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THE EXPERIENCE OF DEVELOPMENT BANKING IN PERU: 1990-2015[†]

LA EXPERIENCIA DE LA BANCA DE DESARROLLO EN EL PERÚ: 1990-2015

Ó. Dancourt* & R. Jiménez Sotelo**

Abstract

This paper analyzes the experience with the state financial entities in Peru and argues that their development banking activities have decreased in importance as instruments of public policy since the structural reforms implemented in the early 1990s. Like all other state enterprises, they have since been subject to discriminatory legal regulation. The four state financial companies analyzed have objectives and goals that are not integrated with one other, duplicate their efforts, and do not take advantage of the possible synergies to be obtained; therefore, none of these institutions constitutes an effective state development bank such as exists in other countries.

Key words: bank lending, state banks, developments banks, financial analysis, financial intermediation. JEL classification: D80, E50, G20, H60, N26, Q14.

Resumen

Este trabajo analiza la experiencia con las entidades financieras estatales en el Perú y arguye que sus actividades de banca de desarrollo han perdido relevancia como instrumentos de política pública desde las reformas estructurales implementadas a inicios de los 90. Como todas las otras empresas estatales, desde entonces han estado sujetas a una regulación legal discriminatoria. Las cuatro empresas financieras estatales analizadas tienen objetivos y metas que no están integrados entre sí, duplican sus esfuerzos y no aprovechan las sinergias posibles de obtener, por lo que ninguna de estas instituciones representa un efectivo banco de desarrollo estatal tal como existe en otros países.

Palabras clave: análisis financiero, crédito bancario, bancos estatales, bancos de desarrollo, intermediación financiera. Clasificación JEL: D80, E50, G20, H60, N26, Q14.

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1. Introduction

At the start of the 1980s, the overall lending of the state financial entities, which exercised the functions of a development bank,¹ amounted to 15% of GDP. By 1993, following Alberto Fujimori's neoliberal reforms, which entailed the liquidation and privatization of almost all of Peru's state-owned enterprises, whether productive or financial, the overall lending of the state-owned financial institutions had fallen drastically to 3% of GDP.

However, the Peruvian economy grew at an average annual rate (GDP) of 5.7%, with very low inflation (CPI) of 2.8% per year, during the period 2002-2015. The country's notable performance over this 14-year period, which was based on the commodities supercycle; minimal state intervention in the economy besides effective monetary and fiscal policies, except for 2014-2016; negligible productive diversification; and maximum commercial and financial openness to globalization, seems to have had no connection whatsoever with the role of these state-owned financial institutions. Peru's commodities export economy did not require a state development bank.

In 2014-15, the external context deteriorated markedly. In tandem with the slump in international metal prices, GDP growth slowed significantly to an annual average of 2.8%. The question is whether the Peruvian economy will survive the acid test of all commodity-exporting economies: extending growth beyond a long cycle of favorable prices for its export products. Is it, then, time to rethink the role that development banking could play in diversifying the Peruvian economy's production and in closing the infrastructure gap?

Diversification of the Peruvian economy's production structure remains incipient.² The administration of Pedro Pablo Kuczynski inherited in 2016 a less-than promising mining-exporting economy, integrated into an urbanized society.³ The external forces - high commodity prices and capital inflows - that drove economic growth over the past 15 years will lie dormant for the foreseeable future.⁴ Sooner or later, the new administration will be compelled to try to diversify the Peruvian economy in some shape or form. Without the expansion of industries besides mining or the components of aggregate demand other than investment in the extractive sectors, there will be no economic growth in the cities as

¹ According to Ferraz, Além and Madeira (2013), development banks are "a non-monetary financial intermediary providing long-term loans, which often are government-controlled institutions and operate in segmented markets aiming at promoting the capital development of the economy."

² See Hausmann and Klinger (2008).

³ Direct employment in the mining industry does not even account for 1% of the workforce.

⁴ See IMF World Economic Outlook (2015) and (2016).

well as insufficient urban job creation. This process of diversifying the productive apparatus requires a master plan underpinned by public investment, a higher exchange rate, and a genuine state development bank.

This international context has revived interest in the relevance of credit for economic development as highlighted by Schumpeter (1967[1934]), and on the conditioning effect of the financial system in the short term as signaled by Keynes (2003[1943]). From there comes the importance of the development banking activities of state financial institutions as a policy instrument to help mitigate those market failures that could hinder a sufficient and adequate credit supply, especially in countries such as Peru where the stock markets are underdeveloped⁵. While several state-owned financial entities exist, to date the Peruvian government does not have an effective development bank as a long-term public policy instrument.

In Peru, the preponderant view of the state's role in the economy is marked by the radical experience of privatization of state-owned companies and financial deregulation accomplished during the dictatorial regime of Fujimori (1991-2000). The 1993 Constitution established that the state can subsidiarily undertake business activities only where expressly authorized by law. This peculiar political-legal context accounts for the performance of development banking in Peru since the 1990s. It is often said that state-owned enterprises can only engage in that which is expressly and specifically provided for by law, unlike private enterprises, which can engage in whatever the law does not expressly prohibit.

On the basis of this controversial "subsidiary role of the state", state-owned companies are not allowed to compete with private firms on an equal footing, unlike in the OECD countries.⁶ In the case of the financial companies, this means that their sources of funding in local currency are not competitive and, on the contrary, oftentimes have ended up adding to the external debt while contributing to the extensive dollarization of the financial system and the underdevelopment of the securities market.⁷

This paper has ten sections, including this introduction. The second and third sections provide a brief overview of the privatization and dollarization of the financial system, as well as the circumstances regarding the three main market failures in the Peruvian financial system. The fourth reviews the political and legal framework in which the state-run financial enterprises have operated since the 1990s. The fifth, sixth, seventh, and eighth

⁵ For an analysis of financial restrictions on economic development, see Hermann (2014).

⁶ See Ferraz, Além and Madeira (2016).

⁷ See Jiménez Sotelo (2009).

sections describe, in broad terms, the legal framework and the economic situation of the four state-owned financial entities currently in existence in Peru. The ninth section outlines the possible strategy and vision of the future to build a true development bank in Peru. The final section contains the conclusions.

2. Privatization and dollarization of the financial system.

At the start of the 1970s, the structural reforms inspired by Economic Commission for Latin America and the Caribbean and implemented by the military regime of Velasco (1968-75) created a strong sector of public enterprises, productive and financial, which came to control more than 30% of GDP and endured without major changes until the 1990s. This process entailed the nationalization of a considerable proportion of foreign investment and much of the real assets owned by the oligarchy of the day.⁸

The neoliberal structural reforms applied by Fujimori's authoritarian regime in the 1990s can be understood⁹ as a near-perfect antithesis to Velasco's reforms. An essential component of these reforms was the privatization of the strong public-enterprise sector,¹⁰ as well as the liquidation of almost all state development banking, which accounted for a sizeable share of the loans and deposits market.¹¹ Foreign capital, oriented toward the extractive export sector and public services, recovered its standout role in the economy upon acquiring much of the privatized state companies.

The relative size of the state-owned financial entities varied substantially with these radical yet diametrically opposed changes to the state's intervention in the economy, as shown in Graph 1. By the start of the 1980s, the credit channeled to the economy (public and private sectors) by state-owned financial companies accounted for, on average, 15% of annual GDP, while the credit granted by commercial banks amounted to only 7% of annual GDP. From the 1990s, lending by state-owned financial entities plunged to less than 3% of annual GDP and remained at that level for the next two decades.

⁸ According to Fitzgerald (1985), "the state assumed responsibility for three-quarters of the exports, half of the imports, over half of the fixed investment, two-thirds of the bank credit, and a third of all employment in the corporate sector." Translation by authors.

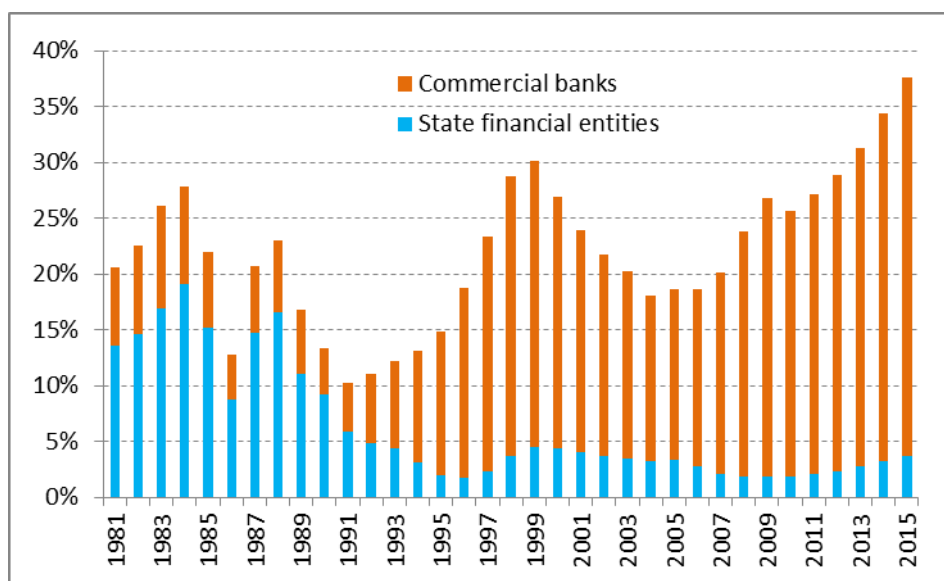
⁹ See Dancourt (1999).

¹⁰ See Ruiz (2002).

¹¹ In 1992 the five state development banks created prior to the Velasco administration were liquidated; see Castillo (2005).

Graph 1

Peru: Overall average lending by state-owned financial entities, out of GDP



Source: SBS, INEI, and BCRP

Compiled by authors

Lending by state-owned financial entities was subject to only a temporary increase during the banking crisis of 1998-99, which ushered in a steep decline in the loans granted by commercial banks that continued until 2004, as well as a series of bankruptcies and bailouts¹² that included the second- and fifth-largest banks in terms of deposits. In the end, the number of commercial banks went down from 25 to 12. From 2005-06, as can be seen in Graph 1, commercial banking grew continuously to the point where the loans granted by the sector exceeded 35% of GDP in 2015.

Graph 2 shows the trajectory of the credit-to-GDP ratio for the different state-owned financial entities over the period 1980-2015. The five state-owned development banks (bancos de fomento) liquidated in 1992¹³ granted loans worth the equivalent of 6-8% of GDP at the start of the 1980s. Corporación Financiera de Desarrollo and the Banco de la Nación, which account for the lion's share, went from lending 10% of GDP at the start of the 1980s to just 2-4% of GDP from the 1990s; during the banking crisis of 1998-99, they temporarily increased their joint lending when they participated in the state bail-out of private commercial banking.¹⁴ The other two state-owned financial companies, Banco Agropecuario

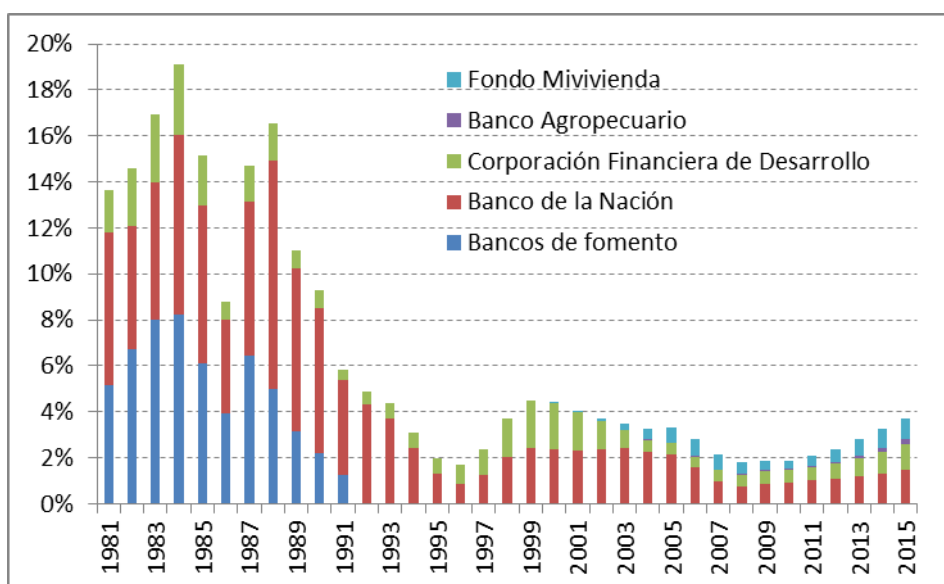
¹² See Rojas and Costa (2002), and Jiménez Sotelo (2010a).

¹³ The agricultural, industrial, mining, and housing development banks were wound up by Decree Law N° 25478, leaving the Superintendence of Banking and Insurance (SBS), whose function was to control, oversee, or liquidate both private or state-owned banks. The mortgage bank, for its part, was declared a private legal entity under Decree Law N° 25479 and wound up three months later under Resolution N° 766-92-SBS.

¹⁴ According to Castillo (2005), COFIDE "had to include commercial loans of [the] liquidated [private financial] intermediaries in its assets." Translation by authors.

and especially the Fondo MiVivienda, took on a degree of importance starting from 2004-05.

Graph 2
Peru: Overall average lending by state-owned financial entities, out of GDP



Source: INEI and SBS

Compiled by authors

The basic processes that transformed the Peruvian financial system in the 1990s were twofold: first, the privatization process that has been succinctly described; and second, the credit dollarization process, which qualifies as another of the main structural reforms of the Fujimori administration.

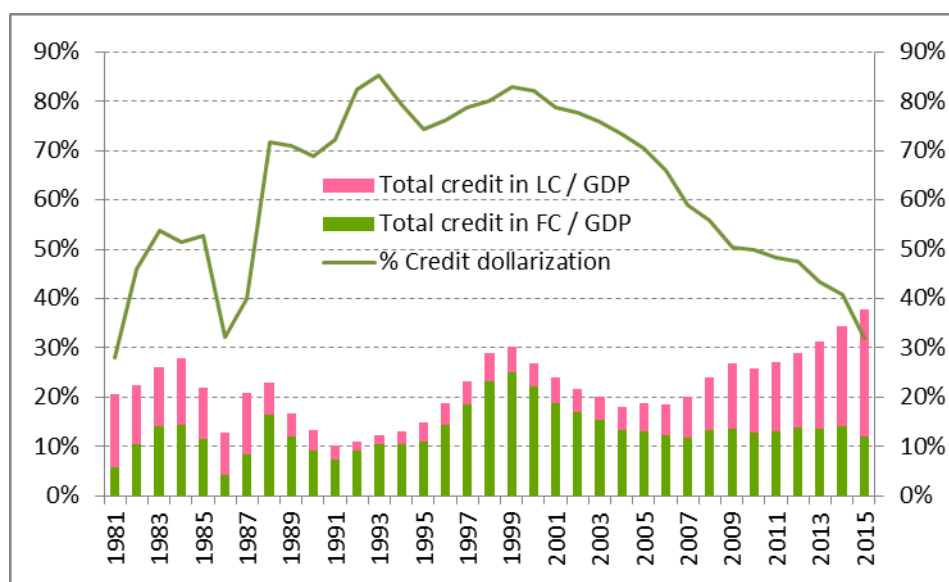
The level of dollarization of the total credit granted by the financial entities climbed to a peak of 80%, as shown in Graph 3. The hyperinflation that emerged in the late 1980s had sparked a brutal contraction in the credit system and its rapid dollarization. The credit expansion of the 1990s, which occurred in a context of macroeconomic stabilization in which economic activity recovered and inflation dropped to below 10% per year, was basically an expansion of credit in foreign currency, which reached a pinnacle of somewhere above 20% of GDP right before the banking crisis of 1998-99.

This dollarization of credit¹⁵ during the 1990s is explained by the characteristics of a monetary regime based on control of the quantity of money, which impeded an expansion of credit in local currency on the initiative of commercial banking; by the authorization given to commercial banks to extend credit and receive deposits in foreign currency without any

¹⁵ García-Escribano (2010) shows that the level of credit dollarization is greater for loans with longer maturities and for loans to large companies, in comparison with those for small companies or for individuals.

limits whatsoever; and by a regulatory system that did not impose reserve requirements on the foreign funding of banks via external debts.¹⁶

Graph 3
Peru: Dollarization of credit from financial entities



Source: SBS

Compiled by authors

Following the banking crisis of 1998-1999, the level of credit dollarization dwindled slowly from 78% in 2002 to 32% in 2015, thus returning to the levels seen at the start of the 1980s. It is also clear, as shown in Graph 3, that this gradual de-dollarization of credit reflects an expansion of credit in local currency, which rose from 3% of GDP in 2002 to 25% of GDP in 2015, rather than a contraction of credit in foreign currency, which fluctuated around 12% of GDP over the last decade.

This gradual de-dollarization of credit is associated, first, with the implementation in 2002 of an inflation-targeting monetary regime, whereby a short-term interest rate became the main monetary-policy instrument, replacing the control of various monetary aggregates that had prevailed during the 1990s and enabling the expansion of bank credit in local currency at the initiative of commercial banking; second, with the banking crisis of 1998-1999, which temporarily reduced local banks' funding capacity via external debt; third, with the development of a domestic public debt market in local currency from the 2000s, with bonds of increasingly long maturities; and fourth, with an active de-dollarization policy on the part of the central bank, which operated, primarily, by imposing reserve requirements on the foreign funding of commercial banks, to a greater or lesser degree depending upon

¹⁶ See Dancourt (2014) and Jiménez Sotelo (2010a).

the specific period.¹⁷

The dollarization of credit not only severely curtails the power of monetary policy, but also increases both the economy's external vulnerability and the likelihood of banking crises. A rise in the real exchange rate prompted by an adverse external shock (a fall in the prices of export commodities or a rise in the international interest rate) increases the debt burden for foreign-currency debtors who receive their income in local currency, which causes a decrease in consumption and investment. This balance sheet effect can impact both the private and public sectors. Typically, delinquency and defaults on foreign-currency loans increase, and runs on local banks by foreign creditors or by depositors may be triggered, as occurred in 1998-99.

3. Main financial market failures.

Development banking has its origins in the need to mitigate market failures in the financial sector. According to Rezende (2017), "most development banks were created to promote social and/or economic development". Of these development banks, "almost half of them (49 per cent) were established during the import-substitution years between 1946 and 1989, nearly two-fifths (39 per cent) came into existence during the globalization years between 1990 and 2011. One implication is that irrespective of policy orientation, the failure of private financial markets to deliver adequate long-term finance forces governments to rely on development banking institutions", according to Chadrasekhar (2016), quoted by Rezende (2017).

In the current Peruvian economy, the main market failures of the financial system are still related to long-term financing, agricultural financing, and the financing of small businesses. Other market failures, such as those related to financing the necessary diversification of production in the Peruvian economy as well as climate change mitigation, are somewhat more convoluted and should be considered in their own right, as the state apparatus does not today encompass a structured plan¹⁸ concerning these objectives or a national development strategy that differs from the commodities export economy promoted in the 1990s.

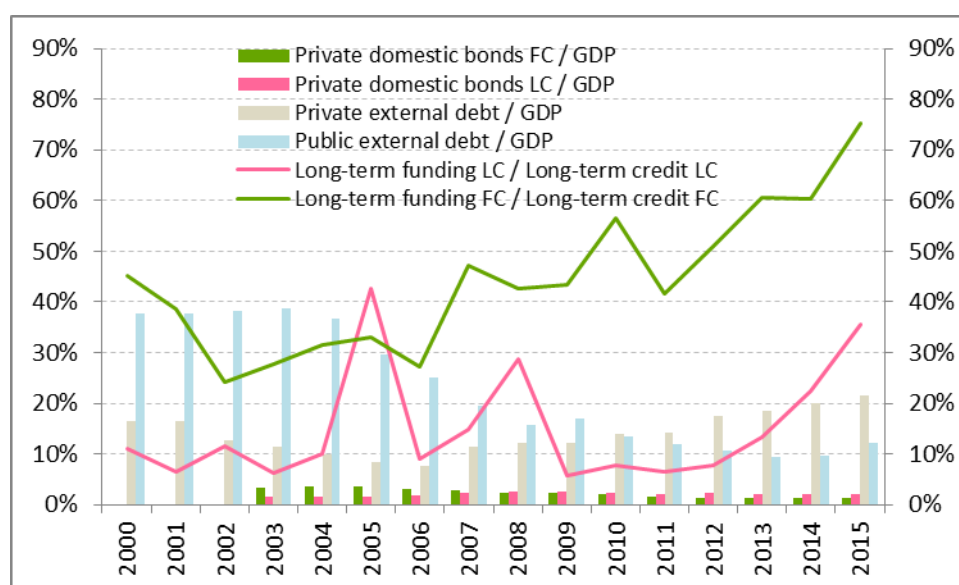
The first failure of the financial system in the current Peruvian economy is related to long-term financing. The dollarization of credit and dependence on the external debt are pri-

¹⁷ See Armas and Grippa (2005), Jiménez Sotelo (2010a), García-Escribano (2010), and Dancourt (2014).

¹⁸ For instance, the China Development Bank participates in the nationwide Five-Year Plan, according to Xu (2017).

marily a result of insufficient long-term financing in local currency. According to BCRP, the level of dollarization of the extended financing (internal and external debt) of the private sector was 48.6% at the end of 2015. As shown in Graph 4, although the external public debt fell from more than 30% of GDP at the start of the 2000s to 10% of GDP in 2013-15 - a decrease explained in part by the development of a local public bond market denominated in local currency - at the same time, the external debt of the private sector increased over the last decade, exceeding 20% of GDP by 2015. Therefore, the overall external debt, both public and private, went up toward the end of this period. In 2014-15 alone, the external debt increased from 31.8% to 35.5% of GDP (Moody's 2016). Most of the state-owned financial companies contributed to this result, since their long-term external debt grew by 42.9% in 2015 (MEF 2016); this is despite one of their general mandates being to develop the domestic securities market.

Graph 4
Peru: Domestic bonds, foreign debt, and credit funding mismatches



Source: INEI and SBS

Compiled by authors

Graph 4 also shows the underdevelopment of the private domestic bonds market in relation to the scale of private external debt. And as recent experience of Peruvian public sector proves, further developing this bonds market and reducing the dollarization of credit are two sides of the same coin (MEF 2014 and 2015).

However, the problem of long-term financing in local currency for the financial entities themselves is still ongoing. In 2015, as shown in Graph 4, almost two-thirds of all long-term credit in local currency (considering mortgages, financial leasing, and loans) granted

by commercial banks did not have long-term funding in the same currency (considering due to banks and other entities and unsubordinated bonds and notes issued), while only a quarter of the credit in foreign currency did not have long-term funding in the same currency. The local-currency mismatch ratio has fallen since 2013, primarily due to the increased supply of longer-term funds granted by the central bank to commercial banking through repurchase agreements guaranteed with deposits in dollars.

A clear area for improvement is associated with the supply of housing loans. State intervention through subsidized withdrawals and guarantees has enabled the expansion of mortgages, albeit in foreign currency through to 2006, as we will see later.

The second failure of the financial system in the current Peruvian economy is related to agricultural financing. According to the SBS, only 4.1% of all business loans granted in 2015 by commercial banks were towards agriculture, livestock, hunting, and forestry, despite the fact that in this economic sector, there is a quarter of the country's occupied work force. This failure is exacerbated by the absence of mass agricultural insurance in the country, a key factor that hampers better management of biological and weather risks, which cannot be controlled by either the bank or the farmer (Jiménez Sotelo 2001: p. 3). Indeed, as "agricultural activity is exposed to adverse climatic conditions that cause production losses and affect the income of farmers and agro-enterprises [their occurrence ends up impacting] public finances, as it is habitual for governments to contribute financial resources or to waive the [collection] of certain taxes in order to assist the affected population" (Hatch et al. 2012: p. 4)¹⁹. In 2006, the Countryside and Agricultural Insurance Guarantee Fund (Fondo de Garantía para el Campo y del Seguro Agropecuario, FOGASA), under the auspices of the Ministry of Agriculture and Irrigation (MAR), was created to cover farmers in the poorest and most vulnerable parts of the country; the state participated by co-sponsoring the financing of all premiums alongside two nationwide insurance companies. However, its weak performance was reflected in a volatile claims rate (cost of claims/premium net of general sales tax), which between 2009 and 2015 fluctuated between 28.9% and 71.4%, with an average of 42.7% (Bartra 2015).

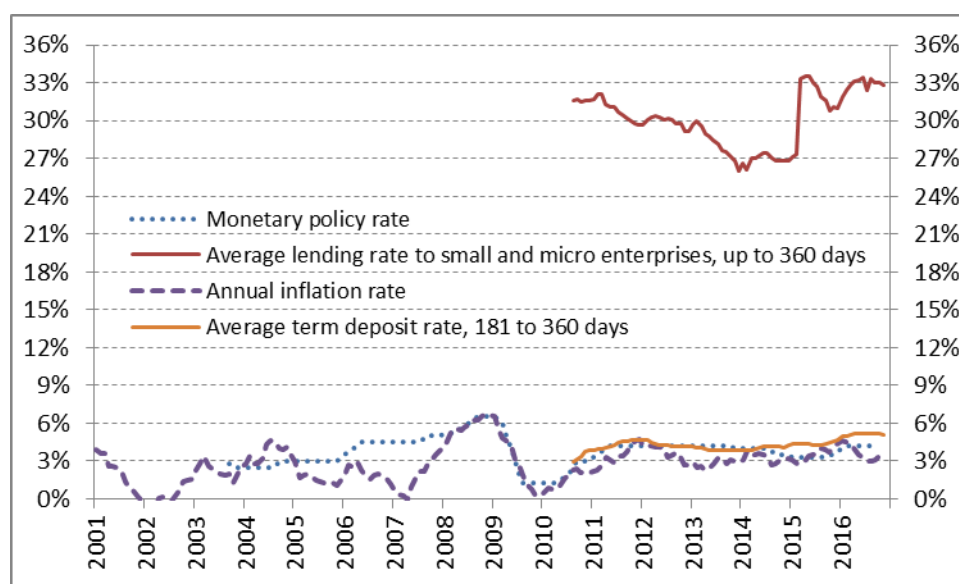
To improve this situation, it would be necessary to design agricultural insurance policies suitable for as wide a variety of crops and microclimates as those of Peru, but in the country there are neither the required actuarial studies, nor universities that train professionals

¹⁹ Translation by authors.

versed in actuarial sciences.²⁰ According to the Peruvian Association of Insurance Companies (Asociación Peruana de Empresas de Seguros, APESEG), there were some 90 professionals engaged in miscellaneous actuarial activities in Peru, but less than 20% were formally trained in the area, and of this proportion, only 40% were Peruvian, despite the considerable demand for labor (Morris 2014). According to representatives of the International Actuarial Association (IAA), Peru requires 1,500 actuaries (Corzo 2015).

Finally, it is worth recalling that much of agricultural financing requires lengthy grace periods, oftentimes not only for the principal but for the interest as well, which is not usually true of commercial credit. For example, as they grow and reach their full production stage, the investment process in fruit tree cultivation requires credit with average grace periods of four to seven years (Jiménez Sotelo 2001: p. 19).

Graph 5
Peru: Commercial banks, monetary policy and inflation rates



Source: BCRP

Compiled by authors

The third failure of the financial system in the current Peruvian economy is related to the financing of small companies. The supply of credit to small and micro enterprises²¹ is limited; according to the SBS, it accounted for only 7.6% of all direct credit granted by commercial banks in 2015, despite companies with between two and 10 employees making up 22.0% of Peru's workforce, according to the INEI.

²⁰ An actuary is a "person versed in mathematical calculation and statistical, juridical, and financial knowledge concerning insurance and the insurance system, who advises insurance companies and acts as an expert in the operations thereof" (DRAE 2015). Translation by authors.

²¹ The SBS classifies credit to micro-enterprises as loans of less than PEN 20,000, and credit to small enterprises as loans below PEN 300,000 (1 USD = PEN 3.41).

This credit rationing is reflected in the high interest rates paid by smaller companies. As shown in Graph 5, the average interest rate that commercial banks charged small enterprises for loans of less than 360 days fluctuated between 27% and 34% per annum during 2010-16, while the monetary policy interest rate or the borrowing rate paid by banks on deposits of 180 to 360 days did not exceed 6% per annum over the same period. It should be noted that the effective or expected inflation rate likewise did not surpass 5% per annum during this period, which implies that the real interest rates paid by small companies are indeed extremely high.

The credit rationing for small and micro-enterprises has been mitigated by the so-called micro-financing institutions, especially by Municipal Savings and Credit Unions (Cajas Municipales de Ahorro y Crédito) established at the start of the 1980s, whose activities were not affected by the banking crisis of 1998-99. However, the interest rates that these institutions charge small and micro-enterprises are equal to or greater than the rates set by commercial banks, which have concentrated on the relatively large ones.

According to international experience, “small companies have greater ease in obtaining financing when: public banks predominate, private banks are domestically owned, smaller and more flexible institutions exist, and there is a national development bank” (Ferraro and Goldstein 2011: p. 11).²² As regards the level of concentration of the Peruvian financial system, of 63 supervised credit entities, the largest four commercial banks cornered 72.6% of the lending market in 2015.

4. Political and legal framework

Over the last 25 years, the Peruvian governments did not give state-run financial entities a major role in tackling the market failures in the financial system cited in the previous section, or in participating in strategic tasks such as diversifying the economy’s productive apparatus or closing the infrastructure gap. As we have seen, the size of these state-run financial institutions in relation to GDP has been minimal since the 1990s.

As was mentioned in the introduction, the neoliberal view of the state’s role in the Peruvian economy is marked by the radical experience of privatization and financial deregulation accomplished during the Fujimori administration.²³ The diminished role of development

²² Translation by authors.

²³ For example, a textbook recently prepared by MEF (2016b: p. 5) states that in “the decade of the nineties, the Peruvian state undertook a process of promoting private investment, in order to transfer to the private sector the leadership of economic sectors that were in the hands of the state for more than 20 years. This process was carried out within the framework of the policy of economic stability and market liberalization. The

banking in Peru after the 1990s cannot be explained without referring to this political and legal context or to the controversial subsidiary role of state-owned companies²⁴ in the 1993 Constitution.

The legal bases of the change of development model were established in 1991, before the change in the Constitution, through four legislative decrees²⁵ whose objective was to: (i) remove obstacles and restrictions to public investment and create a legally stable regime thereto; (ii) grant private investors the guarantees to acquire shares and assets of state-owned companies; (iii) consolidate the program of structural reforms by guaranteeing free initiative and private investment; and (iv) recognize the system of concessions for the construction, conservation, and exploitation of public service infrastructure works.²⁶

In this context, the so-called “public-private associations” appear as a sequel to the 1990s structural reforms that, including a new legal framework approved in recent years encompass all those agreements in which the state delegates a series of typically public activities, especially those concerning public investment. In these operations, the state ultimately retains the bulk of the risks by assuming a series of firm and contingent liabilities or commitments that go beyond traditional concessions. In perspective, these risks gradually put pressure on the sovereign risk rating by reducing capacity to pay the public debt (Graph 6) in the absence of a state-run development bank to act as a counterbalance in keeping the private participation incentives aligned - especially as regards the processes of financial structuring and designing bankable feasibility, supervision of economic-financial balance, or advising in the rescue of the concession - as in other countries.

The structural reforms of the 1990s also had dire consequences for the national strategic planning system. During the 1970s and 1980s operated a national planning system for economic and social development that had been created in 1962²⁷. The National Institute of Planning (Instituto Nacional de Planificación), which drew on a team of able and experienced technicians, was an important factor in the debate and in the construction of economic policies for the Peruvian state apparatus. However, it was wound up and deactivated in 1992,²⁸ its staff transferred or made available as surplus to requirements. The Minis-

central axes of this promotion process were channeled through the privatization of public companies and concessions for the provision of public services, previously delivered by the state.” Translation by authors.

²⁴ Article 60 of the 1993 Constitution establishes that only where expressly authorized by law can the state undertake subsidiary business activities, directly or indirectly, for reasons of high public interest or manifest national convenience.

²⁵ Decretos Legislativos N° 662, N° 674, N° 757 and N°758.

²⁶ See MEF (2016b).

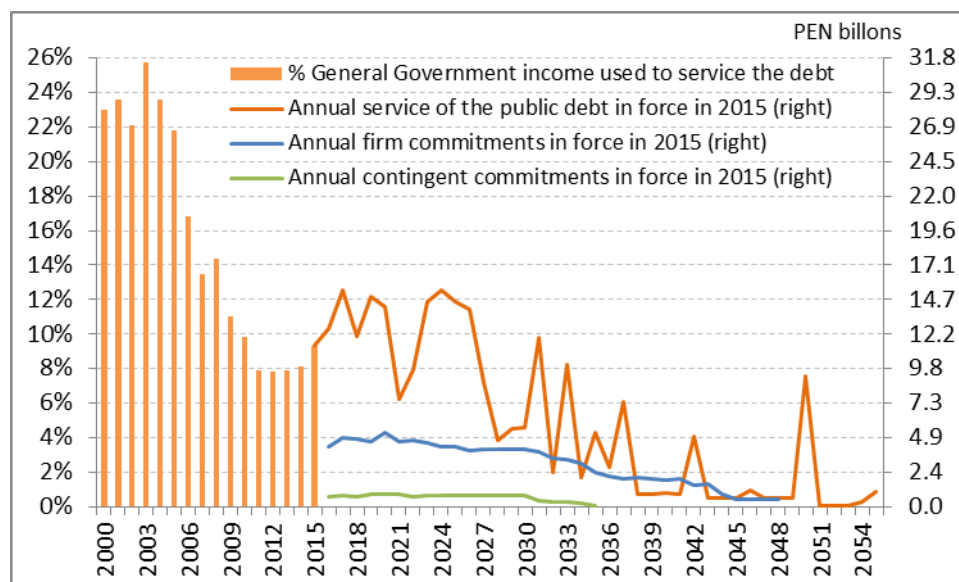
²⁷ Decreto Ley N° 14220.

²⁸ Decreto Ley N° 25548.

try of Economy and Finances (MEF) assumed its functions in theory; but, in practice, no specialized area with responsibility for these matters was created inside it.

Graph 6

Peru: Servicing of the public debt and firm and contingent payment commitments



Source: MEF and BCRP

Compiled by authors

After the fall of the Fujimori dictatorship, the Governance Forum for the National Agreement (Foro de Gobernabilidad del Acuerdo Nacional) revisited the idea of national strategic planning as a state policy agreed between political parties, civil society, religious institutions, and the government, as a basis for democratic transition and consolidation. Although a new national strategic planning system was devised in 2005,²⁹ it was not implemented and was substituted in 2008³⁰ by another system, for which a three-year time frame was given for the initial implementation of its technical agency, CEPLAN (Centro Nacional de Planeamiento Estratégico), to be attached to the Presidency of the Council of Ministers. It was not until 2014 that CEPLAN approved a directive³¹ to commence a real strategic planning process across the public sector.

In consequence, for two decades the Peruvian state acted without planning or calculating the long-term consequences of its actions. This radical neoliberal vision, applied in a specific political and legal context, is a factor that explains both the liquidation in the 1990s of development banks per se (bancos de fomento), and the minimization of development banking activities undertaken by state-owned financial entities that survived or were cre-

²⁹ Ley N° 28522.

³⁰ Decreto Legislativo N° 1088.

³¹ Resolución N° 026-2014-CEPLAN/PCD.

ated subsequently. This vision has not only influenced the financial system but has also had, for example, a negative impact on the development of the country's system of cities, according to World Bank (2016).³²

Finally, it is worth noting that in the Peruvian case no special regulations exist for development banks, unlike, for instance, the case of Mexico. As shown in Table 1, the four state-owned financial companies engage in development banking activities with different forms of intermediation.

Table 1
Peru: Forms of intermediation of the state-owned financial entities

Principal characteristics by financial entity	Banco de la Nación	Corporación Financiera de Desarrollo	Banco Agropecuario	Fondo Mi-Vivienda
Current target market	Public sector plus exceptions	Public and private sectors 6/	Only agricultural sector	Only real estate sector
Authorization of fund-raising (deposits)	Direct and indirect 1/	Only indirect 7/	Direct 10/ and indirect 11/	Only indirect
Authorization of fund placement (credit)	Direct 2/, indirect 3/, and synthetic 4/	Only indirect and synthetic 8/	Direct 12/, indirect, and synthetic	Only indirect and synthetic
Authorization of acquisition of securities (investment)	Direct, indirect, and synthetic	Direct, indirect, and synthetic	Direct 13/	Direct and synthetic 14/
Authorization of placement of securities (issuances)	Direct 5/	Direct 9/	Direct	Direct
Supplementary regulation	General banking	General banking	General banking	Special banking
Current legal regime	Public law	Private law	Private law	Private law
Subsidies from the budget	No	No	Yes	Yes
Trustor and trustee	No	No	No	Yes

1/ As of 2000, it can accept savings deposits from private-sector suppliers, in places where there are no commercial banking branches.

2/ As of 1994, it cannot grant loans to state-owned enterprises governed by private law, but as of 2001 it may grant credit to private-sector employees and pension-holders.

3/ As of 2006, it can undertake direct placements with small and micro enterprises, setting final interest rates.

4/ As of 2012, it can carry out synthetic placements for micro and small enterprises that participate in the financial education programs promoted by public-sector entities.

5/ As of 1994, it requires an annual program to be approved by the MEF.

6/ As of 1991, the financing of investment and infrastructure projects, including underdeveloped areas with limited private-sector coverage, was added as an objective, and in 1992 the financing of small business-owners and farmers, preferably in deprived areas, was added.

7/ As of 1992, it can only raise funds from other intermediaries, and cannot receive deposits from the public.

³² World Bank (2016) states that “on a national level, there is a need for an articulated strategy around the development of a system of cities that fosters economic activity.” Translation by authors. In 2015, 31.8% of the Peruvian population lived in the city of Lima, and 81.5% of the credit granted by commercial banks was concentrated there. The near-900,000 inhabitants of the second largest city, Arequipa, amounted to only 9% the population of Lima. On the infrastructure gap, see Perroti and Sánchez (2011); Bonifaz, Urrunaga, Aguirre and Urquiza (2015); World Economic Forum (2015); and Instituto Peruano de Economía (2009).

- 8/ Through to 1991 it enjoyed exclusive rights to carry out direct, indirect, and synthetic long-term credit intermediation of state companies, but as of 1992 it cannot lend to the public on its own account.
- 9/ Through to 1991 the securities it issued were exempt from all taxes for 20 years.
- 10/ Fundraising through deposits subject to SBS authorization, with the favorable opinion of the MEF.
- 11/ Fundraising through credit from other intermediaries and multilateral agencies, subject to agreement with the MEF.
- 12/ Placement of credit with limits per person (maximum of 15 tax units, UIT, in the case of small producers, 300 UIT in the case of medium-sized producers and, in areas of extreme poverty, preferential up to two tax units) and per company (3% of the bank's effective equity).
- 13/ Only acquisition of public debt securities, BCRP securities, and securities from shares of agricultural investment funds.
- 14/ As of 2001, and ratified in 2005.

Direct intermediation is carried out through the acquisition and placement of funds or securities involving the general public, and indirect intermediation is triangulated through the acquisition and placement of funds or securities involving other financial entities. In some cases, the indirect intermediation of funds (through deposits and loans) is carried out from the origination through to the maturity of the operation, but in other cases it only applies from their distribution, undertaken by the financial institution that originated it. In some circumstances, indirect intermediation is used due to existing legal restrictions and in other circumstances to take advantage of the wide network of agencies of retail financial institutions. Synthetic intermediation is carried out by assuming the risk only, at different levels, through the procurement of bonds, sureties, guarantees, trusts, derivatives and other contracts with equivalent effects, without the need to place funds or acquire securities. Thus, through synthetic intermediation it is possible to assume the same or even greater risk than in the case of simple direct intermediation.

5. The case of Banco de la Nación (BN)

BN is the oldest state-owned financial institution currently in existence, having been established in 1966³³ as a public law company to provide the banking services required by the public sector. Despite having been created as a credit entity, in 1972³⁴ it was granted powers corresponding to an insurance entity to hedge the risks to which individuals, goods, capital, transactions, and operations are exposed and in which the state has a direct or indirect interest. It could, therefore, utilize the operating mechanisms of such entities, directly or through insurance companies. Subsequently, the banking law passed in 1993,³⁵ later superseded by the current banking law passed in 1996,³⁶ established that the activities of the BN would be regulated by its statute, to be enacted by supreme decree approved by the MEF.

³³ Ley N° 16000.

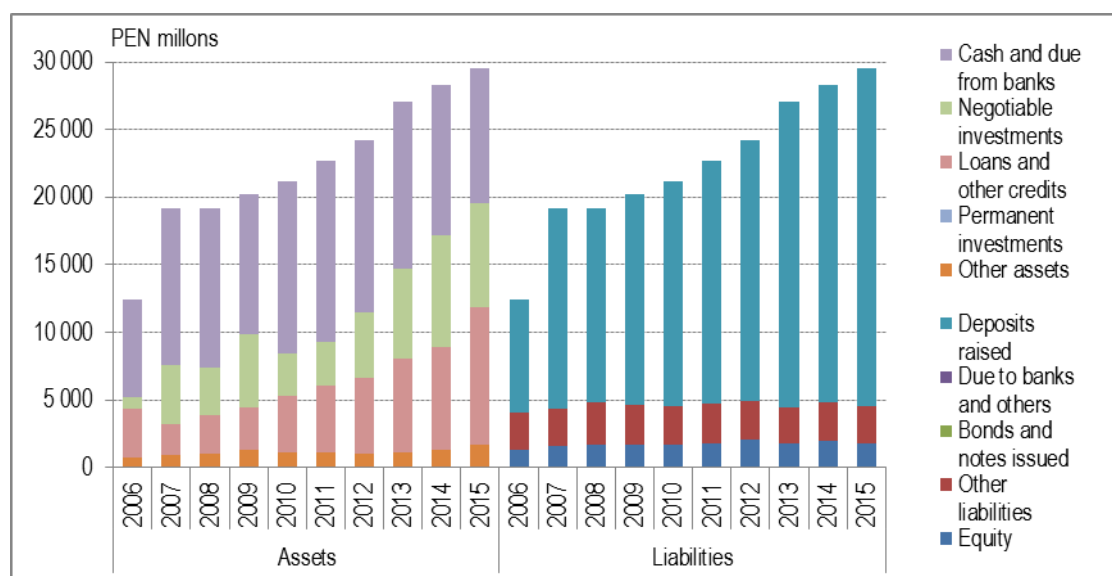
³⁴ Decreto Ley N° 19569.

³⁵ Decreto Legislativo N° 770.

³⁶ Ley N° 26702.

Since 2000, the financial operations that can be carried out by BN have been gradually expanded. In 2000,³⁷ the BN was given authorization to receive demand deposits from individuals and private companies that acted as suppliers to the public sector, and to receive savings deposits from the same entities in places where commercial banks had no branches. In 2001,³⁸ the bank was authorized to issue money orders and transfers on behalf of individuals and private companies in places where private commercial banks did not have branches, and to grant credit to public sector employees and pension-holders.

Graph 7
Peru: Financial structure of BN 2006-2015



Source: SBS and audited FSs of BN

Compiled by authors

In 2006,³⁹ BN was empowered to execute operations and services with entities that lend to small and micro enterprises, and to enter into agreements with these institutions to facilitate access to financial resources; that is, they were authorized to carry out indirect credit intermediation, setting the final interest rate to be charged by each participating credit entity by way of tender. Moreover, in 2012⁴⁰ it was authorized to guarantee operations involving credit granted by these institutions to small and micro enterprises participating in financial education programs promoted by public sector entities, which also enabled synthetic intermediation of these credits after their origination.

As to its financial structure, between 2006 and 2015 BN's balance of assets and liabilities

³⁷ Decreto de Urgencia N° 073-2000.

³⁸ Decretos de Urgencia N° 045-2001 and N° 120-2001, superseded by Decreto de Urgencia N° 014-2004 and recovered and extended by Decreto Supremo N° 207-2004-EF.

³⁹ Decreto Supremo N° 134-2006-EF.

⁴⁰ Decreto Supremo N° 099-2012-EF.

grew by an average of 9% per year, as shown in Graph 7 - a slower rate than that of the commercial banks, which increased by 16% per year. As regards sources of financing, there has been a sustained increase in the relative share of deposits raised, almost all of them from the public, without resorting to debts due to banks and other entities. In the case of resource usage, it maintains very high liquidity surpluses, both in cash and due from banks and other entities and negotiable investments, despite the slight decline in the relative share since 2013. The bank also held negotiable investments of a value that exceeded its loans and other credits for nine out of ten years, which has diminished the potential aggregate yield on its assets⁴¹.

Regardless, since 2009, BN has succeeded in maintaining a favorable average differential of +460 basis points between the aggregate return on interest-bearing assets and the aggregate cost of interest-bearing liabilities. The differential from interest and commission alone - not including the effect of exchange rate, market, and derivative risks - was also favorable, at an average of +433 basis points, as shown in Table 2.

In 2015, BN's overall assets equated to 4.8% of GDP, of which 1.8% was comprised of credits; 1.6% of available funds, almost 90% of which was deposited in the central bank with remuneration below the interbank rate; and 1.3% of negotiable investments, more than 80% of them in central bank securities. Its credits were distributed as follows: 54% in the public sector; 8% across other financial entities; and 36% among individuals. Of this total, 33% had maturities of up to one year, 63% from one to five years, and 4% of more than five years.

In 2015, 90% of all its liabilities corresponded to deposits raised, 97% of which were from the public (53% in current accounts and 25% in savings accounts). The bulk of its assets (93%) and of its liabilities (92%) were denominated in local currency, and it has made a greater contribution than any other state-run financial entity to driving the credit de-dollarization process - more than 50% of its loans have been denominated in domestic currency since 2009. Its return on assets ratio was 2.4%, 0.1 times greater than the commercial banks collectively, but the differential between the return on its interest-bearing assets and the cost of its interest-bearing liabilities was +458 basis points, 0.3 times less than that of the commercial banks, or +461 basis points if the effects of exchange rate, market, and derivative risks are not taken into account.

⁴¹ The commercial banks have historically held available funds totaling less than half of their credit, not to mention the fact that their investments have also been considerably less than those of BN.

Table 2
Financial Entities: Differentials between returns and costs, 2006-2015

Returns and costs by financial entity			2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Return on interest-bearing assets	All financial revenues	BN	6.5%	6.7%	6.8%	5.5%	4.7%	5.2%	5.2%	5.0%	4.9%	5.2%
		CFD	5.9%	5.7%	5.6%	5.0%	5.0%	5.4%	7.0%	6.3%	5.6%	6.5%
		BA	8.7%	8.0%	9.3%	11.3%	12.7%	15.7%	16.7%	16.8%	14.4%	11.6%
		FMV	3.0%	7.3%	8.3%	7.0%	6.5%	7.5%	6.9%	6.0%	5.4%	8.7%
	Only interest and commissions	BN	6.5%	6.6%	6.6%	4.9%	4.1%	4.7%	4.8%	4.6%	4.6%	4.9%
		CFD	4.9%	4.1%	3.8%	4.1%	4.4%	5.2%	5.4%	5.3%	5.1%	5.0%
		BA	8.7%	8.0%	9.3%	11.2%	12.7%	15.7%	16.7%	16.7%	14.4%	11.6%
		FMV	2.7%	5.9%	6.5%	6.3%	5.8%	6.2%	6.1%	5.7%	5.1%	5.0%
Cost of interest-bearing liabilities	All financial expenses	BN	0.7%	1.1%	1.2%	0.9%	0.6%	0.5%	0.4%	0.4%	0.2%	0.6%
		CFD	6.5%	7.8%	8.6%	5.6%	4.1%	5.0%	7.8%	6.3%	5.5%	6.4%
		BA	18.6%	10.5%	8.4%	10.4%	7.0%	9.9%	8.5%	6.6%	7.6%	5.9%
		FMV	-	-	-	-	-	-	-	13.0%	6.4%	12.1%
	Only interests and commissions	BN	0.5%	0.9%	1.1%	0.8%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%
		CFD	3.9%	4.5%	3.8%	3.9%	2.6%	3.9%	4.7%	4.0%	4.1%	4.1%
		BA	13.0%	7.5%	8.1%	10.1%	5.6%	8.7%	7.6%	6.6%	7.6%	5.9%
		FMV	-	-	-	-	-	-	-	4.8%	3.5%	3.0%
Differentials between returns and costs (in basis points)	All financial revenues and expense	BN	585	564	559	454	417	479	487	456	469	458
		CFD	-62	-208	-301	-62	91	48	-77	-2	17	11
		BA	-991	-257	86	87	569	587	824	1020	679	571
		FMV	300	728	832	700	651	750	690	-698	-98	-331
	Only interests and commissions	BN	602	562	548	419	383	441	451	437	438	461
		CFD	103	-39	-6	24	177	132	67	136	105	83
		BA	-423	50	115	107	706	700	907	1010	677	572
		FMV	274	590	648	633	579	622	605	87	168	200

Source: SBS and audited FSs of BN, CFD, BA and FMV

Compiled by authors

6. The case of Corporacion Financiera de Desarrollo (CFD)

CFD was created in 1971⁴² during the military regime of Velasco as a public enterprise charged with coordinating the financial and entrepreneurial actions of the state, capturing and channeling savings for priority investments, creating or strengthening companies, and

⁴² Decreto Ley N° 18807.

contributing to the expansion of the stock market. That is, it was created primarily as a securities entity to promote business investment. According to Castillo (2005), CFD financed large manufacturing and infrastructure investments in the 1970s.

However, in 1981,⁴³ during the Belaunde administration, CFD's paid-up capital was reduced and it was ruled that its business promotion and investment activities along with the investments it held until then would be transferred to another public entity, and it would be turned into a state-owned enterprise governed by private law, as a public limited company. Converted into a credit entity, CFD was given the purpose of contributing to Peru's integral development by attracting savings and financial intermediation to assign it to the financing new or existing companies, and promoting projects, in accordance with governmental plans and policies.

In 1991,⁴⁴ during the Fujimori administration, it was ruled that the institution would also assume the role of executing long-term financing operations in infrastructure and investment projects, including in underdeveloped areas where private-sector coverage was limited; that foreign funding attracted by CFD and intended for purposes other than financing studies or executing nationwide public infrastructure projects should be channeled preferentially through the national financial system; and that CFD's security issuances would lose the tax exemption to which they were entitled. However, in 1992⁴⁵ CFD was prevented from gathering deposits from the public and lending on its own account to individuals or companies that were not classified as financial intermediaries or institutes for the development of rural activities and small business-owners.

As to its financial structure, between 2006 and 2015, CFD's balance of assets and liabilities grew by an average of 14% per year, and at an annual rate that was 20% per year greater than that of commercial banks in 2011-15, as shown in Graph 8. As to sources of financing, CFD has had a volatile funding structure with a high proportion of external debts due to banks and other entities; in the last three years, an explosive growth was recorded in the long-term securities issued abroad. As to the use of its resources, the CFD has had increasing liquidity surpluses since 2012, both in cash and due from banks and other entities and in negotiable investments. Its credit has also been on the increase, but its returns are very low due to the legal obligation to use another financial entity as intermediary,⁴⁶

⁴³ Decreto Legislativo N° 206.

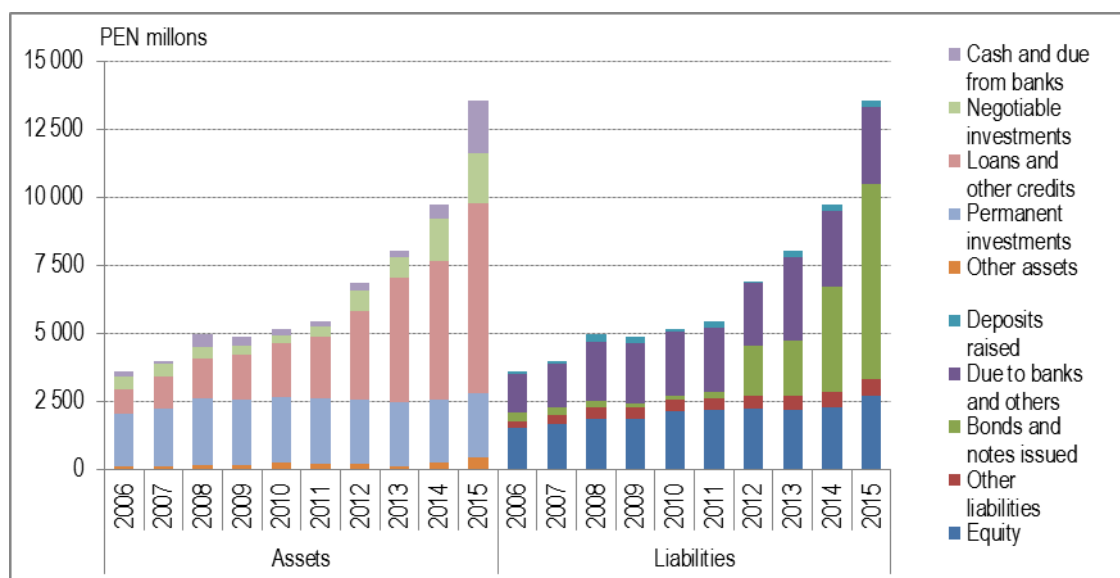
⁴⁴ Ley N° 25382.

⁴⁵ Ley 25382 and Decreto Ley 25694.

⁴⁶ It should be noted that most of its assets are committed to the permanent investments it holds in CAF, which neither generate cash dividends nor possess a liquid market.

which leaves it without any bargaining power over the target market or the final financial conditions involved.

Graph 8
Peru: Financial structure of CFD, 2006-2015



Source: SBS and audited FSs of CFD

Compiled by authors

Since 2009, CFD has maintained a favorable average differential of just +4 basis points between the aggregate return on interest-bearing assets and the aggregate cost of interest-bearing liabilities. If the effect of foreign exchange differences, variations of market prices and the derivatives acquired were to be excluded, the differential would be +103 basis points on average, as shown in Table 2.

In 2015, its total assets equated to 2.2% of GDP, of which credits accounted for 1.2%, cash and due from banks and other entities for 0.3%, and negotiable investments for 0.3%. Of its credits, 97% are granted to other financial entities, (85% to banks, 8% to financiers, and 5% to municipal unions); however, in recent years it has increased its synthetic intermediation, assuming the greatest risk associated with operations and the final debtors involved, rather than only assuming the intermediary risk as in the case of traditional indirect intermediation.

Of this total credits, 40% had maturities of up to one year, 28% from one to five years, and 29% of more than five years. Of all the liabilities, 92% correspond to debts due to banks and other entities and financial obligations (57% to unsubordinated bonds and notes issued, 17% to foreign debts due to banks and other entities, and 10% to subordinated bonds and notes issued), which gives it an uncompetitive funding base. Only 39% of its

assets and 23% of its liabilities are denominated in local currency, with CFD's level of credit dollarization having increased to 66% in 2015 from the 30% posted in 2009. In 2015, the return on assets ratio was 0.7% and the differential between the return on its assets and the cost of its liabilities was +11 basis points, +83 if the effects of exchange rate, market and derivative risks are not taken into account.

7. The case of Banco Agropecuario (BA)

BA was created in 2001⁴⁷ to grant credit to the agricultural sector,⁴⁸ directly or through other financial entities, using public and private resources. For the financial and technical support of small-scale agriculture and livestock it draws on the budgetary resources assigned to it by the MEF and the MAR, while it must raise private funds locally and abroad in order to lend to medium-scale agriculture and livestock. In 2006,⁴⁹ it was established that the resources assigned to BA by the MEF and the MAR would constitute part of its equity, and that the Guarantee Fund for Small-Scale Agriculture (Fondo de Garantía para la Pequeña Agricultura, FOGAPA) would be transformed into autonomous equity, intended to hedge the risks associated with the credit granted to small-scale producers in the agricultural sector by all financial institutions and transferred in trust for 30 years into the Guarantee Fund for Loans to Small-Scale industry (Fondo de Garantía para Préstamos a la Pequeña Industria) - a state foundation tasked with strengthening small and micro-enterprises.

In 2007,⁵⁰ the relaunch of BA was approved as the primary state instrument of financial support for the development of the agricultural sector, and its role was defined as undertaking all activities associated with a banking entity. In 2008⁵¹, following two successive legal amendments - one to reduce the paid-up capital and the other to increase the authorized capital - it was stipulated that the institution should promote private-sector participation, both domestic and foreign, without retaining the previous limit of 49%. Moreover, it was established that the FOGAPA was an autonomous fund administered by the BA, intended to hedge the risks associated with the credit granted by that institution to small-scale agricultural producers.

⁴⁷ By Ley N° 27603, as a company under private law.

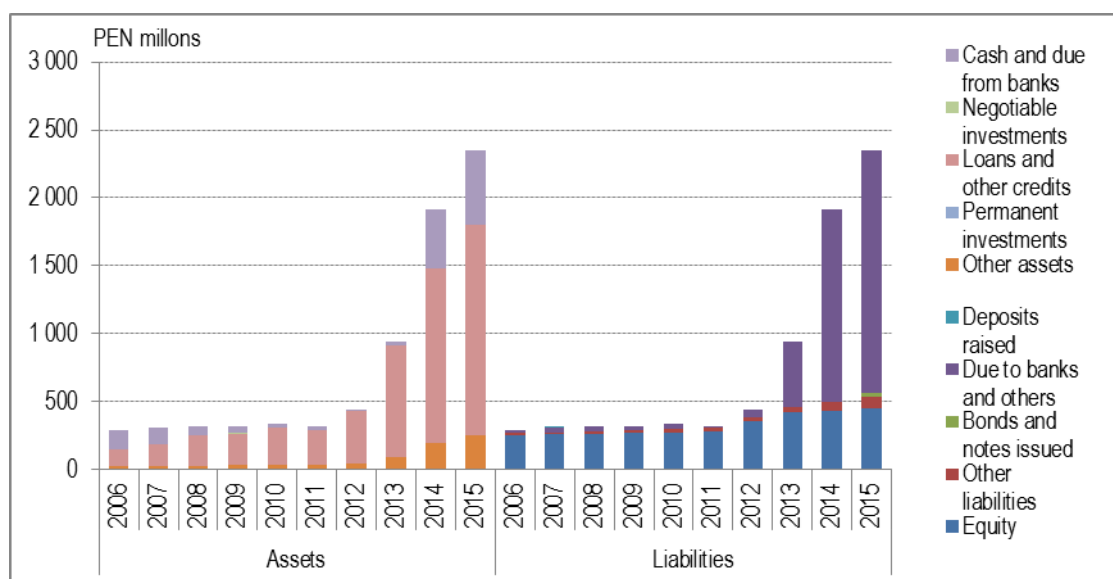
⁴⁸ This sector includes agriculture, livestock, aquaculture, and the associated transformation and commercialization activities.

⁴⁹ Ley N° 28818.

⁵⁰ Ley N° 29064.

⁵¹ Decreto de Urgencia N° 007-2008, Decreto Legislativo N° 995 and Decreto Legislativo N° 1037.

Graph 9
Peru: Financial structure of BA, 2006-2015



Source: SBS and audited FSs of BA

Compiled by authors

Between 2006 and 2015, the BA's assets and liabilities balance grew by an average of 23% per year, although it remains a very small institution. As to the sources of its resources, starting from 2012, the BA embarked upon a drastic change in its funding structure, concentrating both internal and external debts due to banks and other entities but without gathering deposits, whereas in previous years its funding was almost 80% equity-based, as shown in Graph 9. With respect to the use of its resources, the increase in the relative share of credits has been sustained since 2012, but still with a very high proportion of new credits. However, since 2009, BA has succeeded in maintaining a favorable average differential of +619 basis points between the aggregate return on its interest-bearing assets and the aggregate cost of its interest-bearing liabilities. The differential - not including the effect of exchange rate, market, and derivative risks - was also favorable, at an average of +668 basis points, as shown in Table 2.

8. The case of Fondo MiVivienda (FMV)

FMV was created in 1998⁵² with the purpose of facilitating the acquisition of housing, especially social housing, and its resources are to be used to compliment the financing offered by the private banking system. In 2000,⁵³ it was authorized to finance housing constructed as a consequence of the partitioning of residential units, subdivision of land, or

⁵² Ley N° 26912.

⁵³ Decreto de Urgencia N° 091-2000.

the completion of urban renewal projects underway. In 2001,⁵⁴ it was established that it could guarantee the credit or securities of private financial intermediaries, including securitization firms, associated with housing programs. En 2002,⁵⁵ it was granted the power to administrate and concede the family housing payment (maximum of US\$ 12,000), a subsidy for the acquisition, construction, or improvement of social housing drawn from the budget of the Ministry of Housing, Construction, and Sanitation.

In 2005,⁵⁶ the purposes and means of the FMV were extended and it was converted into a state-owned enterprise governed by private law. It was able to engage in the promotion and financing of the acquisition, improvement, and construction of housing, especially social housing, activities related to promoting the flow of capital to the housing financing market, participation in the primary and secondary mortgage lending market, and contributing to the development of the capital market. It was authorized to implement products and services to stimulate supply and demand for housing; encourage the timely payment of housing credit; disburse funds to financial entities; promote savings or private-sector investment; act simultaneously as trustor and trustee for the financing of housing, as well as improver and beneficiary; issue liabilities and other instruments; participate as structuring agent, underwriter, shareholder, and advisor; and other responsibilities associated with housing-financing structures.

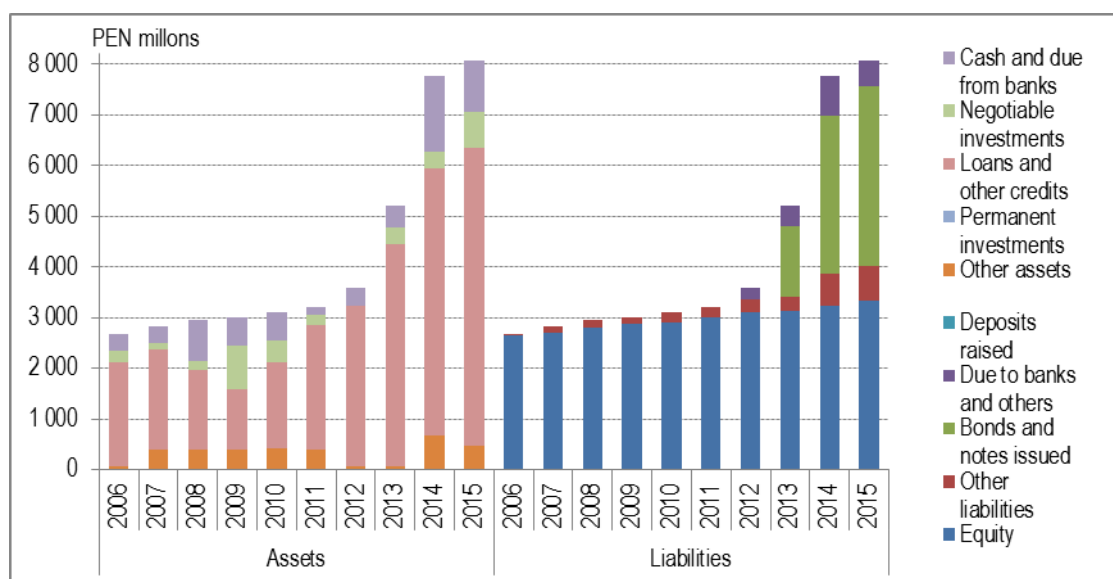
As to its financial structure, between 2006 and 2015 the FMV's balance of assets and liabilities grew by an average of 12% per year, although from 2011-15 it expanded at a rate in excess of 20% per year. As to the sources of its resources, from 2012 the FMV's funding structure has changed drastically, increasing its share of bonds and notes issued, primarily abroad, as shown in Graph 10; this is in contrast to what was observed through to 2011, when its funding was largely equity-based. As to the uses of its resources, credit picked back up after the decline recorded during the recession of 2008-09; however, during the economic downturn of 2014-15, credit increased more slowly than bonds and notes emissions, generating an increase in liquidity, in cash and due from banks and other entities.

⁵⁴ Ley N° 27511.

⁵⁵ Ley N° 27829.

⁵⁶ Ley N° 28579.

Graph 10
Peru: Financial structure of FMV, 2006-2015



Source: SBS and audited FSs of FMV

Compiled by authors

Thus, since 2013, when it started to incur debts due to banks and other entities and issuances of bonds and notes, FMV has faced an unfavorable and volatile differential, greater than -376 basis points, between the aggregate return on its interest-bearing assets and the aggregate cost of its interest-bearing liabilities. If the effect of foreign exchange rate differences and variations in market prices and the derivatives acquired were to be excluded, the differential from interest and commissions alone would be favorable, +152 basis points on average, as shown in Table 2.

In 2015, its total assets equated to 1.3% of GDP, of which its credits accounted for 1.0%, 93% of which corresponded to housing credit through a trust with CFD; available funds were 0.2%, and negotiable investments, 0.1%. Of these total credits, 9% had maturities of up to one year, 23% from one to three years, and 69% of more than three years. Of all the liabilities, 86% correspond to debts due to banks and other entities and financial obligations (75% to unsubordinated bonds and notes issued, 7% to domestic debt due to banks and other entities, and 3% to foreign debt due to banks and other entities), which gives it an uncompetitive funding base that is further deteriorated by derivative arrangements vis-a-vis the currency mismatch to which it is subject. In 2015, 80% of its assets and 20% of its liabilities were denominated in local currency, although it reached a credit dollarization level of 90% in 2006; thereafter, the dollarization of its loans dropped to 10% in 2013. The return on assets ratio was 1.2% but the differential between the return on its assets and

the cost of its liabilities was -331 basis points, but it would have attained +200 basis points without the effect of exchange rate, market and derivative risks.

9. Strategy and vision of future

The economic development of Peru requires a diversified productive structure that reduces dependence on the export of raw materials; but the change will not occur spontaneously. In order to change this, Peru needs to build public institutions that are capable of researching, formulating and implementing public policies and strategies with a vision of the future. In this sense, the state financial institutions dedicated to development banking remain key players to mitigate market failures. The "type of finance that innovators receive is not neutral and can affect both the rate and direction of innovation" (Mazzucato and Semieniuk 2017: p. 25).

However, in the case of the four state financial institutions evaluated here, it is verified that they maintain objectives and goals that are not integrated with each other. On the contrary, in some cases their objectives overlap and their efforts are duplicated, while in other cases they do not take advantage of all possible synergies to obtain economies of scale and economies of scope, not only for administrative efficiency but also for financial economies. For example, the BN could help make the concentrated Peruvian banking system more competitive, but it is allowed to operate only in places that are not covered by any commercial bank. By different legal norms, the CFD as of 1992 and the BN as of 2006 are required to meet the financing needs of small enterprises, but they are not authorized to carry out the direct intermediation of such credit, which means having no bargaining power to alter the prevailing market supply conditions. In fact, the share of microfinance institutions in the balance of credits granted to financial entities by CFD at the close of 2015 was just 5.8%, down on the 6.7% share held by such institutions in overall banking system credit; this is to say nothing of the fact that CFD has assumed synthetically the final credit risk of bigger enterprises in much of the remainder of its loans to other financial entities, without this being explicitly shown in their balance sheets.

As of 1992, CFD must also attend small business-owners and farmers in depressed regions (where there are no commercial banks and which are only covered by the BN, which cannot grant credit to state-owned enterprises governed by private law), but is not authorized to attract deposits from the public or to lend to individuals or companies that are not qualified as intermediaries or financial entities for the development of rural activity or small businesses. Thus, in practice, CFD cannot advance this aim, given the low differ-

ential between yields and costs, and it has not opened up so much as a single office of its own in the Peruvian interior. Indeed, the high costs of external liabilities and derivatives incurred from 2010-15 could have been reduced by almost 100 basis points in the case of the CFD if it had been funded directly by the BN using local currency; at the same time, this would have allowed the BN to improve the yield on its assets by utilizing the liquid resources deposited in the central bank.

Given that the rural sector went unattended by CFD and the private insurers, BA was created following prolonged political and electoral negotiations; the institution's funding was primarily equity-based, drawn from the public purse during the first 12 years of its existence. Since 2014, this institution has posted an increase in credit dollarization due to the higher foreign currency debts due to banks and other entities that it has incurred. The BA extends credit in foreign currency to medium-sized, small, and micro enterprises pertaining to the sector at much lower interest rates (from 360 to 720 basis points) than the local-currency rates, whereby defaults can increase abruptly with a rising exchange rate.⁵⁷

Finally, the FMV increased and de-dollarized its credits from 2013-15, but also using funding in foreign currency. In response to this currency mismatch, FMV began to incur a strong negative differential due to exchange rate, market, and derivative risks, which are currently sustainable due to the still-low level of leveraging, albeit without including the part of the final credit risk that was assumed synthetically in its operations with the financial entities.

Therefore, it could be more efficient and effective to bring about a merger between these four state financial entities to accelerate the economic development of the country, and to take advantage of it to match the conditions of public companies with those of private companies (OECD 2011 and 2016). In this way, it would ensure a permanent coordination and integration of its objectives and goals, it could take advantage of the synergies of its operations at national level and it could constitute a true state development bank. While for the management of loans and investments, practically every entity would become a specialized business unit with differentiated centers of costs and benefits (for example, infrastructure, micro and small business, real estate and agricultural sectors), for the management of cash and due from banks, and deposits raised and other liabilities, a single unit of treasury and balance sheet structure would be formed in a manner similar to what would occur with the formation of a single strategic risk management unit, a single

⁵⁷ See Jiménez Sotelo (2010).

unit of trusts and a single unit of operations. The most viable operational integration would be based on the BN, which not only has the largest network of agencies at the national level, but also has a new headquarters of 30 floors, to which the other three state entities could quickly be relocated.

In any case, the mission of this new entity, even if it can retain the trademark of the other three as well, must be firmly linked to its new strategic vision of the future and to the actions necessary to build it.

10. Conclusions

The state-own financial entities in Peru have not been far-removed from the controversial ideological debate on the role the state has played in the economy over the last 50 years. Since the structural reforms of the 1990s, these institutions have not had much significance as instruments of public policy used to mitigate the market failures of the Peruvian financial system (long-term financing, financing for the agricultural and small-business sectors). On the contrary, as with other state-owned companies, they have been subject to discriminatory treatment in comparison with private companies, going against best international practices such as those recommended by the OECD.

Because of the absence of a system of strategic planning in the public sector for more than 20 years, some state-owned financial entities have ended up promoting greater financial dollarization and greater external debt, thereby hampering the development of the domestic securities market despite the lack of investment opportunities for the considerable domestic savings accumulated over the last decade.

Thus, each of the four state-run financial companies analyzed has objectives and goals in place that are not aligned with those of the others, but which respond to the regulations that have been implemented over more than 50 years and to the political emergencies that have arisen across the different governments of the day. In some cases, their objectives overlap and their efforts are duplicated, while in others possible synergies borne of administrative efficiencies and economies of scale and scope go unutilized. Therefore, none of these institutions constitutes an effective state development bank such as exists in other countries.

Given this context, the likelihood of the state-owned financial entities displaying procyclical behavior in the economy is high, since their lack of market bargaining power and of long-term vision often sees them trailing the bigger commercial banks through direct, indirect,

or synthetic intermediation of their credits or their preferred or subordinated debt instruments. With the exception of the BN, all of the other institutions have ended up as followers of international investment banks through the local intermediation of the greater external debt that these entities offered them and increasing financial dollarization even against the backdrop of efforts by the public treasury reduce these macroeconomic vulnerabilities. Moreover, their capacity to support counter-cyclical policy measures is limited, because they are dependent on express approval in the public budget for those funds for specific ends and with a limited life that they manage as trusts, since in the money market too they are usually treated in an unequal and disadvantageous manner in the central bank's operations.⁵⁸

⁵⁸ See Jiménez Sotelo (2009).

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