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THRIFT INSTITUTION DEVELOPMENT IN
LATIN AMERICA

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON INTER-AMERICAN
ECONOMIC RELATIONSHIPS

OF THE

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CONGRESS OF THE UNITED STATES



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LETTERS OF TRANSMITTAL

JUNE 4, 1970.

To the members of the Joint Economic Committee:

Transmitted herewith for the use of the members of the Joint Economic Committee and other members of Congress is a staff study prepared for the Subcommittee on Inter-American Economic Relationships entitled, "Thrift Institution Development in Latin America." The views expressed in this document do not necessarily represent the views of members of the committee or committee staff.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

JUNE 1, 1970.

HON. WRIGHT PATMAN,
*Chairman, Joint Economic Committee,
U.S. Congress.*

DEAR MR. CHAIRMAN: Transmitted herewith is a staff study entitled "Thrift Institution Development in Latin America." While the views expressed in this document do not necessarily represent the views of the members of the Subcommittee on Inter-American Economic Relationships or its staff, the subcommittee has been impressed in the course of its studies with the crucial need in South America for both additional savings and for thrift institutions to channel such savings into housing, necessary public facilities, and industrial development. We believe that the United States can make an important contribution in encouraging the kind of institutions that promote self-help; gains achieved by reason of local efforts are far more likely to produce a sense of citizen accomplishment and belief in future progress than benefits realized solely by virtue of outside assistance. The development of a network of thrift institutions involving strong member participation should help to promote important changes in Latin America.

First, housing conditions would be improved in both urban and rural areas, and the habit of saving would be promoted among people in the lower middle income category—that segment of the population most able to help itself and largely ignored by institutions. As savings and loan institutions expand, they will issue increasing numbers of mortgage loans to qualified depositors. An increased supply of sound mortgages would encourage the development of secondary mortgage markets. Attractive opportunities for investment in domestic mortgages would help curtail the outflow of flight capital from these countries.

In rural areas, the establishment of credit unions can uncover a surprising potential for saving and lift the burden of usury from farmers with annual incomes of only \$100 or \$200. Moreover, the

granting of credit union loans has often been an essential accompaniment to the introduction of more productive agricultural techniques.

Thus, in both urban and rural areas, the establishment of thrift institutions can make important contributions to economic development.

JOHN SPARKMAN,
*Chairman, Subcommittee on
Inter-American Economic Relationships.*

MAY 28, 1970.

HON. JOHN SPARKMAN,
*Chairman, Inter-American Economic Relationships Subcommittee, Joint
Economic Committee, U.S. Congress.*

DEAR MR. CHAIRMAN: Transmitted herewith is a staff study entitled, "Thrift Institution Development in Latin America." The study which was prepared by Mrs. Ellen O. Wasfi, consultant to the subcommittee, under the editorial supervision of Dr. John R. Karlik, staff international economist, traces the development of savings and loan institutions and credit unions in Latin America since 1960, discusses the obstacles that have impeded the growth of these organizations, and suggests reforms that would encourage saving in the future.

This study was prepared in accordance with your request for additional information on the present institutional structure in South America for channeling of savings into vitally needed housing, industrial development, and public facilities and for an examination of how American experience with thrift institutions might be related to the needs of South America.

It is not possible in the staff study to take cognizance of the most recent developments for the reason that editing and printing schedules present a sufficient lag between publication of manuscript and publication date.

There have been, of course, positive developments in the past year that might be explored in any future studies or hearings. One is the development of a secondary mortgage market in Chile; another is the greater use of the readjustment system in Brazil and other countries; a third has been a greater participation by U.S. savings and loan associations in helping to provide funds through Latin American home loan banks for housing purposes. On the other hand, rising interest rates in the United States are having an impact on the entire housing industry of Latin America and tend to work against the benefits of the investment guarantee programs in the Latin American countries. The views expressed in this document do not necessarily represent the views of members of the committee or committee staff.

JOHN R. STARK,
Executive Director.

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THRIFT INSTITUTION DEVELOPMENT IN LATIN AMERICA

By ELLEN O. WASFI, *Consultant*

Introduction

The use of thrift institutions as a popular source of credit and as a depository for personal savings is a relatively new concept in Latin America. Prior to 1960, commercial credit facilities were available only to upper income groups who could afford high interest rates, make large down payments, and meet stringent repayment schedules. For all practical purposes, savings were never placed in thrift institutions, partly because more profitable areas for investment existed elsewhere and partly because political and economic instability accompanied by inflation encouraged spending rather than saving. Individual savings were either hoarded or spent on consumer goods. More substantial sums were invested in real estate or industrial ventures yielding short-term capital gains. Alternatively, such funds were invested abroad.

Low income groups in need of credit were left at the mercy of local usurers. High interest rates prevailed for consumer credit, and repayment terms often placed the borrower in lifetime debt to the moneylender. In general, private capital resources were rarely channeled into national economic development, leaving the public sector to bear heavy burdens of infrastructure investment. *Although the capacity to save and to mobilize savings existed, the incentives and the institutions were lacking.*

Efforts were initiated in the late nineteen fifties under the U.S. technical assistance program to make long-term, low-interest credit available to lower-middle income groups. The incentive of receiving such loans was used to encourage regular savings habits. On a small scale, this movement took the shape of community credit unions or savings and loan cooperatives. On the larger scale and primarily in urban areas, independent savings and loan associations were formed to serve the needs of lower and middle-income housing finance.

Official government support for these programs in Latin America varied. While politicians paid lip service to the benefits of these institutions, the machinery to implement the systems was not legislated as rapidly as U.S. Agency for International Development (AID) officials hoped, mainly because of the pressing demands of other development problems. As of January 1960, only one savings and loan association was operating in Latin America, while the smaller credit unions had barely begun to attract the savings of the low-income masses.

This study seeks to trace the development of savings and loan associations and of credit unions since 1960 with the introduction of expanded U.S. financial and technical assistance programs. The objective is to determine the role of these institutions in generating additional private capital resources for economic development in Latin America, and in establishing a pattern of individual savings. The study is divided into two sections, the first concentrating on the savings and loan associations which serve the needs of housing finance, and the second dealing with the more widespread Latin American credit union movement.

Part I. Savings and Loan Movement in Latin America

A. Progress and Problems

United States Government policy, stemming from the goals set forth in the Act of Bogotá, of 1960, attempted to stimulate the creation of savings and loan systems in Latin America during the last decade. The Agency for International Development (AID) has provided seed capital loans, housing investment guarantees, and technical assistance for this purpose. Some assistance to savings and loan systems has also come from the Inter-American Development Bank.

On initial observation the advances achieved by the savings and loan industry in Latin America since the initiation of efforts at the beginning of the decade seem astounding. Savings and loan institutions were virtually nonexistent at the beginning of 1960. As of November 1968, there were 105 savings and loan associations, 728,000 savers, \$223 million in net savings, and the systems had made 89,000 loans totaling \$368 million.¹ Beneath the surface of these statistics, however, lie problems and questions that might cloud the future of these institutions in Latin America.

Savings and loan associations (S. & L.'s) in Latin America, as in the United States, invest primarily in home mortgages. The chief objective of those who save in the S. & L.'s is to make a downpayment on a future housing mortgage. In the opinion of experts in the field, contingency saving, or saving for the future in general does not represent a significant motivation for the average Latin American depositor in a savings and loan association. The constituency of these associations comprises the lower-middle to middle income earner who represents approximately one-third of the housing need in Latin America.

The Inter-American Development Bank (IDB) and AID have estimated that the accumulated housing deficit in Latin America by 1970 will range from 15 to 20 million family units, with an added demand for about one million new dwellings every year.² * In

*These totals were derived from national government census statistics estimating housing deficits. The latest such census in most Latin American countries was taken in 1960. Based on these reports IDB technicians projected national population growths to 1975 and divided by the number of persons in the average family unit (five being the usually accepted number) to arrive at the annual increase in housing need. The drawback to this method is the lack of standardized criteria for determining deficient housing. Each country has its own method for arriving at a housing deficit figure. The lack of accurate statistics and efficient methods of data collection contribute to the artificial nature of the estimate. IDB officials suggest that these figures be taken merely as indicators of overall deficit in terms of population growth and flow, rather than as firm statistical references.^{2a}

¹ Quarterly Statistical Report, Free Savings and Loan System, National League of Insured Saving. Associations (NLISA), No. 39, November 1968.

² Statement by Ricardo Garcia Rodriguez, Secretary General of Inter-American Home Savings and Loan Union at Sixth Inter American Savings and Loan Conference, March 1968.

Social Progress Trust Fund/Inter-American Development Bank Eighth Annual Report, 1968, p. 368 (hereafter, SPTF Annual Report).

^{2a} Mr. James Van Fleet, Department of Economics, Inter-American Development Bank (IDB).

order to alleviate housing pressures, approximately \$2 billion should be invested annually in this sector.³ To date, total Latin American housing expenditures have been below this level; an estimated \$1 billion was spent on housing investment in 1967.^{3a}

Savings and loan institutions, however, cannot hope to serve the overall housing need of Latin America, but only the effective demand of those capable of making regular payments toward homeownership. One IDB housing expert has placed this current demand at about 7 million⁴ units and increasing annually. A traditional obstacle to homeownership by this portion of the population has been the lack of mortgage mechanisms offering credit at reasonable rates. Existing mortgage banks often require down payments of up to 40-50 percent of the sales price and offered only 5-10 year financing at annual interest rates ranging from 10-50 percent.⁵

To discuss these problems adequately, one must first understand the origins of the savings and loan movement in Latin America. The S. & L.'s were a direct outgrowth of new efforts by central governments and international agencies to attack the housing problems that resulted from a leap in urban growth rates during the late fifties. While the 3 percent overall population growth rate in Latin America is the most rapid in the world, urban growth rates are reaching 5 percent per annum.

Currently, 25 percent of Latin America's population is concentrated in ten metropolitan areas of over 1 million each. The relative stagnation of rural economies is causing the cities to increase their size daily. Over 60 percent of the people of Argentina, Chile, and Venezuela live in the cities. The urban population of Colombia, Uruguay, and Mexico have already passed the halfway mark, with Peru and Brazil fast approaching 50 percent.^{5a}

These statistics explain why primary attention has been directed to the urban housing situation. While rural housing, no doubt, poses problems, these problems pale in intensity when compared to urban conditions. Firstly, densities are less in rural areas and most housing is put on a self-help basis. Secondly, the rural exodus to urban areas relieves some of the pressure on land ownership.^{5b} A detailed analysis of this deficient capital market situation was made in a recent United Nations study:^{5c}

Recent efforts of many developing countries to establish their own national banking systems have tended to follow the traditional pattern of Western economies, that is, they are based on a central bank with strong reliance on existing or newly established commercial banks. These banks concentrate primarily on loans

³ Op. cit., SPTF Annual Report, 1968.

^{3a} Interview with Mr. James Van Fleet, Department of Economics, IDB.

⁴ Eneas Maza, Consultant for Urban Development, Inter-American Development Bank.

⁵ Op. cit., SPTF Annual Report, 1968, p. 368.

^{5a} Speech by Harold Robinson, Deputy Director, Housing and Urban Development, Bureau for Latin America, AID, at Catholic University, Apr. 6, 1967, p. 16.

^{5b} Op. cit., SPTF Annual Report, 1968.

^{5c} Robert C. Cook, "Housing and Population Growth in Africa, Asia and Latin America," in *Study of International Housing*, by Subcommittee on Housing, Committee on Banking and Currency, U.S. Senate, March 1963, p. 6.

Statements by Morton Bodfish, Retired Member Home Loan Bank Board and Father Dan McClellan, President, People's Mutual Savings and Loan of Lima, Peru, in hearings before the Committee on Banking and Currency, House of Representatives, on the Establishment of an International Home Loan Bank, Aug. 9, 1963, pp. 103, 70, respectively.

^{5e} *Finance for Housing and Community Facilities in Developing Countries*, Department of Economics and Social Affairs, United Nations, New York, 1968, pp. 13-14.

for commerce and do not engage in long-term lending. On the other hand, the entirely new phenomenon of national and regional development banks and corporations, established largely with the help of international agencies, have assumed the heavy burden of development finance in infrastructure and other capital investments necessary for development of industry, agriculture, transport, and communications. Other savings institutions, such as insurance companies, social security or provident funds and occasionally savings banks, do accumulate funds that can be reloaned on relatively long term. But in most developing countries these institutions still account for only a very small percentage of total savings.

It is evident, then, that without acceptable means of canalizing actual savings—to say nothing of potential savings—into institutions that as a matter of policy provide medium- and long-term credit, there can be no real capital market, and those investments not favored by the existing banking system will go wanting. Housing and related capital investments are among those sectors to which long-term credit will continue to be unavailable. Moreover, as long as there is a general scarcity of capital in the country, there is a national preference for lenders to favor short-term commercial loans over the extension of longer term credit. In this situation the responsibility for causing the establishment of long-term credit institutions (and a market for their debt instruments) almost invariably falls to the public sector.

The immediate dilemma faced by Latin American governments has been that of a shortage of financial resources for urban housing investment.

Similar observations on the competition for available domestic capital were made as early as 1963 during a U.S. Congressional inquiry into the problems of world housing:

* * * the establishment of industries has resulted in heavy migration of underemployed rural manpower to cities. But because of the low-income base of the mass market, housing as an industry and as an investment has rarely spread into the low-priced ranges or realized the economics of large-scale development and building, except on the initiative of the government and with government support.

In the overall development program, housing is a form of investment competing with other forms for a limited supply of investment funds * * * housing falls between the quick returns of agriculture and industry, on the one hand, and the very slow returns on investment in infrastructure such as health, and education, on the other. Invariably this limits severely the amounts (of public funds) that can be allocated to housing in the investment programs, especially in the early stages of development when the demands for immediately productive investments and for transportation, communication and education may be relatively great.⁶

This Congressional study went on to state that savings were crucial to meet the needs of housing demand and supply, and conversely, that

⁶ Edward D. Hollander, "Relationship Between Housing and Economic Development," in op. cit., *Study of International Housing*, March 1963, pp. 20-21.

in countries where money markets were nonexistent and savings institutions rudimentary, housing offered an opportunity for the motivation and channeling of saving which might otherwise be lacking.⁷ Another expert qualified this statement by pointing out that upper income groups in Latin America tended to spend their income on consumption or to export it, and that there was relatively little productively invested domestic saving on the part of these groups. He suggested that the problems of savings of the upper income groups, particularly, would have to be tackled by other means in addition to the creation of housing and cooperative financial institutions. Savings by the working and lower middle income groups, however, could be stimulated by devices which would make housing available.^{7a}

The effort to capitalize on the desire for housing led to the formation of savings and loan associations. Peruvian legislation enacted in 1957 was the first to provide for the creation of a savings and loan system, though a 1965 AID report suggests that the movement did not really get underway until September, 1960. Associations had commenced operation in Chile by April, 1960.⁸ Technical experts advised, however, that the financing of housing required more saving than the prospective borrowers alone could be expected to accumulate.

If the saving is limited to a one-third downpayment (or more) on the promise of being able to borrow the rest, the pool of funds for financing homes will accumulate slowly and the stimulus to housing will be diminished and delayed. On the other hand, to the extent that there are more savers than borrowers, or that funds for lending are injected from outside, more investment money from AID or other foreign sources not only helps to provide the initiative but also hastens the accumulation of a pool of savings for financing mortgages.⁹

Consequently, both the U.S. (AID) and the IDB adopted as the principal objective of its work in this field the provision of "seed capital," under which the loans granted would help strengthen or create institutional machinery to finance urban development and housing. Local contributions in the form of capital and/or labor were planned to accompany external financial assistance.¹⁰

Working under this philosophy, AID had by the end of 1968 made over \$60 million in seed capital loans and technical assistance grants to S. & L. systems in Latin American countries. It had also extended \$10 million to the savings and loan organizations supervised by the Central American Bank for Economic Integration (CABEI).^{*} The IDB through 1969 has made loans—channelled through the U.S.—

*These amounts do not include those funds authorized under the U.S. housing investment guarantee program.

⁷ *Ibid.*, p. 21.

^{7a} Robinson Newcomb, "Housing and Economic Development," in *op. cit.* *Study of International Housing*, March 1963, p. 31.

⁸ Sean M. Elliot, *Financing Latin American Housing—Domestic Savings Mobilization and U.S. Assistance Policy*, Praeger, New York, 1968, p. 51. (hereafter, Elliot, *Financing Latin American Housing*).

⁹ *Op. cit.*, Hollander in *Study of International Housing*, p. 22.

¹⁰ Statement by Henri Scioville-Samper, Chief, Urban Development and Housing Section, Inter-American Development Bank, at the Sixth Inter-American Savings and Loan Conference, Rio de Janeiro, Brazil, Mar. 3-9, 1968.

financed Social Progress Trust Fund—to the S. & L. systems of Peru, Chile, Boliva, Guatemala, and Nicaragua totalling \$22 million.¹¹

The continuing flow of external financial inputs into the savings and loan systems of many Latin American countries, however, has called into question the practice of successive low interest “seed capital” loans and “pilot demonstration projects.” S. & L. institutions have often failed to accumulate sufficient domestic capital as the result of two basic factors: (a) The absence of an adequate mechanism to preserve the value of savings and investments in the face of rapid inflation, and (b) the low rate of amortization of mortgage debts. The future of Latin American savings and loan systems depends on the creation of mechanisms to attract additional private resources. Essential steps toward this objective are the provision of reliable mortgage insurance and a strong secondary mortgage market,¹² as well as counter-inflationary readjustment measures, where necessary, to maintain the real value of both savings and investments.

B. Prerequisites to Establishing a Savings and Loan System

The rationale for the formation of savings and loan institutions and for the provision of external assistance to them can be easily explained.^{12a} Mobilizing capital is the first step. External capital, however, can make only a partial contribution. It should be utilized primarily as a stimulant to assist in the mobilization of local resources, and should not be viewed as a primary source of project financing. Local capital to pay for material and labor must come from public domestic savings collected through taxation or from private savings invested in institutions that make housing loans.

As might be imagined, the ability of Latin American governments at any level to collect tax revenues sufficient to support heavily capitalized programs, such as the construction of housing and related facilities, is precarious at best. Social and political pressures demand that such investment be made, however, despite possibilities for more economically productive and rapidly self-liquidating projects in other areas. By drawing upon untapped private capital resources, savings and loan associations relieve over-burdened governments of part of the responsibility for providing homeownership for lower and lower-middle income families.

One U.S. savings and loan expert has pointed out that in nearly all instances where no independent system of thrift exists to accumulate private savings for long-term home financing, there is no real effective capital market organization, either public or private, to meet the needs of lower- to middle-income families for mortgage funds.¹³ Credit institutions, such as mortgage banks, cater to the financial needs of upper-income groups. These banks do not attract large savings volumes, since only a small proportion of the population

¹¹ Harold Robinson, Bureau for Latin America, AID, “Housing and Urban Development Programs,” Oct. 1, 1967 (unpublished report).

¹² Op. cit., Statement by Scoville-Samper at Sixth Inter-American S. & L. Conference, p. 18.

¹² Ibid., pp. 20-22.

^{12a} *International Assistance for Housing Finance in Developing Countries*, Stanford Research Institute, Menlo Park, Calif., December 1968, pp. 6ff.

¹³ Arthur H. Courshon, Chairman of the Board, Washington Federal Savings and Loan Association of Miami Beach, “An Analysis of Thrift Institutions whose Primary Purpose is the Financing of Homes in Underdeveloped Countries,” in op. cit., House hearings on the Establishment of an International Home Loan Bank, Aug. 9, 1963, p. 92.

can accumulate the large down payments, pay the high interest rates, and meet the abbreviated repayment schedules imposed by mortgage banks.

Housing thrift institutions are specialized business concerns that mobilize private savings in order to make mortgage loans. Individual borrowers repay these loans over a period of years out of current income. Because mortgage payments include amortization of principal as well as interest charges, the repaid capital can be loaned out again to finance more housing which, in turn, generates more capital. In the United States during recent years, inflows from mortgage and home improvement loan portfolios have accounted for more than half of the funds invested in new housing loans by the savings and loan system. Secondary sources of loans were net savings and retained earnings (balance left after payments of interest and expenses).¹⁴ Loan principal repayments, however, are not available in large amounts to incipient Latin American savings and loan systems, making it necessary to supplement initial capital available from local savings funds with seed money from external sources. It was anticipated that this "seed capital" would accelerate the process of private capital formation.

Two potential domestic sources of "seed capital"—in addition to loans from abroad—are government budgets and local private investment. As mentioned earlier, governments of developing countries do not have sufficient funds for this purpose because of other equally pressing claims. Within private business circles there is fierce competition for the limited available profits from investment. In an atmosphere of political instability and inflation, it has simply not been possible to attract sufficient commercial investments into 20-year mortgage loans which return only 6 to 10 percent.¹⁵ On the other hand, savings and loan planners thought that seed money from capital-exporting countries, channeled through a national housing finance institution within the developing country, could provide a ready supplement to domestic public funds. In addition, the foreign exchange could be used to pay for those imported materials, equipment and skills not locally available (approximately 10–20 percent of the total cost). However, if the principle of conserving scarce resources was to be observed, such public savings and financing programs had to aim at supplementing and complementing private operations and not merely becoming a substitute.

It was recognized that major housing needs exist that private initiative cannot be expected to meet. In those cases governments had to respond and fill the vacuum. In almost all countries, for instance, housing for the lowest income groups is considered a direct or indirect responsibility of government.¹⁶ In the case of lower- and middle-income groups, however, private savings could be stimulated by creating the financial and psychological atmosphere necessary to encourage voluntary individual actions. The promotional activities which Latin American governments (as well as those of other developing countries) have been urged to pursue include:¹⁷

¹⁴ *Savings and Loan Fact Book, 1967*. U.S. Savings and Loan League, pp. 73, 75.

¹⁵ Testimony of Stanley Baruch, Chief of Housing, Inter-American Development Bank, in op. cit., House hearings on Establishment of International Home Loan Bank, August 9, 1963, p. 60.

¹⁶ Op. cit., *Financing of Housing in Developing Countries*, United Nations, 1968, pp. 31, 39.

¹⁷ *Ibid.*, pp. 39–40.

(1) The establishment of a central housing bank with authority to charter and supervise new special-purpose savings and financial institutions. Its primary function would be to provide an easy and attractive method of individual saving. The secondary role would be to re-lend or directly invest in private or cooperative projects in housing or related fields. Examples of such institutions would include savings banks, mutual and stock-ownership savings and loan associations or building societies, and cooperative savings institutions. A further operation of this central bank would be to provide temporary liquidity in the form of short-term, low interest rate loans to institutions faced with short-term liquidity demands. At present, there is no uniform practice in Latin America regarding the supervision of national savings and loan systems. Each country has established its own rules and methods to respond to local needs and conditions.^{17a}

(2) The creation of a mechanism for insuring individual savings deposits. Part of the attractiveness of the institutions is the guarantee of safety to the individual depositor. The guarantor should be the central government itself working through the central housing bank or a separate corporation set up for this purpose. Initial funding would have to come from the treasury, but these resources would be repaid over the years by member institutions' fees.

(3) The promotion of mortgage lending by both new and existing financial institutions through a variety of incentives:

(a) The development of a countrywide mortgage instrument. Private lenders prefer to deal in debt instruments that are simple and familiar. In many developing countries the form of mortgage debt is unnecessarily complex and ownership difficult to transfer. To overcome this obstacle will require national legislation setting forth clear principles covering land titles and other certificates of ownership and specifying as well the form of mortgage certificates. Not only is this standardization necessary to promote initial mortgage loans, but also to encourage the free transfer of these debt instruments throughout each country in search of available capital.

(b) To further facilitate initial investment in mortgages and their free exchange in secondary markets, the establishment by the governments of mortgage guarantees or insurance. Under such systems, the prototype of which is the mortgage insurance system of the United States Federal Housing Administration (FHA), the lender (or owner of the mortgage) is guaranteed repayment in cash or other securities up to 100 percent of the loan amount, in the event of default by the borrower. Such a system requires careful administration, however, and its success is dependent ultimately on the existence of sufficient savings already accumulated in financial institutions.

(c) One of the greatest deterrents to mortgage investment, especially by savings institutions that are subject to periodic withdrawal demands, is that mortgages are long-term instruments and relatively illiquid. This illiquidity can be reduced, however, if there is a secondary market where existing mortgages can be sold. In many countries, the government itself stands ready to purchase in the secondary market, as an incentive for the potential prime lender to invest. Most of the housing finance systems created in Latin America

^{17a} Draft of United Nations Survey of New Home Financing Institutions in Latin America, edited by Jack Gordon, July 1969, pp. 14, 15 (hereafter, U.N. Draft-69).

carry a tax exemption for the domestic investors. This is a means of providing an incentive for the private sector to make funds available which otherwise would be demanded of the government. Standardization of mortgage instruments and government guarantees will also help develop secondary markets. But since most developing countries cannot be expected to have sufficiently broad capital markets to support extensive secondary market operations in the near future, thought has been given to regional groupings of countries with traditional commercial and financial interchanges. Spreading the risks of mortgage financing across several nations' capital markets would hopefully accelerate housing construction in each of the participating countries.

C. Structure of Latin American Savings and Loan Associations and the Incentive To Save

Latin American S. & L.'s are set up to promote better home living conditions, to encourage habitual saving, and to create instruments for the investment of domestic capital. Constitutionally and legislatively, no association is empowered to lend for other than home improvements, purchases, or construction. There are no regional exceptions to this rule. With some variation, the prospective borrower must have the minimum of 10-20 percent downpayment on the desired home in order to qualify for the maximum loan of 80-90 percent. Generally, this has meant that he will keep the entire downpayment in the form of a savings deposit in that association which is to make the loan, or he will save toward that minimum downpayment in a savings account with the S. & L. to which he will apply for the home mortgage loan. Each new savings and loan program in Latin America has imposed a ceiling on the sale price of homes to be financed by its associations in order to cater to the needs of the middle- to lower-income population.¹⁸

The above practices constitute a type of savings plan common in the United States and throughout most of Latin America. Another plan, known as contract savings, is patterned after the German system. Argentina is the only Latin American country to retain the contract system as the major method of acquiring savings and making loans. Guatemala and Nicaragua experimented with the system and subsequently discarded it. Under the contract plan, prospective borrowers become savings members subject to various charges and rules.

The savings contract is without definite maturity date and there is no legal default if funds are insufficient to make a loan to an applicant upon maturity of his savings contract. The penalty for "late" payments under a savings contract is a postponement of a member's right to borrow. In addition, the system requires high down payments with short-term maturities, and only those relatively well-off financially can get a loan within a reasonable time. These conditions caused serious problems for most of the S. & L.'s in Argentina, since contract sales were not sufficiently controlled, and funds were not available to make loans as savings contracts matured. The resulting

¹⁸ Op. cit., Elliot, *Financing Housing in Latin America*, 1968, pp. 56-57.

loss of public confidence in the system caused the number of Argentine S. & L.'s to decrease from 150 to 30 between 1961 and 1968.¹⁹ These shortcomings and the lack of external assistance to this system notwithstanding,^{19a} * the large middle class population of Argentina still furnishes its S. & L.'s with almost 70,000 savers and assets of over \$40 million.²⁰ Recently there have been efforts to develop a free savings system in Argentina.²¹ However, one IDB expert has suggested that savings so accumulated have merely been used to furnish liquidity to the malfunctioning contract institutions which cannot meet loan obligations.²²

Another variation in Latin American S. & L. structure is found in the ownership and management of associations. Under the "stock" or corporate approach, a limited number of shareholders actually own the association. This type of institution corresponds to some State-chartered S. & L.'s in the United States. The advantages to the businessman in search of immediate and continuing profits are clearly associated with the stock S. & L. His remuneration is geared to the success of operations in a given year, not to salary schedules which are fixed at the annual meetings of association members (those with savings accounts).²³ A number of these stock associations have developed independently in recent years, and are the dominant form of S. & L. ownership in Argentina, Brazil, El Salvador and Guatemala.

Under the mutual²⁴ arrangement ownership of the association is jointly held by all of the depositors who elect officers and board members at annual meetings. This approach is the one utilized by all American associations with federal charters, as well as by most with state charters²⁴ (about 87 percent of all American S. & L.'s). S. & L. legislation in several Latin American countries contains the stipulation that only this type of association will be authorized by the government to make housing loans. U.S. influence in support of the mutual has been strong. Under its early financial and technical assistance programs to incipient S. & L.'s AID gave two reasons for recommending mutuality: (1) It seemed important that the general public have a feeling of ownership in these new entities; and (2) it would not be desirable for U.S. funds to be used to enrich, even indirectly, a few proprietary stockholders.²⁵ However, the decision to exclude one or the other type of institution has the effect of diminishing the opportunity for expansion for a system in a given country. In Panama for

*In June, 1963, AID did make a loan of \$12.5 million to the Argentine Government to provide half the initial capitalization for a central home loan banking facility. The Central Housing Bank was to function along the lines of home loan associations in the United States. By June, 1965, however, the conditions for the formation of the S. & L. system had not been met, and the AID loan was cancelled without disbursement.

¹⁹ *Ibid.*, p. 127. This decrease includes mergers as well as failures of independent S. & L.'s. Memo by Oscar Kreutz, President of First Federal Savings and Loan Association, St. Petersburg, Fla., in op. cit., House hearings on Establishment of International Home Loan Bank, p. 165.

^{19a} Op. cit., Quarterly Statistical Report, National League of Insured Savings Associations (NLISA), No. 39, November 1968.

²⁰ Op. cit., Elliot, *Financing Housing in Latin America*, pp. 124-125.

²¹ Op. cit., Quarterly Statistical Report, NLISA, No. 39, November 1968.

²² Oscar R. Kreutz, Chairman of Board, First Federal Savings and Loan Association, St. Petersburg Florida, in *National League Journal*, NLISA, vol. 23, No. 10, October 1968, p. 55.

²³ Eneas Maza, Housing and Urban Development Advisor, Inter-American Development Bank.

²⁴ Op. cit., Elliot, *Financing Housing in Latin America*, p. 125.

²⁵ *Ibid.*

²⁶ Op. cit., Memo by Oscar Kreutz in House hearings on Establishment of International Home Loan Bank, 1963, p. 164.

instance, where only mutual institutions are protected by the legislation, the most successful institution is stock-owned and was organized outside of the system. It now has acquired more savings than all of the member institutions combined.^{25a} In recent years, the overwhelming need for middle-income housing funds in Latin America, the proven capacity of stock associations to operate competitively in the savings-mortgage market, and the increasing functional distance between managers and members in the larger mutuals have diminished the importance of this administrative distinction in the extension of U.S. assistance. Two U.S. "seed capital" loans totalling \$6.1 million (1965 and 1969) have been granted to the El Salvador S. & L. system, which is comprised of three stock associations.^{25*}

All Latin American S. & L. associations, irrespective of organizational structure, are at least nominally regulated by a Central Housing Bank which acts as an intermediary between the central government and the housing finance institutions. The bank's activities usually include (1) checking and supervising the activities of the S. & L.'s, (2) establishing interest rates and monetary readjustment standards, where necessary, and (3) acting as a central bank for the S. & L.'s. Other functions of the bank, which differ from country to country, may cover the insurance of savings accounts and mortgage loans, and the provision of secondary mortgage markets for the S. & L.'s. The effectiveness of the central banks in carrying out these duties varies greatly between countries, depending on technical and financial capacity, general government policy towards housing finance, and the range of responsibilities assigned to the institutions in the housing field.

Regardless of the type of system used, the vast majority of funds on deposit with savings and loan associations in Latin America represents savings which are and shall continue to be motivated by a desire for better housing. While it can be said theoretically that these deposits constitute newly mobilized savings, the very importance attached to housing as a motivation for saving prompts the question, what will occur when the incentive is removed? Will the saving pattern survive the acquisition of a new home? The lack of available statistical documentation on this subject precludes a simple answer. However, there are a number of more immediate problems that are of greater practical significance.

First, there is the problem of instability, not only in political life generally, but also in governmental attitudes toward economic institutions, both private and public. Governments faced with the dual task of promoting economic development and maintaining economic stability have followed erratic monetary and fiscal policies. Such policies have not been conducive to the establishment of public confidence in savings institutions. For example, shortly before the 1964 Presidential elections in Chile, when there was some doubt as to whether the outcome would leave the Socialists or the Christian Democrats in power, general participation in the system and especially

*Under Salvadorian S. & L. legislation both mutual and stock associations are authorized to conduct mortgage lending operations.

^{25a} U.N. Draft 69, p. 16.

²⁵ Op. cit., Harold Robinson, Housing and Urban Development Programs, October 1, 1967.

loan demands, fell off considerably. This change was attributed primarily to uncertainty about the new government's policies.^{26a}

Inflation is a serious problem in many countries. It is not financially sensible to place money in an association savings account, which promises a return of 5-8 percent annually, when the annual rate of inflation exceeds that dividend rate. Even if the individual saver does not actually lose money in a given year (e.g., if the rate of inflation is lower than the dividend rate paid on his savings account), the very threat of inflation remains a significant deterrent to any investment with a fixed rate of return, such as an S. & L. savings account under normal conditions. There must be either an interest rate high enough to serve as a hedge against inflation or some kind of adjustment of credits and debits to offset currency depreciation. The latter alternative is attractive to savers but not so attractive to borrowers, whose total debt would be adjusted upward from time to time regardless of principal repayments.

Some countries have enacted legislation to permit adjustment of savings accounts and mortgage debts. Brazil has used a general wholesale price index. Chile began with a straight wage-salary index, and was the first Latin American country to adopt such a system.²⁷ Because of political and economic pressures and severe inflation, the Chilean Government has since adopted a complicated compromise of adjusting S. & L. savings and mortgage balances according to the lower of either the wage-salary index or the cost-of-living indicator. Peru has recently adopted a system of monetary correction to be applied to S. & L. funds derived from dollar loans. This step was taken to compensate for the 1967 devaluation.

These measures have met with varying degrees of success. Such savings and loan adjustments have never been offered as a cure for inflation, but rather have been introduced as an accommodation to inflation. They allow people to accumulate savings and obtain mortgage financing, until such time as inflation can be brought under control.

Finally, virtually any investment in Latin America will yield a greater return than the 5 to 8 percent generally paid by Latin American S. & L.'s on savings accounts. Measures such as exemption of saving deposits in S. & L.'s from taxes, savings deposit insurance by the federal government, and lotteries have been used in several countries to attract deposits. Some Latin American S. & L.'s have tried to compete with local commercial banks in terms of interest rates paid on savings accounts with varying degrees of success.²⁸

Thus it would seem that the institutionalization of the saving habit in Latin America and the mobilization of private sources of development capital through the S. & L. mechanism depend to a great extent on the general economic and political environment in each country. Current programs of savings and loan systems, regardless of their structure, do indeed establish a savings pattern on the part of the small-scale earner. The rising popular participation in these S. & L.'s attests to this fact. The "downpayment" nature of these savings,

^{26a} USAID Communique, Santiago, Chile, on Project Implementation Plan, March 18, 1965.

²⁷ Op. cit., Statement of Stanley Baruch in House hearings on Establishment of International Home Loan Bank, 1963, p. 67.

²⁸ Op. cit., Elliot, *Financing of Housing in Latin America*, p. 144.

however, will continue to challenge the liquidity and stability of the system as demands for middle-income urban housing increase, and as long as overburdened government budgets and external loans remain the major source of financing these private associations.

D. External Assistance Programs to Latin American Savings and Loan Associations

Two agencies have been responsible for providing external financial assistance to savings and loan institutions in Latin America: The Agency for International Development (AID) and the Inter-American Development Bank (IDB). In the Foreign Assistance Act of 1961, the U.S. Congress declared that programs to assist organizations and institutions making repayable loans for housing should be given the highest possible priority. Housing cooperatives and savings and loan institutions should be fostered (sec. 601), and guarantees for investment in housing should be promoted (sec. 224, as amended).

It was felt that primary emphasis should be on technical and financial assistance to thrift institutions, since, "AID's greatest opportunity to make a noticeable reduction in the housing shortage is in the lower middle-income level. First, it is a smaller segment of the total population and the total need. Second, this group can contribute the most toward the solution of its housing problem. And third, it primarily requires long-term credit rather than continuing government-supported subsidies."²⁹ AID housing experts also projected that "internal secondary sources of financing are needed and can be developed as the primary mortgages of the savings institutions become seasoned, gain the confidence of the investing public, and become recognized as proper and sound investments for other forms of institutions."³⁰

AID's general policy with respect to savings institutions was based on the rationale that (1) existing market mechanisms by and large served to supply the requirements of upper and upper-middle income groups; (2) without the incentive of home-ownership, earnings of the lower income sectors tended to be expended for other consumer uses rather than saved; and (3) U.S. loans and investments to the locally emerging savings and loan associations would both increase the funds immediately available for home loans and foster the habit of saving in the form of home equities.³¹ AID "seed capital" loans in keeping with these assumptions have been made to Home Loan Bank Boards for relending to individual associations in the following countries:³²

- Bolivia: \$200,000 (local currency equivalent)—1964;
\$500,000 (local currency equivalent)—1966; (both of
the above loans were made directly to the La Primera
S. & L., rather than through the Central Housing
Bank); \$1 million (local currency equivalent)—1967;
\$500,000 (local currency equivalent)—1969.
- Chile: \$5 million (plus \$5 million grant)—1961; \$8.7
million—1964.
- Costa Rica: \$1.0 million—1969.

²⁹ Op. cit., Harold Robinson, Housing and Urban Development Programs, October 1967.

³⁰ Ibid.

³¹ AID Manual Order No. 1612.83.1, August 15, 1966, p. 3.

³² AID Statement of Loan Implementation and Disbursement Progress, March 1, 1969.

Dominican Republic: \$2.1 million—1963; \$5.0 million—1966.

Ecuador: \$5 million—1961.

El Salvador: \$3.1 million—1965; \$3.0 million—1968.

Nicaragua: \$3.7 million—1967.

Panama: \$2.1 million—1966.

Peru: \$1 million (local currency equivalent)—1960; \$7.5 million—1961; \$6 million (S. & L.'s for cooperative housing)—1965.

Venezuela: \$10 million—1961.

CABEI: \$10 million (for secondary mortgage market)—1963.

The loan terms varied from year-to-year and country-to-country, ranging from 20 years at 4 percent interest with no grace period, to forty years at 2 percent interest with a grace period of 10 years, during which interest payments were made at three-fourths percent.³³ All repayment was to be made in dollars, except, of course, in the case of loans from local currency resources.

Under the U.S. technical assistance program, agreements were reached with the two U.S. savings and loan leagues to recruit short- and long-term experts in savings and loan operations on a contractual basis. Some top and middle level advisers have visited Latin American countries for periods of two weeks to two years through this arrangement. They have been employed in Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Nicaragua, Panama, Peru, Uruguay and Venezuela. The Federal Home Loan Bank Board and the Federal National Mortgage Association have also made a limited number of their supervisory personnel available under interagency agreements effected for that purpose.^{33a}

The Inter-American Development Bank has made loans to aid the S. & L. systems of five countries:³⁴

Bolivia: \$0.1 million—1963.

Chile: \$5.0 million—1962; \$5.0 million—1964; \$6.0 million—1967.

Guatemala: \$1.08 million—1969.

Peru: \$1.0 million—1962; \$1.2 million—1965.

Nicaragua: \$2.5 million—1965 (implementation, 1969).

Most of these loans were made through the Social Progress Trust Fund (SPTF) in dollars at 2 percent interest on a 20–25-year repayment basis. The Fund's resources consist of U.S. grants totaling \$525 million under a 1961 agreement. The IDB assumed administration of the funds granted to promote "the social development and institutional progress of Latin America." One of the four purposes of SPTF programs was stated as "Housing for low-income groups, through assistance to self-help housing and to institutions providing long-term housing finance and engaged in mobilizing domestic resources for these purposes."^{34a} Approximately 43 percent of this sum has gone into

³³ Ibid.

^{33a} Op. cit., Harold Robinson, speech at Catholic University, Washington, D.C., April 6, 1967.

³⁴ Op. cit., Harold Robinson, Housing and Urban Development Programs, October 1967.

^{34a} Op. cit., Harold Robinson, speech at Catholic University, Washington, D.C., April 6, 1967.

housing for low-income groups, more or less on a 1:1 funding basis with participating governments.³⁵ With the commitment of most SPTF funds by 1965, the IDB in recent years has turned to its Fund for Special Operations, which is about 80 percent U.S. financed, for further seed capital loans. The 1967 loan to Chile and the 1969 loan to Guatemala both came from this source. IDB participation in the Latin American S. & L. movement has been somewhat muted because of the SPTF directive to finance directly low-cost "social" housing and community development projects, rather than lending to S. & L. systems whose clientele falls into the middle-income brackets.

The following is a summary of savings and loan developments in selected countries which have received assistance under the programs mentioned above. Each of these cases reveals structural and organizational problems which have confronted the development of S. & L's. throughout Latin America. They also reflect the various measures taken to deal with endemic conditions such as inflation, instability, and technical and administrative vacuums.

(1) BOLIVIA

The population of Bolivia has been estimated at about four million. It is a predominantly rural country that has experienced only limited movement of the population toward the cities in recent decades. It is calculated that two-thirds of the population continues to live in rural areas, and that even by 1980 this figure will not drop below about 60 percent. La Paz, the largest city, had 360,329 inhabitants in 1965, and was estimated to reach 500,000 by 1970.³⁶

Enabling legislation for a savings and loan system was not enacted until 1963, after some earlier efforts. The first mutual savings and loan association, La Primera, was established in June 1964, and later set up branches in other cities. The system was incorporated into a National Housing Council (CONAVI) in July 1964, the financial department of which was to act as the Central Bank (Caja Central) for the savings and loan system. However, due to the inadequacy of the financial resources available to CONAVI and the inability of the Bolivian Government to contribute its share, U.S. AID officials suggested that an independent Caja Central be created along with an independent system of S. & L's. A statute along these lines was adopted in 1966 and is still in effect. Since seed capital to start the system could not be procured from private sources in Bolivia, and since the government was unable to provide the necessary capital due to other financial obligations, the only source was external assistance provided by the United States and the IDB.³⁷

From an initial capitalization in 1964 of \$400,000 (excluding external assistance) and a membership of about 1,300, the Bolivian system has grown to four associations with 4,560 members and assets of over \$2 million. Net savings expanded from \$170,000 to \$1 million. The number of new loans granted rose from 87 in December 1965 to 700 in December 1968.³⁸ Much of the new savings constituted "forced sav-

³⁵ Op. cit. SPTF Eighth Annual Report 1968, pp. ix, xi.

³⁶ Ibid., pp. 64-65.

Kingsley Davis, *World Urbanization, 1950-70*, vol. I (Institute of International Studies, University of California, Berkeley), April 1969.

³⁷ Report on Bolivian Savings and Loan System from USAID, La Paz, John Brady, February 3, 1967, pp. 5, 28 (hereafter, Brady AID Report).

³⁸ Savings and Loan Progress Reports, NLISA, No. 27, No. 40.
Op. cit., U.N. Draft-69, p. 46.

ing," due to a requirement which compelled the borrower to place 20 percent of the amount of any loan into a savings account which remained with the association until the loan was repaid. Most of those members who held "free" savings accounts, however, were also seeking loans. Among the complications in administration of the S. & L. system is the fact that while the loan limitation has been set at \$7,500 (at an annual interest rate of 12 percent), the average sales price for new home construction is \$16,000 and for existing homes is \$13,000.³⁹ The fact that the system could grow at all under such inhibiting circumstances attests to the insatiable demand for middle-class housing, even in less urbanized Bolivia.

Without an S. & L. system, there would be very little money available to the people for the private financing of homes. The commercial banks cannot lend for more than one year, and they are not interested in purchasing mortgages because they can obtain a higher yield from other investments. To date no insurance companies have been actively involved. And financing at the one mortgage bank is complicated, limited, and expensive. The people of Bolivia have almost no means to satisfy their financial need for housing without a savings and loan system.⁴⁰

The Caja Central under the Bolivian system has five major functions: (1) Charter and supervise savings and loan associations; (2) insure savings accounts and mortgage loans originating within the system; (3) adjust savings accounts and mortgage loans to counter the effects of inflation;* (4) act as central bank for savings and loan associations; and (5) act as secondary mortgage market. These five functions are primarily intended to maintain liquid funds for increased operating expenditures and secured reserves. Without government assistance, the Caja would have to rely on limited receipts of fees and insurance premiums from incipient associations.

As of December 1968, savings insurance had not yet been put into effect. Therefore, premiums for this insurance were not being paid to the Caja Central by the associations. Mortgage insurance was still being studied. To date, there has been no readjustment of savings accounts and mortgages. The reason given by the Caja Central for these deficiencies is that no official indexes for salaries and cost of living have been prepared by the General Section of Statistics and Census. The readjustment clause is attractive to savers, however, and is considered one of the best tools to compete with the higher interest rates paid on savings accounts by other institutions. S. & L.'s pay 8 percent interest on savings accounts while the commercial banks pay 9-10 percent. The local Mortgage Bank, a private institution which serves upper income housing finance, issues mortgage bonds at 12 percent interest, with principal and interest payable in U.S. dollars.^{40a}

The fourth function—that of a central bank for housing finance institutions—should have as one of its elements the ability to borrow

*According to Bolivia's S. & L. legislation, readjustment is to be computed annually (permanent) and monthly (temporary) by averaging three indexes: (a) Salary index; (b) living cost index; and (c) index on percentage of variation of money exchange between the Bolivian peso and the American dollar.

³⁹ Op. cit., Brady AID Report, pp. 6, 9, 13.

⁴⁰ Ibid, p. 20.

^{40a} Op. cit., U.N. Draft-69, pp. 46, 48.

funds which in turn are loaned to associations for various needs. Under the U.S. Federal Home Loan Bank System, the needs of the associations are periodically reviewed—usually monthly—and the regional banks buy money from the private sector by issuing notes in large denominations for short terms. That money is then loaned to associations, usually for short terms at cost plus a markup. Generating funds through this method is not available in Bolivia, and even if it were, the present cost of money would make it prohibitive. The only methods used by the Caja to generate funds have been to (1) borrow from U.S. AID, (2) invest borrowed funds in savings accounts in commercial banks until they are loaned to associations, (3) charge member associations 3 percent of their profits, and (4) require associations to keep a certain percentage of their liquidity with the Caja.

Buying and selling mortgages is the fifth function of the Caja, and there is no secondary market for selling mortgages in Bolivia at this time. This leaves the Caja the option of either purchasing mortgages from associations for long terms, which would dry up all its available funds, or lending money to the associations for short terms with mortgages as security. AID advisers recommended the latter in view of the lack of any other liquid resources.⁴¹ Very recently Bolivian S. & L. managers have approached the country's large insurance companies in the hope of attracting a portion of their assets into mortgage investment. This method has proved successful in the Dominican Republic. Statistics are not yet available to evaluate the results of these efforts.^{41a}

In view of the current demand for housing, inadequate supply of housing, and inflation (the cumulative cost of living increase was 42 percent from 1961 to 1968), it seems clear that free savings will continue to be limited in the near future, and that the S. & L. system will continue to rely on substantial foreign capital input. A recent United Nations evaluation has cited as further reasons for the slow pace of the Bolivian S. & L. system (a) the stage of development of the country, (b) the lack of aggressiveness on the part of S. & L. management in attracting more local resources, and (c) the general inexperience usually found in new institutions.⁴² The predominantly rural character of the population could be cited as one more reason for slow S. & L. development.

In the long run, AID advisers concluded that the success of the system depended in large part on the development of free savings or savings on which no loan is in force.⁴³ As long as the system is economically dependent on American aid, the unpleasant political implication remains that the S. & L.'s are simply another U.S. financial tool.

(2) CHILE

a. *Housing problem*

In mid-1968, Chile had a population of 9.35 million. The annual rate of demographic growth since the 1960 census is estimated at 2.5 percent, lower than the 3 percent for Latin America as a whole. In contrast to most Latin American countries where the urbanization process is

⁴¹ Op. cit., Brady AID Report, Feb. 3, 1967, pp. 23, 25-27.

^{41a} Interview with Harold Robinson, Deputy Director, Development Resources Divisions, Bureau for Latin America, AID, August 11, 1969.

⁴² Op. cit., U.N. Draft-69, p. 43.

⁴³ Op. cit., Brady-AID Report, Feb. 3, 1967, p. 40.

comparatively recent, the shift to the cities in Chile, as in Argentina and Uruguay, began at the end of the last century. Between 1952 and 1960 the urban population expanded at a cumulative annual rate of 4.3 percent, while the rural population remained virtually constant. The urban population constituted 68.2 percent of the total in 1960.^{43a}

There were approximately 1.3 million housing units in Chile in 1960, of which 70 percent were located in urban areas. The average number of persons per unit was 5.4 for the entire country, ranging from 6 persons per unit in the rural sector to 5.2 in the urban sector. About 29 percent of existing housing was considered unsuitable because of construction and building materials of poor condition.⁴⁴ In May 1960, Southern Chile was hit by severe earthquakes which compounded the housing deficit problem.

The long-range problem was that of mobilizing sufficient capital to increase the rate of local housing construction from approximately 15,000 units per year to an initial goal of 40,000 units per year (required to meet increased population and replacement) and ultimately to 60,000 units per year (required to eliminate gradually substandard housing in the urban slums). As of 1960, the housing shortage was estimated at 260,000 to 500,000 homes, depending on the standards of quality applied when making the estimate. To this was added the short-range problem of generating from combined local and foreign resources approximately \$200-\$400 million equivalent to replace an estimated 50,000 home units destroyed and to repair an estimated 75,000 home units damaged by the earthquake. Many of the homes destroyed in the urban areas were occupied by lower-middle to upper-middle class. Chilean housing experts estimated that the cost range of homes built for reconstruction would be approximately \$1,500 to \$6,000.⁴⁵

U.S. financial and technical assistance was being considered to relieve some of the pressures on the Chilean Government for housing finance. While a number of government home financing institutions already existed through which to channel this assistance, U.S. Development Loan Fund (AID predecessor) officials observed in 1960 that these entities had not solved the housing problem to date, suffered from major bureaucratic rigidities, were subject to crippling political pressures, and were not capable of the expeditious, efficient operations required. These experts strongly recommended that as much U.S. financing as possible be channeled through private financial and administrative entities.⁴⁶

b. Formation of savings and loan system

The Chilean Savings and Loan System had been adopted into law on March 26, 1960. Significant private financing of housing in Chile did not exist prior to the creation of the new savings and loans. This gap was partly due to the lack of an adequate institutional structure, and partly due to rampant Chilean inflation which deterred both private savings and mortgage financing. In all of Chile at that time, not more than \$10 million was invested in mortgages, of which \$8 million was in short-term mortgage loans for commercial properties,

^{43a} Op. cit., SPTF Eighth Annual Report, 1968, p. 95.

⁴⁴ Ibid., pp. 101-102.

⁴⁵ Development Loan Fund (DLF) Memorandum, "Chile Housing," July 1, 1960, pp. 1-2.

⁴⁶ Ibid., pp. 5-6.

and approximately \$2 million in long-term housing finance.^{46a} The new Chilean S. & L. legislation was largely the result of efforts by U.S. housing experts attached to the Embassy in Santiago, and by Savings and Loan authorities contracted under the ICA (International Cooperation Administration) technical assistance program.⁴⁷ Based on brief, but successful, experience with readjusted savings deposits in the Chilean State Bank, these experts concluded that given a stable economy or a savings system adjusted to inflation (with comparable adjustment of home mortgage values), the latent capacity of the Chilean people for savings would provide funds for housing.⁴⁸

From the point of view of Chilean economic development, U.S. technicians felt that the contribution of a private, independent savings and loan system would be threefold. Such a system would become (a) a new contrainflationary nationwide mechanism to stimulate real savings and investment; (b) a tool to strike at the social-economic problem of inadequate housing, and (c) a stimulant to the home materials and home construction industry.^{48a}

Early experiments with monetary correction mechanisms had provided exposure to the contract savings method for low-income housing finance. In June 1959, a separate savings department was established in the State Bank (Banco del Estado) which operated in conjunction with the Chilean Housing Authority. The savings department provided for adjustable savings. Savings were tied to housing by the fact that people who saved in these special accounts were eligible for contracts with the housing authority. After savers had accumulated a certain fixed amount over a certain set period of time, they would receive from the housing authority a definite mortgage loan linked to the amount the saver had built up and governed by the savings plan the individual had joined. This program was limited by the difficulty of allowing for individual choice in selecting the site, type, and timing of home to be built, and was not considered suitable for private S. & L.'s.^{48b} It remains in use today by the housing authority to accommodate the lowest income groups capable of saving for housing.

Chilean S. & L. legislation provided for an autonomous government agency, the Central Fund (Caja Central) of savings and loans with a board of directors insulated from immediate political pressures. It combined in general the functions of the U.S. Federal Home Loan Bank Board, Federal Housing Administration, and Federal National Mortgage Association. Its multiple powers included—

- (1) The power to create independent savings and loan associations.
- (2) The power to regulate these associations.
- (3) The power to insure the savings and the mortgages of these associations and to adjust the savings and mortgage payments under an index the law created. (Annual revaluation on a salary-wage index.)
- (4) The right to act as a central credit agency for these associations.

^{46a} Arthur H. Courshon, Chairman of Board, Washington Federal Savings and Loan Association of Miami Beach, Fla., "Report on Chilean Savings and Loan System and Chilean Home Financing," Aug. 10, 1960, p. 1 (unpublished).

⁴⁷ Op. cit., DLF Memo, "Chile Housing," July 1, 1960, p. 6.

⁴⁸ USAID (Santiago) Communique on Capacity for Saving for Homes in Chile, Dec. 11, 1950, H. Robinson, Dec. 11, 1950, p. 1.

^{48a} Ibid., p. 17.

^{48b} DLF Proposals and Recommendations: Chile—Central Housing Bank Loan, April 1961, pp. 9-10.

Savings accounts in the associations were to be exempt from income and inheritance tax, receive a proportionate distribution of annual profits after an allocation of a minimum 10 percent of profits to a reserve fund, and were insured up to \$4,750 per depositor as to revalued principal amount by the Caja Central. No association housing loan could be in excess of 90 percent of the appraised value of the property, nor in excess of \$9,500 for a single housing unit. Annual interest rate charges could not be greater than 7 percent, to which an annual charge of one-quarter percent could be added to be paid to the Caja Central for a reserve fund. A maximum period of mortgage amortization was established at 30 years.⁴⁹ The Chilean legislation authorized only mutual associations to operate within the system, and stipulated that depositor participation in S. & L's be open ended; i.e., not tied to any loan obligation.

In September 1960, the Chilean Government formally applied to the Development Loan Fund (DLF) for financial assistance to the Caja Central and the S. & L. system. The request was for partial initial capitalization, since time would be required to accumulate sufficient loan capital solely through the deposits of association members. The goal, of course, was to stimulate with utmost speed the flow of private savings into capital formation as represented by low-cost home construction. The United States was particularly disposed to aiding Chile in this effort since this was the first system of its kind created with U.S. technical assistance in Latin America. It was hoped that lending to the Chilean system would form a general pattern for DLF seed capital financial assistance to housing in Latin America.⁵⁰

c. U.S. assistance programs

The initial U.S. contribution came in January 1961, in the form of a \$5 million grant which was part of a \$100 million grant given by President Eisenhower to the Chilean Government for the purpose of reconstruction in the areas of Chile that suffered substantial damage from the May 1960 earthquakes. The \$5 million was to be used to capitalize S. & L.'s in those areas. The Chilean Government promised to match the U.S. contribution with \$5 million in equivalent funds from its budgetary resources.⁵¹ * About \$1.5 million of this amount were drawn from loan proceeds from a Public Law 480 agreement.^{51a} Since all associations were organized as mutuals, they did not have access to share capital to expand their volume of operations.

By March 1961, some 15 private S. & L.'s had been organized or were in the process of organization in the major cities, including key cities in the southern earthquake zone. Since no other financial system in the country had the use of readjustment, the S. & L. savings grew. In anticipation that the system would be a major factor in providing increased lower-middle income housing finance from domestic savings, the DLF proceeded with negotiations for a \$5 million loan to make

*Part of this Chilean contribution was to be derived from a 5-percent tax on business profits earmarked for the Caja Central and the S. & L.'s.

⁴⁹ Op. cit., Courshon, "Report on Chilean Savings and Loan . . .," Aug. 10, 1960, p. 4.

Op. cit., DLF Memo, "Chile Housing," July 1, 1960, pp. 7-8.

⁵⁰ Op. cit., DLF Proposals and Recommendations . . . Apr. 1961, p. 10.

Project Agreement No. 513-85-065, Housing 3-61, Jan. 16, 1961, p. 1.

⁵¹ USAID Communique from Santiago on the State of Development of Savings and Loan Associations in Chile, Sept. 10, 1962, p. 1.

^{51a} Ibid., pp. 1-2.

Caja Central a financially strong and liquid central public financing institution. DLF managers indicated to Chilean officials that if the S. & L. system performed successfully under the first loan, the United States would be willing to consider a second \$5 million loan at a later date.⁵²

The loan agreement was signed on June 14, 1961, "for financing a nationwide system of private mutual savings and loan associations, chartered, supervised, and insured by the Caja Central in Chile to encourage the expansion of Chilean domestic savings for medium and lower-cost private home ownership." The loan was to be repaid within 25 years at 4 percent annual interest. The main obligations of the Caja Central under the loan were as follows:

(1) Insure that all associations shall finance only the construction, improvement, or purchase of houses or cooperative housing units qualifying under the Chilean official regulations for low-cost housing. Financial assistance under the program shall be primarily utilized for the financing of construction, improvement, or purchase of houses or cooperative housing units whose sales price is in the amounts between 4,000 and 10,000 escudos (\$3,800-\$9,500) as may be later adjusted on a basis agreed upon between the Caja and the DLF, to reflect changes in the wage-salary index maintained by the Government.

(2) Encourage the associations to provide private housing financing by means of mortgage loans of an average term exceeding ten years.

(3) In order that it not be the only market for mortgages sold by associations, exert its best efforts to develop a secondary mortgage market by utilizing private Chilean financial institutions.

The annual dividend rate to depositors of any association was not to exceed 5 percent.⁵³

By September 1961, the DLF ceiling placed on the sales price of homes mortgaged through the S. & L. system was already being questioned by Caja Central officials. Their argument was that what S. & L.'s needed at that time was to make as many loans as possible and in the quickest way. The money the associations had received in deposits was subject to readjustment. But increases in the monetary value of existing deposits, as dictated by the rate of inflation, could be financed only by the similar readjustment of outstanding loans to borrowers.

Chilean officials also emphasized that middle-income persons constituted the vast majority of those seeking housing through the S. & L.'s in its early stages of development, and therefore a larger percentage of loan applications were for houses with sales values of over 10,000 escudos (\$9,500). They pointed out that poorer groups were not able to accumulate their down payment so rapidly, and that after the associations were well established, they could then consider smaller loans paid over longer periods. Caja officials feared that if they waited until the greater proportion of their loan applications were from the poorer segments of the population, the inactivity in the lending phase of S. & L. operations would create a lack of public confidence in the entire system.⁵⁴

⁵² Op. cit., DLF Proposals and Recommendations . . . April 1961, p. 15;

DLF Memo on Chile Central Housing Bank Application, Mar. 13, 1961, p. 1.

⁵³ Loan Agreement (Chile Central Housing Bank), June 14, 1961, pp. 2, 29-30, 31;

⁵⁴ Letter from Eduardo Gomien, President, Caja Central de Ahorros y Prestamos, to DLF, Sept. 9, 1961.

The DLF expressed some concern that the higher limit might mean that DLF-financed housing construction would depart from the purpose of the loan agreement of encouraging medium and low-cost private home ownership. Three months later, however, the DLF agreed to the Chilean request to raise the value of houses eligible for loans to 15,000 escudos* (about \$14,250), with the provision that the loan amount should not exceed 75 percent of total sales price of any houses or cooperative housing units valued in excess of 10,000 escudos (\$9,500).⁵⁵

In the spring of 1962, the IDB became interested in the new methods for low-income housing finance in Chile and offered to make a \$5 million loan to the Caja Central for relending through the S. & L.'s. In keeping with general IDB social housing policy, the loan was intended to support housing costing less than those eligible for financing under the DLF loan. It was to assist authorized S. & L.'s in financing—through housing cooperatives affiliated with such associations—the construction of approximately 2,300 homes for low-income families, members of such cooperatives. As of February 1962, 32 housing cooperatives with 3,950 members had become affiliated with established S. & L.'s. Their deposits in the association were in excess of E°1 million (about \$715,000). The cost of the homes financed under the IDB-supported program would average (including land, utilities, construction, and administrative costs) \$3,300. The annual family income of the home purchasers would not exceed \$2,160 (averaging about \$1,400), a low-income group below that usually served by S. & L. financing. The Caja would lend these funds at 5 percent per annum; the S. & L.'s charging the ultimate cooperative borrower about 6 percent.** The loans to the home purchasers would be amortized over 15–25 years.⁵⁶

The IDB (Social Progress Trust Fund) interest rate to the Caja Central for the S. & L. loan was 2 percent per annum, in contrast to the DLF's 4 percent rate. The management of the IDB felt that it should adhere to its 2 percent policy on housing loans followed in eight similar loans since November 1961. AID concurred with this policy, since the loan would benefit very low-income persons who would not normally be able to finance their homes through a S. & L. system.⁵⁷ The loan was signed on June 13, 1962, to be repaid over a 25-year period.

By December 1962, Caja Central officials were requesting additional external support in the form of a second \$5 million loan from the United States. They stated that the first loan—

has already acted not only as "seed capital" but its main importance has been to give confidence to the depositors and executives of the associations, through the knowledge that Caja Central has enough resources * * * to give * * * the system a sound basis. In other words [the loan] has [acted] much better * * * [through its] presence, than [through] actual use of the money.⁵⁸

*Subject to readjustment for inflation.

**Cooperative members affiliated with the S. & L. system received preferential treatment of 1 percent interest in order to foster the cooperative movement.

⁵⁵ ICA Communique on Chile Central Housing Bank, Oct. 19, 1961.
Letter from Arthur McClauflin, Acting Assistant Administrator for Development Financing, DLF, to Eduardo Gomien, Nov. 22, 1961.

⁵⁶ Memorandum from IDB/SPTF to National Advisory Council, May 11, 1962.

⁵⁷ AID Memo on SPTF Loan to Caja Central, May 13, 1962.

⁵⁸ Letter from E. Gomien, President, Caja Central to AID, Washington, Dec. 28, 1962.

On the other hand, they also emphasized the necessity of "playing it on the safe side," hoping to maintain public confidence in the system through 1964 and 1965. They felt that the security of being able to draw from the new loan would encourage the continued growth of deposits, making it unnecessary to draw from AID. In other words, the loan was intended to act as a stimulus to savings. Without the loan, Caja officials feared the associations would not be able to keep up with past growth rates, thus affecting the volume of deposits.⁵⁹

At the same time, Caja officials indicated to AID certain difficulties keeping to the already raised value limit on sales prices of houses financed with loan funds. The 15,000E° (\$14,250) ceiling had been raised in July 1962 to 16,800E° (about \$13,500) to account for the 12 percent readjustment due to inflation. A rise in the cost of land and construction, however, prompted a request to raise the ceiling again to 21,000E° (about \$8,700)* "in order that the system could go on making loans for the same size of houses with the same quality of construction materials."⁶⁰ Five months later, AID approved this change in housing value ceiling in view of the low supply of new housing available, and the need to channel new mortgages into the system.⁶¹

d. Secondary mortgage market

In considering the Chilean request for a \$5 million supplement to the 1961 loan, AID officials expressed concern about the lack of development of a secondary mortgage market to supplement the primary inflows into the S. & L. system; i.e., the velocity of savings deposits and the mortgage purchasing capacity of the Caja Central. The Chileans pointed out, however, that in a country where capitalization in general is weak, there are few possibilities that something new, like savings and loans, will arouse sufficient immediate interest, at least until the stability of the system has been proven. They added that even though savings had increased, the majority of depositors in S. & L.'s were primarily interested in obtaining home loans, and due to the small number of existing homeowners (about 30 percent of the population), they expected this trend to continue for some time. The Caja's President told AID officials that in order to create a secondary market, it would first be necessary to overcome the confusion and lack of understanding about mortgages in the mind of the public. He proposed to do this by working closely with insurance and finance companies, urging them to purchase readjustable paper issued by the Caja and backed by its mortgages. This process would take time, however, and he suggested that during the interim the only way to safeguard confidence in S. & L.'s would be by increasing AID credit.⁶²

AID was totally sympathetic to Chile's problems. The critical reserve problem faced by the Caja Central was due primarily to its progress in meeting its lending goals. Loan commitments by December 31, 1963 numbered 10,322, of which 6,830 applied to individual savers, while 3,492 were low-income mortgages financed by the IDB through cooperatives. Housing demand exceeded savings which amounted to E° 31 million (approximately \$10 million) during the

*The lower approximate dollar value reflects the rampant Chilean inflation.

⁵⁹ Ibid.

⁶⁰ Ibid., p. 3.

⁶¹ Letter from E. Gomien, President, Caja Central to AID, May 31, 1963.

⁶² Letter from Jose Zabala, President, Corporación de Fomento de la Producción, to AID, Aug. 23, 1963.

first two years of operation, and the Caja had to make as many loans as possible in order to stimulate confidence in the system and attract savings at an increased rate.* This expansion of activity created considerable pressure on the Caja's capital reserves. The Caja found it impractical and difficult to check this expansion and maintain an adequate liquidity position. At the same time, its management felt that the system would be tested initially and therefore would need a strong reserve position to meet any eventuality. The most significant problem, then, was immediate liquidity.⁶³

In its evaluation of the Chilean request for additional assistance, AID took into consideration that the Government had to concentrate its budgetary support for housing development in the low-cost subsidized area, including CORVI and emergency housing programs which were completely government owned and controlled. Another important point was the fact that the private savings and loan system was initiated by the Development Loan Fund and its success or failure would be associated with the Alliance for Progress. In this context, AID officials felt it necessary to maintain as much control over the system as possible and to promote its financial independence. They were particularly sensitive to encouraging increased Central Government influence in the associations, since the system did, in fact, belong to the private sector. It was thus felt that external U.S. assistance was completely justified at this critical stage.⁶⁴

In view of the rising construction costs, AID economic analysts were not able to project a rational financial plan based on the original \$5 million request, "without seriously limiting the system's financial capacity." It was therefore decided to revise the plan in order to insure financing at 1964-65 levels, after which it was expected that the system would achieve financial independence. As a result, the loan amount was increased by \$3.7 million to \$8.7 million to match the total 1963 and 1964 Chilean Government contribution of E°20 million (approximately \$6.4 million). The loan thus represented a joint venture with the Chilean Government which anticipated an increased level of savings, mortgage repayments, and secondary market operations.

In view of rapid expansion needs, AID planners felt it important that the last objective—the formation of a secondary mortgage market—be achieved by the end of 1965. Since savings were not expected to catch up with housing demand for some time to come,^{65**}

*The government-owned savings and loan system, CORVI, had about E°33 million (\$11.0 million) in net savings—about equal to those of the Caja. As noted above, CORVI's depositors saved on a contract basis with interest at 4 percent. Mortgages also bore interest at 4 percent. Most of its savers were low income families and housing was usually constructed and financed on a mass production basis. Obviously, the Caja's higher interest rate on savings (7 percent) would attract "real" savers, while many low income families would continue to save towards a downpayment at CORVI. Middle income groups would be attracted to the Caja, not solely due to higher interest rates, but also due to the fact that saving was on a voluntary basis and housing construction was more individualized.

**At the time the loan agreement was signed, 22 S. & L.'s had been chartered with a combined membership of 80,000 and savings equivalent to \$24 million. These savings, supplemented by Chilean and U.S. capital had been used to finance about 10,000 new homes, with the equivalent of \$26 million in mortgage loans.

⁶³ AID Report on Request for \$5 million AID Loan to Assist in Financing the Chilean Private Savings and Loan System, Dec. 20, 1963.

⁶⁴ *Ibid.*

⁶⁵ AID Press Release—Chilean Savings and Loan System Given Boost, Mar. 16, 1964.

the only alternatives to secondary market development were continued AID/Chilean Government support and/or a rigidly controlled loan program, neither of which was considered acceptable.^{65a} Thus, creation of a viable secondary mortgage market was made a provision of the loan agreement.

The loan agreement was signed on March 18, 1964, for \$8.7 million. Repayment terms were 40 years at 2 percent, with a 10-year grace period during which interest would be charged at three-fourths percent. \$250,000 of that loan amount was earmarked for technical assistance related to the project. Under the agreement, the sales value ceiling of eligible housing was raised to E°23,000 (about \$7,500), subject to readjustment.

Five months later, on August 12, 1964, the IDB signed a second loan for \$5 million with Chile from its Social Progress Trust Fund, to be administered by the Caja Central for relending through the savings and loan associations. This loan followed the pattern set by the earlier agreement of financing construction of low-income homes for members of housing cooperatives affiliated with the S. & L.'s. Loan terms were 25 years at 2 percent interest per annum.

By mid-1965, problems began to arise with respect to the creation of a secondary mortgage market. A June 1965 AID audit of the 1964 project loan revealed that approximately E°7 million (\$2 million) had been obtained by the system from secondary market sources. According to the Caja Central secondary market operations were considered to be, "sales of individual mortgages, or certificates, or bonds secured by individual mortgages of the Caja Central de Ahorros y Préstamos (Central Savings & Loan Fund) to private sources and Banco del Estado de Chile (State Bank)." The term "secondary market," however, had not been fully defined in the loan agreement, with the result that the Caja had included mortgages sales with repurchase agreements and short-term loans secured by mortgages in this category. AID felt that such activities could not be considered as true secondary market operations since there was no assurance that the funds would remain available for investment;⁶⁶ in other words, they represented contingent indebtedness on the part of the Caja Central. One AID technical advisor saw this step merely as a device to obtain temporary liquidity, and concluded that no seed capital, in the true sense, had been generated by the March 1964 loan agreement except for the actual amount of the loan principal proceeds received by the Caja Central. On the other hand, he understood the natural hesitation on the part of investors to purchase mortgages without recourse:

It must be borne in mind that the mortgages on the face of them are adjustable and insured by the Government of Chile. Apparently, the agreement to repurchase on the part of the Caja Central was because of the fact that since the mortgages run for a period of ten to twenty years of unexpired term from the date of the purchase, that the purchasers still have some doubt that the future Government of Chile will make good these guarantees.⁶⁷

^{65a} AID Capital Assistance Report on Caja Central de Ahorros y Préstamos, Feb. 7, 1964, pp. 4, 14, 15, 19.

⁶⁶ Report of Audit No. 130, AID Loan 513-L-022, Audit Branch, USAID Mission, June 11, 1965, pp. 5, 7.

⁶⁷ Report of Arthur H. Courshon, Chairman of Board, Washington Federal Savings and Loan Association of Miami Beach, Nov. 1, 1965, p. 7.

The prime reason for this lack of faith was that no financial policy seemed to last for any length of time in Chile. Historically, long-term policies and commitments had been changed as Governments changed.

In response to these findings, the AID Mission in Chile recommended the withdrawal of the secondary market provisions of the loan agreement, and in their place, suggested that loan disbursements be tied to equal cash contributions by the Chilean Government. AID officials felt that in view of the conclusions drawn by the technical advisor, the existing agreement increased the contingent liabilities of the system, since it required the Caja Central to accelerate its secondary market volume proportionately as AID total disbursements increased.⁶⁵ In July 1966, an amendment to the loan agreement was signed which eliminated the secondary mortgage market provision and substituted a cash contribution by the Government to the Caja of E°32 million (approximately \$6.9 million) during calendar year 1966.⁶⁹

Notwithstanding the above, the Caja Central had become attached to the secondary market operation imposed by AID in March 1964. While recognizing its weaknesses, Caja officials firmly believed that the repurchase clause represented the only way to develop a true secondary mortgage market in Chile. They therefore announced the intention to continue selling mortgages, although on a reduced scale from that anticipated in the loan agreement. Currently, the Caja is still carrying on secondary market operations in the same manner. AID officials have taken the view that as long as the system is functioning, perhaps one should not be too critical of steps taken to establish investor confidence in its reliability. At the same time, these experts agree that increased U.S. technical assistance should be made available to the Chileans to improve their techniques in this area.⁷⁰

e. Effect of social housing programs on S. & L. system

Another complication in developing the Chilean S. & L. system has been the tendency of the Frei Government (in power since September 1964) to socially orient the system toward producing more low-cost housing. In the opinion of one technical advisor, "the present Government's social objectives have become so much a part of the system that normal sound financial practices have been relegated to a secondary position." Many of the loans made by local associations in line with the Government's social policy were made at "unrealistically low interest rates" (4½ to 5 percent), considering the fact that associations were proposing to pay a 5 percent dividend to its savers. The associations were initially able to cover most of the cost of this financial policy through AID and Central Government contributions and through the savings attracted by the use of the readjustment index feature. When the S. & L. system was initiated, readjustment was not offered by any other financial competitor. Since 1966, however, this privileged position of the S. & L.'s has been eroded, partly as a result of the Government's overall economic stabilization policies.⁷¹

The Frei Government was firmly committed to the reduction of the country's runaway inflation, which had averaged 30 percent annually

⁶⁵ USAID Communiqué on Chilean Housing and Urban Development, Jan. 21, 1966.

⁶⁶ *Ibid.*, p. 2.

⁶⁷ Harold Robinson, Deputy Chief, Development Resources, Bureau for Latin American Affairs, AID.

⁷¹ Thomas A. Wohl, President, Home Federal Savings and Loan Association of Hollywood, Fla., "The Chilean Savings and Loan System as of February, 1967 (Revised)" (unpublished) pp. 5, 8-9 (hereafter, Wohl Report-67).

from 1964 to 1966. The Government introduced many restrictive measures, including price controls applied especially to those staple products used by lower income groups. Many of these staple products appeared as key items on the cost of living index; thus, price control influenced the accuracy of such an index of inflation. Under pressure from certain interest groups, the Chilean legislature in 1966, changed the law on readjustment and compelled the S. & L. system to use the *lower* of two indices: either (1) the salary and wage index (which was the previous indicator, and a more accurate reflection of inflation), or (2) the cost of living index.⁷² * Since the imposition of price controls in 1965, the cost of living index has remained the lower indicator and has failed to reflect the real rate of inflation as it affected savers participating in the system.

As a parallel development, in order to increase private savings, the Government gave other financial institutions, such as the State Bank (Banco del Estado), permission to apply readjustment to their deposits on more flexible terms than those of savings and loan institutions. S. & L.'s could only apply readjustment annually, at the close of the fiscal year. In addition to the competition offered by the Banco del Estado, several types of government bonds were issued which also offered a more realistic application of readjustment rate and a similar tax exemption. These actions by the Government resulted in a setback for the S. & L.'s singular appeal to develop free savings. By reducing the readjustment rate below the real rate of inflation as it affected savers in the S. & L. system, and by introducing a more favorable readjustment method to other financial institutions, the Government removed the incentive to save of those people who had sufficient funds to invest in the S. & L. system. As a result, the only savers who continue to patronize the system were those who wanted to obtain a home. For the prospective borrower, the fact that a loss in purchasing power was inevitable while saving for a downpayment was more than offset by the expectation of being able to borrow approximately 80 percent of the purchase price of the home after sufficient downpayment had been accumulated in a savings account.

If the S. & L. system had been able to acquire a mortgage portfolio with a sufficiently high yield and a low enough operating cost, it would have been able to compensate in part for the drop in new deposits by raising dividend rates to savers. However, low-yielding mortgage portfolios and high operating costs made such dividend increases impossible. One analysis of capital flows estimated that only one dollar of savings was acquired for every four going out in the form of loans. Since most loans were amortized over a long period, early accumulation of new capital through amortization was almost negligible.⁷³

*This change in readjustment legislation had been proposed as early as 1962. The change was intended to benefit the mortgagors over the depositors by assuring that mortgage payments would never exceed a constant percentage of family income. In years in which the cost of living index remained below the wage index, this percentage would be reduced, which in fact, occurred. The legislation was submitted by the Alessandri Government (the predecessor of the Frei Government) as a means of forestalling left-wing proposals designed to destroy the integrity of all housing finance. Left-wing elements wanted to eliminate all maintenance of value provisions in mortgage arrangements.

⁷² USAID Communiqué on "Legislation Affecting Savings and Loan Associations," Santiago, Oct. 29, 1962, p. 2.

⁷³ Op. cit., Wohl Report-67, pp. 10-13, 15.

Heavy reliance on external financing was the only alternative under such circumstances. As of mid-1967, almost 60 percent of the money loaned through the entire S. & L. system came from sources other than regular savings accounts. Approximately 30 percent of the loans had been financed by U.S. Government funds through AID loans, IDB loans,* and a U.S. Government grant. Fifteen percent came from Government of Chile contributions, and approximately 15 percent through the sale of mortgages on the so-called secondary market, which in fact would have to be repurchased by the system.⁷⁴ Total external inputs (including contributions by the Government of Chile) available for lending by the S. & L.'s approximated \$50 million as of mid-1968. The concessional rates of interest charged and the extensive grace periods further constituted a considerable subsidy to the system.^{74a}

f. Automatic insurance

Another area of the Chilean S. & L. legislation which has come under some criticism is the provision for automatic insurance by the Caja Central of all mortgage loans made through the system. No independent underwriting is required. In practice, this provision has meant that the Caja Central has functioned as a housing authority as well as a financial supervisor. It has consequently set minimum goals as to the amount and type of dwellings the system should finance in any given year.

This arrangement varies from the U.S. method of placing the mortgage insurance responsibility with a separate agency, the Federal Housing Administration. The FHA makes no loans, nor does it plan or build housing. It functions as the insuring agency on loans made by others under prescribed conditions. It is essentially a mutual mortgage insurance plan, initially capitalized by the Federal Government (through the Reconstruction Finance Corporation in 1934), and subsequently built up from insurance premiums paid by borrowers holding FHA loans. The insurance protects the lending institution against loss on FHA-backed mortgage loans. To qualify for insurance under this program, the mortgage transaction must be economically sound and must not exceed the appraisal value of the property as determined by the FHA.⁷⁵

As part of its automatic insurance program, the Caja Central of Chile has drawn up an elaborate set of regulations relating to low-cost housing to be financed by S. & L.'s, using U.S.-FHA standards as a reference. S. & L. financing under these regulations was expected to result in construction of homes within the general price range of \$3,800-\$9,500, inclusive of land.^{75a}

An argument against automatic Caja insurance of these mortgages has been made by an IDB housing expert who suggests that such insurance places the entire financial risk of the program ultimately

*In September 1967, the IDB made a third loan to the Caja Central to be transferred to the S. & L.'s. The fund was in turn loaned to housing cooperatives for the construction of low income units. The loan was for \$6 million to be repaid in 25 years at 3 percent per year interest.

⁷⁴ Ibid, p. 15.

^{74a} 1968 Review—Development Assistance (DAC), OECD Report, p. 225.

⁷⁵ Op. cit., Savings and Loan Fact Book, 1967, pp. 114-115.

^{75a} Development Loan Fund Proposals and Recommendations on Chile—Central Housing Bank Loan, P-296, April 1961, p. 4.

on the shoulders of the Government, rather than stimulating a private, self-sufficient S. & L. system.⁷⁶ Construction companies, on the other hand, complain that automatic insurance results in over-regulation and supervision by the Caja Central.⁷⁷ Similar criticism of the restrictive policies of the Caja under automatic insurance also came from a U.S. technical assistance advisor who evaluated the Chilean savings and loan system.^{77a}

In order to achieve its projected objectives in providing a specific amount of housing units, it has put a limitation on the price and size of dwellings to be financed by the system, notwithstanding the desire and need of the individual borrower. (The) loan regulations are so restrictive that the bulk of the middle class is automatically precluded from using the system for its housing needs * * * the maximum loan which can be financed under the system today is approximately \$10,000* which * * * must be amortized within a period of 8 years * * *. Such severe restrictions automatically remove the system from satisfying the housing needs of middle and upper income people * * * (thus) the system itself has eliminated the possibility of lending to those very same people whose funds must be relied on to support the system through savings.

This expert linked his criticism of Caja operations to the ambitious social policies of the Frei Government by pointing out official pressure on S. & L.'s to make as many low-cost housing loans as possible without regard to the financial capacity of the system. Welfare housing was emphasized rather than the accumulation of free savings. Rising construction costs further lowered the real value of houses eligible for financing through the S. & L.'s under Caja legislation.⁷⁸

Thus, the multiplicity of functions and responsibilities devolving on the Caja Central tended to perpetuate the dependence of the entire system on the Caja's ability to provide continuing liquidity to the associations. Caja control increased further as a result of legislative restraints on S. & L. capacity to attract "true" savings (discussed above). The sale of mortgages to the Caja became the main source of new funds, other than savings deposited in order to obtain a mortgage loan.⁷⁹

g. Progress to date by Chilean S. & L. system

Despite the threat of illiquidity, the Chilean S. & L. system has shown considerable resilience. As of February 1969, the status of the system was as follows:⁸⁰

Number of associations.....	22
Savings (millions).....	\$77. 6
Mortgages resold (millions).....	\$46. 7
Financial assistance from Caja Central to associations (millions).....	\$44. 6
Mortgage loans closed (millions).....	\$165. 0
Number of savings accounts.....	302, 000
Number of cooperative loans closed.....	9, 000
Number of mortgage loans closed.....	47, 500

*1969—raised to \$12,000 in 1969.

⁷⁶ Interview with Eneas Maza, Housing and Urban Development Advisor, Inter-American Development Bank.

⁷⁷ Interview with James Stang, Assistant Director of International Relations, National League of Insured Savings Associations.

^{77a} Op. cit., Wohl Report-67, pp. 16-17.

⁷⁸ Ibid., pp. 17-18.

⁷⁹ Ibid., pp. 25, 28.

⁸⁰ Op. cit., U.N. Draft-69, p. 70.

During 1968, the S. & L. system financed approximately 80 percent of the total number of homes built by the private sector. Over the past 8 years it has financed 56,500 homes, which, while not satisfying the yearly demand for new houses, is a substantial factor in alleviating existing pressures.⁸¹

Despite its deficiencies, the Chile savings and loan system has demonstrated that there is a sometimes unexpected capacity and willingness to save in developing countries. It has stimulated Chile's economic development and has expanded the housing stock. Finally, it is a moderately successful attempt at institution-building with external assistance. As an indication of continued U.S. confidence in the Chilean S. & L. system, in November 1968 a contract was signed between a U.S. savings and loan association and a Santiago association under the AID housing investment guarantee program. The U.S. association, Buckeye Federal, invested \$1 million toward the financing of lower-middle income homes up to the AID price ceiling of \$6,500.

The essential problem, for which at present the Chilean Government does not have a solution, is the lack of private financing. Capital inputs from the United States and Chilean Governments were intended as "seed capital" only, to provide the initial lending impetus and liquidity for an embryonic undertaking, and to substitute only temporarily for domestic savings. An adequate rate of domestic saving is the foundation of any housing finance system. Technical assistance is also of great importance. Recent OECD and U.N. appraisals of the Chilean savings and loan system agreed that additional specialized technical assistance is required to review interest rates, and to adjust maturities to the needs of mortgage holders. They also emphasized that a savings and loan system must not be used as a panacea to ease all housing problems.⁸²

(3) DOMINICAN REPUBLIC

a. Housing deficit

The Dominican Republic in mid-1968 had an estimated population of 4.03 million, indicating a 3.6 percent average annual population growth rate since 1960, the year of the last census. The heaviest population concentration is in the National District, which includes Santo Domingo, the capital, and a number of suburbs. The annual growth rate for this metropolitan area was 7 percent during the 1950's and about 6 percent during the 1960's. The latest censuses show a proportional decline in rural population due to migration to the cities, and chiefly to the capital. The rural population in 1950 represented 76.2 percent of the national total. In 1960 it accounted for 69.7 percent.⁸³ The population of Santo Domingo by 1970 will probably be about 650,000, as compared to 367,000 in 1960.⁸⁴

As in the case of Bolivia, pressure on urban areas has been less intense and less prolonged than in the rest of Latin America. Nevertheless, housing demand has been high, and facilities to serve the demand were virtually nonexistent prior to 1962. The survival of the S. & L. movement in the face of almost constant political turmoil

⁸¹ *Ibid.*, p. 71.

⁸² *Op. cit.*, DAC/OECD 1968 Review, pp. 225-226.

⁸³ *Op. cit.*, SPTF Eighth Annual Report, 1968, p. 138.

⁸⁴ *Op. cit.*, Kingsley Davis, *World Urbanization*, April 1969.

gives some indication of the potential for such activity in a more favorable political and economic climate. After 8 years of activity the system has expanded to ten associations with 21,255 savers. As of December 1968, savings amounted to over \$8 million, and 3,525 mortgages had been closed amounting to \$22.2 million.⁸⁵ In the absence of Government ability to aid the system in any significant way, loan financing has come from foreign sources, mainly U.S. seed capital assistance, and the development of an active, private, secondary mortgage market.

b. Creation of Dominican S. & L. system

Prior to the establishment of lower and middle income housing finance institutions, commercial banks extended mortgage loans for housing but imposed high interest rates and short amortization periods. Public housing institutions largely finance subsidized dwellings to serve the needs of the lowest income groups. The maximum sales price for a house under these programs is \$3,000. In this field, as with the S. & L.'s, organizational activity did not begin before 1962.⁸⁶

The Dominican savings and loan experiment began May 10, 1962 with the establishment of the National Housing Bank (BNV) as the regulatory agency for the S. & L. system. An AID loan of \$2.1 million was signed on January 2, 1963, to promote and develop mutual associations. The primary purpose of the system was to help the middle income class obtain financing for housing on reasonable terms. While savings promotion was exclusively on a free savings basis, the main purpose of savings attracted into the S. & L.'s has been to accumulate the down payment required to purchase a home. Most of the customers of the system—both depositors and borrowers—come from the lower middle income groups, i.e., those having monthly incomes ranging between \$150 and \$300.⁸⁷

c. Operation of Dominican S. & L. system

The most important functions of the BNV were designated as the following: (1) To complement the associations' resources for housing financing purposes; (2) to stimulate the organization and operation of associations where conditions are favorable; (3) to develop mortgage credit policies for the system; (4) to dictate rules and regulations; (5) to insure the savings accounts up to \$15,000 each; (6) to act as financial agent for the National Housing Institute (public housing agency); and (7) to act as insurer of the mortgage loans through an FHA System operating within the BNV. The Bank was made an autonomous institution to act as a liaison between the Government and the associations.

One of the strong points of Dominican middle-income housing finance is the loan insurance system. In both the Dominican Republic and Guatemala a separate agency similar to the FHA in the United States insures mortgages. In addition to the underwriting process of the FHA, the BNV also performs an underwriting function. This technique has attracted institutional and large individual investors seeking a higher return than that provided by savings accounts, who would otherwise invest outside of the home financing field.

⁸⁵ Op. cit., U.N. Draft-69, p. 91.

⁸⁶ Ibid., p. 91.

Op. cit., SPTF Eighth Annual Report, 1968, p. 145.

⁸⁷ Op. cit., U.N. Draft-69, pp. 87-89.

Rather than outright sales of mortgages to potential investors, the BNV offers "Certificates of Beneficial Interest", which are contracts of participation. These have the advantage of avoiding the long and costly process of transfer of mortgages. The key element of personal contact is retained, since the title stays in the control of the association which continues as agent of the investor. This innovation, backed by the FHA system, enabled the S. & L. system to grow without significant government assistance. Largely through this technique, the Dominican S. & L. system has attracted \$7.2 million worth of additional private investment into housing. The main source of private secondary mortgage financing has been the country's insurance companies, which after much urging by the Central Government, agreed to invest in the mortgages generated by the S. & L.'s. The Dominican example illustrates the value of independent mortgage insurance in creating an internal market for the sale of mortgages.⁸⁸

d. Economic environment

Certain characteristics of the Dominican situation have facilitated the growth of S. & L.'s in addition to the initiatives described above. First, inflation in the Dominican Republic is negligible; thus, the threat of currency instability does not discourage saving and secondary investment in mortgages. No readjustment of savings or loans is necessary and no such legislation exists. Second, pressures for urban social reform have not been as intense on the Balaguer regime in the Dominican Republic as on the Frei regime in Chile. In 1967, for example, Chile devoted 22.3 percent of total public sector expenditures to investment in housing, whereas in the Dominican Republic, the comparable proportion was 4.4 percent.⁸⁹ Limited Government programs for low-cost subsidized housing have consequently remained financially isolated from the middle-class housing finance programs of the S. & L.'s.

The progress of the Dominican S. & L. movement, coupled with Washington's apparent optimism as to the country's political and economic future, resulted in a second AID seed capital loan agreement, signed March 29, 1966.* Under the terms of the agreement the BNV was to receive \$5 million, half of which was to finance houses costing less than \$5,500, the rest to be used for financing homes the total cost of which was not to exceed \$8,625. Under Dominican S. & L. legislation, the maximum loan amount permissible is \$10,000 on homes, the total sales price of which must not exceed \$14,500 (including land value).⁹⁰

e. Current S. & L. policies

Mortgage limits under the Dominican S. & L. system are determined as follows: 90 percent for houses with a cost up to \$5,500; 85 percent for houses with a cost up to \$7,500; and 75 percent for houses with a cost ranging from \$7,500 to \$14,500. When the loan is for improvement purposes, the ratios are reduced to 70 percent, 65 percent, and 60 percent, respectively. The initial interest rate on mort-

*Loan repayment terms were 40 years at 2½ percent with a grace period of 10 years at 1 percent interest.

⁸⁸ *Ibid.*, pp. 20-21.

Op. cit., Elliot, *Financing Housing in Latin America*, 1968, pp. 133-134.

⁸⁹ Op. cit., SPTF Eighth Annual Report, 1968, p. 95.

⁹⁰ Department of State, Dominican Republic Affairs, taken from statistics of U.S. Department of Commerce and the Dominican Republic Government Budget.

⁹⁰ Op. cit., Elliot, *Financing Housing in Latin America*, 1968, pp. 133-134.

gages originating with the associations was $7\frac{1}{2}$ percent but was raised to 8 percent in 1968. The BNV, however, intends to raise the interest rate to 9 percent— $9\frac{1}{2}$ percent to conform with the present higher cost of money. The maximum amortization period authorized by law is 30 years, although the average is 20 years. The average sales price of houses mortgaged through the S. & L.'s has been \$7,000.⁹¹

Originally, S. & L.'s paid their depositors an annual dividend of 4 percent. In order to maintain a more competitive position with respect to other investment opportunities, S. & L.'s raised the annual dividend on demand savings accounts to 5 percent, compounded semi-annually, and established the alternative of time deposits (minimum of one year) which earn $5\frac{1}{2}$ percent per annum.^{91a} These rates compare with current commercial bank dividend payments of 4 percent on demand deposits, and $4\frac{1}{2}$ percent to 5 percent on time deposits.^{91b}

Most official observers of the Dominican S. & L. system are satisfied that its progress has been satisfactory, especially in view of the internal conflict the country has gone through since 1962. They agree, however, that the Central Government will remain unable to provide the S. & L.'s with any financial assistance, other than acting as an insuring agent of last resort. Thus, they conclude that for a faster and steadier development of the system external assistance is still required in both financial and technical fields. Savings promotion is especially important. There is general confidence in the management of the system and in the potential for increased private capital participation, given a continuance of relative economic and political stability. Such assistance was forthcoming under the AID housing guarantee program, discussed in greater detail below. Three guarantee agreements—totaling \$4.15 million⁹²—were signed with Dominican S. & L.'s on April 30, 1969, to finance lower-middle income housing.

(4) ECUADOR

a. Housing situation

According to the 1952 census, Ecuador had a population of 4.5 million inhabitants. The estimated population in 1968 was 5.7 million, indicating an average annual rate of growth of 3.4 percent. With 54 inhabitants per square mile, Ecuador is one of the most densely inhabited countries in South America, although its population is very unevenly distributed throughout the national territory. While the population is still predominantly rural, urban growth over the 1950–1962 period was 4.5 percent, higher than the national rate of population growth. In 1962 the urban population constituted 36 percent of the total. Internal migration has largely been to the two most important cities, Quito and Guayaquil. Guayaquil in 1965 had an estimated population of 600,000, and Quito, the capital, an estimated 400,000.⁹³ Poverty is widespread with the exception of a small group of very wealthy people and a limited but rapidly growing middle class. In

⁹¹ Quarterly Statistical Report, NLISA, April 1969, No. 40.

^{91a} Op. cit., Elliot, *Financing Housing in Latin America*, 1968, p. 133.

Op. cit., U.N. Draft-69, p. 88.

^{91b} Department of State, Dominican Republic Affairs, taken from statistics provided by the Dominican Republic Embassy.

⁹² AID-Latin American Housing Guaranty Program Summary Sheet, Mar. 31, 1969 (revised), sec. B.

⁹³ Op. cit., SPTF Eighth Annual Report, 1968, p. 152.

Report for AID on Mortgage Market in Ecuador, L. Douglas Meredith and Roland H. Cook, July 17, 1965, p. 1 (unpublished).

such a primitive socio-economic situation, a tremendous need for housing exists. In 1962 Ecuadorian authorities estimated that approximately 563,000 dwelling units were substandard, or about 50 percent of all housing.⁹⁴

Mortgage loans were known and used in Ecuador prior to 1962. However, housing programs were handled in a sporadic manner. A few projects were built in Quito and Guayaquil through the Reconstruction Board and the Social Assistance Agency. The National Housing Institute was unable to perform at capacity due to inadequate resources.⁹⁵ Commercial bank housing loans followed the traditional pattern of high interest rates, large downpayments, rapid amortization, and very limited loan volume.

b. Formation of S. & L. system

The Ecuadorian Housing Bank (BEV), a semiautonomous government agency, was founded March 26, 1961, in anticipation of a loan of \$5 million from the U.S. Development Loan Fund to establish a nationwide mutual savings and loan system. Aside from encouraging the organization of mutuals, the main objective of the BEV was "to develop a credit policy * * * through the accumulation and provision of funds intended for construction and improvement of medium and low-cost homes."⁹⁶ The authorized operations of the BEV included:

(1) Granting of medium and long-term loans to mutual associations, credit and housing cooperatives and other institutions for the purpose of providing loans for construction, purchase or improvement of low and medium cost houses.

(2) Obtaining funds through loans from domestic or foreign financial organizations, issuing bonds and engaging in other transactions recognized by law.

(3) Creating, maintaining and regulating insurance for deposits, life, fire hazard and mortgage loans granted by the mutual associations, or by the Bank (BEV).*

(4) Planning and proposing the development of housing and urbanization projects.

(5) Constructing housing and urbanization projects directly or under contract.

(6) Deciding when necessary the readjustment of deposits and loans granted by the BEV, the mutual associations, and housing cooperatives by determining the readjustment rates in connection with the fluctuation of the buying power of local currency.⁹⁷

With regard to the last provision, the Ecuadorian *sucre* has been relatively stable since 1961, with the wholesale price index rising at an average rate of 2.2 percent per year between 1961 and 1967.⁹⁸ For this reason readjustment has not been applied to savings or loans, and regulations for such a contingency have not yet been approved by the Superintendency of Banks.⁹⁹

*For this purpose the BEV established its own insurance department and set up an insurance fund for deposits, mortgages, and other risks.

⁹⁴ *Ibid.*, p. 2.

⁹⁵ *Op. cit.*, SPTF Eighth Annual Report, 1968, p. 158.

⁹⁶ *Op. cit.*, U.N. Draft-69, p. 97.

⁹⁷ *Op. cit.*, Meredith-Cook, Report, July 1965, p. 3.

⁹⁸ *Op. cit.*, Elliot, *Financing Housing in Latin America*, 1968, p. 135.

⁹⁹ *Op. cit.*, U.N. Draft, pp. 98-99.

⁹⁵ *Op. cit.*, SPTF Eighth Annual Report, 1968, p. 158.

⁹⁶ *Op. cit.*, U.N. Draft-69, p. 99.

c. AID seed capital loan

The AID \$5 million seed capital loan to the BEV was signed on October 31, 1961, and operations under the agreement commenced in April, 1962. The loan was extended for 25 years at 4 percent. The Ecuadorian Social Security System also subscribed to \$5,525,000 of capital of the BEV. To secure its subscription, mortgage paper was put in escrow as collateral. Under the AID program, the BEV made deposits in the S. & L.'s; 75 percent of the Bank capital used for this purpose originated in the AID loan. The Bank was also authorized to purchase mortgages outright from the S. & L.'s, and thus serve as a "reserve bank" to backstop the associations in a manner similar to that in which the U.S. Federal Home Loan Bank Board serves its members.¹⁰⁰

The special need for low-cost housing in Ecuador was reflected in the price range of housing eligible for financing under the AID program. Loans were made for up to 90 percent of total value and ranged from \$1,650 to \$4,400 from 1963-1967 (the duration of AID loan disbursements). The maximum loan amortization period was 25 years at an annual interest rate of 7 percent plus an insurance rate of 1 percent.^{101 *}

Following the pattern of other Latin American countries, savings generated by the S. & L.'s came principally from those seeking to establish their eligibility for a low-rate, long-term mortgage. Consequently, the funds available to the S. & L.'s were far from adequate to meet the loan demand. This condition developed in part because the BEV could only advance funds at a ratio of three to one of savers' deposits. From 1963 to 1967 BEV financial aid to the mutual associations averaged \$143,014 per month (about \$1.7 million per annum).

December, 1964, represented high water mark for S. & L. development in Ecuador, at least from the standpoint of the system's capacity to mobilize new domestic savings. Thirteen associations had been organized with a total savings of \$2.4 million. The number of homes financed under the S. & L. program was 1,638. However, by June, 1965, although the number of new savings accounts increased from 10,610 to 12,286, the volume of deposits dipped to \$1.51 million. From June, 1965 to March, 1966, a net total of only 560 new savings accounts were added while during the same period, net savings totals dropped to \$1.37 million. Thus, in 1964, Ecuadorians were saving one *sucre* for every four invested in new housing. By March, 1966, the ratio was 1:6. It was clear that participants in the system had shown a greater interest in the associations' capacity to provide home financing than they had in building the savings base needed to sustain that capacity. As a result, the onus of meeting home mortgage demands shifted progressively to the BEV.¹⁰²

*In July, 1967, lending legislation was changed for S. & L.'s to include loans up to \$6,600 and up to 80 percent of property value, including land. Maximum term remained at 25 years, however, the annual interest rate was raised to 9 percent plus the 1 percent insurance charge. In addition, the prospective homeowner had to open and maintain a savings account for at least 6 months prior to the application for the loan. In order to be granted a loan, the savings account had to stay open with at least an amount equal to 10 percent of the selling price of the house.

¹⁰⁰ Op. cit., Meredith-Cook Report, July 1965, pp. 3-4.

¹⁰¹ Op. cit., U.N. Draft-69, p. 102.

¹⁰² Ibid., p. 101.

^{*}p. cit., Elliot, *Financing Housing in Latin America*, 1968, pp. 136-137.

Between October, 1967 and mid-1969, the BEV was only to provide about \$165,000 in financial aid to the mutual associations. This is about one-tenth of the aid given in previous years. The BEV was not able to continue giving assistance at the previous rate because all of the 1961 AID loan had been fully disbursed and used by September, 1967.^{102a}

Aside from this financial burden, which was becoming increasingly difficult to handle, the BEV was called upon to administer the low-cost housing program of the Inter-American Development Bank. In July, 1962, the IDB signed a loan with the Bank for \$10.6 million to finance a program of housing construction and rehabilitation for low income families; i.e., those whose incomes were under \$100 a month. The maximum cost of any home to be financed out of IDB funds was \$3,000. (In the Dominican Republic, such IDB activity was handled entirely by a separate low-cost housing agency.) In 1965 approximately 80 percent of BEV time and personnel were devoted to this responsibility at the expense of its other activities.¹⁰³

d. Secondary mortgage market

Another of the responsibilities of the BEV was the creation of a secondary mortgage market. To date, however, progress has been very limited, primarily because of inadequate insurance for potential investors and because of the questionable stability of the government of Ecuador. The tenuous economic situation in this agricultural country also raises the possibility of wide fluctuation in the value of the *sucre*. Since provisions for readjustment have not been widely advertised, the deterrents are greater than the incentives for private investors. Without additional external assistance, the only alternatives for providing the associations with liquidity are BEV purchases of mortgages from the S. & L.'s or additional private deposits.¹⁰⁴ The potential for the first alternative is limited due to the already burdensome obligations weighing on the meager resources of the BEV. The second alternative is a doubtful possibility, because incentives for private savings are lacking and other sources of investment yield higher returns.

Originally the associations paid 4 percent interest on demand deposits which matched the rate paid by commercial banks. The latter, however, had already obtained the confidence of the saving public and there was little motivation—other than the desire for home-ownership—to change to an unproven institution. The government introduced another significant source of competition through its issues of “bonos calificados.” These are government obligations sold by the Treasury that bear 8 percent interest, are tax-exempt, and are redeemable on demand. This practically riskless security established the basis for the entire money market, and other rates were related to it. “Bonos calificados” provided almost insurmountable competition for savings and loans. Few savers would commit their funds at lower rates and for given terms when such an attractive alternative investment was available.¹⁰⁵

^{102a} Op. cit., U.N. Draft-69, p. 101.

¹⁰³ Op. cit., Elliot, p. 135.

Op. cit., Meredith-Cook Report, July 1965, p. 5.

¹⁰⁴ Ibid., pp. 4, 6, 11-13.

¹⁰⁵ Ibid., pp. 4, 10.

To improve the competitive position of the S. & L.'s, the Government in September, 1968, authorized an increase in annual dividends to be paid by mutual associations to 5 percent on savings accounts and to 6 percent on time deposits of more than 6 months. The commercial banks were restricted to paying 4 percent on demand deposits and 6 percent on time deposits of more than one year. Despite this new advantage for the S. & L.'s, by mid-1969, 94 percent of the Nation's savings deposits were still in the commercial banks, while only 6 percent were in the mutual associations.* Commercial banks have indicated their lack of concern about the rate differential by pointing out that, "depositors have greater confidence in private commercial banks."¹⁰⁶

e. Current operation of S. & L. system

In 1968 there were 9 mutual associations in operation in Ecuador. These associations had approximately 20,000 savings accounts totaling \$2.9 million and had financed 3,200 homes. The system has been financed through the following sources:¹⁰⁷

Sources	Amount	Percent of total
National Social Security Bank.....	\$5,470,297.02	21.00
Foreign Loan 19-TF/EC-BID (July 23, 1962).....	10,600,000.00	41.50
Foreign Loan 213-A012-AID (Oct. 1, 1961).....	5,000,000.00	19.50
Allotment from the Government of Ecuador.....	4,011,634.75	15.60
Transference from the former National Housing Institute.....	422,440.98	1.60
Donation from "Point Four" and "CARE".....	199,806.35	.80
Total.....	25,704,179.10	100.00

Several promotional plans have been advanced to develop local financing, but none as yet have been implemented.

Further U.S. assistance to the development of the Ecuadorian savings and loan system has been proposed under the seed capital loan program and the housing guarantee program sponsored by AID. Because of pessimism at higher levels of the Agency regarding the potential of the system, and because of general reductions in U.S. aid funds, none of these proposals have been approved.¹⁰⁸

The savings and loan movement in Ecuador has developed very slowly. While the number of savers and the number of homes financed has almost doubled since December 1964, the volume of savings has remained approximately the same. The lack of ability to attract private capital indicates the need for more aggressive management to overcome the competition of bonds issued by the Central Bank. But the most difficult obstacle to surmount is the lack of public confidence in the associations and the BEV. The failure of confidence is at least partially due to the double function exercised by the BEV:

*The comparable proportions of savings deposits in the United States, as of December, 1968, is approximately 33 percent held in savings and loan shares, and 51 percent held in commercial banks. The remaining 16 percent of private U.S. savings deposits are in mutual savings banks.^{106a}

¹⁰⁶ Op. cit., U.N. Draft 69, p. 103.

^{106a} Economic Indicators, July 1969, (U.S. Government Printing Office), p. 30.

¹⁰⁷ Op. cit. U.N. Draft 69, pp. 100-101.

¹⁰⁸ Op. cit., Harold Robinson, Housing and Urban Development Programs, October 1, 1967.

(1) Providing subsidized housing to low-income groups, and (2) managing mutual associations created to aid lower-middle and middle-income families able to support mortgage indebtedness.

In trying to serve the demands of both sectors, the BEV has succeeded in satisfying the needs of neither. The Government has given top priority to obtaining funds from foreign sources, mainly from AID and the IDB to finance its multiple housing programs. Consequently, the attraction of savings has not been given adequate attention. Recent legislation makes it compulsory for commercial banks to invest a percentage of their savings accounts in mortgage bonds issued by the Ecuadorian Housing Bank. Although this move will provide some liquidity for the system, and is an indication of Government concern with improving housing finance conditions in the country, the essence of the problem continues to be the lack of new free savings coming into the system via actual deposits and the secondary mortgage market.¹⁰⁹

Observers from the United Nations Center for Housing, Building and Planning, as well as U.S. savings and loan experts, have all recommended that increased financial assistance be channeled to the Ecuadorian savings and loan system in order to insure its liquidity. At the same time, these analysts recommend that such assistance be given only if accompanied by comprehensive technical advice on management methods.¹¹⁰ AID officials are hesitant to approve additional seed capital loans until these technical and administrative problems have been resolved. They nevertheless feel that the system will continue to progress slowly, given the demand for housing finance that only S. & L. institutions can satisfy.

(5) PERU

a. Housing demand

According to the 1961 census, the population of Peru was 10.3 million. The population is estimated to have increased at a cumulative rate of 3.1 percent a year, reaching a total of 12.8 million inhabitants in 1968. Average density for the entire country was 26 inhabitants per square mile in 1968, somewhat less than the average density for Latin America as a whole. But the concentration varies considerably from region to region. Rural migration to the cities has become significant during the last two decades. Only 31.2 percent of the population lived in urban areas in 1950, but in 1965 this percentage rose to 44.1 percent and is expected to reach 50 percent in 1970. The population of Lima, the capital, increased from 590,000 in 1940 to 1,436,000 in 1961, constituting 14.5 percent of the national total.¹¹¹

The 1961 census recorded about 2 million family housing units in Peru, of which 953,000 were in urban centers. On this basis, and taking into account population growth and the number of houses becoming obsolete during the period, it was estimated that the country should construct an average of 70,000 units a year up to 1970.¹¹² Official Peruvian sources estimated the national housing production of 1960 at about 10,000 units.¹¹³

¹⁰⁹ Op. cit., U.N. Draft-69, p. 103.

¹¹⁰ Ibid., p. 103.

Op. cit., Meredith-Cook Report, July 1965.

¹¹¹ Op. cit., SPTF Eighth Annual Report, 1968, pp. 272-273.

¹¹² Ibid., p. 279.

¹¹³ Op. cit., Elliot, p. 69.

In 1958 home financing institutions in Peru were at about the same stage of development as they had been in the United States a hundred years earlier. Commercial banking was established, but thrift and home mortgage banking was sadly inadequate, almost nonexistent. The few mortgage loans that were made carried interest rates up to 25 percent or more. The Central Mortgage Bank of Peru, which had been operating since 1926, had lent primarily to builders of large-scale real estate and residential construction projects, and had not attempted to satisfy the needs of middle and lower income groups. Nevertheless, as of 1960, nearly 85 percent of total housing investment in Peru came from private sources.¹¹⁴

b. Early savings and loan activities

The first step toward a comprehensive national housing policy was made in 1957 when a Supreme Decree was issued to enhance the role of the private sector housing finance. The promotion of housing co-operatives and mutuals was an immediate objective. By virtue of this decree, the Peruvian Mutual Savings and Loan Association came into being in September 1958, under the auspices of a National Housing Fund. But by January 1960, the association had accumulated less than \$1 million in deposits, and had failed to approve its first mortgage loan. During 1960, Peruvian Mutual received a local currency loan from AID (Public Law 480 sales program) equal to \$1 million as seed capital. Its total portfolio after more than three years of business was only 21 mortgage loans.^{114a} Lack of institutional precedent has been cited by AID officials as the main reason for its slow progress.

At this point, a U.S. technical assistance banking team and the Peruvian Government called on the services of Father Dan McClellan, an American priest who had been working in the Peruvian credit union movement since 1955. The *Washington Star* described his activities prior to 1961 as follows:

When Father McClellan was first assigned to the village of Puno, a 13,000-foot-high Andean town * * * most of the 35,000 people there were almost uniformly shoeless and illiterate, and only 2 percent of them had access to credit. If they had to borrow from the * * * loan sharks, for anything from a funeral to roof repair job, the interest rates ranged up to 80 percent.

"Nobody believed these people could save," said Father McClellan. But he got 23 of the villagers to dig up their life savings of about \$24 each and talked them into forming a credit union. The villagers were able to borrow money at 1 percent monthly interest for such enterprises as a shoe business, a supply of seed, or any emergency.^{114b}

With the expansion of his credit union experiment, Father Dan had won such popular favor that he had become a hero to the common people from Puno to Lima. In 1961, he received a loan of \$1 million from the Inter-American Development Bank for his enlarged Central Credit Union. His success with smaller projects led him to consider further expansion of credit union activities to cover home financing. He stated his philosophy in the following manner:

¹¹⁴ *Ibid.*, pp. 73, 76.

Raymond P. Harold, "A Report on Home Financing and the General Problems of New Housing and New Capital Formation in Peru," 1959, p. 2.

^{114a} *Op. cit.*, Elliot, p. 80.

^{114b} *Washington Star*, October 5, 1964, "U.S. Priest Helps Peru Help Itself by Savings."

None of these people wants charity. These families have an average income of \$125 a month. We build them houses, good houses, where they can live in dignity and charge them 25 percent of their income.^{114c}

The Central Credit Union, in fact, became a very important source of housing credits. By 1963 it had made available some \$300,000 to 27 local credit cooperatives which had approved 306 cooperative housing loans. By 1965, just short of \$1 million had been added to earlier investments in housing by the Central Credit Union.

Father Dan decided to follow the suggestions of U.S. and Peruvian technical experts that he supplement his credit union activities with a full-fledged savings and loan association. In January 1961, the charter was granted to Father Dan, authorizing him to form the People's Mutual Savings and Loan Association. The following year, in July 1962, the Inter-American Development Bank signed a \$1 million loan with People's Mutual for the purpose of financing low-cost housing in Lima.

It is doubtful that Father Dan could have expanded his savings and loan activities as rapidly without such external assistance. One AID official has stated that Father Dan was actually given preferential treatment by AID and the IDB over other incipient S. & L.'s because of their belief in the potential of his leadership. To them the man who had come to symbolize the spirit of "cooperativismo" in Peru had also become the chief promoter of savings and loan institutions.^{114d}

c. Creation of a savings and loan system

In November 1962, the National Housing Bank was created to replace the old National Housing Fund. It was empowered to channel all available streams of investment into home financing, to accept savings deposits, to approve loans, and to issue bonds as a means of raising funds for construction. It was also authorized to make all types of home loans and to foster mutual housing finance institutions, the only type authorized to operate in Peru. The National Housing Bank was to serve as the Peruvian counterpart of the U.S. Federal Home Loan Bank in that it licensed, supervised, and stipulated operating regulations for the nation's savings and loan associations.¹¹⁵

Half of the Bank's initial "seed" capitalization of \$15 million came from an AID loan (July 1961), and half from the Peruvian Government. Advisors furnished by the United States under its technical assistance program helped found new institutions in the provinces as well as develop national legislation. In addition to serving the needs of middle-low income housing finance through the savings and loan system, the Bank was also given the responsibility of administering the AID Housing Investment Guaranty Program (\$21 million); a \$10 million cooperative housing program which included a \$6 million AID loan (June 1965); a save-by-mail system; and a home mortgage insurance program.¹¹⁶

^{114c} Ibid.

^{114d} Raymond P. Harold and Joseph T. Benedict, "Report on Savings and Loan Associations in Peru," February 1963, p. 9.

Op. cit., Elliot, pp. 81, 98.

¹¹⁵ Ibid, pp. 73, 75.

¹¹⁶ Ibid, pp. 7-9.

Father McClellan aided in developing public confidence in the new S. & L. system. Only one association was operating before McClellan became involved in January, 1961. Two others were formed that year, six in 1962, four more in 1963 and five more in 1964 and 1965. The established associations had taken in by the end of 1961 new net savings totaling 11,658,000 *soles* (approximately \$435,000). People's Mutual had obtained 66 percent of the total. New net savings by the end of 1962 was 32,063,000 *soles* (approximately \$1.2 million) of which 67 percent had been deposited with McClellan's institution. These two years marked the "take-off" period of Peruvian savings and loan activity. With new confidence in S. & L.'s generally, and a nationwide increase in savings during subsequent years, the percentage of capital in People's declined somewhat.¹¹⁷

The reason for the decline in ratio of savings at People's Mutual was its lack of liquidity for making home mortgage loans. By November, 1964, People's faced a backlog of 6 months in approved loan applications. This problem stemmed primarily from the difficulty in securing funds from the National Housing Bank. The responsibilities of the latter had become so diverse that it had begun to neglect the S. & L.'s, especially Father Dan's institution. One U.S. expert described the situation as follows:

* * * in certain instances the National Housing Bank has, in fact, become directly competitive with the housing and home finance facilities it was created to assist. By administering the AID Housing Guaranty Program, the Bank invites U.S. builders whose edge in experience and knowledge is difficult for Peruvian contractors to match. Its cooperative housing program competes with, more than it supplements other cooperative activities in the country. Its mail saving program and insurance activities place the Bank in a position of dealing in those areas which would normally be reserved to its own associations.¹¹⁸

Thus, People's Mutual was forced to turn to the Inter-American Development Bank again in 1964 to provide liquidity to continue its operations. A loan for \$1.2 million to People's was finally signed in August, 1965, after much haggling between the parties concerned over which agency would administer the funds, the National Housing Bank or People's. The loan terms were standard for an IDB housing loan; i.e., twenty years at 2 percent.

d. Operating problems of savings and loan system

By 1965, it became clear that although savings were being attracted into the system in substantial volume, if the mortgage market was to function effectively, new sources of funds would have to be found.* In late 1964, the Central Mortgage Bank (CMB), a mixed government-private entity, announced its intention to raise the dividend rate of tax-free Government-guaranteed mortgage bonds to 9 percent. The dividend increase was designed to attract savings from com-

*As of June, 1965, Peru had 19 associations with 65,429 savers. Total net savings amounted to \$21,552,000. The system had financed 6,827 new homes amounting to \$27,638,000 in recorded mortgages.¹¹⁹

¹¹⁷ Op. cit., Elliot, p. 82.

¹¹⁸ Ibid., p. 87.

¹¹⁹ Savings and Loan Progress Report, NLISA, No. 25.

mercial banks. The desired results did not occur and savings were actually drawn from the S. & L.'s.* The CMB also competed with the mutuals in that it loaned directly to individuals who wished to buy or build. The terms of CMB loans (75 percent of sales value and 10-12 percent interest) confined its clientele to higher income brackets than those generally served by the S. & L.'s. Nevertheless, by functioning as a primary lender, its secondary market activities were limited. U.S. technical assistance teams felt that the activities of the CMB should be restricted to that of forming a secondary mortgage market in the manner of the U.S. Federal National Mortgage Association, rather than entering the market as a primary lender. These experts also suggested that efforts be made on the part of the Peruvian Government to channel funds from insurance company assets, social security reserves, and business profits into the mortgage market.¹²⁰

No independent FHA-type mortgage insurance program was stipulated under Peruvian S. & L. legislation. In 1965, a U.S. team of S. & L. advisers felt that such a system was not absolutely necessary in view of "ever-increasing real estate values and other inflationary aspects (which provided) an ample measure of protection to investors against loss on defaulted mortgages." They noted, however, that such favorable conditions might not last indefinitely, and that a properly administered insurance program would facilitate the placing of *cedulas* secured by insured mortgages in local and international markets. Such a development, they suggested, would require an expanded technical assistance program to assure adequate implementation. Provision for an FHA was made part of a subsequent loan agreement, but has never been implemented. The same experts noted that the lengthy and complicated nature of mortgage procedures should be simplified to accommodate sales in a secondary mortgage market. Here again, additional technical assistance was recommended.¹²¹

The U.S. team also urged greater cooperation and coordination among the major agencies involved in savings and home finance; i.e., the Central Mortgage Bank, the National Housing Bank, and the National Housing Board (the institution responsible for the formulation of housing policies and the control of subsidized housing finance). They reiterated the point that continued growth of the S. & L.'s could be expected if there were no competition from the CMB for small savings. The liquidity problem had become acute for most associations, particularly in Lima, with the demand for loans far exceeding available resources. Without recourse to an active secondary mortgage market, efforts continued to center around obtaining additional loans from AID and other outside sources.¹²² In February 1965, these efforts resulted in a second AID loan to the S. & L.'s, for \$6 million, designated for cooperative housing finance. The recorded difficulties in coordinating the distribution of available liquid resources between the National Housing Bank and the S. & L.'s were repeated during the implementation of this loan.

*Interest on CMB savings and *cedulas* (certificates backed by mortgage paper) was fully tax deductible if not withdrawn for three years. These provisions applied to both individuals and corporations. For deposits of 3 years or more, S. & L.'s paid 7½ percent interest under the same conditions.

¹²⁰ Report for AID on Mortgage Market in Peru (Hershel L. Greer & Frank H. Pence), August 2, 1965, pp. 5-6, 8-10, 11, 17-18.

¹²¹ *Ibid.*, pp. 11-12.

¹²² *Ibid.*, pp. 14, 16.

AID auditors have also noted several violations of the 1965 agreement in the area of using loan funds for the purpose of financing non-cooperative housing. Such violations have adversely affected the lower income groups. Little action has been taken by AID to remedy the situation in view of the difficulties involved in applying sanctions once loan funds have been disbursed.

e. National economic complications

Continuing inflation after 1965 increased the possibility of devaluation of the *sol*. U.S. observers warned that in the absence of stronger anti-inflationary controls, construction and other costs probably would continue to rise. The Peruvian Government had considered adoption of a mortgage escalation clause (or maintenance-of-value reserve) similar to that used in Chile, but discarded the idea because it was not judged particularly effective. In view of the lack of urgency of the monetary situation in Peru at the time, the AID consultants were not adamant about the insertion of a readjustment clause into the S. & L. legislation.¹²³

Soon after the above evaluation of the Peruvian S. & L. system was made, financial conditions in the country began to deteriorate. In 1967 the growth rate slackened, due to a sharp drop in the production of farm commodities for export (attributed to a severe drought), diminished construction activity, and a reduced rate of private and public investment. Inflation, led by rapid increases in food prices, and government fiscal imbalance accompanied these conditions. In September, 1967, to promote domestic stabilization and to qualify for international financial assistance, the Peruvian Government devalued its currency from 26.80 *soles* per dollar, a rate which had prevailed since 1959, to 38.70 *soles* per dollar in the exchange certificate market, and by the end of 1967 the quotation in the free market was over 40 *soles* per dollar. The cost of living rose by 20 percent in 1967, compared to 15 percent in 1965 and 8 percent in 1966. Inflationary pressures adversely affected saving in the banking system. Savings deposits in local currency declined by 3 percent in 1967, whereas deposits in foreign currency increased by 23 percent in that year. Bonds, certificates, and deposits in mutual savings and loan associations increased annually by approximately 35 percent in 1967 and 1968, compared to increases of over 100 percent in each of the two preceding years.¹²⁴

The stabilization program improved economic conditions to some degree in 1968, but the military coup d'etat in October of that year produced political as well as economic uncertainty affecting the investment climate. U.S. savings and loan experts visiting Peru reported that progress in the Peruvian savings and loan industry had also been retarded by these developments.

f. Recent developments in Peruvian S. & L. system

Despite these unsettling circumstances, the Peruvian Government has not yet instituted a readjustment mechanism for savings or mortgage loans. Only those mortgages financed by funds from future loans under the AID guarantee program will include a readjustable mortgage clause, and this provision was inserted only upon the insistence of AID officials.¹²⁵

¹²³ *Ibid.* p. 19.

¹²⁴ *Op. cit.*, SPTF Eighth Annual Report, 1968, pp. 273, 278-279.

¹²⁵ *Op. cit.*, U.N. Draft 69, p. 170.

Other incentives to saving, however, have been added. Dividend rates have been modified so that regular savings passbook accounts are now credited at 6-percent interest, and time deposits (1-year minimum) receive 9-percent annually. Most of the savings account customers are of the lower-middle income group, whereas time deposit customers are only of the high-income group. The attraction of the latter into the savings system is an advance since 1965. Other incentives to save include lotteries held by the individual S. & L.'s in which the "ticket" is a new savings account and the prize is a new home, tax-free dividends on savings accounts, and exemption from real estate taxes for 5 years on new properties financed within the system.¹²⁶

A mortgage insurance system is currently under study by the National Housing Bank. Although the law which created the Bank required the organization of an FHA department, no such facility has been created. Mortgages originating within the savings and loan system are not specifically guaranteed by the Bank, although it is responsible for the regulation of mortgage loans and for the complete operation of the system. In the past, when an association was beset with financial problems, the Housing Bank made good its liabilities. Branches of the Housing Bank even operate as savings and loan associations where the risk for the operation of a private association appears to be too high. To date, 23 associations, including the temporary branches of the National Housing Bank, have been chartered. Of this total, eight associations operate within the Lima metropolitan area, and 13 operate in the provinces.¹²⁷

The Peruvian Government has provided the largest portion of working capital financing the National Housing Bank's activities. Payments on mortgages purchased from the associations or granted by NHB branches constitute a limited secondary source of funds. Since its inception, the Housing Bank has also been receiving financial assistance from AID and the IDB in the form of "seed capital" for general relending purposes and specific projects. Such contributions totaled \$15.7 million from 1961 to 1965. As of January 31, 1969, mortgage loans granted by the system numbered 18,817 and totalled \$65,630,182 in aggregate value. As of December 31, 1968, the system had attracted \$34,995,558 in savings accounts and \$20,912,391 in time deposits. Thus a total of \$55,907,949 had been accumulated in savings.

The gap between savings and loans has been financed by the National Housing Bank. Forty percent of Bank loans to S. & L.'s is earmarked as seed capital, and the remaining 60 percent is loaned with a collateral guaranty of individual mortgages. Other sources of local working capital for the associations are (a) the new savings and time deposit accounts; (b) interest and principal payments on outstanding mortgage loans;* (c) the margin between interest paid to

*In general, loans originating within the system have been used for the construction, purchase, and/or improvement of homes and have been limited to a maximum of \$6,833 or to 90 percent of the appraised value of the property. Amortization periods have ranged from 5 to 20 years. Interest rates of 11 percent to 12 percent reflect the generally high cost of money in Peru. Despite the cost, such long-term financing has been directed to the lower middle-income groups.

¹²⁶ Ibid., pp. 168-170.

Robert B. Speckles in *National League Journal*, vol. 23, No. 10, October 1968, p. 53.

¹²⁷ Op. cit., U.N. Draft-69, pp. 167-169.

the Housing Bank for loans received and the rate on the individual mortgages financed with the Bank's funds; and (d) the administration fee collected on mortgages sold to the Housing Bank or on mortgages administered by the association as fiduciary agent when AID sponsors specific projects.¹²⁸

g. Evaluation of Peruvian system

Despite recent setbacks due to political and economic disturbances, the Peruvian savings and loan system has been cited as one of the most effective systems developed in Latin America in the past 6 years.¹²⁹ In part, one might say that the initial success of the movement, which established public confidence in a not-so-perfect system by U.S. standards, could be attributed to a series of fortuitous circumstances. The brunt of foreign assistance inflow and Central Government support coincided with the emergence of a charismatic leader of cooperative development, Father Dan McClellan, on the one hand, and a period of economic progress and relative monetary and fiscal stability, on the other. Before Father Dan participated actively in the organization of the nationwide movement, the original agencies established under Peruvian legislation had little impact on housing finance or success in attracting savings. Father Dan brought into the S. & L. experiment the management experience gained from 6 years of trial and error in the Peruvian credit union movement. He also enjoyed the confidence of lower income groups who had benefited from his earlier efforts.

Secondly, despite the duplication of effort and competition between Government agencies managing S. & L.'s, none were saddled with the major burden of low-cost subsidized housing and with those groups totally incapable of participating in housing finance. Subsidized housing has been handled by the National Housing Board, which finances projects to improve or eradicate squatter settlements inhabited by the lowest income class.¹³⁰ Thus, the savings and loans were not weakened by having to deal with a multiplicity of low-cost housing projects, as has been the case in Chile and Ecuador.

Although the growth of savings and home finance activities in Peru has been substantial, certain revisions in the system are required to maintain its momentum in the face of adverse political and economic conditions, and cutbacks in foreign assistance. With respect to the latter, after four "seed capital" loans to the S. & L.'s by AID and the IDB since 1961, it seems unlikely that further assistance of this type will be granted Peru in the near future. The reasons for this policy change are discussed in the next section. Proposed contracts to Peruvian S. & L.'s under the AID Housing Guaranty Program have been held up recently because of political difficulties with that country. Despite recent austerity measures taken by the military government * a high rate of inflation has continued to plague Peru since

* Peru is currently facing a general economic slowdown that is partly attributable to Government actions designed to hold down demand and reduce inflation. The cost of living increase was approximately 10 percent from July 1968 to June 1969, compared with 10 and 19 percent, in the respective 12-month periods ending June 30, 1968 and 1967. On June 14, 1969, the Government implemented price controls on certain basic foods.¹³¹

¹²⁸ *Ibid.*, pp. 169-171.

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*, p. 167.

¹³¹ *International Commerce*, July 14, 1969, p. 16

the severe fiscal setbacks of 1967. The devalued currency continues to hover over 40 *soles* to the dollar on the free market. Until these factors are brought under control, Government action in backstopping the operations of the S. & L.'s cannot be as generous as in previous years. The system must therefore draw its working capital almost exclusively from savings, mortgage repayments, and a weak secondary market.

It seems desirable that steps be taken to institute effective mortgage insurance (preferably along FHA lines) and a maintenance of value mechanism for S. & L.'s in order to maintain public confidence in an independent savings and loan system. Such measures would facilitate the task of promoting saving, as suggested by U.N. Housing Centre observers,¹³² and stimulate activity in the secondary mortgage market.

These reforms, plus the need to improve the performance of middle and low-level personnel within the system (also cited by U.N. analysts), require a stepped up program of technical assistance to the Peruvian savings and loans, as well as to those semiautonomous government agencies responsible for managing the system. Over the past 5 years such assistance has been erratic and inefficient. Increased financial inputs without such expert advice on a continuing basis would simply perpetuate the weaknesses of the current arrangement.

The steady rise in savings volume in the midst of the unsettling circumstances of the past 2 years attests to the strong motivation among the lower- and middle-income population of Peru to place their earnings in accessible financial institutions.* Although the number of homes actually financed during the 8 years of S. & L. activity has been small (21,600) when compared to the total estimated annual need (70,000), the contribution of personal savings generated to finance these homes, and the habits of thrift thus imparted, have greatly enhanced the potential for private participation in development financing on a national scale.

E. Nonmutual Savings and Loans in Latin America

The foregoing case studies have included countries which have participated in U.S. and Inter-American Development Bank assistance programs to develop a savings and loan system for housing finance. They were chosen because they illustrated various degrees of success in implementing such a program and because they demonstrated the range of problems faced by underdeveloped countries, particularly in Latin America, in establishing such institutions. Aside from common sources of external assistance, all these programs have one characteristic in common—their S. & L. systems are all based on the mutual form of organization reflecting the advice and biases of AID consultants.

Recently some U.N. as well as AID observers have suggested that this approach is impractical in view of the limited private resources in

*In the provincial areas, where there are no permanent savings and loan offices, the offices go to the savers through traveling installations that tour the countryside. ¹³³

¹³² Op. cit., U.N. Draft-69, p. 172.

¹³³ Op. cit., Robert B. Speetles in *National League Journal*, vol. 23, No. 10, October 1968, p. 53.

Latin America and the need to use all effective organizational methods to attract savings and investment funds into housing finance.¹³⁴ These advisers support the authorization of capital stock S. & L.'s to operate in the Latin American savings and mortgage market. One frequently cited advantage of stock associations is the high quality of management personnel attracted to the institution. Drawn by the profit incentive, generally from the business world, stock association owners and managers bring invaluable organizational talent and business savvy to the savings and loan industry, as well as a wider access to private investment capital.

These qualities have been seriously lacking in most Latin American countries where the mutual has been the only authorized form of S. & L. organization. As long as the savings and lending operations of these associations can be directed by national legislation to lower- and middle-income sectors of the population, there should be no reason to bar their existence. In the United States, although only mutuals may operate under Federal charter, stock associations, which are state-chartered, represent 12.6 percent of all associations and hold 21.3 percent of the aggregate assets of the savings and loan business.^{134a}

Two countries which have enjoyed relative success with stock associations under widely different economic circumstances are Brazil and El Salvador. The latter has received U.S. financial assistance for its savings and loan institutions, the former has not. In both cases regular operations of S. & L.'s did not begin until 1964—relatively late compared with the other Latin American countries described above. All of El Salvador's three S. & L.'s are stock associations, although mutuals are permitted by legislation. Brazil's system is mixed, with both stock and mutual institutions participating in savings activities and housing finance. The following is a summary of their experiences with S. & L.'s.

(1) EL SALVADOR

a. Population and housing situation

El Salvador in mid-1968 had 3,269,000 inhabitants. The population growth rate, 2.8 percent during the 1950-61 intercensal period, has risen to 3.6 percent since 1961. There is a moderate trend toward a proportional increase in the urban population, which accounted for 36.5 percent of the total in 1950 and 38.5 percent in 1961. During the 1950-61 period, San Salvador, the capital, recorded a demographic increase of 59.7 percent. In 1961, the population of San Salvador was 256,000, and is expected to reach 375,000 by 1970.¹³⁵

Most activity in housing finance and construction, as is the case in all Latin American countries, has been in subsidized housing. During 1967, for example, 2.2 percent of Central Government expenditures were channeled into housing (including water and sewerage) primarily through the Urban Housing Institute (IVU). The IVU had been reorganized in 1961 to assume responsibility for executing housing plans for low-income sectors. Between 1963 and 1968, it had completed

¹³⁴ Op. cit., U.N. Draft-69, p. 16.

Harold Robinson, Deputy Director, Development Resources, Bureau for Latin American Affairs AID.

^{134a} Op. cit., *Savings and Loan Factbook-1967*, p. 53.

¹³⁵ Op. cit., SPTF Eighth Annual Report, 1968, p. 165.

Pan American Union—*América en Cifras, 1967*, Volume: Situación Demográfica, p. 38.

Op. cit., Kingsley Davis, *World Urbanization*, vol. 1, April 1969.

approximately 1,600 units per year, compared to its goal of 5,000 units per year. Under this program the IVU received two loans from the IDB, in 1962 and 1965, totaling \$12.5 million.¹³⁶

In addition to the housing deficit for the lowest income urban sectors, Salvadoran national planners estimated an annual housing construction need of 9,000 units to satisfy the rest of the population. The only other housing finance institutions available in 1961 were the Mortgage Bank of El Salvador and the commercial banks. The Mortgage Bank, created in 1934, served only the upper level of the middle class. Its original purpose was to provide credit to farmers to aid in agricultural development. Seed capital was provided by the Government. Some loans of up to 70 percent of appraised value were made to buyers of houses in the \$6,000 to \$12,000 category. Participation by commercial banks in housing finance was nominal, with less than 10 percent of their assets invested in mortgages. Moreover, mortgage terms offered by the banks—10-year maturities, minimum 40 to 50 percent down payments, and 9.5 percent interest rates—placed the instruments beyond the means of most potential homeowners. Some insurance companies also used part of their resources to finance upper middle class housing on a short-term basis.¹³⁷

b. Formation of savings and loan system

Responding to the need for an overall housing and home finance policy, the Government formed the National Housing Finance Agency (FNV) in 1963, as a public corporation. Essentially a home loan banking facility for the S. & L. system which later emerged, the FNV was charged with (1) providing a credit reservoir for the associations, (2) insuring savings accounts up to 12,000 *colones* (\$4,800), (3) insuring the associations' home mortgages, and (4) developing a secondary market for insured mortgage loans. Under the S. & L. legislation both mutual and stock-owned associations were authorized to carry out savings and lending operations. In 1964, two S. & L.'s began operations as private financial stock-owned institutions. A third was chartered in 1965. Their purpose was to finance housing for low- and middle-income Salvadoran families.¹³⁸

In May, 1965, AID made a \$3.1 million seed capital loan to the FNV to support the operations of the S. & L.'s and to complement a \$2 million (\$800,000) subsidy to the agency from the Salvadoran Government. In a move to attract more savings into the S. & L.'s, the Government engaged in an "unwritten understanding" with the banks and the associations that, because of the social importance of the functions of the S. & L.'s, they should be permitted a competitive advantage in attracting savings. Thus, savings in S. & L.'s earn 6 percent interest payable semiannually, while savings in commercial banks earn 4 percent. These tactics together with the insatiable demand for housing finance resulted in a steady increase in free savings volume from 9.69 percent of total savings in the country the end of 1967, to 12.84 percent at the end of 1968. The number of depositors increased from 1,819 in 1965 to 14,457 in February, 1969. Their total savings as of February 1969 amounted to \$7.4 million, compared with a cumulative loan volume of \$11.1 million on 1,389 mortgages.¹³⁹

¹³⁶ Op. cit., SPTF Eighth Annual Report, pp. 171-172.

¹³⁷ Op. cit., Elliot, pp. 143-144.

Op. cit., U.N. Draft-69, p. 109.

¹³⁸ Ibid., p. 110.

Op. cit., Elliot, p. 144.

¹³⁹ Ibid., p. 144.

Op. cit., U.N. Draft-69, p. 111.

In July 1968, AID made a second seed capital loan of \$3 million to support the lending program of the FNV, through the associations. Through January 1969, the FNV had provided the S. & L.'s with credit assistance amounting to \$4.9 million and was operating at a profit.

An FHA system for mortgage insurance was created as part of the FNV, but has not commenced operations. There was no provision for monetary readjustment in El Salvador's S. & L. legislation because of the continued stability of the currency and the low index of inflation.

c. Operation of stock associations

While no official comparison has been made between the operation of mutuals and stock associations under a pure system (i.e., either one form or the other), recent evaluations by U.N. observers indicate that one of the reasons for the success of the Salvadoran S. & L.'s in such a short period is "that both the supervisory agency and the three associations have been able to attract very talented individuals for top management positions." Their report goes on to say that the growth of the system has been beyond expectations for the number of years it has been in existence.¹⁴⁰ This success may be attributed to the fact that stock associations can attract top quality talent by virtue of the profit incentive. One cannot neglect, however, the value of a stable domestic currency as a powerful incentive to save once sound financial institutions are established.

The major drawback of the Salvadoran associations, however, may also be traced to the form of S. & L. ownership. On an average, loans made throughout the system have been for \$8,000 on homes with a sales price of \$9,200.* The average loan ratio to property value has been 83-87 percent at a 9-percent interest rate and 15 to 20-year amortization period. Thus, the average monthly family income of mortgagors of the association is about \$520, which means that the clientele is upper middle class by Salvadoran standards. The greatest need for housing finance is in the lower-middle class.¹⁴¹ This same problem has arisen in Guatemala where S. & L.'s have also been organized on a capital stock basis.^{141a} Associations operating to earn a profit naturally gravitate to low risk investments which in the housing field would confine lending to the safest mortgages; i.e., those of the upper middle class.

At present, managers of the Salvadoran S. & L. system have not made a serious effort to develop a secondary mortgage market. According to AID officials, this attitude stems in part from the conservative character of the FNV, which is set on first building up the primary system. In addition, the rate of capitalization of the system has been sufficient to keep operations running smoothly without searching for new resources. As a matter of fact, as of April 30, 1969, no funds from the 1968 AID seed capital loan had been used. While this practice of slowly building up the savings and loan system has not resulted in an aggressive middle-class housing construction program, some observers believe that the building up of a stable private finance institution is of greater value in the long run. They emphasize

*By law, the maximum property value for loan eligibility under the system is \$10,000, with lending up to 90 percent of value.

¹⁴⁰ Ibid., p. 112.

¹⁴¹ Ibid., pp. 111-112.

^{141a} General Accounting Office (GAO) Report Draft, "Observations on External Assistance to Guatemala," Dec. 26, 1968, pp. 52-53.

the fact that "seed capital" by definition, is designed as an institution building instrument, rather than primarily a source of funding for housing projects.^{141b}

(2) BRAZIL

a. Population and housing conditions

Brazil is the most heavily populated country in Latin America and the eighth most populous in the world. The 1960 census recorded approximately 71 million inhabitants. By mid-1968, the population was estimated at over 88 million, signifying a national demographic growth of 3 percent a year for the 1960-68 period. Sixty percent of the population is concentrated in 8 States which account for 17.6 percent of the national territory. Rural-urban migration has contributed to a rapid growth of the cities. Between 1950 and 1960 the urban population expanded at an annual rate of 5.4 percent, while the average increase in rural zones during the period was only 1.9 percent. In 1960 the two largest cities, Rio de Janeiro and São Paulo, both had population of over 3 million. By 1980 it is estimated that their numbers will reach 6.3 million and 7.8 million, respectively.¹⁴²

Brazil's housing deficit in 1965 was cited at 10.5 million units, a figure which reflected the need for shelter to relieve overcrowding and replace substandard dwellings. As part of a national effort to improve housing conditions, Brazilian federal authorities enacted legislation in 1964 to establish guidelines for public and private sector cooperation at all levels. A national housing act was passed, and a housing plan was implemented over the following years by various public agencies.

Prior to 1964, the only agencies involved in home financing were (1) the Popular Housing Foundation, which dealt exclusively with low-cost, subsidized housing, (2) the Social Security Institute, which provided home financing for the working class, and (3) the Economic Funds (Caixas Economicas), in existence since the mid-19th century, which financed homes for middle-income groups. These three institutions continually suffered capital depletion through inflation. In 1961, the financial situation of the Economic Funds was so critical that the Federal Bank assigned to them a portion of the proceeds from the Federal Lottery. In 1962, under the auspices of the Inter-American Development Bank, U.S. savings and loan experts were sent to Brazil to help set up a private home finance program, since all such activity had in the past been frustrated by the uncontrolled inflation. The mission was not successful because the Brazilian Government could not be persuaded to adopt some form of monetary correction to make saving and long-term home financing practicable.¹⁴³

b. Formation of the savings and loan system

Under the 1964 legislation, the National Housing Bank (BNH) was created as a division of the Ministry of Finance, and was charged with the development and control of the national housing plan. The plan was to stimulate the construction of low-cost houses and finance the purchase of private homes, particularly for lower-middle income

^{141b} Harold Robinson, Deputy Director, Development Resources, Bureau for Latin America, AID.

¹⁴² Op. cit., SPTF Eighth Annual Report, 1968, pp. 78-79, 376.

¹⁴³ Ibid., p. 86.

Op. cit., U.N. Draft-69, p. 53.

William F. McKenna, President, McKenna and Fitting, Los Angeles, Calif., in *National League Journal*, vol. 23, No. 10, October 1968, p. 53.

groups. The Popular Housing Foundation and the Social Security Institute were liquidated, and the Economic Funds were assigned to the BNH system. Monetary correction was applied to both savings and mortgage loans,¹⁴⁴ in a series of acts and resolutions implemented in 1964, 1965, and 1966.¹⁴⁵ *

The BNH is the principal source of loans for all new housing construction. Among the programs it finances are the following:

(1) Housing cooperatives that promote the construction of subsidized housing.

(2) Employee housing programs for which the employer may obtain financing from the BNH on a 50-50 basis.

(3) Mortgage loans financed by builders or construction firms; the BNH promises to buy these mortgages as long as they are in compliance with BNH conditions.

(4) Apartment building construction that has been stopped because of lack of financing.

(5) The savings and loan system.

The Brazilian savings and loan system is comprised of the Economic Funds (Caixas Economicas), the Real Estate Credit Corporations (SCI's), and the Savings and Loan Association (APE's). The SCI's were created in 1964 with the assistance of U.S. S. & L. representatives who interested Brazilian businessmen in becoming active in the home financing field. They are basically stock-owned and were chartered by the Central Bank mainly to stimulate the home construction industry. Currently there are 43 such companies in operation. The APE's were authorized by Decree-Law in November 1966, and are mutual savings and loan associations. Through 1969, 43 APE's had been chartered, but only 26 were in operation. All of these entities are financed and supervised by the BNH. In addition to its financing operations, the BNH was charged with establishing rules and regulations for savings, mortgage loans and insurance within the system, and creating a secondary mortgage market.¹⁴⁶

Although the BNH insures all savings generated by the system at full value, Brazil has a unique mortgage insurance scheme. Forty of the largest insurance companies in the country formed a consortium to insure all mortgages granted by both stock and mutual savings and loan institutions. Thus, in Brazil mortgage insurance is automatically provided by the private sector instead of a public entity. This insurance, financed by monthly premiums,¹⁴⁷ covers 95 percent of the losses which may result from fraud or forgery of the mortgage documents, and/or from insolvency or nonpayment of three consecutive monthly payments by the mortgagor.

*The savings paid into housing finance institutions are subject to monetary adjustment every 3 months, in line with the "corrected value of the National Treasury's Readjustable Bonds." These bonds are in turn readjusted in line with the "general wholesale price index." In this way the value of savings accounts in housing finance institutions is brought up to date every 3 months, incorporating the appropriate interest and the resulting monetary adjustment. Balances outstanding on loans granted for housing finance are also readjusted every 3 months, using the same index.

¹⁴⁴ Op. cit., U.N. Draft-69, p. 53.

¹⁴⁵ Ricardo Garcia Rodriguez, "Monetary Depreciation and the Financing of Housing," U.N. Report 69-04824, December 1967, pp. 49-50.

¹⁴⁶ Op. cit., U.N. Draft-69, pp. 54-58.

Robert T. Souter, President, World Savings and Loan Association, Lynwood, Calif., in *Nationa League Journal*, October 1968, p. 32.

News release, S. & L. System—Brazil, Sept. 26, 1967.

¹⁴⁷ Op. cit., U.N. Draft-69, pp. 21, 60.

c. Financing the savings and loans systems

The main source of funds supporting the multiple operations of the BNH is a monthly contribution by employees to the social security system, which was created in 1966. The BNH receives 8 percent of salaries paid to all employees every month. With these funds, the BNH, in turn, has financed 50 percent of the mortgage portfolio held by the Caixas, purchased approximately \$62,500,000 in mortgage debentures during the past three years from the SCI's (stock associations), and financed directly as well as refinanced the mortgage portfolio of the APE's (mutuals). Other sources of S. & L. lending capital are:

(1) For the Caixas—savings attracted, payments of mortgages previously granted and the administration fee on mortgages resold or discounted. In addition to free savings, the Caixas have a linked savings program for homebuilding, under which savings are deposited on a monthly basis until the amount required for the downpayment is met.* Interest paid on free savings accounts is 6-percent annually, and on "linked" accounts, 3 percent annually. The mortgage limit is from 60 to 90 percent, depending on the total value of the property. The maximum loan value is approximately \$15,500. Ten percent interest is charged on loans. (The Caixas pay a 6-percent annual rate on BNH loans.) The average amortization period is 15 years.

(2) For the SCI's (stock associations)—issuing mortgage debentures, attracting savings, and direct loans from domestic and/or foreign lenders. The minimum capitalization of an SCI is \$125,000 in the heavily populated urban areas and \$50,000 in the less-developed regions. Lending terms to ultimate borrowers are the same as those of the Caixas; i.e., 10 percent interest rate on loans of up to 20 years. In addition to passbook savings accounts which pay 6 percent interest, the SCI's also issue mortgage paper similar to U.S. Savings Certificates of Deposit. These obligations have either 1- or 3-year maturities and pay an interest rate of 8 percent compounded quarterly on amounts ranging from \$37 to \$1,850.

(3) For APE's (mutuals)—savings attracted,** loans from domestic and/or foreign lenders approved by the BNH, and accumulated reserves. The APE's also invest actively in the deposit certificates issued by the SCI's. Individual loan terms are the same as those of the Caixas.^{148a}

None of the associations has accepted financial assistance from foreign sources, although the IDB has extended three loans to various housing finance entities—BNH (1966), a Federal bank (1963), and one of the early Caixas (1962), for low-cost construction projects.

Savings and loans have almost exclusively devoted their energies to meeting the needs of the middle-income group, where the greatest housing demand exists. Although loan ceilings are high (\$15,500),

* The Caixas are the only financial institutions under the BNH which offer linked savings accounts. The SCI's and APE's are prohibited from having such accounts.

** Interest rates on savings accounts throughout the system are set at 6 percent for regular savings accounts (1 year minimum), and 8 percent for time deposits of 3 years. Both types are, of course, subject to readjustment for inflation.¹⁴⁸

¹⁴⁸ Interview with Mr. James Stang, Assistant Director for International Affairs, National League of Insured Savings Associations, August 12, 1969.

^{148a} Op. cit., U.N. Draft-69, pp. 62, 57-58.

Op. cit., news release, S. & L. System—Brazil, Sept. 26, 1967.

the average price of the houses built within the system has been \$6,500. The limited financial capabilities of the prospective buyers creates difficulties. Conservative estimates indicate that only 20 to 25 percent of the applicants for housing loans under the system have the capacity to make a 10-percent downpayment and monthly payments. But the potential market for the system is within the same income bracket, and is extremely large. The rate of construction has been continuously increasing each year. In 1967, the BNH increased its rate of activity seven times in comparison with the previous year. As of December 1968, the system had attracted savings of approximately \$125 million while the associations had authorized around \$225 million in individual loans.^{149*}

d. Secondary mortgage market

The bulk of the gap between savings and loans was filled by BNH participation in S. & L. financing, either through direct loans or mortgage purchases. Despite the fact that an adequate mortgage insurance system exists, little effort has been made by the BNH to create an active, private, secondary mortgage market. The BNH has relied primarily on its income from the social security system to finance the S. & L. industry. One IDB housing expert has been critical of this method on the principle that any obligatory inputs into the system are temporary and do not contribute to the long term, independent, viable functioning of the savings and loan associations. The same official made a similar criticism of the Chilean method of drawing in 5 percent of industrial profits into the housing finance system on a mandatory basis.¹⁵¹

U.N. experts, on the other hand, feel that the strong financial support given to the system by national legislation will greatly aid in its development, and, as a result, Brazil will rely less on foreign funds to meet its housing needs.** They state further that Brazil probably has the most complete home financing legislation in the Hemisphere. As in the case of all the other systems in Latin America, the continuing recommendation is to expand programs of technical assistance in order to improve the quality of management personnel throughout the system.¹⁵²

* While there are no current statistics available on the relative activity of the various types of institutions operating as S. & L.'s, some indication of comparative potential might be gained from citing a January 1968 BNH projection of increase in net savings. The BNH projected that by the end of the year 1969 the stock associations will have accrued a NC 200 million increase (about \$62 million equivalent as of January 1, 1968) in net savings, while the Caixas and the mutuels combined will have acquired NC 58.5 million (about \$18 million equivalent as of January 1, 1968) in net savings.¹⁵⁰

**As noted earlier, there have been no AID loans of any kind to the Brazilian S. & L. systems. While there are some housing guaranty contracts pending, current political difficulties in the country have diminished prospects of implementation in the near future.

¹⁴⁹ Op. cit., U.N. Draft-69, pp. 59-60, 63.

¹⁵⁰ James Stang, from NLISA feasibility study on Brazil, Jan. 17, 1968.

¹⁵¹ Eneas Maza, Housing and Urban Development Advisor, Inter-American Development Bank.

¹⁵² U.N. Draft-69, pp. 63-64.

F. Observations on Case Studies

Despite the disparities in rates of development and in the problems faced by the various S. & L. systems surveyed, the importance of these institutions in relieving demand pressures on governments cannot be overstated. Governments at all levels face enormous pressures to provide both financial and technical resources for housing. By satisfying a portion of these demands, privately owned and managed savings institutions permit conservation of scarce government revenues and technical expertise. These public resources may then be channelled into low-cost housing, industrial development, or urgently needed social services. In addition, the development of sound, broadly based financial institutions can provide a strong incentive to savers who are not served by present facilities.¹⁵³

Recent observations in Peru and Mexico indicate that once a mortgagor has developed the habit of regularly servicing the debt on his home, he tends to perpetuate this monthly practice through a conventional savings account. Saving institutions thus create patterns of thrift and provide a new source of development capital for the economy. While such evidence is still scanty for Latin America as a whole, it indicates that the potential for mobilizing increased savings does exist and can be realized through the proper financial institutions.¹⁵⁴

The obstacles to development of these institutions fall into two main categories: (1) Those inhibiting the flow of resources into the S. & L. system; and (2) those impeding the effective utilization of these resources; i.e., technical and administrative weaknesses. Naturally, these hindrances interact, and the latter difficulty often intensifies the former.

Chronic inflation, lack of central government support, and unreasonable loan terms all detract from public confidence in savings institutions and the incentive to save. Lack of an adequate mortgage insurance mechanism and the existence of more attractive returns on other investments deter private investors from placing funds in the system through a secondary mortgage market. Restrictions on the type of S. & L. institution authorized to receive savings and loan funds for home financing also inhibit the range of resources, both financial and managerial, which might be drawn into the system.

The overburdening of central housing institutions with the administration of a multiplicity of construction and financing programs in both low- and middle-income sectors has detracted from their ability to function efficiently for either group. On the other hand, S. & L. overdependence on the financial assistance of central institutions, which has often become a substitute for rather than a complement to accrued savings, has dulled the incentives of thrift institutions to attract savings independently. The lack of adequately trained technical and managerial personnel at every level of S. & L. administration,

¹⁵³ "Economic and Financial Implications of Housing Finance Institutions in Developing Countries," United Nations Center for Housing, Building and Planning, Aug. 15, 1968, pp. 11-12.

¹⁵⁴ *Op. cit.*, Elliot, pp. 58-59.

Interview with Harold Robinson, Deputy Chief, Development Resources, Bureau for LA, AID, August 11, 1969.

cited by international experts as a major drawback of all Latin American systems, has further inhibited the development of self-sustaining systems.

The U.S. assistance program, both through AID seed capital loans and through IDB loans to S. & L.'s, has been the moving force behind the S. & L. movement in Latin America. U.S. initiative has also provided the model for many of the techniques applied to counter obstacles to the progress of Latin American systems. The FHA mortgage insurance mechanism implemented in Guatemala and the Dominican Republic was instrumental in stimulating a secondary mortgage market in those countries. The technique of monetary correction to readjust the face value of savings accounts and mortgages to account for inflation was introduced to Latin America by a U.S. AID official who observed the successful operation of the mechanism in Israel. The mutual form of S. & L. organization was also spread throughout Latin America by U.S. technical advisors. In the latter case, however, the U.S. contribution may have been restrictive, since stock companies—as opposed to the more prevalent mutuals—seem to be particularly capable of overcoming the obstacles thrift institutions often confront in Latin America. On the other hand, U.S. influence has been exerted to dispense with the cumbersome and impractical “contract” system of savings, which often served as a disincentive to middle-class savers because of the range of commitments involved and the uncertainty that housing finance would eventually be forthcoming.

Perhaps the most important U.S. contribution to the Latin American S. & L. movement was the injection of the seed capital itself. Faced with an overwhelming loan demand, these infant institutions could not depend on initial savings to provide adequate liquidity, and often could not rely on sufficient financial assistance from their own governments. The infusion of external capital gave credibility to the lending claims of local S. & L.'s and provided a backstop for the financing operations of Central Government administrative institutions. The low interest rates charged under these loan programs also acted as a subsidy to the Latin American systems, since in most cases ultimate mortgagors were borrowing at market rates.

Under the philosophy of seed capital, these external inputs were merely intended to bridge the financial gap until the institutions themselves could cope with local technical problems and generate enough private capital to operate on an independent basis, or at least with a minimum amount of Government assistance. Since 1960, 11 Latin American countries and one Inter-American institution (CABEI) have received aid under this program from both AID and the IDB. Six of these countries have received multiple infusions, both in dollars and in local currency. In the cases discussed, most of the systems assisted still face liquidity problems to various degrees. Many have failed to encourage substantial domestic private investment, despite steady increases in net savings and in their mortgage portfolios. While all official observers of the Latin American savings and loan movement agree that further assistance of both a technical and financial nature is necessary, there is some disagreement as to the manner in which to extend this aid.

U.N. observers feel that Latin American S. & L.'s are still in a position to absorb additional seed capital funds, provided that substantial technical assistance and management training are included in any such program. AID officials are not as certain that this strategy is wise, at least on a bilateral level, in view of the tendency of these institutions to become dependent on the steady inflow of U.S. assistance and to use it as a substitute for locally generated capital resources, thus destroying the entire concept of "seed" capital. The danger also exists that over-reliance on U.S. financial assistance will result in popular identification of these institutions with U.S. political interests, which could damage the potential of the S. & L.'s to attract public savings. One top AID housing official has suggested that a cutback in the seed capital program would probably result in a slowdown in Latin American S. & L. expansion, but certainly not in a breakdown. Seed capital, after all, merely speeds up the development of these institutions. The same expert also feels that if the alternative of seed capital were not available, these institutions would be forced to experiment with methods of stimulating secondary mortgage markets that to date have been ignored. In this respect, AID seed capital loans should be regarded as instruments designed to foster institutional development, rather than as merely another channel for financing housing construction in Latin America.

While specifically directing its assistance to the lowest levels of the middle-income group, the IDB has taken a similar approach with respect to S. & L. lending. A recent loan to the Guatemalan S. & L. system (1969) was prompted in part by the advances that country had already made to develop its secondary mortgage market and by the desire to extend the benefits of this well-established system to lower income groups. However, the scale of IDB lending activity in this area will continue to be minimal, since its resources are limited and it already has far-ranging commitments in other areas of social development.

Alternatives to AID seed capital assistance are under consideration. They include an International Home Loan Bank, foreign equity investment in S. & L.'s and the AID Housing Investment Guaranty Program. All of these programs would remove the subsidy element which is provided by the liberal terms of AID and IDB seed capital assistance, but would maintain a flow of external capital into these institutions on a more business-like basis. To date, only the AID Investment Guaranty program has been implemented.

G. Alternative Channels for External Assistance to Latin American S. & L.'s

(1) AID HOUSING INVESTMENT GUARANTEE PROGRAM

The Latin American Housing Investment Guaranty Program has been administered by AID as an integral part of the Alliance for Progress. It operates in approximately the same manner as the FHA's program for insuring mortgages in the United States. The Contract of Guaranty insures the U.S. investor against the loss of his investment for an approved housing investment project in Latin America. The authority to guaranty is contained in the Foreign Assistance Act

(FAA) of 1961. Subsection (a) of section 224 states the general purpose of the program as that of fostering "self-liquidating pilot housing projects—in rapidly developing countries" to stimulate private home ownership and to assist in the growth of stable economies. Subsection (b) authorizes the President to guarantee investments by U.S. investors "in pilot or demonstration private housing projects in Latin America of types similar to those insured by the Federal Housing Administration and suitable for conditions in Latin America."

In 1961, the conference committee on the FAA, in agreeing to the inclusion of section 224, carefully instructed AID that such guaranties could be issued for no more than 75 percent of an investment. This limitation proved unsatisfactory because AID had difficulty in attracting investors under this 75 percent constraint. In 1962 and 1965, changes in the legislation raised the limitation to a 100 percent guaranty of principal, and in the case of the Latin American program (sec. 224), of accrued interest as well. In 1961, Congress limited the guaranties which AID could have outstanding at any one time to \$10 million. In each year since 1961, Congress has increased the total authorization for the program to its present level of \$550 million.¹⁵⁵

While Congress increased the authorizations, it also expanded the scope of the Latin American housing guaranty program. In 1961, section 224 authorized guaranties for pilot demonstration projects only. The initial objective was to encourage builders to demonstrate advanced techniques and methods of financing, marketing, construction and management. Since these guaranties were for individual projects, the program did not assist housing institutions, such as savings and loan associations, capable of mobilizing local savings and private risk capital, which could continuously finance housing construction. This task was left to other U.S. lending programs.

In testimony on the effects of the guaranty program, AID Administrator William Gaud stated in 1965 before the House Committee on Foreign Affairs that "it has been almost entirely a program in which American dollars went down and built houses in Latin America. It didn't have a multiplier effect." Moreover, the housing constructed under the program had been provided for a relatively high income group, and was criticized as failing to promote the desired demonstration effect. A 1967 AID report revealed that the sales price of houses financed under the program were as high as \$16,602, far beyond the reach of Latin American lower-middle classes. To broaden the program AID proposed that its authority under the program be expanded to guaranty investments in (1) credit institutions engaged in home financing, (2) housing projects for low-income families, (3) housing projects to develop institutions such as free labor unions and cooperatives, and (4) housing projects for which at least 25 percent of the aggregate mortgage financing came from Latin American sources.¹⁵⁶

The Foreign Assistance Act of 1965 granted AID this extended authority. Under its provisions, the sales value of homes financed under the credit institution program (i.e., seed capital loans) was

¹⁵⁵ Latin American Housing Investment Guaranty Program—Information for Applicants, Department of State, Agency for International Development.

Duncan H. Cameron, "The AID Housing Investment Guaranty Program," in *Northwestern University Law Review*, vol. 63, No. 2, 1968, pp. 189-190, 192.

¹⁵⁶ *Ibid.*, p. 193.

Testimony of Wallace J. Campbell, President, Foundation for Cooperative Housing, before Subcommittee on Inter-American Affairs of Committee on Foreign Affairs, U.S. House of Representatives, Apr. 30, 1969, p. 5.

limited to \$5,000, unless 25 percent of the mortgage financing came from host country sources, in which case the eligible sales price would be raised to \$6,500; the maximum price for houses under the low-cost housing program was set at \$2,500.¹⁵⁷ More recently, the sales value of houses financed through the pilot project program was limited to \$7,500. By 1965 congressional allocations for the guaranty program had increased to \$250 million. Under the amended legislation, \$150 million was added for institution building with low income and local participation. The President's Balance of Payments Committee, a Cabinet group headed by the Secretary of the Treasury, effectively reduced these authorizations for both housing guaranties and institution building in the first instance to \$240 million and in the latter to \$100 million.¹⁵⁸

An amendment to the 1965 Housing Act sponsored by Senator George Smathers complemented these increased congressional authorizations for the guaranty program. It "authorized federally chartered savings and loan associations (in the United States) to make loans in Latin America if they are guaranteed by AID * * *." U.S. savings and loans were thus empowered to invest up to 1 percent of their assets in Latin American loans guaranteed by AID and were intended to assume a major responsibility for capital investment aspects of the Housing Guaranty Program. Their Latin American counterparts, as recipients, were to become primary agents of domestic capital formation for home construction and finance. The principal objective of the program was to mobilize additional Latin American capital. In order to provide an incentive for U.S. institutions to invest in Latin American housing finance programs, the FAA of 1966 provided that the maximum interest rate paid a U.S. investor under the program could not be less than one-half percent over the current rate of interest charged on housing mortgages insured by the FHA, nor more than 1 percent over the FHA interest rate.^{158a}

The American home builders objected to this new program because it did not also contain an increased authorization for the pilot demonstration projects. They believed that the new program with its emphasis on the development of thrift institutions and low-cost housing, did not offer them very attractive business opportunities. For example, if AID guaranteed loans to housing institutions, such as savings and loan associations, the American builder would only benefit if he could qualify for a loan from the institution, and the institution might favor local builders. Similarly, the American home builders feared that the local builders might have a competitive advantage in obtaining the required 25 percent mortgage financing from local sources to qualify for one of the other alternatives under the new program.

Yielding to home builder pressures, Congress, in the Foreign Assistance Act of 1966, added \$50 million to the guaranty authorizations of section 224 for further pilot demonstration projects. This authorization was passed despite AID objections that the pilot projects would not promote the development of housing finance institutions. In 1967,

¹⁵⁷ Department of State—AID Announcement—Reopening of Housing Guaranty Program, Apr. 4, 1966, pp. 1-3.

¹⁵⁸ Op. cit., speech by Harold Robinson, Deputy Director, Plans and Programs, Housing and Urban Development Division, Bureau for Latin America, AID, Apr. 6, 1967, p. 12.

Op. cit., Harold Robinson, "Housing and Urban Development Programs," Oct. 1, 1967, section on Investment Guarantees.

^{158a} Op. cit., Elliot, pp. 170-173.

without any encouragement from AID, Congress again increased the guaranty authorization in section 224 by \$50 million, bringing the total authorized to \$500 million, \$325 million of which was specifically earmarked for pilot demonstration projects.¹⁵⁹ In 1968, Congress authorized another \$50 million under FAA section 224, but did not confine the allocation to pilot projects.¹⁶⁰ The 1968 Housing Act complemented this expanded authorization by including the 12 regional Federal Home Loan Banks among these U.S. institutions permitted to invest assets in Latin American savings and loan associations.

The status of the Latin American housing guaranty program as of April 1, 1969, was as follows: 38 projects were authorized and under contract, 30,800 units had been built or were under construction, and 52 additional projects including 38,400 units had received preliminary commitments. These, plus other projects in process cost a total of \$373 million. An additional \$177 million had been authorized, of which \$127 million had been made available by the Balance of Payments Committee for the fiscal years 1970-71; \$50 million of the \$177 million has not been released by the Committee.¹⁶¹ Nearly all these projects were pilot demonstration projects. Not until 1968, when the increase in AID seed capital assistance halted, was the first guaranteed loan for general home financing made directly to a Latin American savings and loan institution. The \$1 million loan was contracted in November 1968 by La Libertad S. & L. of Santiago, Chile, from Buckeye Federal Savings and Loan of Columbus, Ohio, for the financing of 280 family units, each with a maximum sales value of \$6,500. Two contracts totalling \$7.15 million were subsequently signed in April and July, 1969, to benefit S. & L.'s in the Dominican Republic and Guatemala. The average price of the houses to be financed under these contracts is \$5,000.¹⁶² In these cases, several U.S. savings and loans participated in each transaction. Most U.S. S. & L. officials, as well as AID experts, agree that the gradual decline of public seed capital assistance in the coming years will stimulate, through the AID housing investment guaranty program, a commensurate increase in private housing finance in Latin America.

In order to minimize the risk of loss and at the same time promote institution building, AID contracted the support of the following agencies: (1) The FHA International Division to provide AID with a number of underwriting services, including the field investigation teams needed to analyze and evaluate projects,* (2) the Federal Home Loan Bank Board to act as a liaison between the U.S. savings and loan system and host country systems; (3) the Foundation for Cooperative Housing to assist AID in processing, evaluating, and implementing projects to be developed as cooperatives; (4) the National League of Insured Savings Associations to recruit and supervise construction inspectors; and (5) the Washington Federal Sav-

*FHA assistance under AID S. & L. lending programs has recently been discontinued.

¹⁵⁹ Op. cit., Duncan Cameron, "The AID Housing Investment Guaranty Program," 1968, pp. 193-195.

¹⁶⁰ Foreign Assistance Act of 1969, sec. 224C.

¹⁶¹ Op. cit., statement of Wallace J. Campbell, President, FCH, before House Committee on Foreign Affairs, Apr. 30, 1969, p. 6.

¹⁶² Op. cit., AID-Latin American Housing Guaranty Program Summary Sheet, Mar. 31, 1969, updated by William Shea, Housing and Urban Development, Latin American Bureau, AID.

ings and Loan Association of Miami Beach to study the feasibility of projects submitted under the Credit Institution provisions of FHA section 224, to help select administrators for proposed projects.¹⁶³

Institution building through the investment guaranty program faces several obstacles, some of which stem from domestic pressures within the United States. Urban upheavals during the last decade have created demands on potential investors, such as insurance companies and S. & L.'s to concentrate their resources on solutions to domestic problems rather than to channel them to Latin America. Some experts feel, however, that the incentive of a 100 percent investment guaranty with a satisfactory rate of return will still draw substantial financing into the guaranty program.

Current high rates of interest paid in the United States also deter investment in Latin America. The 7.5 percent present market rate for FHA-insured mortgages means that a U.S. investor would earn an 8 to 8.5 percent annual return on a loan made through the guaranty program. Whether this return will provide a sufficient incentive, in light of some U.S. corporate bond yields at about the same level, remains to be seen.

The rise in construction costs in Latin America has also impeded the implementation of housing finance programs. This rise has called into question the appropriateness of the ceilings imposed by the Congress and AID on the value of housing eligible for financing under the program. (Under routine credit institution loan, the ceiling is \$5,000 per unit. If the local S. & L. provides 25 percent of the financing, the ceiling is raised to \$8,500.)¹⁶⁴ For example, under the 1968 guaranteed loan to the Chilean S. & L., complaints were made that it took 8 months to disburse the loan, since available borrowers did not want to limit themselves to such a low-cost house. Many experts argue that such a ceiling is cutting the middle-income borrower out of the guaranty program, while others feel that the ceiling is necessary to direct the program to the sector of greatest effective demand and need; i.e., the lower-middle income groups. Still others suggest the compromise of allowing greater flexibility in the ceilings to account for differences in financial conditions in various Latin American countries, while maintaining the general goals of the program.

Latin American reaction to the interest rates charged under the guaranty program will also affect its financing potential. In addition to the 8-8.5 percent return to the U.S. investor, AID also charges a guaranty fee on the unpaid principal balance of the guaranteed loan that ranges from one-half of 1 percent to 2 percent, depending on the extent of the host country secondary guaranty to the U.S. Government.* Unless the host government subsidizes the loans made under

* Guaranty fees: one-half percent per annum where repayment of the loan in U.S. dollars has been guaranteed by the government of the country in which the project is located; 1 percent per annum where repayment has been guaranteed by a government mortgage insurance institution, housing agency, or other public or private institution; 2 percent per annum in all cases for which AID has no form of co-guaranty.

¹⁶³ AID Pamphlet: The Agency for International Development Latin American Housing Investment Guaranty Program (FCH-72).

¹⁶⁴ Announcement by AID—Reopening of the Latin American Housing Investment Guaranty Program, Department of State, AID, 1969, p. 11.

Conference Report on the Foreign Assistance Act of 1969, H.R. 14580, December 18, 1969. The Conference Committee on the 1969 FAA raised the previous ceiling (\$6,500 to \$8,500).

the program (which has not occurred to date), the annual interest rate to the ultimate borrower in Latin America after government and intermediary agency fees within the host country may reach 10-12 percent. However, even these rates still represent a lower cost to the consumer than he could find in the local money market outside the S. & L. system.

Other problems involved in administering the guarantees include (1) recent repayment delinquencies by Latin American S. & L.'s which have not yet shown up as defaults to U.S. investors; and (2) the continuing tendency of U.S. investors to emphasize the role of capital for housing construction rather than for institution building. Most guaranteed loans for S. & L.'s are still for specific projects, with S. & L.'s merely serving as funnels for U.S. funds. Institution building intended to enable the Latin Americans to generate their housing funds locally has in most cases been a secondary consideration. The inadequate and often inefficiently administered technical assistance programs in this area have also failed to advance the promotion of S. & L. development under the AID housing investment guarantee program.^{164a}

(2) THE NEED FOR CONTINUING TECHNICAL ASSISTANCE

The potential benefits of the AID Housing Investment Guaranty program as a substitute for AID seed capital lending were summarized by Wallace J. Campbell, president of the Foundation for Cooperative Housing:

* * *. It draws private capital into the field of international development; it calls on the technical skills of the U.S. housing industry, finance, builders, developers, architects, engineers, and planners, and technical service organizations; it involves the well proven principle of mortgage insurance (or guarantee) which has been such a large factor in U.S. housing progress; it demonstrates the ability of people to pay for better housing through lower down payments and longer amortization; and finally, it makes possible an expanded program of overseas housing without impact on the U.S. budget or cost to the U.S. taxpayer.¹⁶⁵

While these optimistic pronouncements are valid, such expectations will not be fulfilled without an aggressive program of technical assistance to accompany financial inputs. U.S. investors are not in a position to volunteer these services, since their obligation terminates with their financial commitment guaranteed by the U.S. Government. Thus, the ultimately successful impact of these external funds on institutional development—the primary target of the program—depends upon extensive involvement of local AID missions and U.S. technical advisors during the implementation of successive loans.

To date, technical assistance has taken the following forms:

(1) Training courses in the United States for Latin American savings and loan executives and officials of supervisory agencies. This program, however, has affected only a limited number of people.

^{164a} Harold Robinson, Deputy Chief, Development Resources, Latin American Bureau, AID.

¹⁶⁵ Op. cit., statement of Wallace J. Campbell, President, FCH before Subcommittee on Inter-American Affairs of House Committee on Foreign Affairs, Apr. 30, 1969, p. 11.

(2) Assignment of U.S. savings and loan executives and members of the Federal Home Loan Bank staff as advisors to the savings and loan system. These have been both short-term and 1- to 4-year assignments.

(3) Sponsorship for the past 7 years of annual Inter-American Savings and Loan Conferences in different capital cities of Latin America.

(4) IDB sponsored regional seminars on savings and loan and FHA systems.

(5) Literature in Spanish on savings and loans operations distributed throughout the continent.

(6) IDB assistance in the creation of the Inter-American Savings and Loan Union as the trade organization for all savings and loan institutions in Latin America; U.S. savings and loan associations are also members.

(7) Through the sponsorship of AID, the American Savings and Loan Institute has created the Latin American Savings and Loan Institute. The latter provides correspondence courses, translations of savings and loan texts from English to Spanish, and seminars at its branches throughout the continent.¹⁶⁶

Such programs, however, have not been sufficient to meet the demand for advanced organizational and managerial techniques. The three countries to participate in the housing investment guaranty program to date have all devised some form of mortgage insurance system and private secondary mortgage market considered viable by U.S. investors. Two countries (Guatemala and the Dominican Republic) have stable currencies, while Chile has devised an elaborate readjustment mechanism to counteract inflation. Yet S. & L.'s in all of these countries, according to international housing experts, still require additional technical assistance in order to achieve an independent financial status and expand their operations. Secondary mortgage markets remain undeveloped in most Latin American countries. Inefficient regulation of the S. & L.'s by central housing banks has held back the growth of these systems in some countries, while insufficient incentives have failed to attract savings in others. And finally, managerial techniques at all levels of Latin American S. & L. administration need improvement.

Thus, despite Mr. Campbell's emphasis on the role of U.S. private enterprise under the housing investment guaranty program, the U.S. investor really has little concern for the management which is handling his invested funds, and the program is thus not a sufficient replacement for AID activities. In view of the persistent inadequacies of Latin American S. & L.'s mentioned above, technical assistance on a continuing basis is essential if these institutions are to cope with the growing demand for housing finance. In the foreseeable future, it seems that such external assistance can only be supplied by AID-appropriated funds.^{166a} *

*Not only will the continuation of past AID technical assistance activities be required, but it has been noted that most of the assistance given to Latin American countries to date has been in the form of short-term consultants. AID experience has shown that once a system has been created, a long-term contract advisor is needed to follow through its operational development.

¹⁶⁶ Op. cit. U.N. Draft-69, pp. 9-10.

^{166a} Op. cit., Harold Robinson, Housing and Urban Development Programs, LA Regional Projects Section, Oct. 1, 1967.

Other proposals for simultaneously channeling financial and technical assistance to Latin American S. & L.'s have been made since the initiation of AID efforts in this area, partly to remove the administrative burden from the U.S. Government, and partly to insure a steady flow of assistance despite declining AID appropriations. The two suggestions which stand out have been:

- (1) To provide U.S. legislation for equity investment by U.S. S. & L.'s in Latin American counterpart institutions, and
- (2) To form an International Home Loan Bank.

(3) EQUITY INVESTMENT

Little action has been taken on this proposal supported by former AID Administrator William Gaud. His rationale for suggesting legislation to permit a partnership-type arrangement was as follows:

Thus, we come to the field of Equity Investment where the investor would receive less than a 100 percent guaranty from AID; would accept greater risk on his invested funds; but at the same time, would have the opportunity of greater gain. When this gain is sufficient, he will then, and only then, be interested in the management of his funds in overseas endeavors in which he has invested * * * the largest home investors in the United States, namely, the savings and loan industry, do not have the authority to make equity investments in overseas areas. We believe this would be a most worthwhile tool for the private sector and would create an interest in providing not only investment capital, but the kind of technical management interests essential to safeguarding invested funds. At the same time, the need for AID appropriated funds to provide the necessary technical funds would be eliminated.¹⁶⁷

Since this suggestion was made, there has been no legislation introduced to support the idea, and no format for such a resolution has been agreed upon. The "risky" nature of such investments without a full AID guaranty, and the general controls placed on S. & L. investment activities inside the United States have been mentioned as deterrents to the implementation of the idea.¹⁶⁸ It would also seem that in order to attract external private capital, the Latin American systems benefiting from such a program would have to achieve a more advanced stage of development than most have reached to date. On the Latin side, the problem of degree of equity interest of U.S. institutions in local S. & L.'s might also prove to be a sensitive political issue, since minimum participation by U.S. S. & L.'s (e.g., 10 percent equity) would hardly yield the sustained technical assistance on the scale required by the Latin American institutions.

An idea which has received more support from both Latin American and U.S. politicians and housing experts has been that of forming an International Home Loan Bank to serve as a focal point or central authority for attracting external capital investment. The idea was discussed as early as 1962 in the U.S. Congress and at annual meetings of the Inter-American Savings and Loan Associations. Several proposals for its implementation have been presented.

¹⁶⁷ Draft of statement distributed to Congressmen from William Gaud, former AID Administrator, Jan. 4, 1968, p. 4.

¹⁶⁸ Carl Coan, consultant to Subcommittee on Housing, Committee on Banking and Currency, U.S. Senate, Aug. 20, 1969.

(4) INTERNATIONAL HOME LOAN BANK

The idea for an International Home Loan Bank (IHLB) was first conceived in 1962 as a U.S. Government agency which would operate within the framework of the Federal Home Loan Bank system. Supporters hoped that it would become the nucleus for sustained private investment in the home-financing institutions of developing countries, once the Inter-American Development Bank ran low on public funds for this purpose (which has already occurred). The IHLB was intended to expand the IDB idea of seed money for S. & L.'s to countries other than those in just Latin America.¹⁶⁹ The suggestion presupposed the establishment of national home loan banks responsible for the effective operation of local institutions.

The IHLB would coordinate and assist the national HLB's in various ways, including the provision of guarantees to increase the marketability of the mortgages and other housing finance paper. The international guaranty mechanism would protect potential investors against the risks of devaluation and exchange restrictions. In addition to providing safeguards against devaluation, the IHLB would also provide technical and financial assistance to the HLB's and the savings and loan institutions operating under them. It would act as a clearinghouse for information of all kinds dealing with housing and housing finance.¹⁷⁰ IHLB planners intended the institution to use U.S. S. & L. and home loan bank stockholder's money rather than depending on the Treasury and the taxpayer, as does the AID program.

These concepts were embodied in Senate Resolution 582 proposed by Senators Smathers and Sparkman in October 1962. In 1963, in the early weeks of the first session of the 88th Congress, Congressman Patman introduced a similar bill in the House of Representatives. Their plan was to create one agency whose sole purpose would be the creation of self-perpetuating independent thrift institutions in other countries. These institutions would accumulate capital for home financing in underdeveloped nations throughout the world. The bill would permit U.S. domestic savings and loan associations to invest up to 1 percent of their assets in the new international institution, which would operate under the supervision of the Federal Home Loan Bank Board in Washington. AID and the IDB would therefore be relieved of the necessity to use their people and funds for this purpose. These two institutions would then be responsible for only home and shelter loans and for technical advice to the public housing sectors of participating countries. Most importantly, the IHLB, through its membership, would supply resident technicians to explain and organize the operation of the new S. & L. systems. The Bank could rely upon the multiplicity of its stockholder savings and loan associations to act as schools for the training of visiting S. & L. representatives.¹⁷¹ Filling the technical assistance gap would be a major potential contribution of an IHLB, since short-term contracts under the AID program have

¹⁶⁹ William K. Wittausch, "U.S. Policy on Technical Assistance, International Housing Programs," op. cit., *Study of International Housing*, March 1963, pp. 84-85.

¹⁷⁰ William F. Butler, "A Proposed Procedure for Private Financing of Housing in Latin America," in op. cit., *Study in International Housing*, March 1963, pp. 100-101.

¹⁷¹ Arthur H. Courshon, "Analysis of Thrift Institutions Whose Primary Purpose Is Financing Homes in Underdeveloped Countries," in op. cit., *Study in International Housing*, pp. 286-287, 289.

Hearings before Committee on Banking and Currency, House of Representatives, 88th Cong., 1st sess., on H. R. 8143, Aug. 9, 1963, p. 6.

not provided adequate technical support to the new S. & L. systems. One prospective U.S. investor stated the problem in this manner:

* * * it is impossible for the AID to provide * * * the forceful private missionary leadership which we can obtain from the savings and loan industry to spread the gospel of mutual and stock savings and home financing through these countries.

It is possible for private * * * savings and loan association(s) to do this. But again, they are hamstrung under the present circumstances, because of the fact that they have no organic connection between their association, for which they are responsible and this activity, which they believe in. The connection between a financial commitment and an emotional commitment has not been made * * *. If we had an International Home Loan Bank, the bridge between these two would be made.¹⁷²

Not all the testimony on the IHLB was completely favorable. AID Administrator David Bell was skeptical of creating a quasi-governmental agency to handle this specialized area, indicating that the already activated investment guarantee program offered sufficient opportunity to channel housing capital to Latin America. Mr. Bell also suggested that considering the stage of development of Latin American S. & L.'s at the time, AID contract consultant arrangements were fulfilling the needs of the program. In defending AID's course of action in home finance development, Mr. Bell stated:

The main thing we have suggested is that we don't see why it would be valuable or necessary to establish a quasi-governmental institution here. It seems to us we can use the Federal Home Loan Bank Board as it stands as the formal regulatory body, and we can permit private institutions to set up special private associations for investing a small part of their resources overseas in underdeveloped countries.

It seems to us therefore that it is a simpler and more effective arrangement * * * without needing the International Home Loan Bank as an intermediary.¹⁷³

Evidently, these arguments by the AID representative were convincing enough to forestall further congressional action on the IHLB proposals. Another part of Administrator Bell's testimony, however, seemed to impress Congress with the need to revise the existing investment guarantee legislation. He pointed out that, "Our present system of housing investment guarantees is available to and is being used to provide guarantees for private American capital, not savings and loan association capital, but bank capital, investment banking capital, and so on." He stated that under the projects financed by this capital, only middle and upper middle income demands were being met, whereas direct AID-financed programs were generally meeting the needs of the lower spectrum of the middle classes. He anticipated that S. & L.'s would be more inclined to lean toward lower-middle class financing than would commercial capital.¹⁷⁴

In 1965, as noted above, enabling legislation was approved permitting U.S. S. & L.'s to channel up to 1 percent of their assets to

¹⁷² Statement of Rodman C. Rockefeller, Vice President, Housing Division, International Basic Economy Corporation, in op. cit., *Study in International Housing*, March 1963, pp. 210-211.

¹⁷³ Statement by David Bell, AID Administrator, in op. cit., *Study in International Housing*, March 1963, pp. 256, 259, 262, 265.

¹⁷⁴ *Ibid.*, p. 272.

similar institutions and systems in Latin America under approval and guaranty of AID. In 1968, this privilege was extended to the 12 regional Federal Home Loan Banks. However, to date, efforts to establish a central institution to supervise and stimulate this flow have not been successful, and prospects for its implementation in the near future are poor. Recent efforts have been made to establish an IHLB within the World Bank (IBRD) and even as an autonomous agency within the United Nations. Hopes for the former are dim, mainly because of the IBRD's concentration on engineering development projects and the already heavy demands on its resources. Financial restraints on expansion of U.N. housing programs, as well as the biases of many socialist member countries against private housing finance, would seem to inhibit that organization sponsoring an IHLB. The IHLB as originally conceived; i.e., a quasi-governmental U.S. agency under the Federal Home Loan Bank Board, does not hold much promise of realization.

(5) THE CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION (CABEI)

Despite the failure to implement the International Home Loan Bank, some efforts have been made to develop a multi-national approach to home financing and the creation of thrift institutions. To date, the only regional international lending agency concentrating exclusively on housing is the Home Loan Department (HLD) of the Central American Bank for Economic Integration, known as CABEI.

The HLD was established as a permanent arm of CABEI in 1963, and funded the same year through a \$10 million seed capital loan from AID. The loan terms were 40 years, including a 10-year grace period, and an interest rate of 0.75 percent. At approximately the same time, the U.S. provided a full-time resident mortgage and housing finance expert as consultant to the new HLD. The goal of the institution was similar to that of the IHLB; i.e., to provide secondary mortgage funds to eligible institutions.

The eligibility provisions of the HLD largely precluded participation by government housing agencies or private savings institutions that also engage in the development of land and the construction of houses or that operate under the contract system of savings. The principal reason for these exclusions was to emphasize mobilization of private funds by private institutions and the desire to promote production of housing on a commercial basis. Government housing programs in Central America generally incorporate subsidy elements, tend strongly to concentrate on low-cost housing, and do not compete with private housing of moderate standards that is produced on a purely commercial basis. The exclusion of institutions or private entities which perform savings functions but also engage in construction activities is presumably based on the danger that the savings function may not only be subordinated to the construction activity, but that too great opportunity exists for the savings function to be exploited. Exclusion of institutions which operate contract savings programs is made because (a) their public contribution has been very small; (b) their contract terms have generally been onerous; and (c) they have generally not been financially sound. The operating principle of CABEI/HLD is to make local currency loans to eligible

domestic institutions through dollar loans to central banks or similar entities. The dollars would be retained by the central banks, which would then make local currency available to the local fiduciary.¹⁷⁵

Using the AID funds, CABEI/HLD operated by purchasing 80 percent participation in mortgages on new houses which met its standards. The participations were purchased with recourse to the original lender. Twenty percent was financed locally to provide an incentive for local institutions to attract local savings and thus to become eligible for use of CABEI funds. Mortgages discounted by CABEI had an amortization period of 12-20 years and an interest rate (including all charges) of 8-12 percent per year with the maximum rate set periodically by CABEI. Minimum down payments ranged from 10 percent, increasing with the cost of the home. Maximum price of any house and lot was not to exceed \$10,000. Only new housing could be financed. In its initial operations, CABEI charged participating institutions 6 percent on loans and permitted them to charge a maximum of 9 percent to the home owner. Agreements including necessary safeguards were made with the central banks to cover both the transfer of currency and the maintenance of its value. Negotiating such agreements was probably easier in Central America than in many other developing areas because of the relatively stable currencies and price levels in member countries. The alternative in inflation-prone areas would necessarily be the development of some type of readjustable mortgage scheme.¹⁷⁶

The CABEI project was not aimed at the very lowest income level, but rather was designed to help meet middle-income demand which can be financed commercially. If private institutions could grow to meet the entire middle-class demand for mortgage financing, the limited resources of the Central American governments could then be devoted to the housing requirements of the lowest income groups.

AID estimated that 600,000 homes would be constructed through the use and reuse of the funds during the 40-year life of the seed capital loan. From the formation of the HLD in 1963 to June, 1968, however, CABEI had financed only 1,843 homes, and AID revised its 40-year estimate to 9,000 homes. While rising construction costs accounted for part of the reduced total, a major cause for the shortfall was the almost negligible primary mortgage market in Central America. At the time the loan was made, only Guatemala had an operating S. & L. system. Hence, CABEI was unable to purchase existing mortgages, and it thereby made loans for housing construction and generated its own mortgages through existing banks and housing authorities. The construction loans were then replaced with mortgages upon completion of construction. This procedure discouraged the financial institutions from seeking private sector savings and was thus counterproductive to the establishment of a home savings and loan industry.¹⁷⁷

An official U.S. audit by the General Accounting Office pointed out that during the first stages of S. & L. development in Central America, direct bilateral AID "seed capital" loans to national institutions were

¹⁷⁵ Op. cit., *Financing for Housing and Community Facilities in Developing Countries*, Annex III, United Nations, 1968, pp. 63-64.

¹⁷⁶ *Ibid.*, pp. 64-65.

Op. cit., U.N. Draft-69, pp. 26-27.

¹⁷⁷ General Accounting Office Draft Report: Survey of U.S. Assistance Channeled Through the Regional Office for Central America and Panama, Apr. 29, 1969, pp. 65-67.

more successful stimulants to their growth than the loans made through CABEI. This was the result of CABEI's own institutional infancy and technical weaknesses that made it the prey of political manipulation by the Central American directors of the funds. Loans were made on an "equal share" basis, rather than on the basis of effective demand and institutional preparedness on the part of member countries.

Between 1963 and 1968, CABEI made loans of \$1.9 million to Guatemala, \$2 million to El Salvador, and \$2 million to Costa Rica for general middle class housing construction finance. Nicaragua and Honduras received respectively \$2 million and \$1.5 million in CABEI subloans to establish savings and loan systems. None of these loans precluded AID bilateral seed capital lending to countries receiving assistance from CABEI.

AID's loan to CABEI also provided for the possibility of CABEI issues and sales of bonds as a means of acquiring more funds for mortgage financing. CABEI has not utilized this authority because its board of governors (the presidents of the member countries' central banks and the five Ministers of Economy) are reluctant to issue bonds which may compete with their own governments' issues.¹⁷⁸

In addition to the delays caused by the need to pass laws and set up national housing agencies, the failure of private institutions in Central America to mobilize savings and finalize eligible mortgages led to problems in fully utilizing the initial CABEI capitalization. Moreover, CABEI had considerable difficulty during its early years in explaining its program and gaining acceptance as the primary regional institution concerned with housing and the allocation of financial resources. Its job was further complicated by a lack of trained managerial personnel.¹⁷⁹

AID officials have stated, however, that despite its deficiencies CABEI has been successful in establishing regional housing construction standards and in standardizing housing finance and mortgage practices in Central America. They also observed that as a result of past assistance from CABEI, local credit institutions are now more interested in the use of their own funds for home mortgages.

By acting as a coprimary financing agency, however, CABEI still has not fulfilled its function as a secondary mortgage market for Central American housing finance agencies. Nor has it been instrumental in creating primary mortgage lenders that would marshal the savings of the region, rather than merely construct homes. Given the existing circumstances, however, these shortcomings could be justified.¹⁸⁰

Despite these departures from the original concept of the initial \$10 million seed capital loan, AID officials still feel there is definite potential in CABEI to fulfill its intended functions. To strengthen its financial capacity, AID has recently authorized a \$10 million housing investment guaranty to the Central American Bank for Economic Integration. These funds will be channeled primarily to those home credit institutions devoted exclusively to generating savings for housing. The loan, to be accompanied by technical assistance, is intended to remedy the lack of communication between CABEI and

¹⁷⁸ Ibid., pp. 67-69.

¹⁷⁹ Op. cit., U.N. Draft-69, pp. 27-28.

¹⁸⁰ Op. cit., GAO Draft, pp. 68-70.

the local home credit institutions¹⁸¹ and to stimulate the development of a secondary mortgage market for the region. In order to attain this objective AID insisted under the guarantee program that CABEI maintain a minimum liquidity reserve as an incentive to induce local investment instead of merely serving as a funnel for continued U.S. financial aid.^{181a}

H. Conclusions

The savings and loan system is developing rapidly in most Latin American countries, but it cannot be expected to provide all the financing needed to eliminate the housing deficit. Even a well developed savings and loan system rarely provides more than 40 percent of the home financing needs of the country. In a developing country where more than half the families need housing and there is a high rate of new family formation, the very best systematic savings program would require more than a generation to become substantially self-financing. But homes are needed immediately. Since the beginning of the movement in 1960, Latin American S. & L.'s have financed over 100,000 new middle-income homes. The current demand of this socio-economic sector has been estimated by one IDB housing expert at a minimum of 7 million.

Thus, the savings and loan system and other forms of cooperative savings must be supplemented by additional sources of funds. It is believed that a program with an assured continuity of funds is even more important than the individual magnitude of the program, in view of the importance of building up financial institutions rather than merely financing more homes. Ideally, as the movement becomes established, loan guaranty commitments as indicators of U.S. private investor confidence will become an important device to entice domestic private funds, perhaps even potential flight capital, into the housing market. This capital will provide the basis for a secondary market, and gradually reduce the necessity for external loans.¹⁸²

Capital for housing and related facilities must be mobilized domestically if the deficit is to be substantially reduced. International assistance can best play a catalytic role, i.e., act as a stimulant and a supplement to national efforts, not as a substitute for them. The development of a secondary mortgage market is vital. The ability to convert mortgages—or other debt instruments held as collateral against loans—into cash is essential during the early years of newly established institutions, when the inflow of savings deposits and repayments is low. However, in most developing countries the opportunities for the resale of such securities is limited. The lack of institutional means, the relatively low yield and long-term on mortgages, and the understandable preferences for investments which minimize or offset inflationary risks are but a few of the obstacles to be faced. A well-conceived insurance and reinsurance program can help to improve the attractiveness of these securities.¹⁸³ Adequate

¹⁸¹ Ibid.

^{181a} Op. cit., Harold Robinson, *Housing and Urban Development Programs*, Oct. 1, 1967, p. 196.

¹⁸² Ingredients for a Successful Self-Sustaining Cooperative Housing Program, prepared for AID by Foundation for Cooperative Housing Co., pp. 23, 25, 27.

¹⁸³ "The Role of Financial Intermediaries in Mobilizing Savings for Housing," United Nations Center for Housing, Building, and Planning, February 1969, pp. 12-13.

provisions for the readjustment of investment value in an inflationary economy are also essential.

Continuing financial assistance to the Latin American savings and loan movement is necessary for the growth of these systems. Since 1960, Latin American S. & L.'s have received just over \$100 million in low-interest seed capital assistance from AID and the IDB. These funds have, in turn, generated almost \$250 million in net savings from private domestic sources, most of which has been directed toward middle-income home financing. A small, undetermined percentage of the total can be considered "pure savings." External assistance has provided the infant institutions with "instant liquidity," to give credibility to their lending claims and to nurture public confidence in their investment potential. Further assistance along these lines would seem justified in view of escalating demand for housing in urban areas. Moreover, increased private home financing permits greater Government concentration on the housing needs of the low-income sectors. After the past eight years of AID "seed capital" assistance, an intensive country-by-country re-evaluation should be made to determine the effectiveness of the program as an instrument for institution building rather than merely a funnel for U.S. financing of Latin American housing construction.

Cutbacks in overall AID appropriations in recent years have forced reductions in the seed capital lending program. Furthermore, AID officials have concluded that making successive low-interest loans to these systems no longer constitutes a stimulus, but rather a subsidy, allowing these institutions to become dependent on external assistance for capital resources rather than becoming more financially self-reliant.

On the other hand, as one top AID administrator phrased it, "Planting a seed is not enough. It must be nurtured and fertilized before the plant can stand on its own."¹⁸⁴ If one were to carry this analogy one step further, one might say that this nurturing process, if carried out under "hothouse conditions," would hardly produce a plant that could survive in a natural environment. The AID Housing Investment Guaranty Program would seem to fulfill the two demands made by current circumstances: (1) It counters the shortfall of external assistance funds from the waning AID loan program, and (2) its higher interest rates and more stringent investment preconditions force the Latin American S. & L. systems to become more aggressive and efficient in order to qualify for additional capital assistance. There are indications, however, that the implementation of this more rigorous lending program has been less than effective. Recurrent repayment delinquencies have appeared recently in some countries, which reveals a lack of capacity on the part of several S. & L.'s to operate adequately under nonsubsidized business conditions. The qualitative upgrading of these institutions would seem to depend therefore, on greater coordination between external financial and technical assistance. Such coordination calls for a greater immediate emphasis on the long-term goal of building up the financing capacity of the Latin American S. & L.'s, rather than on the short-term goal of building specific housing projects.

Under the guarantee program, AID's greatest opportunity to reduce the housing shortage and build up the capabilities of S. & L.'s stems

¹⁸⁴ Stanley Baruch, Director, Development Resources, Bureau for Latin America, AID.

from the needs and abilities of the lower-middle income population. First, these persons constitute a small segment of the total population and the total need. Second, this group can contribute toward the solution of its own housing problem. Third, these families require long-term credit rather than government supported subsidies. Highest priority should be directed toward developing home financing institutions for this group.¹⁸⁵ This conclusion would tend to support current AID ceilings on housing values financed under housing investment guaranties, although with some degree of flexibility in countries where the cost of living is high. In all cases, accompanying inputs of technical assistance are mandatory and in the current absence of other significant programs, can only be provided by AID.

Another possible means of channeling both technical and financial assistance to incipient S. & L.'s is through some type of international lending agency. While some progress has been made towards establishing savings institutions across Latin America, the need for their services spreads throughout the developing world. Little has been done in other areas to foment their growth. For this reason, it would seem advisable that a worldwide rather than a regional mechanism be created. On the other hand, the primitive stage of the housing finance industry in most developing nations would tend to limit the impact of such a specialized institution, particularly if it were exposed to the political whims of its membership. CABEI in Central America, founded until the individual national institutions were built up under bilateral assistance programs and until it began to establish a distinct identity.

A more realistic alternative would seem to be to establish an autonomous housing finance agency within an already established international lending institution, such as the IBRD, where political pressures would be muted, conditions of economic development paramount, and financing channels already available. Furthermore, bond issues to finance the agency would be attractive to investors, since they would be secured by a prestigious and trusted institution. The hesitancy of the World Bank to become involved in "housing projects" has been discussed. Nevertheless, the multiplier effects of creating private home financing institutions in developing countries should not be overlooked by this "economic infrastructure"-oriented organization. By mobilizing money not already in the market, these institutions would stimulate activity in other commercial circles and reduce the demand for government support. The stimulus provided to the domestic construction and building materials industries has already reduced the need for imports of these items in some countries. The absorption of a substantial volume of unskilled labor is another contribution of an active construction industry. The Pan American Union has concluded that, "In countries where large-scale housing savings and loan movements have begun, the process of domestic capital formation has been significantly augmented; home construction has become more and more self-financing; and the general economic cost, at least in terms of capital, has been sharply reduced."¹⁸⁶

Regardless of which channels for assistance are employed, all should function through the national housing finance systems. This approach presupposes a degree of domestic institutional development that en-

¹⁸⁵ Op. cit., Harold Robinson, Speech at Catholic University, Washington, D.C. Apr. 6, 1967, p. 29.

¹⁸⁶ "Capital Formation in Latin America," Pan American Union, Washington, D.C. 1963.

courages local savers to participate in home financing. Specific institutional development measures that should be undertaken include the following:

(1) Provide investment insurance to foster confidence in the safety of the funds deposited. In this respect, S. & L. systems could benefit from the experience of the Federal Housing Administration in the United States.

(2) Establish legal monetary correction mechanisms to permit adjustment of savings accounts and mortgage debt in inflationary economies. Care should be exercised that the indices used to adjust currency values reflect rates of inflation accurately (i.e., not give disproportionate weight to controlled prices, as in the case of Chile).

(3) Liberalize S. & L. authorization legislation to allow stock, as well as mutual, associations to operate in the private home financing field. The major restrictions should be value ceilings on housing mortgage granted by S. & L.'s; such limitations are necessary to insure that thrift institutions, lending programs serve the needs of lower-middle and middle-income sectors.

(4) Standardize documents and legal arrangements to enhance the marketability of mortgages and bonds secured by mortgages.

(5) Prevent the proliferation of housing finance activities undertaken by national S. & L. systems; i.e., avoid using the S. & L.'s to administrate "social" housing programs geared to the lowest income sectors. With limited sources of mortgage funds and limited administrative skills, such overloading of an incipient system could inhibit its effectiveness, as occurred in Chile and Ecuador.

(6) Encourage "pure" savings in S. & L. systems by diminishing competition from other sources; e.g., limit commercial bank dividend rates and yields on Government bonds, modify competitive readjustment provisions for institutions other than S. & L.'s.

(7) In cases where initial government financial support is weak, channel domestic capital from banks, insurance companies, social security trust funds, and employers into private home financing. But planners should be careful to avoid total dependence on these sources of private capital at the expense of stimulating voluntary investment in the S. & L. system.

(8) Direct the above measures toward stimulating private secondary mortgage markets to attract local investment into home financing, to lessen dependence on Government and external support, and to discourage capital exports.

Until some international mechanism is established, continued AID support for promoting these institutional reforms will probably still be required in the several forms: (a) Seed capital with "subsidized" interest rates to initiate national systems, (b) investment guarantees for ongoing systems in order to effect the above reforms and stimulate the growth of secondary mortgage markets, and (c) long-term programs of technical assistance tied to both the above to supervise and examine the activities of the central housing banks, and to help improve the legal, administrative and accounting procedures utilized by S. & L.'s.

The goal of these activities, naturally, is that thrift institutions should become permanently established in developing countries to stimulate private domestic capital formation.

Part II. Development of Credit Unions in Latin America

A. Progress and Program

Credit unions—the most readily adaptable of all financial institutions¹—help the people of less-developed countries surmount three major obstacles to economic progress: (1) usury, reflecting the unavailability of credit at reasonable interest rates; (2) the absence of institutions to accumulate savings capital; and (3) the inability to mobilize what resources do exist for effective self-help. In areas where a sophisticated industrial society and consumer economy are years away the credit union requires only a group of people and a few coins for a start. Credit unions in Latin America operate according to the same principles of thrift as do the savings and loan associations, although on a smaller financial scale and with a different type of clientele. S. & L.'s finance housing construction primarily in urban areas and largely for middle-income borrowers. Credit unions have generally originated in rural areas as self-help organizations and deal with the simpler demands of low-income groups for consumer and production credit.

As with the savings and loans, the prime motivation for membership in credit unions is to qualify for a loan. It is part of the philosophy of credit unions to use this immediate stimulus as a means of promoting savings habits. Potential borrowers are required to open a savings account and maintain it with regular deposits in order to qualify for a loan. Thus for the many people who join a credit union thinking they are joining only to borrow money, the loan acts as an inducement for them to become active savers and regular depositors.

Credit unions have a particular appeal in less developed countries. People in these areas, especially those who have been seriously exploited, are often distrustful and suspicious of all enterprises conducted to earn a profit, including financial institutions. But they can be persuaded to accept and participate in credit unions as membership organizations, where they are not only members, but also the owners and recipients of the service.²

In contrast to the recent origins of S. & L.'s in Latin America, the credit union movement was already underway in some countries prior to 1960. CU's had been set up in Costa Rica in 1954, and in Peru in 1955 under the leadership of Father Dan McClellan. In Brazil and Argentina cooperative activity was noted as early as the mid-19th century. Widespread progress was not evident, however, until the introduction of U.S. technical assistance under the 1961 Humphrey

¹ "Mobilizing the Money" A Progress Report on CUNA/AID Programs in 1966, p. 1.

² "Success," A Progress Report on CUNA/AID Programs in 15 Countries of Latin America and Africa, 1967, pp. 3-4.

Amendment to the Foreign Assistance Act (Section 601).^{*} This provision made it a policy of the United States, " * * * to encourage the development and use of cooperatives, credit unions, and savings and loan associations, * * *." Four major goals inherent in this new policy were: (1) building capital through mobilization of local savings; (2) increasing production and especially agricultural production, through access to low-cost credit; (3) developing local human resources via training programs; and (4) teaching self-government through the democratic management of resources.³

The status of the credit union movement in the twelve AID-assisted Latin American countries as of June 1969 can be summarized by the following data:^{3a**}

Credit unions.....	2, 727
Members.....	765, 159
Savings.....	\$60, 221, 079
Loans outstanding.....	\$63, 572, 985
Total loans to date.....	\$219, 144, 883

The savings total amounts to an average of \$80 for each credit union member. The average annual income in these countries is about \$100 a year, especially among credit union members, which means that each member has saved an amount equal to more than 80 percent of one year's gross income.⁴ These people saved despite the disincentives of inflation and currency devaluation. Although their individual savings are small, they add up to significant amounts when thousands of individuals become involved in the process of saving. In Bolivia, for example, savings in credit unions now exceed those in commercial banks. Credit unions have thus proved that the failure of poor people to save has been largely due to the fact that they have not been reached by institutions which provide opportunities and incentives to save, and not because there is no savings capacity among low income groups.

Unlike savings and loan associations, credit unions do not require large inputs of seed capital during the initial stages of development. Members come together because of a common bond, whether it be occupational, residential or associational (i.e., adherence to a common organization, such as a labor union or church), and appoint volunteers from the group to carry out the administrative functions of the credit

^{*}In Costa Rica, for example, during the first ten years of the credit union movement (1954-64) 39 credit coops were organized with 9,386 members and \$950,000 in savings. Since the beginning of AID assistance in May, 1964, through mid-1968, the movement increased to 147 credit unions with 21,248 members, and \$2,204,335 in accumulated savings.^{2a}

^{**}The countries affected by AID technical assistance contracts through 1969 are: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Bolivia, Colombia, Ecuador, Peru, Brazil, and Venezuela. Credit unions have also been set up in non-AID assisted countries of Latin America, which brought the total number of Latin American credit unions at the end of 1968 to 4,377 with 1,955,628 members. Total savings amounted to \$119,671,017 with loans outstanding at \$110,355,259.³

^{2a} Costa Rican CUNA/AID Program—unpublished report, 1968, pt. II, p. 4.

³ "The New Life," 1968 Progress Report on CUNA/AID Programs in 16 Countries (Latin America, Africa, Asia), p. 3.

^{3a} Progress—CUNA/AID Quarterly Report, CUNA International, Inc., July 1969.

⁴ Op. cit., 1968 Progress Report on CUNA/AID Programs . . . , pp. 2, 4.

⁵ International Credit Union Yearbook—1969, CUNA International, Inc., pp. 1, 4

union.^{6*} While the scale of individual savings is small, demands for credit rarely exceed \$100 per loan and the average amortization period is one year. Since administrative expenses can be met with credit union entrance fees, these institutions can operate on a shoestring budget.

Unlike other financial institutions, credit unions in Latin America as in the United States have no central bank through which to maintain liquidity or advantageously place their pooled surplus funds. Without such administrative centralization the credit union movement would find it difficult to expand beyond the smallest scale local operations. Following the U.S. pattern of forming credit union membership leagues and federations,^{**} Latin American credit unions have begun to centralize their funds, putting any surpluses to work either by interlending among themselves, or by investing with local banks. By establishing their credit with local banks, they are also preparing to qualify for larger investments from overseas credit unions and their cooperative financing agencies. Under U.S. technical assistance programs, centralized data processing is being introduced to pave the way for improved statistical and auditing services.⁷ These developments are still in their initial stages, however, and much remains to be done to organize disparate Latin American credit unions into coherent national and international movements.

Although credit unions traditionally provide their own operating capital from the savings of members, in some cases where credit demands were particularly great, credit union development programs have been given seed capital loans by AID, by country and area development banks, and by the IDB. The IDB made a \$1 million loan in 1963 to the Peruvian Central Credit Union headed by Father Dan McClellan. AID has made loans to the credit union federations of Bolivia (local currency equivalent of \$300,000 in 1965), Ecuador (\$1.2 million to Co-op Bank in 1965), and Honduras (total of \$2 million local currency equivalents in 1964 and 1968). The major part of AID assistance to Latin American credit unions, however, has been in the form of grant funds for technical assistance. In Ecuador, seed capital loans are made by the cooperative bank to local credit unions which have good management, good accounting records, and are in need of additional funds for agricultural production loans.⁸ Over 97 percent of the 1968 Ecuadorian credit union loan portfolio

*Overhead costs are relatively low. From 70-80 percent of all organizational and administrative work load is provided by volunteer workers—volunteer organizers, committeemen, etc.—this approach greatly reduces administrative costs. Without the volunteer input, the programs could not operate so successfully and inexpensively. In most instances, credit union development becomes a community project and has widespread assistance and enthusiastic support.^{6a}

**Credit-union leagues and federations are non-profit, voluntary organizations of credit unions. They are formed on a geographic basis and funded through credit union member dues. They perform various services for member credit unions, including bonding, insurance, training of officers and members, and providing information.^{6b}

⁶ Dublin, Jack, *Credit Unions—Theory and Practice* (Wayne State University, Detroit), 1966, pp. 29-30.

^{6a} "The Role of Rural Credit Unions in Developing Countries," Unpublished Report by AID, 1967, p. 6.

^{6b} Op. cit., Dublin, Jack, *Credit Unions*, . . . , pp. 84-85.

⁷ Dublin, Jack, "Cooperatives in Latin America," (unpublished draft), April 1969, p. 7.

⁸ Dublin, Jack, "Capital and Credit for Cooperative Development," Speech at International Cooperation Day Conference, Department of State, Washington, D.C., October 21, 1968, p. 6.

⁹ Op. cit., "The Role of Rural Credit Unions in Developing Countries," unpublished 1967 AID Report, p. 2.

(about \$4.9 million outstanding) was in agricultural production loans.^{8a} Such loans are illustrative of the trend which has recently characterized Latin American credit union policy away from lending for consumption purposes and toward an emphasis on lending for productive investment.

Latin American credit unions do not face the same problem of competition for private savings as do the savings and loan associations. Credit unions simply cannot pay dividends as high as many other banking institutions. However, credit union members point out that while they could earn more dividends on their modest savings from other organizations, the latter offer no opportunity to obtain small loans at reasonable rates and terms.* Standard credit union rates on loans are 1 percent monthly with a maximum amortization period of one to three years.

The decision of these people to save in credit unions is based as much or more on an emotional involvement in building their own cooperative finance system as on the economics of investment.⁹ For this reason, the lack of monetary readjustment legislation for credit unions operating in an inflationary environment has not severely inhibited their progress. Recent pressures in urban areas, however, especially in Brazil and Chile, have prompted technical assistance advisors to suggest some safeguards to maintain the value of credit union assets.

A number of problems face the expanding credit union movement in Latin America, most of which can be overcome only with additional technical assistance.

(1) ACCESS TO MONEY MARKETS

The large number of new credit unions require extensive service and assistance from their Federations (particularly where the unions are widely scattered in rural areas), yet they cannot provide much financial support in return. Caught in an income/expense squeeze, the Federations discover themselves filling an urgent need but at the same time delaying the construction of a self-supporting movement. Some Federations now face the difficult dilemma of concentrating either on the growth and development of existing credit unions or on rapid expansion. Practical programs are needed to assist Federations in obtaining "seed capital" loans from banks and government sources for relending to credit unions.

(2) TRAINING

Credit union movements are rapidly outgrowing the time and manpower available for training, advisory and educational assistance. Additional support is necessary to promote the organization and

* Credit unions cater to a small-scale market which would not be of interest to the larger financial institutions. For example, market vendors borrow from the credit union in the morning to buy merchandise, and repay in the evening at a reasonable rate; fishermen borrow to buy nets and boats; farmers buy seed and fertilizer; and artisans borrow on short-term for tools and materials.

^{8a} Op. cit., *International Credit Union Yearbook—1969*, p. 4.

⁹ Op. cit., "The Role of Rural Credit Unions . . .," 1967 AID Report, pp. 3-4.

training of new credit union groups beyond the limits imposed by the slow accumulation of dues income in the Federations.

(3) TECHNICAL SERVICES

Needs emerging for growing credit unions include insurance and bonding protection by national federations. Peru and Bolivia have already provided coverage through their own programs. Ecuador and Nicaragua are in the process of doing so.¹⁰ National credit union federations are also responsible for centralizing funds to permit credit union interlending. More rapid progress in this direction requires increased technical assistance.

(4) REDIRECTION OF CREDIT

When credit unions were first introduced to Latin America, most loans were made to purchase consumer goods. Recently efforts have been made to redirect credit to productive investment, whether into rural agriculture or urban small business ventures. U.S. and Latin American technical advisors hope to channel 80 percent of credit union loans annually into such capital mobilization for economic development.

B. Pre-Credit Union Capital Market

The following excerpts from case studies illustrate the change in local capital markets after credit unions were established.

Managua, Nicaragua:

It has been customary for years for the small business people doing business in this market place to borrow 500 *cordobas* from a moneylender and repay 600 within 40 days. Now they borrow at 1 per cent a month, ignore the loan sharks, and are able to tell wholesalers what they want, without having to accept whatever the wholesaler offers.

Guatemala City, Guatemala:

One member had borrowed \$50 from a loan shark and in two years had paid back \$500 in interest and still owed the \$50. The credit union made him a loan of \$50 and went with him to the loan shark to impress on him that he was finally paid up with the moneylender and that the credit union was a good idea. That member has more than \$100 in savings today * * *.¹¹

In Rio de Janeiro, Brazil, a taxi driver with three children could only afford to educate his older son. When asked why he didn't borrow to buy books and pay for schooling for the other children, he said, "It would cost me 35 to 50 percent a year to borrow \$10 or \$15 for books and tuition." As he borrowed, he thus used up the opportunity to educate the second or third child. It also reduced the family food.¹² By borrowing at a credit union at the rate of 1 percent per month, this unhappy situation could have been avoided.

¹⁰ Op. cit., 1966 Progress Report on CUNA/AID Program.

¹¹ "Things Are Happening in Central America," *The Credit Union Magazine*, February 1968, pp. 38, 40.

¹² Statement of Congressman James G. Fulton, Pennsylvania in Hearings before the Committee on Foreign Affairs, House of Representatives on H.R. 15263—Foreign Assistance Act of 1968, p. 971.

The above examples were taken from large urban centers in Latin America. A more detailed study has been done on the informal credit market in rural Chile. The study observed that prior to the introduction of credit unions into rural areas, exorbitant rates of interest to small farmers were possible because of the rural lender's semi-monopolistic position.¹³ The study indicated that compared to the formal credit market,* loans in the informal credit market** are usually smaller, granted on a more personal basis, unsecured beyond verbal pledge, and much more expensive. Approximately 30 percent of the total rural population in Chile are clients of formal credit institutions; the remaining 70 percent do not have access to the formal credit market. The former group constitutes the more affluent borrowers who pay an average rate of 18 percent annually to the formal credit institutions. Low income farm operators negotiate most frequently with lenders of the informal credit market and often pay over 50 percent annual interest on loans. Even with inflation discounted from interest rates on currency loans, most local commercial lenders emerge with positive rates ranging from 27 percent to 360 percent, with an annual mean rate of 82 percent.¹⁴

Informal loans in rural Chile are quite small, as is the general case in other underdeveloped rural areas. A field survey found that 78 percent of the informal credit market loans were for amounts less than \$200, and 97 percent were for loans of less than \$1,000. The most typical term was "until the harvest" (from six to nine months) with 40 percent of the loans carrying this term. Most borrowers cannot repay on a shorter term since nearly all substantial earnings come from the annual harvest.

The number of informal commercial lenders (moneylenders and village stores) within a rural credit market area ranged from zero to seven, with a mean of two lenders. The areas with zero or one lender were the neighborhoods of dispersed settlements in the countryside, while the areas of five and six lenders were always nucleated population centers. The ratio of borrowers to these lenders ranged approximately from a low of 100 to 1 to a high of 1,000 to 1. This empirical evidence establishes the range of imperfect competition from monopoly to duopoly to oligopoly. In a sampling of 200 low-income farmers, there was no case where a borrower switched to another moneylender because of price competition (interest rate). In fact, each moneylender's share of the rural credit market area was nearly stationary.¹⁵

The empirical evidence also supported the conclusion that usurious rates are due substantially to the high degree of imperfect competition. Demand for credit is determined by the necessity of farm operators to keep their farms in operation and to support their families until the

*The formal credit market includes state financial institutions, reform agencies, and private commercial banks.

**The informal credit market includes friends, neighbors, relatives, *patrones*, village stores, itinerant traders, and moneylenders.

¹³ Nisbet, Charles, "Interest Rates and Imperfect Competition in the Informal Credit Market of Rural Chile," in *Economic Development and Cultural Change*, vol. 16, No. 1, October 1967, as reprinted by the Land Tenure Center, University of Wisconsin, LTC Reprint No. 39, p. 78.

¹⁴ *Ibid.*, pp. 73, 74, 76, 84, 85, 88.

¹⁵ *Ibid.*, pp. 79-80, 81, 83.

next harvest, rather than by the farmer's estimate of his marginal efficiency of investment.

Charles Nisbet, the author of the Chilean study, adds that the past policies of private and state lending institutions have contributed to the maintenance of imperfect competition in the informal credit market and to the accompanying high rates of interest. Until 1959 there was no important institutional source of credit for the "low income sectors," and as late as 1964 only 4 percent of the total credit extended by private and state lending institutions went to farmers within this sector. His recommendations to improve the credit situation for the small farmer in Chile include providing institutions which depart from traditional Chilean banking practices; i.e., require little or no paper work and no collateral and deliver money or goods without delay. Such institutions would have to contend with the reluctance of the small farmers to submit to highly formalized loan procedures, and a distrustfulness of "outside" personnel to handle their finances. The author also suggests the need to elevate the "credit-worthiness" of borrowers to enable them to compete for credit from existing institutional sources.¹⁶

The above study did not specifically cite credit unions as an alternative to the informal commercial capital market. Most technical experts, however, are convinced that the credit union is the only institution which can operate on a small-scale, local level according to the criteria mentioned above, meet the competition of the money-lenders, and place the small farmer on a more independent financial footing.

C. Recent Efforts in Latin American Credit Union Development

(1) ORGANIZING CREDIT UNIONS

The credit union begins not by immediately supplying credit, but by teaching low income wage earners and farmers to save. In this way credit unions not only meet a basic need of poor people, but they also give fresh hope that the less developed countries can mobilize savings to meet a larger proportion of their capital requirements.

In order to obtain a loan, a credit union borrower must agree to save during the life of the loan. This induces borrowers through their own self-help efforts to pull themselves out of debt—a great achievement for a man who has long been burdened by high-cost loans from usurious moneylenders. From the standpoint of the credit union as a mobilizer of savings, this practice has the effect of putting credit to work in generating additional savings.¹⁷

The "indigenous" and trusted individuals who have been responsible for initiating and supporting much credit union activity in Latin America have been parish priests. These men naturally require no remuneration for their services and in most cases have already attained positions of responsibility and leadership in the community. The case of Father Dan McClellan's achievements in Peru has been most frequently cited. As another example of Church involvement in the

¹⁶ *Ibid.*, pp. 84-85.

¹⁷ "Mobilizing Savings Through Credit Unions," Unpublished Report by Harry W. Culbreth, Global Project Director, CUNA, International, Inc., Washington, D.C., July 15, 1968, pp. 1-2, 4-5.

credit union movement, U.S. Maryknoll priests, beginning in 1964, organized the San Pedro Savings and Credit Cooperative in an old quarter of La Paz, Bolivia. Within three years, the cooperative's 830 members—mostly working class Bolivians—amassed over \$30,000 in savings, deposited for the most part in the local currency equivalent of a dollar or two at a time. The maximum loan permitted is \$1,250, but few members have the required earnings or security to borrow that much. Most members' cash incomes are less than \$50 a month. Borrowing is primarily for consumer items—apartment deposits, furniture, children's school fees, land, even funerals. There have been practically no defaults.¹⁸

The founder of the Bolivian cooperative, the late Father John Higgins, pointed out that the major initial obstacle to setting up the credit union was ignorance.

When we started, we held an eight-week course just to get across the idea that money would be safe in something besides jewelry and gold nuggets. And the idea (that) you could put in \$100 and get back \$110 in a year, without doing anything, was completely mystifying.¹⁹

(2) REDIRECTION OF CREDIT: ECUADOREAN EXAMPLE

The problem of acculturating people to new techniques of saving was further complicated when credit union organizers attempted to redirect credit into productive investment. But with the aid of external technical assistance one such program proved highly successful in Ecuador.

For years Ecuador's small farmers had been on the fringe of the economy, constantly in debt to usurious moneylenders and barely scraping out an existence from their tiny farms. Merely supplying them with low-cost credit would not solve their problems since they did not know how to use it wisely. The solution came through a special AID program first administered in 1964 in coordination with the U.S. Credit Union National Association (CUNA). The program combined credit union services with the technical training necessary to farm profitably. The pilot project began in the Andes Mountain village of Julio Andrade,* and then spread to sixteen other areas of Ecuador.

In Julio Andrade the role of the parish priest as a supporter of the new institution was important, since he permitted the village church to be used as the credit union office at no cost. Members attended classes to learn about the credit union, its organization, and their role in it. The stress was on productive loans; i.e., those which would produce income so that they could be repaid. Loans were granted only after the member showed exactly how he planned to use the money and followed the advice of the agricultural extensionist. Aside from teaching new, more efficient methods of planting to increase yield, the extensionists encouraged diversification to eliminate total dependence of the farmers on the earnings from a single crop.

*Julio Andrade consists of a 55-square mile farming area with about 1,000 families. It is situated near the Columbian border.

¹⁸ "Changing Role of the Church in Latin America," *U.S. News and World Report*, October 16, 1967 pp. 94-95.

¹⁹ *Ibid.*

One side effect of the program, noted by the managing director of the Ecuador Credit Union League, was the drastic change in the life and outlook of the *campesinos* who participated in the credit union operation. It gave them an incentive to place renewed hope in the land, rather than in urban employment. Besides putting the local loan sharks out of business and helping farmers increase production from 100 to 500 percent, the credit unions created a sense of social consciousness, as well as a community obligation to the credit unions. In the case of Julio Andrade Credit Union, more than \$95,000 was loaned between 1964 and 1967 without any writeoffs. Of the approximately \$38,000 in loans outstanding as of mid-1967, only five were delinquent and these amounted to \$141.

Most of the credit unions participating in the CUNA/AID Ecuador program are purely agricultural, but a few are in the semi-rural class. As a result, their loan portfolios also contain loans for productive purposes to artisans, small businessmen, and small industry. As of mid-1967, the 17 credit unions in the program had more than 6,000 members with nearly \$400,000 in savings and more than \$500,000 in loans outstanding.

Filling the gap between the savings of the members and their loan needs is the Bank for Cooperatives of Ecuador. The co-op bank was established in 1964. Its working capital comes in small part from investments by the credit unions and co-ops themselves, but its major source of funds is a \$1.2 million line of credit from AID and a 20-year loan from the Ecuadorian government. Between 1964 and 1967 the co-op bank made \$600,000 in loans to 93 credit unions and 8 cooperatives.* The bank lends in proportion to what the credit union's loans are for: For each *sucre* (\$1.00=18.18 *sucre*s) a credit union has out in productive loans the bank will lend three; for each *sucre* in consumer loans, the bank will lend one.** At Julio Andrade, for example, in mid-1967 the members had \$15,000 in savings but \$37,667 in loans, made possible because of a \$23,250 loan from the co-op bank.²⁰

(3) CREDIT UNION EXPANSION PROBLEMS

The inevitable result of the successful operation of local credit unions is expansion which, of course, places strains on the inadequate management, administrative and technical capacities of these young Latin American institutions. Even at the early stages of their activities, local credit unions recognize the need for a national "service" organization. When only 15 or 20 credit unions have been started in

*The distinction between credit unions and cooperatives is primarily a difference in function; credit unions specialize in the mobilization of savings and the making of loans—in the management of money. Other types of cooperatives specialize in such things as the marketing of agricultural products, the distribution of consumer goods and the development of housing. Regardless of their functional differences, both institutions make use of the cooperative form of corporate structure; i.e., the members control the policies of the organization through the one member-one vote procedure. ^{20a}

**The co-op bank lends to credit unions at 7 percent annual interest rate which includes a government tax of 1 percent.

²⁰ "Teaching Grassroots Economics in Ecuador," *The Credit Union Magazine*, CUNA International, Inc., September, 1967.

^{20a} Op. cit., Harry W. Culbreth, "Mobilizing Savings through Credit Unions." July 15, 1968, p. 11.

a country, the leaders usually proceed to organize a credit union league or federation at a national level. Membership in the federation is open to all credit unions in the country. Those who join it finance its operations with dues. The league, in turn, helps the credit unions prepare promotional campaigns to build up savings, provides information and training on loan procedures and credit regulations, and assists in some cases in persuading the members to use credit productively. Other services provided by the federations include bonding, insurance, and most importantly, the management of interlending.

Some credit unions in every country accumulate more in savings than they need at a given time to meet the loan demand of their own members. This usually occurs in urban credit unions whose members' cost of living tends to rise more slowly than their incomes. Other credit unions, particularly those in rural areas, have a greater demand for loans than they are able to accumulate in savings. This discrepancy produces the opportunity for interlending between credit unions. The federation places the lending and the borrowing credit unions in touch with each other. The federation serves to mobilize the unloaned capital in one credit union for loans to members in another credit union. It thus helps to keep the funds at work in generating additional savings. Credit unions in the United States operate on a similar principle.

In the process of mobilizing the savings of low income people, the federation also raises capital within a country for use by its member credit unions. In Bolivia, for example, the federation borrowed \$300,000 in local currency from AID in 1965. It loaned these AID funds to its member credit unions, increasing their capacity to make more loans and thereby to generate more savings. AID has recently made the Bolivian federation another loan of \$500,000. A similar process is under way in Honduras, where AID made a \$500,000 loan in local currency to the federation in 1964. It was used so effectively that AID made another local currency loan of \$1.5 million in July 1968.²¹

Another service performed by federations that is indispensable to efficient interlending on a large scale is the Centralization of Funds and Accounting Program (COFAC). The program was started in Panama in December 1967; 110 credit unions in that country had accumulated savings of \$1,250,000, but had balances in individual bank accounts which totaled \$110,000. The Federation found that by centralizing these individual accounts into one account in the Chase Manhattan Bank, and with necessary accounting assistance provided by the International Business Machine Company, it could gain the use of this float capital for loans to its member credit unions. This arrangement increased its member credit unions' working capital by approximately 10 percent. The program represented a major effort by both local and national organizations of credit unions to maximize the use of their own resources in the mobilization of domestic savings. It minimizes the possibility that credit unions will have to stop making loans for months at a time because of illiquidity, or that they will be forced to borrow money at commercial bank rates to meet their loan demands.²²

The COFAC Program, as of December 1968, had been implemented

²¹ Ibid., pp. 5-7.

²² Ibid., p. 7.

"They Saved Time, Money and . . . The League," *The Credit Union Magazine*, December 1967, pp. 5, 10.

in three countries: Panama, Colombia, and Nicaragua. In Honduras and Costa Rica planning and pre-implementation activities were under way. The biggest problem that federations will be confronting in the COFAC Program will be their ability to locate substantial amounts of "seed capital." Without "seed capital" the COFAC will be a small, efficiently run, interlending program. But without seed capital the COFAC Program will not be large enough to affect credit union development in Latin America to any great magnitude. Effective technical assistance can train Latin federation officials in such areas as centralized checking, rediscounting, negotiating loan paper with central banks, providing checking services for credit union members, and international borrowing.²³

Another type of expansion in credit union activities arising from increased centralization has been the extension of federation loans to multi-purpose cooperatives. This process widens the criteria for lending from merely "character" lending, the common practice of and between credit unions, to commercial lending based on the borrower's collateral placed as security. The Federations of Bolivia and Honduras have obtained the part-time services of technicians who have helped them make a few such commercial loans. Any expansion of activities of this type would require additional technical assistance.

A similar expansion beyond character to commercial lending has occurred in Peru. In that country the federation helped to set up the Central Credit Union in 1961 as an affiliated organization. Rather than provide an "interlending" service, as Federations have done in other countries, the Central accepted deposits from its member credit unions and made loans directly to them out of its own assets. In 1965, the Central opened its membership to other types of cooperatives. Since then it has been making commercial loans to cooperatives as well as character loans to credit unions. Its loans to cooperatives as of mid-1968 amounted to about 20 percent of its portfolio. The Central has recently taken steps to become a full-fledged Cooperative Bank. It will try to raise additional funds from its member credit unions and cooperatives and may also try to borrow from AID or the IDB. In either case the percentage of commercial loans to its cooperative members will probably increase.²⁴

In three other Latin American countries—Ecuador, Argentina, and Chile—cooperative banks with staffs fully competent to analyze commercial assets were established in 1965 to make such loans. The Co-op Banks of Ecuador and Chile have received AID loans of \$1.2 million and \$3.64 million, respectively, for this purpose. In the case of Chile, however, as of December, 1968, only 1 percent of the cooperative groups served were credit unions, the majority being agricultural cooperatives. In Peru, 71 percent of Central's clients were credit unions and in Ecuador the corresponding figure for the Cooperative Bank was 90 percent. Argentina's Cooperative Bank deals exclusively with agrarian cooperatives.²⁵

²³ Progress—CUNA/AID Annual Report, Latin America Regional Office, December 1968, pp. 11-13.

²⁴ Op. cit., Culbreth, "Mobilizing Savings . . ." July 15, 1968, pp. 10-13.

²⁵ Cooperative Banks and Financial Institutes—Latin American Cooperative Banks Program: Tables prepared by the Cooperative League of the U.S.A. (CLUSA), April 18, 1968. Summary Data on Banks and National Financing Institutions for Cooperatives in Latin America to December 31, 1968, (CLUSA tables).

But Ecuador is the only country in which the Federation and the Cooperative Bank have developed working relationships which might serve as a model for other countries. As the following discussion explains, CUNA/AID assistance to these Ecuadorean institutions has facilitated an especially productive working arrangement.

The recent development in Ecuador of Directed Agricultural Production Credit (DAPC) represents another major area of expanding federation involvement in credit union affairs. This program enables credit unions to enhance the productivity of small farmers by making small loans and rendering financial and agritechnical assistance. The program does not change or alter the characteristics of the credit union in any way; rather, it emphasizes the need to loan for productive rather than for provident needs, thereby doing much toward the mobilization of local capital.

CUNA/AID selected Ecuador as the "laboratory" for testing, perfecting, and evaluating the DAPC program, and the Ecuadorean Federation of Credit Unions gave the program special emphasis. Their efforts, especially in Northern Ecuador, provided a vital link between the isolated farmer and the national credit institution, the Cooperative Bank. Without this link—the credit union and DAPC—small farmers in Ecuador would not have been reached by the credit services of the Cooperative Bank.²⁶

Interest in the DAPC program in Ecuador has spread throughout Latin America. Organizational activity has begun in Bolivia, Costa Rica, the Dominican Republic, El Salvador, Honduras, and Peru. A number of problems lie ahead for the expansion of the DAPC program. The Bolivian credit union movement, for instance, has been concentrated in the urban centers, and much credit has been siphoned off to consumer buying. Fifty percent of Costa Rican credit unions are also in the cities. Political and legal difficulties have frozen credit union expansion of any kind in Peru for over a year.²⁷ Such situations require aggressive efforts on the part of national federations to spread the DAPC program into the rural areas.

The major obstacles to expansion, however, are not unique to specific countries, but common to Latin America as a whole. The greatest single problem is lack of "seed capital" in sufficient quantity to permit the program to move ahead at a desirable pace. Ecuador, where the most flexible operational arrangement exists between credit unions and the Cooperative Banks, is the best example of the manner in which seed capital input can stimulate growth and instill confidence in a way to mobilize local capital in large quantities. In less than three years, the Ecuadorean credit unions have attracted three times the amount of seed capital input. Of the \$1.2 million AID loan to the Cooperative Bank, about 80 percent was loaned to credit unions, which as of December, 1968, had in excess of \$3.5 million in member savings.

Most other Latin American countries do not have Cooperative Banks, and USAID Missions frequently have been unable to make loans, even in small amounts, directly to Credit Union Federations. Other national financial institutions are more concerned with making

²⁶ Op. cit., CUNA/AID Annual Report, December 1968, p. 4.

²⁷ Ibid., pp. 5-7. Op. cit., Costan Rican CUNA/AID Program, part II, p. 5 (unpublished report).

loans to agricultural cooperatives. They are suspicious about credit co-ops and their ability to manage capital, and have little or no desire to work with the small farmers.* Only minor contributions have been made by national governments.²⁸

The need for trained managerial resources also increases as the activities of the credit union movement expand. The DAPC is an aggressive system of placing credit in the hands of small producers. It calls for competent leaders to administer the credit, to render financial counseling, and to assist the small producers in obtaining the specialized technical knowledge necessary to make a success of whatever production innovations are undertaken. Thus, credit union movements in Latin America need to train, develop, and employ full-time professional management in their co-ops, permitting volunteer leadership to dedicate itself to policy making, and to analyzing both the movement's problems and managerial performance.²⁹

Increases in production achieved through the DAPC program have created a demand for the services of both purchasing and marketing cooperatives. This development places an additional burden on national credit union federations and cooperative banks to provide expanded technical assistance and seed capital resources.

D. Current External Assistance Programs

Since the implementation of the Humphrey Amendment to the Foreign Assistance Act in 1961, U.S. assistance to credit union development in Latin America has been mainly in the form of contracts with specialized private U.S. agencies to provide technical advice to the incipient Latin American institutions. This grant assistance has been accompanied in some cases by seed capital loans. The first years of AID assistance were devoted to the organization of credit unions and national federations. In all the assisted countries this phase now has been completed. The current, more complicated stage is that of working with the federations and credit unions to assist them in developing a management capability that will permit them to carry out such sophisticated programs as DAPC and COFAC.

As with savings and loan associations, AID seed money for capital assistance has become relatively sparse. In the case of credit unions the scarcity of available low-interest, public loans occurs at the critical period when these institutions are in greatest need of external capital; i.e., their period of rapid expansion. During the early stages of credit union organization, a volunteer staff and low overhead expenses permitted the proliferation of these co-ops on a small-scale, local level with a minimum of external assistance. The very success of these efforts in mobilizing local savings and expanding credit facilities has created demands to form coordinated national credit union systems, an effort which requires much larger inputs of financial and technical aid.

*In Peru, for instance, one Peace Corps official observed that although the state-owned Agricultural Development Bank is obligated by law to lend a large percentage of its funds to small farmers, in practice it does not do so, partly because it believes the *campesino* a poor risk.

²⁸ Op. cit., CUNA/AID Annual Report, December 1968, pp. 9-10.

²⁹ Ibid.

Assistance programs to date have included:

(1) AID/CUNA INTERNATIONAL, INC., CONTRACT

CUNA International, Inc., is an association of credit union leagues and federations throughout the world. Its broad purposes are to promote the organization and development of credit unions to encourage the accumulation of savings by their members, and to use such savings to make loans to such members. Since 1954, its World Extension Department has actively assisted with the organization of credit unions in overseas countries to the extent permitted by its limited resources. In May, 1962, CUNA signed a contract with AID under which AID funds were made available for hiring additional personnel to provide technical and functional assistance for the development of sound credit unions in less developed countries. Specific CUNA activities have included: (a) Examining and appraising the problems of thrift and credit as related to the economic conditions of the country or region; (b) advising government on appropriate and necessary legislation; (c) organizing credit unions and assisting in their operations and technical problems; (d) training credit union management, officials and committeemen; (e) assisting in the establishment of central organizations (leagues and federations) of credit unions and helping them plan their programs to attain early self-sufficiency; (f) providing guidance to integrate the credit union movement into an international organization; and (g) cooperating with AID and local country government and cooperative leaders in making facilities available in the U.S. or other locations for training credit union managers.³⁰ Currently, CUNA International is the largest single contractor with AID in the field of credit extension through credit unions. The contract calls for efforts in 16 countries (12 in Latin America) and on three continents; it mobilizes \$765,000 in annual funds, 67 technicians, and 777 man-months of personnel.³¹

(2) OTHER TECHNICAL ASSISTANCE AGENCIES

The Cooperative League of the USA (CLUSA) is a national federation of all types of cooperatives active in consumer goods distribution, farm marketing, farm purchasing, housing and rural electrification, credit unions, group health associations and mutual insurance companies. CLUSA has been active in providing technical assistance programs to cooperatives in developing countries since World War II. Since 1964, CLUSA and AID have been working on a program to encourage a strong and viable financing system for cooperatives in Latin America, both within countries and on an inter-American basis. Major efforts have been exerted to develop the capabilities of Cooperative Banks, with special attention devoted to these institutions, in Chile, Argentina, Ecuador and Colombia. Recent initiatives to organize such central finance agencies have also originated with CLUSA/AID assistance in Peru and Venezuela.³²

³⁰ The Cooperative as a Development Tool, pp. 15-17.

³¹ Op. cit., International Credit Union Yearbook—1960, p. 4.

³² Op. cit., The Cooperative as a Development Tool, p. 13.

"A Latin American Cooperative Banking System," unpublished Report of Cooperative League of the U.S.A.

Other cooperative organizations have offered technical assistance to Latin America in more specialized areas; e.g., the National Rural Electric Cooperative Association and the Foundation for Cooperative Housing. In both these cases, the attraction of receiving credit at reasonable rates has stimulated savings among lower income groups.

Private U.S. institutions such as the Pan American Development Foundation and the International Development Association have devised local programs of providing credit to small farmers in the rural hinterlands of Central and South America. These programs have aimed primarily at integrating these peasants into the market economy through the introduction of formal credit operations. Officials of these organizations feel that AID and AID-sponsored credit programs have reached only those farmers who have already had some degree of exposure to the money market and have achieved some economic means. The two agencies mentioned have developed lending programs to involve the very lowest income farmers, i.e., those whose chances of being assisted through government programs are nil. The Pan American Development Foundation, in particular, has tried to involve local businessmen in extending capital to rural communities in their own countries for purposes of production expansion or improvement of community facilities. Stimulating habits of thrift has been a secondary concern of such programs, but an inevitable result.

(3) PEACE CORPS

Peace Corps volunteers (PCV's) have been directly involved in the Latin American credit union movement since 1962. Several hundred volunteers have been assigned since that time to assist both rural and urban savings and credit cooperatives. Their role has been mainly that of organizing the co-ops, assisting in bookkeeping, occasionally stimulating links between the smaller credit unions and the larger production and marketing cooperatives, and in general serving as morale boosters to the new organizations. The degree of success achieved by the PCV's has depended to a great extent on the amount of cooperation received from local government agencies, and local political and religious leaders.

(4) AID FINANCIAL ASSISTANCE

As indicated above, AID seed capital loans to the Latin American credit union movement have been relatively small, primarily because, until recently, absorptive capacity has not been great. However, with the decreasing availability of U.S. public capital resources to assist these institutions, the U.S. private sector has been assigned a more active role in developing Latin American thrift institutions. In November 1967 under an addendum to the Guaranty Provisions of the FAA, Congress authorized an extended risk guarantee program to facilitate the channeling of U.S. credit union funds of up to \$1 million to Latin American counterpart thrift institutions. In 1968 \$500,000 was added to this amount, and the President's Balance Of Payments Committee authorized AID to issue contracts for the entire sum. The legislation provides for a 100 percent AID guarantee to private U.S. lenders under the program. With this type of guarantee,

U.S. credit unions can obtain in Latin America and other developing areas as much security on loans to credit unions as they can obtain from investments in U.S. savings and loan associations. (U.S. credit unions currently have over \$1.5 billion invested in insured domestic S. & L.'s.)³³

Because of the complicated administrative procedures involved in implementing such loan agreements, however, only one such contract has been signed to date. In March 1969 a \$7,000 loan was made to an Ecuadorian rural credit union by Arizona Central Credit Union of Phoenix, Arizona. Under the contract, Arizona Central is to receive 6 percent annual interest over a five year period. In addition, the borrowing credit union was charged a three-fourths percent guarantee fee and a one-half percent CUNA management fee, bringing the total annual interest charge to 7¼ percent.* According to a top official of the U.S. credit union movement, prospects for continued participation in the extended risk guarantee program are good, provided that administrative procedures can be simplified.³⁴ Pending loans as of mid-1969 amount to \$300,000 and involved credit unions and their federations in El Salvador, Dominican Republic, Colombia, and Bolivia.³⁵

E. Proposed External Assistance Programs

The two most likely sources of increased capital and technical assistance to the Latin American credit union movement are international lending institutions and private investment. Agencies such as the World Bank and the Inter-American Development Bank have been suggested as possible sources of thrift institution development loans. However, little progress has been made to date in expanding the lending programs of these organizations for credit union development.

A proposal recently approved by Congress is designed to attract such international agency funds and divert currently appropriated AID funds to promote thrift and community development in Latin America. The amendment to the 1970 Foreign Assistance Act (FAA) allocates \$50 million of AID funds as initial capital for an Inter-American Social Development Institute. The Institute will be empowered to accept funds from Latin American governments, from international organizations—such as the IBRD and the IDB—and from private sources in the U.S., Europe, and in Latin America itself. The major objective of the Institute will be to support social and civic development. Among its stated activities, the two most pertinent to the development of thrift institutions are (1) technical assistance to local governments, legislatures, peasant and urban leaders, cooperatives, credit unions, democratic labor unions, adult literacy and civic education programs, and private foundations devoted to socio-political progress; and (2) capital assistance for small-scale, self-help projects at the community level designed to enhance the incomes of *campesinos*, *barrio* dwellers, and urban workers.

*The effective interest rate charged credit union borrowers from the proceeds of guaranteed loans is expected to be 12 percent per annum or less, the standard rate for Latin American credit union lending.

³³ Op. cit., Culbreth, "Mobilizing Savings . . ." July 15, 1968, p. 8.

³⁴ Harry W. Culbreth, Global Project Director, CUNA, International, Inc.

³⁵ AID Statement on Credit Union Loan Program in Hearings before Subcommittee on Inter-American Affairs of the House of Representatives Foreign Affairs Committee, 91st Congress, First Session, Spring, 1969, p. 73.

The Institute, according to its sponsors does not require increased U.S. financial appropriations, but simply provides a more specialized instrument for doing some tasks which the U.S. presently funds through AID and through a number of international organizations.³⁶

It has also been suggested that the Latin American Federations might be able to get special priorities in obtaining loans from the International Cooperative Bank in Basel, Switzerland, which has assets of \$90 million. The Bank is owned and operated by the Co-operative Banks in Austria, Germany, Israel, and Switzerland and by Cooperative Wholesale Societies in twelve European countries. At present, CUNA is considering membership in the International Cooperative Bank. Such a move would help open a loan window for Federations in the developing countries at this worldwide institution of cooperatives.^{36a}

Increased U.S. private investment in Latin American cooperative development was promoted through an amendment to the 1969 FAA proposed by Congressman John E. Moss of California. The legislation authorizes AID to issue guaranties to private lending institutions, cooperatives and private non-profit development organizations in not more than five Latin American countries. These guaranties, in surplus Latin American currencies held by the United States, would assure against a loss of up to 25 percent of the total loan portfolio of any single Latin American institution. In no case is U.S. liability to exceed 75 percent of any one loan. The maximum amount of guaranties permitted under section 240(c) of the 1969 FAA is \$15 million. Not more than 10 percent of that sum is to be provided for any one institution, cooperative or organization. The Inter-American Social Development Institute is to be consulted in developing criteria for making loans eligible for guaranty coverage under this provision.^{36b}

While not directed specifically at financing thrift institutions, the guaranteed funds will channel local credit to economically marginal communities for self-help projects. Such activity has had the effect of mobilizing capital in ways similar to those employed by rural credit unions and will conceivably stimulate the formation of credit unions once the habit of saving for productive investment has been established.* The low default rate on the type of loans covered by the amendment (5 percent) put the estimated cost to the United States of guarantee participation at \$750,000.

Some controversy has arisen between AID officials and various technical experts on the potential for attracting sufficient funds without a 100 percent guarantee. Preliminary research has indicated, however, that several Latin American financial institutions are optimistic about the program potential.³⁷

*The operations of the Pan American Development Foundation have indicated that such local formal credit facilities have indeed promoted increased capital mobilization for productive investment.

³⁶ Background Memorandum, U.S. Congress, Committee on Foreign Affairs, "Why the Inter-American Development Institute?" 1969.

^{36a} Op. cit., Culbreth, "Mobilizing Savings . . ." July 15, 1968, pp. 8-9.

^{36b} Op. cit., Conference Report on Foreign Assistance Act of 1969, H. R. 14580, Dec. 18, 1969, pp. 14-15.

³⁷ J. Stang, "Community Development Legislation Pending for Latin America," *National League Journal* vol. 24, No. 7, July 1969, pp. 26-28.

F. Conclusions

The above summary of credit union activity in Latin America makes it clear that the very success of the movement on a small scale has created its current problems—the expansion has led to the need for increased technical and managerial sophistication. The trend in the Latin American credit union movement is to acquire outside financing as a means of (a) bringing about a faster pace of credit union development, (b) increasing the rate of savings mobilization, (c) entering into production credit programs, and (d) providing a greater scope of financial services to credit union members.³⁸

The Centralization of Funds and Accounting Program (COFAC), which is in its initial stages of implementation in some countries, constitutes a response to the need for centralization of national credit union financial administration. It serves the needs of scattered and primarily rural credit unions where heavy seasonal demands for credit place strains on liquidity. The obligations of such interlending systems are increasing rapidly, however, and national federations and cooperative banks are finding it more difficult to finance the needs of member credit unions without additional seed capital, as well as a greater number of skilled financial administrators.

The Direct Agricultural Production Credit Program faces similar difficulties in its effort to increase the productive capacity of the rural population through the savings mechanism. In this case, not only additional capital and trained financial managers are necessary, but also skilled agricultural technicians to advise *campesinos* on the most productive ways to utilize their borrowed funds. These more advanced programs require salaried personnel; thus, the operating costs of credit unions are rising relative to the initial period of organization when a few community volunteers could manage the simple accounting procedures.

One Peace Corps official has pointed out that while DAPC is certainly a worthwhile program in rural areas, urban credit unions have been neglected by such efforts to stimulate productive investment. In the cities, most credit union borrowing has been channeled into consumer spending, especially in areas where such spending provides a hedge against inflation, as in the case of Chile. Nevertheless, even in these countries, the accessibility of credit unions to lower income wage earners has encouraged habits of thrift, since only a minimal savings balance qualifies the individual for a loan. The Peace Corps official also suggested that if credit unions were protected by the same monetary readjustment provisions as savings and loan associations in inflationary economies, they would have even greater success in attracting small savers.³⁹

As of December 1968, total participation in credit union movements in the twenty Latin American republics and Guyana was estimated by Credit Union National Association International as follows:⁴⁰

³⁸ Op. cit., Progress, CUNA/AID Annual Report, December 1968, p. 13.

³⁹ Bruce Potter, former Program Officer, Latin America Region, Peace Corps, Washington, D.C.

⁴⁰ Op. cit., International Credit Union Yearbook—1969, pp. 20-21.

Total membership.....	1, 999, 373
Number of credit unions.....	4, 605
Total savings.....	\$127, 025, 516
Total loans outstanding to members.....	\$119, 091, 516

The achievements of credit union organization to date seem pale, however, next to the overall population statistics for Latin America, which estimate the current number of inhabitants at approximately 275 million. Over 40 percent of these people have an average annual income of below \$130,⁴¹ and at least that number are potential credit union members—potential sources of increased capital mobilization for development.

Clearly the technological and financial gap must be bridged before credit union expansion can take place to any great extent in the future, and before these thrift institutions will be capable of serving the mass of the public. External assistance has in the past tried to serve these needs, but the more specialized nature of the current problems require a more coordinated and concerted approach on the part of international assistance agencies. In addition to continuing present AID and private agency grant and loan assistance programs, several proposals have been discussed above as means of channeling additional seed capital and technical expertise to national credit union federations and cooperative banks. Most of these measures have not yet been implemented, and there is little data upon which to evaluate their potential effectiveness. The one private loan which has been signed under the AID Extended Risk Guaranty Program (ERG), i.e., the 1969 loan by Arizona Central to La Guaranda Credit Union of Guaranda, Ecuador, has not been in effect long enough to evaluate the impact of its contribution and the potential contribution of the ERG program on credit union development. The problem of simplifying international inter-lending documentation has still not been solved and continues to hinder a more rapid flow of private U.S. seed capital to these Latin American thrift institutions.

While the organizational problems of Latin American credit unions and savings and loan associations differ in degree and kind, their needs are quite similar; i.e., additional seed capital to support expanded operations and growing demands on liquidity, and increased long-term technical assistance to prepare the Latin Americans to administer their own thrift institutions. Some means to achieve these operational goals have been suggested, but all remain open to re-evaluation. The proven value of credit unions and S. & L.'s, however, as mobilizers of private domestic capital from lower and middle income groups, their potential as sources of productive investment, and their contribution to the managerial, financial and technical training of local middle-level administrators attest to the need for aiding their development.

⁴¹ Social Progress Trust Fund Eighth Annual Report, Inter-American Development Bank, 1968, p. 367.