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AGRICULTURAL CREDIT FOR THE BENEFICIARIES OF PHASE III LAND REFORM IN EL SALVADOR: A DIAGNOSTIC STUDY OF CREDIT USE AND RECOMMENDATIONS FOR USING THE 0307 REDISCOUNT LINE TO PROVIDE CREDIT TO THE BENEFICIARIES

by

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in collaboration with

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Report prepared under USAID Contract 519-0307 to Arizona State University to provide technical assistance to the El Salvador Central Reserve Bank in the financing of the agrarian reform sector.

January 23, 1990

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I. INTRODUCTION

Background

In July 1986, the government of El Salvador entered into an agreement with the United States Agency for International Development (USAID) to establish the 0307 rediscount line in the El Salvadoran Central Reserve Bank. This line was to be used to provide agricultural credit through the nation's banking system to the reformed sector, which consists of the cooperatives in Phase I and the beneficiaries of Phase III (Decree 207). The 0307 Project credit is to be mostly directed to medium- or long-term investment projects, but can also be used for short-term purposes. To date, all of the mixed banks and the Mortgage Bank have used the rediscount line; however, the Agriculture and Livestock Development Bank (BFA) has not participated for lack of satisfying certain prerequisites previously established by USAID. This is unfortunate, because the BFA works with about one-half of the Phase I cooperatives and is the principal lender to the Phase III beneficiaries. It is encouraging, however, that the BFA and USAID are now in serious negotiations to make the Bank eligible for 0307 rediscounts.

The volume of 0307 rediscounts has been less than projected at the beginning of the program. As of September 30, 1989, 61.3 percent of the ¢300 million in available funds had been rediscounted and disbursed. There was a cumulative total of 384 loans contracted in the amount of ¢184.6 million. Of these totals, only 5 banks made a total of 12 loans with a volume of ¢3.0 million had been made to the Decree 207 beneficiaries. These loans were made to solidary groups, cooperatives and communities consisting of 581 members, which represent 1.4 percent of the Phase III beneficiaries. All Phase III lending from the 0307 Project was for short-term annual production purposes, mostly for the production of basic grains and sesame.

Purpose of Study

It is clear that the Phase III land reform beneficiaries have been poorly served by the 0307 rediscount line. There have been only a few rediscounted loans and no lending for investment purposes. It should also be noted that this problem is not unique to the 0307 Project. With the exception of the BFA, other financial institutions have made only a small number of loans to this group of reformed-sector beneficiaries.

The purpose of this research is to undertake a diagnostic study of the Phase III land reform beneficiaries, and the credit programs that currently serve them. The objective is to understand the nature of this class of clientele, the extent they receive credit and, to determine what means might be recommended such that they might make better use of the 0307 rediscount line, as well as other sources of credit.

Organization of Report

The report contains eight chapters. The second chapter describes the Phase III land reform in the context of the nation's total land reform program. The third chapter is designed to provide a comprehensive profile of the Phase III beneficiaries in terms of their land tenancy and farm size, demographic characteristic, levels of social indicators, participation in cooperatives and peasant organizations, farm production, technical assistance received and the marketing of farm products. This background is necessary in order to understand the nature of the clientele The fourth chapter presents an overview of their use of credit. Chapters five through seven respectively analyze the credit directed to the beneficiaries from the BFA, commercial banks and FEDECREDITO. The final chapter contains conclusions and recommendations for better serving the beneficiaries with agricultural credit.

II. LAND REFORM IN EL SALVADOR

Introduction

Since 1932, when El Salvador experienced a campesino revolt, El Salvador has had some form of a land reform program. However, prior to 1979 all lands transferred were done on a voluntary basis. The several programs were not large scale and would not be judged very successful. By 1975 only 10,700 families had been resettled on 132,000 acres (Wise, p.5.).

In the mid-1970's land ownership was concentrated in large estates growing coffee, sugar and cotton which employed colones, persons living on the estate who worked for the owner and who also had a small plot of land assigned to them to use for growing family food. In addition, there were a number of medium-sized farms as well as a large number of farmers scattered across the nation who farmed very small plots. Some of these were owners but mostly they were renters on a cash or share-cropping basis. Most of the small-scale farmers had plots located on marginal land, often times sited on steep hill sides, and most only produced basic grains.

Following the October 15, 1979 military coup, which deposed the regime of General Carlos Humberto Romero, the new government announced a number of emergency programs that included a redistribution of land and natural resources. A few months later, on February 2, 1980 the ruling military junta announced plans for three major economic reforms that would impact on the agricultural sector: land reform, nationalization of the banks and government control of export marketing. On March 5, 1980, the government issued Decree 153, the Basic Law for Land Reform. The next day Decree 154 was issued to implement Phases I and II of land reform. On 4 April of the same year, Decree 207 was issued for Phase III.

Decree 153

The Basic Land Reform Law established the broad conditions under which land reform would take place. In essence, it stated that the nation's farm land was subject to expropriation (i.e., with compensation) if properties belonging to one or more individuals, estates or associations exceeded 100 hectares of land classified as I through IV (according to the U.S. Department of Agriculture land classification system) or were properties in excess of 150 hectares for land classified as V through VII. Property affected included the land as well as all livestock, machinery and equipment permanently located on the property as well as fixed properties constituting industrial, agricultural and livestock complexes. Properties below the above-mentioned limits could be affected if any of the following conditions were not met: (a) land was worked directly by owners, (b) a minimum level of productivity was maintained, (c) renewable natural resources were managed, conserved and protected, and, (d) where hired labor was employed, the owners complied with labor and social security laws (Wise, p.16).

Decree 154

This decree established the conditions for implementing Phases I and II of the new land reform program.

Phase I

This phase was directed at expropriating the largest estates, those exceeding 500 hectares, most of which were located in regions suited for growing coffee, cotton or sugar cane and which often consisted of the nation's best farm land. Most commonly the owners did not live on the farm. To implement the program land sales were halted and the military was used to conduct the expropriations.

The essence of the program was to transfer the properties from the owners to newly-formed cooperatives whose members were the colones who had previously worked the land for the owners. The Salvadoran Land Reform Institute (ISTA), which had been established in 1975 to administer the previous land reform programs, was named to implement the program. ISTA's main functions were to effect the land transfers, organize the cooperatives and co-manage the cooperative for an indefinite period until the cooperative could operate on its own.

The compensation for the expropriated land paid to the former owners was in the form of land reform bonds issued by ISTA. The basic rule was that the value of the bonds was to be based upon the former owners' average declared value of the land for tax purposes in 1976 and 1977. The bonds have a maturity of 20 to 30 years and pay 6 or 7 percent interest. They are tax exempt and can be sold. The cooperatives had to pay for the land by assuming an agrarian debt payable to ISTA equal to the value of the land reform bonds on their property. The debt has the same maturity as the bonds and carries interest at 9.5 percent. Former owners could apply to maintain some of their land, up to 100 to 500 hectares depending on the class of land.

Later, Decree 842 was issued. This decree brought under the Phase I program those land reform cooperatives that were working with ISTA prior to the 1980 reform.

Table II.1 shows the status of Phase I during the 1986/87 agricultural cycle. As of that date there were 322 active cooperatives covering 207,571 hectares. Of this total, 305 were formed under Decree 154. In addition, there were 28 cooperatives that had been formed under Decree 154 but that were no longer active.

Phase II

This phase is designed to effect farm properties ranging between 100 and 500 hectares, but, to date, has not been implemented. The principal reasons are that numerous farms are often family run (not absentee landlords as was typical of Phase I), are important producers of crops for both the

Table II.1 Cooperatives Organized Under Phase I of Land Reform--Decree 154 and 842--as of 1986/87 Agricultural Cycle

Active cooperatives		
Decree	Number	Area (hectares)
154	305	197,513
842	17	10,058
Total	322	207,571
Inactive cooperatives		
154	28	14,309

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Proyecto Planificación y Evaluación de la Reforma Agraria (PERA), VII Evaluación del Proceso de de Reforma Agraria, San Salvador, Diciembre 1987, pp.2-3.

5a

domestic and export markets, and considerable political opposition.

It should be noted, however, that the current government has plans to activate Phase II, but on a voluntary land sale basis. USAID has donated $30 million to help the government start the program which will be administered by the National Financiera for Agricultural Lands (FINATA) which heretofore has only dealt with Phase III. The center piece of the new program is a Land Bank which will allow peasants to purchase land that is voluntarily put up for sale by its present owners, i.e., in contrast to Phase I and III, there will be no expropriation.

Decree 207

Decree 207 implemented Phase III. Issued on 28 April, 1980, it utilized the above-mentioned provisos of the Basic Land Reform Law to extend reform to the true small farmer. Phase III, often referred to as the "land to the tiller program" was based on the principle that land should be the property of those persons that actually farmed it. In essence, Phase III made it possible for small farmers who were renting land, on a cash or share-crop basis, to become owners such that instead of paying rent they could build up equity. They were entitled to obtain up to 7 hectares. The former owners were to be compensated. The National Financiera for Agricultural Lands (FINATA) was created to implement the program. Because the farmers acquired their land through FINATA, they are often called finateros.

In contrast to Phase I, under Phase III farmers had to initiate the action to obtain ownership of the land. If they believed they were eligible and wanted to become owners they would file a petition with FINATA. FINATA would then review each individual case to verify the claim. If it was valid, a provisional title was issued which gave the petitioner the right to farm the land and served as a basis for obtaining bank credit. FINATA then began the procedures to issue a full title which included: (a) a search of documents for land registry and tax payments, (b) site visits to survey parcels and classify soils, (c) signing of official documents by former owner and petitioner, (d) determination of compensation, and (e) establishment of mortgage and the repayment schedule (Wise, pp. 54-55).

Compensation to the former owners is determined by FINATA based on the declared value of land for tax purposes in 1976 and 1977. If these are not available, then the value is based on soil classification and other characteristics. The former owners are to be compensated 50 percent in cash and 50 percent in 30-year FINATA bonds, bearing interest payments of 7 percent. The bonds are tradeable. FINATA pays the former owners using funds collected as mortgage payments from the new owners, who assume a debt to FINATA. The term of the debt is also 15-20 years and carries an interest rate of 6-10 percent.

FINATA assumed a proactive role in encouraging small farmers to make petitions. Through a network of four regional offices, FINATA launched a very active campaign to encourage eligible persons to petition, even to the extent of placing recruiters in central locations such as bus terminals.

One result was that many petitions were later determined ineligible. In June 1984, the period for filing petitions was closed. Since that date, FINATA has dedicated most of its efforts to the processes of verifying petitions and transferring titles.

A problem occurred when it was discovered that some of the petitioned land owners were other small farmers, including widows and orphans and persons whose income was largely dependent on renting out small tracts of land. A transfer of title from these persons to other small farmers was considered contrary to the spirit of the law. Accordingly, FINATA adopted a "widows and orphans rule" so that land owners with 7 hectares or less of land could not have their lands expropriated.

As would be expected, many landlords resisted Phase III to avoid expropriation, many evicted their tenants, but in most cases FINATA was able to establish the tenant's rights and, if necessary, called in the armed forces to return the tenant to the land.

Number of Beneficiaries

The number of reported beneficiaries under Phase III land reform increased through 1984 until registration was completed. However, since then it was followed a downward trend because in the process of verification of petitions many were considered ineligible and, discarded. In the Second Profile of Decree 207 Beneficiaries, PERA reported 63,648 beneficiaries in 1984. In the Third Profile, which corresponded to 1986, the number had declined to 48,344, a 31.6 percent decline over the previous profile. The most recent figures, prepared as of 13 July 1989 by FINATA, and reported in Table II.2, show 41,640 beneficiaries, which is a 16 percent decline over the 1986 number.

As shown in Table II.2, there were 9,541 different properties petitioned of which almost half were discarded leaving a total of 4,974 that are still affected. On these properties there are 41,640 beneficiaries who hold or will hold 42,230 titles.

The total affected land area is 71,708 hectares. The average size of plot per direct beneficiary is 1.72 hectares with an average value of ¢3,290. The average size of land per title is 1.70 hectares with an average value of ¢3,245.

These data are nearly final, since there are only 472 petitioned properties for which the process of verification is not complete. The fact that the numbers of titles exceed the number of beneficiaries is because some persons may have received titles to more than a single plot. Furthermore, it should be noted that the number of properties affected is only 12 percent of the number of beneficiaries. This shows that many of the former landlords rented to a number of different persons.

Indicators of the Relative Size of Land Reform

As shown in Table II.3, in the 1986/1987 agricultural cycle the 41,640

Table II.2 Results of Decree 207 Land Reform Program
(As of July 13, 1989)

Properties affected		
Number of properties petitioned		9,541
less: Number of petitions dismissed		-4,567
Number of properties affected		4,974[a]
Number of direct beneficiaries		41,640
Number of land titles than have been emitted or that will be emitted.		42,230
Area of affected properties		
(Manzanas)		102,542
(Hectares)		71,708
Value of affected properties	₡95,826,383	
Average size of land received or to be received per direct beneficiary		
(Manzanas)		2.46
(Hectares)		1.72
Average size of land per title extended or to be extended		
(Manzanas)		2.42
(Hectares)		1.70
Average cost of land per beneficiary		
(Manzanas)	₡2,301	
(Hectares)	₡3,290	
Average cost of land per title		
(Manzanas)	₡2,269	
(Hectares)	₡3,245	

[a]Of this number, 4,502 have been approved by FINATA for payment of indemnity. These properties consist of 98,763 manzanas (69,065 has.) valued at ₡92,665,324. The remaining properties are under review by FINATA.

Source: Financiera Nacional de Tierras Agrícolas, Anexo a la Memoria Anual de Labores de 1988 (Diagnóstico de la Situación Actual al 13 de julio de 1989), San Salvador, julio de 1989.

Table II.3 Beneficiaries of El Salvadoran Land Reform--Phase I and Phase III--as of 1986/87 Agricultural Cycle

	Phase I		Phase III[a]			
	Number	%	Number	%	Total Number	%
Beneficiaries	30,268	42.1	41,640	57.4	71,908	100.0
Areas (has.)	263,295	78.6	71,708	21.4	335,003	100.0

Source: Phase I: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Proyecto Planificación y Evaluación de la Reforma Agraria (PERA), VII Evaluación del Proceso de Reforma Agraria, San Salvador, Diciembre 1987, pp.3,117.

Phase III: As reported by Financiera Nacional de Tierras Agrícolas in Table II.2.

[a]Phase III data are reported as of July, 1989.

Phase III beneficiaries accounted for 57.9 percent of the total of 71,908 direct beneficiaries of land reform, whereas the 30,268 Phase I beneficiaries constituted 42.1 percent. However, of the total affected properties consisting of 335,005 has., the 207 beneficiaries held only 21.4 percent (71,708 has.), whereas the Phase I beneficiaries had 78.6 percent (263,295 has.).

Total land affected by land reform constitutes about 2.8 percent of all of the El Salvadoran territory (11.96 million has.) and about 4.1 percent of the "land in farms" which was reported in the most recent agricultural census undertaken in 1971. The Phase I and Phase III properties account for only 3.2 and 0.9 percent of the land in farms, respectively. Whereas, these figures are only approximate, they clearly show that the total farm land in El Salvador that has been subject to land reform is quite small relative to the total.

It is possible to estimate the size of the rural population benefited by land reform. Assuming an average size of family per beneficiary of 6 persons, the total rural population benefited is 431,448; that benefited by Phase I is 181,608 and that by Phase III is 249,840. Assuming a rural population of 3 million, the persons benefited by land reform correspond to 14.4 percent, these for Phase I 6.1 percent and those for Phase III 8.3 percent. These figures show that only a relatively small percentage of the El Salvadoran rural population has benefited from land reform. In part, this low figure reflects the extremely high population density in rural areas. Nevertheless, the total numbers of beneficiaries are quite significant.

III. DESCRIPTION OF PHASE III FARMERS AND THEIR FARMING OPERATIONS

Introduction

In order to consider credit programs, it is first necessary to understand the clientele in order to gain insight into their potential use of credit and their credit worthiness. Therefore, the purpose of this chapter is to provide an overview of the Decree 207 beneficiaries and their farming operations. The data presented are largely derived from the Third Profile of Decree 207 Beneficiaries, published by the Office of Planning and Evaluation of the Reformed Sector (PERA) of the Ministry of Agriculture and Livestock. Most data reported in this chapter correspond to the 1985/1986 agricultural cycle.

The chapter begins with descriptions of Decree 207 beneficiaries with respect to their land tenancy and their participation in cooperatives and peasant organizations. These are followed by description of their demographic characteristics, labor force participation, income earned, farm production, technical assistance received and their marketing of farm products. The chapter concludes with a summary and a statement of the beneficiaries' credit worthiness. The succeeding chapter deals with their use of farm credit.

Land Tenancy

There are two basic forms of land tenure for the Decree 207 beneficiaries: individual farms and collective farms. The individual farms overwhelming dominate; only 22 (0.05 percent) of the 41,640 direct beneficiaries are collective cooperatives. (Note, according to FINATA records, a single collective cooperative is considered a single direct beneficiary).

Collective Farms

The exact number of members in the 22 collective farms (or collective cooperatives) is unknown, but PERA estimates there are about 750 in total (Tercer Perfil de Tercer Perfil de Beneficiarios del Decreto 207, p.29). The average number of members per collective farm is 32, but the available records show a range of 20 to 80 members per farm.

The collective farm was formed at the time of the petition. The 22 farms received properties from 30 different owners. Typically, prior to land reform, these groups were functioning as a collective farm, but renting the land. In some cases, groups of farmers farming contiguous rented parcels, petitioned to obtain the land as a collective operation. Most commonly the collective farm's land readily lends itself to producing crops --such as sugar cane, cotton, and coffee-- that can be grown efficiently on a large scale.

Individual Farms

As noted above, the individual farms dominate. In 1986, PERA reported 48,344 direct beneficiaries, all of which had obtained land through FINATA by acquiring one or more parcels from the owners of land they previously rented. Table III.1 shows that the beneficiaries received 70,657 different plots through FINATA, a figure which shows that most farmers obtained more than one plot. These plots accounted for 85.4 percent of the total farmed by the beneficiaries. Another 4.8 percent of the plots were other owned lands. Of this number, 1.3 percent was obtained through inheritance and 3.5 percent through purchase. In addition, 8.9 percent of the plots farmed were rented land and 0.9 percent farmed cooperative land. Thus, although it is the norm that most beneficiaries only farm land obtained through Phase III land reform, a sizeable number also farm rented or other owned lands.

Cooperatives

As noted above, the 22 collective farms are considered as cooperatives. However, the cooperative movement in Phase III is much stronger than these collective operations because many individual beneficiaries are members of cooperatives. As shown in Table III.2, in December 1983 there were 207 cooperatives with 7,339 members formed among the Phase III beneficiaries (included are the 22 collective farms with about 750 members). The total cooperative membership represents about 18 percent of the individual beneficiaries and accounts for nearly 22 percent of the total affected property.

The cooperatives function in one of three different modes: (a) production, where all land is farmed by members in a collective farm, (b) service, where the members farm their own individual plots and only use the cooperative to obtain credit or other agricultural services for their individual operations, and (c) mixed, which is a combination of the production and service modes. In the latter mode some land is farmed collectively and each individual also farms his own plot. As shown in Table III.3, the service cooperative is the most common mode, accounting for 52.7 percent of the total cooperatives; whereas the production and mixed represent 28.5 and 18.8 percent, respectively.

The formation of a cooperative is relatively easy and straight forward according to El Salvadoran law. A cooperative must have at least 11 members. To establish a cooperative, a pre cooperative is first formed. Then an Act is prepared to constitute the cooperative. There are standard by-laws which the cooperative uses. These provide for a general assembly of members, election of an administrative council and officers to carry out the business of the cooperative, and the election of a vigilance committee to oversee the council and officers. In contrast to the Phase I cooperatives, the Phase III organizations do not have a manager nor are they subject to oversight by FINATA. Many Phase III cooperatives employ a bookkeeper.

The movement to form cooperatives was encouraged by the several peasant organizations, which in turn were strongly supported by the Christian

Table III.1 Tenancy of Lands Farmed by Decree 207 Beneficiaries in 1986

Tenancy	No. of Plots of Land	% of Total
Owner:		
Land obtained through FINATA	70,657	85.4
Land inherited	1,055	1.3
Land purchased	2,920	3.5
Renter	7,400	8.9
Use cooperative land	746	0.9
Total:	82,778	100.0

Source: El Salvador, Ministerio de Agriculture y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.27-29.

Table III.2 Types of Cooperatives Organized Under Decree 207 Land Reform Program

(December 1988)

Department	Number of Cooperatives	Number of Members	Area (Mz.)	Type of Cooperative					
				Production		Service		Mixed	
				Coops.	Members	Coops.	Members	Coops.	Members
Ahuachapán	56	1,766	5,276.67	3	119	48	1,474	5	173
Santa Ana	22	994	1,675.89	-	-	21	941	1	53
Sonsonate	13	500	1,346.77	2	38	6	223	5	239
Chalatenango	1	30	103.00	1	30	-	-	-	-
La Libertad	20	794	2,369.33	6	217	11	319	3	258
San Salvador	6	146	388.72	1	14	2	38	3	94
Cuscatlán	2	32	59.76	2	32	-	-	-	-
La Paz	10	252	797.00	9	219	-	-	1	33
Cabañas	6	158	291.00	6	158	-	-	-	-
San Vicente	10	434	2,120.88	-	-	7	294	3	140
Usulután	10	678	3,062.08	8	615	2	63	-	-
San Miguel	16	420	1,375.04	13	372	-	-	3	48
Morazán	15	523	1,061.00	-	-	-	-	15	523
La Unión	20	612	2,418.11	8	249	12	363	-	-
Total:	207	7,339	22,345.25	59	2,063	109	3,715	39	1,561

Source: Financiera Nacional de Tierras Agrícolas.

Table III.3 Classification of Phase III Cooperatives

(December 31, 1988)

Type of Cooperative	Number No.	Number %	Members No.	Members %
Production	59	28.5	2,063	28.1
Service	109	52.7	3,715	50.6
Mixed	39	18.8	1,561	21.3
Total:	**207**	**100.0**	**7,339**	**100.0**

Source: Financiera Nacional de Tierras Agrícolas.

Democrat government. These organizations believe in the cooperative mode for small farmers and were anxious to recruit Phase III beneficiaries in order to strengthen the cooperative movement, build their membership and enhance influence with the government.

Table III.4 presents information on the interest of Decree 207 beneficiaries in affiliating with cooperatives. In 1986, 21.7 percent of the beneficiaries were members of cooperatives or credit union cooperatives. Another 29.1 percent said they would like to be a member, but 49.2 said they do not want to belong to a cooperative. The conclusion is that the Decree 207 beneficiaries are about evenly split with respect to their interest in participating in the cooperative movement.

There appears to be a wide degree of variability with respect to how well the Phase III cooperatives function. Much of their degree of success depends upon their leadership, member commitment to cooperative ideals and the continued support they obtain from support groups, such as peasant organizations. The fact that many cooperatives are organized mostly to enhance the beneficiaries chances for credit, suggests that the individual members may lack of commitment to the cooperative ideals. Indeed, a high official in the Bank of Agriculture and Livestock Development's Cooperative Division considers this is the major reason why so many of the cooperatives served by the bank do not function well and do not repay their debts.

Peasant Organizations

As mentioned above, peasant organizations were active in fomenting Phase III land reform activity, especially in the formation of cooperatives. Undoubtedly, the organizations recognized that Phase III land reform gave them an opportunity to help the peasants get their land as well as to build support for that particular organization's interest. Indeed, FINATA has a record of being sympathetic to beneficiaries participation in peasant groups. The previous Christian Democrat government strongly supported the peasant organizations and the last head of FINATA under that government was president of a nation-wide association of peasant organizations.

In spite of this effort, only a small percentage of beneficiaries belong to a peasant organization. Table III.5, shows that in 1986 only 7.3 percent of the beneficiaries were affiliated, and another 22 percent were not presently members but would like to become affiliated. The most notable fact is that a resounding 70.7 percent did not want to affiliate. These figures clearly demonstrate that the vast majority of beneficiaries do not think it is advantageous to participate in a national-level peasant organization.

Demographic Characteristic and Social Indicators

Demographic data are only reported by PERA for the family members of Decree 207 beneficiaries; they are not presented for the direct beneficiaries. The following is based on PERA'S Third Profile of Decree 207 Beneficiaries for the year 1986. In that profile, PERA reported 48,344 beneficiaries with a total of 294,224 family members, or an average of 6.1

Table III.4 Participation by Decree 207 Beneficiaries in Group Organizations, 1986

Type of group	% of Beneficiaries Participating
Service cooperatives	11.1
Production cooperative	8.9
Credit union	1.7
Do not participate but would like to	29.1
Do not participate and do not want to	49.2
Total:	**100.0**

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Proyecto Planificación y Evaluación de la Reforma Agraria, Análisis Comparativo de la Situación Socioeconómico de los Beneficarios del Decreto 154 y Decreto 207. San Salvador, Agosto de 1988, p.42

Table III.5 Participation of Decree 207 Beneficiaries in Peasant Organizations, 1986

Organization	No. of Beneficaries Participating
Associación de Cooperativas de Producción Agropecuaria (ACOPI)	3.2
Unión Comunal Salvadoreña (UCS)	2.6
Confederación Campesino Salvadoreño (CCS)	0.2
Others	1.3
Not a member but would like to be	22.0
Not a member and do not want to be	70.7
Total:	100.0

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Proyecto Planificación y Evaluación de la Reforma Agraria, Análisis Comparativo de la Situación Socioeconómico de los Beneficiarios del Decreto 154 y Decreto 207. San Salvador, agosto de 1988, p.45.

persons per family.

Sex and Age

Of all family members, 52.5 percent were male and 47.5 percent female. The population was young, the medium age was 16.4 years and 59.4 percent was under 20 years of age. Only 11.5 percent were 50 or older and 3.5 percent were 65 or older. These data suggest that most direct beneficiaries are young to middle aged with large young families. Social indicators for the beneficiaries' families are reported in Table III.6 and are discussed in the following sections.

Infant Mortality

The infant mortality rate was 2.05 percent for persons under 5 years of age. This was less than the national average of 2.51 percent.

Education and Literacy

The reported education figures do not accurately show the levels of education by age which is the most meaningful measure. Nevertheless, they clearly demonstrate that the education levels are low. Of all family members over 6 years of age, 45.8 percent had not completed one year of schooling, another 22.8 percent only finished the second grade and only 5.9 percent had studied past the sixth grade.

The paucity of education is reflected in the literacy figures. Only 58.4 percent of the family members over 25 years of age could read and write. Less than one-third of the family members between the ages of 10 and 24 were literate.

Nutrition

The nutritional levels were deficient. Comparisons were made with the standards of ODECA. The only class of food consumed by the families which exceeded the ODECA nutritional standards was corn. Average consumption for this product exceeded that standard by 52.9 percent. All other food classes were considerably deficient. The consumption of protein bearing foods was low. On the average, family members only consumed 15.5 percent of the standard for milk, 28.3 percent for meat and 61.5 percent for eggs.

Housing

Almost three-fourths of the direct beneficiaries owned their own homes. The housing conditions reflect rural living in El Salvador. More than 80 percent had homes with only one or two rooms, earth floors, and a tile or metal roof.

Sanitary conditions were not good. Some 54.1 percent did not have either an indoor or outdoor toilet and only 33.2 percent had access to potable water. There were only 21.8 percent who had their own well or piped water.

Table III.6 Social Indicators of Decree 207 Beneficiaries, 1986

Infant Mortality	Percent
Death rate for persons under 5 years of age	2.05

Education

Years of school completed for family members over six years of age

Years	Percent
None	45.8
1-2	22.8
3-6	25.5
7-9	4.3
10-12	1.5
More than 12	0.1
	100.0

Literacy

Percent of family members over 6 years of age

Years	Percent
10-15	27.7
16-25	29.5
More than 25	58.4

Nutrition

Average annual consumption of basic foods as percentage of minimum requirements of ODECA

Item	Percent
Corn	152.9
Beans	74.4
Rice	58.7
Eggs	61.5
Milk	15.5
Sugar	91.8
Meats	28.3

Housing

Item	Percent
Beneficiaries:	
Who are home owners	72.5
With homes with one or two rooms	81.4
With homes with floor made of earth	83.7
With homes with tile or metal roof	87.0
With electricity	18.7
Who have home without indoor or outdoor toilet	54.1
Who use firewood as source of heat	96.8
With potable water	33.2
With own well or piped water	21.8
With radio	55.2

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.6-25.

Virtually all families used firewood as their principal source of energy for cooking. Only 18.7 percent had electricity. Most had few household appliances; 55.2 percent had radios in their homes.

Summary

The above figures clearly show that the beneficiaries typically had large young families of which all members had low levels of education. Their living conditions were simple and rustic, sanitation was inadequate and their diets were deficient, especially in proteins. It is readily concluded that the beneficiaries and their families have a low level of living as measured by conventional standards.

Income and Labor Force Participation

The labor force participation rate for all beneficiary family members over 14 years of age or older is 69.5 percent. This means that both males and females are economically active in farm or non-farm activities (PERA, Tercer Perfil de Beneficiarios del Decreto 207, p.6).

The average composition of income for a beneficiary family presented in Table III.7 provides an indication of the sources of income and employment in the household. In the 1985/86 agricultural year the average beneficiary family earnings were ¢3,986 ($797. All U.S. dollar figures in this report are reported at the then official exchange rate of ¢5 = $1. In mid-1988 the official exchange rate was allowed to float, and has leveled at about ¢6.00 to ¢6.50 per dollar.) Of this total, only 39.7 percent was net income from farm activities: 29.4 percent from crop production and another 10.3 percent from sale of livestock. These figures show that about three-fourths of net farm income is derived from crops. The remaining 60.3 percent of income was derived from other sources. Non-agricultural activities accounted for 28.9 percent, agricultural wages 23.5 percent, and remittances from abroad (presumably mostly from the United States) 7.8 percent. Agricultural wages merit a special comment. It is very common among beneficiaries that they work in the harvesting of large-scale labor-intensive crops such as coffee, sugar cane and cotton. During the harvest times many beneficiaries and their families migrate to the regions where the harvest is taking place.

There is not a wide variance in income among the beneficiaries, i.e., their income distribution is relatively uniform. In 1986 PERA reported a Gini coefficient of .38 for the beneficiaries which compared very favorably to the coefficient of .65 for the whole rural population (PERA, Tercer Perfil de Beneficiarios del Decreto 207, pp. 76-77). This result shows that the beneficiaries have uniformly low incomes.

Farm Production and Resource Use

Production

PERA's Third Profile of Decree 207 Beneficiaries presents data on farm crop production. As shown in Table III.8, in the 1985/86 agricultural cycle

Table III.7 Average Income of Decree 207 Beneficiary Families, 1985/86 Agricultural Year

	¢	%
Farm Income	1,584	39.7
Net Farm Income from crops	1,173	29.4
Livestock sales	411	10.3
Other income	2,402	60.3
Agricultural wages	939	23.5
Remittances from abroad	312	7.8
Non-agricultural activities	1,151	28.9
Total:	**3,986**	**100.0**

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.72-74.

Table III.8 Crop Production by Decree 207 Beneficiaries During 1985/86 Agricultural Cycle

Crop	Area (mz)	%	Production (qq)	Yield/mz. 207	Yield/mz. National Average
Corn	67,999	50.4	2,099,930	30.9	29.7
Beans	23,866	17.7	256,396	10.7	9.0
Rice	2,765	2.1	130,403	47.2	60.6
Sorghum	26,367	19.6	413,250	15.7	17.8
Hortalizas[1]	6,666	4.9	649,642	n/a	n/a
Other[2]	7,133	5.3	149,560	n/a	n/a
Total:	134,796	100.0			

[1]Includes melon and watermelon.
[2]Includes coffee, sugar cane, sesame, fruits, sorghum for forage and pasture.

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuariam, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.45-51.

the beneficiaries cultivated 134,796 manzanas (94,263 has) of land. Of the total, 50.4 percent was planted to corn, 19.6 percent to sorghum (maicillo), 17.7 to beans and 2.1 percent to rice. In other words, 89.8 percent of the land was dedicated to basic grains. The remainder was split almost evenly between vegetables and a group of other crops such as coffee, fruits, sugar cane, pasture, etc.

These production patterns reflect several things. First, they are the result of the class of land received by the Phase III beneficiaries. Most of the land is marginal and hilly, which is only suited for these simple row crops. Second, the patterns show the farmers' need to grow crops to provide basic food for their family and livestock. Third, the excess production of these crops can be readily marketed to meet the demand in the national market. In only a few cases do the Decree 207 beneficiaries grow non-traditional crops on a commercial basis.

Resource Use in Production

Table III.9 presents indicators of resources used by beneficiaries in crop production. The farmers cultivated a high percentage of their land: 86 and 95.7 percent of land acquired through FINATA and other owned land, respectively.

The seed used was mostly open pollinated except for corn, where almost two-thirds of the farmers used improved quality. Farmers purchased or hired some inputs. Some 65.7 percent of the expenditures were for seeds, fertilizers and agricultural chemicals, 20.7 for hired labor and the rest for land preparation and transportation services as well as land rental.

The mean value of the production expenditure per direct beneficiary was ¢1,127 ($225). These costs represented 48.9 percent of the value of 1986 crop production, leaving the rest as compensation to the farmer for his family labor, use of land and profit.

Capital Goods

The beneficiaries had very small investments in capital goods used for agricultural and livestock production. In 1986 the median value of such goods per beneficiary was ¢690 ($138). There were 43.3 percent of the beneficiaries whose capital goods were valued at less than ¢500 ($100) and only 24.8 percent had goods worth ¢2,000 ($400) or more. In most cases, the capital goods consisted of farm tools and implements.

During the 1985/86 agricultural cycle a small percentage of beneficiaries invested in capital improvements. The most common investments were for permanent crops, fences and home construction, in which 16, 14.1 and 10.3 percent of the beneficiaries made investments, respectively.

Technical Assistance

During the 1985/86 agricultural cycle most beneficiaries did not

Table III.9 Indicators of Use of Agricultural Resources and Capital Investments by Decree 207 Beneficiaries 1985/86 Agricultural Cycle

Land cultivated during year		
Percent of FINATA adjudicated lands farmed		86.0%
Percent of other owned lands farmed		95.7%

Type of seed used (percent)

	Improved	Open Pollinated
Corn	63.3	36.7
Rice	33.0	67.0
Beans	11.8	88.2
Sorghum	3.4	96.6

Production expenditures for all beneficiaries

Item	¢ 1,000	%
Seeds, chemicals, fertilizers, etc.	35,783	65.7
Services for land preparation and transportation	6,776	12.4
Labor	11,294	20.7
Land rental	627	1.2
	54,480	100.0

Capital goods owned

Median value per beneficiary ¢690

Numbers of beneficiaries undertaking capital improvements

Improvement	% of total Beneficiaries
Fences	14.1
Live fences	9.4
Permanent crops	16.0
Drainage	3.4
Irrigation	1.1
Home construction	10.3
Other	9.6

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.41-42, 63-67, 86.

receive any technical assistance for their agricultural production. As shown in Table III.10, only 20.9 percent had technical assistance. The most common source, 13.3 percent, was from the Agricultural and Livestock Development Bank which apparently provided some advice to some of the farmers who received this Bank's credit. The National Extension Service of the Ministry of Agriculture and Livestock, which is charged with providing technical assistance to the beneficiaries, only reached 8.2 percent of the beneficiaries. FINATA assisted 6 percent of the farmers. These results show the most beneficiaries undertake their production based upon their accumulated knowledge through practical experience and do not have the benefit of technical assistance.

Marketing of Farm Production

As shown in Table III.11, the beneficiaries market about two-thirds of the corn and beans produced and about three-fourths of the sorghum. The rest is used for home consumption and livestock feed. Among the other crops produced, almost all of the production is sold.

The principal buyers for the marketed products were intermediaries. As shown in Table III.12, 80.1 percent of the output is sold through this channel. Only 15.3 percent is sold to the Food Regulation Institute (IRA) and 4.6 percent directly to the consumer.

Summary and Credit Worthiness

The typical Decree 207 Beneficiary is middle aged with a young family, averaging 6.1 persons in size. The farmer and his family have very low levels of formal education and low levels of literacy. They live in simple homes, typically with only one or two rooms, with a tile or tin roof, and earth floors. Sanitation is lacking. Only about one-third have direct access to potable water and less than half have an indoor or outdoor bathroom. Nutritional levels are substandard, especially for proteins.

The typical beneficiary family earns only about 40 percent of its income from farm operations. Wages earned as migrant laborers in the harvest of agricultural crops and non-farm income are the other major sources. Family incomes are low and the variance in income among beneficiaries is not large as shown by relatively low Gini coefficients.

Most of the 41,640 beneficiaries farm their land as individuals, although some 22 collective farms were formed with about 750 total members. In total, there are 207 cooperatives formed among the Phase III recipients. Of this total, only 59 (including the 22 collective farms) are production cooperatives that farm exclusively in a collective farm arrangement. Of the rest, 109 are service cooperatives that mostly use the cooperative organization as a means to obtain credit for inputs used by the members on their individually-farmed plots, and 39 are mixed cooperatives which have both collective and individual farm operations. Many of the cooperatives were formed with assistance from one of the several peasant organizations, who used the land reform as a means to try to provide services to the beneficiaries as well as strengthen their organization. In spite of these

Table III.10 Technical Assistance Received by Decree 207 Beneficiaries 1985/86 Agricultural Cycle

	Number	%
Did not receive technical assistance	38,230	79.1
Received technical assistance	10,114	20.9
Source		
Banco de Fomento Agropecuario	6,447	13.3
Ministry of Agriculture and Livestock	3,963	8.2
FINATA	2,910	6.0
Particular	595	1.2
Other	530	1.1
	48,344	100.0

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, pp.114-117.

Table III.11 Percentage of Basic Grain Production Sold by Decree 207 Beneficiaries, 1985/1986 Agricultural Cycle

(Sales as percent of value of output)

Grain	%
Corn	67
Beans	68
Rice	94
Sorghum	73
Others[1]	98

[1] Includes garden produce, coffee and sugar cane.

Source: El Salvador, Ministerio de Agricultura y Ganadería Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, p.56.

Table III.12 Marketing Channels for Basic Grains Used by Decree 207 Beneficiaries, 1985/86 Agricultural Cycle

(Percentage of crops sold through different channels)

Grain	IRA	Intermediaries	Direct to Consumer	Total
Corn	17.4	78.4	4.2	100.0
Beans	15.3	79.4	5.3	100.0
Rice	26.9	72.5	0.6	100.0
Sorghum	0.0	92.0	8.0	100.0
Total:	**15.3**	**80.1**	**4.6**	**100.0**

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, p. 60.

organizations' efforts, some 71 percent of the beneficiaries stated they prefer not to belong to a national peasant group.

Farm production mostly takes place on very small plots of land, most of which were acquired through the Phase III land reform for which the average size of the plot is 1.72 hectares. However, it is not uncommon that the beneficiary owns other small parcels or may rent land. The beneficiaries' land is typically of marginal quality.

Farm production is mostly directed to basic grains, only a few beneficiaries grow other crops on a commercial basis. It is common that the beneficiaries use some fertilizer and other agricultural chemicals. They typically use opon-pollinated seed. On the average, the farmer has outlays for inputs, including hired labor, equal to about half the gross value of crop production. Only one-fifth of the beneficiaries receive any form of technical assistance, most of that which is received comes from bank credit agents. Most beneficiaries have only a small investment in capital goods, mostly farm tools and implements.

The typical beneficiary markets about two-thirds of the corn and beans produced, the rest being used for home and livestock consumption. When crops other than basic grains are produced, almost all of the production is marketed. About 80 percent of the marketed output is sold the intermediaries and the rest to IRA or directly to the consumer.

The above data show that the typical Decree 207 beneficiary is not very credit worthy, especially for bank credit. Assuming that he is honest, nevertheless the beneficiary is poor and has virtually no assets to pledge as collateral, except his land, and in most cases he cannot pledge that because he has a first mortgage with FINATA. Therefore, at best he can only pledge his harvest. His land is marginal without potential for high yields and his farming operations are small and not very diversified. He typically consumes a sizeable portion of his production and only has the excess to market. There are always possibilities of weather, disease and insect problems. The beneficiary has some years of practical experience in farming but doesn't receive much technical assistance. In addition, he has a financial obligation to FINATA to make a payment on his mortgage. The farmer depends on non-farm income as his major source of income as his major source of income and must use these additional funds to meet his financial obligations. Finally, the beneficiary has a low level of education, is malnourished and often lives in unhealthy conditions.

IV. CREDIT SUPPLY TO AND USE BY DECREE 207 BENEFICIARIES

Introduction

Prior to describing the supply of credit to Decree 207 beneficiaries it is important to have some background about how the supply of institutional credit to the beneficiaries has developed. As noted above, the typical beneficiary is not very credit worthy. However, as part of the land reform package the El Salvadoran Government, with the help of foreign assistance, has provided credit programs for the Decree 207 beneficiaries. Once these programs were established, representatives of both FINATA and the several peasant organizations worked hard to link their clientele with the lenders when land was transferred to the new owners.

The first formal program launched was the 0262 Project in the Agriculture and Livestock Development Bank (BFA) with funding by USAID. Initiated in 1980, this program was folded into the 0263 Project in 1982. Under the two projects there was a grant which was used with El Salvadoran government counterpart monies to establish a rotating credit fund of $93 million to be lent to the reformed sector. To administer the fund a reformed-sector section was established in the BFA main office. There were sub-sections for both Phase I and Phase III. The grant also provided funding for 92 BFA credit agents to work with the reformed sector, of which a number were assigned to work specifically with Decree 207 beneficiaries in the BFA's various agencies. At this time the BFA was the only financial institution assigned to work with the reformed sector.

In 1985, in an effort to direct more credit to Decree 207 beneficiaries through the commercial banks, the government reorganized the system, assigning the commercial banks specific regions to cover as well as identifying borrowers for them to serve. To fund this program the BFA entered into specific agreements with each of the commercial banks to rediscount specific 0263 funds to the commercial banks for a period of two years. The purpose was that the commercial banks would use these funds as a rotating account to finance 207 beneficiaries. In addition, in the same year the Ministry of Agriculture and Livestock, launched the Program for Integrated Rural Development (PRODERIN). The purpose of PRODERIN was to organize Decree 207 beneficiaries into communities, which would receive intensive technical assistance as well as credit. Each bank was assigned a small number of communities. Loans were made by the banks to the community which, in turn, made subloans to the farmers. PRODERIN was not very successful and was very costly to implement. It was discontinued in 1987.

These several programs increased commercial bank lending to the Phase III beneficiaries; however, generally the several banks continued to make only token loans. In late 1984, the BFA was reorganized and the special offices that had been created under the 0263 Project for Phase I and III were disbanded and integrated into the overall Bank's operations. Nevertheless, albeit in a less direct way, the BFA continued to have many credit agents assigned to the various agency offices that worked exclusively with Decree 207 beneficiaries.

This chapter presents an overview of credit use by source by Decree 207 beneficiaries in the 1985/86 agricultural cycle as reported by PERA in the Third Profile of Decree 207 Beneficiaries. Although this data is not current, it is the only source showing the global use of agricultural credit by this group of farmers. There is no reason to believe that the data are unrepresentative of current credit use except that there will be no new loans made under PRODERIN because that program was discontinued. The succeeding chapters describe and analyze the credit provided to the beneficiaries by the major institutional suppliers.

Sources of Financing Farm Production

Table IV.1 presents the sources of financing used by Decree 207 beneficiaries in the 1985/86 agricultural cycle. Two sources stand out: the beneficiaries' own funds, which were used by 81.1 percent of all beneficiaries and bank credit, which was employed by 34.4 percent of the group. Use of cooperative credit was reported by 11.6 percent and another 4.7 percent indicated financing from sub loans such as from PRODERIN. It is almost certain that most of the funds from the latter two sources also came from banks, because these institutions are usually the source of financing for cooperatives and the PRODERIN program. In these cases, it is not clear from the data whether or not the beneficiaries reported both bank loans as well as cooperative or subloans. Consequently, the true degree of bank financing flowing to the beneficiaries is somewhat obscured by the way the data are reported and, therefore, the number of beneficiaries benefited could conceivably range between about one-third to one-half of the total, but is most likely to be near the larger figure.

It is somewhat surprising that so few beneficiaries use informal market credit. No more than 6.1 percent reported credit from intermediaries, money lenders, agroservices (supply stores) and friends or relatives. Of this number, the most frequent source was friends and relatives which were used by 4.8 percent of the beneficiaries.

Bank Credit

Sources

There were three sources of bank credit: the Agriculture and Livestock Development Bank (BFA), commercial banks and the Cajas Rurales, which are affiliated with FEDECCREDITO. As shown in Table IV.2, in the 1985/86 agroindustrial cycle the BFA was by far the largest lender, accounting for 90.9 percent of the bank loans. The commercial banks and the Cajas Rurales provided the rest in almost equal portions.

Purpose of Loans

There is virtually no credit extended for medium- or long-term investment. Almost all credit is for annual production purposes, mostly for the production of basic grains and some sesame.

A few banks have made a handful of loans to Phase III cooperatives to

Table IV.1 Sources of Financing for Decree 207 Beneficiaries to Cover Farm Expeditures During 1985/86 Agricultural Cycle

Source	Number of Beneficiaries	% of total Beneficiaries
Bank credit	16,610	34.4
Cooperative credit	5,599	11.6
Sub-loans	2,274	4.7
Agroservices	261	0.5
Money lenders	356	0.7
Intermediaries	62	0.1
Friends and relatives	2,316	4.8
Own funds	39,196	81.1

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, p.96.

Table IV.2 Sources of Bank Credit
for Decree 207 Beneificiaries in the 1985/86 Agricultural Cycle

Sources of Bank Credit (% of total parcels with financing)

	Number of Parcels	% Distribution by Lender	% of 82,778 Total Parcels
Banco de Fomento Agropecuario	24,070	90.9	29.1
Commercial banks	1,257	4.8	1.5
Cajas Rurales (FEDECREDITO)	1,148	4.3	1.4
Total	26,475	100.0	32.0

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Análisis Comparativo de la Situación Socioeconómico de las Beneficiarios Decreto 207, San Salvador, agosto de 1988, p.92.

produce melons for export. In these few cases, the cooperative has a production contract with an export firm to produce the product. In turn, the firm will provide technical assistance and agrees to purchase the product.

Size of Loans

As shown in Table IV.3, the size of bank loans was very small. The median loan size was ¢500 ($100) and only 8.4 percent exceeded ¢2,000 ($400). These figures clearly demonstrate that the credit for the beneficiaries is small scale and, therefore, is very costly for a bank to administer relative to the expected income from interest earnings. Given this situation, it is surprising that any bank would want to lend to the beneficiaries unless their administrative costs were highly subsidized. Indeed, this is the case. The BFA receives a subsidy to lend to this class of clientele because of the Bank's social mission. The commercial banks only lend to the beneficiaries because the government has forced them to do so. Furthermore, to lower their lending costs, both types of banks look to cost-reducing credit delivery mechanisms, such as lending to cooperatives or to solidarity groups.

It is useful to compare the median loan size with the operating costs in order to gain insight about the relative importance of credit to the beneficiary's farm operations. In Chapter III, the average size of operating costs per beneficiary was reported to be ¢1,127. Given the median loan size of ¢500, it appears that the amount of credit is approximately 45 percent of out-of-pocket production costs. This result is not surprising because a typical BFA loan is only for the purchase of fertilizers and other chemicals and does not include funds to hire labor or cover the costs of family labor.

Reasons Why Beneficiaries Did Not Use Bank Credit

There were 65.6 percent of the beneficiaries who did not have a direct loan from a bank although some may have indirect bank financing through a cooperative or PRODERIN. Of this total, only 2.6 percent applied for a bank loan and were turned down, and the rest did not apply (PERA, Tercer Perfil de Decreto 207 Beneficiarios, p. 107).

The principal reasons the unsuccessful applicants believed they were turned down were that they had outstanding debts with the bank; they didn't belong to a solidarity group; or if they were a member of a group, there were other members who were in arrears with the bank and, thus, the whole group was denied further credit until the debt was repaid (PERA, Tercer Perfil de Decreto 207 Beneficiarios, p.108).

It is clear that most beneficiaries who applied for credit were successful. This suggests that not only the banks readily make loans to applicants but also the majority of beneficiaries either did not want bank credit or did not apply for other reasons.

Table IV.4 provides insight into reasons why beneficiaries did not

Table IV.3 Size of Bank Loans Received by Decree 207 Beneficiaries in 1985/86 Agricultural Cycle

Size of loan ₡	%
Less than 500	49.7
500 - 999	27.8
1,000 -1,000	14.1
2,000 and more	8.4
	100.0

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planición y Evaluación de la Reforma Agraria, Análisis Comparativo de la Situación Socioeconómico de las Beneficiarios del - Decreto 207, San Salvador, agosto de 1988, p.102.

Table IV.4 Reasons Why Decree 207 Beneficiaries Did Not Solicit Bank Credit, 1985/86 Agricultural Cycle

Reason	Number	%
Did not need it	8,297	30.0
Did not think they could get it	1,935	7.0
Do not know how to apply	1,069	3.9
Think it is too difficult to obtain	2,448	8.8
Received credit from a cooperative	4,816	17.4
Other	9,088	32.9
	27,653	100.0

Source: El Salvador, Ministerio de Agricultura y Ganadería, Oficina Sectorial de Planificación Agropecuaria, Actividad, Planificación y Evaluación de la Reforma Agraria, Tercer Perfil de Beneficiarios del Decreto 207, San Salvador, junio de 1988, p.106.

apply. Some 30 percent considered that they did not need credit; 7 percent did not think they would get credit if they applied; 3.9 percent did not know how to apply, and 8.8 percent thought credit would be too difficult to obtain. The latter suggests the borrowers perceived that their transactions costs would be too high relative to the loan size. There were 17.4 percent who did not apply because they had credit from a cooperative which was probably credit obtained by the cooperative from a bank. Finally, there were 32.9 percent who listed other reasons, which could include preference for other sources of financing and the lack of ready access to banks.

Contracts for Producing Export Products

The PERA data do not show a handful of Phase III cooperatives as well as the Phase I cooperatives that currently have production contracts with firms that export vegetables or fruits, such as melons. Under these contracts, the firm offers technical assistance and a guaranteed market under a forward contract arrangement. Banks provide the cooperative financing. In general, the firms are satisfied with this arrangement.

Summary

Most Decree 207 beneficiaries rely extensively on their own funds to finance their agricultural production. Even those with credit must contribute a considerable amount of their own funds to cover production expenses. The 1985/86 data do not permit a precise estimate of the number of different beneficiaries with credit. However, at least one-third had direct bank loans. Some 16 percent had credit from cooperatives or subloans; it is most likely all or a very large portion of these funds also came from bank sources. There also could be some double counting. Nevertheless, it would appear that almost one-half of the beneficiaries got bank credit directly or indirectly.

There was a surprisingly small amount of financing from informal market sources. Only 6.1 percent of the beneficiaries reported financing by intermediaries, money lenders, agro- services or friends and relatives.

More than 90 percent of the direct bank credit came from the BFA, with the rest evenly divided between commercial banks and Cajas Rurales. It can be considered that the coverage by bank credit --direct and indirect-- is relatively large given the credit worthiness of the clients. This coverage is due to the special government programs established in the BFA and with the commercial banks to force lending to this clientele. Programs financed by USAID were especially important in making the credit possible.

Bank loans to individuals were very small, the median size was ¢500 ($100) which is about half of which the average beneficiary needs to cover his out-of-pocket operations costs. Credit is almost exclusively for annual production of basic grains. There were few loans for sesame and a handful of loans for producing melons under a contract with an export firm. Most credit is used for the purchase of fertilizers and chemicals. The small size of loan makes bank lending to the beneficiaries very costly relative to interest income, which completely discourages bank lending to the Phase III clientele on economic grounds.

About two-thirds of the beneficiaries did not apply for a direct bank loan. About 97 percent of those who did apply obtained a loan. This suggests that once a bank makes contact with a borrower a loan is readily made. Those who applied and were turned down reported delinquency on previous loans as the principal reason. The principal reasons that the others did not apply were they felt that they did not need credit or they already had credit from a cooperative. It is also probable that a lack of a ready access to a bank was an important factor.

The following chapters examine in more detail the credit provided by the banking sources. The analysis of these sources provides the basis for our final conclusions and recommendations for directing credit to the Decree 207 beneficiaries.

V. AGRICULTURE AND LIVESTOCK DEVELOPMENT BANK

Introduction

As shown in the previous chapter, the Agriculture and Livestock Development Bank (BFA) was by far the predominate lender to the Decree 207 beneficiaries. The reason is clear, this state bank has a development mission. Therefore, beginning in 1980 when land reform was undertaken, the BFA was considered the main financial institution to lend to the reformed sector. In contrast to the profit-oriented commercial banks, which would prefer to not deal with loans to Phase III, the BFA could carry out this lending because it could cover the losses of these expensive credit programs through subsidies and foreign assistance grants.

This chapter describes and analyzes how the BFA has lent to the Decree 207 beneficiaries. The first section deals with the Bank's structure. The second treats the sources of funds. The third section presents an overview of BFA lending to Phase III and it's relative importance to the Bank's total credit. The fourth section discusses delinquency. The fifth section examines the credit delivery system. The last section consists of a summary and conclusions.

Structure

The BFA was founded in 1973 as an autonomous public-sector institution. It superseded the Administration of Peasant Welfare (ABC) which had been established in 1962 to provide supervised credit to small- and medium-sized farmers. The BFA is to serve all classes of farmers regardless of size, yet it has a priority for the small- and medium-sized farmers.

The BFA has three divisions. The Banking Division which operates very much like a commercial bank and handles non-agricultural credit as well as large-sized agricultural loans, mostly to the non-reformed sector. The Development Division is charged with an economic and social mission for financing activities that foment economic development in the agricultural sector and benefit the small farmers. Finally, there is the Trust Division that works especially with refinanced debts.

The Bank has 5 regional offices and 26 agency offices. It has over 1,700 employees. It is the only bank in the nation that extends widely into rural areas. It's credit agents are agricultural specialists with training at an agricultural technical school or in a university degree program in agriculture.

Source of Funds

The Phase III beneficiaries are financed by funds from each of the Bank's three divisions. As shown in Table V.I., the Development Division accounts for 94 percent of the loan numbers and almost 80 percent of the volume for Phase III. Virtually all of the rest is in the Trust Division. As would be expected, there are only a very few loans from the Banking

Table V.1 Source of Financing for BFA Portfolio of Loans to Decree 207 Beneficiaries by Division, August 12, 1989

DIVISION	Number of Loans.	%	Amount ¢1,000.000	%
Banking	3	0.0	0.05	0.1
Development	13,028	94.0	46.46	79.8
Trust	829	6.0	11.74	20.1
T O T A L	13,860	100.0	58.25	100.0

Source: Banco de Fomento Agropecuario.

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Division.

In the Development Division, the BFA's primary source of funds for Phase III lending were the USAID-financed 0262 and 0263 Projects. As mentioned in Chapter IV, these programs, initiated in 1980, were designed to establish a $93 million revolving fund to be used by the BFA to extend credit to the reformed sector. When the fund was established, the BFA was the government's designated lender to the reformed sector. Therefore, it made sense to place this fund in the BFA proper rather than the Central Reserve Bank (BCR). Moreover, the fund was part of a package to set up a reformed-sector office in the BFA, to hire 92 credit agents to work exclusively with the reformed-sector clients, to purchase jeeps for field visits, etc. Later, in 1985 when the commercial banks were also assigned responsibilities for lending to the Phase III clientele, monies from the 0263 funds were rediscounted by the BFA to these banks to be used for making loans.

The 0263 Project funds were completely disbursed. Since then new lending has been based on reflows. However, extensive and serious delinquency among the Bank's reformed-sector loans, has dwindled the size of the fund. The fund was further reduced when the previous Bank's administration used some of the funds to cover other Bank expenses. Nevertheless, the 0263 funds remain the principal source of funds for the BFA's lending to the reformed sector, including the Decree 207 beneficiaries. In addition, the Bank uses funds from other special programs including the Fund for Production of Basic Grains, Fund for Improving Basic Grain Technology and the Basic Foods Fund.

The Fiduciary Division handles the Bank's financing of the Reactivation of Productive Activities (FRAP) program. This program was initiated in 1988 when the government established the fund as a means to technically alleviate the banking system of it's high degree of delinquent loans. Under FRAP a bank could apply to the BCR to exchange delinquent loans for bonds. Thus, the debt would be erased from the bank's books and would be substituted by the bonds. The bank would then try to collect the debt or use other funds to cancel its obligation to FRAP, return the bonds, and receive cash. The BFA made extensive use of the FRAP arrangement through early 1989 when the FRAP funds were totally committed.

Portfolio

As shown in Table V.2, on August 12, 1989, the BFA had a total portfolio for Phase III beneficiaries consisting of ¢58.25 million ($11.65 million) in 13,860 loans. The number of beneficiaries is not shown, but it would be much larger due to the numerous loans made to groups, cooperatives and associations.

Loans to individuals were most common, accounting for 80.7 percent of the loans and 49.8 percent of the outstanding volume. Credit to cooperatives represented 5.3 percent of the loan numbers and 34.6 of the volume. Solidarity groups received 13.3 percent of the loans and 7.5 percent of the volume. Agricultural associations, had a small number of

Table V.2 BFA Portfolio for Loans to Decree 207 Beneficiaries, August 12, 1989

TYPE OF BORROWER	Loans		Amount	
	No.	%	¢1,000.000	%
Individuals	11,169	80.7	29.00	49.8
Solidarity Groups	1,845	13.3	4.38	7.5
Cooperatives	745	5.3	20.13	34.6
Pre-cooperatives	3	0.0	0.02	0.0
Agricultural Associations	101	0.7	4.72	8.1
Unclassified	1	0.0	0.00	0.0
TOTAL	13,860	100.0	58.25	100.0

Source: Banco de Fomento Agropecuario

loans but accounted for 8.1 percent of the volume.

The relative importance of Phase III lending within the BFA is shown in Table V.3. Only 14.7 percent of the loans and 6.4 percent of the loan volume in the Bank's portfolio as of August 12, 1989 is directed to this group of beneficiaries. In contrast, Phase I received 2.1 percent of the loans and 24.2 percent of the volume. The non-reformed sector dominated with 83.2 percent of the loans and 69.4 percent of the volume.

Annual Credit Flows

Table V.4 shows loans granted to Decree 207 beneficiaries from 1987 through 1989. In 1989 there were 5,940 loans granted in the amount of ¢41,750,000 ($8.35 million) financing an area of 27,224 mzs. (19,037 has.). Over the three-year period lending activity has been steady, with respect to loan numbers. There is a slight downward trend in area financed and a sharp increase in 1989 for the amount lent.

It is useful to examine the relative importance of the Phase III credit to the Bank's total lending. In 1988, Decree 207 beneficiaries received 14 percent of the number of loans, 6.8 percent of the loan volume, and financed 14.1 percent of the area. The figures for the Phase I borrowers were 1.6, 26.8 and 20.0 percent, respectively. The corresponding percentages for the non-reformed sector percentages were 84.4, 66.4 and 65.9. It is clear that Phase III credit constitutes a very small portion of the BFA's total activity, as measured by these three variables.

Purpose of Loans

Table V.5 presents information on the purpose of loans granted in 1988 to Decree 207 beneficiaries. About 85 percent of both loan members and volume were for agricultural development. Another 11 percent was for refinancing with the almost all of the rest for livestock development. Within the agricultural development category, loans for basic grains --corn, beans and sorghum-- were very dominant; with fruits and vegetables and export products --such as sugar cane and coffee-- accounting for almost all of the rest.

It is clear that the credit for the Phase III beneficiaries is very narrowly focused to basic grains, with only a few loans being made for other purposes.

It is noteworthy, however, that there are a few investment loans. Much of the credit extended for machinery, livestock and agroindustry is of an investment nature.

Delinquency

The BFA's Phase III portfolio has a very high degree of delinquency. As shown in Table V.6 only 42.3 percent of the outstanding loans and 65.1 percent of the volume are current. There are 15.2 percent of the loans and 7.5 percent of the volume that are 1-90 days past due. Finally, there are

Table V.3 BFA Total Portfolio by Sector,

August 12, 1989

SECTOR	Loans No.	Loans %	Amount ¢1,000.000	%
Non-reformed sector	78,325	83.2	627.97	69.4
Phase I	1,928	2.1	219.28	24.2
Phase II	14	0.0	.26	0.0
Phase III	13,860	14.7	58.25	6.4
TOTAL	94,127	100.0	905.76	100.0

Source: Banco de Fomento Agropecuario.

Table V.4 Annual Loans Granted by BFA to Decree 207 Beneficiaries, 1987-1989

YEAR	Number of Loans	Area Financed (mz)	Amount (¢100)
1987	6,501	34,631	32,220
1988	5,926	29,007	30,048
1989[a]	5,940	27,224	41,750

Source: Banco de Fomento Agropecuario

a/ Through July 1989.

Table V.5 Purpose of Loans Granted to Decree 207

Beneficiaries, 1988

PURPOSE	Loans		Amount	
	No.	%	¢100	%
Agricultural Development	5,137	86.7	25,404	84.5
Basic Grains	4,637	78.2	20,372	67.8
Fruit and Vegetables	222	3.7	1,979	6.6
Export Products	56	0.9	2,099	7.0
Natural Resources	8	0.1	38	0.1
Machinery	105	1.8	151	0.5
Agroindustry	108	1.8	555	1.8
Other	1	.0	210	0.7
Livestock Development	149	2.5	1,357	4.5
Aquaculture Development	1	0.0	4	0.0
Operations and Administratives Expenses	3	0.1	10	0.0
Refinancing	636	10.7	3,273	10.9
TOTAL	5,926	100.0	30,048	100.0

Source: Banco de Fomento Agropecuario.

Table V.6 Status of BFA Portfolio for Loans Extended to Decree 207 Beneficiaries, July 31, 1989

Type of Borrower	Number of Loans										Amounts ¢ 1,000,000									
	Current		Past Due 1 - 90 Days		Past Due Over 90 Days		Legal Action		Total		Current		Past Due 1 - 90 Days		Past Due Over 90 Days		Legal Action		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	¢	%	¢	%	¢	%	¢	%		%
Individuals	4,856	43.5	1,764	15.8	4,549	40.7	0	0.0	11,169	100.0	18.61	63.5	2.98	10.2	7.71	26.3	0.00	0.0	29.30	100.0
Solidarity Groups	635	34.4	265	14.4	945	51.2	0	0.0	1,845	100.0	2.07	47.6	0.60	13.8	1.68	38.6	0.00	0.0	4.35	100.0
Cooperatives	316	42.6	79	10.7	346	46.7	0	0.0	741	100.0	13.83	68.7	0.81	4.0	5.49	27.3	0.00	0.0	20.13	100.0
Pre-Cooperatives	0	0.0	0	0.0	3	100.0	0	0.0	3	100.0	0.00	0.0	0.00	0.0	0.23	100.0	0.00	0.0	0.23	100.0
Agricultural Asociations	54	53.5	2	2.0	45	44.5	0	0.0	101	100.0	374.00	79.4	0.00	0.0	0.97	20.6	0.00	0.0	4.71	100.0
Unclassified	0	0.0	0	0.0	1	100.0	0	0.0	1	100.0	0.00	0.0	0.00	0.0	0.00	0.0	0.00	0.0	0.00	0.0
Total	5,861	42.3	2,110	15.2	5,889	42.5	0	0.0	13,860	100.0	38.25	65.1	4.39	7.5	16.08	27.4	0.00	0.0	58.72	100.0
Total Bank	49,264	52.4	11,989	12.7	31,723	33.7	1,154	1.2	94,130	100.0	626.93	69.2	50.96	5.6	197,39	21.8	30.79	3.4	906.09	100.0

Source : Banco de Fomento Agropecuario.

42.5 percent of the loans and 27.4 percent of volume more than 90 days past due. None of the Phase III loans have been placed in legal action; the reasons may be because of the political sensitivity of such action and the fact that the Decree 207 beneficiaries do not have much collateral. The figures for delinquency for the whole bank are also presented in the table. The Phase III data are slightly worse than those for the whole bank, which further underlines the problematic nature of lending to this class of clientele. Within the Phase III group the solidarity groups have the worst record. Otherwise, there are not significant differences between types of borrowers. All types have significant problems.

The delinquency problem is larger than these figures suggest, because so many loans have been refinanced. The Bank readily refinances loans when it considers the cause for nonrepayment to be due to factors beyond the control of the borrower, i.e., draught, insect infestations, diseases, poor product prices, etc. As shown in Table V.5, about 10 percent of the new loans extended in 1988 were for refinancing. As of July 31, 1989, there were 1,422 Phase III borrowers with refinanced loans. In these cases, the Bank usually refinances by extending the outstanding loan balance over several years in order to allow the borrower to have sufficient cash flow to pay off the loan. If a loan is refinanced, the farmer is eligible for new loans.

It is not uncommon for a borrower to fall into arrears on a refinanced loan. Of the 1,422 refinanced loans for Phase III borrowers, only 911 (64.1 percent) were current.

Credit Delivery Systems

Types of Borrowers

The BFA lends to three basic types of clients among the Decree 207 beneficiaries: individuals, solidarity groups and cooperatives. The latter two are a means to reduce the Bank's costs of credit delivery per farmer served as well as to try to enhance repayment.

The solidarity group has a minimum of 3 and a maximum of 10 members; the BFA reports that most have about 3 to 5 members. It consists of a group of farmers who voluntarily join together (the BFA seldom organizes groups) to obtain credit by agreeing to sign a Constitutive Act in which they agree to joint liability for each other's loans. The group elects a representative to officially carry out most transactions with the Bank, although in practice most group members participate in these activities.

The cooperative is formed using the standard legal procedures, as described in Chapter III. When a cooperative is formed, it usually begins as a pre-cooperative. There is a minimum of 11 members. Most cooperatives working with the BFA are in the "service" or "mixed" category. Therefore, they obtain credit in order to onlend to their members who use the credit on their individual plots. When this occurs, the members, in the form of the cooperative, also assume joint liability for all members' loans. Therefore, the typical BFA cooperative client is in essence a large-scale solidarity group.

The BFA typically has credit agents in the agency offices that are assigned to work with each class of Phase III clientele, e.g., individuals, solidarity groups and cooperatives. Those that work with cooperatives handle about 6-7 clients, those assigned to solidarity groups handle about 75 clients and those who deal with individuals work with about 150 clients. The differences in numbers reflect the fact that those agents assigned to groups and cooperatives often work with the individual members.

The conventional wisdom in the Bank is that the cooperative mode is the most efficient means to deliver credit from the institution's perspective. However, it is also believed that it is the most problematical for repayment. (Note, however, that Table V.6 shows that the solidarity group has the highest delinquency.) The credit delivery systems for the three types of clients are very similar. The following presents a brief summary of the key features.

Interest

The BFA has applied the interest rates associated with the different sources of funds, most of which were concessionary. These, however, are now standardized in accordance with the new uniform interest rate policy imposed by the monetary authorities. In the cases of loans to cooperatives, it is common that the cooperative will onlend the funds to the members at a rate exceeding the bank rate by 1 or 2 points in order to cover some of the cooperative's costs.

Guarantees

The BFA can use the expected harvest as a guarantee on loans under ¢50,000 ($10,000). Otherwise, they use real goods. The harvest guarantee is the common mode for Phase III loans, although the borrowers are expected to put their title and provisional title on file with the Bank. This, however, does not effectively serve as collateral since the Bank would not take over the land; this would be very risky politically. In the cases of solidarity groups and cooperatives there is also the joint liability guarantee.

Amounts Lent and Form of Disbursement

The size of loan is determined by the BFA's predetermined estimated costs of production for each activity. Therefore, a farmer wanting a loan for 3 manzanas of corn would get three times the predetermined amount programmed per manzana. The BFA does not normally give Phase III beneficiaries funds to cover labor costs, rather just a loan to cover the purchase of other inputs. An exception is the collective farm cooperative loan where a credit is often given to cover the wages of members. In order to avoid having to amend the loan documents to cover unplanned but possible expenditures, the Bank customarily adds about 10-20 percent to the amount planned according to the above-mentioned formula.

Phase III credit is almost always made in kind, whereby the borrowers obtain fertilizers, chemicals, etc., from the Bank's farm supply stores. Under this arrangement, at the time of disbursement, the borrower goes to the Bank and obtains a receipt which he then takes to the Bank's warehouse to withdraw his supplies.

Disbursements are programmed in accordance to the sequence of needs. Each successive disbursement depends upon approval by the credit agent stating that the disbursement is appropriate in accordance with the progress on the financed activity.

Class of Client

To expedite procedures and lower transaction costs, for both the Bank and the borrower, the BFA classifies its borrowers on a scale of A through D. The best clients, based upon their repayment record are classified as "A". The most risky clients are "D" and are generally not considered eligible for credit. The "A" client in essence has a guaranteed line of credit and does not have as much paperwork to carry out with each successive loan. Clearly, this system provides the borrower an incentive to repay.

Procedures and Paperwork

These can be separated into three phases: application, disbursement-implementation and repayment.

Application. The Bank requires a loan application showing personal data, a credit plan, balance sheet and income statement. In the case of group or cooperative loans, the members must fill out a credit plan to be attached to the group application. The credit agent usually assists in the preparation of the plan, often at the farm site (at least for a first-time credit). The application is reviewed at the agency. If it is under ¢50,000 it can be approved at that level, otherwise it goes to the Central office.

Once the credit is approved, a standard loan contract is prepared as a legal document. This needs to be signed by a lawyer. The Bank provides one at no charge. Sometimes when the Bank's lawyer has a backlog of documents the client will choose to use another lawyer in order to expedite receiving his loan.

Disbursement-Implementation. Disbursements are made at the agency office. Normally, they are made in kind and, therefore, the farmer picks up a receipt to take to the Bank's warehouse to pick up his inputs. The disbursements are made in stages in accordance with the use of inputs.

In this stage the credit agent visits the farm site several times to be sure everything is going according to plans and to gather information to authorize disbursements.

Repayment. The borrower usually repays at the Bank's office, but can also pay the agent at his farm site. In most cases the farmer is at liberty to sell his product to whomever he wants. However, in the case of basic grains the Bank has an agreement with IRA to purchase the product and IRA has an irrevocable order to pay the Bank.

Under this arrangement, the farmer delivers the product to IRA, who gives the farmer a receipt. The farmer takes the receipt to the Bank and the Bank will cancel the farmer's loan when IRA pays the Bank. Unfortunately, it often takes months for IRA to pay the Bank (because of IRA's lack of funds). In the meantime, the farmer must continue to pay the BFA interest on the debt. Because of these difficulties, in 1988 BFA decided to get into the business of purchasing the product directly and has constructed facilities to purchase and store the product.

Summary. The procedures and paperwork in the credit delivery system utilized by the BFA are relatively simple compared to these that are commonly used by agricultural development banks. As such, the borrowers' transactions costs are not high. Indeed, among the borrowers that were interviewed none had any complaints about the complexity or costliness of the procedures when they were directly asked the question.

From the Bank's side the procedures are also quite simple. However, it is clear that the Bank spends extra effort to monitor the loans. This is considered necessary because of the bad experience with delinquency.

The credit appears to be delivered on a timely basis. No farmer interviewed indicated that the credit was not available when they needed it.

It is clear that the Bank has tried to develop procedures that make the lending process simple both for themselves as well as the borrowers.

Summary and Conclusions

The BFA has been designated by the government as the main financial institution to lend to the reformed sector, including Decree 207 beneficiaries. The large-scale 0262 and 0263 Projects, funded by USAID in 1980 and 1982, have been the main instruments, consisting of a $93 million revolving credit fund as well as hiring numerous credit agents to work exclusively with the sector. Because of high delinquency the liquidity in the fund has diminished considerably. In addition to the USAID financed projects the Bank uses other sources to lend to Phase III.

The BFA's lending to Decree 207 beneficiaries has been impressive, given the non-credit worthy nature of the clientele. To a large extent this lending has been the result of a social and political as well as an economic mission; unfortunately, the delinquency records reflect this situation. Of the 13,860 outstanding loans valued at ¢58.25 million only 42.3 percent of the loans and 65.1 percent of the volume were current.

To a large extent these results reflect the nature of the clientele but it is also likely that they are due to the fact that the Bank is not under the pressure of holding costs down because of their subsidy. Therefore, the Bank can be somewhat reckless in its lending and not suffer the consequences. The fact that PERA reported that only about 3 percent of the beneficiaries who applied for a bank loan were turned down suggests that the screening process is not very tough. The end result is that as loans are made, bank costs rise, borrowers became head over heels in debt and resources are misallocated.

Most lending has been for the annual production of basic grains. Credit is typically extended in kind in the form of fertilizers, other farm chemicals and seed. These products are distributed through the BFA's warehouse system.

The Bank lends to three basic types of Phase III clients: individuals, solidarity groups and cooperatives. The largest number of loans and about half of the volume go to individuals. However, the Bank likes to lend to groups and cooperatives because they are modes that reduce credit delivery costs.

The BFA has credit agents that specialize in lending to the Decree 207 beneficiaries. The Bank's credit delivery system, by development bank standards, is quite simple and does not involve high transactions costs for either the Bank or the borrowers. To its credit, the Bank has made innovations in the credit delivery system in order to try to reduce costs and enhance repayment.

VI. COMMERCIAL BANKS

Introduction

The commercial banks consist of the nine mixed banks and the Mortgage Bank. In interviews with a sample of the heads of the agriculture credit departments of these banks, they uniformally indicated that they would prefer not to lend to the Decree 207 beneficiaries. Furthermore, to the extent that they do lend to this clientele, it is done almost entirely as a result of government pressure to do so. As indicated in Chapter IV, in 1985 the government arranged for funds from the BFA's 0263 Project, to be assigned to each of the commercial banks for a 3-year period to finance those bank's lending to Decree 207 beneficiaries. This was accompanied by directly assigning each bank a region of the country for its Phase III lending. In the same year the Program for Integrated Rural Development (PRODERIN) was established with the purpose of developing viable communities among Decree 207 beneficiaries. The program provided extensive technical assistance and called for credit, which the banks were expected to provide. The program was judged unsuccessful and was discontinued in 1987.

The principal reasons for the banks' negative attitude toward lending to the Phase III beneficiaries are the high administrative costs per loan and the high levels of delinquency. Nonetheless, because of the government's pressure to lend to the sector most banks extend a limited number of loans but always try to select the best clients available to them.

Sources of Funds

At the outset the commercial banks used the 0263 funds for the lending to Decree 207 beneficiaries. Now that the three-year period for the availability of funds under the 0263 program has expired, the several banks are forced to mostly use their regular sources of funds to lend to Decree 207 beneficiaries, i.e., the BCR rediscount lines and their own funds. Because of the proven high risk for lending to these clients, this is another disincentive for them to lend to the sector.

The banks have made sparse use of the 0307 rediscount line. As of September 1989, only 12 loans had been made for a value of ¢[illegible] million. Five banks made the loans which were extended to solidarity groups, cooperatives and communities which encompassed 581 farmers. The credit was directed to annual production expenses, mostly for basic grains and sesame, but also melon, coffee and cattle fattening. The fact that there was no money lent for investment purposes suggests that it may be difficult to identify bankable projects of this class among the Decree 207 beneficiaries.

Because of high levels of delinquency, the banks have had to refinance many loans. When this occurs, they must repay their obligation to the 0263 fund and use their own funds for refinancing.

In 1988, in an effort to technically reduce the banks' delinquent debt on their books, the government established the Fund to Finance the Reactivation of Productive Activities (FRAP). Under this program the banks could assign their bad debts to FRAP in exchange for bonds. The banks would proceed to try to collect on the debt. When the debt was repaid, the bank could cash in its bond with FRAP. Many banks took advantage of this program and, in effect, refinanced some of their bad debts in this fashion. Therefore, FRAP is also a major source of refinancing. In 1989, the window for refinancing through FRAP was closed.

Credit Granted to Decree 207 Beneficiaries

Overview

As shown in Table VI.1, the commercial banks have a current portfolio of 114 loans that have been granted to Decree 207 beneficiaries for a total of ¢7.0 million ($1.4 million). These loans have been made to 79 individuals, 18 solidarity groups, 10 cooperatives and 23 communities (under PRODERIN). In total, 1,648 beneficiaries have received credit. Virtually all of the approved loans have been completely disbursed. Many of the loans have been in the banks' portfolios for several years because they became delinquent. Of these, many have been refinanced.

Distribution by Bank

The Banco de Crédito Popular, Banco Salvadoreño, and the Banco Agrícola Comercial have made the largest commitments, with 41.7, 31.9 and 16.3 percent of the loan volume, respectively. These three banks account for 90 percent of the total. No other bank exceeds 3.4 percent. Two banks --the Mortgage Bank and the Banco Cuscatlán-- did not make any loans to Decree 207 beneficiaries.

Only one bank --Banco Financiero-- lent to individuals. Two made loans to solidarity groups, five lent to cooperatives and four extended credit to the PRODERIN communities.

The sample of banks interviewed indicated that they mostly lend for basic grains. However, in several cases the banks were lending for sesame. In addition, several banks were lending to selected cooperatives for non-traditional exports such as okra, black-eyed peas and melons. For these loans the cooperative had a special contractual arrangement to produce these products for an exporting firm and the Bank had an irrevocable order to obtain repayment on their loan.

Delinquency

As shown in Table VI.2, all banks experience high levels of delinquency with their loans to Phase III clients. Across all banks the amount of their outstanding portfolio that is technically considered delinquent is 20 percent. The figures for the individual banks range from 3 to 48 percent. However, this does not represent a true picture of the delinquency problem. As mentioned previously, many loans have been refinanced, using the banks' own funds or through FRAP. Across all banks, refinancing accounts for 52 percent of the portfolio. The range among the banks runs from 29 to 72 percent. Combining the outright delinquency and

Table VI.1 Outstanding Loans Granted by Commercial Banking System To Decree 207 Beneficiaries, 31 August 1989

BANK	APPROVED LOANS								Total ¢	Total Loans	Total Beneficiaries
	To Individuals		To Solidarity Groups		To Cooperatives		To Communities				
	No.	¢	No.	¢	No.	¢	No.	¢			
Agrícola Comercial							7	1,138,346	1,138,340	7	350
Capitalizador			6	29,648	2	77,600			107,248	8	149
Crédito Popular							10	2,918,869	2,918,869	10	685
Financiero	79	120,386	12	36,801	1	20,500			177,687	80	103
Comercio							2	157,235	157,235	2	13
Desarrollo e Inversión					2	27,137			27,137	2	28
Mercantil					2	234,700			234,700	2	43
Hipotecario		-.-		-.-		-.-		-.-	-.-		
Cuscatlán		-.-		-.-		-.-		-.-	-.-		
Salvadoreño					3	1,855,950	3	378,292	2,234,242	3	277
TOTAL	79	120,386	18	66,449	10	2,215,887	23	3,517,684	6,995,458	114	1,648

Source: Reports submitted by banks to UTFRA.

the refinancing we obtain a better picture of the true nature of the delinquency problem. Across all banks the figure is 72 percent; the range by bank goes from 42 to 100 percent.

Of course some delinquency can be expected due to natural causes that harm production; however, there are special circumstances among the beneficiaries that have contributed to the problem. Specifically, all bankers interviewed reported that representatives of peasant organizations, and even FINATA, told borrowers that they did not need to pay their bank debts. The reasons were that the borrowed funds came from foreign assistance and, therefore, should be considered as a grant not as a loan. Furthermore, to repay would place the borrower in economic difficulty. In some cases, FINATA pressured farmers to make their payments on the agrarian debt before canceling their bank credit.

It is clear that delinquency is a serious problem. There is no doubt that it is the most important factor discouraging commercial banks from extending more credit to Decree 207 beneficiaries.

Credit Delivery System

There is no standard credit delivery system that the commercial banks employ for credit extended to the Decree 207 beneficiaries. Most banks use their standard system, including forms and bank procedures. However, all recognize that the small-sized loans are very costly for the banks to administer, which is another important factor in discouraging the banks from lending to Phase III clients. The banks believe it is important to monitor closely these loans because of their unfortunate experience with delinquency. Indeed, in a 1988 study of the 0307 Project credit delivery system, Carlos Cuevas (pp. 4-5) found that the banks using 0307 rediscounts were extremely concerned about these costs.

There is also a problem with collateral or guarantees for the loans. Since the beneficiaries have virtually no mortgageable property the banks must seek other methods for guarantees such as solidarity groups. The interest rates charged depended on the sources of funds. Under the new uniform interest rate policy the rates will be determined by the monetary authorities.

In order to lower administrative costs and to enhance loan guarantees, banks have sought ways to streamline the system. The most common means are to lend to cooperatives or solidarity groups. In this mode, the bank makes a loan to the cooperative or group which in turn disburses funds to its members thus reducing bank paperwork. Both the cooperative and the solidarity group also provide the bank a form of loan guarantee. Each member assumes responsibility for guaranteeing the other members' loans. (See Cuevas, pp. 4-5, for a detailed discussion of how the solidarity group credit delivery system is operated by the commercial banks).

Another method is the irrevocable order, which is designed to enhance repayment. Under this arrangement, the borrower gives the bank the first claim on sales receipts for produce resulting from financed activities. The

Table VI.2 Delinquent and Refinanced Loans in Comercial Bank Portfolio of Lending to Decree 207 Beneficiaries, 31 August 1989

B A N K	A Outstanding Balance	B Amount Delinquent	C Amount Refinanced	Delinquency Rates		
				% B/A	% C/A	% (B+C)/A
Agrícola Comercial	1,138,340	319,340	819,000	28	72	100
Capitalizador	63,637	2,000	45,300	3	71	74
Crédito Popular	1,160,600	170,734	984,866	15	85	100
Financiero	135,134	19,657	44,368	14	33	47
Comercio	157,235	157,235	-.-	100	-.-	100
Desarrollo e Inversión	22,475	10,790	8,140	48	36	84
Mercantil	234,700	NA	NA	NA	NA	NA
Hipotecario	-.-	-.-	-.-	-.-	-.-	-.-
Cuscatlán	-.-	-.-	-.-	-.-	-.-	-.-
Salvadoreño	1,632,103	215,873	478,292	13	29	42
T O T A L	4,544,224	895,629	2,384,966	20	52	72

Source : Reports supplied to UTFRA by banks.

NA/ Information not available.

banks require the irrevocable order when they can make a contractual arrangement with the buyer of the product. An example is the production contract for melons that some cooperatives have entered into with export firms. In this case the cooperative signs paperwork which gives the bank first claim on the receipts from the sale of the harvested product to the firm.

One bank used a savings account to control the loans the cooperative made to its members. Under this arrangement, the bank opened a savings account in the name of the cooperative. Each cooperative member could withdraw a certain amount for his loan. Thus, the savings account ledger showed loan disbursements (withdrawals) and repayments (deposits).

Summary

Seven of the nine commercial banks have made loans to the Decree 207 beneficiaries. The current list of approved ,and mostly disbursed, loans number 114 which are valued at ¢7.0 million. Three banks account for 90 percent of the total lending. In general, the banks are reluctant to extend credit to Phase III beneficiaries. The banks' experience of high rates of delinquency with this clientele and their high administrative costs for the small-sized loans have discouraged their lending. Indeed, most loans extended by the banks would not have been made had the government not been able to exercise direct control over the nationalized banks to force them to lend to the Phase III beneficiaries through the 0263 program, PRODERIN and use of direct orders. The use of the 0307 rediscount line has been very limited. Over the life of the 0307 Project only 5 banks have made a total of 12 loans. More recently, the banks have been using more of the 0307 Project funds, but for financing annual production expenses. It appears that the 0307 funds, to some extent, are being substituted for the 0263 funds that were previously available. Foreign assistance from USAID was important in providing loanable funds. When these programs were introduced there were spurts of new loans. However, as the loans came due and delinquency often set in the banks began to back off and the rate of new lending has declined.

Delinquency is a very serious problem. Across all banks, 20 percent of the disbursed loans were currently delinquent and another 52 percent had been refinanced by the bank or through FRAP. Therefore, a total of 72 percent is currently or was delinquent.

The banks have shown creativity in seeking ways to lower administrative costs and enhance collateral. They prefer to lend to solidarity groups and cooperatives, like to use irrevocable orders and have employed some ingenious schemes to monitor disbursements and repayments.

Under the new ARENA government, the banks expect that the pressure to lend to Phase III beneficiaries will be reduced. Accordingly, in the future it can be expected that the commercial banks will make fewer loans to Decree 207 beneficiaries. An exception might be loans to cooperatives for growing products under production contracts with agribusiness export firms.

VII. FEDECCREDITO

Introduction

It was noted in Chapter IV that the Federation of Credit Funds (FEDECRREDITO) had made a number of loans to Decree 207 beneficiaries. The purpose of this chapter is to examine that institution and its potential role in financing this group of clientele.

Structure and Source of Funds

The Federation of Credit Funds (FEDECCREDITO) was established in 1943, as an autonomous public sector institution, to encourage the cooperative movement in El Salvador and to provide financing for small producers. FEDECCREDITO is a federation of cooperatives, known as Cajas Rurales. There are currently 61 cajas throughout El Salvador. The major function of the caja is to extend credit.

Each caja chooses its own members utilizing its own criteria. Each member must own a share in the caja which costs ¢10. The cajas must conform to the general rules specified by FEDECCREDITO with respect to organization and operations.

Although each caja is independently organized, its relationship with FEDECCREDITO is very tight, because the caja depends on the Federation as its source of funds to extend credit. FEDECCREDITO obtains its funds through BCR rediscounts as well as loans and grants from international agencies, which it uses to finance credit extended by the cajas.

The Federation provides services to the caja for purposes of cooperative education, bookkeeping, auditing and supervision of loans.

Portfolio and Delinquency

At the end of 1988, FEDECCREDITO had an outstanding portfolio of 84,000 loans with a value of ¢223,000,000 ($44.6 million). The loans can be for short-, medium-or long-term purposes. They are directed to all classes of small and medium-sized businesses, including farms. Some loans go to cooperatives. The agricultural loans are relatively small scale. The typical size is about ¢4,000 ($800). Most are directed to producing cereals. There have been few loans for production of melon for export, where the borrower is linked to an export firm. In this case the caja requires an irrevocable order to ensure payment.

The level of delinquency for the total portfolio is high, about 45 percent. Many loans are refinanced.

Credit Delivery System

A member of a caja may apply for a loan to his cooperative. His application is reviewed by a Credit Committee. If it is for an amount of ¢5,000 ($1,000) or less it can be approved at that level. If it exceeds

¢5,000 then the application must be forwarded to FEDECCREDITO for approval. Once the loan is approved, FEDECCREDITO supplies the financing to the caja. The system is slow and may take several weeks or months for approval and disbursement.

The interest rate charged depends on the source of funding that FEDECCREDITO uses to finance the loan. The guarantees may consist of real goods, guarantors, or the expected harvest.

Lending to Decree 207 Beneficiaries

FEDECCREDITO does not have a specific program for lending to the reformed sector. However, there are a number of Decree 207 beneficiaries who are members of cajas and, therefore, obtain credit. As the FEDECCREDITO authorities point out, the persons received credit as caja members and not because they were Decree 207 beneficiaries.

Several years ago, under pressure from the Christian Democratic government, FINATA and FEDECCREDITO worked out an agreement whereby the Federation would have a special program to finance Decree 207 beneficiaries. However, the agreement was never put into effect for lack of obtaining a source of funds to finance the program.

FEDECCREDITO officials interviewed gave the clear impression that they would prefer to avoid any major program to finance the Decree 207 beneficiaries because of the problematic nature of this clientele. Rather, they would prefer to continue as at present and finance beneficiaries who are members of cajas and who have been selected as members of the cajas on the basis of the normal standards applied. To date, FEDECCREDITO has not used any 0307 Project rediscounts.

Summary

FEDECCREDITO and the 61 Cajas Rurales have an extensive network throughout El Salvador for extending credit to members of the cajas, who are mostly small- and medium-sized farmers and businessmen or women. The credit operations are centralized in the Federation and the loan approval/disbursement process may take a long time. Although FEDECCREDITO makes many loans to small farmers, it is not interested in any special programs for the Decree 207 beneficiaries, considering this clientele as too risky and problematical. Rather, they prefer to deal with Phase III beneficiaries only when the person is a member of a caja, who meets the cajas membership standards. Therefore, it does not appear that FEDECCREDITO and the cajas offer a large potential for lending to Decree 207 beneficiaries, either through the 0307 Project or from other sources.

VIII. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Summary

The purpose of this study has been to make a diagnostic analysis of the Phase III land reform beneficiaries and the credit programs that currently serve them. The objective was to understand the nature of this class of clientele and their credit worthiness, the extent they receive credit, and to determine what means might be recommended such that they might make better use of the 0307 rediscount line, as well as other sources of credit.

The study's main findings are:

1. The 41,640 Decree 207 beneficiaries mostly farm individual plots received under the Phase III land reform, but some 22 collective farms with about 750 members were also formed. Many beneficiaries own other small plots and/or rent additional land.

   Including the collective farms, there are 207 cooperatives, with 7,339 members, where beneficiaries have banded together, most often to facilitate getting credit. Of these, 28.5 percent are production cooperatives where the land is farmed collectively; 52.7 percent are service cooperatives in which the beneficiaries farm their individual plots; and 18.2 percent are mixed cooperatives, where the members farm their individual plots as well as farm some land collectively. Thus, the Phase III sector is heterogenous. Because the primary motive in forming cooperatives was to obtain credit, most of the cooperatives are not well developed as true cooperatives and lack enthusiasm for this type of organization.

2. The Decree 207 beneficiaries have economic and social characteristics that do not make them very credit worthy. Their small-sized farms (the average size plot received under Phase III is 1.72 hectares) are located mostly on marginal lands and are not well suited for generating much income. Most of the crops grown are basic grains, although there is some coffee, sugar and other crops. In a few cases some Phase III cooperatives grow melons and other non-traditional exports under production contracts with export firms.

3. Surprisingly, about half the beneficiaries directly or indirectly have received bank credit. In 1985/86 the median-size loan was ¢500 ($100). The largest supplier was the BFA which provided about 90 percent of the direct bank loans. Even more surprising was that only 6.1 percent of beneficiaries reported using credit from informal market sources.

4. The reason for the supply of such extensive bank credit to the beneficiaries was the government's policies of trying to force the banks to lend to the Phase III sector.

The most important government measure was to designate the BFA as the principle institution to lend to Phase I and Phase III of the land reform program. To support this, USAID financed the 0262 and 0263 Projects to set up a $93 million revolving credit fund in that Bank and provided grants to hire 92 credit agents to work in the reformed sector.

As a result, the BFA has been the major lender to the Decree 207 beneficiaries, accounting for about 90 percent of all bank loans. This Bank has been able to play this important role because of the personnel and infrastructure provided by the 0262 and 0263 Projects as well as the fact, that as a development bank, it is willing to absorb the losses that are associated with making numerous small-sized loans to risky clients.

Beginning in 1985, the government also tried to force the commercial banks to lend to Phase III. The BFA was asked to rediscount some of the 0263 funds to these banks to be used for this purpose. Furthermore, the Program for Integrated Rural Development (PRODERIN) was initiated and the banks were expected to provide credit. These institutions complied, but only in a token way. Now, because of their bad experience with loans to this clientele, both in terms of high administrative costs and high delinquency, these banks strongly resist lending to the sector. If the ARENA government does not pressure them to make loans, their levels of new lending to Phase III can be expected to decline sharply.

Likewise, FEDECCREDITO has little interest in launching special programs to lend to Phase III beneficiaries. However, they will lend, as they are presently doing, to beneficiaries who are members of the Cajas Rurales and who seek credit through normal caja channels.

5. Delinquency is the more serious problem for the several banks in the lending to the Decree 207 beneficiaries. In the BFA, only 42.3 percent of the loans and 65.1 percent of the outstanding loan volume is non-delinquent. For the commercial banks the portion of the outstanding loan volume that is delinquent is 20 percent. These figures, however, do not clearly show delinquency problems because many formerly delinquent loans have been refinanced.

6. The banks have made innovations in their credit delivery system to lower their costs and reduce risks. The BFA and the commercial banks choose to lend to many solidarity groups and cooperatives formed among Decree 207 beneficiaries. Both of these modes serve to lower bank costs of credit delivery and are designed to enhance repayment, because the members assume joint liability for their individual loans as well as those of other members of the group or cooperative. Furthermore, banks have tried to simplify lending procedures and paperwork to lower costs.

7. The potential for medium- and long-term investment loans among the Decree 207 beneficiaries is limited and is reflected in the fact that the 0307 rediscount line has not been used for this purpose. To date, only 5 banks have made a total of 12 loans to solidarity groups, cooperatives and communities for annual production purposes. The typical beneficiary's small farm does not lend itself to investments for intensified agriculture. It appears that the greater potential for investment lending with 0307 Project funds lies within the cooperatives that would have sufficient area to warrant the purchase of machinery, establishment of irrigation systems, expansion of livestock operations, etc. However, even in this context the prospects are limited.

Conclusions

1. The economic characteristics of the Decree 207 beneficiaries by and large cause them not to be very credit worthy and, therefore, they are poor subjects for bank credit. The high levels of risks as well as the high lender administrative costs relative to income earned from the small-sized loans make them poor clients for credit.

   Nonetheless, the government has felt, and rightly so, an important obligation to help them obtain credit as part of the land reform package. Therefore, the government has taken measures to try to force the banking system to lend to this class of clientele. As a result, almost half of the beneficiaries directly or indirectly have received bank credit. As might be expected, under this type of forced lending to risky clientele, a large portion of the borrowers are delinquent in loan payments. This has negative impact on the financial situation of the lenders and places the borrowers in a difficult position to obtain new credit.

2. Although it is risky, costly and problematical for the banks to extend credit to the Phase III beneficiaries it is economically, politically and socially important that means be sought to deliver credit in a rational and justifiable manner to this clientele. However, it can not be expected that all beneficiaries should be recipients of credit. Therefore, credit programs should concentrate on those beneficiaries that can genuinely make good use of credit. Nor can it be expected that all financial institutions should lend to the recipients, but none should be excluded out of hand.

3. The outlook for using the 0307 Project funds for financing investment credit for the Decree 207 beneficiaries is not bright. There are limited possibilities; the best opportunities are among selected cooperatives where there appears to be potential for a few good projects. The several banks and the UTFRA should try to identify and develop them.

Recommendations

Based on the above, the following are recommendations for continuing directing credit to the Decree 207 beneficiaries in a more rational manner.

1. Do not force the entire banking system to make loans to the beneficiaries. Such actions only cause the individual banks to make bad loans, incur high administrative costs, and run large risks, all of which will lead to losses and a poor allocation of bank resources. If this policy were followed, it is expected that the commercial banks and the BFA would diminish their level of lending to Phase III, and that of FEDECCREDITO would remain about the same.

2. Given the high costs of bank lending, policies should be undertaken to assist the banks in lowering them. These should include:

   (a) Establishing a loan guarantee fund, at least for investment projects, to reduce bank risk. The fund is especially important as an incentive for the commercial banks to lend to Phase III because of the high perceived risk. At present, the BFA is in a better position to assume this risk because of its subsidy. Nevertheless, it too could benefit from such a fund, especially if that Bank is expected to operate on a profitable basis.

   (b) Strengthening programs of technical assistance and marketing through the Ministry of Agriculture and Livestock and/or other appropriate entities.

   (c) Developing programs to strengthen Phase III cooperatives that are voluntarily formed on a production, service or mixed basis in order that they might take advantage of the economies of scale of production and marketing.

   (d) Making better use of the special programs to help selected beneficiaries, especially cooperatives, to design new investment projects and improve farm management. These should include projects for non-traditional exports. Programs currently in place are those of CLUSA/Technoserve and the BCR's 0307 Project.

   (e) Exploring the possibilities of the banks lending directly to agribusiness exporters or processors with the arrangement that the firms would onlend the funds to Decree 207 beneficiaries, and possibly other small farmers, to grow products used by the firm. This arrangement is commonly employed in other countries and serves to lower considerably lender and borrower transaction costs.

3. Continue to charge the market-level interest rates currently required in the banking system. Credit should not be a means to

subsidize farmers, because it creates too many distortions in physical and financial resource use as well as in financial institution management.

4. Explore the possibilities of establishing credit unions in the rural areas where Decree 207 beneficiaries are located. These institutions would serve both as a means to mobilize savings as well as extend credit.

5. Create more off-farm employment opportunities in rural areas in order to reduce the beneficiaries' dependance on farm income and the need for credit.

6. Nevertheless, even with the above measures it can be expected that bank lending to Decree 207 beneficiaries would considerably decline. This is as it should be, as the more marginal clients are weeded out. However, the decline might be greater than the government or society is willing to accept. Therefore, if this is the case, it is proper to continue to use the BFA --which is the only bank that has the infrastructure and experience-- as the principal institution to lend to this clientele, using the personnel and procedures developed under the 0262 and 0263 Projects. However, in contrast to the past, the goal should be for the Bank to make solid viable loans, and not be reckless and simply try to disburse lots of credit. To cover the high costs of making these small-sized, the Bank would most likely need to be subsidized. This may be justifiable given the social and political objectives. Nevertheless, even with subsidization, the Bank should be encouraged to minimize its losses in lending to the Decree 207 beneficiaries.

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