

CHAPTER 1

CREDIT AND FINANCING FOR AGRICULTURE IN PERU

José A. Salaverry Llosa²

INTRODUCTION

Within the broader context of “the modernization of agriculture in the nineties”, the study presented herein refers to the subject of credit and financing for agriculture.

We consider that this subject cannot be properly reviewed or evaluated if we overlook the context in which the events took place, that is, without bearing in mind the main aspects that characterize the evolution of Peru’s economy in the real and financial fields. Section 1 describes the events that occurred at the end of the decade of the eighties in order to provide an adequate background of the characteristics and conditions of the crisis that cover the period of 1987 to 1990 for the purposes of this study.

1. The Scenario of Macroeconomic Policies and Rural Financing at the End of the Decade of the Eighties.

Therefore, we consider that there is a need to discuss two fundamental aspects of macro-economic policies that determined the behavior of the Peruvian economy and its financing.

1.1. The macro-economic background and rural financing.

By the end of the decade of the eighties the economy of Peru followed the trend of most Latin American economies which were characterized by :

- a scarcity of domestic savings that revealed a traditionally low rate of savings in relation to the growth of public and private investment proposed by development plans and programs;
- the effects of the recession generated by the inflationary process that lead to a fall in the level of income and purchasing power;
- a large flight of private capital;
- the application of foreign trade policies based on preferential and promotional quantitatively restrictive mechanisms, *inter alia*, exchange rate, tariffs, tax policy, and subsidized interest rates.

² The author claims intellectual property rights. No part may be used or reproduced in any manner whatsoever without written permission. The author wishes to thank visiting Professor Tatsuya Shimizu from the Institute of Developing Economies in Japan for having provided part of the funds for this study.

- a growing macro-economic unbalance in the fiscal field as well as an income deficit on tax expenditures and the accumulation of surplus earnings by public companies (low prices and public utility rates) and, the balance of payments deficit produced by internal clashes (the foreign debt, the recession of industrialized countries, a restricted access to technology and external financing in particular, direct foreign investments, etc.);
- a lack of technological and productive competitiveness in modern sectorial activities linked to manufacture and services, including their export capacity.
- according to proposals made by Ronald McKinnon (1973) and Edward Shaw (1973), financial repression is characterized by stopping foreign competition of domestic financial markets and applying oligopolic practices that restrict the competition of foreign banks in addition to insufficient banking regulations and interventions by monetary, credit and currency exchange authorities involving preferential interest rates, exchange rate controls, sectorial credit, *inter alia*.

Several experts have indicated that the greatest mistakes of governmental intervention have been made in the field of rural financing, usually characterized by :

- a) the application of concessionary interest rates, very often negative in real terms;
- b) more support for agricultural and livestock operations than rural activities *per se*;
- c) the practically total negligence of attracting rural savings in addition to mobilizing and the capitalization of such savings;
- d) the restricted application of the concept of rural financing to the sources of formal indirect credit granted by banks (commercial banks, financial development institutions, and non-banking entities (cooperatives, rural savings and loans and savings associations, etc.), overlooking other major financing sources described in Section 2.3;
- e) the establishment of expensive and inefficient financial and promotional loan mechanisms;
- f) the application of portfolio subsidies and losses by the Development Financial Institutions, the Development Banks for Agriculture and Livestock, Industries, Mining, Housing and, the Central Mortgage Bank, created since 1930.

1.2 Evolution of the Financial System and Rural Financing

The decade of the eighties was characterized by severe macro-economic imbalance and subsequent economic instability as well as a profound questioning of the old paradigm that dominated the design and proposals of Latin American development policies. In particular, the paradigm of an inward-looking sustainable development based on an industrialization strategy as well as policies that substituted imports and, the effects of the depletion of this “model”.

To this regard, the study carried out by the World Bank (1989) at the end of the decade of the eighties, reveals the main characteristics and problems of the evolution of the financial sector in developing countries covering three decades, from the 1950s to the 80s. The following are the most important characteristics stressed, since they can be applied in the analysis of the evolution of Peru’s financial sector:

- governmental control of finances as one of the most important intervention mechanisms and instruments of a country's financial systems in order to promote strategies to rapidly industrialize and modernize its agricultural sector;
- government intervention in the financial sector to channel cheap credit to the sector considered as priority;
- the inadequate capacity of the financial systems to grant credit resources for working capital and investment credit and other financial services needed to promote a rapid industrialization and modernization of the agricultural sector;
- few commercial banks in the formal financial system with a coverage of branch offices in the main cities of the country that could provide financing, mainly for corporate companies linked to foreign trade: the imports of inputs, spare parts and components for the manufacturing industries in addition to the import of capital goods that this sector needs to produce and export raw material;
- a growing difficulty of medium and small industrial companies to access credit in urban areas and the fact that small businesses in rural areas (rural-agriculture) hardly had any access to credit at all;
- the importance of the informal financial sector, comprised by individual money lenders, businessmen who helped to provide credit resources for small agriculture and livestock producers, small industries and businesses in general;
- a growing share of formal associations of financial institutions such as savings and loans cooperatives and Pro-Housing Mutual Funds, non-financial or quasi-financial institutions regulated by the government, subject to the inflationary impact produced by macro-economic policies and, in particular, an inadequate management and administration due to a lack of appropriate regulations and oversight.

On the other hand, the following are the main problems pointed out in the analysis of the evolution of the financial sector:

- The complexity, extension and high cost of the different government intervention regimes that resulted in a myriad of financial schemes for the distribution of credit resources, applying multiple eligibility criteria, credit guarantees, portfolio ratios, exemption percentages of mandatory cash reserves and a diversity of loans at preferential interest rates in addition to refinancing schemes.
- The Development Finance Companies were the main means of channeling direct credit programs focusing mainly on large and medium-large business sectors. Access to credit by small and medium industrial production units and by agriculture and livestock production units was limited to a few programs as concerns the number of borrowers and the amounts of credit allocated, despite a growing coverage of services through branch offices of the development banks located in the main cities of the country (capitals of departments and some capitals of provinces). (J.A. Salaverry , 1983, 1989).
- Risk of working capital and investment capital granted to medium and large entrepreneurial unit of production mostly related to the internal and external economic crisis cycles, involved increasing amounts of credit problems and losses for the Development Finance Institution.

- As concerns the internally-generated economic crisis, we can point out two types: i) those caused by governmental administrations based on foreign over-indebtedness accompanied by a poor design of financing policies and a worse tax administration, a lack of discipline of fiscal expenditures and resources due to inflationary financing, and ii) effects caused by Acts of God, such as the regular impacts of the El Niño phenomenon brought about by changes in the temperature of the ocean and in the weather.
- Distortions produced in resource distribution and the gradual weakening of financial discipline (including an insufficient control and banks supervision indispensable for the good performance of the entire financial system).
- Access concentrated on commercial bank credit to large and medium-large and medium production units and direct credit programs of development banks (with the influence of their preferential access due to economic and political importance of large corporate and family business units) have been mentioned as the main causes of the lesser need for these units to resort to other financing sources (resulting in a lower effective entrepreneurial savings, source of the flight of capital abroad and the hampering of the development of capital markets).
- The presence of private commercial banks in the national and regional scope and associated banks made up by a small number of institutions, with norms of ownership, limited capital and reserves, organized under the model of a traditional commercial bank, with a coverage of branch offices in the main cities, particularly in Metropolitan Lima, (competing against each other) in segmented and fragmented financial markets; based on the deposits and savings accounts (allowing the national commercial banks to consume the financial resources generated in the provinces); and, placing the resources that can be lent in self-liquidating operations to large and medium-large units, located basically in Metropolitan Lima.

1.3 The Double Financial Duality and Diversity of Rural Markets

Problems in the evolution of the Peruvian financial sector presented in the points mentioned above characterize the existence of what can be referred to as a double financial duality, that is related to fundamental aspects of the policies and practices of Financial Development: the creation of markets and the building up of institutions in under-developed economies.

- the duality in the development of the formal banking system in relation to the services provided in urban markets, characterized by the centralism of banks in Metropolitan Lima and the concentration of credit resources granted (basically in money markets or short term deposits) to the large, medium-large sectorial production units; and, in particular, foreign trade operations.
- the financial duality of rural markets characterized by highly segmented and fragmented local markets that practically have no access to credit or other financial institutional services by small producers and small land owners.

This double financial duality is the consequence of market characteristics that operate on a global, regional and sectorial level prevalent in the under-development of the Peruvian economy. These characteristics determine that the specification and analysis, both in real

and financial activities, to design and propose economic and social policies, are very complex and difficult for themselves and foreigners.

A financial development policy must take into account:

- a) the insufficient technical diagnosis of real local, regional, national and foreign markets that potentially needed to be developed in order to sustain the economic growth and development of the country's economic activities and those of its inhabitants;
- b) the need to develop differentiated policies according to heterogeneities of markets that require different degrees of intervention in the promotion and development of productive and social activities (gradual and orderly decentralization policies at an administrative, economic and financial levels) that will necessarily pass through a process of institutionalization and capitalization of activities on a local level (direct democratization policies).

1.4 Technical proposals concerning the reform of the financial system.

Lastly, we consider that in order to understand the financial reform applied in Peru in the decade of the 1990s, it is of utmost importance to point out that by the end of the decade of the eighties, the technical proposals of the financial system reform headed by the World Bank were based upon the experiences of financial liberalization and de-regulation since the seventies in some Latin American countries (Southern Cone economies) in addition to structural reforms in the real field of the economies:

- These proposals pointed towards eliminating controls on interest rates, applying free and more flexible interest rates; free exchange rates; reducing – or even eliminating – direct credit programs; generating a greater competition among the financial institutions by promoting the opening of domestic markets to foreign banks and authorizing the creation of new banks and non-banking financial intermediaries; improving the flow of information; enhancing banking managerial and administrative skills; promoting savings and financial discipline.
- The strategy proposed indicated the need to apply macro-economic reforms that would precede the gradual application of financial liberalization and de-regulation policies, in particular involving a timely re-structuring of insolvent banks, an improvement and strengthening of the regulation and control of financial systems and, in particular, special care in the opening of balance of payments capital accounts.
- The proposals for the financial reform acknowledged the tendency of the developed countries towards the “model” of a universal bank (entities that operate in commercial activities and investments) and, commercial banks or deposit banks made up by the few large banks in most developing countries would continue dominating the formal markets for many decades to come.

- Concerning the problem of the lack of access to financing by certain types of borrowers (small industrial urban companies and small agriculture and livestock producers and small rural agricultural landowners) the emphasis in the strategy proposed was based on strengthening the existent formal and informal institutions and building up financial institutions, that could adequately and appropriately provide financial services for such activities, in the so-called financial diversification policy.
- This policy stressed as prior actions or simultaneous solutions: i) legal aspects involving ownership rights that restrict access to credit; ii) the link or interrelationship between formal and informal financing through institutional arrangements or forms that are quasi-financial or Para-financial (involving credit granted under the modality of real guarantees or group guarantees, through the establishment of informal community money-lending schemes locally known as *juntas*, closed cooperatives, government credit programs and the development financial companies themselves.

2. Theories and Experiences in Rural Funding

In this part, we present the theoretical aspects, with reference to financing, in general, and the role of the institutions of the financial system, in particular, the financial resource mobilization in the money and credit markets. We stress in the analysis of financial capital resource mobilization – deposits of the public, allocation of credit and other financial services – needed for the growth and development of the productive activities of the agricultural and rural sector, in general.

2.1 The role and importance of finance in growth and development

In general terms, studies on the economic growth and development of an economy (the sectors of activity in different regions and localities) reveal that a country needs to mobilize its capital resources in the broadest and most efficient manner.

In an integrated, broad and general manner, the capital resources of an economy are: 1) physical capital resources, 2) human capital resources, 3) technological-entrepreneurial capital resources, and 4) internal and supplementary external financial capital resources necessary to facilitate the process of production, consumption and capital formation and accumulation (savings-investment) that the different economic agents conduct (the government, the entrepreneurial sector and families and their relationship with the rest of the world)³

³ The main aspects concerning capital resource mobilization, and among these, financial capital resources, can be found in the paper on “Integrated Financing for Agriculture”, the First Part: Conceptual and Theoretical Aspects (J.A. Salaverry, 1986:3-38) and in the paper “Integrated Development Policies and the Peruvian Agrarian Sector” (J.A. Salaverry 1989:63-71). Upon referring to capital resources we take into account the capital stock (at a particular moment in time) with its flows.

Experts, among these, R.W. Goldsmith (1969,1987), point out that in countries that are presently called developed, the process of capital formation and accumulation (savings-investment) that has resulted in their economic growth, are closely linked to the degree of financial development reached in their localities and regions.

The action of promotion and fostering that generates financial development on the growth of local, micro-regional and regional economies, and therefore a national economy in its entirety, depend upon:

- a) the degree of institutional construction and strengthening of the institutions that make up the financial system;
- b) the installation of institutional forms and arrangements of financial services adequate and appropriate for local conditions;
- c) their degree of specialization, geographic coverage and the technology of the services provided;
- d) but, fundamentally, the technical and administrative capacity of their human capital, members of the institutions and, the degree of normality, regulation and supervision that society has over them.

In the financial field, the financial assets are the counterpart of the real field of an economy, that are the physical, human, and technological entrepreneurial assets, and they are part of the capital stock of an economy that has been accumulated over the years in the process of capital formation and accumulation (savings-investments).⁴ The relationship of supplementation and interdependency among the assets (capital stock and their flows) that make up the real field and the financial field of an economy is possibly one of the most complex aspects, and perhaps this is why it is more difficult to understand this concept in the comparative studies on growth and development processes. Experts use the figure that both are two sides of the same coin for a better understanding, differentiation and summplementation between both fields.

This work is not appropriate to conduct an in-depth analysis about the factors and variables that determine a broad and massive mobilization of capital resources that are normally required in order to generate conditions for growth and development. However, we wish to point out that the conceptual and analytical differentiation between the real field and the financial field of an economy is fundamental to design proposals for adequate and appropriate policies adjusted to the conditions of the reality of developing countries.⁵

2.2 The structure of the financial system: Formal and informal financial intermediation markets

⁴ It would suffice to point out that through time, economies and societies have been organized with different degrees of efficiency and sustainability and, with different legal arrangements-institutional (the economic, political and social aspects) in order to satisfy their requirements for production, consumption and savings-investment (for capital formation and accumulation).

⁵ We refer to the deep conceptual and practical differences that exist between the proposals and implementation of policies based on the theories of <<financial development>> and the “modern” theories and practices of <<financial deepening>> upon which the application of financial liberalization and de-regulation policies are based.

The structure of the financial system is made up by a variety of financial institutions, instruments and markets that respond to, in their evolution over time and in their growth and development, increasingly complex and sophisticated requirements for financial services by the economic agents (governments, corporations and families and their relationship with the rest of the world) that for analytical purposes are considered as financing sources as well as users of these services, bearing in mind that the limits amongst each other have not always been clearly defined.

In the mobilization of financial capital resources for the growth and development of an economy in general, or of one of its sectors, such as rural agricultural activities, which is the object of our interest in this paper, the following aspects must be taken into account: the role accomplished by the institutions of the financial system as concerns their structure, the different financing sources and users of financial services.

- The financial institutions include money lenders and banks, pension funds, insurance companies, stock brokerages, investment funds and stock markets.
 - The financial instruments include money (currencies: coins and bills), checks, promissory notes and bonds, up to more sophisticated instruments that include futures and swaps, in addition to a growing paraphernalia of products used in finance.
 - The markets for said instruments are organized into formal and informal intermediation markets in which real and financial transactions are carried out.
2. Table 1 summarizes the main relationships between the formal and informal intermediation markets both in real and financial assets. The former relationships allow us to highlight the use and destination of the production/income surpluses that have not been consumed – the gross savings – generated by individuals and entrepreneurial units that make up the rural “world”. In these we can observe:
- the transactions of real assets (relationship between buyers and sellers, See 1.1 of Table 1) are the relationships between buyers and sellers (the purchase of fixed productive assets such as land and livestock or the purchase of non-productive assets such as precious metals) and,

Table 1

**Relationship between formal and informal intermediation markets
in real and financial assets:**

Destination of gross savings generated by the rural sector

MARKET	ASSETS
--------	--------

	REAL ASSETS	FIANANCIAL ASSETS
1. FORMAL INTERMEDIATION MARKET	1.1 Purchaser of real productive assets (land, livestock, etc.), capital goods.	2.1 Deposits and savings, and other fixed and variable income (formal financial assets) resulting in transactions in the Financial System and Stock Market.
2.INFORMAL INTERMEDIATION MARKET	2.1 Expenditures in non-productive assets, the purchase of precious metals, art objects and jewelry, etc.	2.2 Third party credit (informal financial assets) including hoarding/saving money, etc.
	RELATIONSHIPS BETWEEN BUYERS/SELLERS	RELATIONSHIP BETWEEN MONEY LENDERS/BORROWERS

Source: J. A. Salaverry 1986: 21

- transactions of financial assets (the relationship between borrowers and lenders, see 1.2 and 2.2 of Table 1) are the relationships between fomral borrowers and lenders (savings deposits and other variable and fixed income securities intermediated through formal financial entities that comprise the financial system and the securities market; or informally through third party loans, including hoarding-saving of coins and bills.

In a modern economy, one of the aspects underscored in literature on growth and economic development is the role accomplished by the institutions of the formal financial system in mobilizing financial capital resources (See 2.1 in Table 1) by facilitating (certain costs and risks) exchange, an efficient use of resources, savings and risk investment as fundamental operations for economic growth and development.⁶

In general, we wish to stress the mobilization of financial assets provided by financial services via institutions that belong to the formal financial system (banking and non-banking entities governed by normality, supervision and control by the State's financial authorities: the Central Bank, the Superintendence of Banks and Insurance Companies and the National Securities and Stocks Commission: (CONASEV). These formal financial institutions are important for the efficient use of deposits (in current accounts and savings account) in their financial form to use specialized mechanisms

⁶ However, we must point out that the conceptual and analytical treatment concerning the mobilization of financial capital resources for growth and development is, generally, insufficient, as concerns the extremely general aspects involving the financial sources that can be used, with special mention of the current restrictions of financial resources and the effective possibilities of their use referred to as insufficiency and deficiencies of the current institutional forms and arrangements and, the mechanisms and instruments used to reach the goals and objectives proposed in development plans and programs.

and instruments, with attractive yields, liquidity and acceptable risks that promote a process of exchange, production and savings-investment.

In monetary exchange economies, the financial capital resources made up by flows of financial assets, money and credit (financing working capital and investment capital), facilitate the production, consumption and savings and investment processes of the multiple activities that their economic agents perform. The development of financial services facilitates the exchange of financial goods and services enabling the exchange of these at a lower cost and risk and the activities between lenders and borrowers by mobilizing deposits and savings from the units that produce surpluses towards the deficient units.

To the contrary, in an extreme, we can consider an economy – or parts of it at a sectorial level and/or its regions – that does not have financial services, that would be confined to self-sufficiency or barter trade, restricting the possibilities of specializing the productions, employment and income of their inhabitants, that is, restricting their possibilities for growth and development.

In this economy (a subsistence economy based on primarily agriculture) the separation over time between the process of consumption and production can only be possible through savings in kind of non-consumed stored products; the size of the production units is limited to the self-saving capacity of producers; employment and income reduced to the specific levels of self-sufficient production; and, transformation activities extremely limited.

The lack – or for that matter, the insufficiency – of financial services generates conditions that characterize the classical vicious circle of poverty: economic depression, financial depression, and a greater economic depression.⁷

For this economy or its sector, a subsistence economy based on primary agriculture, the self-financing of working capital and investment requirements would be an alternative. However the opportunities for production and profitable investments would exceed the self-generated resources of the family and business units. The net transfers of resources and public investments would be the other alternative that would require mobilizing resources through the tax system.

⁷ In the last analysis concerning the type of financial and real transactions that have characterized the performance of the Peruvian economy in the second half of the XX century, in its dual relationship between modern and traditional sectors, we discover that the generation of broad sectors of activities, the misnamed “informal sector” is in reality, the result of a growing urban and rural “economy of sub-employment”. The main explanation, on the one hand, in the bad use and worse distribution of capital resources by the Central Government at the level of the interior of the country (a lack of a territorial occupation policy expressed in policies, plans and programs to decentralize development) and, on the other hand, by the entrepreneurial groups and families that concentrate wealth and income generated in different places of their reproductive investments in non-productive expenditures, speculative and sterile “investments” and the flight of capital abroad (J. A. Salaverry 1986: 24 - 26).

Most developing countries have, in varying degrees of importance, an informal financial sector (see 2.2 of Table 1) that provides financial services to this sector but is not really entrepreneurial but rather made up by family units, small agrarian producers and small businesses in general. In this informal financial sector the most important financing sources are loans provided by relatives and friends, money lender intermediaries, businessmen who provide funds to their clients.

Hence, as expressed above concerning the financial system of an under-developed economy, this allowed us to stress, on the one hand, the problem of capital resource mobilization in the real field for activities of the agrarian and rural economy – of their physical, human and technological-entrepreneurial capital resources – and, on the other hand, the great importance of the formal and informal financing sources by facilitating production and capital formation and accumulation processes in the multiple activities of the rural agricultural complex (in practice, the interior of the country).

2.3 Financial sources for rural agricultural development

The second aspect that we have to deal with as concerns financial capital resource mobilization refers to financial sources for rural agricultural development, which undoubtedly, applies to the economy as a whole, to its sectors of activities, such as the case of the rural agricultural activities sector that is of interest to our work, and at the level of their production units.

Table 2 contains a list of financing sources for agricultural and rural development. We have included in the analysis all the internal and external sources that potentially should be considered within an active national promotion and development policy to increasingly integrate national markets. The purpose is to highlight all the financial relationships, at the level of a local community, needed to carry out promotion and development actions as the key elements for development and a decisive factor in the contribution of a growing integration of national markets. (See Section 3.4).

On the demand side, at the level of production/consumption units by family or business, small land owners, or small urban and agrarian individual producers (non-corporate) as well as the larger entrepreneurial units, individually, partially, or entirely apply the first three financing sources (self-financing, credit financing and direct financing) to production/consumption/investment processes.

The internal sources are:

A. Self-financing sources generated in the production/income processes, resulting in the surplus of the non-consumed product/income or gross savings, among which we must take into account:

Table 2

Financial Sources for Agriculture and Rural Development

INTERNAL SOURCE	A. Self finance	A.1 Voluntary family or corporate savings. A.2 Savings through voluntary work
	B. Credit finance	B.1 Formal (from banking and non-banking financial institutions) B.2 Semiformal (from quasi financial institutions) B.3 Informal (family, friends and moneylenders, etc.)
	C. Direct informal finance	Intermediaries, merchants, buyers, transpor companies, venders
	D. Tax	Property tax (land) sales tax, income tax
	E. Payment to services	Improvement of infrastructure irrigation, tolls, comunal services, etc.
EXTERNAL SOURCE	Financial and technical assistance from bilateral and multi-lateral cooperation agencies and private enterprises	

Source: J.A. Salaverry 1986:21.

Note: For the purpose of this study, in the following section, we only present description of first three souces of finance: sel-finance, credit finance and direct finance.

A.1 Family and entrepreneurial voluntary savings.

As has been pointed out in the paper (J. A.Salaverry 1986:20) a generalized assumption concerning the economy of Peru, and in general under-developed economies, is that the rural inhabitants and small rural productive activities, in particular, small agrarian producers and small landowners, have a low voluntary savings capacity due to their extremely low levels of income in addition to a lack of sophistication of the institutions and organizational apparatus that surround them. The real fact that stands out in the studies conducted on credit supply and demand is that even at the subsistence level, people save the surplus of their production/current income over current consumption, and they look for ways to use them best.

The study on the mobilization of deposits in Peru (COFIDE/IDB) Swisscontac, 2000: 7-9) proposes, theoretically, in relation to savings in micro finances, that “the economic agents located in the lower 10% of income group also save by sharing, in general, for the same reasons to create micro-credit with higher income bracket groups.” However, they behave in a differentiated way amongst each other that is closely linked to the reproductive consumption of their enterprises. The lower levels tend to save more out of necessity than opportunity and their savings is the amount associated to the reproductive consumption of production units related to the survival of the family and the foresight of their irregular income levels. In the higher savings levels it is associated with amounts that exceed their reproductive consumption and survival.

The survey of cases reveals that the comprehensive mobilization of mass savings services – in financial institutions and quasi-financial institutions, using adequate and appropriate technologies for small savers/borrowers, in small amounts and a large territorial coverage – helps the producers/consumers to manage their resources in three ways:

- a) To accumulate their savings in a safe place until having enough resources to pursue their objective;
- b) To obtain such resources through a forward payment or credit reimbursement through several types of savings;
- c) To accumulate in certain amounts through a continuous flow of savings in *juntas de ahorrista**, *panderos** and other manners of rotating saving and credit associations (ROSCA) obtaining them through tenders or other options.
(*Informal group savings and loans schemes).

The institutional financial services mentioned above place at the disposal of the micro-savers – individuals, family units, lower income groups and micro and small businesses – their savings, free from any cyclical or structural contingency that involves production and survival and thus allows the family or enterprise to accrue its net worth.

People in rural agricultural areas do generate gross savings that they use in many different ways as real and financial assets (J.A. Salaverry 1986:20-26), as shown specifically in Table 1. We are referring to savings in real assets by small producers and small landowners in the manner of productive assets such as seeds, tools, livestock, capital goods or, non-productive goods, such as, money spent on festivities celebrated by the entire community; and, savings in financial assets under the modality of hoarding or saving their money for unforeseen expenses or for future education expenses; ...and on to more sophisticated ways such as savings deposits in banking and non-banking financial institutions.

A.2 Savings – through voluntary work

One of the important forms of voluntary savings in community tradition and organization (exercising the basic principles of supplement and reciprocity of the Andean cosmo-vision), in particular in the Andean highlands (transferred to urban areas) is work-savings: the participation of the population in community labor in different stages of the agrarian production cycle as well as the maintenance, repair and construction of productive and social facilities owned by the community.

To the former source, we must add as a source of income/savings, the temporary or seasonal supply of labor for third parties (this includes, temporary migration of high Andean inhabitants to inter-Andean valleys, to the coast or the high jungle areas). This allows them, on the one hand, to obtain the necessary income for the family's consumption during periods of a low demand for labor or in between sowing and harvesting crops and, on the other hand, it provides them with the necessary cash to buy inputs or capital goods (i.e. tools, sewing machines, among other items).

Since the 1960s when rural inhabitants began to migrate massively to urban areas (difference in age, education, capital, family support) and the population growth of rural and urban localities increased, the link of seasonal jobs and temporary migration as a source of income/savings has been reduced, and in many cases has been totally eliminated. The de-capitalization of human resources followed a process of the deterioration of physical capital, in particular, in highland areas as step-terraces, irrigation ditches, water canals, and dams in reservoirs and lagoons that are labor intensive and had created through community labor.

We discovered in many rural agricultural communities older people in lesser numbers (insufficient to meet the seasonal demand for labor) needed for community work, and even for the maintenance and repair of their physical infrastructure. The human de-capitalization process is added to the process of the de-institutionalization of the community and local governments. On the one hand this is the result of the growing centralism and concentration of resources and decision making in Metropolitan Lima and a few capitals of departments while, on the other hand, their rural agricultural entrepreneurial activities lose links with the supply of food, clothing and tools produced with primary products at a local level because of imports at subsidized prices (basically through lagging exchange rates and food aids). The former elements explain, to a major degree, the loss of profitability and income by inhabitants dedicated to productive activities such as small landowners and small agriculture and livestock businesses in a broad range of local and sub-regional markets in Peru.

B.Credit financing sources (indirect financing)

These cover three means of development of activities that characterize the relationship between borrowers and lenders – in particular, legal, institutional and instrumental development, and financial services – related to the public interest in promotion and development, the mobilization of deposits, of credit services and other financial services needed to satisfy the production and savings-investment processes of the multiple productive and social sectorial activities that are carried out in rural and urban centers of territorial occupation.

B. 1 Formal financial intermediation sources

Comprised of the banking (commercial banks) financial institutions and non-banking (rural savings and loans associations, municipal and community credit associations and savings cooperatives) that are the Intermediary Financial Institutions (IFIs) governed by normality, regulation and oversight by financial authorities (the Ministry of Economy and Finance, the Central Bank and the Superintendence of Banks and Insurance Companies).

In these sources we must consider, additionally, two specialized public financing institutions: the Financial Development Corporation (COFIDE) as a second tier wholesale bank that provides funds to small scale producers; and, the *Banco de la Nación* (BN) or National Bank, as the financial agent of the Public Treasury and

the State, the latter due to its great importance in financial resource mobilization at the level of a government (central, regional and local governments).

B2. Quasi-financial institutions

These are also called bridge financial institutions among the formal financial intermediation sources (2.1) and the sources of informal credit financing (2.3), that cover a range of entities such as: close cooperatives (that mobilize family and business saving resources in the domestic market), Non-Governmental Organizations (NGOs) that conduct their affairs in the credit field with external funds and, the public rotating funds or similar funds.

The most important consideration concerning the potential role of the quasi-financial institutions in the supply of financial services (savings deposits and credit supply) is the financial development process of an economy. Informal financing activities promote the monetarization of an economy by permitting and fostering the maintenance of money and debt in monetary assets instead of real traditional assets constituting a previous stage, and possibly, a bridge necessary for a more advanced and modern institutional financial development (J.A. Salaverry, 1985:26).

B. 3 Informal credit financing sources

Comprised of several credit agents such as relatives and friends, money lenders, businessmen, pawnbrokers and associations or groups of “acquaintances” that do informal financial intermediation at a very small scale, on a very short term and in forms of access (proximity and knowledge of the client) and, the financial arrangements adjusted to the temporary needs of the micro and small units of production/consumption in rural and urban settings.

In the review of the financing sources and user of the financial services the study on Informal Financing in Peru (COFIDE/CEPE-IEP, 2000:17) stressed that in Peru there are several studies on informal credit, particularly those involving rural areas. These cases are studied in a community or group within a given geographical area. The research revealed:

- a) that in terms of geographic coverage informal credit is the most important source of credit for low income populations (acknowledging that the main source comes from self-financing);
- b) that these transactions are based on the intensive use of information as a result of economic and/or social relationships established before the credit;
- c) that these are short term loans and mostly used for commercial activities and/or consumer credit;
- d) that there are no barriers to access credit;
- e) that the activities of the borrower are interrelated to the activities of the lender in the real sector; and,
- f) that there is a broad range of financial and informal money lending activities in rural areas.

As has been pointed out in several studies in developing countries, and case studies in Peru⁸, the rural and urban non-corporate business sectors referred to as small and micro enterprises made up of extremely small scale producers and businesses – small businesses in the fields of industry, small businessmen and salesmen, landowners and agrarian producers – and they have a great importance in the production process, employment and income of a broad urban and rural population sector.

C. Direct informal financing sources

We distinguish between direct financing sources in the market of informal financial asset transactions due to their great importance in the supply of funds for agriculture and rural development (just like the rest of the productive activities of the other sectors). In particular, through the modalities of granting “credit” that may include from agreements of participation in the harvest, up to modern service modalities such as, supervised insurance systems for climatic and sanitary risks linked to formal financial services and the stock market, such as the producers stock exchange transactions.

In these sources we classify the financial suppliers – salesmen, gatherers and buyers – transport carriers, among others, that provide resources for the different types of agrarian reproductive cycle in money and kind (seed, fertilizers, agro-chemical products, etc.)

D. The function of informal credit in rural financing

In Table 3 we have summarized the possibilities of informal credit that are important in the diverse strata of size of agricultural and livestock production units, in particular, small landowner and small agrarian enterprise sector –and, micro and small businesses in general.

Table 3
Possibilities of Informal Credit:
Supply and Demand per Type of Market

Type of Market	Supply	Demand
Small savers	Individuals Small businessmen and shop owners	Families
Retail businessmen	Individuals businessmen and transport companies	Small production and business units
Wholesale businessmen	Owners of medium and large companies, wealthy	Intermediaries

⁸ This study is on Informal Financing in Peru (COFIDE/CEPES-IEP, 2000: 21-23) and contains a full list of the bibliographic references of these studies on local and regional economies of Peru based on surveys. The conceptual framework of the study provides important elements on credit and development and formal/informal credit relationships.

	merchants	
Commercial credit	Entrepreneurial groups Exporters and importers	Medium and large commercial agriculture
Informal financial intermediaries	Merchants, brokers, etc.	Large traders and businessmen
Savings and credit associations	Associated groups	Associated groups and third parties

Source: J.A. Salaverry, 1986:25

2.4 Rural agricultural financial markets in Peru

One of the most difficult aspects to specify and in which we encounter a considerable deficiency in most of the studies reviewed concerning the problem of agrarian credit in Peru, is the characterization of the elements and factors that determine the high fragmentation, heterogeneity and dispersion over agricultural areas and livestock production units.⁹

At the same time these elements and factors determine the high variability and fragmentation of their real markets and the potential demand for formal, quasi-formal and informal financial services needed to satisfy their requirements of working capital and investments for agriculture and rural development.

A. The Importance in Peru of small and micro businesses in the agriculture and livestock sector

The importance in Peru of small and micro businesses in the agriculture and livestock sector, versus the other rural and urban sectors, can be observed in Table 4. The estimates have been obtained based upon information of the Third Economic Census in 1993, the National Agriculture and Livestock Census of 1994 and, our own preparation based on the National Statistical and Census Office -INEI data base.¹⁰

These estimates point out that the sub-sector of the micro enterprise and small business at a national level both for agriculture and livestock companies as well as the rest of rural and urban companies, represent 91.6% at a national level (3,774,000 units out of 4,120,000 of national total). They employed 75% (4,873,000 of economically active population: EAP,

⁹ The studies reviewed use methodologies usually geared towards describing the supply of credit, placing an emphasis on the functioning, operability and results of the banking and non-banking financial institutions or groups of institutions present in the country and, the type and scope of financial services offered to the agricultural and livestock and rural sectors. J. Alvarado and F. Ugaz (1998), J. Alvarado and F. Ugaz (2000), W. Diaz Alejandro, JM Garizabal, B. Zuttler (1996), M. Reichmuth (1997), M. Reichmuth (2000).

¹⁰ The former study carried out for the Central Reserve Bank on agrarian credit in Peru (J.A. Salaverry, 1983) described the framework for the study on the credit markets and referred to the main characteristics of the agrarian structure, resource base at the level of the three natural regions, problems and main concerns or credit policy for agrarian production.

out of 6,497,000 of total), and, contributed with 42% (39,050 million soles out of 92,976 million soles in 1994) of gross domestic product: GDP.

B. The participation of the sub-sector of small and micro agriculture and livestock businesses

The information concerning the participation of the companies of the agriculture and livestock companies of the national total and of the sector, is contained in Table 4.

- a. The small and micro agriculture and livestock sector involve at a national level 35.8% (1,475,000 units) of the total number of production units; employed 23% (1,493,000 of the total EAP); and contributed with only 3.4% (3,138 million soles in 1994) of GDP. The participation of micro and small business of the agriculture and livestock sector reveals that it covers 84.1% of the total production units of the sector, sustains 65.5% of the population with 82.5% of the EAP, contributing with 44.5% of the GDP of the agriculture and livestock sector.
- b. The medium and large business of the agriculture and livestock sector covered at a national level 6.6% (271,000 units) of the total number of production units; employed 8.2% (583,000 of EAP); and contributed with barely 4.2% (3,913 million soles in 1994) of GDP. Furthermore, the participation of medium and large business of the agriculture and livestock sector covers 15.9% of the total production units of the sector, sustains 34.5% of the population with 17.1% of the EAP, contributing with 55.9% of the GDP of the agriculture and livestock sector.

C. Additional elements to specify the high fragmentation, heterogeneity and variability of the agriculture and livestock sector.

Two additional elements add to the enormously complex problem of the high fragmentation of real markets. At the same time they condition the potential demand and the effective supply of financial services for agriculture and rural development. The first is the number of production units in different forms of tenure/occupation (use and control) of the total surface, agricultural and non—agricultural (agricultural, natural graze lands, green areas and forests and other types of land in Peru). The second is determined by the territorial dispersion of the population in more than 90,000 rural agricultural localities that have less than 4,000 inhabitants.¹¹

C.1 The number of units of production in plots (*parcelas*) and surface per regime of tenure/occupation

¹¹ We consider that many of the theoretic aspects based on the agrarian reality of Peru (although they refer to the end of the decade of the seventies), supplemented with those explained in the work on the problem of financing for rural agricultural development (J.A. Salaverry, 1985) are still applicable, particularly in comparative terms with the present reality and undoubtedly, in the specification of the deepening of the real and financial problem of the agrarian sector.

Table 5 describes the number and surface of plots or *parcelas* per regime of tenure/occupation at a national level. In this information the total 5,766,113 plots in the different regimes of tenure/occupation stand out:

- Regime of ownership with 4,083,728 plots (70.8%) of which 971,669 plots or *parcelas* (16.9%) have registered land titles and 13.3% of the surface; and, 1,382,292 (24%) have land titles still pending registration and 8.1% of the surface.
- Regime of Community Ownership with 14,872 plots (0.3% of the total plots or *parcelas*) and one cultivated and non-cultivated surface of 19,423,841 hectares. (54.9% of total surface).

Estimates based on this information allow us to point out that there are approximately 380,000 agricultural production units (22% of the total 1,750,000 units) that have registered plots of land or are pending same – and this is the prime indicator of potential demand for formal financial services. The remainder 78% of the units, approximately 1,370,000 governed by different regimes of tenure/occupation, lack titles, and approximately 4,700,000 plots (82% of the total) have different types of “legal” problems that hamper their access to these formal financial services. We will apply these estimates to determine the potential demand for agricultural credit in Section 2.5.

Table 6 describes three average indicators of the degree of fragmentation of agrarian property in Peru for different types of businesses according to the size of agrarian production unit obtained from the III Agriculture and Livestock Census in 1994. The analysis has been conducted on a national level with reference to the situations at a regional level.

- At a national level: the number of plots is 3.3 per unit; the agricultural or non-agricultural surface of 6.2 hectares per plot; and, 20.3 hectares per unit. The indicators for:
 - 1) the cultivated land surface per plot is 1.0 hectares (16% of the agricultural and non-agricultural surface per plot of 6.2 hectares); the surface per unit of 3.1 hectares (15.3% of the surface per unit of 20.3 hectares);
 - 2) the cultivated and non-cultivated surface of 0.6 hectares per plot and 1.9 hectares per unit;
 - 3) the cultivated surface of 0.5 hectares per plot and 1.5 hectares per unit.

C.2 Territorial distribution of the rural agricultural localities.

The second element for the specification of the high fragmentation, heterogeneity and variability within which the agriculture and livestock activities are carried out and is determined by the territorial dispersion of the population in more than 90,000 rural agricultural localities that have less than 2,000 inhabitants (made up by small villages and

hamlets and more than 50% of the district capitals) with a population that amount to more than 45% of the country.

The territorial distribution of localities with inhabitants is directly related to the geographic, geological and hydrological reality of the Peruvian Andes that determine the severe scarcity of natural cultivated land (most of these lands are man-made such as step terraces) related to the hydrological contradiction (abundance of the water supply and the enormous difficulties to access water directly related to the construction of different irrigation systems).

To this regard, it is of utmost importance to point out that the population data from the census under estimates rural populations by defining urban population as those that have more than 2,000 inhabitants (INEI, 1993 National Population Census). We are aware of that most of the 90,000 localities that have less than 2,000 inhabitants are rural agricultural localities. Others might have more 2,000 inhabitants but less than 20,000 inhabitants, which is the case of the most rural capital districts and some provinces. In the reality of Peru these are rural agricultural localities, that due to their economic activities, depend directly or indirectly on the agriculture and livestock sector. In fact, the re-classification of urban and rural populations adhering to the previous criteria, reveals that Peru is a semi-urban economy (perhaps best specified as semi-rural in process of urbanization), as has been stated in previous works based on the 1961 and 1972 Census (J.A. Salaverry, 1985: 24-25; 1989: 36-52).

2.5 The determination of potential demand for agrarian credit

Based on information provided in Section 2.4, we can estimate the potential demand for agrarian credit for the four different strata of producers. For this purpose, we start with the universe of producers per size (amount of hectares), and using collateral information (pointed out in each case) we will determine for each group of businesses, the ranges of potential demand for agrarian credit in terms of: a) the number of producers; b) the surface of cultivated land; c) the cultivated surface, and d) the total amount in US dollars (using information on the amount of financing per average hectare for temporary crops). The estimates based on this information are contained in Table 7.

As regards the potential demand according to the legal situation of the owners who have registered land deeds or are pending the same, these estimates reveal:

- Approximately, 380,000 agricultural producers (21.8% of the total 1,750,000 units) with a legal situation of registered land deeds and those pending the registration of their plots (see Table 7) , that are the prime indicator of potential demand for credit.
- The total cultivable surface is 2,065,000 hectares (39.0% of the total) and the cultivated surface is 1,239,000 hectares (48.1% of the total).
- The amount of total demand for agricultural credit from formal sources would be about US\$798 million.

- The remainder 78% of units approximately 1,370,000 producers under different regimes of tenure/occupation, lack land titles of 4,700,000 plots (82% of the total) that have different types of “legal” problems, hampering them to access credit from formal financial sources.

The potential demand resulting from a legal deepening of the titles registered, to be registered, and without land deeds at all but that are trying to be registered, means, practically, doubling the potential demand for short-term credit resources (working capital) with the corresponding coverage:

- Approximately, 750,000 agricultural production units (42.8% of the total 1,750,000 units).
- With an estimated cultivated surface of approximately 3,500,000 hectares (66.9% of the total) and, a cultivated surface of 2,125,000 hectares (82.5% of the total).
- The amount of the total demand of agricultural credit from formal sources would be around US\$1,270,000 million.
- The remaining 57% of the units, approximately 1,000,000 in practice, conform of small landowners and very small and small producers that have a potential access to quasi-financial services, in particular, of the action of promotion and development in the real field: organizing producers, particularly communities at a district level (in the so-called development corporations or similar manners of organization in high watershed areas of the Andes); of the net transfer of technical and human resources for the production and organization of local and zonal markets to market the surplus production of self-consumption; through what we have called CAJAS TÉCNICAS of services such as quasi-financial entities within the financial system for agriculture and rural development.

Lastly, we include in Table 8 information concerning the credit sources for the agriculture and livestock sector by size and production units as well as cultivated surface.

3. The Financial Reform and the Supply of Agrarian Financing in the Decade of the Nineties

In this part of the study we present an analysis of the main macro-economic indicators and agrarian credit supply behavior indicators that have characterized the evolution of the economy of Peru over the past decade. Depending upon the availability of the information sources reviewed we will try to broaden the analysis of the formal institutional sources for agrarian credit supply to the quasi-formal and informal sources. The elements we use to analyze the main aspects that characterize the evolution of the Peruvian economy at the end of the eighties, in the real and financial fields, are contained in Section 1 and the conceptual framework is described in Section 2.

We consider that the methodology applied in addition to the process of ordering the facts are necessary since there have been deep changes in macro-economic policy and the reforms launched at the beginning of the nineties when the Government of Peru adopted a

series of economic measures, not only to stabilize the economy, but also to provide a new political-legal framework for the activities of its economic agents.

3.1 Background of the Peruvian economy and globalization process in the decade of the nineties.

As has been mentioned in the Introduction, we consider that the review and evaluation of the topic of credit and financing for agriculture in the decade of the nineties cannot be carried out without taking into account the main aspects that characterize the evolution in the real and financial field of the economy of Peru within the globalization process.

A. The globalization process and its internationalization in Latin American economies.

The main characteristic of the international economy has been the implementation of globalization policies during the decade of the nineties determined by the following: an opening of markets, financial insertion, an increase of productivity via a growing competition in international transactions (an increase of import and export flows, financial and technical-entrepreneurial flows) which, together with the technological breakthroughs (speed and low cost) in the field of telecommunications, create a system in which change has become a permanent phenomenon.

The application of economic policies in most Latin American countries during the nineties responded to the globalization challenge, supported by the so-called “cult of market economy and its practically unlimited operations” that have had positive and negative effects.¹²

The positive effects of globalization

We wish to point out the following positive effects: a) the technological progress made as concerns the speed and low cost of communications; b) the huge volumes of mobilized capital; c) the variety and options of the supply of goods and services transacted. This has helped to increase the productivity of labor and capital resources producing potential surpluses of savings-investment resources.

The negative effects of globalization

The following are the negative effects: a) an increase of entrepreneurial concentration in a reduced nucleus of large corporations whose investment decisions are linked to the

¹² The economic reforms and positive and negative effects in Latin American economies have been extracted from the Report of the XXX Regular Meeting of the General Assembly of the Latin American Association of Financial Development Institutions, Cartagena de Indias, Colombia, May 17 – 19, 2000.

objectives of high yield and short term recovery of invested capital; b) the volatility and insufficiency of capital flow guidance, supervision and control that has resulted in a deepening of the economic – financial cycles in developing countries, thereby aggravating the effects of the recession; c) the reduction of national production and investment options in medium and large companies giving rise to an increase of unemployment and a reduction of the real income of national economies.

The earnings derived from globalization have basically benefited developed countries and, in national economies, activities linked to the former, import and export companies of a high competitiveness at an international level, at the expense of production, employment and income of medium and small businesses that generate most of the national production, employment and income.

Experts have pointed out that one of the main cause-effect relationships that explains the negative effects of Latin American economies, is that the economic reforms that have taken place at the same time as the globalization process in the nineties ranked the solution of internal economic and social problems as a much lower priority.

In summary, experts have indicated that the dynamics of “market economies that operated with practically no restrictions at all” in the decade of the nineties have concentrated and centralized their benefits in favor of developed countries (industrialized countries), reducing the opportunities for production-investment, employment and income of a broad sector of economic activities in Latin America and, in particular, the less developed internal sectors of small and medium urban and rural agrarian industrial companies.

3.2 Macro-economic framework to analyze the evolution of the agrarian sector in the decade of the nineties

The deep crisis at the end of the decade of the eighties, generated by terrorism and a poor management of macro-economic factors by the government 1985-1990 (characterized by the mixture of popular and state policies that unleashed a process of hyper-inflation from 1987 to 1990) demanded a deep economic-financial readjustment process and the implementation of structural reforms between 1991-1994 (See Section 1).

- The economic-financial readjustment process (1991-1994) responded to a policy demanded by the International Monetary Fund of achieving, through the application of stabilization policies, the necessary internal and external macro-economic and financial balance, covering the fiscal, monetary-credit, currency exchange and commercial relationships of the so-called first generation structural reforms.
- The first generation structural reforms covered the following fields: a) commercial (a rapid opening of imports); b) fiscal (a strengthening of tax and customs institutions); c) financial (an opening of foreign commercial and investment banks, the disappearance of sectorial development banks, the privatization of commercial banks associated to the State) and, practically, the disappearance of all forms of

associations of financial entities such as savings and loans associations, and pro-housing mutual funds); d) the re-definition of the entrepreneurial role of the State (the privatization process, the reduction of its direct interventions, and the creation of regulating organizations of activities that involve public liability).

It is of a great importance to point out that at the beginning of the decade of the nineties the political and technical proposals to establish and re-structure the economy of Peru matched reaching objectives of an market economy. However, that fact remains that the neo-liberal economic model adopted in that decade focused on implementing economic liberalization and modernization policies of what we now recognize as “a cult for market economy and its practically unlimited operations” within the scope pointed out in the previous section.

We wish to mention the following main characteristics of the implementation stage of the economic-financial globalization process geared towards the internationalization of the economy of Peru at any cost:

- 1) A rapid and maximum opening of the national market to the competition of foreign imports added to the entrance of sub-valuated goods and a steep rise in smuggling;
- 2) The mismatch of lagging exchange rates, high interest rates, high energy and public utility costs, and the application of anti-technical taxes have been identified as the main factors for the loss of entrepreneurial profitability, a reduction of surplus savings-investments, a growing level of indebtedness, and eventually the fact that thousands of companies in Peru went bankrupt over the past years triggering the unemployment of half a million industrially-skilled workers;
- 3) An unlimited entrance of short-term foreign capital (speculation) and mass public indebtedness to finance deficits in the balance of payments resulting from a growing lag of the exchange rate (1991-1996) and subsequent jumps (1997-1999) that have hampered national companies to recover their levels of profitability;
- 4) The above mentioned situation has thrust Peru into an increasing process of de-capitalization of its companies – and, in the manufacturing field to a de-industrialization – a substantial loss in production, employment and income, managerial skills and investment opportunities. The negative effects have been become evident in the closing of companies, not only in the case of medium and small national companies that employ the largest portion of labor and support the real income of broad sectors of economic activities, but also, in the closing of branch offices of foreign companies that had made industrial investments to manufacture mass consumer goods.
- 5) Experts have pointed out that the elimination of development banks (particularly the Agrarian Bank) and the drastic downsizing of the private system’s savings and loans cooperatives and pro-housing mutual funds have been predominant factors

that lead to a reduction of financial intermediation in the interior of Peru and its concentration in commercial banks;

6) The scheme or model of financial institutions that sprouted from the definition of the role of private commercial banks as savings-investment intermediaries, with support from COFIDE as the only second tier development bank, is evidently insufficient as a substitute scheme or model for the functional specialization of the financial system in which the role of the commercial banks, the institutions that develop and foster savings-investments, are clearly defined;

7) Within the global evolution of the Peruvian economy in the decade of the nineties we can observe, once again, the recurrence of the traditional performance cycle of the balance of payments of a more or less accelerated economic growth period followed by a severe recession, this is explained: first, by the availability of currency (resulting from private and public indebtedness and resources generated through privatization) and, second, to the depletion of the import capacity (in which the important weight of foreign debt service payments is pointed out) and, the subsequent unbalance of the balance of payments.

3.3 Main macro economic and global financial indicators and the agrarian sector

A) Macro-economic indicators

Table 9 presents the main indicators that have supported the growth of the Gross Domestic Product (GDP) at an average accumulated annual rate of about 4.3% for the past decade. Upon analyzing the sector, this growth was mainly based on the growth of primary export sectors (mining and fish meal industries) and the growth of the agriculture and livestock GDP (See Table 11). In the analysis, the recovery of the gross investment and domestic savings to the levels of historic economic growth and a growing participation of external savings stand out thereby reflecting a growing deficit in the commercial balance as a result of increasing imports. During the decade, the economic result of the public non-financial sector also reveals a decreasing behavior due to improvements in tax collections.

The 1991 – 1995 sub-period reveals a more accelerated growth of 5.6% reaching the highest rate in 1994 (12.8%). Since 1996, growth has slowed down registering an average growth rate of 3.9% for the 1996-2000 sub-period. This sub-period was hit by the negative effects of the El Niño Phenomenon 1997/98 in addition to the Brazilian and Asian crisis. The international crisis is reflected, as of 1998 in lower costs of export products and the restriction of foreign credit lines, triggering the current recession. The greatest achievement of the period has been the control of inflation-economic stability – that, as of 1997, dropped to one digit with an average of 6.9% from 1996-2000.

B. Macro-financial indicators

The performance indicators of the financial counterpart of the economy are shown in Table 10. The restrictive management of the monetary base (issuance of money – primary multiplier) as components of the total liquidity of the system are striking. However, the growing participation of total liquidity in relation to the GDP attracts our attention. This leads us to think that its growth has been mainly due to the effect of less liquid assets (quasi-money) resulting from an increase in the income of the real sector of the economy, made evident by an increase in savings-deposits in general, of economic agents and, among these, the provisional sector such as private pension fund.

The former implies an accumulation by certain agents of the real sector. However, as has been shown through the analysis of the sub-periods, there is a contradiction between the financial and real performance of the economy 1996-2000. The GDP reveals a marked slow down while liquidity practically doubles its share of the GDP.

How can we explain such behavior? We know that the current recession, with the reduction of income and demand of consumer goods, the bankruptcy of thousands of national companies resulting in a reduction of employment and an increase of sub-employment, while on the other hand we observe that savings stocks have not only dropped in proportion but that they (stock and flows) have actually risen as a percentage of the GDP. We propose as a hypothesis that this behavior is the result of the “wealth effect” that occurred in the economy during the post-stabilization period of 1991-1994 that lead to a intense increase in consumption. This “wealth effect” reflects the concentration of income generated in a few corporations such as public utilities that were privatized, mining companies, importers, etc.; the own income generated by the sales of public entities not returned to the economy in investments in productive fixed assets; the increase of domestic indebtedness – and, in many cases, the over-indebtedness – both at the level of entrepreneurial agents as well as family agents (behavior of the new consumer banks and the commercial banks that triggered a crisis in the financial intermediation system with the liquidation and closing of banks).

C.Agriculture and livestock indicators

As we can observe in Table 11, the growth of the agriculture and livestock GDP of an annual average of 5.5% for the decade of 1991-2000 and, within this, the growth of the agricultural GDP, reveals that these growth rates are higher than the global GDP of the economy (4.3%).

- In the sub-period 1991-1995 the negative rate of the year 1992 of about -9.0% reflects the effects of an anti-inflationary adjustment process and the closing of the Agrarian Development Bank.
- In the sub-period of 1996-2000 the rate of 1.27% in the year 1998 reflects the negative effects of the El Niño Phenomenon on the harvesting campaign of 1997/98 and, the positive effects of the growth rate of about 12% for the year 1999 due to the expansion of the agricultural frontier and an increase in production. This behavior can be explained on the one hand, due to strong subsidies granted by the government through the Rotating Funds and FONCODES (National Fund for Compensation and Social Development), while on the other hand, there were favorable post El Niño hydrological and weather conditions. It is important to point

out that the overproductions of potato, rice and white maize resulted in severe fall of their prices and income of producers.

Despite the limitations of access to credit in the sub-period (1991-1995), the positive behavior of the agriculture and livestock sector during the decade of the nineties can be explained through the use of self-financing by agrarian entrepreneurs as a main source to finance their production, as well as informal and direct credit sources. Some experts explain that vis-à-vis the restriction of credit, the producers were obliged to increase their production and improve their income. The flexibility introduced by the Law on Land (Ley de Tierras No. 25505 promulgated in June, 1985) and the Land Titling (PETT-IDB Program) were factors that contributed to this behavior.

The information on credit for the agriculture and livestock sector by the financial system 1985-2000 shown in Table 12 allow us to appraise the annual credit on agriculture and livestock made by formal financial sources. The share of the Commercial Banks, that in 1985 was 9.6% of the total annual credit granted, soared to 28.2% in 1991 and to 100% due to the closing of the Agrarian Development Bank in 1992. Its share in the 1991-1995 period was 84.4% and for the 1996-2000 sub-period it was 90.1%. The Agrarian Development Bank had an average share of 85% of the total credit in the 1985-1990 sub-period and commercial banks had 15%.

In 1994 the Rural Savings and Loans Association (Cajas Rurales) were created and they rose their annual share of 1.2% in that year to 7.8% by 2000 with an average share of 7.3% in the 1996-2000 sub-period. On the other hand, in 1995 the Municipal Savings and Loans Associations (Cajas Municipales) extended their pawn services to granting credit to the agriculture and livestock portfolio by 1.2% in 1995 to 3.6% in the year 2000.

Table 12 presents an analysis of the total amount of credit granted by intermediary financial institutions. For the 1985-1990 sub-period US\$427 million were granted (12% or US\$376 million by development banks, basically the Agrarian Development Bank). When this bank was closed, the average of the total amount of credit dropped to US\$194 million, less than half (45.4%) of the average for the 1985-1990 period recovering the levels of the amount granted for the 1985-1990 period in the last 1996-2000 sub-period with an annual average of US\$442 million (103%).

We have not been able to obtain itemized information from the Superintendency of Banks and Insurance Companies (SBS) concerning the number of loans granted by the IFIs for the 1990-1999 period. However, in Table 13, we use the information provided by the SBS concerning the situation of the financial system portfolio in the agriculture and livestock sector up to October 2000 that contains the number and amounts of debtors per strata summarized below:

Agriculture and Livestock	Producers	Credit	Average Credit
---------------------------	-----------	--------	----------------

enterprises per rank					
Of credit	Number	%	Amount	%	Producer
(1) Micro and very small	18,645	78.4	24.4	5.0	\$1,309
(2) Small businesses	2,812	11.8	23.2	4.7	\$8,250
(3) Medium businesses	1,303	5.5	33.8	6.9	\$25,940
(4) Large businesses	1,019	4.3	409.2	83.4	\$81,845
	-----	-----	-----	-----	-----
Total	23,779	100.0	490.5	100.0	\$20,627
(1) Micro and very small companies: credit less than US\$5,000					
(2) Small companies: debts between US\$5,000 to US\$15,000					
(3) Medium companies: debts between US\$15,000 to US\$50,000					
(4) Large companies: debts more than US\$50,000					

Source: Table 13

- The concentration of credit in large companies is stressed; 1,019 producers (4.3% of the total) have 83.4% of the total amount of credits allocated by the system (US\$409.2 million of the total portfolio of US\$490.5 million). This total fully corresponds to commercial banks, however, we must point out that a major portion of this portfolio is used as investment credit which, in the current recession, is potentially a problematic credit or a delinquent portfolio.
- Expert in commercial banks state that their installed capacity and high costs per operating unit allows these banks to channel credit to medium and large companies; smaller credits demand a close supervision and technical assistance, an expansion of the territorial coverage of commercial banks far from their operative offices (basically located in urban areas) which is difficult and expensive; furthermore they operate with real mortgage collateral subject to legal problems; the absence of business accounting hampers the analysis of credit requirements, that demands a direct supervision of disbursements within the farming cycle of crops and breeds.

D. Comparative indicators with the Agrarian Development Bank

Additional indicators of the operation of the Agrarian Development Bank point out the degree of coverage of their credit services, of great importance in the evaluation of the behavior of the IFIs in the decade of the nineties.

Table 14 shows indicators of the number and amounts of credit granted by the Agrarian Bank for the years 1980 and 1989. The figures show a growth of 2.4 times the number of borrowers, of 97,030 to 230,000 in the decade of the eighties and, a duplication of the amount of current US\$101 million to US\$205 million. As regards the strata of producers, we have summarized the number and amount granted to very small and small agriculture versus medium and large producers.

Small landowners and very small and small agriculture and livestock producers	Medium and large agriculture and livestock producers
---	--

(1+2)					(3+4)			
Year	No of credit	%	Amount Millions US\$	%	No of credit	%	Amount Millions US\$	%
1980	92,770	95.6	44.0	43.4	4,260	4.4	57.2	56.6
1989	184,920	80.4	106.0	50.4	45,080	19.6	101.4	49.6
2000	21,457	90.2	47.6	9.7	2,322	9.8	443.0	90.3

Source: Table 14

Bearing in mind that the Rural and Municipal Savings and Loans Associations provided loans for the amount of US\$49.2 in the year 2000 (Table 12), we can affirm that the totality of their clients came mostly from the strata (1) and (2), while commercial banks focused mainly on strata (3) and (4).

The above reaffirms our understanding of the “new financial repression” that generated the anti-technical disappearance of the Agrarian Bank.

3.4 The deep crisis by the end of the decade of the nineties.

By the end of the nineties and the beginning of the new millennium, the Peruvian economy had fallen into a deep recession, which became worse due to the political instability.

Although it is true that at the beginning of the recessionary cycle (1997/98) there was a strong influence of the Asian financial crisis followed by the Brazilian crisis in addition to increase of military expenditures due to border clashes with Ecuador. The recurrence of the traditional cycle of the balance of payments in Peru has a cause-effect explanation in factors of a structural nature that have become deeper in the last decade, aggravated by a lack of national policies to promote and foster the internal and external integration of their productive activities.

Possibly, the reason why there is such a deep recessionary process in the economy of Peru is mostly because of the idea of the “economic model” itself adopted and implemented, proposes a divorce between “economic” and “political-social achievements,” and therefore, accepts the authoritarian conduct and actions of the government as a “necessary cost” to meet the desired levels of economic growth.

Political and economic analysts agree in pointing out that the severe crisis confronted by Peru today is the result and characteristics of the “political model” of an absolutist and authoritarian government, and therefore, an anti-democratic government that accompanies the “economic model” proposed by the extreme liberalism of the “cult for market economies and its practically unlimited operations”, adopted by the government in the decade of the nineties.

The notion itself of the neo-liberal “political-economic model” of Peru places emphasizes the primary export sector; does not recognize the dimension of the economic and political-social de-centralization as a national integrated development strategy; and therefore

overlooks the INTERNAL INTEGRATION policies and actions that encourage the creation and expansion of the entrepreneurial production and investment options generated by national employment and income.

In this scenario, all economic activity sectors have been severely affected by the deep de-institutionalization and de-capitalization structural crisis undergone by Peru's economy and society since the decade of the seventies.

We wish to firmly point out that one of the most affected sectors by the deep structural crisis of Peruvian economy and society are primary agrarian productive activities and rural activities that the latter depend upon either directly or indirectly.

Primary agrarian productive activities reveal that during the decade of the nineties there has been a reduction of its profitability of approximately forty percentage points from 1990 to 2000 measured in terms of the deterioration of the internal terms of trade between prices received by the agrarian producers and the prices paid for production inputs and factors.¹³

Experts point out the perverse combination of the following factors as the main cause-effect relationships that explain the reduction of profitability of the agrarian sector in the decade of the nineties:

- a) lagged exchange rate;
- b) rapid liberalization of food imports (commodities for the food industry and final processed goods);
- c) the application of social compensation programs during the prolonged adjustment process of the economy through the distribution of subsidized imported food to urban and rural low income populations competing in internal product markets through local, regional and national levels;
- d) to the above we must add the distancing of formal financial credit with the disappearance of development banks (in particular the Agrarian Bank) and, the private non substitutive, effective and efficient saving and loans associations for the amounts and modalities of credit granted by private commercial banks, Rural Savings and Loans Associations, Municipal Savings and Loans Associations and rotating funds granted by the government and some NGOs.

Unfortunately, in Peru in the nineties, the neo-liberal concepts that have dominated the political and economic reasoning has involved a growing neglect of the policies and practices to reinforce and build institutions in order to promote and foster organizations, both in the governmental administrative field as well as the private economic and social

¹³ We consider that it is of most importance to point out that the de-capitalization process of the decade of the nineties is added to the producers in the decades of the sixties and seventies by effect of the Agrarian Reform (due to the loss of entrepreneurial capital and a lack of investments in addition to the practice of freezing the market of land) and, in the decade of the eighties due to the effect of the "counter agrarian reform" (the fragmentation of plots of the land owned by large associations). The structural problems pointed out are aspects of a primary national interest that must be approached, with a political and technical will, and a greater priority and seriousness.

fields. In the diagnosis carried out we wish to highlight the neglect of the following aspects:

- the reforms to create a modern de-centralized, non-bureaucratic and efficient state, were proposed to be implemented during the last decade;
- resource transfers to the most needy were imbued in the social compensation programs or short-term subsidies designed to confront the stage of macro-economic adjustments and later, used in actions of political proselytism for the 1995-2000 government administration re-election process.
- The reform of the financial system was normalized by a Banking Law for multiple services that tend to concentrate in a few entities of the banking system, foreign trade and internal commercial exchange services and centralize resources and decisions in Metropolitan Lima producing what we can call, conditions for a “new financial repression” hampering the productive activities and services installed throughout the interior of Peru, in particular, the activities developed in favor of the small and medium agrarian and industrial companies.

Studies reviewed and proposed on financing policies for agricultural and livestock activities and rural development in the decade of the nineties differ substantially, not much as concerns its analysis on the negative effects generated by the restrictions to access formal financial credit, to working capital and investment resources, required by these activities, but rather particularly, in the conclusions and recommendations concerning the institutional arrangements and forms as considered necessary, to reinforce and create, to achieve the objectives desired and to confront the economic –financial crisis suffered by Peru, its companies and financial system.

BIBLIOGRAPHY

ALIDE, Informe de la XXX Reunión Ordinaria de la Asamblea General de la Asociación Latinoamericana de Instituciones Financieras de Desarrollo, Cartagena de Indias, Colombia, Mayo, 2000.

ALCORTA, AUGUSTO L., Grupos Financieros: Un Estudio Comparativo del Reino Unido y Japón, Artículo presentado para la obtención del Título Profesional de Licenciado en Economía, Universidad del Pacífico, Lima, 1990.

ALVARADO J. y UGAZ, F., Retos del Financiamiento Rural: Construcción de Instituciones y Crédito Informal, CEPES, CIPCA, CES Solidaridad, Lima, 1998.

_____. El Financiamiento Informal en el Perú, COFIDE/CEPES-IEP, Lima, Noviembre, 2000.

CENSO ECONOMICO DE 1993, Lima, 1993.

CENSO NACIONAL AGROPECUARIO DE 1994, Lima, 1994.

COFIDE/Secretaría Técnica, Transformación del Sistema Financiero y el Proyecto BANDES (Banco Nacional de Desarrollo, Setiembre 1986.

COFIDE/División de Planeamiento – Depto. de Estudios Económicos, Lineamientos del Plan Financiero de Largo Plazo, Junio, 1986.

COFIDE/BID, Swisscontac, 2000. Estudio sobre la Movilización de los Depositos en el Perú (Swisscontac, COFIDE/BID), Concurso Público No. 001-99/CI-BID-COFIDE, Lima, Marzo del 2000.

DÍAZ, ALEJANDRO W., GARAIZABAL, J.M., ZUTTNER, B., Los Mercados Financieros Rurales en el Perú, Cooperación Técnica Perú – Alemania, LUSO CONSULT/GTZ, Noviembre, 1996.

GOLDSMITH, RAYMOND WILLIAM, Financial Structure and Development, New Haven, Conn. Yale University Press, 1969.

_____. Premodern Financial Systems, Cambridge, Cambridge University Press, 1987.

INEI, Censo Nacional de Población, Lima, 1993.

MCKINNON, RONALD I., Money and Capital in Economic Development, Washington D.C. Brookings Institution, 1973.

REICHMUTH, M., Elementos de una Estrategia de Desarrollo del Sistema Financiero Rural en Perú, GTZ, Junio, 1997.

_____ Promoción del Sistema Financiero Rural en el Perú, GTZ, Febrero, 2000.

SALAVERRY LL. JOSE A., El Crédito Agrario en el Perú, Banco Central de Reserva del Perú, 1983.

_____ Descentralización Financiera como Estrategia de Desarrollo de los Mercados Financieros en el Perú, Documento elaborado para la Décimo Sexta Asamblea General Ordinaria de la Asociación Latinoamericana de Instituciones Financieras de Desarrollo (ALIDE) en México, D.F., Lima, Mayo de 1986.

_____ “Políticas de Desarrollo Integral y el Sector Agrario Peruano: Importancia y Rol en las Últimas Décadas, en La Semilla: Germinación de una Nueva Era, Fundación para el Desarrollo del Agro, 2do. Seminario Anual, Lima 24-25 de Agosto, 1989.

_____ Autonomía Económica y Descentralización Financiera, Documento elaborado para el Foro Nacional de Regionalización, Congreso de la República, COFIDE, Lima, Setiembre, 1986.

_____ Aportes para la Transformación del Sistema Financiero Peruano, Documento de Trabajo, COFIDE, Lima, 1986.

_____ Propuesta de Desarrollo del Sistema Financiero y el Mercado de Capitales, Documento de trabajo COFIDE, Lima, 1985.

SHAW, EDWARD, Financial Deepening in Economic Development, New York, Oxford University Press, 1973.

WORLD DEVELOPMENT REPORT 1989, Financial Systems and Development, Oxford University Press, Junio 1989.