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THE POTENTIAL FOR RURAL SAVINGS MOBILIZATION: SOME EVIDENCE FROM LATIN AMERICA

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Introduction

The view is widely held that the primary role of financial institutions which serve the rural sector in developing countries is to provide abundant credit at subsidized low rates of interest in order to promote agricultural output and to redistribute income toward the rural poor. However, there is increasing evidence that subsidized low interest rates on agricultural loans have failed to achieve these two objectives. Because credit is fungible, it is difficult and costly, if not impossible, to tie subsidized credit to specific agricultural activities.1/ In addition, recent studies focusing on the recipients of subsidized agricultural credit indicate that the main beneficiaries are not the rural poor, as credit is highly concentrated in large loans to relatively wealthy farmers.2/ The purpose of the present paper is not to pursue these arguments further, but rather to examine the issue of the abundance of credit, that is, whether some alternative to the current approach might not

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1/ See J.D. Von Pischke and Dale W Adams, "Fungibility and the Design and Evaluation of Agricultural Credit Projects," American Journal of Agricultural Economics, November 1980.

2/ See Robert C. Vogel, "The Effect of Subsidized Credit on the Distribution of Income in Costa Rica," paper presented at the Rocky Mountain Council for Latin American Studies, Tucson, Arizona, April 1977.

facilitate a larger volume of credit for the rural sector in developing countries and thereby do more to promote agricultural output and redistribute income toward the rural poor.

Because the current approach emphasizes the provision of credit to the rural sector at subsidized low rates of interest, it must necessarily rely on some external donor or some internal source of tax revenues to obtain resources for the subsidy. In fact, the failure of industrialized countries to provide more subsidized resources, either directly or through international lending agencies such as the World Bank or the Inter-American Development Bank, has been widely deplored in recent years. In spite of urging the industrialized countries to do more, the governments of most developing countries have themselves been unwilling to expand greatly the portion of tax revenues going to support subsidized credit for the rural sector. It is not the purpose of this paper to argue that the industrialized countries should be implored to give more, or the developing countries to allocate more of their scarce tax revenues to subsidizing credit for the rural sector, neither of which is likely to happen in any case. Rather, the present paper argues that substantial resources exist in the rural sectors of most developing countries which are largely unutilized and that these resources are unutilized in part because of the current approach which emphasizes the continuing dependence of the rural financial system on foreign grants or taxation of other sectors of the domestic economy.

The perceived necessity of relying on foreign grants or domestic taxation comes from the widely-held view that savings cannot be mobilized in rural areas of developing countries because most of the rural population has no margin for saving over consumption needs. In addition, urban-based financial institutions are said to be uninterested in the small sums that might be mobilized in rural areas, while rural institutions are thought to lack the administrative and technical skills necessary for the successful mobilization of savings. Based on the experience of credit unions in Peru and Costa Rica, and especially on the experience of the Banco Nacional para las Cooperativas of Peru (BANCOOP), the present paper argues that these views are not correct and that large amounts of voluntary savings can be mobilized in rural areas of developing countries if the proper incentives are present.[3/]

The current approach of relying on foreign grants and domestic tax revenues to provide subsidized low interest rate credit to the rural sector creates strong incentives against mobilizing domestic savings. Financial institutions are certain to prefer obtaining low-cost resources from foreign donors or from agencies of their own government to the alternative of obtaining resources from domestic savers who must be paid

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3/ See Dale W Adams, "Mobilizing Household Savings Through Rural Financial Markets," Economic Development and Cultural Change, April 1978, and F.J.A. Bouman, "Indigenous Savings and Credit Societies in the Third World: A Message," Saving and Development, 1977, #4, for additional evidence.

interest rates high enough to compensate them for the use of these resources. If, in addition, financial institutions are required to make loans at subsidized low interest rates to support certain agricultural activities, they will be faced with two unattractive alternatives: (1) make loans at the same low interest rates with resources mobilized from domestic savers and thereby incur losses on these loans; or (2) charge higher interest rates on loans which are based on higher-cost resources and then attempt to explain to the borrowers paying the higher rates why they were discriminated against. Given such incentives, it is not difficult to understand why financial institutions in developing countries have not focused on mobilizing domestic savings.[4/]

A project sponsored by the Agency for International Development (AID), which was initiated in Peru in 1979, is the basis for much of the evidence presented below in support of the possibility of successful savings mobilization in rural areas of developing countries. This AID project has several segments, but here only the aspects relating to savings mobilization will be discussed in any detail. The project includes technical assistance to help BANCOOP with its savings mobilization efforts

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4/ See Thomas E. Weisskopf, "The Impact of Foreign Capital Inflow on Domestic Saving in Underdeveloped Countries," Journal of International Economics, February 1972, for traditional arguments and evidence based on 44 developing countries for the negative impact of foreign capital on domestic saving.

in two target areas in rural Peru and, in addition, technical assistance through BANCOOP to help the credit unions in these two target areas with their savings mobilization activities. Savings mobilization by the credit unions will be discussed first because in this way the environment in which Bancoop initiated its savings mobilization activities can better be understood. After the discussion of Bancoop's substantial success with savings mobilization in rural Peru, savings mobilization by credit unions in Costa Rica will be examined briefly to show that the Peruvian experience is not, and need not be, unique.

Peruvian Credit Unions

After years of strong growth, Peruvian credit unions began to experience serious difficulties in the mid-1970s, due largely to a dramatic upsurge of inflation and the failure of the credit unions to adjust their traditional low interest rate policies in the face of this inflation. From the early 1950s through 1973 the rate of inflation in Peru averaged less than 10 percent per year, but accelerated to over 30 percent per year in 1976 and 1977 and over 50 percent per year in 1978 and 1979. Until mid-1976, interest rates were rigidly controlled by the Peruvian Central Bank at 5 percent on savings deposits, 7 percent on time deposits, and 12 percent on short-term loans. These interest rate ceilings were raised beginning in mid-1976 and significantly in mid-1978. During 1979 and 1980, the ceiling rate on savings deposits was 30.5 percent, while time deposits earned up to 35.5 percent on deposits of one year duration. The nominal ceiling rate for loans was 32.5 percent during 1979 and 1980, but effective interest rates could easily be 60 percent or higher through the use of commissions, compensating balances and other devices.

When the AID-BANCOOP project was initiated in 1979, none of the five major credit unions in the two target areas had taken advantage of the opportunity to raise interest rates. Rather, these credit unions continued to follow the tradition of charging 1 percent per month on loans. With such low interest rates on loans, the credit unions were unable to pay high enough interest rates on savings and time deposits to compete with other financial institutions, especially the commercial banks, which had quickly taken advantage of the increases in interest rate ceilings. Thus, the credit unions were forced to rely for their resources almost entirely on the capital contributions of their members, on which dividends are limited to 6 percent per year by the regulations of the Peruvian Central Bank.

These interest rate policies have created serious perverse incentives and substantial problems for the credit unions. On one hand, members have an incentive to borrow as much as possible because interest rates on loans far below the rate of inflation mean that borrowers have to pay back in real terms much less than the amount borrowed. On the other hand, members have little or no incentive to make time and savings deposits with their credit unions because the purchasing power of these deposits is rapidly eroded by inflation when adequate interest rates are not paid. Members who make capital contributions to their credit unions do so primarily for the purpose of getting access to loans, and such loans can be as much as three times the amount of a member's capital contribution under the regulations of most Peruvian credit unions.

The results of these interest rate policies can readily be seen in the substantial problems experienced by the five major credit unions in the two target areas of the AID-BANCOOP project. There have been increasing complaints of severe shortages of loanable funds, as the demand for low interest rate loans far exceeds members' capital contributions and meagre time and savings deposits. Disgruntled members who are told that their approved loans cannot be disbursed because of a lack of funds, or that there is no point in even applying for a loan, often cease making capital contributions to their credit unions and become inactive. For some credit unions the loss of active members has spread to serious repayment problems as members see no point in repaying old loans when the prospects of obtaining new loans are bleak.[5/] In addition, many credit unions are experiencing substantial operating deficits as stagnant

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5/ See Robert C. Vogel, "Rural Financial Market Performance: Implications of Low Delinquency Rates," American Journal of Agricultural Economics, forthcoming, for a discussion of the importance of good service on new loans in maintaining good repayment rates on outstanding loans.

interest income fails to keep pace with the operating costs which increase with inflation. Even those credit unions which have managed to continue to grow in nominal terms have seen the purchasing power of their capital more than halved since the mid-1970s.

In spite of the important role in the AID-BANCOOP project of technical assistance through BANCOOP to help the credit unions with savings mobilization, the credit unions in the two target areas have been slow to accept the higher interest rate policies which are a prerequisite to successful savings mobilization. As of the end of 1979, only two of the five credit unions had raised their interest rates. One of these changed its interest rate policies only after it had reached the verge of collapse and had received an inordinate proportion of the project's technical assistance in the form of detailed analysis and persistent explanation of the consequences of its low interest rate policies. The other, however, had quickly raised its interest rates to the maximum permitted by the Central Bank's regulations and has subsequently had significant success in mobilizing additional time and savings deposits.

As of mid-1980, two of the other credit unions in the target areas had also raised their interest rates. One of these became convinced of the need to raise interest rates on loans in early 1980 because of operating losses, but the need to raise interest rates on time and savings deposits sufficiently to compete with other financial institutions in mobilizing savings was not recognized. The other credit union raised interest rates to the maximum permitted on time and savings deposits, but gave so little publicity to these changes that several employees of the credit union were unaware of the new interest rates. As of mid-1980, one credit union still had made no change in its interest rates, although increases have been proposed by members of the credit union's board and discussed at the annual meeting. Because of the slowness to change interest rates, in the case of only one credit union is it possible at this point to see significant success with savings mobilization.

Before proceeding to analyze BANCOOP's success with savings mobilization in the same two areas of rural Peru, it is interesting to speculate why the credit unions have been so reluctant to change their interest rate policies.6/ There are at least four hypotheses worth noting, which are not necessarily mutually exclusive. The first is that credit unions are simply confused by the rhetoric of cooperativism, and members genuinely believe that raising interest rates on loans would be usurious and that problems can best be dealt with by appeals to altruism against the economic rationality of individual members. The second is that members who are on the boards of directors or key policymaking committees have much better access to credit union loans than most other members and use the rhetoric of

6/ See Robert C. Vogel, "Barriers to Financial Reform," International Conference on Rural Finance, Calgary, Canada, August 1979, for a discussion of the difficulties of implementing interest rate reform in a somewhat different context.

cooperativism to keep interest rates low on loans for their personal benefit. The third is that most credit union decision makers, including even management itself, have little professional knowledge of economics or finance and thus view as very risky any departure from traditional policies. The fourth is that credit unions continually hope for some source of low cost resources (if not the capital contributions of their members then donations or subsidized credit from some external source) through which they can avoid raising interest rates to compete for savings. Some evidence for each of these four hypotheses can be found in the technical assistance work with the credit unions in the two target areas, but perhaps most noticeable was the extreme disappointment of the credit unions on finding that the technical assistance with savings mobilization did not include any low cost resources for lending to members.

BANCOOP

In spite of its name, BANCOOP is not in fact a bank under Peruvian law, but it does carry out most functions of a bank such as receiving deposits and making loans. BANCOOP is rather a second level cooperative, that is, a cooperative of cooperatives with its directors elected by the cooperatives which have become members by making capital contributions to BANCOOP. Nevertheless, BANCOOP deals not only with its member cooperatives, but also with non-member cooperatives, individual members of cooperatives, and the general public. BANCOOP was selected by AID to be the primary institution in the project for two main reasons: (1) BANCOOP was already following a policy of relatively high interest rates on loans and deposits within the limits of Peruvian regulations, and (2) BANCOOP had been reasonably successful as an urban-based operation and was interested in expanding its operations to serve a rural clientele.

BANCOOP initiated its savings mobilization activities in the two target areas of rural Peru during 1979 in the face of adverse economic conditions. In addition to the rapid inflation mentioned above, the Peruvian economy had shown no real growth in several years. Moreover, BANCOOP faced potentially formidable competition from established financial institutions including several commercial banks. Yet, by mid-1980, in the two target areas BANCOOP had already mobilized in Peruvian soles time and savings deposits equal to approximately one million U.S. dollars, in contrast to a goal of only $150,000 to be met by the end of the project in mid-1981. This success can be put more clearly in perspective when it is noted that commercial banks and other financial institutions in the two target areas have indicated in preliminary figures much lower rates of saving mobilization during 1979 and early 1980. Offices of BANCOOP outside the two target areas also reported much lower rates of savings mobilization through mid-1980.

The success of BANCOOP in mobilizing savings in the two target areas should not obscure the fact that some significant problems have been encountered. In the early stages of the project, BANCOOP officials that thought that it was preferable to concentrate on mobilizing resources through capital contributions of member cooperatives and demand deposits and to de-emphasize time and savings deposits because the latter two required appreciable interest payments in contrast to the former two. However, the hope of mobilizing low-cost resources through capital contributions and demand deposits proved to be illusory. As in the case of the credit unions, members made capital contributions in order to request loans, so BANCOOP found that capital contributions from member cooperatives increased the demand for loans more than they increased the supply of resources available for lending. The inflows and outflows of demand deposits proved to be quite large relative to balances, so that demand deposits have not provided a stable source of funds for lending, nor have they been particularly low cost because of the clerical expenses involved in maintaining these accounts. The subsequent shift toward emphasizing time and savings deposits has provided far more resources for lending in the two target areas, and the interest and other costs associated with these accounts have easily been covered by the interest earned on the loans made with these resources.

Another problem encountered during the first year of the project was the much slower rate of savings mobilization in one of the two target areas, in spite of the fact that the less successful BANCOOP office had opened several months earlier and serves a more heavily populated area. It was found that attempts by the member of BANCOOP's board of directors from the less successful target area to intervene in the day-to-day operations of that office had led to a high rate of turnover in managers and other key personnel during much of 1979. This, in turn, had harmed employee morale and had reduced public confidence in the ability of the BANCOOP office in that target area to survive and prosper. However, the durability of the current manager of that BANCOOP office has led to improved employee morale and depositor confidence, so that the rate of savings mobilization during 1980 has been approximately the same in the two target areas. A final puzzle worth noting was the slowness of BANCOOP to extend the successful savings mobilization techniques developed in the two target areas to offices in other areas. Perhaps the explanation, as suggested in the case of the Peruvian credit unions, is the difficulty of convincing individuals to deviate from traditional approaches when they do not have enough professional knowledge to be confident in the success of a new approach. In any case, several BANCOOP offices along the northern coast of Peru successfully adopted new savings mobilization techniques beginning in mid-1980.

One of the principal reasons for BANCOOP's success in savings mobilization has been the payment of high rates of interest on time and savings deposits, the maximum permitted under Peruvian regulations. There are, however, other factors which may be equally important. The experience, discussed above, of the BANCOOP office with high turnover of key personnel indicates the importance of depositor confidence and employee morale. Employee performance is an important factor in successful savings mobilization which is often overlooked. It is generally recognized that good service in the form of convenient location of offices and convenient hours of operation is important in attracting potential depositors, and in this respect BANCOOP compares quite favorably with other financial institutions in the two target areas, especially with the commercial banks. However, it is seldom recognized that rapid service with a minimum of paperwork and other formalities is at least as important, and in this respect the advantage of BANCOOP over the other financial institutions appears to be even greater. A principal reason for good employee performance, which results in good service for depositors, is incentives for BANCOOP employees which are tied to the amount of time and savings deposits mobilized. Otherwise, more clients and more deposits simply mean more work for employees.

Savings mobilization campaigns, which include substantial incentives for employee performance, are the other important element in BANCOOP's success in mobilizing savings in the two target areas and, more recently, along the northern coast of Peru. So far during 1980, BANCOOP has run three very effective savings campaigns. The first, which actually began in December of 1979 and ran through the middle of January, involved free instant photographs for those who deposited small amounts, a raffle of cameras, and free cameras for those who made large time deposits. The second, which ran from early February until April, involved free school supplies for small deposits, a raffle of school supplies and bicycles, and free bicycles for large time deposits. The third savings mobilization campaign, which began in July and ran until September, featured raffles of color television sets and other electrical appliances and immediate prizes of these same articles for large time deposits. This campaign departed from the earlier campaigns in some important aspects. First, as noted above, it was adopted by BANCOOP offices outside the two target areas. Second, the emphasis shifted toward time deposits and toward prizes which would have major appeal to more affluent and more urban groups within the target areas. The earlier campaigns not only emphasized a much larger number of smaller prizes but also emphasized immediate prizes in order to spread confidence in the newly-opened BANCOOP offices among a potentially large rural clientele.[7/]

The current phase of the AID-BANCOOP project involves a detailed analysis of BANCOOP's successful savings mobilization efforts. In particular, the thousands of savings accounts which have been opened at the BANCOOP offices in the two target areas are being studied with respect to the characteristics of the depositors and the behavior of the accounts over time. A fear

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7/ See Augusto Chanamé, "Pautas a Considerar en la Planificacion de una Campaña de Promocion," Seminario sobre El Proceso Inflacionario y su Incidencia en las Cooperativas de Ahorro y Credito, San Jose, Costa Rica, September 1980, for a detailed discussion of the BANCOOP savings mobilization campaigns.

expressed early in the project was that savings would be deposited during campaigns in order to secure prizes and would then be quickly withdrawn. This fear has proven unfounded as savings accounts opened during campaigns and those opened at other times do not show significantly different behavior, and both groups of savings accounts have on the average maintained balances over time which tend toward the amount of the initial deposit. The main difference between campaign and non-campaign periods is that substantially more new accounts are opened during savings mobilization campaigns. However, the analysis has not yet progressed to the point where it is possible to evaluate the appropriateness of the recent emphasis on time deposits rather than savings accounts, nor has the importance of the different elements in each of the campaigns yet been analyzed.

Interviews are currently being carried out in one of the target areas with a random sample of 100 BANCOOP depositors and 100 other individuals who are not BANCOOP depositors, but who are similar to these depositors in other respects. The purpose of these interviews is not only to discover what aspects of BANCOOP's savings mobilization efforts are most appealing to potential depositors, but also to discover what are the principal sources of these deposits. Knowing the source of these deposits may be useful for BANCOOP's promotional activities, but for macroeconomic analysis it is particularly important whether they are coming from reduced consumption, reduced holdings of unproductive physical assets, or reduced holdings of other financial assets. In addition, the relationship between time and savings deposits and other BANCOOP services is being studied, that is, whether individuals tend to make time and savings deposits first and then are drawn to other BANCOOP services, such as loans and checking accounts, or vice versa. The daily inflows and outflows from BANCOOP's checking and savings accounts are also being analyzed in order to make recommendations about the appropriate level of reserves for these accounts.

Before turning to the discussion of savings mobilization by credit unions in Costa Rica, it is worthwhile to mention briefly the impact of BANCOOP's savings mobilization efforts on its financial viability and on its lending behavior. Under the impact of inflation BANCOOP had drastically shortened the maturity of its loans and consequently had shifted its loan portfolio away from cooperatives, both member and non-member, and towards individuals. Higher interest rates and the greater availability of resources due to successful savings mobilization have permitted some lengthening of maturities and some shift of the loan portfolio back toward cooperatives. Throughout the period there has been no lack of demand for BANCOOP loans, even at effective interest rates of more than 60 percent per year, and many borrowers have stated that rapid service is more important than low interest rates. BANCOOP's financial viability also appears to have improved during the period of successful savings mobilization efforts. Inadequate accounting procedures, especially with respect to delinquent loans, make BANCOOP's stated profits somewhat dubious, but in any case both the delinquency situation and profits appear to have improved during the past year.[8/]

Costa Rican Credit Unions

A study of savings mobilization by Costa Rican credit unions which served as the main background paper for a recent seminar in Costa Rica shows that the Peruvian experience with savings mobilization is not different from what can be observed in other countries of Latin America.[9/] In late 1978, Costa Rica underwent a major financial reform in which many interest rates were totally freed from control by the Central Bank while others were increased and allowed to float with international interest rates. In addition, increasing rates of inflation during the past two years have tended to push interest rates higher since the beginning of the reform. Many credit unions in Costa Rica, as in Peru, have failed to raise interest rates and have thus been unable to mobilize additional resources through time and savings deposits. These credit unions have also experienced a loss of active members and an increase in

8/ See George Wohanka, "The Impact of Successful Savings Mobilization on BANCOOP's Financial Viability and Lending Behavior," paper presented to AID, Department of State, Washington, D.C., December 1980.

9/ See John F. Gadway and Robert C. Vogel, "La Inflacion y la Tasa de Interes," Seminario sobre El Proceso Inflacionario y su Incidencia en las Cooperativas de Ahorro y Credito, San Jose, Costa Rica, September 1980.

delinquent loans as members discover that these credit unions cannot mobilize adequate resources to provide new loans. However, in Costa Rica several credit unions have been willing to raise interest rates on loans and deposits as high as necessary to compete vigorously with other financial institutions including commercial banks. These credit unions have continued to grow, not just in nominal terms, but in the real volume of deposits and loans and in the number of new active members.

In the discussion at the Costa Rican seminar, many credit unions lamented the lack of an altruistic cooperative spirit among their members, but almost all recognized that individual economic rationality requires realistically high interest rates for credit unions to be able to mobilize the resources necessary to provide good service to their members and, hence, to survive. There was, just as within BANCOOP in Peru, disagreement as to whether it was better to emphasize savings deposits or time deposits in savings mobilization strategies, and the preferred strategy often seemed to depend on the characteristics of the members of the particular credit union. The idea of savings mobilization campaigns did not meet with universal acclaim from Costa Rican credit unions, in part because of apparent confusion among the necessity of lecturing members on the importance of an altruistic cooperative spirit, improving public relations in general, and designing and implementing a savings campaign with specific objectives. There was also considerable debate about the possibility or desirability of careful supervision of the use by members of credit union loans as a complement to savings mobilization.

<u>Conclusion</u>

It is possible to mobilize substantial amounts of savings in the rural areas of developing countries if the proper incentives are present. Proper incentives include not only adequately high interest rates for depositors, but also financial institutions in which depositors can have confidence and which provide good service for depositors, and this in turn requires adequate rewards to promote good performance by the employees of financial institutions. In addition, the success of BANCOOP's savings mobilization campaigns indicates that special promotional efforts for savings can also be very effective.

International lending institutions might consider adjusting their policies and attempting to inject resources into the rural financial markets of developing countries in a way that encourages proper incentives for savings mobilization. One possible approach would be grants or subsidies in the form of low interest rate loans to rural financial institutions to match in some proportion the savings newly mobilized by these institutions. Through the generation of additional savings such an approach would make credit more abundant for the ultimate recipients of loans in the target group. This could be far more effective in promoting agricultural output and redistributing income toward the rural poor than the traditional policies of subsidized low interest rate loans for small farmers and other agricultural producers.

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