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COSTA RICA
POLICY TOOLS FOR RURAL FINANCE

THE POLITICAL ECONOMY OF BANK NATIONALIZATION: THE CASE OF COSTA RICA, 1948-1988

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I. Introduction

Suspicion of private bankers and of their power has had a long history. This suspicion has been especially predominant among social groups whose economic future depended on continued access to a flow of credit at relatively low cost. This was indeed the case for the emerging class of small entrepreneurs-cum-technocrats-cum-politicians of Costa Rica after World War II. At that time, Costa Rica was still a very small, open, rural economy, entirely dependent upon exports of coffee and bananas. Its small banking system reflected, in turn, the simplicity of the economy. The new groups, on the other hand, sought opportunities associated with rapid structural change and were impatient when faced with the constraints typical of a developing economy. In their eagerness, they wanted to harness the power of the state in order to create new economic and political opportunities. In addition, they were confident that through scientific intervention their efforts would not only be privately profitable but would also contribute to economic development at large. The private banks, conservative and cautious, were an obstacle in their way. The 1948 civil war provided them with the opportunity to nationalize the banks. The rationalizations and the justifications came afterwards, but the state monopoly in the mobilization of deposits from the public is still a landmark in the political economy scenery of Costa Rica.

This paper examines first the background for the nationalization. It discusses the role and ideology of the 1948 Junta, the ostensible objectives pursued with the nationalization, and the possible reasons for this interventionist measure. Next, the paper examines the institutional evolution of the Costa Rican financial system. From mimicking the private banks, the state-owned institutions evolved into labor-dominated bureaucracies and borrower-dominated sources of rents. The Central Bank, entrusted with the direction of the system, attempted to influence resource allocation through quantitative/qualitative credit restrictions (topes), credit rationing, and subsidized interest rates. Political parties and interest groups, in turn, attempted to control both the monetary authorities and the banks, in order to benefit from the implicit subsidies and the power that comes from the control of credit. Regulation was followed by avoidance, however, and both private banks and non-regulated intermediaries increasingly challenged the monopoly of the state-owned banks.

The paper includes a brief review of the main outcomes with respect to financial deepening, credit allocation, access to financial services, portfolio concentration, bank efficiency and profitability, transactions costs, and loan collection. In each case, a preliminary attempt is made to identify the influence of the nationalization on the outcomes. Recent deregulation and privatization attempts and the political economy reactions to these initiatives are described.

The paper abandons the assumptions of optimal intervention analysis that consider policymakers as disembodied, altruistic agents who maximize some social utility function and, instead, follows the "new political economy" in the view that the state is composed of groups of self-regarding individuals in strategic interaction with sets of private agents (Lal, Srinivasan). The paper, therefore, attempts to provide a view of the interplay of political, economic, and social forces that affected the decision to nationalize the Costa Rican commercial banks as well as the evolution of the system as the different coalitions changed over time.

II. The Nationalization Decree

During a radio speech the evening of June 19, 1948 José Figueres, head of the *Junta* that ruled Costa Rica for 18 months after a two-month civil war, announced the nationalization of the banking system. That day, only six weeks after it took power, the *Junta* suspended the constitutional guarantees and it decreed a ten percent tax on capital in addition to the nationalization of the banks. The decision, the most important in the political economy history of the country during the second half of this century, represented a major attempt by new social groups to take economic and political power away from the traditional (coffee) exporting groups, which had so far controlled the banks, and to modify to their advantage the country's economic policies and productive structure (Rovira).

Decree 70 of the Junta stated: "Considering: (1) That within the organization of a modern economy, all agricultural, industrial, and commercial activities depend on bank credit, the allocation of which determines the progress or stagnation of the country. (2) That an economic activity of such importance should not be in private hands since it represents, by its own nature, a public function. (3) That the private banks lend not only the shareholders' own funds but also mobilize the country's savings, in the form of deposits from the public. (4) That it is unfair that the high profits of the banks, guaranteed by the state and the social order, be earned by their shareholders, who represent a minimal portion of the capital mobilized. Rather, these profits should become national savings and their investment should be directed by the state. Therefore, the Junta decrees: (1) Private banking is nationalized. Only the state will be authorized to mobilize, through its own institutions, the deposits of the public. (2) The shares of the Banco de Costa Rica, Banco Anglo Costarricense, and Banco Crédito Agrícola de Cartago are expropriated for reasons of public convenience. The state, through its Ministry of Economy, will take over the banks immediately. The form and conditions for payment of the shares will be regulated afterwards. (3) The Ministry of Economy will provisionally keep the present form of organization of the banks and it will appoint their boards of directors and managers."

The banks so expropriated by the nationalization decree were owned and managed by Costa Ricans. No foreign bank had operated in Costa Rica after the Royal Bank of Canada left in 1936, faced with restrictions introduced by that year's Banking Law, which limited dividend payments to 12 percent of equity capital (Ortuño). The nationalization decree, therefore, had two main effects: (1) it created a legal monopoly in the market for deposits from the public, which represented a major restriction to entry into banking by domestic and foreign intermediaries; and (2) it transformed three of the existing private banks into state-owned enterprises. One small private bank (Banco Lyon) was allowed to continue operations, but without authority to mobilize deposits from the public, and it soon specialized in international transactions. The largest bank, Banco Nacional de Costa Rica, created as a public institution in 1914, continued to be operated by the state. Since 1936, its Money Issuing Department (<u>Departamento Emisor</u>) had exercised the functions of a central bank.

III. <u>Rationale for the Nationalization</u>

In his radio speech, Figueres further justified the innovation by indicating that "it is necessary to redirect the country's economic activities, in order to promote savings and the most productive use of resources. The greatest obstacle to this task is the prevailing organization of credit. The banks allocate the funds needed by agriculture, industry, and commerce. For this they use not only their own capital, but also the public's funds, in the form of deposits. This gives them the extraordinary social power that they enjoy and (Figueres believed) this is an incredible anachronism. The administration of money and of credit should not be in private hands, as the administration of water or of the postal system should not be left in private hands. These vital functions should be undertaken by the state, the nation's political organ. Banking is the safest and most profitable business. In a few years the private banks have been able to accumulate reserves well beyond their original capital. Their profits come, to the largest extent, not from the lending of their own capital, but from the mobilization of funds from the public. If the service is public, public must be the ownership of the institutions which manage it, particularly since modern economic conditions make all industries and activities dependent on them. The banks promote the entrepreneurs they want to favor and asphyxiate others. They control the country's economic progress and determine the success or failure of enterprises. Such a power should not be in private hands, but in the hands of the nation. The strictly commercial criteria that characterizes the operation of the banks, although convenient for the shareholders, who make a safe investment when they finance imports of whisky, is not adequate for a country that needs to develop its agriculture and industries and which, for this purpose, possesses no other resources but bank credit. The economic policy of the Junta, which seeks the industrialization of the country and the intense utilization of natural resources, could not be implemented without the effec tive control of credit policy. In order to achieve this control it became necessary to nationalize the private banks" (La Nación, June 22, 1948).

Additional arguments presented by the Junta and their supporters sought acceptance of this highly interventionist measure and revealed its ostensible objectives. These goals included: (1) the selective allocation of funds to priority sectors, in order to promote the diversification of the country's productive structure, under the assumption that a social optimum would not result from the banks' profit-maximization motives but could be achieved through appropriate credit policies; (2) increased access to financial services, particularly to subsidized credit, for large segments of the population and, especially, for new entrepreneurs (the "democratization" of credit); (3) the use of apparently inexpensive resources -bank deposits- to disburse loans at low rates of interest, in order to promote desirable activities, even if this results in losses for the banks; and (4) a reduction in the concentration of power, a constant preoccupation of the Costa Rican polity. It was claimed that "the state-owned banks will serve the interests of all sectors of the economy, the weak and the powerful, without distinctions due to wealth, position, or influence" and that "given its public nature, in the hands of the state banking will always be regulated with the only criterion of maximizing social welfare (Facio, Zuñiga, and Rossi). In general, the country's financial savings were perceived as a "public good" and commercial bank lending, which "creates money," as a natural state monopoly.

These arguments did not differ from those expressed elsewhere. In 1947 Campbell had supported the nationalization of the Australian banks by claiming that it "will take away from the handful of rich men who control the banks the power they now have to dictate financial policy to the nation and will vest this power in the hands of the elected representatives of the people... Nationalization of banking will benefit all sections of the Australian community except the mere handful of wealthy parasites who live on the proceeds of bank usury" (May). Thirty-five years later, the nationalization of the Mexican banks was also justified on the basis of the need to break the power of the private financial institutions (Tello).

IV. Reasons for the Nationalization

Jones and Mason identified four classes of reasons for the establishment of public enterprises: (1) ideological predilection, when the decision rests on the prior belief that certain forms of organization are generally preferable to others; (2) the acquisition or consolidation of political and economic power; (3) historical heritage or inertia; and (4) pragmatic responses to economic problems.

The nationalization of the Costa Rican banking system mostly reflected a struggle for power among several interest groups. It was also a response to the fiscal problems faced by the *Junta*, at a time when it became necessary for the *Junta* to legitimize its continued rule. Although a state monopoly of insurance had been created in 1926, Costa Rica thus far had been characterized by laissez-faire economic policies. The nationalization was consistent, however, with the ideology of the new politicians of the Junta, who most likely selected from the available set those ideas that served them best (mostly those of the Peruvian Haya de la Torre, founder of APRA, a party which nationalized that country's banks when it finally came into power with Allan García in the 1980s).

The immediate justification for the 1948 civil war had been the need to preserve the country's exceptional electoral institutions, since the results of that year's presidential election had not been recognized by the incumbent administration. These results did not become effective until 18 months later, when the Junta turned power over to Ulate, the elected president. In addition, the civil war provided the opportunity to a new group of social-democrat politicians to gain power and to attempt a redirection of the country's economic policies (Rovira). With the civil war, they had a chance to control the government under exceptional circumstances. Indeed, the Junta became Executive and Legislative at the same time and it boldly took the opportunity to restructure the country's institutions. This was unusual in a country that had been and continues to be characterized by sustained political stability and a well-ordered political system with strict separation of powers. The nationalization of the banks was their most important action.

At that time the Costa Rican society was simple and offered few opportunities for entrepreneurial activity beyond coffee. The new groups consisted of a coalition of small industrial entrepreneurs, a strong rural middle class, and the urban intellectual petite bourgeoisie. The Junta included representatives of the Centro de Estudio de los Problemas Nacionales (Center for the Study of National Problems), which grouped young professionals and university professors, and of the short-lived Partido Social Demócrata, a political party of small and medium entrepreneurs and professionals, which eventually became the dominant Partido Liberación Nacional (PLN). Trained at the newly-created University of Costa Rica (1941), in disciplines for which the traditional export sector generated little demand, their leaders were eager to use their newly-acquired knowledge to influence policies and to create for themselves new economic opportunities.

The Center had been established to study national problems and to recommend "scientific and pragmatic" solutions. It's ideology, which gradually replaced a liberal legacy of more than a century, was summarized by R. Facio, who claimed that "the objective of economic policy must be to increase and diversify the country's output: the preeminence of coffee must decline and so the nation's dependency on external markets... (but) the increase and diversification of the national output must result from the stimulus, defense, and organization of small owners" (Aguilar). The state must be a promoter and organizer of economic activity, through scientific intervention. In order to prevent the concentration of power, however, the Center recommended the creation of autonomous institutions: decentralized public agencies in charge of specific services, presumably free of the influence of political parties. With the new 1949 Constitution, the nationalized commercial banks became autonomous institutions.

The Partido Social Demócrata, in turn, attempted "a combination of measures to raise the standard of living and to guarantee the rights of the workers and the peón, to strengthen the small proprietors and to create new ones, to defend the small industrialist, the small merchant, the professional and the public-sector employee, and at the same time promote a general economic reactivation" (Aguilar). This enumeration of goals explicitly identified the party's new constituencies. After its creation in 1945 this party had been active in the political arena, with much visibility, but it had not managed to amass any electoral support. Even after victory in the 1948 civil war and the rule of the Junta, its electoral power remained weak. In the elections for a Constitutional Assembly in December, 1948 this party only got 4 out of 45 representatives. Under normal circumstances, it would have taken a long time before they would have made a difference. The civil war provided Figueres and his followers with a unique opportunity to exercise the control of government before their time and they took advantage of it (Rovira).

While most of the members of the new groups lacked financial resources, bank credit had been particularly scarce during the 1940s, as the private banks restricted lending, in collaboration with the Banco Nacional's efforts to control the inflationary pressures that resulted from the War and from extreme fiscal mismanagement (Ortuño). The nationalized banks would become, thereby, "the most loyal friends of the new entrepreneurs" (Rovira). In a reply to a few protests, the Junta (G. Facio) claimed that "it cannot be communist a reform that promotes private property. The nationalization of the banks does not go against private property and it does not penalize private initiative; on the contrary, it promotes it. The nationalization of credit will enormously promote private initiative, since anyone willing to produce will have loans at very low interest rates" (Gil).

According to Gil, the explicit purpose of the nationalization was to redistribute credit, to promote new businesses, to create new entrepreneurs, to provide a stimulus to private activity, and to avoid, through careful allocation of the funds, the concentration of resources in a few hands. The nationalization of the banks, therefore, was a clear expression of the "opportunity-seeking" activities of new social and economic groups in an economy at the onset of a major structural transformation.

The state-owned Banco Nacional had been created in 1914 in response to the refusal of the private banks to lend to the government. In 1948 the Junta faced a severe fiscal disequilibrium and it feared the influence the private banks would acquire if called upon to finance the deficit (Martén). Moreover, similarly to what Indira Ghandi did in India, the Junta used the nationalization of the banks to consolidate its power (Torri). Six weeks after the end of a civil war fought to protect the results of an election, the Junta had not turned power over to president-elect Ulate. The Junta needed, in addition to its military victory, to introduce a shocking reform in order to justify its exercise of power. To tell the population that bank deposits and the high profits from banking belonged to the people was not only bound to have a strong propagandistic impact on large strata of public opinion, but it also served to signal the Junta's determination to use its exceptional power to transform the country (Solera). Indeed, Lenin, impressed by the powerful political and economic influence of the banks, nationalized all Russian banks immediately after the 1917 revolution as the fastest and most effective way of assuming control over the entire economy.

V. Lack of Opposition

While university professors and students applauded the nationalization, the private sector did not attack or oppose it. Only La Nación, the main conservative newspaper, openly opposed the measure and claimed that it is private enterprise, and not nationalization, which promotes economic development. The editorial feared that this nationalization would place in the hands of the state, and in this way of those who control it, all the power of credit, which at any time can be used as a political tool. Guardia, one of the lonely dissenting voices, asked why, if the nationalization of the banks was such a fantastic idea, few other countries had attempted it. In his view, the state is a poor credit manager and would allocate credit with political, not economic criteria. He feared that those businessmen who opposed the rulers would not have access to loans (Gil).

Given its major impact, the absence of opposition to the nationalization of the banks may be surprising. This passive acceptance reflected, however, the extraordinary power accumulated by Figueres and his followers as a consequence of the civil war and the fear that access to credit would be lost in the case of opposition. Debate about the merits of the intervention increased with time, nevertheless, once normality was restored, but there never was a chance that the measure would be reversed.

There are historical moments when the state is reconstituted and when those elements that have seized the political initiative can set down the initial orientations of the state by devising an array of institutions which embody their ideological vision, by coalescing alliances to form the social foundations of the state, and by formulating a legitimation to transform their might into right (Bennet and Sharpe). The 1948 civil war gave the <u>Junta</u> the power to reconstitute the state, as reflected by the 1949 Constitution. The orientation with which they imbued key institutions became set in ways which delimited the future strategy of growth and which gradually constrained the possibility of anything but marginal changes in orientation.

For a long time, the operations of the nationalized banks were not questioned. The concept of a more equitable distribution of credit was the screen used by the groups which actually appropriated most of the benefits from the nationalization to defend it. These groups invested so successfully in the adoption of this "ideology," that attacks to the nationalized banks became increasingly viewed as "morally wrong." This is a role of ideology that has been stressed by North.

While selective credit allocation and subsidized loans were used to compensate those who contributed to the party's progress, thus reducing the free-rider problem, promotion of the ideology was used to maintain popular consent. Moreover, although credit allocation was actively used to increase the following of the PLN, the portfolio of loans actually became increasingly concentrated in the hands of a few large clients. Thus, the appropriation by a few of most of the rents created by the nationalized banks was reconciled with the political objective of reaching a large clientele through the implementation of special small-farmer loan programs. While these programs reached a large number of borrowers, they required only a small proportion of the amounts disbursed (Vogel, 1984).

Private interest groups were ambivalent about the innovation: they were ready to leave banking to the state so long as access to subsidized loans increased. The Chamber of Industries agreed with the Junta's objective "to increase access to production credit under special terms and conditions" (Facio, Zuñiga, and Rossi). On the other hand, their costs of organization were too high, compared to the potential gains from reversal of the borrower-dominated policies, for the groups of depositors, taxpayers, and excluded potential borrowers hurt by the intervention to oppose it (Olson). This contrasted with the belligerence of bank employees, who had clear interests to defend and ample opportunities for organization.

VI. Institutional Evolution of the Nationalized Banks

Four dimensions of the institutional evolution of the Costa Rican banking system are worth mentioning: (1) the gradual change in organizational culture, from state-owned banks which mimicked the private banks from which they had sprung, to labor-dominated bureaucratic institutions; (2) the gradual change in the degree of autonomy from the Executive branch enjoyed by the state-owned banks, which led to an increasing political intrusion; (3) the changing role of the Central Bank and the recent deregulation attempts; and (4) the gradual emergence of evasion and avoidance mechanisms, which led to increasingly active non-regulated financial systems and to growing competition from private banks.

The Junta decided to keep the expropriated private banks as separate institutions in order to avoid a concentration of power and to promote some competition. These banks, in addition to the Banco Nacional, became the nationalized banking system (NBS). All the banks benefited from immediate capital contributions from the state. A large transfer to the Banco Nacional, earmarked for subsidized, long-term agricultural credit, was the first one of numerous and substantial fiscal and donor contributions aimed at increasing the availability of loanable funds for target populations and end uses. The Junta also kept the old staff of the banks, most of whom had been loyal to Figueres. Bank employees had been at the forefront of the general strike that preceded the civil war and represented a major group among the white-collar middle classes that increasingly supported the PLN. The members of the boards of directors were also asked to retain their positions and most did (Solera). Although not much change in credit policies was to be expected when the directors stayed, this measure might have reflected the Junta's effort to keep the public's confidence in the banks.

In practice, therefore, there had merely been a change of owner: the banks continued to operate for some time as if they were private commercial banks. Highly respected professional bankers, who knew their clientele well, continued as managers for a long time and maintained a considerable independence from the political power. The 1950s were, therefore, the golden age for the nationalized banks, revitalized by the infusions of funds and by exceptionally rapid economic growth.

Gradually, however, the old bankers began to be replaced by politicians in the boards of directors and management of the institutions. The directors were appointed by the Executive branch, for four-year periods, while the managers were appointed by the boards, for similar periods. Given the alternation of different political parties in the control of the Executive and since one-half of the board was replaced every two years, each new administration had to wait for two years before it controlled a majority of the board. This gave the banks considerable independence in those earlier years. In time, however, the appointments more and more became political rewards rather than the identification of a professional capacity in bank management. Appointed for only four years, the directors had little time and incentives to learn the complexities of banking and saw their position merely as an opportunity to advance their political career (Solera). From their political rather than technical perspective, therefore, they were open to the influence of the Executive and their political party and vulnerable to the pressures from the private interest groups which they represented. Political intrusion and rent-seeking thus increasingly characterized their performance.

With the election of Figueres as president in 1970, the independence of the banks sharply declined. According to the 1949 Constitution, the four nationalized banks had become autonomous institutions. The Constitution defined "autonomy" as independence with respect to both policy and management. The purpose was to protect the technical operations of these institutions from political intrusion. By the late 1960s, however, the PLN leaders believed that independence with respect to policy had to be taken away from these agencies, since it was no longer compatible with their desire for an increasing role of planning. The PLN-controlled Legislative approved a constitutional amendment in order to restrict the independence of the autonomous institutions to matters of management only (Romero). As a result, these agencies had to follow the directives of the Executive. In the case of the banks, this influence was exercised mostly through the Central Bank. During the 1950s and the 1960s, the monetary authority had been managed by strong personalities, like Facio and Solera, and had enjoyed considerable independence. This autonomy diminished over time (Gonzalez-Vega, 1988a).

An increasing politicization of the banks came also as a result of changes in the method of appointment of their boards of directors. After 1970, appointments were made at the beginning of each administration, 4 directors chosen from the winning party and 3 directors from the losing party. This explicit distribution of power within the banks was a clear recognition that the institutions had become major redistribution mechanisms according to political rewards. An additional loss of independence took place in 1974, when a new law authorized the President to freely appoint and remove an Executive President for each autonomous institution, as its main executive. This has allowed the winning party to centralize power and to use the banks as a political tool. In the case of the Central Bank, three Cabinet ministers were appointed as _ex officio_ members of the board of directors. These ministers, in addition to the Executive President, gave the Executive branch's representation a majority in the board.

With the nationalization of the banks, the control over management exercised by the private shareholders disappeared. The banks were supposed not to pursue profit maximization any longer, but a set of criteria for the evaluation of their performance was never defined (Lizano, 1977). The staff of the banks gradually filled the vacuum thus created. The number of employees at the banks increased from 686 in 1950 to 8,340 in 1986. This represented a rate of growth of employment at the banks twice as fast as for the economy as a whole. Labor unions of bank employees increasingly used their strength to improve their salaries and fringe benefits. Bank wages became much higher than those for equivalent occupations in other sectors, while an important proportion of the banks' accounting profits was earmarked for employee fringe benefits (pension plans, clubs). Rigid bureaucratic structures controlled by the unions severely restricted the adoption of promotion policies based on efficiency or performance-linked incentives to employees.

VII. Central Bank Policies

In addition to the traditional monetary functions, the Central Bank was entrusted with the direction of the NBS and the promotion of economic development. Ever since its creation, its main policy instrument were the *topes de cartera*, ceilings on the amounts of credit outstanding by economic activity. With these quantitative/qualitative limits on credit volumes, the authorities attempted to influence both the rate of expansion of domestic credit and resource allocation. The Central Bank was also involved in the design of rationing criteria (*cuadros de avío*), which defined maximum amounts to be financed, usually per unit of land, for each particular crop. These amounts were based on hypothetical costs of production, frequently uniform for the whole country, estimated for the best available technology.

While the topes were used to channel credit towards priority sectors or to discourage lending for non-preferred activities, the avíos were rules for loan-amount credit rationing in the presence of under-equilibrium interest rates (Gonzalez-Vega, 1984). Subsidized loans and special credit programs created substantial rents. Directly-unproductive, profit-seeking activities by interest groups followed, in order to create and capture those rents, while individuals spent resources in fulfilling the requirements for eligibility (Krueger, Bhagwati, Kane). The politicians, in turn, used their control of the rent-generation process as a tool to promote support for their political parties and used the topes and avíos as selective incentives, in order to control free riders. Prominent party members, in turn, were rewarded with privileged access to loans and lack of vigorous efforts to collect them.

Over time, the shortcomings of this system became evident. The Central Bank's credit program contained quarterly limits on loans outstanding per bank, for a large number of categories (sometimes over 70). The multitude of often overlapping and inconsistent ceilings became expensive for the banks to administer, while the Central Bank had to distract resources from its more traditional monetary functions to design and supervise the credit program. Given insufficient information and undefined criteria, the credit program simply reflected projections of the ceilings for the previous year and the requests for modifications from the politicians. In this environment, the establishment and implementation of the _topes_ became increasingly vulnerable to interest-group pressures, particularly at the level of the Board of Directors of the Central Bank.

Rather than a maximum of credit allowed per activity, the _tope_ was interpreted as an entitlement which obligated the state-owned banks to lend the amount of the ceiling for each particular purpose. This made it difficult for the Central Bank to use the _topes_ as an instrument to control the expansion of credit, since any reduction would imply a curtailment of these "property rights." The risk-averse banks, on the other hand, interpreted that they were not authorized to lend for a particular purpose, unless the corresponding _tope_ line item had been included in the credit program. In this way, the state-owned banks passed on the blame for the general shortage of credit to the monetary authorities ("we are sorry, there is no _tope_"), but still were able to accommodate preferred clients when necessary ("there is no _tope_, but we can help you"). As a result, year after year, the banks essentially made the same loans, despite major changes in circumstances, and there was little room for innovative lending.

Given the impossibility to accurately forecast the composition of the demand for credit, numerous revisions of the credit program were required during the year. Despite these modifications, the banks hardly ever complied with the regulation (Vogel and Gonzalez-Vega). Moreover, excess demands for credit for some purposes and excess supplies for others, that could not be easily corrected, increased the rigidity of bank management as well as the transactions costs for the banks and the borrowers. Soon the clients learned, moreover, to apply for loans for activities for which _topes_ were available and to rely on fungibility for the implementation of their desired production plans. Over the years, several reforms were adopted in order to minimize the deficiencies of the system and, in the mid-1980s, the Central Bank undertook a major deregulation of the system, completely eliminating the _topes_ (Loría, 1988).

Similar problems became evident with respect to the _avíos_, particularly after inflation accelerated and more frequent revisions became necessary. Active rent-seeking efforts by interest groups attempted to influence the estimation of costs of production and the determination of the proportion of those costs to be financed. Over time, the producers interpreted the amount of the _avío_ as an entitlement to a given loan size, independent of individual circumstances. Given the enormous heterogeneity of farmers, the application of a uniform _avío_ has resulted in major inefficiencies and inequities (Graham).

The Central Bank also set deposit and loan interest rates. The _tope_ system provided ample opportunities for interest-rate differentiation: there was a different interest rate for each line item in the credit program, with a wide margin between the lowest and the highest rates. The implicit subsidies attracted rent-seeking activities. Several subsidized interest rates were also established by law, as an institutionalization of entitlements for specific groups (rural women, cooperatives, and the like).

Given extremely low levels of inflation, of less than two percent per year in the 1950s and the 1960s, even the preferential rates were positive in real terms and therefore the implicit subsidy was moderate. With the acceleration of inflation in the 1970s, on the other hand, real interest rates became negative and the subsidy substantial and highly concentrated in a few hands (Vogel, 1984).

Until the late 1970s, the interest rates paid on deposits were never a concern for the authorities. With the acceleration of inflation and capital flight in the late 1970s, however, the Central Bank began to pay attention to the rewards to depositors. In 1978, a partial financial reform raised real interest rates to positive levels for a few months and a high interest elasticity of deposits was revealed. This reform soon failed, however, due to the absence of fiscal control and the resulting inflationary pressures (Gonzalez-Vega, 1988a). Thus, while the interest-rate reform stimulated deposit mobilization, the financing of the public-sector deficit crowded out the private sector from the NBS credit portfolios.

The explosive fiscal disequilibrium of the early 1980s resulted in a further acceleration of inflation. Interest rates, on the other hand, were not adjusted upwards sufficiently and became extremely negative in real terms. The financial system experienced, as a result, a major contraction. The stabilization program implemented after 1982, on the other hand, resulted in too high real interest rates, in reflection of the large claim of the public sector on available resources (Gonzalez-Vega, 1988b).

The Central Bank has also assumed the foreign-exchange risk associated with substantial flows of foreign financial assistance for the targeted credit programs of the state-owned banks and it has attempted to influence resource allocation through its rediscounting programs, accessible only to the state-owned but not to the private banks. The Central Bank has also diverted considerable amounts of funds to the public sector through its reserve-requirement policies.

Numerous autonomous institutions and state enterprises (particularly CODESA, the development corporation that operates as a holding company of state enterprises, and the CNP, the price-stabilization agency) have become major interest groups in their own right and have participated in the rent-seeking activities.

Both CODESA and the CNP had automatic access to Central Bank funding. CODESA and its subsidiaries have engaged in all kinds of productive activities, usually reserved for the private sector: aluminum smelting; cement, fertilizer, sugar, and cotton production; railroads and urban and maritime transportation; aquaculture and shrimp fishing, and the like. These "productive" state enterprises have not been profitable, however. Between 1977 and 1983, not one of CODESA's 12 main subsidiaries had any profits in any single year of the period. Their accumulated losses represented 57 percent of their assets. On the other hand, the corporation's non-restrict access to Central Bank credit, which in 1983 represented one-half of all domestic credit for the public sector and 18 percent of all bank credit, was a major reason for the severe crowding out of the private sector in SBN portfolios. At the same time, in 1983 CODESA's enterprises contributed only 1.8 percent of the GDP and employed only 0.3 percent of the labor force (Vargas).

This hybrid of state power-private flexibility (a state agency created as a private corporation) has shown the worse features of both worlds. It has not been restricted by the political controls typical of government agencies (e.g., legislative authorization of funding) or by the profit discipline that constrains private firms. Projects have been preferred on the basis of their initial investment: the larger, the better, and the Central Bank has been called upon to automatically provide the funds required.

VIII. <u>Avoidance: Private Banks and Non-Regulated Intermediaries</u>

By erecting restrictions to entry, the nationalization of the banks was a "negative innovation," which destroyed economic opportunities (Kane). Inevitably, over the years, successful mechanisms of avoidance flourished in order to restore some of those opportunities. In the first place, this intervention created a state monopoly of deposit mobilization. Deposits were viewed as the raw material from which loans were produced and as an input in production ("the only resource available," in Figueres' words). The decree actually mandated that "only the state will be authorized to mobilize the deposits of the public."

The first exception to this very general statement came with a narrow regulatory definition of "deposits" as (sight) demand and savings deposits only. This opened the door to the mobilization of term deposits by other intermediaries. Finance companies (financieras) established to mobilize funds for six-month terms and longer were allowed to operate, under the condition that the liability instrument not be called a "deposit" but instead an investment certificate (certificado de inversión). These finance companies remained relatively small for many years and their lending operations were financed, to a large extent, by inflows of foreign funds.

In 1963, the U. S. Agency for International Development (USAID) assisted in the creation of a private financial company (COFISA) with an infusion of low-priced, long-term funds. By 1981, COFISA had borrowed abroad 25 times the US$ 10 million that USAID had initially provided and it had become the largest private financial institution in the country. In the 1970s, moreover, when inflation accelerated, the interest rates paid on deposits by the private financieras began to diverge from those paid by the state-owned banks. Successful competition for deposits increased the relative importance of the finance companies and, by 1975, their assets represented about 7 percent of the total for the financial system (Sagot).

When several of the _financieras_ grew larger, they requested authorization to operate as "banks," under Central Bank regulation. These private banks have been allowed to perform all banking functions, except the mobilization of demand and savings deposits. In addition, they have been denied access to Central Bank rediscounting. Their interest rates have been regulated by the Central Bank and their term deposits have been subject to reserve requirements.

Most of the private finance companies and private banks created, however, subsidiaries registered in Panama, as a mechanism to evade interest-rate ceilings, reserve requirements, and taxes. During the early 1980s, these subsidiaries became very active in the mobilization of foreign-currency-denominated deposits, when they offered a convenient vehicle for currency substitution (Camacho and Gonzalez-Vega). In order to compete more effectively, the state-owned banks have jointly operated their own foreign subsidiary, the Banco Internacional de Costa Rica. Even today, a substantial portion of the deposits and loans of the private intermediaries are booked at these Panamanian subsidiaries.

The role of the private banks expanded considerably in the 1980s, due to substantial support from the USAID. This support reflected both the Agency's new emphasis on private-sector development and disillusionment with the nationalized banks. A report issued in 1983 characterized the NBS as "slow, excessively conservative, and incapable of significantly contributing to the economic development of the country because of its implicit lending policies as well as its inability to mobilize internal savings to any significant degree" (Pratt et al.).

USAID assistance was facilitated by a 1984 reform of the Central Bank Law, which authorized private-bank access to rediscounting when the source of the funds is foreign. The relative importance of the private banks has increased rapidly. Their share in the total portfolio of bank credit was only 0.3 percent in 1978. This share had increased to 4.6 percent by 1983, just before the USAID assistance escalated. By 1986, the share of the private banks in total outstanding credit was 15.3 percent. Moreover, their share in the flow of new loans granted each year increased from 5.4 percent in 1983 to 20.1 percent in 1986. The importance of the private banks has been particularly pronounced in the case of industrial loans. By 1986, these banks granted 43.3 percent of all industrial credit in the country. The expansion of the private banks has clearly reflected the major role of foreign donors in the political economy of a small country.

Dissatisfaction with the performance of the NBS was not limited to the private sector or the international donors. The authorities found it necessary to create new public-sector financial institutions, in order to provide services not supplied by the state-owned commercial-cum-development banks. Savings and loan institutions specialized in housing finance, cooperative financial agencies, a Workers Savings Bank (Banco Popular) which mobilizes forced employee savings, a municipal financial institution and a students' loan program are among the new mechanisms created (Lizano, 1977).

As a result of these institutional developments, the Costa Rican regulated financial system today is comprised of four state-owned commercial banks, 17 private commercial banks, 56 finance companies, 51 credit unions, 7 savings and loan associations, and 7 state-owned non-bank intermediaries. The state-owned commercial banks still accounted for 76 percent of the assets of the system in 1986 (although some of the weight may be illusory, in light of the quality of the loan portfolio of the NBS). There has been, in addition, a rapidly growing number of nonregulated finance companies.

Recently, there has been an increasing concern about the growing number and aggressiveness of these nonregulated intermediaries and about the need to extend the surveillance of the Superintendency of Banks, attached to the Central Bank, over the activities of private intermediaries, in response to concerns similar to those expressed by Dooley and Mathieson. These companies have been offering a wide variety of savings instruments with a variety of yields, ranging from 40-60 percent interest per annum on term deposits, to more sophisticated activities such as managing and investing deposits of clients on short-term securities at the National Securities Exchange (Bolsa Nacional de Valores) and paying 10-12 percent per annum on these "demand deposits" (Sagot).

These concerns reached a climax towards the end of 1987, when millions of colones were lost by depositors of nonregulated companies that went bankrupt. These events, in turn, stained the image of the private financial intermediaries and led to renewed demands for government intervention and for measures to protect the monopoly of the NBS. Several bills have been under discussion at the Legislative Assembly, to more tightly regulate the financial system. This reaction has been unfortunate and it highlights the importance of the superintendency (Gonzalez-Vega and Zinser). In the words of the manager of one of the state-owned banks, "the best thing that could have happened to the nationalized banks has been the competition from the private banks." Adequate supervision seems to be critical for the protection of such competition.

Finally, there has been an explosive growth of the National Securities Exchange (Bolsa Nacional de Valores). Although the overwhelming proportion of both the number and the value of its transactions has been in public-sector debt instruments, private-sector participation in the mobilization of funds has rapidly grown over the past years. Placement of private paper has recently represented about 4 percent of total transactions. More than a market for shares, the Exchange has been a market for obligations (Gonzalez-Vega and Poyo). The expansion of the Exchange has been both a reflection of regulatory avoidance as well as another force for privatization and increased competition in the financial market of Costa Rica.

IX. Financial Deepening

Costa Rica experienced sustained financial deepening during the 1950s and the 1960s. Financial progress, which was particularly rapid during most of the 1970s, was interrupted at the end of the decade, however, and acute financial repression followed. Table 1 shows that both the money supply (M2), in the broad sense of currency and demand, savings, and term deposits, as well as domestic credit increased rapidly, when measured in real terms, during the first 30 years after the nationalization. As shown in Table 2, the ratio of M2 to the GDP augmented from 18 percent in 1950 to 24 percent in 1970 (it had been 27 percent in 1969) and to 42 percent in 1978. Most of this process of financial deepening resulted from the growth of quasimoney, particularly in the 1970s, as changing preferences for liquidity, risk, and returns led to the diversification of financial-asset portfolios. Similarly, the ratio of domestic credit to the GDP increased from 22 percent in 1950 to 41 percent in 1978 (Gonzalez-Vega, 1985). Compared to other developing countries, by the late 1970s Costa Rica's indicators of financial deepening reflected a positive performance.

A difficult question refers to the extent to which financial deepening was facilitated or retarded by the nationalization of the banks. On the one hand, all of the other Central American countries, where the banks had not been nationalized, experienced similarly vigorous financial progress (Gonzalez-Vega and Poyo). This was everywhere produced by price and exchange-rate stability which made, during most of the period, the real returns to domestic financial assets positive. In the case of Costa Rica, financial deepening also reflected rapid and sustained economic growth and political stability. Despite financial deepening, however, Costa Rica's domestic savings ratio has been particularly low and the country has relied heavily on foreign savings for the financing of domestic investment.

On the other hand, the nationalization led to an expansion of the network of bank branches well beyond what could have been expected otherwise, while the idea that the state-owned banks cannot go bankrupt might have promoted depositor confidence. At the time of the nationalization there were 43 bank branches in Costa Rica, one for every 20,000 inhabitants. Of these, moreover, 38 belonged to the state's Banco Nacional (Hess). By 1986, on the other hand, there were 248 bank branches in the country, namely, one for every 10,000 persons. This is the third lowest ratio of population to bank branches in Latin America, after Uruguay and Trinidad and Tobago. A large proportion of these bank offices are rural branches (Juntas Rurales), which have made possible a greater penetration of the countryside than in other developing countries (Gonzalez-Vega and Poyo).

The monopoly of the mobilization of deposits enjoyed by the NBS, however, has been reflected by a poor service to the depositors of the state-owned banks, who have had to incur in high transactions costs. These costs have discouraged many from holding financial assets. Financial deepening in Costa Rica seems to have been, therefore, more the result of the appropriate macroeconomic policies that maintained price stability for a long time, than of explicit concerns with financial intermediation, and particularly with deposit mobilization, by the nationalized banks.

When macroeconomic management failed in the late 1970s and early 1980s, the system rapidly collapsed. Nationalization, *per se*, seems to have had a mixed impact on the process of financial deepening. In particular, it prevented the development of a more integrated financial market, where an appropriate institutional division of labor might have resulted in a more efficient provision of all types of financial services, including deposit mobilization.

X. Fiscal Crises and Financial Repression

The Costa Rican financial system suffered a significant blow with the fiscal crisis of the late 1970s and early 1980s. Given the increasing discrepancy between public-sector revenues and expenditures and the loss of access to foreign financial markets, the fiscal deficit was increasingly financed with domestic bank credit. The rapid expansion of domestic credit made it impossible to sustain the fixed exchange rate and led to the loss of international monetary reserves, to accelerating inflation, and to devaluation. The resulting financial repression produced a significant contraction of the banking system.

Table 1 shows negative real rates of growth for all major money and credit aggregates for the 1978-1982 period. In real terms, by 1982 the money supply in the broad sense (M2) represented only 69 percent of its 1978 value, while the money supply in a narrow sense (M1) represented only 56 percent of its 1978 value. Similarly, by 1982 real domestic credit amounted to only 42 percent of its 1980 value. The most dramatic contraction took place with respect to domestic credit for the private sector which, by 1982, represented only 36 percent of the 1978 level. Domestic credit for the public sector, on the other hand, continued to increase until 1980, but it eventually declined. By 1982, credit for the public sector reached only 46 percent of its 1980 level (Gonzalez-Vega, 1988b).

As claimed by Gonzalez-Vega (1988a), the difficulties were essentially a crisis of the public sector and reflected a misjudgment about the appropriate size and composition of government. In turn, the hyperexpansion of the public sector resulted, in the general manner explained by Lal, from the proliferation of entitlements to income transfers for a multitude of interest groups. These entitlements, which grew well beyond sustainable levels, reflected the overall nature of Costa Rica's political economy environment (Gonzalez-Vega and Céspedes). Interest-rate subsidies and foreign-exchange subsidies granted through the NBS represented a major proportion of these entitlements.

Once the coffee boom of the mid-1970s was over, these transfers had to be financed with domestic bank credit. A major crowding out of the private sector in the portfolios of the NBS was the consequence. Table 2 reports that the ratio of credit for the private sector to the GDP declined from 29 percent in 1978 to 18 percent in 1986, while the ratio of credit for the public sector to the GDP steadily increased. Also, as shown in Table 3, the share of the private sector in total domestic credit declined from 86 percent in 1970 to 49 percent by 1986. Moreover, in the early 1980s, the public sector received about two-thirds of the net annual additions to domestic credit. Autonomous agencies and public enterprises, such as CODESA and the CNP, became powerful interest groups in the struggle for declining credit volumes. In the end, however, inflation was the easy winner and credit for the public sector measured at constant prices declined

All of the Central American financial systems have been in the midst of an acute crisis during the 1980s. To a large extent, the difficulties have resulted from the same causes, both external and domestic. The contraction of the banking system was more pronounced in Costa Rica, however, than in the other countries (Gonzalez-Vega and Poyo). The nationalization of the banks seems to have contributed to the magnitude of this collapse. The nationalization facilitated both the proliferation of implicit subsidies that was at the fiscal root of the crisis as well as the acute crowding out of the private sector from credit portfolios. Numerous public-sector agencies exercised senior claims on the available loanable funds, leading to the exclusion of private clientele. Influential borrowers linked to political parties and powerful interest groups were rationed the least. The nationalization also resulted in a poor service to depositors and, therefore, in greater incentives for currency substitution and the accumulation of inflation hedges. Many depositors feared a freeze of their accounts, particularly after the Mexican experience. With high inflation and devaluation expectations during the crisis, the mobilization of domestic funds through the NBS rapidly shrunk. Moreover, the rigidity of the NBS not only contributed to the crisis, but it has jeopardized the rapid recovery of the economy as well, in view of obsolete financial technologies and bureaucratic procedures.

XI. Agricultural Credit and Access to Financial Services

In many respects, for a long time Costa Rica has been a success story with respect to agricultural credit. The authorities became interested in small-farmer credit in 1914, when the Banco Nacional was created. At that time, the Cajas Rurales were organized, "to liberate the small farmers from the usurious conditions of moneylender loans, and to stimulate production of basic grains for domestic consumption." After one year, 27 Cajas had been established and were lending to 1,000 farmers the equivalent of 15 percent of the bank's portfolio. In 1936, the Cajas became the Juntas Rurales and the concept of credit allocation through a local board of neighbors was maintained (Gonzalez-Vega, 1973).

By 1948, when the private banks were nationalized, the Juntas had already become a major instrument of the government's agricultural policies. Of the 157,146 loans granted between 1937 and 1952, only 36 loans had not been repaid. Of the equivalent of US$ 18 million disbursed during the same period, default amounted to only US$ 2,390. This was a most impressive repayment record by any standards. It reflected the character of Costa Rican farmers, a tradition of respect for contracts and for legal institutions, and the creditworthiness-evaluation practices of the local boards.

This role did not change with the nationalization. In 1952, the 38 Juntas in operation authorized 19,994 loans, for the equivalent of US$ 3.7 million. What is surprising, as shown in Table 5, is that the number of new loans granted every year did not increase beyond 20,000 until the mid-1970s. On the contrary, the number of loans averaged 17,433 per year during the 1950s and 15,525 per year during the 1960s. This number had declined to 11,996 by 1969. In the 1970s, moreover, the number of new loans grew mostly as a consequence of major donor programs, particularly from the USAID, targeted toward small farmers.

After a maximum of 24,284 loans was reached in 1976, during the coffee boom, the number of new loans from the Juntas declined again and in the early 1980s it was well below the numbers already reached in the early 1950s. Therefore, small-farmer access to credit, measured by the number of Junta Rural new loans granted each year, did not increase significantly after the nationalization. Moreover, for a long time the small-farmer credit programs of the other nationalized banks were insignificant compared to the Juntas Rurales.

Costa Rican farmers have enjoyed, however, a comparatively ample access to credit. The proportion of farmers with access to bank loans has been above 30 percent. If bank credit delivered to coffee producers through the beneficios is included in formal credit, this proportion has been close to an exceptionally high 45 percent. These outcomes, however, have been the result of institutional innovations (the Juntas Rurales) that preceded the nationalization of the private banks, of the widespread ownership of titled land among farmers (distribution of property rights), and of the generalized process of financial deepening enjoyed by the country.

On the other hand, at present the private banks operate only a few branches outside San Jose. Although this may reflect their recent establishment, public ownership of the Banco Nacional has possibly been the most important determinant of the extension of its network of branches and, thereby, of its coverage of a wide rural clientele. This may be a reason to promote other financial intermediary types and not only commercial banks, but it is not a justification for the nationalization of the entire banking system, however.

In real terms, the total flow of credit granted each year by the Juntas Rurales grew until the mid-1960s and it then stagnated and declined, as shown in Table 5. By the mid-1980s, the purchasing power of these loans was equivalent to their real value during the mid-1950s. Average size of loan grew until the late 1960s and it then declined. By 1986, this average size was equivalent, in real terms, to the levels observed in the mid-1950s, despite substantial growth of farm incomes and credit demands. This evolution corresponded to the diminishing share of the Juntas Rurales in the portfolio of the Banco Nacional, as shown in Table 6. In effect, this share dropped from 21 percent in 1970 to 6 percent in 1982, at the worst moment of the crisis.

The reduction of the portfolio share of the Juntas Rurales reflected the iron law of interest-rate restrictions (Gonzalez-Vega, 1984). First with the acceleration of inflation after 1973 and the accompanying increasing transfers implicit in subsidized credit and afterwards with the contraction of the availability of real loanable funds as a consequence of the fiscal crisis, the proportion of the loan portfolio allocated to marginal clientele, even in a nationalized banking system, shrunk.

In the case of the Juntas the reason, however, was not a greater risk associated with small farmers, as predicted for profit-maximizing institutions. It has been shown that in Costa Rica small farmers have always had good repayment records (Vogel, 1981). In the political economy context of the nationalized banking system, on the contrary, the state-owned banks were forced to sustain the supply of credit for the larger and influential borrowers, despite their poorer repayment records, at the expense of the more punctual small borrowers. Table 6 shows that after inflation accelerated and real interest rates became negative, the average size of loan in the Commercial Department of the Banco Nacional, which serves large borrowers, grew from 5.6 times the average size of small-farmer loans in 1971 to 12.8 times in 1975. Indeed, as predicted by the iron law, between 1971 and 1975 the real average size of the small-farmer loans declined by 43 percent, while the average size of Departamento Comercial loans increased by 40 percent during the same period. This contrast was even more pronounced during the crisis of the early 1980s.

XII. Implicit Subsidies and Portfolio Concentration

Compared to other developing countries, the nationalized banking system of Costa Rica has provided access to credit for a large proportion of the population. Access to deposit facilities and to other financial services has been provided to a smaller proportion. A survey of agricultural borrowers from the Banco Nacional found that, although on the average these farmers had been clients of the institution for more than nine years, only 17 percent had checking accounts, 25 percent held savings accounts, and 5 percent had term deposits with any of the four nationalized banks (Gonzalez-Garita, 1986).

The emphasis on credit rather than deposits has been a characteristic of public development banks that have enjoyed ample access to Central Bank and donor funds (Bourne and Graham). It is consistent with the political economy of the nationalization and with the desire to use credit as a political tool. An ample availability of loans helps political parties to stay in power. The rent-seeking activities of influential interest groups, on the other hand, will tend to concentrate credit portfolios in a few hands. This will reflect the superior organizational capacity of small and homogeneous groups for collective action, as explained by Olson. These groups will be represented in the boards of directors of the banks and will have a disproportionate influence on the process of credit rationing. They will make sure that a wide <u>tope</u> is always available and that the <u>avíos</u> not only finance a high proportion of potential costs, but are frequently revised upwards.

The state-owned banks of Costa Rica have been a relatively successful instrument for these purposes. On the one hand, they have provided access to loans for large numbers of producers. Through loan-size credit rationing it has been possible to service many borrowers with the available loanable funds, although an unsatisfied demand for credit at the prevailing interest rates has been prevalent (Gonzalez-Vega, 1984). The multitude of bank customers, on the other hand, have elected the politician-entrepreneurs who have captured the lion's share of the credit portfolios and of the implicit subsidies.

As shown by Vogel (1984), despite the nationalization of the banks, there has been a high concentration of credit portfolios in Costa Rica. The distribution of loans by size has been more unequal than the distribution of land or the distribution of income. Moreover, as shown in Table 4, concentration has been increasing, as would be predicted by the iron law of interest-rate restrictions. In 1974, less than 10 percent of the number of borrowers received more than 80 percent of the amounts disbursed for agriculture by the Banco Nacional. In 1981, when real interest rates became particularly negative, less than 10 percent of the borrowers received more than 90 percent of the amounts (Loría, 1982). Similar concentration also characterized other portfolio components and other state-owned banks.

As a consequence of this concentration, few have benefited from most of the implicit interest-rate subsidy, particularly during inflationary periods when the real rates of interest on loans have become negative. As an example, under the conservative assumption that the social opportunity cost of the funds was 10 percent per year, in real terms, the rate effectively charged on loans during 1974 was a negative -20 percent. Thus, the implicit rate of subsidy was 30 percent. Agricultural credit represented close to 60 percent of the value added in agriculture and over one-half of the loan portfolio of the banks. This meant that, in the important case of agriculture, the grant transferred through subsidized credit was equivalent to 20 to 25 percent of value added in the sector.

On the other hand, only between 30 and 40 percent of the agricultural producers had access to bank loans, while the remaining 70 percent were excluded. In addition, there was a high degree of portfolio concentration. In the case of the Banco

Nacional, which granted over onehalf of all agricultural credit in the country, less than two percent of the borrowers accounted for over 60 percent of the amounts loaned, as shown in Table 4. This meant that less than one percent of the agricultural producers of Costa Rica received more than 60 percent of the agricultural credit granted by the banks and over 60 percent of a substantial subsidy, equivalent to almost 25 percent of the value added in agriculture in 1974. In addition, by the end of the decade it was estimated that about 50 percent of the loan portfolio of the banks represented defaulted loans. There was a significant transfer on this count, too, to the few privileged large borrowers who did not repay their loans.

XIII. Credit Allocation

At the time of the nationalization of the banks, only 31 percent of their portfolio was devoted to agricultural and industrial loans. The proportion of agricultural loans was already higher than the average for Latin America in the 1960s and 1970s (Gonzalez-Vega, 1988c). Over the years, however, this proportion at least doubled, to become the highest for Latin America, as shown in Tables 8 and 10. On the other hand, the share of crops in credit outstanding declined, from 47 percent in 1957 to 20 percent in 1979, while the share of industry increased from 10 percent in 1958 to 32 percent in 1985.

These changes in portfolio composition reflected both the structural transformation of the country after the adoption of the import-substitution strategy of industrialization and the relative strength of the manufacturing interest groups that had promoted the protectionist strategy. The political power of the ranchers was also reflected in the rapid growth of the share of credit for livestock, which grew from 12 percent of the total in 1958 to 30 percent in 1973.

The larger shares of credit portfolios devoted to loans for "productive" purposes after the nationalization may be interpreted as an indicator of the successful achievement of the goal to modify the allocation of credit towards a socially more efficient pattern. However, there is a substantial discrepancy between the stated uses of the loan funds and the marginal changes in economic activity, given the fungibility of credit. In view of the characteristics of the _tope_ system, there were strong incentives to request loans for purposes for which _topes_ were available. Furthermore, given the ample access to credit for the larger producers, the opportunities for marginal substitutions seem to have been ample. To the extent to which the loans were granted with political rather than technical criteria, credit deviation and fungibility seem to have been substantial (Lizano, 1977). In these circumstances, on the one hand it becomes impossible to evaluate the use of the loanable funds, while on the other hand one suspects that many loans were not used for socially-optimum purposes.

XIV. <u>Borrowing Costs</u>

What matters for the borrower's investment and production decisions is the total cost of the funds. In addition to interest payments, these cost includes explicit expenses, such as bank fees and commissions; taxes and legal expenditures; the borrower's transportation, lodging, and food costs during trips to the bank; and bribes. Implicit costs include the value of the time spent in completing loan transactions. Lack of timeliness and insufficient loan amounts are also costly. Delays in disbursement result in lower yields, while too small loans make complementary funds from other sources and the additional transactions costs inevitable. Loans from the NBS have been expensive, disbursed late, and insufficient (Gonzalez-Vega and Gonzalez-Garita).

Gonzalez-Garita (1986) measured the level and components of non-interest borrowing costs for Costa Rican farmers from survey data for 394 clients of the Banco Nacional who borrowed, during 1983, from one of ten selected branches. Since many producers do not demand loans when the transactions costs are high, the exclusion of potential borrowers from market participation because of too high transactions costs was not observed by this survey of borrowers. Similarly, long distances and limited access, due to the absence of roads or their poor condition, prevented the completion of some of the interviews in the sample. These clients do incur in high transactions costs, precisely for the same reasons. As a consequence, there was an underestimation of borrowing costs. A detailed questionnaire measured fees and commissions, taxes and document costs, and travel expenses (weighted in the case of multipurpose trips). The interview also generated information to impute the opportunity cost of the time of the borrower and of those acting on his behalf. For these purposes, the minimum wage in agriculture was used, which underestimated true time costs.

The average level of the non-interest costs of borrowing was high, as shown in Table 11. It amounted to 6.8 percent of loan size and, when adjusted for loan term, it was equivalent to 11.5 percent per year. Since average interest rates were 13.6 percent, the total cost of the funds was at least 25 percent per year. This high level was surprising, given the small size of the country, the extension of the network of roads and bank branches, and the development objectives of the NBS.

On the average, therefore, interest payments represented 54 percent of the total cost of the funds. In the case of smaller borrowers (less than US$ 200), however, interest accounted for only 25 percent of total borrowing costs, while for larger borrowers (US$ 10,000 and over) interest accounted for 86 percent of these costs.

More notable was the dispersion of the non-interest borrowing costs. While interest rates ranged between 8 and 30 percent per year, non-interest costs ranged between 0.2 and 117.5 percent per year. The total cost of the funds ranged between 10.8 and 129.5 percent per year, compared to an annual rate of inflation of 26 percent. There was a four-fold difference among interest rates and a 600-fold difference among the non-interest costs of borrowing. Non-interest borrowing costs per colón declined rapidly with loan size, from 37 percent for loans of less than US$ 200, to 2.8 percent for loans above US$ 1,000.

The existence of the trade-off between the interest and non-interest costs of borrowing was confirmed. Underequilibrium interest rates generated excess demands for credit that required strict rationing criteria (more complex procedures, additional steps, and waiting) and thereby increased borrowing costs. The strict end-use targeting for the funds, supervision, and eligibility requirements also increased borrowing costs (Graham).

Borrowing costs were higher in the case of small, basic-grain producers than for export-oriented farmers, and when the collateral was a cosigner rather than a mortgage. The positive elasticity of borrowing costs with respect to distance suggested the potential social gains from a further geographical expansion of the branch network and from a reduction of the required number of trips to the branch.

The 394 borrowers interviewed made 3,675 trips to the branches, with a total duration of 14,700 working hours. This represented an average of 4.5 full working days for the client, usually at the time of planting. The average number of trips was 9.3 per borrower, and it ranged between 1 and 19 trips per loan. Borrowing costs were higher with those with previous delinquency records and lower for those who were also depositors in the bank, as shown in Table 11.

The nationalization of the banks seems to have had a mixed impact on farmer access to credit. By promoting an unprecedented expansion of the network of rural branches, it reduced borrower transactions costs. Interest-rate subsidies, excessive targeting, bureaucratic procedures, and X-inefficiency attributable to the nationalization, on the other hand, sharply increased transactions costs.

XV. <u>Intermediation Costs and Bank Profitability</u>

The debate between the advocates of public enterprise on the one hand and of private firms on the other has been going on for a long time. The issues are complex and no definitive answers have been obtained. Differences between the two types of organization are related, among other things, to the constraints imposed on managers by the external capital markets, to the incentives that result from the internal organization of the firm, and to the behavior of management (Waterson).

The impossibility to transfer the rights of ownership in the state-owned banks leads to a weaker linkage between management performance and rewards which, in turn, reduces efficiency. In a comparison between private and state-owned banks in Australia, Davies concluded that the "managers of government-owned banks hold a higher proportion of their bank's assets in low-risk and low-paying investments than do they private counterparts. They also arrange their bank's affairs so that they have easier, less arduous lives. Their firms grow more rapidly and have larger staffs than privately organized enterprises. Public managers also organize work and workers less effectively than do private managers. This result is reflected in the substantively lower profit rates manifested in the public sector." There has been a growing consensus that most of these features, with some qualification with respect to the treatment of risk, have also characterized the Costa Rican nationalized banks.

The private banks were nationalized explicitly to eliminate the profit-maximization motive from their objective function. Over the years the banks have earned, indeed, a minuscule rate of return on their capital, even after accrued interest not actually received on delinquent loans has been included as part of their accounting earnings. When losses due to defaulted loans are considered, they have incurred in substantial losses most of the time. As a result, in real terms their capital declined by 54 percent between 1966 and 1976 and by an additional 57 percent between 1976 and 1983. By 1985, in real terms the accounting capital and reserves of the NBS represented only 60 percent of the 1966 level (Gonzalez-Garita, 1987). If defaulted loans were written off, the reduction in capital would be even greater.

The losses, moreover, have not been due to relatively narrow financial margins. On the contrary, they have reflected extremely high intermediation costs in the presence of wide bank margins. When these costs are added to those imposed on depositors and borrowers, it is clear that the nationalization of the banks has required a substantial use of resources for the completion of financial transactions. This has been a waste that the country could ill afford.

As shown in Table 12, non-financial intermediation costs at the Banco Nacional represented 6.3 percent of the effective volume of funds mobilized, net of reserve requirements. When accrued interest not effectively earned was added, the gross margin required for zero profits was 10.2 percent of the effective mobilization. Deposit-mobilization costs represented 2.2 percent and lending costs 4.1 percent of effective mobilization. The bank earned 18.3 percent as accrued interest on its loans and investments and paid 10.3 percent on the funds mobilized. This left the bank with a margin of 8.0 percentage points to cover intermediation costs and losses due to default. Transactions costs of 10.2 percent resulted, therefore, in a loss of 2.1 percent as a proportion of effective mobilization. When the reserves against default, depreciation, and staff layoff payments are added, the losses amounted to 4.4 percent of the total mobilization of funds (Gonzalez-Garita, 1987). Another study claimed that the difference between the average loan and deposit interest rates at the state-owned banks was 11.3 percent, compared to 3.9 percent at the private banks (Sagot).

XVI. Political Economy of Liberalization, Default and Rescheduling

Since 1984 the Central Bank, under the leadership of Eduardo Lizano, has slowly undertaken a financial reform. The <u>topes</u> were gradually eliminated and the state-owned banks were given greater independence in the setting of their interest rates. The scope of credit subsidies was specifically defined and limited. Automatic access to Central Bank credit by CODESA and other autonomous institutions was eliminated. An increasing scope was provided for the private commercial banks to compete with the nationalized banks. The Central Bank attempted to regulate monetary expansion with reserve requirements and open market operations, rather than quantitative credit restrictions, as explained by Lizano (1987).

Lizano's strategy had been to introduce the reforms gradually and slowly in order to minimize political opposition. Gradualism, however, allowed time for those hurt by the elimination of the subsidies to combine and exert increasing pressure for the reversal of the policy reforms. Opposition came, in particular, from the agricultural sector, which had recently enjoyed substantial price, credit, insurance, and other subsidies. As Mesalles discusses, the situation became politically sensitive when severe droughts and a reductions in the international price of several export crops created a crisis in the agricultural sector. While Lizano managed to obtain support for his reforms, agricultural lobbies obtained legislation to reschedule most delinquent agricultural loans at subsidized interest rates. The organizational deficiencies of the nationalized banks and the political economy environment had led the banks not to focus their institutional capacity to deal with risk in lending decisions (Von Pischke). Substantial portions of the portfolio became overdue, as a consequence, during the 1980s.

The rescheduling legislation (FODEA) which mandated debt relief for delinquent agricultural borrowers was enacted by unanimity. The implicit subsidy is substantial and it is heavily concentrated in favor of large farmers. In the case of the Banco Nacional, of the 12,593 farmer with rescheduled loans, 10,461 are smaller borrowers (less than US$ 20,000 in total borrowing), but they account for only 26 percent of the amounts rescheduled. Another 1,508 farmers (with total borrowing between US$ 20,000 and US$ 70,000) account for 30 percent of the total amount delinquent and 624 clients (with borrowing above US$ 70,000) are responsible for 44 percent of the arrears. A similar distribution characterizes the delinquent portfolio of the other state-owned banks.

Under the assumption of a rate of inflation of 20 percent per year during the 16 years of the rescheduling, the present value of the implicit subsidy associated with FODEA amounted to US$ 20 million. With the rate of inflation at 40 percent, this subsidy is equivalent to US$ 30 million. About five percent of the beneficiaries (the largest delinquent borrowers) will capture between 30 and 40 percent of this massive transfer of income (Mesalles). This has been one of the most impressive examples of the power of the rent-seeking interest groups within a nationalized banking system.

Conclusions

Most of the literature on government intervention in banking has been concerned with the benefits from the correction of market failures, that would lead private bankers to behavior incompatible with social-welfare maximization, and with the costs that occur as a result of organizational failure, such as the failure of public banks to minimize intermediation costs (Braverman and Guasch). This paper has taken a different, political economy approach. It claims that the decisions that shape the behavior of the nationalized banks are not made by neutral social-welfare maximizers concerned only with economic growth, but by individuals representing particular group interests and having broader political objectives (Ahmad).

The nationalized banks of Costa Rica have been only one of the arenas in which contending forces have played their quest for economic and political power. One of the most important ostensible reasons for the nationalization of the banks in 1948 was the desire to separate the economic power of the banks from the political power of the traditional exporting groups. To a large extent, this goal was achieved. The more general objective of separating economic from political forces in the banking arena, however, was not accomplished. This paper has illustrated how political intrusion has increasingly characterized the evolution of the NBS. Economic and political power have been joined again, this time in different hands.

Notes

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Table 1. Costa Rica: National Banking System. Money and Credit Aggregates. Average Annual Rates of Growth in Real Terms. (Percentages). 1950-1986.

	1950-62	1962-70	1970-78	1978-82	1982-86
Net Domestic Credit	10.2	5.5	11.1	-17.7	18.1
Net Public Sector	4.6	8.7	20.6	-7.7	22.8
Private Sector	11.3	5.1	8.8	-22.6	14.0
Other Net Domestic Assets	6.9	8.9	20.4	46.3	14.2
Total Liquidity (M2)	8.8	7.6	13.8	-8.9	10.4
Quasimoney	11.4	8.3	21.0	-5.6	8.9
Money (M1)	7.7	7.2	8.5	-13.6	12.8
Foreign Borrowing by Banks	n.a.	7.9	19.0	16.5	30.8

Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years. Amounts deflated by the Wholesale Price Index.

Table 2. Costa Rica: National Banking System. Ratios of Money and Credit Aggregates to the GDP. (Percentages). 1950-1986.

	1950	1962	1970	1978	1982	1986
Net Domestic Credit	21.6	30.2	28.9	40.5	33.1	36.3
Net Public Sector	4.6	3.4	4.1	11.1	14.4	18.4
Private Sector	17.0	26.8	24.7	29.4	18.7	17.8
Total Liquidity (M2)	18.4	21.8	24.4	41.6	51.0	42.6
Quasimoney	4.4	7.0	8.3	22.9	32.4	25.7
Money (M1)	14.0	14.8	16.1	18.7	18.6	16.9

Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years.

Table 3. Costa Rica: National Banking System. Composition of Money and Credit Aggregates (Percentages). 1950-1986.

	1950	1962	1970	1978	1982	1986
Net Domestic Credit	100.0	100.0	100.0	100.0	100.0	100.0
Public Sector	21.1	11.3	14.3	27.5	43.4	50.8
Private Sector	78.9	88.7	85.7	72.5	56.6	49.2
Total Liquidity (M2)	100.0	100.0	100.0	100.0	100.0	100.0
Quasimoney	24.0	32.2	33.9	55.1	63.6	60.2
Money (M1)	76.0	67.8	66.1	44.9	36.4	39.8

Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years.

Table 4. Costa Rica: Banco Nacional de Costa Rica. Size Distribution of Agricultural Credit (Cumulative Percentages). 1974 and 1981.

Size (CR$)	1974		1981	
	Number	Amount	Number	Amount
Less than 1,000	100.00	100.00	100.00	100.00
From 1,001 to 5,000	89.89	99.82	97.50	100.00
From 5,001 to 15,000	47.61	96.68	70.50	99.20
From 15,001 to 50,000	22.83	90.83	33.80	96.20
From 50,001 to 100,000	8.52	80.98	13.50	91.30
From 100,001 to 500,000	4.50	73.44	8.70	88.20
From 500,001 to 1,000,000	1.19	55.60	3.40	77.80
Over 1,000,000	0.70	46.43	2.20	70.10

Sources: Vogel (1984) and Loria (1982).

Table 5. Costa Rica: Banco Nacional de Costa Rica, Department of Rural Credit. Number, Amount, and Average Size of New Loans Granted during the Year and of Balances Outstanding at the end of the Year, 1950-1986.

Year	NEW LOANS			OUTSTANDING BALANCES		
	Number of Loans	Amount ('000 1978 CR$)	Average Size (1978 CR$)	Number of Loans	Amount ('000 1978 CR$)	Average Size (1978 CR$)
1950	17,752	57,705.2	3,250.6	21,547	67,763.4	3,144.9
1951	19,403	69,606.4	3,587.4	23,712	90,231.0	3,805.3
1952	19,994	90,293.3	4,516.0	24,998	112,642.5	4,506.1
1953	18,006	91,563.1	5,085.1	24,794	123,548.5	4,983.0
1954	16,838	89,049.0	5,288.6	24,877	124,429.2	5,001.8
1955	16,967	94,466.9	5,567.7	26,456	138,199.0	5,223.7
1956	17,625	108,824.2	6,174.4	n.a.	164,089.2	n.a.
1957	16,675	105,346.4	6,317.6	28,187	168,917.2	5,992.7
1958	15,275	102,263.1	6,694.8	n.a.	n.a.	n.a.
1959	15,797	118,416.7	7,496.2	n.a.	n.a.	n.a.
1960	15,989	157,818.2	9,870.4	28,075	229,403.6	8,171.1
1961	16,007	142,549.9	8,905.5	n.a.	268,006.3	n.a.
1962	19,293	216,560.8	11,224.8	35,190	339,040.4	9,634.6
1963	16,107	165,065.9	10,248.1	36,071	350,911.8	9,728.4
1964	16,209	199,551.1	12,311.1	37,732	382,531.7	10,138.1
1965	17,767	242,230.3	13,633.7	41,218	469,136.7	11,381.8
1966	11,791	138,314.4	11,730.5	39,141	436,070.1	11,141.0
1967	16,063	210,346.6	13,095.1	39,964	443,510.2	11,097.7
1968	14,037	180,407.8	12,852.3	38,465	433,441.3	11,268.5
1969	11,996	184,599.8	15,388.4	37,252	440,892.1	11,835.4
1970	13,148	193,643.9	14,728.0	38,015	454,415.7	11,953.6
1971	17,965	274,366.8	15,272.3	41,992	502,971.1	11,977.8
1972	15,825	243,398.7	15,380.6	43,085	501,468.8	11,639.1
1973	16,208	260,853.1	16,094.1	42,880	438,279.5	10,221.1
1974	19,841	241,192.3	12,156.3	45,715	385,316.1	8,428.7
1975	23,436	203,547.3	8,685.2	51,173	378,516.3	7,396.8
1976	24,284	226,175.9	9,313.8	53,234	397,119.8	7,459.9
1977	21,351	210,232.6	9,846.5	51,261	381,215.4	7,436.8
1978	19,861	235,122.2	11,838.4	49,260	399,504.7	8,110.1
1979	18,721	199,112.9	10,635.8	48,165	347,723.9	7,219.4
1980	15,692	135,258.6	8,619.6	45,563	292,112.5	6,411.2
1981	18,938	126,533.6	6,681.5	44,552	153,276.0	3,440.4
1982	22,198	108,690.9	4,896.4	39,344	108,973.1	2,769.8
1983	18,935	131,178.0	6,927.8	35,591	146,320.9	4,111.2
1984	19,076	105,329.1	5,521.5	36,650	140,214.3	3,825.8
1985	16,821	83,602.6	4,970.1	37,971	127,156.0	3,348.8
1986	18,326	111,916.7	6,107.0	33,731	135,686.8	4,022.6

Sources: Gonzalez-Vega (1973) and Banco Nacional de Costa Rica, unpublished records.

Table 6. Costa Rica: Banco Nacional de Costa Rica. Proportion of the Number of Loans and of Outstanding Balances by Department. Real Average Loan Size by Department and their Ratio. 1970-1987.

	COMMERCIAL DEPARTMENT		RURAL DEPARTMENT		REAL AVERAGE SIZE		
Year	Number	Amount	Number	Amount	Commercial	Rural	Com/Rur
1970	28.8	58.9	60.2	20.9	26,070	4,432	5.9
1971	24.8	61.1	45.0	20.0	26,569	4,778	5.6
1972	20.1	63.2	43.4	19.4	34,058	4,836	7.0
1973	24.6	67.2	75.4	18.0	61,315	5,370	11.4
1974	28.6	73.1	71.4	15.3	72,692	6,110	11.9
1975	32.3	78.3	67.7	12.8	78,296	6,122	12.8
1976	32.7	91.3	59.9	13.7	80,566	6,621	12.2
1977	38.8	81.0	61.2	11.2	80,710	7,087	11.4
1978	46.1	82.0	53.9	10.2	79,276	8,416	9.4
1979	49.7	84.0	50.3	9.3	85,105	9,289	9.2
1980	54.0	88.2	46.0	7.2	103,086	9,841	10.5
1981	n.a.	88.7	n.a.	7.4	n.a.	11,470	n.a.
1982	n.a.	91.1	n.a.	5.8	n.a.	11,875	n.a.
1983	n.a.	90.8	n.a.	7.2	n.a.	25,994	n.a.
1984	n.a.	91.3	n.a.	6.6	n.a.	27,146	n.a.
1985	n.a.	91.3	n.a.	6.5	n.a.	25,578	n.a.
1986	n.a.	90.6	n.a.	6.9	n.a.	34,450	n.a.
1987	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Computed from Banco Nacional de Costa Rica, unpublished records.

Table 7. Costa Rica: National Banking System. Annual Real Rates of Growth of Credit Outstanding, by Sector of Economic Activity (Percentages). 1951-1987.

Year	Total	Agriculture	Livestock	Industry	Other a/
1951	17.5	n.a.	n.a.	n.a.	n.a.
1952	27.5	n.a.	n.a.	n.a.	n.a.
1953	16.3	n.a.	n.a.	n.a.	n.a.
1954	2.4	n.a.	n.a.	n.a.	n.a.
1955	8.7	n.a.	n.a.	n.a.	n.a.
1956	12.8	n.a.	n.a.	n.a.	n.a.
1957	18.3	37.4	1.5	0.1	9.3
1958	4.3	-1.8	19.2	9.6	6.1
1959	21.8	20.2	40.2	30.6	13.5
1960	10.4	11.3	18.6	13.9	3.3
1961	3.9	0.7	7.2	18.5	0.5
1962	4.8	-1.0	8.7	16.5	5.6
1963	20.8	19.8	4.4	20.6	33.1
1964	13.7	8.1	16.1	23.8	14.5
1965	13.2	11.4	25.8	18.5	6.0
1966	-0.1	1.2	5.7	-4.8	-2.5
1967	2.2	-4.2	9.3	11.0	0.7
1968	0.8	-1.0	9.6	3.0	-4.6
1969	1.6	-1.4	10.4	7.2	-5.6
1970	8.0	9.2	8.0	10.1	4.7
1971	23.6	6.9	31.4	10.3	51.7
1972	5.0	-6.8	10.9	8.2	10.2
1973	-11.8	-22.3	2.1	4.2	-24.8
1974	3.1	-6.9	-6.7	20.2	9.2
1975	17.3	27.6	-0.1	19.3	25.4
1976	12.1	18.5	9.4	9.9	11.2
1977	9.7	0.4	8.9	13.4	14.7
1978	13.5	15.3	7.6	15.4	15.0
1979	-3.4	-11.4	-4.4	-9.8	8.7
1980	-5.7	-1.4	-2.8	-14.5	-3.6
1981	-49.5	-41.1	-53.3	-49.7	-52.1
1982	-22.5	-13.7	-13.0	-14.4	-40.4
1983	43.0	63.2	48.0	54.2	5.9
1984	5.5	-8.4	9.9	16.1	8.0
1985	7.1	-10.3	-1.5	18.8	25.1
1986	4.8	-8.6	-2.8	2.9	28.8
1987	10.4	6.2	-11.8	10.5	30.0

a/ Includes: Commerce, electricity, services, housing, personal credit, credit to foreigners and unclassified credit.
Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years. Amounts deflated by the Wholesale Price Index.

Table 8. Costa Rica: National Banking System. Composition of Credit Outstanding, by Sector of Economic Activity (Percentages). 1950-1987.

Year	Agriculture	Livestock	Industry	Other a/
1950	n.a.	n.a.	n.a.	n.a.
1951	n.a.	n.a.	n.a.	n.a.
1952	n.a.	n.a.	n.a.	n.a.
1953	n.a.	n.a.	n.a.	n.a.
1954	n.a.	n.a.	n.a.	n.a.
1955	n.a.	n.a.	n.a.	n.a.
1956	40.1	13.7	12.4	33.8
1957	46.6	11.7	10.4	31.2
1958	43.9	13.4	11.0	31.7
1959	43.3	15.4	11.8	29.6
1960	43.6	16.6	12.1	27.7
1961	42.3	17.1	13.8	26.8
1962	39.9	17.7	15.4	27.0
1963	39.6	15.3	15.4	29.7
1964	37.7	15.6	16.7	30.0
1965	37.1	17.4	17.5	28.0
1966	37.5	18.4	16.7	27.4
1967	35.2	19.7	18.1	27.0
1968	34.6	21.4	18.5	25.5
1969	33.5	23.2	19.5	23.7
1970	33.9	23.2	19.9	23.0
1971	29.3	24.7	17.8	28.2
1972	26.0	26.1	18.3	29.6
1973	22.9	30.2	21.7	25.2
1974	20.7	27.3	25.3	26.7
1975	22.5	23.3	25.7	28.5
1976	23.8	22.7	25.2	28.3
1977	21.8	22.6	26.0	29.6
1978	22.1	21.4	26.5	30.0
1979	20.3	21.2	24.7	33.8
1980	21.2	21.8	22.4	34.6
1981	24.7	20.2	22.3	32.8
1982	27.5	22.6	24.6	25.2
1983	31.4	23.4	26.6	18.7
1984	27.3	24.4	29.2	19.1
1985	22.9	22.4	32.4	22.3
1986	19.9	20.8	31.8	27.4
1987	19.2	16.6	31.9	32.3

a/ Includes: Commerce, electricity, services, housing, personal credit, credit to foreigners and unclassified credit.

Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years. Amounts deflated by the Wholesale Price Index.

Table 9. Costa Rica: National Banking System. Annual Real Growth Rates of New Loans Granted (Percentages). 1974-1987.

Year	Total	Agriculture	Livestock	Industry	Commerce	Other a/
1974	10.1	8.1	-14.5	26.3	126.1	-0.8
1975	7.0	17.7	-25.9	5.4	12.6	21.4
1976	4.4	-1.1	17.9	-2.3	-17.6	19.8
1977	1.1	-9.6	21.4	3.7	-15.2	1.7
1978	10.1	8.9	6.9	9.0	6.9	15.0
1979	-8.1	-11.5	-3.0	-32.0	72.9	7.6
1980	-20.2	-6.8	-12.3	-32.5	-7.1	-27.0
1981	-26.3	-8.2	-44.6	-28.9	-35.9	-26.6
1982	-7.3	20.3	29.1	13.7	-42.9	-57.5
1983	17.6	17.2	7.9	29.2	1.8	17.0
1984	-13.0	-19.5	-22.9	1.0	54.7	-28.3
1985	-11.1	-34.7	-53.9	14.9	46.2	18.5
1986	26.9	28.7	44.1	7.5	40.2	54.8
1987	14.8	14.8	14.8	14.8	14.8	14.8

Source: Same as Table 10.

Table 10. Costa Rica: National Banking System. Composition of New Loans Granted During the Year (Percentages). 1970-1987.

Year	Total	Agriculture	Livestock	Industry	Commerce	Other a/
1973	100.0	24.8	20.8	29.4	2.8	22.3
1974	100.0	24.3	16.1	33.7	5.8	20.1
1975	100.0	26.7	11.2	33.2	6.1	22.8
1976	100.0	25.3	12.6	31.0	4.8	26.2
1977	100.0	22.6	15.1	31.8	4.0	26.3
1978	100.0	22.4	14.7	31.5	3.9	27.5
1979	100.0	21.6	15.5	23.3	7.4	32.2
1980	100.0	25.2	17.1	19.7	8.6	29.5
1981	100.0	31.4	12.8	19.0	7.5	29.3
1982	100.0	40.7	17.8	23.4	4.6	13.5
1983	100.0	40.6	16.4	25.7	4.0	13.4
1984	100.0	37.6	14.5	29.8	7.1	11.0
1985	100.0	27.6	7.5	38.5	11.7	14.7
1986	100.0	28.0	8.5	32.6	12.9	18.0
1987	100.0	28.0	8.5	32.6	12.9	18.0

Source: Computed from data in Banco Central de Costa Rica, Credito y Cuentas Monetarias, several years.

a/ Includes: Electricity, services, housing, personal credit, credit to foreigners and unclassified credit.

Table 11. Costa Rica: Banco Nacional de Costa Rica. Interest and Non-Interest Farmers' Borrowing Cost (Percentages) 1983.

	Interest Rate	Average Cost	Annualized Av. Cost	Cost of Funds
Loan Size				
Less than 10,000	12.2	22.5	37.1	49.3
10,001 to 50,000	12.5	6.9	12.6	25.1
50,001 to 100,000	13.4	2.9	4.4	17.8
100,001 to 500,000	15.6	2.4	2.8	18.4
More than 500,000	20.1	2.9	3.4	23.5
End Use of the Loan				
Export Crops	15.6	4.9	5.2	20.8
Basic Grains	12.7	11.5	26.0	38.8
Other Crops	12.1	5.1	8.1	20.2
Livestock	15.8	6.8	7.0	22.9
Interest Rate				
Less than 12%	12.0	7.7	13.7	25.7
15%	15.0	3.8	3.9	18.9
18-29%	18.4	4.4	4.4	22.8
22-26.5%	23.2	3.3	4.5	27.7
Department				
Commercial	18.1	3.7	4.2	22.2
Rural	12.0	7.9	13.9	26.0
Educational Level				
No Education	12.8	12.1	19.4	32.2
Primary School	13.1	8.8	15.4	28.1
High School	14.0	4.5	5.7	19.7
University	17.3	3.0	3.7	21.0
Default Record				
Yes	13.7	8.1	14.5	25.3
No	12.8	6.1	10.0	23.9
Checking Account				
Yes	17.8	3.3	3.9	21.7
No	12.7	7.5	13.0	25.7
Savings Account				
Yes	14.1	4.0	5.5	19.6
No	13.4	7.7	13.4	26.8

Source: Gonzalez-Garita (1986).

Table 12. Costa Rica: Banco Nacional de Costa Rica. Financial Intermediation Costs (Million CR$). Revenues and Costs as a proportion of Effective Mobilization (Percentages). 1985.

	AMOUNT	PERCENTAGE
Total Mobilization a/	23,746.3	100.0
Actual Reserves b/	3,640.7	15.3
Effective Mobilization	20,105.7	84.7
Interest and Commissions Accrued	3,685.3	18.3
Non-Financial Lending Cost	833.2	4.1
Expected Net Lending Revenue	2,852.0	14.2
Defaulted Interest	769.0	3.8
Effective Net Lending Revenue	2,083.1	10.4
Interest and Commissions Paid	2,062.8	10.3
Non-Financial Mobilization Cost	441.4	2.2
Total Mobilization Cost	2,504.2	12.5
Gross Effective Profits c/	(421.1)	(2.1)
Reserve Against Default	425.0	2.1
Depreciation Reserve	21.2	0.1
Layoff Reserve	27.4	0.1
Net Effective Profits after Reserves	(894.7)	(4.4)
Expected Intermediation Margin	1,622.5	8.1
Effective Intermediation Margin	853.5	4.2
Total Non-Financial Transaction Costs	1,274.6	6.3
Total Non-Financial Transaction Costs plus Defaulted Interest	2,043.5	10.2

a/ Average of outstanding daily balances of all funds mobilized (Deposits from the public, Bonds placed with the public, Loans and Rediscounts from the Central Banks, and Foreign Loans).
b/ Average daily balances of actual reserves held by the bank.
c/ Effective net lending revenue - Total mobilization costs.
Source: Gonzalez-Garita (1987).