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**financiamiento del desarrollo**

**A**ccess to credit in Argentina

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## Abstract

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The present work examines the access to credit by financially constrained SMEs in Argentina over the last decade, focusing on the role played by public banks, state credit policies, and non-traditional lending contracts such as leasing, factoring, microcredit and others. We loosely define financially constrained firms as those with good projects and insufficient internal funding. Our conclusions are the following: (a) Since not all SMEs are financially constrained in the previous sense but many of them would be willing to raise at better-than-market terms, a major challenge of any governmental policy aimed to deal with market failures (asymmetric information and intermediation costs) is to carefully sorting out applicants; (b) However, the actual operation seems to lack the technical independence nor resources to implement this basic principle; (c) More importantly, credit policies do not show the desirable degree of transparency towards taxpayers and other interested parties, making it difficult to pass any sound judgment about the impact of the programs in place on production, employment, and income distribution; (d) Based on publicly available information, public banks do not appear to perform better than private banks in improving the access to credit; and (e) Non-traditional instruments should not be expected to be the key for a structural solution to this issue. We finally propose a number of practical guidelines to strengthen the effectiveness, transparency and accountability of governmental credit policies.



## Introduction

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It is a profusely documented fact that the development of credit markets boost national economic growth and welfare (see Levine (2005) for a survey). Credit markets improve the selection and monitoring of productive and consumption projects, contain financial and liquidity risks, and reduce the costs of mobilizing funds across economic units. However, the functioning of this market is far from perfect, as transaction costs and asymmetric information create serious obstacles in the intermediation process. The problem stems from the fact that borrowers have better information and control over the projects and enjoy limited liability on their unpaid debts, which jointly encourage debtors to disguise the actual risk of their projects (adverse selection), to apply the funds to riskier projects than the ones agreed upon with the creditor (moral hazard) and to falsely declare default. As a conflict of interest unravels jeopardizing their expected returns, uninformed creditors react by raising the cost of capital and even rationing its supply, undermining the ability of both good and bad projects to tap financial markets. This kind of behavior has been intensely investigated since the 1980s in the finance and institutional fields.

Our main interest is to assess, focusing on the Argentine case, the access to credit for small and medium enterprises, which are the most likely group to be afflicted by the asymmetric information syndrome, and to discuss the role played in this regard by public sector intermediaries and policies.<sup>1</sup> Defining access to credit is a tricky issue

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<sup>1</sup> Strictly speaking, one should include in this definition both the credit for productive purposes as well as that for welfare-enhancing consumption. However, we will restrict ourselves to the analysis of the former.

that requires further clarification. From a social point of view, one should only be concerned about financially constrained units, that is, those that are willing to use internal funds to undertake profitable projects but, lacking those funds, are unable to obtain capital at a similar cost (or at any cost, for that matter). In a more general setup, the financial constraint should be characterized in a broader sense to include all credit conditions, namely: amount, interest rate, maturity, and collateral, all of which will be discussed throughout the paper. From now on, we will refer to access to credit in this narrow sense, restricting our attention to the segment of SMEs. In this way, we are disregarding cases where credit (i) is not used because of insufficient demand – some firms may not need external funding, be it due to lack of good investment opportunities or to adequate internal funding; or (ii) is over-used because of moral hazard –some firms may borrow to develop projects that they would not with their own money so as to take advantage of their limited liability. Even though it is hard to make this notion operational, it is important to recall that not all new credit is bound to create a net social gain.

It should come as no surprise that a large number of Argentine SMEs find it difficult to gain access to credit. For instance, based on a survey of 1,200 industrial SMEs, Observatorio Pyme (2006) shows that only 8% of the investment expenditures is financed with bank credit, while self-financing represents 83% -other sources account for the remaining 9%. Using a similar earlier survey and balance sheet data for 140 SMEs, Bebczuk (2003a) finds an average loans-to-assets ratio of just 13.3%, with most of the credit coming from overdraft lines at high interest rates and short terms.<sup>2</sup> However, we will contend later on that laying excessive emphasis in these leverage indicators as an indisputable symptom of financial constraints might be misleading.

Apparently, faced with the disruptive frictions previously described, the traditional loan market seems to be unable to fully meet the financing needs of this segment of firms. Accordingly, this calls for at least two options to be explored throughout the paper, one being an active public sector intervention in the market, and the other being the use of credit instruments other than traditional loans. Given the broad scope of our work, the methodology will be mostly descriptive. The organization is as follows. In Section 1, we portrait the situation of public banks in Argentina. In Section 2 attention is devoted to non-traditional credit instruments. We evaluate our findings in Section 3 and discuss some viable policy options in Section 4.

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<sup>2</sup> Formal tests have been conducted for big and listed firms in Argentina confirming the presence of financial constraints (see Fanelli et al. (2002) and Elosegui et al. (2006)).

## 1. Public banking in Argentina

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Asymmetric information represents a market failure, in that risky and dishonest borrowers create a negative externality on safe and honest ones. As with any market failure, some state intervention is warranted via the regulatory regime and, more directly, through the ownership of commercial banks.<sup>3</sup> As a matter of fact, the financial industry is one of the most regulated activities around the world, on the grounds that it is the government's duty to monitor banks' moral hazard behavior so as to protect small and uninformed consumers and to prevent the systemic effects of financial instability.<sup>4</sup> While a widely accepted intervention, critics point to the strong assumption that regulators are benevolent and able to undo the potential wrongdoing of private agents (see Barth, Caprio and Levine (2003) for arguments and cross-country evidence). A similar controversy surrounds the operation of state-owned banks. Private banks may refuse to serve some clienteles because they are too difficult to screen and monitor, or because intermediation costs are prohibitively high. Small and young firms, as well as the population living in poor and distant regions, are likely to be excluded from formal credit markets. In dealing with these market failures, below-market interest rates, longer maturities, and innovative instruments may be part of the toolkit. The usual caveat is that public banks suffer from severe agency problems themselves, as they are subjected to distorting political interference, have managers appointed

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<sup>3</sup> Other forms of intervention are the passing of bankruptcy laws (see La Porta et al. (1998) and the building of public credit registries (see Japelli and Pagano (2001)).

<sup>4</sup> The desire to promote particularly strategic sectors from a policy point of view or to smooth business cycles are additional arguments in favor of the public ownership of banks, although these are considered as old-fashioned and obsolete by modern economics.

based on political connections rather than on professional skills, lack performance-linked remuneration structures, and enjoy some degree of regulatory forbearance. These conditions incubate socially harming actions, such as corruption, state capture, and soft-budget constraints (see Aprea (2005)).<sup>5</sup> In the absence of the right incentives, proper accountability, transparency and checks and balances, these institutions are unlikely to perform as expected in terms of solving the deficient access to credit of some economic units. The evidence supports this negative view. For instance, the public ownership of banks is associated with subsequent low financial development and income growth (La Porta et al. (2002) and Galindo and Micco (2003)) and a higher probability of crisis (Beck et al. (2003)).

In what follows we will examine the importance of public banks in Argentina and their impact on the access to credit.

## 1.1 Public banking in Argentina

As of July 2006, out of a total of 71 banks operating in the country, there were 13 public banks: three are national (Banco Nación, Banco de Inversión y Comercio Exterior y Nuevo Banco Bisel), eight are provincial (Córdoba, Corrientes, La Pampa, Neuquén, Buenos Aires, Chubut, Tierra del Fuego and Chaco) and two are municipal (Buenos Aires and Rosario). Public banks have a major stake of the financial system in a number of countries, and Argentina is no exception. According to official data, public banks (including national and subnational institutions) agglutinated a third of total deposits in 1997 and increased their share to 45% in 2005, with somewhat lower participations in total assets and loans:

**TABLE 1**  
**PUBLIC BANKS SHARES**  
*(As a percentage of the banking system as a whole)*

	December 1997	December 2005
Assets	30.5	41.7
Loans	32.9	30.4
Deposits	33.4	45.3

Three national public banks display a preponderant weight: Banco de la Nación Argentina (Banco Nación), Banco de la Provincia de Buenos Aires (Banco Provincia) and Banco de la Ciudad de Buenos Aires (Banco Ciudad), which belong to the respective government jurisdictions. Banco Nación has historically led the statistics as the biggest bank in the country, Banco Provincia is the second one by volume of deposits, and Banco Ciudad has recently made to the top 10:

<sup>5</sup> This does not necessarily mean that some of these features are uncommon among private intermediaries.

**TABLE 2**  
**RANKING OF PUBLIC BANKS IN ARGENTINA**  
*(Percentages)*

Bank	Indicator	December 2000		March 2006	
		Ranking	Market Share (%)	Ranking	Market Share (%)
Nación	Assets	1	10.9	1	22.5
	Loans	1	10.4	1	13.7
	Deposits	1	15.9	1	25.3
Provincia	Assets	3	9.3	3	9.7
	Loans	2	8.7	5	6.8
	Deposits	2	10.6	2	9.4
Ciudad	Assets	11	2.5	6	4.1
	Loans	14	1.3	6	5.9
	Deposits	10	3.4	6	5.3

Source: Central Bank of Argentina.

The strong presence of the public banks in the country was not even put under threat during the foreign bank entry wave of the 1990s, and was indeed consolidated after the financial crisis of 2001-2002, as depositors became attracted by the implicit state guarantee these banks offered. This contingent financial backing from the Executive Power, coupled with the access to more stable and less expensive public sector deposits, undermine the desirable level playing field that should prevail in a competitive banking system.<sup>6</sup>

## 1.2 Public banks and access to credit in Argentina

Do public banks in Argentina deliver a net social benefit in terms of easing the access to credit? Any answer is bound to be controversial. Ultimately, we would like to identify all projects that were passed up as a result of the market charging informational and monopoly premia on the cost of capital.<sup>7</sup> If public banks were able to finance those projects at a cost free from such premia, the net social benefit could be calculated as the net present value of the projects minus the losses faced by the public banks in pursuing this policy (see Bebczuk (2001)). Regrettably, this would be a cumbersome exercise per se, let alone the fact that detailed information about potential and actual borrowers is not disclosed by either public or private banks, an issue we will resume momentarily. Although we do not intend to pass a categorical statement -which would require a deeper investigation that is beyond our present scope-, it is still possible to exploit the available aggregate information to support our stand about the role of public banks in Argentina based on a number of quick acid tests:<sup>8,9</sup>

<sup>6</sup> As observed in Table 3 below, public sector deposits represent 29.4% of public bank deposits and only 5.4% of private banks. Also notice that it is likely that, without enough regulator's political independence, public banks will be under a lax supervisory regime vis-à-vis private banks, especially during financial panics.

<sup>7</sup> Small borrowers may benefit from a close lending relationship with one or few banks but they have the minus side of giving some monopolistic power to the bank. In line with international evidence, small borrowers reveal a preference for operating with few banks: as of April 2006, 80.2% of small borrowers (with a loan balance below 0.5 million pesos) operate with only one bank, while just 25.9% of the big borrowers does so.

<sup>8</sup> As Argentina went through violent macroeconomic changes during the last decade, we check the robustness of our claims by looking at dates before and after the recent financial crisis. Given that we follow a purely descriptive approach relying in aggregate rather than bank-specific or time series data, we do not compute any tests of statistical significance. Moreover, our elemental null hypothesis is that public banks should do better, on average, than private banks in each of the following items, which in general is not the case.

<sup>9</sup> Given our narrow goal, we do not stress here differences between public and private banks in terms of accounting performance or risk management strategies.

(a) *Do public banks provide more credit to the private sector than private banks?* One well recognized problem of Argentine banks since the late 1990s is that lending to the public sector (stimulated by high yields on seemingly risk-free sovereign securities) tended to crowd out lending to the private sector.<sup>10</sup> Table 3 reveals that the share of assets allocated to private sector loans steadily diminished from about 50% in both bank groups in 1997 to 30.6% in private banks and just 17.3% in public banks in 2005.<sup>11</sup> According to Table 4, this ratio is even lower (13.3%) in Banco Nación.

**TABLE 3**  
**BALANCE SHEET AND PERFORMANCE OF PUBLIC AND PRIVATE BANKS**  
(As of December of each year, in % of total assets unless stated otherwise)

	Public Banks			Private Banks		
	1997	2001	2005	1997	2001	2005
<b>A. Balance Sheet Structure</b>						
<b>Assets</b>						
Cash holdings	8.6	4.3	7.1	8.1	9.7	9.8
Public and private securities	11.2	6.6	40.1	10.2	4.4	23.0
Loans	64.0	59.1	28.4	53.6	63.9	44.1
To the public sector	10.5	22.6	10.3	3.4	16.3	12.1
To the financial sector	4.2	1.8	0.8	3.4	2.2	1.3
To the private nonfinancial sector	49.2	34.6	17.3	46.8	45.3	30.6
Other assets	16.1	30.0	24.4	28.1	22.1	23.1
<b>Liabilities</b>						
Deposits	58.1	54.5	66.8	50.8	53.1	57.6
From the public sector	16.6	8.7	29.6	1.2	1.0	5.4
From the financial sector	0.5	0.3	0.6	0.2	0.3	0.1
From the private nonfinancial sector	41.0	45.5	36.6	49.4	51.8	52.1
Foreign credit lines	4.7	7.8	2.2	6.7	5.7	2.0
Other liabilities	17.8	23.8	19.1	30.1	22.7	22.9
<b>Net Worth</b>	16.7	10.5	10.1	10.2	14.4	13.7
<b>B. Performance Indicators</b>						
Return on assets	1.0	-1.0	1.2	0.6	0.1	0.5
Return on equity	6.1	-9.5	11.6	6.3	1.0	3.9
Net interest	4.0	3.4	4.1	4.1	6.2	3.8
Net services	2.5	2.2	1.4	2.5	2.9	2.4
Provisions	2.6	1.6	0.4	1.4	3.2	0.6
Expenses	5.1	4.9	3.3	5.1	6.3	4.9

Source: Author's calculations based on Central Bank of Argentina.

<sup>10</sup> The building of precautionary cash cushions was also a component of bank risk management strategies.

<sup>11</sup> Government assets in bank portfolios comprise Treasury and Central Bank debt, with the latter rapidly growing in the post-crisis period.

**TABLE 4**  
**BALANCE SHEET AND PERFORMANCE OF MAJOR PUBLIC BANKS**  
*(As of December of each year, in % of total assets unless stated otherwise)*

	Banco Nación			Banco Provincia			Banco Ciudad		
	1997	2001	2005	1997	2001	2005	1997	2001	2005
<b>A. Balance Sheet Structure</b>									
<b>Assets</b>									
Cash holdings	12.0	3.9	6.4	7.4	4.1	5.3	12.2	6.6	11.2
Public and private securities	12.2	1.3	40.0	10.8	15.6	46.3	20.9	5.0	29.4
Loans	57.1	64.6	24.0	65.1	52.7	27.3	50.0	58.5	50.1
To the public sector	6.5	22.5	10.7	17.8	23.2	3.1	15.2	30.9	31.4
To the private nonfinancial sector	46.1	41.4	13.3	46.5	29.5	24.2	32.6	27.3	18.5
To the financial sector	4.5	0.7	0.0	0.8	0.1	0.0	2.3	0.4	0.2
Other assets	18.7	30.2	29.5	16.8	27.6	21.1	16.8	29.8	9.3
<b>Liabilities</b>									
Deposits	62.5	60.2	66.5	69.7	44.8	60.9	70.9	72.6	81.9
From the public sector	15.7	9.5	34.8	22.8	6.6	22.0	2.2	6.3	22.9
From the private nonfinancial sector	45.7	50.6	30.7	46.7	37.7	38.9	68.6	66.2	59.0
From the financial sector	1.1	0.2	1.0	0.1	0.5	0.1	0.1	0.1	0.0
Foreign credit lines	2.9	6.5	2.8	11.1	14.1	2.5	1.5	0.5	0.0
Other liabilities	34.5	33.2	30.7	19.2	41.1	36.6	27.6	26.8	18.1
<b>Net Worth</b>	13.3	8.5	10.1	10.3	8.9	6.0	8.5	8.1	13.2
<b>B. Performance Indicators</b>									
Return on assets	0.8	0.0	0.6	0.9	-0.7	1.2	0.6	0.4	3.5
Return on equity	5.7	0.0	5.9	8.3	-8.4	19.5	6.7	5.4	26.8
Net interest	3.2	3.5	3.1	3.2	2.9	3.6	4.8	3.7	7.0
Net services	2.1	1.6	1.0	3.2	2.6	1.6	1.8	1.6	1.1
Provisions	1.5	1.1	0.3	0.7	0.5	0.5	1.7	1.4	0.5
Expenses	3.9	4.1	2.2	5.3	4.9	4.1	4.5	4.1	2.9

Source: Author's calculations based on Central Bank of Argentina.

*(b) Do public banks lend more to small borrowers?* A priori, small firms and consumers are the economic units facing the worst credit conditions as a consequence of asymmetric information. Their situation may even be more unfavorable if competition does not prevail. Consequently, once we make the realistic assumption that their demand for credit is not fully met, on average, by the market, public banks can ameliorate the problem by focusing more intensely on this clientele. After classifying borrowers by size (below and above a loan balance of 0.5 million pesos), Table 5 suggests that small borrowers normally account for more than 99.7% in both public and private banks.<sup>12</sup> Obviously, this figure is misleading as a result of the disproportionate number of small borrowers vis-à-vis big ones. More to the point, small borrowers received, in 1998, 50% of total loans to the private sector in the case of public banks and 38% in the case of private banks. However, by 2005, this fraction had dropped to 36% and 34%, respectively.

<sup>12</sup> In the table, we refer to records rather than borrowers because the same borrower can have several loans from different banks. Also notice that we are assuming a direct correspondence between loan and borrower size.

**TABLE 5**  
**SMALL AND BIG LOANS OF PUBLIC AND PRIVATE BANKS**  
*(Indicated in each column)*

Loan Size	Bank Type	Records <i>(In % of total records)</i>	Amount <i>(In % of total loans)</i>	Collateral <i>(In % of loans)</i>	Nonperforming loans <i>(In % of loans)</i>
			<b>December 1998</b>		
Less than \$0.5 million	Public Banks	99.76	50.0	65.2	19.7
	Private Banks	99.75	38.3	38.9	13.2
More than \$0.5 million	Public Banks	0.24	50.0	52.2	17.7
	Private Banks	0.25	61.7	22.8	3.0
			<b>March 2006</b>		
Less than \$0.5 million	Public Banks	99.83	36.2	26.1	21.8
	Private Banks	99.85	34.1	25.6	22.1
More than \$0.5 million	Public Banks	0.17	63.8	13.1	15.8
	Private Banks	0.15	65.9	12.2	7.2

Source: Author's calculations based on Central Bank of Argentina.

(c) *Do public banks require less collateral?* As stated in the Introduction, high collateral requirements may hamper the access to credit to financially constrained units. Even though collateral facilitates credit by alleviating adverse selection and moral hazard problems, at the same time it makes intermediation less efficient by acting as a substitute for the genuine information processing role of banks. Besides, collateral-intensive lending may at times keep good investment opportunities out of the market, affecting in particular small and young firms without enough capital to post guarantees (see Bebczuk and Sangiacomo (2006)). Going back to Table 5, we see that, back in 1998, public banks used to require much more collateral than private banks on both small and big loans: 65% of small debts and 52% of big debts was collateralized in public banks, well above private banks' ratios (38.9% and 22.8%).<sup>13</sup> This proportion noticeably went down as of late for the financial system as a whole, but no significant difference emerges between public and private banks.

(d) *Do public banks have less non-performing small loans?* By successfully specializing in small borrowers, public banks may be able to lessen their information disadvantage more efficiently than private banks. Table 5 above teaches us that this does not seem to be the case, as the ratio of non-performing small loans of public banks exceeded that of private banks before the crisis and is very similar across both groups after the crisis. It could be argued that bearing the burden of bad small loans is the acceptable (social) price of lending to small units at all, given the presence of asymmetric information and lacking special ability to screen good from bad credits. But the non-performing ratio is equally high when it comes to big loans (with an even wider gap in favor of private banks), implying that public banks have a generalized difficulty to build more solvent portfolios.<sup>14</sup>

(e) *Do public banks serve poor regions better than private banks?* one often overlooked issue in the empirical analysis of public banking is that private institutions may lack economic incentives to expand their business in poor or distant regions. given that social benefits from the

<sup>13</sup> It is true that borrowers may voluntarily decide to pledge collateral to convey a signal about their project quality. However, the international and Argentine evidence points toward the conventional wisdom that are lenders who ask for collateral, implying that the signalling story is not much relevant on an empirical basis.

<sup>14</sup> Another reply to this is that public banks lend to projects with higher expected productivity and thus higher risk. However, no casual nor hard evidence is available to back this up.

provision of credit and payment services may be quite high, public banks may subsidize, if needed, the opening of new branches and the installation of ATMs, among other services. Table 6 shows that public banks have in fact a slightly lower relative share of branches and ATMs in poor provinces than private banks –the total joint number of branches and ATMs in poor provinces is 901 for private and 409 for public banks. Being the case that two of the major public banks –Banco Ciudad and Banco Provincia– have the bulk of their activity in the city and the province of Buenos Aires, we eliminated in Table 7 these districts and included individual figures for Banco Nación, the one with the most widespread geographical presence. Now it is clear that private banks as a whole have a similar relative presence than Banco Nación in poor provinces, and both outperformed other public banks.

**TABLE 6**  
**PROVINCIAL DISTRIBUTION OF BRANCHES AND ATMS**  
(As of March 2006)

Provinces	Private Banks		Public Banks	
	Branches	ATMs	Branches	ATMs
Poor provinces (*)	12.8	12.9	11.1	9.5
Rich provinces (*)	87.2	87.1	88.9	90.5
Memo item: Total number of branches and ATMs	2 270	4 719	1 583	2 462

Source: Author's calculations based on CEPAL, INDEC and Central Bank.

(\*) Poor (rich) provinces are the 11 (13) provinces with lower (higher) per capita GDP in 2002.

**TABLE 7**  
**PROVINCIAL DISTRIBUTION OF BRANCHES AND ATMS, EXCLUDING THE CITY AND PROVINCE OF BUENOS AIRES**  
(As of March 2006)

	Private Banks		Public Banks		Banco Nación	
	Branches	ATMs	Branches	ATMs	Branches	ATMs
Poor provinces (*)	28.0	32.6	20.2	24.0	31.5	33.1
Rich provinces (*)	72.0	67.4	79.8	76.0	68.5	66.9
Memo item: Total number of branches and ATMs	1 036	1 872	867	974	374	387

Source: Author's calculations based on CEPAL, INDEC and Central Bank.

(\*) Poor (rich) provinces are the 11 (13) provinces with lower (higher) per capita GDP in 2002.

These exploratory tests cast serious doubts about the effectiveness of Argentine public banks in coping with the market failures that allegedly justify their existence from a technical standpoint.<sup>15</sup> At first glance, public banks do not behave in a significantly different fashion than private banks and neither do they perceptibly contribute to enhance the access to credit. We will discuss in Section 3 and 4 possible explanations for this outcome and some options to deal with it.

<sup>15</sup> Financial conglomeration is another debatable phenomenon. According to Golla (2006), 80% of total financial intermediation (including banking, pensions and insurance) in Argentina is in hands of conglomerates, and Banco Nación and Banco Provincia groups are the top one and top six in terms of assets under management, with market shares of 16.2% and 9%, respectively. There are no visible market distortions in the pensions and insurance market to help rationalize the expansion of public banks into these activities –risk mitigation does not seem to be a good empirical explanation, either. On the contrary, conglomerates tend to exacerbate the risks of empire building and a number of conflicts of interest, which might affect the efficiency and stability of the financial system.

### 1.3 Official SMEs credit programs

National and provincial governments have in place specific subsidy programs aimed to help SMEs raise finance. At the national level, the main initiative is the Régimen de Bonificación de Tasas de Interés, whereby the government auctions among commercial banks a subsidy of up to 8 percentage points on loans to the private sector –the banks offering the lowest loan interest rates receive higher quotas. About 160,000 loans for a total \$1,100 million (about US\$360 million) have been granted under this regime since August 2003.

In the case of Banco Nación, the subsidy is administered by FOMICRO (Fondo Nacional para la creación y consolidación de Microemprendimientos). FOMICRO was created by Banco Nación in 2004, and works as a second-floor program by delegating the actual operation on almost 400 ONGs, which retain 5% of the loans to cover their expenses conditional on full repayment by the ultimate borrower.

FONAPYME (Fondo Nacional de Desarrollo para la MIPyME) is also run by Banco Nación, with the mission of providing credit to SMEs. The interest rate is variable and equal to half the average rate charged by the bank on its normal loans. Since 2004, 350 projects were financed for \$34.8 million.

FONCAP (Fondo de Capital Social) is a corporation in the orbit of the Ministry of Social Development (with the government holding 49% of capital but with control over the Board, and 51% integrated by Acción Internacional and Fundación Emprender). Like FOMICRO, its goal is to manage public funds that are allocated through microfinance institutions.

FOGAPYME (Fondo de Garantías Pyme) is a reinsurance \$100 million fund for private and public guarantee programs, and is entitled to provide direct insurance to firms in regions not covered by such kind of schemes. To date, it has carried out no operations.

Fuerza Pyme is a program launched in 2004 by Banco Provincia which, through a subsidy from the provincial Ministry of Production, lends to SMEs at a annual interest rate of 7%. Loans for \$450 million were granted so far to 6,000 SMEs. FOGABA (Fondo de Garantías Buenos Aires), created in 1995, is a corporation with provincial majority (but with private shareholders), which extends loan guarantees for firms whose assets are not directly acceptable by the bank as collateral –however the firm must pledge some form of collateral to FOGABA.

BICE (Banco de Inversión y Comercio Exterior) is a second-floor bank created in 1991 with the mission of financing productive investments and international trade transactions. It is not allowed to receive deposits from the public. Its shareholders are Banco Nación (98%) and Ministry of Economy (2%). As of December 2005, its private sector portfolio amounts to \$237.7 million.

## 2. Non-traditional credit instruments

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In order to overcome the informational barriers that contaminate the intermediation process, lenders have devised an array of remedial mechanisms to protect themselves against the opportunistic behavior on the part of debtors, namely: (a) Lending short-term, so as to monitor every stage in the project's life, and using the threat of calling off the loan instead of rolling it over in the case that the entrepreneur appears to be taking excessive risks (see Stiglitz (1998)); (b) Engaging in close and lasting relationships with their clients, aiming to obtain first-hand information on the entrepreneur's character and business (see Petersen and Rajan (1995) and Brewer et al. (2003)); (c) Sharing track record and balance sheet information on borrowers through private and public credit registries (see Pagano (2001) and IDB (2005)); (d) Asking borrowers to pledge collateral and to co-finance their projects (see Menkhoff et al. (2005); and (e) Including positive and negative covenants in the loan contract.

Probably the most effective of them all from the lender's perspective is the posting of collateral, as it eradicates repayment risk regardless of the project's outcome –all the other mechanisms just listed only help reduce the probability of misbehavior by the borrower, but do not ensure repayment. Also to the advantage of the lender, collateralized transactions involve low costs and effort compared to the other strategies. However, from the borrower's side, an evident obstacle, already underlined in Section 1, arises once many firms with good investment opportunities do not possess tangible capital to pledge.

In sum, traditional loans suffer from serious drawbacks that led market players to come up with other contracts to make lending to these groups viable. To distinguish them from traditional loans, we label as non-traditional credit instruments a number of contracts including the following: leasing, factoring, warrants, financial trusts, credit guarantee schemes, and microcredits. A lease is an agreement under which a property owner transfers the use of the property for a specified period of time. In a factoring transaction, a firm simply sells its account receivables at a discount to a financial intermediary (the factor). The seller benefits from transferring and prematurely cashing invoices typically repayable at least a month after being issued. The intermediary, besides getting a service fee, ends up facing the credit risk of the buyer, in spite of having dealt with the seller. Since many times the seller is a small firm and the buyer a big and reputable one, factoring is a risk-containing strategy for the factor. The warrant (not to be confused with the warrant arrangement attached to a bond and equity issue) allows a producer, most often in the agricultural business, to borrow against his stored merchandise. A financial trust is a structured transaction in which an originator transfers a pool of assets to a trustee -a legal special purpose vehicle with oversight and management functions-, who issues securities backed by the underlying asset pool. The various credit guarantee schemes are arrangements under which a third party commits itself to partially or totally cover lender's losses in case of default. The guarantor can be a public or private entity. Finally, microcredits are small scale loans extended on the basis of a specific lending technology. As we will argue shortly, all these products, while different from traditional loans, may and are partly intermediated by commercial banks along with specialized intermediaries.

Beyond their seeming differences, this variety of instruments share one feature in common: they break the link between borrower's risk and repayment risk by providing different credit enhancements (see Bebczuk (2003)). In other words, they embody different and innovative forms of collateral. It is worth noting that, as a matter of fact, most of these instruments do not entail credit in the sense of financing activities that, after a while, will produce cash flows. Instead, they just provide liquidity, by transforming illiquid (but already produced, and sometimes sold) goods and services into cash. Nevertheless, such a service is extremely valuable for a large number of entrepreneurs.

## 2.1 Leasing, warrant, factoring and financial trusts

Table 8 compiles information from different sources on the stock of bank loans, leasing, warrant, factoring and financial trusts in Argentina in 1998-2005. It is clear that all these markets are by all means underdeveloped. Bank loans, the chief credit instrument in the country, amounts to barely 10.5% of GDP as of December 2005 and 16.5% on average over 1997-2005. Subtracting bill discounting (which is computed also as a factoring product), the figures drop to 9% and 12.5%, respectively. The leasing, warrant and financial trust transactions are negligible in terms of GDP (below 0.4%), save for factoring (4.4% of GDP). Notice that this disheartening panorama has to do with the 2001-2002 financial crisis but appears to be a rather structural deficiency that can be traced back even to the height of the Convertibility Plan in the 1990s.

There exists no reliable series of interest rates on non-bank instruments. Nevertheless, as a proxy, Central Bank statistics can be used, in particular the rates on pledge lending (*crédito prendario*) and bills (*documentos descontados*). According to Table 9, the annual nominal interest rate on these credit lines was 17.2% and 15% on average over 1997-2005 (but excluding the 2001-2002 due to the noise associated to the crisis).<sup>16</sup> Of course, these interest rates are only indicative,

<sup>16</sup> Subtracting the observed annual consumer inflation rate and again excluding 2001-2002, the real interest rate was 14.2% and 12% on average for 1998-2005, with high positive values in the 1990s and declining and even negative levels in 2003-2005.

and it is most likely that SMEs faced costs well above the previous averages. Additional charges for administrative costs are in the range of 0.25%-2.5%.

**TABLE 8**  
**STOCK OF BANK LOANS AND OTHER NON-TRADITIONAL CREDIT INSTRUMENTS**  
(In % of GDP)

Year	Bank Loans	Bank Loans excl. factoring	Leasing	Warrant	Factoring	Financial Trusts	Memo Item: Nominal GDP
1998	22.44	16.00	0.17	0.73	7.55	0.11	298948
1999	23.01	17.08	0.30	0.37	7.08	0.43	283523
2000	22.68	17.19	0.39	0.35	6.76	0.56	284204
2001	19.37	14.42	0.38	0.36	6.17	0.26	268697
2002	12.31	12.03	0.23	0.43	3.59	0.05	312580
2003	8.88	7.18	0.12	0.24	0.02	0.10	375909
2004	9.17	7.64	0.17	0.32	1.82	0.39	447643
2005	10.51	8.87	0.33	n.a.	1.97	0.77	531939
Average	16.05	12.55	0.26	0.40	4.37	0.33	

Sources: Ministry of Economy, Bertora y Asociados (2006), Central Bank of Argentina, and Deloitte (2006).

**TABLE 9**  
**ANNUAL NOMINAL INTEREST RATES ON BANK LOANS**  
(In percentage)

Year	Prime Rate	Overdraft	Pledge lending over 1-year term	Bills over 90-day term	Excess over Prime Rate		
					Overdraft	Pledge lending	Bills
1997	9.2	28.2	17.4	14.9	19.0	8.2	5.7
1998	10.6	28.8	19.6	15.9	18.1	8.9	5.3
1999	11.0	30.6	19.5	16.9	19.6	8.5	5.8
2000	11.1	30.0	19.8	15.9	18.9	8.8	4.8
2001	26.5	40.4	18.8	20.1	14.0	-7.7	-6.3
2002	53.0	63.2	26.7	32.5	10.2	-26.2	-20.5
2003	19.1	40.6	20.7	20.2	21.5	1.5	1.0
2004	6.8	16.3	13.5	10.9	9.5	6.7	4.1
2005	6.2	15.7	9.7	10.1	9.6	3.5	4.0
Average	17.1	32.6	18.4	17.5	15.6	1.4	0.4
Average exc. 2001-02	10.6	27.2	17.2	15.0	16.6	6.6	4.4

Source: Central Bank of Argentina.

## 2.2 Credit guarantee schemes

Authorized by law in 1995, Mutual Guarantee Societies (*Sociedades de Garantías Recíprocas*, henceforth SGRs) are private corporations whose mandate is to guarantee loans extended to their equityholders (*Socios Partícipes*, SMEs with annual sales below 86.4 million pesos -about 27.9 million dollars). No SME can hold more than 5% of total capital and jointly must have at least 50% of the votes. While the Socios Partícipes (which must be at least 120 to obtain the licensing) contribute with a small investment (less than US\$300) for the SGR's capital, a Risk Fund (*Fondo de Riesgo*) is built up by one or more public or private organizations denominated *Socios Protectores*. The incentive for the latter to participate comes from a tax advantage, as their contribution to the Social Capital and to the Risk Fund is exempted from the income and the value added tax, provided it is not withdrawn for at least two years and that the SGR registers a stock of guarantees equivalent to 80% of the Risk Fund. The SGR also provides technical assistance to its member SMEs in setting up business plans and filling out loan applications. SGRs are classified into open and closed, the latter structured around a big firm and comprising solely its SMEs providers. Garantizar is the only SGR with significant public sector involvement, as its two main Socios Protectores are Banco de la Nación Argentina and Banco Ciudad de Buenos Aires.

The system has two reinsurance devices. For one, the beneficiary has to post a counterguarantee. Besides, since 2004, each SGR can celebrate reinsurance contracts with FOGAPYME (Fondo de Garantías Pyme), created by the national government. However, to date, the fund was not used, partly because of its cost.

Table 10 summarizes the activity and composition of SGRs in Argentina:

**TABLE 10**  
**SGRS IN ARGENTINA**  
(As of June 30, 2005)

Type	Open	Of which: Garantizar	Closed	Total	Average (per SGR)
Number of SGRs	8		10	18	
Socios Partícipes	3 793	1 599	1 726	5 519	307
Socios Protectores	120	44	47	167	9
Risk Fund (in mill. \$)	155.6	60.9	175.5	331.0	18.4
Number of Guarantees Extended	8 097	2 253	1 7258	25 355	1 409
Amount of Guarantees Extended (in mill.\$)	347.7	218.1	1 057.6	1 405.3	78.1
Stock of Outstanding Guarantees (in mill \$)	162.7	100.9	93.9	256.5	14.3

Source: Cámara de Sociedades y Fondos de Garantía (CASFOG).

## 2.3 Microcredit

Banks are especially well equipped to establish close lending relationships. The resulting better knowledge about expected cash flows and especially the entrepreneur's character helps banks to struggle with their informational handicap. Microfinance institutions take fuller advantage of these relationships than traditional banks. Given their proximity to the borrowers and a smaller and more manageable loan portfolio, these institutions are able to better screen and monitor their clients. Adding to this, the microlending technology encompasses a variety of incentive devices to ensure debt repayment, such as group lending (all borrowers within each group are held responsible

if any member defaults), progressive schemes (performing borrowers are granted increasing amounts and terms in subsequent rounds of borrowing), and short-term, revolving lending.

In spite of global and national initiatives to foster the microcredit market in Argentina, no substantial progress has been made so far. Ernst & Young (2006) estimates that, at the end of 2005, the different official programs in place have 67,000 clients with a total portfolio of US\$50 million. There are at least 200 non-governmental microfinance institutions operating in Argentina, but the market is dominated by 9 of them grouped in the Red Argentina de Instituciones de Microfinanzas. These NGOs (most of them not-for-profit) serve 15,000 clients with a portfolio of US\$12 million. The annual interest rate is in the range of 24% - 60% and loans are rolled over at least once a month. The high interest rate is chiefly explained by considerable screening and monitoring costs coupled with the small average loan scale.<sup>17</sup>

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<sup>17</sup> Bekerman et al (2005) develop field work on private and public programs, and find that public programs suffer from higher non-performing (25% against 2% in private programs) and longer delays to accept or reject applicants (100 days vs. 42 days in private programs).



### **3. Understanding the problem of access to credit in Argentina**

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The data shown so far has just confirmed a recurrent view among academic and practitioner circles concerning the modest development of credit markets in Argentina, especially for the most vulnerable borrowers. Such diagnosis commonly goes on to infer that SMEs (and other firms and households as well) are financially constrained and thus public interventions should be in order to surpass the existing market failures. A more in-depth inquiry into this issue unveils other less explored angles. To begin, it is convenient to distinguish three key dimensions of the problem: (1) Institutional barriers to credit growth as a whole; (2) The scarce use of non-traditional credit tools in particular; and (3) The actual social costs of this limited financial deepening and the public policies designed to deal with it.

#### **3.1 Structural barriers to financial development**

The law and finance literature has made a compelling argument about why credit needs a solid institutional environment to bloom. As other countries with a French legal origin, creditor protection in Argentina is lower than in common law countries –the popular La Porta et al. (1998) index, updated by IDB (2005), is 0.25 on a 0-1 scale, against a Latin American average of 0.33 and an average of 0.54 for developed countries. Galindo and Micco (2001) interact this index with a rule of law indicator to proxy for an effective creditor rights index, delivering values of 0.15, 0.14 and 0.44 for Argentina, Latin America, and the developed countries, the wider gap now being explained by the deficient enforcement framework. The effectiveness

of the legal system can also be evaluated using the contract enforcement indicators reported in World Bank's Doing Business (downloadable at [www.doingbusiness.org](http://www.doingbusiness.org)). For Argentina, resolving a payment dispute entails 33 different procedures, 520 days, and a 15% cost over debt value; for an OECD country, these values drop to 19.5 procedures, 226 days and a 11% cost. In practical terms, this implies that even collateralized transactions are risky, as asset repossession is far from automatic.

Another related institutional aspect concerns the efficiency and coverage of credit bureaus. According to Doing Business, the Argentine ones are top quality (6 out of 6), even above OECD's (4.7). Nevertheless, these registers, both from the public and private sector, record no white or positive information on SMEs, limiting their use for banks and other creditors at the time of making a more informed decision.

Summing up, financial markets do not work as desired around the world, and even more so in countries, like Argentina, where the institutional infrastructure is far from optimal. This factor, magnified by the pervasive violation of property rights in the aftermath of the 2001-2002 financial crisis, does not leave room for excessive optimism in the near future.

Over and above this institutional weakness, small businesses face two additional barriers: (a) As screening and monitoring involves substantial fixed costs, credit is bound to be more expensive for these firms than for big ones, everything else equal; (b) Many of these firms are part of the underground economy, thus lacking reliable accounting systems and required tax compliance.<sup>18</sup> Informality impedes access to formal financial intermediation and prevents the exploitation of tax shields, like the deductibility of interest payments. In fact, non-bank credit cards, cooperatives and informal lenders are important financiers for small and medium enterprises. Although the interest rate and term conditions are extremely unfavorable, the lax formal requirements constitute an appealing feature that seems to outweigh the administrative and tax costs of formality for this segment.

In the regulation department, the regime works reasonably well when it comes to banks (leaving aside the forbearance measures put in place during the financial crisis of 2001-2002) and pension funds, but it shows some flaws in the insurance and capital markets (see CEF (2003)). Beyond some budgetary tightness, the main criticism has to do with the mere auditing approach (as opposed to a risk-based one) followed by the regulators and the overwhelming concern with systemic risk over consumer protection. In the case of non-traditional credit contracts, a participation deterrent is the lack of effective control on moral hazard behavior on the part of both lenders and borrowers, which calls for more prevention and punishment at the micro level, beyond the required compliance with legal and accounting norms. To make things worse, harmed parties have no way of filling a complaint or obtaining redressing, due to the lack of an efficient consumer protection mechanism and the slowness and steep costs of litigation. For instance, cases have been reported that merchandise deposits backing warrant contracts were emptied or the product quality altered. When made public, these episodes have a magnifying adverse effect on potential players.

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<sup>18</sup> Schneider (2002) estimates the size of the underground Argentine economy in 2000 in the order of 25.4% of official GDP, against an average of 41% in developing countries and 18% in OECD countries. The Instituto Nacional de Estadísticas y Censos (INDEC) estimates labor informality in 44% of employment.

## 3.2 The use of non-traditional credit contracts

The other dimension of the problem is the scarce use of credit instruments such as the leasing, warrant, and the like. The ultimate question is why they have little use vis-à-vis bank loans. We next discuss the following explanations:

### a. Instrument specificity

Bank loans can be allocated to various ends agreed upon writing the contract (purchasing new capital, paying for debts or short-term liabilities, and so on). The other instruments do not enjoy such versatility, which in turn restricts their massive use. Factoring is an option only to firms acting as suppliers of big companies. Leasing is only helpful for firms willing to purchase certain capital goods. In Argentina, agricultural, transport, communication and IT equipment respond for above 90% of leasing operation.<sup>19</sup> A narrow set of underlying assets is also observed in the warrant and financial trust funds markets:

**TABLE 11**  
**WARRANTS: UNDERLYING ASSETS (2005)**  
(Proportion)

Asset	Proportion
Sugar	45
Steel	27
Shoes	12
Tobacco	6
Wheat	3
Others	7
Total	100

Source: Bertora y Asociados (2006).

**TABLE 12**  
**FINANCIAL TRUST FUNDS: UNDERLYING ASSETS (2005)**  
(Proportion)

Asset	Proportion
Personal Loans	42
Public Bonds	21
Credit Cards	11
Comercial Loans	10
Mortgage Loans	10
Others	6
Total	100

Source: Source: Central Bank (2006).

In the case of financial trusts, it is worth noticing that the structure of underlying assets in Table 12 hardly implies a direct impact on productive financing needs. Also, as mentioned earlier, these alternative instruments, with the exception of leasing, do not solve the ultimate financing problem of the firm, as they provide a liquidity rather than a credit service. At best, they allow to

<sup>19</sup> This data was provided by the Asociación de Leasing de Argentina and corresponds to 2004.

raise short-term credit.<sup>20</sup> Consequently, these products cannot be expected to become a universal answer to the lack of access to credit, as they are not suited to meet long term financial needs.

## **b. Demand awareness**

One apparent bias in SMEs' financing policies is that they do not seem to care or be aware of credit opportunities beyond traditional loans. While it might be claimed that this search is time-consuming, it is clear that internet capabilities have turned this argument obsolete to a great extent. Also, SMEs may have incentives to be loyal to one or few banks in order to take advantage of long-lasting lending relationships (see Petersen and Rajan (1994) for U.S. evidence and Bebczuk (2003a) for Argentina). However, as discussed in (c) below, it is not clear that both party's interests are aligned. Moreover, it might be the case that, especially for the less sophisticated entrepreneurs, loan contracts are more familiar and simpler to understand than other contracts, but this is a debatable point as well. Insufficient dissemination of publicly sponsored credit programs adds to the problem.

## **c. Market structure**

Argentina is a bank-centered financial system (see Levine (2002)). Accordingly, savers tend to heavily invest in bank deposits (see Baer (2005)).<sup>21</sup> This by itself deprives nonbank intermediaries, including independent factoring, warrant and leasing companies, from adequate funding to expand their operations. Of course, banks are allowed to and in fact develop these lines of business within the bank unit or through a subsidiary. But this does not mean that banks actively pursue them. From Bertora y Asociados (2006), commercial banks directly control 80%, 84% and 62% of the leasing, factoring and financial trust markets, respectively. Further investigation is required to assess the incentives banks have to lend through credit lines different from standard loans.

## **d. Tax aspects**

Tax asymmetries exist among instruments, but they are unlikely to justify the scarce use of credit instruments compared to loans: (i) Some instruments have indeed a tax advantage over traditional loans, such as the leasing transaction (see Bertora (2006)); (ii) Informal businesses and those carrying losses are unable to exploit tax shields; (iii) Market trends in Argentina show that tax incentives are not strong enough to significantly change the preference for internal funds. Cases in point are the little growth of the SGRs before the financial crisis in spite of their tax advantages, and the modest demand for SMEs-specific capital market instruments.<sup>22</sup>

### **3.3 Shallow financial markets, social costs and government policies**

As stated several times in this study, public interventions involve costs, and these costs must be outweighed by the social benefits such interventions bring about. When it comes to credit policies, there seems to be a consensual opinion that insufficient finance from the market severely hampers the expansion of many firms. Accordingly, credit policies favoring small, dynamic and labor intensive projects is a recurrent and top issue in the political agenda.

<sup>20</sup> According to Observatorio Pyme (2006), SMEs in Argentina have trade receivables with an average 42-day term and payables with a 28-day term.

<sup>21</sup> However, Argentineans show a strong preference for foreign assets, with an estimated 60% weight in the private sector portfolio.

<sup>22</sup> According to Bertora (2006), these instruments (including corporate bonds, financial trusts and the discount of deferred checks) were used in 2005 by only 1,000 SMEs and involved transactions for about \$300 million.

Provocative as it may seem, we believe that the imperative need to develop massive public programs is to some extent overstressed. Our principal theoretical underpinning is the celebrated Myers and Majluf's (1984) pecking order model advancing the hypothesis that, in a world of asymmetric information and intermediation costs, firms start by exhausting their internal funds, and only then raise debt and equity. Empirical tests provided overwhelming evidence in favor of this theory across countries and over time. Just to illustrate the point, suffice it to say that recent contributions show that about 90% of aggregate corporate investment is self-financed (see Aizenman, Pinto and Radziwill (2004) for developing countries, and Bebczuk and Garegnani (2006) for OECD countries). For Argentina in particular, Bebczuk (2003b) estimates this ratio to be 81% during 1990-1996.

Regarding the specific SME case, we must rely on survey information –these companies rarely do public offering and most of them do not even prepare certified accounting statements. Grant Thornton (2003) runs a large survey of SMEs in 19 industrial and developing countries (not including Argentina), and concludes that only 23% of all respondents said that the shortage of working capital was a constraint for their ability to grow. The percentage falls to 20% when asking about long-term capital. For Argentina, Observatorio Pyme (2006) finds this proportion to be 31%.

Also relevant to the analysis is that, at odds with the profit-maximizing paradigm in economics, firms do not always behave rationally in a textbook sense (see Baker et al. (2004) for a survey). In fact, the desire for financial and personal independence appears as a major goal of small entrepreneurs (see LeCornu et al. (1996)), discouraging the search for external finance and blurring the actual extent of supply-determined financial constraints.

Naturally, more rigorous surveys and information are needed to estimate the real dimension of the problem.<sup>23</sup> But the figures strongly suggest that conventional wisdom should be put to the test before taking costly and potentially inefficient measures. Particularly deleterious to the financial viability and economic impact of subsidy schemes is that they tend to attract unprofitable and risky projects, especially when screening and auditing is flawed –the usual moral hazard problem. We elaborate on this in the closing section to the study, but we can convey a sense of our stand using a simple matrix. By definition, there are good and bad projects, the former being defined as those with a positive net present value when discounting at the same interest rate charged by banks on other projects with similar maturity and cash flow risk, but less affected by intermediation and information costs. At the same time, projects may or may not be in demand of external funding at the above notional cost of capital –let us call the former financially constrained units. Accordingly, we can come up with the following representation:

**Table 13**  
**FINANCIAL CONSTRAIN**

Project / Funding	Financially Constrained	Not Financially Constrained
Good Projects	A	B
Bad Projects	C	D

The challenge for the authorities is to channel their limited resources towards the projects in quadrant A and avoid to divert resources towards the rest. The worst outcome is to end up lending to bad projects, be them financially constrained (quadrant C) or not (quadrant D), because the expected return would probably lie below the program's cost of funding. Less costly but equally

<sup>23</sup> For instance, the previous surveys cover only ongoing concerns, and neglect new potential projects and those that were already push out of business as a result of the lack of credit. By the same token, in light of the procyclicality of investment, financing needs are high during economic bonanzas and low during downturns. Since economic growth boosts revenues and thus internal funding, the demand for external funding is not necessarily high even in good times.

inefficient is to provide funding to projects that otherwise would have been undertaken with internal funds. This could be the case whenever the credit terms are too generous compared to a normal loan and even to the usually low opportunity cost of retained earnings.

Needless to say, the ability to turn this ideal approach into a working credit policy requires political independence, transparency and technical and human resources. With Table 13 in mind, these conditions should ensure a correct project selection. Once satisfied this crucial first step, public programs should be managed not differently than a good private bank's credit department concerning risk management, screening and control over the beneficiaries, and periodic output evaluation. Equally important, public programs have a clear obligation to disclose information to taxpayers, but in practice this matter is still pending..

In the public banking arena, corporate governance deficiencies coming from political interference are the most visible obstacle. Corporate governance has lately become a prominent issue in the banking literature (see Levine (2003)). Having a complex assets side, banks (either public or private) are expectedly quite opaque. This lack of transparency also obeys to their direct reporting to the financial regulator, which might favor a low degree of transparency to avoid bank panics. The downside of this is that market discipline is weakened. CEF (2006) compiled bank-level information for 2005 on disclosure practices of Argentine banks regarding management and board procedures, organizational structure, and dividend and remuneration policies. Based on 26 items, the survey shows a low index of transparency and disclosure on average (34 points on a 0-100 scale), but an even lower rating for public banks (14 points). In the same spirit, these banks do not disclose detailed information on their purely commercial transactions and those with a subsidy component, making it virtually impossible to draw strong conclusions about their contribution to mitigate market failures. Furthermore, the document looks at the charters of Banco Nación, Banco Provincia and Banco Ciudad, concluding that the Executive Power has discretionary power to appoint and dismiss authorities -in the case of Banco Nación, it does not even require Legislative approval.<sup>24</sup>

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<sup>24</sup> In the case of Banco Provincia, the regulatory powers of the Central Bank are restricted due to a Constitutional provision by which the Province of Buenos Aires keeps its exclusive jurisdiction over the bank.

## 4. Conclusions and policy prescriptions

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The chief lesson we draw from the analysis is that the premises under which special credit programs for SMEs are designed and implemented might be carefully revisited. While it is undeniable that private financial intermediaries have an anti-SME bias, it does not necessarily follow that any regulatory or official credit program will make things right. Simply put, not all SMEs are credit constrained nor all credit constrained SMEs are assisted via public credit policies. Since these official programs should not be confused with plain subsidies, they should be aimed to maximize productive impact while minimizing fiscal costs, targeting good projects without enough internal funding nor the ability to raise money in the market. This certainly is not an easy task, as it requires high standards of political independence, transparency, and technical skills to screen, monitor and audit a large pool of applicants and beneficiaries. Otherwise, good intentions will only translate into an inefficient and possibly regressive allocation of scarce resources.

Unfortunately, from our look at the last decade's experience, we conclude that, first, state programs are consistently small in magnitude and, second and more important, that little information is disclosed (and probably exists at all) on project selection criteria and the costs and benefits of the programs in place. Moreover, based on public information, we find that public banks, in spite of their major market share, do not perform better than private banks in terms of easing the access to credit. Also, we discussed the limited role that non-traditional credit instruments can play in alleviating the observed obstacles. It would be unrealistic to expect that even well run public

programs will solve the problem of the access to credit, but they can have a potentially large positive effect on production and employment levels.

This reflection calls for setting broad intervention principles and appropriate management, disclosure, and accountability rules. Steps that may be taken include:

(a) Implement and disclose periodic impact evaluation reports for each official program containing detailed information on (i) Amount, sources and costs of funding as well as management structure and costs; (ii) Beneficiaries' selection criteria; (iii) Characteristics of the beneficiaries (sector, geographical distribution, etc.); (iv) Loan performing; (v) Gross production, value added and employment impact of the program in the short- and medium-run;

(b) Design an objective methodology to identify and target future beneficiaries of credit programs.<sup>25</sup> The own program's track record from (a) above plus ad-hoc surveys, sectoral performance reports, international experiences and other pieces of information may be used to this end. The resulting parameters should even be made public through the program's internet site and other dissemination means so as to allow interested entrepreneurs to do a self-pre-qualification preceding official application. Besides the increased transparency, this would allow substantial time savings for applicants and program officials as unacceptable projects will be discarded in advance;

(c) Set as a goal to assist firms to enter the formal credit market. Many firms find it difficult, for several reasons, to apply and obtain their first bank loan. Once inside the banking system, and after keeping a good track record for a while, state assistance should become much less necessary;

(d) Establish proper transparency standards towards the Executive and Legislative Power, and especially towards taxpayers, so as to induce more effectiveness and accountability;

(e) Improve the coordination among the different national and local programs; and

(f) Develop a sustained dissemination plan of future schemes to raise awareness among all possible projects searching for funding, and provide financial education and technical assistance to contribute to better financial decision making.

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<sup>25</sup> Many decisions should be made beforehand. For instance, whether to support firms already borrowing from the financial system or those that have not yet enter the formal credit market. Another dilemma to be addressed is how to deal with firms in the informal sector. Likewise, credit initiatives with a social focus –say, microcredits to poor households- should be run separately from those with an eminently economic focus.

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