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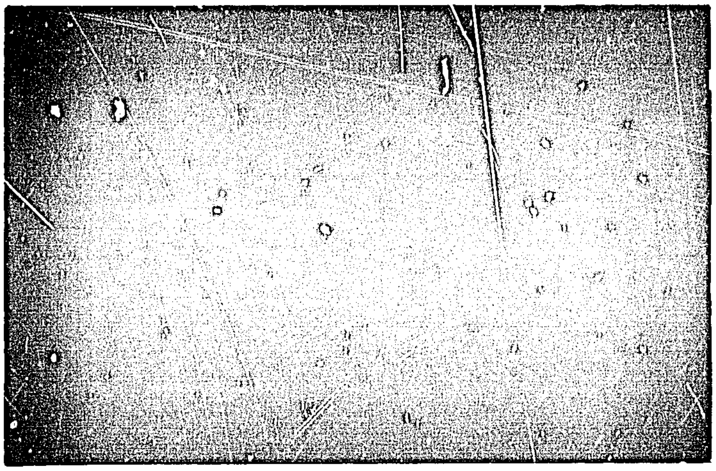

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THE POLITICAL ECONOMY OF BOLIVIAN AGRICULTURAL CREDIT

by

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THE POLITICAL ECONOMY OF BOLIVIAN AGRICULTURAL CREDIT

Jerry R. Ladman and Ronald L. Tinnermeier

Introduction

Agricultural development in less-developed countries (LDCs) has been given an increasingly prominent role since World War II. As a result a number of institutions and policy measures have been established in LDCs to foster rural development. At first, emphasis was directed to the broad goals of increasing production of export goods or import substitutes. Recently, when it became obvious that such policies left most of the rural poor virtually outside the orbit of development, more attention was aimed at policies to directly benefit the rural poor or small farmers. [1]

Agricultural credit has always been a cornerstone in these programs. It is argued that farmers need additional capital in order to adopt technologically superior inputs and to expand production. Thus domestic governments and donors of foreign aid alike have allocated significant sums for agricultural credit programs.

This paper argues that although such programs are conceived as being fundamentally economic in nature that they were initially designed by LDC governments in part for political purposes and that their operational characteristics provide a heavy political component. There are two basic reasons.

First, the government typically controls the formal market supply of agricultural credit. Much credit flows to agriculture through government agricultural development banks. Most which comes from the private sector formal market only comes about as a result of government policies which force lending to agriculture.[2] Therefore, the government has the ability to strongly influence the distribution and allocation of credit. Second, the concessionary interest rate policy, which is almost ubiquitous in LDC agricultural credit programs, provides for an attractive concessionary income transfer to borrowers. Third, when the government permits long-term delinquency and default, a common condition in LDCs, the borrower receives a default income transfer. The advantages of obtaining these transfers are sufficiently attractive that they can be used by the government to curry the favor of borrowers and, conversely, by borrowers to pledge support to the government. Thus there is a political economy of agricultural credit. The extent to which economic decisions are influenced by political factors, or vice versa, is difficult to ascertain in practice. It is becoming increasingly clear, however, that not only is there the potential for political forces to impact heavily on agricultural credit programs, but also that they probably play a more important role than has been previously recognized.[3] Bolivia is a case in point.

This paper first describes the evolution of the institutional and policy structure of credit programs in LDCs. The role of foreign aid is emphasized. Second, a model of the political economy of agricultural credit is specified. Third, the model is applied to Bolivia. Fourth, conclusions and policy implications are set forth.

THE EVOLUTION OF THE INSTITUTIONAL AND POLICY STRUCTURE

Throughout history in developed countries (DCs) and LDCs alike the private sector has shunned lending to agriculture because of the higher costs and risk embodied in these loans compared to alternatives in commerce and other sectors. Thus pressures were placed on governments to provide alternate sources of financing. The solution has been to establish government agricultural banks. In the case of LDCs many countries had established these banks prior to the postwar emphasis on development. Typically, however, with some notable exceptions such as Mexico, they were utilized to finance the already established and oftentimes wealthy farmers rather than small farmers. It can be argued that the political influence of this rural clientele pressured the governments into establishing these banks. In the case of Mexico it was the ejidatario, however, in most countries it was the more prosperous large farmer.

In the development decades of the 1950s and 1960s many other countries established government agricultural banks in response to economic and political pressures for development. From an economic view the passivity of the agricultural sector dictated a supply-leading financial approach.[4] From a political view agricultural development, or at least the opportunity for development in subrural sectors or regions, was stabilizing.

When it became obvious that governmental institutions could not meet the needs of financing agriculture, means were sought to force the private sector to lend to agriculture. The typical measure was to employ the power of the central bank. Often the central bank forced commercial banks to maintain at least a minimum percentage of their loan portfolio in agricultural loans. Also the central bank typically provided special lines of credit to discount the agricultural paper of the banking system.

Almost without exception all of these agricultural credit programs incorporated a feature transferred from the United States Farmers Home Administration program credit model; e.g., the concessionary interest rate, because, from an economic standpoint, it provided elements deemed very appropriate to the conditions of LDCs.[5] The concessionary transfer, the income transfer due to the concession, was justified on grounds to encourage the use of the more capital-intensive technologically superior inputs, and to compensate the farmer for: the inherent risks in agriculture due to yields and product prices, the paucity of cost-reducing infrastructure in the countryside, the past injustices done to farmers by moneylenders, and low product prices imposed by the government to protect the interests of urban wage earners.[6] Little attention has heretofore been directed, however, at the tremendous political leverage that the concessionary transfer offers. Upon reflection, however, it is difficult to imagine that both government officials and borrowers did not quickly perceive the inherent power in the instrument.

The foreign influence in formulating and abetting the whole system and policy structure is apparent. First, most institutions and policies were adopted in LDCs based upon the received doctrine from the DCs, often with the advice of foreign advisors. Second, bilateral and multilateral donors of foreign aid have made considerable loans for agricultural credit programs which have been fed into this institutional structure and policy framework.[7]

A MODEL OF THE POLITICAL ECONOMY OF AGRICULTURAL CREDIT

It is clear the institutional structure of agricultural credit in LDCs was created in response to both economic needs and political objectives. Moreover, that the present structure easily permits government sway over the distribution and allocation of credit for both economic and political reasons. Now it remains to carefully specify the importance and possible consequences of the concessionary transfer and other income transfers in the political economy of agricultural credit.

Figure 1 presents a countrywide demand curve, DD', for agricultural credit.[8] Assume that the prevailing annual nominal rate of interest for

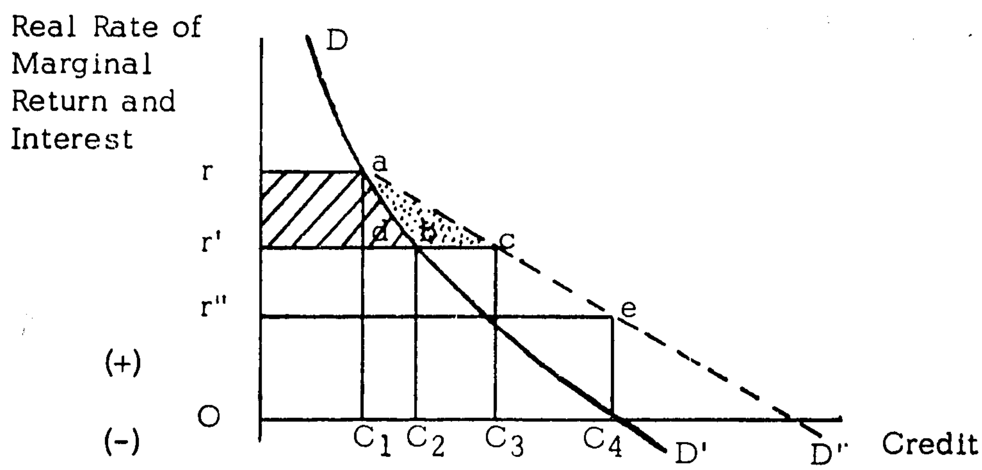

FIGURE 1. Kinked Demand for Agricultural Credit

nonagricultural loans is r. If farmers were to borrow money at this rate they would want to utilize OC_1 credit. Suppose, however, that the government subsidized agriculture by means of a concessionary interest rate policy for agricultural loans; a concession of three to ten points is common. If the rate were r' then farmers would want to borrow an additional amount, C_1-C_2, for agricultural purposes. In the process they would receive a subsidy or income transfer; i.e., the concessionary transfer, of r'rab if nonprice credit rationing was not employed.

There is an additional effect, however, which adds to the demand for agricultural credit. Credit is fungible, and although borrowed ostensibly for agricultural purposes it can be diverted to nonagricultural activities. The result is agricultural illusion--a situation where some agricultural loans have the appearance of going to that sector but in fact are directed to nonagricultural purposes such as consumption or investment in other sectors. This would be expected in particular among farmers who have multiple occupations and/or knowledge about other investment opportunities. The effect of agricultural illusion is to cause an additional demand for agricultural credit. The addition of this demand to DD' causes a kink in the new demand schedule at r to form a new demand for "agricultural" credit of DD". Thus, at the concessionary rate r', the concessionary transfer becomes r'rac.

When inflation is present, a situation common to LDCs, the real rate of interest may be quite low or even negative. The effect is to enlarge the income transfer by an additional inflationary transfer. For example, assume the real concessionary rate was r", borrowers would then gain an inflationary transfer of r"r'ce.

Clearly the concessionary transfer, and if inflation is present the additional inflationary transfer, is to be coveted. Therefore, a government with its control over agricultural credit institutions can use it to induce certain types of economic activity and/or to reward certain behavior among borrowers. Moreover, borrowers in their competition for access to and their share of the transfer, will undoubtedly be willing to bargain with the government to have access to this credit. Thus, there is an interplay between the government and farmers in which political factors may take on considerable importance. In the cases of authoritarian governments, typical of most LDCs, such an interplay takes on increasing importance the weaker the government since the government will find it more necessary to garner and maintain clientalistic support in the economy.

Similar motives and interplay create another possibility for an income transfer due to defaulting. This default transfer is equivalent in real terms to the real amount of the loan plus interest payments less any real amount repaid on the loan and interest. Note it is independent of the concessionary or inflationary transfers. The default transfer may be temporary or permanent. It is temporary when a loan is considered delinquent but will be repaid in a period of months or even years. It is permanent when the loan is truly defaulted and no future repayment is expected. Even a temporary transfer is of economic value, particularly when inflation is present and reduces substantially the real value of the loan when repaid.

In fact heavy delinquency and default rates may be symptomatic of the degree of political factors that have entered into the loan. When the government does not take the legally available measures to bring pressure on the borrower to repay indicates an unwillingness to bear the economic and/or political costs that such action would incur. Moreover, when political factors rather than economic considerations determine a loan it is to be expected that higher delinquency and default rates would occur.

The sheer existence of the concessionary transfer and the possibility of an easy default transfer creates a potential for corruption. Government officials, if they are securely ensconced and not subject to a public auditing, could easily appropriate part of the transfer for themselves by directly or indirectly lending to themselves, or by receiving kickbacks from borrowers.

Consequences

The consequences of using credit as a political instrument will vary depending on the specific situation in any country. It is possible, however, to draw generalizations about expected consequences in four areas: resource allocation, economic development, income distribution and financial institution viability.

The concessionary interest rate policy leads to a nonsocially optimal allocation of credit, other resources, and the production of goods in society unless there is an effective means of nonprice rationing. Experience demonstrates, however, that nonprice rationing schemes are difficult to enforce. To the extent that political factors intervene the schemes are even more unworkable. In terms of Figure 1 a nonprice rationing scheme would limit the concessionary transfer to r'rad. Thus political factors contribute to a misallocation of resources not only in agriculture but also between sectors. If inflation is present, the additional inflationary transfer makes political motivation even more attractive and exacerbates the resource allocation consequences, for example, as it may encourage speculative investments and inventory stockpiling as well as capital flight as components of agricultural illusion.

There will be additional indirect impacts of credit allocation on the balance of payments, government expenditures and revenues, price stability, rural-urban migration, sectoral development and economic development in general. It is beyond the scope of this paper to pursue these consequences. It should be noted, however, that there is increasing evidence that an agricultural development strategy based on small-farmer development provides a better approach to overall economic development than that which concentrates on large farmers.[9] Where this holds, political factors which direct credit to small farmers in combination with other services such as extension, new technology and improved markets will provide more social benefits than those which favor large farmers.

Clearly access to the concessionary transfer will effect income distribution.[10] Those who receive it as a result of borrowing or corruption will gain at the expense of others. In terms of Figure 1 the amount to be transferred with effective nonprice rationing is r'rad. Without effective rationing and agricultural illusion there is an additional gain of dac. Clearly, inflationary conditions will increase the benefits of those who receive the transfer. If delinquency or default occur, the income transfer is even greater. The net result under any combination of the several transfers is that the borrower gains income at the expense of the taxpayer or saver whose money is utilized to provide credit. Moreover, the borrower will gain income relative to those who have no credit or who borrow at true market rates of interest.

Political lending will lead to lesser revenues for credit institutions due to extensive delinquency default inherent in such loans. This in combination with the well-recognized high costs of administering agricultural credit programs, will seriously jeopardize a credit institution's financial viability. The result is that to maintain or increase its loanable funds the institution must be subsidized by the government or obtain foreign loans or assistance. Without these props the institution's financial resources would soon dry up. It is clear how the subsidy and foreign aid can be used to further political as well as economic objectives with all the attendant effects on resource allocation, income distribution and economic development.

The Role of Foreign Aid Donors

Foreign economic assistance programs contribute to the use of credit as a political instrument in two ways. First, they have promulgated the policy of concessionary interest rates with the direct effect of creating a concessionary transfer. Second, they have provided considerable economic assistance for agricultural credit programs. As a consequence they have been a contributor to the use of credit for political purposes. This is particularly true where loans have been made for general agricultural sector development, where credit typically flows to the larger and more sophisticated farmers and agricultural illusion takes on large dimensions. However, even in cases where foreign aid funds are earmarked for small farmers the additional funds simply increase the size of the total portfolio and perhaps even permit some substitution for other funds previously directed to small farmers thus releasing them for other purposes including political.

Can't Interest Rates Be Raised and Default Reduced?

The obvious solution, from an economic view, to prevent all these distortions is to raise interest rates and decrease default. There is increasing evidence that the conventional wisdom of concessionary rates is wrong. Policymakers in foreign assistance institutions and governments are now privately advocating this change on economic grounds. The private and government banking communities have long recognized the advantages of higher rates as a means to increase revenues, decrease defaults, and render their institutions more profitable. Why, then, have policies of higher rates not been put into effect? Furthermore, why don't many lenders use their legal powers to limit default? The answer is clear: the political cost is too great. First, governments would lose attractive elements available to them to bargain for political support. Second, farmers accustomed to the concessionary transfer and default transfer would stand to lose substantially. In particular, the impact would fall on the larger farmers with access to alternative investment-consumption activities. The bottom line is that most LDC governments do not see it in their political interests to either give up their options for a political weapon or to suffer the protests and resultant instability that is to be expected from raising interest rates or more stringently controlling default--a further verification of the political importance of agricultural credit.[11]

THE CASE OF BOLIVIA

In this section the above model is applied to Bolivia over the 1966-1975 period. To put the discussion in context, a brief overview of the political and economic situation of the country in the last several decades follows.

The Recent Situation - An Overview[12]

In 1952 the MNR (National Revolutionary Movement) Party undertook a revolution which was to provide a considerable social and economic change in that country. The MNR had middle-class support and remained in power twelve years. During that time it carried out an extensive land reform program, nationalized the three major tin mining companies, began to develop the tropical Oriente (eastern lowlands) and, in general, liberated the Indians. Between 1964 and 1971 Bolivia had three military governments. The third, the pro-communist government of General Juan José Torres, was overthrown in August of 1971 by a military junta led by General Hugo Banzar who assumed the presidency. His moderate authoritarian government was able to provide a sufficient political coalition of diverse interests to give the country relative stability. This, in combination with the opportunities in the economic boom of Oriente, provided the country a period of unprecedented economic growth in modern times until he was overthrown in July, 1978, following elections which had been nullified on account of fraud.

The most salient aspect of Bolivian agricultural growth since the revolution has been the development of the Oriente. The region not only had major deposits of petroleum but also offered considerable potential for agricultural and livestock production. The first highway to the region from the highland urban centers was opened in 1953. Early thereafter sugar and rice production quickly expanded, was marketed in the highland urban centers, and contributed substantially to import substitution of basic foodstuffs. Later cotton was introduced as an important export crop. Livestock production flourished. Most of the agricultural growth took place on large land holdings: some held by a few long-time residents, others by immigrants. Very few properties were subjected to land reform. In addition, there was a considerable amount of government-directed colonization on smaller farms by settlers from the highlands.

Meanwhile, agricultural development in the rest of the country received relatively little attention from the government once the land reform process was completed. Traditional crops were grown using time-worn technology. Few programs reached the masses of Indian farmers in the highlands; most resources that went to agriculture were directed to the

Oriente. Over the period of 1960-1971 an average of only 3.1 percent of total government expenditures went directly to agriculture. Most went to mining, petroleum and infrastructural development.[13]

The Political Economy of Agricultural Credit

Institutional and Policy Structure. In 1942 the Agricultural Bank of Bolivia (BAB) was founded in order to provide credit to agriculture, to carry out banking and commercial operations and to import agricultural inputs. At this time its clients were basically the larger well-established farmers. Following the 1952 revolution BAB was reorganized in 1954 in order to provide credit to the campesinos, or beneficiaries of land reform. In spite of a special U.S. assistance program to carry out this mission the campesinos received only 10 percent of the loan volume and 30 percent of the loans.[14] Corruption and administrative problems plagued the bank--problems which were to remain, albeit on a lesser scale, up to the mid-1970s. Donors of foreign aid used their leverage to try to straighten out the situation by causing BAB to undergo successive administrative reorganizations as conditions to receiving additional loans. Such reorganizations were undertaken in 1954, 1963, 1974 and 1976. With the 1963 reorganization BAB discontinued all banking services except credit.

BAB was virtually the sole source of institutional credit to agriculture in Bolivia prior to the mid-1960s. In 1967 it accounted for 90 percent of the total. Their share of an increasing flow of credit to agriculture declined thereafter such that by 1975 BAB was responsible for only 57 percent.[15] The decline was due to a Central Bank (CB) policy instituted in 1967 which required commercial banks to keep a larger proportion of their loan portfolios in agricultural paper. To back up this policy a number of special lines of credit to agriculture were set up at the CB to be used to discount commercial bank agricultural loans. The more important special lines came as foreign aid. Much of the sharp increase in commercial bank lending to agriculture came from the government owned State Bank (BDE); over the 1973-1975 period this institution accounted for almost two-thirds of the commercial bank loans.[16] Thus, it is clear that between BAB and BDE government institutions directly controlled at least 80 percent of the institutional agricultural credit in the country.

The concessionary interest rate is the cornerstone of Bolivian agricultural credit policy. Between 1966 and 1975 there was a government-established six to nine point spread between commercial bank interest rates for commercial and agricultural loans. Furthermore, over the same period BAB clients received at least another six point concession.[17]

The Role of Political Factors

Thus, the combination of government control and influence over agricultural credit institutions and concessionary interest rate policy suggests that the system is vulnerable to political factors. In order to examine this possibility it is necessary to first examine data on patterns of credit distribution and repayment.

In a word, credit distribution in Bolivia in recent years can be described by "*Oriente*." Over the 1964-1974 period 76 percent of BAB credit was directed to the Department of Santa Cruz and another 9 percent to Beni, both in the *Oriente*.[18] Major products financed were cotton, sugar and rice in Santa Cruz and beef in Beni. Loans made with CB discounts were also directed to the *Oriente*. A conservative estimate is that at least two-thirds of all CB discounts to commercial banks and BAB went to Santa Cruz and another 4 percent to Beni.[19] Data on farm size are incomplete but, given the regional skewedness of the *Oriente*, it can be concluded that large farmers have received a majority of the credit.

Loan delinquency is a major problem in Bolivian agricultural credit use. BAB's delinquency rate climbed steadily from the high teens in the late 1960s to about 50 percent in the mid-1970s. If many delinquent loans had not been refinanced the rate would have been higher. In 1976 more than a third of BAB's portfolio had been refinanced; many loans had been refinanced several times.[20]

Analysis of State Bank data showed that 76 percent of soybean loans made from 1972 to 1976 were delinquent. Comparable figures for wheat, dairy, swine, corn and rice were 44, 48, 20, 66, 31 and 17 percent, respectively.[21]

Strong economic arguments can be made to explain the highly skewed distribution of credit towards the *Oriente*. First, the region was undoubtedly viewed by the government and foreign donors as the best place to gain rapid increases in output of not only many basic food products but also export products. In part this was due to the external economies created by massive foreign assistance in the development of a transportation infrastructure. Second, once the Santa Cruz-Cochabamba highway was opened, the production of these products could help solve Bolivia's seemingly ever-present balance of payments problem. Inputs could readily go into the region and products could be shipped to population centers to substitute for food imports and for export.

Geopolitics may also have been a factor. The government wanted to develop the region to not only lay a definitive claim to its hydrocarbon and agricultural resources but also to provide a buffer zone against possible encroachment by its eastern neighbors, particularly Brazil.

Internal politics may also, however, explain some of the extensive distribution of credit to the region. In accordance with the model the coexistence of predominantly government controlled credit institutions and a policy of concessionary interest rates for agricultural credit provide a basis to facilitate the use of political motives in distributing credit.

It is clear that the government did not heavily rely on credit as a political weapon to gain the support of the campesino in the Altiplano and highland valleys. Virtually no credit was directed to the numerous peasants in the Altiplano. Although considerably more was directed to the mountain valley regions of Cochabamba and Tarija, many funds allocated to these areas went to medium-sized farmers or the capital-intensive livestock, orchard, poultry and vegetable farmers; persons who are not typically classified as campesinos. Thus either the government has not viewed it in its best economic nor political interest to use credit for the development of campesinos in the highlands, or political considerations elsewhere were overriding any economic advantages in the highlands. Indeed, it was only after 1974 that the BAB and CB began making special and extensive efforts to direct credit to the small farmer as a result of pressures from foreign assistance donors.[22]

In contrast, in recent decades the rapid growth of the Oriente created an elite power base in that region composed of large farmers and businessmen which rivals the traditional elite of La Paz. President Banzar came from the region and depended upon that elite as a base of power. With the long history of political instability that Bolivia has, and is currently experiencing, it is clear that Banzar and his predecessors had to work closely with the Santa Cruz elite in order to keep their fragile governments together.[23] Given the agricultural base of the region, agricultural credit and its implicit concessionary transfer was a logical vehicle for both governments to offer and for the elite to demand in order to maintain this important base of support. The above data suggest that it was used in this manner. First, the sheer volume of credit flowing to the Oriente to the neglect of other areas is highly suspect. It is doubtful that the marginal returns to credit in the Oriente were higher than those in other regions.

Second, the high delinquency rates in the Oriente strongly suggest that many farmers are practicing agricultural illusion in nonproductive activities, or at least those that do not have a short-term payout; or simply are not repaying because they feel little obligation to do so. In either case they are capturing a temporary or long-term default transfer. It is widely said in the region that many large farmer recipients of agricultural credit are using their funds in nonagricultural investments at home and abroad as well as using them for consumption expenditures. The cases of delinquent soybean and cotton loans illustrate how the government has not pressed for repayment, which might be taken as an indication of trying to curry the favors of the borrowers.

Nearly 21,000 hectares of soybeans were financed in Santa Cruz under the discounts financed by the First Agricultural Refinancing Credit Line held by the CB. Discounts were made to BAB, the BDE and private commercial banks. The average number of hectares financed per loan was 104. Over the 1972-1976 period the BAB and the State Bank recovered only 5 and 30 percent of their soybean loans, respectively, whereas the private commercial banks recovered 65 percent.[24] This suggests that the governmental institutions either did not select their clients as carefully as private banks on economic grounds and/or did not pressure the farmers for repayment. In either case it implies that political considerations did come into play. Nevertheless, a contributing factor to poor repayment was an excess supply which drove down bean prices.

BAB began to finance cotton heavily in Santa Cruz beginning in 1972. From the outset they experienced high delinquency for the crop which explains the sharp jump in BAB's delinquency beginning that year. In part this was due to inexperience with the crop and natural disasters. In 1973 BAB and commercial banks financed more cotton and ADEPA (The Cotton Growers Association) made forward contracts to sell their cotton on world markets. The world price continued to rise and surpassed the forward price. ADEPA refused to sell at the forward price and asked the world price. The contracting cotton merchants would not pay more than the forward price. The government backed ADEPA but to no avail. The cotton went unsold and delinquency for all lenders soared. Eventually, the government implicitly absorbed the debt of private banks by indirectly transferring those from these institutions to BAB. BAB has held these loans as delinquent as well as those financed by itself and does not expect to be repaid. Clearly political factors were predominant, and at the expense of BAB's portfolio.

The bottom line of the above is that in Bolivia there were substantial concessionary and default income transfers that gave agricultural credit its potency as a political tool. It should be noted, however, that inflation also contributed to this potency. With the annual rates of inflation shown in Table I it is clear that the real rate of interest was at least 28 percent less than the nominal rate in all years except in 1968. In the postdevaluation period of 1972 and 1973 the real rate was -.14 and -.29 percent, respectively, for BAB loans.[25] Thus in all years there was a substantial inflationary transfer to sweeten the attractiveness of borrowing and enhance the political potency of agricultural credit.

TABLE I

GENERAL CONSUMER PRICE INDEX - LA PAZ
1966 = 100

Year	Index	Annual Percent Change
1966	100.00	
		11.2
1967	111.18	
		5.5
1968	117.28	
		2.2
1969	119.88	
		3.8
1970	124.53	
		3.7
1971	129.11	
		6.5
1972	137.51	
		31.5
1973	180.83	
		62.8
1974	294.43	
		7.9
1975	317.92	

Source: Banco Central de Bolivia, Gerencia Técnica, Estudios Económicos y Estadística, <u>Boletin Estadístico</u> No. 220, Marzo, 1976, La Paz Bolivia

Foreign Aid

Foreign assistance to Bolivia for agricultural credit purposes has been substantial. Between 1966-1976 over 92 million U.S. dollars were committed to Bolivia for this purpose. Of this amount 41.4, 22.8, 9.5, 19.5 and 6.8 percent came from the United States Agency for International Development, World Bank, Inter-American Development Bank, Banco do Brazil and other sources, respectively.[26] Almost two-thirds of the loans went to BAB directly and most of the rest went to CB to establish special lines of credit to both BAB and commercial banks. A conservative estimate is that at least 42 percent of the institutional agricultural credit over the eleven-year period came from foreign assistance programs.[27] Although such loans enabled Bolivia to sharply expand agricultural credit since 1966 they also undoubtedly were used to offset the heavy defaults. The aid was used to finance general agricultural production but in particular for crop and livestock activities in the Oriente. There has been a definite regional bias in favor of that region and against the Altiplano and mountain valley areas. Also most credit has flowed to large and medium-sized farmers. Only since 1975 has a major donor, the United States Agency for International Development, established programs specifically for campesinos.

CONCLUSIONS

A model of the political economy of agricultural credit in LDCs was presented. This model hypothesizes that the nearly ubiquitous conditions in

LDCs of extensive government control of formal market agricultural credit institutions, concessionary interest rate policies and high default ratios allow political elements to play an important role in what is normally considered economic activity. Apart from the government's control over institutions the key element in the model is the concessionary transfer which provides such a premium to borrowers that it can be both offered by the government to a specific clientele or conversely sought by the clientele in return for support of the government. The possibilities to practice agricultural illusion increase the size of the transfer and if inflation is present the additional inflationary transfer makes the credit even more attractive to borrowers. If default is negotiable, the possibility of a default transfer considerably enhances the attractiveness of the loan and its political potential. Where political elements come strongly into play they will impart impacts on credit distribution and allocation, agricultural production, economic development, income distribution and financial institution viability.

The model was applied to Bolivia for the 1966-1975 period. This country's development of the institutional structure, policy formulation and reliance on foreign assistance is an archetype of the growth of an LDC agricultural credit system. Although data do not exist to measure the marginal productivities and social benefits of alternative distributions of agricultural credit in the country there is evidence that strongly suggests that political factors played an important role in the distribution of credit. First, the government controlled institutional structure and concessionary interest rate policy provide the direct basis for political elements to enter into the distribution.

Second, the data show that more than 75 percent of the credit went to the Oriente. Third, that delinquency and default rates; i.e., default transfers, on this credit are unusually high. These rates would have been even higher had not extensive refinancing taken place. This evidence, in combination with the well-known political power base of the Santa Cruz elite and the fragility of the recent Bolivian governments suggest that farmers in that region have sought access to the concessionary and default transfers and that the government was willing to provide it. An inflationary transfer, especially in 1972 and 1973 postdevaluation period sweetened the arrangement. The government's willingness to support the large farmers of the region is poignantly illustrated by their implicit absorption of the cotton farmers' losses in 1973 when ADEPA refused to honor forward price contracts. Thus, political elements appear to have played an important role.

That political motives were applied in lending in Santa Cruz is not out of context historically. Since its founding in 1942, BAB has continually been assaulted by critics charging political loans have seriously harmed the institution's financial viability for lack of repayment. In fact, several international donors have required a total of four reorganizations of BAB in an effort to clear up this problem and to improve administrative efficiency before they would make additional loans to the institution.

The model states that political motives might cause the government to want to lend to the campesino. Although there has been rhetoric about credit for campesinos relatively little credit flowed to this class of farmer. Apparently the government felt the economic-political benefits of lending extensively to this class were overridden by the benefits of lending in the Oriente.

Limited data does not permit measuring the economic consequences of political lending in the Oriente. It is suspected, however, that personal and interregional income distribution has worsened and that overall economic development has suffered. Clearly financial institutions such as BAB and BDE would have been rendered nonviable for lack of loan repayment were it not for government subsidies and infusions of foreign aid.

Foreign aid has played an important role in financing agricultural credit in Bolivia. While well-intentioned on economic grounds, it is clear that the concessionary interest rate feature and the willingness of donors to cover bank losses due to default have contributed to the potential for credit to be used as a political weapon.

The obvious means to substantially reduce the political elements in agricultural credit programs would be to eliminate the concessionary interest rate and to decrease default. To eliminate government agricultural credit institutions would also help, but that would be going to far, given the historical evidence of commercial financial institutions shunning agricultural loans, especially those to small farmers. The elimination of the concessionary rate would put the cost of agricultural credit on a par with the opportunity cost of money as measured b' prevailing interest rates on the domestic market. The resultant loss of income transfer to borrowers would eliminate agricultural illusion. Thus, the attractiveness of credit would diminish its potential to be used as a political favor. Moreover, by raising the price of credit it would flow to its more productive employments. If this meant more funds flowing to the highlands and to the campesinos, then both interregional and interpersonal income distribution would be improved. Moreover, higher interest rates should enhance the financial viability of credit institutions. Not only would they receive a higher return on their loans but, as the opportunity for agricultural illusion is reduced, there should be fewer nonproductive and political loans which should lead to lower delinquency rates.

It is expected, however, that there would be considerable difficulty in raising interest rates. The borrowers are accustomed to receiving the concessionary transfer and would resist losing this benefit. For the large farmer it would mean reducing the opportunity to practice agricultural illusion. For the small farmer it would be a loss of the preferential treatment he believes is owed to him. Thus from both farmer classes the government would expect resistance to raising the rate were it inclined to do so. Furthermore, it is doubtful that the government would have the inclination to raise the rate because it would seriously reduce its options in using agricultural credit to gain political favor in an already fragile environment.

The reduction of defaults should be easier, although still difficult for the same reasons, because when a default is permitted by not bringing to bear the existing legal sanctions the income transfer is overt. In contrast the concessionary transfer is readily obscured by the legitimate policy of concessionary rates.

In conclusion, in Bolivia and many other LDCs, while there are many merits to eliminating concessionary interest rates and lowering unnecessary default for agricultural credit,[28] it will be a difficult task to accomplish--the political consequences will be severe and will dictate against the change.

ENDNOTES

1. See, for example, Bruce F. Johnson and Peter Kilby, Agricultural and Structural Transformation, Economic Strategies in Late-Developing Countries (New York: Oxford University Press, 1975).

2. It is important to distinguish between the formal market sources; e.g., those legal entities which are established for purposes of providing credit and, perhaps, other financial intermediation services and informal market sources; e.g., those who provide credit but do not have such status as moneylenders, friends, relatives and merchants. In LDCs the size of the informal market is unknown but in most counties it is considered quite important in terms of numbers of farmers reached.

3. In a more specialized sense than is in this paper, this has been recognized by J.D. Von Pischke, "The Political Economy of Specialized Farm Credit Institutions in Low Income Countries," typewritten draft.

4. The supply-leading approach in contrast to the demand-leading approach is set forth in Hugh T. Patrick, "Financial Development and Economic Growth in Underdeveloped Countries," Economic Development and Cultural Change, XIV (1966), 174-189.

5. The Farm Security Administration, later renamed the Farmers Home Administration (FHA), was established in the U.S. in the Great Depression to provide subsidized and supervised credit to low-income farmers who offered strong potential for economic advancement but did not have access to credit from normal formal market sources. Because of the similarity of conditions in LDCs it was natural that the FHA model should have been transferred to those countries. This tendency was reinforced by the fact that many FHA officials were used as advisors to LDCs in establishing credit programs. Subsequent experience in LDCs has shown that the supervision function was so expensive that most institutions have considerably diminished this aspect of the model, but the concessionary interest rate subsidy has remained for reasons set forth in this paper.

6. For a good discussion of the reasons see, Gordon Donald, Credit for Small Farmers in Developing Countries (Boulder, Colorado: Westview Press, 1976), pp. 100-103.

7. See Dale W Adams, "Agricultural Credit in Latin America: A Critical Review of External Funding Policy," American Journal of Agricultural Economics, 53 (1956), 163-172.

8. The pioneering work on the concepts formalized in this model was done by Adams, op. cit. and Claudio Gonzalez-Vega, "On the Iron Law of Interest Rate Restrictions, Agricultural Credit Policies in Costa Rica and Other Less-Developed Countries," (unpublished Ph. D. dissertation, Stanford University, 1976).

9. See, for example, Johnson and Kilby, op. cit.

10. Claudio Gonzalez-Vega, "Interest Rate Restrictions and Income Distribution," American Journal of Agricultural Economics, 59 (1977) 973-976.

11. Also where corruption occurs, government officials would lose their access to these sources of income transfers.

12. For a good discussion of the political developments in Bolivia over this period see, James M. Malloy and Silvia Borzutzky, "The Praetorianization of the Revolution: Bolivia 1964-1977," in Jerry R. Ladman (ed.) Modern Day Bolivia: Legacy of the Past and Prospects for the Future (Tempe, Arizona: Center for Latin American Studies), forthcoming.

13. E. Boyd Wennergren and Morris D. Whitaker, The Status of Bolivian Agriculture (New York: Praeger Publishers, 1975), p. 45.

14. Tom C. Royden, "A Review of Small Farmer Credit in Bolivia" (La Paz: United States Agency for International Development, September, 1972), p. 34 (mimeographed).

15. Jerry R. Ladman, Ronald L. Tinnermeier, J. Isaac Torrico, "Agricultural Credit Flows and Use in Bolivia," report submitted to RDD/USAID (La Paz: United States Agency for International Development, March 15, 1977), p. 23.

16. Ibid., p. 35.

17. Banco Central de Bolivia, Departamento de Estudios Economicos as reported in ibid., p. 48.

18. Ladman, Tinnermeier and Torrico, op. cit., p. 93.

19. Ibid., p. 93.

20. Private communication to the authors from Banco Agricola de Bolivia.

21. Ladman, Tinnermeier and Torrico, op. cit., p. 148.

22. Ibid., p. 13.

23. Malloy and Borzutzky, op. cit.

24. Ladman, Tinnermeier and Torrico, op. cit., pp. 78 and 84.

25. The formula for computing the real rate of interest is $\frac{i-p}{1+p}$ where i and p are the nominal interest rate and the rates of inflation, respectively.

26. Ladman, Tinnermeier and Torrico, op. cit., p. 62.

27. Ibid., p. 63.

28. Gonzalez-Vega, "Interest Rate Restrictions and Income Distribution, op. cit.