USAID Support for Development Finance Institutions in Central America

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I. INTRODUCTION

Companies in Central America have limited options for acquiring capital to make long-term investments in agriculture and industry. Commercial banks generally make short-term loans, and the majority of Central American stock markets have begun to operate only recently. Trading is limited to bonds and other debt-instruments in most countries, because stocks are not widely traded. To address the lack of long-term credit, USAID established 12 development finance institutions in Central America over a span of three decades—from the 1960s to the 1980s—to provide loans and equity investment to businesses.[1] In addition, USAID recently has supported the development of stock markets in the region.[2]

The focus of this paper is on USAID support for capital markets through the creation of development finance institutions. It provides an overview of the institutions, tracing their history and examining their present status to determine whether they were financially sustainable as development banks. The paper is based on a review of USAID documentation, as well as interviews and data collected in El Salvador, Guatemala, and Honduras (see annex A for a list of persons interviewed). The fieldwork was conducted to obtain additional information, especially on the financieras set up in the 1960s, due to the lack of USAID material. Another objective was to examine the sources of long-term lending in Central America.

The paper first provides a brief overview of economic development in Central America since the 1960s, including the sources of long-term lending in the region today. The following section highlights the importance of long-term lending and examines a key USAID study, published in 1990, which concludes that most donor-funded development finance institutions have not been financially sustainable. The bulk of the paper focuses on a review of the institutions that USAID established in Central America (see table 1). These include seven banks (known as "financieras") set up in the 1960s to promote the creation and expansion of enterprises; the Central American Bank for Economic Integration (1961); the Latin American Agribusiness Development Corporation (1971); and three financial institutions established in the 1980s in Costa Rica and Honduras.[3]

[1] Equity investment refers to the process of acquiring shares in the issued capital of a company.
[2] Through the Private Sector Initiatives Project, implemented from 1989 to 1993, USAID provided a grant to the Central American Federation of Private Sector Organizations (FEDEPRICAP) for technical assistance and training to the private sector. Among the important achievements of the grant was the creation of an Association of Central American Stock Exchanges (BOLCEN). The purpose of this association is to share information, hold seminars, and work toward the eventual integration of the region's stock exchanges. FEDEPRICAP also helped to set up stock exchanges in El Salvador, Panama, and Honduras under this USAID project. However, documentation on the Agency's activities in this area is lacking. In Nicaragua, USAID supported the creation of a private stock exchange and an agricultural commodities exchange. Through the FEDEPRICAP grant and other projects, several studies were published in 1992 and 1993 on securities markets in Central America.
[3] Excluded from this report are government agricultural banks as well as national housing banks and institutions. USAID has provided technical assistance and funding to several of these, including BANDESA in Guatemala (an agricultural bank), and national housing banks in Costa Rica (BANHVI) and Honduras (Financiera Nacional de la Vivienda).

Table 1:
Development Finance Institutions Established by USAID to Provide Long-Term Credit/Equity Investment in Central America

INSTITUTION	COUNTRY	DATE EST.	PURPOSE
Agro-Industrial and Export Bank (BANEX)	Costa Rica	1980	Originally set up to provide credit for nontraditional exports. It has diversified its services and is a leading private bank in Costa Rica.
Costa Rican Corporation for Industrial Finance (COFISA)	Costa Rica	1963	To provide medium- and long-term financing to the private sector.
Private Investment Corporation (PIC)	Costa Rica	1984	To provide credit and equity financing for export-oriented businesses.
Development and Investment Financiera (FDI)	El Salvador	1964	To promote industrial investment in El Salvador.
Salvadoran Industrial Development Institute (INSAFI)	El Salvador	1963	To promote industrial investment in El Salvador.
Industrial and Agricultural Financiera (FIASA)	Guatemala	1968	To provide medium- and long-term credit and equity investment to new and expanding industries.
Honduran Financiera	Honduras	1964	To make medium- and long-term loans and limited equity investments in private enterprise projects.
Industrial y Agricultural Financiera (FIA)	Honduras	1984	To provide credit to small and medium enterprises.
National Development Institute (INFONAC)	Nicaragua	1963	To make loans and equity investments in industrial enterprises.
Nicaraguan Investment Corporation (CNI)	Nicaragua	1964	To promote private industrial development in Nicaragua.
Central American Bank for Economic Integration (CABEI)	Central America	1961	To foster economic integration and development in the region.
Latin American Agribusiness Development Corporation of Central America (LAAD-CA)	Central America	1971	To provide loan and investment capital to Central American businesses involved in nontraditional agricultural exports.

The financieras of the 1960s targeted their lending toward industrial development, and several institutions established in the 1970s and 1980s provided loans for export-oriented businesses, particularly for nontraditional products.

II. OVERVIEW OF ECONOMIC DEVELOPMENT IN CENTRAL AMERICA SINCE THE 1960s

The governments of Guatemala, El Salvador, Honduras, and Nicaragua formed the Central American Common Market (CACM) in December 1960, and Costa Rica joined the process two years later. It was the first attempt by developing countries to establish an economic union for the purpose of promoting new investment in industry (McCamant 1968). The countries eliminated tariffs within the region to promote intra-regional trade, created a common external tariff to protect new industries, and promoted industrial development. During this period, Central America focused on import substitution industrialization and inward-looking development. As a result of the common market, internal trade rose from 7 percent of total trade in 1960 to over 25 percent by 1970 (Holbik and Swan 1972). Another positive effect of the CACM was the rapid growth of industry; the contribution of manufacturing to GNP is estimated to have increased from 12.8 percent in 1962 to 15.1 percent in 1966 (McClelland 1972). Industrial growth was mainly in consumer and intermediate goods, including flour, beer, cigarettes, cement, textiles, fertilizer, plastics, and insecticides (USAID 1969).

Beginning in 1969, the CACM experienced several setbacks. Armed conflict broke out between El Salvador and Honduras in that year, and Honduras temporarily withdrew from the union in 1971. The late 1970s and 1980s were marked by economic and political crises in Central America that led to a total collapse of regional integration. With the takeover in Nicaragua by the Sandinistas in 1979, the internal civil wars in El Salvador and Guatemala, and the deepening economic crisis, there was no support for integration. The Central American countries tended to follow economic strategies that were “mutually exclusive” (Weeks 1989, 24). For example, Guatemala attempted to liberalize trade and expand nontraditional exports, while El Salvador and Nicaragua pursued closed-economy policies in response to war. The reasons for the economic crisis of the 1980s include the oil shock of 1979–1980, rising interest rates on the external debt, falling prices for commodity exports, flawed domestic and regional policies, and civil war and other political conflicts (Zuvekas 1992).

Most countries in Central America considered the import-substitution policies of the past a failure and pursued a new strategy in the 1980s and 1990s of liberalizing trade and promoting nontraditional exports. Central America has experienced a limited economic recovery since the mid-1980s (Zuvekas 1992). On the political front, the situation improved with the democratic election of Violeta Chamorro in Nicaragua and the signing of peace accords in El Salvador and Guatemala. With a renewed commitment to Central American integration, the countries have undertaken regional initiatives in economic, environmental, and other areas.

The instability in the region has been an obstacle to private investment. According to a 1987 report on Central American capital markets, medium- and long-term financing or equity capital is generally lacking (Arthur Young 1987); interviews conducted in 1997 with Central American bankers and others in the financial sector confirm this finding. Commercial banks dominate the financial scene in Central America today and most lending is short term. The sources of long-term credit include the Central American Bank for Economic Integration (CABEI), the Inter-American Development Bank (IDB), international donors, and governments. Some Central American banks and financieras access long-term loans from CABEI or the IDB to on-lend to the private sector. USAID and other donors have funded private and public banks and institutions that provide long-term lending, such as the ones reviewed in this paper. In regard to government sources, El Salvador created the Multi-Sectoral Investment Bank (BMI) in 1993 to provide medium- and long-term credit for industrial and agricultural development. Most governments in the region also have supported development banks, especially for the promotion of agriculture.

III. DEVELOPMENT BANKING

Development vs. Commercial Banking

Development finance institutions have filled a credit gap in developing countries by providing long-term loans and channeling funds to priority groups, such as small and medium businesses (McKean 1990). They depend generally on funding from the government or bilateral and multilateral donors. Many are restricted legally from certain financial activities, such as deposit banking and leasing, thus making it difficult to increase profits (McKean 1990). Commercial banks, on the other hand, provide short-term loans (less than three years) and are permitted to accept deposits and offer savings and checking account services. Because of a commitment to their depositors, commercial banks have conservative lending policies and do not enter into high-risk ventures, such as factory expansion. Commercial banks can finance the short-term working capital needs of companies, such as operating expenses. But credit from commercial banks is generally inadequate for financing the creation and expansion of new and existing enterprises "so crucial to the promotion and sustainment of economic growth in the region" (Arthur Young 1987, 16).

Commercial banks finance their loans through short-term savings such as checking accounts. Development finance institutions, which face the challenge of loaning funds over the long term, must borrow long term. The reason they have relied on funding from governments or donors is the lack of domestic long-term lending on the deposit side. Markets for longer-term domestic instruments have been poorly developed (World Bank 1989).

In an article examining development banks, Vincente Jayme highlights two problems regarding capital in developing countries: 1) mobilizing sufficient resources, and 2) matching saver needs with investor needs (Jayme 1980). Low-income countries have scarce domestic capital, because income is barely sufficient to pay for basic needs and households do not save. Another problem is that while there may be sufficient savings, they are either short term and require "term transformation" to match investors' requirements, or they are in nonfinancial forms, such as real estate and consumer durables (Jayme 1980, 172). The challenge is encouraging households to invest over the long term, but there are a number of obstacles that may prevent this, such as inflation. When the economy suffers from chronic inflation, it is difficult to persuade savers to make long-term monetary investments. In Central America, households do not save or invest over the long term, mostly due to the instability in the region.

This situation may change, however, as Central America moves toward more economic and political stability. Also, the increase in the number of nonbanks, such as insurance companies, investment banks, finance companies, and private pension funds, is critical. These provide ways for developing countries to channel their savings into longer-term investments. According to Francisco Bertrand Galindo, the superintendent of the financial system in El Salvador, pension reform in El Salvador makes it possible to have a local source of long-term lending for the first time in many years (Francisco Bertrand Galindo, interview, November 1997). Dr. Nick Rischbieth Glöe, an official of CABEI, also pointed out that banks can provide long-term loans if there are pensions and long-term investments (Nick Rischbieth Glöe, interview, November 1997).

USAID Study of Development Finance Institutions

In 1990, USAID's Center for Development Information and Evaluation (CDIE) published a report examining donor experience with development finance institutions (McKean 1990). The report points out that few of them have achieved financial sustainability; the most successful are "full-fledged financial institutions" capable of mobilizing domestic savings and offering a variety of services (McKean 1990, ix). Restrictions on their activities have limited the capacity to improve profits and diversify risk. Donor evaluations also found that the sustainability of development finance institutions is linked to their management capacity, and that they have limited success in reaching target beneficiaries. The report concludes that these institutions have not been effective in contributing to strengthening financial markets in developing countries, but that financial policy reform may be more critical.

The following chapters provide an overview of twelve development finance institutions in Central America to determine whether the findings of the CDIE study, particularly the financial sustainability issue, hold true.

IV. USAID-SUPPORTED FINANCIERAS OF THE 1960s

USAID funded a total of seven industrial banks in the 1960s, both public and private financieras, in all Central American countries to provide long-term lending and equity investment to expand or establish businesses. The Agency provided two loans totaling $8 to $10 million to most financieras. According to Tom Mooney, a former USAID loan officer involved in setting up and overseeing the financieras, it was unusual for USAID to fund private development banks during this period, since the focus of the Agency's activities was in the public sector (Tom Mooney, interview, November 1997). USAID support of these banks was part of an effort to promote industrial development in Central America and support the Common Market.

The majority of USAID reports available on these financieras are design documents and evaluations of the first loan. The reports are positive, showing that the banks helped to create or expand industries in the region. The following section provides a brief history of the financieras in each country and primarily focuses on what happened to them after USAID funding ended.

Costa Rica

The Costa Rican Corporation for Industrial Finance (COFISA), created in 1963, was the first financiera that USAID funded in Central America and the only one that the Agency continued to support in the 1980s. From the time of its creation until September 1981, COFISA had multiplied by 25 times the resources USAID had provided with its two loans in the sixties (USAID 1982). During this 20-year period, COFISA moved away from development lending and became more involved in short-term loans. The COFISA short-term portfolio as a percentage of the entire COFISA portfolio increased from 21 percent in 1968 to over 57 percent in 1980. While still involved in long-term lending, COFISA had become a commercial financial institution by 1980 (USAID 1982).

In 1981, COFISA almost went bankrupt. The bank was hard hit by the economic crisis in Costa Rica, but what dramatically affected its financial situation were two decisions made by the Costa Rican Supreme Court in July 1981. The court first ruled that the Executive Branch had acted unconstitutionally with its December 1980 decision to allow the colon to float, and declared that the official rate of exchange was 8.60 colones to the dollar. The court also ruled that debts incurred in Costa Rica in foreign currency could be repaid in colones at the official exchange rate. As a result of these decisions, COFISA borrowers paid back their dollar-denominated debt in over-valued colones (USAID 1982). By September 1981, COFISA's cash flow problems had become so serious that it was in default with the international banking community and no longer able to service its more than $60 million in debts (Loría 1996; USAID 1982).

USAID came to COFISA's rescue in 1982 by providing a $10 million loan and $5 million in local currency funds. According to a 1987 evaluation, USAID support helped the bank re-establish itself as a solid financial institution and regain public confidence (USAID 1987b). COFISA committed $10 million to 41 borrowers, and only 11 percent were short term (for one year or less) (USAID 1987b). The rest were for loans between three to seven years. COFISA also had diversified its activities—it established a local private bank in 1986 involved in lending, letters of credit for import and export, purchase and sale of dollars, and bank transfers.

COFISA continues to provide credit to the export sector today, but it has moved away from long-term lending. According to the general manager of COFISA, approximately 65 to 70 percent of its lending is short term (between one and three years), while 30 to 35 percent is medium term (between three and five years) (Guillermo Serrano, interview, March 1998). The main function of COFISA is still financing, but it has continued to diversify its portfolio and in 1997 established an insurance company. At the time this paper was published, COFISA was merging with a Costa Rican bank, the Banco BFA (Serrano, interview).

El Salvador

USAID funded both a private and public sector finance institution in El Salvador. The private Industrial Development Financiera (FDI) was established in 1964 with $1 million in capital from Salvadoran shareholders and a $5 million loan from USAID.

According to the former manager of the FDI, the financiera was successful as a development bank in the 1960s and 1970s (Roberto Hill, interview, November 1997). In fact, it was the only financiera that did not receive a second loan from USAID, since the Agency determined in 1968 that the bank was profitable and could apply for funding directly from the U.S. Export-Import Bank (Eximbank). From the time of its creation to 1980, the bank increased it assets from $6 million to $400 million (Hill, interview). The bank was also successful in terms of impact. It promoted and helped to create a private bank, an insurance company, a warehouse, a leasing firm, a publishing company, and a slaughterhouse.

FDI turned into a commercial bank in 1978, was nationalized by the Salvadoran government in 1980, and became privatized in 1993. The bank is known today as the Banco Desarrollo, and is strictly a commercial bank. The problem facing the FDI was how to survive as a development bank without donor resources. It turned into a commercial bank to obtain funds from the public, because as a financiera it could not receive deposits.

The Salvadoran Institute for Industrial Development (INSAFI), a government-sponsored bank, is one of the few financieras that became involved in equity investing. INSAFI was created to promote industry, mining, and tourism through both loans and equity investment. It purchased stock and actually owned several companies, including a hotel in El Salvador (Hotel Presidente). In 1982, the Salvadoran government decided to dissolve INSAFI and create two institutions: 1) the National Bank for Industrial Promotion (BANAFI), the lending division; and 2) the Salvadoran Investment Corporation (CORSAIN), which would manage all the equity investments. According to a former official of INSAFI, the institution was split up because it had become too large (Alvaro Ernesto Guatemala, interview, November 1997).

In the 1980s, BANAFI turned into a commercial bank that provided short-term credit. According to a former manager of BANAFI, the Salvadoran government did not have a strategy for promoting industrialization through long-term lending, nor did it focus on building up industries and businesses during the civil war (Bertrand Galindo, interview). The bank was dissolved in 1994, along with several other national banks under the Cristiani Administration, due to the government policy of closing national banks and privatizing the banking system. Since BANAFI had to compete with private commercial banks, maintaining it as a government bank did not make sense (Bertrand Galindo, interview).

CORSAIN, the only remaining vestige of INSAFI, also may dissolve in the next five years, according to the company's director (Edgardo Suárez Mallagray, interview, 1997). Today, CORSAIN owns and manages a sugar refinery and an industrial fishing complex, both of which will be privatized. CORASIN also owns gold and silver mines, some land, and stock in several companies. Some of its land and equipment belonged to businesses that had received loans from the old INSAFI but went bankrupt. CORSAIN currently manages the government Free Trade Zones, which will be privatized, and the Salvadoran government has used CORSAIN as a vehicle for privatizing other state-owned firms. According to Salvadoran law, CORSAIN eventually has to sell the companies it has managed or invested in. Although CORSAIN still exists, the purpose of the institution has changed since the 1960s from a provider of equity investment for newly established or expanding businesses to an institution that manages and privatizes government assets.

Guatemala

USAID helped to establish the Industrial and Agricultural Financiera (FIASA) in 1968, the last industrial bank that USAID set up in Central America. From the time of its creation to the present, the role of the bank has changed. It does not focus exclusively on long-term lending; today, approximately 30 to 35 percent of FIASA's loans are long term (six years or more). The rest are between three to six years, and it finances nothing less than three years. FIASA provides credit to the productive sectors, including industry, tourism, agriculture, cattle, and construction. The general manager of FIASA stated that the company has focused more on short-term investment, as opposed to long-term development lending, because of the instability in the country and the economic environment (Alejandro Mejía, interview, November 1997).

FIASA spawned a variety of sister companies and is now part of a conglomerate, the Continental Financial Group, which includes a commercial bank (Banco Continental), a credit card company, and brokerage houses. FIASA is an example of a bank that diversified its activities and developed into a full-fledged financial institution. Together with the commercial bank, FIASA is the second largest financial institution in the country. There are seventeen financieras in Guatemala, and only two or three of them provide medium- to long-term loans (Mejía, interview).

Honduras

The Financiera Hondureña, which went bankrupt in 1980, continues to be a source of controversy in the country today. USAID helped to establish the financiera in 1964 with a $5 million loan and provided $3 million two years later. The financiera functioned as a development bank for 10 years. One of its accomplishments was the purchase of bonds issued by a sugar mill, the first private bond issue in Honduras. According to USAID, the purchase was a "major step in the direction of the development of the private capital market in Honduras" (USAID 1966, 7). The financiera, however, followed the path of other financieras in Central America and converted into a commercial bank, known as Banfinan, in 1974.

Banfinan suffered from poor management and inefficient loan administration. One of the major problems was that the bank provided short-term loans to coffee exporters, and when the price of coffee dropped, firms could not pay back their loans (Tom Mooney, interview, November 1997, and Mario Rietti, interview, November 1997). Banfinan also provided credit and supported companies and individuals that did not have guarantees. One coffee exporter obtained a $1 million loan and used as a guarantee coffee stored in bags in his warehouse, which was inspected by a bank official. Banfinan later discovered that most of the bags were filled with sand. Gabriel Mejia, Banfinan's last president, stated: "we made some pretty bad mistakes" (Schuster 1981, 16).

In 1980, the Central Bank dissolved Banfinan, the first and only bank in Honduras that went bankrupt. There is disagreement about whether the bank took the appropriate action, and some argue that the Central Bank liquidated Banfinan too quickly. At stake was $24 million in loans that Banfinan owed about 30 foreign commercial banks, and the creditors counted on the Central Bank's supporting Banfinan, or at least making sure that they were repaid (Schuster 1981). U.S. banks told Mr. Mejia that representatives were coming to Honduras with their own reorganization plan and to hold off doing anything until then (Schuster 1981). However, the Central Bank asked the courts to start bankruptcy proceedings against Banfinan—one day before U.S. creditors arrived. The Central Bank's version of the story is that they had tried to come up with a solution to bail out Banfinan, but the shareholders were not willing to put their own capital into the bank. The Central Bank also was concerned that Banfinan's inability to repay its loans to U.S. commercial banks would jeopardize all banks in Honduras (El Heraldo 1989).

The case of Banfinan continues to appear in the newspapers in Honduras because the Central Bank has never published a report on the liquidation of the bank. There is no record of how much money was left after all the debts were repaid, and the shareholders of the bank have not received any remaining funds (La Prensa 1997).

Nicaragua

In the 1960s, USAID funded the Nicaraguan Institute for National Development (INFONAC), a government-owned financiera, as well as the private Nicaraguan Investment Corporation (CNI). According to Tom Mooney, a former USAID loan officer responsible for overseeing these financieras, INFONAC was the "greatest development bank that existed in Central America" (Mooney, interview). Support from President Luis Somoza, who was determined to promote the economic development of Nicaragua, contributed to its success (Mooney, interview).[4] Though a public development bank, INFONAC was managed like a private sector one. In fact, INFONAC set up a small office in New York to do outreach to companies that planned on doing business in Central America, offering companies tax-free incentives for 5 to 10 years, as well as duty-free imports of raw material and equipment. However, INFONAC and CNI did not survive because of political factors outside their control (i.e., the Sandinista takeover in Nicaragua in 1979).

V. OTHER USAID-SUPPORTED DEVELOPMENT FINANCE INSTITUTIONS

The Central American Bank for Economic Integration (CABEI)

The Central American countries established CABEI in 1961 to "promote the economic integration and balanced economic development" of the region (U.S. House of Representatives 1969, 2). This public sector institution was first capitalized with funding from the member countries, as well as concessionary loans from USAID and IDB. In the 1960s, USAID supported CABEI as a way to foster economic integration in the region (USAID 1969). From 1962 to 1968, USAID channeled $112.5 million to CABEI through USAID's Regional Office for Central America and Panama (U.S. House of Representatives 1969).

Throughout its history, CABEI has financed mainly public sector infrastructure projects, such as highways, telecommunications, and electric power. The bank has provided some support to the private sector, particularly for industrial development and agribusiness. CABEI also has played a role in housing finance in the region. USAID, which helped to establish a Housing Fund within CABEI, provided $139.9 million in Housing Guaranty loans from 1963 through 1992 (USAID

[4] President Luis Somoza Debayle, who served a six-year term from 1957 to 1963, was part of the Somoza family that ruled Nicaragua for four and a half decades (from 1936 to 1979).

1994). Under this program, the U.S. government underwrote loans from the U.S. private sector. Through its Social Development Fund, the bank has financed projects in education, health, and urban and rural development.

Since it was established in 1961, has CABEI contributed to the development of capital markets in Central America? To answer this question, the following three issues should be considered:

1) Is CABEI a source of long-term lending for the private sector?

2) Has the bank obtained funding from sources other than the major donors and mobilized external capital for the region?

3) Has CABEI re-invested that capital, as opposed to just serving as a conduit for loans?

Long-Term Lending

An objective of USAID programs in the 1960s in Central America was to help CABEI become a regional development bank that would "serve as a major source of long-term capital for the private sector" (USAID 1967, 100). In the past, however, CABEI focused mainly on public sector infrastructure projects, loaning about 86 percent to the public sector and 14 percent to the private sector. According to CABEI officials, approximately 28 percent of its credit today is for the private sector, and the goal is to reach 40 percent (Victor Rheinboldt and Enrique Paredes, interview, November 1997). CABEI, which is one of the few sources of long-term lending for the private sector in Central America, provides credit to public and private banks, which then on-lend to businesses. However, its support for the private sector has been limited.

Funding Sources

When CABEI was established in the 1960s, it depended mainly on loans from USAID, the IDB, and other donors. The bank then began to diversify its funding base and obtain capital from foreign commercial banks. However, resources from the private sector and member countries dried up in the late 1970s due to the economic crisis in Central America. High oil prices, inflation, weak demand and low prices for commodity exports, foreign debt, and political problems within countries affected the region (Price Waterhouse 1984). Several countries could not keep up their payments to CABEI, which experienced a sharp increase in the level of arrears (Price Waterhouse 1984). As of June 30, 1984, 65 percent of the public sector arrears were attributable to Nicaragua and approximately 13 percent each to Costa Rica and Honduras. CABEI also suffered from a liquidity crisis, since its liquid assets only covered 15 percent of its total debt outstanding; most regional banks tend to maintain liquid assets covering at least one half of total debt outstanding (Price Waterhouse 1984).

In 1985, USAID stepped in with $35 million in loans and $15 million in grants to help CABEI overcome its short-term liquidity problems. In its justification of the project, USAID stated that CABEI played an important "historical role" in mobilizing external resources for Central America, accounting for almost 20 percent of the external financing flowing to the region (USAID 1985, 2). USAID also recognized that the bank was a "more credible and reliable channel for external financing than the various national financial institutions" (USAID 1985, 15).

A 1992 evaluation concluded that CABEI had improved its financial situation, and bank officials confirmed in 1997 that CABEI was in a strong financial position. Data show that it has diversified its funding base and no longer relies on funds from USAID and IDB. As of October 31, 1997, total external credit to CABEI was approximately $2 billion (based on 1997 data provided by CABEI officials). This included $1.7 billion in medium- and long-term loans from banks and governments (excluding USAID and IDB), and $300 million in short-term loans from foreign commercial banks. Approximately $800 million of this was bank credit guaranteed by export agencies, such as Eximbank (Paredes, interview). Since the crisis of the early 1980s, the bank has re-established itself financially.

Reinvesting Capital

While the bank has captured external resources for economic development in Central America, it has not been as successful at re-investing capital. In the area of housing, an objective of USAID assistance was to establish a secondary mortgage market in Central America based on the U.S. system. To help the bank accomplish this goal, USAID provided $24.5 million to CABEI in 1980. The funds were to be invested by CABEI through the financing of mortgages and mortgage-backed securities from national housing finance institutions, including savings and loan associations, housing banks, cooperatives, and housing trust funds (USAID 1985). An evaluation of the project concluded that CABEI was not successful in creating a secondary mortgage market for a number of reasons (USAID 1985). First, the lack of convertibility of local currencies limited the ability to transfer resources from a country with excess capital to a country with scarce capital. Second, the bank was unable to sell securities to local investors due to the low level of capital market development in Central America. CABEI discounted mortgages and established a variety of securities to facilitate a secondary mortgage market, but was not able to sell them to private investors. And third, participating countries did not establish market instruments such as mortgage-backed bonds to be traded. Costa Rica, for example, was unable to do so because of debt restrictions imposed by IMF stand-by agreements (USAID 1985).

An official at CABEI also mentioned a number of other external factors that limited CABEI’s ability to develop a secondary mortgage market (Rischbieth Glöe, interview). The lack of long-term lending in local currencies in Central America and the difficulty in obtaining mortgages at a fixed interest rate because of devaluation have been obstacles. Other limiting factors include the lack of correlation among the currencies of the region, and the inefficiency of some state-run housing banks in Central America (Rischbieth Glöe, interview).

Instead of developing a secondary mortgage market, CABEI provided mortgage finance to primary lenders and served as a bank for banks. According to the president of a stock brokerage firm in El Salvador, Central America needs an institution that can purchase stock and reinvest the capital. So far, CABEI has obtained external credit and provided loans (Rolando Duarte, interview, November 1997). The bank has not reinvested the capital, either in housing or other areas, partly because of the low level of capital market development and the constraints of the financial markets in Central America.

Latin American Agribusiness Development Corporation (LAAD)

The Latin American Agribusiness Development Corporation is a private company based in Florida that has subsidiaries in Central and South America, as well as the Caribbean. The Central America subsidiary (LAAD-CA) was established in 1971 to provide loan and investment capital to businesses involved in producing, processing, and exporting nontraditional agricultural and aquacultural products. From 1971 to 1989, LAAD-CA received four loans from USAID totaling \$32 million. The company specializes in funding businesses that export part or all of their production to international markets, and it finances high-risk projects.

LAAD-CA stands out as being one of the most successful development finance institutions that USAID established in Central America. Two USAID evaluations conclude that LAAD-CA has been an effective lender and that its loans resulted in considerable benefits (Booz Allen & Hamilton 1985; Magill et al. 1989). LAAD-CA even remained financially strong from 1976 to 1985 when the region suffered from an economic and political crisis (Booz Allen & Hamilton 1985). Most banks were hard hit during this period, including CABEI and COFISA, and USAID provided concessionary loans to bail them out. Over this nine-year period, LAAD-CA's annual net income more than tripled and its net worth doubled. Between 1979 and 1985, its debt-to-equity ratio declined from 2.7 to 1.6. An evaluation conducted by Booz Allen & Hamilton concluded that it survived the crisis because of its excellent management team (Booz Allen & Hamilton 1985). Other factors responsible for making LAAD an effective lender include the short timeframe for loan approvals, as well as its ability to identify and approve loans for sub-borrowers who are solid business managers.

Tom Mooney, who headed LAAD-CA from 1971 until 1990, pointed out that LAAD-CA was extremely successful in its lending, and that the key was loaning to a reliable manager. LAAD-CA paid attention to the "man rather than the product" (Mooney, interview). He also highlighted an important difference between the financieras that were set up in the 1960s and LAAD-CA: USAID funding. LAAD-CA received assistance from USAID during a period of almost 20 years, while the financieras only received two loans in the 1960s. This assistance from USAID, coupled with LAAD-CA's successful management and effective lending policies, were critical to its success.

Agro-Industrial and Export Bank (BANEX)

In addition to COFISA, USAID helped establish two other development finance institutions in Costa Rica in the 1980s: the Agro-Industrial and Export Bank (BANEX) and the Private Investment Corporation (PIC). USAID provided a \$10 million loan to BANEX to establish an integrated program of credit, export-oriented banking services, and export management assistance for nontraditional export businesses. Under the third component, Banex was tasked with setting up a trading company with offices in both the United States and Costa Rica.

BANEX did not become the export bank that was planned for in the original USAID project. A 1983 evaluation pointed out that BANEX was an efficient alternative to the national banking system, but that it had evolved into a commercial rather than a development institution. Lending criteria emphasized profitability and security, and high-risk, long-term development loans were not made (USAID 1983). BANEX was established initially as a commercial bank, and its personnel were more experienced as commercial bankers. According to the evaluation, the project design may have been too ambitious (USAID 1983). It proposed taking a small, newly established commercial bank and adding both an investment banking capability and a trading company providing a wide range of services. BANEX was expected to put as much attention into development goals and services as into more profitable activities.

As of 1995, BANEX was the third largest private bank out of 24 operating in Costa Rica (Loría 1986). BANEX also pioneered the development of private pension funds in the country (Loría 1986). Beginning in 1988, it was the first company to sell savings plans specifically designed for retirement. In a little over three years, coverage increased from 772 employees participating in the program in December 1988 to 12,000 participating in April 1992 (Cartin et al. 1993). The amount of funds accumulated in the program increased more than 200 fold.

Private Investment Corporation (PIC)

The PIC, established in 1984 in Costa Rica, was designed to provide medium- and long-term financing, equity investment, and other merchant banking services for the private sector, specifically export-oriented businesses. Through the merchant banking component, the PIC would actively promote new projects, provide technical assistance to clients, and coordinate all necessary elements for successful project development, financing, and implementation. The goal of the PIC was to finance activities of a higher risk than those supported by existing institutions in Costa Rica, specifically new endeavors, so that Costa Rica could better react to the export opportunities available through the Caribbean Basin Initiative (USAID 1984).

A 1993 evaluation conducted by Price Waterhouse highlighted a number of management problems. The PIC did not have a long-term strategic plan; it underwent a major reorganization in 1992 that eliminated its merchant banking function and left the bank without a clear institutional direction (Price Waterhouse 1993). In addition, the bank did not take advantage of the 10-year grace period for repayment of the USAID loan by building up a solid loan portfolio (Price Waterhouse 1993). A report examining the Costa Rican financial sector points out that despite the PIC's initial failures, the company made important contributions to financial development in Costa Rica. It introduced new financial instruments and activities, such as leasing, underwriting, joint ventures, and equity investments (Loría 1996).

Today, the PIC does not provide long-term loans. According to Mauricio Gomez, the general manager, 90 percent of its loans are medium term (from three to seven years, with an average of five), and 10 percent are short term (Mauricio Gómez, interview, March 1998). Before the 1990s, approximately 50 percent of its credit was long term (greater than seven years). Mr. Gomez stated that the lack of external resources, such as funding from USAID, has limited the ability of the PIC to provide long-term credit (Gómez, interview). In the past, PIC focused more on agricultural and agro-industrial projects, but today it provides credit mainly to the industrial sector, which requires shorter loan terms and involves less risk.

Industrial and Agricultural Financiera (FIA)

Located in Honduras, FIA is the third institution that USAID created in the 1980s. It was established in 1984 to provide credit to small- and medium-scale enterprises. Five Honduran banks organized and capitalized FIA, which received $4 million from the Government of Honduras in local currency funds generated from the USAID-supported Economic Recovery program. Data from the end of 1985 showed that 60 percent of approved loans were for working capital; these were loans between one and three years (USAID 1987). Today, the majority of loans are short term, from 18 to 24 months. According to the general manager of FIA, the financiera provides some loans of up to four years by accessing credit from the re-discount facility of the Honduran Central Bank (Wilfredo Modenessey, interview, November 1997). He also pointed out that sources of long-term lending in Honduras are limited (Modenessey, interview).

VI. CONCLUSION

Of the twelve development finance institutions that USAID established in Central America, only four focus on medium- or long-term loans today: PIC in Costa Rica, FIASA in Guatemala, CABEI, and LAAD-CA. The remaining institutions either turned into short-term lenders or dissolved. Why did eight of the twelve institutions fail as development banks? Rolando Duarte, the president of a stock brokerage firm in El Salvador, stated that the financieras set up in the 1960s in Central America were not sustainable because of external factors, such as the economic situation and political instability (Duarte, interview). This is certainly true, but it only explains part of the reason why they and the other development finance institutions failed.

Table 2 lists the eight institutions that did not survive as long-term lenders and shows their outcome and problem areas. Five of the eight were affected by the policy environment and factors external to their operation. The government policy of nationalization and subsequent privatization in El Salvador affected both FDI and INSAFI. The two banks in Nicaragua, INFONAC and CNI, dissolved because of the Sandinista takeover. And COFISA almost went bankrupt because of the decisions of the Costa Rican Supreme Court, which led COFISA's borrowers to pay back their debt in over-valued colones. Devaluation was a problem for COFISA and other financieras that provided credit in local currency, but had to pay back their loans to USAID in dollars. LAAD-CA, which loaned in dollars, was better protected.

Another problem facing the development finance institutions was attracting funding. When resources from USAID dried up, the institutions no longer had a source of long-term capital. Four institutions converted into commercial banks: BANEX in Costa Rica, FDI and INSAFI in El Salvador, and the Financiera Hondureña (before it went bankrupt). COFISA, which is part of a financial group that includes a commercial bank, today provides mainly short-term loans. The case of COFISA highlights the problem of resources. USAID provided two loans to COFISA—one in the 1960s and the other in the 1980s. After each injection of capital, COFISA focused on long-term lending for a while, but then reverted back to short-term lending. The one development finance institution that failed because of poor investments was the Financiera Hondureña. As a result of loaning funds to coffee exporters and making poor investment choices, the Financiera Hondureña went bankrupt.

The issue of resources and access to credit helps to explain why only a few of the development finance institutions survived. One factor contributing to the success of both CABEI and LAAD-CA is support from USAID. The Agency had provided funding to CABEI since the 1960s. And when the bank was hard hit by the economic crisis of the early 1980s, USAID stepped in with $35 million in loans and $15 million in grants to help it overcome its short-term liquidity problems. As a regional bank and a main source of long-term capital for Central America, CABEI also has benefited from sources outside USAID, such as the IDB. Today, CABEI has diversified its funding base and no longer relies on USAID or other donors. In regard to LAAD-CA, funding from USAID over a period of almost two decades contributed to its success. Other factors include successful management and effective lending policies.

Of the seven financieras established by USAID in the 1960s, FIASA is the only one that survived as a medium- and long-term lender. It did not benefit from decades of USAID support. The reason for FIASA's success is that it diversified its activities and became a financial conglomerate. FIASA also created a separate commercial bank while still maintaining the original long-term credit function.

The majority of USAID-supported development finance institutions were not financially sustainable. In a region like Central America that is politically and economically unstable, long-term lending generally does not work unless there is funding from donors or governments. It involves risk, and most of the lending in the region is short-term and dominated by commercial banks. Also, long-term lending is only possible with long-term borrowing. But in Central America, domestic sources of long-term savings are scarce. This situation may change with the growth of pension funds and other sources of long-term investment.

The main problem for these institutions was how to continue as development banks without donor support. The findings of this paper concur with the 1990 CDIE study, which concluded that few development finance institutions achieved financial sustainability, and the most successful diversified their activities and mobilized domestic resources. The findings from the CDIE study and this paper also suggest that establishing development finance institutions may not be the best way to support capital markets.

Table 2:
Institutions That Did Not Survive as
Development Banks in Central America

Institution	Country	Outcome	Problem Areas		
			Policy Environment	Attracting Funding	Poor Investments
BANEX	Costa Rica	Turned into a commercial bank.		X	
COFISA	Costa Rica	65-70% of its lending is short term, and only 30-35% medium term.	X	X	
FDI	El Salvador	Turned into a commercial bank. It was then nationalized by the government and later privatized.	X	X	
INSAFI	El Salvador	Lending and equity investment functions dissolved. Part of INSAFI still exists as an institution that manages and privatizes government assets.	X	X	
Honduran Financiera	Honduras	Turned into a commercial bank and then went bankrupt.		X	X
FIA	Honduras	Provides mainly short-term loans.		X	
INFONAC	Nicaragua	Dissolved	X		
CNI	Nicaragua	Dissolved	X		

VII. BIBLIOGRAPHY

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Annex A:
List of Persons Interviewed

Persons interviewed in Central America, November 10-24, 1997

El Salvador

1) Jorge Adalberto Salazar, Lawyer, Central Reserve Bank of El Salvador

2) Francisco Bertrand Galindo, Superintendent of the Financial System and former official of the National Bank for Industrial Promotion (BANAFI)

3) Pilar Coto Cevallos, General Manager, CORSAIN

4) Rolando Duarte S., President, Servicios Generales Bursatiles (brokerage firm), and former General Manager of the Development and Investment Financiera (FDI)

5) Alvaro Ernesto Guatemala, Director of the Program for Small and Microenterprise Development and former official of the Salvadoran Industrial Development Institute (INSAFI)

6) Roberto Hill, President, Bancorp, and former General Manager of FDI, 1967-1972

7) Patricia de Magaña, Economist, Servicios Generales Bursatiles (brokerage firm)

8) Herman Navas, Consultant to the Banco de Crédito Inmobiliario (CREDISA)

9) Edgardo Suárez Mallagray, Director of the Salvadoran Investment Corporation (CORSAIN)

Guatemala

10) Julio García Motta, Director, Consultores para el Desarrollo, and Former Vice President, Association of Bankers

11) Alejandro Mejía A., General Manager, Industrial and Agricultural Financiera (FIASA)

12) Tom Mooney, Former Loan Officer involved in setting up the financieras of the 1960s. Also, former director of the Latin American Agribusiness Development Corporation of Central America (LAAD-CA) from 1971-1990.

13) Juan Carlos Vercessi, Consultant, Banco del Quetzal

14) Julio Vielman, founder of FIASA and General Manager from 1968-1974 (phone interview)

Honduras

15) Dr. Felix Martínez, Former Legal Advisor, Central American Bank for Economic Integration (CABEI)

16) Práxedes Martínez S., Journalist, *El Heraldo*

17) Wilfredo Modenessey, General Manager, Industrial and Agricultural Financiera (FIA)

18) Enrique Paredes, Chief, International Finance, CABEI

19) Victor M. Rheinboldt, Director, Financial Division, CABEI

20) Dr. Mario Rietti, President, Consultores Financieros Internacionales, and former manager of the Tegucigalpa office, Financiera Hondureña

21) Dr. Nick Rischbieth Glöe, Treasurer, CABEI

Other Interviews

22) Mauricio Gómez, General Manager, Private Investment Corporation (PIC), Costa Rica, phone interview, March 1998

23) Guillermo Serrano, General Manager, Costa Rican Corporation for Industrial Finance (COFISA), Costa Rica, phone interview, March 1998