

ALIGNING RURAL CREDIT WITH THE FOREST CODE

RESULTS CAN BE OBTAINED AT NO ADDITIONAL COSTS

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Context

Currently in Brazil, there is an important opportunity of aligning agricultural growth with protection of natural resources. According to estimations, it is possible to more than double the country's production in already available areas, that is, with no necessity of deforestation and suppression of native vegetation.¹ The combination of public policies, such as Rural Credit and the new Forest Code,² can bring substantial benefits to both rural modernization and climate change mitigation, at no additional costs and without causing ruptures in the current credit system. In a complex fiscal context and at a moment in which the government plans on implementing important reforms, aligning these two policies has the potential of helping correct distortions in Brazil's rural credit policy, which is outdated. **This document, which was elaborated by PUC Rio's *Núcleo de Avaliação de Políticas Climáticas* /Climate Policy Initiative (CPI), recommends the association between Rural Credit and the Forest Code to be put in practice in the next *Plano Safra* (2019/2020) – which is Brazilian annual agricultural plan.**

The new Forest Code goes beyond the protection of remaining forest areas.³ On the one hand, enforcing the code guarantees that Brazil's production is in compliance with sensible environmental legislation – a condition that has been increasingly valued in international trade. On the other hand, by establishing restrictions to the expansion of areas designated to agriculture in rural establishments, the law fosters productivity increases in place of area expansion, accelerating the modernization of production.

Recommendation for Public Policy

Amplification of credit limits to rural producers that comply with the new Forest Code—producers without environmental liabilities or producers with environmental liabilities and Environmental Regularization Program (PRA) approved by the competent agency.

A simple way to implement this change would be to reestablish the rules in the Central Bank's Resolutions 4,106/2012 and 4,226/2013, which amplified the limit to producers that met certain environmental requisites.

¹ See Antonaccio et al., 2018.

² The 2012 Law 12,651 of Protection of Native Vegetation is known as the Forest Code.

³ See Chiavari and Leme Lopes (2015a, 2015b and 2017).

Benefits of Integrating the Forest Code and Rural Credit

- I. **The Forest Code contains encompass public-good provision (environmental conservation) that could justify channeling public subvention—a concern that is even more important in the current fiscal crisis. Moreover, the public subvention would be focused on producers that comply with the legislation.**

The usual arguments used to justify credit subsidy programs (e.g. income generation and favorable commercial balances) hold not only to agriculture, but also to other sectors. The component of public-good provision of the new Forest Code, associated with the Legal Forest Reserve (*Reserva Legal*) and Permanent Preservation Areas (*Áreas de Preservação Permanente* – APP), brings rationality to the allocation of public funding to the sector. To remain in compliance with the new Forest Code, producers will have to preserve or recover native vegetation in their establishments. Channeling public resources can help boosting environmental preservation, bringing it closer to the socially desirable level, and justifying, from an economic perspective, the Rural Credit policy.

- II. **The new Forest Code can leverage the opening of new markets.**

Complying with the code represents a guarantee that food production in Brazil will be carried in consistency with the protection of natural resources. This is a very promising path for the country to associate climate negotiations with commercial negotiations of its own interest, creating a virtuous circle. On the other hand, the access to new markets constitutes a revenue source to producers, facilitating the implementation of the new law.

- III. **Rural Credit can contribute to foster resources that are necessary to the implementation of the Forest Code.**

The amount of resources distributed by the rural credit program can be an important funding source to the implementation of the new Forest Code. Moreover, if Rural Credit provides advantages to producers that comply with the law, it will be able to boost rural producers' private resources to the implementation of the Forest Code.

The Recommendation is simple and feasible

The proposal of amplifying the credit limit can be easily implemented for three reasons:

I. There is no need of additional resources from the National Treasury.

Indeed, current Rural Credit resources will only be preferably directed to producers that operate according to the legislation in force, promoting environmental conservation in line with the new Forest Code.

II. There is no incompatibility with the technical and political conception of Rural Credit.

The proposal doesn't interfere in other rules of credit granting, in the amount of available resources in each credit line or any other regional, economic or political issues.

III. Rural Credit distribution channels will remain unchanged.

Therefore, there is no great interference in the operation of the credit system, which involves thousands of managers spread in bank branches all over the country. These managers will be authorized to expand the limit only to producers who meet the proposal's prerequisites.

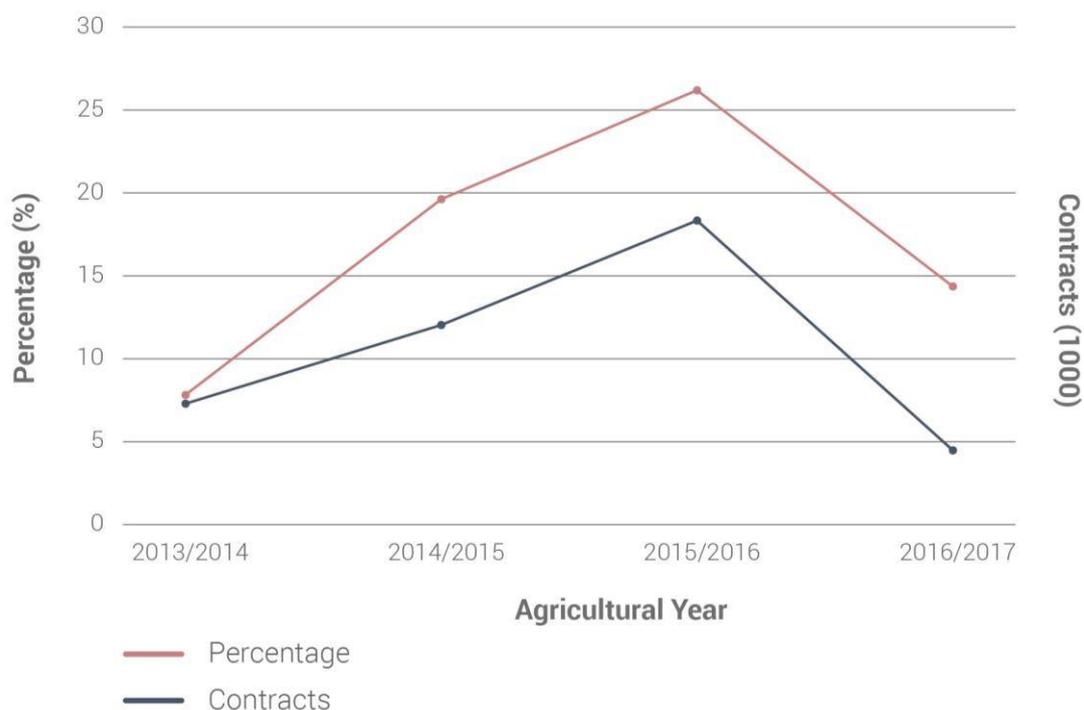
Relevance of the Proposal: Which Credit Contracts will be Impacted?

Over the past years, a considerable amount of rural credit was granted with contract values significantly close to the limits of the respective lines. This means that several producers are borrowing as much as they can within the established credit limits, and that they could benefit from expansions in those limits. Therefore, the proposal presented in this document has the potential of substantially impacting the rural credit policy, offering advantages to producers through the possibility of raising the contract values.

Figure 1 presents the percentage of the total amount of rural credit granted with contract values close to each line's limits (contract value over 95% of the respective line's limit). To produce this graphic, we considered the following credit lines: Compulsory Resources (*Recursos Obrigatórios*) not linked to a specific program, Rural Savings (*Poupança Rural*) not linked to a specific program, Pronaf, Pronamp, ABC, Inovagro, Moderagro, Moderinfra, Procap-Agro, Prodecoop. In 2016/2017, loans that followed the rules determined by these two funding sources⁴ and eight programs accounted for 70% of the total amount of rural credit and around 1.7 million contracts (91% of the total number of contracts).

⁴ Loans from Compulsory Resources (no specific program) or Rural Savings (no specific program) follow the funding source's rule, given that they are not attached to specific programs.

Figure 1: Percentage of the volume and number of contracts with values close to the credit lines' limits (over 95% of the limits), by agricultural year.



Source: The graph was elaborated by the Climate Policy Initiative with data from *Sistema de Operações do Crédito Rural e do Proagro* (SICOR) from the Brazilian Central Bank

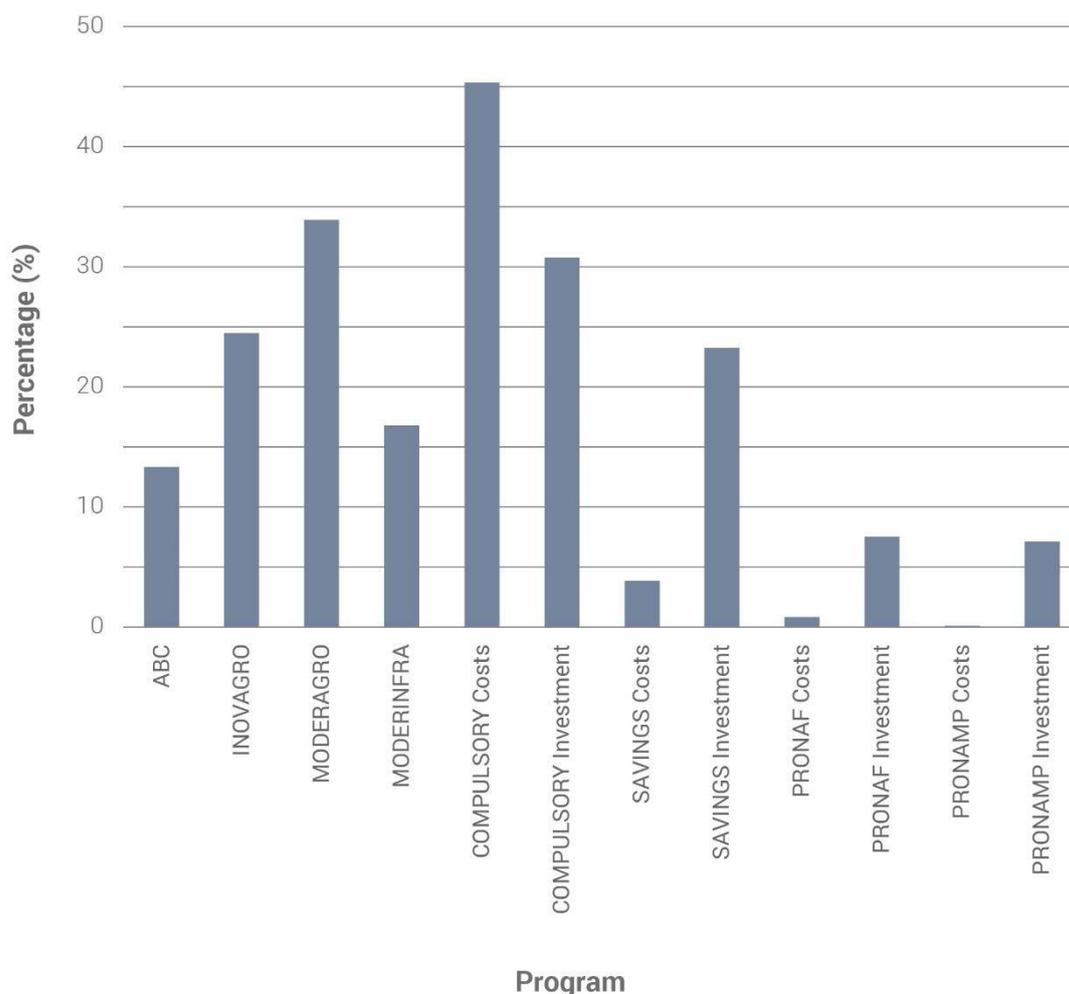
Figure 1 also shows that, in the 2016/2017 agricultural year, 14% of these lines' amount of credit came from loan contracts granted with values over 95% of the limits. In the previous agricultural year, 2015/2016, 26% of the amount were granted in contracts equally close to the limit.

Figure 2 presents the percentages of the amount of credit from each of the 10 credit lines analyzed that were granted at values over the 95% limit for the respective line in the 2016/2017 agricultural year.⁵ The Compulsory Resources credit line offered to finance production costs, which is one of the primary credit lines in the country, had 45% of its amount lent to contracts over 95% of the line's limit. Moreover, Compulsory Resources for investment and Moderagro also had important proportions of the amount of contracts close to the limit: over 30%.

Therefore, the potential impact of the proposal presented here is significant.

⁵ Solely Pronaf, Pronamp, Rural Savings and Compulsory Resources finance production costs. The other credit lines only finance investments. The programs Procap-Agro and Prodecoop didn't offer loan contracts with loans over 95% of their respective limits.

Figure 2: Percentage of the volume of credit with values close to the credit lines' limits (over 95% of the limits), by credit line, in the agricultural year 2016/2017.



Source: The graph was elaborated by the Climate Policy Initiative with data from *Sistema de Operações do Crédito Rural e do Proagro* (SICOR) from the Brazilian Central Bank

Relevant Facts

Record of Integration between Credit and Environmental Protection in Brazil

The idea of using credit instruments to foster the protection of natural assets is not new to Brazil. In fact, the use of Rural Credit to boost environmental protection precedes the enactment of the new Forest Code.

The Brazilian Central Bank's Resolution 3,545/2008 conditioned rural credit granting in municipalities in the Amazon to compliance with environmental rules and proven legitimacy of the property titles. Assuno et al. (2013) calculate that R\$2.9 billion (approximately US\$ 730 million) in credit were not loaned in the years spanning 2008 and 2011 as a consequence of this rule. The effect was a 15% reduction in deforestation during this period. This suggests that rural credit can, indeed, be an effective instrument for environmental preservation in Brazil.

As for the Central Bank's Resolution 4,106/2012, it determined that the rural credit limit for production costs could be raised up to 15%, in case the borrowers proved the existence of Permanent Preservation Areas or Legal Forest Reserve in their establishments. The limit was also extended to those that presented an environmental recovery plan approved by competent agencies.

After the new Forest Code was approved, the Central Bank launched the Resolution 4,226/2013. A new possibility was included: rural producers who were registered in the Rural Environmental Registry (*Cadastro Ambiental Rural* – CAR) could also benefit from a limit increase in credit for production costs of up to 15%. This way, in case the borrower legally proved the existence of Permanent Preservation Areas and Legal Forest Reserve and were also registered in CAR, the available ceiling could be raised up to 30%. However, this rule was revoked by the Resolution 4,412/2015.

Improvement of the Rural Credit policy is needed

Over R\$ 200 billion (approximately US\$ 50 billion) have been offered annually in the form of rural credit.⁶ However, the current rural credit policy design is based on a structure created in the 1960's and needs reforms in order to better assist producers and bring satisfactory returns to society.

Nonetheless, policy reforms of such magnitude and relevance need to be gradually implemented, so as not to cause ruptures to agricultural production funding in the country. Important changes should be introduced in the medium and long run, such as the simplification of programs and credit lines, and the development of more appropriate financial instruments for the sector's needs (e.g. insurance and derivatives).

This document focuses on a proposal that can already be implemented in the 2019/2020 *Plano Safra*, and which would represent an important step towards the reduction of distortions and provision of public goods. Moreover, the proposal creates incentives for States to advance in the code implementation, with the definition of still pending parameters. The proposal's goal is to simultaneously foster environmental preservation, agricultural productivity increases and efficient land use.

Brazil has a dual prominent position: agricultural and environmental

In the global context, Brazil is one of the countries that is most capable of contributing to the challenges of food safety while, simultaneously, mitigating climate change.

Since the 1970's, the country has had several cases of agricultural productivity gains and production intensification.⁷ Thus, the increase in food production has been linked to the

⁶ Amount of resources announced for the government plan focused on medium/large producers - *Plano Agrícola e Pecuário* (PAP) – and the plan focused on small producers - *Programa Nacional de Fortalecimento da Agricultura Familiar* (PRONAF).

⁷ See Assunção and Bragança (2015), Assunção, Lipscomb, Mobarak and Szerman (2016), Assunção, Pietracci and Souza (2016) and Bragança (2015).

modernization of cultivation practices and better use of large areas which are historically underutilized.

The integration between Rural Credit and the Forest Code has the potential of accelerating this process and favoring Brazil's leadership, both in agriculture and in the environmental debate.

The experience of the European Union's Common Agricultural Policy

The proposal is aligned with what the European Union has been efficiently applying for decades. The Common Agricultural Policy (CAP), which is the European Union's primary agricultural policy, has more than 95% of its expenditures concentrated in direct payments to rural producers, conditioned to the provision of public goods. Among the public goods that stand out are forest conservation, maintenance of good soil conditions and biodiversity conservation. To receive most of the funding available at CAP, producers must compulsorily comply with basic environmental rules. Moreover, the Green Payments currently compose 30% of the available budget and have three requirements: maintenance of permanent pastures, ecological interest areas and diversification of cultures. Note that CAP's Rural Development programs have an important role in expanding the adoption of climate-friendly practices, such as organic agriculture.

Differently from the European case, Brazil's resources are not channeled to the provision of public goods (with exception of the ABC Program, which is currently limited in scope). Better targeting of the subsidized rural credit program can make public subventions more effective.

Conclusion

The new Forest Code offers a unique opportunity to consolidate the sustainability of food production in Brazil. However, its implementation faces important challenges which require expressive effort and resources. A better alignment with the Rural Credit policy can be an easily executable alternative and bring Brazil closer to the best international practices. Finally, the improvement and better articulation between these policy instruments can accelerate the process of **modernization and productivity increase of Brazilian agriculture**, besides guaranteeing the protection of native vegetation.

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About CPI and INPUT

The **Climate Policy Initiative** (CPI) comprises a group of analysts and consultants who work to improve the most relevant public policies of energy and land use in several countries. CPI offers applied knowledge and solutions to decision-makers through in-depth analyzes, in order to support the improvement of the regulatory environment that is relevant for climate concerns. In Brazil, CPI has a partnership with PUC-Rio's Núcleo de Avaliao de Políticas Climáticas (NAPC/PUC -Rio).

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