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FINAL REPORT

**RURAL SAVINGS MOBILIZATION/AGRICULTURAL
CREDIT PROJECT**

PREPARED FOR USAID/EL SALVADOR

BY

CONTRACTING CORPORATION OF AMERICA

**Jerry R. Ledman
José Isaac Torrico
T. Dwight Bunce**

Contract No. 519-0263-C-00-5475

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² The study was financed by USAID/El Salvador. However, reported opinions, conclusions, and recommendations are those of the authors and not necessarily those of the Agency for International Development.

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PREFACE AND ACKNOWLEDGEMENTS

This report was prepared by Contracting Corporation of America. The study was undertaken by a three-person team which was headed by Jerry R. Ladman (Agricultural Economist). The other team members were José Isaac Torrico (Rural Financial Markets Specialist), and T. Dwight Bunce (Financial Analyst). Field research and data collection were carried out by Daniel Quinteros, Frank Navarrete and Jorge Burgos. Two Arizona State University research assistants Jorge Gobitz and Rosalie Bondad, also made important contributions in the formulation of the econometric model for the empirical estimation of the elasticity of savings and for the revision of literature.

We received assistance from many persons and from various financial institutions too numerous to mention by name. We are very grateful to Kenneth Ellis, Clemence Weber and Ana Luz de Mena of the USAID/El Salvador Rural Development Office for their excellent support and backstopping of the project. Above all, special appreciation is due to ABANSA. From the beginning of the study, we had the support of the ABANSA's manager, Licenciado Ricardo Escalante. Much of the data we needed from the mixed commercial banks was provided through ABANSA. We are also very grateful to Eng. Rafael Antonio Alvarenga and BFA's executive personnel and field agents for their help in providing information. Appreciation is also expressed to Licenciado René González Paz, from BCR banking statistics department, to presidents and head officers of agriculture departments of the mixed commercial banks, and the Mortgage Bank. Gratitude is also due to INCAFE's financial manager and to FEDECCREDITO and FEDECACES executive personnel for their support in providing information.

We also express our appreciation to Rosa María Quinteros, María Agustina Magaña and Irma Valenzuela Guzmán for their secretarial assistance. We are very grateful to Elizabeth Pelegero, Contracting Corporation of America Administrative Assistant, for her considerable assistance in making logistic arrangements.

Doctor Alfonso Rochac was of invaluable help in providing the institutional background on Salvadorean financial institutions' development.

EXECUTIVE SUMMARY

This report is a study of El Salvadorean rural financial markets. It specifically focuses on the supply and demand of agricultural credit and rural savings mobilization. The report has three broad objectives: (1) to examine and analyze rural savings mobilization and agricultural credit in El Salvador, (2) to identify the needs for and possibilities for mobilizing more rural savings and extending more agricultural credit, and (3) to make recommendations to USAID and the government of El Salvador for policy and project interventions in rural savings mobilization and agricultural credit. Particular emphasis is placed on the needs of the reformed sector and other small farmers.

The report consists of fourteen chapters which contain the detailed data and analysis. The reader is referred to Chapter XIV for a detailed summary, conclusions and recommendations. The executive summary presents a condensed version of the principal findings and recommendations.

Agricultural Credit

Institutional Structure

There are six classes of formal-market institutions that extend credit to agriculture: the state Agricultural Development Bank (BFA), Mortgage Bank, nine mixed banks, National Coffee Institute (INCAFE), El Salvadorean Federation of Credit Unions (FEDECACES) and the Federation of Rural Credit Funds (FEDECCREDITO). In addition, there is an active informal-credit market consisting of money lenders, middlemen and some input suppliers.

BFA and the Mortgage Bank each provide about one-fifth of the annual flows of formal-market credit. The mixed banks provide about half. INCAFE is disengaging from lending for coffee production, directing its credit to processing.

Agricultural lending is highly centralized in the capital city. Virtually all loans from the mixed banks and the Mortgage Bank are managed out of the central offices, despite the fact that they have numerous branches in urban centers outside the capital. BFA decision making is more

decentralized, the twenty-five agencies and zonal committees have loan approval authority for loans up to ₡50,000.

Credit

In 1984, whether measured by annual flows or year-end portfolio, the agricultural sector received less credit in real terms, after taking account of inflation, than it received in 1980. This figure, however, understates the decline because it includes refinanced loans, which by 1984 accounted for about 28 percent of the portfolio. Over the 1980-1984 period, the mixed banks were the only class of institution to show a positive real rate of growth in lending to the sector.

The large majority of credit is for short-term production purposes. Lending is heavily concentrated in the capital-intensive traditional export crops of coffee, cotton and sugarcane, however, between 1980 and 1984 the real amounts of credit for these crops as well as for basic grains declined. Land reform, civil strife, terrorism, soft world markets for exports and unfavorable domestic pricing policies were contributing factors. The real levels of credit for non-traditional products such as fruits, vegetables, livestock, poultry and fisheries increased, reflecting some new diversification in the sector. These new activities were undertaken by non-reformed sector borrowers. Reformed sector clients used credit for traditional crops and in a lesser extent for diversification.

Clientele

Over the 1980-1984 period, the reformed sector received 18.2 percent of the credit; with the large bulk of the rest going to medium- and large-sized farmers. Most reformed-sector credit goes to Phase I cooperatives. In 1984, 244 cooperatives were served. All have been assigned to specific institutions. BFA had almost half and the mixed and Mortgage Bank the other half. FEDECREDITO and INCAFE had less than one percent. Over the 1980-1984 period BFA's portion has risen, as some problematical cooperatives were transferred to it from other institutions: a factor which contributed to BFA's difficulties.

About 19,000 Phase III beneficiaries received credit in 1984; the equivalent of 30 percent of those with titles. Of these, four-fifths were served by BFA and most of the others by the mixed banks. In order to reach

more farmers, BFA has formed solidarity groups to make group loans to the beneficiaries and other small farmers.

Delinquency and Refinancing

The delinquency is a major and serious problem for all institutions lending to agriculture. Rates of 25 percent or more for most institutions are common. The true state of delinquency is masked over, however by refinancing. Since 1980, the government has applied a policy of liberal refinancing of delinquent loans to counter the serious problems that arose due to the difficulties associated with agrarian reform, civil strife and unfavorable market conditions. As a consequence, between 1980-1984 refinanced loans in the year-end portfolio grew at an average annual rate of 13.7 percent. Although, this was a short-run solution to help financial institutions and make borrowers eligible for future credit, in the long run it will be problematical. It is probable that a large portion of the refinanced loans will never be repaid or if they are their real value will be considerably less than the amount lent. In either case, they represent income transfers from the lending institutions (or indirectly from the government) to the borrowers.

Source of Funds

Institutions use their "own" funds (deposits, capital), Central Bank of Reserve (BCR) rediscounts or special domestic or foreign aid sources of funds. Of these sources BCR rediscounts and foreign aid are the most important. Since 1980 USAID and IDB have made major loans commitments, totaling \$178 million, to El Salvador to establish loan funds in BFA. These commitments account for 61 percent of foreign assistance to the agricultural sector. USAID has also provided financing for FEDECACES as well as projects to support the organization development of the Phase I cooperatives. This has been BFA's principal source of funds for extending credit to the reformed sector.

BCR rediscounts are the most important sources of funds for Mortgage Bank and mixed-bank lending to agriculture. The institutions prefer to use their deposits for financing other classes of loans.

Credit Delivery Systems

The banks were found to use credit delivery systems that are generally cumbersome, time consuming and costly. This would be expected, however, because they are used as credit rationing mechanisms in face of an excess demand for credit. Another reason is their concern for control over the use of credit, both in the loan application phase and during the course of the loan. Much of this concern is derived from the government's credit plan to direct credit, especially BCR rediscounts, to targeted purposes.

There is considerable room for streamlining the credit delivery systems, which would reduce costs for both lenders and borrowers. The motives for doing this, however, lie in needs to reduce administrative costs and/or to reduce the need for using costly credit delivery systems as a way to ration credit; matters to be discussed below.

Informal-market Credit

Case studies in four communities showed considerable informal-market lending by identifiable moneylenders and middlemen. Both lend money for the crop cycle, usually in rather small amounts to numerous small farmers. Some of these lenders obtain their funds from bank loans, especially BFA. The annual interest rate in 1985 was 24 percent. The credit delivery system is very simple, there is virtually no paperwork, so transactions costs are low. These lenders are clearly performing an important service to many small farmers. Competition among lenders, keeps them from exercising excessive monopoly powers. It is a system that is worthy of more exploration as a way to get credit to small farmers, for example by means of bank loans to informal-market lenders.

Monetary and Credit Policies

The Monetary Board has taken a passive stance with respect to monetary and credit policies; it makes infrequent use of changes in its instruments of legal reserve requirements, maximum interest rate structure, rediscount rate and foreign exchange rate to influence macroeconomic performance and financial markets. With respect to credit it has preferred to use regulations and controls to direct amounts and flows. In the case of agriculture, the basic instruments are BCR rediscounts within the fixed interest rate structure. The rediscounts are limited in amount and are directed towards targeted activities that are established by a national credit

plan. In the 1984/1985 agricultural year there were sixteen rediscount lines for agriculture.

The interest rate structure establishes maximum loan rates and minimum deposit rates. There are several classes of loan rates, with preferential and concessionary rates given for priority activities, the rate structure for most agricultural loans was 13 or 14 percent, including agriculture.

The Monetary Board has kept the interest rate structure at low levels, using cheap credit as a stimulus for economic activity and as a means to reduce inflationary pressures. It is also political, concessionary credit implies subsidies and income transfers. After taking account of inflation the loan rates are low or even negative, thus the income transfer is substantial.

The low rates also contribute to an excess demand for credit which creates the need for other credit rationing mechanisms. The low rates contribute to the misallocation of financial and real resources, worsening income distribution, the lack of financial viability of financial institutions, the creation of higher borrower transactions costs and serve as a disincentive for financial savings since they implicitly put a ceiling on deposit rates.

The rediscount lines attempt to limit the amount of lending and to direct the flow of credit to the sector. The rediscount policy undoubtedly has an impact on the amount of credit flowing to agriculture and on how credit is distributed, but there is little doubt that its net impact is different than is planned because of fungibility. As a result "agricultural illusion" can be expected, some funds that are ostensibly borrowed for agricultural purposes at concessionary interest rates are indeed directed to other endeavors, investments or even consumption.

Demand and Supply of Credit

Excess Demand

The decline in agricultural credit use over the 1980-1984 period was associated with a decline in sector GDP. If the government had not made special efforts to lend to the reformed sector cooperatives the demand would have declined even more. The decrease in demand was accompanied by a decline in supply. The monetary authorities were reducing credit to control inflation and forestall devaluation. Nevertheless, there continued to be an excess demand, as would be expected with concessionary interest rates.

There is evidence of excess demand because of non-interest rate credit rationing mechanisms that were imposed by both the Central Bank and the several financial institutions. The extent of the excess demand in 1985 was estimated by interviews with the chief agricultural credit officers of the mixed banks, the Mortgage Bank and BFA. In their view, there was \$94.6 million in unsatisfied demand, which was the equivalent of 33 percent of the annual flows of new credit, excluding refinancing, in 1984. According to the bankers' judgement, even if the interest rate were raised to the level of the informal market, an excess demand would exist.

Of the total estimated excess demand, \$36.98 was in the reformed sector, mostly in the Phase I cooperatives, and \$19.32 for other small farmers. About three-fourths of this demand was for medium-or long-term investments, including livestock irrigation, coffee plantations and agroindustry.

Future Demand

Future demand for credit will be basically a function of the profitability of farming. Unfortunately, the outlook for significant growth in El Salvador's traditional exports is limited and may even be problematical, especially in cotton and sugar. Non-traditional exports of shrimp, fruits and vegetables appear to offer growth potential and, the demand for more financing of these products can be expected. There will be an increase in demand for domestic foodstuffs associated with economic recovery and population growth.

Government policy will play an important role. Domestic price supports and preferential entry into the U.S. market have bolstered sugar productions. If either of these were to be withdrawn this activity would encounter trouble. Coffee producers continue to be lamed through unfavorable exchange rates and windfall taxes when prices rise. Both discourage production, but, of course, El Salvador has limits imposed on its production by the International Coffee Organization's country quotas. Government support prices have bolstered cotton production in face of a declining and problematical world market; nevertheless, cotton production has declined considerably. The government has a domestic price support program, but IRA cannot buy all of the production. Since the government subsidizes the consumer by selling the products at lower prices in the domestic market, market forces take the price to less than the support levels, decreasing profitability. There are attempts to keep input prices low. Many are sold through the BFA's input supply stores. With the new and higher official

foreign exchange rate, prices of inputs will be higher in the future. This will put a squeeze on profits.

Social conflict and terrorism will also play important roles. Agricultural production in conflict regions is seriously disrupted. In these areas and others, terroristic activities, like burning of fields, has created an additional production risk. Both of these contribute to a decrease in demand. Although these problems have diminished since the early 1980s, they are still significant.

These problems were identified by the bankers when asked to specify the most important factors limiting the demand for credit. Their responses were: high costs of inputs, low export prices, social conflict and terrorism, high interest rates, low prices for domestic products, high interest rates and lack of marketing infrastructure. Phase I cooperatives were also considered to face problems of cooperative management and organization.

In spite of these difficulties, the bankers were optimistic about the future demand for credit. In these view, between 1986 and 1990 the real demand for credit will increase at an average annual rate of 10.7 percent. At this rate, by 1990 El Salvador will have a total demand for agricultural credit of \$639.1 million.

Savings Mobilization

The Record

El Salvadorean rural financial market policy has been almost exclusively directed to agricultural credit; scant attention has been given to mobilizing deposits in rural areas. For example, the BFA is authorized to mobilize deposits, yet it has only done this in a token way in three offices.

The mixed Banks and the Mortgage Bank have been quite successful in mobilizing deposits, but not among small farmers. Their clients are mostly urban residents and the urban working class. It is almost certain that they are effective in mobilizing deposits among the medium-and large-sized farmers, most of whom reside in urban sites.

Indeed, over the 1980-1984 period, El Salvador has had an impressive record of mobilizing time and savings deposits in financial institutions. In each year, the real value has increased. There has been a shift, however, to the longer-term but higher interest paying time deposits, which reflects and

increased confidence in the economic and political situation as well as the desire to combat the effects of inflation. Most of the savings were in the mixed banks, the Mortgage Bank and the savings and loan association.

This has occurred in spite of monetary policy that has created few incentives for savers. Deposit rates are pegged to the loan rates and the structure has been changed only infrequently. Taking account of inflation, the real rates have been very low, mostly negative the mixed banks use other incentives to mobilize deposits, including promotional campaigns, raffles and life insurance.

A longitudinal study of the determinants of time and savings deposits in financial institutions showed the level of GDP and financial deepening to be the most important determinants of savings. The interest rate also played a positive role, but deposits were found to be inelastic with respect to the interest rate, probably because there were so few changes in the rate structure over the time period.

Small-farmer Saving

As noted above, financial institutions lending to the agricultural sector have depended to a large extent on infusions of capital--foreign assistance, BCR rediscounts and government subsidies--to obtain their loanable funds for the sector. The terms and conditions of these funds have been sufficiently attractive to not motivate the institutions such as BFA, to make special efforts to mobilize savings among small farmers. Thus, an opportunity for financial intermediation is lost, the institutions remain dependent on outside funding and farmers lose the opportunity to save in financial institutions.

BFA Feasibility

BFA is an ideal institution for trying to mobilize savings in rural areas, because it has twenty-six offices throughout the republic. Recently, the Bank has developed an interest in mobilizing more savings as a result of a shortage of loanable funds, in part caused by the high rates of delinquency and refinancing, and prospects of reduced foreign assistance. Feasibility studies for deposit mobilization on BFA agencies were conducted. These indicate that deposit mobilization can be profitable for the Bank.

There is a question whether small farmers have much capacity for saving. Although they are low income it is almost certain that they are

presently saving in some form, inventories of crops, livestock, cash or other liquid merchandise. Experience from other countries suggests that if savings facilities were made accessible to them and transactions costs of deposits and withdrawals are low that farmers will prefer to place at least a portion their savings in financial institutions. If real deposit rates were higher, the incentives would be even greater.

The experience of the mixed banks and the Mortgage Bank suggests that many low income persons save in financial institutions. The number of savings accounts in these institutions is equivalent to about 12 percent of the nation's population.

If the BFA begins to mobilize deposits in a more serious way, important side effects can be expected. The Bank will be forced to deal with higher financial and risk costs which will force a greater cost consciousness in the Bank and an incentive to reduce delinquency. The end results should be to make the institution more independent and financially viable.

BFA deposit mobilization will not only benefit small farmers. Deposits can also be expected from other rural residents, businesses and even larger farmers.

FEDECACES Feasibility

Credit unions offer another good opportunity for mobilizing rural savings. At present, they obtain forced savings by means of monthly deposits from their members. They could, however, mobilize voluntary savings with promotional efforts and other incentives. Although, it is doubtful that they have the potential to mobilize the volume of savings as BAF does it would be useful to encourage savings mobilization in these institutions. In this regard, FEDECACES should be encouraged to develop a training unit to work with credit unions in developing saving mobilization capabilities.

Recommendations

On the basis of this study there are two broad recommendations: (1) to increase the supply of agricultural credit to the reformed sector and other small farmers in the near term and (2) to develop the capacity for greater savings mobilization among El Salvadorean financial institutions to reduce their dependency on outside infusions of capital and to create more viable

financial institutions in rural areas. As part and parcel of these two concepts it is recommended that the monetary and credit policies as well as other policies that impact on the agricultural sector be reviewed with the goal of seeking ways to revise them in order to create better incentives for farming and financial intermediation. If the latter is done, it will be easier to obtain the goals desired from the first two programs.

The specific recommendations are the following.

1. To increase the supply of credit.
 - a. Establish a flexible rediscount line at BCP, rather than tie the credit to specific institutions.
 - b. The rediscount line should be available to all classes of intermediate credit institutions (ICIs) to refinance loans that are for all classes of investment and short-term production purposes. The uses should be kept flexible, and not targeted, in order to allow the funds to flow in accordance with demand.
 - c. Interest rates on the funds should be at the maximum levels authorized by the Monetary Board, e.g., they should not be concessionary. The Monetary Board should be encouraged to raise all rediscount line rates to this level.
 - d. Appropriate incentives for all participants, BCR, ICI and final borrower need to be carefully considered. Especially important is the spread for the ICI. Perhaps a large spread could be given for loans to Phase III beneficiaries and other small farmers because of the higher costs of administering these loans.
 - e. Credit worthiness criteria need to be applied for loans. To this end, the credit should be linked as much as possible to programs designed to provide management training to the Phase I cooperatives as well as technical assistance to small farmers in general. Further work should be done to improve group loans as a means to reduce the cost of lending to and borrowing of small farmers.
 - f. Consideration should be given to having ICIs use the rediscount line to lend to informal market lenders, since this class of lender can efficiently reach large number of small farmers.

- g. Consideration should be given to having ICIs use the rediscount line to lend to private sector processing or exporting firms in order that they can or lend the funds as production credit to small farmers that will supply the firm with its raw materials.
- 2. To mobilize rural savings.
 - a. A pilot study should be undertaken in BFA to experiment with savings mobilization and to learn from experience so that if it is successful, savings mobilization can be expanded to other agencies. The pilot study should concentrate on incentives for savers, including ways to keep transactions costs low, as well as an analysis of the financial, risk and administrative costs to BFA.
 - b. A pilot study should be undertaken with FEDECACES and several credit unions to experiment with voluntary savings mobilization.
 - 3. To provide technical assistance to BCF, BFA, FEDECACES and other entities on the development of the above programs and appropriate policies.
 - a. There will be need for some research and evaluation of the programs.
 - b. There will be need for educational and training programs.

I- INTRODUCTION

Objective and Purpose of Study

This report has been prepared in accordance with the scope of work specified in Contract No. 519-0263-C-00-5475-00 between USAID/El Salvador and Contracting Corporation of America. As stated in the scope of work, the fundamental objectives of this contract are to provide USAID/El Salvador and the El Salvadorean government with detailed information and analysis on rural financial markets in El Salvador that is "...consistent with and supportive of their collaborative efforts to increase agricultural production and income, expand rural employment, and promote equitable growth in the rural sector".

In this context the contract deals with two aspects of rural financial markets in El Salvador: agricultural credit and rural savings mobilization.

The purpose of the study as stated in the scope of work is:

The Contractor will identify and analyze alternative policies and project initiatives containing new incentive packages and management systems capable of mobilizing savings in rural areas and promoting the utilization of those funds as new investment capital for local lending. The Contractor will also identify for USAID and the government of El Salvador economic and socio-cultural constraints to savings mobilization for rural financial purposes, elaborating upon those circumstances wherein savings mobilization is most promising and examining the roles of formal and informal financial institutions in the development of rural El Salvador.

Furthermore, the Contractor shall describe in analytical terms the ability and willingness of the Salvadorean financial system, both its formal and informal components, to provide credit to agricultural producers. This analysis will serve as the basis for both a description of factors constraining the Salvadoran financial system's ability to deliver adequate credit to the agricultural sector and the presentation of an appropriate framework for policy analysis as well as the identification of prospective project

interventions for USAID and the government of El Salvador in the area of rural credit.

Organization of Study

The problems to be studied are specific yet many are general, broad and cut across the whole of El Salvadorean rural financial markets. Many are financial institution specific. Therefore, to obtain the information and analysis requested in the contract, it was decided that the approach to the study should be three fold. The first element was to gain an understanding of the underlying policies that impact on the rural financial markets, especially monetary and credit policies that provide the underlying basis for financial activities. The second element was to undertake disaggregated analysis of each of the formal and informal market credit institutions with respect to the purposes of the study. The third element was to aggregate and consolidate this information to address the broad questions of credit demand and savings mobilization and to make specific recommendations.

Data on financial statistics are only available through the end of 1984. Trends between 1980 and 1984 were examined to put the situation of the latter year in perspective. Where possible more recent data are added.

The report is organized in the following manner. Chapter II deals with government policies that impact on rural financial markets. Emphasis is placed on monetary and credit policies and the very important rediscount lines that the government uses to direct credit to agriculture. Chapter III examines the important role of foreign assistance, especially in providing funds for financing the reformed sector. Chapter IV provides an overview of rural financial markets in El Salvador with the purposes of showing the aggregate credit flows to the sector and the relative importance in the total of the different institutions in providing credit and mobilizing savings. Chapters V through X provide detailed descriptions and analysis of each of the formal-market institutions. Chapter XI deals with informal markets in rural areas. Chapter XII presents the analysis of recent credit demand and projections of future demand. Chapter XIII describes savings behavior and the potential for more savings mobilization in rural areas. Finally, Chapter XIV presents a summary and conclusions.

To begin, however, it is useful to provide a background on the El Salvadorean situation of recent years to set forth the basis for understanding the economic situation, policy setting and rural financial markets. Three aspects are presented: brief overviews of the political situation and

associated civil strife, the performance of the economy and agrarian reform. More detailed descriptions and analysis of policies are presented in Chapter II and elsewhere.

The Political Situation and Civil Strife

The civil strife that El Salvador has experienced since 1979 has taken a major toll on the country, not only in terms of human life but also in terms of its impact on the economy.

In its essence, the civil strife has been a struggle between two relatively small groups of the population: radical leftists who have organized terrorist and guerrilla activities and the conservative right whose base is in the traditional wealthy and elite class. The conflict was frequently manifested in open warfare between the military and the guerrillas. Terrorism was practiced by both the right and the left.

The initial strife led to a military coup in 1979 by reform-minded officers. They immediately undertook several major reforms to simultaneously blunt the leftist's arguments and to strip the wealthy elite of their control of the economy. The three major reforms undertaken in 1979 and 1980 were land reform, nationalization of the banking system and savings and loan associations, and nationalization of coffee and sugar marketing and export activities.

The reforms themselves were very destabilizing for agricultural output and the economic outlook for the country. The uncertainty that overcame the country was strong and, although it has lessened, much remains. It has created an atmosphere that has discouraged investment and encouraged capital flight. The economic picture was worsened by major weakenings in the export markets for Salvadorean traditional exports.

Terrorism and open conflict are also destabilizing. Agricultural activities in zones of conflict have been harmed. Open fighting, burning and razing of crops, livestock and homes by both the guerrillas and the military forces have interrupted productive activities, created uncertainty and encouraged outmigration. Terrorism itself has had its impacts. Farmers fields, including those of the reformed sector, have been burned to disrupt normal activities.

Since 1984 with the election of a democratic government the situation has stabilized somewhat. The conservative right has become less belicose and has tacitly accepted the new government. This new political environment has contributed substantially to a renewal of economic activity,

nevertheless the basic conflict still exists. Selective leftist terrorism continues and there are regular conflicts between government troops and the guerillas.

With respect to agriculture civil strife has created problems for the reformed and non-reformed sectors alike. It has impacted negatively on farming profitability and, hence, credit demand and use; a factor that has contributed significantly to problems in repaying agricultural loans. Although, these problems were most severe prior to 1984, they continue to be important.

State of the Economy

The 1970s were characterized by strong economic growth fueled by increases in domestic investment and favorable markets for traditional exports. After the oil price increase of 1973, inflation rose to an average of about 10 percent between 1974 and 1978. Open unemployment was low.

The years of 1979-1981 were in marked contrast. Political instability and armed conflict were unsettling to the business community and led to considerable capital flight. In this period, real GDP fell by some 18 percent. In 1982 and 1983, GDP continued to decline. By 1984 real GDP had fallen to the 1974 level. In 1984, there was a slight real increase in GDP, which is continuing in 1985.

Agricultural production was seriously impacted by the events of these years. The land reform measures of 1980 were very unsettling both in terms of production and in making significant changes in the productive base that were not easily nor quickly consolidated. The situation was worsened by a number of other factors. The war and terrorism in regions of conflict led to constant upheaval and destruction of crops in the field and farms. World markets for traditional export crops--coffee, cotton and sugar--softened, thus reducing producers' revenues. An increasingly overvalued exchange rate in combination with rising costs of production significantly contributed to the problems. To make matters worse, there were adverse weather conditions, especially in 1982, and increased incidence of coffee rust.

It is clear that all of these factors impacted negatively on agricultural output and profitability and should have discouraged credit use. A countervailing factor was the government policy to direct credit to the reformed sector, which was expected of the whole banking system--

including the recently nationalized commercial banks-- and was largely accomplished by the use of Special Credit Funds and Central Bank of Reserve rediscounts. Much of the credit was financed by foreign assistance, especially the United States Agency for International Development and Inter-American Development Bank programs in the Agricultural Development Bank. Another factor was the government policy of a willingness to refinance debts that were in arrears but were caused by the above-mentioned factors. This policy immediately alleviated the burden of debt for both borrowers and lenders, thus minimizing disruption of the credit system.

The agricultural sector is the backbone of the Salvadorean economy. Production of coffee, cotton and sugar cane for export have been the main engines of growth and sources of foreign exchange. Therefore, the problems that these crops have faced have had important negative impacts on the economy. Agriculture accounts for about one-fourth of GDP, about two-thirds of export revenues and two-fifths of total employment.

There is a continuing need for financing in the sector. The demand for credit will be influenced by world market conditions for traditional exports, the ability to develop more foreign markets for non-traditional exports, substitution of food imports for domestic consumption, as well as the overall domestic economic expansion and population growth.

Land reform imposes an obligation on the government to assist this new group of land owners to become established as farmer/owner/manager, something quite different from their situation as workers on the previous large estates. In this regard, there is a need for technical assistance and credit will also contribute to credit demand.

Agrarian Reform

Beginning in March 1980, El Salvador undertook a drastic and rapid land reform program which was designed to break up large land holdings and create opportunities for the former landless peasants to improve their way of life. It is estimated that the land reform will eventually directly benefit about 30 per cent of the rural poor and affect about 33 per cent of the agricultural land.

The medium-term objectives of the reform are three fold: (1) to improve income distribution of rural families, increase their capacity to save and to enhance capital formation, (2) to increase and diversify agricultural

production and (3) to increase effective employment and reduce its seasonal variations. Because of the size of the reform program and the rapidity with which it was implemented, the short-term objective is to consolidate the land reform effort.

To date, the land reform program has met strong political opposition and has created major challenges for the government to implement. It has also created important challenges for the nation's financial system, which has been asked to provide credit to the reformed sector.

There are three phases of the land reform program.

Phase I

This phase began on March 6, 1980, when the Basic Agrarian Reform Law, Decree 153, was established. In this phase, properties consisting of good quality lands, which exceeded 100 hectares, or lesser quality lands exceeding 150 hectares, were subject to expropriation. Only a few days later, the upper limit was raised to 500 hectares. Not only is the land itself subject to expropriation but also the machinery and equipment, livestock, buildings and other constructions on the affected properties are to be turned over to the new owners. In Phase I the expropriated land and other goods are consolidated into a collective farm, called a reformed sector cooperative. Peasants who had lived on the lands and worked as day workers or colonos for the ex-landlords were made members of the cooperative. The former owners are to be paid a partial settlement in cash or bonds. Later an equal amount was to be paid them by the cooperatives in the form of an agrarian debt. Under the debt arrangement, the cooperatives were forced to take out a loan that was to be repaid within twenty or thirty years along with annual interest charges on the outstanding balance.

A government agency, The Institute of Agrarian Transformation (ISTA) was formed to implement Phase I. ISTA has four major roles: (1) land acquisition, (2) temporary co-management until the cooperatives become organized and capable of self management, (3) land adjudication and (4) coordination of inputs and technical assistance provided by other government organizations.

As of July 1985, 469 properties had been acquired and 311 cooperatives formed. Some 31,359 families consisting of an estimated 188,154 persons, are beneficiaries of the reform.

Phase II

Phase II consists of expropriating properties of more than 100 hectares or more but less than 500 hectares, i.e., it deals with those properties that were originally included for expropriation under Decree 153 but were excluded a few days later when Decree 154 was announced. Phase II remains to be implemented. It has been postponed indefinitely and there is strong doubt that it will ever be implemented because to do so would be politically destabilizing as well as very disruptive to agricultural sector production. A large bulk of the nation's agricultural output comes from these farms.

Phase III

This phase was established in April 1980 with Decree 207. The time for implementation was continued through June 1984. It established the right for all renters and sharecroppers to purchase the land they tilled, up to a maximum of seven hectares. It was designed to provide the numerous small-farmers who were renting land the opportunity to buy it. Note, in contrast to Phase I, the government does not expropriate the land unless the renter initiates the action.

A government agency, the National Financiera of Agricultural Lands (FINATA) was created to implement Phase III. FINATA is charged with: (1) promoting Phase III, (2) preparing renter claim application forms, (3) issuing provisional titles, (4) obtaining affected land from the owner, (5) verifying titles and preparing new deeds, and (6) establishing the amount of the former renters agrarian debt and payment. In contrast to ISTA, FINATA does not provide directly technical assistance to its beneficiaries nor does it assist in farm management.

Through July 1985, 63,668 small farmers with an estimated 382,008 family members had received 97,147 hectares of land under Phase III.

II- GOVERNMENT POLICIES AND RURAL FINANCIAL MARKETS

Introduction

This chapter presents an overview of the El Salvadorean government policies and institutional structures that have the most to bring to bear on rural financial markets. The classes of policies discussed are: (a) monetary and credit, (b) foreign exchange rate, (c) special rediscount lines, (d) marketing and prices for agricultural products, (e) agricultural inputs, and (f) technical assistance and research for agriculture.

In January 1986 the government introduced a new economic package. The above analysis is written in the context of the old policies and needs to be adjusted to take account of this. Therefore, the chapter concludes with an analysis of this package as it impacts on rural financial markets.

Institutional Structure for Credit and Monetary Policy

The El Salvadorean monetary and financial system is regulated by the March 25, 1982, Monetary System Law. Under this law there are three entities that have control over the system: The Monetary Board, the Superintendency of the Financial System and the Central Bank of Reserve. The Monetary Board is the policy-making unit. It holds the ultimate authority in the system because it is responsible for the government's monetary, foreign exchange and financial matters. The Superintendency of the Financial System is responsible for enforcing the Monetary Board's policies in the Central Bank and other financial institutions. The Central Bank of Reserve is assigned the role of carrying out the activities under the control of the Monetary Board.

The modern-day monetary system had its beginnings in 1934 when the private-sector El Salvadorean Central Bank of Reserve was created. Twenty-seven years later, in 1961, this Bank was nationalized. It was not until 1973, that the Monetary Board was formed. On March 15, 1980, when the commercial banks and savings and loan associations were nationalized, and the government obtained majority ownership, there were major structural changes in the financial system. However, with this action, although the institutional structure for monetary and credit policy was not altered, it was clear that the state was able to exert considerable control and discipline over the nation's financial system.

Monetary Policy

There are three main instruments of El Salvadorean money policy: a) legal reserve requirements, b) maximum interest rate structure, and c) rediscounts. These policies are intimately related to credit and exchange rate policies.

Reserve Requirements

The legal minimum reserve requirement on savings time and demand deposits serves as the fundamental base to limit monetary expansion. The current requirement for both types of deposits is 20 percent. The requirement on deposits in foreign currencies is 10 percent. These reserve requirements have been at this level for a number of years. Clearly, the Monetary Board has not used this policy to effect changes in the money supply.

Maximum Interest Rate Policy

Loans. The Monetary Board has established a loan interest rate structure that is designed to influence the demand for and, hence, the flow of credit to targeted and priority economic activities. The structure is based on two classes of loans, A and B. Class A loans are for production purposes and these of class B are for commercial and personal uses. Each class is further subdivided by the term of the loan: short-, medium- and long-term. There may also be subdivisions by type of activity financed; for example, preferential interest rates are established for high priority activities, such as basic grains, that have low profitability due to the government's policy of maintaining low prices for the consumers of these products.

The maximum interest rate structure policy employs price rationing mechanisms to induce credit flows to selected activities by means of lower interest rates, e.g. lower borrowing costs. The policy is employed in conjunction with the non-price rationing mechanism of establishing upper limits or quotas to the amount of funds available for financing specific types of economic activities through the BCR rediscount lines. This policy combination is discussed in detail in the following section.

Table II-1 presents the loan interest rate structure for the period 1978-1985. Beginning in March 1984, regular short-term class A loans had maximum rates of 14 percent. The medium- and long-term loans were 15 percent. The preferred class A loans were 1 percent less for each term. Class B loans were 16.5 percent for short-term and 17 percent for medium- and long-term purposes. These rates were, respectively, 2.5 and 2 points above the regular class A loans and 3.5 and 3 points above the preferred class A loans.

Over the seven-year period from 1978 to 1985 there were only two changes in the rate structure despite the fact that the annual rate of inflation varied between 14.1 and 19.7 percent. It is clear that the Monetary Board does not use changes in interest rate structure as an active policy instrument to fine tune credit flows. When changes in the structure are made they are abrupt and typically remain in effect for long periods. As will be shown below, the Monetary Board prefers to use the quotas assigned to the BCR rediscount lines as the major credit rationing device. This suggests that the interest rate, at the levels established by the Monetary Board, does not have a lot of rationing power. An examination of the real interest rates presented in the table, shows, after taking account of the impact of inflation, that the real rates have been quite low and, in many cases, slightly negative. The low real rates offer solid evidence that the interest rate does not serve as a major rationing mechanism indeed, the low rates contribute to a strong demand for credit. Given that the supply of credit is limited, there is an excess demand and the Monetary Board is forced to use non-price rationing mechanisms.

Deposits. The interest rates on deposits have two important dimensions. First, their level, relative to other forms of savings and investments, influences the amount of deposits held by the financial system. Second, their level, relative to loan rates, determines the interest rate spread and, hence, the profitability of financial intermediaries. Therefore, the maximum deposit rates influence the behavior of both savers and the financial institutions.

The Monetary Board has established a structure of differential rates. As is shown in Table II-2, deposit interest rates are higher the longer the saver's commitment to place the funds on deposit. The objectives of this structure are to compensate longer-term savers for the uncertainty associated with future inflation and to compensate the financial institutions for the higher costs of administering the shorter-term accounts where there are frequent transactions.

Table II-1. Maximum Loan Interest Rate Structure for Lending by the Financial System Using Their Own Resources, 1978-1985...						
Class of Loan	Sept. 18, 1978 to Feb. 1, 1982		Feb. 1, 1982 to March 1, 1984		March 1, 1984 to December 1985	
	Nominal	Real	Nominal	Real	Nominal	Real
Regular class A loans						
Short term	13	-1.0	15	0.9	14	2.1
Medium and long term	14	-0.2	16	1.6	15	3.0
Preferred class A loans						
Short term	13	-1.0	13	-0.9	13	1.2
Medium and long term	14	-0.2	14	0.0	14	2.1
Class B loans						
Short term	14	-0.2	18	3.5	16.5	4.3
Medium and long term	15	0.1	18.5	3.9	17	4.7
Source: Banco Central de Reserva de El Salvador, Memorias 1980-1984.						
a) Deflated with average inflation rate in each period, 14.19, 14.01, and 11.71 percent respectively.						

Table II-2. Deposit Interest Rate Structure for the Salvadoran Financial System, 1978-85							
Class of deposit	September 18, 1978		February 1, 1982		March 1, 1984		
	to February, 1982		to March, 1984		to December, 1985		
	Nominal	Real	Nominal	Real	Nominal	Real	
I- Saving deposits							
A- Without advance notice							
1. Banks	8.5	-5.0	8.5	-4.8	7.0	-4.2	
2. Savings and loan associations	9.5	-4.1	9.5	-4.0	8.0	-3.3	
B- With advance notice							
1. Banks			9.0	-4.4	7.5	-3.8	
2. Savings and loan associations			10.0	-4.4	8.5	-2.9	
II- Deposits in saving and loan associations	11.0	-2.8	11.0	-3.5	11.0	-0.9	
III- Time deposits							
a. 60 days	8.75	-4.8	11.0	-3.5	9.5	-2.0	
b. 120 days	9.75	-3.9			11.0	-0.9	
c. 180 days	9.75	-3.9	12.5	-1.3	12.5	0.7	
d. 360 days and more	flexible		flexible		13.0	1.2	
IV- Saving deposit certificate in							
savings and loan associations							
a. 60 days			11.0	-3.5	9.5	-2.0	
b. 120 days					11.0	-0.9	
c. 180 days			12.5	-1.3	12.5	0.7	
d. 360 days and more			flexible		13.0	1.2	
Source: Banco Central de Reserva de El Salvador, Memorias 1980-1984.							
a) Deflated with average inflation rates in each of the periods, 14.19, 14.01, and 11.71 per cent, respectively.							

Beginning in March 1984, there was a difference of 5 percent between the lowest deposit rate, (7 percent on savings deposits that can be withdrawn without advance notice) and the highest rate, (13 percent on deposits of one year or more in banks and savings and loan associations). Between these two extremes are a number of rates that vary according to the length of time the funds are placed on deposit; i.e., as the term increases the rate rises.

As is the case for loan rates, there were only two changes in the structure of deposit rates since 1978. With these changes, the deposit rates were adjusted parallel with the loan rates. Therefore the interest rate spread for the financial institutions was maintained.

It is striking that over the 1978-1985 period the real interest rates paid on deposits were consistently negative. Undoubtedly, this condition does not stimulate saving in financial institutions. Rather, it would encourage investments in other types of assets as well as capital flight. It is very probable that the Monetary Board followed this policy because of its primary interest in keeping low loan interest rates. Therefore, it has been forced to keep the deposit rates at the low levels in order to maintain the required spread. The unfortunate outcome is that the interest rates for deposits provide little incentive for saving.

Rediscounts

The mechanism. The Central bank rediscounts many loans made by the intermediate financial institutions (ICI's). Under this arrangement the ICI requests a rediscount from BCR and presents loan documents as collateral. If the BCR approves the request, it makes a loan to the ICI, in the form of a rediscount on the loan documents presented, for the full amount of the collateral. The ICI assumes the responsibility for collecting the loan from the final borrower and repaying BCR.

Sources of Funds. Funds for the rediscounts come from external and domestic sources. External funds are made available through programs of foreign assistance. Domestic sources are from the BCR's own funds.

Policy Instruments. Rediscounts are used as instruments for two policies. First, they influence the level of money supply in the nation. As BCR rediscounts expand (contract) the money supply increases (decreases) accordingly. Therefore, if the Monetary Board wants to expand (contract) the money supply it can make rediscounts more (less) easy to obtain. This

can be accomplished by the price-rationing mechanism of lowering (raising) the interest rate charged on rediscounts, commonly call the rediscount rate, or by the non-price rationing mechanism of making more (less) funds available for rediscounting.

Second, rediscounts are used to selectively direct credit to targeted and priority economic activities. This is accomplished by specifying the purposes of the loans that the ICI's may present for rediscounting. This policy instrument is supplemented by establishing upper limits, or quotas, to the amounts of rediscount funds available for each purpose. Moreover, as noted above, differential rediscount rates may be employed. Therefore, this policy instrument may have both price and non-price rationing components.

Credit Plan. The BCR is responsible for the preparation of a draft credit plan to the Monetary Board. This plan is consistent with the government's overall economic plan that is also prepared by the BCR. The plan specifies how much credit is projected to be needed to finance the different economic activities in the coming year. The credit needs are determined by an analysis of production costs. On this basis, the amount of financing per unit of production is established. The total financing for the product is simply this amount multiplied by the number of units projected in the plan. Of course, these figures are also tempered by the overall economic situation and other factors.

The Monetary Board establishes the final credit plan and assigns credit quotas for rediscount lines that are targeted to specific purposes based upon the perceived need for financing in the plan. These credit quotas and the variable loan interest rates are the main instruments that the Board uses to effect it's monetary and credit policy.

Implementation. Table II-3 presents the rediscount lines as well as the rediscount rates and loan rates for each line that were in effect in 1984. The lines are grouped in two major classes: these financed by foreign and domestic sources of funds. Within each class are a number of lines. Many of the lines are directed to a specific activity or class of activities. Examples of the former are exports to Central America, other exports, coffee rust control and cotton harvesting. Others are directed to a type of institution, such as cooperative associations and the Federation of Credit Funds. Furthermore there are special lines for refinancing of delinquent loans.

It is important that most of the rediscount lines are for agricultural purposes. This demonstrates the particular importance of this policy for directing the flow of credit to this sector. As will be shown in the following

Table II-3. Maximum Interest Rates and Rediscount Rates from Central Bank of Reserve Rediscounts, March 1, 1984.

	Rediscount rate to JCI		Maximum interest rate for final borrower	
	Nominal	Real	Nominal	Real
I- Foreign Resources				
1- Short-term a)	13	1.2	15	3
2- Medium and long-term b)				
Small business	13	1.2	15	3
Other	15	3	17	4.7
3- Special credit line for manufacturing				
Large and medium industry	8	-3.3	10	-1.5
Small industry	4	-6.9	7	-4.2
Through industrial cooperatives c)	3	-6.9	7	-4.2
4- Coffee rust control				
Producers up to 500 qq of green coffee	8	-3.3	10	-1.5
Producers of more than 500 qq of green coffee	11	-0.6	13	1.2
II- Domestic Resources				
1- Export and Pre-export				
Central America	12	0.2	14	2.1
Outside Central America	11	-0.6	13	1.2
2- Coffee, short-term 1984/1985				
Producers up to 500 qq green coffee	11	-0.6	13	1.2
Producers of more than 500 qq of green coffee	12	0.2	14	2.1
Pre-rust harvest 1983/1984 for producers up to 500 qq green coffee	11	-0.6	13	1.2
First six months	11	-0.6	13	1.2
More than six months	12	0.2	14	2.1
3- 1984/1985 and refinancing of delinquent loans harvest of 82/83, 83/84	11	-0.6	13	1.2
Refinancing of delinquent loans 1978/79-79/80, 80/81 and 81/82	9	-2.4	11	-0.6
4- Cereals, vegetables, watermelon, cantaloupe, sesame, peanuts, etc. 1984/1985	11	-0.6	13	1.2
5- Sugar cane	12	0.2	14	2.1
6- Purchase and fattening livestock	12	0.2	14	2.1
7- Special line for operation capital for beekeeping	12	0.2	14	2.1
Cooperative associations and societies	12	0.2	14	2.1
FEDECREDITO				
Direct credit	12	0.2	14	2.1
Credit through cajas	10	-1.5	14	2.1
Source: Banco Central de Reserva				
a) Modifiable each month				
b) Modifiable each six months				
c) Rate low loan from JCI to cooperatives is 5 percent and from cooperatives to user 7 percent				
Average 1984 inflation rate as reported by the San Salvador Consumer Price Index was 11.71 percent				

chapters, many of the credit institutions, especially the mixed banks and the Mortgage Bank obtain a large portion of these funds for lending to the sector through rediscounts.

For each special line, the rediscount rate to the ICI and the interest rate charged the final borrower are specified. In most cases there is a spread of 2 percent. There is, however, considerable variance in the loan rates, although none can exceed the maximum established by the Monetary Board. The lowest rates are for priority purposes and/or for the small-sized entrepreneurs, for example, small businesses and small farmers.

BCR data on the rediscount lines and terms and conditions of rediscounts are not reported in a uniform manner over the 1980-1984 period. Therefore, it is not possible to make explicit comparisons. Nevertheless, the available data over the five-year period suggest that the rediscount system, as described in this section, has been used as a policy instrument during the whole period but the rediscount policy is becoming increasingly more specific in terms of number of rediscount lines and differential interest rates.

Analysis. It is clear that the rediscount policy, which consists of both price and non-price rationing mechanisms, is used as a major policy instrument to direct credit flows and influence the level of money supply. In particular it is important as an attempt to direct credit to priority activities in agriculture.

The effects of inflation on the interest rate structure are evident. In 1984, the real interest rates for loans were quite low; some were negative. Most of the rediscount rates were negative. Low real loan rates provide implicit income transfers to borrowers, serve as incentives to borrow and contribute to excess demand for credit. They do not serve as an incentive for ICIs, however, since the effect of inflation is to reduce the expected returns from the interest rate spread.

The rediscount policy undoubtedly has an impact on how credit is distributed in the nation not only by economic activity but also by type of institution. This is especially the case for agriculture since much of the rediscounting is directed to this sector. It is almost certain, however, that the system is open to wide-scale fungibility, and, therefore, the net impact of the funds on the economy is different than planned. Rational borrowers will attempt to secure the lowest interest rates possible. Therefore, they will try to justify their credit for the credit line which is associated with the lowest interest rate, even though they do not use the funds for that purpose, or if they do, other of their financial resources are freed up that allow the borrower to undertake an additional activity that would not otherwise have

been done, had the cheap credit not been available. Therefore, the net effect of the lending for the targeted purpose may be considerably less than would appear by the amount of funds lent. Following this analysis it should not be surprising that the net effect of the highly-directed credit through the rediscount mechanism is not as envisioned in the credit plan. Much of the rediscount credit may well have its impact on financing other investments and consumption.

Refinancing

The use of rediscounts for refinancing loans merits separate discussion since this has been a major policy of the Monetary Board, especially in the last five years. There are two purposes of refinancing.

The first purpose is to refinance past-due or delinquent loans held by ICI's. In this context, refinancing may occur when, for a justifiable cause, a borrower cannot repay the loan at the scheduled time nor within the customary grace period. Rather than place both the borrower and the lending financial institution in jeopardy with a bad debt the loan is refinanced. Since loan payment must come out of future income the term of the refinanced loan is usually several years and, therefore, is long-term.

The need for this type of refinancing is very justifiable, particularly for lending to agriculture, where there are several external variables such as product prices, weather conditions, diseases and insect infestations that are beyond the control of the borrower. When one or more of these conditions are present, losses can be expected and the farmer may not be able to repay his credit. Therefore, refinancing of the loan is a means to postpone the debt repayment and, in the meantime, not destroy his ability to obtain credit for the next production cycle.

The second purpose of refinancing is to change the debt from a production loan to a prendario, a loan secured by an agricultural product, while the processing, storage and marketing take place. This is the system utilized in El Salvador for the traditional export crops. For example, a farmer will obtain a short-term loan to produce coffee or cotton. After harvest his product is delivered to the National Coffee Institute (INCAFE) or for the Cooperative of Cotton Producers (COPAL) warehousing until it is sold on the international market. In the meantime, the producer must continue financing his production because he will not receive income to pay off the loan until INCAFE or COPAL sells the product. Rather than continue to carry the loan as a short-term production loan the practice in El Salvador is that

the first (production) credit will be cancelled and refinanced as a prendario loan to cover the processing, warehousing and marketing of the product. No new loan money exists. The refinanced loan will be guaranteed by the coffee or cotton in storage. The original borrower continues to hold the debt. When the coffee or cotton are sold and the producer receives his income the refinanced debt is cancelled. Note, this type of refinanced credit is usually for a period of less than one year and hence is short term.

Both of these types of refinancing consist of paper transfers from the original debt to the refinanced debt. No new loan money is created. Note, however, that both loans are considered as separate credit transactions and, as such, will appear in the records of financial institutions in this form. In practice, this is a double counting of the amount of credit extended.

The Monetary Board and the BCR have provided special credit lines for both types of refinancing. Although both types of refinancing have been employed for many years, refinancing of the bad debts has taken on particular importance since 1979. The combination of land reform, problems with Phase I cooperatives, civil strife and terrorism, as well as several years of unfavorable markets for traditional exports have led to high levels of delinquency. In light of these unsettling and external problems the government has taken the position of being very liberal in extending refinancing for delinquent debt at favorable and preferential interest rates. Although there are good economic arguments for doing this, much of the decision has been based on reasons of political and social consciousness. Refinancing reduces political instability in the country side. It also has kept many of the newly formed Phase I cooperative in the reformed sector from becoming ineligible for more credit. If this had not been done, the land reform program would have been seriously jeopardized.

Since 1979, the amounts refinanced have soared such that refinanced debt has become the most important component of the BCR rediscount portfolio and as well as of the loan portfolios of most of the ICI's.

Foreign Exchange Rate Policy

Although not strictly part of monetary policy, exchange rate policy has important implications for the financial system. Moreover, it is determined by the Monetary Board and carried out by the Central Bank.

For decades El Salvador had followed a fixed foreign exchange rate policy with a rate of $\text{¢}2.50$ per dollar. When there were pressures for a devaluation

of the colon, rather than devalue foreign exchange controls were employed. In the early 1980s such pressures occurred. When the exchange control measures were insufficient and a strong black market developed, the government adopted a two-tier exchange rate: the official rate and a parallel market rate. Since then, there has been an implicit devaluation as the government gradually reduced the numbers of imports and exports of goods and services eligible for the official rate and passed them to the parallel rate. By 1985, those that remained at the official rate were imports of basic foods, energy, medicines, raw materials and government debt service and exports of coffee and other selected products.

The exchange rate is the cornerstone of policy for maintaining external stability but also it has important consequences for internal price stability as it influences the flows of imports and exports of goods, services and capital. Devaluations generally result in inflationary pressures because the prices of imports rise and put upward pressures on wages and prices. Anticipated devaluations result in capital flight.

Both of the above effects have occurred in El Salvador. Moreover, the two-tier exchange rate policy has been damaging to agriculture. The government's policy of keeping food prices low and, therefore, importing basic foods at the lower official rate, serves as a disincentive for domestic production. Likewise, the policy of selling traditional exports, such as coffee, at the lower rate is a disincentive for coffee production.

Monetary Policy: Summary and Conclusions

The Monetary Board makes infrequent use of changes in legal reserve requirements and the interest rate structure as policy instruments to bring about changes in the national money supply or flows of credits. As a result, since 1978, when inflation has been at historically high levels, the real interest rates on many loans are at best slightly positive or negative. Deposit rates are negative. Therefore, the loan rates are not effective in rationing credit nor are the deposit rates attractive to savers. The low loan rates provide significant income transfers to borrowers. Indeed, this policy was undoubtedly deliberate to try to encourage more investment and productive activity in the unstable and uncertain economic environment. The expected consequences would be a strong excess demand for credit and less mobilization of savings.

El Salvador has established a monetary policy that relies basically on directed credit to targeted and priority objectives. The instruments used are

the extensive BCR rediscount lines and preferential rates of interest. The purposes for which rediscounts are available, the amount of funds available for rediscounting and the rates of interest are determined by the Monetary Board in accordance with their annual credit plan and general economic conditions.

The credit planning system used by the Monetary Board undoubtedly is less effective than planned. Because of fungibility and the ability of borrowers to substitute borrowed funds for their own funds it can be expected that fungibility and credit diversion will occur. The net effect of the credit extended will not be to finance the activities to the effect that was planned.

The preferential interest rate policy will not be as effective in rationing credit to targeted activities as planned because of fungibility. Moreover, the fact that most real loan interest rates are negative or only slightly positive will have important and negative consequences, not only for the financial system, but also resource use and income distribution.

With respect to the financial system, the low loan interest rates impose implicit upper limits to the rates offered on savings deposits. Because the deposit rates are also negative they do not stimulate saving. The end results are that savers will not want to place as much of their deposits in the financial system as they would if real deposit rates were positive and attractive. Therefore, the financial system is not able to perform as well in its role as an intermediary.

The low loan rates contribute to the misallocation of resources for several reasons. Low rates encourage an excessive use of financial resources relative to the opportunity cost of capital. Furthermore, low rates encourage the use of credit in activities that have low rates of return, even consumption. In this manner, they contribute to the misallocation of resources.

The low interest rates in general and the preferential interest rates in particular contribute to income distribution since they involve implicit income transfers to borrowers. Therefore, those persons that have access to credit gain relative to those who do not. The size of the loan as well as the degree of preferential treatment on the interest rate also influence the degree of implicit income transfer. Therefore, it is usually the larger farmers, who have more access to credit and who receive the largest loans who benefit the most from the income transfer.

The refinancing of delinquent loans has been an important and problematic element of the Monetary Board's policy. Given the difficult times and economic conditions it has been employed liberally to help keep the productive activities alive --particularly agriculture in general and the reformed sector in specific-- rather than have them become moribund because they cannot get new loans due to delinquent debt. It is clear that there have been political and social considerations as well as economic objectives in the use of this policy. In this regard it has been successful, although it is probable that it has been abused, by allowing refinancing when it was not necessary. For example, given the low loan rates and high inflation it is economical for a borrower to try to extend a current loan rather than repay it and, therefore, when the loan is eventually repaid, the real value of the repayment is considerably less than the amount originally borrowed. If the borrower can get refinancing, he is not penalized and can take out another credit in the next production cycle. This behavior, is exacerbated by the preferential interest rates charged on this class of refinancing. Refinancing has been of particular importance for the new reformed sector Phase I cooperatives, which by their very nature could be expected to default on credit as they go through the processes of learning and consolidation. Nevertheless, as a result of this liberal refinancing policy the financial system has inherited a legacy of much debt that probably will never be recovered. In a real sense the current problems were postponed to the future.

Central Bank Lending

The BCR lends money to the financial system by means of regular rediscounts and rediscounts from special lines. In addition it lends directly to non-banking public-sector entities. Unfortunately, the two types of loans are not disaggregated in Central Bank data, and, therefore, must be considered jointly. Although the basic purpose of this report is to examine rediscounts from the special rediscount lines, it is useful to review the total BCR portfolio.

Sources of Funds.

In 1984, as shown in Table II-4, 80.9 percent of the BCR's loans were financed with the Bank's own resources, 4.3 percent from the Economic Development Fund (FDE), a special fund held by the BCR for specific development purposes, and 14.9 percent from foreign sources. Over the 1980-1984 period, the nominal amount of funds increased in 1981 over the

1980 level and then progressively declined. The increase in 1981 was due to a major injection of foreign resources. Meanwhile, BCR's own resources and FDE funds have declined over the whole period apparently because of the attempt to limit the expansion of credit as a means of controlling inflation. In real terms the decline was very drastic. Between 1980 and 1984 there was an average annual decrease of -12.7 percent in total funds available. It is clear that the BCR had considerably fewer available funds with each successive year.

Intermediate Credit Institutions

Most of the formal El Salvadorean financial institutions have been designated intermediate credit institutions (ICIs) and are therefore eligible to receive Central Bank rediscounts. Institutions that are of mixed ownership or public sector entities are the: mixed commercial banks, Agricultural Development Bank (BFA), Industrial Development Bank (BANAFI), Salvadorean Investment Corporation (CORSAIN), National Housing Financiera (FNV), National Agricultural Land Financiera (FINATA), Salvadorean Financiera, Small Business Guarantee Trust Fund (FIGAPE), Salvadorean Preinvestment Study Fund (FOSEP), Social Fund for Housing (FSV), and National Coffee Institute (INCAFE). Private sector institutions are the: Mortgage Bank, Federation of Credit Funds (FEDECREDITO), Federation of Salvadorean Credit Unions (FEDECACES), and Salvadorean Cooperative of Cotton Producers (COPAL).

The BCR also makes loans directly to the federal government, local governments, decentralized government agencies and state enterprises.

BCR Loan Portfolio

At the end of 1984, as shown in Table II-5, 73 percent of the BCR loan portfolio was in refinanced loans and the remainder was in new credits which include non-refinanced loans carried over from previous years. Over the 1980-1984 period refinancing rapidly increased, both in absolute and relative terms. In 1980, it accounted for only 27.9 percent of a portfolio that was larger in absolute terms. The information for BCR annual flows of loans presented in Table II-6 shows how this occurred. This table shows that annual flows increased each year and the increases were in refinancing. However, it is important to note that when credits are refinanced that there is no corresponding increase in funds lent. It is just a BCR paper transfer;

Table II-5... Central Bank of Reserve, End-of-Year Loan Portfolio by class of institution, 1980-84 (Billion Colones)												
Institutions	1980		1981		1982		1983		1984		Average annual rate of growth	
	Nominal Value	Percent										
Commercial banks and Mortgage Bank	577.7	27.2%	553.6	25.9%	612.3	30.9%	759.6	39.2%	601.1	32.4%	1.1%	
Other private financial institutions (a)	567.4	28.7%	186.0	8.7%	157.6	7.9%	151.4	7.9%	229.6	12.3%	-20.2%	
Public entities (b)	832.0	42.1%	1497.4	65.5%	1214.7	61.2%	1912.4	52.9%	1029.7	53.3%	5.5%	
Total	1977.1	100.0%	2149.0	100.0%	1984.6	100.0%	1914.4	100.0%	1861.6	100.0%	-1.5%	
New portfolio	1425.1	72.1%	1136.3	52.9%	949.1	47.8%	829.5	52.2%	503.1	27.0%	-22.9%	
Refinancing portfolio	552.0	27.9%	1012.7	47.1%	1035.5	52.2%	915.9	47.8%	1358.5	73.0%	25.3%	
Real values												
Commercial banks and Mortgage Bank	577.7	27.2%	483.9	25.9%	477.4	30.9%	517.3	39.2%	372.1	32.4%	-10.4%	
Other private financial institutions (a)	567.4	28.7%	162.0	8.7%	122.9	7.9%	101.3	7.9%	141.6	12.3%	-27.3%	
Public entities (b)	832.0	42.1%	1225.9	65.5%	947.1	50.4%	627.7	52.9%	634.7	55.3%	-6.5%	
Total	1977.1	100.0%	1871.8	100.0%	1547.3	100.0%	1319.4	100.0%	1149.4	100.0%	-12.7%	
New portfolio	1425.1	72.1%	989.7	52.9%	740.0	47.8%	689.1	52.2%	310.4	27.0%	-31.7%	
Refinancing portfolio	552.0	27.9%	882.1	47.1%	807.3	52.2%	631.2	47.8%	839.1	73.0%	11.0%	
Source: Banco Central de Reserva de El Salvador, Departamento de Investigación Económica, Revista, various issues.												
a) Incluye FEDECREDITO, FEDECACES and COPAL.												
b) Incluye Central Development, CEA, IRA, ANDA, RAZUCAR, ANTEL, SERA, FURAPE, BAHAFEL, FINANCIERA SALVADOREÑA, INCAGE and DEL.												

the paperwork in the old account is closed and new paperwork is entered in the refinancing account.

Table II-6 shows that the absolute amount of annual BCR lending for new loans declined. This is reflected in the year-end BCR loan portfolio presented in Table II-5. The average annual rate of growth in new credits was negative, -28.0 percent. Measured in real terms it was considerably more severe.

Therefore, the conclusions are that although refinancing has increased dramatically, over the 1980-1984 period, it has not been at the expense of new lending. Rather the BCR simply has not been lending as much for new credits with each passing year. The BCR action has been to contract the credit supply.

Why did this occur? There are several reasons. First, as an anti-inflationary measure the Monetary Board kept down the level of rediscounts to keep the money supply from expanding too rapidly. Second, there were some major new credit funds that were placed directly in the financial institutions. Examples are the 1980 USAID Agrarian Reform Credit Project, which was placed with the Agricultural Development Bank and which disbursed almost \$48 million between 1981 and 1984, and the 1981 IDB Agricultural Reform Sector Loan that was also placed with that bank and under which almost \$36 million were disbursed.

Institutional Distribution

As shown in Table II-6, in 1984 the combination of mixed banks and the Mortgage Bank received 64 percent of BCR's annual credit flows, other private financial institutions 5 percent and public entities 31 percent. Over the 1980-1984 period the mixed banks and the Mortgage Bank increased their relative share substantially. In 1980 they received only 17 percent of BCR loans. There were three reasons for their growth.

First, BCR lending to other private sector institutions declined and lending to the public entities did not grow as fast. This is shown in Table II-7. Although the absolute amount of BCR lending for new credits declined over the 1980-1984 period, the mixed bank and Mortgage Bank combination received proportionately more of the new loans.

Table II.6. Credit Flows from Central Bank of Reserve to Institutions, 1990-1994 (Million Colones)												
Institutions	1990		1991		1992		1993		1994		Average annual growth rate	
	Percent											
Mixed commercial banks and Mortgage Bank	654.7	16.9%	857.2	27.4%	1082.2	37.1%	1714.2	53.7%	2376.1	61.1%	50.7%	
Other private financial institutions	1793.4	46.4%	229.0	7.3%	122.1	4.4%	210.9	6.6%	269.2	5.1%	-37.8%	
Public entities	1420.0	36.7%	2036.9	65.2%	1564.2	56.5%	1269.4	39.7%	1673.3	30.9%	3.4%	
Total	3868.1	100.0%	3123.1	100.0%	2766.9	100.0%	3195.1	100.0%	5269.3	100.0%	9.0%	
New credit	3237.5	83.7%	1963.3	62.9%	942.2	34.1%	904.9	28.3%	857.7	16.5%	-29.0%	
Refinancing	630.6	16.3%	1159.9	37.1%	1824.7	65.9%	2290.3	71.7%	4400.6	83.5%	62.5%	
Mixed commercial banks and Mortgage Bank	654.7	16.9%	746.6	27.4%	843.9	37.1%	1191.2	53.7%	2092.7	64.1%	33.6%	
Other private financial institutions	1793.4	46.4%	199.5	7.3%	93.9	4.4%	145.3	6.6%	165.2	5.1%	-41.3%	
Public entities	1420.0	36.7%	1774.1	65.2%	1219.6	56.5%	874.9	37.7%	1001.4	30.9%	-9.4%	
Total	3868.1	100.0%	2720.2	100.0%	2157.2	100.0%	2202.0	100.0%	3259.0	100.0%	-4.3%	
New credit	3237.5	83.7%	1710.0	62.9%	735.1	34.1%	623.6	28.3%	535.3	16.5%	-36.2%	
Refinancing	630.6	16.3%	1010.2	37.1%	1422.0	65.9%	1578.4	71.7%	2714.7	83.5%	41.0%	

Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, Revista.

Table 11-7. New Credit Flows (from Central Bank of Reserve) to Financial Institutions, 1980-84 (Million Balances)											
Millions	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Mixed commercial banks and Mortgage Bank	618.4	19.1%	679.3	34.6%	580.3	61.6%	483.4	53.4%	451.1	52.0%	-7.6%
Other private financial institutions	1483.5	45.8%	71.4	3.8%	2.9	0.3%	145.0	16.1%	21.21	2.4%	-65.4%
Public entities	1135.6	35.1%	1210.5	61.7%	359.7	39.2%	275.3	30.4%	325.6	45.6%	-23.2%
Total	3237.5	100.0%	1963.2	100.0%	942.9	100.0%	904.7	100.0%	657.91	100.0%	-23.0%
Mixed commercial banks and Mortgage Bank	618.4	19.1%	580.9	34.6%	452.4	61.6%	333.1	53.4%	278.3	52.0%	-19.1%
Other private financial institutions	1483.5	45.8%	64.9	3.8%	2.2	0.3%	109.6	16.1%	13.1	2.4%	-69.4%
Public entities	1135.6	35.1%	1054.4	61.7%	287.4	39.2%	183.7	30.4%	244.0	45.6%	-31.3%
Total	3237.5	100.0%	1710.0	100.0%	725.1	100.0%	623.5	100.0%	535.4	100.0%	-36.2%
Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, Revista, various issues.											

Second, one of the reasons that lending to the public entities did not grow as fast was because foreign assistance was made directly available to those institutions and bypassed BCR.

Third, the mixed banks and Mortgage Bank combination received a disproportionate share of the refinanced credits. Table II-8 shows this clearly. In 1980 the combination received only 5.8 percent of the total refinancing. By 1984, the percentage was 66.5.

Sectoral Distribution

In 1984, as shown in Table II-9, the agricultural sector was the largest recipient of BCR new credits, with 44.1 percent. Other credits, mostly financing for the government accounted for 37.8 percent. None of the other sectors received more than 9 percent. Agriculture's share of BCR credit is disproportionately high relative to its share of GDP. Therefore, it is clear that BCR is forcing lending to that sector and trying to direct its flow to specific purposes.

It is likely that much of the amount provided by the BCR to the sector comes from the need to finance the reformed sector Phase I cooperatives. After all, these new clients had to be attended to, they were assigned to all of the banks and the banks were expected to extend them credit. To make the process more palatable, BCR funds were made available, rather than forcing the banks to use their own resources. In 1981, the year after the reform, both the amount lent to agriculture and its relative share rose substantially.

Refinanced credits are concentrated in agriculture and the non-classified category, which mostly consists of loans that are refinanced for only short periods of time. As shown in Table II-10, in 1984, the agriculture and non-classified refinanced loans accounted for 24.9 and 75.0 percent of all refinancing.

Over the 1980-1984 period the two sectors accounted for virtually all of the refinancing, both sectors tended to increase the amount of refinancing, but the non-classified sector grew more rapidly, especially in 1984.

Table B.8. Refinancing from Central Bank of Reserve to Financial Institutions, 1980-84 (Million Colones)											
Institution	1980		1981		1982		1983		1984		Average annual rate of growth
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent		
	Nominal Values										
Mixed commercial banks and Mortgage Bank	36.3	5.8%	178.9	15.4%	301.9	27.5%	1231.4	53.8%	2925.1	66.5%	199.6%
Other private financial institutions	309.8	49.1%	154.6	13.3%	117.5	6.4%	64.8	2.8%	247.7	5.6%	-5.4%
Public utilities	284.5	45.1%	826.4	71.2%	1204.5	66.0%	994.1	43.4%	1227.9	27.9%	44.1%
Total	630.6	100.0%	1159.9	100.0%	1823.9	100.0%	2290.3	100.0%	4400.6	100.0%	62.5%
	Real Values										
Mixed commercial banks and Mortgage Bank	36.3	5.8%	155.8	15.4%	321.3	27.5%	848.7	53.8%	1804.5	66.5%	165.5%
Other private financial institutions	309.8	49.1%	134.7	13.3%	91.6	6.4%	44.7	2.8%	152.9	5.6%	-16.2%
Public utilities	284.5	45.1%	718.8	71.2%	939.1	66.0%	685.1	43.4%	757.4	27.9%	27.7%
Total	630.6	100.0%	1010.3	100.0%	1422.0	100.0%	1578.4	100.0%	2714.7	100.0%	44.0%
Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, Revista, y Archivo Estadístico.											

Table II-9. New Credit Flows from Central Bank of Reserve by Economic Sector, 1980-84 (Million Colons)												
Economic Sector	1980		1981		1982		1983		1984		Average annual rate of growth	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent		
Agriculture	499.1	15.4%	621.8	31.7%	420.6	44.6%	365.0	40.4%	382.7	44.1%	-6.4%	
Mining	---	---	---	---	---	---	---	---	---	---	---	
Industry	177.8	5.5%	97.0	4.9%	94.6	10.0%	170.0	18.8%	77.6	8.9%	-18.7%	
Construction	478.1	14.8%	110.6	5.6%	1.4	0.1%	9.7	1.1%	4.2	0.5%	-69.4%	
Electricity, water and sanitary services	5.0	0.2%	---	---	---	---	1.3	0.1%	---	---	---	
Commerce	1864.2	57.6%	753.3	38.4%	83.2	8.8%	230.3	25.5%	67.7	7.8%	-56.3%	
Transport, communication and storage	---	---	---	---	0.2	0.0%	0.2	0.0%	0.8	0.1%	---	
Services	3.6	0.1%	7.6	0.4%	7.3	0.8%	7.3	0.8%	7.1	0.8%	18.5%	
Other credit	209.6	6.5%	373.0	19.0%	335.6	35.6%	120.7	13.3%	327.8	37.8%	11.8%	
Total	3237.4	100.0%	1963.3	100.0%	942.9	100.0%	904.5	100.0%	867.9	100.0%	-28.0%	
Real Values												
Agriculture	499.1	15.4%	541.6	31.7%	327.9	44.6%	251.6	40.4%	236.1	44.1%	-17.1%	
Mining	---	---	---	---	---	---	---	---	---	---	---	
Industry	177.8	5.5%	84.3	4.9%	73.8	10.0%	117.2	18.8%	47.9	8.9%	-28.0%	
Construction	478.1	14.8%	96.3	5.6%	1.1	0.1%	6.7	1.1%	2.6	0.5%	-72.9%	
Electricity, water and sanitary services	5.0	0.2%	---	---	---	---	0.9	0.1%	---	---	---	
Commerce	1864.2	57.6%	656.1	38.4%	64.9	8.8%	158.7	25.5%	41.8	7.8%	-61.3%	
Transport, communication and storage	---	---	---	---	0.2	0.0%	0.1	0.0%	0.5	0.1%	---	
Services	3.6	0.1%	6.6	0.4%	5.7	0.8%	5.0	0.8%	4.4	0.8%	5.0%	
Other credit	209.6	6.5%	324.9	19.0%	261.7	35.6%	83.2	13.3%	202.2	37.8%	-0.9%	
Total	3237.4	100.0%	1710.0	100.0%	735.1	100.0%	623.4	100.0%	535.4	100.0%	-36.2%	

Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, *Revista*, various issues.

Table II-10. Refinancing of Loans from Central Bank of Reserve, by Economic Sector, 1980-84 (Million Colons)											
Economic Sector	1980		1981		1982		1983		1984		Average annual rate of growth
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent		
	Nominal Values										
Agriculture	262.9	41.7%	573.0	49.5%	278.4	15.3%	925.0	40.9%	1095.4	24.9%	42.9%
Industry		0.0%		0.0%	0.6	0.0%		0.0%		0.0%	
Construction		0.0%		0.0%	8.4	0.5%	4.0	0.2%	3.7	0.1%	
Transport, communication and storage		0.0%		0.0%		0.0%		0.0%		0.0%	
Non classified	367.7	58.3%	586.0	50.5%	1536.5	84.2%	1350.5	59.0%	3301.5	75.0%	73.1%
Total	630.6	100.0%	1159.0	100.0%	1823.9	100.0%	2290.3	100.0%	4400.6	100.0%	62.5%
	Real Values										
Agriculture	262.9	41.7%	492.0	49.5%	217.1	15.3%	644.9	40.9%	675.0	24.9%	26.6%
Industry					0.5	0.0%					
Construction					6.5	0.5%	2.0	0.2%	2.3	0.1%	
Transport, communication and storage											
Non classified	367.7	58.3%	510.4	50.5%	1198.0	84.2%	939.7	59.0%	2036.7	75.0%	53.4%
Total	630.6	100.0%	1010.2	100.0%	1422.0	100.0%	1578.4	100.0%	2714.7	100.0%	44.0%
Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, Boletín, various issues.											

Lending to Agricultural Sector

Growth and Institutional Distribution. As shown in Table II-11, in 1984 the mixed bank and Mortgage Bank combination received 84.1 percent of the total new BCR credit to the sector. Public entities were next with 14.9 percent. The other private financial institution received only 1 percent.

Over the 1980-1984 period, total BCR lending to the sector declined. Lending to each class of institution also declined, except public entities. Particularly noteworthy is the decline in lending to the other private sector institutions. In 1980 they received 24.1 percent of BCR lending to the sector, but by 1984 their share was only 1.0 percent.

Distribution by Activity. Traditional export crops dominated BCR credit. As shown in Table II-12, in 1984, coffee, cotton and sugar cane received 62.8, 22.4 and 6.0 percent of the total new BCR credits, respectively. Combined they accounted for 91.2 percent. Over the 1980-1984 period the pattern was virtually the same.

Refinanced loans were also concentrated in the three traditional export crops. As reported in Table II-13, in 1984 coffee, sugar cane and cotton received refinancings that, respectively, accounted for 58.3, 31.1 and 10.0 percent of the sector total. Combined, they represented 99.4 percent of the refinancings.

The annual patterns over the 1980-1984 period have varied slightly. Between 1980 and 1982 cotton and cereals took on much more importance, which reflects the bad years for these crops due to weather, terrorism and markets. In 1983 and 1984 refinancing for coffee become more important due to the low prices in the world markets and the increasingly overvalued exchange rate.

Rediscount Lines for Sector

The BCR has utilized numerous special rediscount lines to support specific agricultural activities. The sixteen that were in effect for the 1984/1985 agricultural year are reported in Table II-14. With this number of lines and the specific uses, it is clear that the BCR is trying to selectively direct credit to certain purposes in accordance with a national plan. The activities eligible for refinancing vary considerably but are centered around coffee, cotton, sugar, basic grains and livestock. The reformed sector has

Table II-1. New Agricultural Credit Flows from Central Bank by Institution, 1980-84, (Million Colons)											
Institution	1980		1981		1982		1983		1984		Average annual rate of growth
	Percent										
Commercial banks and Mortgage Bank	339.9	67.9%	497.7	80.0%	319.6	76.0%	322.1	89.2%	321.9	84.1%	-1.3%
Other private financial institutions	120.3	24.1%	43.0	6.9%			14.6	4.0%	3.9	1.0%	-57.6%
Public entities	40.0	8.0%	81.1	13.0%	101.0	24.0%	29.3	7.8%	55.9	14.9%	9.2%
Total	499.1	100.0%	621.8	100.0%	420.6	100.0%	365.0	100.0%	392.7	100.0%	-6.4%
Commercial banks and Mortgage Bank	339.9	67.9%	433.5	80.0%	249.2	76.0%	222.0	89.2%	197.6	84.1%	-12.5%
Other private financial institutions	120.3	24.1%	37.5	6.9%			10.1	4.0%	2.1	1.0%	-62.4%
Public entities	40.0	8.0%	70.6	13.0%	79.7	24.0%	19.5	7.8%	35.1	14.9%	-3.2%
Total	499.1	100.0%	541.6	100.0%	327.9	100.0%	251.6	100.0%	235.1	100.0%	-17.1%

Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, Boletín, various issues.

Table II-13. Resinancing of Agricultural Loans by the Central Bank of Reserve, by Activity, 1980-84											
(Million Colones)											
Activity	1980		1981		1982		1983		1984		Average annual rate of growth
	Nominal Values	Percent									
Coffee	27.6	10.5%	174.9	89.5%	117.2	42.1%	573.0	61.2%	679.5	59.3%	119.3%
Cotton	163.4	62.2%	120.7	21.0%	62.6	22.5%	95.6	10.2%	109.3	10.0%	-9.6%
Cereals	60.3	22.9%	259.6	43.7%	99.6	35.4%	0.0	0.0%	5.9	0.5%	-44.3%
Sugar cane	1.0	0.4%	2.6	0.5%			267.2	29.6%	340.1	31.0%	327.4%
Other agriculture	10.6	4.0%	25.0	4.4%			0.0	0.0%	1.7	0.2%	-36.7%
Total	262.9	100.0%	573.8	100.0%	279.4	100.0%	935.9	100.0%	1095.4	100.0%	42.9%
Real Values											
Coffee	27.6	10.5%	152.3	89.5%	91.4	42.1%	374.9	61.2%	373.9	59.3%	94.4%
Cotton	163.4	62.2%	105.1	21.0%	49.9	22.5%	65.9	10.2%	67.4	10.0%	-19.9%
Cereals	60.3	22.9%	218.3	43.7%	76.9	35.4%			3.6	0.5%	-50.6%
Sugar cane	1.0	0.4%	2.3	0.5%			184.1	29.6%	209.9	31.0%	280.6%
Other agriculture	10.6	4.0%	21.8	4.4%					1.0	0.2%	-43.9%
Total	262.9	100.0%	499.8	100.0%	217.1	100.0%	644.9	100.0%	673.9	100.0%	26.6%

Source: Banco Central de Reserva de El Salvador, Departamento de Investigaciones Económicas, San Salvador, Yachux Janyax.

Table (11.4). Central Bank of Reserve Reducement Loans for Agricultural Sector, Agricultural Year 1985/86								
Reduction line	Source of fund	Purpose	Term	Interest rate (%)	Rate (final year)	Amount	Authorized ICIS	Beneficiaries
Coffee production	BCR	To finance the operating cost of coffee production	One year	12 11	14 13	Up to 100 colones per 93 of coffee	BFA, Commercial banks, Mortgage Bank, FIDECRE-DITO, INCAFÉ	Individual producers and associations
Coffee harvest 1984/85	BCR	To repay production loans with BCR funds	Up to Oct. 31 1985	12 11	14 13	Up to 100 colones per 93 of coffee		
Coffee planting	Mexican funds	To finance planting of coffee	5 years 3 years or less period	9 7	10 9	Up to 3.05 colones per plant	BFA, Commercial banks, Mortgage Bank, FIDECRE-DITO, INCAFÉ	Coffee producers
Coffee rural extension	BCR	To finance tools and inputs to attack coffee rust	Up to April 30 1986	8	10	Up to 179.50 colones per manzana		
Sugar cane production	BCR	To finance operating costs of sugar production	April 30 1986	12	14	100 colones per manzana	Commercial banks, Mortgage Bank, BFA, FIDECREDITO	Sugar cane producers
Old harvest				12	14	1,679 colones per manzana		
New harvest				12	14	1,679 colones per manzana		
Cotton production	BCR	To finance operating costs of cotton	March 30 1986	11	13	73.0 colones per 91	Commercial banks, Mortgage Bank, BFA, FIDECREDITO	Cotton producers
Summer vegetable production	BCR	(a)		11	13	Average of 3000 colones		Individual farmers
Corn for human consumption	BCR	To finance operating costs of corn production	March 31 1986	11	13	Up to 900 colones per manzana		
Rice production	BCR	To finance operating costs of rice production	March 31 1986	11	13	Up to 1,515 colones per manzana		
Corn seed production	BCR	To finance corn for seed	June 30 1986	11	13	Up to 2850 colones per manzana		
Sorghum production	BCR	To finance operating costs for sorghum	March 31 1986	11	13	Up to 840 colones per manzana		
Beans production	BCR	To finance bean production	March 31 1986	11	13	Up to 1155 colones per manzana		
Cattle fattening	BCR	To finance the purchase of the cattle and forage	Up to one year	12	14	Up to 853 colones per head	Commercial banks, Mortgage Bank, BFA, FIDECREDITO	Cattlemen
Beekeeping	BCR	To finance beekeeping	Up to one year	12	14	Up to 30 colones per 93 of honey		Beekeepers
Investment credit for PL-480 funds reformed sector	PL-480 funds	To finance long-term investment in the reformed sector	5-15 years including grace period	7 10	10 12	As needed	Commercial banks, Mortgage Bank, FIDECREDITO, INCAFÉ	Reformed sector cooperatives
Refinancing reformed sector funds	PL-480 and 519.253	To refinance unpaid loans in reformed sector	4 years	9	6	As needed to refinance interest and	Commercial Banks, Mortgage Bank, BFA, FIDECREDITO, INCAFÉ	Reformed sector cooperatives

Source: Banco Central de Reserva de El Salvador, Gerencia de Crédito y Valores.

special lines for investment and refinancing. The following subsections provide an overview of these special lines.

Source of Funds. The BCR used its own resources for most of the lines. The exceptions are the Mexican funds for medium-term loans for coffee planting; BCIE funds for coffee rust campaign; PI480 funds to support long-term investments in reformed sector cooperatives; and PI480 funds for refinancing the unpaid portion of loans to these cooperatives.

Intermediary Credit Institutions. The intermediary credit institutions for BCR funds for agriculture have been the nine commercial banks, the Mortgage Bank, the Agricultural Development Bank, FEDECCREDITO, FEDECACES, and INCAFE, for coffee financing. According to the BCR rediscount regulations, no foreign bank has been allowed to use rediscount lines. Some rediscount lines are limited to specific institutions.

Clientele. Most lines are open to both reformed and non-reformed sector farmers. Two are limited to only the reformed sector.

Term of Loans. Most production loans are short term. Loans for coffee planting are to be repaid in six years with a three-year grace period. Investment credit for cooperatives have terms between six and fifteen years with grace periods ranging from one to four years, depending the end use of funds. The term for refinancing of unpaid loans for reformed sector cooperatives is four years.

Interest Rates. Most interest rates for annual production credit loans were fixed at 13 or 14 percent depending upon the type of borrowers. Small and medium-size farmers are favored with lower interest rates; for example, medium-term coffee planting loans have been fixed at 10 percent for large farmers and 9 percent for small farmers. Interest rates for cattle fattening and beekeeping are 14 percent and those for reformed sector investment credit are 10 percent if funds are for purchasing domestic products 12 percent for loans to purchase imported goods. Finally, the interest rates for loans for refinancing unpaid loans have been fixed at 6 percent. Clearly these borrowers are getting a substantial break on interest charges.

The rediscount rates for ICI's are usually two percentage points lower than the loan rate thus giving the ICI a spread of two percent. In the case of investment credit for reformed sector cooperatives for the purchase of domestic goods, the BCR has fixed three points. The BCR encourages supervision of loans by providing four points of spread when the

intermediary credit institutions are able to demonstrate they provide close supervision of the loan.

Size of Loans The Monetary Board in conjunction with BCR fixes a credit quota per unit of production for each type of activity based on production costs. Therefore the loan size is the number of production units multiplied by the quota. For example, in the case of crop loans, the size usually has depended upon the number of manzanas planted. For coffee, the loan size in any year is based on the average quintales the farmer has delivered in the previous year to INCAFE. In the case of cattle fattening loans, the amounts are fixed by the number of head in the project. There is no limit to loan size for credit for investments in the reformed sector.

The Process The ICI receives a application from a potential borrower and presents it to the BCR along with any special documentation required by the specific line. The documentation is basically designed to show that the borrower is eligible for a loan to undertake the activity to be financed. For example, coffee growers must show that they have been producing coffee in the past few years.

A BCR financial analyst reviews the application. If it is in order it is sent to the department head for approval. Once approved, it is sent to the BCR credit committee. Up to this point usually five to fifteen days have passed. The credit committee meets twice a week. It can approve loans up to ₡1 million. Larger loans must be approved by the BCR board of directors. The board meets once each week. This step of the process usually takes eight to ten days.

Once the rediscount is approved, the ICI is notified. Disbursement follow. The ICI needs to visit the BCR for each disbursement.

When the loan reaches maturity the BCR charges the ICI principal and interest. If the ICI does not repay the loan, the full amount including interest, is taken out of the ICI's legal reserves. Therefore, the BCR runs no risk, it is all carried by the ICI.

The system is designed for control, it is cumbersome and subject to delays. Fortunately, the BCR is implementing a new system that gives the ICI the power to approve the loan directly. This makes a lot of sense because it is less costly and reduces delays.

Central Bank Rediscounts: Summary and Conclusions

This section amply shows the importance of BCR rediscounts for financing agriculture, and, as such, in directing credit to the sector. In the 1984/85 agricultural year there were sixteen special rediscount lines for the sector. In 1984, 44.1 percent of the total BCR lending for new credits was to agriculture. In addition much of the rediscounts for refinancing was directed to agriculture. Rediscounts for new credit and refinanced credit in the agricultural sector are concentrated in the traditional export crops, with coffee receiving almost two-thirds of the total.

The real value of total BCR rediscounts declined over the 1980-1984 period. So did the rediscounts directed to agriculture. There appear to be two basic reasons. First, the Monetary Board cut back on rediscounts for new credits in an effort to control inflation and reduce pressures on the exchange rate. Second, other funds were created that substituted for the need to increase rediscounts to agriculture. Specifically these are the large loans from USAID and IDE to BFA for the reformed sector. The latter is also a reason that the mixed banks and the Mortgage Bank rapidly increased their share of BCR rediscounts.

An increasing portion of the declining real value of rediscounts were for refinancing. Indeed, the real value of refinancing increased substantially over the period. In 1984, 13 percent went for this purpose. In contrast, in 1980, only 27.9 percent went for this purpose. This reflects the increasing importance of refinancing, especially long-term, over the period. It is important to recognize, however, that the growth of importance of refinancing is another indicator of the effort by the Monetary Board to cut back in credit. Refinancing does not create new money since it is just a paper transfer between an old and a new debt. As such it does not represent new credit, rather it is just a continuation of previous loans. Therefore, the increases in total rediscounts do not accurately reflect the true flows of rediscounted credit in the economy and the agricultural sector; they serve to inflate growth. Furthermore, it is important to recognize that refinancing does not substitute for new rediscounted credit.

Marketing and Pricing Policies

The government has a highly structured set of policies to control the marketing of the most important agricultural products. This policy is oriented around two basic principles: control of the marketing channels and

direct or indirect control of product prices. The latter is accomplished by means of domestic price regulation, multiple exchange rates and taxation.

Basic Grains

A government agency, the Supply Regulatory Institute (IRA) is charged with the responsibility on enforcing the prices of basic grains paid to producers and sold to consumers. The prices for these goods are established by the Internal Commerce Division of the Ministry of the Economy.

IRA's mission is to pay support prices to farmers, especially small- and medium-sized farmers and reformed sector cooperatives. In this role it actually purchases the product. These products are then sold to ensure supplies of basic grains, sugar and milk at reasonable prices. To this end it operates consumer stores. IRA is also charged with marketing PL480 food imports.

IRA's policy is to set prices for producers that exceed the prices the product is sold to the consumer. In this way IRA subsidizes the producer at a direct cost to the state. In practice IRA does not exert the control over prices that is expected. On the producer's side, it does not have the capacity to purchase all of the production. Therefore, many farmers are forced to sell their output at lower prices to other buyers, such as middlemen. While this reduces the farmers' profits, in one way this outcome is advantageous to the producer because he gets an immediate cash payment whereas there are usually delays in getting paid by IRA.

IRA has set low prices for consumers. As a consequence, stocks in their stores are exhausted rapidly and most consumers are forced to pay higher prices.

The same phenomenon has occurred with imported food products, which are brought into the country at the considerably overvalued exchange rate. The artificially low prices of imported goods have simultaneously led to active black markets for consumers and discouraged local production.

It is clear that the price control mechanisms are not functioning as they were planned. The official low consumer prices, the knowledge by farmers that they cannot expect to receive the minimum price, and the overvalued currency all tend to discourage production. In this regard, they discourage credit use. Alternatively, if credit use is encouraged by the minimum prices and farm plans are made accordingly, but then prices received by farmers are much lower than expected at the planning stage, the producer may

experience losses. This factor may be reflected in the high delinquency situation.

The government is attempting to encourage more production of basic grains. Policies employed are special rediscount lines and use of the parallel market rate for exports of these products. These measures should stimulate production, but the results are often mitigated by the countervailing forces of the above described pricing policies.

Coffee

The National Coffee Institute (INCAFE) was created in 1980 as a government agency with complete monopoly power over foreign and domestic sales of coffee. Under this arrangement INCAFE purchases and sells all production. When the product is sold and after deductions are made for export taxes, processing and INCAFE expenses, the producer is paid. In some cases, where INCAFE also lends money for coffee production and processing, the loan principle and interest are also deducted.

There are several major problems with this system, which discourage both coffee production and credit use. The first is that the producer must refinance his production credit with a prendario and then wait until the coffee is sold until the loan is cancelled. This extends the period of indebtedness and adds considerable interest charges. The second is that it forces the producer to accept the price obtained by INCAFE. Many producers argue that this price is lower than it would be under competitive market conditions.

The coffee producer is also penalized by being forced to sell exports at the official exchange rate. With the wide current disparity between the official and parallel market rates and even more with the black market rate the producer is subject to a large implicit tax, a factor that discourages production and credit use.

Export taxes are another factor that discourage production. El Salvador relies on these taxes as a major source of revenue. The problem for the producer is that the taxes have been maintained at previously existing levels while world prices have not risen enough to compensate for the increase in production costs.

El Salvador is a member of the International Coffee Agreement. Nevertheless El Salvador's dependence on world coffee market conditions put the nation and its coffee producers in a vulnerable position. As market and

growing conditions change, growers incomes and the nation's export revenues can be expected to change sharply. Indeed, the softening of world coffee markets on recent years as well as the above policies, civil strife and land reform have all been contributors to the decline in Salvadorean coffee production.

Cotton

The state does not control cotton marketing; it is the only major export crop that is not marketed by a government agency. Cotton is marketed through the Cooperative of Cotton Producers (COPAL), which has a monopoly on both foreign and domestic sales. It maintains this monopoly because cotton growers are required to get a license from the Ministry of Agriculture and Livestock.

The situation for cotton growers and the implications on the profitability of the crop and for credit use are similar to that of coffee. When growers deliver their product to COPAL, they have their production credits refinanced, which is repaid with interest when the cotton is sold. As with coffee, the farmer is extending his indebtedness and paying interest while the product is being processed. Therefore, these costs and the burden of the debt are shifted from the Cooperative to the borrower.

The government has treated cotton producers more favorably with respect to the exchange rate. Nevertheless, producers are negatively impacted. COPAL can exchange the first \$15 million exported at the parallel rate. Then 50 percent of additional sales are exchanged at the parallel rate.

As with coffee, Salvadorean cotton is very dependent on the condition of world markets. Cotton prices are subject to international market conditions and the major declines in prices in recent years reflect a worsening world market for producers. To counteract this trend, in 1982, the government established a guaranteed price for producers.

Finally, as with coffee, all of these factors in combination with the effects of civil strife and land reform have contributed to a considerable reduction in cotton production in El Salvador in recent years.

Sugar

In 1980 a government agency, the National Sugar Institute (INAZUCAR), was created to have monopoly power over the domestic and foreign sales of sugar.

INAZUCAR has designed a national distribution plan to distribute sugar directly from the processing plants to wholesale distributors using independent carriers. To give added support to producers INAZUCAR has established a policy of maintaining the domestic price level higher than that on the international market.

For external sales, El Salvador benefits from access to the United States preferential market. This means that El Salvador has a guaranteed market and probably receives better prices than are available on the normal international market. However, El Salvador also places exports on the world market.

Sugar cane appears to encounter less restrictive factors than coffee and cotton. The export quota to United States with preferential prices and internal market price levels have been sufficient incentives for production.

Marketing and Pricing Policies: Summary and Conclusions

The government has attempted to establish control over the marketing and pricing of the most important crops produced for export and domestic use. Their goals have been to maintain price stability for producers and domestic consumers, and to control the inflow and the use of foreign exchange earned by exporters. To accomplish this, government institutions have been established that exercise monopsony and monopoly powers.

The government's programs have met with mixed success. The controls established for domestic products have proven to be insufficient. They incorporate subsidies to producers because the government fixes a minimum price to producers that exceeds the price at which the product is sold to consumers. A large portion of the producers products are not sold to IRA because of the Institute's lack of sufficient budget, after all it is designed to lose money, and capacity to buy all products. Consequently, many producers do not receive the minimum prices established by the government. Furthermore, there are inconsistencies in policies. The facts that the government fixes lower prices for consumers than are paid to producers and that imported foodstuffs are purchased at the low official exchange rate both serve to keep prices below the minimum prices. Clearly the policy to maintain producers prices at a minimum level is inadequate. Because of IRA's inability to buy the production many farmers don't receive these prices. Other farmers are forced to accept lower prices, which are

brought about in part by the government's policy to import food products at the official exchange rate.

The government programs for exports are more successful as control because of the monopoly powers of the exporting institutes. Cotton and sugar growers have benefited from better foreign exchange rates and artificially supported prices; in the case of cotton government minimum prices and in the case of sugar the preferred entry into the U.S. market. Coffee growers, on the other hand, have been taxed heavily, because of coffee exports being subject to the lower official exchange rates. This implicit tax has been a major disincentive for coffee production.

Finally, there is no doubt that such tightly structured programs are subject to considerable abuse and lead to evasion. On the first account, monopoly buyers can take advantage of sellers by offering them lower prices because they have no alternatives. It is almost certain that some sellers get more favorable treatment than others. Furthermore, such programs create opportunities for bribery and corruption. On the second account, it is to be expected that growers will try to sell their products at higher prices if they can. In this regard, considerable Salvadorean coffee has found its way to Guatemala, where it can be sold at higher prices.

Agricultural Input Policy

As means to stimulate output as well as a means to compensate producers for low product prices, the government has established subsidized prices for many agricultural inputs. As noted above, one of these inputs is credit. The government has made special credit lines available to the agricultural sector and has consistently maintained low and sometimes even negative real interest rates on these loans.

The government has also given subsidies to imports of fertilizers, seeds and other chemicals by permitting these importations at the most favorable official exchange rate. Limits are established on the amounts imported based upon estimated needs for the next agricultural season.

The government has established an input distribution system in the Agricultural Development Bank through a system of three input supply stores. These stores sell a large portion of the nation's inputs and, therefore, serve to keep retail prices at the low levels.

Technical Assistance and Research

Many public and private sector organizations provide technical assistance to farmers and conduct agricultural research in El Salvador. The extent that these activities improve the profitability of farming will enhance the profitability of using credit. The organizations providing technical assistance include the following:

Public Sector

MAG: Ministry of Agriculture and Livestock

CENTA: National Center of Agricultural Technology

ISTA: Salvadoran Institute of Agrarian Transformation

ISIC: Salvadoran Institute of Coffee Research

CENREN: National Center of Renewable Resources

CENDEPESCA: Center of Fishing Development

CENCAP: National Center of Agricultural Training

C.D.G.: Center of Livestock Development

FINATA: National Finance Agency of Agricultural Lands
Office of Agricultural Defense

ENA: National School of Agriculture

D.G.R.P.: Headquarters of Fishing Resources

BFA: Agricultural Development Bank

Private Sector

COPAL: Cooperative of Cotton Producers

Cattle Raisers Association

Coffee Producers Association

Sugar Cane Growers Association

A.P.A.: Agricultural Suppliers Association

Agro-Tecnia

Technoserve, Inc.

This section briefly discusses the activities of some of the above organizations, those that provide the most technical assistance to El Salvadorean farmers.

Public Sector

Prior to the 1980 agrarian reform the large haciendas did not rely on governmental advisory services; most of them had competent management and hired advisory assistance when needed. With the reform, the government, in particular the Ministry of Agriculture and Livestock (MAG), assumed the responsibility for the introduction of virtually all crop and livestock science and technology among most farmers. Although serving all farmers, MAG gives priority to the agrarian reform beneficiaries. As indicated above, there are many branches of MAG that, to one degree or another, provide technical assistance to farmers; of them CENTA is particularly important.

CENTA. This is the research and extension branch of MAG that provides assistance to farmers through its sixty-three agricultural extension agencies. Its assistance has been basically oriented to specific crops, livestock operations, or other specific problems. In the 1982-1983 period it is estimated that relatively more assistance was provided to traditional export crops (75 percent) than to basic grains (25 percent). CENTA has a staff of 503 in its extension department, of which 207 are field agronomists. Its provision of services to farmers has been limited by its resources, including a shortage of vehicles.

CENTA has given priority to the reform sector. The third evaluation of PERA indicated that during 1982-1983 that agricultural extension staff of CENTA served 105 cooperatives or about one-third of all the Phase I cooperatives. Assistance was provided primarily on the cultivation of cereals, coffee, cotton, and sugar cane, which covered 42,300 hectares, and represented approximately 20 percent of the area of all of the cooperatives.

CENDEPESCA. This agency encourages the capture, processing, and marketing of fish in various ways, including the provision of technical assistance. Personnel of CENDEPESCA help organize fishing cooperatives; in 1984, for example, fifteen artisan cooperatives with some 800 fishermen were assisted. CENDEPESCA does not work with any of the Phase I cooperatives.

ISTA. This institution is responsible for the execution of the first phase of the agrarian reform and, as such, its main goals are to award affected properties to peasant groups and to help them until they become self-managing economically viable enterprises with the active and conscious participation of their members. Through four regional offices ISTA provides assistance to all the cooperatives and their some 35,000 members. Its assistance consists basically in the provision of consulting services

concerning the planning of agricultural work, preparation of credit applications, training, marketing, the formulation and execution of productive and social projects, and social and business organization. ISTA has emphasized assistance for the production of coffee, cotton, and sugar cane. The cooperatives, with the assistance of ISTA technicians develop an annual work plan at the beginning of each crop year. This plan becomes an important element in the banks' subsequent evaluation of the cooperatives' credit applications. Another function of ISTA is to provide a loan guarantee to the banks that provide credit to the cooperatives. The guarantee is equivalent to 50 percent of the credit provided by a bank to a cooperative. In determining the amount of its guarantee, ISTA makes use of the previously-developed plans and the maximum credit quotas per unit of output that the Monetary Board establishes for each crop. ISTA has not been fully successful in its activities due to both internal difficulties and external circumstances.

FINATA. This agency works with the Phase III portion of agrarian reform. The activities of FINATA are directed to achieve the legal possession of small parcels of land by the Phase III beneficiaries and the improvement in their social and economic well-being. FINATA has an office in each of the fourteen departments of the country. In addition to facilitating the transfer of land titles, FINATA has also encouraged a number of organizations to provide technical assistance to the Phase III beneficiaries, such as CENTA, which served 12,789 beneficiaries in 1984, and OPOR (Office of Small Irrigation Works), which helped with fifteen irrigation projects. In addition, FINATA has employed the private firm of Agro-Tecnia to provide assistance in production, administration, marketing, finance, and accounting to 2,284 direct beneficiaries on 4,104 hectares.

Agricultural Development Bank. BFA, which is a major lender to the beneficiaries of the agrarian reform, has provided limited amount of farm planning assistance to some of the Phase I cooperatives it serves. This activity is assisted by consultants made available through the USAID-supported Agrarian Reform Credit Project. The objective of the farm planning assistance is to lay the basis for expanding production and productivity of the Phase I cooperatives, promoting better land use, exploiting full land and other resources, and improving their loan repayment capability. BFA has been able to provide only eight cooperatives with complete farm planning assistance because it lacked resources to help more cooperatives.

In another program, the USAID-supported Agrarian Reform Sector Support Project, technical assistance is provided to a number of institutions

involved in implementing agrarian reform. In 1985, for example, specialists have assisted MAG and its dependencies in areas such as policy coordination, training of cooperative members, computerization, farm resource utilization and management, small scale irrigation systems, and registering of property.

Private Sector

Growers Associations. Associations of growers of particular crops such as cotton and coffee provide some technical assistance to their members in addition to performing other services. For example, COPAL, receives and gins its members' cotton and sells it domestically and abroad; provides technical and financial services, including the sale of inputs to its members; and, in general, encourages the cultivation and industrial use of cotton in El Salvador. COPAL's agronomists provide technical assistance to members. COPAL, which has a marketing monopoly for cotton in the country, serves the traditional and reform sectors. For the 1983-84 crop year, 42 percent of the cotton was produced by Phase I cooperatives.

Technoserve, Inc. This is a private, non-profit organization funded by USAID. Its goal is to improve the economic and social well-being of low-income people in developing countries through the community-based enterprise development process. It began working in El Salvador in 1975. The agrarian reform created an additional need for its services and its scope of activities was extended to include assistance to Phase I cooperatives. Since October 1982, Technoserve has worked with twenty-four of these cooperatives helping them resolve a variety of agricultural, financial, organizational, and management problems.

Input Suppliers. Some technical assistance to farmers is also provided by sellers of inputs, such as Bayer Químicas Unidas, Moore Comerical, Química Integrada, and Servicio Técnico Agrícola Industrial. Sixteen of these firms are members of the Agricultural Suppliers Association.

Technical Assistance: Summary and Conclusions

Since 1980 there has been a major effort by the Salvadorean government, with considerable foreign assistance, especially by USAID, to develop technical support programs in agriculture. The large bulk of the programs have been directed to the reformed sector, since this group of farmers obviously has the greatest and most pressing needs. These needs are not only in technical agricultural assistance but, even more importantly,

in management and organization, especially in the Phase I cooperatives. As would be expected, the programs that have been established have not been able to meet the needs, indeed they have come far short. This is due to both the size of the task and the fact that most of the technical support programs were new and, consequently, had to build their own organization, recruit personnel and train them. Nevertheless, a good start has been made, but much more needs to be done. It is extremely important to recognize the linkage between these programs and credit worthiness of the reformed sector farmers. Therefore, as a complement to credit technical assistance should be provided.

New Economic Measures

On January 21, 1986, the Salvadorean government announced a long-awaited economic package designed to deal with the increasing economic problems that the nation had been experiencing in the last several years. Many argued that the policies should have been taken much earlier. It was clear that they had been postponed because they would certainly be politically destabilizing. Indeed, in order to mitigate this result it is apparent that the measures were less harsh than were called for by the economic conditions.

The measures consisted of several basic components: devaluation of the colón; import restrictions; limited tax changes, raises in interest rates; increases in minimum wages; higher prices for petroleum products; present or future modifications in prices of basic foods, housing, medical services and education; and a new pricing policy for producers of coffee. A number of these will modify some of the above-described policies of this chapter. These will be addressed below.

Exchange Rate

The implicit devaluation that had been occurring in recent months was formalized when the official exchange rate for all foreign transactions was raised to ₡5 per U.S. dollar. This exchange rate was double the previous official rate of ₡2.50 and was 3.1 percent higher than the previous parallel market rate of ₡4.85. The parallel market rate was eliminated. To try to stabilize the new rate, import restrictions were imposed on luxury goods, including automobiles.

The more favorable rate will benefit the revenues of exporters especially those of sugar and cotton. The revenue benefits for coffee

producers are limited, however, as will be explained below. On the negative side, the new rate will raise the costs of imported agricultural inputs, including fertilizers, other agricultural chemicals, seeds and machinery. This will have important ramifications for growers of products that require large amounts of imported inputs, such as cotton.

Interest Rate Structure

As shown in Tables II-15 and 16 the loan and deposit rates were raised. Interest rates on the class A preferred loans were raised 2 percentage points to 15 or 16 percent and class A regular loans were raised 3 percentage points to 17 or 18 percent. Class B loans were raised, 3.5 or 3 percentage points to 20 or 21 percent. It is noteworthy that only the new rates of class B loans exceed the 1985 rate of inflation. Therefore, the structure basically consists of negative real rates. Clearly, the new rates are lower than the opportunity cost of capital. The adjustment probably should have been greater in order to avoid the problems of distortions in the economy that result from negatively and low-priced credit.

On the deposit side, rates for regular savings accounts were not increased. Clearly, there is no interest to attempt to increase this type of savings. Time deposit rates were raised from 2 to 2.5 percentage points to 11.5 up to 15.5 percent depending on the length of time. The policy is designed to encourage this type of deposit. Nevertheless, none of the rates will be positive if the 1985 rate inflation continues. This also suggests the interest rate structure is too low.

Coffee

Coffee revenues for producers are to be pegged to the world price. The basic relationship is that producers will receive ₡400 for 500 pounds of central standard grade coffee if the world price, FOB, is \$200. This is an implicit exchange rate of ₡2 per dollar for the growers. If the world price for coffee exceeds \$200 then the producers will receive the additional revenues, but in the form of two-year Central Bank bonds that pay 5.5 percent annual interest. This policy neutralizes the growers' access to additional foreign exchange. These bonds may be used to cancel delinquent coffee debts with banks. If the world price is less than \$200, then the growers must absorb the difference between the price at which coffee is sold and \$200. There is an additional policy, if coffee growers' profits are judged to be extraordinarily high they are subject to an excess profits tax.

Table II-15. Maximum Interest Rate Structure for Loans of Banking System as Established by January 21, 1986, Economic Package. a)		
Class of loan	Previous rate	New rate
Regular class A loans		
Short term	14	17
Medium and long term	15	18
Preferred class A loans		
Short term	13	15
Medium and long term	14	16
Class B loans		
Short term	16.5	20
Medium and long term	17	21
Source : "Programa de Estabilización y Reactivación Económica, La Prensa Grafica, 22 Enero de 1986, p.36.		
a) The interest rate structure for savings and loan associations may differ from these rates.		

Table II-16. Deposit Interest Rate Structure for Financial System			
as Established by January 21, 1986, Economic Package			
Class of Deposit		Previous rate	New rate
Savings deposits			
Without advance notice			
Banks		7	7
Savings and loan associations		8	8
With advance notice			
Banks		7.5	7.5
Savings and loan associations		8.5	8.5
Deposits in savings and loan associations		11	13
Time deposits in banks and certificates of deposits in savings and loan associations			
60 days		9.5	11.5
120 days		11	13
180 days		12.5	15
360 days or more		13	15.5
Source: "Programa de Estabilización y Reactivación Económica"			
La Prensa Gráfica, 22 Enero de 1986, p.35			

The new coffee policy clearly is disadvantageous to coffee growers. The low implicit exchange rate and excess profits tax, combined with the rising costs of inputs means that coffee growers will continue to have their profit margins squeezed.

Basic Food Prices

Prices of basic foods, except butter and vegetable oil, were not raised in the near future. There are plans, however, to raise these prices later in 1986. Nevertheless, the low current prices and what undoubtedly will low future prices will continue to serve as brakes on increasing incentives for basic food production.

Costs of Production for Agricultural Products

Several of the measures directly contribute to raising the costs of producing agricultural products. One factor will be the above-mentioned rise in loan interest rates. Another is the increased in minimum wages in agricultural activities. For example, wages for male adult workers were raised 74 percent from ₱5.20 to ₱8.00 per day. Prices of petroleum products were also elevated. The cost of regular gasoline was hiked 42 percent per gallon, and that of diesel fuel went up 63 percent. Finally, the devaluation of the colon will increase the costs of imported inputs, such as fertilizer, other chemicals and machinery.

Summary and Conclusions

The new economic package does not bode well for much of agriculture. Production costs are sure to rise. Revenues per unit of product for exporters will rise due to the devaluation. Sugar cane and cotton growers will benefit on this account. Coffee producers, on the other hand, will be harmed. These appear to be few incentives to increase the output of basic grains and other foodstuffs because of the government's desire to keep these prices low for reasons of controlling inflation and maintaining political stability.

The modifications in the interest rate structure are in the right direction. However, they appear to be insufficient unless the rate of inflation declines sharply. If inflation continues at the pace of 1985 most real loan rates and all real deposit rates will be negative.

III - FOREIGN ASSISTANCE FOR AGRICULTURAL CREDIT

Introduction

Since 1979, El Salvador has been the recipient of nearly \$1 billion in foreign assistance commitments for development. This chapter describes this foreign assistance and the extent to which it was directed to agriculture and agricultural credit. This is followed by a brief overview of the foreign assistance for agricultural credit and how it relates to assistance for the agricultural sector. The chapter is designed to show the role that foreign assistance for agricultural credit has played and to provide a background for the references to foreign assistance programs that appear in later chapters.

Foreign Assistance

From 1980 to 1984 commitments of \$ 983 million were made to El Salvador by the United States Agency for International Development (USAID), the Interamerican Development Bank (IDB), the Central American Bank for Economic Integration (CBEI), and the World Bank. As shown in Table III-1, of the total, 30 percent was directed to agriculture and 18 percent to agricultural credit. Of the commitments to the agricultural sector, agricultural credit accounted for 61 percent. When measuring assistance on a disbursement basis, the shares are similar.

USAID was by far the largest provider of foreign assistance over the 1980-1984 period; its commitments of \$617 million represented 63 percent of the total. Were PL480 funded programs included the sum would be even higher.

IDB was next with \$280 million or 28 percent, followed by CBEI with \$69 million or 7 percent. The World Bank did not lend to El Salvador until 1984. Its commitments of \$17 million in that year represent less than 1 percent of the five-year total.

Lending to the agricultural sector was concentrated in IDB and USAID, which lent 51 and 46 percent of the total respectively. The remainder was provided by CBEI; the World Bank did not have agricultural projects.

In relative terms, IDB concentrated its assistance in agriculture and agricultural credit more than did the other two donors; 53 percent of IDB's total lending commitments were directed to agriculture and 37 percent to agricultural credit. USAID committed 22 percent of its 1980-1984 assistance

to agriculture and 12 percent to agricultural credit. The CBEI directed only 15 percent of its assistance to agriculture and none to agricultural credit. The following sections discuss assistance to El Salvador by USAID and IDB. The total commitments for agricultural credit were \$178 million of which \$75.6 was from USAID and \$102.4 from IDB.

United States Agency for International Development

USAID's agricultural projects consisted of the following: Small-farm Irrigation Systems, \$ 2.30 million committed; Small-producer Development, \$9.75; Agrarian Reform Organization, \$11.75; Agrarian Reform Sector Support, \$34.90; and Agrarian Reform Credit, \$75.63. All of USAID's assistance for agricultural credit was contained in the Agrarian Reform Credit project, which demonstrates the Agency's commitment to assisting the reformed sector. The large credit project accounted for 63 percent of all USAID commitments to agriculture. Another indicator of the Agency's support of the reformed sector is the fact that most of the rest of their support was directed to the Agrarian Reform Organization and the Agrarian Reform Support projects. Clearly, these projects and the credit project are complementary.

Reformed Sector: Non-credit Projects

Through the Agrarian Reform Organization project and its successor, the Agrarian Reform Support project, USAID has provided and continues to provide substantial assistance to the Ministry of Agriculture and Livestock (MAG) and its agency, the Salvadoran Institute of Agrarian Transformation (ISTA). At the beginning of the agrarian reform, this assistance emphasized the preparation of standardized systems for the development of the Phase I cooperatives as business enterprises and the training of cooperative members. Efforts have been made to accelerate the land transfer process for Phase I and III beneficiaries and to improve the ability of the government to provide resources and services to these beneficiaries.

In order to increase the managerial capacity of the cooperatives, project funds were made available on an annually declining basis (first year, 75 percent; second, 50 percent; and third, 25 percent) to help pay the salaries of the managers and accountants of participating cooperatives. Assistance has also been provided to a number of MAG's dependencies in areas such as policy coordination, training, computerization, farm resource utilization and management, small-scale irrigation systems, and registration of property.

The complementarity of these projects with credit is obvious. Efficient land utilization and good farm and cooperative management by the agrarian reform beneficiaries would enhance their credit worthiness, enable them to use borrowed funds more effectively, and increase their ability to repay their loans.

Although the Agrarian Reform Organization/Support projects and the Agrarian Reform Credit project were intended to help the same beneficiaries, the former and the latter were not closely linked or coordinated. For example, a cooperative could receive an USAID-financed loan from the Agricultural Development Bank but not be required to overcome its management, technical or structural weaknesses by taking advantage of MAG services, which may have had financing by the USAID-funded Agrarian Reform Support project.

Agrarian Reform Credit Project

At the outset of the agrarian reform in 1980 it was recognized that adequate, timely, and effective credit was critical to the achievement of the reform's objectives. In order to supplement the credit resources for the agrarian reform program, USAID initiated the Agrarian Reform Credit project in 1980. The goal of the project was to maintain agricultural production and earnings in the reformed sector, by increasing credit to the sector and increasing the capacity of the banking system to provide such credit. Through this project, USAID has provided financial and technical assistance to the Agricultural Development Bank (BFA). The resources of the project were channeled through the BFA because: (a) it is the chosen vehicle of the El Salvadorean government for providing credit to the reformed sector and has played a major role in financing Phase I cooperatives; (b) it is the most important institution providing credit to the agricultural sector in general and to the reform sector in particular; and (c) it has the largest network of branches in the countryside.

In 1980 USAID committed \$10 million to this project. In the ensuing years, through 1985, a series of nine amendments have raised the commitment to \$85.8 million and extended the completion date until 1987. Of the total, \$81.5 million were loan funds and the balance USAID's grants.

USAID disbursements for this project amounted to \$68.1 million between 1980 and 1984. Of the amount disbursed \$45.0 million, 66.1 percent, went to the Phase I cooperatives, \$10.9 million, 10.9 percent to the Phase III

beneficiaries, and \$12.3 million, 18.0 percent to the traditional small farmers.

In the design of the Agrarian Reform Credit project it was recognized that investment credit resources were not being made available to Phase I cooperatives by commercial banks. To facilitate these banks lending to the cooperatives for investment purposes an Investment Credit Rediscount Line (ISAR) was established in the Central Bank using the governments' Agrarian Reform Credit project counterpart funds acquired from PL 480.

The Agrarian Reform Credit project has been a qualified success in terms of the attainment of its basic objectives. Its contribution to the flow of credit to the reformed sector is beyond question. Yet the repayment problem has mitigated these results, without substantial reflows the ability of the BAF to provide new credits is limited. The financial and technical assistance to the BFA channeled through this project led to some improvement in the financial viability and institutional capability of the BFA. However, for reasons that could not be fully anticipated at the time of the design of the project, such as the disturbed conditions prevailing in the country and the lack of continuity in BFA leadership, these accomplishments have fallen considerably short of expectations, particularly in terms of the strengthening of the institutional capability of the BFA. Major improvements are still needed in the areas of financial management, cost control, accounting and data processing, loan processing, loan supervision, and loan recovery.

Inter-American Development Bank

From 1980 to 1984, as indicated in Table III-1, IDB approved \$ 149.2 million and disbursed \$77.9 million to El Salvador for agricultural purposes. Commitments were made by IDB to fund seven agricultural projects: Community Development in the Northeast Program (IDB loan number 561/SF); Livestock Development and Animal Sanitation Program (349/OC); Marketing of Inputs and Agricultural Products (676/SF); Development of Agricultural Research and Extension (705/SF); Agricultural and Agroindustrial Credits for Small Producers (605/SF); Comprehensive Credit to the Agricultural Reformed Sector (642/SF and 124/TF); and Third Stage of the Comprehensive Program of Agricultural Credit (480/OC and 481/OC). The last three are agricultural credit projects, in which the IDB funds were made available to the Agricultural Development Bank .

Table III-1. Assistance To El Salvador From The U.S. Agency For International Development, The Inter-American Development Bank, And The Central American Bank For Economic Integration.

Commitments And Disbursements, 1980-1984	U.S. Agency For International Development (a)	Inter-American Development Bank (thousands of U.S. dollars)		Central American Bank For Economic Integration	World Bank	Total
Commitments:						
Total	617,020	280,000 (b)		68,700	17,160 (e)	982,880
Agriculture	134,325	149,200 (c)(d)		10,000	0	293,525
Percentage of total	22%	53%		15%	0%	30%
Agricultural credit	75,625	102,400 (d)		0	0	178,025
Percentage of total	12%	37%		0%	0%	18%
Percentage of agriculture	56%	69%		0%	0%	61%
Disbursements:						
Total	455,249	290,000 (b)		73,380	n.a.	818,629
Agriculture	75,641	77,923 (c)(d)		10,000	n.a.	163,564
Percentage of total	17%	27%		14%	n.a.	20%
Agricultural credit	47,652	56,750 (d)		0	n.a.	104,402
Percentage of total	10%	20%		0%	n.a.	13%
Percentage of agriculture	63%	73%		0%	n.a.	64%
<p>(a) Data are for the fiscal years ending September 30. Data are for projects which were active as of 1985; accordingly projects previously completed are excluded and commitments and disbursements are understated. For example, in 1980-84 actual disbursements were \$534,992 thousand, which is greater than the \$455,249 reported in this table. Data for active projects are used because disaggregations for agriculture and agricultural credit were available. The data do not include Public Law 480 assistance. Amounts committed are the amounts authorized.</p> <p>(b) Estimated.</p> <p>(c) Includes the loan for the Community Development in the Northeast Program which took effect on April 20, 1979, and had its final disbursement on April 20, 1985.</p> <p>(d) Through September, 1985.</p> <p>(e) @ 42.9 million converted to U.S. dollars at a rate of 2.5 colones per dollar.</p>						

Agricultural and Agroindustrial Credits for Small Producers

The BFA borrowed \$ 16.5 million from IDB for the Agricultural and Agroindustrial Credits for Small Producers project. The loan took effect on September 11, 1980. The purpose of the project was to finance the production of basic grains, vegetables, livestock, and agroindustrial products. The principal objective was to raise the productivity of small producers by financing technical inputs, livestock, and machinery, equipment and plants for fishing and agroindustry. The final disbursement for this loan was made in September 1985.

Comprehensive Credit to the Agricultural Reformed Sector

The Comprehensive Credit to the Agricultural Reformed Sector project consisted of a loan to the BFA that took effect on January 15, 1981. A total of \$ 45.4 million was approved by IDB of which \$ 36.39 million, or 80 percent, had been disbursed through September 1985. The loan was made for forty years with a ten-year grace period on the payment of interest. The annual rate of interest is 1 percent during the grace period and 2 percent thereafter. The loan, which began less than a year after the start of the agrarian reform, was specifically intended for the financing of technical inputs, machinery and equipment, and other fixed assets of the Phase I cooperatives. The project's objective is to support the transformation of the agricultural land tenure system and to better the distribution of income in order to improve the welfare of peasant families. The final disbursement of this loan was scheduled for January 1986.

Third Stage of the Comprehensive Program of Agricultural Credit

The Third Stage of the Comprehensive Program of Agricultural Credit project was approved on August 16, 1984. Under this project IDB has lent \$40.5 million to the BFA of which \$ 3.86 million, or 10 percent, had been disbursed as of September 1985. The annual interest rate is 9.5 percent on \$11.4 million of principal and 4.5 percent on \$ 29.1 million. The term of the loan is twenty years with a five-year grace period on the payment of interest. BFA uses this loan to finance small farmers, including Phase III beneficiaries. The program has the objective of recovering and increasing the levels of production and productivity of agricultural lands in the traditional sector by means of taking advantage of existing productive capacity.

For the Agricultural and Agroindustrial Credits for the Small Producers loan and the loan for the Third Stage of the Comprehensive Program of Agricultural Credit the BFA was both the borrowing and implementing institution. Disbursements of these two IDB loans are reflected in BFA's foreign obligations, which totalled 475 million as of December 31, 1984. On the other hand, for the Comprehensive Credit to the Agricultural Reform Sector loan, the government was the borrowing institution and the BFA the implementing institution. Disbursements of this loan are reflected in the net worth of the BFA. As of December 31, 1984, 467 million or 18 percent of the BFA's net worth was attributable to IDB loans.

Summary and Conclusions

Since 1980, some 18 percent of total foreign assistance and 61 percent of the foreign assistance directed to the agricultural sector has been for agricultural credit. The \$178 million for credit has come from two sources, USAID (\$75.6 million) and IDB (\$102.4 million). Moreover, all of the credit was channeled through BFA and was directed to Phase I and Phase III reformed sector beneficiaries and, to a much lesser extent, to other small farmers. Not included in these figures are the rediscount lines at the Central Bank provided by USAID. PL480 assistance was used to establish rediscount lines for investment and refinancing of reformed sector cooperatives. In 1985, USAID Economic Support Fund monies were used to refinance credits in the private sector, including some coffee loans.

It is clear that foreign assistance has played a major role in financing the reformed sector during its formative years. A substantial amount of the credit flowing to the land reform beneficiaries came from funds made available by foreign assistance. If this assistance had not been forthcoming, it is almost certain that the sector would have received much less credit, rural political instability would have been much higher, and the land reform program would have been less successful. The credit projects were designed to be complemented by other foreign assistance programs to develop Phase I cooperatives into more variable economic units.

Nevertheless, the credit projects have had problems. The most severe has been the high levels of delinquency, which is symptomatic of the inherent problems in the new reformed sector and other economic conditions. Perhaps given the nature of land reform, high delinquency rates should not be surprising. However, they do have important implications for the BFA because the lack of reflows seriously and negatively impacts on the

continued ability of that institution to provide adequate credit services to the reformed sector. The delinquency problem has been considerably masked over by the extensive refinancing of past-due loans. Therefore, the delinquency rates reported by the institution considerably understate the true extent of the problem.

The complementary projects to assist the Phase I cooperative with better management, organization and technical assistance have not proven as successful as was planned. Considerable work needs to be done on this aspect of the reformed sector development. Success here should greatly reduce delinquency by increasing credit worthiness.

The foreign assistance credit programs have had important benefits for BFA. Apart from increasing the Bank's supply of loanable funds, the bank has received considerable technical assistance and capital goods to enhance its work with the reformed sector as well as to improve its overall efficiency in general. Progress on the latter has been limited and much more remains to be done.

Foreign assistance has greatly enhanced BFA's financial position, in spite of the delinquency problems. The reason is that under most of the projects USAID and IDB lent the money to the El Salvadorean government, which, in turn, transferred the funds to BFA as a contribution to its capital with no interest charges. The net result was a sharp increase in the Bank's net worth since 1980. As of December 31, 1984, \$61 million (41 percent) and \$27 million (27 percent) of BFA's \$149 million in net worth came from USAID and IDB, respectively.

IV. OVERVIEW OF RURAL FINANCIAL MARKETS IN EL SALVADOR

Introduction

This chapter provides a broad overview or panorama of El Salvadorean rural financial markets. The purpose is to build upon the previous two chapters and continue to provide the setting or framework for the detailed discussion in the following chapters about each class of financial institution in both the formal and informal markets.

El Salvadorean rural financial markets have had a credit bias, i.e., most institutions have been structured to be providers of credit and not mobilizers of savings, and, as such, are not providing financial intermediation services in rural areas. The two major exceptions are the mixed-commercial banks and the Mortgage Bank; both of these institutions have active savings windows, but both are predominately urban oriented.

After land reform in 1980, the rural financial market gained a new dimension with the addition of the reformed sector that encompasses two classes of clients, the Phase I cooperatives and Phase III small-farmer beneficiaries. Since that time, a number of government and foreign assistance programs have been designed to target lending to the reformed sector.

In addition, since 1980, another new dimension has appeared. For a number of valid reasons--social conflict, terrorism, unfavorable prices in export markets and land reform-- the amount of delinquency has risen. As noted in the previous chapter, the government has coped with the problem by liberal long-term refinancing of many delinquent loans. This, in combination with the normal short-term refinancing for the processing and sale of traditional exports, has come to dominate credit in the agricultural sector.

This chapter is organized as follows: (a) a brief discussion of the financial institutions; (b) a picture of the relative importance of agricultural lending by these institutions; (c) an overview of the activities financed; (d) a presentation of the delinquency and refinancing problem; (e) a discussion of the clientele; (f) an overview of the savings mobilization activities and (g) a discussion of the importance of agricultural credit to sector output.

Institutional Structure

El Salvadorean rural financial markets can be subdivided into two parts: formal and informal markets.

Formal Market

There are seven classes of formal-market institutions that are active in rural areas and/or financing agriculture.

Central Bank of Reserve (BCR). As noted in Chapter II, the BCR plays an important role in implementing the policies of the Monetary Board. Of particular importance for the agricultural sector are the BCR rediscount lines that are available to intermediate financial institutions for credit for selected purposes and/or certain institutions.

Agricultural Development Bank (BFA). The BFA is the government development bank for agriculture. It extends credit, often on very favorable terms, to the sector through its twenty-six offices throughout the republic. It has the authority to receive savings, time and demand deposits. The BFA is the principal recipient of foreign assistance for the sector.

Mortgage Bank. The Mortgage Bank is structured as a commercial bank but with the specific and unique capability of raising capital by the sale of long-term mortgage certificates. It is entirely owned by the private sector. Its operations include all manner of commercial banking activities.

Mixed-commercial banks. There are nine of mixed banks. All were formerly privately owned, but were nationalized in 1980. Since then the government holds at least 51 percent of the stock in each bank, and, therefore, has direct control over these institutions. These banks undertake the typical activities of commercial banks.

Federation of El Salvadorean Credit Unions (FEDECACES). FEDECACES is a federation of forty-four credit unions nationwide, fifteen of which are located in rural areas. FEDECACES has the status of an ICI and, therefore, is eligible for BCR rediscounts. It receives limited funds from this source. Most of its funds come from foreign assistance and its affiliates' paid-in capital. With these funds it

makes loans to credit unions, which, in turn, onlend to their members. Although FEDECACES does not receive voluntary savings it receives forced savings from the member credit unions by means of paid-in capital and monthly dues.

Federation of Credit Funds (FEDECCREDITO). FEDECCREDITO is an autonomous public sector institution. It is the umbrella organization for forty-two cajas located across the nation. FEDECCREDITO is an ICI, and receives financing from the BCR and foreign assistance. These funds are onlent to the cajas, which lend them to their members. FEDECCREDITO and the cajas are authorized to receive demand and savings deposits, but do not undertake these activities. Small amounts of capital are mobilized through membership dues.

National Coffee Institute (INCAFE). INCAFE is a government entity endowed with monopoly powers to market coffee in foreign markets. It also extends credit for all aspects of coffee production, but especially growing and processing. It does not undertake savings activities.

Informal Market

The informal credit market is active in rural El Salvador. Three types of lenders were identified: moneylenders, middlemen and input suppliers. Moneylenders and middlemen play the most important role in financing agricultural production for numerous small farmers. In the case of middlemen, credit is usually tied to marketing. Input suppliers extend credit for very short periods of time but are much less important lenders.

Unfortunately there is no good data on the extent of informal lending activity nation wide. Therefore, they are not included in the overview. The reader is referred to chapter XI for a discussion of their activities. Nevertheless it appears, that the informal market lenders are numerous and that they make many small loans. Although they do not lend the volumes of funds that are provided by the formal market they play an important role in making credit available to many small farmers that would not otherwise be able to obtain credit from most formal-market institutions. Their credit delivery systems are very simple and efficient. Although borrowers pay an interest rate that is higher than the bank rates, it is very economical for farmers to borrow small amounts of credit because of the low borrower transaction costs.

Agricultural Lending and Distribution by Institution

Growth of Lending

The annual agricultural credit flows (as measured by contracted credit) and the year-end portfolios are presented in Table IV-1. In 1984, for all lenders, \$1.8 billion was contracted and \$1.5 billion was in the year-end portfolio. Since 1980 both of these figures have increased steadily when measured in nominal terms. The average annual increases were 12.2 and 10.8 percent. This is particularly the case for the BFA. When measured in real terms, however, the growth rates were negative, -0.6 and -1.8 for flows and portfolio, respectively.

These figures overstate the size of lending for two reasons. First, because all contracted credit is not disbursed. Second, the above figures include refinanced loans in the agricultural sector, which accounted for the largest increases in lending to the sector each year. If the refinanced loans were eliminated then both the nominal and real growths would be negative. The conclusion is that the agricultural sector is receiving considerably less credit for new loans in 1984 than it was receiving in 1980. Furthermore, the growth in the system is due to the sharp increases in refinancing.

Institutional Distribution of Credit

In 1984 the mixed-commercial banking system was the largest class of lender with 47.6 and 43.1 percent of the annual flow and year-end portfolio respectively. However, no one single mixed bank was as large a lender as the Mortgage Bank (22.9 and 23.9 percent) nor BFA (19.1 and 24.2 percent). FEDECACES and FEDECCREDITO had relatively very small volumes of loans. INCAFE was intermediate in size with 9.1 and 4.8 percent of the annual flows and portfolio, respectively.

Between 1980 and 1984 the institutional pattern changed somewhat. INCAFE's lending declined as it began to withdraw from financing coffee production. Therefore, its relative importance went down considerably from the level it commanded in 1980. FEDECCREDITO experienced both absolute and relative declines. The mixed banks became much more active in lending to the sector and their share of credit increased considerably. The Mortgage Bank and BFA increased their lending, in nominal terms but because of the

Table No. 1. Annual Credit Flows and End-of-Year Portfolio by Selected Financial Institutions, El Salvador, 1980-1984 (a)											
(Million Colones)											
Institutions	1980		1981		1982		1983		1984		Average Annual Growth Rate, 1980-1984
	Flow	Percent									
Nominal Values											
BFA											
Annual Flow	296.1	24.2%	223.7	18.8%	212.6	14.3%	272.8	17.7%	341.7	19.1%	17.7%
Portfolio	297.6	29.8%	353.8	27.5%	373.9	23.2%	310.7	20.1%	367.5	24.2%	6.1%
Mortgage Bank											
Annual Flow	292.7	23.9%	371.0	31.2%	242.2	16.3%	413.3	25.1%	407.7	22.7%	8.8%
Portfolio	273.1	27.1%	311.5	24.0%	392.8	27.3%	410.1	26.5%	362.5	23.7%	7.3%
Mixed commercial banks											
Annual Flow	301.1	24.7%	361.1	30.4%	608.2	34.4%	706.1	44.6%	651.9	41.8%	29.7%
Portfolio	344.7	34.2%	401.1	33.5%	583.1	40.5%	652.4	42.2%	653.6	43.1%	17.3%
FEDECACES											
Annual Flow	2.0	0.2%	3.5	0.3%	3.2	0.2%	4.1	0.3%	4.1	0.2%	13.7%
Portfolio	4.4	0.4%	5.8	0.5%	6.8	0.5%	7.5	0.5%	9.1	0.5%	16.3%
FEDECREDITO											
Annual Flow	33.4	3.4%	33.0	3.3%	36.3	2.4%	19.1	1.1%	13.5	1.0%	-16.7%
Portfolio	64.0	6.4%	69.4	5.8%	71.3	5.0%	62.0	4.0%	52.5	3.5%	-4.8%
MICAFEB											
Annual Flow	199.3	17.6%	189.7	16.0%	182.1	12.3%	170.2	10.7%	162.7	9.1%	-4.8%
Portfolio	31.2	3.1%	57.4	4.8%	50.7	3.5%	104.1	6.7%	72.5	4.8%	23.5%
Total											
Annual Flow	1128.6	100.0%	1187.9	100.0%	1484.6	100.0%	1584.6	100.0%	1759.7	100.0%	12.2%
Portfolio	1007.0	100.0%	1193.0	100.0%	1438.8	100.0%	1346.8	100.0%	1516.7	100.0%	10.8%
Real Values (c)											
BFA											
Annual Flow	296.1	24.2%	194.8	18.8%	165.8	14.3%	189.0	17.7%	210.8	19.1%	-9.1%
Portfolio	297.6	28.8%	328.2	27.5%	260.3	23.2%	214.1	20.1%	226.7	24.2%	-5.9%
Mortgage Bank											
Annual Flow	292.7	23.9%	325.1	31.2%	189.8	16.3%	284.8	25.1%	252.7	22.7%	-1.5%
Portfolio	273.1	27.1%	271.3	26.0%	326.3	27.3%	282.6	26.5%	223.6	23.7%	-4.9%
Mixed commercial banks											
Annual Flow	301.1	26.7%	314.5	30.4%	620.1	34.4%	486.6	44.6%	525.9	41.8%	14.9%
Portfolio	344.7	34.2%	349.4	33.5%	454.6	40.5%	443.6	42.2%	403.2	43.1%	4.0%
FEDECACES											
Annual Flow	2.0	0.2%	3.0	0.3%	2.9	0.2%	2.8	0.3%	2.5	0.2%	-1.8%
Portfolio	4.4	0.4%	5.1	0.5%	5.3	0.5%	5.2	0.5%	5.0	0.5%	3.2%
FEDECREDITO											
Annual Flow	33.4	3.4%	34.0	3.3%	28.3	2.4%	12.5	1.1%	11.4	1.0%	-24.2%
Portfolio	64.0	6.4%	60.4	5.8%	55.6	5.0%	42.7	4.0%	32.4	3.5%	-13.7%
MICAFEB											
Annual Flow	199.3	17.6%	163.1	16.0%	142.0	12.3%	117.3	10.7%	109.5	9.1%	-13.6%
Portfolio	31.2	3.1%	50.0	4.8%	39.7	3.5%	71.7	6.7%	41.7	4.8%	9.4%
Total											
Annual Flow	1128.6	100.0%	1034.6	100.0%	1157.5	100.0%	1092.1	100.0%	1103.6	100.0%	-0.6%
Portfolio	1007.0	100.0%	1044.3	100.0%	1121.8	100.0%	1066.0	100.0%	979.7	100.0%	-1.8%

Source: Based on information provided by financial institutions.

a) Flow is measured by amount of contracted credit.

b) Flow represents the contracted credit from October 1 to September 30. Portfolio gives balance as of September 30.

c) Deflator is San Salvador Price Index, base year 1978.

strong growth of the mixed banks their shares fell. FEDECACES increased its lending but still maintained less than 1.0 percent of the flows and portfolio.

Inflation took its toll in the real size of the loan portfolios and credit flows. Whereas all institutions except FEDECCREDITO and INCAFE experienced increasing rates in the nominal flows of credit over the period, the mixed banks were the only ones to show a real increase. The conclusion is clear, in 1984 the real values lent by all institutions except the mixed banks were less than in 1980. Similar results were found for the year-end portfolio; the institutions' assets are being eroded away by inflation. If the refinanced portion of the loans were eliminated the declines would be considerably more severe.

Activities Financed

Most lending to the agricultural sector is for production credit of less than one year. These loans are tied to the agricultural cycle. A much smaller amount is lent for medium- and long-term investments.

Data for the end-of-year portfolio figures are used. They undoubtedly understate the importance of the activities since they do not capture loans made during the year but that are not on the books at the end of the year. Nevertheless, the portfolio figures serve as a good proxy to show the relative importance of the purpose of the loans.

In 1984, as shown in Table IV-2, coffee, cotton and other crops (vegetables, fruits, sesame and cardamon) accounted for 24.7, 11.6 and 16.4 percent respectively. The most important purpose was refinanced loans with 28.2 percent of the total. Were the refinanced loans eliminated, the relative importance of the others would increase substantially. Examination of the refinanced portfolio held by the financial institutions shows that refinanced loans are concentrated in the traditional export crops. A considerable amount represents short-term refinancing associated with the processing and marketing of the products. A large and increasingly large portion is the long-term refinancing of delinquent loans.

There have been changes in the patterns of activities financed over the 1980-1984 period. The traditional export crops of coffee and cotton have always been the largest recipients of credit, but both have declined in importance, especially cotton. The declines in the basic grains of corn, beans and rice are very noticeable. In contrast, there have been sharp increases, beginning mostly in 1983 in lending for livestock, poultry, fisheries and the other crops category. This reflects some diversification in the economy as

Table IV.2. End-of-Year Agricultural Credit Portfolio by Main Activities Financed, Selected Institutions, 1980-1984											
(Million Colones)											
Activities	1980		1981		1982		1983		1984		Average annual rate of growth 1980-1984
	Percent		Percent		Percent		Percent		Percent		
Nominal Values											
Coffee	276.0	27.4%	338.0	28.2%	515.0	33.8%	458.0	29.3%	376.0	24.8%	8.0%
Cotton	197.0	19.5%	231.0	19.3%	208.0	14.5%	129.0	8.3%	176.0	11.6%	-2.8%
Sugar cane	52.0	5.2%	58.0	4.8%	60.0	4.2%	80.0	5.2%	60.0	4.0%	3.6%
Corn	106.0	10.5%	45.0	3.8%	40.0	2.6%	56.0	3.6%	31.0	2.0%	-26.5%
Beans	23.0	2.3%	39.0	3.3%	20.0	1.4%	14.0	0.9%	10.0	0.7%	-18.8%
Rice	21.0	2.1%	43.0	3.6%	19.0	1.3%	3.0	0.2%	16.0	1.1%	-6.6%
Sorghum	10.0	1.0%	5.0	0.4%	5.0	0.3%	6.0	0.4%	6.0	0.4%	-12.0%
Other crops a)	97.0	9.6%	110.0	9.2%	109.0	7.5%	271.0	17.5%	248.0	16.3%	26.5%
Livestock	54.0	5.4%	54.0	4.5%	54.0	3.8%	73.0	4.7%	118.0	7.8%	21.6%
Poultry	7.0	0.7%	4.0	0.3%	4.0	0.3%	15.0	1.0%	23.0	1.5%	34.6%
Fisheries, beekeeping, others	6.0	0.6%	22.0	1.8%	7.0	0.5%	27.0	1.7%	23.0	1.5%	39.9%
Refinancing	159.0	15.8%	250.0	20.9%	398.0	27.7%	433.0	28.0%	430.0	28.3%	28.2%
Total	1008.0	100.0%	1199.0	100.0%	1438.0	100.0%	1543.0	100.0%	1517.0	100.0%	10.8%
Real Values b)											
Coffee	276.0	27.4%	294.4	28.2%	401.5	35.8%	301.9	29.3%	232.0	24.8%	-4.3%
Cotton	197.0	19.5%	201.2	19.3%	162.2	14.5%	88.9	8.3%	109.6	11.6%	-13.8%
Sugar cane	52.0	5.2%	50.5	4.8%	46.8	4.2%	55.1	5.2%	37.0	4.0%	-8.1%
Corn	106.0	10.5%	33.2	3.8%	31.2	2.8%	38.6	3.6%	19.1	2.0%	-34.8%
Beans	23.0	2.3%	34.0	3.3%	15.6	1.4%	9.6	0.9%	6.2	0.7%	-28.0%
Rice	21.0	2.1%	87.5	8.6%	14.8	1.3%	2.1	0.2%	9.9	1.1%	-17.2%
Sorghum	10.0	1.0%	4.4	0.4%	3.2	0.3%	4.1	0.4%	3.7	0.4%	-22.0%
Other crops a)	97.0	9.6%	93.8	9.2%	84.2	7.5%	186.8	17.5%	153.0	16.3%	12.1%
Livestock	54.0	5.4%	47.0	4.5%	42.1	3.8%	50.3	4.7%	72.8	7.8%	7.8%
Poultry	7.0	0.7%	3.2	0.3%	3.1	0.3%	10.3	1.0%	14.2	1.5%	19.5%
Fisheries, beekeeping, others	6.0	0.6%	19.2	1.8%	5.3	0.5%	18.6	1.7%	14.2	1.5%	24.0%
Refinancing	159.0	15.8%	217.8	20.9%	310.3	27.7%	298.4	28.0%	263.3	28.3%	13.7%
Total	1008.0	100.0%	1044.3	100.0%	1121.2	100.0%	1064.8	100.0%	935.8	100.0%	-1.8%
Source: Based on data provided by financial institutions.											
a) Includes vegetables, fruits, sesame and cardamom.											
b) Deflator is San Salvador Price Index, base year 1978.											

well as unfavorable impacts of civil strife and market conditions on traditional exports.

The real values show the drastic impact of inflation on credit. The only activities that register a positive real growth rate between 1980 and 1984 are the other crops category, livestock, poultry, fisheries and beekeeping. In other words, all of the other activities experienced a decline in the real amounts of the year-end portfolio.

Delinquency

Delinquency has been a major problem in the financial system since 1979. A number of factors are responsible, unfortunately many of them occurred simultaneously, compounding the problem. Civil strife and terrorism contributed significantly as production and living patterns were upset in the countryside and fields were burned. Low world market prices for cotton and coffee reduced profitability. Land reform and the formation of cooperatives were others.

In 1984 the following delinquency rates were reported for all loans. The rates for agricultural sector credit were typically higher. 24.1 percent for BFA, 29.0 percent INCAFE, 26.1 percent FEDECACES, 35.0 percent for FEDECCREDITO and 20.0 percent for the Mortgage Bank. The mixed banks apparently fared better, information for six of the nine banks showed an average rate of 10.6 percent.

These figures understate the problem. The large amount of long-term refinancing has reduced delinquency considerably. It is probable, however, that much of the refinanced loans will not be recovered. In this sense the delinquency problem has been postponed; its impact will be felt by the financial institutions in the future.

Relative Importance of Agricultural Lending in Institutions

The agricultural sector is a major recipient of loans made by the financial institutions that are operating in the sector. In 1984, as shown in Table IV-3 100 percent of INCAFE's contracted credit went for agricultural purposes. The percentages for the other institutions were BFA, 81.4; FEDECACES, 66.1; Mortgage Bank, 38.7; mixed banks, 23.1; and FEDECCREDITO, 20.3.

Table No. 3. Total and Agricultural Credit (Debt) by Selected Financial Institutions, 1980-1984 (Million Colones)																
Institution	1980			1981			1982			1983			1984			Average annual Total credit Debt
	Total credit Debt	Agricultural credit Debt	% of total Debt	Total credit Debt	Agricultural credit Debt	% of total Debt	Total credit Debt	Agricultural credit Debt	% of total Debt	Total credit Debt	Agricultural credit Debt	% of total Debt	Total credit Debt	Agricultural credit Debt	% of total Debt	
Nominal Values																
SEA	311.4	296.1	95.1	263.5	223.7	84.9	236.6	212.6	90.3	336.5	272.0	81.1	419.9	341.7	81.4	7.8
Commercial Bank	456.3	292.7	64.1	446.1	371.0	83.2	273.4	262.2	96.0	67.9	603.2	413.3	61.5	1050.6	407.9	38.7
Other commercial banks	1513.9	301.1	19.9	1435.9	361.1	24.9	2064.3	809.2	39.2	40.3	2201.0	704.1	17.4	3658.0	831.0	22.7
FIDUCIARIA	3.5	2.0	57.1	3.1	3.5	68.6	3.7	3.2	86.5	4.1	4.1	100.0	6.2	4.1	66.1	15.4
FIDUCIARIO	124.3	38.4	30.9	103.1	33.0	34.1	32.9	36.3	39.1	81.4	19.1	22.2	21.1	18.5	20.3	7.5
FINANCIERA	198.3	198.3	100.0	183.5	183.5	100.0	182.1	182.1	100.0	170.2	170.2	100.0	162.9	162.9	100.0	-4.0
Total	2607.7	1129.6	36.7	2427.8	1187.8	327.1	2739.1	1464.6	443.7	3372.2	1334.6	366.0	3429.6	1178.9	329.6	74.3
Real Values (a)																
SEA	311.4	296.1	95.1	223.5	194.9	84.9	194.9	159.9	89.9	231.9	159.0	81.1	259.0	210.9	81.4	-4.3
Commercial Bank	456.3	292.7	64.1	383.6	323.1	83.2	214.7	189.9	87.9	553.6	254.0	51.5	654.3	222.9	38.7	9.1
Other commercial banks	1513.9	301.1	19.9	1273.9	314.5	24.9	1562.7	630.1	40.3	1317.5	456.6	32.1	2733.3	522.5	23.1	10.7
FIDUCIARIA	3.5	2.0	57.1	4.4	3.0	68.6	2.2	2.5	65.5	2.8	2.8	100.0	3.8	2.5	66.1	1.4
FIDUCIARIO	124.3	38.4	30.9	94.2	31.0	34.1	72.4	29.3	33.1	54.1	12.5	22.2	26.2	11.4	20.3	-16.0
FINANCIERA	198.3	198.3	100.0	165.1	165.1	100.0	142.0	142.0	100.0	117.3	117.3	100.0	100.5	100.5	100.0	-5.6
Total	2607.7	1129.6	36.7	2173.6	1054.6	327.1	2173.9	1157.5	443.7	2473.2	1022.1	366.0	3349.2	1104.7	329.6	-16.4
Source: Based on information provided by financial institutions.																
a) Data (1980-1982) are annual; (1983-1984) are semi-annual.																
b) Data correspond to consolidated credit (from October 1 to September 30).																
c) Data for 1984 are preliminary, based on 1984 data.																

The figures for the 1980-1984 period show clear trends. With the exception of the mixed banks and FEDECACES, the annual credit flows for agriculture have grown at a lesser rate than the total flows for all credit in the institutions. Particularly noteworthy is the relative decline in agricultural lending by BFA and the strong growth in non-agricultural lending by the Mortgage Bank. Finally, when measured in real terms, all institutions except the mixed banks experienced real declines in contracted credit over the period.

Clientele

Traditionally, El Salvadorean banks have concentrated their lending with credit to medium - and large-size farmers. The Mortgage Bank and the mixed banks dealt almost exclusively with this class of clientele. The BFA lent to this class of farmer through its banking division but also did considerable lending to smaller farmers in its development division. The clientele of FEDECACES and FEDECCREDITO in this agricultural loans are mostly small- or medium-sized farmers. Consequently the size of loans received by these persons is quite small compared to loans made by banks.

After the agrarian reform the situation changed. All banks, INCAFE and FEDECCREDITO were assigned Phase I cooperatives and were expected to attend to their credit needs.

As shown in Table IV-4, between 1980 and 1984, the reformed sector has received 18.2 percent of the credit flows to the agricultural sector. The amount flowing to the sector has tended to increase over the period, which is suggestive of an increase in demand or at least a greater supply to satisfy an existing excess demand.

The number of cooperatives served by each type of financial institution is presented in Table IV-5. It is clear that the BFA has been the single most important institution in terms of number of cooperatives served. By 1984 it financed almost half of the 244 cooperatives receiving credit. The commercial banks were the second most important with 38.7 percent. The only other important institution is the Mortgage Bank with 11.5 percent.

The trend over the four-year period has two characteristics. First, there has been a tendency for both the BFA and commercial banks to increase their relative importance. They have both tended to finance an increasing number of cooperatives. The Mortgage Bank has remained active but has decreased the number of cooperatives served. Both FEDECCREDITO and

Table IV-4. Credit Flow to Agriculture and to the Reform Sector: Nominal and Real Terms, 1980-1984.						
	1980	1981	1982	1983	1984	Average annual growth rate
			Nominal	Terms		
Total agriculture credit	974.4	1424.9	873.5	893.9	1749.6	15.8
Credit to reformed sector	165.7	204.4	218.6	194.1	224.5	7.9
Percentage share of reformed sector	17.0%	14.3%	25.0%	21.7%	12.8%	
			Real	Terms		
Total agricultural credit	974.4	1242.0	681.0	616.1	1079.4	2.6
Credit to reformed sector	165.7	178.0	170.4	133.9	138.5	-4.4
Percentage share of reformed sector	17.0%	14.3%	25.0%	21.7%	12.8%	
Source : Based on information provided by financial institutions.						

Table IV-2. Number of Cooperatives Served by Financial Institutions, 1980-1984											
Financial Institutions	1980		1981		1982		1983		1984		
	No.	Percent									
Agricultural Development Bank	81	35%	81	34%	105	39%	115	44%	119	49%	
Mortgage Bank	43	17%	46	17%	39	14%	30	11%	28	11%	
Mixed banks	69	27%	79	29%	84	35%	89	36%	94	39%	
FEDECACES	20	8%	20	7%	18	7%	10	4%	2	1%	
FICAFE	33	13%	33	12%	14	5%	13	5%	1	0%	
Total	256	100%	269	100%	269	100%	263	100%	244	100%	
Source: Based on data provided by financial institutions.											

INCAFE started serving a number of cooperatives, but by 1984 the former was only working with two and the latter one. What happened was that these institutions were tending to transfer their assigned cooperatives to other institutions, especially BFA. Unfortunately, in many cases BFA received the most problematic cooperatives. A second factor was also at work, some cooperatives disbanded. This tended to occur in zones of serious civil conflict.

The second characteristic is that the number of cooperatives served has declined. In 1980, 256 received credit; by 1982 the number had risen to 269; in 1984 it fell to 244. At present there are 311 reformed sector cooperatives. In 1984, the 244 receiving credit represented 78.1 percent of the total. There are several reasons why the others are not receiving credit. Some are located in zones of heavy civil conflict. Others have outstanding delinquent debt and are not eligible for fresh credit. A few have not solicited credit because they didn't need or want it. Finally, some are not sufficiently organized to be considered as subjects of credit.

As shown in Table IV-6 in the 1984-1985 agricultural cycle 18,915 Phase III beneficiaries received credit. This corresponds to 29.7 percent of the total who have received land. Over the 1980-1984 period the number financed has steadily expanded. About 80 percent of the credit activity for Phase III has been concentrated in the BFA, who took it on as a social responsibility. There was some activity by the commercial banks but none by the Mortgage Bank. Compared to lending to cooperatives, credit to this class of borrowers represents small loans and there was virtually no financial incentive for a credit institution to seek out lending to this group.

Savings Mobilization

Data on rural savings mobilization are not available for institutions, but global data serve to show which institutions mobilize savings, their relative importance and growth trends.

There are two classes of savings held by these institutions, savings and time deposits. The latter have fixed periods of 60 to 360 days and offer higher rates of interest than savings deposits which have no fixed time period.

As shown in Table IV-7, in 1984, 78 percent of the combined savings and time deposits were held by the mixed commercial banks, with virtually all the rest held by the Mortgage Bank. Between 1980 and 1984 several

Table IV-6. Number of Phase III Beneficiaries Receiving Bank Loans								
1981/1982 - 1984/1985								
	81/82	%	82/83	%	83/84	%	84/85	%
Number of farmers with credit	13,115	20.6	14,252	22.4	16,919	26.6	18,915	29.7
Number of farmers without credit	50,533	79.4	49,396	77.6	46,729	73.4	44,733	70.3
Total	63,648	100	63,648	100	63,648	100	63,648	100
Source: Ministerio de Agricultura y Ganadería,								
Oficina Sectorial de Planificación Agropecuaria,								
Proyecto Planificación y Evaluación de la Reforma Agraria,								
Segundo Perfil de Beneficiarios del Decreto 207.								

changes occurred. The deposits of the mixed banks grew considerably more rapidly than did those in the Mortgage Bank. The mixed banks were observed to aggressively pursue savings mobilization. Many used incentives such as raffles to encourage saving. In addition, BFA's small level of deposits declined considerably. FEDECACES's deposits remained at almost a constant level. FEDECCREDITO does not receive deposits. With the exception of the mixed banks, all institutions experienced real declines in their holdings of savings and time deposits. The growth in savings and time deposits by the mixed banks was strong enough to compensate for negative effects of inflation on the other institutions, such that the real growth of deposits for all institutions over the five-year period was 7 percent.

Time deposits increased more rapidly than savings deposits. This shift is particularly notable in 1983 and 1984 when there was more political stability and higher rates of inflation. The former created more confidence in the banking system and the latter caused savers to shift to time deposits that offered higher rates of interest.

Data for the deposits for the mixed banks and Mortgage Bank show that the time deposits are largely held by medium- or large-sized businessmen, including farmers. The savings accounts are mostly held by lower-income persons. There is a large number of these accounts; a fact that demonstrates this class of person wants to save in a financial institution.

Importance of Financing in Agricultural GDP

Credit is important to El Salvadorean agriculture. As shown in Table IV-8, in 1984, agriculture credit flows were the equivalent of 76 percent of the value of the sector output. This figure is high compared to 1980, when it was 45.5 percent. The reason for the increasing percentage is the strong growth of credit compared to the slight decline in sector GDP. This, however, is misleading. As noted previously, much of the growth in lending was due to long-term refinancing. If this were eliminated the proportion would have been much less.

Summary and Conclusions

There are six classes of formal market institutions operating in the sector: nine mixed commercial banks, BFA, Mortgage Bank, FEDECACES, FEDECCREDITO and INCAFE. Credit to the sector is concentrated among the first three institutions, which in 1984 accounted for 90 percent of the loan

Table IV.8. Gross Domestic Product, Agriculture, Gross Domestic Product and Credit Flow to Agriculture, El Salvador						
(Million Colones.)						
	1980	1981	1982	1983	1984	
Total GDP	8916.5	8646.5	8966.2	10091.7	11409.8	
Agricultural GDP	2480.2	2106.0	2075.4	2109.6	2354.9	
Agricultural GDP as percent of total GDP	27.8	24.4	23.2	20.9	20.6	
Credit flow to agriculture	1128.6	1187.8	1484.6	1584.6	1788.9	
Credit flow as percent of agricultural GDP	45.5	56.4	71.5	75.1	76.0	
Total Credit Flow	2607.7	2497.8	2795.1	3597.2	5428.6	
Agricultural credit flow as percent of total credit	43.3	47.6	53.1	44.1	32.9	
Source: Banco Central de Reserva de El Salvador.						

volume to the sector. In addition there is an active informal market consisting of moneylenders and middlemen who operate in the rural areas. These lenders make loans that are much smaller than bank loans, but serve an important need by providing financing to many farmers.

Over the 1980-1984 period, although the amount of agricultural credit grew in nominal terms, after inflation is accounted for there was negative real growth. This means the sector was receiving less credit in terms of its purchasing power in 1984 than in 1980.

However, these figures understate the decline, because they include the large increase in refinanced loans over the period. If these credits were excluded the amount of new credit entering the system each year would have declined at a much more rapid rate.

A decline in the real value of total credit in the system was also observed but the average annual decline was less than that for the agriculture. Therefore, over the 1980-1984 agricultural financing became less important to the total credit in the financial system.

As a class, the mixed banks were the largest lender to agriculture. In 1984 they were responsible for 47.6 percent of the total flow, however, none of the single banks was a large lender as the Mortgage Bank or the BFA, which accounted for 22.9 and 19.1 percent of the flows. INCAFE had 9.1 percent and FEDECACES and FEDECREDITO 1 percent or less. Over the 1980-1984 period the mixed banks were the only lender to show a positive real growth in annual flows of agricultural credit.

Lending is concentrated in the traditional export crops of coffee, cotton and sugar. Since 1980, the relative importance of lending for these crops as well as basic grains has declined and increases have occurred in livestock, poultry, fisheries and other crops. There were absolute declines in cotton, corn and beans. Most credit is extended for short-term production purposes. Very little is for investment.

After land reform all banks were expected to lend to the Phase I cooperatives. Consequently over the 1980-1984 period almost one-fifth of the credit was directed to this group. Most institutions, except BFA, lent very little or nothing to the Phase III beneficiaries.

Delinquency was a serious problem for all institutions. This was the major reason for the considerable and increasing long-term refinancing over the 1980-1984 period. Much of this delinquency has been in the reformed

sector cooperatives. This should not be surprising, since these were completely new economic units that were organized and immediately given credit; often before they were credit worthy.

Data are not available for rural savings; but are provided for total savings. Over the 1980-1984 period total savings grew in real terms at the average annual rate of 7 percent, but the only class of institution to experience an increase were the mixed banks, who have aggressively pursued capturing resources in this form. Among the institutions, the mixed banks mobilized more than three-fourths of the savings and time deposits held by the system. The Mortgage Bank accounted for almost all of the rest. Most savings were held by middle and upper classes who concentrated their funds in time deposits that offered higher rates of interest. Most of numerous low-income persons were found to hold savings accounts, which indicates these persons save in financial institutions.

V- AGRICULTURAL DEVELOPMENT BANK

Background

The Agricultural Development Bank (BFA) was established in 1973 as an autonomous public sector institution to provide financial and related services to promote development of the agricultural sector. It superseded the Administracion de Bienestar Campesino (ABC) which was founded in 1962 as a branch of the Ministry of Agriculture to provide supervised credit and technical assistance to small-and medium-sized farmers. With time, delinquency became an impossible problem. Thus, in 1972, the government decided to abolish ABC and create a new institution, the Agricultural Development Bank.

The purpose of creating BFA was to serve the credit needs of all types of farmers regardless of size. However, it still had a priority for providing credit to the small-and medium-sized farmers. Moreover, it was intended that the new institution would function as a full-service bank with the characteristics and philosophy of a commercial bank. Provisions were made to open three special divisions within the Bank: (a) Banking, (b) development, and (c) trust fund. The banking division was to provide credit services to clients in amounts over ₡100,000. This division was also authorized to receive deposits and perform other banking operations. The development division was to serve the credit needs of small-and medium-sized farmers. The trust fund division was responsible for administering trust funds made available to the Bank.

The Bank began its operations in May 1973, under the new law, and with new executive personnel. However, the line workers, the ABC's administrative and field personnel, continued in their positions and carried forward, a factor that hindered the change expected of the new bank and the philosophy of the predecessor institution. It was not until January 1977, the Bank initiated mobilizing deposits in San Salvador, and the central office. In 1980, it opened the deposits window at La Libertad agency. In addition in 1980, it began to play an important role in financing the reformed sector Phase I cooperatives. At present, it provides credit resources to approximately 60 percent of those cooperatives that receive credit.

Structure and Organization

BFA is governed by a board of governors composed of representatives of related ministries, presidents of BCR and BFA and the Agricultural

Cooperatives Association. The board establishes policies which are carried out by a board of directors and BFA general management. The board of directors provides guidance for operations and has the responsibility for approving large-sized loans.

BFA carries out its operations from its headquarters in the capital city and twenty-five branch offices located throughout the country. In addition to its lending activity, it sells agricultural inputs to both its clients and other persons through three input stores. The Bank appears over-staffed. As of December 31, 1985, there were approximately 1,700 persons working in the Bank, with 38 percent of employees concentrated in the central office.

Credit Portfolio

Growth

As shown in Table V-1, at the end of 1984, the BFA portfolio was \$529 million. Between 1980 and 1984 the nominal value of the portfolio increased at an average rate of 13.5 percent. Inflation, however, took its toll; in real terms the portfolio grew only 0.6 percent. These figures, however, overstate the growth. Much of the increase was in refinanced loans, which do not represent new credits in the system. Therefore, it is clear that the real value of new credit in the BFA portfolio declined significantly between 1980 and 1984.

Distribution by Activity

Portfolio data are not available by activity financed. The information presented in Table V-1 was estimated by applying the percentages of contracted credit for each activity to the total portfolio.

At the end of 1984, the "other" category consisting of loans for administrative costs, construction and other non-agricultural purposes had the largest portion, 20.9 percent, of the BFA portfolio. Refinanced loans were a close second with 18.9 percent. Corn, cotton, livestock and coffee followed with 14.1, 10.6, 9.8 and 7.7 percent of the portfolio, respectively.

Over the 1980-1984 period, the distributional patterns were similar, except that both refinancing and "other" loans grew substantially in real terms such that their relative importance also increased. In real terms, all crops financed experienced negative rates of growth. In contrast, positive

real growth rates were observed for livestock, fisheries, machinery and equipment, marketing and agroindustry. These figures not only show the growth of BFA financing of "other" activities and refinancing, but also a shift to financing a larger amount of livestock, fisheries and medium-and long-term investments.

Annual Flows of Credit

Whereas the analysis of the portfolio shows the size and composition of the Bank's outstanding portfolio at year's end, it does not necessarily reflect the amount and distribution during the year. Credit flows, the amount of loans made during the year are more accurate measures of annual lending activity. Unfortunately, the only available data to measure flows are the amounts of contracted credit. There are two problems with this measure. First, there is a wide gap between BFA's contracted credit and the amount disbursed. BFA has only been disbursing about 75 percent of its contracted credit. Consequently, the reported figures considerably overstate the amount of funds reaching farmers. Second, contracted credit includes refinanced loans, which do not represent any net addition to credit; they are just paper transfers from production to prendario credit. Therefore, on this account, the figures are also overstated. In the case where a loan is refinanced in the same year that the production credit is extended there is a double counting of contracted credit.

Growth

In 1984, BFA contracted \$419.8 million in loans. As shown in Table V-2, over the 1980-1984 period, the annual flows grew at an average annual rate of 7.8 percent in nominal terms. In real terms, however, they declined at an average rate of -4.5 percent. Clearly, BFA was lending less in 1984 than in 1980. It should be noted, however, that their lending was on an upward trend. After falling in 1981 and 1982 the amounts of contracted credit grew in 1983 and 1984. Much of this increase, however, was due to increasing levels of refinancing, which understates the rate of decline in BFA credit flows.

Distribution by Activities

For reasons noted above, the percentage distribution of credit by activities financed is the same as discussed under portfolio. Therefore, the

Table V-2. Annual Flows of Credit from CFA by Activities d), 1980-1984

Activities	(Millions Colons)										Average annual rate of growth
	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	
	Nominal Values										
Coffee	32.6	10.5%	11.0	4.2%	12.7	5.4%	23.1	6.9%	32.4	7.7%	-0.2%
Cotton	58.6	18.8%	38.9	14.8%	37.8	16.0%	35.1	10.4%	44.4	10.6%	-6.7%
Sugar cane	18.0	5.8%	11.0	4.2%	12.7	5.4%	11.9	3.5%	16.5	3.9%	-2.2%
Corn	72.7	23.3%	65.5	24.9%	57.3	24.2%	51.1	15.2%	53.4	14.1%	-4.9%
Beans	10.4	3.3%	12.4	4.7%	10.5	4.4%	6.7	2.0%	8.8	2.1%	-4.1%
Rice	16.0	5.1%	13.6	5.2%	11.7	5.0%	14.0	4.2%	16.3	3.9%	0.5%
Vegetables	4.0	1.3%	4.4	1.7%	3.4	1.4%	4.5	1.3%	4.9	1.2%	5.2%
Other crops a)	19.6	6.3%	11.1	4.2%	8.2	3.5%	8.1	2.4%	12.7	3.0%	-10.3%
Livestock	36.7	11.8%	23.2	8.8%	19.5	8.2%	33.2	9.9%	41.2	9.8%	2.9%
Fisheries	0.0	0.0%	0.0	0.0%	0.4	0.2%	1.2	0.4%	0.7	0.2%	15.0%
Machinery and equipment	0.0	0.0%	3.8	1.4%	3.2	1.4%	7.5	2.2%	7.3	1.7%	17.7%
Marketing and agroindustrial	3.9	1.3%	7.2	2.7%	5.7	2.4%	10.6	3.2%	8.0	1.9%	19.7%
Refinancing	10.1	3.2%	11.4	4.3%	25.7	10.9%	54.2	16.1%	79.3	18.9%	67.4%
Others b)	28.8	9.2%	50.0	19.0%	27.6	11.7%	75.3	22.4%	87.9	20.9%	32.2%
Total	311.4	100.0%	263.5	100.0%	236.5	100.0%	326.5	100.0%	419.8	100.0%	7.8%
	Real Values c)										
Coffee	32.6	10.5%	9.6	4.2%	9.9	5.4%	15.9	6.9%	20.0	7.7%	-11.5%
Cotton	58.6	18.8%	33.9	14.8%	23.5	16.0%	24.2	10.4%	27.4	10.6%	-13.3%
Sugar cane	18.0	5.8%	9.6	4.2%	9.9	5.4%	8.2	3.5%	10.2	3.9%	-13.3%
Corn	72.7	23.3%	57.1	24.9%	44.7	24.2%	35.2	15.2%	36.6	14.1%	-15.7%
Beans	10.4	3.3%	10.8	4.7%	8.2	4.4%	1.6	2.0%	5.1	2.1%	-15.0%
Rice	16.0	5.1%	11.8	5.2%	9.3	5.0%	9.6	4.2%	10.1	3.9%	-11.0%
Vegetables	4.0	1.3%	3.8	1.7%	3.7	1.4%	3.1	1.3%	3.0	1.2%	-6.8%
Other crops a)	13.6	6.3%	9.7	4.2%	6.4	3.5%	5.6	2.4%	7.8	3.0%	-20.5%
Livestock	36.7	11.8%	20.2	8.8%	15.2	8.2%	22.9	9.9%	25.4	9.8%	-8.8%
Fisheries	0.0	0.0%	0.0	0.0%	0.3	0.2%	0.8	0.4%	0.4	0.2%	17.7%
Machinery and equipment	0.0	0.0%	3.3	1.4%	2.5	1.4%	5.2	2.2%	4.5	1.7%	10.8%
Marketing and agroindustrial	3.9	1.3%	6.3	2.7%	4.4	2.4%	7.3	3.2%	4.9	1.9%	6.1%
Refinancing	10.1	3.2%	9.9	4.3%	20.0	10.9%	37.4	16.1%	48.9	18.9%	48.4%
Others b)	28.8	9.2%	43.6	19.0%	21.5	11.7%	51.9	22.4%	54.2	20.9%	17.1%
Total	311.4	100.0%	229.5	100.0%	184.4	100.0%	231.9	100.0%	259.0	100.0%	-4.5%

Source: Based on information provided by CFA's Memorias Anuales.

a) It includes sorghum, fruits and Agroindustrial crops.

b) It includes loans for the purchase of land, loans paying administrative, construction, and other non-agricultural lending.

c) Deflated using the San Salvador Price Index, 1978 base year.

d) Flows are measured by amounts of contracted credit, not actual disbursements.

reader is referred to the above section. Suffice is to note here that over the 1980-1984 period, the real flows of resources to all crops declined and flows for refinancing, "other", livestock, fisheries, machinery and equipment, marketing and agribusiness increased.

Clientele

Since its establishment BFA has financed all types of farmers. After the 1980 agrarian reform, the institution became an important credit supplier to the reformed sector Phase I cooperatives. Later, in 1982 it also began to finance Phase III beneficiaries. BFA has obtained substantial resources from AID and IDE to implement credit programs for the reformed sector. To a lesser extent it has also used those resources for the small-and medium-sized farmers of the non-reformed sector.

As shown in Table V-3, the 1980 contracted credit was distributed between the Phase I clients and the non-reformed sector. The latter included the small-medium-and large-sized farmers. In 1980, 40.5 percent of that year contracted credit supported the Phase I cooperatives and 59.5 percent went to the non-reformed sector. By 1984 the importance of the reformed sector had declined. Phase I cooperatives received 32 percent of the annual flows of credit and 5.2 percent went to Phase III beneficiaries, while 62.9 percent to the non-reformed sector. Financing to the Phase III beneficiaries began in 1982. In that year they obtained 7.3 percent of the contracted credit.

Between 1980 and 1984 the nominal units of total annual credit flows from the BFA increased at an average annual rate of 7.8 percent. Most of the increase was registered in the non-reformed sector which grew at a rate of 9.3 percent. Phase I cooperatives were much lower at 1.5 percent. In real terms the growth rates were, -10.1, 53.9, and -3.2 percent respectively, thus, showing the fact that the real amount of resources flowing to all classes of BFA clients in 1984 was lower than in 1980, except, of course, the Phase III beneficiaries. Note, these figures include refinancing and, therefore, overstate the growth.

The distribution of annual flows to the different clientele is disaggregated by activities financed. The data for 1984 clearly show BFA lending patterns. The non-reformed sector receives the loan's share of financing for "other" (95.3 percent), livestock and fisheries (86.2 percent), and basic foods (68.4 percent). Financing of export crops was evenly split between the Phase I cooperatives and the non-reformed sector.

Table V-3. Annual Flows of Credit from BFA by Climate and Activities Financed, 1980-1984 (a)
(million pounds)

Social sector and activities	1980		1981		1982		1983		1984		Average annual rate of growth
	Amount	Percent									
Basic foods	115.6	100.0%	104.7	100.0%	82.2	100.0%	81.4	100.0%	95.4	100.0%	-4.7%
Phase I	30.6	26.6%	17.0	16.3%	11.0	12.5%	9.9	12.2%	13.4	14.0%	-18.8%
Phase III	0.0	0.0%	0.0	0.0%	6.3	7.1%	11.8	14.5%	16.7	17.5%	62.8%
Non-reformed	85.0	74.4%	87.7	83.7%	70.9	80.4%	59.7	73.3%	65.3	69.4%	-6.4%
Export crops	109.2	100.0%	60.9	100.0%	63.2	100.0%	70.2	100.0%	93.2	100.0%	-3.9%
Phase I	68.5	62.7%	27.7	45.5%	24.2	38.3%	31.4	44.7%	44.4	47.6%	-10.3%
Phase III	0.0	0.0%	0.0	0.0%	0.3	0.5%	1.8	2.6%	2.9	3.1%	210.9%
Non-reformed	40.7	37.3%	33.2	54.5%	38.8	61.4%	37.0	52.7%	45.9	49.2%	3.1%
Other related with crops (a)	11.6	100.0%	14.6	100.0%	12.5	100.0%	28.2	100.0%	23.3	100.0%	19.0%
Phase I	6.7	57.8%	5.7	39.0%	5.5	44.0%	10.0	35.5%	13.1	56.2%	16.2%
Phase III	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.2	0.7%	0.8	3.4%	300.0%
Non-reformed	4.9	42.2%	8.9	61.0%	7.0	56.0%	18.0	63.8%	9.4	40.3%	17.7%
Livestock and fisheries	36.7	100.0%	23.2	100.0%	19.5	100.0%	23.8	100.0%	41.2	100.0%	2.9%
Phase I	9.9	27.0%	6.0	25.9%	2.9	14.9%	2.6	10.9%	4.9	11.9%	-16.1%
Phase III	0.0	0.0%	0.0	0.0%	0.1	0.5%	0.4	1.7%	0.6	1.9%	182.8%
Non-reformed	26.8	73.0%	17.2	74.1%	16.5	84.6%	20.8	87.4%	35.7	86.2%	7.3%
Forestry	10.1	100.0%	11.4	100.0%	23.7	100.0%	34.1	100.0%	79.5	100.0%	67.4%
Phase I	0.0	0.0%	2.8	24.6%	16.3	69.2%	31.9	93.5%	53.8	67.8%	167.8%
Phase III	0.0	0.0%	0.0	0.0%	0.6	2.5%	1.8	5.3%	0.7	0.9%	8.0%
Non-reformed	10.1	100.0%	8.6	75.4%	8.6	36.5%	20.4	59.7%	24.7	31.1%	20.1%
Other (b)	28.0	100.0%	48.9	100.0%	27.4	100.0%	78.8	100.0%	87.4	100.0%	32.9%
Phase I	10.3	36.8%	17.9	36.6%	2.8	10.2%	3.1	3.9%	4.2	4.8%	-20.1%
Phase III	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.1	0.1%	0.0	0.0%	0.0%
Non-reformed	17.7	63.2%	31.0	63.4%	24.6	89.8%	73.6	93.4%	83.2	95.3%	47.3%
Total	311.4	100.0%	263.5	100.0%	236.6	100.0%	336.3	100.0%	419.8	100.0%	7.8%
Phase I	126.2	40.5%	77.1	29.3%	62.9	26.6%	90.9	27.0%	133.6	31.9%	1.5%
Phase III	0.0	0.0%	0.0	0.0%	7.3	3.1%	16.1	4.8%	21.9	5.2%	73.2%
Non-reformed	185.2	59.5%	186.4	70.7%	166.4	70.3%	229.3	68.2%	264.1	62.9%	9.2%
Real Values											
Basic foods	115.8	100.0%	91.0	100.0%	68.8	100.0%	56.1	100.0%	58.9	100.0%	-15.6%
Phase I	30.8	26.6%	14.8	16.3%	8.6	12.3%	6.8	12.2%	8.3	14.0%	-28.0%
Phase III	0.0	0.0%	0.0	0.0%	4.9	7.1%	8.1	14.5%	10.3	17.5%	44.8%
Non-reformed	85.0	73.4%	76.2	83.7%	55.3	80.4%	41.1	73.3%	49.3	84.4%	-17.0%
Export crops	109.2	100.0%	53.0	100.0%	49.3	100.0%	48.4	100.0%	57.5	100.0%	-14.8%
Phase I	68.5	62.7%	24.1	45.5%	18.9	38.3%	21.6	44.7%	27.4	47.6%	-20.5%
Phase III	0.0	0.0%	0.0	0.0%	0.2	0.5%	1.2	2.6%	1.8	3.1%	176.6%
Non-reformed	40.7	37.3%	28.9	54.5%	30.2	61.4%	25.6	52.7%	28.3	49.2%	-8.7%
Other related with crops (a)	11.6	100.0%	12.7	100.0%	9.7	100.0%	19.4	100.0%	14.4	100.0%	5.5%
Phase I	6.7	57.8%	5.0	39.0%	4.3	44.0%	6.9	35.5%	8.1	56.2%	4.8%
Phase III	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.1	0.7%	0.5	3.4%	258.1%
Non-reformed	4.9	42.2%	7.8	61.0%	5.5	56.0%	12.4	63.8%	5.8	40.3%	4.3%
Livestock and fisheries	36.7	100.0%	20.2	100.0%	19.2	100.0%	16.4	100.0%	23.4	100.0%	-8.8%
Phase I	9.9	27.0%	5.2	25.9%	2.3	14.9%	1.8	10.9%	3.0	11.9%	-25.7%
Phase III	0.0	0.0%	0.0	0.0%	0.1	0.5%	0.3	1.7%	0.5	1.9%	131.6%
Non-reformed	26.8	73.0%	15.0	74.1%	12.9	64.6%	14.3	87.4%	21.9	86.2%	-4.9%
Forestry	10.1	100.0%	9.9	100.0%	20.0	100.0%	37.3	100.0%	48.9	100.0%	48.4%
Phase I	0.0	0.0%	2.4	24.6%	12.9	64.2%	22.0	59.0%	33.7	67.8%	128.7%
Phase III	0.0	0.0%	0.0	0.0%	0.5	2.3%	1.2	3.3%	0.4	0.9%	-3.9%
Non-reformed	10.1	100.0%	7.5	75.4%	6.7	33.5%	14.1	37.7%	13.2	31.1%	10.8%
Other (b)	28.0	100.0%	42.6	100.0%	21.4	100.0%	54.3	100.0%	53.9	100.0%	17.8%
Phase I	10.3	36.8%	13.6	31.6%	2.7	10.2%	3.5	6.5%	2.6	4.8%	-22.2%
Phase III	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.1	0.1%	0.0	0.0%	0.0%
Non-reformed	17.7	63.2%	29.0	63.4%	19.2	89.8%	50.7	93.4%	51.4	95.3%	20.5%
Total	311.4	100.0%	229.5	100.0%	184.5	100.0%	231.9	100.0%	299.0	100.0%	-4.5%
Phase I	126.2	40.5%	67.2	29.3%	49.0	26.6%	62.6	27.0%	82.5	31.9%	-10.1%
Phase III	0.0	0.0%	0.0	0.0%	5.7	3.1%	11.1	4.8%	13.5	5.2%	54.1%
Non-reformed	185.2	59.5%	162.4	70.7%	129.7	70.3%	158.2	68.2%	162.9	62.9%	-3.2%

Source: BFA Memorandum Annual

- a) Includes natural resources, agriculture/machinery and agroindustry.
- b) Includes interest for administrative expenses, and post-agricultural lending.
- c) Flows are measured by amount of contracted credit, not actual disbursements.

Viewed in another way, the non-reformed sector lending was concentrated in basic grains, export crops, livestock and fisheries and "other" activities. Phase I credit went mostly for export crops and to a much lesser extent basic foods and other credits related to crops. Phase III beneficiaries received relatively little credit, but the bulk of what they were lent went for basic grains.

Refinanced credit was concentrated in the Phase I cooperatives (67.8 percent) with most of the rest in the non-reformed sector (24.7 percent) and very little in Phase III (0.9 percent). This reflects the relatively greater delinquency problems experienced by the Phase I cooperatives.

Over the 1980-1984 period, there has been a shift in the importance of financing for the reformed sector. As noted above credit extended to the reformed sector has grown at lesser rates than for the non-reformed sector. There has also been a shift in activities financed. In 1980, the Phase I cooperatives received proportionately much more credit than they have in later years; undoubtedly, this reflects the government policy to trying to provide the newly-formed cooperatives with credit in that year. Moreover, the cooperatives received more credit for basic grains, export crops and livestock and fisheries in that year than they did in later years. Indeed, the increase in annual flows of credit to the cooperatives comes entirely from refinancing. This again shows that less credit is flowing to this sector in 1984 than in 1980.

Delinquency

BFA faces a serious delinquency problem. At the end of 1984, 24.1 percent of the portfolio was past due, 90 days or none. This is a major increase over 1980 when the figure was 14.4 percent. In the intervening years delinquent loans reached a high of 27.8 percent in 1982. The major cause of the sharp rise in delinquency since 1980 has been the problems of repayment by the Phase I cooperatives. Other contributing factors include unfavorable prices in export and domestic markets and terrorism.

The delinquency problem is partially masked over by refinancing. As shown above, the amount of refinancing has increased sharply; most of it due to the long-term refinancing of passt-due debt. Had this refinancing not occurred the delinquency rates would have been much higher. The delinquency problem appears to be a continuing problem. Futhermore, it is very likely that much of the long-term refinanced debt will never be

recovered. If this occurs, the Banks liquidity and loanable funds will be restricted.

Table V- 4. BFA's Past-Due and Total Portfolio, End-of-year 1980-1984

<u>Year</u>	<u>Past due portfolio</u>	<u>(Million Colones)</u>		<u>Percent</u>	<u>Total portfolio b)</u>	<u>Percent</u>
		<u>Percent</u>	<u>Not-Past-due a) portfolio</u>			
1980	46.0	14.0 %	272.9	86.0 %	318.9	100.0 %
1981	69.0	19.3 %	187.6	80.7 %	356.6	100.0 %
1982	105.2	27.8 %	272.9	72.2 %	378.1	100.0 %
1983	110.5	25.2 %	328.1	74.8 %	438.6	100.0 %
1984	127.6	24.1 %	401.7	75.9 %	529.3	100.0 %

Source: BFA's financial statements

a) The past-due portfolio only includes over-due loans with an age of more than 90 days.

b) Total portfolio includes reserves for bad debts.

Credit Delivery System

Terms and Conditions of Loans

Term. BFA makes short-medium-and long-term loans. At the end of 1984, the portfolio showed that 45.3 percent of its loans were short-term (18 months or less), 29.6 percent long-term (more than 5 year up to 20 years). These figures understate the importance of short-term loans because they do not capture credit flows. By the same token they overstate the medium-and long-term lending because these categories include the long-term refinancing.

Collateral. BFA loans may be covered by one of three types of guarantees: personal, pledge of harvest or liens on assets. The criteria for the type of guarantee depend on loan size, loan term, class of borrower and projects financed. At the end of 1984, 25 percent of the portfolio was covered by a personal guarantee, 50.6 percent by a personal guarantee and 24.4 percent with liens on assets.

Short-term loans to Phase I cooperatives are guaranteed by the pledge of the harvest as well as the ISTA endorsement. Other loans with terms up to two years for amounts up to ₡10,000 are covered by a personal guarantee. Finally, loans in excess of ₡10,000 or for more than two years must have collateral with a pledge or liens on assets. Clearly, the collateral

requirements are not very onerous and do not serve as major non-price rationing mechanisms.

Interest Rates. BFA has as many as sixteen different credit lines, each with a specified rate of interest. All rates must not exceed the maximums established by the Monetary Board, but they vary considerably. In the 1985/1986 agricultural year, loans made with BFA's own resources or with most BCR rediscounts carried interest rates of 12 to 14 percent. The rates for loans from IDB, USAID and FIDA funds were 9.0 to 12.0, 13.0 and 11.0 percent, respectively.

Application Phase

The potential borrower must prepare a loan application and present documentation. For loans to individuals the required documents include land title, I.D. card, and certificates of previous years of cotton or coffee deliveries if loans are requested for cotton or coffee.

The credit application is reviewed by the credit coordinator of an agency. What happens next depends on how the applicant is classified. Clients are classified as A, B, C, A, and D. The criteria used to rank clients were mainly based upon previous repayment records. The A category corresponds to a client who has repaid his loans without delays during the last three years. The B category is the client that has repaid loans. However, he has had in his record delays and refinancing. The C category is the client who has been delinquent. However, he is still eligible for new loans. The D category is the client who has maintained delinquent balances in his loans and he is not eligible for new loan any more. In the case, a client is classified as A client, he is entitled to an automatic loan. Therefore, in this case the analysis finishes with a review of the application.

For clients in other categories the agency credit coordinator assigns a credit agent to continue with the credit planning stage. The agent visits the farm, inspects the land, the collateral, and requests other information that is needed in the credit analysis and the final decision for approval or disapproval. The credit agent submits a report to the agency, where it is typed and forwarded for approval or further analysis. It could take from two to four weeks before the application is forwarded for approval or further analysis.

Loans are approved at different levels corresponding to the size of the loan. An agency credit coordinator may approve loans up to ₦25,000 and the chief of the agency up to ₦50,000 if the clients are classified as excellent clients or are in the category of the automatic credit. If the borrower is considered a normal client the agency committee can approve loans up to ₦25,000 and the zonal committee up to ₦50,000. In case the borrower is classified as risky client, the agency committee approves loans up to ₦5,000 and the zonal committee up to ₦25,000, and over ₦25,000 the board of directors. These levels of approval authority are shown in Table V-5. Note, the board of directors must approve all loans that are over ₦50,000 and risky loans that exceed ₦25,000.

Table V-5 BFA Loan Approval Levels

<u>Size of loan</u>	<u>Excellent Clients</u>	<u>Normal Clients</u>	<u>Risky Clients</u>
Up to ₦5,000	Credit Coordinator		Agency Committee
₦ 5,001 to ₦25,000	Credit Coordinator	Agency Committee	Zonal Committee
₦25,001 to ₦50,000	Agency Chief	Zonal Committee	Board of Directors
Over ₦50,000	Board of Directors	Board of Directors	Board of Directors

Source: BFA Credit Department.

From the application to loan approval or disapproval the process could easily take up to two months. In the case of the automatic credits the process is rapid. For loan approved at the agency level it can also be speedy. However, for large borrowers a feasibility study is required, which further extends the time for obtaining these loans.

Disbursement and Implementation Phase

Once the loan is approved the contract is prepared and signed. The disbursement is usually made in stages, according to the needs specified in the farm plan. The disbursement is made in cash or in kind. Since the Bank sells inputs it is easy to make loans in kind. The borrower can get the inputs at the agency or any BFA input store. Cash disbursements are also made at Bank's offices.

The loans are supervised. Credit agents are assigned to each loan by the credit coordinator. The agents are expected to supervise the status of collateral, inputs needed and other aspects related to the project. Further disbursements depend upon how the financed project is moving along. If

the borrower is using credit resources for the purpose of the loan, the agent authorizes further disbursements.

Repayment Phase

When the loan comes due, another person, a collections officer, is responsible for collecting the loan.

There are thirty-six collections officers assigned to the twenty-six agencies for carrying out the loan recovery plan. In January 1984 a new plan was developed. The most problematic clients are identified and special efforts are made to collect their debts. When collection appears impossible, the case is forwarded to a special recovery committee comprised of the deputy credit manager, the legal advisor, and the chief of the portfolio recovery division in the central office. In spite of those efforts, the delinquency problem appears more serious in 1985 than in 1984, because the delinquent portfolio as of December 31, 1985 was around 28 percent without taking into account the refinanced portfolio.

Procedures for Reformed Sector

For loans to cooperatives the following documents are required: (a) the cooperatives by-laws that have been approved by the Ministry of Agriculture, (b) supporting documentation from the cooperative that they want credit from BFA, and (c) a balance sheet and income statement for the cooperative. BFA assigns credit agents to cooperatives to assist them in the preparation of documents. However, if the cooperatives require investment credit, they have to hire a consultant firm for the development of a feasibility study. Applications are analyzed in the credit analysis department and they are forwarded to the board of directors' approval. The approval of loans to cooperatives has been delayed because of the delinquency problems faced by this type of clientele.

BFA applies a group lending system for the Phase III beneficiaries. Solidary groups of up to ten persons are organized. The maximum amount of credit granted to these groups was ₡15,000, i.e., maximum ₡1,500 per individual person. The system has been successful in lowering the transactions costs for both the borrowers and BFA.

Evaluation of the Credit Delivery System

BFA's credit delivery system is complicated and time consuming. Loan approval procedures and documentation requirements may lead to delays. The system is costly for both the borrower and the Bank. The procedures are basically designed to control the flow of credit to targeted activities and to supervise credit use in an attempt to avoid diversion of funds to non-authorized purposes.

The high costs of delivering and receiving credit serve as rationing devices that exclude farmers from getting small loans and encourage the bank to work with clients seeking large loans. To combat this problem for the Phase III beneficiaries BFA has instituted the solidarity group loan. This has been implemented with relative success.

BFA is concerned about the high costs of credit delivery. It has streamlined procedures somewhat with a new client classification system that reduces bank and borrower paperwork, for borrowers who have a good repayment record. In spite of these innovations, the system remains costly and cumbersome. More attention needs to be paid to ways to further reduce credit delivery costs. One solution that would significantly reduce the need to supervise and control credit would be to raise loan interest rates to market levels. If this were to occur, borrowers would be much less prone to divert credit and, therefore, the costly control and supervision procedures could be substantially streamlined.

Indicators of Credit Demand

There are several indicators that BFA is not satisfying the existing demand for credit. First, the Bank receives more applications than can be approved. Of the amount of loans approved it contracts a lesser amount and disburses even less. Over the 1980-1984 period, BFA approved an average of 87 percent of amounts requested. In 1984 it only approved 82.9 of the amount requested, contracted 95.7 percent of the amount approved, and disbursed only 69.2 percent of the amount contracted. See Table V-6. The amount disbursed was only 54.9 percent of the amount requested:

One explanation for the large gap between loans approved and disbursements may be a shortage of funds. Another is that some disbursements are not made after field inspections show that the client is not using the funds as planned or has offered a natural disaster. Another explanation for the large difference might be found in the fact that BFA is

Table Y-6. Amount of credit requested, approved, contracted, and disbursed, BFA 1980-1984					
(million colones)					
Description	1980	1981	1982	1983	1984
Requested amount	374.2	357.2	315.0	427.2	529.2
Approved amount	366.2	299.7	269.5	370.7	439.8
Contracted amount	311.4	263.5	236.6	336.5	419.8
Disbursed amount	212.4	229.1	174.8	261.8	290.6
Amount approved as % of requested	97.9%	83.9%	85.6%	86.8%	82.9%
Contracted amount as % of approved	85.1%	87.9%	87.8%	90.8%	95.7%
Disbursed amount as % of contracted	68.2%	86.9%	73.9%	77.8%	69.2%
Source: Information provided by the BFA, Department of Finance.					

subject to political pressures to approve loans and therefore, is very liberal in its loan approval. Then, in the process of contracting and disbursement it can apply rationing mechanisms to provide less amount than planned. All of these explanations contribute to the difference, but because of the size of the gap on a regular basis it would appear that the last explanation is probably quite important; the first two could be readily dealt with by better planning.

Savings

Although the bank was authorized to receive deposits, it did not begin to accept deposits until 1977, and then in two agencies: San Salvador and the Central Office. In 1980, it expanded this capacity to La Libertad Agency. Table V-7 provides information on end-of-year balances of deposits in the three agencies. As shown in the table, since 1977 the total amount of deposits decreased in both nominal and real values.

The same phenomenon was observed for all classes of deposits: demand, savings and time. There are several explanations. BFA has never had the need to rely on deposits, it has always had access to other sources of funds that are easier to obtain and less expensive. Examples are foreign assistance and government grants or subsidies. In addition the management of the bank has traditionally had a development bank orientation and not that of a financial intermediary.

Sources of Loanable Funds

BFA has used four sources of financial resources: Central Bank of Reserve rediscounts, foreign donors, and Bank's own resources. Prior to 1980 BCR's rediscounts and the Bank's own funds were the main sources of loanable funds. Since 1980, however, BFA has relied increasingly on loans from USAID and IDB. As of the end of 1984, BFA has received \$170.2 million from USAID and \$197.7 million from IDB. Next in importance were BCR rediscount accounting for 23 percent of loans.

The relative importance of deposits in relation to BFA's portfolio is not significant. In 1980 when the amount of deposits reached the highest level, deposits only represented 12 percent of the portfolio. This is another indicator of the relative unimportance of deposits in BFA's manner of doing business.

Table Y-7. BEA's End-of-Year Balances of Deposits, 1980-1984											
(Million Dollars)											
Type of deposits	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Nominal Values											
Demand deposits	7.2	19.8%	8.0	20.6%	9.5	29.2%	10.6	43.3%	6.5	39.6%	-2.5%
Savings deposits	6.4	17.6%	16.6	42.7%	18.3	54.3%	8.0	32.7%	3.9	23.2%	-12.2%
Time deposits	22.9	62.6%	14.3	36.8%	5.7	17.5%	5.9	24.1%	6.1	37.2%	-29.1%
Total	35.4	100.0%	38.9	100.0%	33.7	100.0%	24.5	100.0%	16.4	100.0%	-18.1%
Real Values											
Demand deposits	7.2	19.8%	7.0	20.6%	7.4	29.2%	7.3	43.3%	4.0	37.5%	-17.6%
Savings deposits	6.4	17.6%	14.5	42.7%	14.3	54.3%	5.5	32.7%	2.3	23.2%	-22.2%
Time deposits	22.9	62.6%	12.5	36.8%	4.6	17.5%	4.1	24.1%	3.9	37.2%	-56.3%
Total	35.4	100.0%	33.9	100.0%	26.3	100.0%	16.9	100.0%	10.1	100.0%	-27.4%
Source: BEA's (annual) statements.											

Summary and Conclusions

BFA is the most important institution providing credit to the agricultural sector. It has network of twenty-five branch offices located throughout the country. The bank has had an important role in financing the reformed sector; it grants credit to almost 50 percent of the Phase I cooperatives and accounts for a large portion of the credit provided to the Phase III beneficiaries.

The BFA credit delivery system is complex, lengthy, and costly for both the Bank and the borrower. There are delays in loan approval and the timely delivery of credit. Efforts were made to simplify the system in recent years. A set of criteria for client classification was developed and a fast mechanism of loan approval for good clients was implemented. Moreover, a group lending system was implemented to deal with small-sized farmers, both Phase III beneficiaries and others. Nevertheless, more can be done to improve the credit delivery system and lower borrower and BFA costs.

Over the 1980-1984 period there was an average annual 4.5 percent decline in the real amount of BFA credit. The decline in credit for agricultural crop production was even more severe, because increasing amounts of credit were directed to the non-production "other" activities. Furthermore, a considerable and increasing portion of the flows were for long-term refinancing of delinquent loans. The latter portion of the portfolio does not represent new credit since it is just a paper transfer from one form of credit to another. It is clear, therefore, that BFA was providing considerably less production credit in 1984 than in 1980.

Most of BFA new credit is for short-term production purposes. It is heavily concentrated in basic grains and traditional exports. In recent years there has been an increase in annual real flows for livestock and fisheries, thus indicating a tendency to diversify its financing away from traditional activities.

The BFA is a major lender to the reformed sector among El Salvadorean credit institutions. In 1984, almost 32 percent of BFA's contracted credit went to the Phase I cooperatives and 5.2 percent went to Phase III beneficiaries. Almost two-thirds of the credit went to the non-reformed sector. Reformed sector financing of new credits was concentrated in traditional exports and basic grains. The bank's growth activities of loans for livestock, fisheries were heavily concentrated in the non-reformed sector. This shows that lending to the reformed sector has been for traditional, non-experimental activities. In contrast, the non-reformed sector is more

adventuresome by obtaining credit to enter new lines of enterprises. Delinquency is a major problem. At the end of 1984, 24.1 percent of the portfolio was in arrears 90 days or more. The problem, however, is much more severe. Much of BFA portfolio, especially in the reformed sector cooperatives has been refinanced. Indeed, these loans accounted for 40.2 percent of all credit flows to the Phase I cooperatives in 1984. Phase III lending was much more favorable, only 3.2 percent was in refinancing.

BFA makes most of its loans at concessionary interest rates. These rates in themselves give rise to an excess demand for credit. The effect of inflation in recent years had been to make the real value of most of these rates negative, a factor which serves to increase the excess demand.

The concessionary interest rate structure is one of the major factors contributing to BFA's considerable financial problems because it decreases the bank's revenues, limits its ability to mobilize savings, makes it more subject to political pressures (because of the implicit income transfers with the interest rate subsidy) and forces the bank to undertake costly non-price rationing mechanisms in order to ration credit in a situation of excess demand.

BFA has been authorized since its founding to mobilize demand and savings deposits. The Bank, however, has done very little, only operating deposit accounts in three offices. The BFA interest rate structure has been a factor discouraging the mobilization of deposits, because with concessionary loan rates the bank cannot maintain an adequate interest rate spread and at the same time offer competitive deposit rates. Furthermore, the Bank has not needed to rely on deposits as a means to obtain loanable funds. As a development Bank, BFA has received considerable foreign assistance and, moreover has been the beneficiary of considerable government subsidies. With inexpensive funds available from these sources there was little incentive to mobilize deposits. Thus, these conditions plus a development banking mentality by its officers and technocrats have kept BFA from becoming a true financial intermediary that both collects deposits and extends credit.

Likewise, under these circumstances the Bank has not had the incentives to be particularly cost effective. As a public institution it has a large payroll with heavy concentration of employees in the central office. With its social mission of serving small farmers it has to undertake costly loans. The Bank has had to take in a political role. For example, it has had to assume an inordinate portion of the responsibility for financing the troublesome reformed sector. All of these factors have contributed to the bank's high

operating costs. The delinquency problem has also raised costs in that it has immobilized or sterilized a considerable portion of the portfolio as well as raising loan recovery costs.

There is an acute awareness of these problems under the current BFA management as the Bank has experienced a lesser amount of the real loanable funds due to the effects of inflation, high levels of delinquency and prospects for less foreign assistance. Under these circumstances the Bank has begun to seek ways to reduce some costs. The classification of clients and lending to solidarity groups are examples of efforts to cut costs. There is also interest in mobilizing deposits. These are good starts, but much more needs to be done. The interest rate structure will be a key factor in BFA's success. If concessionary rates were eliminated the Bank would gain more revenue, be able to mobilize more deposits, and, therefore, would become more viable financial institution. Other effects would be to reduce excess demand for credit and the need for non-price rationing mechanisms, make the Bank less subject to political pressure enhance the efficient use of credit in the economy, and reduce BFA's dependency on foreign assistance and government subsidies. Raising loan rates sufficiently to eliminate the concessionary aspects will be difficult to do in the current political environment, with the high levels of inflation and because of a long history of using cheap credit to subsidize the agricultural sector. Nevertheless, it should not be dismissed out of hand. If it were accomplished, the Bank would have gone a long way to easing its inherent financial problems.

VI-MIXED COMMERCIAL BANKS

Introduction

On March 7, 1980, under Nationalization Decree 158, the nation's commercial banks (with the notable exception of the Mortgage Bank) and savings and loan associations were nationalized. This was done to give the government control over these institutions as well as to break up the effective power of their ownership, which was concentrated in the hands of relatively few persons who were simultaneously the main users of financial resources. With nationalization, a majority of the stock in each bank is owned by the government. Consequently, the commercial banks are usually referred to as mixed banks. There are nine such banks: Banco Agrícola Comercial, Banco Capitalizador, Banco de Comercio, Banco de Crédito Popular, Banco Cuscatlán, Banco de Desarrollo e Inversión, Banco Financiero, Banco Mercantil and Banco Salvadoreño. The banks provide all of the financial services that are typical of commercial banks.

Structure and Organization

The mixed commercial banks' structure and operations are subject to the Law for Credit Institutions and Auxiliary Organizations (LICOA) as well as policies and regulations set forth by the Monetary Board and enforced and implemented by the Superintendency of the Financial System and the Central Bank of Reserve.

According to law, the government must be the principal stockholder in each bank, with at least 51 percent of the capital. Bank employees may hold up to 20 percent and individuals or legal entities up to 29 percent. No single individual or entity, however, may hold more than 1 percent of the stock of a bank nor can they hold stock in more than one institution.

Each bank has a three-person board of directors. Two of these persons, the president and vice-president, are appointed by the Monetary Board. This solidifies the government's control over the commercial banking system.

The mixed banking system is structured similarly across banks. Each of the banks has its headquarters office in San Salvador. Typically the bank has branches in the capital city and most have several branches in the departments. Even though there are a considerable number of branches, the system is highly centralized. Branch offices primarily serve as places to

carry out deposit functions. Lending, at least for large loans, is mostly carried out in the headquarters office.

This operational structure is representative of agricultural credit. Agricultural loan officers typically reside in San Salvador and travel to the departments to visit clients. Most loan transactions take place in the capital city. The branch offices in the departments have little to do with making loans. Their activities are limited to disbursements and repayments. This operational structure and style of operations is a carryover from the pre-1979 period, when most of the major agricultural families resided in San Salvador, although their lands were located in other parts of the country.

Table VI-1 presents information on the structure of system. It is noteworthy that there are almost as many bank offices in the capital city as in other departments. The table also shows the significant differences among the banks in terms of the numbers of their offices and the extent that they are spread throughout the nation. Five of the banks have six or seven offices in the capital city. Only three have as many offices in the departments. The Banco de Comercio has the largest number of branches, ten, outside San Salvador. It is followed by Banco Salvadoreño and Banco Cuscatlán with nine each. In contrast, Banco Financiero has none.

As measured by size of loan portfolio, Banco Cuscatlán, is the largest, holding nearly 25.9 percent of the total, as of December 31, 1984. It should be noted that this bank merged with the Banco Internacional in 1982, a factor which contributes to its large size. The only other banks with more than one-tenth of the system's portfolio are: Banco Agrícola Comercial (15.8 percent), Banco de Comercio (12.2 percent), Banco Capitalizador (11.8 percent) and Banco Salvadoreño (11.4 percent).

As shown in Table VI-1, the Banco Cuscatlán has the largest portion of the mixed banking system's deposits, holding 23.1 percent of the total. Three other institutions hold more than one-tenth: Banco Agrícola Comercial (21.7 percent), Banco de Comercio (14.6 percent), and Banco Salvadoreño (14.5 percent).

The above clearly shows that the mixed banking system has a considerable degree of concentration. First, its operations are centralized in the capital city. Second, its loans and deposits are highly concentrated in five of the system's nine banks.

Table YI-1. Structure of Mixed-Banking System, December 31, 1984						
Bank	Number of offices		Total portfolio (million colones)	Percent of system total portfolio	Savings and time deposits (million colones)	Percent of system's total
	Capital city	Other				
Banco Agrícola Comercial	6	7	356.2	15.8	419.2	21.7
Banco Capitalizador	7	9	266.1	11.8	185.0	9.6
Banco de Comercio	7	10	275.8	12.2	282.3	14.6
Banco de Crédito Popular	7	4	202.7	9.0	134.3	7.0
Banco Cuscatlán	7	3	584.8	25.9	445.8	23.1
Banco de Desarrollo e Inv.	2	3	156.2	6.9	97.1	5.0
Banco Financiero	2		65.3	2.9	21.4	1.1
Banco Mercantil	1	2	90.7	4.0	66.0	3.4
Banco Salvadoreño	5	9	256.9	11.4	280.8	14.5
Total	44	47	2254.7 a)	100.0	1931.9	100.0
Source: Based on information in banks' annual reports.						
a) This figure is slightly higher than that reported by Central Bank of Reserve and reported in Table YI-2.						

Credit Portfolio

Distribution by Institution

As noted above, at the end of 1984 the system's loan portfolio was concentrated in several banks. One bank, Banco Cuscatlán had more than one-fourth of the outstanding loans and the next four largest banks, as measured by loan portfolio held another one-half. Therefore, five of the nine banks controlled three-fourths of the system's portfolio.

Growth of System

At the end of 1984, as shown in Table VI-2, the combined loan portfolio for all commercial banks was 42.2 billion. Between 1980 and 1984, the combined portfolio grew at an average annual nominal rate of 12.3 percent; in real terms the rate was -0.5 percent. The latter figure shows that, after taking account of inflation, there was a slight decline in the real value of the system's portfolio over the five-year period.

Sectoral Distribution of Portfolio

At the end of 1984 loans to commerce accounted for the largest portion, 25.2 percent, of the system's portfolio. Agriculture was next with 17.9 percent. The other sectors in descending order of importance were industry 16.1 percent and construction 7.8 percent. Another 33.0 percent was in the rest of the economic activities. It is important to note that 28.1 percent of the portfolio consisted of refinanced loans, a symptom of the banking system's delinquency problem.

Over the 1980-1984 period, the nominal value of the portfolios for all sectors experienced positive growth rates. When converted to real terms, all sectors except agriculture and construction, grew or remained about the same. The agricultural and construction portfolios declined slightly in real terms, -1.9 percent, and -3.3 percent, respectively. It is important to note the high growth rate of refinanced loans; in nominal terms they increased at an average annual rate of 17.4 percent and in real terms 4.1 percent. This reflects the government's policy of refinancing delinquent loans, especially those in the agricultural sector. It is clear that this has been the growth sector in the banking system's portfolio over the five-year period.

Table VI-2. End-of-Year Balances of Portfolio from Salvadoran Mixed Banks by Economic Sector, 1990-1994 (Million Colones.)											
Sector	1990		1991		1992		1993		1994		Average annual rate of growth 1990-94
	Nominal Value	Percent									
Agriculture	264.0	19.0%	309.4	20.9%	410.3	24.0%	407.4	20.8%	375.5	17.7%	10.7%
Mining	0.7	0.0%	0.9	0.1%	1.3	0.1%	1.2	0.1%	1.1	0.0%	12.8%
Manufacturing	215.4	15.5%	203.0	13.7%	199.1	11.7%	297.3	12.5%	353.5	16.1%	13.4%
Construction	154.3	11.1%	135.8	9.2%	160.3	7.4%	131.0	6.7%	171.5	7.8%	2.7%
Electricity, gas and utilities	0.1	0.0%	1.1	0.1%	3.9	0.2%	1.0	0.0%	8.3	0.4%	215.6%
Commerce	391.9	29.2%	378.2	25.5%	361.1	21.1%	476.1	24.3%	556.2	25.2%	3.1%
Transportation, storage and communication	4.6	0.3%	3.4	0.2%	5.0	0.3%	5.2	0.3%	10.5	0.5%	23.3%
Services	32.5	2.3%	36.1	2.4%	44.1	2.4%	53.2	2.8%	91.3	3.7%	25.9%
Refinancing	327.0	23.5%	406.6	27.5%	517.1	30.3%	620.7	32.2%	621.7	29.1%	17.4%
Other	1.0	0.1%	3.1	0.2%	6.9	0.4%	5.5	0.3%	9.5	0.4%	72.8%
Total	1391.4	100.0%	1477.4	100.0%	1703.1	100.0%	1950.5	100.0%	2211.5	100.0%	12.3%
Sector											
Real Value a)											
Agriculture	264.0	19.0%	269.5	20.9%	319.9	24.0%	280.9	20.8%	244.7	17.7%	-1.9%
Mining	0.7	0.0%	0.7	0.1%	1.0	0.1%	0.9	0.1%	0.7	0.0%	0.0%
Manufacturing	215.4	15.5%	176.8	13.7%	155.3	11.7%	170.5	12.6%	213.4	16.1%	0.5%
Construction	154.3	11.1%	118.3	7.2%	129.0	7.4%	80.3	6.7%	109.8	7.8%	-9.0%
Electricity, gas and utilities	0.1	0.0%	1.0	0.1%	3.0	0.2%	0.7	0.0%	5.1	0.4%	179.7%
Commerce	391.9	29.2%	322.4	25.5%	281.5	21.1%	328.1	24.3%	343.1	25.2%	-3.3%
Transportation, storage and communication	4.6	0.3%	3.0	0.2%	3.9	0.3%	3.6	0.3%	6.5	0.5%	3.3%
Services	32.5	2.3%	31.5	2.4%	34.4	2.4%	39.1	2.8%	50.2	3.7%	11.5%
Refinancing	327.0	23.5%	354.1	27.5%	403.2	30.3%	434.5	32.2%	393.5	29.1%	4.1%
Other	1.0	0.1%	2.7	0.2%	5.3	0.4%	3.8	0.3%	5.2	0.4%	53.2%
Total	1391.4	100.0%	1285.9	100.0%	1332.9	100.0%	1351.2	100.0%	1364.3	100.0%	-0.5%

Source: Banco Central de Reserva, Departamento de Estadísticas Bancarias.

a) Deflated using the San Salvador Consumer Price Index, 1978 base year.

If the need for refinancing had not existed, it is certain that lending from the mixed banking system would not have experienced as much growth as it did. Refinancing does not represent any new credit, it is just a paper transfer. Therefore, it does not compete with nor substitute for other uses of loanable funds.

Annual Flows of Credit

Whereas the analysis of the portfolio shows the size and composition of the system's outstanding portfolio at the year's end, it does not necessarily reflect the actual lending during the year. It is unlikely that the end-of-year balances will accurately reflect the lending during the year. Moreover, compared to annual flows the end-of-year balances will be inflated by the amount of delinquent loans.

Credit flows, the amount of loans made during the year, are a more accurate reflection of activity in the course of a year. Yet, these too have inherent problems, many loans that are refinanced are double counted as flows. This occurs when a loan that was made in a given year is refinanced in the same year. To the extent that this occurs, flows are overstated. Because of the extensive refinancing in recent years this has to be dealt with. Unfortunately, figures on flows often are not available. For the mixed banks data on flows are available in the form of loans contracted. It is common, however, that the amounts reported as loans contracted are not fully disbursed. To the extent that this occurs, the figures for loans contracted overstate the flows. Nevertheless, the contracted figures serve as a reasonably good proxy for showing the total flows of credit as well as the distribution of loans by purpose.

Growth of System

In 1984, as shown in Table VI-3, the system contracted \$3,768.3 million in loans. Over the 1980-1984 period, the average annual flow of credit from the mixed banks grew in both nominal and real terms, 25.6 and 11.3 percent, respectively. The strong growth rates reflect, in part, the fact that following the 1979 crisis that lending declined in both 1980 and 1981. Lending increased some in 1982 and stabilized in 1983. In 1984 there was a very substantial increase. Most of the growth over the period can be attributed to the gains in this year.

Table VI-3 Credit Flows from Salvadoran Mixed Banks by Economic Sector, 1980-1984 a)

Sector	(Million Colones)										Average annual rate of growth 1980-1984 (%)
	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	
	Nominal Values										
Agriculture	249.6	16.5%	289.6	19.5%	588.3	29.3%	499.0	22.6%	643.7	17.1%	26.7%
Mining	0.7	0.0%	0.7	0.0%	1.1	0.1%	1.0	0.0%	0.6	0.0%	-3.8%
Manufacturing	184.3	12.2%	186.1	12.5%	238.8	11.9%	250.1	11.3%	388.8	10.3%	20.5%
Construction	62.5	4.1%	54.5	3.7%	113.5	5.7%	84.2	3.8%	143.6	3.8%	23.1%
Electricity, gas, water, and utilities	0.2	0.0%	3.0	0.2%	6.8	0.3%	6.0	0.3%	14.3	0.4%	190.8%
Commerce	681.2	45.0%	568.7	38.3%	550.5	27.5%	825.5	37.9%	1966.2	52.2%	30.3%
Transport, storage, and communication	3.1	0.2%	2.2	0.1%	3.2	0.2%	6.9	0.3%	12.7	0.3%	42.3%
Services	20.7	1.4%	28.0	1.9%	34.7	1.7%	43.3	2.0%	68.0	1.8%	34.6%
Refinancing	309.4	20.4%	350.1	23.6%	458.2	22.9%	477.6	21.7%	519.9	13.8%	13.9%
Other credit	2.3	0.2%	2.7	0.2%	2.4	0.5%	2.4	0.1%	10.5	0.3%	46.2%
Total	1514.0	100.0%	1483.6	100.0%	2004.5	100.0%	2206.0	100.0%	5768.3	100.0%	23.6%
	Real Values b)										
Agriculture	249.6	16.5%	252.2	19.5%	458.7	29.3%	343.9	22.6%	397.1	17.1%	12.3%
Mining	0.7	0.0%	0.6	0.0%	0.9	0.1%	0.7	0.0%	0.4	0.0%	-14.7%
Manufacturing	184.3	12.2%	162.1	12.5%	186.2	11.9%	172.4	11.3%	239.9	10.3%	6.8%
Construction	62.5	4.1%	47.5	3.7%	88.5	5.7%	58.0	3.8%	88.6	3.8%	9.1%
Electricity, gas, water, and utilities	0.2	0.0%	2.6	0.2%	5.3	0.3%	4.1	0.3%	8.8	0.4%	157.7%
Commerce	681.2	45.0%	495.3	38.3%	429.2	27.5%	575.8	37.9%	1213.0	52.2%	15.5%
Transport, storage, and communication	3.1	0.2%	1.9	0.1%	2.5	0.2%	4.8	0.3%	7.8	0.3%	26.1%
Services	20.7	1.4%	24.4	1.9%	27.1	1.7%	29.8	2.0%	41.9	1.8%	19.3%
Refinancing	309.4	20.4%	304.9	23.6%	357.2	22.9%	329.2	21.7%	320.7	13.8%	0.9%
Other credit	2.3	0.2%	2.4	0.2%	2.3	0.5%	1.7	0.1%	6.5	0.3%	27.5%
Total	1514.0	100.0%	1294.0	100.0%	1562.8	100.0%	1520.3	100.0%	2324.7	100.0%	11.3%

Source: Banco Central de Reserva de El Salvador, Departamento de Estadísticas Bancarias

a) Flows are measured by the amount contracted not by actual disbursements.

b) Deflated using the San Salvador Consumer Price Index, 1978 base year.

The growth rates for the flows are considerably higher than those for the portfolio. The differences in annual growth rates between the two figures are largely attributable to the low levels of lending in 1980 and 1981 and the sharp growth in lending in 1984. Moreover, the rapid increase of yearly flows is also explained because of the significant amount of short-term credit directed to commerce, especially in 1984. As the turnover of these loans is rapid, the end-of-year portfolio does not capture much of this lending activity. Refinancing is another fact or that should be taken into account to explain the more rapid increase of the annual flows. As noted above, much of it is double counted. For example, much of the portfolio is in cotton and coffee loans and these loans are typically double counted because the farmer borrows to produce the crop during the year. But after he has delivered the harvested crop to INCAFE or to COPAL this credit is cancelled and a new obligation is created transferring the debt from short-term to refinanciado prendario. Those figures appear once in the end-of-year portfolio, but are registered twice as flows.

Sectoral Distribution of Flows

In 1984, commerce received the largest portion of loans, 52.2 percent. Agriculture, refinancing and manufacturing were the only other sectors to receive more than one-tenth of the contracted credit, with 17.1, 13.8 and 10.3 percent, respectively. Over the 1980-1984 period, these four sectors maintained their relative importance. There were, however, some shifts in their shares, which are related to the increased availability of financing for agriculture and the general level of economic activity in the nation, which strongly influences lending for commerce. Over the 1980-1984 period, all sectors except mining experienced positive average annual rates of growth in both nominal and real terms.

The real amounts contracted for refinancing remained about the same over the period. Therefore, with the sharp increase in lending in 1984, refinancing took on lesser relative importance for the whole picture, dropping to only 13.8 percent of the portfolio, compared to 21.7 percent in 1983. Nevertheless, the absolute increase and the relative importance of loans for refinancing are other indicators of the important role of this policy to diminish the effect of delinquency on the banks and their borrowers.

Agricultural Credit

The mixed banks are major lenders to agriculture. For this credit they rely extensively on the BCP. rediscount lines.

Most loans are for production credit with terms of one-year or less. In 1984, 87.5 percent of the loans were in this category, 10.5 percent were for investment purposes with terms of one to five years and only 2 percent were for periods of ten years or more.

Distribution in Mixed-Banking System

As shown in Table VI-4 the distribution of the agricultural credit portfolio in the mixed banking system was concentrated. At the end of 1984, the Banco Cuscatlán held 25.9 percent of the system's portfolio, followed by the Banco Agrícola Comercial (15.8 percent), Banco de Comercio (12.2 percent), Banco Capitalizador (11.8 percent) and Banco Salvadoreño (11.4 percent). The three banks with the largest agricultural portfolios accounted for more than half the system's portfolio and the five largest lenders about three-fourths.

Some 30.5 percent of the mixed banks' total portfolio was in agriculture if refinanced amounts are included. As shown in the table, however, there was considerable variation among institutions, ranging from 43.2 percent for the Banco de Crédito Popular to 21.6 percent for the Banco de Desarrollo. It is noteworthy that the largest lender to the sector, Banco Cuscatlán, held only 23.6 percent of its portfolio in agriculture.

Reformed Sector Financing

Of the total portfolio for the sector an average of 20.2 percent was in the reformed sector, mostly for Phase I cooperatives. The bank making the biggest commitment to the reformed sector was the Banco Salvadoreño, which not only had the largest portfolio but also was the institution with the largest portion, 54.4 percent, of its agricultural portfolio placed in the reformed sector. The Banco Agrícola Comercial was next, followed by the Banco Cuscatlán.

Table VI-4. Distribution of Agricultural Lending in Mixed Commercial Banking System, December 31, 1984.						
(Million Colones)						
Bank	Agricultural Portfolio	Percent of bank's total portfolio	Percent of system total	Reformed sector portfolio	Percent of system total	Reformed sector as % of agrico. portfolio
Banco Agrícola Comercial	113.6	31.9	15.8%	31.4	21.8%	27.6
Banco Capitalizador	73.1	27.5	11.8%	6.1	4.2%	8.3
Banco de Comercio	84.1	30.5	12.2%	17.2	11.9%	20.5
Banco de Crédito Popular	87.6	43.2	9.0%	11.7	8.1%	13.4
Banco Cuscatlán	137.8	23.6	25.9%	28.6	19.8%	20.8
Banco de Desarrollo	33.7	21.6	6.9%	2.7	1.9%	8.0
Banco Financiero	23.2	35.5	2.9%	3.0	2.1%	12.9
Banco Mercantil	30.2	33.3	4.0%	4.9	3.4%	16.2
Banco Salvadoreño	70.8	27.6	11.4%	38.5	26.7%	54.4
Total	654.1	30.5	100.0%	144.1	100.0%	20.2
Source: Based on information in banks' annual reports.						
a) It includes sorghum, fruits, and Agroindustrial Crops.						
b) It includes loans for the purchase of land, loans for administrative costs, constructions, and other non-agricultural loans.						

Distribution of Portfolio by Activity

At the end of 1984, as shown in Table VI-5, the mixed banking system's portfolio was highly concentrated in El Salvador's traditional export crops of coffee, cotton, and sugarcane, which accounted for 45.3, 19.7 and 9.6 percent of the non-refinanced total, respectively. The outstanding loans for livestock, poultry, corn and other crops were considerably less important.

Over the 1980-1984 period all activities financed experienced positive nominal growth rates. The relative importance of the three principal crops remained the same. There was, however, some shift in the shares. Most noteworthy was the slow growth in cotton and basic grains. There was rapid growth in lending for livestock, poultry and fisheries. Refinancing also increased very rapidly.

Information on annual credit flows, as measured by credit contracted, is presented in Table VI-6. Again, it shows the heavy concentration in lending for the three traditional export crops. In 1984, 85.2 percent of total contracted loans were in coffee, cotton and sugar cane which received 58.7, 21.7 and 4.8 percent, respectively. Over the 1980-1984 period, there were no changes in the relative importance of the major activities financed. It is noteworthy, however, that lending for cotton and sugar cane lost part of their share of the total. Lending for the non-traditional crops of beans and corn also declined, whereas those for livestock, poultry and fisheries, etc., showed very rapid rates of increase.

In real terms the credit flow to coffee has increased at a high average annual rate of growth. The flows to the other two traditional export crops, cotton and sugarcane, have also increased, but at lower rates. Flows to basic grains and other crops has shown negative average annual rates of growth. On the other hand, credit flows to livestock, poultry and fisheries, and beekeeping have increased at rates of 61.6, 87.7, 59.4 percent, respectively.

The above figures include refinanced loans. For the reasons explained for the total portfolio, the flow figures are considerably higher than the end-of-year balances. In the case of agriculture the differences are even more marked because of the large proportion of the flows that represent short- or long-term refinancing.

Table VI-5. End-of-Year Balances of Agricultural Portfolios in Salvadoran Mixed Banks by Main Activities, 1980-84 (Million Colones)																
Activities	1980			1981			1982			1983			1984			Average annual rate of growth 1980-1984
	Amount	%	%													
New credit	263.9	100.0	16.4	309.4	100.0	11.1	410.3	100.0	10.4	407.4	100.0	62.4	376.6	100.0	60.1	10.7
Coffee	114.5	43.4	33.2	123.6	39.9	39.9	219.6	53.3	37.5	219.2	54.0	33.7	173.5	45.3	27.8	11.2
Cotton	74.6	28.3	21.6	99.9	32.0	24.7	99.2	21.9	15.4	77.6	19.0	11.2	79.3	19.7	12.0	1.2
Sugar cane	21.0	8.0	6.1	29.8	9.6	7.4	35.9	8.7	6.2	32.7	8.0	5.0	39.1	9.6	5.9	16.1
Corn	11.5	4.4	3.3	12.1	3.9	3.0	14.7	3.6	2.5	11.5	2.8	1.9	12.0	3.0	1.9	1.1
Beans	1.2	0.5	0.3	1.9	0.6	0.5	2.6	0.6	0.4	1.5	0.4	0.2	1.5	0.4	0.2	5.7
Rice	6.6	2.5	1.9	7.4	2.4	1.8	6.4	1.6	1.1	6.1	1.5	0.9	8.3	2.1	1.3	5.9
Other crops ^{a)}	13.0	4.9	3.8	12.0	3.9	3.0	16.3	4.0	2.9	17.3	4.2	2.7	21.4	5.4	3.3	13.3
Livestock	19.5	7.4	3.0	13.3	4.3	3.3	15.5	3.8	2.7	19.3	4.8	2.9	29.4	6.4	3.9	24.7
Poultry	7.0	2.7	2.0	3.9	1.3	1.0	4.2	1.0	0.7	7.0	1.9	1.2	17.1	4.3	2.6	25.0
Fisheries, beekeeping, others	4.0	1.5	1.2	6.5	2.1	1.6	6.2	1.5	1.1	14.7	3.6	2.3	15.0	3.8	2.3	33.2
Refinanced credit	80.8		23.4	91.7		22.9	172.9		29.6	245.0		37.6	257.0		39.3	33.6
Total	344.7		100.0	401.1		100.0	523.1		100.0	622.4		100.0	653.6		100.0	17.4

Source: Banco Central de Reserva de El Salvador, Departamento de Estadísticas Bancarias.

a) Includes vegetables, fruits, olives, and cardamom.

Table VI-6. Credit Extent in Agricultural Sector from Salvadoran Mixed Commercial Banks, ^{a)} by Main Activities, 1980-1994 (Million Colones)											Average annual rate of growth 1980-1994
Activities	1980		1991		1992		1993		1994		
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	
Coffee	123.1	49.3%	123.9	44.5%	151.2	60.2%	145.4	69.2%	177.9	59.7%	32.4
Cotton	75.6	30.3%	91.6	32.7%	123.9	22.9%	66.2	13.3%	132.9	21.7%	16.6
SUGAR CANT.	15.3	6.1%	25.5	8.8%	41.2	7.0%	27.9	5.6%	31.2	4.8%	19.5
Corn	9.2	3.7%	9.3	3.2%	14.6	2.5%	7.9	1.5%	7.1	1.1%	-6.3
Beans	1.0	0.4%	2.1	0.7%	3.0	0.5%	1.2	0.2%	1.3	0.2%	6.8
Rice	3.8	1.5%	4.6	1.6%	5.9	1.0%	3.7	0.7%	5.3	0.8%	11.6
Other crops b)	17.5	7.1%	9.1	3.1%	19.5	3.3%	16.9	3.4%	26.0	4.0%	10.2
Livestock	1.7	0.7%	5.7	2.0%	9.2	1.4%	2.9	2.0%	18.8	2.9%	82.4
Poultry	1.2	0.5%	2.2	0.8%	3.0	0.5%	7.4	1.5%	24.1	3.7%	111.7
Fisheries, beekeeping, others	1.1	0.4%	7.4	2.6%	4.9	0.8%	12.8	2.6%	11.5	1.8%	72.8
Total	249.5	100.0%	283.5	100.0%	533.3	100.0%	497.1	100.0%	643.6	100.0%	25.7
					Real Value						
Coffee	123.1	49.3%	112.3	44.5%	276.2	60.2%	239.0	69.2%	233.1	59.7%	17.3
Cotton	75.6	30.3%	82.4	32.7%	104.4	22.8%	45.6	13.3%	86.3	21.7%	3.4
SUGAR CANT.	15.3	6.1%	22.3	8.8%	32.1	7.0%	17.2	5.6%	17.2	4.8%	5.9
Corn	9.2	3.7%	9.1	3.2%	11.4	2.5%	5.2	1.5%	4.4	1.1%	-16.8
Beans	1.0	0.4%	1.8	0.7%	2.3	0.5%	0.9	0.2%	0.9	0.2%	-5.4
Rice	3.8	1.5%	4.0	1.6%	4.6	1.0%	2.5	0.7%	3.6	0.9%	-1.3
Other crops b)	17.5	7.1%	7.9	3.1%	15.2	3.3%	11.6	3.4%	16.0	4.0%	-2.4
Livestock	1.7	0.7%	5.0	2.0%	6.1	1.4%	6.9	2.0%	11.6	2.9%	61.6
Poultry	1.2	0.5%	1.9	0.8%	2.3	0.5%	5.2	1.5%	14.2	3.7%	87.7
Fisheries, beekeeping, others	1.1	0.4%	6.4	2.6%	3.7	0.8%	8.9	2.6%	7.1	1.8%	52.4
Total	249.5	100.0%	252.2	100.0%	459.7	100.0%	344.0	100.0%	397.0	100.0%	12.8

Source: Banco Central de Reserva de El Salvador, Departamento de Estadística Bancaria

a) Flow generated by the amount of contracted credit, not the actual disbursement.

b) Includes vegetables, fruits, grains and gardening.

Delinquency

Delinquency is a problem for the mixed banks; especially in the agricultural sector due to the various problems and special circumstances experienced by that sector in recent years. It was not possible to get information on delinquency from the mixed commercial banks for their agricultural portfolio. However, six of these banks provided information. As of December 31, 1984, the average portion of the agricultural portfolio that was delinquent for these six banks was 10.6 percent. Much of the delinquency, however, has been mitigated by the heavy refinancing of loans in arrears.

Refinancing

Refinanced credit is reported separately in the year-end portfolio. As shown in Table VI-5, there were \$257 million in refinanced agricultural loans in the portfolio at the end of 1984. The importance of refinancing is shown by the facts that these loans were the equivalent of 64.8 percent of the non-refinanced agricultural loans and 39.3 percent of the sum of refinanced and non-refinanced agricultural loans.

It is clear that refinancing has become increasingly important in the mixed banks, especially after 1982. The amount of refinanced credit for agriculture in the portfolio grew rapidly over the 1980-1984 period. The average annual rate of growth was 33.6 percent. In 1980 the refinanced portion of the portfolio was only 23.4 percent.

The annual flows of contracted refinanced credit presented in Table VI-7 also show this trend. Refinancing flows increased at annual average rate of 47.4 percent. This is considerably higher than the 26.7 percent growth rate for all agricultural loans reported in Table VI-6. Again this shows the role that refinancing has played in the growth of agricultural credit. The annual flows clearly show the trend in refinancing by activity over the 1980-1984 period. Coffee has consistently been the largest recipient of refinancing, and, apart from basic grains, has the largest average annual growth rate. Refinancing for cotton increased sharply up to 1982 and then began to decline, presumably because of the decline in the importance of this crop. The fact that refinancing has been concentrated in the traditional export crops reflects the importance of these crops in the agricultural portfolio, and the fact that production loans for these purposes are always refinanced as prendario loans for a short-term after the harvest and when the crop is delivered by the producer to INCAFE or COPAL. Therefore, the growth of

Table VI-7. Flows of Refinanced Agricultural Loans by Salvadoran Mixed Commercial Banks by Main Activities, 1980-1984 (Million Colones)											
Activities	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth 1980-1984
Coffee	27.4	49.4%	56.6	65.2%	144.7	61.3%	170.3	71.7%	171.0	65.1%	59.1%
Cotton	8.1	14.6%	5.5	6.3%	64.2	27.2%	34.7	14.6%	17.7	6.7%	21.6%
Basic grains a)	0.9	1.6%	1.8	2.1%	3.0	1.3%	4.9	2.1%	13.2	5.0%	95.7%
Sugar cane	3.2	5.8%	1.2	1.4%	0.6	0.3%	2.8	1.2%	5.2	2.0%	12.9%
Other agriculture b)	15.9	29.6%	21.7	25.0%	23.5	10.0%	24.7	10.4%	55.4	21.1%	36.6%
Total	55.5	100.0%	86.8	100.0%	236.0	100.0%	237.4	100.0%	262.3	100.0%	47.4%

Source: Banco Central de Reserva de El Salvador, Departamento de Estadística Agropecuarias.

a) Includes corn, rice, beans and sorghum.

b) Includes vegetables, fruits, sesame, cardamom, livestock, poultry, beekeeping and fisheries.

refinancing for these crops reflects the short-term refinancing counterpart of the increases in the absolute amounts lent for production over the 1980-1984 period. It also is due to major difficulties that were encountered in marketing and production conditions during the period that contributed to delinquency and, hence, the need for long-term refinancing.

Clientele

Exact data on the mixed-bank's clientele is not available. Nevertheless some generalization is possible. The mixed banks have mostly lent to the medium-sized farmers of the non-reformed sector who are the principal producers of the traditional export crops. These banks infrequently lend to small farmers, to those of either the reformed or non-reformed sectors.

The mixed banks, however, have lent extensively to the Phase I reformed sector cooperatives. After the land reform, each bank was assigned specific cooperatives and made loans accordingly. Over the 1980-1984 period the banks have begun to work with some additional cooperatives, while they have discontinued working with some of the more problematical cooperatives. Most of the latter were picked up by the Agricultural Development Bank, however, their delinquent portfolio remained with the mixed banks. In 1985 the total number of cooperatives served by the mixed banks was 128. Since the loans to the cooperatives are large-sized, lending to this group accounted for about one-fifth of the total agricultural portfolio.

Credit Delivery System - Agricultural Loans

Virtually all of the mixed-bank loans to the agricultural sector are made with funds from rediscount lines of the Central Bank of Reserve. Therefore, the banks must follow the procedures for intermediate credit institutions (ICIs) specified by the Central Bank. These are described in Chapter II.

The mixed banks have some latitude in terms of their requirements and procedures. For loans made for traditional exports in the non-reformed sector, the banks typically require that the borrower have a checking account and keep a compensating balance of some 5 or 10 percent of the face value of the loan on deposit in that account. The bank will lend the client up to ten times the amount on deposit. Of course, the bank can lend the borrower the amount to be placed on deposit. The end result is that the deposit serves to raise the implicit rate of interest paid by the client on the

loan. The reformed sector is not required to meet this condition. Therefore, under this arrangement these clients are getting an implicit interest subsidy that is not offered to other borrowers.

The maximum contractual rate of interest is established by the Monetary Board, however, many of the rediscount lines have lower rates (See chapter II for the rate structure). Most loans are for production credits of one year or less. For this type of loan the typical collateral is a personal guarantee. In 1984, 70.6 percent of the loans carried this form of guarantee, 17.2 were backed by the pledge of the crop and 12.2 percent with a mortgage on fixed assets.

As noted previously, most agricultural credit transactions are carried out by agricultural loan agents who work out of the headquarters office in San Salvador. This is common because of the highly-centralized operations of the banking system. Moreover, many of the clients have residences in the capital city, and, furthermore, because of the small size of the country it is relatively easy for the credit agents to travel to the countryside.

The Phase I cooperatives have special requirements. They are required to develop a farm plan when they apply for short-term production credit. An application for an investment loan should be justified by a feasibility study. The cooperatives served by the mixed banks received assistance from the PL 480-financed Coordinating Unit of Credit Agents project. Under this arrangement each bank has been assigned one or more agronomists paid by the project. These credit agents have proven helpful in working with the cooperatives in designing projects for financing and in facilitating the relationship between the bank and the cooperative.

The credit delivery system of mixed banks appears simple. However, there are considerable borrower transactions costs which include time spent in paperwork and documentation, taxes, lawyer's fee, the compensating balance, and the registration of loan document. For small-size loans, these transactions costs make it unprofitable to get a bank loan.

Since most mixed bank's loans are financed through rediscounts from BCR, once the bank approves the loan the documents should also be approved by this institution. In the case of loans to Phase I cooperatives, the cooperative must have the required Salvadorean Institute of Land Transformation (ISTA) endorsement prior to contracting of the loan and the disbursement.

Deposits

Mixed banks receive four types of deposits: demand, savings, time and foreign currency. At the end of 1984, as shown in Table VI-8, the mixed banking system held \$2,729.8 million in deposits. Of this amount 41.7 percent was in time deposits which are fixed-term deposits with periods ranging from 60 to 360 days. Another 29.7 percent were in savings, which have no fixed term, 28.4 percent were in checking accounts, and only 0.3 percent in foreign currency.

Over the 1980-1984 period, total deposits grew in both nominal and real terms, at the rates of 19.5 and 5.9 percent, respectively. Much of the increase occurred in 1984. This probably reflects the beginning of the economic recovery as well as increased confidence by the public as a result of the elections and a decline in civil strife. Another factor is the extensive savings promotion campaigns undertaken by many of the banks. The campaigns include advertising and raffles.

Over the period the relative importance and shares of deposits changed markedly. The major shift was in the increasing importance of time deposits and the declining share of demand deposits. In 1980, time deposits only accounted for 19.8 percent of the total, whereas savings and demand deposits were 36.2 and 43.9 percent respectively. Whereas all classes of deposits have increased in nominal terms, it is clear that as the nation gained more liquidity it increasingly placed it in time deposits. One probable explanation is that as the rate of inflation increased, the opportunity cost of placing funds in demand and savings deposits rose considerably. Another is that in last several years the community regained its confidence in both the banking system and in El Salvador and, therefore, increased its bank deposits at home rather than investing abroad or non-financial assets. These same factors may explain the sharp increases in deposits in foreign currency. It is noteworthy that this all occurred over a period when the level of GDP was declining, although at a progressively slower rate.

The mixed banks have well-established systems for receiving deposits. They operate demand, savings and demand deposits in all of their branch offices. As such, they are reasonably accessible to persons in most of the larger urban centers. Nevertheless, they probably are not well situated to attend to most small farmers.

Most mixed bank clients for demand deposits are found among medium- and large-sized businessmen engaged in commercial or industrial activities and medium-or large-sized farmers. Since, most banks required a minimum

Table VI-B End-of-year of Deposits in the Salvadoran Mixed Commercial Banks, 1980-1984											
(Million Colones)											
Type of deposits	Nominal Values				Real Values				Annual average rate of growth 1980-1984		
	1980	Percent	1981	Percent	1982	Percent	1983	Percent		1984	Percent
Demand	588.3	43.9%	599.4	38.3%	646.5	35.1%	637.5	29.5%	774.6	29.4%	7.1%
Saving	485.6	36.2%	595.7	37.5%	668.6	36.3%	717.6	33.2%	809.6	29.7%	13.6%
Time	264.9	19.8%	373.4	23.9%	508.5	27.6%	795.7	36.8%	1,137.1	41.7%	43.9%
Foreign currency	1.1	0.1%	4.8	0.3%	17.7	1.0%	10.1	0.5%	8.5	0.3%	66.7%
Total	1,339.9	100.0%	1,562.3	100.0%	1,841.3	100.0%	2,160.9	100.0%	2,729.8	100.0%	19.5%
Demand	588.3	43.9%	521.2	38.3%	504.1	35.1%	439.4	29.5%	477.9	29.4%	-5.1%
Saving	485.6	36.2%	510.1	37.5%	521.3	36.3%	494.6	33.2%	499.5	29.7%	0.7%
Time	264.9	19.8%	325.2	23.9%	396.5	27.6%	548.4	36.6%	701.5	41.7%	27.6%
Foreign currency	1.1	0.1%	4.2	0.3%	13.8	1.0%	7.0	0.5%	5.2	0.3%	47.6%
Total	1,339.9	100.0%	1,360.8	100.0%	1,435.6	100.0%	1,489.4	100.0%	1,684.1	100.0%	5.9%

Source: Banco Central de Reserva de El Salvador, Departamento de Estadísticas Bancarias.

deposit of ¢1,000 to open an account, low-income people do not use the service. The same is true for time deposits; most account holders are people with surplus resources. In contrast, savings account holders are mainly from the low income classes in San Salvador or major departmental cities. The minimal balance according to law is only ¢1, but most banks require ¢25 or ¢50 to open an account. Some reformed sector cooperatives with credit from the mixed banks are also using the banks' deposit services.

Sources of Loanable Funds

The mixed banks have four sources of funds for financing their credit operations: own resources, foreign loans, Central Bank of Reserve rediscounts and the Economic Development Fund. As shown in Table VI-9, at the end of 1984 the banks' own resources--capital, savings, time and demand deposits were the most important source, accounting for 77.3 percent of the total. The next most important source was Central Bank rediscounts with 16.2 percent. Year-end balances may not accurately represent how the system's lending was financed during the year since they represent the balance at a point in time. Nevertheless, they probably serve to show the relative importance, if not the exact shares, of the various sources. It should be recalled, however, that the mixed banks rely mostly on BCR rediscounts to finance agriculture.

Over the 1980-1984 period, the relative importance of the sources has not varied. The shares have altered, however, as the banking system has increasingly relied more on its own resources and less on Central Bank rediscounts. This trend probably reflects the fact that the banks were able to increase their deposits substantially over the period.

Summary and Conclusions

El Salvador has a system of nine mixed commercial banks which have majority government ownership and, hence, control. The system is highly concentrated in San Salvador with almost half of its ninety-one offices located in the capital city and with most decision making, including agriculture lending, being made in the home office. The activities in the system are concentrated in five banks, with one bank, Banco Cuscatlán, being the predominate institution, as measured by sizes of total loan portfolio, deposits and agricultural loans.

Table VI-2. Salvadoran Mixed Banks' Sources of Loanable Funds, 1980-1984 (Million Colones)											
Source	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth, 1980-1984
Own resources	1915.1	73.0%	1996.3	74.2%	1330.7	77.9%	1464.2	74.7%	1709.3	77.3%	13.9%
Foreign resources	28.3	2.0%	27.0	1.8%	74.8	4.4%	155.3	7.9%	92.3	4.2%	34.4%
BCR resources	283.4	20.4%	294.9	20.0%	241.9	14.2%	314.8	16.1%	357.8	16.2%	6.0%
FPE resources	61.5	4.6%	59.2	4.0%	61.6	3.6%	26.2	1.3%	52.0	2.4%	-5.2%
Total	1391.3	100.0%	1477.4	100.0%	1709.0	100.0%	1960.5	100.0%	2211.4	100.0%	12.3%
Source: Banco Central de Reserva de El Salvador, Departamento de Estadísticas Bancarias.											

The banks mobilize demand, savings, time and foreign currency deposits. They have facilities in their branches. In spite of the difficult times these deposits increased at an average annual real rate of 5.9 percent between 1980 and 1984. Much of the increase occurred in 1984 and there has been a trend for the share of time deposits to increase in importance, such that by 1984 they became the most important, accounting for 41.7 percent of the total. This probably reflects the improved conditions in the domestic economy, decline in civil strife, and the relatively attractive real interest rates offered on this form of saving. These deposits account for a large majority of the resources to finance the system's credit, with the second most important being Central Bank rediscount lines.

There was a slight negative growth in the real value of the system's total loan portfolio, as measured by year-end balances, between 1980 and 1984. A major decline occurred in 1981, but after that year and through 1984 there was growth in the portfolio, such that by the end of the period the real value of the portfolio was only slightly less than it was in 1980. As measured by contracted credits, the real annual flows of credit increased at an average annual real rate of 11.3 percent over the period. Most of this growth, however, occurred in 1984. The improvement in economic conditions, political stability and the increasingly extensive refinancing explain this phenomenon. This growth is somewhat misleading because of the sharp increases in refinancing that are included as part of annual flows. Were refinanced loans eliminated the real growth of new credits would have been considerably lower.

The nine mixed banks as a group are the largest class of lender to agriculture, but none of the individual banks in the system lends as much to the sector as the Agricultural Development Bank or the Mortgage Bank. Lending to the sector by the mixed banks is highly concentrated with five banks responsible for about three-fourths of the portfolio. The Banco Cuscatlán is the largest with almost one-fourth.

The real value of annual flows of credit to the agricultural sector increased over the 1980-1984 period at an average annual growth rate of 12.3 percent. Lending is concentrated in the traditional export crops of coffee, cotton and sugar cane. Over the 1980-1984 period, coffee has received from 45 to 69 percent of the mixed banks' lending to the sector each year. The real value of annual lending for basic grains has tended to decline, whereas credit for poultry, livestock and fisheries has increased.

Much of this growth reflects increases in refinancing, which increased considerably over this period. Between 1980-1984 refinanced agricultural

loans increased at an average annual rate of 33.6 percent such that by 1984 they accounted for 39.3 percent of the agricultural portfolio compared to 23.4 percent in 1980. The growth in refinancing is due to the increases in the credit extended for coffee and cotton, which have a built in short-term refinancing feature when the crop is transferred to INCAFE or COPAL. However, there were substantial amounts of long-term refinancing for Phase I cooperatives and, as well as for coffee and cotton loans of non-reformed sector farmers which resulted from delinquency. The collectibility of these loans may be problematical. If they are not collected the banks could face liquidity problems because they are responsible for the loans to the BCR.

Agricultural credit is directed mostly to medium-sized farmers who cultivate traditional crops. They also lend a considerable amount to the Phase I cooperatives that were assigned to them by the government after the land reform. In 1984, 20.2 percent of the system's portfolio was in loans extended to cooperatives. In the last several years some of the more problematical cooperatives have been shifted to the Agricultural Development Bank. In 1985, there were 128 cooperatives served by these banks. The Coordinating Unit of Credit Agents has proven to be useful in facilitating the relationships between banks and cooperatives.

The mixed bank's credit delivery system is straightforward. It is somewhat complicated and has considerable borrower transactions costs. Even so it should not be an impediment to seeking large loans, especially by persons who are accustomed to working with the banks. It is an impediment, however, for borrowers who are inexperienced or who are seeking small loans, because of the high transactions credits. This is a factor that keeps small borrowers from working with these banks.

VII- THE MORTGAGE BANK

Introduction

The Mortgage Bank (BH) was founded in 1935. It functions as a commercial bank, but has the additional and unique characteristic to issue interest-bearing mortgage certificates. Among, El Salvadorean banks, it is the only one that is entirely privately owned. Since its establishment, it has always had a priority of lending to the agricultural sector.

Structure and Organization

The Mortgage Bank's structure and operations are subject to the law for Credit Institutions and Auxillary Organizations (LICOA) as well as the policies and regulations set forth by the Monetary Board and enforced and implemented by the Superintendency of the Financial System and the Central Bank of Reserve.

The Mortgage Bank has 9,000 outstanding shares of stock, of which 98 percent are owned by the Coffee Producer's Association. The rest are owned by the Livestock Producer's Association and a few individuals. The Bank has this configuration of ownership because, when it was founded, receipts from the sale of coffee exports were used to provide the Bank's initial capital, in exchange for ownership.

The Bank is governed by an eleven-person board of directors consisting of members appointed by the shareholders and the government. The president of the board is elected by the directors, subject to the approval of the government cabinet. Therefore, although the BH is privately owned, the government has a voice in its governance. The Bank is administered by the general manager, credit manager and manager of finance and operations.

The Mortgage Bank has its headquarters and four branch offices in San Salvador. There are eleven branches located in the departments.

Credit Portfolio

Growth

Between 1980 and 1984, as shown in Table VII-I, the nominal value of BH's end-of-year portfolio grew at an average annual rate of 3.8 percent.

Table VIII. End-of-Year Balances of Portfolio from the Mortgage Bank by Economic Sector, 1980-1994
(Million Colones)

Economic Sector	1980		1981		1982		1983		1984		Average annual rate of growth
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent	
Nominal Values											
Agriculture	205.0	29.1%	212.7	29.2%	229.9	27.1%	195.9	22.5%	181.0	21.4%	-3.1%
Mining	0.3	0.0%	0.5	0.1%	0.6	0.1%	0.8	0.1%	1.1	0.1%	39.4%
Industry	59.5	8.2%	60.1	8.0%	59.4	6.9%	61.9	7.1%	67.1	7.5%	3.1%
Construction	108.1	14.8%	98.1	13.0%	89.5	10.4%	80.8	9.3%	65.2	7.8%	-11.6%
Electricity, gas, water, and other services	0.0	0.0%	0.0	0.0%	0.1	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Commerce	182.1	25.0%	161.7	21.5%	152.7	18.0%	154.1	17.7%	151.0	17.9%	0.0%
Transport, storage, and communication	0.9	0.1%	0.6	0.1%	0.4	0.0%	0.4	0.0%	0.2	0.0%	-28.9%
Services	7.5	1.0%	7.1	0.9%	7.8	0.9%	8.7	1.0%	6.9	0.8%	-1.9%
Refinancing	163.3	22.7%	212.3	28.2%	311.4	36.6%	369.2	42.4%	371.0	43.9%	22.4%
Other credit	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Total	728.71	100.0%	753.1	100.0%	849.8	100.0%	871.7	100.0%	844.4	100.0%	3.8%
Real Values (a)											
Agriculture	205.0	26.1%	185.3	28.2%	179.3	27.1%	135.0	22.5%	111.7	21.4%	-14.1%
Mining	0.3	0.0%	0.4	0.1%	0.5	0.1%	0.6	0.1%	0.7	0.1%	22.6%
Industry	59.5	8.2%	52.4	8.0%	45.5	6.9%	42.6	7.1%	41.4	7.9%	-9.7%
Construction	108.1	14.8%	85.5	13.0%	69.0	10.4%	55.7	9.3%	40.7	7.8%	-21.7%
Electricity, gas, water, and other services	0.0	0.0%	0.0	0.0%	0.1	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Commerce	182.1	25.0%	140.8	21.5%	119.1	18.0%	106.2	17.7%	93.2	17.9%	-15.4%
Transport, storage, and communication	0.9	0.1%	0.5	0.1%	0.3	0.0%	0.3	0.0%	0.1	0.0%	-37.0%
Services	7.5	1.0%	6.2	0.9%	6.1	0.9%	6.0	1.0%	4.3	0.8%	-13.1%
Refinancing	163.3	22.7%	184.2	28.2%	242.8	36.6%	254.5	42.4%	229.9	43.9%	8.5%
Other credit	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Total	728.71	100.0%	656.0	100.0%	662.6	100.0%	600.8	100.0%	520.9	100.0%	-9.1%

Source: Banco Central de Reserva, Departamento de Estadísticas Bancarias.

a) Deflated using the San Salvador Consumer Price Index, 1978 base year.

Over the period its lending increased through 1983 and then declined in 1984 to about the same level as in 1982. Small decreases in lending for agriculture and construction in 1984, accounted for the decline.

Growth in real terms, after taking account of inflation, was negative. The average annual decline was -8.1 percent. Clearly, the BH portfolio was considerably lower in 1984 than in 1980.

Sectoral Distribution

In 1984, refinanced loans accounted for 43.9 percent of the Bank's portfolio. Agricultural credit was next in importance with 21.4 percent and was followed by commerce with 17.9 percent. The only other sectors accounting for more than 1 percent of the total were industry and construction, with 7.9 and 7.8 percent, respectively. The importance of agriculture in the portfolio is clear. If the agricultural portion of the refinanced portfolio is included, 39.8 percent of the portfolio would correspond to this sector.

Over the 1980-1984 period, the relative importance of the portfolio's components have remained about the same, except for the fact that refinancing grew rapidly up through 1983 when it leveled out. Apart from refinancing, only loans to industry and mining experienced positive growth rates. When converted to real values the only sectors with positive growth rates were refinancing and mining. Agriculture declined at an average annual rate of -14.1 percent. It is clear that the real value of the portfolio for the nation's most important productive sectors was much less in 1984 than 1980.

Annual Flows of Credit

Whereas the analysis of the portfolio provides the size and composition of BH's outstanding portfolio at year's end it does not necessarily reflect the actual lending during the year. Credit flows are a more accurate measure of annual activity because many loans, such as those to commercial establishments, will be made and repaid in the course of the year. Annual flows for the Mortgage Bank are not available, but data are reported for contracted credit. These data will overstate the actual flows for two reasons. First, all credit contracted is not disbursed. Second, there may be considerable double counting with refinanced loans if the refinancing is for a loan that was made previously in the same year.

Growth

Over the 1980-1984 period, as shown in Table VII-2, the nominal annual flows grew at an average rate of 24.8 percent. In real terms the growth rate was 10.6 percent. The real value of total flows remained about the same from 1980 through 1983 and then increased sharply in 1983 and 1984.

Sectoral Distribution

In 1984, commerce was the largest recipient of credit with 54.6 percent of the flows. Refinancing was next with 22.3 percent and agriculture followed with 19.5 percent. Between 1980 and 1984 commerce, refinancing and "other" credits showed positive nominal rates of growth. In real terms the growth rates for only commerce and refinancing were positive.

Therefore, the flow measure, like the portfolio measure, shows that lending to agriculture declined over the period. Refinancing and commerce were the sectors experiencing the highest growth. Refinancing increased considerably between 1980 and 1983 due to heavy refinancing of agricultural loans in the first years of the period. Commerce did not grow much until 1983 and 1984 when there was more political stability and improved economic conditions.

Agricultural Credit

Agricultural lending is a major endeavor of the Mortgage Bank. It makes mostly short-term production loans of less than one year. A majority of its borrowers are medium- or large-sized farmers. However, about 40 percent of its portfolio is directed to Phase I cooperatives of the reformed sector.

Growth

As noted above, over the 1980-1984 period, the real values of agricultural lending by the Mortgage Bank declined in real terms at average annual rates of -14.1 and -14.0 percent when measured by the year-end portfolio and annual flows. It is clear that the sector was receiving less credit in 1984 than in 1980.

Table VII-2. Credit Flow a) from the Mortgage Bank by Economic Sector, 1980-1984.
(Million Colones)

Economic Sector	1980		1981		1982		1983		1984		Average annual rate of growth
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent	
	Nominal Values										
Agriculture	204.7	53.4%	220.9	59.5%	253.9	49.6%	199.9	26.0%	181.5	19.5%	-3.0%
Mining	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Industry	16.4	4.3%	0.4	0.1%	1.9	0.4%	1.0	0.1%	22.1	2.4%	7.7%
Construction	13.6	3.5%	3.9	0.9%	4.0	0.8%	3.3	0.4%	10.4	1.1%	-6.5%
Electricity, gas, water, and other services	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Commerce	82.9	21.6%	27.1	6.3%	23.1	4.5%	343.4	45.6%	509.6	54.6%	57.4%
Transport, storage and communication	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Services	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Refinancing	65.0	17.0%	145.3	33.9%	227.0	44.3%	210.4	27.5%	207.6	22.3%	33.7%
Other credit	0.9	0.2%	1.7	0.4%	2.5	0.5%	2.8	0.4%	1.2	0.1%	7.5%
Total	383.4	100.0%	429.2	100.0%	512.4	100.0%	765.8	100.0%	931.4	100.0%	24.6%
	Real Values b)										
Agriculture	204.7	53.4%	218.5	59.5%	198.0	49.6%	137.1	26.0%	112.0	19.5%	-14.0%
Mining	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Industry	16.4	4.3%	0.4	0.1%	1.9	0.4%	0.7	0.1%	13.6	2.4%	-4.5%
Construction	13.6	3.5%	3.3	0.9%	3.1	0.8%	2.3	0.4%	6.4	1.1%	-17.1%
Electricity, gas, water, and other services	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Commerce	82.9	21.6%	23.6	6.3%	18.0	4.5%	240.8	45.6%	313.8	54.6%	39.5%
Transport, storage and communication	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Services	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0%
Refinancing	65.0	17.0%	126.6	33.9%	177.0	44.3%	143.0	27.5%	129.1	22.3%	18.5%
Other credit	0.9	0.2%	1.5	0.4%	2.0	0.5%	1.9	0.4%	0.7	0.1%	-4.6%
Total	383.4	100.0%	373.9	100.0%	399.5	100.0%	527.9	100.0%	574.6	100.0%	10.6%

Source: Banco Hipotecario de El Salvador - Departamento de Estadística.

a) Flows are measured by the amount contracted not by actual disbursements.

b) Deflated using the San Salvador Consumer Price Index, 1978 base year.

Distribution of Portfolio by Activity

The 1984 end-of-year portfolio, presented in Table VII-3, shows that 50.2 percent of the agricultural portfolio was in refinanced loans. Coffee loans accounted for 28.9 percent of the total and 58.1 percent of the non-refinanced loans. Cotton was the only other major activity financed, with 13.0 percent of the total and 26.2 percent of the non-refinanced loans.

Over the 1980-1984 period, BH consistently placed the bulk of its new credit in these two traditional export crops. The lending for them, as well as all other activities, except sugar cane and refinancing, declined over the period in both nominal and real terms. Lending for cotton had little variation until 1984 when it declined. Coffee credit increased until 1983 when it began to descend. Refinanced credit also grew through 1983, before declining. The distribution by flows, presented in Table VII-4, shows the same trends and patterns. These figures, however, include refinancing. Therefore, the proportion going to coffee is much higher because of both short-term and long-term refinancing for this activity.

Refinancing

As shown in Table VII-5, refinanced credits in the year-end portfolio are concentrated in coffee and cotton. In 1984, these two crops accounted for 60.6 and 27.0 percent of the total agricultural refinanced portfolio, respectively, i.e., combined, they represented more than three-fourths of the total. This would be expected because of the built-in structure for short-term refinancing associated with the processing, storage and marketing of these crops. Furthermore, these two crops have been heavily impacted by delinquency resulting from poor external markets, terrorism and land reform. Both crops experienced rapidly increasing refinancing from 1980 through 1982. Coffee refinancing peaked in 1983, whereas cotton refinancing leveled off after 1982.

When measured by credit flows, as shown in Table VII-6, refinancing for coffee is completely dominant. The reasons are because of the overwhelming importance of this crop in the portfolio and because the production credit is refinanced in the processing-storage-marketing stage.

Table VII-3. End-of-Year Balances of Agricultural Portfolio from the Mortgage Bank by Main Activities, 1990-1994. (Million Colones)																
Activities	1990			1991			1992			1993			1994			Average annual rate of growth
	Amount	New Credit %	Percent													
New Credit	209.0	100.0%	75.1%	212.9	100.0%	69.3%	229.9	100.0%	58.5%	195.9	100.0%	47.8%	180.5	100.0%	49.8%	-3.1%
Coffee	117.9	57.5%	43.1%	120.9	56.8%	39.8%	140.9	61.3%	35.8%	116.4	59.4%	29.4%	104.8	58.1%	28.9%	-2.9%
Cotton	57.5	28.0%	21.1%	57.7	27.1%	19.5%	57.4	25.0%	14.6%	49.6	25.3%	12.1%	47.3	26.2%	13.0%	-4.8%
Sugar cane	3.9	1.9%	1.4%	5.9	2.7%	1.9%	6.6	2.9%	1.7%	7.2	3.7%	1.8%	6.6	3.7%	1.8%	14.1%
Corn	5.6	2.7%	2.1%	6.3	3.0%	2.0%	4.7	2.0%	1.2%	4.3	2.2%	1.0%	3.9	2.2%	1.1%	-8.6%
Beans	0.4	0.2%	0.1%	0.6	0.3%	0.2%	0.4	0.2%	0.1%	0.3	0.2%	0.1%	0.2	0.1%	0.1%	-15.9%
Other crops ^{a)}	13.0	6.3%	4.8%	14.3	6.7%	4.6%	13.2	5.7%	3.4%	11.4	5.8%	2.8%	11.8	6.5%	3.3%	-2.4%
Livestock	6.3	3.1%	2.3%	6.6	3.1%	2.1%	6.3	2.7%	1.6%	6.4	3.3%	1.6%	5.6	3.1%	1.5%	-2.9%
Poultry	0.2	0.1%	0.1%	0.2	0.1%	0.1%	0.1	0.0%	0.0%	0.0	0.0%	0.0%	0.0	0.0%	0.0%	-43.6%
Fisheries, beekeeping, others	0.3	0.1%	0.1%	0.4	0.2%	0.1%	0.3	0.1%	0.1%	0.3	0.2%	0.1%	0.3	0.2%	0.1%	0.0%
Refinanced credit	68.1		24.9%	99.7		31.7%	163.0		41.5%	214.2		52.2%	182.0		50.2%	27.9%
TOTAL	273.1		100.0%	311.5		100.0%	392.9		100.0%	419.1		100.0%	362.5		100.0%	7.3%

Source: Banco Hipotecario de El Salvador - Departamento de Estadística.

a) Maíces Verdes, frijoles, Soya, Cardamom, etc.

Table VII-6. Credit Flow a) to Agricultural Sector from the Mortgage Bank by Main Activities, 1980-1984 (Million Colones.)											
ACTIVITIES	1980		1981		1982		1983		1984		Average annual rate of growth
	Value	Percent									
Coffee	127.4	62.5%	153.4	62.4%	171.8	69.4%	159.3	70.7%	131.1	72.8%	0.7%
Cotton	64.8	31.8%	69.5	27.9%	64.2	25.6%	49.0	22.8%	35.9	20.5%	-13.1%
Sugar cane	2.8	1.4%	7.2	2.9%	6.5	2.6%	7.1	3.6%	6.4	3.6%	23.0%
Cereals b)	6.3	3.1%	13.0	5.2%	6.6	2.6%	4.0	2.0%	3.7	2.1%	-12.5%
Other agriculture c)	2.4	1.2%	4.0	1.6%	2.1	0.8%	1.6	0.8%	2.1	1.2%	-3.3%
TOTAL	203.7	100.0%	249.1	100.0%	251.2	100.0%	197.0	100.0%	180.2	100.0%	-3.0%

Source: Banco Hipotecario de El Salvador - Departamento de Estadística.

a) Flow is measured by the amount of contracted credit, not the actual disbursement.

b) Includes corn, rice, sorghum and beans.

c) Includes vegetables, fruits, sesame, cardamom, livestock, poultry, beekeeping and fisheries.

Table VII-9. End-of-Year Balances of Refinanced Agricultural Portfolio for Mortgage Bank by Main Activities, 1980-1984. (Million Colones)											
Activities	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Coffee	34.7	50.9%	60.7	61.4%	101.2	62.1%	145.8	69.0%	110.2	60.6%	33.5%
Cotton	18.8	27.6%	22.5	22.8%	43.0	26.4%	49.6	22.7%	43.1	27.0%	27.1%
Cereals a)	5.9	8.7%	7.0	7.1%	9.5	5.8%	9.3	4.3%	11.0	6.0%	14.9%
Sugar cane	1.7	2.5%	1.7	1.7%	1.7	1.0%	1.6	0.7%	1.9	1.0%	2.8%
Other agriculture b)	7.1	10.4%	6.9	7.0%	7.6	4.7%	9.1	4.2%	9.7	5.3%	0.1%
Total	69.2	100.0%	99.8	100.0%	163.0	100.0%	214.4	100.0%	191.9	100.0%	27.6%
Source: Banco Hipotecario de El Salvador, Departamento de Estadística.											
a) Includes corn, rice, beans, and sorghum.											
b) Includes vegetables, fruits, sesame, cardamom, livestock, poultry, beekeeping and fisheries.											

Table VII-6. Refinanced Agricultural Loans from the Mortgage Bank by Main Activities, 1980-1984.

Activities	1980		1991		1992		1993		1994		Average annual rate of growth
	Amount	Percent									
Coffee	37.4	84.4%	100.4	91.7%	125.07	77.9%	149.0	81.9%	145.1	93.4%	40.3%
Cotton	5.4	12.2%	7.3	6.7%	31.6	19.7%	29.4	16.3%	3.6	3.5%	0.9%
Cereals a)	0.2	0.5%	1.0	0.9%	2.3	1.4%	1.1	0.6%	2.7	1.7%	21.7%
Sugar cane	1.0	2.3%	- 0.0	0.0%	0.0	0.0%	0.1	0.1%	0.5	0.3%	-15.9%
Other agriculture b)	0.3	0.7%	0.7	0.6%	1.6	1.0%	2.2	1.2%	1.5	1.0%	49.5%
TOTAL	44.3	100.0%	109.4	100.0%	160.6	100.0%	180.8	100.0%	153.4	100.0%	26.8%

Sources: Banco Hipotecario de El Salvador - Departamento de Estadística.

a) Includes Corn, Rice, Sorghum, and Beans.

b) Includes Vegetables, Fruits, Sesame, Cardamom, Livestock, Beekeeping, and Fisheries.

Clientele

The Mortgage Bank has traditionally served medium- and large-sized farmers, mostly producers of traditional export crops. Since the land reform it has continued mostly with this clientele. It was assigned forty-eight Phase I cooperatives of the reformed sector. In 1985 it was working with thirty-one of these. It discontinued working with those cooperatives with which it had serious problems of delinquency. These four were transferred to the Agricultural Development Bank, however, their delinquent portfolio remained with the Mortgage Bank. BH has not lent to any Phase III beneficiaries.

Delinquency

The Mortgage Bank has a serious delinquency problem, at the end of 1984, 20 percent of its portfolio was in arrears. For agricultural loans the problem is worse, 31 percent of the loans are delinquent. The heavy refinancing is also symptomatic of the delinquency problem. Some 44 percent of the total portfolio is refinanced and almost half of this in agriculture. Some of this is in short-term refinancing but much of it is derived from refinancing of delinquent loans. BH anticipates problems in collecting much of these funds.

Credit Delivery System-Agricultural Loans

Virtually all of the Mortgage Bank loans to the agricultural sector are made with funds from rediscount lines of the Central Bank of Reserve. Therefore, the Bank must follow the procedures for intermediate credit institutions (ICIs) specified by the Central Bank. These are described in Chapter II.

The Mortgage Bank has some latitude in terms of their requirements and procedures. For loans made for traditional exports in the non-reformed sector, the Bank typically requires that borrowers have a checking account and keep a compensating balance of some 5 or 10 percent of the face value of the loan on deposit in that account. The Bank will lend the client up to ten times the amount on deposit. Of course, BH can lend the borrower the amount to be placed on deposit. The end result is that the deposit serves to raise the implicit rate of interest paid by the client on the loan. The reformed sector is not required to meet this condition. Therefore, under this arrangement, these clients are getting an implicit interest subsidy that is not offered to other borrowers.

The maximum contractual rate of interest is established by the Monetary Board, however, many of the rediscount lines have lower rates (see Chapter II for the rate structure). Most loans are for production credits of one year or less. For this type of loan the typical collateral is a personal guarantee.

As noted previously, most agricultural credit transactions are carried out by agricultural loan agents who work out of the headquarters office in San Salvador. This is common because of the highly-centralized operations of the Bank. Moreover, many of the clients have residences in the capital city, and furthermore, because of the small size of the country it is relatively easy for the credit agents to travel to the countryside.

The Phase I cooperatives have special requirements. They are required to develop a farm plan when they apply for short-term production credit. An application for an investment loan should be justified by a feasibility study. The cooperatives served by the BH received assistance from PL480-financed Coordinating Unit of Credit Agents projects. Under this arrangement BH has been assigned agronomists paid by the project. These credit agents have proven helpful in working with the cooperatives in designing projects for financing and in facilitating the relationship between the Bank and the cooperative.

The credit delivery system of BH appears simple. However, there are considerable borrower transactions costs which include time spent in paperwork and documentation, taxes, lawyer's fee, the compensating balance, and the registration of loan document. For small-size loans those transactions cost make it unprofitable to get a bank loan.

Since most BH loans are financed through rediscounts from BCR, once the Bank approves the loan the documents should also be approved by this institution. In the case of loans to Phase I cooperatives, the cooperative must have the required Salvadorean Institute of Land Transformation (ISTA) endorsement prior to contracting of the loan and the disbursement.

Source of Funds

The Mortgage Bank relies mostly on its own resources -- capital, demand deposits, savings deposits, time deposits and mortgage certificate deposits--as sources for its loanable funds. As shown in Table VII-7, for each year in the 1980-1984 period, between 66 and 79 percent of their funds come from its own resources. Almost all of the rest were from Central Bank rediscounts.

Table VII-7. Sources of Loanable Funds of the Mortgage Bank, 1980-1984 (Million Colones)											
SOURCES	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Own resources	499.6	69.4%	549.6	72.9%	578.9	68.1%	580.2	66.5%	659.5	79.3%	7.6%
Foreign resources	3.8	0.5%	2.7	0.4%	22.3	2.6%	24.6	2.8%	25.7	3.2%	62.9%
B.C.R. resources	224.7	30.8%	200.6	26.6%	247.9	29.2%	239.3	27.3%	147.7	17.5%	-10.0%
F.O.E. resources	1.6	0.2%	1.1	0.1%	0.9	0.1%	29.7	3.3%	0.9	0.1%	-25.2%
TOTAL	729.7	100.0%	753.0	100.0%	849.9	100.0%	871.8	100.0%	844.4	100.0%	3.8%

Source: Banco Hipotecario de El Salvador - Departamento de Estadística

These funds were mostly directed to financing of agricultural activities, including the reformed sector cooperatives.

Deposits

The Mortgage Bank receives four types of deposits -- demand, savings, time and foreign currency. In addition, it has the unique capability to sell mortgage certificates as a further means of raising funds. The mortgage certificates are issued for periods of five or ten years. They carry a fixed interest rate. In 1985 the rates were 13.0 and 14.0 percent, respectively for the five-year and ten-year certificates. These rates, as well as the maximum interest rates for other deposits, are set by the Monetary Board.

The distribution of deposits at the end of 1984, is presented in Table VII-8. Time deposits were the most important with 34.2 percent of the total. Mortgage certificates were next with 32.9 percent and savings deposits followed with 22.4 percent. This distribution is representative of that over the 1980-1984 period. The notable exception is the decline in demand deposits.

Over the 1980-1984 period, the average annual growth rates of the Mortgage Bank's deposits were 8.4 percent in nominal terms and -3.9 percent in real terms. All classes of deposits, except foreign currency and mortgage certificates, experienced negative growth rates. Therefore, it is clear that BH had less real deposits in 1984 than in 1980. Furthermore, it was the growth in mortgage certificates that kept the decline from being worse. The fact that savers shifted to this type of deposit is understandable given the inflationary conditions and the more attractive rates of interest offered. It is the only type of deposit which showed a positive real rate of interest in 1984.

The BH has established policies regarding deposits. To open a new checking account a minimum deposit of ₡1,000 is required. For time deposits the minimum amount is ₡500 and is ₡25 for savings deposits. The Bank has begun to carry out promotion campaigns to mobilize savings and the sell mortgage certificates.

Most demand deposits holders in the Bank are medium- and large-sized farmers, notably coffee producers, cotton producers and cattlemen, as well as businessmen. Since the BH requires a sizeable minimum deposit to open an account this service is not used by the low-income person. The same is true of the time desposits. Many low-income persons, however, have savings

Table VII-B. End-of-Year Balances of Deposits in the Mortgage Bank, 1980-1984 (Million Colones)											
Type of deposits	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
	Nominal Values										
Demand	104.4	15.6%	95.0	13.1%	83.0	10.5%	77.0	9.2%	73.5	8.6%	-6.6%
Saving	157.1	23.5%	201.6	27.7%	224.7	28.5%	166.7	22.3%	207.0	24.4%	7.1%
Time	225.9	33.8%	231.4	31.8%	213.1	27.1%	293.5	35.1%	316.1	34.2%	8.8%
Foreign currency	0.0	0.0%	0.0	0.0%	0.2	0.0%	0.5	0.1%	17.9	1.9%	549.5%
Sub total	487.3	72.8%	528.0	72.7%	521.3	66.2%	557.7	66.7%	620.6	67.1%	6.2%
Mortgage securities	181.9	27.2%	199.7	27.3%	266.0	33.8%	278.1	33.3%	304.9	32.9%	13.8%
Total	669.2	100.0%	726.7	100.0%	787.3	100.0%	835.8	100.0%	925.5	100.0%	8.4%
	Real Values										
Demand	104.4	15.6%	82.7	13.1%	64.7	10.5%	53.1	9.2%	49.0	8.6%	-17.2%
Saving	157.1	23.5%	175.6	27.7%	175.2	29.5%	129.7	22.3%	177.7	22.4%	-5.0%
Time	225.9	33.8%	201.6	31.8%	166.4	27.1%	202.3	35.1%	175.2	34.2%	-3.6%
Foreign currency	0.0	0.0%	0.0	0.0%	0.2	0.0%	0.3	0.1%	11.0	1.9%	475.7%
Sub total	487.3	72.8%	459.9	72.7%	406.4	66.2%	384.4	66.7%	392.9	67.1%	-5.7%
Mortgage securities	181.9	27.2%	173.1	27.3%	207.9	33.8%	191.7	33.3%	189.1	32.5%	0.8%
Total	669.2	100.0%	633.0	100.0%	613.8	100.0%	576.0	100.0%	570.9	100.0%	-3.9%

Source: Banco Hipotecario de El Salvador, Departamento de Estadística.

accounts. The large majority of these accounts correspond to branches located in low-income urban areas and some rural areas.

The amount of deposits in the branches outside the capital city are reported to be important. Some 52 percent of the combined amount of deposits correspond to departmental branch offices.

Summary and Conclusions

The Mortgage Bank, founded in 1935, is a private-sector institution that operates as a commercial bank, but has the unique capability of raising funds by issuing mortgage certificates. It has always been a major lender to the agricultural sector and its clientele in that sector mostly consists of medium- and large-sized farmers who grow traditional export crops. Since the agrarian reform, it has also extended credit to Phase I cooperatives. About 40 percent of its agricultural portfolio is in loans to this group.

Between 1980 and 1984, BH experienced a negative average annual growth in its portfolio of -6.1 percent. Lending to all sectors except mining and industry declined. Agricultural loans accounted for 21.4 percent of the 1984 portfolio. Strong growth occurred in refinancing such that by 1984, this type of loan accounted for 43.9 percent of the portfolio, reflecting the Bank's earlier problems with delinquent loans and the need for short-term refinancing for the processing-storage-marketing of coffee and cotton, the two crops that strongly dominate its agricultural credit portfolio.

Loan delinquency remains a problem; about 31 percent of the agricultural portfolio is in arrears, compared to 20 percent for the whole portfolio. Delinquency has been alleviated by refinancing, otherwise it would be worse. The causes of delinquency are problems with some of the reformed sector loans, terrorism and unfavorable markets for the two principal export crops, cotton and coffee.

The agricultural credit delivery system is costly for persons who are inexperienced or who want small loans, one factor that explains why BH does not have many loans for small farmers.

BH has used Central Bank rediscount lines to finance much of its agricultural portfolio, but also has used considerable amounts of its own resources from deposits and capital. Time and mortgage deposits are dominant in its deposit portfolio. Between 1980 and 1984, the Bank lost ground in its real deposits, they have declined at an average annual rate of -

3.9 percent. If there had not been a positive growth in the high-interest bearing mortgage certificates, the decline would have been more severe.

VIII- NATIONAL COFFEE INSTITUTE (INCAFE)

Introduction

In 1979, as part of the structural reforms of the new government, the National Coffee Institute (INCAFE) was created as a public institute with broad powers over the marketing and financing of coffee, El Salvador's most important crop. INCAFE supplanted a private-sector entity, La Compañía Salvadoreña del Café, S.A. In contrast to its predecessor, INCAFE was given the exclusive right to market Salvadorean coffee in foreign markets and considerable control over sales in domestic markets. With this change, the marketing of coffee was placed in the hands of the state. It should be noted, however, that coffee production and processing remains in the hands of the private and reformed sectors.

Although INCAFE's main function is marketing it is also important as a financial institution. Over the 1980-1984 period it was responsible for about one-third of the total credit extended by the financial institutions for coffee production. However, its role as a financier of production has sharply declined in recent years.

In its role as a financial institution, INCAFE is authorized to: (a) extend credit for the producing, processing, transporting, and storing of coffee, (b) maintain deposits in BCR or other domestic financial institutions, (c) hold deposits in foreign currencies in foreign financial institutions, (d) undertake investments in foreign and domestic liquid assets, (e) receive deposits in foreign or domestic currency, (f) hold and manage trust funds, and (g) to issue and sell bonds. It is clear that INCAFE is given broad powers that will facilitate its financial and marketing transactions. In its capacity as a financial institution, INCAFE must follow the regulations specified in the Law of Credit Institutions and Auxiliary Organizations (LICOA) and is subject to the regulations of the Monetary Board.

Organization and Structure

INCAFE is administered by a governing assembly, and a board of directors. There is an advisory council comprised of nine persons representing producers associations, coffee processors and the government.

The governing assembly is the policy making unit and is constituted of five cabinet ministers, the ECR president and a representative of the president of the republic. It establishes the norms and policies for external marketing of coffee, determines the amount of advance payments the growers receive at harvest and when the product is sold and provides the norms to be followed in financing producers, processors, and other borrowers. The assembly appoints a three-person board of directors. The president of the board and the other directors guide and supervise the daily operations of INCAFE.

Credit Operations

Credit Portfolio

As shown in Table VIII-1, over the 1980-1984 period, INCAFE's year-end loan portfolio grew in both nominal and real terms; the rates were 23.5 and 9.4 percent respectively. The composition of the portfolio, however, changed over the period. In 1980 all agricultural credit was directed to production. In 1981 and 1982 some funds were directed to combat coffee rust disease and beginning in 1982 considerable funds were directed to processing. By 1984, 63.3 percent of INCAFE financing was directed to processing. At this time it was not necessary to direct as much financing to rust control. It is clear that the Institute has shifted away from financing production and is now concentrating on financing processing. The 1980 and 1981 figures, however, are misleading. In those years INCAFE made loans for processing, but they reported them under the category of industrial credit.

A principal factor in this trend has been INCAFE's rapid decline in financing production for reformed sector cooperatives. In 1980 the Institute financed thirty-three cooperatives in the amount of ₡43.4 million. By 1984 it provided financing to only one cooperative in the amount of ₡9.8 million. The reason for the decline was problems with loan delinquency.

Credit Flows

The annual flows of credit, provide a better perspective for viewing INCAFE's financial operations. As shown in Table VIII-2, the flows of credit over the 1980-1984 period decreased in both nominal and real terms with negative annual average growth rates of -4.9 and -15.7 percent, respectively. The negative growth rates, compared to the positive rates for the end-of-year portfolio clearly show the amount of financing has declined over the period. Moreover, the flows do not include the delinquency and

Table VIII-1. End-of-Year Balances of Agricultural Portfolios INCAFE by Main Activities, 1980-1984 (Million Colones.)											
Activities	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
	Nominal Values										
Production credit	31.2	100.0%	56.4	98.3%	48.2	94.7%	40.2	89.6%	25.5	85.2%	-4.9%
Rust control	0.0	0.0%	1.0	1.7%	2.7	5.3%	1.9	1.8%	1.1	1.5%	2.4%
Coffee processing	0.0	0.0%	0.0	0.0%	0.0	0.0%	62.0	59.6%	45.9	63.3%	-7.2%
Total	31.2	100.0%	57.4	100.0%	50.9	100.0%	104.1	100.0%	72.5	100.0%	23.5%
	Real Values										
Production credit	31.2	100.0%	49.1	99.2%	37.6	94.7%	27.7	89.5%	15.7	85.1%	-15.8%
Rust control	0.0	0.0%	0.9	1.8%	2.1	5.3%	1.3	1.8%	0.7	1.6%	-6.1%
Coffee processing	0.0	0.0%	0.0	0.0%	0.0	0.0%	42.7	59.6%	29.3	63.3%	-9.8%
Total	31.2	100.0%	50.0	100.0%	39.7	100.0%	71.7	100.0%	44.7	100.0%	9.4%
Source: INCAFE, Departamento de Créditos.											

Table VIII-2. Annual Credit Flows from NCAFE, by Main Activities, 1980-1984 (Million Colones)												
Activities	1980		1981		1982		1983		1984		Average annual rate of growth	
	Percent	Nominal Value										
Production credit	100.0%	199.3	99.4%	186.4	41.0%	74.7	37.7%	64.2	24.5%	39.8	-33.4%	
Coffee rust control	0.0%	0.0	1.6%	3.1	2.3%	4.2	0.6%	1.1	0.5%	0.8	-43.0%	
Coffee processing	0.0%	0.0	0.0%	0.0	56.7%	103.2	61.6%	104.9	75.1%	122.3	3.9%	
Total	100.0%	199.3	100.0%	189.5	100.0%	182.1	100.0%	170.2	100.0%	162.9	-4.9%	
				Real Value								
Production credit	100.0%	199.3	99.4%	162.4	41.0%	58.2	37.7%	44.2	24.5%	24.6	-41.0%	
Coffee rust	0.0%	0.0	1.6%	2.7	2.3%	3.3	0.7%	0.8	0.5%	0.5	-50.0%	
Coffee processing	0.0%	0.0	0.0%	0.0	56.7%	80.5	61.6%	72.3	75.0%	73.4	-2.1%	
Total	100.0%	199.3	100.0%	165.1	100.0%	142.0	100.0%	117.3	100.0%	100.3	-15.7%	
Source: IICAFE, Departamento de Crédito.												

refinancing that appears in the total portfolio. As is the case with the year-end figures the largest declines were observed in production and rust control loans.

Delinquency

As of October 31, 1985, 29.0 percent of total portfolio was in arrears. The refinanced portfolio amounted to \$1.7 million, it represented 3.2 percent of the portfolio. The reason that the refinanced portion of the portfolio is so low for INCAFE is that the Institute is in better condition to recover loans because borrowers and non borrowers must deliver their production to INCAFE's coffee mill or deliver green coffee to the Institute for exportation. Thus, INCAFE directly deducts the amount of the loan plus interest from the final payments it makes to the borrower after his product is sold.

Source of Funds

The main objective of INCAFE is the marketing of coffee. It buys coffee from producers, facilitates its milling and markets the final product abroad. To provide financing for planting, for the maintenance of coffee plantations, and harvesting INCAFE has depended upon the BCR rediscount funds. Likewise, INCAFE, has used BCR rediscount funds to extend credit to the coffee millers. INCAFE has used the institution's own resources only to make disbursements in advance until the BCR rediscounts are approved.

Credit Delivery System

The following describes INCAFE's credit delivery system for loans to finance coffee bean production.

Pre-application Phase

Agronomists from the INCAFE's agricultural department promote the lines of credit available and provide the application form to farmers interested in obtaining the loan. Farmers who do not get application forms from agronomists, may obtain them from the credit analysis department in INCAFE's central office in San Salvador.

Application Phase

The credit analysis department receives the application forms along with the required supporting documents. The documents vary depending upon the type of borrowers. For individual loans the farmer presents certificates of land title and of previous years' coffee deliveries to INCAFE. The latter is to demonstrate that he has been a coffee producer. If the loan is to be made with INCAFE'S own funds certificates of delivery are required for the three prior years. If loans will be financed with BCF funds certificates for the previous five years must be submitted. Each applicant is charged a fee of \$5.65 in stamps to file a loan application.

For loans to cooperatives there are four required documents: (a) a certificate issued by the cooperative department of the Ministry of Agriculture with the list of the cooperative administrative council, (b) the name of a legal representative of the cooperative to sign the loan contract and supporting documentation from the cooperative certifying that they want credit from INCAFE, (c) a balance sheet and income statement for the cooperative, and (d) the cooperative's by-laws that have been approved by the Ministry of Agriculture.

The application is analyzed in the credit analysis department. The process of analysis can take from one to six weeks, depending upon the size of loan. If the analyst considers it necessary, or in case of new clients, another inspection of the farm by the agricultural department might be made.

Once the credit is approved in the credit analysis department, the documents are sent to the agricultural department for approval. For producers for less than 2,000 qq of green coffee the two approvals are sufficient. For producers of more than 2,000 qq of green coffee the documents are sent to the credit committee for approval. This committee is comprised of the finance manager, the internal commerce manager, the agricultural manager, and chief of credit analysis.

Loans to coffee processors must be approved by the board of director's after they are analyzed and approved in the credit analysis department.

Disbursement and Implementation Phase

The approved loan is sent to the legal department for the preparation of the loan document. However, the final approval is sufficient to obtain the

first disbursement. At this time INCAFE uses its own funds until BCR financing is obtained. For any disbursement the borrower should request the written authorization from the agricultural department. The disbursement authorization is sent to the Loan Division to process the disbursement.

In general, the system appears bothersome and lengthy. On the average, it could take from one to four months between the application and first disbursement.

Repayment Phase.

Since INCAFE is the monopolistic exporter, producers have to deliver their coffee to INCAFE. In some cases producers deliver their coffee to INCAFE's coffee mills. If this is the case, INCAFE has the power to deduct the amount loaned and interest from liquidation. If producers went to private sector coffee mills the coffee mills deliver the coffee as well as a list of producers and their corresponding amount of coffee to INCAFE. In either case, INCAFE would recover the loans. However, there have been problems of loan recovery when producers did not deliver a sufficient amount of coffee to repay the loan. This has occurred typically due to crop failure, terrorism, or other uncontrollable factors.

Summary and Conclusions

In 1979 INCAFE was created as a government monopoly for exporting coffee, El Salvador's most important export. It was also authorized to finance all aspects of coffee production and processing, although it does not have monopoly powers in these activities.

INCAFE has been an important financier of coffee production and processing, but, since 1981, it has considerably reduced its financing for production. In real terms credit for production in 1984 was only about one-eighth of what was undertaken in 1980. Much of this decline is attributable to INCAFE's exit from financing Phase I cooperatives in the reformed sector. There has also been a slight real decline in its processing loans. It is clear that INCAFE has decided to place the bulk of coffee production financing in the hands of other lenders.

INCAFE has experienced delinquency problems. In October 1985, 29 percent of its portfolio was in arrears due to problems in production,

terrorism, and low market prices. However, only a small portion of the portfolio is refinanced. This is a low figure, compared to other lenders. The reason is that INCAFE always deducts loan repayments from the receipts it gives to borrowers when the Institute sells their coffee. The INCAFE credit delivery system directly uses this mechanism, but it is also employed for credit on coffee processed by other millers.

IX- FEDERATION OF EL SALVADOREAN CREDIT UNIONS

Introduction

Credit unions in El Salvador are organized as savings and loan cooperatives. The Federation of El Salvadorean Credit Unions (FEDECACES) was established in June 1966 with the objectives of: (a) serving as a second-level cooperative organization for affiliated credit unions, (b) promoting the philosophical principles of cooperativism, (c) supporting the affiliated credit unions financially, and (d) providing technical assistance to the affiliated credit unions. As of April 1985 there were forty-four affiliated credit unions; twenty-nine (66 percent) in urban areas and fifteen (34 percent) in rural areas. Of those in urban sites, twelve were located in San Salvador. These credit unions had a total membership of 15,744 persons, 30 percent of whom resided in rural areas.

Structure and Organization

The supreme authority of FEDECACES is the general assembly, which is comprised of one representative from each of the affiliated credit unions. The general assembly is responsible for the broad policies of the Federation and elects the members of the administrative council, vigilance board, credit committee and education committee. The administrative council is responsible for directing the governance of the Federation, the credit committee oversees the credit operations, the education committee is responsible for guiding training programs and the vigilance board plays the roles of internal auditor and watch dog. The day-to-day program operations and management are carried out by the management office and the sub-offices for operations and technical services. Credit is administered by the operations office.

In April 1985, the federation had a staff of thirty-nine: three managers, twenty professionals and sixteen administrative staff. These numbers do not include the membership of the administrative council the vigilance board and the committees, which are comprised of credit union representatives.

FEDECACES activities are basically two-fold. First, they provide training and educational programs for its affiliates. These programs emphasize cooperativism, cooperative management and leadership training. Second, they provide loans to the affiliates in order that the affiliates can onlend

money to their membership. In this manner the affiliated credit unions can expand their credit operations considerably compared to what they would be able to do if they were forced to rely on their own deposits.

Sources of Loanable Funds

FEDECACES obtains its capital by means of the required contributions of the affiliated credit unions. These contributions consist of a commission of \$25 at the time of affiliation, a \$25 monthly membership fee and 15 percent of each affiliate's social capital. There is no interest paid on the affiliates' deposits. Additional loanable funds are obtained by loans from domestic sources such as the Agricultural Development Bank (EFA), and external institutions including the United States Agency for International Development (USAID), Inter-American Development Bank (IDB), Central American Bank for Economic Integration (BCIE), Confederation of Latin American Credit Unions (COLAC), and National Association of Credit Unions (CUNA). FEDECACES has intermediate credit institution (ICI) status and, therefore, is eligible to receive Central Bank rediscounts. Funds from all sources are available for lending to affiliated credit unions.

At the end of 1984, 26.3 percent of the total portfolio of loanable funds of FEDECACES were the Federation's own resources. Only a small amount, less than 1 percent, came from Central Bank rediscounts. The largest source of funds, which accounted for 55.6 percent of the total, was the USAID project for Small Producer Development, whose purpose was to develop and expand small-scale enterprises owned and operated by the poor in rural areas. COLAC and BCIE were responsible for 9.0 percent each. The COLAC funds were made available for a production and marketing project in rural areas. BCIE's Rural Enterprise Project was designed to help establish and expand rural enterprises.

Over the 1980-1984 period there were important changes in sources. USAID funds were introduced in 1981, and since that time this source has accounted for a majority of the loanable funds. Previously, IDB was the principal source but after 1980 it has dropped completely out of the picture. The Federation never has been major recipient of Central Bank rediscounts. COLAC or CUNA funds have never exceeded more than one-fifth of the total, and in most years were considerably less.

Because of USAID assistance, FEDECACES has experienced a 5.1 percent average annual increase in the nominal value of loanable funds over the five-year period. However, when the effect of inflation is accounted for,

Table IX-1. FEDECACES, Source of Funds, End-of-year Balances, 1980-84 (Million Colones)												
Source of Funds	1980		1981		Nominal Value		1983		1984		Average annual rate of growth	
	Value	Percent	Value	Percent	1982	Percent	Value	Percent	Value	Percent		
Central Bank	0.8	7.3%	0.1	0.7%	0.1	0.4%	0.0	0.3%	0.0	0.1%	-66.6%	
Agricultural Development Bank	0.2	1.8%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	--	
IDB	4.5	41.3%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	--	
COLAC	2.0	18.3%	1.3	9.2%	0.7	5.1%	0.2	1.7%	1.2	9.0%	-12.0%	
CUNA-Mutual	0.1	0.9%	0.1	0.7%	0.0	0.3%	0.0	0.0%	0.0	0.0%	-36.8%	
BCE	0.8	7.3%	1.1	7.7%	1.2	8.7%	1.2	10.1%	1.2	9.0%	10.7%	
USAD	0.0	0.0%	8.1	57.0%	7.9	57.2%	7.7	65.0%	7.4	55.6%	-3.0%	
Own resources	2.5	22.9%	3.5	24.6%	3.9	28.3%	2.7	22.8%	3.5	26.3%	8.6%	
Total	10.9	100.0%	14.2	100.0%	13.8	100.0%	11.8	100.0%	13.3	100.0%	5.1%	
Real Value												
Central Bank	0.8	7.3%	0.1	0.7%	0.0	0.4%	0.0	0.3%	0.0	0.1%	-70.4%	
Agricultural Development Bank	0.2	1.8%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	--	
IDB	4.5	41.3%	0.0	0.0%	0.0	0.0%	0.0	0.0%	0.0	0.0%	--	
COLAC	2.0	18.3%	1.1	9.2%	0.5	5.1%	0.1	1.7%	0.7	9.0%	-22.0%	
CUNA-Mutual	0.1	0.9%	0.1	0.7%	0.0	0.3%	0.0	0.0%	0.0	0.0%	-44.2%	
BCE	0.8	7.3%	1.0	7.7%	0.9	8.7%	0.8	10.1%	0.7	9.0%	-1.9%	
USAD	0.0	0.0%	7.1	57.0%	6.2	57.2%	5.3	64.7%	4.6	55.6%	-13.5%	
Own resources	2.5	22.9%	3.0	24.6%	3.0	28.3%	1.9	22.7%	2.2	26.3%	-3.6%	
Total	10.9	100.0%	12.4	100.0%	10.8	100.0%	8.2	100.0%	8.2	100.0%	-6.8%	

Source: FEDECACES, Memorias Anuales de Labores, 1980-84.

FEDECACES has lost ground since 1980; in real terms the average annual growth rate was -6.9 percent.

Credit Operations

FEDECACES makes loans to the affiliated credit unions, using the above - mentioned sources of funds. Upon receipt of the loan the credit union onlends the funds to its membership. The membership of the credit unions consists of persons practicing all types of economic activities common to their area. The farmers that are members are typically small farmers of the non-reformed sector.

At the end of 1984, FEDECACES's loan portfolio was \$13.3 million. Of this amount, 45.1 percent was in loans for commercial purposes, 29.3 percent for consumption, 15.0 percent for agriculture and 10.5 percent for investment. These figures are another indicator of the Federation's urban bias.

Over the 1980-1984 period, the nominal value of the portfolio increased at an average annual rate of 5.6 percent. However, after taking account of inflation, the real rate of growth was -6.4 percent. Clearly, the real value of the FEDECACES portfolio had declined substantially over the period.

The portfolio for only two sectors showed positive real growth rates, agriculture and commerce. These results demonstrate the impact of the USAID loan in making funds available for non-traditional agricultural lending or rural enterprises and the continuing importance of lending for commerce. The economic recession and political instability were undoubtedly important factors causing the declines in investment and consumption lending.

FEDECACES loans to agriculture have been highly concentrated in three objectives. In 1984, 56 percent of the loan volume went for livestock, 32 percent to basic grains and 12 percent to sugar cane. This pattern was typical of the 1980-1984 period.

Delinquency and Refinancing

At the end of 1984, 26.1 percent of the portfolio was delinquent, of which 14.9 percent corresponded to loans in arrears and 11.2 percent to over-due installments. Loans in arrears are those that have passed their maturity date. Over-due installments correspond to delinquent payments

Table X-2. FEDECACES Portfolio by Purpose of Loan, End of Year 1980-84 (Million Colones)												
Purpose	1980		1981		1982		1983		1984		Average annual rate of growth	
	Nominal Values	Percent										
Agriculture	1.1	10.3%	2.4	20.7%	2.2	18.6%	1.9	16.0%	2.0	15.0%	16.1%	
Commerce	3.1	29.0%	3.4	29.3%	4.6	39.0%	5.6	47.1%	6.0	45.1%	19.0%	
Consumption a)	5.0	46.7%	4.1	35.3%	3.3	28.0%	2.7	22.7%	3.9	29.3%	-5.0%	
Investment b)	1.5	14.0%	1.7	14.7%	1.7	14.4%	1.7	14.3%	1.4	10.5%	-1.7%	
Total	10.7	100.0%	11.6	100.0%	11.8	100.0%	11.9	100.0%	13.3	100.0%	5.6%	
Real Values												
Agriculture	1.1	10.3%	2.1	20.7%	1.7	18.6%	1.3	16.0%	1.2	15.0%	2.2%	
Commerce	3.1	29.0%	3.0	29.3%	3.6	39.0%	3.9	47.1%	3.7	45.1%	4.5%	
Consumption a)	5.0	46.7%	3.6	35.3%	2.6	28.0%	1.9	22.7%	2.4	29.3%	-16.7%	
Investment b)	1.5	14.0%	1.5	14.7%	1.3	14.4%	1.2	14.3%	0.9	10.5%	-12.0%	
Total	10.7	100.0%	10.1	100.0%	9.2	100.0%	8.2	100.0%	8.2	100.0%	-6.4%	
Source: FEDECACES, Memorias Anuales de Labores, 1980-84.												
a). Includes household items and housing.												
b). Includes investment in capital goods.												

Table B-3. FEDECACES Delinquent Portfolio, 1980-84 (Million Colones)											
	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Total portfolio	10.9	100.0%	11.6	100.0%	11.8	100.0%	11.9	100.0%	13.1	100.0%	5.3%
Portfolio in arrears	0.9	8.3%	1.6	13.8%	2.2	18.6%	2.5	21.0%	2.0	14.9%	22.1%
Overdue installments	1.5	13.8%	1.5	12.9%	1.5	12.7%	1.4	11.8%	1.5	11.2%	0.0%
Delinquent portfolio	2.4	22.0%	3.1	26.7%	3.7	31.4%	3.9	32.8%	3.5	26.1%	9.9%

Source: FEDECACES, *Memorias Anuales de Labor*, 1980-84.

for loans that have not reached maturity. Agricultural production loans have been the most problematical. As of September, 1985, 72.7 percent of the delinquent portfolio was in this type of credit.

Over the 1980-1984 period, the Federation experienced continued problems with delinquency. In 1980, 22.0 percent of the portfolio was delinquent. The figures increased each year through 1983, before declining in 1984 due to the Federation's active measures in that year to reduce delinquency as well as its securing BCR refinancing for a substantial portion of the portfolio in arrears. In September 1985, \$1.5 million, 11.3 percent, of the total portfolio was refinanced, mostly to refinance delinquent debts.

Delinquency has been concentrated in five credit unions. In fact, one credit union accounted for \$1.2 million of the delinquency, which was nearly one-third of FEDECACES's total. The credit unions with the most serious delinquency problems are located in conflict zones. Apart from the social conflict, the major factors contributing to delinquency have been the unstable political and economic conditions of the country.

Credit Delivery System

There are two stages to the credit delivery system: Federation to credit union and credit union to members. Both are presented below, following a discussion of the general terms of the credit.

Federation to Credit Union Cooperatives

Terms and Conditions of Credit. The Federation provides short-, medium- and long- term credit to its affiliates. Most, however, are medium term, ranging from three to four and one-half years. There are upper limits to the loan size. FEDECACES normally will extend a credit union a loan that is no more than ten times the amount of the credit union's deposits at the Federation. Some Federation loans are targeted for specific purposes, especially these that are funded from foreign sources. USAID monies are specifically to be used for production and commercial activities in the eighteen cooperatives located outside the capital city. The IDB-COLAC funds are targeted to six affiliates for production purposes.

The Federation typically charges the credit union 10 percent interest, which under most arrangements gives FEDECACES a 6 percent spread on the funds it has borrowed. USAID loans, however, provide the Federation with a 7 point spread. The Central Bank rediscounts offer only 2 points of spread.

Compared to other sources this very low spread undoubtedly explains why FEDECACES seldom uses BCR rediscounts.

The credit union pledges its assets to the Federation as the loan guarantee. Additional collateral is provided because the credit union endorses over to the Federation the guarantees provided by its members on their loans obtained from the funds borrowed from the Federation.

Eligibility Requirements. To be affiliated with the Federation a credit union must demonstrate that it is properly organized, pay a \$25 commission fee and agree to make a \$25 monthly contribution. Eighteen months after the credit union is accepted as a member in the Federation, 15 percent of credit union's social capital must be transferred to the Federation to form part of the latter's social capital. At this time the credit union is eligible to apply for a loan from FEDECACES.

Application Phase. The credit union fills out a simple form requesting a loan. The application states the purpose of the loan and how it will be distributed among members. The application is received by the Federation and analyzed by the credit division of the operations office. On an average it takes a week to complete the analysis. Once it is completed, the application passes to the general manager for review. This step takes an average of two days. Finally, it goes to the credit committee for final action. The credit committee meets every two weeks. Thus, the final decision on a loan application could take from fifteen to thirty days.

Implementation and Disbursement Phase. Once the loan has been approved, the Federation prepares the loan document. The first disbursement is typically done immediately. The number of disbursements are determined in accordance with the nature of the project financed. At this stage FEDECACES may provide educational programs to the administrative personnel of the credit unions. They do not provide technical assistance for agricultural production.

Repayment. Once the loan has reached maturity, the Federation grants a thirty-day grace period before charging an additional 2 percent penalty interest on the unpaid balance of the loan. In some special cases, the Federation changes the maturity date without charging the penalty interest. If the credit union is deemed unable to repay the loan, the Federation may require that FEDECACES jointly administer the loan with the credit union until the loan is entirely repaid.

Credit Unions to Members

Terms and Conditions of Credit. Most loans are for terms of less than one year. Agricultural production loans are scheduled in accordance with the crop cycle. The borrower's guarantee consists of his deposits with the credit union and one or more cosigners.

The contractual interest charged by the credit unions is between 16 and 24 percent; most frequently it is 18 percent. For funds borrowed from the Federation the interest rate spread for the credit union is usually 8 percent. Members can borrow funds up to a multiple of their deposits in the credit union. The multiple coefficient may vary from three to ten, depending on the purpose of the loan.

Eligibility Requirements. To become a member of a credit union an applicant must be attend at least three lectures on cooperative organization. There is a \$15 admission fee and a required contribution of \$10 to the credit union's social capital. Moreover, a member assumes the obligation to make a minimum monthly deposit of an amount determined by the credit union. Members may make additional deposits at any time.

Application Phase. A member fills out a one-page application form. The application is analyzed, approved or disapproved by the credit committee of the credit union. This committee usually meets twice a month. Therefore, the decision should take about fifteen days.

Implementation and Disbursement Phase. Once the loan has been approved a loan document is prepared. Disbursement normally follows within a few days. The borrower must also obtain the required number of cosigners to serve as a guarantors for the loan. A credit union member can receive credit up to five times the amount of his deposits at the credit union. Some credit unions have granted loans for an amount of eight times the member's contribution. These loans are usually for agriculture.

Repayment Phase. Some credit unions send advance notices of the loan maturity date to members. When a loan is delinquent the cooperatives charge an additional penalty interest. In some cases, new maturity dates are fixed in order to extend the loan. When the repayment problem is considered serious, the credit unions have recourse to legal collections.

Borrowing Costs

It is clear from the previous section that the credit delivery systems for loans both the Federation to the credit union and from the credit union to its member are simple and structured for reasonably rapid loan approval and disbursement. It is useful, however, to examine the systems in more detail to determine the costs of borrowing. Borrowing costs have three main components: interest charges; out-of-pocket transactions costs such as those for fees, stamps and documents; and costs of time to undertake transactions. Interest charges consist of explicit interest costs based upon the contractual rate of interest and the implicit costs derived from the required compensating balances of deposits. The explicit and implicit interest costs are used to calculate the effective interest rate.

Loans from Federation to Credit Union.

The out-of-pocket transactions costs are small, consisting of the one-time \$25 membership fee, a \$22 charge for seal paper used in preparation of documents, 1 percent fee to cover legal expenses and supervision, and travel costs. The time costs depend upon the amount of time that credit union officials spend in obtaining, implementing and repaying the loan. Because of the simple application procedures these figures should not be high.

These loans typically have a 10 percent contractual interest rate. This, however, does not represent the true effective rate of interest because of the implicit interest. For example, if the multiple coefficient is 7.5 then the effective rate of interest is 11.54 percent.

Loans from Credit Union to Member

The member has low out-of-pocket transactions costs. For a typical loan there are charges \$10 for the one-time membership fee, \$20 for a lawyer's fee, and \$2.20 for seal paper. Transportation costs are low since most members live near the credit union office and little travel is involved. By the same token the time costs are low. It would appear that the total transactions costs are not very important as a borrowing cost, unless the loan is of small size.

The loans typically have a contract interest rate of 18 percent. However, the required deposits that are used as compensating balances give rise to implicit interest costs that can be sizeable depending on the multiple coefficient. The multiple coefficient varies between three and ten. The

Table IX-4. FEDECACES Financial Magnitudes and Ratios, 1980-84						
Financial magnitudes and ratios	1980	1981	1982	1983	1984	Colac standards
Total assets	13,708.8	16,255.1	15,969.5	15,449.9	15,540.1	---
Social capital	3,955.9	3,959.3	4,306.4	4,352.4	4,190.5	---
Net worth	4,629.9	4,312.2	4,691.5	4,972.2	4,688.4	---
Debt	8,394.8	10,710.6	9,937.8	9,408.1	10,381.7	---
Total liabilities	9,078.9	11,942.9	11,278.0	10,477.0	10,651.6	---
Social capital/total asset (Grade of autonomy)	0.29	0.24	0.27	0.28	0.27	0.5 min.
Net worth/total assets	0.34	0.27	0.29	0.32	0.31	0.16 average
Debt/social capital	2.12	2.71	2.31	2.16	2.48	8.1 average
Debt/net worth (Indebtedness capacity)	1.81	2.48	2.12	1.90	2.12	10.0 max.
Total liabilities/total assets (Indebtedness ratio)	0.66	0.73	0.71	0.68	0.69	0.9 max.
Source: Authors' calculations based on FEDECACES financial statements.						

Table IX-5. FEDECACES Profitability, 1980-84						
(Thousand Colones)						
	1980	1981	1982	1983	1984	
Financial costs	485.1	551.0	432.9	351.4	324.4	
Administrative costs	796.4	695.5	1,241.2	1,092.7	1,125.2	
Risk cost (5 % of portfolio)	545.0	580.0	590.0	595.0	670.0	
Total cost	1,826.5	1,826.5	2,264.1	2,039.1	2,119.6	
Total portfolio	10,900.0	11,600.0	11,800.0	11,900.0	13,400.0	
Cost per colon lent	0.1676	0.1575	0.1919	0.1714	0.1582	
Total income	1,381.0	966.5	1,648.3	1,663.5	1,585.2	
Income per colon lent	0.1267	0.0833	0.1397	0.1398	0.1183	
Profit (loss) per colon lent	(0.0409)	(0.0742)	(0.0522)	(0.0316)	(0.0399)	
Source: Author's calculations based on FEDECACES data.						

effective interest rate on loans will therefore vary between 20 and 27 percent.

Financial Soundness

Three financial ratios are calculated to measure FEDECACES's financial soundness: (a) indebtedness ratio (total liabilities/total assets), (b) grade of autonomy (social capital/total assets), and (c) indebtedness capacity (debt/net worth). The ratios are figured for each of the years 1980 through 1984 and reported in Table IX-4. They are compared with standards established by COLAC for credit union federations as reported in the 1985 CEPAL report "Rasgos Principales de las Federaciones de Ahorro y Crédito del Istmo Centroamericano".

The results show that FEDECACES could undertake additional debt without endangering its financial soundness. The indebtedness capacity and indebtedness ratios are well under the COLAC maximums. It does appear, however, that the Federation should try to increase its social capital in order to improve its grade of autonomy.

Profitability

FEDECACES income statements report two cost components: (a) financial costs and, (b) administrative costs. Taking the sum of these two costs as total cost, FEDECACES's income has covered its costs and made profits in 1980, 1983, and in 1984. In 1981 and in 1982, losses were shown. It should be noted, however, that such an analysis overlooks the important cost of risk. Risk costs associated with lending activities are extremely important for financial institutions. In countries where the default rate is high, as is the case in El Salvador, the risk cost should be taken into account as an important cost item. Assuming this to be 5.0 percent, which is the COLAC recommendation for uncollectable loans of the portfolio, then cost would be higher than income in each of the years over the whole period.

Summary and Conclusions

FEDECACES, the Federation of Credit Unions in El Salvador, is an active organization with forty-four affiliates that have a total membership of 15,700. Its two main functions are providing training and education as well as credit to its affiliates. It is urban oriented; about two-thirds of its

affiliates are in cities. Nevertheless, it has major operations in rural areas, especially in its credit programs where it has special lines of funds directed to this sector. For example, the largest is the USAID loan for Small Producer Development established in 1981 which has played an important role for growth in lending to non-traditional agriculture and rural enterprises.

The Federation has ICI status and thus is eligible from Central Bank rediscounts. However, it uses this source of funds infrequently, probably because of the relatively unattractive interest rate spread on these loans compared to other sources of funds. Its principal source of financing has been foreign assistance or foreign loans. Since 1981 the USAID project has accounted for a significant majority of FEDECACES's loanable funds. Another one-fourth has come from its own resources -- social capital, deposits and contributions from affiliates.

FEDECACES has experienced serious delinquency problems. At the end of 1984, 26.1 percent of the portfolio was delinquent. Delinquency is concentrated in loans for agricultural purposes and in regions that have experienced high social conflict. Therefore, it would appear that the disruption of production in these zones is the major factor. Of course the generally unfavorable economic conditions have also had an impact. FEDECACES has done some refinancing, but not a lot. A campaign in 1984 to reduce delinquency had good results.

Agricultural loans account for about only 15 percent of the FEDECACES portfolio. Most loans are made to credit unions to finance commercial activities and consumption; another indication of the Federation's urban bias. If the Federation did have the USAID funds, it is doubtful that as much would have been lent to agriculture. Among the agricultural loans, most were made to finance livestock and basic grains.

The credit delivery systems for the two stages of lending, Federation to affiliate and credit union to members, are simple and involve low borrower transactions costs. Credit appears to be delivered in a timely fashion. The 18 percent contractual interest rate charged the member by the credit union is higher than the bank rate. Moreover, because of the required deposits, the effective rate is somewhat higher. The effective rate varies between 20 and 27 percent. These rates appear to approximate the opportunity cost of capital. As will be noted in the chapter on informal markets, moneylenders typically charge 24 percent.

The interest rate structure should allow sufficient spread for both the Federation and the credit union. Nevertheless, a profitability analysis shows

that FEDECACES's income is insufficient to cover costs if an allowance is made for the risk of bad debts. This implies a need to try to reduce costs and/or increase revenues as well as to reduce delinquency.

FEDECACES is financially sound. Financial ratios show that it has the capacity to absorb more debt. On the one hand given the problematic status of the economy and the related delinquency problem this conservative approach may be in order. On the other hand, given that FEDECACES believes that there is a considerable excess demand for its credit, it would be financially sound for the Federation to borrow more to enable it to reach more credit union members. In addition, FEDECACES should consider means to increase its own resources by increasing the contributions of social capital from its affiliates.

X- FEDERATION OF CREDIT FUNDS (FEDECCREDITO)

Background

The Federation of Credit Funds (FEDECCREDITO) was established in 1943 under the Rural Credit Law. It is an autonomous public sector institution. Its principal objectives are to encourage the cooperative movement in El Salvador, especially in relation to small producers and merchants; promote cooperative education; form rural cooperative funds (cajas) ; oversee the organization and operations of cajas; and serve as an intermediary and guarantor for cajas with respect to third parties. The powers and responsibilities of FEDECCREDITO include: financing cajas; receiving demand, savings and time deposits from cajas and others; and obtaining loans from domestic and foreign sources.

The cajas are cooperatives formed in accordance with the Rural Credit Law. Their main functions are to store agricultural and industrial products, to make loans using the stored products as guarantee and to receive money deposits. A caja may be formed by persons or organizations residing in the rural locale who are involved in rural production or marketing. Autonomous public institutions may also belong. Upon joining a caja members must take out shares of stock that serve as the capital of the caja.

Organization and Structure

FEDECCREDITO is responsible to a general assembly comprised of representatives of each affiliated caja , two representatives of the state, one of the Banco Hipotecario, and a representative of each member autonomous public institution. FEDECCREDITO is directed and administered by a seven-person board of directors consisting of FEDECCREDITO's president, who is named by the president of the republic, two other government appointees, a representative each from the Central Bank and the Banco Hipotecario, and two directors elected by FEDECCREDITO's general assembly. The president appoints a manager who carries out daily operations and who acts as secretary to the general assembly and to the board of directors.

At the end of 1984, there were forty-two cajas located in all fourteen departments. Each is governed by a general assembly and a board of directors. The cajas are very highly integrated with FEDECCREDITO. All members must be approved by the Federation, both when a caja is formed and when any new member joins. FEDECCREDITO appoints the presidents of the cajas's boards of directors, determines the capital and reserves that can

be invested in any activity, and exercises close supervision over the operations of the caja.

The Federation must respond to rules established by the Monetary Board.

Credit Operations

Portfolio

FEDECCREDITO makes loans to cajas for targeted purposes. The cajas then relend to their members.

Breakdown data of portfolio by economic sector are not available. At the end of 1984, FEDECCREDITO held a portfolio of ¢180.8 million. Between 1980 and 1984 its portfolio grew at an average annual rate of 0.3 percent. In real terms, there was a decline of -10 percent.

Credit Flow

Table X-1 provides information on credit flow by economic sector for the 1980-1984 period. On an average lending to agriculture represented 30 percent of the total flow of the period. The relative importance of lending to various economic sectors was as follows: Agriculture 30 percent, commerce 20 percent, and other credit shared with the remainder 40 percent. The relative importance of the sectors changed in 1984. Commerce became more important with 40 percent, other credit was second with 30 percent, and agriculture third with 20 percent. The remaining 10 percent of the credit flow was placed in refinancing of bad debts.

The total credit flow over the period has decreased in both nominal and real values at an average annual rates of -7.5 and -18.0 percent. Lending to all economic sectors has declined at even greater rates. The reason is that the flow of refinancing grew at high average annual rates in both nominal and real values. This shows the serious delinquency problems faced by the institution. Furthermore, it shows that FEDECCREDITO was lending much less in 1984 than it was in 1980.

Table X-1. Credit Flow from FEDECREDITO by Economic Sector, 1980-1984											
(Million Colones)											
Sector	1980	Percent	1981	Percent	1982	Percent	1983	Percent	1984	Percent	Average annual rate of growth
Nominal Value											
Agriculture	38.4	30.9%	39.0	36.1%	36.3	39.1%	18.1	22.3%	18.5	20.3%	-16.7%
Manufacturing	0.7	0.6%	0.7	0.6%	0.4	0.4%	0.3	0.4%	0.3	0.3%	-19.1%
Construction	4.3	3.5%	4.2	3.9%	3.2	3.4%	2.5	3.1%	2.1	2.3%	-16.4%
Commerce	26.7	21.5%	27.8	25.7%	28.4	30.6%	29.6	36.4%	36.0	39.5%	7.8%
Refinancing	2.5	2.0%	5.8	5.4%	1.9	2.0%	9.4	11.6%	9.9	10.9%	41.1%
Other credit	51.6	41.5%	30.6	28.3%	22.6	24.4%	21.4	26.3%	24.3	26.7%	-17.2%
Total	124.2	100.0%	108.1	100.0%	92.8	100.0%	81.3	100.0%	91.1	100.0%	-7.5%
Real Value											
Agriculture	38.4	30.9%	34.0	36.1%	28.3	39.1%	12.5	22.3%	11.4	20.3%	-26.2%
Manufacturing	0.7	0.6%	0.6	0.6%	0.3	0.4%	0.2	0.4%	0.2	0.3%	-29.3%
Construction	4.3	3.5%	3.7	3.9%	2.5	3.4%	1.7	3.1%	1.3	2.3%	-25.9%
Commerce	26.7	21.5%	24.2	25.7%	22.1	30.6%	20.4	36.4%	22.2	39.5%	-4.5%
Refinancing	2.5	2.0%	5.1	5.4%	1.5	2.0%	6.5	11.6%	6.1	10.9%	25.0%
Other credit	51.6	41.5%	26.7	28.3%	17.6	24.4%	14.7	26.3%	15.0	26.7%	-26.6%
Total	124.2	100.0%	94.2	100.0%	72.4	100.0%	56.0	100.0%	56.2	100.0%	-18.0%
Source: Based on information provided by FEDECREDITO.											

Agriculture Credit

In 1984, lending for agriculture was only about one-third of what it was in 1980. Financing for all activities has declined. Table X-2 provides the information on the agricultural credit flows by the main activities financed. In 1980, lending to basic grains production represented 36.6 percent. It lost its level of relative importance in 1984. However, it still represented 28.4 percent of the agricultural flow. Financing for coffee has dropped drastically over the period. Whereas loans to livestock became important. In real terms total financing to agricultural activities declined at the average annual rate of -22 percent. The only positive real growth was refinanced loans. It is clear that this financial institution has less available funds for its lending activities. One of the reasons is its serious delinquency problems and the need for refinancing unpaid loans.

Cientele

FEDECCREDITO lends primarily to small farmers, other producers, and merchants. It lends to two of the Phase I cooperatives and to some Phase III beneficiaries.

Delinquency

FEDECCREDITO has a major delinquency problem. At the end of 1984, 35 percent of the outstanding portfolio was delinquent. Agricultural loans are particularly bothersome, 57 percent of this sector's portfolio were delinquent. This figure understates the problem, refinancing of agricultural loans has reduced the reported delinquency.

Credit Delivery System

The borrower fills out a loan application form at caja. Since most members are illiterate, the staff fills out the loan application for them. Once the application is completed, it is reviewed and approved at the caja. The approved loans are forwarded to the FEDECCREDITO central office in San Salvador.

It takes from one to five weeks for the application to be approved at the caja. The review and approval by FEDECCREDITO varies between eleven and

Table X-2. Agricultural Credit Flow from FEDECREDITO by Main Activities, 1990-1994 (Million Colones)											
Activities	1990	Percent	1991	Percent	1992	Percent	1993	Percent	1994	Percent	Average annual rate of growth
	Nominal Values										
Coffee	7.2	17.5%	3.5	7.9%	2.5	6.4%	1.4	5.1%	0.9	3.5%	-40.9%
Cotton	3.9	9.2%	3.9	9.7%	1.6	4.2%	0.6	2.5%	0.5	2.5%	-36.1%
Sugar cane	1.1	2.7%	0.8	1.8%	0.9	2.3%	0.9	3.8%	1.0	4.2%	-1.9%
Basic grains a)	15.0	36.6%	15.0	33.5%	12.7	33.1%	8.6	34.6%	7.1	29.4%	-17.1%
Other agriculture b)	0.5	1.1%	5.9	13.0%	10.4	27.2%	0.4	1.6%	0.6	2.2%	4.9%
Livestock	7.5	18.2%	7.5	16.7%	6.5	16.9%	4.6	18.8%	6.9	27.5%	-2.1%
Poultry	0.3	0.6%	0.4	0.9%	0.4	1.1%	0.3	1.4%	0.2	0.8%	-4.9%
Fisheries, beekeeping and others	0.1	0.3%	0.1	0.1%	0.2	0.4%	0.1	0.4%	0.2	0.6%	-7.5%
Other activities	3.0	7.4%	2.0	4.5%	1.2	3.1%	1.1	4.6%	1.1	4.6%	-21.8%
Refinancing	2.5	6.2%	5.9	13.0%	1.9	5.1%	6.6	26.8%	6.4	25.6%	26.1%
Total	41.0	100.0%	44.8	100.0%	39.2	100.0%	24.8	100.0%	24.9	100.0%	-11.7%
	Real Values										
Coffee	7.2	17.5%	3.1	7.9%	1.9	6.4%	0.9	5.5%	0.5	3.5%	-47.6%
Cotton	3.9	9.2%	3.4	8.7%	1.3	4.2%	0.4	2.5%	0.4	2.5%	-43.4%
Sugar cane	1.1	2.7%	0.7	1.8%	0.7	2.3%	0.6	3.8%	0.5	4.2%	-13.0%
Basic grains	15.0	36.6%	13.1	33.5%	9.9	31.1%	5.9	34.6%	4.4	29.4%	-26.5%
Other agriculture	0.5	1.1%	5.1	13.0%	8.1	27.2%	0.3	1.6%	0.3	2.2%	-7.0%
Livestock	7.5	18.2%	6.7	16.7%	5.0	16.9%	3.2	18.8%	4.2	27.5%	-13.2%
Poultry	0.3	0.6%	0.3	0.9%	0.3	1.1%	0.2	1.4%	0.1	0.8%	-15.7%
Fisheries, beekeeping and others	0.1	0.3%	0.0	0.1%	0.1	0.4%	0.1	0.4%	0.1	0.6%	-4.8%
Other activities	3.0	7.4%	1.7	4.5%	0.9	3.1%	0.8	4.6%	0.7	4.6%	-30.7%
Refinancing	2.5	6.2%	5.1	13.0%	1.5	5.1%	4.6	26.8%	3.9	25.6%	11.8%
Total	41.0	100.0%	39.1	100.0%	29.8	100.0%	17.1	100.0%	15.4	100.0%	-21.7%
Source: Based on information provided by FEDECREDITO.											
a) Includes corn, beans, rice, and sorghum.											
b) Includes marketing, agricultural machinery, fruits, vegetables and other crops.											

thirty-eight days when no special difficulty exists. The approval process could take from three to ten weeks. Following approval another two to eight days are needed to execute the loan contract and to make the first disbursement.

The type of guarantee required varies according to the amount borrowed. Agricultural production loans are typically guaranteed by the crop being financed. Loans in excess of ₡10,000 must be secured by a lien on assets. Interest rates on agricultural loans vary between 8 and 16 percent depending on the source of financing, and the type of borrower.

Sources of Loanable Funds

The principal source of loanable funds are various lines of credit of the Central Bank, which accounted for 60 percent of the funds flowing to the Federation and its cajas in 1984; the Federations own funds were in second place with 35 percent. Funds from AID, IDB, and the central government together represented about 5 percent of the total funds received in 1984. The Federation channeled funds from outside sources, such as the Central Bank, to the cajas.

Savings

Mobilization of Savings

According to the Law of Rural Credit, both the Federation and the cajas have the right to receive deposits (with and without interest) subject to the requirements set by the Monetary Board. At present the cajas do not offer demand and savings accounts facilities to their members with one exception. The Popular Credit lender program, to small merchants, which has enjoyed much popularity, includes a component of forced savings for participating borrowers. FEDECCREDITO's deposits at the end of 1984 were ₡ 11 million or 4 percent of the total of liabilities and net worth.

Summary

The central office of FEDECCREDITO exercises considerable control over the activities of the forty-two member cajas, for example, all loans must be approved by the Federation. FEDECCREDITO has done little to mobilize savings and is very dependent on Central Bank financing. Total and

agricultural lending has declined in recent years because the Federation has experienced major delinquency problems that have sterilized its portfolio.

The credit delivery system is cumbersome and lengthy. Paperwork and delays especially, at the central office have probably contributed to high transactions costs.

FEDECREDITO was assigned the responsibility of financing reformed sector cooperatives. However, its experience in lending to cooperatives has been unsatisfactory. The high delinquency portfolio in agricultural loans and considerable refinancing reduce the institutions liquidity. As a consequence, less amount of credit flows was observed to the sector activities. Whereas refinancing was growing at high rates in both nominal and real terms.

The lack of a savings window in the cajas in the central office makes the institution dependent on foreign and BCR funds. Thus, it could only direct credit for targets specified in projects or the rediscount lines.

In conclusion, FEDECREDITO appears to be in serious trouble. Major delinquency has sterilized much of its portfolio and forced it into extensive refinancing of past due loans. It has utilized no internal mechanism to generate additional resources, which makes it entirely dependent on external funding for expansion due to the low levels of reflows.

XI- INFORMAL FINANCIAL MARKETS

Introduction

There are active informal financial markets functioning in El Salvador in rural areas. In these markets a considerable amount of credit flows to agriculture through moneylenders, middlemen, farm input suppliers, and, probably, friends and relatives. This chapter describes the structure and operations of these markets based upon reasonably detailed case studies in four small El Salvadorean towns: Atiquizaya, Izaico, Metapán and San Juan Opico, located in the departments of Ahuachapán, Sonsonate, Santa Ana, and La Libertad, respectively. The selected towns appear to be representative of many towns in El Salvador.

Since it was difficult to determine the universe of all suppliers of credit in the informal market in each of the four towns, the methodology was to try to identify the input suppliers, moneylenders and middlemen by means of information obtained from local authorities and knowledgeable townspeople. All input suppliers, moneylenders and middlemen, that were so identified were interviewed. This does not mean, however, that these persons constitute the universe of informal-market lenders. It is probable that some moneylenders and middlemen operating in the regions were not identified. In the case of input suppliers, it is very likely that the whole universe was identified because they had stores. There are probably a number of other informal-market lenders that were not identified. There are two groups of such persons. Those individuals who have another primary occupation and lend money occasionally and, hence, are not widely recognized as moneylenders in the community. Also there are many individuals that only lend to family members and friends. Based upon detailed studies in other countries, it would be expected that this is a very common source of credit.

This chapter presents the consolidated results of these case studies. First, the studied areas are described. Second, a rough quantification of the credit flows in the informal market is attempted. Third, descriptions of credit delivery systems and the associated transactions costs are presented. Finally, some concluding comments are made.

Description of Studied Areas

Atiquizaya

The town of Atiquizaya is an important regional center located 88 kms. north of San Salvador in the department of Ahuachapán. It is located in the municipio of the same name which has a population of 50,000.

The region is composed of both small-and medium-sized farmers. There is a wide variety of agricultural activity in the region, including some sugar cane and beef. A considerable amount of land is planted to cereals.

There are offices of three formal market financial institutions in the town: an agency of the Agricultural Development Bank, a branch of the Banco Capitalizador, and Rural Credit Fund that is affiliated with FEDECREDITO.

Izalco

Izalco, located 55 kms. southwest of San Salvador, is an important town in the department of Sonsonate. It is located in a municipio by the same name with an estimated population of 50,000. The surrounding region is basically agricultural. Most farmers have small land holdings with an average size of two manzanas. The principal crops are corn, beans and sorghum. The Rural Credit Fund is the only formal-market institution providing credit to farmers.

Metapán

Metapán is located 112 kms. northwest of San Salvador in the department of Santa Ana. The municipio of Metapán has approximately 64,000 inhabitants, of which 85 percent live in rural areas. Most of the farms are small holdings, consisting of about three manzanas each. There are some farmers with larger holdings of about ten manzanas and a small number with land holdings of about 100 manzanas. The predominant crops of the region are corn, beans, sorghum, vegetables and livestock.

There are three formal-market financial institutions with offices in the zone: The Banco de Comercio, the Agricultural Development Bank, and a Rural Credit Fund.

San Juan Opico

San Juan Opico is located 45 kms. northwest of San Salvador in the department of La Libertad. The municipio of San Juan Opico has an estimated population of 50,000.

The people of the town of San Juan Opico and the surrounding rural areas are mainly engaged in agricultural activities. There is a variety of land sizes. The most numerous group are the small farmers who have an average farm size of three to four manzanas. There is a small number of medium-sized farmers with holdings ranging from two-to-four hundred manzanas. In addition, there are seven reformed sector cooperatives in the municipio. Small farmers mainly plant corn, beans, sorghum, vegetables and citrus. The medium-sized farms typically cultivate sugar cane and coffee, some raise dairy and beef cattle.

There are two offices of the formal-market financial system in the community, the agency of the Agricultural Development Bank and the credit union Agrícola Opicana. The latter is affiliated with FEDECACES.

Informal Credit Suppliers and Their Importance

Three common types of informal lenders were identified in each of the four communities: moneylenders, middlemen, and input suppliers. In San Juan Opico ten moneylenders, seven middlemen and five input suppliers were identified. In Atiquizaya there were ten money lenders, four middlemen and four input suppliers. In Izalco, there were six money lenders, five middlemen and four input suppliers. In Metapán, there were seven moneylenders, eight middlemen and five input suppliers. The fact that these informal-market lenders exist in areas served by formal market institutions suggests that they are filling a different credit need than is provided by the formal market institutions.

In 1984, as shown in Table XI-1, the thirty-three interviewed moneylenders combined granted loans totaling ₡4.5 million. Of this amount ₡1.3 million was in Atiquizaya, ₡0.9 million in Izalco, ₡0.8 in Metapán, and ₡1.5 in San Juan Opico. These amounts do not all correspond to agricultural loans. Compared, however, to middlemen and input suppliers moneylenders were the most important sources of informal credit in the region.

Table XI.1 Number of Interviewed Informal Credit Suppliers and Estimated Amount of their 1984 Operations (Thousand Colones)						
Towns	Moneylenders		Middlemen		Input Suppliers	
	Number interviewed	Estimated credit	Number interviewed	Estimated credit	Number interviewed	Estimated credit
Atiquizaya	10	1300	4	120	4	160
Izalco	6	900	5	160	4	140
Metapón	7	800	8	270	5	180
San Juan Opico	10	1500	7	400	5	108
Total	33	4500	24	950	18	588
Source: Based on information provided by interviewed credit suppliers.						

Twenty-four middlemen were interviewed. Combined, in 1984, they advanced ₡950,000 for agricultural production. Of this amount ₡120,000 corresponded to Atiquizaya, ₡160,000 to Izalco, ₡270,000 to Metapán, and ₡400,000 to San Juan Opico.

In 1984 the eighteen input suppliers in the four cities made in-kind loans for ₡588,000. Those in Atiquizaya extended credit of ₡160,000, in Izalco ₡140,000, Metapán ₡180,000, and San Juan Opico ₡108,000.

As noted previously, the estimated amounts of credit in each region undoubtedly understates the informal credit. Nevertheless it is clear that it is considerably lower than formal-market credit in each region. For example, in the case of San Juan Opico, formal market credit was ₡14.4 million. The estimated informal-market credit was one-seventh of this amount. The informal lenders, however, play an important role. In most cases if the informal sources of credit did not exist it is likely that most of their clientele would have gone without credit; with the small size of their loans they would not have been suitable borrowers for the banking institutions.

Credit Delivery Systems

Moneylenders

These persons typically provide small-sized cash loans. They lend not only to farmers but also to other persons in the region. Some moneylenders make in-kind loans to farmers consisting of fertilizers, pesticides and insecticides that the lender has obtained at favorable prices from a supplier, usually the Agricultural Development Bank's input supply stores. Repayment typically is made in cash. Some money lenders will take repayment in product which they then sell on the local market or to the Supply Regulatory Institute (IRA).

The moneylender typically does not require a loan document, especially for small loans. They make disbursements with a simple receipt, and by recording the amount and date in a notebook.

The size of loans ranged from ₡20 to ₡60,000. The nominal interest rates are consistent within and between regions. About 90 per cent of the loans granted during 1984 and 1985 had a 2 percent per month, or 24 percent

annual, interest rate. In some cases the rate varies with the size of loan. Some larger loans had a 12 percent annual interest rate.

There appears to be flexibility in the term of loans. In the case of crop loans the terms are usually fixed in accordance with the crop cycle. Most are short-term loans with maturities of less than a year.

Neither cosigners nor collateral are required for most of the small-sized loans. However, for loans of larger size, such as \$60,000, a mortgage lien may be required. According to the lenders, prior knowledge and/or satisfactory experience with their clients is the basis for making their lending decisions. They tend to make loans only to people that they know.

Delinquency does not appear to be a major problem. Lenders reported that almost all loans granted for the 1984/1985 agricultural year were recovered. In two cases, lenders reported default rates of about 5 percent. In some cases, the lenders knew that borrowing farmers had experienced serious losses in their crops, but nevertheless were able to repay the loans. Most of these borrowers had non-farm income from work as salaried workers in the coffee or sugar cane harvest that was used to repay the loan.

Moneylenders typically use their own capital as the major source of loanable funds. Many, however, also use bank loans, especially from the Agricultural Development Bank where they can obtain the most favorable rate of interest and for a time period that coincides with the crop cycle.

Middlemen.

Most middlemen operate with their own trucks. Their principal business is the marketing of agricultural products, which they buy in the local region and sell to wholesalers and retailers in the cities, mostly San Salvador. About half of them live in the region or neighboring cantones and the balance come into the region from nearby municipios. Their marketing function is often linked to production credit, which they provide to the farmer in the form of cash advances or in-kind inputs in the planting season and/or at harvest time. Some 80 percent of them deal with cereals such as corn, beans, sorghum, and sesame. Some deal in vegetables and citrus.

Middlemen typically operate in one of two modes. The first is an outright loan of cash or in-kind inputs. In these cases they charge interest; in 1984/1985 the rate was 2 percent per month, or 24 percent per year. The client typically repays the middleman with in-kind produce which is

valued at the going market price in the rural area. Simultaneously, the farmer sells the rest of his product to the middleman. There is considerable competition among buyers in the countryside, therefore, it appears that the middlemen buyers are forced to pay competitive prices.

The second mode is share cropping. Under this arrangement the middleman makes a loan of in-kind inputs and is repaid with a predetermined share of the product at harvest time.

In either mode the credit delivery system is simple. Funds arrive in a timely fashion. There is no paperwork or guarantee required. The middleman selects his clients based on personal knowledge and prior experience.

The middlemen's sources of funds for their credit activities are loans from banks, especially the BFA, and their own operating capital. Those who make in-kind loans of inputs typically purchase these products from the Agricultural Development Banks input supply stores. Some of them are still paying instalments on trucks purchased with credit.

Input Suppliers.

Those are a number of small-scale stores selling agricultural inputs such as fertilizers, insecticides, herbicides, vaccines and hand tools. These suppliers may provide very short-term credit to well-established and responsible customers for periods of less than a month. They charge an interest rate of 1 percent per month. The length of the loan does not correspond to the agricultural cycle. These suppliers typically do not have the financial resources to extend credit for longer periods, because they acquire their products from importers or wholesalers in San Salvador (such as Avelar Hermanos, Servicio Agrícola Salvadoreña, FERTICA, Laboratorio Zoológico, Droguería Buenos Aires, and the BFA), with the obligation to settle their accounts within thirty days. Thus, the store owners take advantage of this period of time to earn interest on the amounts they owe the wholesalers.

Summary and Conclusions

Notwithstanding the presence of formal-market financial institutions in the four communities studied, there is an active informal credit market in these regions. Three types of lenders were identified: moneylenders, middlemen and input suppliers. Of the three, the first two were most

important as purveyors of agricultural credit. Input suppliers played a less important role, typically only selling goods on account for periods up to one month.

The loans extended by informal market lenders tend to be small, compared to those made by formal-market institutions. Agricultural loans are directed mostly to non-traditional crops, especially cereals and vegetables. Middlemen lend almost exclusively to agriculture. Moneylenders have a large portion of their credit in this sector but also lend to individuals and persons engaged in other economic activities. Informal-market loans are typically for less than one year. The term of loans for agricultural production are pegged to the crop cycle from planting to harvest.

The credit delivery system is extremely simple and efficient, with virtually no paperwork or collateral required. Lenders obtain information on borrowers on the basis of prior experience and personal knowledge, something that is relatively easy to obtain because they have lived and worked in the same region for many years. Very low rates of loan delinquency were reported.

Moneylender credit is typically extended in cash, whereas middlemen often lend in the form of in-kind inputs. Middlemen are involved in a marketing function, which may be a more important activity for them than credit. When they extend credit they enter into an agreement with the borrower to purchase his crop at harvest time or to share the harvest with him. Therefore, the middleman may be in an advantageous position with respect to the price paid to the farmer for the product. This was not studied explicitly, but it is debateable since the middleman provides the farmer a marketing service. In addition, there appears to be sufficient competition among buyers for products, which should reduce the monopsony power of the middleman.

The 1984 nominal interest rates on moneylender and middlemen loans was found to be quite uniform -- 2 percent per month or 24 percent per year -- across the communities studied. In real terms the rate was 11 percent. Competition among moneylenders would suggest that this rate is determined by market forces under reasonably competitive conditions. Therefore, this interest rate may be a good proxy for the opportunity cost of capital in rural areas.

Both moneylenders and middlemen used their own resources as important sources of loanable funds. Some, however, borrowed from banks, especially the Agricultural Development Bank, where they could obtain the

most favorable interest rate. For these that supplied in-kind inputs, most purchased them at the Bank's input supply stores. The fact that these lenders are obtaining loans and inputs from the Agricultural Development Bank at favorable prices and onlending them to small farmers appears to be a very efficient system for getting agricultural credit to this class of clientele. These lenders are able to borrow large sums and then redistribute them to a number of farmers as small loans. Therefore, the informal-market lenders are providing important financial services in the communities. They are not competing with formal-market institutions. Rather they are providing small amounts of credit to small farmers and small businessmen; the type of loans that banks typically do not want to get involved with, because of the high administrative costs relative to the income that can be earned.

Borrowers, too, prefer this type of credit for small loans. Compared to working with banks, the ease of obtaining a loan, the rapidity of disbursement and the low transactions costs more than compensate for the higher interest rates. In other words, the average borrowing costs of working with an informal-market lender are lower when both interest and transactions costs are included than they would be when borrowing from a bank.

Compared to the amounts lent by the formal-market institutions, the credit extended by the informal market is relatively small. It is suspected, however, that the volume of informal market credit obtained in the present study is underestimated because it only deals with identifiable lenders, persons who are prominent in their communities for this activity. Experience in many other countries shows that there is a considerable amount of additional informal-market lending taking place; by persons for whom moneylending is a secondary occupation as well as by friends and relatives.

It is inappropriate to make the heroic step of generalizing the results of these four case studies to the whole of El Salvador. Nevertheless, given that the four communities studied are widely separated geographically, had different agricultural structures, and that the characteristics of informal markets in the four sites were quite uniform, it is not unreasonable to think that the manner in which the informal-markets are structured and operate in the four communities are probably quite similar to the country as a whole.

XII- SUPPLY AND DEMAND FOR AGRICULTURAL CREDIT

Introduction

This chapter consolidates information from previous chapters and introduces new data to address directly the demand for credit in the agricultural sector. The approach is to analyze the use of credit in El Salvador over the 1980-1984 period to interpret how demand and supply were interacting to determine credit use. Then, using this as basis of reference the approach uses indicators and measurements to determine if an excess demand for credit existed at the end of this period. Projections are then made about the future demand for agricultural credit. To begin, however, it is helpful to develop a brief theoretical framework for the analysis that is applicable to El Salvador.

Theoretical Framework

This section provides a brief theoretical framework for the use of credit in El Salvador. It is based on demand and supply factors.

Demand

The demand for credit in the agricultural sector is the sum of the demand schedules by all individuals who would like to borrow for agricultural purposes. In other words, each individual makes his own decision about how much agricultural credit he would want to employ at various levels of interest, and the total demand is the aggregate or sum of these decisions. Therefore, to analyze sector demand it is desirable to begin from the base of the individual.

Individual Demand

Individual demand for agricultural credit is expressed in Equation 1.

$$(1) \text{ Individual demand for agricultural credit} = f(\text{interest rate, expected benefits from credit.})$$

The expected benefits attributable to credit use are mostly the expected net income or profit after taking account of the cost of borrowing. There are,

however, other benefits that can arise from outright consumption and credit diversion. There is also a time horizon. Much credit is desired for short-term purposes (one year or less); this is typically considered as production credit to cover operating expenses. Other credit is desired for medium- or long-term purposes, such as for investments.

Profitability. The expected profitability will depend on a number of factors. The most obvious are the levels of and relationships between expected product prices and input prices, the technology employed in the enterprise and the management ability of the borrower. Profitability also depends upon risk. Agricultural production typically is subject to risk associated with weather, diseases, insects and market prices. Furthermore, in a situation, such as El Salvador encounters at the present time, there are also the risks associated with civil strife and terrorism because of potential damages to crops and livestock while they are in the phases of production or marketing.

Consumption. There may also be a consumption element of agricultural credit demand. In this case, the potential borrower seeks credit to cover some or all of his family's living expenses and, perhaps, purchases of other consumption goods and services, during the agricultural production period. The use of credit in this manner is common practice among all classes of farmers.

Diversion. There may be elements of "agricultural credit illusion" in the individual demand. In this instance, the potential borrower seeks agricultural credit but diverts it to finance other endeavors including, operating expenses or investments in other enterprises, speculative investments, and consumption goods and services. This element is hard to identify, but it is almost certain to exist because of the fungibility of money.

There are cases of open diversion, where the potential borrower ostensibly would seek credit for agricultural purposes but would use the funds for other purposes and not undertake the activities for which the credit was designed. There are also cases of hidden diversion, where the borrower would actually undertake the activities indicated in the loan purpose but where the real effect of the credit is to add to the borrower's liquidity such that he can also undertake another endeavor. This can occur readily when the borrower has multiple occupations and/or access to investments in other activities.

Agricultural credit illusion is most common when interest rates for agricultural loans are lower than those for credit for other purposes. It should be expected that the rational borrower would try to seek out the source of funds that are the least expensive and, when he has them, then use the funds to his best advantage.

Interest Rate. Demand should be considered as a schedule, i.e., it is the amounts of credit that an individual would seek at different loan interest rates. The higher (lower) the interest rate the less (more) the quantity of credit that would be demanded. Therefore, the role of the interest rate is apparent.

Consideration of interest rate should focus on the real rate of interest, i.e. the nominal loan rate adjusted for inflation. When inflation is present, it is common that the real rate may be at low positive or even negative levels. Ceteris paribus, the lower (higher) the interest rate the greater (lesser) amount of economic activity will be profitable. Furthermore, the lower (higher) the interest rate the greater (lower) the tendency for credit diversion, especially if agriculture loan rates are concessionary or preferential.

Transactions Costs. In addition to the interest charges there are other borrowing costs that will affect the individual's borrowing decision. These represent the transactions costs associated with time and out-of-pocket costs associated with credit. Transactions costs typically are most important when the potential borrower is applying for the loan and it is necessary to fill out forms and obtain proper documentation. These procedures may require considerable sums of cash outlays and time commitments, as they typically do for loans from all classes of banks. If transactions costs are high relative to loan size they may discourage borrowing because they reduce the profitability of using credit. Indeed, they typically make borrowing of small amounts from banks uneconomical.

Demand. Therefore, the net effect of these considerations is that the individual demand for agricultural credit should be viewed as a schedule, where, as shown in Figure XII-1, the quantity of credit demanded increases (decreases) as the real interest rate declines (rises). Furthermore, it should be recognized that the demand for agricultural credit will represent a demand to finance both short- and longer-term agricultural activities, some farmer consumption and the "other" activities that are possible because of credit diversion. If agricultural credit is made available at concessionary

interest rates it can be expected that the demand for this credit will be greater because of diversion. The individual credit demand can be rewritten in more detail as in Equation 2.

- (2). Individual demand = $f(\text{real interest rate, transaction costs, for agricultural credit profitability, consumption, diversion})$

Change in Demand

The demand schedule is defined at any point in time. The demand can change as the result of alterations in any of the factors that determine demand. For example, factors that contribute to increased (decreased) profitability would cause the demand schedule to shift upward (downward). This is shown in Figure XII-2 by demand schedules D3D3 (D2D2). Likewise, factors influencing consumption or credit diversion will cause changes in the demand schedule.

Sector Demand

The sector demand for agricultural credit, is the horizontal sum of all the individual demand schedules, i.e., the sum of the amounts demanded by all individuals at the different levels of the real interest rate. It should be clear that the sector demand, hereafter referred to as the demand for agricultural credit, is determined by all of the above-described factors, including profitability, consumption and credit diversion.

Supply

It is clear that most funds used for agricultural credit in El Salvador are those which come from special lines of credit, either rediscounts from the BCR or funds held by the BFA. The characteristics of these sources of funds are that they are available at fixed interest rates up to maximum limits. Under this arrangement the supply of credit for each source has a specific form. The supply of credit is perfectly elastic at the level of the fixed interest rate until it reaches the limit and then it becomes perfectly inelastic.

The total supply of credit is thus the horizontal sums of each credit supply. Assuming that all have the same nominal and, therefore, real rate of interest the sector supply curve can be presented as in Figure XII-3. The

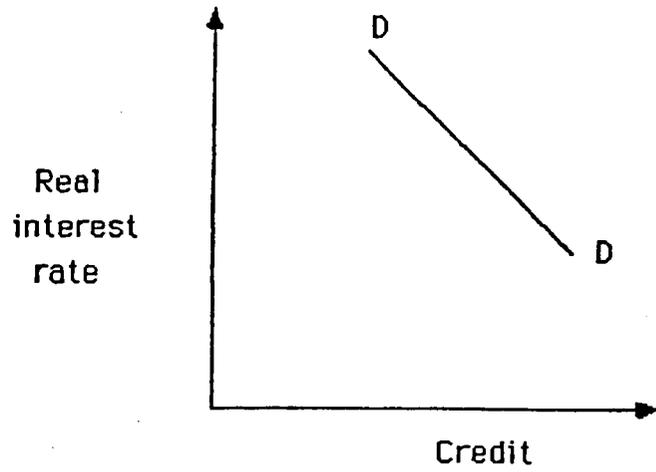


Figure XII-1 Individual demand for agricultural credit

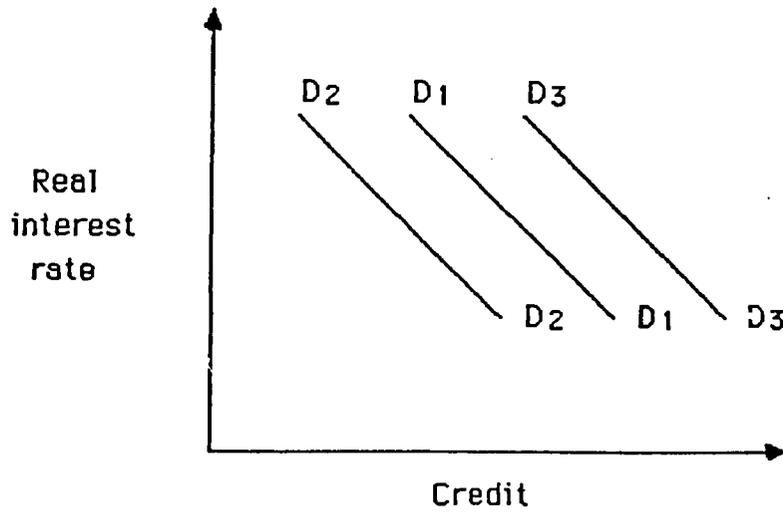


Figure XII-2 Sector demand for agricultural credit

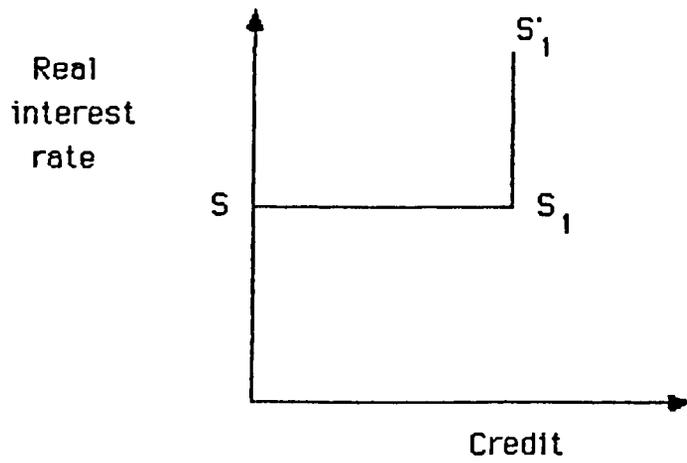


Figure XII-3 Supply of agricultural credit with fixed interest rate and non-price rationing

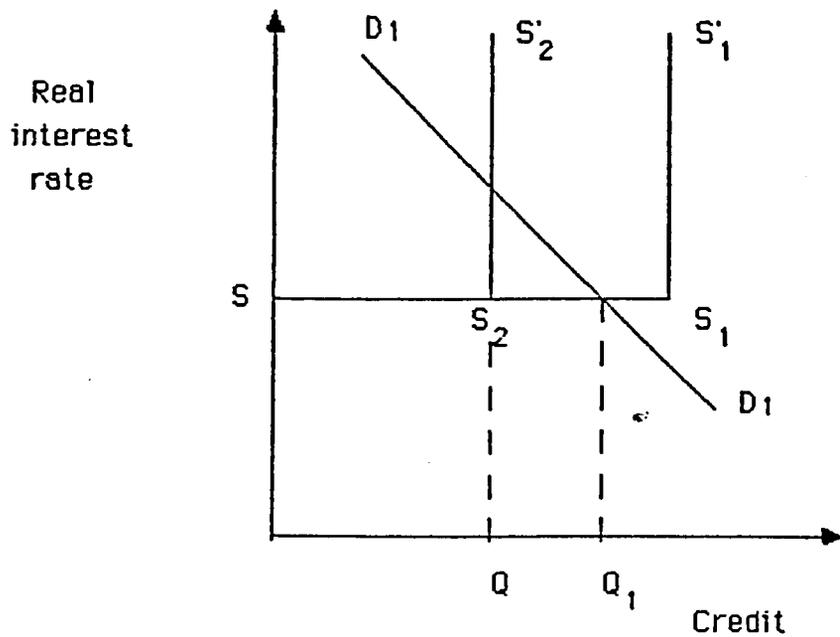


Figure XII-4 Agricultural credit market

total supply of credit to the sector is SS_1 , which is offered at a single rate of interest. When the limit (S_1) is reached the supply becomes vertical ($S_1S'_1$).

The Market

Sector demand and supply are brought together to explain how the agricultural credit market is cleared. As shown in Figure XII-4 if the demand is D_1D_1 and the supply is $SS_1S'_1$, then the market is cleared at Q_1 where the interest rate serves as a price rationing device and no excess demand exists. If, however, the supply were $SS_2S'_2$ then there is insufficient supply to meet the demand at the interest rate and the limit, Q_2 , to credit serves as an effective non-price rationing mechanism. There is an excess demand for credit of Q_2Q_1 .

The Case of El Salvador

As shown in Chapter IV and others, over the 1980-1984 period the real value of the flows of credit extended for agricultural purposes by El Salvadorean financial institutions followed a slight downward trend. However, much of the lending in this period was for refinancing of delinquent debt, which should not be considered as part of the demand for credit since it only represents the continuation of a previous loan. If the refinanced loans are excluded, the decline was considerably worse. Both demand and supply factors were at work to bring about the decrease in credit use in the sector; and both were important. The following interpretation of how this occurred serves as one base for making projections about the need for additional agricultural credit in the nation.

Demand Factors

The reader is referred to Chapters I and II for a more detailed discussion of the factors and policies that influence credit demand. It is sufficient at this point to just highlight some of the important points.

Political Situation and Civil Strife. Political instability, turmoil and civil conflict were very destabilizing for the country and its economy. The change in political power and the accompanying major reforms created considerable uncertainty. Agricultural production patterns were upset and sector GDP

declined. Terrorism and open warfare contributed to the problem. There is no doubt that this had an important negative impact on credit demand over the years, 1980-1983. The improvement in political stability in 1984 gave rise to an increase in the level of economic activity and should have contributed to a strengthening of credit demand.

Agrarian Reform. Land reform proper has had major impacts on credit demand apart from its contribution to political instability and change in the social order. Different features of land reform had two broad impacts on credit demand.

First, the Phase I cooperatives had a need for operating capital and funds to use for basic consumption needs. This was recognized by the government and means were established for the banking system to lend to the cooperatives. This had the effect of maintaining at least some of the demand for credit that existed with the previous landlords. If the government had not quickly developed a program to force-feed credit to the cooperatives through the banking system it is likely that the cooperatives would have used considerably less credit than they did. Indeed, given the cooperatives low state of credit worthiness this force-feeding system probably gave the cooperatives an excess supply of credit, a factor which contributed to later delinquency.

Second, Phase I Agrarian reform put the lands in control of persons that were unaccustomed to operating their own farms and making management decisions. In most instances they were not used to working together as groups for the collective good, the manner in which cooperatives are organized. This contributed to disorganization and inefficiency. Undoubtedly, the profitability of credit use by this class of borrower was lower than that of the previous landlords. Moreover, risk was high. These were factors which reduced credit demand. Some of this reduction was mitigated, however, by government programs that were developed to provide technical assistance and training to the cooperatives. The programs have helped some but have not been sufficient.

The results with the cooperatives have been mixed. Some work very well, many do reasonably well, and a large number have serious problems. In the first five years there appears to have been considerable consolidation and a sorting out. The successful cooperatives have gained strength. There is considerably more to be done.

Phase III beneficiaries are less problematical as farmers and managers because they had formerly been farming rented land. They, however, are

more problematical with respect to demand. Only about 30 percent of the nearly 19,000 have received credit. The effect of this group on increasing credit demand was probably very small.

The net effect of land reform has probably been a decrease in credit demand, compared to what would have been had land reform not occurred. It is clear however, that the government policy of forcing credit to the sector has mitigated considerably the decline in demand.

Technical Assistance and Research. El Salvador has a number of public-sector and private-sector institutions whose broad purpose is to provide services to the agricultural sector in order to improve productivity, efficiency and raise rural incomes. Many of these have been created since 1980 to work with the land reform beneficiaries, especially the Phase I cooperatives. The more successful these institutions have been in bringing about the changes in production and efficiency it would be expected that the decline in demand would be offset. This has been accomplished to some extent. The programs of these institutions have been helpful in developing some of the Phase I cooperative and a few of the Phase III beneficiaries. This assistance has assisted them in becoming more credit worthy and increasing their demand for credit. There has been good success with a small number of cooperatives. It is widely recognized, however, that the task is large and that considerably more needs to be done.

Marketing and Pricing of Domestic Products. IRA is charged with the responsibility to enforce the prices of basic grains paid to producers and sold to consumers. IRA's mission is to pay support prices to farmers, especially small-and medium-sized farmer's and Phase I cooperatives by purchasing their product. The institute then sells these products to ensure consumers of supplies of basic grains, sugar and milk at reasonable prices. In practice IRA does not exert the control over prices that is expected. The institute does not have the capacity to purchase all of the production. Therefore, many farmers are forced to sell their output at lower prices to other buyers, which reduces the farmers' profits.

Domestic producers also faced competition from food imports, which were brought into the country at the considerably overvalued exchange rate. The artificially low prices of imported goods have discouraged local production.

It is clear that the price control mechanisms have not functioned as planned. In theory they should serve to raise demand by offering

guaranteed prices, thus, reducing risk due to price. In practice they have not worked well. The official low consumer prices, the knowledge by farmers that they cannot expect to receive the minimum price, and cheap imports resulting from the overvalued currency all have tended to discourage production and credit use.

Marketing and Pricing of Exports. There is probably not a single policy in El Salvador that gets as much criticism than that for coffee. The monopoly powers of INCAFE give the state total control over coffee exports and foreign exchange earnings from the sale of coffee abroad. Moreover, the coffee producers are continually taxed to benefit the government or nation. Not only are there heavy export taxes but also over the 1980-1984 period, coffee was sold at the official exchange rate thus denying growers the larger incomes associated with the parallel rate. This was done to keep down inflationary forces and reduce pressures for devaluation.

El Salvador is a member of the International Coffee Agreement. World market conditions were also soft over the period and prices did not rise. Meanwhile, input prices rose considerably. All of these pressures on the coffee market contributed a cut back in coffee production and the associated demand for credit for El Salvador's principal agricultural crop, and most important consumer of agricultural credit.

The nation's second most important export, cotton, faced equally difficult times and the demand for credit to finance this crop also declined. Cotton is marketed through the private-sector Cotton Producer's Cooperative (COPAL), which has a monopoly on foreign and domestic sales. In contrast to coffee, the government treated cotton growers more favorably with respect to the exchange rate. The first \$15 million of cotton sales by COPAL were traded at the parallel market rate. For the rest of the sales, 50 percent are exchanged at the parallel rate.

The most severe problem has been the rapid deterioration of the world cotton market. As cotton prices have plummeted and production costs have risen, the demand for credit to grow cotton has declined. To counteract this, in 1982 the government established a guaranteed price that has provided some stability to the new production of the crop and mitigated the decline in demand.

The nation's third most important export crops, sugar is marketed through the National Sugar Institute (INAZUCAR). The Institute's pricing policy has been to maintain the domestic price higher than the world price with respect to exports, INAZUCAR has been fortunate in being able to sell

considerable quantities to the United States through the special import quotas granted to El Salvador. Both of these policies have helped to maintain the demand for credit to produce sugar.

To summarize, it is clear that world market conditions and government policies have had major impacts on the demand for agricultural credit for the traditional export crops. The demand for coffee credit was impacted negatively by both markets and government policies that "taxed" producers. In the case of cotton, the impact of unfavorable world markets on growers income was offset some by more favorable exchange rate policy and support prices.

Sugar cane has encountered less restrictive factors than coffee and cotton. The export quota to United States with preferential prices and internal market price levels have been incentives to increase production.

Input Prices. As means to stimulate output as well as a means to compensate producers for low product prices, the government established subsidized prices for many agricultural inputs. Fertilizers, seeds and other chemicals were imported at the most favorable official exchange rate. Limits on the amounts imported were established based upon estimated needs for the next agricultural season. BFA input stores, play an important role in distributing these products at favorable prices.

Credit Diversion. As shown in Chapter II, the Monetary Board has maintained an interest rate structure that, taking account of inflation, has led to low and even negative real interest rates. Within this structure there are preferential rates, many of which are pegged to agricultural credit. Over the 1980-1984 period, these low rates for agriculture have undoubtedly contributed to credit diversion and, as such, have increased the demand for agricultural credit. Had the El Salvadorean economy not been in a recession it is likely that the diversion would have been even higher. The group of persons that would most likely be able to practice this diversion would be the medium-and large-scale farmers of the non-reformed sector. Many of these farmers have multiple occupations and/or access to other forms of investments. Reformed sector borrowers would be much less likely to practice diversion.

Summary-Demand. It is probable that the net effects of civil strife, land reform, domestic and external markets and marketing policies all have contributed to a decrease in demand over the period. Its doubtful that the government created demand in the reformed sector, substantial technical

assistance, nor diversion were able to offset much of this decline. The net impact should have been a decrease in the demand for agricultural credit. Therefore, it should not be surprising that the use of credit declined. What is somewhat remarkable is that credit use did not decline more. The most probable reason is that the government's policy of creating a demand for credit in the newly-formed Phase I cooperatives contributed strongly to maintaining the demand. Furthermore, the level of demand got a boost with the government's decision not to carry out the Phase II portion of the land reform program. This decision gave new life to the sector that is so important for producing the export crops.

The decline in credit demand is reflected in the decline in output.

In 1984, the real value of agricultural sector GDP was only 63 percent of that of 1980. As shown in Table XII-1 there were substantial declines in the levels of physical output of most of El Salvador's principal crops over this period.

Table XII-1. Volume of Production for Selected Agricultural Products,
El Salvador 1980-1984
(Million qq)

<u>Products</u>	<u>1980</u>	<u>1984</u>	<u>Average annual rate of growth</u>
Coffee	4.1	3.2	-6.0
Cotton	1.4	0.7	-15.9
Cereals*	16.2	16.5	0.5
Sugar cane (million tons.)	2.6	3.4	6.9
Milk (million bottles)	330.5	275.0	-4.5
Eggs (million)	818.6	845.5	1.1

* It includes corn, beans, rice, sorghum.

Source: Banco Central de Reserva, Revista de el Banco Central de El Salvador, Julio-Agosto-Septiembre, 1985.

Supply

Credit supply policy relied on non-price rationing. Low nominal and very low or even negative real rates of interest were maintained by the rigid structure of maximum loan rates. The levels were kept low deliberately to

control inflation and to try to encourage economic activity by means of the implicit income transfers that were offered. At the same time, however, the government wanted to direct credit to specific activities in accordance with its national plan. There was a special effort to direct credit to the reformed sector. USAID and BID made large loans to BFA for this purpose. In addition new BCR rediscounts lines were open. This had the effect of increasing the supply. However, to control inflation and avoid devaluation the government felt it necessary to keep a lid on total credit use. Therefore, they imposed lower limits to credit. The result was to offer less credit than would clear the market at the fixed rates of interest, i.e., there was an excess demand.

Credit Demand Study

An objective of the current study is to determine if there is a demand for agricultural credit in El Salvador that is not being presently satisfied. The above analysis shows that the real value of credit use has declined. Given the nature of the supply function it solidly suggests that there has been an excess demand for agricultural credit. The present section presents evidence that this is, indeed, the case.

Methodology

There are basically three ways to obtain information about whether or not the demand for agricultural credit is being met. The first method is to determine if non-price rationing mechanisms are what effectively limit the use of credit. If this is found to be the case then excess demand exists. This method, however, does not provide any indicator of the amount of excess demand.

The second method is to obtain the opinion of agricultural credit officials who make loans to determine if they believe that they are restricted in lending by limits to supply. If this is the case, then excess demand exists. If there is excess demand these persons can also be asked to state how much additional credit they could extend and for what purposes. In this manner, both quantitative and qualitative estimates of the demand can be obtained.

The third method is to undertake a farm survey to gain the opinions of farmers as to whether or not their credit needs are being met. If they are not, then there is an excess demand for credit.

In the present study, the first two methods were employed. Not only are they considerably less costly than the farm survey but also they probably are more reliable.

To this end, it was decided to take a census of all branch managers in the BFA, Mortgage Bank and mixed-bank system. A questionnaire was designed. The year of reference was the agricultural year 1985. The questionnaire was also to be administered to the chief agricultural credit officer of each institution. The objective was to obtain each of their estimates of excess demand and then sum across institutions. There was a likely problem with some overlap of the estimates between institutions, but it was not considered serious enough to invalidate the methodology.

In practice, the method did not function as planned. There were two reasons. First, it was quickly discovered that many branch managers did not have a good sense of the agricultural credit demand in their region. In the cases of the mixed banks and the Mortgage Bank the managers reported that their function was mostly administrative and operations oriented and that the agricultural credit decisions took place in the agricultural credit department of the main office in San Salvador. Therefore, they were unable to answer the quantitative questions on credit demand.

The second reason was that many of the branch managers did not attend the meetings where the questionnaire was administered. Because of the first problem there was no attempt made at follow up interviews.

These findings are good evidence of the highly centralized agricultural credit system in these financial institutions. They also demonstrate that the only means to get reliable estimates of credit demand is to rely on the opinions of the chief agricultural credit officers of the various institutions. This is what was done for the quantitative questions. Nevertheless, it was felt that the branch managers who were interviewed, did have knowledge about agricultural credit and therefore it was decided to use their responses for the qualitative dimensions of the study.

Indicators of Excess Demand

There are two basic indicators of excess demand for agricultural credit in El Salvador. The first indicator is the extensive use of non-price rationing mechanisms in the government's credit policy and the operations of the individual banks. This shows that there is an insufficient supply of credit to clear the market at the prevailing interest rates.

At the level of the government, BCR rediscounts are used to finance a large majority of the credit extended to the agricultural sector by the mixed banks and the Mortgage Bank. There are limits to the amount that can be lent from each rediscount line. Furthermore, institutions are assigned limits for the amount that will be available to them. Each of these is an example of non-price rationing.

At the level of the bank there are upper limits for loans to individual borrowers established by the Monetary Board, based on quotas figured on the basis of production costs. In addition the banks use non-price rationing mechanism in their credit delivery systems to ration funds away from small borrowers.

The second indicator is the fact that there are insufficient funds for the banks to be able to disburse all of the funds for which they contract, thus leaving part of the demand unsatisfied. This is especially true for the BFA. The figures for the other banks are somewhat lower.

Estimates of Excess Demand

Agricultural credit officers from the nine mixed banks, Mortgage Bank and BFA, were asked to estimate the amount of unsatisfied demand among the clientele of their institution in 1985. Their responses summed to a total unsatisfied demand in that year of ₡474.8 million (\$94.96 million at the rate of exchange of ₡5 = \$1 U.S). Of this amount ₡180.8 (\$36.16 million) was short-term credit and ₡294.0 million (\$58.8 million) was for in medium-or long-term projects. The results are reported in Table XII-2.

The excess demand in the reformed sector was estimated to be \$36.98 million, which corresponded to 39.1 percent of total excess demand. Virtually of this unsatisfied demand was perceived to be in the Phase 1 cooperatives. Of the total for the cooperatives, \$7.4 million was in short-term and \$28.6 million medium-or long-term. Short-term credit would have been mostly used for cotton, coffee, livestock and sugar cane. Medium- or long-term credit would have been lent for agroindustry, livestock, irrigation and coffee.

Small farmers in the non-reformed sector were estimated to have an unsatisfied demand of \$19.32 million, or 20.3 percent of the total. Short-term credit was ₡4.22 million and medium- or long-term was \$15.1 million.

Table XII-2. Estimates of Excess Demand for Agricultural Credit in 1953 by Agricultural Credit Category of Farming Units, Mortgage Rate and Agricultural Development Bank

Agricultural Credit Category	Number of farming units	Estimated excess demand	Total excess demand		Purpose of additional credit							Use of additional credit						
			Short term	Medium term	Production	Basic Capital	Cattle	Cotton	Sugar Cane	Other or unspecified	Medium or long term credit							
			(\$1000)	(\$1000)							Production	Cattle	Sugar Cane	Other or unspecified				
Fixed loans and mortgage loans		612.50	146.00	263.50														
Reformed sector, Phase I	9 of 10	134.00	18.00	116.00	3.00		6.00	6.00	3.00		2.00	21.00	6.00	20.00	58.00			
Reformed sector, Phase II	3 of 10	1.50	1.40	0.10	0.40	0.00			0.20			0.30						
Other small farmers	7 of 10	93.10	18.10	75.00	0.40		6.70	0.60	2.40			60.00						10.00
Medium and large-scale farmers	10 of 10	183.20	107.50	75.70	17.20		33.00	8.00	3.50		23.30	34.00		1.00				11.00
Agricultural Development Bank		62.50	34.00	28.50														
Reformed sector, Phase I		56.00	19.00	37.00			19.00							13.00	3.00			7.00
Reformed sector, Phase II		3.00	2.00	1.00			2.00					1.00						
Other small farmers		3.50	3.00	0.50			3.00					0.50						
Medium and large-scale farmers		10.00	10.00				10.00				10.00							
Total		674.80	380.00	294.00	31.20	0.00	92.70	14.60	11.10		20.30	143.00	21.00	33.00				77.00
Reformed sector, Phase I		180.00	87.00	143.00														
Reformed sector, Phase II		4.50	3.40	1.10														
Other small farmers		96.60	21.10	75.50														
Medium and large-scale farmers		173.50	119.50	74.00														
Total (1953, before 1954)		74.24	44.16	30.08	0.21	0.14	18.20	2.77	3.21	3.04		28.60	4.20	6.60				17.40
Reformed sector, Phase I		36.00	7.40	28.60														
Reformed sector, Phase II		0.98	0.68	0.30														
Other small farmers		17.22	6.22	11.00														
Medium and large-scale farmers		39.84	23.84	14.80														

1. 1953 Q. 2. 1954 Q. 3. 1955 Q.

The short-term credit would be used for mostly livestock, coffee and sugar cane. The medium or long-term credit mostly would be for livestock.

The medium- and large-sized farmers would have received \$38.66 million, the equivalent of 40.7 percent of the total. Of this amount, \$23.86 million was for short term and \$14.8 for medium-or long-term. Short-term credit would have been used mostly for coffee, livestock, melons for export or cotton. Long-term credit mostly would have gone for livestock.

It is clear that there was a perceived unsatisfied demand for short-term credit for coffee production. It was the largest need for each class of farmer, except the Phase III beneficiaries. Other traditional exports were also judged as unsatisfied. A need for additional funding for short-term livestock operations was also evident. In the medium-or long-term categories livestock dominated. There were some estimates of needs for funds to finance irrigation and coffee planting. It should be noted that the estimated unsatisfied demand in the Phase I cooperatives was heavily concentrated in investment needs.

Relative Importance of Excess Demand

In 1984, the annual flows of new (non-refinanced) agricultural credit for these banks was 1439.9 million. If the same level of flows existed in 1985 as in 1984 then the amount of excess demand would corresponded to 33.0 percent of the new credit in the latter year. This clearly shows that the excess demand was sizeable, relative to new credit flows. The fact that more than 60 percent of the estimated excess demand was in the medium-or long-term financing suggests a particular need for this type of credit. In the case of the reformed sector Phase I cooperatives the percentage is even higher, nearly 80 percent.

Excess Demand and Interest Rate. The nominal interest rate for a class A short-term loan in 1985 was 14 percent. With inflation the rate was -4.2 percent. There is no doubt that the loan rate contributed to excess demand. The interesting question is how much would the quantity of credit decline (move along the demand schedule) if the interest rate were to be raised. Data obtained from the survey of credit agents provides an estimate of the answer. Data from Table XII-3 show the mean of their estimates of the decline in the quantity demanded if the nominal loan interest rate were raised. As would be expected the quantity declines as the rate is raised. For example, if the rate were raised 4 points to 18 percent, 1.5 points above the

class B loan for short-term credit, it was estimated that the quantity demanded would decline 6.1 percent. If the rate were raised 10 points to the rate charged by the informal market the quantity demanded would decline by 26.8 percent.

The latter figure is 6.2 percentage points less than the estimated excess demand for new credit. Therefore, if the bank interest rate were raised to the informal market level, which is about as good a proxy as available for the opportunity cost of capital in El Salvador, there would still be a sizeable excess demand for agricultural credit. This is another indicator of credit rationing and the ability of the sector to absorb more financing and use it productively.

Table XII-3 Estimates of Decline in Quantity of Credit Demand if Interest Rate were Raised

<u>Percentage Points Rise In Interest Rate</u>	<u>Percent Decline in Quantity Demand of Credit</u>
2	6.08
4	11.46
6	17.48
8	23.78
10	26.79

Future Demand

The future demand for agricultural credit in El Salvador will be principally determined by the demand for agricultural products, both in domestic and foreign markets. The extent that El Salvadorean production takes place to meet that demand will be determined by the economics of local production conditions, e.g. profitability. As noted earlier in this chapter these are a number of factors that will determine this profitability, such as world prices for exports, domestic prices for goods sold on the domestic market, the costs of inputs, technological efficiency, and, of course, El Salvadorean agricultural policy.

Export Markets

The outlook for long-run major improvements in the markets for El Salvador's traditional exports are not favorable. At the present time the world coffee market has been seriously impacted by the Brazilian drought. The consequent reduced supply has placed an upward pressure on prices. International Coffee Organization countries, of which El Salvador is a member, have been able to increase their sales by drawing down on inventories to fill in the vacuum created by Brazil's problems. The current coffee boom should last only about two years, according to previous experience. There will be some incentive to increase production in this period but much of this will be mitigated by the governments' new tax and windfall profits for coffee producers. The conclusion is that the boom will have only a minimal impact on production and production incentives. Once the boom is over coffee producers can expect only a slow growth in the El Salvadorean export quotas and only slow increase in prices, such as was the trend prior to the recent Brazilian drought.

Likewise, the outlook for the world cotton market is not strong. World consumption of cotton has been growing slowly but there have been important increases in production, especially in China. As a consequence, world stocks are rising which will keep a downward pressure on world prices. The outlook is for a continuation of the past trend of slightly increasing world prices. El Salvador has experienced substantial increases in recent years of the exports of cotton thread. If this continues, it could contribute to an increase in the growth of demand.

The market outlook for El Salvador's third traditional export, sugar, is likewise not sanguine. World production of sugar is declining and prices continue to fall. Sugar substitutes such as synthetic sweeteners and high-fructose corn syrup have cut into this market. El Salvador's exports are being supported and highly subsidized by its preferential treatment for sales in the protected U.S. market. Were this to be discontinued, incentives for production for export would be reduced.

The best long-term prospects for growth of agricultural exports are in the relatively new non-traditional products such as shrimp, melons, tomatoes, cucumbers and speciality vegetables. The potential for these exports is just beginning to be developed. In contrast to the traditional exports, the markets for these products are highly specialized. Many of the products are delicate to produce and perishable. To sell on the international market they must meet quality standards.

Therefore, sophisticated technology for both production and marketing is required. In addition, many of the Caribbean and Central American countries are trying to capture some of the market potential of these products for export to the United States. El Salvadorean producers will face tough competition.

Domestic Markets

Economic recovery and population growth will contribute to a growing demand for food in El Salvador. Government policy, however, has not provided strong stimuli for production. The IRA program of support prices has not been satisfactory. Cheap imports have also discouraged domestic production. The latter should change, however, with the new official change rate, which will reduce the price advantage that basic food imports had when they were imported at the highly overvalued former official exchange rate.

Profitability Data

The profitability of El Salvador's basic grains and cotton were estimated using data from the Ministry of Agriculture. The results are reported in Table XII-4. The estimates of profitability are based on favorable climate conditions, use of fertilizers and other chemicals at the recommended levels, appropriate cultural practices and minimum losses at harvest. The estimated costs, prices and yields are considered to be typical, neither high nor low.

On the basis of these figures production of cotton and sorghum should lose money. This may explain why output of these crops has declined so much in recent years. It is also noteworthy that the rate of return (profit/total cost) is not very high for any crop. This is a further reflection of the above problem. The conclusion is that if current costs and price trends continue the profitability of production of El Salvador's basic crops will be low.

Table XII-4. Profitability of Selected Crops, El Salvador, 1985/1986 Agricultural year.

Crop	Area(*)	Yields qq/mz	Farm price	Gross Income per mz.	Total cost/mz	Rate of return	
						Profit (Loss)	Profit/total cost (percent)
Cotton	1	35	93	3,255	3,298	(43)	-1.3
Corn	1	50	31.50	1,575	1,537	38	2.5
Rice	1	60	30	1,800	1,684	116	6.9
Sorghum	1	40	24	960	1,054	(94)	-5.6
Beans	1	18	80	1,440	1,362	78	5.7

(*) The Salvadorean Unit area is the "manzana" equivalent to 7,000 square meters.

Source: Based in data provided by the Ministry of Agriculture, Dirección General de Economía Agropecuaria.

Estimates of Future Demand

Agricultural credit officers from the eleven banks were asked to estimate the average annual rate of increase in the real demand for credit in their institution in the five-year period 1986-1990. Their estimates ranged from 2 to 16 or more percent. The mean average annual growth rate was 10.7 percent and the median was 12 percent. It is clear that these officials are optimistic about the future for the agricultural sector and agricultural lending in El Salvador.

These growth rates were used to estimate a weighted future demand. The rate supplied by the credit official for each bank was multiplied by the sum of the 1984 agricultural credit flow for new loans and the estimate of excess demand from his bank. The estimates for each bank were then summed to obtain a yearly total. They are reported in Table XII-5. By 1990 the total demand for credit would be ₡3,197.6 million (\$639.5 million).

Table XII-5. Estimated Demand for Agricultural Credit, 1986-1990

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Million Colones	2257.8	2457.0	2678.3	2924.1	3197.6
U.S. Dollars a)	451.6	491.4	535.7	584.8	639.5

a) Rate of exchange ₡5.00 = U.S.\$1.00.

These results do not give any reasons for the growth. It is assumed that the credit officials took the relevant factors into account in their estimates. Data are available in the credit agent survey, however, which provide an indication of the factors that will be most significant. Credit agents were asked to rank the importance of factors limiting growth of demand. The results are presented in Table XII-6.

All of the factors were considered as important limits by a majority of the respondents. The six most important, as measured by the number of respondents considering them "very important" were, in order of descending importance: high costs of inputs, low prices for export products, social conflict and terrorism, high interest rates, low prices of non-export products and the lack of marketing infrastructure.

Table XII-6. Importance of Factor that will Limit Agricultural Credit Demand 1986 - 1990

<u>Factor</u>	Degree of Importance (Percent response)			
	<u>Very</u>	<u>Important</u>	<u>Little</u>	<u>None</u>
Low prices, export products	70.4	24.1	1.9	3.7
Low prices, other products	53.8	32.7	9.6	3.8
Lack of infrastructure (storage, roads, etc.)	48.1	31.5	14.8	5.6
Farmer's lack of farm management skills	24.1	42.6	33.3	--
Farmer's lack of technological knowledge	22.2	53.7	24.1	--
High costs of inputs	85.5	14.5	--	--
Risk from weather, insects, diseases, etc.	31.5	31.5	31.5	5.6
High interest rates	54.5	34.5	10.9	--
High borrower transactions costs	25.9	46.3	25.9	1.9
Civil strife and terrorisms	54.5	30.9	12.7	1.8
Shortage of cultivable land	18.5	42.6	35.2	3.7
Competition from other financial institutions	16.4	27.3	36.4	20.0

Reformed Sector

The credit worthiness of the reformed sector has been identified as problematic due to structure, organization and the previous experience of its members in farm management. Yet, a considerable amount of unsatisfied demand in 1985 was estimated for the sector, especially the Phase I

cooperatives. If additional measures were taken to improve the credit worthiness of the reformed sector, the demand in that sector could be expected to increase. Data from the credit agents survey provide insight about the problems of the sector, and, therefore, are suggestive of measures that might be taken to improve the credit worthiness of the land reform beneficiaries.

Table XII-7 presents the opinions of the credit agents about the important problems for lending to the Phase I cooperatives. All of the potential problems were listed as important by most respondents. Yet, there are three that stand out in terms of their frequency of being considered "very important". The three are the lack of management ability in the cooperative, lack of organization in the cooperative, and that the members of the cooperatives do not feel the obligation to repay the loan. All of these are related to the central concept of organization and structure of the cooperative. They are consistently rated as more important than factors related to production, such as lack of technology and high risk due to low profitability of production. It is noteworthy that problems related to the civil conflict and terrorism were also ranked high.

Table XII-7. Importance of Problems in Lending to Phase I Cooperatives

<u>Problem</u>	<u>Degree of Importance (Percent response)</u>			
	<u>Very</u>	<u>Important</u>	<u>Little</u>	<u>None</u>
Lack of management capacity	79.2	10.4	10.4	--
Lack of organization in the cooperative	66.7	27.1	6.3	--
Cooperative members do not have a sense of responsibility to repay loan	70.8	22.9	6.3	--
Cooperatives do not use adequate agricultural technology	34.0	46.8	19.1	--
Dishonesty	48.9	31.9	17.0	2.1
High risk because of low level of profitability of products	31.3	56.3	12.5	--
Civil strife and terrorism	60.4	29.2	6.3	4.2

These results suggest that the efforts to improve the credit worthiness of the cooperatives should be concentrated in improving the organization and administrative capabilities of the cooperatives. Indeed, this was what the credit agents responded. As shown in Table XII-8, when asked to indicate the importance of measures to improve the credit worthiness of the

cooperatives. The same factors received the higher ratings. Improvements in administrative capacity and a higher sense of cooperativism received the highest ratings. Production-related factors such as agricultural technical assistance and better product prices were also ranked high, but not as much as those related to organization. A reduction in social conflict was also considered important.

Table XII-8. Importance of Factors to make Phase I Cooperatives more Credit Worthy

<u>Factors</u>	<u>Degree of Importance (Percent response)</u>			
	<u>Very</u>	<u>Important</u>	<u>Little</u>	<u>None</u>
Assistance in management	98.1	1.9	-.	-.
Assistance in agricultural technology	80.8	17.3	1.9	-.
Capital investments (machinery, irrigation, etc.)	46.2	44.2	9.6	-.
Better product prices	73.1	21.2	5.8	-.
Better incentives to members to work	61.5	28.8	9.6	-.
More dedication to cooperative philosophy	90.4	7.7	1.9	-.
Reduction on civil strife and terrorism	75.0	19.2	3.8	1.9

The responses to these two questions show that the cooperatives confront a wide variety of important problems and that all of them need to be addressed to improve credit worthiness. The relative importance of the problems indicates, however, that the problems of cooperative organization and management are perceived to be the most important.

The data for the Phase III beneficiaries reflects a different and less well-defined set of problems for this class of borrower. As shown in Table XII-9, none of the problems listed were ranked "very important" by a majority of the respondents. The range of responses was much more uniformly dispersed. Nevertheless, it is clear that civil strife and terrorism are considered as major impediments to lending to these farmers. Furthermore, that they are considered risky because of low profitability and lack of management skill. Also, that these farmers would benefit from using better technology. It therefore appears that this group of farmers need more assistance in production-related matters to make them more credit worthy.

The contrast between the measures needed to make the two classes of agrarian reform beneficiaries more credit worthy is clear and understandable. The principal problems of the cooperatives are structural and organizational in character; whereas those of the Phase III farmers are those more conventional and typical of small-farmer agricultural production. This indicates that in order to improve credit worthiness that different priorities need to be assigned to programs to work with the two different classes of farmers in the reformed sector. This is not to suggest, however, the Phase I cooperatives do not need technical assistance, the data suggest this is also necessary.

Table XII-9. Importance of Problems in Lending to Phase III Beneficiaries.

<u>Problems</u>	<u>Degree of Importance (Percent response)</u>			
	<u>Very</u>	<u>Important</u>	<u>Little</u>	<u>None</u>
High lending costs of loans due to small loan size	41.7	20.8	18.8	18.8
Farmers are poor managers	25.0	37.5	31.3	6.3
Farmers are dishonest	10.6	29.8	38.3	21.3
Lack of adequate agricultural technology	27.1	39.6	22.9	10.4
Lack of capital goods	33.3	10.4	33.3	22.9
High risk because of low level of profitability of products	43.8	27.1	10.4	18.8
Civil strife and terrorism	46.8	38.3	8.5	6.4

Summary and Conclusions

Over the 1980-1984 period the use of agricultural credit in El Salvador to finance new production declined in real terms. The decline is associated with the general decline in sector GDP over the period. The decline in credit use would have been even more severe had not the government, with the aid of substantial foreign assistance, created a supply of credit to be directed to the newly-established reformed sector, especially the Phase I cooperatives.

The decrease in credit use appears to be associated with both a decrease in demand and supply. In spite of the decline in demand, there is strong evidence that a condition of excess demand prevailed because of the extensive use of non-interest rate credit rationing mechanisms, by both the

monetary authorities and the credit institutions. With low concessionary interest rates other rationing devices are necessary to limit credit use.

At the prevailing interest rate structure, agricultural credit officers were surveyed to determine the unmet needs for financing. Combined, they estimated an excess demand of \$94.96 million, which was the equivalent of 33.0 percent of the total flows of new credits (does not include refinancing) to the agricultural sector in 1984. It was estimated that if the interest rate were raised, even as much as to the level in the informal market, the excess demand would continue to exist.

The unsatisfied credit needs in the reformed sector were estimated to be \$36.98 million. Of this total, \$28.6 million (77.3 percent) were for medium- or long-term credits in livestock, irrigation, coffee plantations and agroindustry. Virtually all of these needs were in the Phase I cooperatives; only \$1 million was for Phase III beneficiaries. It is the authors' judgement that the latter may have been an underestimation.

Other small farmers were estimated to have an unsatisfied demand of \$19.32 million, of which about three-fourths was directed to medium- or long-term investments.

Medium- and large-sized farmers were estimated to have unsatisfied credit needs of \$38.66 million. Almost two-thirds was for short-term credit, mostly for coffee and livestock.

These estimates do not take into account the credit flowing to the sector through informal markets. Data are simply not available to make these estimates. The case studies of informal credit markets demonstrate, however, that there are sizeable amounts of funds lent to numerous small farmers. It would be expected that the demand for credit from this source is also unsatisfied, although to a much lesser degree than in the formal markets because of the higher rates of interests that prevail in the informal market.

The future demand for agricultural credit will depend on many factors as they influence the profitability of farming and the individual crop or livestock activities. Unfortunately, the long-term outlook for growth in El Salvador's traditional export markets is not strong. El Salvador is a price taker in world markets. The prospects for long-term improvements in world markets are slim. World demands for coffee, cotton and sugar are growing slowly or stabilizing while production tends to increase. The impact of the current coffee boom will be short-lived, moreover, the government taxes many of the windfall profits that would occur for local producers.

Sugar exports are supported by El Salvador's preferential entry into the U.S. market.

The best prospects for export growth are in non-traditional agricultural exports of shrimp, fruits and vegetables. These crops are capital intensive. If El Salvador can gain a solid entry into these highly specialized export markets there will be needs for financing.

There is a new type of financing that has been developed in the Dominican Republic that uses the private sector as a conduit of credit to finance production of export products and some domestic foodstuffs. It is called a bridge credit that is made available to small farmers to produce products for private-sector processing or exporting firms. The concept is that the firm borrows from a financial institution and then on lends the funds to the small farmer on the premise that the farmer will sell the product to the firm; thus ensuring the firm of a product supply. The firm often supplies technological assistance to ensure the quality of the product. The firm directly assumes the repayment responsibility and the risk for the loan.

With economic recovery and population growth there will an increasing demand for domestic foodstuffs. In this arena government policy has an especially important impact. The IRA price support program has been inadequate to purchase production and, therefore, many producers cannot earn the support price. The free market price was kept low by inexpensive imports brought into the country at an overvalued exchange rate. The new economic policies, which raised the official exchange to ₡5, should provide more incentives to local producers and stimulate credit demand.

In spite of this problematic setting for the future, the bankers estimated that the real demand for credit would rise at a rate of 10.7 percent for the next five years. At this rate, by 1990 El Salvador will have a total real demand of credit of about \$639.51 million in agricultural credit. Factors limiting the growth of demand were identified. The most important were high costs of inputs, low prices for exports, social conflict and terrorism, high interest rates, low prices of non-export products and the lack of marketing infrastructure. The latter were also important limitations for the growth of demand in the Phase I cooperatives. Even more important, however, were factors relating to cooperatives management and organization. In contrast, the limiting factors for Phase III beneficiaries are more of a technical agricultural nature.

If these limiting factors were eased, the implication is that the demand for agricultural credit might grow even more rapidly. This is of particular relevance for the reformed sector cooperatives. As technical assistance and management training programs are implemented successfully in the cooperatives, their credit worthiness should rise rapidly and the demand for credit would increase.

XIII- SAVINGS AND DEPOSITS MOBILIZATION

Introduction

The previous chapters have amply demonstrated that rural finance in El Salvador has been almost exclusively directed towards agricultural credit. Policies of the government and foreign assistance donors have been to develop credit programs and Central Bank rediscount lines for the sector. Therefore, the emphasis has been on directing financial resources towards the sector rather than on trying to mobilize those resources within the sector that can be used for future financing through the financial intermediation process. To be sure, financial intermediation does occur, especially among the commercial banks, and deposits are mobilized from rural residents or urbanites who derive income from agricultural endeavors. Nevertheless, there has been no major policy or programmatic thrust in this direction in rural areas. Under these conditions, rural financial markets are not fully developed; they lack deposit mobilization and financial intermediation. Under these conditions lending to the agricultural sector has become dependent on outside infusions of capital by foreign assistance, Central Bank rediscounts or direct government subsidy.

The lack of good financial intermediation services in rural areas has denied many rural citizens, particularly the small farmers, accessible opportunities for holding financial savings and earning income on these savings while maintaining liquidity. These farmers are thus disposed to look to other forms of savings-- such as holding cash, crop inventories, or purchasing livestock--as alternatives, with the result that the financial system's ability to serve in its intermediary role is greatly reduced.

The present chapter addresses rural savings mobilization in El Salvador in depth. To begin, the material presented in the previous chapters is consolidated and analyzed. This is followed by an analysis of the determinants of saving in financial institutions in El Salvador. The chapter concludes with an analysis of the potential for mobilizing more rural savings, especially through the Agricultural Development Bank.

Overview of Financial Savings

The Policy Framework:

The government's main policy instrument for savings mobilization has been the interest rate structure. Specific maximum rates for time and savings deposit have been established. These savings deposit rates have

been pegged to the loan rate in order to maintain an interest rate spread. As noted in Chapter II, this rate structure has been changed very infrequently; therefore, the savings and time deposit rates are not regularly adjusted for changing market conditions and inflation. In recent years when the rate of inflation has been high, most of the real interest rates offered on savings and time deposits have been negative. Under these conditions, the expected returns from interest payments will not be an inducement to save. If foreign interest rates are more favorable then capital flight can be expected.

The interest rates for time deposits are maintained at higher levels than for savings deposits and they increase the longer the commitment to keep the funds on deposit. For example, in 1984-1985 the savings deposits rates for banks were 7.0 and 7.5, depending on whether withdrawals could be made without or with advance notice, respectively. Time deposit rates varied between 9.5 and 13.0, depending on the term of the deposit. With the economic package of January 21, 1986, the savings deposit rates were maintained at the previous levels, whereas the time deposit rates were increased from 1 to 2.5 percentage points. If, however, inflation continues at the pace of 1985 or above, all of the deposit interest rates will be negative in real terms.

Apart from mobilizing deposits the other principal source of obtaining loanable funds for the financial intermediaries has been the Central Bank rediscounts. It is useful to compare the interest rate spread that the financial intermediaries earn on the rediscounts compared to that for mobilized deposits. The spread on almost all rediscounts is 2 percent, whereas the spread on funds obtained from savings accounts--after taking account of the 20 percent legal reserve requirements should be much higher. If the financial institutions can maintain relatively low administrative costs compared to those associated with rediscounts it would appear that the spread obtained from savings accounts would be higher. The spread on funds in time deposits is much more narrow. Under these circumstances the financial institutions are motivated to mobilize demand or savings deposits because they would appear to be the least expensive sources of funds. Time deposits and Central Bank rediscounts are more expensive and, hence, less desirable as sources of loanable funds.

The Agricultural Development Bank has had access to direct foreign assistance. These loans or grants carry low concessionary rates of interest and are low cost. Therefore, it is clear that this Bank would prefer to obtain its financing from this source rather than Central Bank rediscounts or mobilizing savings or time deposits.

The foreign exchange rate is another policy that brings a lot to bear on savings. If the exchange rate is overvalued and an explicit devaluation is anticipated there will be strong inducements for capital flight. As this occurs there should be less domestic saving as it is substituted by saving abroad. In recent years, the exchange rate has been progressively overvalued. This has undoubtedly contributed to flight capital.

The devaluation in the January 21, 1986 economic package should make some correction for this, but it may not have been enough to keep the colon from losing its foreign exchange value in the near future.

Growth Trend and Relative Importance of Institutions

Table XIII-1 presents the trends in savings and time deposits over the 1980-1984 period for the institutions studied in this report. It is surprising, given the extreme political and economic instability of these years, that, after taking account of inflation, the real value of the sum of these deposits has increased each year; the average annual real rate of growth was 7.0 percent.

These growth, has been entirely concentrated in the mixed banks, which are also the most important holders of savings and time deposits. In 1984, these banks accounted for 78.8 percent of the total of these deposits. In 1980, they held 64.3 percent. The increase in their share reflects the average annual real growth rate of 12.5 percent over the period. In nominal terms the growth rate was 26.9 percent.

The Mortgage Bank the second largest holder of deposits with 21.1 percent at the end of 1984, experienced a -4.2 percent average annual decline in real deposits over the 1980-1984 period. In nominal terms they experienced an annual increase of 8.1 percent.

FEDECACES and the Agricultural Development Bank (BFA) were the other two institutions to receive deposits (FEDECREDITO and INCAFE do not mobilize savings) but each accounted for less than 1.0 percent of the total in 1984. Over the 1980-1984 period, FEDECACES experienced an average annual real decline in deposits of -9.6 percent although in nominal terms the annual growth rate was 1.9 percent. BFA, experienced declines in both real and nominal values of deposits. The average annual rates of decline were -33.4 and -24.8 percent respectively.

Table XIII-1. End-of-year Balance of Savings and Time Deposits by Financial Institutions (Millions Colones)											
Financial Institutions	1980		1981		1982		1983		1984		Average annual rate of growth 1980-1984
	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent		
	Nominal Values										
Mixed Commercial Banks	750.7	64.3%	959.1	67.2%	1177.1	71.6%	1513.3	75.2%	1946.6	78.4%	26.9
Savings	483.7	41.6%	583.7	41.0%	668.6	40.7%	717.6	35.7%	809.6	32.6%	13.6
Time deposits	265.0	22.7%	373.4	26.2%	508.5	30.9%	795.7	39.6%	1137.0	45.8%	43.9
Mortgage Bank	383.0	32.8%	433.0	30.3%	438.1	26.7%	480.2	23.9%	523.3	21.1%	8.1
Savings	157.1	13.5%	201.6	14.1%	224.7	13.7%	166.7	9.3%	207.0	8.3%	7.1
Time deposits	225.9	19.3%	231.4	16.2%	213.4	13.0%	293.5	14.6%	316.3	12.7%	8.8
BFA	29.4	2.5%	30.9	2.2%	23.7	1.4%	13.1	0.7%	9.4	0.4%	-24.8
Savings	6.6	0.6%	14.3	1.0%	17.8	1.1%	7.2	0.4%	3.3	0.1%	-15.9
Time deposits	22.8	2.0%	16.6	1.2%	5.9	0.4%	5.9	0.3%	6.1	0.2%	-28.1
FEDECACES (only time deposits)	3.9	0.3%	3.9	0.3%	4.3	0.3%	4.4	0.2%	4.2	0.2%	1.9
TOTAL	1167.7	100.0%	1426.9	100.0%	1643.2	100.0%	2011.0	100.0%	2483.5	100.0%	20.8
Savings	649.4	55.6%	801.6	56.2%	911.1	55.4%	911.5	45.3%	1019.9	41.1%	11.9
Time deposits	517.6	44.4%	625.3	43.8%	732.1	44.6%	1099.5	54.7%	1463.6	58.9%	29.7
	Real Values										
Mixed Commercial banks	750.7	64.3%	835.3	67.2%	917.8	71.6%	1043.2	75.3%	1200.8	78.4%	12.5
Savings	485.7	41.6%	510.1	41.0%	521.3	40.7%	494.6	35.7%	499.4	32.6%	0.7
Time deposits	265.0	22.7%	325.2	26.2%	396.5	30.9%	548.6	39.6%	701.4	45.8%	27.5
Mortgage Bank	383.0	32.8%	377.2	30.3%	341.6	26.7%	331.0	23.9%	322.8	21.1%	-4.2
Savings	157.1	13.5%	173.6	14.1%	175.2	13.7%	124.7	9.3%	127.7	8.3%	-3.0
Time deposits	225.9	19.4%	201.6	16.2%	166.4	13.0%	202.3	14.6%	195.1	12.7%	-3.6
BFA	23.4	2.5%	27.0	2.2%	18.5	1.4%	9.1	0.7%	5.8	0.4%	-33.4
Savings	6.6	0.6%	12.5	1.0%	13.9	1.1%	3.0	0.4%	2.0	0.1%	-23.8
Time deposits	22.8	2.0%	14.5	1.2%	4.6	0.4%	4.1	0.3%	3.8	0.2%	-36.1
FEDECACES	3.9	0.3%	3.4	0.3%	3.4	0.3%	3.0	0.2%	2.6	0.2%	-9.6
TOTAL	1167.0	100.0%	1242.9	100.0%	1281.3	100.0%	1386.3	100.0%	1532.0	100.0%	7.0
Savings	649.4	55.6%	698.2	56.2%	710.4	55.4%	628.3	45.3%	629.1	41.1%	-0.8
Time deposits	517.6	44.4%	544.7	43.8%	570.9	44.6%	758.0	54.7%	902.9	58.9%	14.9

Source: Based on information provided by financial institutions.

The above clearly shows that savings and time deposit operations are almost entirely concentrated in the commercial mixed banks and the Mortgage Bank. Most of the operations of these banks are in the urban areas of San Salvador and major cities in the rest of the country. Nevertheless, it is very likely that a considerable amount of these deposits are from incomes derived from agricultural production, given the importance of the agricultural sector in the nation and the fact that many of the medium- and large-sized farmers have residences in urban centers, and, therefore, have direct access to these institutions. A survey of the savings operations of these banks, which is reported in more detail below, shows that these classes of farmers are important holders of time deposits.

The above figures also show the low degree of savings mobilization by the BFA. Although this Bank is authorized to obtain deposits, it has made only a minimal effort to do so, with savings windows in only three of its twenty-six offices.

The fact that FEDECACES is relatively unimportant in the total picture is not surprising given its relative size and the nature of its operations. It should be noted, however, that FEDECACES does not hold the savings of its fourty-four affiliated credit unions. Rather, it only holds a portion of them as the affiliated credit unions must make a contribution of social capital and pay monthly dues to FEDECACES. The affiliated credit unions, have nearly 16,000 members. Each credit union mobilizes forced savings because each member is expected to make montly deposit, usually ¢25. In this manner, members are forced to save and large numbers of persons are involved. The average level of member deposits, however, are considerably smaller than the average size for commercial banks.

There is another class of institution, the savings and loan associations, that mobilize considerable savings. Data for the association are not reported here since they are urban oriented. Nevertheless, it is important to note that these institutions have also experienced an increase in the real value of their savings over the 1980-1984 period. It might be expected that some of these deposits also came from persons with incomes derived from agricultural activities.

Shift to Time Deposits

The data of Table XIII-1 clearly show a shift from savings to time deposits over the 1980-1984 period. For the institutions reported in the table, the nominal and real values of time desposits grew, at an average

annual rates of 29.7 and 14.9 percent, respectively. In contrast, the corresponding growth rates for savings deposits were 11.9 and -0.8 percent.

A number of factors have contributed to this change. There are three that appear to be most plausible. The first factor is the interest rate premium paid on time deposits. With the increasing rate of inflation, savers have shifted their deposits to the more lucrative time deposits instruments to mitigate the effects of inflation. A second factor is the substantial improvement in political stability since 1983, which has given savers more confidence and, therefore, encouraged them to shift to the longer-term but less liquid deposits. This same phenomenon has probably reduced capital flight and caused these funds to be placed in domestic financial institutions. Finally, banks have aggressively sought deposits as a means to gain access to additional resources. All institutions have felt the crunch of restrictive monetary policy, the loss of resources through capital flight and the impacts of extensive refinancing on their ability to extend new credit. As a result, some, especially the mixed banks, have aggressively pursued savings through campaigns and non-interest price incentives, such as raffles. These same conditions have also caused the BFA to spark an interest in savings mobilization. In the case of these institutions there is another motivating factor for savings mobilization; BFA is facing a probable decline in foreign assistance for agricultural credit.

Deposit Mobilization in Commercial Banks

Given the strength and success of savings mobilization in the commercial banks--the mixed banks and the Mortgage Bank--it is useful to examine these institutions more closely in order to understand their clientele, procedures and policies. This analysis will be helpful not only in gaining a better understanding of successful deposit mobilization but also in developing recipes for expanding deposit mobilization in other institutions, such as the BFA.

Size and Number of Deposits

Savings. As shown in Table XIII-2, at the end of 1985, these banks held a large number of deposit accounts. There were 744,231 savings accounts. To put this figure in perspective, assume a national population of 5.8 million and one savings deposit account per person. This means that 12.8 percent of the population holds savings accounts. If there was an average family size of five members and one savings account per family, then some 60 percent of

Table XIII-2. Number, Amount, and Average Size of Deposits by Commercial Bank, as of December, 1995															
Bank	Demand deposits			Savings deposits			Time deposits								
	Number	%	Amount (million \$)	%	Average deposit size	Number	%	Amount (million \$)	%	Average deposit size	Number	%	Amount (million \$)	%	Average deposit size
Banco Agrícola Comercial	22,114	19.29%	227.9	30.08%	10,289	256,370	34.45%	311.4	24.66%	1,214	6,199	19.54%	271.1	14.34%	43,732
Banco Capitalizador	8,784	7.66%	84.9	7.49%	9,661	62,839	8.44%	108.5	8.59%	1,727	8,121	2.84%	181	0.97%	57,988
Banco de Comercio	21,682	18.91%	124.9	11.02%	5,763	91,103	12.24%	169.5	13.42%	1,861	2,970	9.36%	185.5	9.81%	62,450
Banco de Crédito Popular	7,170	6.25%	75.8	6.69%	10,572	61,000	8.20%	101	8.00%	1,636	1,187	3.74%	107.1	5.66%	90,227
Banco Diferencial	20,295	17.70%	294.3	25.98%	14,502	71,699	9.63%	137.7	10.90%	1,921	6,297	19.85%	452.8	23.94%	71,901
Banco de Desarrollo e Inversión	2,246	1.96%	39	3.44%	17,363	5,989	0.80%	19.5	1.54%	3,250	1,034	3.25%	99.2	5.25%	95,920
Banco Financiera	1,800	1.57%	22.9	1.99%	12,508	3,429	0.46%	10.8	0.86%	3,149	343	1.08%	20.5	1.61%	68,980
Banco Mercantil	2,370	2.24%	46.6	4.11%	18,129	6,206	0.83%	22	1.74%	3,549	620	1.99%	67.6	3.57%	109,074
Banco Salvadorana	13,000	11.34%	114.1	10.07%	8,778	85,400	11.47%	158.1	12.52%	1,851	8,300	10.40%	169.5	8.96%	31,354
Banco Hispanoamericano	15,009	13.09%	103.3	9.12%	6,882	100,196	13.46%	224.4	17.77%	2,239	6,658	20.99%	326.8	17.28%	49,089
Total	114,659	100.00%	1,132.9	100.00%	1,445	744,231	100.00%	1,262.9	100.00%	2,241	31,729	100.00%	1,891.1	100.00%	72,071
Source: Based on information provided by financial institutions.															

five members and one savings account per family, then some 60 percent of the nation's families hold savings accounts. The mean size of deposit was ¢2,239. This figure probably overstates the mean size of personal or family savings deposits, however, because it would be expected that business firms would keep reasonably large sums in these accounts as a means to store short-term surpluses of cash as well as to meet their needs for short-term liquidity.

These average number of deposits per bank was 74,423. There was a considerable range across institutions, presumably a function of their size of operation.

Bankers in all institutions were interviewed. It is their opinion that most savings accounts are held by low-income urban and, to lesser extent, rural dwellers. Many of these customers do not use other bank services. Therefore, they use the bank as place to safekeep their money and earn a small nominal return. The above figures clearly demonstrate a propensity for low-income El Salvadoreans to save in financial institutions.

Time Deposits. There were 31,729 time deposits, only about 4.3 percent the number of savings deposits. Clearly, these deposits are much larger. The average deposit size of ¢73,071 was considerably larger, almost thirty-two times, than the ¢2,241 average saving deposit. Bankers reported that customers with time deposits were mostly middle- and upper-income persons representing families medium- and large-sized business and farms.

Demand Deposits. The banks also had a considerable number of demand deposit accounts, 114,669. It is noteworthy that this number was only about one-seventh the number of savings deposit accounts. This shows that a considerably large number of persons are using savings account services of these banks than demand deposits. Therefore, in terms of numbers of persons served, the savings accounts are the most important. This is strongly suggestive of the development of financial intermediation, or financial deepening, in El Salvador.

Policies and Incentives for Deposits

The observed patterns of deposits in the commercial banks reflects their policies and national monetary policy.

The banks employ requirements for minimum-sized deposits that limit the access of small depositors to demand and time deposits but encourage

them to make use of savings deposits. For checking accounts the minimum deposit is usually ₦1,000. In addition, the banks usually require compensatory balances for loans. The minimum amount for savings accounts ranges from ₦25 to ₦50, although the law establishes the floor at ₦1. The high deposit threshold for entry into demand and time deposits serves to keep low-income persons from having access to demand and time deposits.

The banks are limited by the Monetary Board policy with respect to the interest they may pay on deposits. Given the low or even negative real rates of interest in recent years, as well as the Monetary Board's restrictive monetary policy, many of the banks have been aggressively seeking deposits by offering additional inducements to potential savers. They employ advertising and promotional campaigns and offer non-interest financial rewards such as chances in a raffle and life insurance that is double the amount to savings deposits. Furthermore, the banks give their employees incentives by rewarding them for opening new accounts.

Selected Deposit Ratios

Three ratios were calculated to show the relative importance of deposits in the commercial bank's operations. They are reported in Table XIII-3. The first ratio is total deposits less legal reserves as a proportion of the total loan portfolio, which serves to show the relative importance of net deposits (after reserves have been subtracted) to loans. Higher ratios show that the banks are using deposits in financing credit. The mean for the ten banks was .95, which shows that these banks have a high degree of self-financing their loan portfolio. Therefore, deposits are an important source of loanable funds to these banks.

The second ratio is the size of deposits relative to equity capital less reserves, which indicates the degree of leverage by the banks. The mean for the ten banks, was 21.0, which shows that the banks have leveraged their own capital extensively to obtain deposits.

The third ratio is the proportion of deposits relative to assets. The mean for the ten banks is .66, which shows that the banks' deposit liabilities are considerably less their assets.

TABLE XIII-3. Selected Ratios for the Salvadoran Commercial Banking System, As of December 31, 1985.

	Deposits Minus <u>Legal Requirement</u> Portfolio	<u>Deposits</u> Equity Capital Minus Reserves	<u>Deposits</u> Assets
Banco Agrícola Comercial	1.05	21.7	0.63
Banco Capitalizador	0.89	26.8	0.71
Banco de Comercio	0.95	13.8	0.70
Banco de Crédito Popular	0.86	12.4	0.45
Banco Cuscatlán	0.98	28.3	0.71
Banco de Desarrollo e Inversión	0.75	9.4	0.55
Banco Financiero	0.84	21.3	0.63
Banco Mercantil	1.13	13.6	0.78
Banco Salvadoreño	1.10	17.7	0.73
Banco Hipotecario	0.92	44.6	0.74
System Average	0.95	21.0	0.66

Source: Based on Institutions' Financial Statements.

Conclusions

The El Salvadorean commercial banking system, but especially the mixed banks have been quite successful in mobilizing deposits. They hold over 744,000 savings accounts, mostly for low-income and small-scale depositors, 32,000 time deposit accounts and 114,000 demand deposit accounts. These are impressive numbers. A rough calculation suggests that as many as three-fifths of the families may hold savings accounts in these financial institutions (note that the savings and loan associations, which all have a number of depositors, were not included, were they included the proportion would be expected to be higher).

Time and demand deposits are much fewer in number and are held by medium- and large-scale business and farmers. Fairly large minimum deposits keep low-income people from having access to these financial instruments.

These banks have aggressively pursued mobilizing savings and time deposits through campaigns and non-interest rate incentives. Bank employees are rewarded for performance. It clearly appears that these institutions are very interested in deposit mobilization and therefore, financial intermediation. The fact that many of these banks have adopted modern banking technology such as open credit lines and automatic tellers,

suggests that they are endeavoring to cut costs and provide better financial intermediation services.

The Determinants of Aggregate Savings and Time Deposits in the Financial System

This section undertakes an analysis of the determinants of the levels of savings and time deposits in El Salvadorean financial institutions. It begins with the formulation of a model that is hypothesized to explain the levels of these savings and concludes with an estimation of the model using multiple regression techniques.

Theoretical Considerations

There are a number of factors that determine the levels of saving and time deposits in financial institutions. Of course, the most fundamental factor would be expected to be the aggregate level of income earned from economic activity since this is the source from which current savings must come. A related factor would be the distribution of the incomes earned. If the distribution of income is highly skewed toward the wealthy, then less saving in financial institutions might be expected.

Given a base of income and its distribution, there are a number of factors directly associated with the financial institutions and monetary policy that will influence savings in the institutions. These can be grouped into two broad categories: interest rate and financial deepening. The interest rates paid on savings and time deposits are the principal rewards that the potential saver would receive as a return for placing funds on deposit. The levels of the interest rates on these deposits will be compared to the expected rates of return on other types of domestic investment-- for example, purchase of durable goods or direct investment in capital goods-- as well as foreign investments in financial instruments, real estate, capital goods, etc. Of course, considerations of liquidity are also important. A saver may be willing to receive a smaller gain by placing resources in a liquid financial instrument rather than tie them up in a longer-term investment that offers a higher rate of return.

The second factor of financial deepening has implications for transactions costs associated with savings and withdrawals. In this regard the accessibility of savings institutions will make an important difference, especially for potential savers of small amounts. A saver experiences costs

in undertaking savings and withdrawal transactions. If financial institutions are readily accessible these transactions costs should be lower and encourage more savings. Paperwork is another factor that can lead to transactions costs. Delays in time that the saver experiences in making withdrawals is another factor contributing to these costs.

Model

The aggregate level of saving and time deposits (hereafter referred to as savings for sake of brevity) in El Salvadorean financial institutions will undoubtedly be influenced by a number of factors.

Gross Domestic Product. Current GDP is the source from which current savings must come. It is hypothesized that as GDP increases (decreases) savings deposits will increase (decrease).

Interest Rate on Deposits. The interest rate is the return the saver receives on deposits. It is hypothesized that as the interest rate rises (falls) savings deposits would increase (decline).

Financial Deepening. As the economy develops more financial intermediation relative to its level of economic activity, it is expected that the institutions will have a larger number of and more accessible offices. Furthermore, competition will lower transactions costs. Therefore, with financial deepening, savings deposits would be expected to rise because of the availability of financial services. It is hypothesized that as financial deepening increases (decreases) savings deposits will increase (decrease).

Capital Flight. Residents would be expected to send savings out of the country the higher the rate of return on investment abroad relative to rates of return on domestic investment. It is hypothesized that as the rate of return is more (less) attractive capital flight will increase (decrease).

Inflation. As inflation increases, the incentive to save in the form of financial assets declines if the nominal rate of interest is not adjusted for the effect of inflation. Under these conditions savings will be directed more to investment in real or speculative goods. It is hypothesized that as the rate of inflation increases (decreases) savings deposits will decline (increase).

Political Instability. Political instability is expected to discourage savings because it leads to economic uncertainty. Indeed it may lead to less saving

and greater capital flight. Therefore, in El Salvador the years between 1979 and 1984 may be associated with a lower level of savings-deposits.

To estimate the importance of the above factors influencing saving deposits the following model was estimated.

$$(1) \text{TPDO} = a_0 + a_1 \text{NGDP} + a_2 \text{MINT} + a_3 \text{FD} + a_4 \text{TBILL} \\ + a_5 \text{INF} + a_6 \text{DUM}_1 \text{ and } a_7 \text{DUM}_2$$

where:

TPDO = nominal private domestic currency deposits in commercial banks and other financial institutions.

NGDP = nominal gross domestic product.

MINT = proxy for domestic interest rate on deposits, the percent nominal interest rate paid on Mortgage Bank certificates. (Note: time series for other interest rates were not available for the complete period).

FD = proxy for financial deepening. Ratio of quasi-money (time, savings and foreign currency deposits of residents) to nominal gross domestic product.

TBILL = proxy for attractiveness of capital flight, the percent average annual interest rate on U.S. Treasury Bills.

INF = annual rate of inflation based on San Salvador Consumer Price Index (1980=100.0).

DUM₁ = dummy variable for political instability and economic uncertainty. DUM₁ = 1 from 1979-1984, and = 0 for all other years.

DUM₂ = dummy variable for the creation of non-banking financial institutions in 1969. DUM₂ = 1 for 1969-1984, and = 0 for other years.

The Results

Equation 1 was estimated by step-wise multiple regression techniques in linear, semi-logarithmic and logarithmic forms. The equation was estimated for two periods 1956-1984, and 1969-1984. The latter period was considered in isolation because in 1969 new savings and loan associations were introduced and there was a considerable increase in savings and time deposits in financial institutions in that year, and, moreover, in the 1970s and 1980s the El Salvadorean economy encountered economic difficulties that were not present in the 1950s and 1960s. Therefore, it was expected that the shorter period might more readily capture the effects of changes in the independent variables on savings.

When equation 1 was estimated not all of the independent variables were significant and/or had the hypothesized sign. These results led to a consideration of modifications in the equation, such as using annual changes in savings, per capita variables. The most relevant results are those of the linear form and are reported on Table XIII-4.

Before discussing the specific equations it should be noted that neither of the dummy variables proved to be significant. With respect to DUM_2 this means that the increase in savings coming from deposits in savings and loan association beginning in 1969 was insufficient to raise the fitted trend line between 1956 and 1984 significantly. This suggests that these savings probably were substitutes for what would have been increases in savings in the commercial banks.

The DUM_1 variable was designed to detect whether the political instability and economic uncertainty contributed to a change in the level of domestic saving. Although the variable consistently had the hypothesized sign it was not significant. The conclusion is that the events between 1979 and 1984 did not disrupt domestic financial savings sufficiently to cause a significant change in the fitted trend. This is borne out by the data presented in Table XIII-1.

1956 - 1984

Equation (4.1) of Table XIII-4 provides very illuminating results on the determinants of savings deposits in El Salvador. Over the period, the strongest determinant of deposits was nominal GDP. The 0.21 coefficient on the NGDP variable is highly significant at the 0.01 percent level and it says

Equation	Period	R						
(4.1)	1956-1984	0.98	TPDO =	-717.18 (5.47) 99.99	+ .21 NGDP (7.47) 99.99	+69.04 MINT (2.42) 97.58	+2744.77 FD (2.94) 99.25	-34.01 TBILL (2.25) 96.52
(4.2)	1956-1984	0.99	TPDQPC =	-215.96 (14.92) 99.99	+ .21 NGDPPC (9.81) 99.99	+12.41 MINT (2.97) 99.29	+1002.93 FD (6.82) 99.99	-5.31 TBILL (2.15) 95.73
(4.3)	1956-1984	0.99	TPDO =	-1593.76 (10.66) 99.99	+ .24 NGDP (20.82) 99.99	+10557.25 FD (8.84) 99.99	-10.73 INF (2.43) 96.67	
(4.4)	1956-1984	0.99	TPDQPC =	-336.68 (13.87) 99.99	+ .24 NGDPPC (21.03) 99.99	+2294.95 FD (11.13) 99.99	-1.64 INF (1.97) 92.56	

that for each $\$1.00$ increase in GDP $\$0.21$ will be saved in financial institutions. The result may strike some as being a little high but it easily falls within the bounds of savings ratios found for other countries.

Financial deepening (FD) was the second most important variable, being significant at the 0.75 percent level. The coefficient should be interpreted as a ratio, which says that if financial deepening occurs savings deposits will increase.

The interest rate variable (MINT) is also highly significant at the 2.42 percent level and of the hypothesized sign. It should be interpreted as meaning that a one percentage point increase in the nominal rate will give rise to $\$69$ million in additional savings deposits.

The capital flight variable (TBILL) has the hypothesized sign and is also highly significant at the 3.48 percent level. The coefficient should be interpreted as a one percentage point increase in the U.S. Treasury Bill interest rate will cause increased capital flight and a $\$34$ million decline in domestic savings deposits.

Finally, the inflation variable was not significant and was, therefore, eliminated.

When the variables were expressed in per capita terms, as in Equation 4.2, the results were very similar. In summary, these results confirm the hypotheses. They show that savings deposits depend mostly on GDP. Indeed, if NGDP were the only independent variable the R^2 would be quite high. Financial deepening occurred over time in El Salvador and, in effect, served as a trend variable over the period. The interest rate variable behaved as expected as did the proxy for capital flight.

1969 - 1984

When the shorter time period was employed the results were similar but with some significant differences. The interest rate and capital flight variables were of the hypothesized signs but not significant and, therefore, were eliminated. For this period, the inflation variable (INF) had the hypothesized sign and was significant. The results for nominal aggregate and per capita values are presented in Equations 4.3 and 4.4. There is an explanation why the inflation variable entered. In this period, but particularly in the 1980s, El Salvador began to experience inflationary pressures. As inflation rose, there was decline in savings deposits because of

two related factors. First, there were very few changes in the nominal interest rate structure over the period because of the rigid interest rate structure of the Monetary Board. The interest rate variable therefore, does not show much change nor does it reflect the real rate of return on domestic deposits. Second, there were pressures for devaluation. Both of these factors would cause more capital flight. Therefore, what may be reflected in the equations is that inflation variable captures both of these factors, in a combined way better than the interest rate variable or the capital flight variable, independently.

Interest Rate Elasticity. The elasticity of regression coefficients is directly measured from logarithmic forms. Unfortunately, the interest rate variable in this form behaved quite erratically, depending on the variables included in the equation; its sign and the level of significance fluctuated considerably. This is because the two principal explanatory variables were the levels of GDP and financial deepening. Therefore, little confidence can be placed in these results.

Equation 4.1 in Table XIII-4 can be used, however, to estimate arc elasticity over the whole twenty-nine year period. The arc elasticity is 0.68, which shows that savings deposits are quite inelastic with respect to changes in interest rate. In other words, the percentage increase (decrease) in deposits will be .68 as large as the percentage increase (decrease) in interest rates. This undoubtedly reflects the fact that the Monetary Board infrequently changes the interest rate structure. Therefore, when changes in deposits rates did occur there was a less than corresponding percentage increase in savings deposits.

The Case of the Agricultural Development Bank

Among financial institutions serving the rural areas BFA has the best infrastructure to mobilize rural deposits because it has twenty-six offices nationwide. Yet, although it was authorized to mobilize deposits when it was not established in 1973 it was not until 1977 that it began to mobilize them. In 1985 it was only receiving deposits in three of its twenty-six offices.

BFA simply has not been of the mind to nor has it had incentives to mobilize deposits. As a development bank and as an outgrowth of its predecessor institution, ABC, it has concentrated on development credit to the agricultural sector. It has regularly received government subsidies of one form or another. The process has been abetted by foreign assistance, which made concessionary-priced loans to the government of El Salvador,

which in turn used the funds to make interest-free grants to BFA to augment its capital. Under these conditions BFA has had little incentive to mobilize deposits because they involve financial costs (to cover interest paid on savings and time deposits) administrative costs (to manage the funds) and risk costs (to cover against uncollectable loans). The end results are that BFA has not had reason to become a highly efficient and financially viable institution nor does it carry out a role as a financial intermediary in rural areas. Rather, it, just concentrates on credit.

In recent years, however, BFA has experienced problems of extremely high rates of delinquency; at the end of 1984, 24.1 percent of the portfolio was more than 90 days in arrears. Refinancing of delinquent loans between 1980 and 1984 increased at an average annual rate of 67.4 percent. The result is that BFA has found much of its assets tied up in bad or refinanced debt which has limited its ability to lend. The future prospects are less sanguine because of the probabilities that BFA will receive considerably less foreign assistance. Faced with this situation BFA has to look inward to gain additional resources and it has chosen two paths: to try to cut costs and mobilize more savings. They have made some changes with respect to the latter, they have only begun to contemplate how it might be done. This report undertakes a preliminary analysis by undertaking feasibility studies for savings mobilization in three agencies. The results are favorable. To begin, however, it is useful to review BFA's deposit mobilization to date in both the aggregate and the agency level.

Experience in Deposit Mobilization

BFA began to mobilize deposits in January 1977 in the central office and in the San Salvador agency. In 1980 it extended its operations to the agency in La Libertad. The reasons for opening the deposits window were to capture some funds from input suppliers and borrowers, to gain experience in deposit mobilization, and to provide banking services to some government entities.

Portfolio. Table XIII-5 provides information on the end-of-year balances of the various types of deposits over the 1980-1985 period. As shown in the table, the total amount of deposits decreased from \$36.4 million 1980 to \$18.6 million in 1985. In 1981 the total amount of deposits increased. However, since 1982 total deposits have declined.

It is noteworthy that the most important depositors were government institutions such as IRA, the Public Employee National Retirement Institute

(INPEP), ANTEL, Salvadorean Institute of Social Security, ANDA, Financiera Nacional de la Vivienda. Most of those institutions held substantial amounts of time and demand deposits in BFA. This was a means that the government could indirectly benefit the Bank by placing some of its organizations' funds in BFA. At present, INPEP is the one of the most important bank clients, with a substantial amount of time deposits. The others are still maintaining small amounts of balances. Other important depositors are suppliers of inputs for the BFA retail outlets and some reformed sector cooperatives.

As noted above, there was a decrease in deposits in BFA in the past land reform period, but this was accompanied by increases in foreign assistance, especially by USAID and IDB. Most foreign assistance funds were loans to the government which then passed them on to BFA as a contribution to its equity capital or/as soft long-term loans. Thus, it has become more profitable for BFA to use those funds instead of competing with other financial institutions for domestic resources. The availability by new foreign assistance to BFA may also have caused the government to place the financial resources of its organizations in other institutions, i.e., there was a substitution of foreign for domestic resources in the Bank.

BFA's deposit balances are concentrated in time and savings deposits. At the end of 1985, 40.1 and 24.2 percent of the deposits were in these accounts, respectively.

Table XIII-5. BFA's End-of-Year Balances of Deposits, 1980-1985
(Million Colones)

Year	Total deposits	%	Demand deposits	%	Savings deposits	%	Time deposits	%
1980	36.4	100	7.2	19.8	6.4	17.6	22.8	62.6
1981	38.9	100	8.0	20.6	16.6	42.7	14.3	36.7
1982	33.7	100	9.5	28.2	18.3	54.3	5.9	17.5
1983	24.5	100	10.6	43.3	8.0	32.6	5.9	24.1
1984	16.4	100	6.5	39.6	3.8	23.2	6.1	37.2
1985	18.6	100	6.5	34.9	4.5	24.2	7.6	40.1

Source: BFA's financial statements.

Number of Accounts. As shown in Table XIII-6 BFA's deposit accounts were concentrated in demand and savings deposits, which at the end of 1985, accounted for 23.0 and 75.5 percent of the number of accounts respectively. Time deposits corresponded to only 1.5 percent of the total. Each type of deposit experienced a sharp increase in the numbers of accounts over the 1980-1984 period, but the number of savings accounts grew most rapidly so

their share increased. This increase is mostly due to the requirement that participants in the USAID Small Enterprise project be required to have a savings account in order to obtain credit. Another factor is that the Bank has encouraged its employees to open deposit accounts. It is curious, however, that the amounts on deposit in all three categories declined. This means that the average size of deposit in each category declined sharply. This pattern reflects the above-mentioned increase in the numbers of Bank clients and employees using deposit activities as well as the afore-mentioned simultaneous decline in the balances of the former big depositors, the government organizations.

Table XIII-6. BFA's Number of Deposit Accounts 1980-1985.

Year	Total	%	Demand deposits	%	Savings deposits	%	Time deposits	%
1980	2,269	100	1,037	45.7	1,179	52.0	53	2.3
1981	2,988	100	1,145	38.3	1,790	59.9	53	1.8
1982	4,062	100	1,462	36.0	2,554	62.9	46	1.1
1983	3,944	100	1,056	26.8	2,846	72.1	42	1.1
1984	4,420	100	1,064	24.0	3,300	74.7	56	1.3
1985	5,176	100	1,192	23.0	3,909	75.5	75	1.5

Source: BFA Department of Deposits.

Selected Deposit Ratios. The relative importance of deposits as a source of loanable funds and as a part of the general bank structure is measured through three ratios: (1) the deposits less legal reserve requirement/portfolio ratio, (2) the deposits/equity capital ratio, and (3) the deposits/total assets ratio. An examination of these ratios shows the role of deposits in BFA. Comparisons of the BFA figures with these calculated for the commercial banks and reported in Table XIII-3 serve to show the relative unimportance of deposits in BFA.

As shown in the Table XIII-7 the first ratio indicates that deposits were more important as source of funds in 1980, 1981 and 1982. Beginning 1983 they lost their relative importance.

However, even in 1980 when deposits represented 12 percent of the portfolio they were far from the 95 percent average estimated for the El Salvadorean Commercial Banking system.

The deposits/equity capital ratio, indicates that BFA is not using its capital as leverage for capturing deposits. Finally, the deposits/assets ratio shows that BFA has a great deal of potential for growth if it were to expand

its deposits. At the end of 1985 the average deposits/equity capital less reserves ratio for commercial banks was 21, the same ratio for BFA was 0.11. This means that the commercial banks deposits represented 21 times their equity capital minus reserve. In the case of BFA, deposits were only 11 percent of the equity capital less reserves. The average deposits/assets ratio for the commercial banks was 66; for BFA it was 0.03. This is another indicator of the relative unimportance of deposits for BFA.

The lack of deposits in BFA makes the institution highly dependent on infusions of capital from the government, foreign aid or Central Bank rediscounts. Since inflation and delinquency erode the funds constantly, if the bank does not mobilize deposits it will permanently need new infusions of fresh capital to sustain its previous levels of operations. Its financial viability and its long-run survival will depend upon these infusions.

Table XIII-7. Selected Deposit Ratios for BFA.

Year	Deposits less legal <u>reserve requirement</u> portfolio	Deposits equity capital less reserve	<u>De. asets</u> Total assets
1980	0.12	0.70	0.07
1981	0.11	0.49	0.07
1982	0.10	0.39	0.06
1983	0.06	0.23	0.04
1984	0.04	0.13	0.03
1985	0.04	0.11	0.03
Average Salvadorean commercial banks	0.95	21.0	0.66

Source: Based on BFA's financial statements and Table XIII-3.

Agency Deposit Analysis

Deposits. The number and amount of various type of deposits at the end of 1985 are shown in Table XIII-8. As shown in the table, the amount of deposits were concentrated at the central office; 77.2 percent of the total amount were at that office, 12.8 percent at San Salvador and only 10.0 percent at La Libertad. The number of deposits was more evenly distributed.

Time deposits were also concentrated, 94.7 percent were held by the central office. The distribution of saving deposits was less concentrated, 55.6 percent of the amount and 36.6 of the number of savings accounts were held

TABLE B. Number and Amount of Deposits in Three EFA Agencies as of December 31, 1995																
Agency	Demand deposits				Savings deposits				Time deposits				Total deposits			
	Number	\$	Amount (million)	\$	Number	\$	Amount (million)	\$	Number	\$	Amount (million)	\$	Number	\$	Amount (million)	\$
Central Office	446	52.7	4.2	71.2	1431	36.6	2.3	55.6	59	79.7	7.4	74.7	2036	40.6	13.9	77.2
San Salvador	573	36.0	1.8	22.0	676	17.8	0.7	15.6	6	8.0	0.9	4.0	1055	21.0	2.3	12.9
La Libertad	117	11.3	0.6	6.8	1002	44.1	1.1	28.8	10	13.3	0.1	1.3	1929	39.6	1.9	19.0
Total	10350	100.0	6.6	100.0	3909.0	100.0	4.1	100.0	75.0	100.0	7.6	100.0	3020.0	100.0	16.0	100.0
Source: EFA Deposits Department																

at the central office. La Libertad had 46.1 percent of the number and 28.8 percent of the amount. San Salvador held the balance. Demand deposits were concentrated mainly at the central office, which had 71.2 percent of the volume and 52.7 percent of the number. San Salvador was second in relative importance.

There are several explanations for these patterns. Time deposits and demand deposits were derived from non-agricultural bank clients who did their banking at the central office. La Libertad and San Salvador were holding some resources of reformed sector cooperatives in time deposits.

Deposit Turnover. In order to determine the turnover of demand and savings deposits, an analysis was made of the daily changes of five variables in the above-mentioned agencies over the period January 2 through November 30, 1985 (data were not available for December). The variables studied were the number and amount of daily deposits, number and value of daily withdrawals and the daily balances. This analysis was not necessary for time deposits because these deposits are not subject to substantial day-by-day changes. They can increase very rapidly due to new deposits but withdrawals are not so frequent.

The results of the univariate statistical analysis for the variables are shown in Tables XIII-9 and 10. For demand deposits the average number of deposits per day for the central office was 100 (upper and lower limits of 106 and 94 for San Salvador Agency 51 (upper and lower limits 55 and 48). For La Libertad, 18 (upper and lower limits of 19 and 17). All upper and lower limits are determined by the 99 percent confidence interval.

The mean average of daily deposits of demand deposits were ₡557,491 for the central office, ₡158,697 for San Salvador, and ₡44,019 for La Libertad. The mean daily withdrawals were ₡549,250 per central office, ₡156,662 for San Salvador Agency, and ₡43,928 for La Libertad.

The above operations determine the mean daily balance of loanable funds before the legal reserve requirements is deducted. The daily balance for the central office was ₡4,345,538 (upper and lower limits of ₡4,590,790 and ₡4,100,286); for the San Salvador Agency ₡1,643,124 (upper and lower limits of ₡1,521,776 and ₡1,404,473); and for La Libertad ₡356,360 (upper and lower limits of ₡367,376 and ₡345,345). Again, all upper and lower limits are determined by the 99 percent confidence interval.

Table XIII-10 presents the data for the same type of analysis of savings accounts. As shown in the table, the daily mean deposits in the three

Table III B. Statistical Summary of the Daily Flow of Demand Deposits in Banks of A. S. America, January-December, 1953.															
MEASURES	CENTRAL OFFICE				SAN SALVADOR				LA LIBERTAD						
	No. of items	Value of Deposits	No. of withdrawals	Value of Withdrawals	Balance	No. of deposits	Value of Deposits	No. of withdrawals	Value of Withdrawals	Balance	No. of deposits	Value of Deposits	No. of withdrawals	Value of Withdrawals	Balance
Mean (AVERAGE)	100 3454	227491.1	225 3367	549250.8	434737.8	51,11374	159497.9	28 57331	151451.7	1473124	18,17622	44019.4	18 61227	43129.02	326360.8
Variance	1251281	2 720 7446+11	10874 17	2 001 8725+11	2 273 137+12	765 7619	1432774+10	172 9041	1 637 774+10	1 179 316+11	31 61457	80 2446+8	44 12 741	6 113 446+10	4 222 251+07
Standard deviation	15 35644	1 632 355.4	104 2134	447415.8	150 354	19 4032	127770	11 24291	127775.4	342 259.1	5 622 666	283 2 45	6 692 741	24 727 39	64533 37
Standard error	2 210181	75222 57	6 397254	28740 43	97276 54	1 215277	9425 162	0 974 734	8434 447	227 69 82	0 17 0 74 76	18 64 56	0 44 12741	1612 743	6276 304
Upper 95% con. limit of mean	104 7567	632925.1	248 2275	604102.4	4732143	53 0214	172212	63 308	172201	152 7722	18 93448	4768 25	20 33444	4712 743	14474 4
Upper 95% con. limit of mean	23 8322	482228	242 4229	473899.1	4129331	46 77459	1421818	24 92582	140122.3	1418493	17 4216	4360 44	13 00467	4212 54	14737 1
Upper 97% con. limit of mean	105 1741	153673 7	272 2821	621928.4	4520170	54 4716	180402 2	42 92671	178197.1	1521774	17 12331	48926 23	21 00423	48 27 78	16731 6
Upper 99% con. limit of mean	2492262	459129.4	278 3718	476322.9	4100286	67 77692	136973.7	56 62111	134924.2	1404478	17 22122	35210 45	18 73291	17729 25	345315.1

FORM #1111R - Statistical Summary of the De V. C. of Service Deposits in Over 100 P.A. Agencies, January-December, 1955															
MEASURES	CENTRAL OFFICE				SAN SALVADOR				LA LIBERTAD						
	No. of Depos.	Value of Dep.	No. of Withdrawals	Value of Withdrawals	Balance	No. of Deposits	Value of Deposits	No. of Withdrawals	Value of Withdrawals	Balance	No. of Deposits	Value of Deposits	No. of Withdrawals	Value of Withdrawals	Balance
Mean (AVERAGE)	34,6484	10497.94	50,63745	10216.79	244297	9191304	13227.31	14,13044	11342.52	821263.7	13,63452	11102.11	15,43344	10261.77	1230672
Variance	176,1337	2,374041E+10	378,056	2,432671E+10	2,194362E+11	25,6925	4,259132E+02	31,63191	1,306848E+08	2,69275E+10	25,01425	1,712337E+09	19,37549	10261.77	1230672
Standard deviation	13,27132	169219.2	19,44266	156066.9	468447.1	5069777	20732.52	5,643749	36150.29	164042.4	5,021425	1,316119	4,465139	7,591632E+07	4,384272E+11
Standard error	1,22452	10151.97	1,227273	1020021.	24450.51	0,3742253	1361.662	0,7721379	2561.679	10918.61	0,1297862	1,316119	0,465139	0,707371	1,521213
Upper 95% con. limit of mean	15,81167	11155.4	16,24291	109844.6	2500115	7,046166	16205.81	14,05983	16054.53	84255.9	14,50227	13031.16	14,06922	7,741424	1,375133
Lower 95% con. limit of mean	13,21659	8160.45	14,28291	71229.14	2355115	7,046166	10847.81	11,40104	6710.911	80034.7	13,21014	10101.12	14,06922	11,72109	1,344431
Upper 99% con. limit of mean	17,54777	117513.7	18,79591	115312.9	2518757	9,522649	17049.91	15,08326	17022.89	84342.9	14,76409	14037.22	14,18217	14,71424	1,749214
Lower 99% con. limit of mean	11,26491	63032.69	12,47579	69161.04	2467021	7,136334	10025.87	13,17181	2242.165	757701.7	13,007	9554.519	14,67129	9,112754	1,147561

agencies were 34.4, 8.2 and 13.8 for the central office, San Salvador and La Libertad, respectively. In the same order, the mean number of withdrawals was 58, 14, and 15. The mean values of deposits were ₡90,497, ₡13,527, and ₡11,802. The average values of withdrawals were ₡58,637, ₡11,382, and ₡10,597. The daily mean balances were ₡2,442,892 (upper and ₡849,429 and ₡793,702), and ₡1,260,672 (upper and lower limits of 1,373,383 and 1,147,961), for central office, San Salvador and La Libertad, respectively. The upper and lower limits were based on the 99 percent confidence interval.

These figures clearly demonstrate that, in 1985, BFA maintained favorable and sizeable balances in both its savings and demand deposits account. The number of transactions and balances in the demand deposit accounts were substantially higher than in savings. The balances, however, suggest a potential for using funds derived from these sources to finance credit operation.

Agency Costs

BFA does not keep separate accounts in the agencies. However, recently it has begun to try to identify the direct costs by agencies and the various bank departments. With the available information it is possible to make reasonable estimates of the operating costs of mobilizing resources through deposits in three agencies. Moreover, the limited information on income received by agencies is sufficient to estimate income statements for three agencies. The estimated income statements as of December 31, 1985 are shown in Table XIII-11. Several assumptions were made. The end-of-year portfolio was assumed to be distributed according to two sources of loanable funds. One portion is assumed financed by deposits obtained in each agency and the balance is financed from other sources including funds from USAID, IDB, Central Bank rediscount, and the World Food Program. The interest rates are assumed to be 8.75 and 11.5 percent on savings and time deposits, respectively. The amount of loanable funds available from demand and savings deposits are assumed to be the mean average balances in Tables XIII-9 and XIII-10 less legal reserve requirements. The available loanable funds from time deposits were assumed to be the end-of-year balances minus the legal reserve requirements.

The administrative cost figures were obtained from the BFA budgeting and administrative cost control department. They represent the actual direct costs of agencies in 1985. It is difficult to estimate the corresponding indirect costs of agencies. Thus, no effort was made to determine these costs,

Table XIII-11. Income Statement for three BFA's Agencies as of December 31, 1985:			
(000's Colones)			
Description	Central Office	San Salvador	La Libertad
I- Operating costs	2,262	3,654	1,364
Financial costs	1,092	2,026	623
Administrative costs	520	1,040	635
Risk costs (5% of delinquent portfolio)	650	588	106
II- Operating income	2329 (2735)*	3259 (5175)*	896 (1533)*
Interest received	2,165	3,125	834
(Interest received from 95% of the portfolio)	(2571)*	(5041)*	(1471)*
Commissions	164	134	62
III- Profit (loss) **	67	(395)	(468)
IV- Profit (loss under second assumption) ***	473	1,521	169
Source: Authors' estimates base on information available in BFA.			
* Estimated under assumption of interest receipts from 95 percent of the 1985 end-of-year portfolio			
** This level of profit (loss) is obtained when actual Agencies interest receipts are used to estimate income			
*** This level of profit (loss) will be obtained if 95 percent of recuperation would occur			

although, it should be recognized that those costs are high and they affect the profitability of agencies. The administrative costs for the central office include the direct costs of deposits and the treasury department.

Table XIII-11 presents findings. The key variable which determines the final result of the income statement: is interest income. This, in turn, depends on the interest rate. For example, for the central office it is assumed that ₡16.4 million of the portfolio is placed in loans that earn a 16.5 percent interest rate, and that 68.3 percent of the portfolio is financed through deposits. It is assumed that 20 percent of the portfolio is delinquent and does not generate interest earnings. Under these conservative circumstances there is a profit of ₡ 67 thousand. When it is assumed that there is interest income from 95 percent of the portfolio the profit rises to ₡473 thousand.

In case of San Salvador, the 1985 end-of-year portfolio was ₡48.8 million in loans earning 13 percent interest. Of this portfolio, 5.2 percent was assumed financed through deposits and the remaining 94.8 percent from other sources. When the actual amount of interest earnings are considered there is a loss of ₡345 thousand. Assuming interest receipts from 95 percent of the portfolio the final result changes to a ₡1.5 thousand profit. Similar results are observed for La Libertad.

Suggested Strategy for BFA

The above results, although based on rough estimates, offer encouraging evidence about the profitability of BFA using deposits as means to obtain additional loanable resources. There appear to be a number of advantages for BFA to expand its capacity for obtaining its own financial resources in all agencies. With small additional cost the Bank should be able to mobilize domestic resources to be used for a significant level of financing activities in rural areas. The wide-spread presence of BFA offices throughout the country puts the institution in a advantageous situation. The amount of its equity capital of ₡170.3 million as of December 31, 1985 would support ten times this amount in deposits. In this manner, BFA could expand lending operations without depending so much on foreign assistance or Central Bank rediscounts. Furthermore, it is very important to note, that if the BFA begins to rely on mobilized resources, it will be forced to become more cost conscious in its administration. This would be an indirect benefit to help it become a more financially viable institution. However, the expansion should be carefully planned and implemented accordingly. It should begin with a pilot programs.

First of all, the three agencies; central office, San Salvador and La Libertad, should expand to their full potential in mobilizing resources.

The strategy for these agencies should include promotion campaigns for voluntary savings; required compensating balances in demand deposits for loans made to large-sized farmers and non-agricultural borrowers; and forced savings components in loans to Phase I cooperatives and small-sized borrowers. Prior to granting any credit, an opening of demand or savings accounts should be required from new clients. Simultaneously, BFA should implement a plan of a portfolio diversification. Given the fact that agricultural loans are risky, the expected losses for bad debts from these loans might be compensated with more lending to other rural activities such as commerce that are shorter-term, less-risky, and have a high turnover. In this way, the rapid flow of resources should permit BFA to maintain an adequate degree of liquidity.

As part of the pilot project, BFA should begin to build the necessary infrastructure in about four more agencies. It is recommended to begin with the agencies of Ilobasco, San Juan Opico, Sonsonate and San Miguel. Ilobasco and San Juan Opico are recommended because BFA is the only bank with an office in these towns. Thus, they will not be subject to local competition with other institutions and, moreover, will be offering new financial services to the communities that should help the Bank establish its deposits mobilization activities.

There would be costs involved. BFA's department of deposits estimates the additional costs of carrying out the savings mobilization amounts to ₡75 thousand for construction, office equipment, radio transmitter and receiver, and telephone. It will not be necessary to budget for computer terminal hardware and software, because the Bank is in the process of negotiating the purchase of data processing equipment with terminals located in each agency that are connected to a central unit. Additional variable costs are estimated to be ₡400 thousand for personnel compensation, fringe benefits and logistical support.

Projected Cash Flow for One Agency

In an attempt to demonstrate the profitability and feasibility of mobilizing domestic resources in BFA, a statement of projected sources and uses of funds is developed for the agency of San Juan Opico.

In order to develop the cash flow some assumptions are made: (1) the initial amount of loans is the 1985 end-of-year portfolio; (2) the annual interest rate paid by the agency of the portfolio made with funds different from deposits will be 5 percent; (3) in the first year, the agency will mobilize at least the equivalent of 30 percent of the end-of-year portfolio deposits; (4) the distribution of these deposits is 40, 30 and 30 percent for demand, savings, and time deposits, respectively; (5) the resources obtained from savings will earn 20 percent interest as short-term loans placed in non-agricultural lending; (6) the interest rates paid on savings are 8.75 and 11.5 percent on savings and time deposits, respectively; (7) the administrative costs will increase at an average annual rate of 10 percent and the amount of deposits at an average annual rate of 20 percent; (8) the agency will use resources other than deposits to finance short-term and medium-term loans; of which nine-tenths will be in short-term credit; (9) the recovery rate of loans made with deposits will be 95 percent for the first three years and 98 percent thereafter; for the rest of the portfolio, the recovery rate will be 90 percent for the first three years and 95 percent thereafter; (10) beginning with the fourth year, 5 percent of the previous year's delinquent portfolio will be written off; (11) there is a commission of 1 percent charged on new loans, (12) beginning the third year the medium-term loans will be transferred to the category of short-term, and (13) the annual interest rate for the long-term loans will be 16 percent.

The statement of the projected sources and uses of funds developed for BFA's San Juan Opico agency show, as reported in Table XIII-12, some interesting results. The presence of the medium-term portfolio and the recovery rate of loans are critical variables. When 10 percent of the initial portfolio is placed in short-term credit and the rate of recovery is fixed at 90 or 95 percent, the amount of cash available becomes negative in the second and in the third years. Once the rate of loan recovery is raised from 90 to 95 percent in the agricultural portfolio, and to 98 percent in the rest of the portfolio, liquidity improved substantially. The other important action taken to improve liquidity was to place the total portfolio in short-term loans.

The cash flow does not reflect the effect of compensating balances on raising the effective interest rate on loans that is received by BFA. The bank could easily indirectly add one to three points in the final interest charged to borrowers by means of this policy. There is yet another advantage of opening deposit windows. The rapid turnover of deposits, withdrawals and good loan recovery provide the institutions with possibilities of increasing interest and non-interest earnings.

Table XIII-12. Statement of Projected Sources and Use of Funds for BFA's San Juan Office agency					
	(million copies)				
Description	First year	Second year	Third year	Fourth year	Fifth year
Cash available at the beginning of the year		3.0	-0.5	-0.7	1.0
Sources of funds					
Initial amount of loanable funds	29.0				
Recoveries of initial fund		23.5	26.7	27.8	27.7
Demand deposits	3.5	4.2	5.0	6.1	7.2
Savings deposits	2.6	3.1	3.8	4.5	5.4
Time deposits	2.6	3.1	3.8	4.5	5.4
Recoveries of loan from deposits plus legal reserve		8.4	10.3	12.5	14.9
New demand deposits					
New savings deposits					
New time deposits					
Interest earnings	5.3	5.7	6.0	6.5	7.0
Non interest receipts	0.4	0.3	0.3	0.4	0.4
	43.4	51.3	55.4	61.5	69.1
Use of funds					
Short-term loans from initial loanable funds	26.1	23.5	26.7	27.8	27.7
Medium-term loans from initial funds	2.9	2.9	--	--	--
Loans from deposits	7.0	8.3	10.1	12.1	14.5
Unpaid loans from initial funds		2.9	2.6	1.4	1.5
Unpaid loans from deposits		0.8	0.4	0.0	0.2
Administrative expenses	0.9	1.0	1.1	1.2	1.4
Interest payment on deposits	0.5	0.6	0.8	0.9	1.1
Withdrawals of deposits		8.7	10.4	12.6	15.1
Interest payment on initial portfolio	1.5	1.5	1.5	1.5	1.5
Legal reserve requirement	1.7	2.1	2.5	3.0	3.6
Writing off of bad debt	--	--	--	0.1	0.1
Total	39.9	51.8	56.1	60.6	66.7
Cash available at the end of the year	3.5	-0.5	-0.7	1.0	2.4
Source: Authors' estimates under assumptions specified in this section.					

Summary and Conclusions

Since 1980, El Salvador has had an impressive record of savings mobilization, as measured by savings and time deposits in its financial institutions, despite all of the political and economic uncertainty that has occurred in this period. In each year the real value of total savings and time deposits has increased. Particularly noteworthy is the strong growth in the real value of these deposits that began in 1983 when civil strife began to decline and firm plans were established to elect a government.

This reflects confidence in the economy and the future of the country.

This record is strongly suggestive of a good degree of financial intermediation in the nation. This concept is supported by the rough calculation that about one-sixth of the population holds savings accounts and that there is a total of 133 Bank offices in the country (91 mixed banks, 16 Mortgage Bank and 26 BFA). In addition, there are other non-banking financial institutions such as the savings and loan associations.

Policy Constraints

All of this has occurred in spite of a monetary policy that has created few incentives for savers. The main policy instrument that directly deals with savings is the minimum deposit interest rate. These rates, however, has been kept at low levels because they are tied to the loan rates. Loan rates have been kept at low and concessionary levels have considerably been less than the opportunity cost of capital. Deposit rates are pegged to the loan rate to maintain a sufficient spread between the two rates for financial institutions. Indeed, with the relatively high rates of inflation in recent years the real deposit rates have been negative. In its policies, the Monetary Board has concentrated on the loan rate and, even so has made very infrequent adjustments in the interest rate structure, preferring to use other means to try to control the flows of credit. As a consequence, there has been little attention directed to using the interest rate as an active policy variable to induce saving.

Within the deposit rate structure lower interest rates are set for savings accounts that are subject to withdrawal and higher rates are established for time deposits that range from 60 to 360 days. In the last five years there has been a shift to time deposits away from savings deposits. This reflects both the saver's desires to earn higher returns and their increased confidence in political stability.

A longitudinal study of the determinants of savings and time deposits in the nation's financial institutions provides good insight into El Salvador's success in mobilizing resources in spite of a passive interest rate policy. This study showed that the level of GDP and the degree of financial deepening were the main factors explaining the levels of total savings and time deposits in El Salvadorean financial institutions. The interest rate was shown to be a significant and positive determinant of savings over the 1956-1984 period. Deposits, however, were shown to be quite inelastic with respect to changes in the interest rate. This probably reflects the fact that the Monetary Board seldom changes the interest rate structure. Therefore, when changes in the interest rate occur, there is not a corresponding change in savings deposits. The interest rate was not found to be significant as an explanatory variable for savings deposits over the 1969-1984 period. Inflation, however, was significant for the latter period. When inflation was higher there were fewer deposits, showing that savers were responding to the reduced incentives associated with lower real interest rates and, therefore, tending to place more of their savings in other forms of investment, including those abroad.

All classes of savers would be expected to behave in this manner, but those holding time deposits, who are mostly the medium- and large-sized business firms and middle- and upper-income families caused the largest changes in the amounts saved. The reasons are that, in comparison to most of those persons with savings accounts, they control a larger volume of deposits and they have better access to alternative domestic and foreign investments and other financial instruments.

The study did not detect any significant change in savings trends as a result of the instability that began in 1980.

Commercial Bank Experience

The mixed banks and the Mortgage banks held 99.5 percent of the savings and time deposits among those institutions operating in rural areas. A very large portion of their deposits however, came from customers located in urban areas. It would be expected, however, that a substantial portion of the deposits was originated from incomes earned in agricultural endeavors, given the importance (about one-fourth of GDP) of agriculture in the economy and that many of the medium- and large-sized farmers reside in urban areas.

The commercial banks have aggressively pursued deposits. Without the benefit of interest rate incentives they have developed promotional campaigns and non-interest price incentives, such as raffles and life insurance for depositors, as means of attracting deposits. Financial analysis shows that these banks have leveraged their capital extensively in obtaining these deposits and that they use deposits as a major source of obtaining loanable funds. Nevertheless, these banks have used Central Bank rediscounts as important sources of funds to finance agricultural lending. A probable explanation is that they prefer to use their deposits to finance loans in other sectors than are shorter-term, have a faster turnover and have better collateral, rather than tie up the funds derived from deposits in agricultural loans that are longer-term and offer lesser collateral (usually the expected harvest).

Small-farmer Saving

In spite of El Salvador's success in mobilizing savings in financial institutions, it is very doubtful that there are much savings and deposit mobilization among most small farmers. As noted above, it is likely that many of the medium- and large-sized farmers do save in financial institutions because of the size of their incomes and their close linkages with the capital city and other major urban centers in the country. Government policy towards the sector in general, and small farmers in particular, has been to supply targeted credit. Therefore, the financial system has relied on government subsidies, Central Bank rediscounts and extensive foreign assistance, the latter especially since the 1980 reforms. Under these circumstances, there has been little incentive for rural-based institutions to mobilize savings. Both the institutions and the government policy makers have given scant attention to the savings mobilization dimension of rural financial markets.

It might be argued that small farmers do not save. There is increasing evidence from many countries that this is not true; small farmers do save, but unless they have accessible financial institutions they do not save in financial institutions. Rather they keep money in cash or liquid assets such as crops in storage or livestock. Farmers, like all classes of persons, have needs to save from current income in anticipation of foreseen and unexpected future business and family expenditures. The evidence showing the large numbers of low-income persons with savings accounts in urban El Salvador is convincing that poor people want to save in financial institutions.

A principal factor determining small-farmer saving is income. Although prospects for increased rural incomes in El Salvador are limited due to the dependency on soft world markets for traditional exports, unfavorable domestic pricing policies for agricultural products and rising costs of production, farmers will still want to save a portion of their income. With continued economic recovery there should be an increase in demand for basic foods which should enhance farmer incomes. If the government's pricing policies were to change to become more favorable for producers, further increases in income could be expected. In addition, some small farmers can be expected to gain larger incomes as they move into the increasing opportunities for producing non-traditional exports such as fruits, vegetables and shrimp. As these occur, more savings mobilization can be expected.

The reformed sector cooperatives also represent an opportunity for savings and deposit mobilization. As a business, the cooperatives will have needs for liquidity and a place to keep funds safely in anticipation of future investment. Means should be devised to encourage the cooperatives to do this and make financial intermediation services available to them.

The Agricultural Development Bank

The country's principal institution for lending to agriculture, and particularly the small farmers, the Agricultural Development Bank, has not been inclined to mobilize deposits from this type of clientele, although it has had the legal authorization to do so since its founding in 1973. An inherent development bank philosophy and the ready availability of cheap resources from government subsidies, foreign assistance and Central Bank rediscounts have been the principal factors that have worked against deposit mobilization in this institution.

A comparison of BFA with the commercial banks shows that BFA has hardly not begun to develop its capacity for savings and deposit mobilization. The Bank has undertaken deposit mobilization on a limited basis in three of its twenty-six branch offices, two of which are in urban San Salvador. Closer analysis shows that a substantial portion of these deposits came from government organizations. This was another way for the government to make funds available to the Bank. After large amounts of foreign assistance became available in the 1980's, the government's deposits declined. It appears that part of the foreign aid substituted for the government deposits as a source of loanable funds for the BFA.

BFA is encountering pressures that have caused it to take a greater interest in deposit mobilization. Its serious delinquency problem and the associated refinancing have sterilized much of its portfolio. Furthermore, prospects for continued high levels of foreign assistance to the Bank are not promising. These conditions, have forced the BFA to look to other means to obtain financial resources.

BFA Program Intervention

BFA, among all Salvadorean financial institutions operating in rural areas, appears to offer the best possibilities for mobilizing savings among small farmers on a reasonably large scale because of its extensive network of twenty-six agency offices located throughout the nation. Credit unions offer another possibility.

Feasibility studies for deposit mobilization in BFA agencies were conducted. Although these are rough estimates that depend on many assumptions, they indicate that deposits as a source of loanable funds can be a profitable operation for the Bank.

Given the interest of the Bank in mobilizing more deposits, the time is propitious to move ahead on this front. To begin, deposit mobilization should be done as a pilot study, utilizing the three offices that currently receive deposits as well as three or four others. Regular evaluation of the pilot study will provide good lessons not only on how the program is functioning but also about how to extend it to other agencies.

Apart from generating resources and creating a means for financial intermediation, one of the most beneficial aspects of the savings mobilization in BFA will be a side effect: deposit mobilization will force a change within the bank that will enable it to become more viable as a financial institution and less dependent on subsidies and foreign assistance. The need to account for the financial and risk costs of mobilizing resources will force BFA to have a new appreciation of cost consciousness and the virtues of reducing delinquency. The end results of these side effects for the Bank should be reductions in administrative costs, more efficient credit delivery systems and lower delinquency.

With BFA saving mobilization, farmers will also benefit by having the opportunity to place their savings and surplus cash in a safe place where they can earn some return. It will create a new possibility for earning income. The record with the large numbers of low-income urban residents

that hold savings accounts in the commercial banks provides strong evidence that probably this would occur if institutions with savings windows were made available and accessible in rural areas.

The evidence from the commercial banks also suggests that this will occur without major changes in the deposit interest rate structure. However, if the government were to establish an interest rate structure that would offer larger incentives to savers the whole process would be enhanced. It does not appear likely, however, that the government will do this. For example, the January 1986 economic measures retained a structure with deposit and loan interest rates that are very low given the domestic rate of inflation and the apparent opportunity cost of capital. The result is that in the current year deposit rates may well continue to offer negative real rates of return. Nevertheless, as was shown above, substantial increases in savings and time deposits have occurred in El Salvador despite the lack of favorable interest incentives and even when real interest rates are negative. Increases in savings were more tied to the levels of income and the degree of financial intermediation.

Therefore, there is reason for optimism that aggressive deposit mobilization by BFA should be successful. It is recommended that this be done on a limited, pilot study basis to experiment and learn. The eventual extension of BFA deposit mobilization to all BFA agencies should go a long way toward enhancing financial intermediation and deepening in rural areas.

The BFA pilot program should use an active promotional campaign to make potential depositors aware of the new income-earning possibilities, while at the same time providing a safe keeping of their funds. Other forms of non-interest incomes, such as raffles, should serve as additional inducements. At first, existing clients are likely to be the largest number of savers, but promotion should not be limited to just this group and other farmers. Efforts should be made to appeal to all classes of business and families in the rural areas.

Consideration should be given to forced savings or forced deposit programs. For example, borrowers could be expected to place a fixed proportion, say 10 or 20 percent, of their loan deposit. Interest could be paid on this deposit during the loan and when the loan is repaid a higher or more attractive rate could be paid to induce the borrower to keep the funds on deposit.

BFA should concentrate on good and efficient service to keep the savers' costs associated with transactions and withdrawals to a minimum. It

will also need to develop means of maintaining reserves and liquidity to meet legal and business requirements. This will be a new endeavor for the Bank and will require training and education of personnel and management.

Technical assistance will be required. Moreover, Bank personnel could benefit by visiting new and successful savings mobilization projects in other countries, such as with the Agricultural Development Bank of the Dominican Republic.

FEDECACES Program Intervention

FEDECACES and credit unions offer another viable means for savings mobilization. At present they mobilize forced savings. Opportunities for voluntary savings mobilization should be explored. Experiences in many other countries clearly show that credit unions can be viable sources of voluntary savings mobilization, extend credit and, therefore, play a meaningful financial intermediation role in rural areas.

Several credit unions should be identified to work with FEDECACES for a pilot study. With appropriate and periodic technical assistance, good results can be expected. In the pilot study, FEDECACES should be developed as the unit with the capacity to expand the program to other credit unions through training and management development.

XIV- SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This report is a study of El Salvadorean rural financial markets. It specifically focuses on the supply and demand of agricultural credit and rural savings mobilization. The report has three broad objectives: (1) to examine and analyze rural savings mobilization and agricultural credit in El Salvador, (2) to identify the needs and possibilities for mobilizing more rural savings and extending more agricultural credit, and (3) to make recommendations to USAID and the government of El Salvador for policy and project interventions in rural savings mobilization and agricultural credit. Particular emphasis is placed on the needs for the reformed sector and other small farmers, as well as the broad range of policies that impact, positively or negatively, on savings mobilization and credit use.

The previous chapters examined the credit and savings operations of formal-market financial institutions and the credit activities of informal-market lenders. There were also descriptions and analyses of monetary and credit policies, other government policies that impact on rural financial markets and the role of foreign assistance. Detailed summary and conclusions sections were presented at the end of each chapter; the reader is referred to the several chapters for detailed information and analyses. The present chapter synthesizes and consolidates this material in order to focus on the most important and urgent elements and to put the whole study into a broader perspective and to prepare recommendations for policy and program interventions for rural savings mobilization and agricultural credit.

The Setting

The agricultural sector is extremely important in El Salvador. Almost 60 percent of the population lives in rural areas. The agricultural sector accounts for about one-fourth of GDP, two-fifths of total employment and two-thirds of exports, mostly coffee, cotton and sugar cane. In 1979 there was a social revolution in the country which led to three major reforms in 1980 that had important implications for agricultural finance: agrarian reform, nationalization of the commercial banks and nationalization of the coffee and sugar export industries. Agrarian Reform created two new classes of borrowers: the Phase I cooperatives, who took over the lands of the former large landowners (over 500 hectares) and the Phase III beneficiaries, small farmers who were formerly renters of land. In order to

try to ensure the success of the agrarian reform the government assigned each of the new cooperatives to one of the formal-market credit institutions. Some cooperatives were problematical for the institutions because of their credit worthiness; there were problems of their organization, management and understanding the cooperative philosophy. In contrast, Phase III beneficiaries manifested typical lending problems that are characteristic of small-farmer credit. One result was an increase in delinquency.

The problems associated with the restructuring of the land tenure were compounded by the civil strife and political instability that led to open conflict and war that encompassed the nation between 1980 and 1983. These problems continue today, but have been mitigated considerably since 1984 when a civilian government was elected. After 1979 the deteriorating economic situation (the annual growth rates of GDP were negative from 1980 to 1983) disrupted domestic markets for agricultural products. To make matters worse, the world markets for El Salvador's principal agricultural exports remained soft or worsened.

All of these factors contributed to serious loan delinquency problems in financial institutions, and in particular in their agricultural credit portfolios. To cope with the rapidly deteriorating portfolios of financial institutions the government instituted a policy of long-term refinancing of much of the bad debt. This amounted to a paper transfer of the bad-debt to refinanced debt, which was extended for several years or more at highly favorable interest rates. This policy was beneficial to both financial institutions and borrowers in the short run. For the former it helped to clear up their portfolio, for the latter it kept them eligible for future credits. In the long-run, however, the problem will not go away. It is very likely that much of the refinanced debt will never be recovered. Furthermore, if it is repaid, the financial institutions will receive much less real value than was lent due to the impact of the relatively high inflation El Salvador has been experiencing in recent years. In effect, the refinancing represents an income transfer to the delinquent borrowers from the financial institutions because the refinancing sterilizes so much of the portfolio there is, and will continue to be, a need to provide new injections of capital and loanable funds into the financial system.

To summarize, the changes in land tenure, civil strife and unfavorable economic conditions have caused considerable changes and problems in El Salvador's agricultural credit picture. Whereas production was formerly concentrated in the hands of a few extremely large farmers and numerous medium-sized farmers the former group has been replaced by the Phase I cooperatives. In addition, much more attention has been directed to serving

small farmers, including Phase III beneficiaries, of which both groups exhibit the typical characteristics that are problematic for small-farmer credit. The medium-sized farmers have not been subjected to agrarian reform, although they have been threatened, which has negatively impacted on their investments and maintenance of properties, including coffee plantations. There are legal provisions for a Phase II expropriation of their lands. It is doubtful, however, that this phase will be implemented.

Institutional Structure

There are six formal-market financial institutions that extend credit to agriculture. Two single institutions are the most important, the government Agricultural Development Bank (BFA) and the Mortgage Bank. In 1984, each of these banks handled about one-fifth of the annual credit flows to the sector. BFA has twenty-six offices, mostly in the interior of the country and the Mortgage Bank has fifteen offices, eleven of which are in the interior.

The nine mixed commercial banks account for the most of the rest, about one-half, of the credit. These banks have ninety-one offices in the republic, of which forty-seven are outside the capital city. Among these banks, about three-fourths of the agricultural credit is concentrated in five banks; listed in order of importance they are Banco Cuscatlán, Banco Agrícola Comercial, Banco de Comercio, Banco Capitalizador and Banco Salvadoreño. No single mixed bank extends as much credit to the sector as BFA or the Mortgage Bank.

The government-owned National Coffee Institute, INCAFE, which has monopoly rights on foreign coffee marketing, also extends credit for all matters related to the coffee industry. In 1984, it accounted for about 5 percent of credit flow, but most of this was for coffee processing. In the past few years INCAFE has progressively disengaged from financing much coffee production.

The National Federation of Credit Funds (FEDECCREDITO) is a federation of forty-two cajas. In 1984 the Federation's credit accounted for only 3.5 percent of the annual flows.

The National Federation of Credit Unions (FEDECACES) lent funds to its affiliates, which accounted only 0.5 percent of the total credit flows in 1984. There are forty-four affiliated member credit unions, of which fifteen are located in rural areas. Data on all of the credit from the affiliates is not available. It is certain, however, that they lent more to the sector than the resources they obtained from FEDECACES.

It is clear that at the national level, agricultural credit is highly concentrated in BFA, the Mortgage Bank and five mixed banks. The other formal-market institutions play a much smaller, but important role. There is also an active informal market, which will be discussed below.

Credit

Growth

In 1984, whether measured by annual flows or year-end portfolio, the agricultural sector received less credit in real terms, after taking account of inflation, than it received in 1980. This figure, however, understates the decline because it includes refinanced loans, which by 1984 accounted for about 28 percent of the portfolio. Over the 1980-1984 period the real refinanced loans in the portfolio grew at an average annual rate of 13.7 percent. If the refinanced portion of the lending were subtracted, it is clear that the amount of credit for new production in 1984 was considerably less than in 1980.

Over the 1980-1984 period the mixed banks were the only class of institution to show a positive real rate of growth in lending to the sector. Their annual credit flows increased at an average annual rate of 14.9 percent. In contrast, the average annual percent declines for the other institutions were: BFA -8.1 percent; Mortgage Bank -3.6 percent, FEDECACES -7.8 percent. It is clear that the mixed banks are not only a major lender to the sector but also that they are becoming increasingly more important. Furthermore, it is important that the real credit flows from the two largest lenders, BFA and the Mortgage Bank, have declined substantially. The contrasts between these two institutions and the mixed banks reflect the differences in the problems and success experienced by these classes of banks.

Activities Financed

The large majority of agricultural credit is for short-term production purposes; very little is extended for investment. Lending is heavily concentrated in the capital-intensive traditional export crops of coffee, cotton and sugar cane. Between 1980 and 1984 the real amounts of credit for these crops as well as basic grains declined. Land reform, civil strife, soft world markets for exports and unfavorable domestic pricing policies were contributing factors. These activities that showed positive real growth in financing were the non-traditional crops such as fruits, vegetables, livestock,

poultry, and fisheries. There was little variation in the relative importance of activities financed across the banking institutions. The conclusion is that the demand for credit remains the strongest in the traditional export crops but that some new activities for domestic consumption and non-traditional exports are rising. The new activities were mostly financed by the mixed banks and the borrowers were seldom in the reformed sector. Reformed sector clients typically financed traditional crops.

Clientele

Between 1980 and 1984 the reformed sector has received 18.2 percent of the credit flowing to the agricultural sector. The large bulk of rest went to medium- and large-sized farmers. Over the period, however, the reformed sector progressively received less than a proportional amount of credit flows and, indeed, was receiving considerably less credit in real terms than in 1980. In part, this reflects the government's big push to finance the cooperatives after land reform in 1980.

Most of the reformed sector credit goes to the Phase I cooperatives. All institutions except FEDECACES were assigned cooperatives after the agrarian reform. With time there has been some realignment. The numbers served by the mixed banks and BFA have increased whereas those attended by the Mortgage Bank have declined. FEDECCREDITO and INCAFE both started out with sizeable numbers but by 1984 they had only two and one, respectively. BFA has picked up some of the most problematical cooperatives, including those that were transferred from other lenders. This has compounded the Bank's already serious delinquency problem. In 1984, the institutional distribution of the 244 cooperatives was: BFA 49 percent, mixed banks 39 percent, Mortgage Bank 11 percent, FEDECCREDITO and INCAFE, 1 percent or less.

There were nearly 19,000 Phase III beneficiaries that received credit in 1984. This corresponds to 29.7 percent of those who received land. Four-fifths of the beneficiaries receiving credit were BFA clients. As a means to attend to these large numbers the Bank organizes them into solidarity groups to receive group loans. Other beneficiaries were attended by the mixed banks. The Mortgage Bank does not lend to this type of client.

Although most institutions are participating in lending to the reformed sector, it is clear that the BFA has been assigned a disproportionate load. Not only does it have the largest number of reformed sector clients, it also has many of the most problematical ones.

Delinquency and Refinancing

Delinquency has been an important problem for all financial institutions. In 1984, the financial institutions reported the following delinquency rates for all their loans. The rates are: BFA 24.1 percent, FEDECACES 26.1 percent, and FEDECREDITO 35.0 percent. Six of the nine mixed banks reported an average of 10.6 percent. Clearly the mixed banks have a better record than the other institutions.

It is very important to realize that true state of delinquency is masked over by refinancing. As noted above, refinancing has increased sharply since 1980. Virtually all of the increase in this type of credit was to provide long-term refinancing of delinquent loans. Refinancing of reformed sector loans, especially those to the Phase I cooperatives, has been large. This reflects the difficulties experienced by this class of borrowers.

Sources of Funds

There are three basic sources of funds that are available to El Salvadorean institutions to finance agricultural credit: their own resources, consisting of capital and deposits; Central Bank of Reserve (BCR) rediscounts; and domestic or foreign assistance. The importance of these sources depends on the institution.

The "own" resources are important for institutions that mobilize deposits. BCR rediscounts are available to all institutions that are officially classified as financial intermediaries, which include all that are covered in this report. Foreign and domestic assistance are available to selected institutions.

Foreign Assistance

Considerable foreign assistance, \$178 million in commitments, has been directed to agricultural credit since 1980. This amount is the equivalent of 61 percent of assistance directed to the agricultural sector and 18 percent of all development aid. It has come from two-sources; USAID (\$75.6 million) and IDB (\$102.4 million). All of this assistance was channelled through BFA for lending to Phase I and Phase III beneficiaries in the reformed sector, and, to a lesser extent, other small farmers. There are two other USAID projects that complement the credit project--the Agrarian Reform Organization project and its successor the Agrarian Reform Support project by providing technical support and training to the Phase I

cooperatives. In addition to the above figures, USAID is also financing the Small Producer Development project in FEDECACES, to develop small businesses, including non-traditional agriculture. PL480 funds have been used to finance Central Bank rediscount lines for investment and refinancing of reformed sector cooperatives.

Central Bank of Reserve Rediscounts

The government has utilized BCR rediscount to selectively direct credit, up to predetermined limits, to a wide range of targeted activities in agriculture. In 1984/1985 agricultural cycle there were sixteen lines for agriculture. In 1984, \$1478.1 million total new and refinanced credits were extended by the Central Bank to agriculture, which was the equivalent of 82.6 percent of the flows of credit going to the sector in that year. This clearly shows the importance of the BCR in financing agriculture.

An intermediate credit institution may apply to rediscount any eligible loan paper. In this manner, the intermediate institution can expand its loan portfolio using BCR funds. There is usually a 2 percentage point interest rate spread for the intermediate institution. The institution assumes 100 percent of the risk for the loan in case the borrower defaults.

Institutions

BFA relies almost entirely on the funds it has obtained from foreign assistance. These are clearly its most inexpensive source of funds because most of these funds have been made part of BFA's capital and, therefore, carry no finance costs. The reason is that the government is the borrower from the foreign donor and passed the foreign aid on, interest free, to the Bank as part of the institution's capital stock. This is another example of government subsidy. Moreover, the foreign funds undoubtedly substituted for what would have been other forms of government subsidies to the Bank. Prior to this assistance, BFA relied considerably more on Central Bank rediscounts and deposits from government organizations.

The mixed banks and the Mortgage Bank use their capital and deposits to finance about three-fourths of their total credit. The rest is financed with BCR rediscounts. These banks, however, tend to use the rediscounts for much of their agricultural lending, preferring to use their own resources for other types of loans that are shorter-term, have faster turnover and have more solid collateral.

INCAFE finances its credit with Central Bank rediscounts along with its own funds. FEDECCREDITO does likewise. FEDECACES obtains its financing from many different sources. The Federation's holdings of required contributions from its affiliates are the equivalent of about one-fourth of its loan portfolio. Most of the rest of its loans are financed with funds obtained from USAID, COLAC, IDB, BCIE, and CUNA. Of these, the USAID funds are the most important. FEDECACES seldom uses Central Bank rediscounts, the other sources of funds are available at considerably less financial costs.

Credit Delivery Systems

There are many elements that are common to the credit delivery systems in the several El Salvadorean credit institutions. First, agricultural credit operations are highly centralized in the capital, where most decisions are made. For example, the agricultural loan officers of the mixed banks and Mortgage Bank mostly operate out the main office in San Salvador. Because of the small size of the country, it is easy for them to travel to other sites to visit their clientele. Moreover, many of their farmer customers reside in San Salvador and, therefore, it is easy for them to carry on their business with the banks in the capital. Likewise FEDECACES, FEDECCREDITO, and INCAFE conduct their credit out of their headquarters in the capital city. BFA is more decentralized; the officers in their twenty-five agencies and zonal committees have approval authority on loans up to ₡50,000. Larger loans must be approved by the central office.

In these loans, the review procedures may lead to lengthy delays in loan approval and credit disbursement.

Second, because the Monetary Board establishes maximum but low and concessionary loan interest rates there is an excess demand for credit. Therefore, the financial institutions, cannot use the interest rate as a credit rationing device and are forced to seek other means to ration funds, such as costly loan application procedures, high collateral requirements and compensating balances, all of which raise the cost of borrowing and thus discourage borrowers of small amounts. In the case of the loan application, the procedures, paperwork and documentation required by all banks, tend to be cumbersome, time-consuming and require considerable documentation. The credit unions have a much more simple process. One reason is that they are small and know their members well. Another reason is that they charge effective interest rates that exceed the official maximum.

Third, a very large majority of agricultural financing is for short-term production purposes. The collateral for this class of loan is typically a personal pledge or the pledge of the expected harvest. In these cases, collateral is not a very effective rationing device since it is not discriminatory, at least on the surface. Collateral for medium- and long-term loans is typically fixed assets. In these cases it is more discriminatory, those persons without sufficient collateral, typically the small farmer, cannot obtain this type of credit.

Fourth, there are built-in control procedures. Because of the concessionary loan rates and the targeted purposes of credit, there is concern that credit might be diverted to other ends. To try to prevent this from occurring the credit institutions employ control devices. This is accomplished by careful specification of the purpose of the loan through feasibility studies in the credit application process. In addition, prior to each successive disbursement credit agents visit the farm to ensure that the funds are being used as programmed and that the activity warrants more credit.

Fifth, because of the importance of Central bank rediscounts in agricultural credit, the credit delivery procedures imposed by the Central Bank are common to many loans.

Sixth, special procedures have been established for the reformed-sector Phase I cooperatives. Specifically, these include detailed farm plans that are prepared for the cooperative and additional collateral in the form of an ISTA loan guarantee.

Each of the financial institutions has special features for its credit delivery. For non-reformed sector borrowers, the mixed banks and the Mortgage Bank require compensating balances in checking accounts of about 5 to 10 percent of the face value of the loan. They also charge a commission. Both serve to raise the effective rate of interest. Reformed sector borrowers are not required to keep compensating balances, but are charged commissions.

BFA has made several innovations to cut credit delivery costs. Clients are classified by risk, based on past repayment performance. Those with good records have less paperwork and faster loan approval than others. The Bank has tried to reduce costs for lending to small farmers, including Phase III beneficiaries, by means of group loans to solidarity groups. Under this arrangement, loans are made to the group, which onlends to its members. These innovations reduce transactions costs for both lenders and borrowers

and are examples of the types of innovations that should be considered by other institutions for dealing with small farmers.

The credit union credit delivery system is the most simple. There is little paperwork. Loan cosigner as well as member's deposits at the credit union are used as guarantees. The system works very well in this type of organization.

In general, the credit delivery systems for agricultural loans are cumbersome, time consuming and costly. Many of the procedures, documents and controls that are employed are used to ration credit, given the excess demand that results from the concessionary loan interest rate. Were the interest rate to be raised to the market level, much of the motivation within the institutions to use these costly procedures as credit rationing devices would disappear and the credit delivery system likely would be simplified. The direct result would be lower transactions costs for both lenders and borrowers.

Even it is not possible to raise interest rates directly, they could be raised indirectly through compensatory balances (such as forced savings) and commissions. Under these circumstances the institutions would have incentives to impose other obstacles to borrowing because the effective interest rate would be higher. Then, the institution could simplify procedures, documentation and collateral and reduce borrower and lender transactions costs as well as delays in loan approval. For example, the streamlining innovations such as open lines of credit for proven reliable clients could be employed.

Informal Market lending

Studies of informal market lending were conducted in four communities: Notwithstanding the presence of formal-market financial institutions in the four communities studied, there appears to be an active informal rural credit market. Three types of lenders were identified: moneylenders, middlemen and input suppliers. Of the three, the first two were most important as purveyors of agricultural credit. Input suppliers played a less important role, typically only selling goods on account for periods up to one month.

The loans extended by informal market lenders tend to be small, compared to those made by formal-market institutions. Agricultural loans

are directed mostly to non-traditional crops, especially cereals and vegetables. Middlemen lend almost exclusively to agriculture. Moneylenders have a large portion of their credit in this sector but also lend to individuals and persons engaged in other economic activities. Informal market loans are typically for less than one year. The term of loans for agricultural production are pegged to the crop cycle.

The credit delivery system is extremely simple and efficient, with virtually no paperwork or collateral required. Lenders obtain information on borrowers on the basis of prior experience and personal knowledge, something that is relatively easy to obtain because they have lived and worked in the same region for many years. Very low rates of loan delinquency were reported.

Moneylender credit is typically extended in cash, whereas middlemen often lend in the form of in-kind inputs. Middlemen are involved in a marketing function, which may be more important activity for them than credit. When they extend credit they enter into a agreement with the borrower to purchase his crop at harvest time or to share the harvest with him. Therefore, the middlemen may be in an advantageous position with respect to the price paid to the farmer for the product. This was not studied explicitly, but it is debateable since the middlemen provides the farmer a marketing service. In addition, there appears to be sufficient competition among buyers for products, which should reduce the monopsony power of the middleman.

The 1984 nominal interest rates on moneylender and middlemen loans was found to be quite uniform-- 2 percent per month or 24 percent per year -- across the communities studied. In real terms the rate was 11 percent. Competition among moneylenders would suggest that this rate is determined by market forces under reasonably competitive conditions. Therefore, this interest rate may be a good proxy for the opportunity cost of capital in rural areas. Note, this should be compared to the 13 or 14 percent nominal rate that is typical of most bank loans to agriculture.

Both moneylenders and middlemen used their own resources as important sources of loanable funds. Some, however, borrowed from banks, especially the Agricultural Development Bank, where they could obtain the most favorable interest rate. For these that supplied in-kind inputs, most purchased them at the Bank's input supply stores. The fact that these lenders are obtaining loans and inputs from the Agricultural Development Bank at favorable prices and onlending them to small farmers appears to be a very efficient system for getting agricultural credit to this class of clientele.

These lenders are able to borrow large sums and then redistribute them to a number of farmers as small loans. Therefore, the informal-market lenders are providing important financial services in the communities. They are not competing with formal-market institutions. Rather they are providing small amounts of credit to small farmers and small businessmen; the type of loans that banks typically do not want to get involved with, because of the high administrative costs relative to the income that can be earned.

Borrowers, too, prefer this type of credit for small loans. Compared to working with banks, the ease of obtaining a loan, the rapidity of disbursement and the low transactions costs more than compensate for the higher interest rates. In other words, the average borrowing costs of working with an informal-market lender are lower when both interest and transactions costs are included than they would be when borrowing from bank.

Compared to the amounts lent by the formal-market institutions, the credit extended by the informal market is relatively small. It is suspected, however, that the volume of informal market credit obtained in the present study is underestimated because it only deals with identifiable lenders, persons who are prominent in their communities for this activity. Experience in many other countries shows that there is a considerable amount of additional informal-market lending taking place; by persons for whom moneylending is a secondary occupation as well as by friends and relatives.

It is inappropriate to make the heroic step of generalizing the results of these four case studies to the whole of El Salvador. Nevertheless, given that the four communities studied are widely separated geographically, had different agricultural structures, and that the characteristics of informal markets in the four sites were quite uniform, it is not unreasonable to think that the manner in which the informal-markets are structured and operate in the four communities are probably quite similar to the country as a whole.

Monetary and Credit Policies

The Monetary Board is responsible for making monetary and credit policies. The Central Bank of Reserve carries them out.

There are three basic instruments of monetary policy: legal reserve requirements, maximum interest rate structure, and BCR rediscounts.

Foreign exchange rate policy is a very important and related policy that is also controlled by the Monetary Board. The analysis shows that the Board does not make frequent changes in monetary policy instruments to try to effect changes in macroeconomic and credit conditions. Rather, changes are made only infrequently, when the economic conditions get to the point that a change is necessary. At other times, the Board tries to rule by using all manner of controls and regulations.

Interest Rate Structure

The maximum interest rate structure is the foundation for credit policy. In this structure loan rates are established in accordance with a classification based on the purpose of financing. Preferential or concessionary rates are set for production loans, with further concessions for priority activities within this class. Higher rates are set for commercial and personal loans. The Monetary Board has kept the nominal rates deliberately low to encourage borrowing, stimulate economic activity and keep down inflationary pressures. It is also politically propitious to do so; increased rates not only raise the cost of doing business but also reduce income transfers associated with concessionary-priced credit. Therefore, a rise in rates is politically unpopular. Since 1978, the real rates, after adjustment for inflation, have been slightly positive or even negative. The low level of the structure plus the effects of inflation have most certainly contributed to an excess demand for credit, with the result that both the monetary authorities and the lenders have needed to resort to credit rationing mechanisms other than the interest rate.

Rediscounts

In the case of agricultural credit, the principal control mechanism is the BCR rediscounts. In accordance with a national agricultural credit plan, prepared by the Central Bank and approved by the Monetary Board, rediscount lines are established with financial limits to direct credit towards priority or targeted activities. Most of these lines are financed directly by the Central Bank and, therefore, are under their control. For the 1984/1985 agricultural year there were sixteen lines. The interest rates to the final user varied going up to the maximum rate established by the Monetary Board. The spread for the intermediate institution is typically 2 percent. Intermediate institutions may apply for rediscounts. Funds are distributed until exhausted. In this manner, the Central Bank expects to be able to control the flows of agricultural credit in the sector. As noted previously, it

is effective doing this because of the heavy reliance of the major lenders on the use of rediscounts for new credits and refinanced credits.

The rediscount policy undoubtedly has an impact on how credit is distributed in the nation, not only is it very sizeable but it also seeks to distribute lending by economic activity and by type of institution. This is especially the case for agriculture since much of the rediscounting is directed to this sector and it accounts for a sizeable portion of all sector credit. It is almost certain, however, that the system is open to wide-scale fungibility, and, therefore, the net impact of the funds on the economy is different than planned. Most of the rediscount lines have low concessionary interest rates, some of which have negative real values. Rational borrowers will attempt to secure the lowest interest rates possible. Therefore, they will try to justify their credit for the credit line that is associated with the lowest interest rate, even though they do not use the funds for that purpose, or if they do undertake the financed activity, other of their financial resources are freed up that allow the borrower to undertake an additional activity that would not otherwise have been done had the cheap credit not been available. Therefore, there is an agricultural credit illusion, i.e., the net effect of the lending for the sector and for targeted purposes may be considerable less than would appear by the amount of funds lent. Following this analysis it should not be surprising that the net effect of the highly-directed credit through the rediscount mechanism is quite different envisioned in the credit plan. It should not be surprising that some of the rediscounted credit for agricultural purposes may well have its impact on financing other investments and consumption.

Refinancing

Rediscounts are used for refinancing. There are two purposes of refinancing.

The first is to refinance past-due or delinquent loans held by financial institutions. In this context, refinancing may occur when, for a justifiable cause, a borrower cannot repay the loan at the scheduled time nor within the customary grace period. Rather than place both the borrower and the financial institution in jeopardy with a bad debt the loan is refinanced, usually at a lower rate of interest. This type of refinancing is considered long term; since loan payment must come out of future income the term of the refinanced loan is usually several years.

The need for this type of refinancing is justifiable, particularly for lending to agriculture, where there are external variables such as product

prices, weather conditions, diseases and insect infestations that are beyond the control of the borrower. In recent years terrorism has been another factor. When one or more of these conditions are present, losses can be expected and the farmer may not be able to repay his credit. Therefore, refinancing of the loan is a means to postpone the debt repayment and, in the meantime, not destroy his ability to obtain credit for the next production cycle.

The second purpose of refinancing is to change the debt from a production loan to a prendario, a loan secured by an agricultural product, while the processing, storage and marketing take place. This system is utilized in El Salvador for the traditional export crops. For example, a farmer will obtain a short-term loan to produce coffee or cotton. After harvest, his product is delivered to the National Coffee Institute (INCAFE) or to the Cooperative of Cotton Producers (COPAL) for warehousing until it is sold on the international market. In the meantime, the producer must continue financing his production because he will not receive income to pay off the loan until INCAFE or COPAL sell the product. Rather than continue to carry the loan as short-term production loan, the practice in El Salvador is that the first (production) credit will be cancelled and refinanced as a prendario loan to cover the processing, warehousing and marketing of the product. When it occurs, no new loan money exists. The refinanced loan will be guaranteed by the coffee or cotton in storage. The original borrower continues to hold the debt. When the coffee or cotton are sold and the producer receives his income the refinanced debt is cancelled. Note, this type of refinanced credit is usually for a period of less than one year and hence is short term.

Both of these types of refinancing consist of paper transfers from the original debt to the refinanced debt. No new loan money is created. Note, however, that both loans are considered as separate credit transactions and, as such, will appear in the records of financial institutions in this form. In practice, this is a double counting of the amount of credit extended.

The Monetary Board and the BCR have provided special rediscount lines for both types of refinancing. Although both types of refinancing have been employed for many years, long-term refinancing of the bad debts has taken on particular importance since 1979. The combination of land reform, problems with Phase I cooperatives, civil strife and terrorism, as well as several years of unfavorable markets for traditional exports have led to high levels of delinquency. In light of these unsettling external problems the government has assumed the position of being very liberal in extending refinancing for delinquent debt at favorable and preferential interest rates. Although there are good economic arguments for doing this, much of the

decision has been based on political reason and social consciousness. Refinancing reduces political instability for more credit. If this had not been done, the land reform program would have been seriously jeopardized. Nevertheless, it needs to be recognized that long-term refinancing represents an income transfer from the lender to the borrower. Due to inflation, when the loan is repaid it will have a real value that is considerably less than when the original credit was extended. If it is not repaid it is an outright transfer. Also, because lower interest rates are changed, the borrower also receives a subsidy on this account.

Since 1979, the amounts refinanced have soared such that refinanced debt in refinancing debt has become the most important component of the BCR rediscount portfolio and as well as in the loan portfolios of most of the intermediate credit institutions. As such it represents a major income transfer to the agricultural sector, especially to reformed sector cooperatives, which have received a disproportionate share of total refinancing. As noted earlier, it is doubtful that much of these loans will be repaid. This will create serious problems for financial institutions in the future. At present, the delinquency/refinancing problem has sterilized much of the portfolio, reducing loanable funds and creating a dependency on infusions of new capital.

Foreign Exchange Rate Policy

Although not strictly part of monetary policy, exchange rate policy has important implications for the financial system. Moreover, it is determined by the Monetary Board and carried out by the Central bank.

For decades El Salvador had followed a fixed foreign exchange rate policy at ₡2.50 per dollar. When there were pressures for a devaluation of the colon, rather than devalue foreign exchange controls were employed. In the early 1980's such pressures occurred. When the exchange control measures were insufficient and a strong black market developed, the government adopted two-tier exchange rate: the official rate and a parallel market rate. This amounted to an implicit devaluation as the government gradually reduced the numbers of traded goods and services eligible for the official rate and passed them to the parallel rate. By 1985, those that remained at the official rate were imports of basic foods, energy, medicines, raw materials and government debt service and exports of coffee and other selected products. In the January 1986 package the official exchange rate was raised to ₡5.00 and the parallel rate was eliminated.

The exchange rate is the cornerstone of policy for maintaining external stability but also it has important consequences for internal price stability as it influences the flows of imports and exports of goods, services and capital. Devaluations generally result in inflationary pressures because the prices of imports rise and put upward pressures on wages and prices. Anticipated devaluations result in capital flight.

Both of the above effects have occurred in El Salvador. Moreover, the two-tier, exchange rate policy has been damaging to agriculture. The government's policy of keeping food prices low and, therefore, importing basic foods at the lower official rate, served as a disincentive for domestic production. Likewise, the policy of selling traditional exports, such as coffee, at the lower rate is a disincentive for coffee production.

Demand for Credit

Excess Demand

As noted previously, over the 1980-1984 period the use of agricultural credit in El Salvador to finance new production declined in real terms. The decline is associated with all of the factors that contributed to the general decline in sector GDP over the period. The governments' policy of directing considerable credit to the reformed sector cooperatives was an important factor in mitigating the decline in credit use and in raising demand.

The decline in credit use was associated with both a decrease in demand and supply. On the supply side the monetary authorities were reducing credit in an effort to reeduce inflationary forces and forestall devaluation. Strong non-interest rate rationing mechanisms by both monetary authorities and the financial institutions are strong evidence of an excess demand. Of course, the excess demand would have been expected given the low and concessionary interest rate structure.

The degree of excess demand was estimated by polling the chief agricultural credit officers of the mixed banks, the Mortgage Bank and BFA. They estimated that they could have lent another \$94.96 million dollars in 1985 had they not faced restricted funds. This was the equivalent of 33 percent of the annual flows for new (not refinanced) agricultural credit in 1984. If the interest rate were raised, even to the levels charged in the

informal market, it was estimated that an excess demand would continue to exist.

The unsatisfied credit needs in the reformed sector were estimated to be \$36.98 million. Of this total, about three-fourths were needed for medium- and long-term investment credit in livestock, irrigation, coffee plantations and agroindustry. All but \$1 million was for Phase I cooperatives. These figures show that bank officials receive an important need for investment credit in the cooperatives.

The rest of the estimated credit needs were distributed as follows: \$19.32 million for other small farmers, of which about three-fourths was for medium- and long-term investments, and \$38.66 million for medium- and large-sized farmers of which about two-thirds was for short-term production needs. This again points to the need for investment credit needs for small farmers.

Future Demand

The future demand for agricultural credit will depend on many factors as they influence the profitability of farming. Unfortunately, the outlook for significant growth in El Salvador's traditional exports is limited. El Salvador is a price taker and cannot exert much influence on world markets. The prognosis for future markets in cotton and sugar is problematical. Fortunately, El Salvador has preferred treatment in entry to the U.S. sugar market, but this is not likely to expand. Were this to be discontinued, sugar production would be seriously harmed. Although the coffee market is currently experiencing sharp price increase due to the Brazilian drought, the boom should disappear within two or three years and a return to a slowly growing market can be expected. Furthermore, government policy does not serve as an incentive to coffee production. The government taxes coffee producers both through the exchange rate and through taking much of the gain from windfall profits arising from favorable prices.

Perhaps the best for growth, but on a limited scale, are non-traditional exports such as shrimp, fruits and vegetables for the developed country markets, principally the United States. Production technological requirements are high and marketing sophistication is needed to compete in the markets. If El Salvador is successful expanding its production for these markets, there will be a need for credit. For these products there is a possibility of making loans to private-sector processing or exporting firms which are oriented to small farmers to finance their production. Consideration

should be given to using this in the reformed sector, perhaps with cooperatives.

The domestic demand for agricultural goods will expand with economic recovery and population growth. To encourage output more attention needs to be directed to government policies that provide incentives rather than disincentives to producers.

In spite of these difficulties the agricultural credit officials were optimistic about the future needs for credit. For the five-year period, 1986 to 1990, they projected an average annual real rate of growth of 10.7 percent. At this rate, by 1990 El Salvador will have a total real demand for agricultural credit of \$639.1 million. At the same time, factors limiting the growth of demand were identified. The most important were high cost of inputs, low export prices, social conflict and terrorism, high interest rates, low prices for non-export products and lack of marketing infrastructure. Phase I cooperatives were considered to also face the problems of cooperative management and organization. Phase III beneficiaries needed more assistance in technical agriculture.

Program Intervention

There appears to be a substantial unsatisfied demand for agricultural credit in El Salvador. Restrictive monetary policy and heavy refinancing have severely limited the funds for lending to the sector.

Foreign assistance should be directed to the reformed sector and other small farmers since they are the groups that are most often neglected or rationed out of credit by formal-market institutions.

There were strong needs for investment credits in the reformed sector and among small farmers. In addition, there were needs for production credit. If new funds were to be made available to the sector it would appear that they should be made available for both types of needs to permit flexibility in use, both in the near future and in the long run.

Rather than assigning program funds directly to a specific institution, it would be best to make them available to all institutions, again to allow flexibility in use and to create conditions of competition for the funds. Therefore, the already well-established mode of Central Bank rediscounts seems to be the most satisfactory arrangement. Of course, proper incentives must be put in place such that the Central Bank, the intermediate credit

institutions and the final users of the credit all want to participate. To establish such a program would require limited full-time technical assistance and periodic short-term consultants or evaluators. There is a need for education and training programs.

Strong consideration should be given to making rediscounts to intermediate credit institutions for purposes of lending to private-sector exporting or processing firms so that they can onlend to small farmers in the above-described manner. Also the possibilities of using rediscounts for loans made by credit institutions to money lenders and middlemen, who were shown to be so effective in making credit available to numerous small farmers.

Savings Mobilization

Rural finance in El Salvador has been almost exclusively directed towards agricultural credit. Policies of the government and foreign assistance donors have been to develop credit programs and Central Bank rediscount lines for the sector. Therefore, the emphasis has been on directing financial resources towards the sector rather than on trying to mobilize financial resources within the sector that can be used for future financing through the financial intermediation process. To be sure, financial intermediation does occur, especially among the commercial banks, and deposits are mobilized from rural residents or urbanites who derive income for agricultural endeavors. Nevertheless, there has been no major policy or programmatic thrust in this direction in rural areas. Under these conditions, rural financial markets are not fully developed; they lack deposit mobilization and financial intermediation. Under these conditions the agricultural sector has become dependent on outside infusions of capital by foreign assistance, Central Bank rediscounts or direct government subsidy.

The lack of policies for financial intermediation--both deposit mobilization and credit--have denied many rural citizens, particularly the small farmers, accessible opportunities for holding financial savings and earning income on these savings while maintaining liquidity. These farmers are thus disposed to look to other forms of savings--like holding cash, crop inventories, or purchasing livestock--as alternatives with the result that the financial system's ability to serve in an intermediary role is limited.

The Record

Since 1980, El Salvador has had an impressive record of savings mobilization in the whole economy, as measured by savings and time deposits in its financial institutions, despite all of the political and economic uncertainty that has occurred in this period. In each year the real value of total savings and time deposits has increased. Particularly noteworthy is the strong growth in the real value of these deposits that began in 1983 when civil strife began to decline and firm plans were established to elect a government, this is undoubtedly a response to improved stability and increased confidence in the economy. This reflects confidence in the economy and the future of the country.

This record is strongly suggestive of a good degree of financial intermediation in the nation. This concept is supported by the rough calculation that about one-sixth of the population holds savings accounts and that there is a total of 133 Bank offices in the country (91 mixed banks, 16 Mortgage Bank and 26 BFA). In addition, there are other non-banking financial institutions such as the savings and loan associations.

Policy Constraints

All of this has occurred in spite of a monetary policy that has created few incentives for savers. The main policy instrument that directly deals with savings is the interest rate structure which includes minimum deposit interest rate. The Monetary Board, however, has concentrated on the loan rate. As a result the deposit rates, which are tied to the loan rate in order to maintain an interest rate spread, have been kept at low levels. Because the loan rates are low and concessionary, with the relatively high rates of inflation in recent years the real deposit rates have been negative. The Monetary Board makes infrequent adjustments in the interest rate structure. As a consequence, there has been little attention directed to using the interest rate as an active policy variable to induce saving.

Shift to Time Deposits

Within the deposit rate structure lower interest rates are set for savings accounts than are established for time deposits that range from 60 to 360 days. In the last five years there has been a major shift to time deposits

away from savings deposits. This reflects both the savers' desires to earn higher returns and their increased confidence in political stability.

Determinants of Savings and Time deposits

A longitudinal study of the determinants of savings and time deposits in the nation's financial institutions provides good insight into El Salvador's success in mobilizing resources in spite of a passive interest rate policy. This study showed that the level of GDP and the degree of financial deepening were the main factors explaining the levels of total savings and time deposits in El Salvadorean financial institutions. The interest rate was shown to be a significant determinant of savings over the 1956-1984 period. Deposits, however, were shown to be quite inelastic with respect to changes in the interest rate. This probably reflects the fact that the Monetary Board seldom changes the interest rate structure. Therefore, when changes in the interest rate occur, there is not a corresponding change in savings deposits. The interest rate was not found to be significant as an explanatory variable for savings deposits over the 1969-1984 period. Inflation, however, was significant for the latter period. When inflation was higher there were fewer deposits, showing that savers were responding to the reduced incentives associated with lower real interest rates and, therefore, tending to place more of their savings in other forms of financial instruments and investment, including these abroad.

All classes of savers would be expected to behave in this manner, but those holding time deposits, who are mostly the medium- and large-sized business firms and middle- and upper-income families should cause the largest changes in the amounts saved. The reasons are that, in comparison to most of those persons with savings accounts, they control a larger volume of deposits and they have better access to alternative domestic and foreign investments and other financial instruments.

Commercial Bank Experience

The mixed bank and the Mortgage Banks held 99.5 percent of the savings and time deposits among those institutions operating in rural areas (this does not include savings and loan associations). A very large portion of their deposits however, came from customers located in urban areas. It would be expected, however, that a substantial portion of the deposits came from persons who derived their income from agricultural endeavors, given the importance (about one-fourth of GDP) of agriculture in the economy and that many of the medium- and large-sized farmers reside in urban areas.

The commercial banks have aggressively pursued deposits. Without the benefit of interest rate incentives they have developed promotional campaigns and non-interest price incentives, such as raffles and life insurance for depositors, as means of attracting deposits. Financial analysis shows that these banks have leveraged their capital extensively in obtaining these deposits and that they use deposits as a major source of obtaining loanable funds. Nevertheless, these banks have used Central Bank rediscounts as important sources of funds to finance agricultural lending. A probable explanation is that they prefer to use their deposits to finance loans in other sectors that are shorter-term, have a faster turnover and have better collateral, rather than tie the funds derived from deposits in agricultural loans that are longer-term and offer lesser collateral (usually the expected harvest).

Small-farmer Saving

In spite of El Salvador's good success in mobilizing savings in financial institutions it is very doubtful that there is much savings and deposit mobilization among most small farmers. As noted above, it is likely that many of the medium- and large-sized farmers do save in financial institutions because of the size of their incomes and their close linkages with the capital city and other major urban centers in the country. Government policy towards the sector in general, and small farmers in particular, has been to supply targeted credit. Therefore, the financial system has relied on government subsidies, BCR rediscounts and extensive foreign assistance, the latter especially since the 1980 reforms. Under these circumstances, there has been little incentive for rural-based institutions to mobilize savings. Both the institutions and the government policy makers have given scant attention to the savings mobilization dimension of rural financial markets.

It might be argued that small farmers do not save. There is increasing evidence from many countries that this is not true; small farmers do save, but unless they have accessible financial institutions they do not save in financial institutions. Rather they keep money in cash or liquid assets such as crops in storage or livestock. Farmers, like all classes of persons, have needs to save from current income in anticipation of foreseen and unexpected future business and family expenditures. The evidence showing the large numbers of low-income persons with savings accounts in urban El Salvador is convincing that poor people want to save in financial institutions.

A principal factor determining small-farmer saving is income. Although prospects for increased rural incomes in El Salvador are limited due to the dependency on soft world markets for traditional exports,

unfavorable domestic pricing policies for agricultural products and rising costs of production, farmers will still want to save a portion of their income. With continued economic recovery there should be an increase in demand for basic foods which should enhance farmer incomes. If the government's pricing policies were to change to become more favorable for producers, increases in income could be expected. Some small farmers can be expected to gain larger incomes as they move into the increasing opportunities producing for non-traditional exports such as fruits, vegetables and shrimp. As these occur, more savings mobilization can be expected.

The reformed sector cooperatives also represent an opportunity for savings and deposit mobilization. As a business, the cooperatives will have needs for liquidity and a place to keep funds safely in anticipation of future investment. Means should be devised to encourage the cooperatives to do this and make financial intermediation services available to them.

The Agricultural Development Bank

The country's principal institution for lending to agriculture, and particularly the small farmers, the Agricultural Development Bank, has not been inclined to mobilize deposits from this type of clientele, although it has had the legal authorization to do so since its founding in 1973. An inherent development bank philosophy and the ready availability of cheap resources from government subsidies, foreign assistance and Central Bank rediscounts have been the principal factor that have worked against deposit mobilization in this institution.

A comparison of BFA with the commercial banks show that BFA has hardly begun to develop its capacity for savings and deposit mobilization. The Bank has undertaken deposit mobilization on a limited basis in three of its twenty-six branch offices, two of which are in urban San Salvador. Closer analysis shows that a substantial portion of these deposits came from government organizations. This was another way for the government to make funds available to the Bank. After large amounts of foreign assistance became available in the 1980's, the government's deposits declined. It appears that part of the foreign aid substituted for the government deposits as a source of loanable funds for the BFA.

BFA is encountering pressures that have caused it to take a greater interest in deposit mobilization. Its serious delinquency problem and the associated refinancing have sterilized much of its portfolio. Furthermore, prospects for continued high levels of foreign assistance to the banks are not

promising. These conditions, have forced the BFa to look to other means to obtain financial resources.

BFA Program Intervention

BFA, among all of the El Salvadorean financial institutions operating in rural areas, appears to offer the best possibilities for mobilizing savings among small farmers on a reasonably large scale because of its extensive network of twenty-six agency offices located throughout the nation. Credit unions offer another possibility.

Feasibility studies for deposit mobilization in BFA agencies were conducted. Although these are rough estimates that depend on many assumptions, they indicate that deposits as a source of loanable funds can be a profitable operation for the Bank.

Given the interest of the Bank in mobilizing more deposits, the time is propitious to move ahead on this front. To begin, deposit mobilization should be done as a pilot study, utilizing the three offices that currently receive deposits as well as three or four others. Regular evaluation of the pilot study will provide good lessons not only on how the program is functioning but also about how to extend it to other agencies.

Apart from generating resources and creating a means for financial intermediation, one of the most beneficial aspects of the savings mobilization in BFA will be a side effect: deposit mobilization will force a change within the Bank that will enable it to become more viable as a financial institution and less dependent on subsidies and foreign assistance. The need to account for the financial and risk costs of mobilizing resources will force BFA to have a new appreciation of cost consciousness and the virtues of reducing delinquency. The end results of these side effects for the Bank should be reductions in administrative costs, more efficient credit delivery systems and lower delinquency.

With BFA saving mobilization, farmers will also benefit by having the opportunity to place their savings and surplus cash in a safe place where they can earn some return. It will create a new possibility for earning income. The record with the large numbers of low-income urban residents that hold savings accounts in the commercial banks provides strong evidence that probably this would occur if institutions with savings windows were made available and accessible in rural areas.

The evidence from the commercial banks also suggests that this will occur without major changes in the deposit interest rate structure. However, if the government were to establish an interest rate structure that would offer larger incentives to savers the whole process would be enhanced. It does not appear likely, however, that the government will do this. For example, the January 1986 economic measures retained a structure with deposit and loan interest rates that are very low given the domestic rate of inflation and the apparent opportunity cost of capital. The result is that in the current year deposit rates may well continue to offer negative real rates of return. Nevertheless, as was shown above, substantial increases in savings and time deposits have occurred in El Salvador despite the lack of favorable interest incentives and even when real interest rates are negative. Increases in savings were more tied to the levels of income and the degree of financial intermediation.

Therefore, there is reason for optimism that aggressive deposit mobilization by BFA agencies should go a long way toward enhancing financial intermediation and deepening in rural areas.

The BFA pilot program should use an active promotional campaign to make potential depositors aware of the new income-earning possibilities, while at the same time providing a safe keeping of their funds. Other forms of non-interest incomes, such as raffles, should serve as additional inducements. At first, existing clients are likely to be the largest number of savers, but promotion should not be limited to just this group and other farmers. Efforts should be made to appeal to all classes of businesses and families in the rural areas.

Consideration should be given to forced savings or forced deposit programs. For example, borrowers could be expected to place a fixed proportion, say 10 or 20 percent, of their loan deposit. Interest could be paid on this deposit during the loan and when the loan is repaid a higher or more attractive rate could be paid to induce the borrower to keep the funds on deposit.

BFA should concentrate on good and efficient service to keep the savers' costs associated with transactions and withdrawals to a minimum. It will also need to develop means of maintaining reserves and liquidity to meet legal and business requirements. This will be a new endeavor for the Bank and will require training and education of personnel and management.

Technical assistance will be required. Moreover, Bank personnel could benefit by visiting new and successful projects in other countries, such as with the Agricultural Development Bank of the Dominican Republic.

FEDECACES Program Intervention

FEDECACES and credit unions offer another viable means for savings mobilization. At present they mobilize forced savings by means of required deposits. Opportunities for voluntary savings mobilization should be explored. Experiences in many other countries clearly show that credit unions can be viable sources of voluntary savings mobilization, extend credit and, therefore, play a meaningful financial intermediation role in rural areas.

Several credit unions should be identified to work with FEDECACES in a pilot study. With periodic technical assistance good results can be expected. FEDECACES should be developed as the unit with the capacity to expand the program to other credit unions through training and management development. In this regard, they have the infrastructure in place in their education and training division.

Recommendations

Policies

1. Rural financial markets in El Salvador are credit-oriented. The basic underlying policy instrument is a rigid and concessionary interest rate structure that is changed only infrequently. Because of inflation, loan and deposit rates are very low and often negative in real terms. On the loan side this contributes to an excess demand for credit. Under these conditions, the Monetary Board has resorted to extensive and severe non-price credit rationing mechanisms to allocate credit and direct it to targeted activities. The principal means is the BCR rediscount lines with maximum limits.

The policy of maintaining low and concessionary loan rates contributes to excess demand for credit, misallocation of financial and real resources, capital-intensive technology in a labor-surplus economy, political use of credit as borrowers seek access to the income transfers associated with the concessionary interest rates, worsening income distribution and lesser financial viability of financial institutions.

Because deposit rates are tied to loan rates, savings mobilization is discouraged, financial intermediation is reduced, capital flight is encouraged, and the financial system becomes dependent on outside infusions of funds from domestic or foreign sources.

If the interest rate were raised to market levels that are commensurate with the opportunity cost of capital, many of these trends would be reversed. Credit would be more appropriately allocated, more savings would be mobilized and financial intermediation would be enhanced. It is, therefore, recommended that the interest rate structure be made more flexible and that the levels be increased to where they are commensurate with the opportunity cost of capital.

2. El Salvador has become increasingly dependent on foreign assistance for agricultural credit. Although this has been necessary and appropriate for the past five years, it is recommended that the nation attempt to decrease this dependency in the longer run through domestic savings mobilization. If this is done, not only will the nation become more self-sufficient financially, but also it will force individual credit institutions, especially the development banks, to become more financially viable institutions and less reliant on costly government subsidies and foreign assistance.

3. There is a host of government policies that impact on the demand for agricultural credit. Especially important are policies that influence the profitability of farming, such as policies for product prices, costs of inputs product prices for domestic foodstuff, technical efficiency and risk. It is recommended that these policies be reviewed with the objective of increasing the profitability of farming.

Current product pricing policies discourage production. Government policy to provide price supports for domestic foodstuffs have not functioned as planned, hence the farmer is often forced to sell his product at lower prices that are brought about downward pressures on prices due to government subsidies of food sold to consumers as well as inexpensive imports. This discourages production of basics food stuff. It is recommended that these policies be changed to provide more incentives for production.

Price support for sugar has helped encourage th production of sugar cane despite soft world markets. Coffee growers were penalized because of the tax imposed on them by the exchange rate. Prices of inputs such as agricultural chemicals and labor are rising, which is another argument for raising product prices. A more rational pricing system needs to be

established. In the present policy framework, many policies discourage production.

The government has established a network of programs to provide technical assistance to the farmers, especially those in the reformed sector. Most are new and have experienced problems. It is recommended that the successful programs need to be consolidated and expanded. Of particular importance is the need for improved management and cooperative training for the Phase I cooperatives.

Program Intervention

1. Based upon a current, and growing excess demand for credit in the reformed sector there is an immediate need for additional financial resources for this class of farmer. The long-run goal should be to make the financial system more self financing through deposit mobilization. In the meantime there is need for an infusion of funds. To do this it is recommended that a rediscount line for providing agricultural credit to the reformed sector, and perhaps other small farmers, be established at the BCR. The advantages for this mechanism are:

a. Rediscounts for this line would be available to all intermediate credit institutions (ICIs). All expressed a need for more funds. This flexible mechanism would create competition for funds among ICIs and allow funds to flow to the reformed sector through all ICIs. This should improve efficiency in use of credit and enhance repayment. It also will decrease the reformed sector's dependence on BFA and reduce BFA's direct control over funds, a factor that has caused it to develop inefficiencies in its operations and to discourage it from mobilizing deposits.

b. This mechanism takes advantage of the BCR's extensive experience with and institutional capacity for administering rediscount lines.

c. This mechanism takes advantage of the ICI's experience in working with rediscounts, i.e., it does not create a new mechanism that would require the ICI's to learn, understand and implement.

2. Rediscounts should be available for both short-term production credit and medium-term investment credit needs since both types of credit were identified. In as much as possible, these funds should be non-targeted in order to give the mechanism flexibility and to be consistent with the needs of the sector, i.e, let the funds go to where they will have the highest rates of return.

a. The rediscount should also be used to support bridging credits where ICIs lend to private-sector processing and exporting firms who on lend to small farmers as production credit a means for the firm to get a guarantee of supply of raw materials. Experience in the Dominican Republic shows this to be a succesful means to get credit to large numbers of small farmers.

3. The terms of the rediscount should contain adequate incentives to make the mechanism attractive for the BCR, ICIs and the ultimate borrower as well as to not create distortions in financial markets. These terms should include:

a. A flexible rate of interest to the ultimate borrower that is maintained at the equivalent of the market rate (the standard rate for regular bank loans to agriculture as established by the Monetary Board).

b. A generous spread of about 4 percent between the rediscount rate charged the ICI by BCR and the interest rate charged the ultimate borrower by the ICI.

To cover the higher per loan costs of working with the small credits to Phase III beneficiaries, an additional point or two of spread might be utilized.

c. The spread between the interest cost to BCR and rediscount rate to the ICI should be sufficient to cover both the BCR's administrative costs of running the program and to capitalize the rediscount fund and protect its real value, as much as possible, against inflation.

d. More efficient credit delivery systems should be devised to lower both borrower and lender transactions costs.

e. Require ICIs to put up a minimum of 10 percent of the size of the rediscount loan as their counterpart funds.

f. In case of default by the ultimate borrower, make the ICI responsible for the debt to BCR.

4. Loan rediscounted from the fund should meet credit worthiness criteria based on expected profitability of the credit and the personal characteristics of the borrower.

5. Credit worthiness of reformed-sector cooperatives, Phase III beneficiaries and other small farmers should be enchanced by linking rediscounts to

existing and new technical assistance and training programs for the reformed sector. Examples include USAID 0265 and Technoserve, Inc.

6. To encourage more small-farmer savings mobilization a pilot program should be established in the several BFA agencies and credit unions, the latter with the assistance of FEDECACES. This would be undertaken as an experiment in mobilizing savings in the rural sector by using the existing savings windows at the BFA and in credit unions. Particular attention should be directed to trying to mobilize savings in the reformed sector. Based upon the success of the pilot program, consideration would be given to expand or discontinue the savings mobilization efforts.

7. There should be an educational dimension of the project designed to institutionalize the program, increase credit worthiness of reformed-sector borrowers and improve financial market policy. This dimension would:

a. Undertake applied research to evaluate the success of the program and make recommendations for improvement.

b. Educate and train BCR, ICIs and the reformed sector personnel about the availability, and benefits and management aspects of the rediscount fund. This could be accomplished by formal training programs, technical assistance and on-the-job training.

c. Provide information and advice to credit officials, bankers, and policy makers on agricultural credit, savings mobilization and financial markets. This could be accomplished through structured programs, seminars, meetings and informal visits.

d. Provide for long-term formal education of key persons in BCR and ICIs to M.S. or M.B.A. levels.

8. The project should include a long-and short-term technical assistance.

a. One or two long-term advisors will be needed to work with BCR and ICIs.

b. Periodic short-term consultants will be needed to: (1) assist in establishing and implementing the program, (2) trouble-shoot problems that arise, (3) undertake research and studies that are necessary or useful to the successful implementation and evaluation of the program, and (4) to provide educational services.

9. Appropriate USAID credit officials and representatives of the various ICIs should be sent for short-term visits to the Dominican Republic or other Latin American nations where successful savings and lending programs have been implemented in order to gain first-hand experience that can be used in applying the program in El Salvador. There is no need to reinvent the wheel.

10. The BCR rediscount fund project should have a projected life of about five years. The objective would be to have the BCR fund continue on its own upon the completion of this period. The pilot savings mobilization program will require about two years.

Although it would not be included as part of the project, it should be recognized that any efforts to improve the exchange rate, marketing and pricing policies; and other factors that will improve the profitability of agriculture would enhance the success of this project.