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SUBJECT: Rural Finance in El Salvador

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EQUITABLE RURAL ECONOMIC GROWTH PROJECT (CRECER)

RURAL FINANCE IN EL SALVADOR

Technical Paper

November 10, 1994

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RURAL FINANCE IN EL SALVADOR

A. BACKGROUND

1. PRIOR TO 1993.

Rural finance in El Salvador has historically been channelled primarily towards the larger, more affluent landholders and businesses -- those with significant tangible personal property (land, livestock, houses, equipment, etc.), power, and/or influence. They had little problem securing credit from the formal financial sector of the economy (local, regional and international commercial banks and other established financial organizations), as well as from the informal sector.

As the size of a person's wealth diminished, the more difficult it was to obtain financial services from the formal sector. Therefore, in order to grow and survive, the small farmer and entrepreneur had to access the non-formal or informal sector because they lacked sufficient collateral and other resources, or did not possess an impeccable credit history to support the requirements of the formal sector.

Another impediment to credit was the perception by the banks that small borrowers were too transaction intensive and costly to manage effectively, thereby prohibiting them from generating a profit.

In 1980, the government nationalized all banks and finance companies, and placed the Central Bank in a position of having to perform many of the functions of commercial banks. Furthermore, the Central Bank had to finance the public sector. As a result of these changes, mismanagement, and abuses of the system, the banking sector became insolvent

With the change in government in 1989, reforms were initiated to bring the Central Bank back to the more traditional/orthodox role of monetary policy. The financial industry was also to be modernized, made solvent, and converted back to the private sector.

The "informal" sector consisted of family and other relatives, friends, money lenders, and so forth (See list in Appendix 3.). They would charge little or no interest up to usurious rates for the funds they provided. Justification for the higher rates was

the fact that they did not normally require collateral, and therefore had a greater risk. In addition, their terms were not always favorable, tending towards shorter maturities (30 to 90 days in most cases).

The civil war severely affected productivity in the country. Farmers in the conflict areas were unable to work their land, or, if they did, they did so at night. The entrepreneurs in those same localities did not fare much better. Many closed down their businesses and moved to San Salvador, to other peaceful cities, or to Honduras, Guatemala, the United States, and other countries.

2. 1993 to Present.

With the conclusion of the civil war and the signing of the peace agreement, economic activity in the country has begun to return to normal. The government has enacted various reforms aimed at improving the country. Included therein was the implementation of the 1991 Central Bank law, which prohibited the Central Bank from financing the government nor any public agencies or businesses.

The financial sector was also to be reformed, strengthened, modernized and made competitive. The last phases of this process involved the privatization of the individual banks and finance companies that were solvent. Stock in each new institution was first to be offered to its employees, and any excess would be made available to investors in the open market. This effort has now been basically completed.

Nevertheless, the formal financial industry continues to be reticent to changing its prior attitude towards extending credit to the small farmers, small entrepreneurs, cooperatives and small businesses. According to Carlos Benito in his APAP II Technical Report No. 134, dated September 1993, banks (other than the Banco de Fomento Agropecuario and the cajas rurales) provided credit to only 1.3% of all farmers during the period 1992-1993, based on the "Survey of Land Tenure in El Salvador, 1993."

It also appears that the ex-combatants of the civil war, individually and as a group, will not immediately be able to secure

credit from the formal sector for the fear that they will not repay the debt.

B. SOURCES OF RURAL FINANCING

Rural financing in El Salvador is available through the following major groupings, each of which will be elaborated upon separately:

- Formal Sector
 - Commercial Banks
 - Finance Companies

- Informal Sector
 - Non-Governmental Organizations "NGOs"
 - Other Traditional Entities

- Other Financial Intermediaries
 - International Donor Organizations
 - Public Sector

C. FORMAL SECTOR

1. Commercial Banks.

Appendix 1. contains a list of eight banks that have been privatized and are operating in the country. In addition, the names of a key contact person, along with available telephone and fax numbers are included. Of particular importance for the CRECER design team are the data on number of rural branches.

Because the CRECER project's focus is rural El Salvador, the expansion of the commercial banks outside of the capital city is a significant factor to consider. To date, the Banco Agrícola Comercial and Ban Co have twelve such branches each, followed by the Banco Salvadoreño with eleven. These institutions have already been privatized. The CRECER design team may want to gather a listing of the rural cities where each bank maintains a branch office, to generate a larger picture of the penetration of the financial services industry.

The privatized banks do extend credit to the agricultural and rural enterprise sectors. Nevertheless, they do not take risk and generally require collateral on the order of up to 200% of the loan value to protect their investment. In other words, they continue to be collateral lenders, versus cash flow lenders. A positive cash flow is occasionally a criterion, but the final decision rests upon the type and amount of collateral available as security.

The current policy of the private commercial banks is to not finance small producers, and to set a minimum loan amount for the small borrowers at an level reported to be around 50,000 Colones (approximately U.S.\$ 5,734 at current exchange rates). Real, tangible collateral is required. Any applicant not able to meet these conditions is referred to the Banco de Fomento Agropecuario.

In addition to business and agricultural loans, the privatized banks offer a full array of standard commercial bank products and services, such as: checking and savings accounts, certificates of deposit, consumer and mortgage loans, foreign exchange, letters of credit, collections and remittances, and so forth.

1.1 Banco de Comercio de El Salvador "Ban Co" -

Ban Co has an interest in increasing its portfolio of good loans to the agricultural and rural enterprise sectors, but in a very prudent manner. They minimize risk by lending primarily for traditional agricultural products and for rural enterprises with adequate capital and collateral. With sufficient justification, they would access the government's FOGARA program (Fondo de Garantía Agropecuario), which is an agricultural loan guarantee mechanism initially run by the Central Bank. With the recent changes in the Central Bank's role, this operation has been transferred to the new Banco Multisectorial de Inversiones "BMI".

The CRECER design team may want to investigate whether Ban Co uses the other BMI guarantee fund called "Fondo de Financiamiento y Garantía para la Pequeña Empresa" (FIGAPE), the counterpart fund for small business.

The bank is also reluctant to extend credit (secured or otherwise) to the ex-combatants, for fear that the loans would not

be repaid, and the negative image that such an event would convey.

1.2 Banco Agrícola Comercial -

The Banco Agrícola is another commercial bank with a significant involvement in the agricultural sector, financing production and processing (agribusiness) ventures through their main office and the branch network. They have utilized the FOGARA mechanism when dealing with the small farmers and farmer groups and will probably continue to invest a large portion of their funds in the agricultural sector. Their interest in small, rural enterprises remains to be explored.

1.3 Banco Salvadoreño S.A. -

The Banco Salvadoreño, with eleven rural branches, is a very active player in the agriculture and rural enterprise sectors, and may be the most aggressive of the commercial banks in the country at this time. They are familiar with international donor programs and critically analyze them as mechanisms to safely increase their portfolios.

1.4 General Comments -

The extent to which the other privatized commercial banks expand beyond the larger farmers and businesses in the country and enter the more "risky" segment of the economy will depend on many factors. First and foremost is the fact that in all of the commercial banks and financial institutions in El Salvador, the level of sound credit training and experience of the lending officers is weak (albeit improving).

To compensate for this shortfall, the banks take a more conservative approach to reduce their exposure to potential non-earning assets. They develop a base of middle to large size clients, obtain as much collateral as possible, and finance only the more stable/traditional products.

As they grow and open additional branches throughout the country, competition for loans will force the banks to take a second look at the small farmer and entrepreneur as a customer. In the

meantime, all of the banks will continue to capture deposits in the rural sectors and invest them in businesses in the larger cities.

2. Finance Companies.

A brief list of those finance companies which have been privatized is detailed in Appendix 2., followed by a second list of institutions classified as finance companies and which are known to offer rural credit. The CRECER design team will have to spend some time interviewing some or all of these entities, as no data on them was able to be located for inclusion in this paper (except for UCRAPROBEX). They should gather specific information on:

- types of loans offered
- target clientele (including small farmer and rural entrepreneur)
- terms and conditions of their loan programs
- do they utilize the BMI guarantee programs
- interest rates and fees charged
- collateral and other security requirements
- number and location of rural branches or offices

2.1 Privatized Finance Companies -

The four finance companies known to have been privatized are: AHORROMET, ATLCATL, CASA, and CREDISA. What information that we have at the present time is that they are typical finance companies -- borrowing money (or using their equity) to lend to creditworthy clients for housing, commerce, and industry. Agricultural loans are not one of their products, and it is not known if they will expand into that area. They do offer a variety of other financial services, such as: savings deposits, foreign exchange, and now credit cards.

Not much information is currently available on the rural activities of these privatized finance companies. The design team should establish contact with at least two or more of them and document their position regarding assistance to the small farmer, cooperative, and small business segment of the rural economy. Further, the team should gather information on the other products and services offered by them, and the questions listed above.

2.2 Other "Finance" Companies -

The organizations listed in the second half of Appendix 2. are known to have an involvement in rural finance, and provide credit and other services to farmers and small businesses. Since they are not "traditional" finance companies, the term "other" is used to differentiate them. The extent of their efforts in supplying rural financial services and their plans for the future should be documented in more detail by the design team, along with responses to the other specific questions cited above. Information on entities included in this group was only available on UCRAPROBEX, as more fully described below.

2.3 UCRAPROBEX -

Within the second group considered "other" finance companies is UCRAPROBEX (Unión de Cooperativas de la Reforma Agraria, Productoras, Beneficiadoras y Exportadoras de R.L. de C.V.), which is a second tier cooperative focussing on economic and social improvement of its member cooperatives.

There were ten founding cooperative members when the organization was formed in 1988. The Central Bank, UTRFA (Unidad Técnica de la Reforma Agraria -- no longer in operation) and USAID provided assistance to the group. Since 1988, membership has grown to over 60 cooperatives with more than 70,000 individual farmers.

UCRAPROBEX provides a number of services to its members. It markets certified organic coffee and other non traditional crops, extends short term financing for production and processing activities and medium term credit for land/crop improvement and equipment, makes short term advances against foreign collections, and sells farm inputs (principally fertilizer).

With the technical assistance and support of CLUSA/El Salvador, UCRAPROBEX has developed into a strong, profitable, well organized and self sufficient business. For all of these reasons, it is the type of local institution that fits nicely in the CRECER project and a working relationship should be developed.

D. INFORMAL SECTOR

The largest and most diverse sector of the rural economy that provides financial services to the small farmers and entrepreneurs in the informal sector. Appendix 3. contains a list of the general types of entities considered as part of the "informal" sector. This list was adapted from the APAP Technical Report No. 134 by Carlos Benito, September 1993, based on the "Land Tenure Survey of El Salvador, 1993."

For purposes of this paper, the NGOs have been considered as part of the informal sector because they are not strictly financial institutions, nor are they public sector organizations.

1. Non-Governmental Organizations "NGOs".

Appendix 4. lists only a small part of the PVOs/NGOs in operation, along with the names of several key contacts, their telephone numbers, and cities where they have branches. These organizations solicit and mobilize funds to finance diverse activities and reportedly are active in the rural areas.

The design team needs to follow up on these contacts to develop an information base on each one, as well as identifying others who may be active players in the rural credit markets. Information to be gathered might cover:

- who is their target clientele?
- what services do they offer?
- where do they operate?
- what is their objective / mission?
- what are their short, medium and long range plans?

Through the design team's investigation, other PVOs/NGOs may surface that provide credit to the rural sector. Baseline data on them should also be obtained to enrich the final paper.

2. Other Traditional Entities.

In terms of servicing the financial needs of the small farmers and rural enterprise people, the informal sector plays the

principal role. For the farmers, they have access to credit from any cooperative to which they may belong. Table 1.4 of the Benito Technical Report No. 134 shows that 25.9% of farmers use informal sources of credit. Of that number, 5.2% obtain credit from a cooperative, compared to 11.5% from friends (the largest source) and 2.4% from the church. See also Figure 1.2 of the same document, which is a pie chart showing the percentage of total informal credit provided by these same sources: friends (44%), cooperatives (20%), church (9%), and money lenders (1%), among others.

Depending on the type of cooperative and the purpose of the loan, a cooperative may require collateral as a condition for approval. However, friends and family usually do not require any. Therefore, for the small farmer or entrepreneur without tangible assets, his/her only source of financing is from the latter group.

No studies were found that dealt with the rural entrepreneurs and how much of the informal sector they utilize. A gut feel is that it may be significant when one realizes that the formal sector works in terms of high minimum loan amounts and collateral (because of the perceived high transaction costs and high risk).

The design team may be able to gather more exact data through additional research or via interviews with a sample of small rural entrepreneurs. USAID/El Salvador may have information on 'the existence of any studies relating to credit to rural entrepreneurs, beyond the former Central Bank (now BMI) guarantee program (Fondo de Financiamiento y Garantía para la Pequeña Empresa).

2.1 Agricultural Cooperatives -

There are a number of agricultural cooperatives operating successfully in the country. CLUSA/El Salvador is working with some of them, and has assembled good information. Several which appear to be progressing are:

- Cooperativa Santa Teresa
- Cooperativa La Providencia
- Cooperativa San Mauricio
- Cooperativa Cara Sucia

2.2 Credit Unions -

The credit union system in El Salvador is fairly well established, although many of the individual credit unions are weak (poor management, no formal credit policies and procedures, no MIS systems, accounting not current, no effective marketing of products and services, no savings mobilization strategies, little business planning, untrained leaders and members, undercapitalization, etc.).

Credit unions are probably one of the most active participants in the rural credit sector for the small entrepreneur, after family and friends. According to WOCCU, there are some 52 credit unions throughout the country, which are affiliated to a federation of credit unions called FEDECACES (Federación de Cooperativas de Ahorro y Crédito de El Salvador).

FEDECACES should be able to provide information to the design team on its membership and activities. As a federation, it offers various services to the member credit unions, such as: credit, insurance, technical assistance, and training. Another source of information on credit unions is contained in the Chemonics International proposal for the CRECER project, Annex B-2, written by WOCCU.

E. OTHER FINANCIAL INTERMEDIARIES

Two other sources of credit to the rural sector of the Salvadoran economy are the international donor organizations and the public (governmental) entities.

1. International Donor Organizations.

Without the benefit of first hand research, a preliminary list of international donor organizations (excluding USAID) with offices in El Salvador was assembled (See: Appendix 5.). To assist the design team, the information includes an indication of the types of programs each one offers, and a contact person where available. Information on the cities where these organizations operate (or have offices) should be gathered by the design team.

As can be seen from the data, many of the donor organizations offer the same types of programs. The most common programs are agricultural credit and development of productive agricultural projects. Obviously, there may be some "stepping on toes" and duplication of efforts. A mechanism to centralize and coordinate these resources (without actually managing them) could benefit each one and El Salvador in the long run.

Other programs promoted by the international donor organizations are:

- Marketing of agricultural products
- Social and productive development of cooperative sector
- Promotion of animal traction
- Post harvest technology
- Food exchange

2. Public Sector.

The public sector financial organizations include the Banco de Fomento Agropecuario "BFA" and FEDECREDITO. They are listed in Appendix 6., with the name of a contact person and telephone numbers. The design team may want to assemble a listing of the locations of the rural branches of both institutions to determine the extent of coverage.

2.1 Banco de Fomento Agropecuario -

The BFA has 26 rural branches, which accept credit applications for agricultural and agroindustrial loans. According to the Benito report, the BFA provided credit to 7.2% of all farmers (10.3%) who received credit from the formal sector.

The BFA tends to be the institution of "last resort" for many small farmers and cooperatives. Loan applicants that the private banks don't want to finance are referred to the BFA.

2.2 FEDECREDITO -

FEDECREDITO is the second public sector financial entity. It promotes and assists the "cajas de crédito" or "cajas rurales" as

their "Federation." There exist approximately 62 "cajas rurales" in El Salvador that are affiliated to FEDECREDITO, of which 52 are located in the rural areas. They are funded by FEDECREDITO under lines of credit now handled by the Banco Multisectorial de Inversiones. Their organizational and operational structure is very similar to "open bond" credit unions. To date, the cajas are not permitted to capture deposits. Nevertheless, there are now undercurrents pushing for this policy to be changed.

Clients/members of the cajas include a broader spectrum of the rural populace. Credit is extended for the purchase of houses, personal needs, agriculture, retail trade, commerce, and cottage industries. The Benito report estimated that the cajas rurales, as a component of the formal financial sector, extended credit to approximately 1.9% of all farmers who borrowed from the formal sector during the period 1992-1993. This is slightly higher than the percentage of farmers who accessed credit from all other banks.

An excellent summary description of FEDECREDITO and its affiliated cajas rurales may be found in Annex B-2 of the Chemonics International Technical Proposal (Volume I) for the CRECER project. It touches on their internal bureaucracy, structure, policies, and weaknesses that require attention. Therefore will not be repeated here.

F. BANCO CENTRAL DE RESERVA (CENTRAL BANK)

In April 1994, the Central Bank began the process of transferring all of its credit functions to the Banco Multisectorial de Inversiones "BMI," leaving itself with the primary function of managing the country's monetary policies. The outcome of this change is that the rate of inflation has fallen to an adjusted monthly average of 1% since 1993. (For June 1994 it was 9.8%.) The exchange rate vs. the U.S. dollar has stabilized between 8.72 to 8.78 Colones per U.S.\$1.00.

In 1992, interest rates were decontrolled and allowed to fluctuate according to supply and demand. Prior to its divestiture of the credit functions, the interest rates for Central Bank lines of credit using their own and external funds ranged between 15.25% and 16%. The lower rates tended to be targeted towards the various

specialized credit programs (industry and agribusiness, housing and construction, agriculture, micro to small business, and services.

Nominal interest rates paid to depositors for deposits of 180 days were estimated to average 13 - 14% for the first half of 1994.

The reserve requirements for deposits in the banks were increased to 20% for savings and time instruments, and 30% for sight deposits.

According to the 1993 *Memoria of the Banco Central de Reserva*, the following objectives were established:

- "1. Reduce the rate of inflation.
2. Maintain a flexible and unified exchange system.
3. Facilitate the growth of the production of goods and services.
4. Complete the process of straightening out and strengthening the financial system institutions.
5. Reduce the fiscal deficit."

G. BANCO MULTISECTORIAL DE INVERSIONES

The BMI, as stated earlier, was created by an act of the Legislative Assembly at the end of 1993, to assume the credit and other non-monetary functions previously handled by the Central Bank. Since this is a relatively recent event, there is little in writing which provides a description of its role and responsibilities, except for the legislative decree that established it. Under the decree, the purpose and objective of the BMI is to normalize the credit policy of all of the productive and service sectors.

Assuming that the BMI has undertaken all of the functions the Central Bank had handled in the past that are not the traditional "monetary" functions of a central bank, then it would have been entrusted with managing the two loan guarantee programs: one for the small farmer ("FOGARA"), and the other for small business ("FIGAPE").

Besides these two guarantee funds, the BMI will manage the Investment Credit Fund (Fondo de Crédito para Inversiones "FCI"). The FCI focusses on assisting economic and social development. It

does not provide credit for either agriculture or industry.

Secondly, two commissions were created to tend to the traditional sectors:

- Agriculture Maintenance Service Commission (for large businesses)
- Energy Generation Commission.

1. Fondo de Garantía Agropecuario "FOGARA".

This guarantee mechanism was established initially through the Central Bank with USAID funds to assist small farmers, farmer groups and cooperatives in securing credit from the private banking sector when they lack sufficient tangible collateral to qualify otherwise. Under this fund, a lending bank's risk is covered up to 70%.

Nevertheless, the private banks have not been heavy users of the program for the paperwork involved, the fee they have to pay, and the 30% uncovered risk. Only the BFA has had any substantial activity under the fund, probably because they have borrowers who had been previously rejected by the other banks. The design team should interview the BMI to determine their position on assisting the small producer and cooperative.

According to the Central Bank (1993 Memoria), the fund granted 6,614 guarantees, totalling 101.5 million Colones. These guarantees are supporting credits totalling 181.3 million Colones.

2. Fondo de Financiamiento y Garantía para la Pequeña Empresa "FIGAPE".

The design team should attempt to obtain more information on this guarantee mechanism, which may also have been funded by USAID. It is a program to guarantee credit to the small entrepreneurs and businesses, and may be structured very similar to the FOGARA fund. FEDECREDITO and the cajas rurales may be the principal users.

As per the Central Bank's "1993 Memoria," this fund extended 2,566 guarantees for small business loans totalling 40.5 million

Colones. The guarantees supported loans of 73 million Colones.

3. Fondo de Crédito para Inversiones "FCI".

This fund is available to all commercial banks, the BFA, and FEDECREDITO for medium to long term loans to large businesses. Investments in coffee are excluded, however. All short term credit is to be provided by the banks from their own resources.

During 1993, the Central Bank's "Memoria 1993" reported that three new programs were added to the FCI:

- Social Development
- Construction and housing
- Services

Access to this fund is through a rediscount line at the BMI. Credits over 10 million colones must be reviewed and approved by the BMI's Board of Directors. The interest rate is 13% to 14%, plus a 3% to 4% management fee.

H. INTEREST RATES

1. Formal Sector.

The formal sector market rates of interest on loans to the small borrower and cooperative have fluctuated around 20%, excluding fees and other service charges. The cost of short to long term credit to the small farmer and entrepreneur, when rediscounted at the BMI, could run from 17% to 19%. This, of course, is contingent upon a bank accepting their credit application and utilizing the BMI programs.

2. Informal Sector.

Because of the nature of the market, interest rates charged by the lenders in the informal sector vary much more widely than in the formal sector. Current investigation and estimates put the range at a low of 14%, to highs of up to 36%. However, most of the credit is fixed at rates closely approximating those charged by the formal sector. One rationale for this is that the largest source

of informal credit is from friends and relatives. Those sources that traditionally charge higher rates (money lenders, suppliers, landlords) have less than 5% of the small farmer market.

Based on the Benito APAP II Technical Report No. 130, page 1. He states that "Reasons commonly offered to explain why many small farmers do not use formal credit are: ... because of high transaction costs involved in applying for a formal sector loan. The latter reason may explain why farmers prefer to obtain credit from informal sources (moneylenders, trader/suppliers, friends). In the informal sector, simple, low-cost credit delivery systems often more than offset higher interest costs."

The informal sector further minimizes the collateral requirements. Depending on the provider of the informal credit, the approval decision is based primarily on the character and personal reputation of the borrower, rather than on receipt of tangible assets. In other words, friends and relatives and the church may be less likely to require collateral, whereas the money lenders, suppliers, landlords and others typically request liens on crops. (See: Table A.1 of the Benito Technical Report No. 130 for more detail.)

Land, houses, and personal property in the rural areas are less likely to be used as collateral because of their dubious value and difficulty of liquidation. Particularly, titles do not often exist for many parcels of land and property. This complicates any efforts at perfecting liens.

3. Observations.

In general, the rates of interest paid by the small farmer, cooperative and rural entrepreneur are not unreasonable. They should be paying market rates rather than receiving subsidies. The biggest problem to overcome is involving the private (formal) sector in this market segment; convincing them that the risks of, and costs to manage these smaller sized credits are not so high that they cannot make a decent profit with minimal delinquency.

The interest rate structure in the formal sector does not normally reflect risk, i.e., the banks and finance companies do not

necessarily base the interest rate to be charged on the loan to the amount of risk they are accepting, but rather based on what the market dictates and the client is willing to pay.

Normally, the interest rate is higher when the loan is risky and when the term is longer. Because of the competitive nature of the banking system in El Salvador, banks try to maintain their good client base. Otherwise the customer would change to a more responsive institution. The effect on interest rates reflects this competition.

I. SUPPLY AND DEMAND FOR CREDIT

From all indications, there are sufficient resources within the financial system to meet the needs of the borrowers. Although the situation may change from day to day, the private sector financial institutions do not seem to be actively seeking new deposits. Otherwise, they would be offering higher rates. The Central Bank's *1993 Memoria de Labores* showed that the nominal interest rates for 180 day deposits ranged from about 16% at the beginning of the year, falling to about 14% by year's end.

An analysis of the commercial banks' total deposits at 12/31/93 showed a balance of 19.8 billion colones, compared to 15.5 billion at 12/31/92. This was an increase of 4.3 billion or 28%. Approximately 15.1 billion of the deposits at 12/31/93 were in savings accounts and time deposits. [Source: Central Bank's "Revista Trimestral," April - June 1994.]

On the asset side of the balance sheet, the commercial banks ended the year 1992 with private sector loan volume of 12.2 billion Colones. By November 1993 it reached 12.7 billion, then jumped to 14.4 billion in December, an increase of 2.2 billion or 18%.

Except for the noticeable change in December 1993, private sector loan volume was fairly flat. Nevertheless, deposits showed a rather steady increase during the whole year.

The finance companies showed a combined savings deposits balance at 12/31/93 of 4.2 billion Colones, up from 3.5 billion on 12/31/92. This represented an increase of 700 million or 20%. On

the asset side, their loans to the private sector rose from 2.9 billion Colones at 12/31/92 to 3.6 billion by 12/31/93, representing an increase of 700 million or 24%.

From 12/31/93 to 3/31/94, finance company deposits fell to 3.1 billion, while loans fell to 2.8 billion. From the data, it appears that the finance companies manage their asset and liability positions very closely. Without having more information, one might say that the loan demand was declining so they did not attract new deposits.

Summarizing these data, one could assume that either loan demand was weak or the banks and finance companies were selective in the loans they made. Deposit volume seemed to be controllable, especially considering the decline in interest rates paid on deposits from January to December 1993.

What does this mean for the small producer, cooperative and rural entrepreneur? One conclusion is that the private, formal financial sector is not willing to accept additional risk by extending credit to that potential client base, even though they can obtain the funds in the open market. If this is true, then the only source of funding is from the informal sector.

J. CASH FLOW vs. COLLATERAL LENDING

The formal sector in El Salvador has been noted for being primarily collateral lenders. Since the implementation of the reform program and the privatization of the solvent banks, the quality of the banks credit structuring, review, approval and administration has been improving.

Borrowers are now being asked to present annual financial statements of condition (preferable audited), as well as budgets, feasibility studies and cash flow projections for term loan requests. If the project or loan request appears financially feasible, the bank will generally approve the credit, provided that the borrower is credit worthy, has a good credit history, and pledges sufficient collateral to support the amount. A collateral value to loan ratio on the order of 1.5 times to 2 times is common.

Effectively, the banks consider the cash flow a the means of determining whether there is a repayment capacity, and the source. Nevertheless, the final approval and disbursement is contingent on adequate tangible collateral.

Therefore, any small producer, cooperative or rural entrepreneur that can put up collateral to support a credit request stands a better than average chance of having the loan approved, provided that all other aspects of the request are in order.

K. RECOMMENDATIONS

Given the current situation in El Salvador of minimal competition in the formal financial sector, it will be difficult to change the mentality of the banks without government intervention, i.e., regulate that a certain percentage of their credit portfolio be placed with a specific interest group (for example, small farmers, small farmer cooperatives, small rural entrepreneurs, cottage industries, small retailers, etc.) This is a possible near term solution, but would require substantial political clout to get implemented.

Over the longer term, existing formal financial sector institutions will expand their operations and branch network, thereby increasing the competition among themselves. Secondly, new institutions will enter because of the potential for profits. The combination of these two factors will exert pressure on the institutions to be more efficient and set their sights a little lower, in order to maintain a customer base large enough to support their desired level of operation.

The ideal situation for rural finance in El Salvador would be to have the majority of the credit (and savings) managed by the private sector -- commercial banks, finance companies, and informal institutions like the cooperatives, credit unions, and to some extent the *cajas rurales*. This, of course, implies that they have reached a level of development, sophistication, professionalism, and stability to properly attend to the needs of the market. The international donor organizations, PVOs/NGOs, and other minor segments of the informal sector should only be considered as interim vehicles in the process of economic and financial

readjustment and stabilization. Competition will then keep the system honest.

A rural finance specialist, with a strong credit background, should be part of the implementation project to assist the formal financial sector in how to evaluate risk and modify their credit policies to allow for more (and safe/sound) loans to the rural sector. Included would be appropriate recommendations on how to minimize the transaction costs of servicing smaller credits.

Technical assistance and training of the small farmers, cooperatives and rural entrepreneurs in how to manage their businesses and work with private sector financial institutions to develop a good reputation is also needed. In other words, the constituent group must be brought up to the professional standards expected of any other functioning business if they want to compete in the local or regional economies.

By working with some of the informal sector institutions, such as the large suppliers, second tier cooperatives, credit unions and cajas rurales, the small farmers and rural entrepreneurs can gain experience in managing their finances and operating their businesses. They can then begin in the formal sector by opening checking and savings accounts, demonstrating that they can handle their finances, and gradually move up to requesting small, secured loans.

Again, we must not forget that the country is emerging from a very difficult period, both with the civil war and with the near bankruptcy of the private sector financial industry. It will take some time to return to normalcy.

A consolidated list of recommendations for the design team is contained in the appendixes as Appendix 7. It summarizes in one page all of the follow up issues presented in this paper that the design team should consider.

A P P E N D I X E S

PRIVATIZED BANKS

The following commercial banks have been privatized and will take loan applications for agriculture and agroindustrial projects, private enterprise needs (commerce and retail), and consumer credit.

<u>NAME</u>	<u>CONTACT PERSON</u>	<u>TELEPHONE</u>	<u># RURAL BRANCHES</u>
Banco Agrícola Comercial	Ing. Ricardo Benek, Sub-gerencia de Crédito Agropecuario	279-4522 279-4542 223-4566 (fax)	12
Banco de Comercio de El Salvador "Ban Co"	Ing. Vicente Serpas, Jefe del Depto. Agropecuario	271-4144 223-1761 224-3238 (fax)	12
Banco Cuscatlán	Ing. Jorge Zelaya, Gerencia Agropecuaria	298-2022 228-6851 228-6853 (fax)	5
Banco Desarrollo	Ing. Rubén Echegoyen, Sub-gerencia de Crédito Agroindustrial	224-0511 224-3967	7
Banco Hipotecario de El Salvador	Ing. Orlando Rodríguez, Sub-gerencia de Crédito Agropecuario	298-0449 298-3344 279-1270 (fax)	7
Banco Salvadoreño S.A.	Ing. Mario Barahona, Sub-gerencia de Crédito Agropecuario	222-2144 271-4455	11
Banco de los Trabajadores	Lic. Efraín Fuentes, Gerente General	225-5347 225-6305	
BANFIDEX	Lic. Guillermo Belloso, Gerente de Créditos	298-5777 298-0772	0

PRIVATIZED FINANCE COMPANIES

As part of the reform, stabilization and strengthening of the financial institutions in El Salvador, the finance companies were also included. Through early 1994, the four institutions listed below have been privatized. Additional research remains to be done to determine specifically what products and services they offer, and to whom.

If any are involved in the small producer or rural entrepreneur sectors, their names will have to be noted. A principal contact person and telephone / fax numbers should be further documented.

- AHORROMET
- ATLCATL
- CASA
- CREDISA

For the sake of classification, the following institutions have been included under finance companies. They offer rural credit.

<u>INSTITUTION</u>	<u>CONTACT PERSON</u>	<u>TELEPHONE</u>
FEDECOOPADES		298-2705
FIDECOOP	Lic. Antonio Baños	298-2740 fax
Fundación Obrero Empe- sarial Salvadoreña "FOES"	Dr. Eduardo Tenorio	223-3972 223-1611
Servicios Crediticios AMPES/GTZ	Ing. Juan Buchenau	298-6346 298-6755 fax
UCRAPROBEX	Lic. Néstor U. Palma	278-0064

INFORMAL SECTOR ENTITIES

The following list of informal sector entities has been adapted in part from the APAP II Technical Report No. 134 by Carlos Benito, dated September 1993, and based on the "Land Tenure Survey of El Salvador, 1993." The list has been expanded to include entities that also extend credit to the small rural enterprises.

- Private lenders
- Friends and relatives (local and international)
- Suppliers
- Churches
- Cooperatives
- Credit Unions
- Community banks / village banks
- PVOs / NGOs
- Purchasers
- Others

NON-GOVERNMENTAL ORGANIZATIONS

Of the many Private Voluntary (PVO) and Non-Governmental (NGO) Organizations operating in El Salvador, the ones listed below are known to extend credit in the rural economy.

<u>INSTITUTION</u>	<u>CONTACT PERSON</u>	<u>TELEPHONE</u>	<u>RURAL BRANCHES</u>
ASAI	Lic. Luis Castillo	224-3310 279-1813	Zacatecoluca
CODECOSTA	Mr. Antonio Rodríguez	226-6070 226-9834	Usulután
CONCORDE	Ing. Roberto Cruz	661-0321 661-6480	San Miguel
CORDES		225-2547 fax	
CREA	Mr. Harold Sibaja	224-2020	

INTERNATIONAL DONOR ORGANIZATIONS

The following are the more important international donor organizations operating in El Salvador. The types of rural finance programs that they promote, or are involved in, are listed in the second column. Where a contact person is known, their name is indicated in the third column.

<u>ORGANIZATION</u>	<u>PROGRAM(S) OFFERED</u>	<u>CONTACT</u>
Canadian Co-operative Association "CCA"	Agricultural credit; Agricultural product marketing.	Ing. Jorge Garza
CARE/CAS	Sustainable agricultural credit.	Mr. Jorge Simán
Cooperación Suiza	Development of traction animals; Postharvest program; Productive agricultural projects.	
European Economic Community "EEC" (Comunidad Económica Europea "CEE")	Productive agricultural projects; Agricultural sector development.	
Fundación Conrad Adenauer	Social and productive development of Cooperative sector.	
Fundación Finlandesa "FINNIDA"	Social and productive development of Cooperative sector.	
Fundación Internacional para el Desarrollo Alimentario "FIDA"	Agricultural credit; Agricultural product marketing.	Lic. Rubén Alvarez
Instituto Americano para el Desarrollo del Sindicalismo Libre "IADSL"	Productive agricultural projects through peasant organizations.	
Inter American Foundation "FIA/DEICO"	Productive agricultural projects.	Mr. Maldonado
Programa Mundial de Alimentos "PMA"	Food exchange support.	
Programa para el Desarrollo "PRODERE"	Productive agricultural projects.	Mr. Carlo Venturello
United Nations Development Program "UNDP"/PNUD	Agricultural credit, training and research.	

PUBLIC SECTOR FINANCIAL INSTITUTIONS

The following public sector financial institutions have not been privatized, but are involved with making or facilitating agricultural and/or agroindustrial loans, private enterprise credit, etc.:

<u>NAME</u>	<u>CONTACT PERSON</u>	<u>TELEPHONE</u>	<u># RURAL BRANCHES</u>
Banco de Fomento Agropecuario	Lic. Juan Martínez M. Gerente de Créditos	279-2791 228-4698 228-4924 (fax)	26
Federación de Cajas de Crédito "FEDECREDITO"	Lic. José María Arévalo Jefe del Depto. de Créditos	225-5551 (fax)	52

RECOMMENDATIONS FOR DESIGN TEAM

To assist the design team in its efforts to prepare the CRECER activity paper, and appropriately cover the rural finance area, a follow-up list of recommendations/additional information needed is detailed below. It was extracted from the body of this technical paper and summarized here.

1. Gather a listing of the rural cities where each privatized bank maintains a branch office, to generate a larger picture of the penetration of the formal financial services industry.
2. Investigate whether the Banco de Comercio and other banks: 1) extend credit to small rural businesses, and 2) utilize the other BMI guarantee fund "Fondo de Financiamiento y Garantía para la Pequeña Empresa."
3. Spend a little time interviewing some or all of the finance companies, to assemble information based on the questions proposed in section C.2 of this paper.
4. Contact at least two or more of the privatized finance companies and document their position regarding their interest in, and possible financial assistance and other services to the rural small farmer, cooperative and small business segment of the economy.
5. Obtain information of the other "finance" companies referred to in section C.2.2.
6. Follow up on the NGO contacts listed in the Appendix, to develop an information base on each NGO, as well as identifying others who may be active players in the rural financial markets.
7. Gather baseline data on any other PVO/NGO (providing credit to the rural sector) that may have been identified as a result of the initial research, and attempt to secure answers to at least the questions posed in section D.1.
8. Gather more data, through additional research or via interviews with a sample of small rural entrepreneurs, on how much they access credit and other financial services from the informal sector, for what purposes, and at what interest rates. Are they able to obtain adequate financing to meet their projected needs?
9. Provide information on the cities where the international donor organizations operate (or have offices) and whom they assist.
10. Assemble a listing of the locations of the rural branches of both the BFA and FEDECREDITO, to determine the extent of their

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penetration in the rural finance arena.

11. Interview the BMI to determine their position on assisting the small producer, entrepreneur and cooperative.

12. Attempt to obtain more information on the FIGAPE guarantee mechanism, primary users (institutions), and beneficiaries.