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RURAL SAVINGS MOBILIZATION IN THE DOMINICAN REPUBLIC: CHALLENGES, ACCOMPLISHMENTS, AND LESSONS

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RURAL SAVINGS MOBILIZATION IN THE DOMINICAN REPUBLIC: CHALLENGES, ACCOMPLISHMENTS, AND LESSONS

TABLE OF CONTENTS

SUMMARY

The AID-sponsored Rural Savings Mobilization Project in the Dominican Republic, with technical assistance from the Ohio State University (OSU), has been a source of unusual challenges, lessons, and achievements, and constitutes a most interesting experiment in rural financial market development. This report discusses the project's background, its innovative design, objectives and activities, its flexible style of implementation, its successful results and the problems still unsolved, and derives useful lessons from the experience. It shows that financial savings can be successfully mobilized in the rural areas of low income countries and that the institutions involved can be thereby strengthened, but that the task is not easy.

The Dominican Republic's rapid financial development of the 1960s and 1970s was characterized by a strong urban bias. The banking network had been concentrated in the two major cities, a small proportion of the rural population had had access to formal financial services, and the ratio of agricultural credit to output had been very low. Moreover, this bias has been accentuated by the recent financial crisis. Also, Banco Agricola's 31 branches had offered only loans, but not deposit facilities. This bank had been an incomplete intermediary, disbursing foreign and Central Bank funds, on concessionary terms, and as a result it lacked financial viability and did not offer farmers permanent and

reliable services. This institutional design as well as frequent political intrusions led to severe default problems. During the recent financial crisis, moreover, Banco Agricola lost its access to public-sector funds and could not even perform its usual credit functions.

By the early 1980s, AID's dissatisfaction with donor efforts to improve the country's agricultural credit system led to the consideration of a rural financial market reform project. As the political constraints on interest-rate reforms became clear and on OSU advice, however, AID decided to rather sponsor a pilot rural savings mobilization project, based on the notion that the rural population could generate funds to meet some agricultural credit needs, if convenient, low-cost deposit facilities were offered.

The main objective has been to improve the supply of financial services--deposits and loans--in the rural areas, by strengthening institutions and promoting changes in policies and procedures. The activities designed included pilot savings mobilization campaigns by Banco Agricola and selected credit unions, the improvement of the financial management of these institutions, the establishment of a Dominican research capability on financial-market issues, and dissemination of the results. The purposes were to demonstrate that rural savings exist and can be successfully mobilized, to learn about mobilization techniques, and to promote policy reforms.

The establishment of deposit facilities at selected branches of Banco Agricola involved complex preparations. Support from the bank's management and staff had to be generated, procedures had to be designed, authorization from the monetary authorities was required, and a publicity campaign was launched. In July, 1983, passbook savings accounts and time deposits were offered at a first branch. One at a time, these services were to be eventually offered in four more branches. Soon, however, the political decision was made to gradually expand the system to all of the Bank's branches and the OSU team had to deal with the issue of the optimum speed of expansion of this service. While, as originally designed, deposit mobilization was to be an experiment, at a few branches the change of approach created new challenges for OSU and the bank.

Soon it became clear that rural financial savings did exist and that the bank was attracting them, but that even at a small scale of operations this was not an easy task. It was expected that deposit mobilization would create imbalances and force institutional reforms for Banco Agricola, but these second-generation problems became more acute with the rapid expansion of the system. The project had indeed been designed as a Trojan Horse, to promote policy and organizational changes from within, in response to disequilibria created. The willingness of the bank's management to rapidly expand the effort was fortunately matched by a desire to support the reforms required, buy these could not be improvised. Changes have included a new information management system, the introduction of microcomputers, new client classification and portfolio management criteria, renewed collection efforts, a new human-resource strategy, and lots of staff training.

Preparation efforts at the four credit unions selected were even more arduous, given their weak institutional base. On the other hand, a more flexible interest-rate structure was adopted. The initial build-up of excess liquidity, which has been a problem at Banco Agricola was rapidly resolved, as managers became more adept in credit analysis. They are now facing a substantial unsatisfied demand for credit, even at high interest rates. At the same time, their new procedures and improved image have resulted in significant reductions in borrower delinquency.

Three generations of research projects by Dominican institutions, designed and evaluated at an equal number of major workshops, have been the main vehicle for research and dissemination, in addition to numerous minor workshops, seminars, and lectures. About 120 reports and publications have resulted from the project. Research results, public discussion, and operational innovations have been a powerful instrument for policy dialogue and problem solving.

Achievements at Banco Agricola have included the establishment of the Savings Mobilization Department, numerous organizational changes, a new data-processing system and the use of microcomputers, and a much improved recuperation record. The new deposit mobilization activity was introduced with the addition of only three employees to the Bank's total staff. Interest rates charged on loans were revised up to the maximum allowed to improve profitability. By October, 1985 deposit services were being offered at 29 branches, 20,813 accounts had been opened, DRS 7.0 million (US 2.4 million) had been mobilized, while the system continued to expand rapidly. The average balance of a passbook account of DRS 194 (US$ 67) suggests that numerous deposits from small savers had been captured. Deposit mobilization among the four credit unions has also been very successful. In little more than a year, savings deposits have increased ten times in two of them, and in substantial amounts for the other two. (Towards the end of 1985 they had mobilized DRS 1.65 million--over half-a-million US dollars). Borrower delinquency, which had ranged between 45 to 71 percent of their portfolio (in three of them), had declined to the range of 7 to 15 percent.

Many lessons have been learned. It has been confirmed that rural savings can be attracted by financial institutions and that a demand for rural deposit facilities exist. For an institution with an established network of branches (like Banco Agricola) this can be done at a relatively low marginal cost. The task, however, is not easy. A complex preparation and the mobilization of political support are required. New dilemmas about strategy and organization have to be faced and second-generation problems solved. The introduction of deposit mobilization activities creates imbalances and brings to light deficiencies that necessitate correction, leading to a global restructuring of the intermediary. This may be the Project's most important contribution.

RURAL SAVINGS MOBILIZATION IN THE DOMINICAN REPUBLIC: CHALLENGES, ACCOMPLISHMENTS, AND LESSONS

Claudio Gonzalez-Vega and Jeffrey Poyo[1]

I. Introduction

For over two years, the Rural Savings Mobilization Project in the Dominican Republic has been a source of complex challenges, numerous lessons, and remarkable achievements, that have outrun its initial modest targets. Sponsored by the U.S. Agency for International Development (both the Mission in Santo Domingo and the Bureau for Science and Technology in Washington), it has involved The Ohio State University (OSU) as well as the Central Bank, Banco Agricola (public agricultural development bank), and numerous other Dominican institutions. Given the innovations introduced in its design, its flexible style of implementation, and its exceptionally successful results, the Rural Savings Mobilization Project represents one of the most interesting experiments in rural financial market development anywhere in Latin America.

This report illustrates how it is possible, if the required ingredients are available, to successfully mobilize financial savings in the rural areas of low income countries, and thereby strengthen the financial institutions involved. At the same time, it highlights the complexity of financial development and the subtleties of the policy reforms, institutional transformations, and technological innovations that are required for the task. It recognizes how little the profession, in general, knows about the operations of rural financial markets and how long the road towards an efficient provision of financial services in the rural areas of the low income countries will be. It suggests that the approaches being tested by the OSU group in the field may be among the most promising.

The report includes several sections. First, it discusses the background of the Project, both from the perspective of the financing of rural activities in the Dominican Republic and of USAID's involvement in this field. Second, it presents the Project's objectives and the nature of the activities designed to achieve them. Third, it examines the process of Project implementation. This is a section about "how events never evolve the way it had been planned" and "why it is essential to be flexible and not to insist in strictly adjusting to original plans." Fourth, the report also describes the results and achievements to date. Fifth, some problems still to be solved and an agenda for the future are discussed, while the report finally suggests the nature of some of the lessons learned.

II. Background: The Financing of Agriculture

During the 1960s and most of the 1970s, the Dominican Republic experienced a significant degree of financial deepening. This financial development was reflected by the establishment of numerous and diverse institutions, the provision of a wider range of financial services, the rapid growth, in real terms, of funds mobilized and of credit volumes, and the increasing ratios of financial assets with respect to the gross domestic product.2/ This financial progress was made possible by rapid economic growth and by relative exchange-rate stability and absence of inflation, which resulted from the openness of the economy and cautious fiscal, credit, and monetary policies, targeted to keep the external value of the D.R. peso stable.

Despite this progress, the Dominican Republic did not reach the degree of financial deepening achieved by some other countries in the region and continued to rely heavily on foreign savings in order to finance domestic investment.3/ Access to abundant foreign financial assistance and Central Bank rediscounting, on concessionary terms, reduced the need for and weakened the willingness of domestic intermediaries to mobilize voluntary deposits from the public. Moreover, financial markets are still highly fragmented, largely as a result of excessive and detailed regulation. The transaction costs imposed on most market participants appear to be very high and vary significantly across depositor, borrower, and lender classes. In addition, the loan portfolios of regulated financial institutions show a very high degree of concentration: among those few with access to loans, a small proportion has captured a very large share of the amounts loaned. All of these deficiencies have been accentuated by the contraction of the regulated segment of the financial market that has resulted from the most recent economic difficulties.

The most conspicuous deficiency of the Dominican financial development has been its pronounced urban bias. The very large network of regulated and non-regulated financial institutions has been concentrated in the two major cities: Santo Domingo and Santiago. As a result, only a very small proportion of the rural population has had access to institutional credit. It has been estimated that less than 20 percent of the country's agricultural producers have received institutional loans. The proportion that has had access to a permanent and reliable credit source is smaller still. The proportion of the rural population with access to deposits and other financial services is smaller, too. Moreover, the ratio of agricultural credit to value added in agriculture increased from 10.5 percent in 1965 to 19.8 percent in 1976 and then declined, reaching at best levels much below those observed in other Latin American countries.[4/] The insufficiency of this credit coverage has been further highlighted by a high degree of concentration of loan portfolios.

Banco Agricola has been the only regulated institution with an important presence in the rural areas, with 31 branches scattered throughout the country. Up to 1983, however, it had been an incomplete financial institution, which disbursed loans but did not mobilize deposits, provide money-transfer services, store valuables, serve as fiduciary, or supply any other financial service. It had only been a "lending window" for external (foreign or Central Bank) funds, to be disbursed in order to meet lending targets, on terms and conditions determined by outsiders. It had been a conduit, not an intermediary, for funds moving only in one direction. Authorized by its 1947 Charter to mobilize deposits from the public, it had faced no compulsion and received little incentive to do so. This structure undermined its financial viability. External funds came in waves, overloading the bank's capacity at that time, and leading to an irreversible expansion of its personnel, to be followed by acute scarcities of loanable funds. As a result, the institution did not offer farmers a reliable and permanent credit service. Absence of deposit facilities further prevented the development of "bank-customer relationships," and limited the bank's access to market information, both crucial for a more efficient portfolio management, and led to the alienation of the institution from its clientele. Banco Agricola generally projected the image of a political tool to favor particular constituencies, with frequent political intrusions undermining its financial viability. Political mandates and limited participation in project design weakened the bank's willingness to accept responsibility for collection. All of this contributed to severe default problems and to interest rate levels that did not allow the bank to cover costs, further accentuating its dependence on government transfers of funds to cover losses.

In view of the recent financial crisis, however, this reliance on public funds could not be continued. During the late 1970s and early 1980s the Dominican Republic has been characterized by increasing public-sector deficits and by an even more rapid expansion of domestic credit in order to finance these deficits. As a result, an increasing proportion of domestic credit has been allocated to the non-financial public sector and private producers have been "crowded out" of the loan portfolios of regulated intermediaries. This fiscal and credit expansion has resulted in a loss of the country's international monetary reserves, accelerated foreign-borrowing, inflation, and the devaluation of the D.R. peso. Inflation and devaluation expectations, coupled with interest-rate ceilings, have made the real returns on the assets issued by domestic financial institutions unattractive and the regulated financial system has experienced a drastic contraction, resulting in a reversal of the favorable financial-deepening trends that the country had enjoyed for over two decades. On the other hand, the non-regulated and informal segments of the financial market have expanded considerably, thus reducing the volume of capital flight or the extent of currency substitution that otherwise would have been associated with the repression of the regulated financial system.

In effect, compared to other Latin American countries, the Dominican Republic seems to have always enjoyed relatively active non-regulated and informal financial activity. The recent explosion of non-regulated intermediation, however, has been unprecedented and has further fragmented Dominican financial markets. Very high rates of interest have been paid for deposits in these non-regulated markets, averaging about 30 percent per year, while rates charged on loans have averaged 50 percent per year. In contrast, regulated institutions can not pay more than 18 percent per annum on deposits (and in many cases the ceiling is even more constraining) and find their competitiveness for funds substantially reduced.5/

This fiscal and monetary crisis has had significant consequences for the financing of agriculture. Credit volumes from regulated institutions, in real terms, have not contracted uniformly. Agricultural loans have suffered more than proportionately, while many rural producers have been excluded from institutional portfolios, spilling over to other markets. Access to the urban non-regulated intermediaries has not been easy for rural producers. Interest rates have been very high and mortgages have been usually required from borrowers. With the share of the public sector in domestic credit increasing and limits on its total growth imposed by the stabilization program, Banco Agricola has lost access to the Central Bank and other sources of rediscounted funds (FIDE). Moreover, funds from international donors have not been forthcoming, in view of increasing delinquency and other operational difficulties, further reducing the supply of loanable funds for agricultural purposes. In addition, the volume of informal lending, that has always been important in the rural areas, has declined, as funds have been attracted by the high returns paid on deposits by non-regulated urban financial institutions, while marketing and other intermediaries, which usually retail funds in the countryside, have also been constrained by the liquidity crunch. This has been accentuated by the inability of the price-support institution (INESPRE) to pay for grain purchases. The crisis, therefore, has seriously diminished the supply of financial services in the rural areas.

III. Background: AID's Role in Agricultural Finance

During the 1960s and the 1970s, the major international donors (AID, IDB, and IBRD) channelled substantial resources towards the Dominican agricultural sector. By the late 1970s, however, it was clear that the results of this foreign assistance were disappointing. Rural incomes had remained relatively low, while substantial migration to the main cities continued. The country was importing many staple commodities. This was explained in large part by the low profitability of crucial agricultural commodities, mostly as a result of price distortions. Inadequate provision of financial services was also part of the problem. A number of efforts had sought to improve the performance of Banco Agricola and to provide credit, on subsidized terms, to small farmers, but by 1979 dissatisfaction with the results of these programs led AID to give preliminary consideration to a major effort to assist the reform of rural financial markets.6/ Unfortunately, the 1979 hurricanes forced a redirection of attention towards more pressing problems of relief and reconstruction.

In early 1980s, AID had become increasingly disappointed with Banco Agricola, in view of high borrower delinquency, elevated operating costs, and lack of financial viability. Also, AID had accepted OSU's criticism of subsidized-credit programs, loan supervision and targeting, and specialized financial institutions. It was apparent, however, that raising interest rates without fundamental policy and financial-market reforms was impractical to negotiate, even it if was theoretically sound and operationally workable.[7] The approach of offering funds for a credit program as leverage for interest-rate reforms did not work. All of this led to a shift of the focus of the financial-reform controversy, from raising interest rates to mobilizing rural financial savings. The core of the new view was based on the notion that the rural population can save and thus generate funds for meeting other rural credit needs. To attract these funds, not only higher interest rates were needed, but also convenient, low-cost deposit facilities. It followed, of course, that higher rates must be charged on loans, but changes in the behavior of financial institutions were also required. The scope for intervention in rural financial markets was thus widened and the new view was thoroughly discussed at a Workshop on Rural Savings Mobilization at the Central Bank in October, 1982.[8] After the Workshop, AID, OSU, and the Dominican authorities discussed the design of a Rural Savings Mobilization Project. Emphasis shifted from an original interest in only experiments with credit unions, similar to those previously sponsored by OSU and AID in Peru and Honduras, to participation by Banco Agricola and eventually other financial institutions in deposit mobilizatic The local counterpart was also changed, from the Ministry of Agriculture to the Central Bank, in an effort to call the attention of the monetary authorities towards the special problems of rural financial markets and to locate the project in a position to influence policy.[9] The project had a long gestation period of about a year. The grant agreement between AID and the Central

Bank was signed during the Summer and the Project officially initiated operations on October 1, 1983.

IV. Project Objectives and Activities

The Project's main objective has been to improve the supply of financial services - deposits and loans - in the rural areas of the Dominican Republic. In particular, its purpose has been to strengthen those institutions that were providing some of those services or may do so in the future, and to promote changes in policies and procedures in order to increase the access of the rural population to financial services.

The project was designed to include four types of closely linked activities:

1. Pilot savings mobilization campaigns by Banco Agricola and selected credit unions. The purpose of this activity was to demonstrate that rural financial savings do exist and that they can be successfully mobilized, even under the present adverse economic circumstances. Also, the experiments were designed as a learning exercise about the appropriate techniques to mobilize rural deposits in the Dominican Republic. It was hoped that this empirical evidence would facilitate the reform of policies that so far had been based on the assumption that such savings did not exist.

2. Improvement of the financial management of Banco Agricola and selected credit unions. Deposit mobilization forces institutions to lend and recuperate loans more efficiently.

Liquidity and portfolio management, collection methods, and pricing policies had to be revised as a precondition for a successful mobilization effort.

3. Establishment of a Dominican research capability on financial-market issues. The purpose was to enrich the policy dialogue and improve project design with results from locally-conducted research and the savings mobilization experiments. The belief was that Dominicans would be more inclined to accept the new ideas if their validity was confirmed by their own research.

4. Dissemination of the results of the studies and institutional experiments, in order to generate political support for the Project's objectives and methods.

Technical assistance from OSU was obtained through an add-on to the AID-OSU Cooperative Agreement on Rural Savings for Capital Mobilization. OSU provided the services of a project leader, a long-term advisor on savings mobilization, and short-term research and consulting services. A Project Coordination Office was established in the Financial Department at the Central Bank. 10/

V. Project Implementation: Banco Agricola

The establishment of deposit facilities at selected branches of Banco Agricola was preceded by long and complex preparations. This institution had no accumulated experience in mobilizing funds from the public and had no expertise in competing for them. This major step required the support of the bank's management and staff and the belief that such efforts were both desirable and feasible. At the beginning, however, the idea encountered much skepticism among the bank's staff. Many feared that the Project's only objective was to force higher interest rates, with little net gain for the institution. A patient effort was required to convince them about the Project's broader scope and potential benefits.

Preparation for deposit mobilization also included the design of manuals, policies, and procedures. Authorization had to be obtained from the Monetary Board, which had to set the interest rates to be paid as well as reserve requirements. Resolution XXX of the Monetary Board authorized Banco Agricola to issue passbook savings accounts and time certificates of deposit. Reserve requirements were set at 10 percent, but the bank voluntarily decided to keep a reserve of 20 percent during the earlier stages of the project. Interest rates of 6 percent per annum for savings accounts and of up to 10 percent per annum for time deposits were authorized. The Monetary Board imposed as conditions for its authorization that a separate accounting be used for these funds, that they be lent in the same region where they were mobilized, and that participating branches be chosen on the basis of efficiency criteria. Five branches were selected for the pilot effort on the basis of default ratios and administration costs, which were measured for the first time within the bank. In a few cases improvement of the branch's physical appearance and installation of a safe were required. Branch employees were trained on the new procedures, and an aggressive publicity campaign was conducted.

On July 2, 1983 Banco Agricola initiated its deposit mobilization activities at its branch in La Vega. One at a time, deposit services were offered in other branches, at intervals of about two weeks. Soon the institution decided to expand the pilot effort to more branches than had originally been planned. Within three months, the project was operating in nine branches, and the management of Banco Agricola indicated that it desired to expand the service rapidly.[11/] The OSU team had to face the issue of the optimum speed of expansion of the system. In the original project design, deposit mobilization was an experiment involving only a few branches, in order to learn about the conditions under which deposits can be best mobilized and the changes in policies and procedures that are required. The decision to proceed more rapidly presented both opportunities and danger. The team recommended caution.[12/] Although there were economies of scale from the expansion, the design of the effort was still experimental. The bank had not adopted the operational and structural changes required for success, whose absence might have reduced the quality of the service. To the extent that confidence is a major incentive for depositors, such a deterioration might have resulted in a run on the bank and the failure of the mobilization efforts. Given the management's political decision, however, OSU decided to take advantage of this enthusiasm, while attempting to immediately face the new challenges.

What became clear after a few weeks of operation was that rural financial savings did exist and that the bank was attracting them. At the same time, even at a relatively small scale of operation, several complications soon appeared. These second-generation problems became more acute as the dimensions of the mobilization effort increased. This was not surprising or totally unwelcome. It had been expected -hoped- that the deposit mobilization activity would create imbalances and tensions within the bank, and bring to light deficiencies that would necessitate correction, and that this, in turn, would force the institution to evaluate its own performance from new perspectives, leading to major changes in organization and policies. That is, the project was conceived as a "Trojan Horse," which would result in institutional strengthening "from within," in response to the disequilibria created by deposit mobilization. Given the rapid expansion and much larger dimensions of the mobilization efforts, however, the second-generation problems appeared earlier and with greater urgency of solution than had been expected. Fortunately, the willingness to rapidly expand the service was matched by a desire to support many of the reforms required.[13]

The addition of the deposit mobilization activities, without increasing branch staff, for instance, had created massive information requirements which some branches found difficult to face. A separate accounting system and reports to the Central Office on the daily evolution of the accounts were required; interest was compounded daily. That is, the project created a "problem," that made deficiencies of the bank's information system evident. The solution involved a revised, integrated accounting and data-management system, the installation of microcomputers, etc.[14]

It has become increasingly clear that Banco Agricola has been facing significant difficulties in lending out the funds mobilized, mostly as a result of the severe restrictions imposed upon borrower elegibility by the bank's Board of Directors. This has reflected fears based on the institution's historic delinquency problems, as well as a -desired- change in attitude. Both the Board and branch managers have been less willing to lose the funds when they did not come from AID or the Central Bank but from their neighbors. The slow lending of the funds, in turn, has reduced the willingness of some branch managers to actively promote deposit mobilization. These problems and the high cost of accumulated exces' liquidity have led to some loosening of the lending requirements, in order to permit a more rapid turnover of the funds, but this has not been enough. OSU has been arguing about the need for more decentralization and increased responsibility for branch managers. The Project has supplied substantial training inputs for this purpose, in order to modify the rigid and paternalistic management style that characterized the bank in the past. The new attitude about repayment, moreover, has spilled over to the whole portfolio of the bank. New client classification and portfolio management criteria have been designed and the more active collection efforts have resulted in improved recuperation indexes.

Change within the institution has been taking place rapidly and on many fronts. Inevitably, not all of the changes have been fully understood, accepted, and internalized by the bank's staff.

OSU has been involved in a major effort in training and in technical assistance in human-resource management, in order to consolidate the reforms. Several workshops on managerial attitudes and techniques have been conducted. In September, the savings-mobilization office was upgraded to a department level, fully integrating the Project with the overall operations of the bank.

Expansion of the system continued rapidly and by April, 1985 the new deposit services were offered at 21 of the bank's 31 branches, while the second-generation problems were still being addressed. In April, Banco Agricola started the implementation of a quarterly raffle among depositors, in order to make the services more attractive. One account has been chosen from each of the participating branches and the winner's balance has been doubled, up to a maximum of DR $5,000. This incentive has apparently attracted much interest in the accounts.

VI. Project Implementation: Credit Unions

In the earlier stages of the Project, many credit unions were investigated, in order to select those five that would participate in the pilot savings campaigns. Preparation efforts at the credit unions were even more arduous and costly than at Banco Agricola, given their very weak institutional structure. In addition, the whole membership had to be convinced about the modifications of policies and organization (mainly interest rates and collection procedures) required for successful deposit mobilization. This gestation period lasted about a year. The accounting system of these credit unions required substantial improvement, as previously they only managed to close their books once a year. Partial subsidies have been provided to cover the added administrative and promotional expenditures required, but they have been relatively minor and temporary. Substantial progress in delinquency control has also resulted from the portfolio-management system designed by the Project and from the credit unions' improved image. Borrowers have found it attractive to become clients in good standing, in the expectation of larger loans in the future. Major training efforts have been directed toward credit union leaders and staff, while three Dominican technicians have been trained and have actively participated in all of these efforts.

In spite of the delays due to the lengthy preparation effort, by December, 1984 four credit unions were successfully mobilizing deposits. One attractive dimension of this other experiment has been greater flexibility in their interest-rate policies. The interest rates on deposits of two of the participating credit unions have closely resembled those paid in the non-regulated segment of the financial market; however, due to their nature as mutual organizations, where the clients are at the same time the owners, and due to economies of scope and of scale, the rates charged on loans have still been far below those charged by informal moneylenders.

Despite an initial build up of excess liquidity, as a result of conservative lending policies in combination with successful deposit mobilization, this problem was rapidly resolved in the credit union case, as their administrators became more adept in credit analysis. On the contrary, given the limited availability of financial services where they operate and the generalized liquidity crunch, as the image of the credit unions has improved, they have faced a substantial unsatisfied demand for credit, even at rates substantially higher than those charged at present.

VII. Project Implementation: Research and Dissemination

The Project's research activities have been implemented through three generations of research projects, designed and evaluated at an equal number of major workshops. The First Workshop on Rural Savings Mobilization in the Dominican Republic was conducted in early November, 1983 in Puerto Plata, with representatives from all participating institutions, in order to evaluate and improve the research proposals prepared by a dozen Dominican institutions. In order to provide a conceptual framework and criteria for the research efforts, a concepts paper and several technical notes were prepared.[15/] Those responsible for the projects were visited periodically by the OSU team during the following year, until completion.

The Second Puerto Plata Workshop was conducted in October, 1984 in order to review the results from the first year of research activities and plan for a second generation of research projects. The progress of the pilot savings mobilization efforts and proposals for financial reform were also discussed.[16/] The results from the second year and planning for a third generation of projects were the topic of the Third Puerto Plata Workshop that took place in September, 1985.[17] The amount of research sponsored has been substantial. Dissemination has included numerous minor workshops, lectures by OSU staff, seminars, publications, etc. About 120 papers, research and progress reports, technical notes, and policy reform proposals have been written within the Project. (See list of publications).

VIII. Project Results

Major achievements associated with the Banco Agricola component of the Project have included the establishment of the Deposit Mobilization Department, with a full-time staff of five persons, that has effectively participated in the design, implementation, and monitoring of the savings campaigns. Overall, the new activity has resulted in the addition of only three employees to the bank's total staff. Several organizational changes to improve efficiency have included new forms for reporting information, computer programs for data management, a new system of portfolio and client classification, and better collection procedures. Microcomputers are being introduced and major training efforts have been undertaken. The bank has modified its interest-rate policies, raising loan rates to the maximum level allowed and making them more uniform.

The bank has steadily expanded its deposit services to 9 of its 31 branches and to six "satellite" offices linked to rural branches. By the end of October, 1985 total deposits amounted to DR $6,958,094 (US $2.4 million), of which 58 percent was accounted by passbook savings accounts and 42 percent by time deposits (See Tables 1 and 2). This represented 20,539 savings accounts and 274 time deposits. The average balance of a savings account was DR $194 (US $67), and the average size of a time deposit DR $10,824. The small size of the savings accounts reflects the demand for this service from thousands of small depositors. Average mobilization per branch was DR $240,000. August to August, the number of accounts had increased by 133.5 percent and the amount mobilized by 57.1 percent.

Deposit mobilization among the credit unions has also been strong. In Vallejuelo, savings accounts increased from DR $3,554 (March 1984) to $37,465 (August 1985) and DR $18,500 of time deposits, not used previously, were added. During the same period delinquency declined from 71 to 10 percent of the portfolio. In Santa Lucia, savings accounts, offered for the first time since November, 1984, amounted to DR $67,523 by July, 1985. Delinquency declined from 48 percent (December 1983) to 7 percent (July 1985). In La Vega, savings accounts increased from DR $4,427 (December 1983) to DR $35,294 (July 1985), while DR $9,960 of the new time deposits were added. Delinquency declined from 45 percent (December 1984) to 15 percent (December 1985). In San Jose de Las Matas, savings accounts increased from DR $305,541 (January 1985) to DR $693,791 (May 1985) and time deposits grew from DR $418,278 to DR $779,554 in the sa[illegible] eriod. This cooperative was already successful, following policies similar to those promoted by the Project, but has experienced a substantial expansion since. Its volume of operations has become so large that the Project advisors have recommended the introduction of a microcomputer.

Table 1. DEPOSIT MOBILIZATION AT BANCO AGRICOLA

	August 1984	March 1985	August 1985	October 1985
1. Branches participating	7	21	29	29
2. Number of accounts:	1,160	7,441	17,376	20,813
Savings	1,140	7,297	17,110	20,539
Time deposits	20	144	266	274
3. Amounts (DR$ '000)	434	4,017	6,309	6,958
Savings	--	1,574	3,377	3,992
Time deposits	--	2,443	2,932	2,966
4. Average per Branch				
Number of accounts	166	354	599	718
Amount (DR$ '000)	62	191	218	240
5. Average size of deposit (DR $)	374	540	363	334
Savings	--	216	197	194
Time deposits	--	16,997	11,022	10,824

Source: Internal Banco Agricola records. DR $2.90 make US $1.

Table 2. DEPOSIT MOBILIZATION AT BANCO AGRICOLA
OCTOBER 31, 1985

BRANCHES	SAVINGS		TIME DEPOSITS		TOTAL	
	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT
Santo Domingo	713	109,871	13	827,059	726	936,930
Higuey	829	129,806	3	29,708	832	159,514
San Cristobal	634	26,839	6	3,530	640	30,369
San J. Maguana	1110	145,495	2	4,765	1112	150,260
Comendador	882	257,603	7	8,287	889	265,890
Cotui	1008	106,694	58	115,128	1066	110,224
La Vega	1629	250,975	29	217,931	1658	468,906
Santiago Rodr.	335	80,874	6	177,514	341	258,388
Puerto Plata	1287	229,379	50	164,640	1337	394,019
Nagua	424	42,922	1	5,973	425	48,895
El Seybo	480	184,901	8	10,941	488	195,842
Santiago	774	86,808	6	54,080	780	251,448
San J. Ocoa	746	59,725	2	58,105	748	117,830
Azua	627	163,791	3	4,542	630	168,333
Bani	1061	122,298	9	304,923	1070	427,221
Valverde	534	95,835	9	186,369	543	282,204
Moca	289	165,807	4	41,006	293	206,813
Dajabon	530	77,836	4	67,265	534	382,759
San J. Matas	1001	388,452	8	409,619	1009	798,071
Rio San Juan	1083	304,331	14	59,608	1097	363,939.
Salcedo	751	204,601	8	137,855	759	342,456
Bonao	716	81,119	5	10,500	721	91,619
Arenoso	673	131,475	2	5,500	675	136,975
Barahona	373	55,168	0	0	373	193,023
Montecristy	253	64,398	2	5,100	255	69,498
Hato Mayor	262	31,292	2	10,500	264	41,792
Samana	477	185,878	2	21,000	479	185,878
Villa Riva	326	88,064	2	2,165	328	90,229
Monte Plata	732	120,131	9	22,113	741	142,244
Total	20,539	3,992,368	274	2,965,726	20,813	6,958,094

The Project has promoted a substantial amount of research activity, using PL-480 local currency, and has made important inroads into institutionalizing research units within the Central Bank, Banco Agricola, and several universities. During the first year, 8 research projects were completed and 6 more were added during the second year, to investigate rural informal financial markets, urban nonregulated financial institutions, the evaluation of agricultural credit projects, depositor behavior, lending costs, the implementation of savings campaigns, the interaction between foreign-exchange and financial markets, the role of financial regulation, and problems of financial reform, among several other topics. Research results have been an effective instrument for policy dialogue and problem-solving innovations in the participating institutions. As claimed by the project's evaluators, "The combination of public discussion, research by Dominican investigators, and operational innovation by Dominican institutions--all supported and encouraged by flexible technical assistance and financial arrangements--is a powerful model for assistance."18/

IX. LESSONS LEARNED

Many lessons have already been learned from the Dominican experiment in rural deposit mobilization. The most important one has been the confirmation that financial institutions can attract deposits in the rural areas of low income countries, even under adverse economic circumstances. Substantial volumes of funds have been deposited with Banco Agricola and the credit unions by relatively small rural economic agents. This reflects the existence of a demand for deposit facilities, a valuable service not available before in the rural areas. The reduction of transaction costs for potential depositors, particularly in remote communities where other deposit services are not available, seems to be the most important inducement. Households and firms need to hold cash and reserves for liquidity, risk, emergency, and investment management. Households without deposit alternatives are forced to invest in real assets, even at high risks and low returns. (The loss of the rural savings incorporated in pigs because of the African swine fever epidemic is a dramatic example in the Dominican context). Availability of these deposit options has improved rural welfare, as shown by the revealed preference of thousands of depositors, who have voluntarily chosen to use the service. The lottery, simple procedures for frequent deposits and withdrawals, the compounding of interest, and the expectation of a future loan have also been important incentives.

Development banks and other institutions with an established network of branches can mobilize rural deposits at a relatively low marginal cost, by using their underutilized installed infrastructure. Deposit mobilization, however, is not easy. The operation of deposit facilities by an agricultural development bank that has not offered these services must be preceded by a gestation period of complex preparation. An effective mobilization will not be accomplished unless the authorities, management, and staff of the institution are convinced that the efforts are desirable and feasible. Several methods may be used to bring about this understanding of the need for and benefits of deposit mobilization. The myth that the rural population does not possess assets that may be transformed into deposits and does not have a margin over consumption for further accumulation needs to be questioned. Evidence has to be provided in order to show that potential depositors do respond to higher returns, lower transactions costs, greater security and liquidity, and other economic incentives. The bank's management must understand the problems associated with subsidized credit, high default rates, and dependence on outside financing if internal opposition is to be effectively dealt with.

Similarly, political support for institutional and policy reforms must be obtained both from the domestic authorities and major international donors. This is particularly crucial with respect to central banks, which will usually be requested to authorize the mobilization efforts and to set interest-rate structures, reserve requirements, and other determinants of the profitability of deposits. Technical assistance may play an important role in initiating thinking about the benefits of deposit mobilization, but local involvement in this process is crucial. In the Dominican Republic, a combination of public discussion over the years, research by Dominicans, in-depth policy dialogue, and operational innovations on a pilot basis, supported and encouraged by flexible technical assistance, proved to be a powerful model for change. The deteriorating financial situation of the 1980s and the harsh reality of more restrictive access to traditional sources of funds created the required economic incentives for the new activities.

Deposit mobilization, moreover, usually forces the intermediary to face new dilemmas about strategy and organization; that is, it becomes necessary to deal with a set of "second-generation" problems. The need to keep records and to calculated interest on the savings accounts frequently places additional burdens on the personnel and may overload existing information systems, possibly bringing to light its deficiencies and inducing a modernization. Experiments with microcomputers, to reduce data management costs, may be tried. Branch managers must quickly turn around the funds mobilized into loans, given their cost, in order to maintain profitability. In view of the source of these funds, branch managers must try to lend to clients who demonstrate a high probability of repayment. Given previous experiences with high delinquency, these managers have to learn to make lending decisions quickly, while still being very selective among borrowers. As a result, the institution is faced with a revision of its portfolio management techniques. With a new awareness about profitability, the intermediary also recognizes the need to reduce the costs associated with deposit and loan operations and with delinquency and finds it necessary to revise pricing policies in order to increase revenue from interest. In the case of Banco Agricola, all of this brought about changes in institutional structure, policies, and procedures, and rained fundamental questions about national financial policies and regulations.

In general, the introduction of deposit mobilization activities in a rural financial institution creates imbalances and brings to light deficiencies that necessitate correction. If successful, the experiment will lead to a global evaluation and restructuring of the intermediary and to a revision of policies, thus increasing institutional viability and improving the quality of the financial services provided in rural areas. Changes in information and data management systems, the degree of operational decentralization, portfolio management and delinquency control, and standards of administrative efficiency may be needed, possibly requiring a reconsideration of the institution's human resources and incentives strategy and considerable amounts of training. All of these changes, however, may be among the most important contribution of a rural deposit mobilization experiment.

FOOTNOTES

1/ Professor of Agricultural Economics and of Economics and Senior Research Associate in Agricultural Economics, respectively, at The Ohio State University. The first has been project leader and the second resident advisor of the Rural Savings Mobilization Project in the Dominican Republic (AID) 517-0179). The authors acknowledge the contributions to the Project of many institutions and individuals, including Roberto Castro, Pirie Gall, Henry Bassford, Ronald Venezia, Eva de Canela, John Chang, Marion Ford and many others at USAID in Santo Domingo; project consultants, in particular James Zinser, Eduardo Montiel, and Alvaro Cedeño; the project evaluators Charles Blankstein and Jerry Ladman; OSU colleagues Dale W Adams, Carlos Cuevas, and Douglas Graham, and graduate student Archibaldo Vasquez; Sandra Frydman of AID/S&T; Julio Llibre, Arturo Martinez Moya, Zunilda Paniagua, Opinio Alvarez, Agueda de Checo, Persia Alvarez, and many others at the Central Bank; Rafael A. Suarez, Camilo Caonabo, Ramon Aquino, Maria Cristina Mañana, and the staff of Banco Agricola; and Andres Dauhajre, Jose Luis Aleman, Alfredo Pablo, Jose Manuel Lopez Valdez, and many other Dominicans. This report was written in November, 1985 for a presentation at the Interamerican Development Bank, Washington, D.C. The authors are grateful for the hospitality of Hunt Howell, Yves Franchet, Stephen McGaughey and others at IDB, as well as with all participants in the discussion. The conceptual framework, not fully discussed here, may be found in the Project's many publications, listed at the end of the report, and in other OSU material. The report presents, in any case, only the opinion and conclusions of its authors.

2/ The ratio of financial assets of the banking system with respect to the gross domestic product increased from 30.8 percent in 1972 to 50.3 percent in 1982. See Claudio Gonzalez-Vega, "Notas Preliminares para una Reform Financiera en la Republica Dominicana," Second Workshop on Rural Savings Mobilization in the Dominican Republic, Puerto Plata, October 1984, and Claudio Gonzalez-Vega and James E. Zinser, "Regulated and Non-Regulated Financial and Foreign-Exchange Markets and Income Inequality in the Dominican Republic,"in Michael Connolly and Claudio Gonzalez-Vega, eds. Economic Reform and Stabilization in Latin America, New York: Praeger, forthcoming 1986.

3/ See Claudio Gonzalez-Vega, "Impacto de la Crisis Economica Sobre la Movilizacion de Recursos Internos en Centro America, " Third International Conference on the Financial Development of Latin America and the Caribbean, Interamerican Institute of Capital Markets, Caraballeda, Venezuela, March 1985.

4/ See Claudio Gonzalez-Vega, "Las Political de Tasas de Interes y la Asignacion del Credito Agropecuario por las Instituciones Financieras de Desarrollo de America Latina," Eduardo Sarmiento, ed. Politicas de Tasas de Interes, Inflacion y Desarrollo en America Latina, Washington, D.C.: Interamerican Development Bank, 1982.

5/ See Claudio Gonzalez-Vega and James E. Zinser, "Regulated and Non-Regulated Financial and Foreign-Exchange Markets and Income Inequality in the Dominican Republic," in Michael Connolly and Claudio Gonzalez-Vega, ed. Stabilization and Economic Reform in Latin America, New York: Praeger, forthcoming 1986.

6/ Claudio Gonzalez-Vega, Douglas Graham, and Jerry Ladman, on behalf of the Ohio STate University (OSU), participated in a Workshop on Rural Credit at the Central Bank, as part of these efforts, and a long-term association was initiated. Dale W Adams, Edward Ray, and Clark Reynolds, also on behalf of OSU, contributed with an assessment of rural financial markets. Claudio Gonzalez-Vega and Dale W Adams periodically advised AID or Dominican institutions on agricultural credit issues.

7/ Charles Blankstein and Jerry Ladman, "Report of Evaluation of the Rural Savings Mobilization Project," February 1985.

8/ Roberto Castro, who had recently joined AID, refocussed Mission attention to these problems and organized the workshop. Dale W Adams, Claudio Gonzalez-Vega and Robert Vogel, from OSU prepared the main papers and thus provided the framework for the discussion.

9/ These changes of perspective reflected the views of Claudio Gonzalez-Vega, from OSU, who, with Roberto Castro of AID, eventually designed the new project and negotiated it with all the interested parties.

10/ The Project leader has been Claudio Gonzalez-Vega, the long-term advisor has been Jeffrey Poyo, and through July of 1985 the local Project coordinator was Isidoro Santana. Victor Feliz replaced him.

11/ Rafael Angeles Suarez was appointed as the bank's new Administrator by the end of March, and immediately decided to push the project beyond the pilot stage.

12/ OSU found itself in the curious position of delaying rather than promoting deposit mobilization.

13/ See Claudio Gonzalez-Vega, "Rural Savings Mobilization in the Dominican Republic, Progress Report," June 1984; Claudio Gonzalez-Vega, "Rural Savings Mobilization in the Dominican Republic, Second Progress Report," November 1984, and Jeffrey Poyo and Claudio Gonzalez-Vega, "Rural Savings Mobilization in the Dominican Republic, Third Progress Report," April 1985.

14/ Some of these problems are still being resolved. The OSU team has collaborated with the IDB advisors, Jaime Moreno and Jose Luis Pedemonte, in the design of new forms, software, and reporting practices.

15/ See Claudio Gonzalez-Vega, "Los Mercados Financieros Rurales in la Republica Dominicana. Un Marco Teorico de Referencia para su Investigacion," First Puerto Plata Workshop on Rural Savings Mobilization in the Dominican Republic, November 1983. The topics of the first generation of projects included an analysis of the non-regulated financial markets, the connections between financial and foreign-exchange markets, the evaluation of credit-program impacts, economic and social profiles of financial markets in a few communities, and monitoring of deposit mobilization at Banco Agricola and selected credit unions. Dale W Adams, Claudio Gonzalez-Vega, Jeffrey Poyo, Douglas Graham, Ranulfo Jimenez, Donald Larson and Eduardo Montiel participated for OSU.

16/ The conceptual framework was provided by Claudio Gonzalez-Vega, "Notas Preliminares para una Reforma Financiera en la Republica Dominicana," Second Puerto Plata Workshop on Rural Savings Mobilization in the Dominican Republic, October 1984. Research topics included deposit mobilization and operational costs at Banco Agricola, the behavior of households as depositors, regulation of financial markets, rural informal intermediaries, etc. The OSU team present included Claudio Gonzalez-Vega, Jeffrey Poyo, Jerry Ladman, Charles Blankstein, Carlos Cuevas, James Zinser, and Eduardo Montiel.

17/ A conceptual framework was provided by Claudio Gonzalez-Vega, "Hacia el Fortalecimiento de los Sistemas Financieros Rurales en America Latina y el Caribe." The OSU team included Claudio Gonzalez-Vega, Jeffrey Poyo, Douglas Graham, Carlos Cuevas, Jerry Ladman, Eduardo Montiel, and James Zinser. A Salvadorian delegation sponsored by USAID in El Salvador also attended.

18/ Charles Blankstein and Jerry Ladman. "Report of Evaluation of the Rural Savings Mobilization Project," February 1985.

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- 40