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The Provision of Banking Services In Latin America: Obstacles and Recommendations

By Liliana Rojas-Suarez

Abstract

The depth of and access to financial services provided by banks throughout Latin America are extremely low in spite of its recognized importance for economic activity, employment and poverty alleviation. Low financial depth and access hurts the poor the most and is due to a variety of obstacles that are presented in this paper in four categories, along with recommendations to overcome them. The first category groups socio-economic obstacles that undercut the demand for financial services of large segments of the population. The second category identifies problems in the operations of the banking sector that impedes the adequate provision of financial services to households and firms. The third category captures institutional deficiencies, with emphasis on the quality of the legal framework and the governability of the countries in the region. The fourth category identifies regulations that tend to distort the provision of banking services. Recommendations to confront these obstacles include innovative proposals that take into consideration the political constraints facing individual countries. Some of the policy recommendations include: public-private partnerships to improve financial literacy, the creation of juries specialized in commercial activities to support the rights of borrowers and creditors, and the approval of regulation to allow widespread usage of technological innovations to permit low-income families and small firms to gain access to financial services.

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The Provision of Banking Services in Latin America: Obstacles and Recommendations[1]

By Liliana Rojas-Suarez[2]

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1. Introduction: The Nature of the Problem

Two issues of finance are increasingly being recognized as crucial for development: the depth of and access to financial systems. *Financial depth*, defined as the ratio of key financial aggregates (such as overall credit or deposits) to GDP, has been shown to be crucial for economic growth and poverty alleviation.[3]. High financial deepening translates into adequate channeling of savings toward productive investments, an efficient payments system that facilitates transactions between economic agents, and appropriate monitoring of business risks. All these factors are conducive to growth. In addition, *access to finance*, broadly defined as the percentage of households and firms that are able to use financial services, if they so desire, can have important consequences on welfare and contribute to the reduction in poverty and inequality, especially if better access to finance is conducive to higher levels of education.[4]

In Latin America, banks are the most important source for the provision of financial services to both individuals and firms. Although the activities of other non-bank financial intermediaries, and especially those geared toward small enterprise loans, have been increasing recently, their share of the financial system is still very small[5]. In addition, the capital markets remain underdeveloped in Latin America, and some financial instruments, such as corporate bonds, remain at extremely low levels in the region.[6]

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[1] This working paper was originally published by the author in Spanish with the title: "El Acceso a los Servicios Bancarios en América Latina: Identificación de Obstáculos y Recomendaciones," in *La Extensión del Crédito y los Servicios Financieros: Obstáculos, Propuestas y Buenas Prácticas*, Secretaría General Iberoamericana, 2006. For more information see www.segib.org. The author acknowledges the very useful comments and suggestions by Paulina Beato, Eduardo Moron and David Roodman. JEL Codes: G21, G32, O16, O17, O54.
[2] Liliana Rojas-Suarez is a senior fellow at the Center for Global Development.
[3] See, for example, Beck, Levin and Loayza (2000) and Rajan and Zingales (1998).
[4] See Claessens (2005) for a review of the literature regarding the effects of access to financial services. As recognized in that paper, lack of sufficient data has not allowed to derive empirically-strong conclusions regarding the benefits of increased access to finance.
[5] For example, in Peru, non-bank microfinancial institutions account for only 3.6 per cent of the financial system's total assets; however, these institutions have increased their share of the total credit in the country from 4 per cent in 2001 to 7.6 per cent in 2005 (Morón 2006).
[6] Chile is an exception in this regard.

Even in Chile, the country with the most financial intermediation in the region, bank credit is the most important source of financing for enterprises; this, despite the greater importance of the capital markets in this country since the early 1990s.[7] Data for Colombia allow for a better breakdown by business size[8]. Although, as is to be expected, larger enterprises have greater diversity in sources of financing, bank credit, with a 30 per cent share, continues to be the most important source. In the case of mid-sized enterprises, this percentage reaches almost 50 per cent.

Because of banks' central role in the provision of financial services, the analysis in this paper focuses on the identification of problems for the provision of these services by banks and on potential solutions to overcome identified constraints.

Despite its relative importance in business financing in the region, the levels of bank credit to the private sector as a percentage of GDP are extremely low compared to those reached in industrial countries. Although the rapid growth of credit in some countries in the region in 2005 is encouraging, it implies a recovery, to a great extent, from the drop in credit in the early 2000s, and it is still too early to tell whether this growth will continue in a sustained manner or whether it only reflects a transitory effect associated with the current external conditions, which are extremely favorable for the region.

The bank credit penetration indicator is complemented by the ratio of bank deposits to GDP. Table 1a shows both indicators for a sampling of countries during the 1990-2005 period[9]. The table's conclusion is clear. With the exception of Chile (and El Salvador, to a certain extent), the levels of financial intermediation in the region have remained extremely low and very far from those attained by industrialized countries[10] [11].

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[7] In Brazil, the National Financial System (SFN) includes a large number of credit cooperatives. However, these cooperatives' share of the credit market stands at only about 2 per cent of the value of credits granted by the SFN.

[8] However, the data do not allow for a breakdown at the small and micro business level.

[9] According to information from the International Monetary Fund (*Staff Report* on Portugal, October 2005), Portugal has the highest Credit to GDP ratio in the European Union.

[10] In Brazil and Peru, the financial penetration indicators improved significantly during the 1990's, but the ratios of credit and deposits to GDP did not continue their acceleration in the 2000's (although the data for 2005 are encouraging). In the case of Peru, the credit to GDP ratio increased from less than 5 per cent in 1990 to over 26 per cent in 1999, only to decrease during the 2000-2004 period. In the case of Brazil, the credit to GDP ratio increased from 17 per cent in 1991 to around 29 per cent in 1999, and then dropped in the early 2000's. The data for 2005 show a slight recovery.

[11] The data for the first half of 2005 show a significant improvement in the growth of bank credit to the private sector in the majority of the countries in the sample (the exception is El Salvador). However, it is still too early to reach conclusions with respect to this financial penetration indicator in the medium or long term.

Table 1a
Indicators of Financial Deepening

	Deposits/GDP		**Credit/GDP**	
	Average 1990-99	Average 2000-04	Average 1990-99	Average 2000-04
Latin America				
Brazil	0.18	0.22	0.25	0.27
Chile 1/	0.39	0.50	0.46	0.59
Colombia	0.14	0.22	0.15	0.19
Costa Rica	0.25	0.33	0.13	0.26
El Salvador	0.35	0.42	0.32	0.41
Mexico	0.23	0.24	0.23	0.15
Peru	0.16	0.24	0.14	0.23
Industrial Countries				
Australia	0.55	0.68	0.68	0.92
Canada	0.52	0.60	0.57	0.67
France	0.59	0.66	0.90	0.88
Norway	0.51	0.49	0.59	0.71
Portugal	0.84	0.91	0.62	1.46
Spain	0.64	0.82	0.79	1.05
Sweden	0.42	0.72	0.42	0.84
United States	0.54	0.59	0.54	0.62

Source: IMF, International Financial Statistics (November, 2005)
1/ The deposit data for Chile come from the Central Bank of Chile

The data on financial deepening discussed above is reinforced by some preliminary estimation on financial access. Table 1b presents a recent estimation of the percentage of the adult population that have access to financial services (provided by banks and other formal and semi-formal non-bank financial institutions). The most revealing feature of this estimate, constructed by Honohan (2007) is that the degree of financial access is much lower in Latin America than in industrial countries.

Table 1b

An Estimate of the Percentage of Adult Population with Access to Financial Services

Latin America	
Brazil	42.70
Chile	60.40
Colombia	41.20
El Salvador	25.73
Mexico	25.00
Peru	26.00
Industrial Countries	
Australia	90.00
Canada	96.00
France	96.00
Norway	83.70
Portugal	84.00
Spain	95.00
Sweden	99.00
United States	90.90

Source: Honohan (2007)

These results are a cause of great concern for many of the governments in Latin America, not only because financial intermediation is far from maximizing its contribution to economic growth, but because the countries in the region have been carrying out significant reform efforts since the 1990s, which, though they have strengthened the banking systems, have not imbued the sector with the expected dynamism.

Two aspects of the problem are particularly alarming. The first is the limited access of small and mid-sized enterprises to the financial services offered by banks. These sectors are not only important job-creation engines, but with adequate financing they should act as *incubators* for larger-scale business projects. In addition, despite the recent advances in the region that have allowed for increasing credit to small enterprises, this sector also faces serious problems of access to financial services. It is important to mention that, although the problem of access to credit afflicts the region as a whole, its magnitude differs significantly from country to country.

The second aspect of the problem is the high percentage of the population that does not use banking services to perform transactions more efficient and invest savings. For example, recent data indicate that, while the percentage of families with access to the financial system exceeds 90 per cent in industrialized countries, in urban areas in Brazil and in the city of Bogotá in Colombia, this access reaches only 40 per cent. The situation is more dramatic in Mexico City, where the data indicate access by only 25 per cent.[12] Even in Chile, almost one-third of workers do not have access to the financial system.[13]

The causes of insufficient access to bank financial services in Latin America encompass a wide variety of economic and social factors, in addition to those related solely to the financial system. Moreover, although there are many common causes, important elements also exist that are specific to each one of the countries in the region. The purpose of this paper is to identify the most important obstacles to the process of bank usage in Latin American and to put forth recommendations for overcoming them.

Both the identification of obstacles and the recommendations in this work include the results of specific studies that the Secretaría General Iberoamericana (SEGIB) commissioned for six countries in the region: Brazil, Chile, Colombia, El Salvador, Mexico and Peru. These studies, in turn, are based on conclusions reached by the roundtable discussions that the SEGIB held during the January-May 2006 period in each of the countries, which included representatives of the financial authorities, banks, other financial intermediaries, NGOs, and academics. The recommendations arising from there included policies and reforms at the government level, initiatives in the financial sector, and agreements between the government and the private sector.

This paper classifies the obstacles to financial intermediation into four categories. The first category groups together the factors of a social and economic nature, which constrain the demand from large segments of the population for banking services. The second category identifies problems in the banking sector's method of operation that prevent greater financial penetration. The third category brings together institutional deficiencies, with an emphasis on the quality of the legal framework and the "governance" of the countries in the region. The fourth category identifies regulations that tend to distort the provision of banking services. Though all the categories affect financial intermediation overall, the emphasis of the discussion and the recommendations focuses on the population segments with the greatest difficulties of access: small and mid-sized enterprises and low-income families.

Each one of the four categories of obstacles takes up one section of this paper. In each of the sections, the first part focuses on identifying the problems and the second on putting forth recommendations for overcoming them.

[12] Data taken from Claessens (2005)
[13] See Association of Banks and Financial Institutions of Chile (2005)

2. Social and Economic Factors that Limit Financial Intermediation

a. Identification of Obstacles

Although their resolution is a long-term issue, a discussion about the restrictions to access to financial services in the region cannot fail to mention two problems that profoundly affect the use of financial services by significant population segments. The first has to do with the low social development indicators in many Latin American countries, and the second with the degree of *trust* and *credibility* that the banking systems elicit in the people.

Insofar as social indicators are concerned, it is clear that a positive relationship exists between greater social development (access to health and education services, for example) and financial penetration. Graph 1 shows this relationship by comparing the data on the United Nations Human Development Index (HDI) and the ratio of bank deposits to GDP. As is to be expected, in general terms countries with greater access to social services and which enjoy a better quality of life are countries that have also developed a stronger "financial culture," in which the use of financial services through formal markets becomes indispensable. Thus, Chile, the country with the highest value in the HDI index is also the country with the highest deposits-to-GDP ratio.[14] An additional important message that can be inferred from the graph is that there is still a long way to go to reach the high levels of quality of life (including the use of financial services) that the industrialized countries enjoy (the dots in the upper right section of the graph)[15]. Although the direction of causality between social development and financial development is controversial, what is clear is that both variables are complementary and that efforts aimed at improving the social indicators of countries in the region should go hand in hand with efforts to develop the financial infrastructure and improve the bank regulation and supervisory systems.

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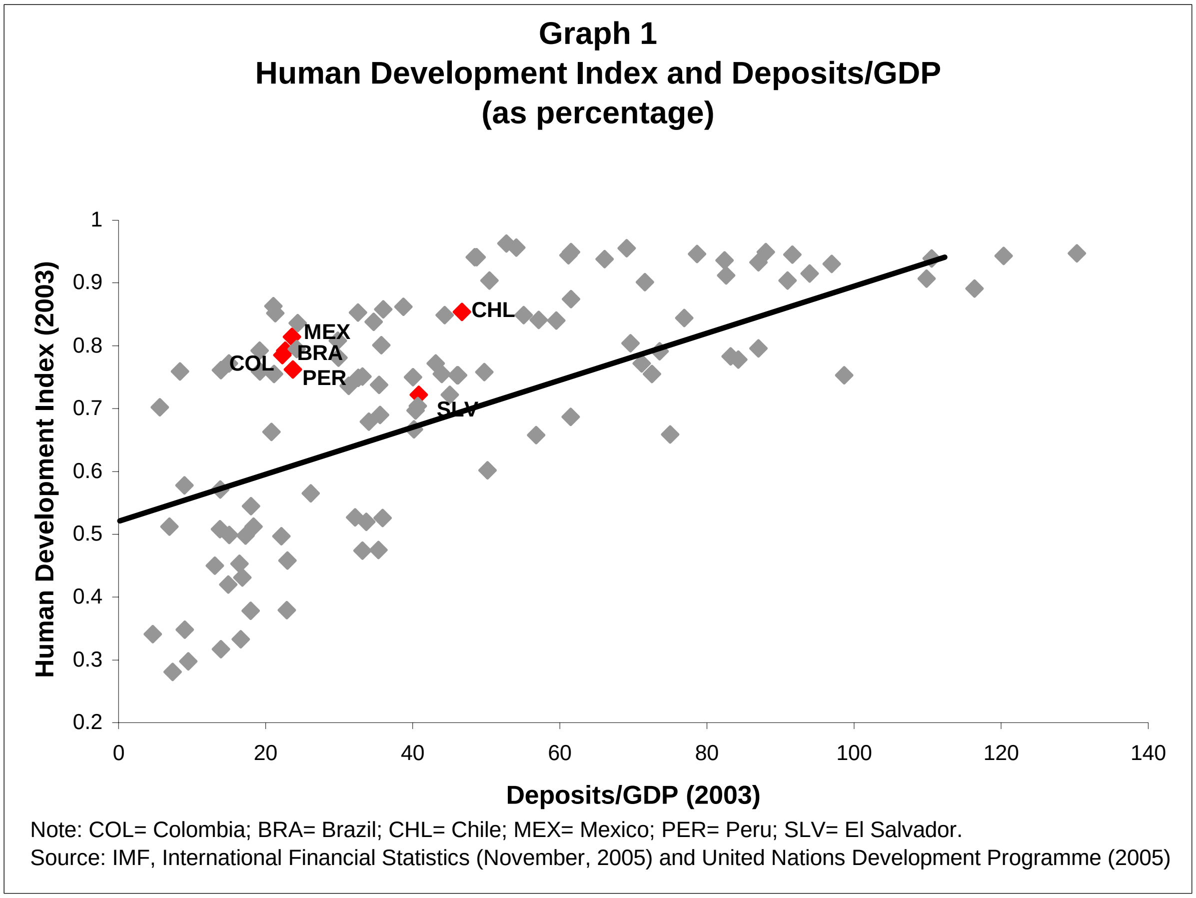
[14] However, in Chile a significant part of the population still has low income levels. For example, around 45 per cent of Chilean workers have income of less than 250 dollars a month; this hinders the ability to use financial services.

[15] Although the foregoing discussion suggests that low levels of social indicators are correlated with lower demand for financial services, it is necessary to clarify that social indicators are also correlated with the *supply* of bank financial services. Moreover, as stated by Claessens (2005), the financial *exclusion* of people from credit is normally part of a wider social exclusion, which involves levels of education, type of employment, training, etc.

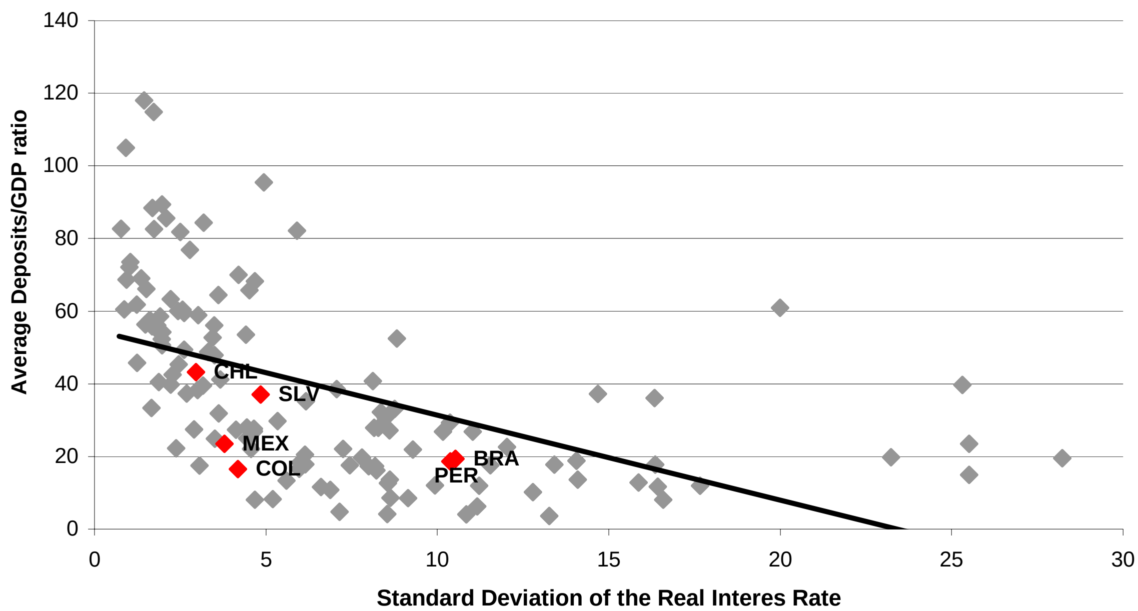


The issue of the people's *trust* in bank soundness is also an important factor for understanding the barriers to *demand* for financial services. The recurring economic and financial crises in Latin America in the last three decades have resulted in significant losses for depositors, in terms of the real value of their wealth. These losses are the result of a series of factors, including deposit freezes, interest rate ceilings, forced conversion of deposits in foreign currency into deposits in local currency using undervalued exchange rates, and hyperinflation that practically destroys the value of bank savings. As a result of these factors, many countries in the region have experienced enormous interest rate fluctuations, which in some periods took on negative values.

Graph 2 shows the negative correlation between the volatility of real interest rates (approximated by the standard deviation during the 1990-2004 period) and the deposits to GDP ratio for a sampling of 132 countries. Clearly, the countries with the least volatility in real interest rates enjoy greater financial penetration. Within the sample of countries in Latin America considered in this paper, Peru and Brazil are the two countries with the greatest volatility in real interest rates during the period analyzed. This high volatility in part reflects the extremely high inflation rates in the early 1990s in both countries and the speculative balance of payments crisis in Brazil in the late 1990s. Both countries show the lowest rates of deposits to GDP among the countries in the sampling.

The lesson is clear: the strengthening of the demand for bank services requires the people's trust in the conservation of the real value of their deposits. Without this trust, not only will there be no incentives for *bank usage*, but the meager deposits in the banking system will tend to be short-term, to be available for quick withdrawal at the slightest sign of trouble. Short-term bank liabilities limit the banks' ability to extend the terms of their assets (loans), thus harming long-term financing. Brazil provides a clear example of this problem, given that 80 per cent of the bank credit to individuals is channeled into consumer loans and only 20 per cent to mortgage loans[16]

Graph 2
Deposits/GDP and Interest Rate Volatility
(1990-2004)



Note: COL= Colombia; BRA= Brazil; CHL= Chile; Mex= Mexico; PER= Peru; SLV= El Salvador.
Source: IMF, International Financial Statistics (November, 2004)

The effect of the banking crises can also influence the demand for credit. For example, as mentioned by the study by Castañeda and Ruiz (2006), the lack of dynamism in the demand for mortgage loans in Mexico may be due to the fact that this credit segment was particularly hard hit during the 2005 banking crisis.

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[16] According to data presented by the Santander Banespa bank during the roundtable discussion, this data is in contrast to the one for Chile, where the percentage of mortgage loans is 63 per cent of personal credit.

b. Recommendations

As mentioned above, it is widely known that the solutions for social problems that affect bank usage, especially those associated with education, are long-term ones. However, the countries' roundtable discussions identified two areas of action in the social area in which joint action by the government and the private sector can in some cases start and in others deepen initiatives aimed at encouraging bank usage. The first area refers to the issue of informality, especially in low-income areas, a prominent issue for Brazil, Colombia, El Salvador, Mexico and Peru. One important recommendation in this area is to not only allow but also encourage firms in the informal sector to create a credit history by their participation in the records of the credit bureaus. The idea is that by building a credit history, good-quality firms will have an incentive to become formalized, since they could have access to better terms in credit agreements.[17] [18]

In addition to this important recommendation, the discussions in Colombia resulted in a proposal which may be pertinent for other countries, and it is redefining the concept of small-scale credit for the purpose of supporting informal firms. In Colombia, a small businessman's total credit cannot exceed the equivalent of 25 minimum salaries (around US$5,000) and must be earmarked for a productive purpose. Over and above that amount, which includes credit cards, the Supervisory Authority mandates that intermediaries require accounting documentation, which many enterprises operating informally do not have. The proposal is for the definition of small-scale credit to take account of small business risks, which are directly related to the type of activity and resources that a small business has for the repayment of its obligations. In other words, a modification of the definition of small-scale credit is proposed, so as to go from an arbitrary and pre-set amount to amounts related to the real risk of the business.

The second area of action refers to the development of financial culture, through financial literacy programs aimed at school students. In Peru, for example, an agreement has been signed between the Banking Supervisory Authority and the Ministry of Education to achieve this purpose. In that same country, the Banking Supervisory Authority has increased its transparency requirements to make it easier for the public to compare the financial products offered by intermediaries. In other countries, such as El Salvador, financial education programs are just starting; they have come from government entities and have concentrated on educating the people on the proper use of financial products. It is advisable to encourage greater participation by the financial private sector in these programs, especially given the direct benefit these institutions derive from dealing with better-informed customers. Thus in Colombia, one of the proposals consists in signing an

[17] As stated by the work of Morón (2006), in a great majority of cases, informality is a choice by enterprises that find it more convenient to operate under those conditions.

[18] The study on Mexico in this project suggests the establishment of public support (guarantees or subsidies) to encourage formalization. The idea is that these privileges be granted temporarily until the business generates an adequate credit history enabling the business to dispense with these benefits. This suggestion requires greater discussion, since it opens up a "moral hazard" problem in the sense that it creates incentives for enterprises to try to continue receiving the subsidy. This could imply excessively high government costs.

agreement between the Government and the financial sector to develop knowledge and mass dissemination of the services that the latter provides.

As far as recommendations to improve trust in the banking system are concerned, the consensus of the countries' roundtables was that the primary solution lies in achieving and maintaining macroeconomic stability and the banking system's solvency. Given that the Latin American economies are subject to external shocks, such as strong fluctuations in the terms of trade or pronounced changes in the interest rates of industrialized countries (especially the United States), it is advisable to have counter-cyclical arrangements that would minimize the adverse effects of negative external shocks. From this point of view, the creation of the new Economic and Social Stabilization Fund in Chile is extremely apropos; there, budget surpluses greater than 1% of GDP would be saved to finance the budget in deficit years.[19] In addition, the government will reinvest between 0.2 per cent and 0.5 per cent a year in a Pension Reserve Fund, which will subsidize the minimum pensions guaranteed to workers who were not able to accumulate enough savings through their private pension accounts. In assigning resources directly to social expenses, especially during periods of lower economic activity, the Fund becomes a counter-cyclical mechanism not only economically, but socially as well. This will contribute to the stability of family income, and therefore, to bank usage. It is advisable to consider the creation of similar funds in other countries in the region, above all in those more vulnerable to changes in the terms of trade.

Another recommendation to increase trust in the banking system is to continue with the bank "internationalization" process. In the case of Mexico, foreign interests in banking (which reach over 80 per cent) have allowed for a substantial improvement in corporate governance practices, in a sector that was characterized by a high level of related ties between banks and manufacturing companies. Of course, the roundtable discussions acknowledged and supported the need to continue improving the regulation and supervisory systems as mechanisms for increasing trust in the banking system.[20]

3. Bank Inefficiency or Inadequacy Problems: High Costs in the Provision of Financial Services

In this category, we first identified the problems of access to banking services that economic agents encounter in their role as depositors. It is interesting to mention that the problems of access to credit that individuals and companies face include the same obstacles that depositors face, plus a series of additional factors that we will discuss in this section.

[19] This Fund replaces the Copper Stabilization Fund.
[20] The document by Castañeda and Ruiz (2006) summarizes the efforts of the Mexican authorities to improve the systems of regulation, supervision, and deposit insurance, early warning indicators, and bank problem resolution procedures that have been implemented since the 1994 banking crisis.

a. *Obstacles within the banking system faced by depositors*[21].

In general terms, these obstacles can be classified into those that affect all the income segments of the population and those that primarily affect lower-income segments. In Latin America, the poor quality of customer service, the extremely long waiting time to make banking transactions, and inadequate information about the financial services available constitute examples of inefficiencies in the provision of banking services.

Insofar as the access problems that are peculiar to low-income depositors are concerned, of key importance are: (a) the insufficient number of bank branches, especially in small rural communities, (b) the high documentation requirements to open a bank account and (c) the high costs associated with keeping a bank account, including maintaining minimum balances. The first two problems stem from both the banks' method of operation and the institutional framework in which they operate. For example, the insufficient number of branches may be due to the fact that private banks do not find it profitable to establish branches where the population density is very low, such as in rural areas, since the level of activity may be insufficient to cover the fixed costs of a branch. For example, in Peru there is no kind of private bank financial office in 104 out of a total of 194 provinces.

But the lack of branches may also be influenced by security problems (protection against crime), which rein in the expansion of bank branches in remote areas. Colombia is the best example of this problem, since the existence of armed conflict has resulted in substantial increases in the cost of moving and handling cash, especially in rural areas.

Although the causes of the insufficient number of branches are varied and in some cases it is difficult to distinguish among them, the fact is that in several countries in the region, such as Colombia and Brazil, the provision of banking services in rural areas is basically handled by state-owned banks or non-financial public institutions (for example, Banco Agrario in Colombia, the postal offices in Brazil.[22])

Table 2 shows that the coverage of branches per inhabitant in the Latin American countries is extremely inferior to the coverage in industrialized countries. Although the coverage improves when automatic teller machines are included, the differences vs. the industrialized countries continue to be enormous. It is interesting to note, however, that in some banking systems, such as those of Chile and Mexico, the provision of (certain) financial services by automatic teller machines is much greater than by branches, a trend similar to that of the industrialized countries.[23] In spite of the expansion of automatic

[21] Financial services to depositors include, primarily, savings and time deposits, checking accounts, debit and credit cards, money transfers (remittances and receipts), utility payments and pension collections.
[22] As stated by Marulanda (2006), if the activities of Banco Agrario are excluded, the coverage of the private banking system would only reach 25 per cent of the country's municipalities, which includes 73 per cent of the population.
[23] A recent development worth mentioning is the dataphones that allow for the use of debit cards and which are promoting the use of bank products in countries like Brazil and Colombia.

teller machines in some countries in the region, this growth has not always been optimal. For example, the Chilean banking system acknowledges that the automatic teller machine expansion model which seeks to maximize the profitability of each automatic teller has been a limitation on bank usage, since the cost structure for the automatic teller machines is high and fixed, and discourages the installation of a larger number of automatic teller machines. Moreover, the high cost of using automatic teller machines has encouraged commercial firms to develop their own networks with potentially lower costs.

Table 2

Access to Financial Services through Branches and ATMs (per 100,000 people)

Country	Number of Branches	Number of ATMs	Number of ATMs + Branches
Latin America			
Brazil	14.6	17.8	32.4
Chile	9.4	24.0	33.4
Colombia	8.7	9.6	18.3
Costa Rica	9.6	12.8	22.4
El Salvador	4.6	11.1	15.7
Mexico	7.6	16.6	24.3
Peru	4.2	5.8	10.0
Industrialized Countries			
France	43.2	70.3	113.5
Germany	49.4	61.2	110.6
Norway	22.9	n.a.	n.a.
Portugal	51.6	109.9	161.5
Spain	95.9	126.6	222.5
Sweden	21.8	29.6	51.4
United Kingdom	18.3	42.4	60.8
United States	30.9	120.9	151.8

Source:Beck, Demirgüç-Kunt & Martinez Peria (2005)

The issue of the high documentation requirements to open bank accounts may be the result of inefficiencies in the collection and processing of information by the banks. But it may also be the result of institutional and socioeconomic problems which make the financial evaluation of a bank customer difficult, such as the lack of titles for assets and the proliferation of informal employment markets in which no contracts specifying a worker's salary exist.

Finally, the high maintenance costs for bank accounts (including the minimum balance requirements) are directly related to the banking system's method of operation. The causes, however, are also varied; they may reflect inefficiencies in banking operations, lack of competition, or simply the high financial cost of providing services on a small scale. Distinguishing among causes is, of course, exceedingly difficult. However, to provide a rough idea about whether these costs in any way reflect inefficiencies in banking operations in Latin America, table 3 shows information about a common indicator of bank efficiency: administrative costs as a percentage of total assets.[24] Although significant differences exist among the countries in the sample, it is clear that the banking systems of Latin America still have significant room for improving the efficiency of their operations as compared to industrialized countries. It is interesting to note that Colombia, the country that shows the highest financial administrative costs among the countries in the sample is, at the same time, the country in which the roundtable discussions highlighted these high costs as a significant hurdle to bank usage. In particular, this roundtable identified the high fees charged for handling accounts and transactions as an important factor that keeps the people at a remove from the financial system. As mentioned above, the high costs of using automatic teller machines in Chile have been a hurdle for the use of banking services in lower-income sectors, since people do not receive greater benefits in having transactional accounts at banks (demand deposits). This has prompted the use of credit cards of commercial firms. As noted in Larraín (2006), the poorest segment of the population (segment D in the Chilean classification) has a very low share for bank credit cards (only 14 per cent of the population in this group has a bank card), but a high share for the credit cards of commercial firms (89 per cent of the population in segment D have store cards).

In conclusion, there is much left for banks to do to attract depositors, especially in terms of the development of new methods and technologies for *reaching the customer*, as well as in improvements of account maintenance costs. But it is also important to recognize the presence of institutional obstacles that strongly limit the effectiveness of bank initiatives to improve financial intermediation. The institutional problems issue will be the topic of discussion in the next section. Before this, however, it is worth analyzing the obstacles that the banking system's mode of operation imposes on small and mid-sized enterprises' access to credit.

[24] These data are informational only since they represent average information for the 1996-2003 period and therefore ignore the possibility of significant recent changes.

Table 3

Efficiency of the Financial System
(Average 1996-2003)

	Overhead Costs 1/
Brazil	0.073
Chile	0.040
Colombia	0.097
Costa Rica	0.052
El Salvador	0.046
Mexico	0.068
Peru	0.080
Latin America	0.065
Industrialized Countries	0.030

Source: World Bank,
Financial Structure Dataset
(http://www.worldbank.org/research/projects/
finstructure/FinStructure_Database_60_03.xls)

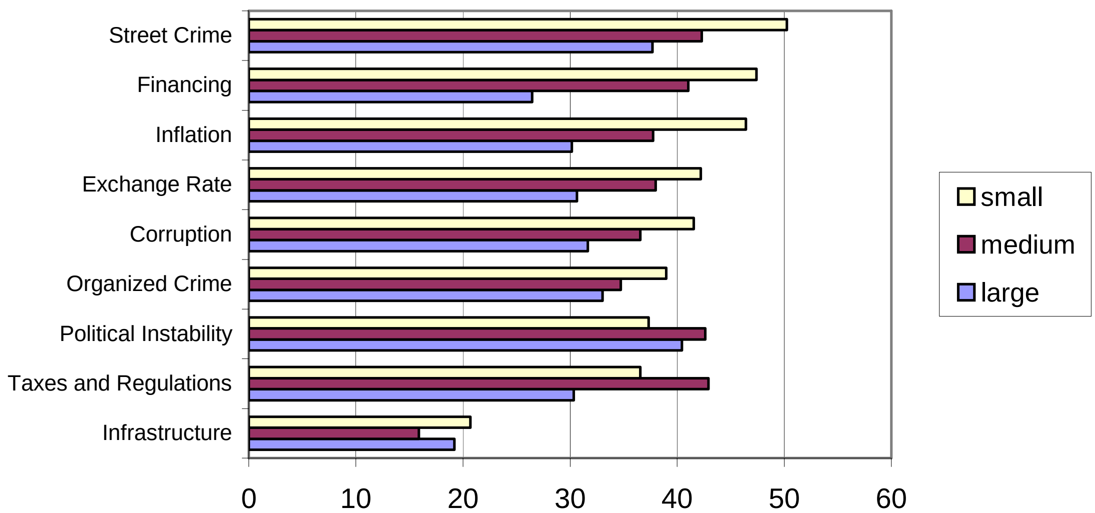
1/ Average value of banks' overhead costs as a share of total assets.

b. Obstacles within the Banking System Faced by Enterprises

In a survey conducted by the World Bank and analyzed by the Inter-American Development Bank (2004), small enterprises in Latin America and the Caribbean reported that, after crime, the lack of financing constitutes the greatest obstacle for their development. For mid-sized enterprises, the problems of lack of financing and crime are on a par with regulatory and political instability problems. These data contrast with the ones for large enterprises, the majority of which do not report financial restrictions as a major impediment to their activities. Graph 3 shows the results.

To understand the factors that limit access to bank credit by small and mid-sized enterprises (SMEs) in the region, it is necessary to first highlight an important feature of these enterprises: in general, they are riskier borrowers than larger-sized enterprises. In a recent study, the Latin American Shadow Financial Regulatory Committee (CLAAF, 2004) identified a series of factors that explain this greater risk: (a) meager diversification of their sources of income and/or high concentration compared to large enterprises (with the possible exception of consumer-oriented SMEs); (b) high sensitivity to changes in the operations of large enterprises, which generally exert a monopolistic power over the SMEs that supply them with inputs; (c) insufficient amount of adequate collateral; (d) high uncertainty with respect to the amount of taxes that they must pay during the course of their operations; and (e) lack of transparency in their financial balance sheets, as a result of inadequate accounting practices and the lack of a clear distinction between a company's financial activities and its owner's.

Graph 3
Major Obstacles for firms' development reported by firms in Latin American
(percentage of firms surveyed, 1999-2000)



Source: IDB (2004)

In making their credit evaluations of SMEs, financial institutions deal not only with all the risk factors described, but also with the high monitoring costs for lending to this sector. These are due to the fact that the banks face fixed costs *per project*, which depend very little on the amount of the loan. Accordingly, the smaller the amount of a loan, the higher the cost of monitoring relative to the income earned from the loan.

The high costs of monitoring and the sector's greater risk induce the banks to require more security and collateral and to charge higher interest rates to the SMEs than to larger-sized enterprises. In addition, the credits tend to be short-term and geared toward financing working capital. This latter point is illustrated in Table 4, which shows the results of a survey of 111 banks in the region on the type of credit they offer to the SME sector. It is clear that, in the three geographical areas represented in the chart, the highest percentage of loans is short-term.

Table 4
Type of Financing Granted by Banks in Latin America to SMEs
(percentages of total banks surveyed)

Type of Credit	Mexico	Latin America and the Caribbean	South America
Short-term commercial credit for investing in working capital	38	46	59
Short-term commercial credit for financing foreign trade transactions	--	3	3
Credit for long-term investment	13	9	17
There are no active credit policies	12	34	9
Other response	12	8	12
No response	25	--	--
Total	100	100	100

Source: FELABAN, Fomin, D'Alessio, Irol (2004)

It can be inferred from the foregoing discussion that, to improve the conditions for access by SMEs to credit (amounts, interest rates and terms), parallel actions (and in some cases joint actions) by banks, business and government are necessary.

For example, the solution to the problem of the opaqueness on SME balance sheets, generated by both the use of inadequate accounting techniques and lack of *business knowledge and experience*, involves both SME owners and managers and the government authorities that are in a position to offer technical assistance programs[25]. In the aforementioned survey of banks, 42 per cent of the bankers surveyed reported that a core problem SMEs face in gaining access to medium- and long-term bank credit is that these enterprises have great difficulty meeting the requirements that banks stipulate, in part due to the high level of informality with which they carry out their business. Given that the potential improvements in the quality of SMEs as borrowers would benefit the banks, these technical assistance programs could be supported by the banks, which could be in charge of providing advisory services to this business sector. According to the survey, 38 per cent of those surveyed indicated that their banks are already providing training to the SME sector. It is interesting to note that in some cases, instruments and mechanisms exist that could enhance the SMEs access to credit, but they are not utilized to their full potential due to a lack of sufficient information. Such is the case for the system of Mutual Guarantees for rural and urban micro-, small- and mid-sized enterprises in El Salvador.[26]

An additional hurdle for access to credit by SMEs lies in the deficiencies of risk assessment at many banks in the region. As shown in Table 5, the great majority of banks use traditional *case by case* assessment. The “credit scoring” method is used only by some banks and these tend to be the largest banks in the region.

[25] Especially in standard accounting areas, financial documentation processes and business strategic planning and financial analysis techniques.
[26] See García and Morera (2006).

Table 5
Type of Model that Banks Use to Assess Financial Risk of SMEs
(as a percentage of total banks surveyed)

Type of Model	All Banks	By Bank Size		
		Large	Medium	Small
Pre-assessment credit scoring	4	n.d	n.d	n.d
Credit scoring	15	31	12	14
Case by Case	70	44	74	71
Other responses	9	6	9	5
No response	2	n.d	n.d	n.d

Source: Felaban, Fomin, D'Alessio, Irol (2004)

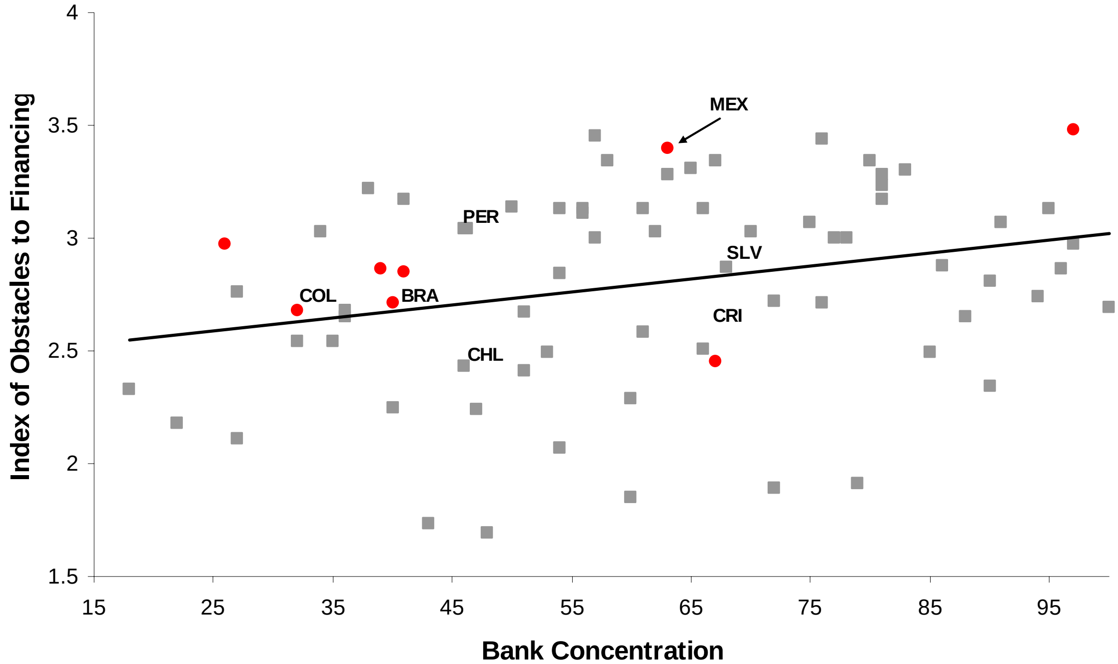
It is interesting to note that, based on the survey mentioned above, it appears that close to half the banks surveyed would be interested in receiving some form of technical assistance for the purpose of improving their credit assessment models for SMEs[27].

Other characteristics of the region's banking systems that potentially affect SMEs are the high administrative costs, which tend to increase the fixed costs of each loan (Table 3), and the levels of banking concentration. With respect to the latter, recent studies have found that highly concentrated banking systems obstruct SMEs' access to credit in those countries with weak institutions and strong restrictions on the range of permissible banking activities.[28] The main argument is that in systems in which severe difficulties exist for the enforcement of contracts, the monopolistic power arising from a high banking concentration leads to greater discrimination against debtors who face greater risks, such as SMEs, than there would be in a more competitive banking system.

Graph 4 shows the relationship between bank concentration (defined as the percentage of total system assets held by the three largest banks) and a World Bank indicator of "obstacles to business financing," which takes values from 1 (there are no obstacles) to 4 (lots of obstacles exist). The relationship is clearly positive. But, in addition, to understand the effect of the institutions' quality on this relationship, the countries with a poor performance in observing the law are indicated with a circle[29]. As would be expected, the countries with greater institutional weaknesses tend to be concentrated at the upper part of the graph, indicating that for a given level of bank concentration, the firms in the countries with institutional weakness tend to face greater obstacles to financing.

[27] As will be discussed below, the Basel II proposal's most important contribution lies in creating incentives for banks to improve their risk assessment systems.
[28] See, for example, Beck et al. (2003)
[29] This indicator and other institutional variables will be discussed with greater attention in the next section.

Graph 4
Bank Concentration and Obstacles to Financing



Note: The countries in dark circles have a low Institutional Quality Index
Note: COL= Colombia; BRA= Brazil; CHL= Chile; CRI= Costa Rica; MEX= Mexico; PER= Peru; SLV= El Salvador.
Source: Beck, Demirgüç-Kunt and Maksimovic (2003)

The cases of Mexico and Costa Rica exemplify these relationships[30]. In both countries, bank concentration is quite high (the assets of the three largest banks constitute over 60 per cent of the total system assets). However, the two countries differ significantly in the observance of law indicator, with much better performance for Costa Rica. Consistent with the argument expressed in the previous paragraph, the obstacles to financing that enterprises face in Mexico are, in general, greater than those encountered in Costa Rica.

c. Recommendations

One issue that the region as a whole continues to debate and that requires clear proposals is the role of state-owned banking institutions. As mentioned above, in several countries in the sample, namely Brazil, Colombia and Peru, the private banks have few or no branches in the poorest areas (especially the rural ones) and the scant financial service in existence is provided primarily by public entities, especially insofar as microcredit is concerned. However, in some countries such as Peru, commercial banks have recently begun to move more actively into microcredit.[31] This situation raises an important

[30] Although Costa Rica is not one of the case studies included in this project, it is included in graph 4 for comparative purposes.
[31] Contrary to Peru, the document by Castañeda and Ruiz (2006) notes that the large commercial banks in Mexico have few incentives for financing micro-, small- and mid-sized enterprises.

question: How to manage the competition between private- and public-sector financial institutions? The recommendation of this paper is simple: equal regulatory and supervisory treatment. The ultimate objective of economic policy is to increase the well-being of the financial *customer*. Thus, the recommendation is clearly to allow active competition between the different financial institutions and not introduce distortions for the simple objective of keeping a state-owned entity in operation. In the end, the use of public resources in financial activities of a commercial nature is justified only in situations of market imperfections (asymmetrical information, economies of scale, etc.) which impede private activity. If financial policy actions, including those of the public-sector financial entities themselves, contribute to decreasing or eliminating those imperfections, the ideal thing would be, then, to facilitate the activities of private financial enterprises[32]. In this sense, it is advisable for the Banco de la Nación in Peru to be supervised by the Banking Supervisory Authority (SBS), especially since it has begun to perform activities for granting credit in association with other private- and public-sector financial institutions (which are under the supervision of the SBS).[33] [34]

One example of the natural evolution that development banks should follow may appear through an analysis of the activities of NAFIN (Nacional Financiera) in Mexico. This second-tier bank has had considerable success in the development of the factoring market by granting lines of credit to financial institutions for them to discount SME invoices for goods supplied to large, AAA-rated enterprises. However, as noted in the study by Castañeda and Ruiz (2006), the relevant question is whether NAFIN should continue in the business of factoring between SMEs and large enterprises, since it would appear that this market can already be handled by the private sector alone without support from the public sector. The suggestion of Castañeda and Ruiz (2006) is that NAFIN's work could now be focused on the discounting of invoices issued by SMEs to other SMEs. In sum, the success of the governmental intervention in the development of financial markets must be reflected in the withdrawal of this support when the market in fact consolidates itself.

With respect to efforts geared toward increasing the number of customers serviced by private banks in areas where banks find it prohibitive to operate, whether due to security problems or to lack of scale, there is a proposal in Colombia to allow the operation of “non-bank correspondents,” in other words, to authorize credit institutions to provide financial services through non-bank entities. The proposal's core objective is to seek

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[32] In the case of Peru, the financial entities that support the microfinance sector have experienced very fast expansion, especially the municipal banks. They have achieved this through the implementation of technologies specifically designed to service this sector. As private banks move in to support this sector, the competition will intensify, to the customers' benefit. It is important to note, however, that the role of bank supervision takes on key importance, since greater competition also creates greater incentives for risk taking.

[33] New incentives, such as the Banca de Oportunidades in Colombia, also require bearing very much in mind the need to avoid regulatory distortions between state-owned banks and private ones.

[34] To prevent political interference at the development bank in Mexico, Castañeda and Ruiz (2006) recommend that the term of the development bank's director general be superimposed on two consecutive government terms. It is also recommended that the management autonomy of the development bank in Mexico be increased, including a combination of public officials and private-sector professionals on its board.

arrangements that would decrease the cost of moving cash in areas with low-income populations. It is important to emphasize that one requirement for the success of this proposal is for the banks that use correspondents to have adequate risk control systems; this would prevent the expansion of their activities through this system from resulting in excessive risk taking at the level of the bank's aggregate balance sheet.

Brazil offers an example of bank usage through correspondents. This system was created in the late 1990s, and its expansion has been impressive. Based on data from the Federation of Brazilian Banks (FEBRABAN), bank points of service through correspondents increased from 14,000 in 2000 to 70,000 in 2005.[35]

Complementing the bank correspondent proposal, the Colombia roundtable proposed the creation of a special small-scale savings account that would be attractive to low-income families.[36] To enable the banks to offer low transaction costs (for example, allowing users to make a certain number of transactions each month by electronic means at no cost and eliminating the imposition of account management fees), this account would have special regulatory treatment: it would be exempt from the tax on financial transactions and forced investments and it would have simplified requirements for complying with the Money Laundering Prevention System regulations. In my opinion, this proposal, though interesting, requires in-depth analysis prior to its implementation, since it raises the possibility of "regulatory arbitrage"; in other words, it encourages the use of this arrangement to evade certain regulations, but it does not create incentives for increasing the financial sector's efficiency in the provision of services. The incentive of using the account may in turn increase the authorities' supervisory costs for corroborating that the account is in fact being used only by families with a certain income. In addition, at the international level, it is difficult to imagine that a modification of the requirements for complying with the Money Laundering Prevention System regulations will be approved.

Various countries' roundtables recommended expanding the banks' business hours to serve the public. One important argument is that banking hours do not coincide with the time that a significant proportion of workers have available to go to the banks. In this regard, it is important to note the success that Peru has had with extended banking hours. The Peruvian case may serve as an example on this subject for other countries in the region.

The recommendations for the Chilean banks to expand banking services directly acknowledge some of the inefficiencies existing in the banking system (identified at the beginning of this section), as well as the competition to banks generated from credit cards issued by commercial firms. In particular, the Association of Banks and Financial Institutions (ABIF) of Chile proposes to extend the network of automatic teller machine significantly, not only in number but also by means of a change in the policy for the

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[35] According to a report by Marulanda (2004), the incentive for the development of the bank correspondent system in Brazil was the use of non-bank workers, so that high labor costs associated with labor unions in the banking sector could be avoided.

[36] An analysis of the use of financial products by income bracket reveals that the savings account is the bank instrument most used by low-income families.

operation of this equipment: instead of looking for the profitability of each automatic teller machine separately, the focus should be on the profitability of the network as a whole and on reducing fees for the use of automatic teller machines in lower-income areas. This initiative would be complemented by a substantial increase in POS (points of sale). These terminals allow for operating with banks' credit and debit cards, require a low investment, and therefore have the capacity to further bank usage.

In the same direction as the Chilean proposal, but involving the public sector, in Mexico a program has been developed recently between the Federal Government and the Association of Banks for the purpose of significantly increasing the installation of POS at small enterprises, at no cost to the latter. In this country, the Government has established an Electronic Means of Payments Fund (FIMPE). The banks provide resources to this trust, which are used to install POS at small enterprises. In exchange for their contribution, the banks receive certain tax incentives.

In Brazil, besides the aforementioned expansion of correspondents, the financial network penetration efforts are being geared toward the use of Internet banking, the use of which increased by 55 per cent during 2005.

As previously discussed, one solution to the problems of opaqueness on the balance sheets of micro and small enterprises (especially informal ones), as well as these companies' lack of ability to meet credit application requirements, lies in training. In this regard, the ABIF of Chile proposes establishing a support program for the sector that would include: (a) free training for a number of firms and (b) a free credit evaluation for a number of micro-entrepreneurs.[37]

Finally, few things can help more the development of a credit culture than a high level of transparency by financial institutions. The Chilean banks propose the development of an information dissemination structure that would allow bank customers to get the necessary information easily and quickly.

[37] Currently, some initiatives already exist in Chile that have been very successful. One is the public-private FECU SME initiative, which involves creating a single standardized financial information file aimed at allowing small and mid-sized enterprises to organize and disclose necessary information to improve their access to bank credit at lower costs than for large enterprises. Another program is the support to credit by means of the Fondo de Garantías a Pequeñas Empresas [Small Enterprise Guarantees Fund](FOGAPE).

4. Institutional Problems

a. Identification of Obstacles

The discussion in the previous sections has made it clear that the quality of the institutions plays a fundamental role in access to credit and in financial intermediation in general.[38] Although this paper has already identified a series of problems associated with "market failures" that hinder access to financial services, the fact is that the institutional environment in which banks operate is a central determining factor in their decisions, especially credit-related ones.[39]

In a broad sense, institutions can be defined as "the series of formal rules –and informal conventions— that constitute the framework for human interaction and determine the incentives for members of society"[40]. It follows from this definition that institutions underlie a wide range of economic activities, including those of the financial sector and, as will be seen further on, they are an indispensable element for the latter's deep and sustained development.

This paper will first analyze those institutions of a general nature which are the result of a long history of interaction between the various players in the public and private sectors. The institutions that determine the *quality* of the legal and "governance" framework fall into this group and provide a valuable message: the financial system will develop more in countries where observance of the law, political stability, and judicial enforcement of fair and efficient legal rules prevail and where creditors' and debtors' rights are respected. Recently, a series of indicators has been developed, which measure and compare the quality of this type of institutions between countries. Among the best-known indicators are the Kaufmann, Kraay and Mastruzzi (2005) Governance Indicator, the World Economic Forum (2005) indicators, and the World Bank *Doing Business* indicators.

Table 6 shows the relative position of the countries considered in this paper in a sample of 104 countries for three key institutional variables analyzed by the World Economic Forum: (a) judicial independence (which measures how free the judicial system is of political influence from government officials, citizens or firms, with higher values indicating greater independence); (b) efficiency of the legal framework within which private companies resolve disputes and challenge the legality of government actions and/or regulations (on the negative end, the legal framework is inefficient and subject to manipulation; on the positive end, the legal framework is efficient and follows a clear and neutral process); and (c) degree of respect for property rights, including rights to financial assets (on the negative end, property rights are poorly defined and not protected by law;

[38] An analysis of the effect of institutional quality on access to bank services is found in Beck et al. (2003). A relevant study by La Porta et al (1997) shows that capital markets remain underdeveloped in countries where investor protection, measured by the strength of the legal framework and the ability to enforce the law, is weak.
[39] Another very important factor is the regulatory framework that banks face. This subject will be discussed in the next section.
[40] See IMF (2005)

on the positive end, they are clearly defined and protected by law). The table also shows a fourth variable analyzed in *Doing Business*, a report by the World Bank: the index of legal rights, which reflects the rights of creditors and debtors, and measures whether collateral and bankruptcy laws facilitate credit. The table shows the ratings obtained by the countries in the sample on a scale that runs from 1 (very poor respect for legal rights) to 10 (very high respect for legal rights).[41]

Table 6
Other Indicators of Institutional Quality

	Judicial Independence 1/ 2/	Efficiency of Legal Framework 1/ 3/	Property Rights 1/ 4/	Legal Rights Index 5/
Brazil	Position 51	Position 53	Position 47	Rating 2
Chile	Position 37	Position 29	Position 31	Rating 4
Colombia	Position 73	Position 65	Position 65	Rating 4
Costa Rica	Position 33	Position 39	Position 52	Rating 4
El Salvador	Position 71	Position 73	Position 45	Rating 5
Mexico	Position 65	Position 75	Position 63	Rating 2
Peru	Position 94	Position 94	Position 79	Rating 2

1/ Based on a sample of 104 countries

2/ The judiciary is independent from political influences of government, citizens or firms (1=no, heavily influenced; 7=yes, entirely independent)

3/ The legal framework for private businesses to settle disputes and challenge the legality of governement actions and/or regulations (1= is inefficient and subject to manipulation; 7= is efficient and follows a clear, neutral process)

4/ Including rights to financial assets and wealth (1=are poorly delineated and not protected by law; 7=are clearly delineated and well protected by law)

5/ On a scale of 0 to 10, higher numbers indicated better performance. The Index measures the degree to which collateral and bankruptcy laws facilitate lending.

Source: World Economic Forum (2005) and World Bank (2005)

The results indicate that, among the countries in the sample, Chile is the one that has the strongest institutions, although it still has a number of obstacles to overcome. For example, this country only received a rating of 4 on the legal rights index, which indicates that there are 6 criteria in the index that are not met. The results for Peru indicate that this country has serious institutional weaknesses, including the fact that it only meets two of the 10 criteria for the legal rights index. Colombia, El Salvador and Mexico, although relatively better positioned than Peru, are in the lower third worldwide insofar as quality of institutions is concerned. Brazil, for its part, is positioned about midway in the worldwide sampling.

Table 7 complements the information about institutions, showing the scores obtained by the countries in the sample with respect to the six indicators that make up the Kaufmann et al. governance index[42]. The scale of scores runs from -2.5 to 2.5 and a higher score

[41] The index includes three criteria related to bankruptcy rights and to collateral laws.

[42] The governance indicators are: the “Voice and Accountability” indicator, which measures political, human, and civil rights; “Political Instability,” which measures the likelihood of threats of violence or changes in the government, including terrorism; “Government Effectiveness,” which measures how competent the bureaucracy is and the quality of the goods and services offered by public servants; “Regulatory Quality,” which measures the incidence of practices that negatively affect the functioning of the market; “Rule of Law”, which measures agents’ confidence in and commitment to abiding by the rules of society, the quality of contract enforcement, the police, the courts, and the likelihood of crime and

indicates better performance. It is not surprising to find that the results are similar to those in Table 6. For example, insofar as the average of indicators is concerned, Chile gets the highest score among the countries in the sample and is not very far behind the average score for the industrialized countries. In addition, Colombia and Peru obtained the lowest scores among the countries in the sample. One discouraging result is that the latter two countries showed deterioration in the scores obtained between 1996 and 2004 (in contrast to Chile, which improved its score). The average of the indicators for Brazil, El Salvador and Mexico is extremely low, although it showed a slight improvement from 1996 to 2004.

The countries differ in their relative strengths and weaknesses. While for Colombia the weakest indicator is “political stability”, for Brazil, El Salvador and Mexico, “control of corruption” and “observance of the rule of law” are the most worrisome factors. Thus, during the roundtable discussions, the Federation of Banks of Brazil identified the lack of judicial certainty for contracts as one of the most significant legal obstacles to bank usage. In the case of Peru, all the indicators have very low scores.[43]

violence. Finally, “Control of corruption,” which measures the exercise of public power to obtain private gains, on a small and large scale, as well as in the case of capture of the State by private interests.

[43] The “regulation quality” indicator is the one with the highest score among the indicators for Peru, but that value is the lowest among the countries in the sample.

Table 7

World Bank Governance Indicators
(Scores)

	Voice and Accountability		Political Stability		Government Effectiveness		Regulatory Quality		Rule of Law		Control of Corruption		Average of Indicators	
	1996	2004	1996	2004	1996	2004	1996	2004	1996	2004	1996	2004	1996	2004
Brazil	0.23	0.34	-0.17	-0.13	-0.16	0.02	0.21	0.19	-0.26	-0.21	-0.11	-0.15	-0.04	0.01
Chile	0.93	1.09	0.75	0.89	1.20	1.27	1.52	1.62	1.26	1.16	1.28	1.44	1.16	1.25
Colombia	-0.07	-0.47	-1.25	-1.69	0.07	-0.18	0.49	-0.12	-0.46	-0.70	-0.43	-0.16	-0.28	-0.55
Costa Rica	1.37	1.11	0.89	0.98	0.16	0.49	0.68	0.67	0.64	0.57	0.76	0.78	0.75	0.77
El Salvador	-0.22	0.26	-0.09	-0.23	-0.38	-0.22	0.73	0.56	-0.48	-0.34	-0.75	-0.39	-0.20	-0.06
Mexico	-0.23	0.36	-0.36	-0.13	-0.12	-0.02	0.59	0.55	-0.12	-0.26	-0.34	-0.27	-0.10	0.04
Peru	-0.73	-0.04	-0.90	-0.68	-0.18	-0.58	0.65	0.17	-0.35	-0.63	-0.10	-0.35	-0.27	-0.35
Industrialized Countries	1.48	1.34	1.19	1.08	1.84	1.69	1.38	1.45	1.74	1.62	1.71	1.84	1.56	1.50

Source: Kaufmann, Kraay and Mastruzzi (2005)

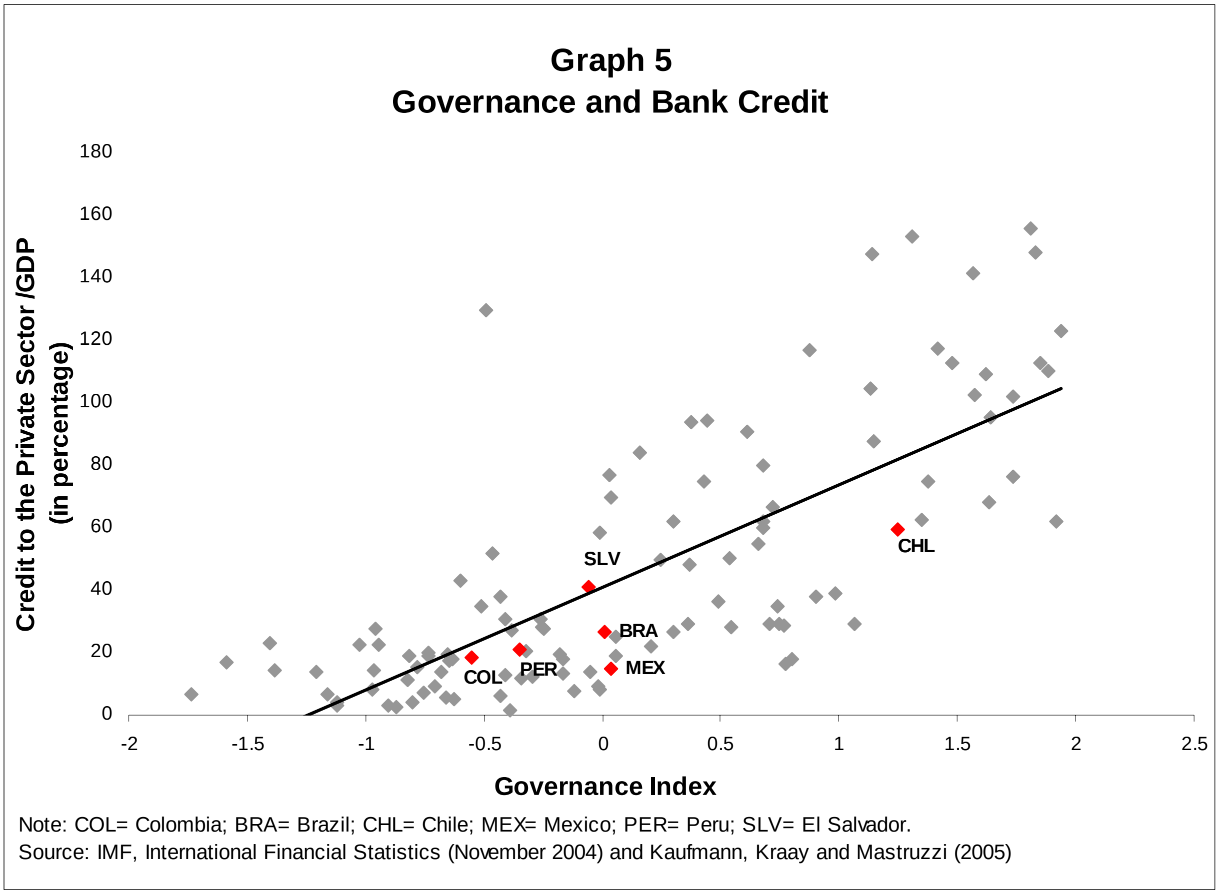
1/ The six governance indicators are measured in units ranging from -2.5 to 2.5, with higher values corresponding to better governance outcomes.

Graph 5 removes all doubt with respect to the relationship between the quality of institutions and financial penetration in countries, since it shows a clear relationship between the average of the governance indicators and the ratio of credit to the private sector to GDP[44]. Two general lessons can be inferred from this exercise. The first is that efforts for ensuring that contracts between creditors and debtors are observed will have favorable effects on bank usage: depositors will have more incentives for entrusting their savings to banks and increasing their financial transactions using banking products. In turn, banks will have incentives to lend at better rates and longer terms to enterprises, since they will trust that they will be able to enforce security and collateral in case of late payment of a debt, and in the event of a company's bankruptcy the creditors will be paid in accordance with pre-established arrangements. The second lesson is that, for contracts to be honored, it is necessary to address problems in different institutional areas, ranging from corruption to political instability, from the effectiveness with which the government implements laws to the achievement of impartiality and independence by the judiciary. The necessary effort is enormous, but as graph 5 shows, the potential gains are even greater.

Mexico's experience provides an example of how institutional weaknesses can prevent even the development of electronic methods of payment, which lower transaction costs and therefore contribute to bank usage. In this country, the “automatic discount system” (whereby funds transfers can be made between banks when for some services the customer authorizes his bank to automatically discount from his account charges made by specified providers and have the charges credited to the provider's bank account) has not been very successful despite the fact that the financial and legal infrastructure is already in place. The reason for scant progress with this system lies in the consumers’ fear that the charges will not be suspended by the provider when suspension of the service is requested. These fears have been based on problems with fraud and bureaucratic inefficiencies (see Castañeda and Ruiz, 2006).

Although the quality of the institutions is not determined by the functions of a single entity, there is a group of agencies whose functions are geared specifically toward strengthening and deepening the banking system and that have a direct impact on the institutions. Two of them, the Central Bank and the Bank Supervisory agency, affect the *quality of regulation* and the *efficiency of the legal framework.* Another institutional quality indicator, *respect for property rights*, requires clear definitions of property titles; this function is exercised by the property registry offices. Finally, it is recognized that the judicial system's independence is one of the most difficult institutional reforms to achieve. It is interesting to note that access to information on potential debtors through public or private credit information disclosure offices could encourage banks to grant credits in circumstances in which the legal and judicial framework are not the most appropriate for claiming creditors' rights. The role of these entities in increasing the depth of financial intermediation is described below.

[44] The relationship between the variables is positive and significant



The adequate functioning of the **Central Bank** in its role of controlling inflation is essential for greater deepening of financial intermediation. As discussed in Section 2, saving through bank deposits in Latin America has been adversely affected by the region's very high inflation rates, which drastically reduce the real value of bank savings, reducing the attractiveness of deposits as a financial instrument. In addition, the central banks also play an important role in regulating the banking system and they accordingly affect the sector's efficiency and the costs of intermediation. Proper ***banking supervision*** is also essential to the process of bank usage, both from the standpoint of bank liabilities and from that of assets, since this institution's primary duty is to ensure the stability of the banking system. A healthy banking system gives depositors confidence and thus helps increase the sources of funding for credit. In addition, a healthy banking system avoids excess risk taking and is accordingly not forced to raise lending rates in response to a high percentage of loans in arrears. In general, the region's bank supervision offices have improved significantly over the last decade, but some deficiencies still exist, such as inadequate consolidated supervision of financial conglomerates.

Property registry offices play a central role in access to credit for individuals and enterprises, but especially for SMEs. As mentioned above, the problems in obtaining adequate information on SMEs and the high costs of monitoring this business sector lead banks to require more guarantees and collateral than are demanded of larger-sized firms. The data from the FELABAN et al. (2004) survey show that 80 per cent of the banks request guarantees in the form of real properties titled to the business and 73 per cent of the banks request personal guarantees. But in the great majority of Latin American countries, providing guarantees and collateral is extremely difficult for SMEs, due to deficiencies in the property registries[45]. For example, in El Salvador, where civil war, land reform, and high migration rates have resulted in the majority of the country's productive lands' being unoccupied, the lack of a legal system that regularized landholding prevents land from being used as collateral to obtain credit[46]. Similarly, the non-existence of a proper leasing law for the rural sector prevents producers who work leased land from using their harvest as collateral for bank loans.

In addition, in many countries the information in the property registries is obsolete or incorrect, and it is frequently the case that two or more potential owners claim the same property titles. Mexico is a good example of these deficiencies. This problem also adversely affects the development of long-term mortgage loans. The solution, of course, lies in reforming the property title registry systems so that they offer true information, as well as service with fewer delays and costs than the current ones. This reform would allow the banks to reduce their costs of lending to SMEs, since they could trust that the customer is in fact the sole owner of the collateral that is being put up when a loan is requested.

Another problem that affects some countries, such as El Salvador, is that guarantees are difficult to mobilize due to the lack of coordination between the different legal codes (such as, for example, the titling and factoring laws with the Banking Act and Commercial Code).

Public credit registries and private credit information bureaus deal head on with problems of information on potential borrowers, and accordingly, could be of special benefit to the SMEs, which face the most severe information asymmetry problems[47]. The work of these entities is the gathering of *relevant* information on debtors and distributing it among banks associated with the registry (public or private). The emphasis on the relevance of the information is due to the fact that, although credit registries have been operating in Latin America for many years, they have not always gathered the information that interests banks the most for purposes of assessing a customer's credit. For example, some registries have copious information about a debtor's socioeconomic characteristics but do not keep the information about the current status of his debts up-to-date. One case of incomplete information is that of Chile, where banks do not have consolidated information available to them about bank debts and those acquired through commercial firm credit cards (which constitute a significant percentage of consumer credit, as mentioned in the previous section). This information is extremely relevant for

[45] Of course, this problem also affects individuals and is a limitation on access to long-term personal financing.
[46] The Salvadorean Foundation for Economic and Social Development [Fundación Salvadoreña para el Desarrollo Económico y Social] (FUSADES) estimates that around 20 per cent of the beneficiaries of land reform do not have titles that vouch for legal possession of the land that they work.
[47] As noted in the IDB document (2004), gathering information about debtors can aid the creation of a *reputation collateral*, which can help decrease the adverse selection problems that SMEs face.

banks, since they need to know with exactness the status of the customer's liabilities at the time that credit is requested.

In comparing the effectiveness of public registries versus private credit bureaus, a recent study by the IDB (2004) concluded that, in general, both types of institutions have had appropriate performance, but that the private bureaus have worked relatively better. Table 8 shows the results of a registry quality index developed by the IDB. The index takes values from 0 to 1. Clearly (with the partial exception of El Salvador), the private bureaus in the Latin American countries in the sample have shown a very favorable performance, which exceeds that of other emerging countries. One problem that the credit bureaus face in El Salvador is the absence of sufficient relevant information, since there is a lack of regulatory clarity between what constitutes the right to privacy and the need to have reliable information available to grant credits.[48]

Table 8

Credit Registries in Latin America and in other Regions

	Registries Quality Index 1/	
	Privates Bureaus	Public Registries
Brazil	0.74	0.59
Chile	0.72	0.49
Colombia	0.7	No registry
Costa Rica	0.29	0.44
El Salvador	0.55	0.51
Mexico	0.7	0.15
Peru	0.71	0.62
Latin America	0.65	0.47
United States	0.9	No registry
Other OECD Countries	0.48	0.53
Other Emerging Countries	0.47	0.52

Source:IDB (2004)

1/ On a scale of 0 to 1. It is the average of seven sub-indexes that measure: Number of institutions reporting information, Quantity of information reported about individuals, Quantity of information reported about businesses, Number of procedures for verifying the information, Number of institutions which are allowed access to the information, Whether positive and negative information is reported; How many types of loans reported.

[48] See García and Morera (2006).

b. Recommendations

Although the institutional problems that rein in the process of bank usage are relatively easy to diagnose, the proposals for specific and realistic solutions are much harder, since they involve fundamental changes to the “rules of the game” under which the financial systems operate. In many cases, these rules of the game are associated with the interests of entrenched political and economic groups, which prevent change.

Despite these restrictions, however, it is possible to achieve significant advances through innovative proposals that emerged from the countries’ roundtables, which are presented below.

In the countries that have greater problems involving compliance with the rule of law and protection of creditors' and debtors' rights, such as Colombia, Mexico and Peru, the optimum solution is a comprehensive reform of the judicial system's operation. This reform, however, has proved to be very difficult to implement. In the short run, there are two alternative, albeit partial, solutions, which are being considered in the region and should be actively promoted. The first is the creation of courts specializing in different commercial activities. Although they continue to be public entities, these courts have the advantage that their specialization equips them with processes that are more transparent (minimizing corruption problems) and much faster than at courts that have to handle all types of legal matters. In Peru, which holds the worst relative position among the countries in the sample with respect to judicial independence, the establishment of these courts is being supported by the Banking Association and constitutes an example of public and private sector cooperation.

A second alternative, which is being increasingly implemented in the region, is recourse to private conciliation/arbitration arrangements for business disputes. Chile is one of the countries where these arrangements are yielding very good results.

With respect to public entities whose functions are geared specifically to strengthening the financial system, the recommendations differ significantly between countries. For example, in Peru, whose Bank Supervisory agency works quite well, the main recommendation is to modify the Deposit Insurance Fund coverage, since it is considered excessive and therefore creates a problem of “moral risk” encouraging banks to take risks above and beyond what is prudential, thereby complicating the supervisory agency's work.[49] In Brazil, where supervision of the financial system (banks and non-banks) is vested in with the Central Bank, the challenge is to increase efficiency in the supervision of cooperatives and non-bank institutions, which are not only very numerous but whose variety of activities is expanding.

Another example, specific to El Salvador, is the interpretation of the Consumer Protection law (LPC) and the Consumer Defense Office (DC). The LPC prohibits sharing

[49] As documented in Morón (2006), the Deposit Insurance Fund offers protection to depositors up to a limit of around US$20,000, putting Peru among the top five places in the world when the insurance is calculated in relation to per capita GDP.

personal and credit information without the consumer's authorization. To comply with this law, financial entities included special authorization clauses in financial contracts. However, the DC considers that this authorization should not be included in financial contracts, but should be executed separately. This separation increases operating costs for banking activity and decreases the flow and speed with which credit bureaus can have up-to-date and relevant information. Given that the disclosure of information benefits both debtors and banks, it would be interesting to try to achieve a consensus between both parties for the Consumer Defense Office to validate the use of financial contracts as an instrument whereby customers authorize the disclosure of information.

In Colombia, one recommendation with respect to information disclosure is to enrich the databases of the credit information registries with information from the cooperative sector and NGOs, as well as from commerce and industry. One proposal in Mexico (see Castañeda and Ruiz (2006)) is for the government to establish a system of guarantees for SMEs without a credit history, which would make use of the guarantee funds subject to the disclosure of information on the business' data to credit bureaus. The rationale for this proposal lies in the fact that once an SME is past the incubation period, with the resulting elimination of guarantees, the business would have an incentive for continuing to provide information, since it would thereby be able to explore alternate sources of financing and negotiate better terms.

In Chile, it is highly advisable to consolidate the information on bank and commercial debts so that banks can make a proper assessment of debtors. This can be achieved by going back to a bill on this subject that was sent to Congress in August 1993, but whose information consolidation component did not pass.

Modernization and improvement of property registries is also an important recommendation, being an especially urgent reform for El Salvador and Mexico. In the case of Colombia, an in-depth review of the laws and regulations on guarantees is recommended. Both recommendations, geared to improving the utilization of collateral and the use of guarantees, have the objective of facilitating access to credit by SMEs.

5. Regulatory Problems

The reasons for regulating banks are varied and well known. For example, the argument for imposing capital requirements is that the presence of deposit insurance (whether explicit or implied) creates an incentive for banks to take excessive risks with the expectation of being *bailed out* by the authorities in cases of severe problems (the so-called moral risk). The capital requirements act as a *cushion* to absorb bank losses, reducing the potential costs to the authorities of covering deposit insurance costs.

As discussed in Section 2, there is a generalized acknowledgment of the importance of adequate bank regulation. However, despite their good intentions, some regulations can result in significant distortions that discourage the development of the financial markets, hinder bank usage and can even promote severe inefficiencies. Although regulatory distortions vary from country to country, they can be lumped into three groups: (a) risk assessment distortions stemming from the adoption of Basel I (and a very brief mention with respect to the Basel II proposal), (b) the tax on financial transactions and (c) interest rates ceilings and other rules that generate distortions.

a. Obstacles to Access to Credit created by the Basel Capital Requirements

As will be recalled, the Basel I Agreement was proposed for the largest banks in the industrialized countries with a significant level of international activity. In this context, the Basel recommendation established the calculation of capital requirements utilizing five weightings (0, 10, 20, 50 and 100%) applicable to bank assets according to their category of risk. One of these categories pertains to government bonds. Basel I recommends that banks assign a risk weighting equal to zero to the government debt of OECD countries and a weighting of 100 per cent to non-OECD countries (unless the debt is issued and underwritten in local currency). The idea, of course, is that government assets in developed countries can be considered *safe* (non-risky) assets.

Although the Basel recommendations were designed on the basis of the characteristics of industrialized countries, most of the regulators in Latin America implemented the recommendations and assigned a risk weighting of 0 to the debt issues by their governments (whether issued in local or foreign currency). In other words, in the calculation of capital requirements, the banks in many countries of the region treat government debt as a safe asset – an assumption quite far removed from reality given the frequency of crises in these countries. In comparison, Basel I recommended, and the countries in Latin American implemented, assigning a weight of 100 per cent to all private sector bonds.

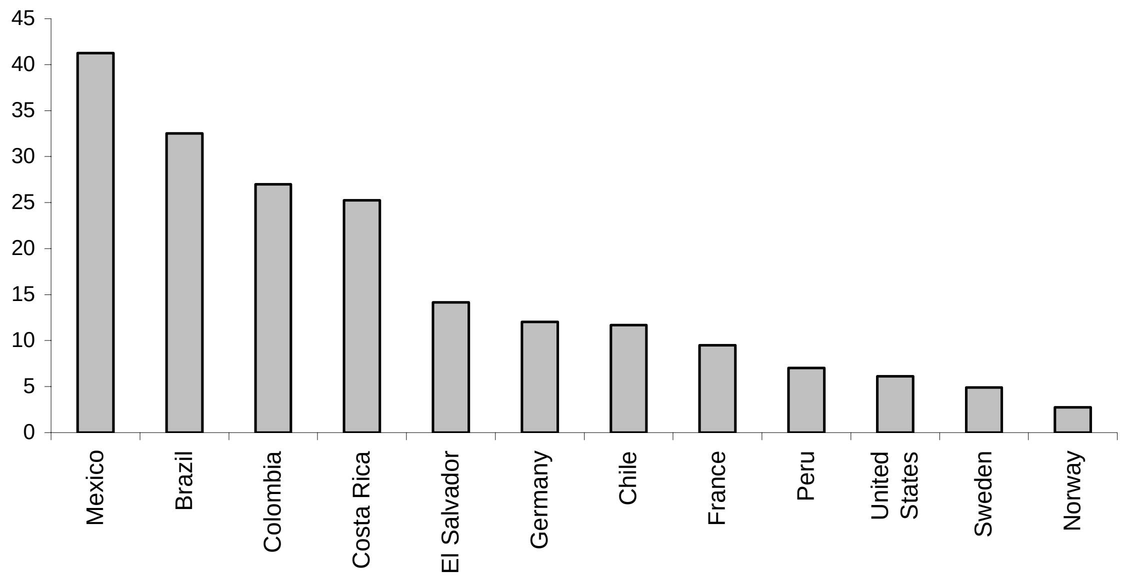
The problem with this practice is that it creates an incentive for banks to keep a significant proportion of their assets in the form of government debt, to the detriment of credit to the private sector. This incentive is accentuated in periods of economic contraction by the fact that banks face greater pressures on capital during these periods.[50] In other words, it is precisely during periods of recession that banks have a greater incentive to reduce financing to the private sector; which clearly tends to deepen the recession.

Graph 6 illustrates this problem. In general terms, most Latin American countries maintain a high percentage of government debt as a share of total bank assets, far above the percentage found in the majority of industrialized countries. Brazil and Mexico have the highest percentages.[51] In Mexico, the proportion of bank assets allocated to credit to the private sector amounts to only 27 per cent, in sharp contrast with an average of

[50] This is due to the fact that in recession periods, there is a higher ratio of loans in arrears or problems to total loan portfolio.
[51] Peru maintains a low proportion of government bonds, but due to high liquidity requirements, it keeps a high proportion of Central Bank bonds.

around 70 per cent in industrialized countries (and Chile, which reached a percentage of 78 per cent in mid-2005).

Graph 8
Public Debt held by Banks
(as a percentage of total bank assets) 1/



Source: IMF, International Financial Statistics (November 2005)
1/ It includes credit to the public sector and securities issued by the Central Banks

This problem of government securities “crowding out” credit to the private sector was specifically mentioned by the private banks during the roundtable discussions in Brazil. Although the entire *crowding out* effect cannot be attributed to the regulations on capital requirements, the fact is that the incentives are present. It must be noted that, although these incentives penalize access to credit by all types of private-sector enterprises, the negative effect is even greater on SMEs, which, unlike the large companies, do not have alternate sources of financing.

Can this problem be solved with the new Basel II proposal? The answer is potentially yes, since the greatest contribution of Basel II is improving risk assessment, in which case many countries would have to increase the risk weighting assigned to government securities. However, in reality the great majority of countries in the region are considering keeping Basel I or adopting the “standardized” Basel II approach, which contains a clause that allows banks, at supervisors' discretion, to continue applying a weighting of 0 to government bonds if the bond is denominated and underwritten in local currency. The decision to properly assess the risk of government securities thus remains as a challenge for the region's supervisors and regulators[52].

b. The inefficiencies of the Tax on Financial Transactions

The tax on financial transactions (ITF) is a regulation that creates significant distortions in the region's banking systems.[53] This tax applies to bank liabilities, typically fund withdrawals from checking and savings accounts, through checks, automatic teller machines, debit cards, etc. Curiously, there is no disagreement on the adverse effects of the tax. This is due to the fact that its existence is not intended to correct any problem in the banking system, but rather for strictly fiscal purposes: the tax was introduced under situations of severe fiscal problems because it had the ability to collect revenue quickly and tax collection administration is simple.[54] Table 9 shows the countries where the ITF is applied and its respective rates, which are all under 1 per cent.

Table 9
Transaction Taxes, 2006 1/
(in percentages)

Argentina	0.60
Bolivia	0.025
Brazil	0.38
Colombia	0.40
Peru	0.08
Venezuela	0.50

Source: Doing Business (2007)
1/ On each side of a transaction

In Chile a tax on financial transactions also exists (the seal and stamp tax), which stipulates a rate of 0.134 per cent per month (with a maximum of 1.608 per cent per year) on monetary credit transactions and a fixed tax (currently at 146 pesos—US$0.27) for every transaction drawn on checking accounts.[55]
The problems associated with the ITF are multiple, but for the subject that concerns this paper two stand out. The first problem is that the tax encourages financial

[52] In Chile, the bank supervision agency has indicated its intention to go forward with Basel II. Given the greater development and financial penetration in this country, as well as the history of banking stability over the last two decades, Chile is relatively better positioned than many other countries in the region to begin the implementation of Basel II.
[53] For an analysis of this tax in Latin America, see Singh et al. (2005), Coelho et al. (2001) and Marulanda et al. (2005).
[54] The banks and the Central Bank are generally the ones in charge of withholding and collecting the tax.
[55] As discussed in the study by Larraín (2006), given that the tax on checking accounts is set at a fixed amount, it strongly distorts the allocation of resources among methods of payment, taxing less costly methods of payment more heavily. Hence the tax penalizes transactions in electronic accounts, automatic teller machines, and debit cards significantly more than transactions using checks.

disintermediation since depositors (individuals and enterprises) try to avoid paying the tax by making fewer transactions through banks and increasing the number of cash transactions. By increasing the cost of bank usage, the ITF runs counter to the efforts to increase people's access to banking system services. The second problem is that the tax weighs more heavily on enterprises with fewer resources. This is due to the fact that larger companies have a greater ability to avoid the tax through access to off-shore transactions and operations with derivatives.

The work of Singh et al. (2005) documents the decrease in financial intermediation in Colombia and Brazil as a result of this tax. In Colombia, the ratio of deposits (M3) to GDP decreased from 36 per cent in 1999, the year in which the tax was introduced, to 31 per cent in 2001. Similarly, in Brazil, bank deposits as a percentage of GDP decreased from 25.6 per cent to 24.1 per cent during the 1998-2001 period, in part due to the fact that investors can redirect funds toward mutual funds, which are not subject to the tax[56].

It is interesting to note that in general, at the time of its introduction the ITF was announced as transitory, but its effective duration has been extended. In the opinion of many analysts, maintaining this tax implies a shortsighted view of its costs and benefits. The reason is that the consequences on financial intermediation and, therefore, on potential economic growth, entail lower tax collections over the long run that outweigh the short-term collection benefits.

c. Other regulatory problems: interest rates ceilings and other rules

Finally, it is important to mention that other regulations exist which are very controversial. One of them is the so-called *usury law,* which stipulates maximum interest rates for bank credits to prevent banks from imposing excessive rates on debtors. Despite the good intentions underlying this regulation, which applies in some countries in the region such as Chile and Colombia, it is interesting to note that a large number of analysts and bankers argue that the regulation has had counterproductive effects, since it has hindered access to credit for certain SMEs, which, due to their risky nature, are subject to interest rates higher than the maximum ones allowed by law. For example, some financial intermediaries in Colombia argue that the existence of these restrictions prevents loans to microenterprises in amounts below US$600.

In the case of Chile, the banks' core argument against interest rates ceilings (contractual maximum interest rate --TIMC) is that it creates a distortion between banks and commercial firms in the ability to grant credit. This is due to the fact that the latter are not subject to the regulation and therefore can offer credit (by means of credit cards) at rates far above the TIMC, but which reflect the debtor's risk. How have banks responded to this distortion? As Larraín (2006) indicates, banks offset the restrictions that the TIMC imposes by charging fees and insurance for managing checking accounts and/or credit cards. This is possible because the opening of checking accounts and/or credit cards is among the procedures that banks require from individuals who wish to obtain a consumer

[56] It is worth noting that in Brazil, besides the ITF, a variety of other taxes apply to banking activities.

loan. Thus, the TIMC not only fails to perform its function of protecting the consumer, but creates non-transparent mechanisms in the banks' method of granting credits.

Although no interest rate ceilings exist in Peru, the document by Morón (2006) notes that there has been repeated pressure to implement this regulation. The problem in this case is that it would create an obstacle for formal microfinance enterprises – which, as mentioned previously, are increasing their activity significantly – to seek to expand the access to credit for new small firms with a higher degree of risk.

Another rule that creates distortions, since it adversely affects consumer credit to small customers, is the control over the expenses for collecting credits (collection expenses). These controls, which exist in Chile, have two significant problems. In the first place, they are regressive, since a percentage is allowed per collection (on the debt or installment due) that is higher for loans in small amounts (9 per cent for obligations of up to 10 UF (approximately US$327), 6 per cent on amounts over 10 UF and up to 50 UF, and 3 per cent on the portion that exceeds 50 UF[57]. In the second place, these controls are arbitrary, since the percentages are not based on economic or financial fundamentals. This rule has resulted in a significant decrease in small-scale consumer credit (see Larraín, 2006).

d. *Recommendations*

In the discussions about the ITF, it is important to note that there is a consensus between bankers and analysts on the recommendation to eliminate this tax. In case the eradication of the tax is not feasible, Morón proposes that the ITF rate be set at zero per cent. This proposal is based on the acknowledgment that this tax mechanism supports the expansion of the tax base, since it allows for having high-quality information on taxpayer transactions, thereby facilitating tax oversight[58]. In the case of Chile, the proposal emerging from the roundtable discussion is to eliminate the tax on monetary credit transactions in the case a credit is renegotiated from one institution to another; this would allow small enterprises to be able to take advantage of better financing terms that alternative banks offer them, without having to pay the tax again. To avoid the distortions that the tax imposes in Chile, Larraín (2006) proposes that instead of the tax's being defined as a set amount that affects all methods of payment equally, the check tax be increased and the one applied to the remaining payment instruments be reduced.

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[57] The UF (Unidad de Fomento) [Inflation-index unit] is a daily amount determined by the Central Bank of Chile and set according to the geometric average rate corresponding to the change experienced by the "Consumer Price Index" during the month immediately prior to the period for which that unit is calculated. In general, monetary credit transactions are indexed by this method, which has been extended to other transactions, such as service contracts, leases, etc.

[58] In my opinion, the ITF is not the right mechanism for gathering information; this can be obtained by making it mandatory for transactions to be reported by banks to the office in charge of tax collection in Peru (SUNAT). Keeping the ITF even at a zero level creates uncertainty as to whether the rate will increase again at any time.

In the case of Brazil, where there is a multiplicity of taxes on financial intermediation, it is advisable to streamline the tax system and analyze the overall tax policy's effects on financial transactions. A simpler tax framework may not only maintain tax collection levels, but also decrease the administrative costs associated with compliance with excessive taxation.

As far as interest rates ceilings are concerned, there is no unanimous recommendation, since there is no agreement between bankers and supervisors. An interesting proposal by the Chilean banks is to create maximum interest rates differentiated by type of product in order to at least partially acknowledge the differences in risk among different financial products (for example, differentiating maximum rates between mortgage and consumer loans). A similar proposal comes from Colombia. Implementation of this proposal requires a very careful design and high transparency requirements, for otherwise it could create regulatory arbitrage whereby one category of credit could be classified as belonging to another category in order to charge higher rates[59].

Similarly, since it is not considered politically feasible to eliminate the limits on collection expenses in Chile, it is recommended that these limits be made flexible so that they would be calculated on the basis of analytical criteria (see Larraín, 2006).

6. Closing Remarks

The discussion in this paper makes it possible to arrive at some general conclusions. The first is that the obstacles to the provision of financial services by banks in Latin America are multiple and involve actions and decisions by banks, governments, businesses and families. For example, the low access by low-income families to financial services is due to both supply and demand factors. The lack of supply is reflected in inadequate financial networks and high costs for the provision of financial products. In turn, these deficiencies are the result not only of inefficiencies in bank operations but also of regulations that discourage bank usage. On the other hand, the low level of demand for services provided by the *formal* financial sector reflects both socioeconomic problems, which limit the development of a financial culture, and the experience of repeated banking crises, which have impaired depositors' trust in the banking systems.

Consistent with the foregoing, the second conclusion is that many of the causes of insufficient bank usage are interrelated. For example, the degree of concentration in the banking system negatively affects access to bank financing by SMEs in economies with weak institutions. In addition, from these first two conclusions we can infer the need to carry out joint efforts involving the private sector and the public sector.

The third conclusion is that there is a series of obstacles common to the region, though the intensity of the problems varies significantly between countries. In addition, there are

[59] One version of this proposal (combined with the elimination of the TIMC for transactions in high amounts) was, at the time of this writing, before the Chilean Parliament.

obstacles that affect only one country or a subgroup of countries in the region. The tax on financial transactions is a good example. That is why the preparation of specific recommendations requires a detailed analysis of the obstacles specific to each country.

The fourth conclusion is that despite the complexity of the obstacles, roundtable discussions in the countries succeeded in drafting innovative proposals to deal with them. In many cases, these proposals have taken into account the political restrictions on reforms. For example, although the experts recommend the elimination of interest rates ceilings, they also propose alternate systems (such as differentiating maximum rates by financial product) in case the elimination of the original restriction is not possible.

While more work is certainly needed to assess the relative importance of the different kinds of obstacles, it is likely that the hardest obstacles to overcome are those related to institutional deficiencies, the incentives for informality, the lack of a credit culture, and the lack of adequate levels of education that would allow low-income families and small firms to have access to formal credit. These are issues that go beyond financial matters, since they reflect problems bound up with underdevelopment: the weakness of judicial and legal institutions and the poverty extant in many areas in the region's countries. However, it is very encouraging to note that several of the initiatives proposed by the roundtables imply cooperation between the private sector and the government to *invest* in bank usage through specific proposals. These initiatives include: conducting financial education support programs, expanding and deepening the financial infrastructure, and creating courts specializing in commercial activities that would afford protection for debtors' and creditors' rights under circumstances in which a comprehensive judicial system reform does not seem to be on the horizon in the short term.

Having identified the problems and having proposed alternatives for overcoming them, the next step is for each country to evaluate these proposals and, more importantly, to quickly implement those initiatives that clearly promise a net societal gain.

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