit. Given that US credit relative to GDP is about ten times greater than is that of most developing countries, non-bank credit is an astonishing 120 times greater relative to GDP in the United States than in most developing countries. Understanding how these institutions operate is central to understanding the dynamic of modern rural credit. And understanding how these institutions operate is inextricably linked to the laws that govern them.

Several different legal frameworks affect the entry and exit of such institutions from financial markets. These laws and regulations affect such financial institutions directly, insofar as they affect licensing of financial institutions and shutting them down. However, they exert a larger effect on the chain of rural credit. They affect the entry and exit of non-bank financial intermediaries, such as dealers and producer cooperatives. Finally, they affect the ability of both bank and non-bank financial intermediaries to lend to rural producers and to collect debts from them once they have lent.

A. Regulated Financial Institutions

For regulated financial institutions, the regulator controls entry into the market. The regulator also forces exit, by determining the rules for writing off bad loans, for provisioning, and for recapitalizing. Ordinary business creation rules (see below) typically do not apply to them. Nor do the ordinary rules that govern the exit of insolvent institutions (see below).

B. Exit of banks and deposit-taking non-banks

Typically the rules of bankruptcy do not apply to deposit taking banks because the regulator declares the portfolio non-performing and shuts the bank down for capital inadequacy.

C. Legal Problems in Entry: Licensing, and Registration of Rural Businesses

In some developing countries more than half the total businesses operate informally. "Informal" means that these businesses do not follow the legal requirements set out by the law for registering a business. Why? First, the law often sets out unreasonable, difficult and expensive requirements. They reach well beyond the public policy and business development justifications for commercial registration. Inform firms find those legal requirements expensive and see their effect mainly in increasing their chances of being taxed. At the same time, because of other problems in the legal framework, registration does not change their access to credit. Without expanded access to credit, becoming formal rarely enables small firms to get large contracts to deal with other formal sector firms. Faced with those high expected costs and low expected benefits, most rural micro businesses and even SMEs operate informally. Farmers may face greater hurdles, as some laws classify them as non-commercial entities that cannot operate as businesses at all.

1. The Commercial Registry

A simple economic objective underlies commercial or business registration: a business should establish a certain domicile with the public so that the business can be found "legally" for purposes of contract enforcement or in case it causes damages, such as not paying its taxes, owing penalty fees for improper waste management, or owing a tort claim. It also provides a

place for designating officials with the power to obligate the firm, facilitating business transactions. Almost every legal system provides for some form of business registration.

However, laws in most developing countries go far beyond these basic public policy objectives. For example, in El Salvador, among other requirements, the law asks for annual audited tax returns; corporate documents signed in a notary public deed; paper filings in person in the registry; and certificates related to the business real estate establishment, to name a few. In addition, the commercial registry office in most developing countries is in complete disarray. Long lines, bad service, errors and fraud are common complaints. As with the registration of security interest, which in many countries takes place at the same commercial registry, state and monopolistically run registries rarely serve the public well.

Box 9. Costa Rica: Privatizing a Business Registration System:

CEAL's design of a one-stop-shop for business registration for Costa Rica (Inter-American Development Bank project) calls for operation of an integrated business registration system electronically linked to existing government data bases and offices. A consortium of NGOs, including the chamber of commerce and chamber of industry will run this archive. Designing an organization where service venders compete is crucial in avoiding the problems of ordinary monopolistic privatizations of public services. Before the system is set up, the legal framework will be reviewed and changes proposed. Similar opportunities arise in organizing arbitration, processing bankruptcy, and filing security interests against land rights.

2. Other Licensing Requirements

In addition to registering to do business, farmers and merchants must also comply with numerous other legal requirements and licenses, each often imposed by a separate government agency. For example, in Costa Rica there no coordination exists among these agencies and the farmer or business must consecutively undertake each step repeating the documentation that it must submit. These add costs, in terms of time and money, to entering the formal business community.

Best Practice Reform

As in any registry reform, the first and most important step lies in thoroughly reviewing the commercial and other business laws that set the requirements for entering the formal sector for doing business in the country. Such a review should present a detailed analysis of the law's costs and expected benefits, including the public policy objectives they espouse.

Quick fixes rarely work (see box). Rather, the analysis should evaluate each legal requirement, the procedural steps it encompasses, and the options for minimizing the costs in both time and money to comply with them. For example, when the requirements are administered by six different agencies, the best intervention lies in designing a "one-stop-shop" for business registration that centralize all requirements at once. Such registration system can further permit private and competitive sustainable operation.

Box 10. Quick Fix: Exclude Small Business and Farmers

The best fix usually does not lie in a blanket exclusion of small businesses and farmers from environmental certification or other commercial law requirements, as it is incorrectly the case in El Salvador Commercial Code. Quite the contrary, the benefit to public health of many environmental regulations far outweighs their costs. Often, small businesses and farmers pose as great risk to the environment as large ones. For example, a farmer who dumped toxic material into the water and killed two families in Bolivia caused great damage even though a poor small farmer. Small businesses excluded from the commercial registry get none of the benefits of formalization.

D. Legal Problems in Exit: Bankruptcy Laws

Though sometimes grouped together under the rubric of "debtor-creditor" laws, bankruptcy and secured lending serve different economic purposes and social ends: Bankruptcy terminates debt collection. Bankruptcy replaces other penalty systems for defaulting debtors, including debtors' prison, slavery, dismemberment, transportation, and death. Secured lending, on the other hand, facilitates debt collection. It works by improving security and information. Borrowers can then more readily prove their creditworthiness. Lenders can make loans with less risk and collect them more easily.

1. The Gain from Bankruptcy Law

The original gain from bankruptcy arose from ending practices perceived as socially damaging. An imprisoned debtor not only produced nothing and required feeding. Originally, bankruptcy had no direct effect on the position of the secured lender: the secured lender's first recourse was to the collateral for the loan. Only if that collateral was insufficient did the bankruptcy system apply to the deficiency balance -- a debt balance exceeding that realized from the sale of the collateral. Several unreformed bankruptcy laws in Latin America will still reflect this economically efficient isolation of secured loans from bankruptcy, such as the Honduras Commercial Code.

2. Problems in Bankruptcy Laws

Some bankruptcy laws have given **priority to some unsecured claims over secured claims**. These laws permit using the proceeds from selling the collateral to satisfy unsecured claims before those of the secured lender. For example, bankruptcy laws in Argentina, Mexico and India give priority over the claims of the secured lender to the fees of bankruptcy lawyers, taxes, unpaid wages of workers, tort claims, subcontractors, and costs of the bankruptcy court.

Evaluating the social value of these provisions involves complex issues in productive efficiency and troubling issues of fairness about which reasonable people might reasonably disagree. Fortunately, it is possible to bypass most of these issues. Other methods exist for achieving these same ends that would not damage the framework for secured lending or reduce the benefits that it concurs. Debts to the state could be collected in the same framework as other secured loans if the state merely filed a lien in the debtor's property at the time that the debt to the state was created. Unpaid claims of workers could be protected by a floating lien equal to the unpaid claims. Tort claims could better be provided by requiring insurance by the firm in question. Subcontractors, like workers, could file liens when the debtor's obligation was created. Attorney's fees and the costs of bankruptcy would have priority only from the time of bankruptcy, thereby minimizing incurring social costs for dissolving firms with no net assets left.

Much of the impetus of bankruptcy reform arises from the donor-supported efforts to spread U.S. Chapter 11 business reorganization measures to developing countries. Do developing countries gain from introducing such procedures that aim at **judicially-administered methods of preserving the ongoing value of the firm**? Such procedures can damage the credit system, as they nearly must always require a stay in execution of the secured creditor's rights. Such a stay presents the risk that these rights will be diminished in the course of the reorganization proceedings.

This issue merits further investigation. Nonetheless, the evidence from developed countries indicates little social gain from a stay in execution of secured claims in the

reorganization of firms. Indeed, most studies have difficulty finding any gain from reorganization proceedings at all.[30]

VI. Land Rights, Land Titling, Cadasters, and Access to Credit

A legal system conducive to rural finance defines clear legal rights to the use of land -- particularly for the transfer and use as collateral of those land rights. These elements underlie an efficient market in land rights and using land rights as collateral for loans. Land titling and cadasters are neither necessary nor sufficient conditions for using land rights as collateral and improving access to credit. Success depends, rather, on clearly defined land rights and a system for secured transactions that can use those rights.

A. Land Rights and land titling

The laws of most countries set out many rights to land, including the right to fee simple ownership associated with titled land. However, the fee simple ownership of titled land is not the only possible interest in land, or the even, necessarily, the most important land right. There are rights of way, long term leases or usufructs, easements; land held by cooperatives, corporations and associations with long-term contracts for land-use rights; property conveyed with different state deeds conveying different rights; and, finally, future rights these land rights.

One land-use right is fee simple ownership. A titling system can give a state certification of that ownership right. Many countries use titling. However, most legal systems define different rights in property, including ownership, without necessarily referring to a title. For example, in Vanuatu, Papua New Guinea and Samoa, farmers can demonstrate that they "own" real estate without having a title. So can residents of Bolivia and New York.

The more land rights that the law covers, the more these rights can be traded and used as collateral for loans. Advanced economies have most of these types of ownership arrangements. For example, the United States is popularly seen as the heartland of "fee-simple" titled ownership - the type of property underlying the mortgage as an instrument. However, more than 25% of the land in the United States belongs to the federal government -- closer to 50% in the state of California, the third largest economy in the world. Farmers, miners, and businesses use this land under a wide variety of leases and use rights granted by agreements with the Federal government. Much of the land under Wall Street is owned by religious institutions that rent it to the commercial entities that occupy it. Large blocks of US land under the control of Native Americans are administered under traditional systems.

Land is leased all over the world. Much of the land in the city of London is owned by the British royal family, which, like South Pacific customary tribes, does not alienate its land; the entire city of Hong Kong was built on land leased from the government of China. The "owners" of rights to this land may not alienate because it is their policy; or they may not alienate because the terms under which they inherited or otherwise obtained the land prevent them from alienating it. Nonetheless, well-developed legal systems permit an active market in land rights and such land rights routinely serve as collateral.

Creating economic useful land rights require the same four key features in the law: the law must define and create land-use rights; it must set logical and clear priorities among the different land-use rights; it must provide a practical, effective and sustainable system for publicizing these land rights; finally it must set out a workable system for enforcing these rights.

B. Creation: Defining clear Interests in Land

Most legal systems permit a many different interests in land. Each interest requires careful definition. For example, a conveyance of a fee simple interest in a sales contract requires a law that clearly defines how to create the fee simple land-use and a description of what that fee simple land-use right encompasses. Donors often insist on systems that require transferring land without impediment - fee simple title. Such a Procrustean stance can create enormous political problems in systems where such ownership is politically objectionable. Prohibitions against alienation occur commonly in traditional cultures in Africa, Latin America and the South Pacific as well as in most transitional economies that stress long-term use rights and state-owned property or cooperative ownership. This rigid stance in support of fee-simple title also misses the opportunity to better define and concretize other land rights, paying particular attention to the terms of transferability, certainty, and use as collateral. Such refinement could improve the economic value of these land rights in ways more harmonious with the other social values of the residents.[31]

1. Lowering costs

In most developing countries, expensive legal requirements such as notary deeds block farmers from legally acquiring and transferring land rights or using them as collateral for loans. These high costs arise from laws that set up monopolistic and state supervised systems of notaries, lawyers and other public employees that, by law, intervene in the legal creation of land rights with innumerable procedures that have no clear public policy benefit.

Successory proceedings in developing countries, applicable to all transfers and whenever the registered owner dies, involve extremely costly judicial steps to transfer land. In Bolivia, much land already titled and registered with donor support under the agrarian reform comes back to the informal market at least every generation because farmers cannot bear the expense of following all the legal steps set out by the Bolivian Civil Code required for transferring the land by inheritance. Most land projects missed a key point of reform by completely avoiding reforming these laws. Donor-funded projects come in at astronomical prices (see box).

Box 11. Can Developing Countries Afford Property Rights?

The World Bank funded reform of the movable property laws and registries for all of Romania came in at under $700,000. The World Bank funded reform of immovable property registry for only the district of Bucharest, one of 41 districts, cost $26 million and reportedly remains incomplete. Pro-rated, that means a cost of more than $1 billion to formalize Romanian real estate, about 4% of Romanian GDP. Imagine someone proposing a $320 billion project for the United States. Movable property amounts to about 1/3 of the national capital stock; immovable property amounts to about 2/3 of the stock. Why the difference in costs? Poor project design that leaves obsolete laws unchanged. Can countries afford property rights at these rates?

2. State Cadaster System

A cadastral system is necessary neither for the operation of a mortgage market nor for establishing land-use rights, including fee simple ownership. Typically, a deed will make reference to the physical location of the land or the building and include a natural boundary description. It may be helpful to include the cadastral mapping identification number in the deed. Under most laws, however, the legally binding property description and location will be the natural description set out in the deed. That is, if someone claims your land, you defend against that claim with the natural description in the deed, not with the cadastral entry. This

requirement prevails for all the mortgages securitized in the United States today. If the cadastral boundary description in the cadaster conflicts with that in the deed, most laws, including all US states, provide that the natural boundary description in the deed will prevail.

A cadaster performs several useful purposes: zoning, tax collection, and land use planning. However, donors and policymakers must balance these features against their costs and the reality that most developing countries do not tax land.

C. Priority: Establishing a Clear Ranking Priority of Interests in Land

Without clear rules for ranking the priority of interests in real estate, no land market can function properly. Land may have great value as a productive asset, but that value cannot be realized if a purchaser cannot tell who has other rights to the property. It is common to hear of owners who must purchase the real estate twice because the owner has also sold the property to another person and the law does not provide for which purchase interest will prevail. Such legal muddiness creates great risk in land rights. While the importance of this may seem basic, most land reform projects assume that the priority rules in custom, the civil code or the land laws are clear. They assume that they all apply the known rule, "first in time, first in right", which assigns priority to the first to register in the real estate registry. However, most developing countries lack priority rules, provide for unclear priority rules, or have conflicting laws that defeat the land right priority. [32]

D. Publicizing Interests in Land, the Registry of Real Estate

A traditional land titling system puts a record of title in a state-operated registry. This "registered title" may have a strong government guarantee, as it does in New Zealand, Australia, and some Canadian provinces. Or it may have a weak government guarantee, as in most states of the United States. In those states, lenders typically require additional assurance of the quality of the title; they require that borrowers purchase title insurance. The fees for this registration are typically high. Moreover, although the land is permanently in the same place, it must be re-registered each time the owner changes. This, of course, includes each time an owner dies and bequeaths the land to another person.

The policy issue for developing countries arises in deciding how much additional security such a registration gives. In most countries, the law gives specific guidance about ownership and land rights. The registration procedure typically cannot be any stronger than the underlying law. Therefore, the fundamental point of intervention lies in laws that set out clear land rights. Many countries, therefore, have three institutions involved in establishing land rights: the law and the courts, the title-granting agency, and the registry. In most developing countries, none of these institutions work very well. Should developing countries invest, therefore, in registration systems?

A second and separate issue, however, arises in where lenders will file the security interest against the titled property. Most mortgage laws specify that the security interest be filed in the same registry as the title. This is a practice, not a logical necessity. However, many problems arise in depending on filing registries for the security interest function. First, in many countries, the titling registries don't work, work badly, or have no clear timetable for establishment. Second, obviously if only a mortgage can be filed against titled land, what security device applies to other land rights? Where do lenders file notices of those security interests? Finally, titling registries are typically local and not national. When financial centers

are distant from such areas, the costs of search rise and only local lenders will be able to check. That adversely affects rural finance: it makes it expensive for borrowers in major financial centers to use rural land located collateral and limits competition in financial services in distant areas.

The registry problems discussed above (III.F) for security interests will also apply to the registration of other interests in real estate. We set out here some public policy considerations specific to the issue of land rights.

Notice Filing

The economics of collateral do not require a registry for creating security interests against real estate; they require that people have a clear, unambiguous and publicly accessible system for establishing a ranking of priority in real estate. For this, notice of this right must appear in a place where parties can easily search and determine their priority. So, for example, in Washington DC, rights for fee simple real estate ownership are filed in the DC real estate registry; but rights to cooperative units are filed in the private books of the cooperative while public notice of security interests in those rights appears in the security interests filing archive; rights to use and occupy Federal land, which might be physically adjacent to the cooperative and fee simple property governed by other rights, are filed in different Federal registries. As discussed above in the secured transactions section, a better strategy would avoid the restrictions of title/registry systems and create a single national filing archive for notices of such interests in real estate.[33]

E. Enforcing Interests in Real Estate

Enforcing interests in real estate face the same problems in the eviction and sale of real estate discussed above for security interests. Non-consensual real estate disputes, such as trespassing damages, will face the same judicial court problems as other non-consensual claims. These were described in section IV.

F. How Land Rights can serve as Collateral

The elements of a financing system for land rights were set out earlier, where the main issues in creation, priority, publicity and enforcement of security interests were discussed for both movable property and real estate. This section concerns the strategic issue of whether reform should depend on a mortgage and trust law versus a broader security interest law in which a broader array of land rights could serve collateral. The difference could not be more stark. Most residents in developing countries cannot use co-tenancies, leased, or cooperatively owned land as collateral, even when titled.

Box 12. Land Titling is not Enough

In Peru, improvements in land titling were not accompanied by a reform of the mortgage law. A recent study found that though titled land offered substantial benefits, it did not improve access to credit by using land as collateral. Land, as collateral, requires a functioning system of secured transactions.

In addition to the secured transactions problems mentioned above, the security interest laws in developing countries do not include all possible land rights as collateral. In Peru, for example, an usufruct of land, a long term lease, cannot be the object of security.

By contrast, owners of land rights in industrial countries can readily use them as collateral for a loan even though the interest in land they have is not a "titled" fee simple. Owners of shares in cooperative housing units such as the Watergate apartment complex transfer them and get external financing for purchases of valuable and elegant housing. At the same time, much donor effort is expended in stamping out exactly the same co-ownership and co-tenancy land rights in transitional and traditional economies on the grounds of their "unworkability".

Nonetheless, banks and lenders readily finance building and construction on this land and investments inside these buildings. The key lies in flexible and complete secured transaction laws that readily permit a broad array of interests in land to serve as collateral for loans. Most unreformed jurisdictions, however, only provide for restricted mortgage and trust laws that narrow the possible collateral to only presently titled fee simple land.

Box 13. Land as Collateral in A System Based on the Mortgage or Trust Law

Many donors support reforming some version of a trust or mortgage law, often based on American practice. Under unreformed civil code and common law practices, the instrument of the mortgage or the trust, requires title to the land. These security instruments are filed in the same registry that registers title to the land, and their priority is determined by the time of filing in that registry. Therefore, property that is not titled cannot possibly serve as collateral under these laws, as the lender would have no physical place under law to file and obtain priority.

This is not a major problem in countries such as the United States. The United States has a well-developed framework or secured transactions and well-developed non-titled land rights. The latter legal framework permits financing by taking as collateral land rights other than titled land, such as leases and cooperative shares. However, in developing countries where much land is not titled, choosing a title/mortgage or trust system will provide no additional access to credit. Despite this, donors press ahead with mortgage and trust laws in countries like Egypt and Ukraine where more than 90% of the land is not titled and could not, under a mortgage or trust law, serve as collateral.

VII. Intellectual Property Rights

Over the past ten years, intellectual property rights have become increasingly important both in total value and for rural development, as the use of biotechnology protected by these rights can increase production and reduce poverty. This paper cannot fully address his vast field. This section, however, lists some of the key legal issues that bear importantly on rural development[34.]

A. Why Should Developing Countries Support the Framework for Intellectual Property in their Rural Development Strategies?

Modern genetic modification of plants could, potentially, dramatically change rural production possibilities for developing countries. Improvements include not only traditional higher yields, but better drought resistance, and insect and disease resistance that will reduce the need for pesticides fungicides, while enhanced resistance of crop plants to common herbicides will reduce cultivation needs. Functioning intellectual property (IP) laws can bring some benefits directly to rural areas in developing countries by permitting protection of their own research in crops and native plants and fauna. Possibly as a result of weak laws, only 10% of biotech research in developing countries is private, compared to 50% in industrial countries.[35] Even public research institutions might usefully protect their IP rights, both as an income source and as bargaining chip with private companies.[36]

Some have questioned whether the "balance of trade" in IP rights justifies a large effort in developing countries. Some ask whether developing countries might not be better off not honoring the IP claims of industrial countries and foregoing their own.

Whatever the merits of this strategy, it may not be feasible. Sanctions for non-compliance grow and the withholding of the advantages of modern products of intellectual property, such as genetically managed crops, become increasingly costly. Indeed, as part of the biotechnology revolution, developers can now better protect their property rights (for example, by producing plants with sterile seeds or seeds that can only germinate with a chemical whose formula only the developer knows):

The Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement sets the schedule under which developing countries must bring their IP systems into conformity with TRIPS. Under that schedule, middle-income developing countries come into compliance by 2000, while low-income developing countries have until 2006. After these dates, non-compliant countries are subject to general trade sanctions.

However, non-conforming developing countries already face private sanctions. These can mean exclusion from segmentation agreements. For example, donors made hundreds of agricultural journals available free on CD-ROM to India and Pakistan, but denied them to China because they believed China could not enforce the use agreement.[37] Sanctions can also mean bans on exports of seed and plants and reductions in foreign direct investment in developing countries whose governments cannot enforce IP rights.

B. Problems in Intellectual Property Law

Several key problems still lie at the core of intellectual property law. First, the international standards for an acceptable law remain vague. The TRIPS agreement provided only broad guidelines for a variety if IP rights including patents, copyrights, trademarks, and geographic names. That leaves to developing country governments many issues whose economic aspects have not been well investigated. For example, should the length of the protection match developed country practices? Should practices vary with different crops? What are the appropriate complementary biosafety laws?

C. Other Laws and Institutions that Affect Intellectual Property Rights

The intellectual property rights law of a country is not the only one that sets rights and obligations relating to patent and trademark rights in a country. Many other laws have some bearing on the scope of these rights and on their enforcement. For example, compulsory licenses in some countries limit the competing sales of foreign firms.

1. Patent and Trademark Office

Implementing an IP law requires a working patent and trademark office. In most countries, the patent and trademark office is part of the commercial registry. Most registry laws in developing countries provide an obsolete registry framework. Most commercial registries offer a cumbersome system for registration and retrieval of patent and trademarks. The legal issues involve:

- **Regulations for the patent and trademark office**. These regulations often establish a state monopoly registry service. What are the options for introducing privately and competitively run registries?

- Can the developing country **share databases** for patent registration with an advanced country.[38]
- Do the general administrative law and regulations applicable to patent and trademark office produce proper **incentives for good governance**?

2. Enforcement of IP Law

Poor enforcement of intellectual property law hampers developing a functional intellectual property rights framework. Poor enforcement arises from problems in alternative dispute resolution mechanisms, court systems and the use of police. Because IP legislation in developing countries does not reform the enforcement laws, enforcement is often left to the general contract, procedural, and judicial laws of the country. China, for example, has a model IP rights law but its enforcement is regarded as weak[39] Within the general contract, procedural and judicial framework; the enforcement of IP rights does not effectively resolve either contractual or non-consensual disputes. Private vendors understand when a country cannot enforce an IP law, no matter how nice the provisions of the IP law.

Enforcement problems in developing countries were discussed earlier in the context of security interests, land rights, and contract enforcement. The same issues arise in dispute resolution in intellectual property rights.

A key issue requiring further study, however, is whether the IP law itself should specify an alternative dispute resolution system that can bypass the courts.[40]

D. Other Legal Issues Affecting the Business Aspects of Biotechnology Firms in Developing Countries

Does local law sanction modern legal forms for access to proprietary technologies? For example, joint venture, secrecy agreements, licensing, purchase, and material transfer agreements? Most developing countries have had little experience with these agreements and little existing analysis aims at identifying the best models for them.[41]

Moreover, some issues in the general business legal environment directly affect biotechnology. Anti-trust laws and their enforcement require careful attention in developing countries -- commercial codes often limit competition at the same time that they provide no workable means for controlling foreign firms. For example, the commercial codes of El Salvador and Nicaragua limit competition by limiting freedom of contract in distributorship agreements and opening foreign-owned business. The public policy issues in these restrictions require analysis. Subsequently, these restrictions should be redrafted or removed. Firms in industrial countries can often undertake anticompetitive activities in developing country markets that are prohibited by industrial country laws in their home markets. Developing countries need a manageable legal framework for attacking these problems.

Of great possible importance for developing country intellectual property policy is a working requirement test that would permit adverse possession of unused intellectual property rights. Similar provisions in customs laws, such as those forbidding parallel imports can have a very restrictive effect on competition in technically advanced products.

VIII. Labor and Debtor Protection

Rural financial markets also depend on the laws and regulations that surround labor. These laws limit rural agents in their borrowing; potential non-bank lenders in their lending;

rural financial institutions in their attempts to present well structured and legal loan portfolios; and rural NGOs in influencing their government to change the rules. Even well-intentioned lenders and credit sellers cannot surmount these problems without themselves violating the law.

--Laws can require that citizens be inscribed in the civil registry in order to issue national identity cards; such laws also specify expensive procedures for being inscribed in the civil registry; in some countries, most rural residents have no valid proof of citizenship.

--Other laws then require a national identify card to establish lawful businesses or register to vote.

--Laws specifying the age of majority prevent young heads of households, often women, from signing lawful business or loan contracts

--Poorly drafted homestead exemptions mean that low-income borrowers cannot use any of their property as collateral.

--Usury laws force small borrowers into an illegal lending network with limited competition

A. Identity Cards and Civil Registration

The Civil Law specifies the proof of citizenship. The civil registry often is responsible for issuing identity cards that demonstrate citizenship. However, processes for reinstating a name in the Civil Registry after a person is born are expensive and complex. Many rural residents have their children beyond the reach of hospitals and, sometimes, churches where standard inscription procedures apply. In some civil wars, combatants have taken great pains in destroying civil registries so that local citizens lose their national identities -- Kosovo, Guatemala, and El Salvador are recent examples. As the civil identify card is essential for a variety of other purposes, this rarely noted problem can be a key blockage in other activities. Except for a USAID project in Kosovo, donor projects typically leave the Civil Registry untouched. Even there, it appears only that the physical registry was reconstituted without changing the laws that make civil registration so expensive.[42]

B. Civil Registration and Voter Registration

Expensive and difficult civil registration procedures can restrict voter registration, as voting typically requires proof of citizenship. Such problems, common in rural areas, mean that areas and associations of cannot vote and have less influence in promoting solutions to their problems through legislative assemblies.

C. Civil Registration and Commercial Registration

The commercial registry will typically require presentation of a civil identify card for registering a business. A business not inscribed in the commercial registry is, ipso facto, informal. Promoting formalization of business in rural towns where citizens often have no civil identity card or only a forged one, is a fruitless effort. Unlike the link between voter registration and civil registration, however, the public policy need for a civil registration behind every commercial registration needs more careful analysis.

D. Identification for Financial Transactions

Obviously, a formal sector lender must know the identity of a borrower; responsible supervision and regulation will require evidence that the lender knows the identity of the borrower. However, laws and regulations that require civil identification for such loans

represent unreasonable requirements that simply have the effect of depriving many rural residents of financial services. Laws and regulations should let financial institutions use any reasonable method of identification. Such methods could include state-issued identification other than the civil identification card or non-state identification such as phone listings, utility bills, employee identification cards, and cooperative and credit union memberships. Such an approach has been in place for US financial institutions for many years now and has worked very well.

E. Age of Majority

All countries have a law specifying an age of majority, an age at which a person can engage in lawfully binding acts. In Bolivia, for example, the age of majority is 21 years.[43] While minors may be emancipated prior to that age they still cannot legally borrow until they are 21. Moreover, for minors, transactions such as selling, borrowing or offering property as collateral for loans must carry the co-signature of the minor's legal representative. Emancipation of the minor creates even more difficulties: an emancipated minor may enter into these transactions only if a judge authorizes them; even then, the emancipated minor must prove that the transaction has great necessity and usefulness.[44]

In many developing countries, however, especially those with low incomes and high birth rates, many rural heads of households are younger than 21 years of age. Some households have female heads and include dependent children. Still more households contain one parent under the age of 21. These households are predominantly poor.

These heads of households cannot sign legally enforceable debt contracts and, therefore, are absolutely barred from the legal credit market. The provider of such a loan or credit sale would have no legal recourse in the event of non-payment. The prospects for repayment would depend entirely on the willingness of the borrower to pay. Such a loan would be even more risky than an ordinary unsecured loan, which would be legally enforceable against other property or income of the debtor. Proper bank supervision would recognize the danger of these loans in setting capital requirements; provisioning would relatively quickly affect profits. With such laws, only the informal sector can service such borrowers. While this problem may have little practical effect on loans by formal sector banks to poor minors, it makes "non-legal" or "illegal" the portfolios of micro finance lenders or rural dealers who could otherwise use their portfolios of loans as collateral for refinancing their operations under a reformed secured transactions regime.

F. Homestead Protection and Exempt Property

All civilized countries restrict creditors in seizing the property of a debtor. All laws so far examined by CEAL, including those of both industrial and developing countries, contain "homestead" and "exempt property" protection provisions providing that the lender cannot seize certain property. Just as societies have learned that creditor's true interests do not lie in enslaving, imprisoning, dismembering, or killing defaulting debtors, they have also learned that no public policy purpose is served by sending debtors into the world destitute. All countries have limits to debt collection procedures. No law yet inspected permits taking the bed, shoes, or clothes of the debtor.

The provisions set out in Ukraine and Bolivian laws for example, list a wide range of goods and are clearly motivated by concern and compassion for the impoverished debtor.

However, these provisions must be drawn very carefully: the debtor cannot use whatever is on that list as collateral. That typically means that people cannot buy these items on credit. So, for example, when the Bolivian mining law stated that the miner's tools could never be seized, it doomed Bolivian miners to fifty years during which equipment could not be purchased on credit. Similar provisions preventing seizing the tools of a worker can cripple programs to provide formal sector credit to the poor and micro-enterprises. What dealer would sell these goods on credit, what lender would extend credit to purchase them, if the law plainly says they could not repossess these items in the event of nonpayment?

When well-drafted, these same homestead and exempt property provisions can achieve their intended effect without such a great reduction in access to credit and its attendant economic cost.

G. Usury

Many developing member countries limit interest rates. For example, Bolivian law limits the interest rate charged on loans to 3 percent per month.[45] The usury limitation applies to transactions among consumers, between a merchant and a consumer in installment sales, and to the loans of any lender[46] including banks.[47]

Box 14. Usury Laws?

A street vendor in La Paz reported being charged 300 Bolivianos in cash for a case of crackers or 310 Bolivianos if she paid three days in the future --an implicit interest rate of more than 5,000 percent a year on the cost of carrying this part of her inventory. For such a borrower, obtaining a loan at 4 percent interest per month from a nonprofit lender would result in substantial annual interest savings. Would a usury law benefit such a borrower? Not at all.

Private lenders in developing countries frequently charge more than the usury interest rate on unsecured loans. In Bolivia, for example, where the rate of inflation is less than 10 percent, interest rates can amount to as much as 48 percent a year on small, unsecured loans made by nonprofit lenders that have access to funds at a zero interest rate. Rates can run as high as 70 percent a year on loans by unsubsidized public interest lenders attempting to cover their costs of operation.

While these interest rates sound high, private borrowers operating small farms and businesses can face even higher implicit interest rates in the course of doing business (see box). A usury law that caps interest rates forces poor borrowers into other markets. Neither usury laws nor other laws are enforced in those markets, thereby increasing the interest charges to the borrower and making the borrower worse off.

Why doesn't competition drive such interest rates down? First, because usury laws limit competition by reducing the number of legal and scrupulous lenders; second, because these laws force lenders into practices that hide the true interest rate with hidden charges and obscure loan contracts; third, because illegal lenders, pawnshops, and jewelry stores operate their pawn businesses well outside public scrutiny and are known to only a few customers.

Best Practice Reform

Eliminate usury restrictions to promote entry and competition in the provision of small personal loans. Devise other ways to protect poor borrowers. Regulations may require that lenders provide written statements of the true annual interest rates. Give simple numerical examples of what such interest rates mean. Protect illiterate borrowers by requiring exhibition of a videotaped discussion, in the borrower's native language, of the implications of such rates

IX. Conclusions: Policy Guidelines and Recommendations

All rural finance efforts have important legal and regulatory components. Rural finance and rural development efforts would be much more effective if these issues were addressed at the same time or before the non-legal components were begun.

Even where a project cannot support an entire legal or regulatory component, it should at least exhibit and record a clear understanding of the links between the project goals and the legal and regulatory environment. That would help get those changes onto the agenda of other specialized donor legal reform programs.

A. Fix the Legal Framework for Microfinance

Microfinance lenders would be much more viable if their borrowers were signing legal contracts, if they could take collateral legally, and if they could use their portfolios of loans as collateral for refinancing their operations. Yet no microfinance donor has issued a position paper on what reforms are desirable. To the contrary, microfinance donors often advocate state run refinancing operations[48] that undercut long-term viability and indicate that the donors themselves may not understand the key role played by law in making these institutions viable. The bizarre consequence? Donor-funded legal reform projects - same donor, same country - leave untouched the legal barriers facing microfinance.

B. Refocus Land Titling Projects Toward Reforming Land Use Rights and Using These Rights as Collateral for Loans

Present donor and MDB efforts focus on fee simple titling and cadasters. They ignore the broad range of land rights actually in use. Codifying these land rights could make rural land markets more liquid in ways that were politically and socially more acceptable. Existing titling projects typically ignore the mechanism by which land rights, including fee simple title, become usable as collateral. Consequently, these projects do not expand access to credit. These projects should be refocused on the broad set of land rights and fixing the legal system so that more land rights can serve as collateral.

C. Reform The Fundamental Laws Governing Economically-Relevant Rights

Donor and MDB projects typically lament the consequences of bad laws without attempting reform of the underlying laws. Donors support the expansion of cooperative organizations without fixing laws that prevent cooperatives from undertaking commercial transactions, including buying, selling, and lending to their members. Donors promote voter registration in countries where as much as 50% of the population is not in the civil registry and therefore not entitled to vote by law. Donors lament the failure of formal sector banks to lend to micro finance lenders where the underlying laws make those portfolios of credits useless as collateral. Donors promote using rural dealers as conduits for new technologies, ignoring the inability of rural dealers to use their inventories or accounts receivable as collateral or take the pledge on real estate or future crop from those to whom they sell new technologies. Donors promote rural cooperatives, ignoring laws that prohibit cooperatives from engaging in commercial or for-profit activities. These donor objectives are all worthy, but donors cannot achieve them without a careful analyses and reform of the laws that govern these arrangements.

D. Is There a Minimum Legal Framework for Effective Rural Finance?

No. The legal framework for finance in the United States permits bank (40% of total)

and non-bank (60% of total) lenders to supply credit amounting to about 220% of GDP. The typical Latin American country has a ratio between 20% and 40%; economies in transition can be as low as 10% of GDP. A broad range of legal frameworks permits a broad range of results.

These reforms could probably be ranked in order of importance and ease. Reform of the framework for secured transactions secured by movable property would probably rank at the top in terms of ease and effectiveness. Broadening the scope of land and fixing the system for using land as collateral would probably be second. Shortly thereafter, bypassing defective judicial systems with arbitration and petty claims courts would probably come third. After that ordering is not so simple.

The pity is that these reforms, done properly, are inexpensive relative to other donor programs and could all be undertaken without seriously compromising other objectives.

E. Proper Sequencing of Legal, Regulatory, and Institutional Reform

The first step in legal reform is a careful diagnostic paper that looks at the legal roots (citing laws, chapter and paragraph) of obstacles to rural finance projects and discusses options for solution. Such work requires a study of the law and fieldwork that verifies the law's presumed consequences. That paper should explain clearly the economic links between the legal problems and the rural finance problem. The options for reform should explain clearly how they would work and, in particular, set out a clear feasible path in which existing institutions or modified institutions will make the option work. As unremarkable as this point may seem, it is even more remarkable how many donors move ahead on legal reform without such a diagnosis. Or with a diagnosis that is mainly hand-waving: "Gee, no credit for housing? We need a mortgage law!" In more than ten years of work, we have seen fewer than ten diagnoses that explain clearly why an economic problem has legal roots and how the proposed legal solution will achieve its stated economic effect.

The second step lies in drafting the law. There may be general agreement about the diagnosis in the paper, but a great deal of resistance once solutions appear in black and white. Resistance is especially likely when good drafting tracks down all the other laws that must be amended or repealed. Many more public policy issues will emerge at that point.

The last step is institutional reform. Laws sanction the operation of institutions. Little real impact can come from a reform of a commercial registry without fixing the commercial code; or the real estate registry without a reform of the legal system for filing security interests against land-use right. However, the design of institutional reform should started in the diagnostic paper and continued through the legal drafting. The lawyers, economists and technicians should work together at all points. Achieving an Internet based commercial registry has less to do with programming than with a law that sets out how that will work and that addresses the public policy issues involved in dropping signature and verification requirements. Only then can the registry operate with low cost modern technologies.

F. Reforming on a Limited Budget

Many rural finance projects have limited budgets, certainly insufficient for a full-scale legal reform. In such cases, the most crucial first step, which will never waste money, lies in preparing a careful investigation of all the points at which the law impedes a successful project. That would at least permit the individual project - e.g. Microfinance, or dealer outreach, or producer cooperatives -- to have an agenda for reform that could be presented to other donors or

managers of other projects to get these items on the legal reform agenda. For example, World Bank, BID, and IMF task managers often propose banking reforms that call for regulation of firms engaged in any financial activity instead of deposit taking institutions. At a stroke, this places rural fertilizer dealers under the regulatory system of the Central Bank. This is absurd. But when such task managers draft these laws, they are usually not worrying about rural fertilizer dealers. Yet, what rural finance project or document warns against this provision in a banking or financial sector reform? Donor-funded secured transactions projects routinely fail to address the problem of registration of accounts receivables transfers. The result? Even after a donor-funded legal reform, microlenders still cannot use their portfolios as collateral.

Aside from this, limited budgets might be guided by the rough rules about priority areas and the sequence of analysis, law, and institutions set out earlier. Interestingly, few donors have supported work analyzing these questions. Some interesting exceptions: a thoughtful USAID-funded piece on the experience in reforming Latin American Codes; an Asian Development Bank piece on integrating the legal frameworks for bankruptcy and secured lending; World Bank on best practice rural finance reforms; and GTZ on the requirements for opening a small business in Costa Rica.

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Nuria de la Peña, Heywood W. Fleisig, Alejandro M. Garro, and Roberto Muguillo "Costo Económico de los Defectos en el Marco Legal Argentino para los Créditos con Garantía de Bienes Muebles": Volume II, Poder Judicial, Desarrollo Económico y Competitividad en la Argentina, FORES (Foro de Estudios para la Administración de Justicia) y CONICET, Editorial Depalma, Buenos Aires, Marzo 2001.

This paper contains an overall discussion of the secured transactions issues that limit access to credit in Latin America and the Caribbean. It focuses on rural finance issues:

Nuria de la Peña and Heywood Fleisig "Marco Legal e Institucional de Garantías Reales Mobiliarias en Países de la Región: Presentación en el Taller Regional: "Desarrollando la Economía Rural de Puebla a Panam " Inter-American Development Bank, available at in Spanish only at: http://www.iadb.org/regions/re2/en2/Nuria.doc (2001).

These short notes discuss the collateral problems of microenterprises and small and medium scale enterprises:

Heywood Fleisig and Nuria de la Peña "Microenterprise and Collateral" IDB 2002.

Nuria de la Peña and Heywood Fleisig "SMEs and Collateral" CEAL Issues Briefs 2002.

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[1] See bibliography for a selection of important articles.

[2] Moreover, the security interest of a secured creditor will be satisfied in the order of its priority among the other secured creditors that have a security interest against that same collateral. Without a security interest, a creditor is "unsecured". An unsecured creditor has only a general claim against a debtor's property - a claim that gives that creditor no better right to payment than any other unsecured creditor.

[3] In both, in Civil Code and Common Law countries, secured transactions are a subset of the general legal area of "property rights", also known as "real rights" or "*derechos reales*," in Civil Code jurisdictions. Often, legal frameworks in developing countries extensibly let creditors enter into a secured loan by creating a security interest against a debtor's property. For Civil Code countries, the Civil Code and, perhaps, one of more laws on pledge and mortgage might provide the conceptual legal basis for security interests, known as a "real guarantees" or garantías reales, in Spanish. For common law countries, the company charge and some version of "hire purchase" , and chattel mortgage, might, similarly, provide such a legal basis.

[4] Draws on Professor John A. Spanogle, Proposed Polish Charges Act (1992).

[5] Moreover, with only one unit of capital backing twelve units of loans, loan losses that may seem reasonable to the non-specialist can have grave consequences for a bank. At this level of leverage, if only one loan in twelve goes bad, a bank has lost all of its capital and is technically bankrupt." William Amstrong, THE IMPORTANCE OF IMPROVING THE MECHANISMS FOR SECURITY INTERESTS IN CENTRAL AMERICA, Inter-American Development Bank, Presentación en el Taller Regional: "Desarrollando la Economía Rural de Puebla a Panam " Banco Interamericano de Desarrollo, Guatemala, 5 - 7 de March 2001. For this reason, the research on secured transactions concludes that securing loans with collateral, in order to quickly recover the funds lent, has great bearing in the country's financial sector stability.

[6] As a first approximation, legal systems in developing countries can be divided into Common Law and Civil Code systems. Most former British colonies follow a Common Law system, most former European colonies follow a Civil Code system, and countries that were never colonies adopted one code or another for their own historical reasons. Within the Civil Code tradition, for secured transactions, there are three important basic models: French, German, and Dutch.

[7] De la Peña / Fleisig, “Nicaragua: Draft Law on Security Interests in Personal Property and Commentaries,” CEAL (1998); and Nicaragua: Options for Filing Security Interests in Personal Property and Nicaragua: How Problems in the Framework for Secured Transactions Limit Access to Credit, CEAL (1998) and Pacific Basin Research Abstracts, Federal Reserve Bank of San Francisco (1998).

[8] See "Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral," prepared by Nuria de la Peña and Heywood Fleisig, Center for the Economic Analysis of Law, and Philip A. Wellons, Program on International Financial Systems, Harvard Law School, for the Asian Development Bank and published in Law and Policy Reform at the Asian Development Bank 2000 -- Volume II, Asian Development Bank, Office of the General Counsel, Manila, Philippines; and also available at http://www.adb.org/Documents/Others/Law_ADB/lpr_2000_2.asp?p=lawdevt.

[9] This restrictive view arises from the original concept of a pledge as a limited type of security interest. Moreover, the pledge provisions evolved from, and followed, real estate rules that required a strict identification of real estate offered as collateral.

[10] Nuria de la Peña and Heywood Fleisig, "Marco Legal e Institucional de Garantías Reales Mobiliarias en Países de la Región"; Presentación en el Taller Regional: "Desarrollando la Economía Rural de Puebla a Panamá " Banco Interamericano de Desarrollo, Guatemala, 5 - 7 de Marzo, 2001, Revista de BANCOS Y EMPRESAS en Ed. Depalma, Argentina (Revista No. 3), 2001.

[11] For example, in Argentina and Guatemala, the registry law requires a specific description for filing the security interest. In Indonesia, the law requires that the judge state specifically what is to be seized in a collateral recovery action.10 Therefore, the provision of the law concerning "general description" cannot be used. These restrictions on general descriptions limit the use of floating security interests financing inventory and securitizing portfolios. They make it impossible to draft security agreements secured by the inventory of a store AND its accounts receivables. These limits have no obvious justification in public policy.

[12] Some legal problems arise from discrepancies within the framework for secured transactions; others arise from conflicts between the framework for secured transactions and other important objectives of the developing country's legal system This problem, common in unreformed systems, such as those in Bolivia, Guatemala, Honduras, Nicaragua, Peru, and Ukraine, limits the economic benefits that arise from using collateral. Creditors know they bear the costs of revisiting courts to reinstate their security interests, that the time involved will increase the risk of total loss, and that the threat of loss of priority defeats much of the economic advantage from collateral. These problems explain why the system of security interests in unreformed systems is weaker than in reformed systems. Some unreformed laws do provide under the general Civil Code principles that a pledge will continue in "fruits and products". However, "fruits and products includes only one exchange of the original collateral; e.g. the cash from selling the pledged crop. It does not, as do modern concepts of proceeds, extend to subsequent dispositions. In the example above, had the farmer purchased a tractor with the cash obtained from the sale of the pledged crop, the creditor secured by the original crop would not have an automatic claim against that tractor. Moreover, upon court granting such a judgment lien against the tractor, the priority of that lien would date from the time it was filed, not from the time of the original security interest in the crop. In short, even if the court re-establishes a security interest in the farmer's property, that security interest has a lower priority. See idem footnote 6 de la Peña, Fleisig, Wellons, "Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral," at table V.1 and para. 125.

[13] As with all good drafting, the new law must rule as inapplicable or derogate all procedural and other rules that conflict with this principle. In those derogations, it must address the other public policy issues that arise when amending those laws. It must also add enforcement rules consistent with this principle.

[14] In default, loans without priority will become portfolios of uncollectible loans. Indeed, a secured loan by definition cannot have a conflict of priority. Without resolution of priority, even a loan that the law defines as a secured loan is, in economic terms, unsecured.

[15] One of the first systems of priority, still used in most countries, uses the possessory pledge and establishes priority by possession. In this system -- used by pawnshops and warehouses -- the debtor gives possession of the collateral to the creditor. Since the possession of the collateral by the first creditor cannot easily be hidden from subsequent creditors, the law grants priority to collect to the creditor that has possession of the collateral. However, under the system of priority by possession, a debtor cannot use the collateral until the loan is paid. Such a system can work for pawnshops or warehouses holding goods in storage. However, it has major economic disadvantages for debtors who seek to use their collateral for economic ends -- e.g. the future crop, production and harvesting equipment, or raw materials that they hold for the very purpose of transforming them in production processes, and land.

The non-possessory priority system was developed to address these problems with the possessory pledge. This system permits the borrower to retain possession of the goods or real estate offered as collateral. Crucial to the operation of this system, the non-possessory system sets out the rules for assigning priority among different claimants to the collateral . It also establishes some process by which the claimants make the priority of their claims public. The most successful and advanced systems (discussed below) assign priority by the time of filing in a public registry. Central in such a system of priority, however, is a law that develops the logic of the system well enough so that conflicts and inconsistencies do not prevent the creditor from being able to gain commercial value from the collateral.

[16] The law may specify that priority is set by date, but not by date and time, permitting two security interests filed on the same day to have uncertain priority against each other. The law on pledge may give priority to the first to file a pledge on the future crop, while the law on warehouses gives priority to the holder of the warehouse receipt, leaving legally undetermined the priority of lenders in a crucial transaction where a farmer harvests a pledged crop and moves it to a warehouse. The law on pledge may give priority to the first to file in a registry for a security interest against a portfolio, but the law on assignment of rights may give priority to the first to notify a debtor of a transfer of accounts, leaving the priority status of refinancing of microlenders and dealer portfolios legally ambiguous. The laws on pledge may give priority to the financier of a new generator or grain drier, but the law on mortgage may give priority against that generator the holder of the existing first trust. Finally, badly drafted bankruptcy laws overturn the priority of secured lenders compared to unsecured creditors such as the state (taxes), the bankruptcy court (fees), and workers (unpaid wages). Such a feature largely destroys the usefulness of a secured lending system, because it makes collateral useless at precisely the time of liquidity stress that firms need collateral to support their search for financing. For example, most former socialist republics, with the exception of Romania, and all Latin American and Caribbean countries provide conflicting priority rights for the claims of the trustee in bankruptcy, labor dues, and taxes due, vis a vis a secured party. These discrepancies increase risk; and this in turn reduces lending and increases interest rates. In Ukraine, for example, see Law on Leases, Art. 13, which requires registering a lease agreement only for title goods, e.g., cars, and does not govern priority of the lease against registered pledges at the State Registry. See also Law on Pledge, art. 1, which does not include in its scope of application any transfer of account receivables and other credit rights, leases, sale agreements with retention or reversion of title, warehouse receipts, consignment of goods, and simulated transactions for purposes of security. Peruvian, Argentine, Bolivian, Honduras, Thailand, or China's laws include similar problems.

[17] A filing notice might contain 14 fields and occupy a space of 15 kilobytes. The same notice scanned as a picture image would require 30 kb to 60 kb depending on the technique used. The underlying security agreement, however, would be many times larger. As underlying security agreements must vary with the nature of the transaction and the type of collateral, they do not follow a standard format. As a result, they must be scanned in. At a minimal resolution of 150 dpi, such a document would require about 100 kbs per page. Even a streamlined loan agreement would have two to four pages, representing a file of 200 kb to 400 kb. But loans contracts can run on for hundreds of pages. The speed of electronic access is directly proportional to the size of the file: accessing the streamlined version of the text would require 15 to 30 times more time to download. A 100-page loan agreement would require about an hour - more than 600 times more time than the notice of this agreement. Add these times up for looking at a portfolio of 1000 loans in a securitization and the incompatibility of modern financial techniques with the registering the entire contract becomes apparent. The United States of America and most Canadian provinces have adopted this filing system, so has Romania. Creditors obtain information directly from the database where security interests are electronically filed.

[18] Where lenders find notices filed, they can ask borrowers for evidence of the relevant security agreements or for authorization from the borrower to gather information directly from the debtor's other creditors.

[19] See, for example, projects at http://www.property-registration.org/Project-list.htm.

[20] These private operators could include associations, such as the association of banks, chamber of commerce, and association of lawyers. This approach has been followed in Romania and Colombia with great success. Canada has experimented with monopoly private franchise with less success. The United States has kept a state-operated core with many private points of entry. All these systems work better than traditional state-operated systems.

[21] An effective publicity system requires that the law must uniquely designate the place in which notice is filed. When that place is a state monopoly, the danger always exists that the administering agency will use this monopoly power in collecting fees to fund its other activities. Placing a heavy tax on lending transactions to fund unrelated activities of the ministry that should be funded from general tax revenues is not socially efficient. To avoid this, even when the roll of the government is narrowed to supervising, the law must specify a cap on the fees charged, so that total revenues never exceed the amount based on the cost of operating the registry archive and supervising it.

[22] Under the priority issues above, the priority rule "from the time of filing a notice" must also apply to all "interest" or "claims" in real estate. Then, for example, any sale, lease for more than one year, usufruct, grant, transfer or other interest in real estate could file a "notice" to obtain priority vis-a-vis all claimants. Such a system can be quickly expanded to include non-traditional land-use rights whether devised by traditional communities, economies in transition, or industrial country governments. In this approach, property titling projects, although desirable on other grounds, would not be a necessary feature for creating security interests in real estate. Lenders themselves could determine how much and what kind of security of tenure they require for a mortgage.

[23] See, for example, the Ukrainian Law on Pledge art. 20.

[24] These may include obtaining a court judgment and a writ of execution. Typically, the law will set time limits on each stage of this process; however, most unreformed codes of civil procedure permit many appeals. Often, other laws apply to eviction: for example, some countries will not evict families with young children. Sometimes tightly scheduled eviction proceedings are suspended and restarted: sometimes the judge does this because of an overcrowded court calendar, sometimes on any appeal by the debtor/tenant. Some laws permit a wide range of grounds for postponing eviction including business trips, hospital treatment, and vacations. In Peru, an attorney for lenders recently interviewed, reported at least one year to evict tenants from real estate, and further delays if tenants appealed. Peruvians have recently begun using the trust under a recently passed trust law. However, the attorney explained how the trust law does not solve this problem. The slow eviction time can not be avoided under a trust instrument, since eviction requires the use of force to break and enter the premises, it necessarily requires judicial action under the constitution of Peru as well as in most other countries. Trust laws do not govern the procedural rules for such judicial eviction process. Rather, the subject is governed by the code of civil procedure and rules of the courts, and is affected by the enormous problem of malfunctioning in the judiciary.

[25]Some laws require this procedure even if the creditor could arrange a private sale at a price acceptable to the debtor. Unreformed laws typically do not permit a creditor-controlled sale or a strict foreclosure (transferring ownership of the collateral to the secured party). Sometimes poorly drafted laws permit a creditor to administer the sale but do not permit the creditor to transfer title without a judicially supervised sale; so a creditor would always need to use a judicially supervised sale for titled property such as real estate or automobiles.

[26] Called "harmless repossession" in reformed systems.

[27] Suitable measures, when properly drafted and explained, include legal instructions for summary court judgments (ex parte court orders); harmless repossession, wherein the lender can repossess collateral without court intervention; expanded private authority for repossession; expansion of public services to include some private incentives and competition. Suitable measures include penalties against public officials who do not carry out duties in conformity with law; these might be personal or they might involve automatic compensation from state funds for delays (e.g. a credit against taxes equal to the interest foregone on the uncollected debt). It provides a legal framework for creditor-administered sale, sanctions for creditors that abuse that process, and a workable way to enforce those sanctions. That legal framework should cover the rules of commercial reasonableness, rules for notification of debtors, specification of rights of redemption, and conditions under which the secured party may undertake strict foreclosure (seizing and keeping the collateral).

[28] "… Third, for loans with mortgages on real estate or chattel, the break-even interest rate is almost unaffected by the higher risk weight of chattel mortgages. This suggests that the scarcity of chattel loans in Argentina is not likely the result of regulation but rather of inefficient registries and a legal framework that impede low-cost foreclosure on pledges (Fleisig and de la Peña, 1996; de la Peña and Muguillo, 1995). Fourth, the break-even interest rate for the small, short-term loans demanded by small producers is close to the interest rates on credit cards, overdrafts, shopkeeper credit, and other small, short, unsecured loans in Argentina (BCRA, 1996c). Regulation is not what keeps banks from lending to small producers." Microfinance, Regulation, and Uncollateralised Loans to Small Producers in Argentina, Mark Schreiner and Héctor Horacio Colombet, February 2001. This is an earlier version of a paper that appears in pp. 137-152 of Douglas R. Snow, Terry Buss, and Gary Woller (eds) Microcredit and Development Policy, Nova Science Publishers: Huntington, NY, ISBN 1-59033-001-3.

[29] "Costo Económico de los Defectos en el Marco Legal Argentino para los Créditos con Garantía de Bienes Muebles," by Nuria de la Peña, Heywood W. Fleisig, Alejandro M. Garro, and Roberto Muguillo: PODER JUDICIAL, DESARROLLO ECONOMICO Y COMPETITIVIDAD EN LA ARGENTINA, Foro de Estudios para la Administración de Justicia (FORES) and Consejo Nacional de Investigaciones Científicas y Técnicas (CONICET), Volumen II, Ed. Depalma, Argentina, March 2001.

[30] The economic gain from secured lending is large; it is distributed over a wide group of rich and poor citizens. This large and widely distributed gain justifies extreme caution in abridging the system. Addressing the serious issues raised by adherents of limiting the rights of secured creditors requires a broad reform of a wide range of laws, concerning tax collection, workers rights, and coverage of risk to the citizens at large. However, that broad range of reforms would, without question, promote public welfare better than would limiting the rights of secured creditors without passing the suggested reforms elsewhere. On the difficult question of judicially administered reorganizations, further study is necessary. However, based on the existing studies, no involuntary delay in the exercise of the rights of secured creditor can be justified.

[31] In the analysis by the Instituto Libertad y Democracia in Egypt, Mr. Hernando de Soto shows that:

25% of Egyptians live on agricultural land whereupon both law and the constitution forbids construction;

Another substantial fraction lives in the upper (illegal) floors of nominally two-storied public housing.

Altogether, 92% of all land and buildings is held extralegally

About $245 billion in Egyptian real estate cannot be mortgaged because it is not legally titled, an amount 40x greater than all bilateral aid to Egypt and 50x all World Bank loans.

Filing a mortgage requires 207 bureaucratic steps and takes 17 staff-years to complete.

Source: http://www.ild.org.pe/posters/egypt/egypt_poster_1.htm

[32] Developing country courts are awash in land-use right cases that dispute unclear legal principles in the courts. Peruvian Civil Code, for example, opens the door for challenging a first to register priority rule under the grounds of bad faith. In Romania, property taxes rank first regardless of registration, and can show up, "unexpectedly" at any time. In several countries of South Pacific, such as Vanuatu, Papua New Guinea and Samoa, the law endorses the application of customary rules, and it is very unclear what the applicable customs will say about conflicting priority claims. Many mortgage laws are silent on the question of a second security interest, creating uncertainty around the possible development of a market in security interests of 2nd or lower priority. See also, "Trabas Legales al Acceso al Crédito en Peru" book by the UNIVERSIDAD PERUANA DE CIENCIAS APLICADAS, Lima, Peru, (2000) http://infodev.upc.edu.pe/fondo-editorial/libros/00ttrabas/.

[33] Such a filing archive would not contain the underlying documentation concerning transfer and ownership but, rather, would only carry notices of such rights and transactions. As a technical matter, this would be a simple database and each entry would have a few digital entries. Such an archive for a relatively largely country could be operated out of a modern desktop computer and be available on the Internet for a nominal charge.

Separating the notice filing archive from the underlying registries division permits the coexistence of different individual registries of land-use rights, even administered by different government agencies. It also permits these registries to develop at different speeds, which may be appropriate given possible differences in importance and difference in the difficulty of the tasks that they face. Of course this notice can include data linked to any other registry - for example the notice in the filing archive can include a reference to the cadastral identification number. However, it is not necessary that it contain such a number for it to be a valid notice of a valid interest in real estate.

[34] An excellent survey of the importance of biotechnology to rural development in developing countries appears in "Diversifying Social Research at the International Food Policy Research Institute" by Ruth Meinzen-Dick, Michelle Adato, Marc Cohen, Curtis Farrar, Lawrence Haddad and Agnes Quisumbing Paper presented at CGIAR Conference on The Role of Social Research in CGIAR: Supporting the Strategy -Achieving Development Impact Cali, Colombia, 11-13 Sept, 2002, IFPRI: Washington, DC., International Food Policy Research Institute, 2000) at http://www.ciat.cgiar.org/src/pdf/ifpri_rmeinzen.pdf.

[35] Derek Byerlee and Ken Fischer, Accessing Modern Science, (AKIS Discussion Paper, November 2000)

[36] Derek Byerlee and Ken Fischer, Accessing Modern Science, p. 17 (AKIS Discussion Paper, November 2000)

[37] Derek Byerlee and Ken Fischer, Accessing Modern Science, p. 20 (AKIS Discussion Paper, November 2000). The Essential Electronic Agricultural Library made full text of 130 agricultural science journals available o CD-ROM free of royalties. China and India were excluded from this agreement because it was believed they could not enforce contracts preventing further copying.

[38] Supachai Panitchpakdi, "How Intellectual Property Rights Could Work Better for Developing Countries and Poor People."

[39] Derek Byerlee and Ken Fischer, Accessing Modern Science, p. 12, (AKIS Discussion Paper, November 2000).

[40] Many of the issues in IP rights cross over to the issues discussed elsewhere in the paper. Offer expensive new crop production technologies to farmers cannot have much effect when farmers cannot use their future crop as collateral for a loan to repay the seed dealer. Similarly, developing new genetically-modified technologies faces many obstacles in developing countries if biotech companies cannot use their intellectual property rights or accounts receivables as collateral for loans to finance their operations.

[41] Civil Code, Art. 4.

[42] In Guatemala and Ecuador, donors supported voter awareness projects to promote participation and democracy. However, the laws of each country require that voters present a government ID (a "cédula" in most Latin American countries), showing evidence of inscription in the Civil Registry. This followed from the reasonable requirement that a person prove citizenship before being able to vote. What was less reasonable was the complex nature of the civil registration process that led to only 10-30% of the rural indigenous population being inscribed in the Civil Registry. Donors did not support the fundamental reform required in the Civil Registry. Their expenditures on voter registration were largely wasted.

[43] "Los bienes de los menores emancipados no pueden enajenarse ni constituirse en hipoteca, sino por decreto del juez, cuando hubiera gran necesidad y utilidad conocida y por causas y la forma establecidas por ley" (G. J. No. 557, p.13).

[44] See Código Penal, Art. 360 (usura) and 361 (usura agravada).

[45] See the Código Penal Boliviano, Editorial Los Amigos del Libro, La Paz, 1987 (effective since April 2, 1973), art. 360, which provides: The one who takes advantage of someone's necessity, rasher inexperience, provides assets in any way, in exchange for interest higher than the legally established or obtains any other disproportionate economic benefit, will be penalized with imprisonment of 3 months to 2 years and fine of 30 to 100 days. The same sanction will apply to one who knowingly acquires, transfers or enforces an usurious credit. Intermediaries, middlemen and abettors will face the same sanction. Art. 361 (Aggravated usury) of the same Code provides "The sanction will be increased to a half of the above article and fine of up to 100 days as follows:

1) If the perpetrator was a professional lender or agent regularly engaged in usury;

2) When artifices or trickery is used to obtain the victim's consent;

3) If the transaction is disguised in any way under other type of contract with a penal accessory contractual clause providing for interest;

4) If interest is compounded (anatocism)." .

[46] Although some lawyers interviewed considered that the civil code places banks outside the usury limitation, comments to the Penal code provisions specifically consider usury limitations applicable to banks. The note to Art. 361 of the Penal Code provides: ".Por ello si un banco da préstamos con intereses superiores a los legales, incurre en usura." (Código Penal, Concordado y Anotado, by Benjamin Muguel Harb, Ed. Los Amigos del Libro, 1987, note to Art. 360, p. 410).

[47] See Mayer, at p.8.

[48] Donors Review at: http://www.basis.wisc.edu/rfc/lit/donor.html.