SAPRIN / EL SALVADOR

THE LIBERALIZATION OF THE FINANCIAL SYSTEM IN EL SALVADOR

SUMMARY

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Introduction

The liberalization of the financial system constitutes one of the priority areas in the Structural Adjustment and Economic Stabilization Programs, in the context of promoting the deregulation of economic activities. Financial system liberalization is of transcendental importance to "achieving the adequate level of competitiveness, increasing investment and increasing productive capabilities"[1].

The principal theoretical premises[2] that form the foundation for the liberalization of the financial system sustain that the monetarization of the economy and financial intermediation promote economic development, and that the policies that control interest rates and the direction of credit allocation limit the development of financial intermediation. These premises also sustain that the increase in the interest rates promotes higher profit investments.

As in the privatization process, the liberalization of the financial system also rests on the same orienting principle that emphasizes market mechanisms as the most efficient vehicles for assigning economic resources, as well as on the premise that this will lead to increased competitiveness and will better approximate the economy's maximum utilization potential.

In this context, the liberalization of the financial system required the privatization of the banks as a first step in its implementation, in order to continue with the establishment of a new legal and institutional set-up, in which the traditional role of the Central Banks would be modified. This would permit that the markets "acts freely" in the definition of the processes and the promotion of competitiveness.

The process of liberalization of the financial system

The re-privatization of the state banks

The nationalization of the banks in El Salvador occurred in March of 1980 in the middle of a civil war that defined military and political criteria for this reform. These criteria later created a crisis in the functioning of the financial system, which did not collapse thanks to governmental aid and the counterinsurgent conception of its performance.

Ten years after nationalization of the banks, the crisis of the banking system was undeniable. The banking deposits had contracted by a fourth, the total credits by a third, the debt level had

[1] As is expressed in the Social and Economic Development Plan (1989/994) of the Salvadoran Government.
[2] As argued by Ronald McKinnon and Edward Shaw

tripled and the liquidity coefficient had suffered a drastic fall to the point where it threatened the possibility of the banks to cover the legally required limit.[3]

Not withstanding the liquidity problems, the nationalized bank continued to channel its resources principally to large companies involved in traditional exports, commercial and manufacturing industries, through the concession of short-term loans and the predominance of property-based security agreements for loans.

These financing conditions and the performance of the economy increased the lack of confidence in the Salvadoran banking system, resulting in permanent capital flight out of the country. These conditions justified the re-privatization of the nationalized bank. The private intermediation would "guarantee" greater efficiency and competitiveness. Also, the liberalization was conceived exclusively based on the dominance of private bank capital.

The political predominance of the country's most conservative business class determined the form that the reprivatization of the banks took, reflecting the typical processes of accumulation and taking advantage of the State apparatus observed during past centuries. The Salvadoran business class, particularly those connected to government officials, resorted to their influence in the new banking authorities in order to achieve a privatization favorable to their economic interests, taking special advantage of the deficiencies in the legal and regulatory mechanisms.

In order to proceed with the privatization of the bank, it was necessary to first take care of the clients in debt. This function was assumed by the government, based on the law of "Financial Restructuring and Strengthening of the Commercial Banks and the Savings and Loan Associations" passed in 1990. In this law it states that given the insolvent situation of the banks, the State would assume responsibility for rectifying their insolvency through the creation of the Fund for Financial Restructuring and Strengthening (FOSAFFI).

In December of 1990, the "Law of Privatization of the Commercial Banks and the Savings and Loan Associations," was created. Among its objectives were the restructuring and strengthening of the financial system, the democratization of the system through the sale of bank stocks to a large quantity of new stockholders—including bank workers and small investors—given that no bank owner could hold more than 5% of the stocks.

In practice, the privatization privileged the interests of the principal private stockholders. The process for selling the stocks was been heavily criticized. Although workers from the financial sector and small investors were granted participation in the stock sale, it is widely known that the financial system ended up, once again, under the control of the dominant economic groups.
The privatization of the banks created a new setting for the concentration of capital, giving origin to a new process of original capital accumulation that permitted the recomposition of the

[3] Góchez, Roberto. "Evaluation of the Banks and Financial Institutions Based on the Objectives of the Privatization of the Financial System 1992-1996". BA thesis, UCA, September 1997

country's dominant economic groups. By 1992, eight banks had been privatized along with four other financial institutions. In 1998, there existed more than fifteen commercial banks and another five financing institutions (financieras), as well as a complex financial structure that gave way to the consolidation of financial groups consisting of private banks, financing institutions, insurance and finance societies, stock-exchange brokers, money-changing houses and pension-fund administrators.

Despite the achievement of relative equilibrium in some macroeconomic variables, the Structural Adjustment and Economic Stabilization Programs contributed strongly to the formation of a process of accumulation and concentration of a group of businesses that in five years has converted itself into the principal controller of Salvadoran capital.

The regulatory and institutional framework for the liberalization of the financial system

The privatization and liberalization of the financial system required the restructuring and modification of the public institutions linked to the sector, as well as the creation of new institutions capable of facilitating the functioning of the system.

During the first five years of the nineties, there were important transformations in the regulatory framework for the financial system, given that the laws that regulated its functioning did not respond to the new logic that the global process demanded in terms of financial performance.

The restructuring of the debt portfolio in the banks was a condition required to further the privatization process. In the context of the functioning of FOSAFFI, it was the Central Reserve Bank of El Salvador (BCR) that carried out the selection of the commercial banks and the savings and loan associations that would be subject to restructuring and strengthening.

As part of the process of transformation of the financial system, there are two important modifications that were carried out, that would be reflected in the system's future performance: the Superintendence of the Financial System was created and the functions and competencies of the Central Reserve Bank were modified.

The Law establishing the Superintendence of the Financial System, approved in November 1990, was meant to guarantee an agile and solvent financial system. Its principal goal was to supervise compliance with the dispositions applicable to the institutions subject to its control. This included the supervision of the Central Bank, the commercial banks, the savings and loan associations, the stock exchange markets (at that time), the National Housing Fund, the Social Housing Fund, the National Pension Institute for Public Workers, the Social Provision Institute of the Armed Forces, the Agricultural Development Bank, the National Bank for Industrial Development, the Mortgage Bank of El Salvador, the Federation of Credit Unions, the *FOGAPI*, the Salvadoran Social Security Institute, among others.[4]

[4] Organic Law of the Superintendence of the Finanical System, Article 2.

Parallel to this, various attributions and functions of the BCR were modified through the Organic Law of the Central Reserve Bank of El Salvador, passed in April 1991. This law establishes as its principal objectives the orientation of monetary policy, with the stability and growth of the economy, the promotion of domestic savings, the institutional autonomy of the BCR and the limitation on credit from the BCR to the State for financing the fiscal deficit, among other things.[5]

In the same period (April 1991), the Law of Banks and Financial Institutions was approved to prepare for the functioning of the private financial system starting with the privatization of the nationalized bank. The stated goal was the creation of an efficient, stable and solvent financial system with an adequate level of organization.

Other modifications undertaken during these five years, were the redefinition of the role played by the state development banks and the creation, in 1994, of the Multisectoral Investment Bank (BMI), as a second-tier bank. Its mission would be the promotion of the growth and development of all the productive sectors, enterprise development and competitiveness, fomenting the development of the small and medium enterprises, generating employment and improving educational and health services.[6]

Other laws were also approved in the liberalization process of the financial system, including: the Law of Foreign Money Exchange Houses (April 1990), the Law of the Stock Market--with the objective of "regulating the supply of stocks, the transactions, their respective markets and intermediaries and their emission, with the final goal of promoting the efficient development of these markets and supervising the interests of the investing public"[7]--, and the Organic Law of the Stock Superintendence (September 1996).

The Stock Superintendence was to supervise the stock market and the entities involved in it, among which the primary ones are: the stock exchanges, the stock exchange brokerage houses, the general deposit storage institutions, the societies specialized in the deposit and custody of stocks, the risk classification societies and other institutions related to the stock market's functioning.

In this liberalization process, some of the operations managed by public institutions are transferred to the private companies. In this way, in the context of the financial system reforms, in December of 1996 a law was approved for the creation of a system of savings for pensions. This changed the logic of the former system based on inter-generational solidarity to a logic of individual capitalization, and created for this purpose a private intermediary called the Pension Fund Administrators (PFAs).

[5] Organic Law of the Central Reserve Bank of El Salvador, Article 3.
[6] Law creating the Multisectorial Investment Bank, Article 2.
[7] Law for the Sock Market, Article 1.

The PFAs are defined as "provisional institutions of a financial character that will be exclusively concerned with the administration of the Pension Fund and will manage and provide the benefits that the law establishes. They will be constituted as private business societies of fixed capital, with no less than ten individual shareholders, of an indefinite time span, located in El Salvador and required to maintain at least one agency or national office destined to serve the public." [8]

The system is supervised by the Superintendence of Pensions, which regulates affiliation, transfers and dues (contributions), the institutions administrating the pension funds as well as the administration process, their dissolution and liquidation. With the passage of this Law, the Superintendence assumed the principal purpose of supervising, monitoring and controlling compliance with the legal dispositions applicable to the functioning of the System of Pension Savings and the System of Public Pensions (the Salvadoran Social Security Institute and the National Institute of Pensions of Public Employees and the FPAs).

In addition, to supervise and monitor the functioning of the insurance companies, responsibility of the Superintendence of the Financial System, the Law of Insurance Companies was approved in October 1996. The purpose of this law was to regulate the establishment and functioning of the Insurance Companies and the participation of the insurance intermediaries, as well as their organization, administration and operations. In the same fashion, it legislates the regulation, intervention and liquidation of these companies.

The normative and institutional framework required by the financial system to consolidate the liberalization was completed with this last law. After this process the Central Reserve Bank of El Salvador was the monetary authority; the regulatory agencies were the superintendencies of the financial system, the stock market and the pension funds; the financial intermediaries were the private banks[9] and the private financing institutions[10]; and the official institutions were the Foreign Information Office, the Official Credit Institutions, General Deposit Storage Institutions, Financial and Insurance Companies, Stock Broker Companies and Money Exchange Houses.

Characterization and functioning of the financial system

The structure of assets, liabilities and capital resources

The bank assets predominantly constitute the structure of the financial system assets. In 1997, these represented more than 90% of the total (58 billion colons), while the financing institutions represented 5% and the insurance companies 2.8%, the official credit institutions 1.6% and the money exchange houses 0.2%.

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[8] Law of the Savings System for Pensions.

[9] They are constituted as anonymous business societies, with a minimum capital of ¢50.0 million. They need previous authorization from the Superintendence of the Financial System in order to initiate operations.

[10] They are constituted as anonymous business societies with a minimum capital of ¢25.0 million. They can carry out all transactions as a bank, except capturing deposits in checking accounts.

The structure of liabilities maintains the same scheme. Almost all of the total liabilities correspond to the banks (54.2 billion in 1997), while the rest only represented 2.1 billion or 3.4% during 1997. This because of the default of several of these institutions[11], but mostly because of the transformation of the financing institutions into banks.

In terms of patrimonial assets, the commercial banks had 78.3% in 1997, the financing institutions 5.0% and they are followed in order of importance by the insurance companies (10.5%), the official institutions (5.8%) and the money exchange houses.

The portion of assets belonging to the private banks reflects an oligopolistic structure that is a defining characteristic of the Salvadoran financial system. The five principal banks accumulated 77.3% of the system's total assets in 1994: the *Banco Agrícola* held 24.8%, the *Banco Cuscatlán* held 21.3%, the *Banco Salvadoreño* held 13.7%, the *Banco de Comercio* held 10.4% and the *Banco de Desarrollo* held 7.1%. Although the total accumulation of these banks was reduced in percentage terms to 69.3% in September 1998, this does not imply that the oligopolistic characteristic has been overcome.

The composition and geographical distribution of deposits

The banking deposits have been permanently and considerably increasing during the process of financial liberalization. Analyzing the deposit structure in 1997, 74.2% of the total deposits were short term, followed by checking accounts (16.8%) and the long-term deposits (11.2%). It is possible that this structure reflects certain public fear of placing their money in long-term deposits, especially after the financial bankruptcies that have occurred since 1995.

The participation of banks in the structure of the deposits also confirms the oligopolistic character of the financial market. In 1998, among the five principal banks that managed 83.8% of the total deposits in checking accounts, the *Banco Agrícola* and the *Banco Cuscatlán* managed more than 50% of these accounts.

Analyzing the structure of deposits geographically, one observes an important concentration in four of the fourteen departments of the country. In 1998, San Salvador, La Libertad, Santa Ana and San Miguel held 91% of the checking accounts, while 47% of the total users of the commercial banking system were concentrated in the department of San Salvador alone.

The composition and placement of credit

[11] When you analyze the privatization, or the buying of shares from other financial institutions such as the insurance companies, pension fund administrators and stock brokerages, one finds that the concentration of the capital of the financial system is the principal economic movement in the last decade of the last century and, it has been argued, is of significant importance for the development of the national and regional economies. Including a greater importance than the structural adjustment and economic stabilization programs that were implemented.

The loans granted by the commercial banks have been increasing since the privatization of the state banks. They went from 26.513 billion colons in 1994 to 30.041 billion in 1998, with a growth rate of approximately 11.7%.

The strong concentration of loans among the five most important banks of the system is also noteworthy. The *Banco Agrícola*, with 8.141 billion colons in it loan portfolio in September of 1998, represented 19.3% of total loans and the *Banco Cuscatlán*, with 7.903 billion colons, represented 20.5%, meaning that 39.8% of the total was accumulated in the two banks. If we include the loans made by the *Banco de Comercio*, *Banco Salvadoreño* and *Banco de Desarrollo*, these five banks represent 67.3% of loans.

Reviewing the terms of the loans made by the principal banks of the system, it can be seen that, on average, 86% of loan portfolios represented loans of up to three years, which is considered short term, while 6.1% were medium term (3 to 5 years) and 6.9% were long term.

The placement of credit in terms of the total amount granted has increased by 119.3% between 1992 and 1997. The sectors that have showed the greatest growth are commerce (252.8%), services (783.8%) and construction (183.8%), while the agricultural sector has experienced an important decrease in the use of credit during this same period. It is evident that the commercial banks have influenced the placement of credit, privileging non-productive sectors to the detriment of the sectors that have traditionally constituted the most important sources of value-added generation, foreign exchange and employment.

The lines of credit established by the private banks are financed by diverse sources: their own funds, funds from the Multisectorial Investment Bank and other sources. In general they are used to grant personal loans, mortgages, microenterprise loans, rotating credit funds and special credit lines. During the period 1990-1997, only 16.2% of the total loan amount was granted to small and medium-scale enterprises, and the individual loan amounts were quite reduced -- less than 500,000 colons -- with the exception of those oriented towards industry, agroindustry and construction.

Loans for environmental activities are included in credit lines for new perennial crops, for the planting of new areas of tree-based crops (primarily coffee) and for environmental recovery and conservation. This last credit line only represented 4.1% of loans for the environment, or 3.2 million colons, representing only 0.06% of the total loan portfolio of the Multisectoral Investment Bank.

The banking system debt

Analysis of the banking system debt allows us to detect the level of liquidity of the system. This is calculated based on the credits and other loans granted by financial institutions that have not been paid in full before the date of their contract expiration.

The conditions for recovery of loans in the private banking system have been generally quite favorable and have increased during the period of the research. In 1998, the loan portfolio had an acceptable rate of loans in good or relatively good standing, representing 92.0% of the total, while loans in arrears or those considered difficult to recoup represented 6.0% and unrecoverable loans represented only 1.8% of the total.

In general, all the banks present a debt rate of less than 5.0%, including loans rated as delinquent, difficult to recoup and unrecoverable. This gives an idea of the situation of liquidity of the system, with the exception of the state bank, which presents high levels of debt.

The interest rates

The reference rates for borrowing, corresponding to loans of up to a one-year term, following privatization of the banks, experienced a monthly increase in the first years of functioning before declining somewhat and stabilizing. In January 1992, these rates were around 13.8%, increasing to 20.2% in February of 1996 and later contracting to 14.6% in September 1998. In contrast, the interest rates for savings have experienced a monthly oscillation with a tendency to decrease. In January 1991, the reference rate for savings (deposits of 180 days) was 12.0% and in June 1998 it had decreased to 10.1%.

The difference between the borrowing and savings interest rates is called the spread, and it measures the margin of financial intermediation. The dynamics of the spread have demonstrated a relative stability in recent years, with an average margin differential of 4.5 percentage points for loans less than a year and interest rates on deposits of up to 30 days. Similarly, the average spread was 4.6 percentage points when considering loans longer than a year and deposits of between 30 and 60 days.

It is important to indicate that the interest rates available in the country are significantly different from those prevailing in the United States market. The rates in the local market are generally significantly higher and in some cases are double the existing rates in the United States. This shows that the state has favored speculative investment rather than investment directed to productive activities.

Without a doubt, the differences between the interest rates for borrowing and for savings reflect the fact that banking capital has experienced extraordinary profits. This is not only due to the margin of difference, but also to a period of relative price stability in which inflation rates have been reduced but have not been reflected in the interest rates for loans.

The guarantees and the banking commissions

From the perspective of the user of credit, one of the biggest weaknesses and limitations of the banking system is the guarantees required as a condition for receiving loans, given that these severely limit access and the possibility of getting a loan approved.

In the majority of cases, guarantees such as a mortgage or trust are required, which strongly limits access to credit given that this condition is applied without considering the origin of the applicants, whether they are urban or rural, or whether they are from small, medium or large-scale businesses. Frequently it is also necessary to present two or more co-signors as well as comply with a large number of other conditions to obtain credit. These requirements can explain, in some way, the low levels of loans in arrears or unrecoverable loans.

The commissions, the administrative and legal costs that the bank charges for the evaluation of loans and for the use of the resources provided through loans, are another relevant aspect.

The profitability of the banking system

The profitability of capital resources measures the relation between the utility or loss after taxes and the average net capital resources; it also indicates the profitability after taxes for stockholders. The performance of this ratio shows a reduction from 21.4% in 1994 to 4.2% in 1998, which shows the drastic reduction in the reported levels of financial profitability experienced by the banks during this period.

These results are observable for the private system in general, which suggests the existence of a recessive tendency or an important increase in the competition between banks. It is worth noting that in specific banks, the loss of profitability of capital resources is very significant, having decreased from 41.7% to 6.6% in the case of the *Banco Agrícola Comercial*.

On the other hand, the indicator of after-tax utility for average assets from intermediation reflects the net profits obtained in the process of intermediation, that is, the level of efficiency with which the resources of financial institutions have been used for intermediation. This indicator decreased from 1.9% in 1994 to 0.4% in 1998, showing a similar trend to that involving profitability of capital resources.

The development bank and the financial institutions of the State

The loans granted by these institutions have increased between 1994 and 1998. The *Banco de Fomento Agropecuario* (Agrarian Development Bank, BFA) went from loaning 1.066 billion in 1994 to 1.228 billion in 1998, while the *Banco Hipotecario* (Mortgage Bank) increased its loans from 1.128 billion to 1.277 billion in 1998. However, both banks show the poorest conditions in terms of recovery of their outstanding loans within the system. In fact, in 1992 the loans rated as delinquent, difficult to recoup and unrecoverable represented 68.5% of the total loan portfolio in the BFA and 34.3% in the *Hipotecario*. In 1998 these dropped to 43.6% and 10.0%, respectively, reflecting and important restructuring of their loan portfolios.

The amount in arrears in the loan portfolios of these public intermediaries is very significant. In 1994, the BFA had a rate of 24.8%, increasing to 25.8% in 1998, while the *Banco Hipotecario*, with a rate of overdue loans still above that of the private banking system, went from 6.9% in 1995 to 5.5% in 1998. The interest rates, the lines of credit by sectors, the commissions and the administrative costs were similar to those of the private banks, given that in recent years these institutions have increasingly begun to function using criteria closer to those in the financial market.

The indicator that measures utility after taxes with respect to the assets of the intermediating institutions is not significantly different with respect to the private system. In the case of the BFA, this indicator decreased from 1.2% in 1994 to 0.3% in 1998, while in the case of the *Banco Hipotecario*, it dropped from 0.4% to 0.03%, demonstrating that there were serious problems of profitability for these banks. Equally serious are the levels of profitability of other state institutions, including *FIGAPE*, with a ratio inferior to 10%, and *FONAVIPO*, which has suffered a notable decrease in this indicator over the last several years.

Repercussions of the liberalization of the financial system for the environment

The functioning of the Salvadoran economy does not take into account the environmental requirements that natural resources demand for their sustainability and recovery. In fact, El Salvador is one of the most environmentally degraded countries in Latin America, only surpassed by Haiti. However, there is no adequate environmental legislation -- the necessary regulations to put the new environmental law into effect do not exist -- and there is no real interest to solve environmental problems.

If the process of liberalization of the financial system has influenced the deterioration of the environment, it has been basically due to the absence of clear policies in this field. Examples of this are: the absence of a specific credit line for the environment; the lack of environmental criteria for making loans; the lack of adequate supervision in the approval of loans intended for use in technologies that are non-degradable, contaminating or dangerous; the reduction in the effective protection of the agricultural sector and the effects this has had on environmental deterioration; and the impact on environmental management resulting from the reduced role of the development bank.

Equally, there is a clear lack of criteria to reconcile the improvement of business competitiveness and efficiency with care for the country's environment. It is important to consider that the environmental costs are not taken on either by private businesses or by the State, and that their incorporation could modify the prevailing criteria of competitiveness and efficiency.

In addition, the Superintendence of the Financial System does not include among its functions an analysis that takes into account environmental criteria. Indirectly, it could be said that if the formal financial system has been financing the current growth model in the country that has caused a permanent deterioration of the environment, then the liberalization of the bank has contributed to said deterioration. Projects financed through private banks for construction, the installation of environmentally contaminating companies, tourist installations and the importation of contaminating materials, confirm the compliant attitude of the banking system in this sense.

Repercussions of the liberalization of the financial system for small and medium-scale enterprises

The participation of the micro, small and medium-scale enterprises in the credit structure of the formal financial system has been very small. The loan portfolio of the banking system oligopoly for this sector barely amounts to 23.3% of the total loans made, with 13.4% given to microenterprises, 5.0% to small-scale enterprises and 4.9% to medium-scale enterprises.

The formal financial system financed a total of 97,737 micro and small-scale enterprises in 1995, with an average value of only 6,720 colons per loan. Although this amount increased to 9,600 colons in 1996, it is still insufficient to permit investments that would favor the development of the productive capacities of these businesses and achieve an adequate level of investment.

The formal financial system has not been capable of covering the credit needs of the urban microenterprises. A study carried out for this sector indicates that their principal source of financing is from loan sharks (38.8%), followed by *Fedecrédito* (18.8%), the commercial banks (15.0%), family resources (8.8%), NGOs providing credit services (7.5%), the communal banks (1.2%) and other forms of financing (10.0%).

From this same study[12], it can be seen that 29.1% of the people interviewed said that lack of credit was one of the principal problems limiting their development. This is the case in spite of that fact that 71.4% of shop owners and 60% of the businesses in the service industry

[12] "*Créditos para los sectores populares en El Salvador*," pages 81 and 86.

continually use credit services. In the agricultural sector, 61.5% of producers of basic grains, 50.0% of cattle farmers, 53.4% of producers of non-traditional crops and 4.0% of producers of traditional crops do no receive credit.

In the cooperative sector, the principal sources of credit have been the BFA with 59.0%, NGOs with 5.3%, the banks and financing institutions with 11.4% and the cooperative federations with 10.6%. Individual cooperative producers depend on the cooperatives and credit federations for over half their financing; the other sources they access are the BFA (26.7%) and NGOs (4.1%), while they have almost no access to the formal banking sector.[13]

The primary obstacle to the access of formal-sector credit is the imposition of restrictive requirements that are not in tune with the particularities of the diverse sectors that need credit. This difficulty of access to financing has stimulated the appearance of unauthorized loan intermediaries (loan sharks), who provide credit at high rates of interest under conditions that are unfavorable for the micro and small-scale enterprises.

Among the credit lines established by the Multisectoral Investment Bank (BMI) are: financing for industrial reconversion, financing for the development of free-trade zones; the commercialization of industrial and artesanal products for export; conservation, distribution and marketing of agricultural products and their industrial derivatives; financing for service companies for the repair and maintenance of machinery and equipment; development of agricultural and animal husbandry; and planting of tree-based crops (coffee).

The amount of funds available from the BMI in 1998 was greater than 2.8 billion colons, although in the practice the funding available for micro and small-scale enterprises was only 16.2% of this total amount. Furthermore, businesses have not been able to take advantage of the existence of funds for the small and medium-scale enterprises available from the Central American Bank for Economic Integration (BCIE).

Without a doubt, the new guarantees demanded by the financial system after the privatization of the banks, the criteria for making loans and the absence of a development bank providing credit to the sector explain the weak performance of the financial system in terms of financing for small and medium-scale enterprises.

With the liberalization of the financial system, the structure of loans was abruptly modified to favor activities of the tertiary sector, particularly commerce and services, which clearly affected the productive capacity of the micro, small and medium-scale enterprises. This showed not only that there was a clear discrimination in channeling credit to specific economic sectors, but also that there was very little credit channeled for infrastructure -- a basic condition for increasing the competitive capacities of national enterprises -- and sectoral reactivation, given the absence of

[13] Ibid. pg. 95 - 97

credit lines for industrial and agricultural development that increase the working capital of the businesses.

The role of the BMI and the consistency of its policies are very debatable in that it services the interests of the country's big banks instead of carrying out the development functions for which it was created.

The liberalization process claimed to manage real positive interest rates, and in the decade of the nineties, there was an indiscriminate increase in interest rates that favored the margin between borrowing and savings rates to the benefit of banking capital. The positive spread will be one of the achievements of the new process of bank privatization. However, it is not a coincidence that representatives of micro and small-scale enterprises indicate that after privatization the interest rates for borrowers have been much higher while the interest rates for savings have been reduced, a situation that has negatively influenced their levels of business capitalization resulting from a reduction in their savings capacity due to a drop in profits.

Also, the additional rates imposed on overdue loans, when the businesses get behind in their payments, lead to the accumulation of interest. This is especially damaging for the small and medium-scale businesses because it reduces their liquidity and increases their chances of falling into insolvency and thus encountering important difficulties in solving their credit problems.

Additionally, there continues to be renegotiation of new terms of payment of overdue loans without defining new alternatives for training of the micro, small and medium-scale enterprises to offer them greater productive possibilities that could compensate for the disadvantages that these additional payments mean for their businesses.

In the agricultural sector, the discontent of many farmer representatives is related to the lack of correlation between the interest rates and the real conditions of production and commercialization of agricultural products. The high prices of agricultural inputs and the low prevailing prices being paid for various crops are not taken into account in setting interest rates, meaning that the policy becomes a restraint on investment and development in the agricultural sector.

The performance of the financial system, with respect to interest rates, has created a perverse effect on relative prices to the detriment of the productive sectors and, thereby, of employment generation, thus negatively affecting the living standards of the population.

Another explanation for the limited use of credit by the micro, small and medium-scale enterprises, is the guarantees required. With the liberalization of the financial system, there was a considerable reduction in the use of pledge guarantees and the system of group solidarity guarantees disappeared, and these were replaced by mortgage guarantees.

In the financial system there is no possibility for new businesses to cover these guarantees through alternative means. This is particularly true for micro and small-scale entrepreneurs who are young or female. The guarantees are inflexible and very conservative in relation to the new development ideas that exist in the world.

Given the prevalence of loans made for less than five years (more than 93%), borrowers have little time to let their investments mature and, thus, there are few possibilities to invest in infrastructure, machinery and equipment that require a period longer than five years for investment recovery. This is a significant limitation for increasing the productive capacities of businesses in this sector.

Also, given that the financing provided by the financial system has been insufficient to cover the investment and operating needs of small and medium-scale enterprises, it is to be expected that the development banks would take responsibility for filling these needs. However, these banks have assumed a role very much like that of the commercial banks, such that the objective of development has disappeared with the justification that it is competitiveness and market criteria that should determine the credit conditions for businesses to be supported.

More important than the small contribution of the development banks to the financing of the micro and small-scale enterprises is the loss of the development vision that should inspire the functioning of these banks. This is reflected by the fact that the government and international financial institutions pay little attention to the micro and small-scale enterprises, ideologically insist on market criteria as a guarantee of efficiency and rationality, and establish favored relationships with the private banking system. Above all, it is expected that micro and small-scale enterprises should perform as modern and efficient businesses without the training needed to achieve a transformation and improve their productivity, forgetting the traditional form of functioning that prevails in this sector. Furthermore, there is no recognition of the important contribution of this sector in generating employment and income.

It is evident that one cannot demand that the private bank act as a development bank, as its interests and purposes are different. However, likewise one cannot demand that the development bank act using the criteria of a private bank, as its objectives are also different. It is precisely on this equilibrium that the successful development of the future financial system depends.

Women's access to credit

As has been stated, for the formal financial system the requirements of guarantees and the credit history of the potential borrower are what determine credit access. Although there are financing programs in which women participate,[14] in reality women do not satisfy the loan requirements,

[14] See financing programs from the BMI, BCIE and others.

given that most of them are not property owners, lack documentation and business records, and therefore have great difficulty meeting the mortgage guarantee requirement.[15]

From the point of view of the formal financial market, "the management of the finances is in the hands of monopolistic banking companies and the national and international stock markets that direct lending toward big business and urban industry to the detriment of small and medium-scale enterprises and the rural sector."[16] These areas are where the majority of independent, working women are concentrated, especially women heads of household on whose income the family is entirely dependent.

Studies carried out on the problem of providing financing for women show that a high percentage of women who enter the informal market have to compete in a saturated market in which the possibilities for growth are few. This is tied to the lack of training and knowledge of marketing techniques for those activities with greater growth potential.

Despite the proliferation of credit programs promoted by NGOs and by governmental agencies, access to credit by women in the informal sector continues to be low. Only 23.0% of the women reported having received any credit for business operation or investment, while the remaining 77.0% indicated a clear lack of access to credit by their sector.

Women are caught in a vicious circle. Unable to guarantee loan repayment according to the cost-benefit criteria of the formal banks, women do not receive loans to invest in their businesses, thus reducing their ability to continue their business activities at levels that would allow them to move from subsistence to accumulation.

In addition, there are other aspects that make women's access to credit difficult. Among these are: the lack of information to present and justify financing for a project, along with the lack of opportunities and meagre income that does not allow them to maintain an organized accounting register; the very high interest rates, given that women generally only access loans outside the formal system; the small size of loans approved for women to finance their enterprises -- 92.0% of loans provided for women do not exceed 3,000 colons; and delays in disbursements of funds once approved.[17]

Furthermore, the structural problems of Salvadoran society are not reflected in credit policies for Salvadoran women. Instead, the system seeks to resolve this problem using business criteria that do address the situation of the population sector involved. This is one of the greatest weaknesses of the social compensation programs incorporated into the structural adjustment and economic stabilization programs.

[15] Ibid, pg 10.11
[16] "*El acceso de las mujeres al crédito*," *Movimiento de Mujeres "Mélida Anaya Montes"*, San Salvador, August, 1998, p.6
[17] Ibid, p.11 and 12

Conclusions and final reflections

One of the stated purposes of the bank privatization process was the democratization of participation by stockholders. However, this was not carried out and far from it, the process permitted a new concentration of banking assets in those families that have traditionally been the most powerful in the country. These groups were those most favored by the privatization and liberalization of the financial system.

Analyzing the privatization of the financial institutions demonstrates that the concentration of capital from the financial system was the principal economic movement of the last decade of the past century. This permitted the financial sector to convert itself into the strategic, most important sector in the Salvadoran economy. This is made more evident by showing the oligopoly structure of the financial system in which five banks control the majority of the financial market, although competition has increased in the last few years of analysis.

Until 1998, financial indicators showed that the performance of banks and other commercial financial institutions was highly favorable, achieving a significant level of growth. Financial assets performed well, and there was an increase in public deposits (increased savings) and in the loan amounts provided to various economic sectors in the country. However, the loans provided during recent years have been directed fundamentally to the commerce and service sectors, to the detriment of agricultural and industrial activities.

During the first half of the nineties, the amount of loans in arrears was quite small, showing a convenient relationship between loan repayment and banking assets. In this way, the indicators of liquidity and solvency of the commercial banks were satisfactory, as were the indicators of banking efficiency and profitability. However, in the second half of the nineties there has been a slight tendency to increase the ratio of loans in arrears.

Despite having achieved one of the principal objectives of liberalization -- real positive interest rates -- with a spread highly favorable to the interests of banking capital, El Salvador is the country with the worst credit conditions for borrowers, given the margin that exists between the interest rates and inflation.

It is important to emphasize that the financial system has contributed little to the business reconversion and the technological transformation required for the country to achieve greater levels of competitiveness and efficiency in a global context. Furthermore, in environmental terms there have been no considerable efforts made by the system to recover the country's natural resources.

The planned dismantling of the development banks is well-known, and these banks have been gradually disappearing without creating alternatives for those sectors they served. On the contrary, the second-tier state bank has begun to function more and more with highly questionable development criteria, significantly favoring the commercial banks. The small and medium-scale enterprises have been seriously affected by this situation and would have been affected much more had it not been for the significant increase in the operations of non-formal financial institutions.

The Superintendence of the Financial System, has played a very passive and questionable role, almost exclusively favoring the interests of the financial institution owners. Thus, the majority of indicators provided by this superintendence and utilized in this work should be taken with prudence, given that they do no adequately reflect the accounting reality of the financial institutions. It is sufficient to cite the astonishing accounting data from institutions like FINSEPRO, INSEPRO, FINCOMER and CREDISA that were suddenly considered institutions in bankruptcy or with serious operational problems. The attitudes of the “monetary authorities” have contradicted the new role that had been assigned to the Central Reserve Bank, and demonstrate again the inseparable relation that exists between the management of this institution and the interests of the private finance capital.

The Salvadoran financial system has operated almost exclusively based on an effort aimed at accumulation, far from the requirements that economic development demands. Its has converted itself into the dominant sector in the Salvadoran economy and has generated a process of economic transfer from other sectors towards itself, particularly through interest rates, commissions and extra charges on overdue loans.

Based on the above, it is possible to conclude that the financial system in El Salvador has been relatively efficient in its administrative performance and its profitability. However, its performance has been highly insufficient with regard to what the country needs to achieve development. In addition, much of the system’s performance has become an obstacle to the achievement of national competitiveness and to economic efficacy in the long term.

Financial liberalization in the first half of the nineties was a partial success in improving the performance of the financial system, permitting a more rational and competitive functioning. The global objectives set out for the reform, however, were not satisfactorily achieved. The country finds itself with greater poverty levels, few advances in the area of sectoral competitiveness, greater concentration of wealth and low levels of productivity.

Based on this analysis, the following reflections from this work are relevant:

Using a broader concept of development, it is necessary to reconsider the role of development banking in the context of the liberalization of the financial system. Development banks should be given importance as such. The second-tier state bank should be strengthened and closely linked with the objectives of growth, employment and income generation, giving it a role in intermediation that benefits society’s most vulnerable groups and takes into account the needs and interests of diverse sectors of the population. For this type of intermediation, competitiveness and efficiency are not the only requirements; rather it should be separated from the formal banking system in order to decrease the margins of intermediation.

Modernization of the development bank continues to be a challenge. This bank should strengthen sectors that the commercial bank traditionally does not serve but are strategic for the economy and the population. This bank can and should be conceived as an instrument of social and economic compensation for the perverse effects of adjustment programs.

Finally, it is also indispensable to strengthen the supervision of the financial system. It is necessary to maintain its independence and autonomy, with adequate staff and without ties to the interests of the financial institutions under supervision. In this way, it will be possible to guarantee truthful and transparent information flow concerning the financial system, permitting the public to make adequate decisions concerning the management of their capital and also an adequate functioning of the private financial system.

[NOTE ON CURRENCY EXCHANGE: One U.S. dollar is equal to 8.75 Salvadoran colons. This rate has not varied in any significant way over the past 10 years.]