

Brazil

Agricultural Policies



Ministry of Agriculture, Livestock and Food Supply
Secretariat of Agricultural Policy

Brazil

Agricultural Policies

Mission

*To “promote the sustainable development
and the agribusiness competitiveness
in benefit of the Brazilian society”.*

2008

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Introduction

The restructuring of the Brazilian economy in the 1990s was marked by deep changes in economic policy based on the liberalization of domestic and foreign markets and on the deregulation of the domestic market. This is a guiding process which continues to be followed.

In the course of the aforementioned process of economic adjustment and consolidation of macroeconomic stability, the credit and minimum price policies were reformulated and the levels of official support for the sector were substantially reduced, being among the smallest in the World. Not only subsidies were eliminated, but there was also a substantial reduction in the real volume of rural credit, creating space for price support and producers' income guarantee programs as the main agricultural support instruments. The merit of such policy was to reduce government's intervention in the market and its spending in the sector, helping to stabilize prices and control inflation. This has been particularly true since the mid 1990's, when new marketing and agricultural credit instruments were created so as to increase the participation of private sources of financing.

The reform of the Brazilian agricultural policy sought to avoid the need for government's casual interventions in situations of crisis, caused by economic and climatic factors, minimize the use of public resources to support the sector, and increase the sector's efficiency, as well as ensure better conditions for rural producers to overcome adversities. Other challenges faced in the effort to improve policy instruments consisted of promoting the continuity of agribusiness's competitiveness gains, reducing price and income fluctuations inherent to agricultural production, reducing imbalances in the relationship between producers and processors of agricultural and livestock products, promoting a more equitable distribution of the sector's income, and avoiding that the increase in agricultural production for energy purposes might hinder the development of the agro-food complex.

Thus, it was sought to equip Brazilian agricultural policy with instruments that would give it sustainability, bearing in mind the limitations dictated by the public budget and the need of coherence with other governmental policies. Emphasis was attributed on the invigoration of market mechanisms, on the participation of private initiative in agricultural financing, and on the support of agricultural prices. The continuous effort to modernize agricultural policy and consolidate its instruments will allow farmers better adjust themselves to market incertitude and expand and consolidate their insertion into the international market.

Agricultural Financing

2

Rural credit has ceased being the main instrument of support to agriculture, but continued to play an important role, contributing to increase productivity and production. The magnitude of rural credit has been strongly influenced by the limited availability of public resources to support official credit operations, due to the control of government's fiscal deficit and prevalence of high interest rates. This situation led to the reformulation of agricultural financing policy based on the introduction of supporting instruments operated by the market according to the criteria established by the government in order to minimize the participation of public resources. This is particularly the case of governmental spending on agricultural working credit, due to the introduction of new instruments for raising resources, mostly since this decade, when several commercial notes aimed at facilitating access to financial and capital markets were created. Regarding preferential credit to agriculture, the participation of the National Treasury has been drastically reduced, reaching levels close to zero in the last few years.

The foundations of a private system of financing the agribusiness were implemented and agricultural policy was reformulated, but it may be further improved and its instruments adjusted so as to fully attain the objective of greater efficiency on the operation and distribution of public resources. It is equally important to disseminate the use of those instruments by rural producers and financial agents in order to consolidate the insertion of agribusiness in the stock market.

Preferential rural credit at interest rates controlled by the government corresponds to 30% of the demand of resources for working capital. Rural producers receive financing from suppliers (input industry), buyers (processing industry and exporters), and free resources¹ from commercial banks, at interest rates that reached 25% in the 2006/2007 period and at present is about 20%. The prevalence of high-interest rates increases the opportunity cost of resources owned by producers.

The insufficiency of official credit resources at preferential rates and the high cost of the resources owned by producers (self-financing) and the ones obtained in the free market result in a weighed average interest rate for the financing of working capital which is higher than the one paid by international competitors. It means that Brazilian agriculture works with limited and expensive credit, which reduces its competitiveness. That was the basic motivation for the implementation of new measures related to agricultural and livestock credit, financing and insurance.

2.1 National System of Rural Credit (SNCR)

The government guarantees the availability of agricultural credit resources at preferential interest rates for working capital and marketing, mainly from demand deposits in commercial banks, and for investments, which are provided through specific programs for inputs, products, and rural activities. These resources correspond to 40% of the required amount to finance agriculture, and the remaining 60% are covered by farmers self financing and by resources financed at market interest rates.

The resources for working capital and marketing provided by the government are complemented by resources offered by commercial banks, including the official ones, at market interest rates, as indicated in Table 1.

Table 1

BRAZIL RURAL CREDIT SOURCES*				
Credit Sources	Interest Rate %	Participation %	Maturity (Years)	Main Activities
Agriculture				
1. Working capital and Marketing	8.63	84.6	1	Working credit for expenditures related to the productive cycle of periodic crops, off season of permanent crops or the drawing of vegetable products, including primary processing and storage. Marketing credit to allow producers and cooperatives to store their crops and better distribute their supply throughout the year.
1.1 Preferential Interest Rate	6.75**	82.5	1	
1.2 Free Market Interest Rate	17.5	17.5	1	
2. Investment	7.47	15.4	-	Rural facilities; acquisition and maintenance of vehicles, machines and equipments; irrigation, drainage and soil modification; clearing of timber and clearing from stubs or trunks to make the land arable; reforestation; permanent crops; pasture; rural electrification and telephony; acquisition of breeding and working animals, small household allotment;
Total	-	-		
Programs				
Moderagro	6.75	8.5	8	Implementation or improvement of fruit trees, investments related to floriculture, sheep and goat raising, aquiculture, apiculture, swine, poultry, dairy, sericulture and systems of cattle and buffalo tracking.
Moderinfra	6.75	5.0	8	Irrigation and modernization of farm warehouses and other facilities.
Moderfrota	9.5	25.0	6 a 8	Farm tractors, harvesters and equipments for processing coffee, and used tractors and harvesters.
Moderfrota - Proger Rural	7.5	5.0	6 a 8	Financing of small and micro rural producers for the creation of jobs and income.
Prodecoop	6.75	10.0	12	Value adding to agricultural production by cooperatives.
Proflora	6.75	1.5	12	Commercial forestation, forest preservation in areas of legal reserve, and wood production for burning in the drying of grains.

Table 1

BRAZIL RURAL CREDIT SOURCES*

Credit Sources	Interest Rate %	Participation %	Maturity (Years)	Main Activities
Produsa	5.75 and 6.75	10.0	5 a 12	Recovery of degraded soil and pasture, and support to the use of environmentally sound practices, which is a requirement introduced by this Program on the financing for soil correction and preservation, recovery of pastures and systematization of food forests.
Constitutional Funds	5 — 9	35.0	12	The 1988 Federal Constitution establishes that 3% of the resources from income tax and IPI (tax on industrialized products) shall be utilized to finance production in the the estates of North, Northeast and Center-West.
Total	-	-	-	-

* Exclusive Pronaf: National Program for the Strengthening of Family Agriculture.

** Exclusive Coffee (7.5%) and Proger Rural (6.25%)

Historically, rural credit resources were applied almost exclusively at preferential interest rates, but as a consequence of agricultural policy reforms implemented in the 1990s there was an increase in the participation of resources applied at market interest rates, reaching 22.4% in the 2006-2007 harvest, and then declined to about 15% in the 2008-2009 harvest.

Table 2

RURAL CREDIT RESOURCES FOR THE 2008-2009 HARVEST

Resources	July '08 to June '09 (%)
Controlled Interests	85.2
Liabilities	49.2
Rural Saving	16.9
BNDES	10.0
Constitutional Funds	5.4
FUNCAFE	3.4
Other	0.3
Free Interests	14.8
Rural Saving	4.0
Free Resources	10.8
Total	100.0

Source: SPA/MAPA

The participation of resources from rural credit liabilities², excluding the National Program for the Strengthening of Family Agriculture (Pronaf), in total rural credit has increased since the mid-1990s and became the main source of agricultural funding. This is mainly due to the stability of the economy, stimulating the

² It refers to the requirement that commercial banks should devote 25% of their demand deposits for the financing of agriculture, with the charging of interest rates established by the government at below-market levels.

³ Rural credit resources from liabilities do not have any cost for the government.

holding of demand deposits in commercial banks and, consequently, exonerating government's expenses with rural credit policy³.

2.2 New Instruments of Agricultural Financing

Law No. 11.076/04, of 12/31/2004, created new agricultural policy instruments and new credit titles specially designed to finance the agribusiness. Afterwards, the Securities and Exchange Commission (CVM) regulated the Commercial Agribusiness Note (NCA), or Agrinote, by means of the Regulatory Instruction No. 422, of 9/20/2005.

The new negotiable instruments will continue to strongly modify the financing of Brazilian agribusiness because their aim is to attract urban investors, whether small savers or huge pension funds, to finance the rural activity, complementing the credit regulated by the Government. In this sense, the accentuated cultural differences that characterize the receivers and potential providers of funding are a challenge whose overcoming shall be realized precisely through those credit instruments.

There are three agribusiness refinancing instruments: the Agribusiness Credit Bite (LCA), the Certificates of Agribusiness Credit Rights (CDCA), and the Certificate of Agribusiness Receivables (CRA). These instruments are pegged to documents representing previous financing operations denominated receivables. Thereby, any commercial note issued by rural producers that corresponds to a promise of future payment, such as Agricultural Credit Notes, Rural Product Certificates, Rural Promissory Notes, Rural Trade Notes, and export supply contracts, among others, will always be issued by rural producers or cooperatives.

Those three instruments are differentiated fundamentally by the type of issuing entity. The LCA is issued exclusively by financial institutions and the CDCA is issued exclusively by agribusiness companies, such as cooperatives, companies that supply inputs to the rural sector or demand raw material from agriculture (processing industry, businesspeople, exporters, etc.). The CRA is issued by securitization companies. These instruments are subject to the Tax on Financial Operations (IOF), and the earnings provided by these and other agribusiness instruments, as is the case of the CPR, were exempted from Personal Income Tax (Law No. 11.311, of 6/13/06).

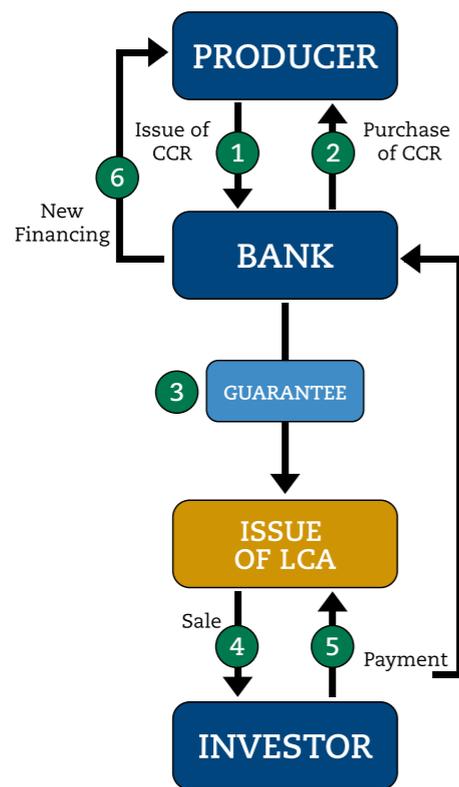
Agribusiness Credit Note – LCA

As shown in Figure 1, at planting time the producer goes to a bank to obtain resources for the purchase of inputs whose loans are accomplished utilizing Rural Credit Note (CCR), Rural Promissory Note (NPR), or other similar instruments.

Consequently, rural producers have a higher availability of resources to finance their activities. This increase of liquidity until redemption date is important for agricultural modernization through the use of modern inputs and better handling and cultivation practices.

Instead of keeping the instruments resulting from those operations in its portfolio, the bank may issue an LCA, pegged to those instruments, and trade it in the market. Thus, an urban investor can buy LCA, which provides additional resources to the bank for the financing of agricultural projects. This is equivalent to say that the urban investor – buyer of the LCA – feeds the bank with resources that will finance other farmers who otherwise would not count on the expansion of bank credit.

Figure 1: Operational Flow of LCA



At the respective maturity of those instruments, the producer will redeem his debt at the bank and will pay the LCA to its holder, completing the operation. In order to increase the security of the operation, it is required that the issuance of LCA's and the respective sources to which it is pegged be in a system of recording and settlement of assets, authorized by the Central Bank (BM&F and Cetip)4.

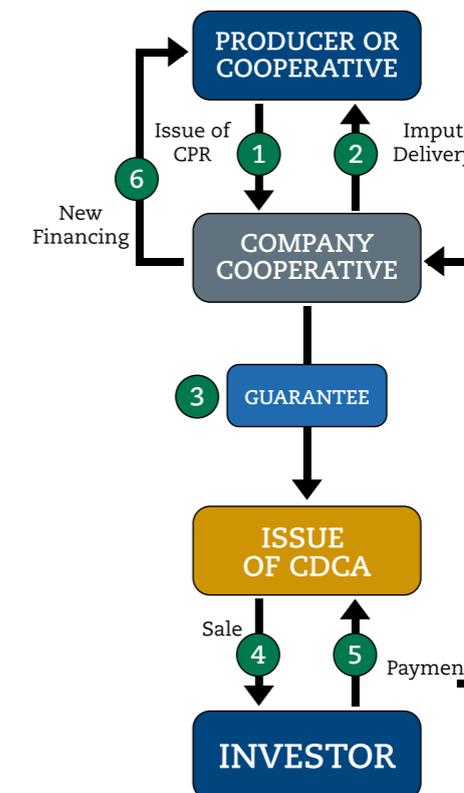
It is important to observe that investor's face risk only at the LCA's issuing bank, given that in case of rural producer default the bank is obliged to honor the payment of that instrument.

Certificate of Agribusiness Credit Rights – CDCA

In this case the operation is similar to that of the LCA and occurs with the participation of a company, or cooperative, which provides inputs to agriculture and livestock farmers, or any other non-financial private company that finances the agricultural sector, such as an agroindustry, an exporting company, etc. It should be noted that a cooperative may work as an issuer of receivables or CDCA's.

In the past, the capacity of vendors to offer financing to its customers was determined by its budget or by the availability of working capital. This limit be strongly expanded and the company may use the CPR's it receives from its customers to peg the CDCA's to be offered in the market and thus obtain new resources to expand its sales (Figure 2).

Figure 2: Operational Flow of CDCA



The use of CDCA implies that the agricultural and livestock financing capacity of a company or cooperative is no longer linked to its working capital and depends fundamentally on the level of risk to which it chooses to be exposed, and on its credibility in the financial market.

As it occurs with LCA's, the CDCA's and their respective pegging ought to be registered in systems of recording and settlement of assets. It is obligatory that the receivables which serve to peg the CDCA's be kept in the custody of a financial institution. The issuing company is responsible for the CDA pegging instruments. Therefore, the investor will be exposed only to the risk related to the CDCA issuing company.

Certificate of Agribusiness Receivables – CRA

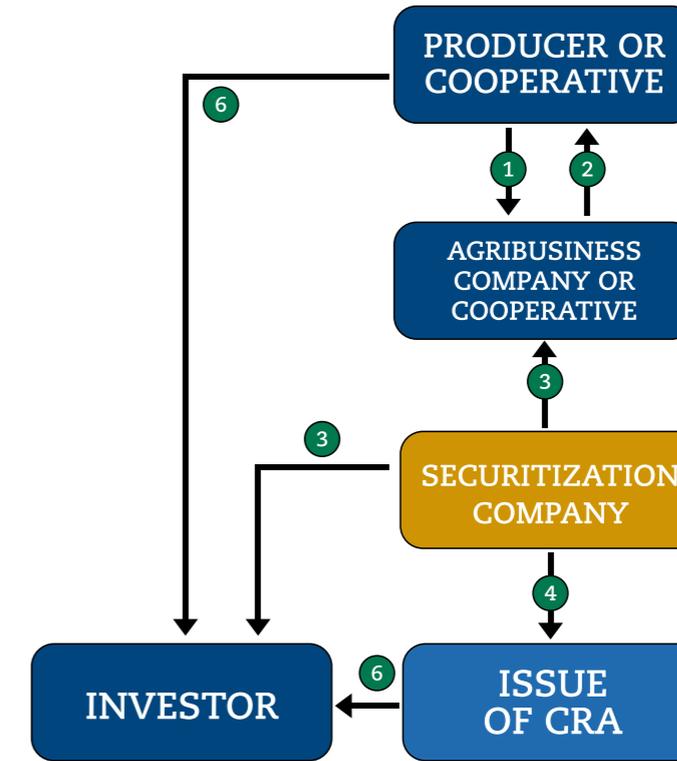
Operations with CRA's have their own characteristics (Figure 3) and are exclusively carried out by specific purpose societies (SPE's), specially formed to carry out securitization businesses.

The legislation prevents securitization companies from assuming any risk in the market. For that reason, operations with CRA's are negotiated in advance among the parties. Another important characteristic of these operations is the fact that CRS buyers are exposed to the rural producers' risk, and not to the risk of the securitizing company, as in the two previous cases.

According to the diagram of Figure 3, the securitizing company has among its customers a traditional cooperative or an agribusiness company with good standing in the market. The securitizing company tries to identify investors willing to take that type of risk. Once the negotiation among the parties is done and the details of the operation, such as investor's remuneration, expiration date of the instruments, etc., are agreed upon, the securitizing company buys the receivables from the cooperative, issues a CRA pegged to them, and immediately transfers the CRA to investors. Thereby, the default risk is fully assumed by the investor.

The set of instruments for obtaining resources, created by Law No. 11.076, is a new "agribusiness financial highway" that provides access to financial and capital markets, with the objective of taking advantage of its immense potential of financing Brazilian agriculture.

Figure 3: Operational Flow of CRA



In close cooperation with the private sector, the Government created the foundations of a private agribusiness financing system, almost 40 years after the inception of the SNCR. In that new system the beneficiaries are not only rural producers and cooperatives, but the whole agribusiness. It is the beginning of a process of strengthening the Brazilian agribusiness competitiveness, providing greater liquidity to the sector and reducing capital cost as well as the operational risk.

Marketing and Income Guarantee Agricultural Policies

3

Since 2003 the government has promoted an ample revision of its marketing and income guarantee agricultural policy instruments. The objective is to increase public resources efficiency and expand the direct participation of private initiative in the process of stabilizing producers' income. Therefore, the government has promoted the improvement of cooperation and coordination among members of the productive chains in order to overcome budgetary restrictions in executing the programs of price and income guarantee.

Law No. 11.076, of 12/31/2004, authorized the Federal Government to offer economic subsidies for contracts of agricultural product sale option, when issued by the private sector on behalf of rural producers and cooperatives. In this partnership the private companies take the place of the government with respect to the price guarantee.

3.1. Marketing Support Policy Instruments

Minimum Prices Guarantee

This is an instrument that works as a basis for several types of purchase or financing operations, always with the objective of supporting the producer's income.

In the past, minimum prices were practically the only income support instrument, leading the Government to make purchases and keep stocks that reached almost 20 million tons of grain. Since 1996 new support mechanisms were created, such as the Sale Option Contract, the Premium for Commercial Buyers Program (PEP), and the Product Drainage Value (VEP). The advantage of these intervention mechanisms is that they are low cost for society.

Despite the intense process of modernizing agricultural policy tools, which started in the mid-1990's, the Policy of Minimum Prices Guarantee (PGPM) still plays an important role on producer's planting decisions, mainly in low-price settings.

Federal Government Purchase (AGF)

This instrument allows the Government to acquire agricultural product from rural producers or cooperatives at the minimum price, whenever this is higher than market price. It also allows for the acquisition of products at market prices

within the sphere of family agriculture for the purpose of supporting them and building strategic stocks.

Federal Government Loan (EGF)

It is an instrument for the financing of producers, cooperatives, and agro-industry, based on the minimum price, with the objective of making it possible to form stocks and contribute to improve supply distribution throughout the year.

Special Credit Line for Marketing (LEC)

This credit line was created in 2003 to support agricultural marketing. Its operation is similar to EGF. While in the EGF the value of the operation must be based on the minimum price, the LEC allows the Government to arbitrate another price as parameter for the calculation of the amount to be financed. This instrument allows the execution of a stock carrying financing operation even without adjustments in the minimum price when it is not updated. The products eligible for that operation are defined by the MAPA and the Ministry of Finance.

Sale Option Contract

The Government offers this instrument to rural producers and cooperatives through auctions. The purchase of an option guarantees its holder the right to sell to the Government the amount of product linked to the contract, at its expiration, at a certain price (option price), provided that the specifications of quality, place of delivery, etc., are met. This contract indicates to market agents the government expectation of future prices, and constitutes an insurance price for producers and cooperatives. This is a more efficient way of intervention in the market than the Government's purchase of stocks through the AGF.

Repurchase or Transfer of Sale Option Contract

The economic subvention mechanisms, operated through auctions, exonerate the Government from the obligation of receiving the product from a Sale Option Contract, without any damage to the interests of their holders (producers and cooperatives). The repurchase happens when the Government is not interested in receiving the product and makes a reversion auction of the option contracts, so as to induce the holders of the options, by means of a subvention, to forgo delivering the product to him. Generally speaking, the holders of the options receive, in cash, the difference between the option price and the current market price. The Transfer consists in the substitution of the Government – the original issuer of the option contract – by a private agent, and attains the objective of supplying a certain region. The buyer of the transfer auction assumes Government's obligations towards

the holders of the option contracts. In both cases, the Government assumes the subvention, equivalent to the difference between the option price and the market price.

Premium for Commercial Buyers Program (PEP) and Product Value of the Commercial Buyers Program (VEP)

PEP is an economic subvention (premium) offered through public auction to buyers interested on the purchase of products in a given region directly from a producer or cooperative, by the minimum price set by the Government. It does not require government acquisitions. The payment of the difference between the minimum price and the market price made to a producer or cooperative through the final buyer is a tool that Government uses to complement the supply in deficient regions making use of private stocks. That is also the purpose of VEP, in which case the product comes from public stock.

Rural Product Note (CPR)

This instrument was created in 1994 to allow producers to anticipate the commercialization of their harvests and obtain resources to finance them. It can be issued by producers or cooperatives and represents a promise of future delivery of the product linked to it. The “CPR Financeira” was created in January 2000. It can be liquidated in cash and is frequently used as collateral for input financing operations. In 2004 it was canceled the authorization given to banks to finance industries interested in the early purchase of agricultural products, through CPR, using resources from bank liabilities.

Rural Promissory Note and Rural Trade Note (NPR and DR)

The use of NPR's and DR's allows processors of agricultural origin inputs to obtain rural credit resources to pay agricultural producers.

Equalizing Premium Paid to Producer (PEPRO)

This is a new instrument that allows the Government to provide price guarantee to producers (reference price), whose operation is similar to the ones of the Premium for Commercial Buyers Program (PEP). The main difference is that the premium is paid directly to the producer. This instrument exonerates the government from acquiring the product and allows the drainage of product from the producing regions to complement the supply in consuming regions. It is an operation in which the difference between the market price and the reference price defined by the Government, through public auctions, is paid to producers or cooperatives.

Private Sale Option Contracts and Private Option Risk Premium – PROP

The PROP was also created by the aforementioned Law No. 11.076, of 12/31/2004. This instrument works in a similar way to the classic Contract of Options of Sale to the Government. The government may make auctions of Sale Option Contracts of that product, according to the previously set price, amount, quality, place, and time of delivery, with the objective of supporting price quotation for a given product or signaling to the market the price trajectory it works with. Producers who want the guarantee that they will be able to sell their stocks to the Government must qualify themselves for those auctions and buy the options, paying a premium. If at the option's expiration date market prices are higher than the price established in the option contract, the producer will lose the paid premium and will sell the product in the market. If, however, the prices are below that value, the producer will sell the product to the Government, thus receiving a price above the one of market. When the producer purchases an option and pays for the premium, he acquires an insurance against price falls. In this new instrument, unlike the Private Sale Option Contract, the private sector issues the options instead of the Government, which is always subjected to budgetary restrictions in executing the agricultural policy.

The rural producer, or cooperative, is the holder of the option sold at auction and is entitled, but not obligated, to deliver the corresponding product to the issuing company. The issuing company is obliged to receive the product under the condition of fulfilling the specifications set at the time when the options sale auction is noticed. Therefore, the options issuer is exposed to the risk of being forced to pay a higher price than the one in effect in the market. The Government created the Private Option Risk Premium (PROP) to stimulate the issuance of Private Sale Option Contracts, which eliminates, up to a certain price level, the risk to which the issuing company is exposed.

According to the diagram in Figure 4, the application of the aforementioned instrument begins with the government's decision to hold an auction of PROP's to make possible the holding of Private Sale Option Contracts. The government anticipates the conditions of that operation, indicating the limit of official resources committed with PROP, sale option prices, option exercise dates, product quality, place of delivery, etc., and interested companies must qualify themselves for PROP auction. In this auction there is no premium payment. If the demand for PROP's by private companies surpasses the offer that the Government is willing to make, the value of the guarantee (the premium) will be reduced until offer and demand conditions match each other.

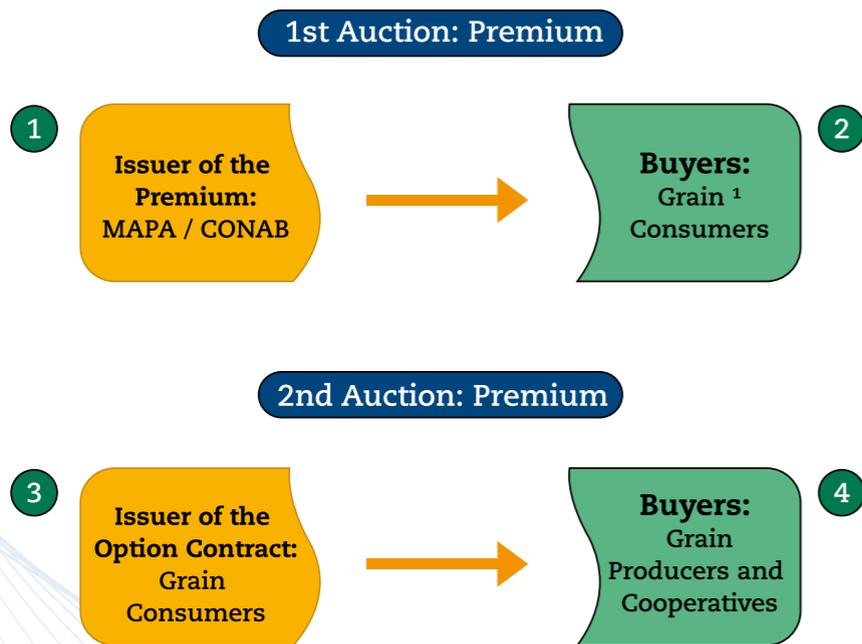
The PROP purchasing companies assume the obligation of holding Private Sale Option Contracts under previously set conditions of price, period, quality, delivery places, etc. If at options' expiration date the market price exceeds the option price, there will be no contractual obligation to any of the parties. However, when market

price exceeds the option price, there is usually an understanding among the parties so that they can negotiate the delivery of the contracted products at the price in effect in the market.

If at option's maturity market price is below the option price, the option issuing company will be obligated to pay more for the raw material than its competitors who did not adhere to the program. The Government, for its part, will be obligated to support the operation until the limit set in the PROP auction, but above that limit the option issuing company will be responsible for bearing the risk of overprices.

With respect to the cooperatives, they have the advantage of working in one side as issuer of private option contracts for their producers, and in another side as purchaser of option contracts issued by a given private company.

Figure 4: Operational Flow of PROP Auctions and Private Sale Option Contracts



¹ Cooperatives, poultry and swine farmers, feed and food industries, exporters, etc.

Agricultural Deposit Certificate (CDA) and Agricultural Warrant (WA)

The Agricultural Deposit Certificate (CDA) and the Agricultural Warrant (WA), created by Law No. 11.076/04, are credit instruments pegged to the production deposited in warehouses.

The CDA represents the promise of delivery of deposited goods, and WA grants the lien right on the goods described in CDA. Those instruments are twins, in that they are issued in the same moment and refer to the same lot of goods. They are issued by the depository of goods that belong to the owners of the stocks or to the successive buyers of those instruments. It must be registered in a system of recording and settlements of assets authorized by the Central bank.

In the past, after making a deposit of his production in a warehouse the producer could request that the depository issue the CD-W. The Warrant allowed him to pledge the goods as collateral for a loan, and the CD could be sold. That operation, however, was equivalent to a physical product sale that paid ICMS (State Sales and Service Tax) and hindered the execution of purchase and sale operations without the participation of the economic agent interested in processing or exporting the raw material. Consequently, it also prevented other economic agents from getting involved in the commercialization process, targeting as an example the carrying of price risk for a certain good.

Figure 5: Maturity of Private Sale Option Contracts

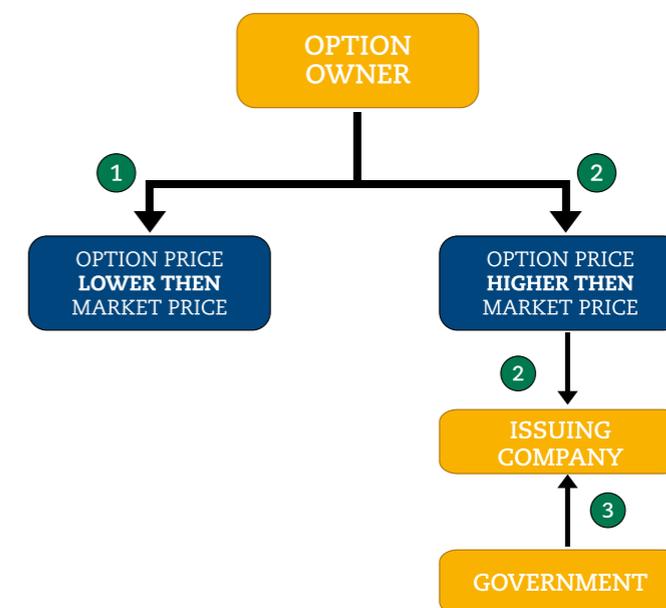
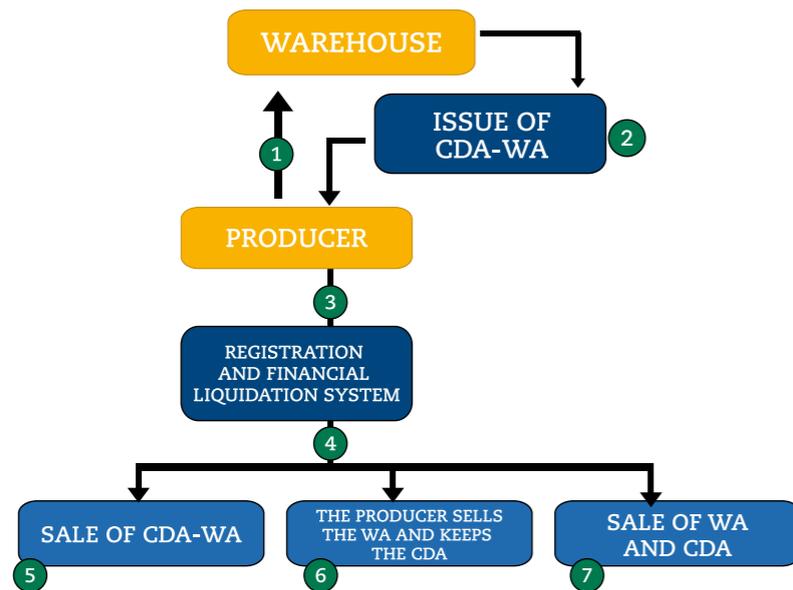


Figure 6: Operational Flow of CDA-WA

The new instruments bring a new dynamic to the commercialization of the stocks deposited in warehouses. As shown in Figure 6, the producer harvests the product, deposits it in a warehouse he trusts, and requests from the depository the simultaneous issuance of CDA-WA. The producers take these instruments go to a bank and request that they be registered and held in an entity authorized by the Central Bank. From that moment on the negotiation of the instruments necessarily becomes electronic. The WA allows its holder to pledge the product as collateral for a bank loan, while the CDA allows its holder to sell the goods, without any tax being due until the owner of the instruments, as economic agent, effectively desires to use the stored product for processing or sale.

After depositing the goods, and issuing and registering the CDA and WA instruments, the owner of the stored product has the following options, as indicated in Figure 6:

1. Sell the CDA-WA (the equivalent of selling the totality of its rights on the stored product);
2. Sell the WA (meaning the pledging of the goods as collateral for a financing transaction, and the producer may, at a future time, pay off the debt and fully retake his rights on the deposited goods);
3. Sell the WA and then the CDA (the equivalent of making a loan guaranteed by the deposited goods and later selling the CDA for the difference between the value of the CDA and the debt balance of the WA. In that type of operation the buyer can use deposited goods by redeeming the pledged WA).

A large number of operations became feasible by the creation of those instruments, because the depositor of the goods can request the issuance of the CDA-WA in lots equivalent to fractions of the deposited quantity. It allows the holder of the instruments to program the sale of the deposited product along the time.

The non-incidence of taxes in each commercial transaction that uses CDA-WA allows the holder of the instruments to sell them to someone who is not interested in the physical product as, for instance, the case of a pension fund that wants to carry the market risk of the deposited product, betting on price rises. The CDA-WA made it possible an expansion of the demand for rural production and created a new investment alternative for financial market operators. A new type of policy shall be created by the insurance market to insure those transactions.

AgriNote or Commercial Agribusiness Note – NCA

Regulated by the Securities and Exchange Commission (CVM) through Regulatory Instruction No. 422, the AgriNote or Commercial Agribusiness Note (NCA) is mainly characterized by its flexibility. Inspired by the old Promissory Note or by a contemporary

Commercial Paper, the AgriNote can be issued by an institution linked to any of the chains of agribusiness, by companies organized as corporations, limited liability companies, and cooperatives, or by rural producers organized as a legal entity.

The pegging of those operations can be based on receivables, on future or already available production, or simply on the good standing of the issuing company, and it is possible to add to them any type of insurance (performance, rural, moral, etc.), bank guarantee, rating, etc. The resources mobilized through this collateral can be used to finance working capital, commercialization, exportation, investment programs, modernization of the productive process, or for any other purpose.

Commercial Agribusiness Note are always issued and settled in Reals, but they can have any other currency as their reference and be distributed in Brazil, abroad, or in both markets concomitantly. They were conceived in such a way as to attract foreign investments, such as in the case of an importer of “in natura” or processed agricultural products, interested in financing an investment program of its supplier. However, the NCA can equally be used in shorter-term transactions, such as those of funding credit or production stocking financing, for two or three months, preventing the issuer from having to sell its harvest after the crop.

It is important to state that CVM’s regulation is extremely rigorous when the target public is formed by small investors, but quite liberal when it refers to big investors.

4

Rural Insurance

The rural insurance market comprises a large number of modalities and products, focused on agricultural income and productivity. In Brazil, whose insurance market is still incipient, productivity insurance is the most common modality. It offers protection to farmer's investments in the case of bad weather, plagues and diseases or other adversities, under the condition of performing appropriate production and harvesting techniques.

Rural insurance is one of the most important agricultural policy instruments, indispensable for the good performance of agribusiness, especially considering its size, dimension and socio-economic importance.

The Brazilian government is determined to expand and consolidate a private rural insurance system in the country and passed Law No. 10.823, of 12/19/03, regulated by Decree No. 5.121, of 6/29/04, which authorizes the granting of economic subventions to the rural insurance premium. It seeks to ensure the compatibility between the value of the premium that the producer can pay and the value that the insurance companies need to charge to keep the actuarial balance of their portfolios. Thus, the government provides subvention to part of the producer's expenses with the rural insurance.

The idea is to introduce a new culture among rural businesspeople and insurance market's leaders, and overcome the challenge of popularizing the use of insurance and break the vicious circle created by the idea that insurance is expensive because it is not used and it is not used because it is expensive.

Among the factors inhibiting the expansion of the rural insurance market, the following stand out:

- The risk of loss in rural activity, mainly due to adverse climatic events;
- Producers are unaccustomed to purchase rural insurance, hindering its popularization and reducing the value of the premium;
- The reduced number of insurance companies whose offer is concentrated in the South and Southeast regions.

Rural insurance premium is very high, which keeps producers from buying it, forcing the government to take the aforementioned measures for the development of the rural insurance market in the country.

4.1 Rural Insurance Premium Subvention

The Rural Insurance Premium Subvention Program (PSR) main guidelines are to promote ample access to rural insurance, assure the role of rural insurance as an income stability instrument, induce the use of appropriate technologies, and modernize the administration of agricultural enterprises.

The operations of the PSR began middle November 2005, benefitting seven cultures. In 2006, the PSR expanded its assistance to all cultures in the agricultural modality and included livestock, aquiculture and forest as beneficiaries of the subvention. Other measures taken by the government that represented important advancements in the implementation of rural insurance include the following ones:

a) Expansion of the credit limit

Producers willing to buy rural insurance receive an increment of 15% in their credit limit related to resources financed at preferential interest rates (controlled resources).

b) Financing of the rural insurance premium

The rural insurance premium can be financed with controlled resources, which increases the rural producers' liquidity as there is no need to allocate their own resources to cover that expense at the beginning of the harvest. The Government pays part of the premium and the remaining share is financed by the rural credit. Thanks to this support instrument and the increasing amount of resources allotted to it, the rural insurance program will cover 10% of the cultivated area in the harvest 2008/2009.

c) Support to insurance companies against climatic adversities considered catastrophic

In May 2008, the administration sent to the National Congress a complementary bill that creates a fund to support insurance and reinsurance companies in case of climatic events considered catastrophic. It will make possible the offer insurance products in regions of more unstable climate that was not assisted by insurance companies.

The financial and operational administration of the aforementioned insurance system would be private and would count on federal government's financial support through annual economical subventions and Government collateral, such as National Treasury securities to be deposited in a federal financial institution for a consortium of insurance companies that would manage the system.

d) Opening of the reinsurance market

Complementary Law No. 126, of January 15, 2007, opened the Brazilian reinsurance market to international reinsurers. There was a monopoly of the “Instituto de Resseguros do Brasil” (IRB – Brazil’s Reinsurances Institute) whose elimination will stimulate competition and further expand the insurance market, reduce premium values and improve the quality of insurance products through the incorporation of new technologies mastered by the international reinsurers.

Climatic Risk Agricultural Zoning

5

The climatic risk agricultural zoning, published by MAPA, is a technical-scientific tool of support to the management of risks in agriculture which seeks to guide the granting of agricultural working credit and the acquisition of rural insurance and Proagro.

The program was introduced in 1996 and expanded gradually, widening its utilization throughout the Country. Unlike other existing zonings, the agricultural zoning of climatic risk is based on the concepts of potentiality and agricultural aptitude. It analyzes the parameters related to soil, climate and plants, using mathematical and statistical functions to determine the probability of the occurrence of adverse climatic events that may cause crop losses.

The agricultural zoning of climatic risk identifies the best planting time for the cultivars for each municipality, analyzes historical climatic series of at least 15 years, and cross-checks those data with information on the cycle of cultivars and type of soil according to its capacity of retaining water. The goal is to reduce the possibility that the cultivars suffer from climatic adversities in their more sensitive phases by following restrictions imposed by the zoning, which are easily assimilated and adopted by rural producers, agronomists, extension officer, financial agents, insurance companies, and other users.

Considering the technological content of that program, the ministerial ordinances that annually publish the agricultural zoning also indicate the cultivars included in the National Cultivar Registration (RNC) of MAPA, adapted to each region in the country. This technical-scientific tool results from the work of a multidisciplinary team of nearly 50 specialists and uses the methodology developed and published by federal and state agricultural research institutions, following the methodological standardization and technical assistance set by the Brazilian Agricultural Research Company (Embrapa).

In this year of 2007 there are 272 zoning studies available for 23 cultivars, but they will be expanded to 600 until 2012.

Agricultural and Livestock Guarantee Program (Proagro)

6

Proagro seeks to exempt rural producers from meeting financial liabilities in rural working credit operations when they have income loss as a consequence of climatic adversities or diseases and plagues without a widespread method of combat, control, or prophylaxis. This program also indemnifies the resources owned by producers and applied in production.

The insurance operations made under the Program for the Strengthening of Family Agriculture (Pronaf), which is carried out by the Ministry of Agrarian Development, was included in Proagro in the 2004-2005 harvest and was denominated “Proagro Mais.”

Producer’s adhesion to Proagro occurs through the payment of a premium fee, whose rates vary according to the technology used, kind of product and compliance with the conditions established by the agricultural zoning of climatic risk published by MAPA.

Agroenergy

7

The world agriculture plays a new role in the economy as a source of energy and increases its participation in the energy market as supplier of raw material for the production of biofuel. In this area Brazil is acknowledged as a world leader in the generation and implementation of modern, tropical agricultural technology and has a robust agro-industry.

The Brazilian Federal Government created the Agroenergy Development Program whose aim is further insert agroenergy in the country energy matrix and contribute to its strengthening. This Program establishes both a framework and an orientation for the public and private actions involved in the generation of knowledge and technology that will contribute to the sustainable production of renewable sources of energy. The main goal is to enhance the competitiveness of Brazilian agribusiness and provide support to public policies aiming at social inclusion, regional development and environmental sustainability. Thus, its *purpose is to organize and develop the technological research, innovation and transfer in support to the sustainability and competitiveness of the agroenergy chains. The Brazilian Agroenergy Program also establishes institutional arrangements need to structure research, under which it was created an agroenergy consortium and a new Embrapa unit, the Embrapa Agroenergy.*

The actions undertaken under the Agroenergy Program, oriented towards the domestic market, are the identification of raw material that might be more adequate for biofuel production; the fostering of research with focus on productivity; regional studies on potentialities related to the production of bioenergy; support to improve producer organizations and technology transfer.

In the foreign sector, the government main goal is that biofuels become commodity in the international market. Thus, Brazil intensifies its initiatives of cooperation with major world producers and consumers, and with developing countries for which biofuel production and consumption might be an important source of economic and social development.

Governmental strategic actions on agroenergy

- **Sugar Cane Agro-ecological Zoning:** The agro-ecological zoning identifies areas suitable to sugar cane production and the ones where the planting should be avoided (environmental protection areas, vulnerable ecosystems, Indian reserves and areas used for other agricultural activities).

- **Oilseed Agricultural Zoning for Biodiesel Production:** Mapa works with Embrapa and MDA on the expansion of the zoning program for other crops considered as priority by the National Program for Biodiesel Production and Use. These measures shall stimulate farmers to choose the best regional investment alternatives, contributing to increase production efficiency and mitigate the risk of harvest loss, and improving the access to rural insurance and credit.
- **Strengthening of International Partnership:** The Brazilian Government undertook actions for the creation of the International Biofuel Forum, with the participation of the USA, European Union, China, India and South Africa. Brazil has cooperation agreements and memorandum of understanding with several countries (South Africa, Germany, Argentina, Denmark, EUA, France, Holland, India, Mexico, Paraguay, United Kingdom, Suede, Uruguay and others). The purpose is to work jointly for the development of the biofuel market.
- **Guidelines for Biofuel Social and Environmental Certification:** The Brazilian Government provides specific guidelines on safety at work and environment requirements so as to ensure that Brazil biofuels are produced according to desired social and environmental criteria. These measures shall qualify the country exports to the more demanding markets.
- **Complementary Actions:** Creation of an electronic information system (SAPCANÁ) to work on information provided by sugar and alcohol producers so as to improve sugar cane harvest forecasts and have greater information accuracy, including on the use of new areas of sugar cane production.

Infrastructure

The Brazilian agricultural and livestock sector's production and productivity has increased substantially in the midst of strong transportation and logistic constraints. Infrastructure deficiencies have strong impact on production costs and on food prices as well, which need to be properly faced to consolidate the country status as a major agricultural producer and exporter. The ongoing initiatives under the Enhanced Development Program (PAC) are deemed vital to solve Brazil infrastructure problems in the long run.

Investments on the construction and maintenance of roads, railroads, waterways and port facilities are essential for the adequate flow of agricultural production to the domestic and foreign markets, so as to ensure the country's agricultural competitiveness and income. Therefore, the coordinated actions between the Ministry of Agriculture and other ministries indicate the initiatives that should be undertaken and were included in PAC, such as dredging the navigation channel and the work on the basin to boatage service at the Itaquí port. This port and the Grain Terminal (Tegram) of São Luis in the State of Maranhão will allow the increase shipping capacity from 2.1 to 3 million tons of grains in 2009 and up to 5 millions afterwards.

Highways

The ongoing work of restoration, duplication, pavement, maintenance and construction deemed as essential to transport the harvest, mainly in the Center-West region, are the following:

BR 158: pavement of 400 km between Ribeirão Cacalheira, in the State of Mato Grosso (MT) and Mato Grosso frontier with the State of Pará (PA);

BR 364: construction and pavement of 185 km between Diamantino (MT) and Campo Novo dos Parecis (MT). The work shall be concluded in 2010;

BR 163: pavement and conclusion of its construction (1024 km), between Guarantã do Norte (MT) and Santarém (PA). The work shall be concluded in 2011;

BR 242: construction from Ribeirão de Cascalheira (MT) to Sorriso (MT);

BR 174: conservation and maintenance of it in MT until the end of 2008.

Waterways

The first Tucuruí navigation lock in Tocantins River (PA) construction will be completed by 2010.

Railways

The recovery of railway investments will bring a better equilibrium in the transport matrix favorable to the outflow of agricultural and livestock production. Among the works under way is the construction and extension of the railways that will compose the passage (corridor) Center-North, and will contribute to reduce freight costs and alleviate the problem of overcapacity in the ports of the southern and South-west regions.

The railway North-South will interconnect the States of Tocantins, Goiás, Mato Grosso do Sul e São Paulo, and will have 2258 km. 358 km will be completed by the end of 2009, covering the North part of the railway between Açailândia (MA) and Palmas (TO). Out of it, 147 km is already finished.

Another important railway for the Center-West is the so called Ferronorte (MT) on its interval of 260 km between Alto Araguaia (MT) and Rondonópolis (MT). The agribusiness will benefit from the construction of a railway branch of the so called Railway of the West of Paraná (Ferroest) between Cascavel (PR) and Maracaju (MS).

In the North-East region, the emphasis is on the construction of the railway Nova Tansnordestina, which will connect the ports of Pecém, in the State of Ceará (CE) and Suape, in the State of Pernambuco (PE), to Eliseu Martins in the State of Piauí (PI). This work shall be concluded by 2010.

Feasibility studies for the construction of the railways Transnordestina and North-South, between Estreito (MA) and Eliseu Martins (PI), shall be concluded by 2008.

Ports

The National Program of Drainage under implementation by the Special Secretariat of Ports will benefit 16 ports in the country. Most of them are of great importance for the import/export of raw materials and agricultural and livestock goods, such as the ones of Rio Grande (RS), Paranaguá (PR), São Francisco do Sul (SC), Itajaí (SC), Santos (SP), Vitória (ES), Aratu (BA) and Itaquí (MA).

Measures deemed as crucial for straightening the Brazilian Agribusiness

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Merchant Tax Elimination (AFRMM)

This tax of 25% is paid over the freight on the imports of agricultural and livestock raw materials and on the cabotage for the transport of agricultural goods. It has strong negative impact on agribusiness production costs and competitiveness. The Ministry of Agriculture is in favor of eliminating this tax.

Market openness of cabotage navigation for agricultural and livestock goods

Market reserve for Brazilian flag ships on the cabotage transport, mainly after Mercosul, became an obstacle to domestic marketing of Brazil agricultural production, as a consequence of the lack of maritime transport competition between Brazilian flag ships and foreign ships whose effects are higher freight costs. The Ministry of Agriculture believes this market reserve should also be eliminated.

Fertilizer

Fertilizer in Brazil is a strategic issue for agriculture due to its dependence on foreign market, high participation on production costs, price hikes and oligopoly in the domestic market.

The government mobilized its institutions in order to identify short and long run means of dealing with those constraints and evaluate the perspectives of auto-sufficiency along the next 10 years on phosphatic fertilizer and mineral nitrogenous fertilizer, and lower dependence on potassium.

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