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MOBILIZATION OF DOMESTIC RESOURCES

I

PUBLIC ENTERPRISES: THEIR PRESENT SIGNIFICANCE AND THEIR  
POTENTIAL IN DEVELOPMENT

II

FINANCIAL INTERMEDIATION IN LATIN AMERICA

Discussion paper



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## INTRODUCTION

This document contains two papers on the over-all problem of the mobilization of domestic resources, a subject that has been of concern to the Commission for some time because of its obvious importance for development policies.\*/

The first deals with a subject that up to now has not received the attention it deserves in view of its present scope, its latent potential, and namely, the public enterprise sector. Although the background material available and the differences between individual situations preclude the possibility of a detailed analysis, this paper does give an idea of the scope of the sector in several representative countries, and it highlights the questions that should be considered when a policy on State-run enterprises is being formulated.

The second paper investigates the evolution and characteristics of the financial system, with a view to showing its significance as an instrument for mobilizing savings for various purposes. In addition to giving a general view of the trends and structure of the system of financial intermediaries that has emerged and of the transformation that the system has undergone in the last decade, a detailed analysis is made of events in several countries of the Andean region. This analysis gives rise to a number of queries concerning the policies that might be applied in order to expand and improve the assistance the financial system could give in carrying out the priority tasks in development programmes.

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\*/ On this subject see "La movilización de recursos internos" (E/CN.12/827).

## Part I

PUBLIC ENTERPRISES: PRESENT SIGNIFICANCE AND FUTURE  
POTENTIAL IN THE DEVELOPMENT PROCESS

The public enterprise sector has received very little attention in discussions of the agents or institutions capable of speeding up development or, more specifically, of mobilizing resources and channelling them towards priority development objectives. It has been left very much in the background compared with fiscal operations, the private sector or the role of external factors.

The purpose of the present paper is to provide an idea of the scope and significance of the sector and to discuss certain issues and the main options open to State policy. Owing to the shortage of data, this study is exploratory in character, and it is hoped that further studies will be made as and when the data available permit of delving more deeply into the experience of each country.

The fact that the sector has received relatively little attention is at variance with the scale and influence of all the productive units which are under State control and have the legal status of enterprises - these being the two criteria for defining the public enterprise, and they clearly exclude other public agencies engaged in similar activities (for example, postal and telegraph services). One of the most striking features of the post-war period in Latin America, as in other regions, has been the expansion and diversification of the public enterprise sector, owing to a variety of reasons often quite unconnected with the countries' positions of principle and sometimes related to the nature and stage of their economic growth.

Irrespective of the path taken and the targets to be reached, however, the net result has been that public enterprise has become a sector of great significance in the economy.

1. The importance of public enterprises

It may be appropriate to look first at what public enterprises represent in terms of capital information, and to consider the coefficient of investment in relation to the product and the share of public enterprises

/and general

and general government in fixed capital formation in a number of countries.<sup>1/</sup> In Colombia, Chile and Peru, the proportion of public investment in total investment increased substantially between 1960 and 1968, while the investment coefficient in relation to the product declined; both these ratios increased in Argentina, Bolivia, Mexico and Paraguay, and decreased in Brazil and Ecuador; in Panama public investment remained at the same level and total investment increased. Taking public investment alone, Bolivia, Brazil, Chile and Paraguay show the highest coefficients. In general, a rising trend is observable in the share of public investment in all countries except Ecuador and, to a much smaller extent, Panama.

The proportion of investment by public enterprises was highest in Bolivia (nearly 40 per cent of the total). In Argentina, Brazil, Chile and Venezuela it ranged from 14 to 16 per cent, and in Colombia, Costa Rica, Panama and Perú from 6 to 10 per cent. These figures, in general, reflect the presence or absence of large-scale mining, petroleum, energy or communications enterprises, and of extensive State railway networks, which are usually the biggest investors.

It is also worth while looking at the place of public enterprises among the largest enterprises in each country. Public and foreign enterprises accounted for the lion's share of the thirty largest enterprises in Argentina in 1969.<sup>2/</sup> Of total sales by these thirty enterprises, public enterprises accounted for 43 per cent, foreign companies for 42 per cent, and local private enterprises for 15 per cent. In Brazil, 65 per cent of the liquid net worth of the thirty largest companies was owned by public enterprises, 28 per cent by foreign enterprises and 7 per cent by local private enterprises.

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<sup>1/</sup> See data on investment published by ECLA on the basis of official statistics.

<sup>2/</sup> For data on Argentina, see Mercado, issue of 23 July 1970, and official statistics on public enterprises. For data on Brazil, see Conjuntura Económica, vol. 24, N° 9, 1970.

Turning now to the relative importance of public enterprises in their particular sector of operation, the data available <sup>3/</sup> indicate that there are two standard situations. In one group, of which Argentina and Colombia are good examples, public enterprises are important in certain sectors related to the infrastructure (transport, communications and electrical power) and the supply of inputs (petroleum in both countries and steel in Argentina); about half the sales of the enterprises considered - excluding the steel enterprises - are accounted for by the petroleum enterprises. In contrast, there are few public enterprises engaged in manufacturing; out of the total number of enterprises studied, they account for 3.8 per cent of sales in Argentina and 2.2 per cent in Colombia. In other countries, for example Mexico and the Dominican Republic, there are a good many public enterprises engaged in manufacturing, in addition to those providing public services and basic inputs; in the Dominican Republic they account for 30 per cent of sales and in Mexico for 28 per cent of the total capital of the public enterprises studied.

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3/ The data on public enterprises given here were taken from the following sources, except where otherwise indicated:

Argentina: Secretaría de Hacienda, División Nacional de Programación Presupuestaria, Desarrollo de Egresos del Estado, año 1969. Informe al Cuarto Trimestre, Buenos Aires, March 1970.

Brazil: Fundação Getulio Vargas, Instituto Brasileiro de Economia.

Colombia: Contraloría General de la República, Informe Financiero de 1968.

Chile: Ministerio de Hacienda, Dirección de Presupuestos, Balance Consolidado del Sector Público de Chile, año 1968 y período 1904-68, Santiago, 1970.

Mexico: Secretaría de la Presidencia, Dirección General de Inversiones Públicas.

Dominican Republic: Oficina Nacional de Planificación. Plataforma para el Desarrollo Económico y Social de la República Dominicana (1968-1985) and balance sheets of certain public enterprises.

Venezuela: Contraloría General de la República: Balance de la Hacienda Pública Nacional - 1968 y Memorias (1968) of the Venezuelan Corporation for the Development of Guayana (Corporación Venezolana de la Guayana) and the Venezuelan Development Corporation (Corporación Venezolana de Fomento).

/As regards

As regards transport enterprises, virtually all the railways are State enterprises.<sup>4/</sup> The same is roughly true of the merchant shipping,<sup>5/</sup> for State shipping companies own approximately 60 per cent of Latin America's total gross registered tonnage. With respect to the airlines,<sup>6/</sup> apart from a multitude of small lines which are generally privately owned, public enterprises absorb approximately 45 per cent and 40 per cent of passenger and of freight traffic respectively.

As regards energy and fuel,<sup>7/</sup> State petroleum enterprises, with the exception of those in Venezuela, are responsible for most of the petroleum extraction and refining, and they produce and distribute much of the electric power. Moreover, in most Latin American countries, there is a clear trend towards State control of the electric power sector, since activities to expand installed capacity have mainly been channelled through public enterprises. In Argentina, for example, while public utility generation increased by about 70 per cent from 1960 to 1968, State-owned enterprises doubled their output; in Chile the increases were 60 and 86 per cent, respectively; in Mexico with the nationalization of the sector, the State enterprise was responsible for the whole increment; and in Brazil, the subsidiaries of ELETROBRAS and the State semi-public enterprises (in which ELETROBRAS holds a minority share) are at present producing over 60 per cent of public demand.

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<sup>4/</sup> Data on the railways can be found in ECLA, El Transporte en América Latina (United Nations publication, Sales N°: 65.II.G.7) and Latin American Railways Association, Anuario Estadístico, 1968.

<sup>5/</sup> Data on shipping companies from Instituto de Estudios de la Marina Mercante Iberoamericana, La marina mercante iberoamericana, Buenos Aires, 1969.

<sup>6/</sup> Basic data from ICAO, Development of civil air transport. Traffic statistics, February 1970, and IATA, World Air Transport Statistics 1969.

<sup>7/</sup> See reports of petroleum and electric power enterprises.

As regards steel production,<sup>8/</sup> in 1966, out of a total of seventeen major integrated enterprises producing 80 per cent of the region's steel, eight were State enterprises proper and accounted for 47 per cent, two with mixed public and private capital accounted for 12 per cent; two controlled by foreign capital accounted for 7 per cent; and the remaining five, owned by domestic private investors were responsible for 14 per cent.

(a) Influence on the course of development

The above information gives an approximate but fairly clear idea of the "specific gravity" of public enterprises in the economy as a whole and in key sectors. But the actual influence they have goes far beyond these limits and can only be properly assessed if account is taken of some of the qualitative implications of their size and management.

It should be emphasized that the public enterprise sector is under State control and is hence a direct tool of over-all State policy and its specific directives. The decision-making power of the State is exercised in a number of different areas that can be classified according to how far the State controls or has a say in their activities. First and foremost comes the nucleus of the central government, followed by the local government and the decentralized agencies, and lastly the public enterprises. In all these areas the power of the State is virtually absolute, irrespective of whether the State itself actually exercises this power, or of the degree to which it does so. Beyond these areas of direct control there are areas of indirect influence, i.e., the policies and instruments that guide and regulate the workings of the economy (exchange rates, prices, credit, incentives, restrictions, etc.).

Now that the strategic role of the public enterprises has been established - and the effectiveness of this role depends on the size and composition of the enterprise and on the level of State control, it is appropriate to consider the various levels at which they operate.

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<sup>8/</sup> Data on steel enterprises was obtained from a number of publications by the Latin American Iron and Steel Institute (ILFA).

(b) The formation of capital for investment

From the standpoint of the present study (namely the mobilization of resources for economic growth), a key aspect is the capacity of the public enterprise sector and its individual components to accumulate investment resources or, in other words, to generate current account surpluses that can be used in capital formation by the enterprise generating the surplus, elsewhere in the public enterprise sector, or outside it.

In this connexion, it may be useful to examine the financial results of the activities of public enterprises, and also the main factors affecting these results, such as price and tariff levels, wages, management efficiency, and economic policy guidelines.

To give a rough idea of the situation, the financial results of the activities of the major public enterprises of four countries on which data are available <sup>2/</sup> have been considered, using two indicators: the operating surplus or deficit in terms of earnings from sales or operating income, and the proportion of capital expenditure covered by the surplus - in cases where there is an over-all surplus. Subsidies and other current transfers were deducted from current income, as they distort the real financial results of operating the enterprise. Moreover, as these data only apply to one year, they should be considered as nothing more than a rough indication of the true financial situation, which in any case does not necessarily reflect the enterprise's efficiency since a deficit may be the result of circumstances beyond its control, as will be seen below.

An analysis of these indicators leads to some conclusions that are applicable to all the enterprises considered and to others that are applicable only to those of some of the countries. Taking the universe of enterprises considered in each country, the operating surplus is seen to represent 14 and 9 per cent of earnings in Argentina (1969) and Chile (1968) respectively, while in Colombia in 1968 it was as high as 32 per cent, and in Brazil showed a deficit (1965). Not one of these countries, however, had a large enough surplus to cover fixed investment: in

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<sup>2/</sup> Argentina (1969), Brazil (1960 and 1965), Chile and Colombia (1968). See also footnote 3 above.

/Argentina it

Argentina it financed slightly less than half, in Colombia 40 per cent and in Chile 34 per cent. When compared with total capital expenditure, the figures are naturally lower and stand at around a third for Argentina and Colombia and only 9 per cent for Chile (not including steel, for lack of information).

Taking each country and enterprise separately, it can be seen that a single enterprise in Argentina, Ferrocarriles Argentinos, was responsible for 86 per cent of the total operating deficit of eight enterprises in 1969, Yacimientos Carboníferos Fiscales (YPF) for a further 9 per cent, and others, mainly transport companies for the remainder. In absolute terms, the biggest operating surpluses came from YPF, the Empresa Nacional de Telecomunicaciones, Agua y Energía Eléctrica and the Sociedad Mixta Siderúrgica Argentina. In only two cases, however - Transportes de Buenos Aires and the Administración General de Puertos - were the over-all surpluses large enough to cover capital expenditure.

As regards the Brazilian enterprises, the largest operating deficits were found in transport and communications and the biggest surpluses in chemicals and petroleum, mining, energy and steel. Nonetheless, it is precisely in energy and steel that the over-all surplus covers least of the capital expenditure, owing to the high level of investment involved.

In Colombia, Ferrocarriles Nacionales accounted for 84 per cent of the combined deficit of five enterprises, the remainder deriving, in descending order, from the Instituto Colombiano de Energía Eléctrica, which constructs generating plants and carries out studies on electrification, the Empresa Colombiana de Aeródromos, the Corporación de la Industria Aeronáutica and the Compañía Nacional de Navegación. The biggest operating surpluses came from the Empresa Colombiana de Petróleo, the Empresa Nacional de Telecomunicaciones and the Empresa de Puertos de Colombia.<sup>10/</sup> Only two enterprises, however, - the Empresa Colombiana de Productos Veterinarios and the Industria de Concreto (INCO) - had an over-all surplus that was more than enough to cover their capital expenditure.

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<sup>10/</sup> Details of the financial results mentioned in this and the preceding paragraphs are to be found in the tables contained in the annex to the ECLA document "Public enterprises: their present significance and potential in development" (E/CN.12/872).

As to Chile, nine of the fifteen enterprises considered showed an operating deficit: of the total deficit, 60 per cent was accounted for by the Ferrocarriles del Estado, 16 per cent by the Empresa de Comercio Agrícola, 8 per cent by the Empresa de Transportes Colectivos and 6 per cent by the Empresa Portuaria, the five remaining enterprises making up the rest. The enterprises with the highest operating surpluses were the Empresa Nacional del Petróleo (ENAP), the Compañía de Acero del Pacífico and the Empresa Nacional de Electricidad (ENDESA) but only ENAP and the Empresa de Agua Potable had big enough over-all surpluses to cover capital expenditure. Nothing can be said about the Compañía de Acero del Pacífico, on whose capital expenditure only fragmentary data are available.

Taking the enterprises according to type, it can be seen that, as a general rule, the operating surpluses were not large enough to cover capital expenditure, even in the case of the most profitable of them - the petroleum enterprises. Apart from Chile's ENAP, whose earnings in 1968 more than covered its fixed investment and exceeded its capital expenditure by 55 per cent, the petroleum companies considered, managed to cover only between 40 per cent (Empresa Colombiana de Petróleo) and 80 per cent (YPF Argentina) of their capital expenditure from their own resources. Of the electricity enterprises, Argentina's Agua y Energía Eléctrica financed slightly more than 40 per cent of its capital expenditure in 1968, whereas two semi-public state enterprises in Brazil covered, on an average, only 10 per cent of theirs, and ENDESA, in Chile, 26 per cent. The financial situation seems to be rather more alarming in the steel sector, where a study carried out in 1964 by the Latin American Iron and Steel Institute (Instituto Latinoamericano de Hierro y del Acero - ILAFA) showed that, in twenty-two public and private enterprises, reinvested profits covered a mere 4.6 per cent of total investment.<sup>11/</sup> Finally, all the railway companies considered showed current operating deficits.

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<sup>11/</sup> ILAFA, Condiciones económicas que regulan el crecimiento de la producción latinoamericana de acero, a document presented to the second United Nations Interregional Symposium on the Iron and Steel Industry, Moscow, September-October 1968.

/Briefly then,

Briefly then, it may be concluded from the figures by country, that countries cannot generate any appreciable share of their investment resources by operating public enterprises. The figures by type of activity, however, show that petroleum and electric energy enterprises financed quite a substantial percentage of their investment.

(c) Some relevant factors

One of the main factors influencing the financial results of the operation of public enterprises - or, in other words, their profitability - is the price and rate policy, which is usually under strict government control.

Opinions differ on this point. According to one view, all that a public enterprise need do is to make sure that it has no operating deficit, and there are some who go so far as to maintain that there is nothing wrong with an enterprise running at a loss in order to permit the subsidizing of other activities. According to another view a public enterprise should not only avoid deficits, it should also cover its capital expenditure and even build up a surplus. Without going into too much detail, it is worth while to examine empirically the trend of the real rates charged by public enterprises in some countries over the past few years.<sup>12/</sup>

Except in a few cases, railway rates, measured by average receipts per transport unit, declines in real terms between 1960 and 1963. In passenger transport, they dropped about 10 per cent in Mexico, 20 to 30 per cent in Chile and Peru, and as much as 45 per cent in Uruguay. On the other hand, they improved somewhat in Argentina and Colombia, and remained at about the same level in Brazil. Freight rates plummeted in all countries except Colombia, where there was no change in real terms.

The average prices for electric power charged by the two Argentine enterprises considered fell by about 10 per cent. That of the Comisión Federal de Electricidad de México rose 17 per cent, as a result of changes in the composition of sales by groups of users. The average sales price of the main Peruvian company, which is privately owned, declined 20 per cent,

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<sup>12/</sup> Current values have been deflated by the consumer price index: see footnotes 4 to 8.

while in Venezuela the State-owned enterprise CADAPE recorded a very slight reduction and the most important private company a drop of 17 per cent. Average prices of the Compañía Panameña de Fuerza y Luz dropped by about 30 per cent over the same period. Only in the case of Chile and some Brazilian enterprises were there real increases in average sales prices.

For steel enterprises, the prices considered were those quoted on the principal market of each country, according to the data published by ILAFA in its Anuario Estadístico for 1969. From 1965 to 1969, real prices of steel products in Buenos Aires decreased by proportions ranging from 20 per cent for round bars and zinc-plated rolled products to 36 per cent for angles and flat bars. In Sao Paulo, prices of rolled products fell by about 9 per cent over the same period, but those of all other steel products rose by approximately 5 per cent. The drop in prices in Mexico City ranged from 4.4 per cent for rolled products to 17.5 per cent for wire rod, except in the case of bars for construction purposes, which showed a slight increase. In contrast, Santiago, Chile, recorded a general rise of about 40 per cent in steel prices - in real terms - over those four years.

A second important factor in determining the profitability of public enterprises is the level of wages and salaries. In order to examine this question, for want of information on the particular situation of each enterprise in relation to the national wage policy, a wages/current expenditure ratio was established for the main enterprises in selected countries. What stands out here is the small share of total expenditure accounted for by wages and salaries in petroleum enterprises, the high proportion they absorb in railways, and the extent to which this ratio varies in electric power enterprises.

In any case, in the light of the incomplete data available, it may be assumed that, in general, wage and salary levels in public enterprises are relatively high. This is attributable to many factors, such as, the fact that they are usually more or less monopolies, that they produce essential goods and services and that investment per person employed is consistently high and the workers and technical personnel employed in this sector are strongly organized and have considerable bargaining power.

A third factor that is nearly always considered in any discussion of this question is the greater or lesser efficiency of the management of public enterprises. There are not enough data available to substantiate objectively the differing views on the subject, which is essentially complex because of the difficulty of choosing adequate evaluation indexes that are not merely a replica or applicable to private business management.<sup>13/</sup> It is only too well-known and accepted, however, that in quite a number of cases for different reasons government activities have become merely an opportunity to hand out sinecures or political favours. It would be advisable, however, to take into account a factor which is not always considered, i.e., the fact that the results also depend on the nature of the sector or of the activities of the State enterprises concerned. In other words, it might be argued, for example, that the deficit generally found in railway enterprises are due not so much to their being State-run as to their being engaged in rail transport.

It might also be maintained that the profits of petroleum enterprises are due not to the fact that they are public enterprises but to their being engaged in a particularly lucrative activity.

Lastly, attention is drawn once again to the fact that the profitability of the enterprises considered is nearly always decisively determined by the government's policy in establishing prices and rates, and that it varies according to which of the criteria indicated at the beginning of this discussion is adopted.

(d) Influence of public enterprises through investment

The significant share of public enterprises in capital formation takes on even more importance if consideration is given to the sectors in which they operate, i.e., rail transport, electric power and petroleum. Even though investment is not, by its very nature, a recurring annual expense, it is very important because it has an impact on two key areas: industry and imports of capital goods.

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<sup>13/</sup> See the studies presented at the Meeting of Experts on Administration of Public Enterprises in Latin America and the Caribbean (Santiago, Chile, November 1969), in particular, "Profitability and efficiency measures of public enterprises" (ST/ECLA/Conf.35/L.9).

The demand for goods generated by the public sector is sufficiently large to justify or stimulate the operation of domestic activities capable of satisfying it, wholly or partly, or in respect of specific components. In some cases, this circumstance has led to the establishment or expansion of domestic suppliers. In Brazil, for example, the machinery and equipment requirements of PETROBRAS acted as a spur to manufacturing companies and led to the merging and reorganization of existing plants. The same is true of the orders of State-owned shipping enterprises, particularly Lloyd Brasileiro, which helped to promote the expansion and modernization of Brazilian shipyards to a point where, early in 1969, fifty ships totalling 484,000 tons deadweight were under construction.<sup>14/</sup> In Argentina, moreover, demand from Ferrocarriles del Estado has been a decisive factor in promoting the manufacture of railway equipment by local private enterprises.

These possibilities are, however, limited by the option of importing the material required. The alternative chosen has not always been the development of import substitution industries, and it has not always been chosen merely on the basis of price and quality considerations. As is well known, the advantageous terms of the financing offered by foreign suppliers, which contrast with the limited financial facilities available locally to domestic producers, have also carried considerable and sometimes decisive weight.

(e) Effect on the balance of payments

It is easy to see how demand from public enterprises affects the balance of payments, not only because of their total imports but also because of those associated with investment. In this respect, it is illuminating to consider Chile's experience, which is by no means exceptional, in that purchases by the public sector have represented half or more than half of the country's total imports of capital goods.<sup>15/</sup>

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<sup>14/</sup> See ECLA, Economic Survey of Latin America, 1969, Part Three, chapter III.

<sup>15/</sup> Balance Consolidado del Sector Público de Chile, 1970.  
Ministerio de Hacienda.

/Furthermore, a

Furthermore, a point which should be remembered is the dual effect of the sector's operations, inasmuch as they involve either the replacement of imported goods or contributions to exports. In the latter respect, and particularly in regard to manufacturing enterprises, it should not be forgotten that, because of their size and technological level, public enterprises are in an advantageous position to gain a footing in external markets. In fact, in countries such as Brazil and Mexico, public enterprises operating in the steel sector, for example, have had a great deal to do with the growth of exports of manufactures.

(f) Technological progress

It is unnecessary to repeat observations regarding the importance of technological progress and the opportunities and problems deriving from the introduction of new foreign techniques. The point to emphasize here is the key importance of public enterprises in this connexion, because of their influence on the balance of payments and, in particular, their actual or possible role as adapters of foreign techniques or as innovators.

It is a well-known fact that if they are to play this role economies of scale are essential and that only relatively large-scale units - as public enterprises usually are - can undertake original research or adapt foreign know-how.

Research can be carried out by the enterprise concerned or by a specialized body, which could be a separate enterprise. Here too, it is useful to consider the experience of Chile, where research has been undertaken for different sectors of activity for some time now. For example, CORFO carried out important experiments for the benefit of its mining enterprises, which consisted in treating copper ore oxides by flotation and dry sulphurization, thus making it possible to exploit mixed copper ore or copper found in dry areas, with a considerable saving in sulphuric acid and scrap iron. The Industria Azucarera Nacional, S.A. studies the production of industrial by-products of its alcohol distilling process in order to obtain a synthesis of yeast that would provide high-protein products. The Empresa Nacional de Semillas made experiments in plant-breeding with a view to producing improved seeds. Many other enterprises are engaged in research and investigation in their own fields.

/For example,

For example, the Technological Institute of Chile was established in 1969, as a subsidiary of CORFO, to operate as a technological pool, mainly through research contracts with the interested enterprises. Under this system, the Institute operates as if it were temporarily the research department of the enterprise concerned. This service has the advantage that it is operated by multi-disciplinary groups of specialists and has access to expensive instruments which are costly to service and which can be moved easily to wherever they are required. Its current research is intended to meet the requirements of certain State enterprises in connexion with electronics, engineering, chemicals, mining, food, plastics, metallurgy, inorganic chemistry and mechanical engineering.

Certain variations of the methods that have been tried out by public enterprises in Chile are found in other countries, although in some cases the agency responsible for centralizing the research does not have the legal form of an enterprise but is a decentralized government agency. A case in point is the National Institute for Agricultural Technology in Argentina, which was set up in 1956, whose research among other improvements, led to a substantial increase in maize and wheat yields and a revolution in potato growing. It also carried out specific investigations which were useful to enterprises.

(g) Contribution to supply and role in market regulation

The last points to be considered among the most important implications of the operation of public enterprises are their contribution to the supply of certain goods and services and their role in regulating the market.

As regards the first point, State enterprises account for a large proportion and sometimes have a monopoly of supply in certain sectors, through railway, electric power, petroleum and other enterprises. Because of the very nature of most of the goods they produce, the operations of public enterprises are of key importance.

As regards market regulation, in addition to their contribution to supply, public enterprises exercise State control over prices, the quality and type of goods and services. In several countries, State-owned enterprises are concerned specifically with regulating the market through the purchase

/and sale

and sale of primary products, particularly agricultural commodities. A case in point is wine production in Argentina, where the largest winery - GIOL, in Mendoza - is owned by the provincial government. The Empresa de Comercio Agrícola de Chile (ECA) has widely varying functions. It purchases the products required either locally or from other countries, deposits them in its own refrigerating rooms, silos or stores, and subsequently puts them on the market.

2. Policy on the public enterprise sector:  
alternatives and queries

The importance and far-reaching influence of public enterprises highlight the need to define a policy on their operation and functions. As was said at the beginning of this paper, that need does not appear to have been satisfactorily met up to now.

The lack or inadequacy could be put down to several factors, one being the diversity of the activities concerned, the other, the incorporation of enterprises in the sector over a long period of time, in response to differing needs and with different degrees of urgency which sometimes coincided with the requirements of different stages of development. Moreover, the very conception of a public enterprise sector or their grouping as a "sector" is a departure from the normal procedure of lumping them together with private firms under the heading of "enterprises", in conjunction with private enterprises. However, and there has been a clear trend, particularly in Europe, towards considering public enterprises separately and as a whole sector.

In view of Latin America's position in this field with regard to public enterprises and the field covered by this paper, a brief review and discussion are in order which are most relevant and must be defined in policy or policies that may be formulated for the sector.

Starting with the points that are directly relevant and about which there is the least argument, the first question to be considered is what role the sector might play in the accumulation of investment capital.

/Mention has

Mention has already been made of the many different views expressed for and against public enterprises. However, recent trends seem to indicate that the balance is inclining in their favour. This is made clear in a detailed study of recent policy orientation in different representative economies,<sup>16/</sup> in which it is stated:

"...In several developing countries observed, the sentiment of supervisory authorities is increasingly more favourably disposed to the commercial profitability criterion. In India, to begin with, public enterprise was characterized, when development planning was instituted, as 'actuated by basic development objectives'. In the earlier days of development planning, there was evidence of official hostility to the notion of commercial profitability. More recently, a different doctrine has been enunciated, namely, that public enterprises should behave so as to generate surpluses or profits for self-financing of their capital expansion. Proponents have pointed out that self-financing out of retained earnings has been a major source of capital formation in private industry in developed countries. Reference has also been made to the fact that state enterprises in the Soviet Union and other centrally-planned economies are conducted so as to yield a 'profit' for financing high rates of capital formation. The shift away from the practice of 'no profit, no loss' in the British nationalized industries together with the renewed emphasis on profit in the recent Soviet reform programme have reinforced this trend of official thinking. The profitability criterion, it seems, has now become the accepted official doctrine."

In a study of the problem of the financing of the public enterprises that would form the nucleus of economic expansion (petroleum, electric energy, steel, and iron ore), a Brazilian authority points to three principal

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<sup>16/</sup> See "Improving profit performance of public enterprise in developing countries" (ST/ECLA/Conf.35/L.8), pages 3 and 4; paper presented by the Public Administration Division of the United Nations to the Meeting of Experts on Administration of Public Enterprises in Latin America and the Caribbean (Santiago, 17-22 November 1969).

means of action: accumulation of funds through forced saving, a profitable commercial policy, and doing away with paternalism in the social services that are financed by price subsidies and other means.<sup>17/</sup>

Of course, no simple deductions can be drawn from the prevailing trend, and the diverse levels of preparedness of the different public enterprises to become profit-makers cannot be left out of account. Some would have no difficulty in doing so because of their favourable position on the market. For others, however, it would be almost out of the question and they could become profit-making only within certain limits, as in the case of railways, whose position has already been discussed.

On the other hand, it might also be possible to apply a policy of profitability to the sector as a whole, or even to groups of similar or related enterprises, and not to each individual firm. This point will be taken up again later, when internal relations in the sector are discussed.

Lastly, account should be taken of the fact that investment is not a steady flow and of the magnitude of the resources required for expansion. Obviously, these investment requirements cannot, as a rule, be met from the enterprises' over-all operations, or even from that of the whole sector when it is under co-ordinated management. Recourse would have to be had to other sources of savings, and for that purpose it would doubtless be an advantage for the individual enterprises or the sector as a whole to have fairly large operating surpluses that would help them to meet the commitments undertaken in the circumstances described above.

It should not be inferred from what has already been said that the formation of capital for investment or, in other words, the profitability of the enterprise, depends solely on decisions concerning prices and rates. Other factors that have an influence were mentioned earlier, such as the general efficiency of operations and wage and salary levels. These are subjects about which there has been considerable controversy and their complexity precludes the possibility of any cut-and-dried approach that could be generally applied. At all events, it seems very clear that the

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<sup>17/</sup> See the book by the Brazilian Minister of Mines and Energy, Antonio Dias Leite, Empresa pública e desenvolvimento económico (Rio de Janeiro, 1965).

approach to these and other relevant questions will depend to a large extent on the adoption or rejection of the basic orientation described above, that is, on whether or not the enterprises concerned or the sector as a whole are to play an important part in the formation and mobilization of savings for priority investment.

For these reasons, there is no doubt that State ownership of enterprises and the trend towards nationalization of the most important public services has, in theory, increased the chances of applying a policy of the type described above.

(a) Position of public enterprises in the public sector and in planning machinery

Another important question that has not yet been properly clarified and is therefore controversial is the position of the public enterprises in the machinery of government, i.e., their links with government.

The main point of discussion is well-known and is summed up by an authority already quoted, who points to the need for a uniform legal status that would guarantee the autonomy of public enterprises with respect to the government bureaucracy and, at the same time, make effective control of the enterprises feasible.<sup>18/</sup>

When the subject is analysed, the effects and the importance of the sector's heterogeneousness in respect both of operations and of legal form are obvious; this, in turn, implies different forms of management or State control and, as a result, different forms of integration in the public sector.

In the case of enterprises controlled directly by the State, which do not have a legal personality of their own, there is the normal hierarchy that prevails in a public administration. Public enterprises may be responsible to a ministry or a parent body, which as a rule appoints managerial staff and lays down policy guidelines. On the other hand public corporations are managed and controlled from within through the normal decision-making machinery, under the rule of private law; however, as the State is the only share-holder, the directors of the

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<sup>18/</sup> A. Dias Leite, op cit.

company are appointed by decree or administrative decision. This is also the case for semi-public companies where, depending on the number of shares held by the State, its representatives will operate the company or have a minority voice in decision-making. It is common in such cases for the chief government representative to have the right of veto. Greater freedom of action can be obtained by creating different types of shares, reserving certain privileges for those owned by the State.

In any case, there is often much less effective control by the State than seems to be the case or than is provided for by law. Truth to tell, the enterprises may be on widely varying positions of autonomy or subordination in relation to the higher authority and its policies. As is stated in a specialized document, in this variety of situations "a continuum can be observed" in which turbulent interrelationships predominate, "at one end of which are the enterprises subjected to the numerous conflicting pressures exerted by the various components of the central guiding nucleus, to many regulatory measures which have a paralysing effect and to ambiguous power relationships. At the other extreme are the enterprises which maintain univocal power relationships with some components of the nucleus, generally the Office of the President, relations which are similar to those of a feudal lord with a king".<sup>19/</sup>

To sum up, there is likely to be a great deal more discussion about the position of public enterprises in relation to central government and the degree of their subordination to it - and not only in Latin America.

The other aspect to be discussed is the place of public enterprises in the planning process and machinery. As is observed in a recent study, the practice has been to treat the economy more or less from a sectoral/technological angle, and it is not often that an institutional conception of public sector participation is to be found. Thus, although the plans refer to many State activities, for which targets are fixed and

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<sup>19/</sup> See "Interrelationships between public enterprises and the central government: their implications for performance" (ST/ECLA/Conf.35/L.2), paper presented by the ECLA Public Administration Unit to the Meeting of Experts on Administration of Public Enterprises in Latin America and the Caribbean mentioned in foot-note 16.

funds assigned, especially those connected with the creation of capital and the production of commonly used inputs, they always do so from the point of view of the sector - i.e., the productive activity - in which they are to be found, and not from an institutional angle that defines the scope of the public sector and takes account of the characteristics that are peculiar to it.<sup>20/</sup>

The problem is particularly clear in the light of what was said above about the areas of State control or dominion. Obviously, if the responsibilities and decisions of the central government and the public enterprises are to be considered separately and as a whole it is first necessary to define the field which can best be governed by economic policy - a field in which, as has been shown, a high proportion of total investment is made.

Moreover, a rough definition of this kind might help to specify and distinguish the instruments that are suitable for implementing and promoting the planning directives in the public enterprises sector, where the government is dominant, and in the others (the sphere of private enterprises) where its influence is more indirect.

(b) Internal organization of the public enterprise sector

A third subject that should be considered concerns the internal organization of the public enterprise sector, which may be said to be a counterpart or complement of their organic incorporation in the public sector. As will be shown, these two aspects are closely interrelated, and it could even be said that the solution of the first problem might be a decisive step forward towards the solution of the second.

In the Latin American experience, various methods have been used to operate a group of enterprises jointly. One consists in administrative co-ordination, which may range in form from a consultative system to the setting up of a ministry to control the State enterprises. Another method consists in the creation of a controlling or holding company, which

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<sup>20/</sup> See Ricardo Cibotti and Enrique Sierra, El sector público en la planificación del desarrollo, Textos del Instituto Latinoamericano de Planificación Económica y Social (México, Siglo XXI, 1970).

purchases shares in the firms that it wishes to manage or supervise. The State body that administers this holding company may be a government office or a second holding company.

An interesting case is that of the Chilean production development corporation (Corporación de Fomento de la Producción - CORFO) and its eighty-one subsidiaries that operate in the most diverse fields (agriculture, fishing, wood pulp, mining, metal transforming, coal, communications, films and television, energy, electronics, petroleum, petrochemicals, chemicals, construction, steel and metallurgy, tourism, and multisectoral support organizations). As a rule, these enterprises take the form of limited companies, in which CORFO holds some or all of the share capital and appoints a corresponding number of directors.

In any case, despite these and other attempts to regulate operations in the private enterprise sector (or in some parts of it) through a central development agency, the enterprises are usually widely scattered and without connecting links. For the reasons already given, the sector is more like an archipelago than a solid mass.

There seems to be general agreement that the situation has many disadvantages and could be improved by greater internal co-ordination or integration. Naturally, this does not mean only, or necessarily, dumping all the various units together under some higher authority. A far more realistic approach would undoubtedly be to adopt one of the various methods of integrating more or less similar enterprises, though it would always be useful, in principle, to have a common centre linked with the government or the planning authority.

None of this, of course, would entail interference in the actual administration of the individual units; basically, it would merely mean the adoption of a concerted plan of action and common standards in certain areas of fundamental importance.

One of these areas might be the handling of the sector's current resources. An interesting possibility along these lines would be the creation of one central government account for public enterprise funds so as to promote greater concentration of resources and greater flexibility in their use. Under this system, which few Latin American countries have

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so far adopted, the cash receipts of all centralized and decentralized public institutions must be deposited in current bank accounts forming part of a single or central account administered by the Ministry of Finance. Consequently, the balance on the central account is equal to the sum of the balances in all the subsidiary accounts and the Ministry can draw on a certain percentage of the accumulated total. In Chile, where this system has been in operation since 1959, the Ministry may draw up to 70 per cent. Both central and subsidiary accounts are with the Banco del Estado.

The obvious advantage of a central government account is that better use can be made of the public funds, since it prevents the kind of situation where, while in one enterprise an excess of income over expenditure is generating large surplus cash reserves, another is obliged to cut down its disbursements because its earnings are insufficient. It is important for the State to be able to transfer resources from enterprises with surpluses to those showing a deficit in two cases: first, to deal with any seasonal fluctuations in the income and expenditure of public institutions and, secondly, in cases where an enterprise is permanently, or for long periods, generating substantial cash surpluses. This, for instance, has been precisely the situation of Chile's Empresa Nacional de Petróleos for many years.

The point should, however, be made that two fundamental conditions must be fulfilled if the central government account system is to work efficiently. First, there must be a certain amount of programming to indicate the probable trend of the enterprises' cash balances, so that estimates can also be made - even if only roughly and in accordance with the country's monetary policy - of the percentage of the combined balance on the central account to be drawn upon by the Ministry of Finance. Secondly, the commercial banks must not be allowed to use the increases in the central government account reserves as backing for larger loans to the private sector, since this would diminish the flexibility with which the account could be used in the context of the over-all monetary programme.

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The opposite situation arises under the system of water-tight compartments, sometimes based on a variety of different "funds" (Public Works Fund, Housing Fund, etc.), where there is no possibility of transferring resources from one compartment to another, even on a temporary basis. A case in point is the operation of the National Housing Fund (Fondo Nacional de la Vivienda) in Uruguay in 1970. Established in 1969 and mainly financed out of a tax on wages and salaries, this Fund, which was to have started to develop a housing construction programme, last year accumulated unused reserves amounting to nearly 10 million dollars (about one eighth of Uruguay's total direct public investment), which were left lying in banks and were one of the main reasons for the shrinkage in the amount of money in circulation during that period. At the same time, other priority sectors, such as transport, were suffering from an acute shortage of government funds, which prevented enough money being invested to meet the country's needs.

(c) Integration for other purposes

The opportunities outlined above may also arise in other, more important, spheres, which were dealt with in the section on the influence of the public sector.

For example, prospects would obviously be brighter if various forms of internal integration were applied to such fields as the promotion of local capital goods industries, capital goods import policies, and the adaptation and development of technology. Naturally, whatever the present importance and, above all, the future potential of the principal public enterprises - even if they operate independently -, they would increase substantially if procedures and instruments were established to co-ordinate policy.

By and large, the various stages of this process and the method employed closely resemble what has occurred in certain countries at the centre as a result of the emergence of conglomerates and the subsequent decline in the importance of the old kind of monopoly or oligopoly. As in the case of conglomerates, the fundamental factor in the association or co-ordination of separate public enterprises is the existence and

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operation of a pool or joint fund of current and investment resources, administrative talent, and opportunities for developing and assimilating technological innovations.

This is not, of course, to advocate the creation of one vast public conglomerate. All that is intended here is to point out that the trend is towards a greater co-ordination of government enterprises, under any number of forms.

(d) Function of the public enterprise sector

There are two fundamentally different approaches to the sector's role and to its relations with private enterprise. According to one school of thought, the public enterprise sector is merely an extension of the State's traditional responsibilities, dictated by circumstances which does not affect the basic division into public and private sector. Seen in this light, the sector's legitimate activities would be to build up the infrastructure and other basic services so as to improve the performance of private enterprises. Moreover, when the State, for imperative reasons, must go further than this, such a situation is regarded as essentially transitory, pending the reversion to the private sector of any activities that play more than a supporting role. According to the other school of thought, the public enterprise sector should have a broader and more autonomous function, namely, that of becoming (in association with the central government) the motive force behind the expansion and orientation of the development process.

It is not for the author of this study to take sides. The situation as it stands in Latin America today presents a whole range of experiments in this field, with different methods, different emphasis, and with more or less lasting results, according to the case. One point that must be made, however, is that, whatever the dominant approach may be, policy towards the sector must be faithful to, and consistent with, the formulation adopted, since ambiguities and contradictions in the decision-making process may be far more harmful and have much more far-reaching consequences than any leaning in one direction or the other.

(e) Expansion and diversification of State activities

The question that has just been discussed is obviously bound up with another: the conflicting views about the expansion and diversification of the public enterprise sector, which are the reflection of the broad attitudes or schools of thought outlined in the previous section. For those that do not hold the traditional view, a move in the direction either of expansion or of diversification, apart from other justifications, would have the advantage of extending government operations to more profitable activities than in the past, thereby increasing the possibility of accumulating investment resources.

Here, even more than before, it is impossible to be absolutely objective or purely technical about the situation. The fact is that very few attempts have been made to do so and that the more traditional kind of approach is far more common. One exception to this rule is the study previously mentioned, which endeavours to draw a distinction between enterprises constituting the "nucleus of economic expansion" that it refers to, which must be government-run, and those intended or more suitable for private management. The author of that study points out that the industries composing the nucleus of economic expansion utilize a limited range of technology, with few innovations. Their range of activity is relatively limited; certain services, electric energy, two or three kinds of coal and a few dozen petroleum, common steel and iron products. These sectors are assured of fairly easy access to the vast range of international know-how, either by ordering models, designs and specifications or through technical assistance.

The industries in the second group, the author continues, are more numerous and produce every kind of article. Most of them employ a wide range of constantly evolving know-how often bound up with processes and equipment which uncovered by patents or involve facilities that are the exclusive property of international enterprises. In some cases, these innovations can only be introduced into the national economy by allowing the foreign enterprises that are the sole possessors of the know-how into the country, while in others, it entails the signing of sharing agreements between the foreign and the national enterprises.<sup>21/</sup>

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<sup>21/</sup> See A. Dias Leite, op.cit.

A number of objections can however, be levelled against these views on the allocation of functions, and not only on political and ideological grounds but also for a more important and less debatable reasons, namely, the fact that the framework and functions of the private and public sectors also have their historical dimension, that is to say that they change over time and according to circumstances or the stage of social development. To understand the situation properly, then, it may be more useful to take into account the major changes that have occurred and their possible implications.

Looking at the problem from this angle, it would, for example, be helpful to bear in mind that, under the new or existing conditions of economic development in Latin America, the traditional idea of conflict between the public and the private sector has often lost all meaning. This is due to the fact that frequently - and especially in connexion with certain important basic industries that are leaders in technological progress - the real choice is between public or semi-public enterprises and foreign or international enterprises. At the same time, there is the obvious fact that, in many Latin American countries, the expansion and diversification of the State enterprise sector - far from being an obstacle to private enterprise or competing against it - has definitely had the effect of helping the private sector to extend its operations.

Of course, this does not mean that the various problems inherent in the management of public enterprises should be overlooked, these are amply illustrated by the discussions that have taken place both in industrialized market economy countries and in socialist or centrally-planned economies.

## Part II

### FINANCIAL INTERMEDIATION IN LATIN AMERICA

#### INTRODUCTION

The problem of attracting and allocating funds and the role of the agencies or institutions that act as intermediaries in that process are analysed in this document.

The study is concerned primarily with how the domestic resources accumulated by family units and, part of those earned by enterprises are tapped, and how external savings are attracted through the system of intermediation and the ways in which they are allocated. The mobilization of public sector funds is outside the scope of the present study.<sup>22/</sup>

One thing which was borne in mind during the drafting of this document was the development of the system of intermediation during the 1960s. The situation in Colombia, Chile, Ecuador and Peru was studied in some detail and that in Argentina, Brazil and Mexico in more general terms. The character of the analysis has therefore been affected by the situation in those countries, which are considered to be among the most developed in Latin America, and this means that the general lines and conclusions of this paper may not apply entirely to the other countries of the region or may be invalid for them.

Lastly, this document is only exploratory in nature, and it is planned to make more detailed studies of some of the questions discussed here at a future date.

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<sup>22/</sup> See ECLA, "Public enterprises: their present significance and their potential in development" (E/CN.12/872).

## I. NATURE AND FUNCTIONS OF FINANCIAL INTERMEDIATION

It is often assumed that the existence of a capital market is both necessary and in itself enough to raise the over-all saving rate, since appropriate action by financial intermediaries should increase the mobility of community surpluses and promote their use as investment in sectors that are of prime importance for economic development.

It is true that, as they become more diversified, the financial intermediaries provide an increasingly diversified economy with the means of transferring funds from the surplus to the deficit sectors, and in so far as their action is more rapid and efficient than the system of direct transfers from enterprise to enterprise or family unit to enterprise, they will improve the general level of efficiency of the modern economic sector. This does not necessarily mean that progress in the field of financing is enough to increase the over-all rate of savings and investment and to channel savings to the strategic sectors, which are of greater significance for development in the long term. In fact, this assumption is not borne out by the actual operation of financing and credit institutions in most countries, or by studies on theoretical bases of financial intermediation.

As far as can be seen from Latin American experience, it may be assumed that, except in cases where developmental financing institutions under the direction and control of the public sector have been set up for this express purpose,<sup>23/</sup> there are very few countries that have solved the problems associated with the transfer of funds to the more backward sectors, or to new sectors or poorer regions, through the normal working of financial intermediaries. This is not to deny that the recent development of capital markets in Latin America has led to a certain amount of diversification in the supply of funds in some cases and, in others has prevented personal savings from being widely dispersed or rendered unproductive for lack of suitable catchment.

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<sup>23/</sup> On the distinction between traditional intermediaries and developmental intermediaries see "Mobilization of domestic resources", Economic Bulletin of Latin America, vol. XIV, N° 2, chapter III, section 3 (a).

In this connexion, it should be recalled that there are two stages in the action of financial intermediaries. In the first, the financial intermediaries tap the savings accumulated by families and enterprises; and in the second, they pass the savings on to their clients. Obviously, how great an effect this system has on speeding up development will depend on the extent to which a developmental slant is given to each stage, and on the co-ordination of the two stages.

It may well be, therefore, that a considerable increase in the flow of funds from families and enterprises to financial intermediaries is not enough to ensure an over-all improvement, as the second stage may be governed by considerations of profitability and liquidity, and of the risk involved in loaning the funds requested, and not by developmental or social goals. Access to the funds of the financing and credit institutions is likely, therefore, to depend largely on the guarantees that can be furnished by the applicants for loans, which generally means, that the clients operating in the highest profit-making sectors, who are consequently more solvent, will get better attention.

In Latin America, in practice, many of the applications for this type of loan are made in order to pay for family consumer durables and to provide working capital for enterprises, and not for real investment in new activities or in sectors which are of prime importance for development.

The situation on the capital markets of developed countries is not much different.<sup>24/</sup> There, too, the main recipients of funds are the large enterprises that are already established on the market; small and newly-established enterprises are always given a hard time by the intermediaries, which are apt to make them smaller loans at higher financial cost and to require more guarantees than in the case of larger enterprises. The problem of financing small enterprises, from which most of the developed countries have suffered, has been solved, to a greater or lesser extent, by setting up special financing institutions, which usually have no connexion with

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<sup>24/</sup> See United Nations, World Economic Survey 1960 (United Nations publication, Sales N°: 61.II.C.1), chapter 2.

the regular financial markets. In several developed countries it has also been found necessary to create special funds for financing investment in new sectors of strategic importance for development; these sectors have also been neglected by the classic financial intermediaries, and the necessary funds have generally come from the public sector.

The above remarks on the nature of financial intermediaries call for a review, though not in depth of their functions and a consideration of the results of the fulfilment of those functions. The intermediaries have three types of function: to create credit; to make loans; and to permit the accumulation and diversification of assets.

The creation of credit means that the various spending units (enterprises, government and family units) are allowed to incur debts, i.e., that their total expenditure is higher than their current income. Thus each spending unit can spend more than its earnings, over different periods of time, while its indebtedness is reaching the level agreed upon.<sup>25/</sup>

Credit is created in order to help finance real capital formation, current production, consumption and the purchase of existing real or financial assets. Obviously, the first of these aims is the most directly related to the increase of country's productive capacity and, consequently, to its growth in the long term. Moreover, real capital formation will be the more important, the lower the level of self-financing of the investment units, i.e., enterprises and the public sector.

The other three uses of fresh credit are also important for the process of economic development. However, there is no doubt that the financing of current production (which is done mainly by the commercial banks), the financing of consumption so as to maintain or raise effective demand or change its composition, and the purchase of existing real or

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<sup>25/</sup> It should be noted that, in a developed capitalist economy, the growth of funds is more rapid than the capital formation. Therefore, the direct indebtedness of the spending agents, plus the indebtedness incurred indirectly by the intermediaries, accounts for an ever larger proportion of national income and wealth. See Gurley and Shaw, "Financial aspects of development", The American Economic Review, September 1955.

financial assets for speculative purposes or to accumulate savings in which the stock market plays the central role, have only an indirect influence on the economy and do not by themselves ensure the expansion and diversification of productive capacity.

The second function of the financing system, i.e., the financial intermediaries is to make loans. Thus instead of the economic agents with surpluses supplying financing direct to the units with a deficit, intermediaries are established to permit a more efficient channelling funds and a much larger number of debits and credits in the economy as a whole. The intermediaries, on the one hand, purchase securities, i.e., documents giving the purchaser a direct claim on the deficit spending units which issue them, and, on the other, they issue and sell other securities to the surplus spending units, thus giving them an indirect claim on the deficit units.

The diversification of the securities sold by the intermediaries explains the origin of the third function of the system: to permit the accumulation and diversification of assets. The intermediaries provide an appropriate range of assets, differing in terms of denomination, liquidity, yield and safety as an investment, which enables the surplus units to use their excess earnings, which they probably would not be able or willing to do if they were in direct contact with the deficit units.

If the financing and credit institutions are to fulfil their various functions, there must be compatibility between the interests of the different economic agents involved, i.e., those of the recipients of loans, which require the loans they receive to be tailored to their expenditure; of the surplus units, which are the source of the funds to be mobilized; and of the financial intermediaries themselves, which lies in expanding their operations with the least risk and the greatest profit.

If the interests of these three basic economic agents coincide, it can be said that the system is functional, quite apart from whether or not it is efficient in the micro- and macro-economic sense. However, its function is neutral, which means that the financing system can always provide flexible service to meet the short-, medium- and long-term needs of the growth sectors,

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despite the fact that it does not do so in the most efficient way either from the micro economic standpoint (minimum costs and an optimum scale of operations of the financing units), or in the macro-economic context (an optimum distribution of real resources and a maximum growth rate in the economy),<sup>26/</sup>

It might be maintained, therefore, that the sole purpose of functionally neutral financing institutions is to permit and facilitate the accumulation of just the amount of investment actually required by the agents of the economy, and to promote the channelling of funds to - and, most probably, their concentration in - the most important sectors or activities from the point of view of their profitability and sure prospects of dynamic growth, given the structure of demand. If the sector is viewed in this light, it can hardly be expected to assume such responsibilities as that of correcting the intrinsic features of a specific pattern of development, channelling allocations of real resources in a specific direction, or even of raising the real investment rate.

Financial intermediaries may of course, be conceived to have a development function, i.e., to be institutions that play an active role in the allocation of resources. In this case, the intermediaries channel resources in a different direction from that in which they would flow if the intermediaries had a neutral function: they direct the flow to those fields which are considered to be of prime importance to the economy because they act as a spur to economic and social development, and these fields will mostly be different from those that would be selected purely for reasons of private profit.

When financial intermediation has a development function, it may have two other avowed objectives as well: first, to raise savings and investment rate of the economy and increase the flow of financing that goes through the

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<sup>26/</sup> The concept of a functional financial system is not the same as what has been called the optimum structure of financial development. In this connexion, see John G. Gurley, "Hacia una teoría de las estructuras financieras y el desarrollo económico", in Estructura financiera y desarrollo económico (Editorial del Instituto Torcuato Di Tella, 1968).

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intermediaries; and secondly, to spread the allocations of funds. This is the reverse of what happens when the intermediaries are neutral in function because, on the one hand, the conventional standards of private profit and guarantees for channelling funds (which implicitly tend to favour the large enterprises, most of them monopolies) are discarded and, on the other, a conscious effort may be made to encourage productive units other than those which have always received financing or that have already consolidated their position, i.e., to favour units which for various reasons deserve priority attention, such as export firms and small and medium-sized enterprises.

Among the forms that the system of intermediation may assume to fulfil the function of promoting economic and social development, two separate possibilities may be considered.

The first consists, essentially, in readapting and restructuring the intermediation that is functionally neutral, that is, in linking intermediation with an explicit development strategy and imposing on it a strict and effective government policy with proper co-ordination and central control. This means that the State should have effective means of influencing the quantity and quality of the financing provided by the system as a whole and by each individual intermedy, whether public or private.

The second alternative, which is followed in most centrally-planned economies, is for the financial intermediaries to be entirely State-run and to meet directly the applications for financing to mobilize real resources in accordance with the current development plan. In other words, the flow of financing conforms strictly to the directives and controls of the central planning authority.

Obviously, there are many intermediate positions between these two model alternatives for the organization and operation of a neutral or developmental financing system. There is ample evidence of this in the world context, and clear examples exist even in the experience of different Latin American countries, as will be shown when consideration is given to the development of the system in selected countries and, in the final section of this paper, to the chances of success and possible features of a system of intermediation that would serve the general purposes of development.

## /II. DEVELOPMENT

## II. DEVELOPMENT OF FINANCIAL INTERMEDIATION IN LATIN AMERICA

### A. MAIN FEATURES OF RECENT TRENDS IN LATIN AMERICA

By the beginning of the 1960s, several Latin American countries had achieved a certain degree of industrial development at varying levels of diversification as regards the internal structure of the manufacturing sector. In the major branches, however, virtually all the dynamic growth possibilities afforded by import substitution based on reserved markets or limited market expansion had been exhausted.

As a rule, the domestic market acts as a brake on growth when the process of expansion ceases to be stimulated by the demand from the various sectors for complementarity and diversification that is a natural concomitant of rapid change in the productive apparatus. A sign of this phenomenon was the downward trend of the growth rate in several Latin American countries towards the middle of the 1960s, and it can be attributed to a number of closely related problems.

This was the time when it was found that the mechanisms used to expand the domestic market were inadequate and that maintaining the level of activity in the most modern branches of industry no longer depended on or even required new and sweeping changes in the production structure. Of greater and perhaps decisive importance was the need to expand and diversify demand, at a time when the possibility of rapidly increasing consumption of goods, especially durables, was directly related to the income distribution pattern in the region and to the demonstration effect of the conspicuous consumption of the high-income groups on the middle-income strata in urban areas. In other words, the key issue was to find medium-term financing for the sale of goods that could be produced with the existing installed capacity.

The need to make more credit available to urban consumers and to extend repayment periods, however, came up against the inflexibility of the financial apparatus, and its basic nucleus the traditional banking system, which was unable to make credit available on easier terms because of increasing control by the monetary authorities of the secondary expansion of the money supply as a means of holding down inflation.

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In many countries the situation led to the formation of an embryo financial market outside the banking system, side by side with or superimposed upon the traditional market and composed of a number of new financial institutions whose function was to supply enterprises with additional resources to finance sales or to enable consumers to broaden the margin between their disposable current income and their capacity to spend.

The initial capital providing the basis for expanding consumer credit has three main sources. First, the traditional banking system, which tends to create subsidiary financial enterprises as a means of putting its profits to better use and expanding its total credit capacity with some degree of independence from the growth in the money supply permitted by the monetary authorities. Secondly, inflows of short-term foreign capital attracted by the quick profits likely to accrue from the rapid growth of the new financial sector. Thirdly, surpluses generated by certain enterprises in the sectors of production which are directly concerned with increasing sales - particularly of consumer durables - and which in many cases have created their own sales subsidiaries and consumer financing agencies.

The subsequent increasing expansion of this new kind of credit has been based on the resources accumulated by the new financial intermediaries and on their sales of securities which attract investors because they pay higher rates of interest than the other alternatives offered on the financial market.

The second main feature of recent trends in the operation of financial intermediaries relates to the development of financing for the public sector.

It should be recalled, in this connexion, that Governments have been obliged to bear a high and often increasing share of the total expenditure of the economy, owing to commitments assumed in respect of investment in the basic sectors of the economic and social infrastructure, for which as a general rule they cannot take the easy way out merely by putting more money into circulation. Furthermore, the possibilities of cutting down the operating and transfer costs of the public sector are somewhat limited. Hence, the public sector has found it necessary either to increase taxation, or to establish new mechanisms for tapping domestic credit by competing in

/the financial

the financial market, or in some cases, by increasing the external debt. The extent to which these three approaches have been used varies according to the individual characteristics of each country.

What is interesting is that as a general rule financial policy has provided public agencies with new instruments to attract resources (for example, readjustable bonds and debentures, special funds, etc.) and that virtually all countries have sharply increased their external debt.

## B. TRENDS IN FINANCIAL INTERMEDIATION

### 1. Criteria

Before examining the trends of financial intermediation in Latin America and looking at its most characteristic features in various countries, it may be useful to indicate the criteria used.

The first point is that the development of financial intermediation has been affected by factors relating to inflationary pressures, stabilization policies and, more specifically, the monetary policies instituted in recent years in various Latin American countries. Hence, it may be that the trends that can be taken as normal in the financial sector as per capita income rises - for example, an increase in liquidity and a gradual decline in the importance of the traditional intermediaries - will change as a result of concern with inflation and the possible effect of an over-all expansion of the money supply.

Secondly, the institutional range of financial intermediation must be taken into account, which has been affected by three basic factors:

(a) Modernization of the traditional financial apparatus, chiefly the banking system, in two respects: first, the use of new installations and equipment (incorporating modern banking techniques); and secondly, an effort to find more specialized ways of tapping and allocating resources that will enable the system to extend its coverage to more sectors and persons;

(b) Creation of new public and private institutions with different machinery for tapping resources and different functions as regards the use of funds;

/(c) Adaptation

(c) Adaptation of the new institutions or readaptation of traditional institutions to bring them into line with changes in the international financial system, as regards the activities of new international private groups and of inter-governmental and other financing groups, such as IBRD, IDB and USAID. Some of these institutions were even specifically set up to tap certain external resources directly.

Wherever this process has occurred, successive changes have had to be made in the legal and institutional framework of the financial sector, both to provide greater flexibility for private operations and to pave the way for government financial policy of a kind that would make the intermediaries more suited to the new growth needs of the key sectors. In some cases, more cohesion has been given to the internal structure of the system as a result of greater control by the financial authorities; in others, a traditional line of monetary policy has virtually confined public operations to the banking system or to State development agencies and given free rein to the proliferation of agencies outside the banking system which do not operate in a co-ordinated fashion and which compete for the same total stock of resources.

Thirdly, the development of financial intermediation in Latin America has a basically functional side with respect to the tapping and the allocation of resources. A number of major factors are involved:

(a) As to attracting resources, several mechanisms have been introduced to tap domestic savings, relying in varying degrees on a number of incentives (degree of liquidity, profitability, readjustability, coverage, tied saving, etc.),<sup>21/</sup> which have led to a substantial increase in the income of the intermediaries and provided them with a broader scope for distributing resources among the financial agencies and among the various functions.

In this connexion, it should be noted that voluntary saving has remained the principal mechanism, and that forced saving has not become widespread; if it had, it would have completely changed the structure of

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<sup>21/</sup> See ECLA, "Mobilization of domestic resources", Economic Bulletin for Latin America, vol. XV, N° 2, (second half of 1970), chapter III. (In the press.)

the relations between savers and intermediaries. Only in a few countries have compulsory deductions from wages been instituted as a means of financing the construction of housing.

Furthermore, external resources are being attracted on an increasing scale and form an important part of the flow of resources to the financial intermediaries.

(b) With respect to the allocation of resources, the dominant trend is for resources to be channelled towards four major areas. First, a substantial part of the new funds obtained has been devoted to increasing consumption of durable goods. Secondly, there has been appreciable growth in the use of resources to finance housing construction. The allocation of resources for these two purposes is of relatively recent data in Latin America, for in a number of countries it began in the late 1950s or early 1960s.

Thirdly, the resources of the intermediaries have continued to flow towards more traditional areas, and the criteria governing loans have mainly been of private profit and the guarantees offered by prospective borrowers.

Lastly, a proportion of resources, which differs appreciably from one Latin American country to another, has gone to finance real capital formation in priority growth sectors, and more flexible and "developmental" criteria have been used in evaluating the corresponding investment.

## 2. Main institutional and functional aspects of financial intermediation in Latin America

In line with the criteria suggested above, this subject will be discussed under two broad institutional heads, while a third and supplementary subsection will deal with the "foreign infiltration" that has occurred in various parts of the financial system. Thus, a distinction will be drawn between public and private financial intermediation, and the functional aspects of each will be considered.

/(a) Public

(a) Public financial intermediation

(i) Modernization of traditional machinery. The first point to note is that the central banks or equivalent monetary authorities have modified their regulatory activities, on the one hand, by using new instruments for attracting resources, and, on the other, by strengthening their general operational capacity. Where the former procedure is concerned, the monetary authorities in several countries (in particular, Brazil, Chile and Colombia, together with Argentina and Mexico, which adopted the practice some time ago) collect funds through the sale of securities. What is more, in Brazil and Chile, because of the inflation affecting both these economies, the securities issued are readjustable in accordance with the rise in the cost of living. That is, the institutions issuing them have specialized in tapping "untied" domestic savings, i.e., those funds that the surplus spending units place at the disposal of the intermediaries financial gain motives not with the aim of subsequently obtaining resources from intermediaries to cover expenditure for specific purposes.

There has also been a widespread tendency to strengthen the operational capacity of central banks, through administrative and legal changes in their financial systems, and by making greater and more careful use of the means at their disposal.

Although the Latin American monetary authorities guide and control the intermediation process in its over-all aspects, they have exerted much less influence on the sectoral distribution of resources, despite the efforts made in this direction. The case of Mexico is an exception to the general rule, since such devices as, for example, making it compulsory to maintain reserves of 100 per cent of all increases in deposits within the financial system have enabled secondary monetary expansion to be kept under better control.

Secondly, State banks run as commercial banks have not been modernized to any great extent, especially as regards their modus operandi for the tapping and allocation of resources. Although some progress has been achieved in respect of the methods used to obtain funds, as in the case of the Banco del Estado de Chile with its readjustable savings accounts, in

/general the

general the role played by such institutions has undergone no radical change, and their operation has resembles, in broad outline, that of the commercial banks.

Thirdly, official development agencies or corporations have likewise shown little sign of moving with the times, especially inasmuch as they do not have their own sources of financing, and their expansion and the extent of their sectoral operations are therefore conditioned by the inflow of official external loans - mainly those granted by international agencies - and the funds obtainable from the Governments concerned, whose action has generally been cramped by budgetary stringency.

In several of the countries analysed (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru and Uruguay), official external resources intended for specific purposes (in industry and agriculture, and the energy and other sectors) are no longer transmitted through public development institutions but directly to specialized public and private agencies and even to the investor enterprises themselves. This trend is particularly marked in the case of the International Bank for Reconstruction and Development and the Agency for International Development; only the Inter-American Development Bank has continued to channel its credits through the official development organizations.

Similarly, short-term foreign capital has found its way primarily into the new private financial associations, and the public development agencies have been disregarded.

Owing, therefore, to the limits set to their supply of funds, the traditional development agencies seem to be playing a less important part in the promotion of Latin America's economic growth, despite the improvements in their internal organization and in the loan methods applied.

Once again Mexico presents a different picture. Virtually all negotiations for official external loans are centralized in the Nacional Financiera, and it also taps private-sector resources, especially "untied" savings, through the issue of its own securities, which tend to determine the structure of rates and expiry periods for the market as a whole. This agency, which is in essence a public development corporation and the leading

/finance: of

financer of industrial investment in Mexico, has, as is commonly known, other functions of major importance, acting, for example, as a government agent for the sale of State securities in Mexico and abroad and for the negotiation and administration of foreign loans. But perhaps its most significant role from the standpoint of the development of the financial intermediation system consists in the action it takes jointly with the Banco de Mexico, which is in effect the country's central bank. The decisions adopted by these two government institutions in connexion with the patterns and levels of interests rates, with the formation of specialized indirect financial assets and with the supervision of private financing agencies have played a crucial part in the process of channelling investment and, above all, directing an adequate supply of funds into projects on which the rates of return would be of dubious interest for the private sector or as an immediate proposition, but which are held to be deserving of priority.

The relations of the Nacional Financiera with the private intermediaries are also unusual. Besides asserting its leadership in the financial market through the issue of its own securities, it influences private financial agencies by subjecting the flows of funds within the system to strict quantitative and qualitative regulations, with the aim of directing resources towards priority objectives. Accordingly, with an over-all framework of selective credit controls, official securities have come to cover a growing proportion of the increase in deposits in the hands of private financial agencies, which have risen steeply during the past twenty years.

The fourth group comprises specialized official banks or agencies. It should first be pointed out that they are not very common in Latin America (especially in terms of one for each sector, for instance, industry, agriculture and housing). Of the countries studied, Brazil, Colombia and Peru are among those that have developed these specialized agencies to the greatest extent.

Generally speaking, the modernization of these intermediaries has been linked to the countries' increasing practice of negotiating loans from international agencies, since there has been no additional tapping of domestic resources through the use of new instruments. Similarly, funds for

/investment purposes

investment purposes have continued to be allocated according to largely traditional patterns, and guiding principles stemming from the external loans themselves.

Lastly, the traditional public intermediaries include social security institutions. In almost all the Latin American countries studied, with the probable exception of Peru, a concomitant of the failure to modernize these agencies has been a steady decline in the savings generated by the social security system. Thus the tendency for social security systems to act as instruments of distribution rather than of capital formation has become more marked. In view of this decrease in the formation of social security savings, it is not surprising that little has been done to improve the administration of the systems in question or to introduce new methods of tapping and allocating resources.

(ii) Establishment of new agencies. Hence the first observation to be made is that during the 1960s new and specialized official development agencies were established, where they did not already exist, partly because of the lack of modernization and of diversification characterizing the traditional development agencies and partly because of the specialized nature of the external loans obtained from some international credit institutions. These agencies have accordingly acquired increasing importance in the negotiation of official external loans and in the financing of investment in specific sectors.

A second instance of new public intermediaries is afforded by the central and controlling agencies of savings and loan associations with housing as their object. Examples of such agencies, which act as veritable "central banks" of the financial subsystem for housing, are the Banco Nacional de Habitação in Brazil, the Caja Central de Ahorro y Préstamos in Chile, and the Banco Central Hipotecario in Peru. Besides guiding and monitoring (i.e., supervising and controlling) the operations of savings and loan associations, their functions include channelling public funds and obtaining external and internal savings in order to provide support for the housing subsystem and give it liquidity. For the purpose of tapping "untied" savings, these institutions have mainly resorted to the sale of securities which they themselves issue, while their principal source of external funds has been the Inter-American Development Bank.

/(b) Private

(b) Private financial intermediation

(i) Modernization of traditional machinery. The traditional group of private financial institutions comprises most of the banks, and the insurance companies. On the other hand, the new private intermediaries sector would seem to be made up of the investment banks and almost all the private agencies other than commercial banks: savings and loan institutions, mutual funds and financial associations.

Among the traditional private intermediaries, the modernization process has consisted primarily in improving the operational efficiency of the institutions concerned, through the purchase of new equipment and the introduction of more up-to-date organization systems and methods. In several countries it has been linked - especially in the case of the commercial banks - to the increasing participation of foreign (particularly United States) banks which have been set up in various parts of Latin America where new branches have been opened or national banks bought up.<sup>28/</sup>

In most of the countries considered, little has been done to introduce new techniques for tapping and allocating resources in the deposit and savings banks. Practically no new methods of absorbing domestic funds have been adopted, and there have been few changes in time deposit systems, except in Brazil, where a monetary readjustment clause has been included in their regulations.

On the other hand, the commercial banks have played an important part in obtaining and channelling a substantial proportion of the private foreign loans negotiated by the region.

The granting of loans has continued to follow traditional patterns, although some countries have begun to apply such procedures as higher percentages of cash reserves in relation to increases in deposits - with provision for allowing the monetary authority to release these reserves for specific purposes -, and credit lines in accordance with cash budgets agreed upon by the enterprises and the commercial banks. In addition, the

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<sup>28/</sup> See Miguel S. Wionczek, La banca extranjera en América Latina, a document presented at the ninth session of a group of technical experts from Latin American central banks (Lima, Peru, November 1969).

commercial banks may have kept up or increased their indirect financing of the expansion of consumption of durable goods, through the general credits granted to producers of consumer durables.

It should be noted that the low degree of modernization of deposit and savings banks in the private sector is often due to the more or less restrictive monetary policies which are applied in many Latin American countries as part of a broader anti-inflation strategy, and which especially affect the expansion possibilities of these financial intermediaries. In effect, the area which best lends itself to manipulation by monetary policy is constituted by the aggregate sums that the private banks absorb and lend.

The mortgage banks have not been modernized either to any significant extent, and, in practice, the movement of resources through the sale and purchase of mortgages has lost importance in Latin America, except for the operations of these banks in financing of house-building.

Lastly, among the traditional private-sector intermediaries are the insurance companies. As a general rule, they have not been modernized, and at the same time their contribution to the intermediation system has become much less significant than it used to be. In Latin America, in contrast to what has taken place in some of the industrialized countries, particularly the United States, the endowment policy type of insurance, which is tantamount to a form of tied savings, has gained little impetus.

(ii) Establishment of new agencies. While the public sector has been characterized by the modernization of the existing machinery for financial mediation, the opposite has been true of the private sector, where the establishment of new agencies has usually been preferred.

In banking, the outstanding development has been the establishment of investment banks, although this solution is not widespread and appears only in Brazil, Colombia and Mexico, of the countries under review.

Investment banks have taken over functions which in a sense complement those of the public development agencies; in other words, their task is to channel resources into enterprises to finance the expansion of production capacity and, although on a lesser scale, to meet requirements in terms of more working capital.

/These banks

These banks have some salient characteristics which are to be found in the various banks established in Latin America. First, they have shown versatility in tapping funds, using various procedures which range from selling securities and receiving deposits, in the domestic market, to extending loans, mainly short-term private loans with a high rate of return, in the external market. Secondly, the establishment and expansion of these agencies has been directly related to foreign financial agencies or groups, including the International Finance Corporation (IFC), the ADELA Investment Company, the United States conglomerate, DELTEC, and the Hanneman group in Europe. Thirdly, the investment banks have generally been associated or have acted in co-ordination with important national financial groups which are offshoots of the commercial banking system itself - especially where the commercial banks have been prevented by the monetary authorities from expanding very much -, with fairly large private enterprises or groups of enterprises, and with other intermediaries outside the banking system, particularly mutual funds and some financial associations. Fourthly, they have used their funds flexibly and for many different purposes, i.e., on the one hand, they have rapidly mobilized resources by lending to some enterprises and investing in others and, on the other hand, they have not confined themselves to financing one type of productive activity but have spread their operations over such widely different fields as petrochemicals, livestock breeding, construction and supermarkets.

An important factor in the role played by investment banks is the high proportion of their resources that has been channelled into priority sectors. This is due both to the slant given to their operation by the banks themselves and to the degree of control exercised by some government agency. As mentioned previously, Mexico's Nacional Financiera is the most representative example of centralized management in this field.

Among the intermediaries outside the banking sector, the most important group of new agencies is the savings and loan associations for housing purposes. These have developed considerably in some countries, particularly Brazil and Chile, and to a lesser extent Peru. They are a typical example of saving tied to a powerful motive, such as home ownership, which involves

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a complete transformation of the system of intermediation. In other countries, such as Colombia and Mexico, on the other hand, the amount of resources mobilized in this way has been small, while in others these associations have got off to a very slow start.

Savings schemes linked to specific goals also include financial associations whose function is to finance the consumption of durable goods, particularly motor vehicles. These financial associations have usually been supported by the enterprises which produce the articles concerned, and which are wholly or partly owned by parent companies abroad.

In some countries, including Argentina, Brazil and Uruguay, financial associations have also come to participate in the regular financing of enterprises, which has given rise to a parallel credit market operating side by side with the commercial banks.

There is very little quantitative data available on private financial associations in Latin America, so it is not easy to gauge how much they have developed with any degree of accuracy. They are, however, becoming more and more important in most of the Latin American countries examined, where the growth pattern of demand and the effect of the urban high- and middle-income groups on its structure, and any restrictions there may have been on banking operations have encouraged their expansion. The application of restrictive monetary policies and the legal ban on paying more realistic interest rates on savings have favoured the expansion of operations outside the banking system, which were not subject to control or could generally evade it. Furthermore, in order to continue expanding, the financial associations have adopted the procedure of selling documents representing money owed to them (their own securities) and investing the profits, contracting short-term external loans, and obtaining loans from the commercial banks also.

Only a small proportion of the resources handled by financial associations seem to have been used for expanding production capacity in priority sectors, for two main reasons: first, allocations are determined by the consumption to finance which the associations were established and, secondly, the central government has hardly any control over their policy or their operations.

Mutual funds constitute another group of private intermediaries outside the banking system that have been recently established in Latin America. They have become quite important in countries such as Brazil, Colombia and Mexico. Their development has been largely determined by the growth of investment banks, and the operation and rapid expansion of the security markets. The participation of some foreign groups has been a decisive factor in the establishment and operation of these funds, and has strengthened and extended the influence they exercise through the investment banks.

As to whether or not they perform a useful function, it can be said that mutual funds have become of some importance in tapping domestic resources and securing short-term external loans, and in allocating the funds thus obtained for the purchase of existing assets.

(c) Foreign infiltration in the financial system

Increasing foreign influence in financial intermediation calls for a study in greater depth.

In the first place, foreign infiltration has obviously been taking place in the private rather than the public intermediaries. Nevertheless, as pointed out above, the foreign influx has played an important part in the establishment and strengthening of specialized public agencies in several countries, while the traditional development institutions have had less importance. Moreover, in some countries, the trend towards decentralization of the public agencies in contracting external loans and allocating the resulting funds has been accentuated, since these funds have been channelled not only directly to public or private enterprises, but also to private financial intermediaries. It may be inferred, therefore, that the first fact to be stressed in connexion with the infiltration of the system is that it has been due in some degree, to the way in which the relationship between public intermediaries and foreign lenders has been developing.

In the case of private intermediaries, the procedure has followed different patterns, and has more resembled a take-over. In some cases, foreign institutions have acquired a majority share of the capital stock

/of existing

of existing national agencies, which has gained them control of the intermediary concerned. This has happened mainly in the case of some of the commercial banks in several Latin American countries.

In other cases - also in connexion with commercial banks - the parent firm has acted directly and set up subsidiaries. This has been the procedure followed by the principal United States banks in many capitals and other important cities of Latin America. But the take-over has been particularly marked among the non-traditional intermediaries, especially through the establishment of new investment banks and mutual funds. To that end, representatives of foreign firms have often operated in co-ordination with national groups of private investors and have taken up a minority or a majority share, as the case may be, of the new intermediaries' capital stock.

The influence of foreign groups on private financial intermediation in Latin America cannot, however, be measured, only in terms of their share of the intermediaries' capital. Through a minority share they can sometimes be very influential in the management of these agencies, and even in policy-making and decisions on key appointments.

The new "foreign" agencies grant loans and make fresh capital investments, using their own resources and also acting as intermediaries for foreign - and sometimes national - investors, who generally delegate their powers to them. They also seem to have been making more and more use of domestic resources for their own purposes. The impact of these agencies, particularly investment banks and mutual funds, has therefore snowballed.

Through this procedure, "foreign" intermediaries have come to control or influence the decisions of a great many enterprises in the region, particularly in the manufacturing sector. In other words, the foreign take-over of financial intermediaries has spread to the production area, and is a process which has acquired considerable importance in several Latin American countries.

### 3. Particular aspects of the evolution of the structure of financing in selected countries

The foregoing analysis may be completed with a few comments on various Latin American countries.

In Mexico, which was able to pass without great difficulty from a stage of easy import substitution to a stage of diversification and expansion of consumption and production, public financing institutions were ahead playing a decisive role in the financing and reconciliation of public and private objectives as early as the 1950s. In the period 1960-1968, the combined share of the Banco de México and other national development institutions in the country's total financial assets fell from 55 to 46 per cent. Most of the drop was accounted for by the Banco de México itself.<sup>29/</sup>

In the meantime, private financial associations, which had developed rapidly in the second half of the 1950s, continued to expand, and increased their share in the total financial assets from 15 to 24.5 per cent between 1960 and 1968, while the share of private deposit banks declined.

Brazil experienced an even more radical change, especially from 1964 onwards. A number of institutional changes in its financial system have improved the different methods of channelling financial flows and caused the traditional institutions to lose considerable ground. Thus, the banking system, including the Banco do Brasil and the commercial banks, which in 1964 was the source of 80 per cent of the credit accorded to the private sector, granted only 55 per cent in 1969.<sup>30/</sup>

At the same time, what is now known as housing financing, which did not exist in 1964, expanded so rapidly that in 1969 it already represented 13 per cent of the total financing of the private sector. Moreover, private financial groups, such as credit corporations and investment banks operating outside the banking system, which accounted for barely 6 per cent in 1964, almost tripled their share in 1969. In

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<sup>29/</sup> Banco de México, Informe anual, 1961 and 1968.

<sup>30/</sup> Central Bank of Brazil.

contrast, the importance of public development agencies declined slightly in over-all terms, although they greatly diversified their operations and created new financing funds which were closely connected with international agencies.

All these changes are reflected in the composition of the financial assets owned by the public. In 1963, 95 per cent of the financial assets in the hands of economic units consisted of bank-notes and coin, and bank deposits; investment securities at fixed or variable interest rates represented only 2 per cent of the total. By 1969, the new private and public securities, which were introduced after the adoption of the currency readjustment clause, already amounted to 26 per cent of the total financial assets in circulation.<sup>31/</sup>

In Argentina, on the other hand, at least until 1965 (the last year for which data are available), banking institutions had not lost ground in the intermediation system, except for mortgage credit institutions. This is clear from the evolution of the structure of Argentina's financial assets. Outside the banking system, private financing agencies practically doubled their share between 1960 and 1966, while social security institutions followed a completely opposite trend.<sup>32/</sup>

It should be borne in mind that the Argentine system developed within the context of a restrictive monetary policy which reduced the economy's liquidity. This is evident from the data on the balances of securities representing indirect obligations issued by the group of traditional financial intermediaries, which diminished in real terms between 1955 and 1965.<sup>33/</sup>

Colombia's traditional banking system has also maintained its position in total financial assets of which it owns about 60 per cent, divided equally between the Banco de la República and the commercial banks. The 10 per cent of the Banco Hipotecario and the Banco Popular must be added to this figure.

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<sup>31/</sup> Central Bank of Brazil.

<sup>32/</sup> S. Itzcovich, Los intermediarios financieros extrabancarios en la República Argentina (Instituto Torcuato Di Tella, September 1966), Table 2.

<sup>33/</sup> Ibid., Table 5.

Changes are taking place mainly in the intermediaries outside the traditional banking system. The share of all insurance and capital formation companies in the country's total financial assets declined from 12 per cent in 1960 to just over 5 per cent in 1969, while the Caja Agraria recorded a somewhat smaller decrease. In contrast, the financing corporations, including investment funds, increased their share from 1.5 per cent in 1960 to 9 per cent in 1969.<sup>34/</sup>

It is interesting to note two points regarding the development of Colombia's financing corporations: first, the role played by the International Finance Corporation of the World Bank Group in setting them up; and, secondly, the practice followed by these corporations of participating in the financing investment projects by acquiring part of the capital of the enterprises with which they operate.

Chile shows much the same trend as Argentina as regards the overall liquidity coefficient or the ratio of financial assets to the gross national product. This ratio declined steadily from 36 per cent in 1940 to 13.2 per cent in 1959. It recovered slowly after that year and more quickly from the years 1964-1966 onwards, as a result of changes in monetary and financial policy, reaching 22.6 per cent in 1968.

Although the banking system expanded its investment in real terms, its share in the total credit granted by the system declined, the trend affecting both the Banco del Estado and commercial banks. In contrast, the Housing Corporation (Corporación de la Vivienda - CORVI) and savings and loan associations (organized since 1960), which operate within the system of savings linked to housing construction and of adjustable income and disbursements, boosted their sales to over 19 per cent of the total for the whole financial system in 1968.<sup>35/</sup>

As in Brazil, this development of intermediaries outside the banking system alters the composition of the financial assets; the share of currency and banking assets proper (bank-notes and coins, and

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<sup>34/</sup> Revista del Banco de la República and Revista de la Superintendencia Bancaria.

<sup>35/</sup> Pedro Jeftanovic, Estudio sobre el Mercado de Capitales Chileno, Centro de Estudios Socioeconómicos de Chile (CESEC), 1969.

bank deposits) in the total funds of the financial system declined from 98 per cent in 1960 to 86 per cent in 1968. In other words, virtually the whole increase in the ratio of financial assets to gross national product since 1964 is attributable to the new forms of mobilizing resources for housing.

A noteworthy feature in Chile's experience - in addition to that already described in relation to the Central Bank's substantial sales of readjustable savings certificates (certificados de ahorro reajustables - GAR) since 1965 - is the evolution of State development institutions. The Production Development Corporation (Corporación de Fomento de la Producción - CORFO), and, more recently, the Banco del Estado have continued to make an increasing amount of resources available to the production sectors. CORFO has been mainly concerned with mobilizing public and external resources, while the Banco del Estado has drawn on the private savings it has tapped since 1966, through the system of readjustable savings accounts.

The National Mining Enterprise (Empresa Nacional de Minería - ENAMI) and the Agricultural Development Institute (Instituto de Desarrollo Agropecuario - INDAP) have also continued to channel public resources into the private sector.

It will be noted, moreover, that no investment banks have been established in Chile, in spite of the development bank act that was promulgated in 1965. But advantage has been taken of some of its provisions act by the Banco del Estado and the mortgage banks.

In Peru, significant changes are also observable in the financial structure, in both within the banking system and outside it, besides the drastic institutional reforms initiated in 1970, which introduce very different financing rules and modes of operation from those previously in force. In the banking system, apart from the smaller participation of the Central Bank and the commercial banks in the total assets, credit and deposits, new government banks have made their appearance not only in the general credit area (Banco de la Nación) but in specialized areas

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as well (Banco de Vivienda). The Banco de la Nación, in particular, has assumed considerable importance, accounting for over 17 per cent of the total credit accorded by the financial system in 1969.<sup>36/</sup>

As regards specialized development banks, the relative importance of the Banco Central Hipotecario, the Banco Agropecuario and the Banco Minero did not change, while that of the Banco Industrial increased. It is interesting to note that in 1969 the State development agencies accounted for over 20 per cent of the total credit accorded by the financial system, and that their participation in the whole group of public financial institutions in Peru was nearly 60 per cent.

Moreover, as in other countries, the decline in the relative importance of insurance companies contrasted with a substantial increase in the number intermediaries operating outside the banking system which are linked with foreign financial groups, particularly in mutual funds and savings and loan co-operatives, of which there were virtually none in 1960, but which had come to provide more than 8 per cent of the total credit in 1969.

Lastly, some investment banks were established in Peru - one with the participation of the International Finance Corporation and ADELA - but they were of no great importance since resources continued to be channelled through public development institutions.

Ecuador also followed the general trend towards a decline - although less pronounced than in other countries - in the share of the banking system in the system's total assets, and the emergence of new public financing agencies. The National Finance Corporation was founded in 1962 to finance the fixed capital formation of industry, assuming the main functions formerly assigned to the National Development Bank. Although the latter's operations have continued to expand, it has lost much of its character as a general and industrial development agency and has become practically the main public agency for agricultural financing.<sup>37/</sup>

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<sup>36/</sup> Superintendencia de Bancos y Seguros, Memoria 1969.

<sup>37/</sup> Junta Nacional de Planificación y Coordinación, Indicadores económicos, July 1970.

Specialization in private financial intermediation has been less intensive than in other Latin American countries and, in fact, the relative importance of private commercial banks is still considerable. The most important form of diversification in intermediaries not belonging to the banking system was the establishment of a private financing agency, the Ecuadorian Finance Corporation (COFIEC), jointly by IFC and ADELA.

### III. CONCLUSIONS AND ALTERNATIVES

1. The background material and the comments in this document show that during the 1960s there has been considerable development of the systems of financial intermediation in Latin America.
2. It has also been shown that this development has features which are peculiar to each country, for in each it is determined by a variety of factors, the most important being the stage of economic and social development they have reached, the pattern and pace of their development, and, lastly, the over-all and the specific policy towards the financial sector adopted by each Government. Of these, those connected with the objectives and requirements of development seem to have been most instrumental producing the structural changes that have occurred in the machinery of intermediation.
3. One striking fact which emerges from recent experience is that Latin America possessed a substantial personal savings potential and that hardly any of these potential savings had been tapped or channelled through the system of intermediation.

Thanks to introduction in most of the countries considered of various tied and untied savings schemes, fundamental structural changes have been made in the intermediation machinery, when the intermediaries began to receive a substantial proportion of the new funds generated by family savings. These funds have largely gone to finance housing construction and to increase consumption of durable goods.

4. Another conclusion that emerges from this paper is that a development and sophisticated intermediation system does not necessarily promote economic and social development and may not even be consistent with

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development policy. Indeed, the function of the intermediation systems in Latin America, given the basic structures of the economies, has been to facilitate the flow of funds from the surplus to the deficit spending units, although the activities or goals of the latter are not always and most frequently are not among those usually considered to be of prime importance for development.

Experience seems to show that the intermediation systems with a neutral function aggravate certain unfavourable trends or do not help to solve problems that have been brought to light by most analyses, such as inequalities between social groups, regional imbalances, and the lag in the production of consumer goods that are essential for the bulk of the population or to maintain economic growth. Such a situation may have an unfavourable effect on the allocation of resources and the rate of savings and investment, and may increase the existing sectoral, regional and social disparities in the different countries.

5. In several countries there has been considerable foreign infiltration in financing and credit institutions, which, in turn, has led to the take-over of some enterprises, particularly in the manufacturing sector. This process has been fostered by short-term foreign loans, which have been attracted to the region mainly by the possibility of making profits and dominating markets.

On the other hand, most official long-term external loans have been granted to government development agencies, particularly the specialized institutions, to be channelled into enterprises. In many countries, however, these loans have been made directly public and private enterprises.

It is interesting to note that foreign infiltration of several intermediation systems in Latin America has gone hand in hand with greater control of the financial sector by the government monetary authorities. This shows that foreign infiltration has been encouraged in some cases, or at least permitted by financial policy, while in others no definite line has been followed. At all events, the fact that the financial authorities have focused their attention on over-all policy-guidance and control of the intermediation system has made possible structural changes such as those described above, unintentional though they may have been.

6. In the light of the foregoing conclusions, it may be of interest to present some possible and alternative ways of improving the operation of the intermediaries with a view to speeding up and reorienting the process of intermediation along the lines laid down in national development strategies.

Generally speaking, it is essential to give the financial system a function that enables it to respond immediately to the basic needs of economic and social development. Obviously, therefore, the guidelines of the system cannot be laid down in vacuo, they will have to be in line with each country's own economic policy.

One way of making the intermediaries function in this way is to make some changes in the system prevailing in the region but leaving the existing structure more or less untouched.

Another method consists in making substantial changes in the system to enable it to fulfil the economic and social requirements of development. The line of action being followed by Chile at the present time seems to be based on this more radical approach. In Chile, the intermediaries, or most of them, have been nationalized, so that, as was pointed out earlier, the flow of funds should conform strictly to the Government's directives and controls.

In any event, if the system is to operate properly, the first prerequisite is that financial policy should be part of economic policy. For this purpose, it is essential that development plans should go into the planning sector of the financial sector explicitly and in some detail. In other words, it cannot be assumed - as has sometimes been done in the past - that the flow of funds will adapt itself almost automatically to the requirements of the planned mobilization of real resources; on the contrary, there must be a prior definition of the ways in which the financial resources will be used to help achieve the stated goals.

Consideration should be given to other factors that are also important if the system is to have a development function, especially in cases where the existing structure has been adapted.

(a) The strengthening of government guidance and control of the over-all and sectoral aspects of the intermediation system, in terms of institutions, functions and in deciding whether funds shall be drawn from local or foreign sources. In this last connexion, the lines laid down for the extent and the form of foreign infiltration and for its control are important.

(b) It is also important that financial policy should be realistic and enable the intermediaries, especially the private and public banks, to offer attractive loan conditions - in respect of interest rates and degrees of liquidity, for instance - to the surplus spending units, so as to induce them to pour their funds into the system.

Experiments like Mexico's provide some suitable formulas for achieving the above aims. On the other hand, wherever there have been no explicit guidelines and restrictions, or the controls exercised by the financial authorities have proved ineffective, the intermediation system has expanded more or less unchecked, especially in the private sector, outside the commercial banks and led to unproductive specialization and competition, the misuse of resources and higher costs for financing.

(c) From the institutional standpoint, it is advisable that support be given to government bodies such as development agencies or corporations, whose influence declined in the last decade in nearly all the countries that had been using them as a lever for development with support, these agencies would be able to use a wide range of devices in order to gain access to untied community savings and channel them into investment in priority sectors. In addition, most of the foreign savings, in the form of official credit and short-term loans, could flow to and from those bodies, thus guaranteeing greater efficiency in borrowing and allocating foreign resources and avoiding an undesirable take-over of the intermediation system.

(d) The strengthening and modernization of the traditional government intermediaries could be accompanied by the creation of carefully selected new public development bodies, without leading to excessive specialization of functions, and, hence, to a proliferation of agencies and unnecessary

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competition to attract resources. In achieving this purpose, flexibility in the allocation of resources within the public sector is important, so as to obviate such competition and ensure a suitable distribution of funds among the priority objectives.<sup>38/</sup>

(e) Tied savings for housing construction may continue to account for a significant and growing proportion of the resources mobilized by the intermediation system. For that reason, it is advisable that the development of this subsystem should be planned and oriented towards the solution of the housing problems of the lower income groups. Definite policies for this purpose must be formulated and adopted so as to give these groups better and easier access to housing savings and loan facilities.

(f) It is possible that tied savings to finance increased consumption of durables may also continue to grow in importance in Latin America's development. Bearing this possibility in mind, it will be advisable to calculate how much is to be spent for this purpose and to make provision for this amount in financial programming and in whatever policies are formulated and applied.

In the policy to be adopted in this field, the measures that the authorities may adopt to influence the volume and possible categories of such consumption are of great importance.<sup>39/</sup> By influencing the volume and structure of consumption, the authorities can thus intervene in the process of intermediation.

Lastly, it should be stressed that all these aspects are particularly important when it has been decided to modify the existing system, and many of them are important also if a government opts for more radical changes in the financial system.

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<sup>38/</sup> In this connexion, see ECLA, "Public enterprises: their present significance and their potential in development" (E/CN.12/872), Part II.

<sup>39/</sup> In the case of automobiles, which is the most representative, it is most important to specify the plans for the production and annual sales of vehicles and their price. Both variables, quantity and price, are flexible enough to make it possible to determine the amount of funds needed to market the annual output on the market. It may be noted incidentally that the automobile models chosen for domestic production in the Latin American countries have a considerable influence on the amount of resources required from the intermediaries. For example, at a given level of output, a United States compact vehicle costs about twice as much as a small European car. Unfortunately, manufacturers have been allowed considerable freedom to produce relatively expensive automobiles, unlike producers in some European countries, such as France and Italy, twenty years ago.

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