

## WHAT IS CPR AND ITS IMPORTANCE TO THE BRAZILIAN AGRICULTURE FINANCE

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### ABSTRACT:

In the eighties, when several economic crises forced the public sector to reduce its budget and caused the bankruptcy of the credit system in Brazilian agriculture, a new instrument was developed: CPR (certificate of rural product).

This paper presents a discussion of what is CPR, how this new instrument of credit has been developed and how it is important for producers to finance their activities.

### 1. INTRODUCTION

Brazilian economy, by mid 70's, started to suffer inflationary pressure and imbalances in external payments (Mendonça de Barros, 1979). As a consequence, the government could no longer supply the usual amount of financial resources to the farmers and the formal credit system created in 1965 started to shrink.

The reduction of resources for the rural credit system is strong evidence that this model had exhausted. Besides, inappropriate legislation and bureaucracy biased the process of credit distribution in favor of larger farmers.

In the macroeconomic context, the general situation of agricultural financing is not less comfortable. The interest rates prevailing in the Brazilian economy have been extremely high, thereby increasing the cost of credit to the farmers. Unfortunately, the short-to-medium perspectives for a considerable interest rate reduction are not promising.

The lack of rural banking facilities (almost all credit lines are in the banking system) and the high producers' risks (no protection system exist to dilute the risk for the whole system) are also great constraints for the development of a new financing system (Gasques et al., 2000)

Despite a series of proposals discussed in academia and in Congress, nothing that could be considered a new system of financing agricultural has appeared so far. The only noteworthy new credit instrument is the CPR (Certificate of Rural Product), described below.

### 2. THE AGRICULTURE PRODUCERS' RISK AND FINANCIAL INSTRUMENTS

Agriculture has some aspects that increase the risks of the activity, as:

- Production quality
- Prices volatility
- Technical characteristics of productivity
- Climate risks

To reduce the price's risk in agriculture, the producers can make hedge, in other words, make use of forward contracts or options to minimize risks caused by prices volatility.

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Forward markets, futures & options are relevant instruments, for producers, investors and traders to reduce the risk of agricultural activity. Forward contracts obligate buyer to buy or sell a certain amount of product at a future date.

Usually, forward contracts are settled between agents who expect to receive or make payments by units of product; the amount of product and the date are set by the agreement.

Futures are contracts to trade given amounts of products at a specified date. And, Options provide the holder with the right (but not the obligation) to buy or sell contracts of products at an agreed rate within a period of time, in return for a fee paid to the seller of the option.

### 3. THE FINANCIAL INSTRUMENT KNOWN AS CPR

Early experiences with CPR began in 1994 by Banco do Brasil. It was a financial asset, issued by farmers and their cooperatives with the following characteristics:

- a) The issuer sells his/her own agricultural production, receiving in advance a certain amount of money<sup>3</sup>. The CPR specifies the product negotiated in terms of quantity, quality, place and date stipulated;
- b) The value of CPR is determined by the quantity of commodity specified;
- c) It may be transferable to third parties through endorsement; and,
- d) It may be negotiated in the secondary market, as a financial asset, before its expiration date.

Basically, CPR is a financial asset. Its mechanism is very simple: the farmer issues a CPR, promising to deliver a given quantity of product at a given future date and local. In exchange, the buyer pays, in advance, a given amount of money corresponding to the quantity of product specified. The operation is nothing else than an advanced sale of (future) production. Figure 1 shows the transaction mechanism of CPR:

Early experiences, in mid eighties, were mainly with soybeans in the Cerrado Region. The prices were “to-be-fixed” by the farmer at any time before the “due” date (Pimentel, 2000).

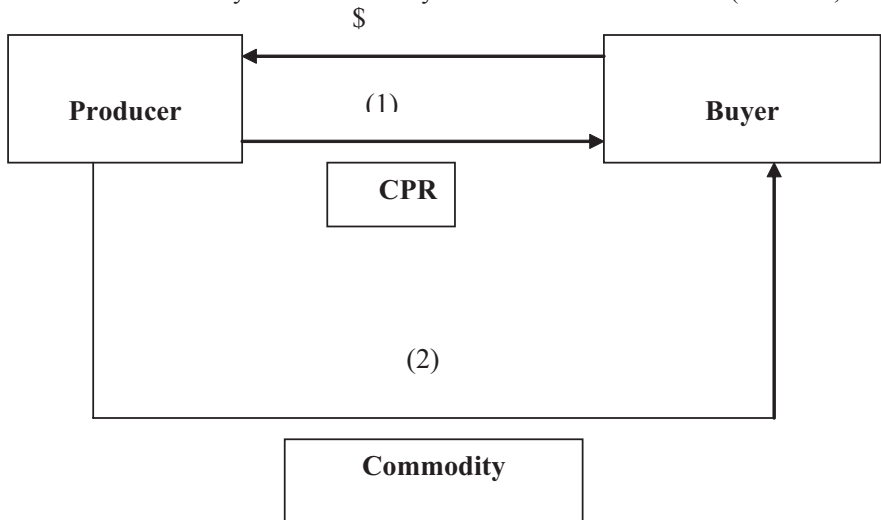


Figure 1- The mechanism of CPR's transaction.

<sup>3</sup>Instead of payment in cash, farmers may receive inputs (fertilizers, chemicals and/or machinery)

A legal instrument, called the “Medida Provisória” 2,017 of 19/01/2000, created the so-called “financial liquidation” of CPR. In this case, at its maturity date, the farmer repays the CPR at a previously defined price, as calculated by equation 1.

A great advantage of financial liquidation is its attractiveness to any investor, since it does not require the delivery of the product. Rather, the CPR’s liquidation is through the payment (in cash) of an amount equivalent to the quantity/quality of the product specified in the contract.

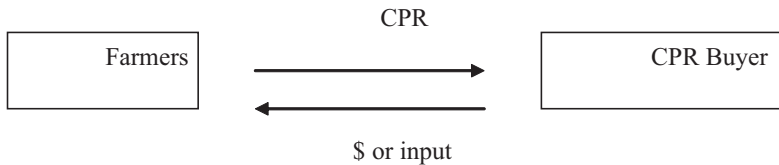
$$VR = VL \times (1 + ja)^{n/252} \quad (1)$$

- VR = Repayment value;
- VL = CPR’s value;
- n = CPR’s duration (in days); and,
- ja = Annual interest rate.

Of course, this means that the liquidation price must be precisely stated in the CPR. Ideally, this price should be transparent, widely known and easily accessible<sup>4</sup>. Figure 2 shows the transaction mechanism of CPR with financial liquidation:

However, there are two problems related to the financial liquidation of the CPR: the high risk to the farmer (in the event of crop failure), once the production risk is considerable; and,

- At the planting Time



- At Harvest

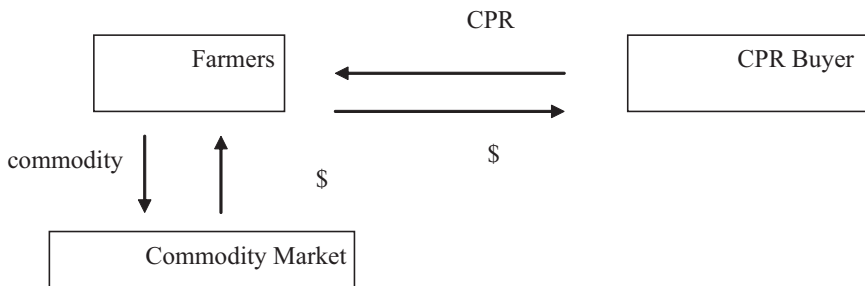


Figure 2. the transaction mechanism of CPR with financial liquidation

the high interest rates prevailing in the Brazilian economy (Schouchana, 2000). On the other hand, the interest rate of CPR is the second lower rate in Brazil compared with Selic Tax, that is the basic interest rate of Brazilian economy. Figure 3 shows the recent evolution of CPR interest rate and Selic rate.

It is important to consider that the market players are not the just speculators, but com-

<sup>4</sup>Schouchana (2000) argues in favor of prices negotiated in formal exchange markets.

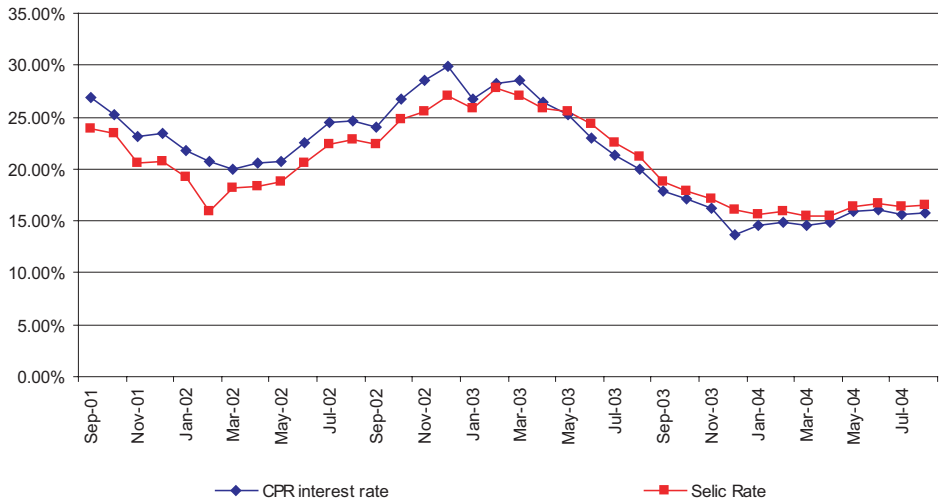


Figure 3. Evolution of CPR interest rate and selic rate – Sep/2001 to Aug/2004.

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panies and traders that need rural products for export or processing. The high competition in this market makes the CPR rate lower than selic rate since May/03, which financial volume is higher than R\$ 90 millions.

### 3.1. The Evolution of CPR Market in the Last Decade

Since the guarantee’s costs of CPR are high, there is a considerable amount of CPR’s called “of drawer” without official registration in CETIP (Pimentel, 2000). Informally, it is estimated

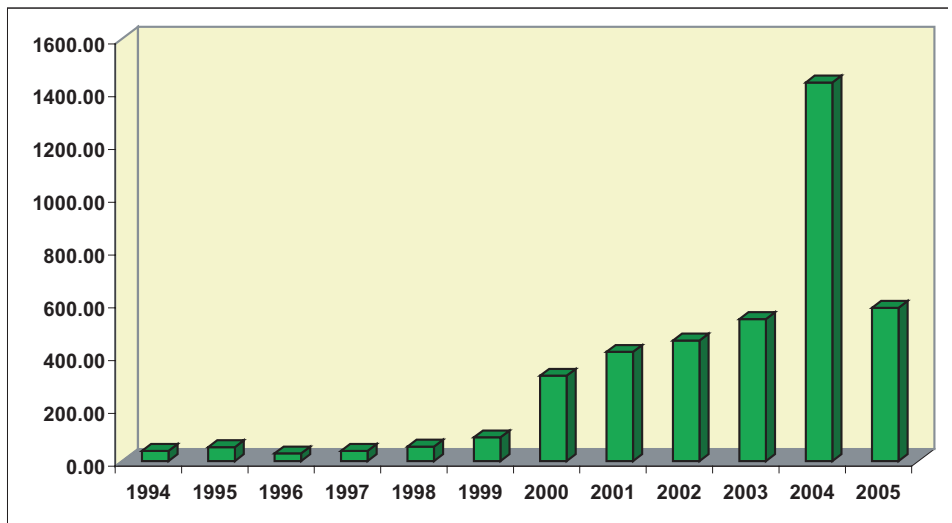


Figure 4 – Evolution of CPR’s in Brazil, 1994–2005\* (R\$ million).

Source: Bank of Brazil \* Values from January to May 2005.

that around R\$ 4 billion in “drawer CPR” are negotiated. However, no formal study confirming this amount exists so far. On the other hand, CPR does seem to have potential value. Even with high guarantee and interest costs, its recent evolution has been quite significant (Figure 4).

The growth of CPR’s was approximately 3629% in the period 1994 to 2004. Most of the CPR is with financial liquidation. Coffee, soybean and cattle, together, represent around 80% of the operations. One of the justifications for that growth is the fact that the CPR allows protection against price drops, besides the financing of the production.

The figure 4 shows the transactions with CPR, considering the categories of commodities. The most part of transactions is concentrated in coffee, cattle and soybean.

1995	1996	1997	1998	1999	2000 to 2004
COTTON	CATTLE	COTTON	COTTON	COTTON	COTTON
COCOA	COFFEE	CATTLE	RICE	RICE	RICE
COFFEE	SOYBEAN	COFFEE	BEEF CATLE	BEEF CATLE	CHICKEN
MILK		SOYBEAN	COFFEE	COFFEE	CATTLE
CORN			CORN	VEGETABLES	COFFEE
SOYBEAN			SOYBEAN	CORN	SUGAR CANE
ORANGE JUICE			WEAT/TRITIC ALE	SOYBEAN	NUTS
				WEAT/TRITIC ALE	EDIBLE BEANS
					SOYBEAN

Figure 4. Selected commodities negotiated with CPR

Source: Bank of Brazil

2001 was the period when CPR had a big market expansion, when 24 products were negotiated. These products were: SUGAR, COTTON, RICE, CATLE, BUFALOS, COFFEE, SUGAR CANE, PALM OIL, SHELL-FISH, FRUITS, TURF, GRASS, MILK, WOOD, CORN, EGGS, BLACK-PEPPER, SOYBEAN, PIGS, WEAT/TRITICALE, SUN-FLOWERS, CHEESE, GRASS SEEDS. Today, these products are still been negotiated and they represent 1.7 percent of all negotiations during 1994 to 2004.

## CONCLUSION

Since several economic crises forced the public sector to reduce its budget, and the lack of alternative funding caused the bankruptcy of the traditional system, a new instrument was developed to fill the gap: CPR (certificate of rural product).

The evolution of CPR market, in last decade, shows the potential of this instrument, that is an alternative system to finance the Brazilian agriculture activity. On the other hand, this market has potential problems like:

- Risk of crop failure
- Farmers may not be able to honor contract
- Crop insurance not widely available (high interest rate)
- Cost of CPR due to the high interest rate
- Unregistered CPR ( “de gaveta”)
- Lack of futures markets with a wide range of products



The improvement of laws that regulate this market should be the next step to support the strong growth of CPR market. The legislation must guarantee the repayment for the CPR buyers, and reduces the costs of loans to farmers.

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