OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as "developed", "industrialized" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

D00047

Distr.
LIMITED

ID/WG.30/5
3 March 1969

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Interregional Seminar on Incentive Policies
for Industrial Development

Vienna, 10 - 21 March 1969

ISSUE PAPER NO. 5

ASSISTANCE WITH FINANCING AS AN INCENTIVE MEASURE[1]

1/ This document has been reproduced without formal editing.

id.69-743

ASSISTANCE WITH FINANCING AS AN INCENTIVE MEASURE

> "A number of measures and instruments of industrial policy are mainly concerned with the financing of the sector's development . . . consequently the efficacy of these measures and instruments can only be gauged by analysing the characteristics of industrial financing and the importance of the contribution made by each of the principal sources of funds."
>
> ECLA: The Process of Industrial Development in Latin America

I. INTRODUCTION - THE PROBLEM

1. It is generally recognized that a lack of adequate financing for industries is an obstacle to industrial development in many developing countries. This situation is reflected mainly in a shortage of available financial resources, inadequate institutional arrangements to channel the resources available into investment in industry, and as a consequence a high cost of financing.

2. It is because of this situation that assistance with financing has proved to be a powerful incentive measure in many developing countries. The incentive effect depends both on making adequate financial resources available and on providing better terms and conditions than would otherwise be available.

II. SURVEY OF ISSUES RAISED

3. The issues raised in the paper can therefore be discussed under the following three headings:

(A) The mobilisation of a sufficient volume of finance for the industrial sector;

(B) The channelling of these resources into industrial projects through appropriate institutional arrangements, and the opportunities for creating incentives which result;

(C) The improvement of the terms and conditions of the financing supplied as an incentive measure;

(D) The selection of enterprises to benefit from this assistance;

A. Mobilisation of a sufficient volume of finance for the industrial sector

4. The development of the industrial sector in many developing countries is handicapped by difficulties in mobilising a sufficient volume of finance. In some cases this reflects a general shortage of savings within the country and is an experience shared by other sectors. In other countries, policies and institutions have not been adopted rapidly enough to meet the growing requirement for finance which an expanding industrial sector requires. In this situation the industrial sector frequently suffers more than other sectors because it relies more heavily on the mobilisation of private savings for its development. Where there is such a general shortage of finance for the industrial sector, the mere availability of finance for a project can act as an incentive measure.

5. A number of the Country Background papers show that governments have allocated an increasing proportion of the nation's investment resources (for example, as outlined in the Development Plan) for the financing of industrial development. Some of these funds can be generated by the industrial sector itself; the proportion depends on the stage of industrialization reached and varies greatly from country to country. But the remainder has to be raised from other sources. The issue arises: have developing countries made sufficient provision for the mobilisation of a rising proportion of national investment for the industrial sector to permit it to accelerate its growth?

6. Some countries who are dissatisfied with the amount of private savings which are mobilised for industrial investment by their existing institutional arrangements, have supplemented the available funds by government action. This action has taken various forms, such as a direct allocation from the budget for investing in selected projects, financial support for the capital market, and rediscounting of finance provided for industry by the Central Bank. The issue arises: to what extent can these forms of assistance be used to provide a sufficient volume of finance? What criteria should be used to select the form(s) chosen?

7. One way of increasing the volume of finance available in an appropriate form is to mobilise finance abroad for the industrial sector. In some of the countries studied in the Background Papers (for example India and Turkey)

part of the financial assistance from foreign governments has been channelled into the industrial sector. A wider range of countries recognise that private foreign investment in industry is useful both to supplement the nation's savings and to bring other benefits. The issue raised here is: to what extent can foreign financial resources be used to supplement domestic resources for industrial investment? [1]

B. The channelling of financial resources into industrial projects

8. Besides requiring a certain volume of finance, the industrial sector requires that this finance be made available in various forms. The new industrial enterprise, or the expansion of an existing one, requires equity capital and long-term loans to finance the purchase of fixed assets. To finance inventories and working capital requirements, short- or medium-term loans are needed. And even before the plant is constructed it may require a certain amount of pre-financing (i.e. loans to carry it over the period until permanent financing is arranged.). The issue arises, therefore, is the problem of mobilising sufficient finance also one of making funds available in the appropriate form?

9. In most developing countries this is a question of developing appropriate institutional arrangements for mobilising finance in the right form. Industrial projects established in the private sector are the main sources of demand for equity capital and long-term loans. The Country Background Papers show that lack of availability of finance in these forms has held up expansion of the industrial sector. The issue therefore arises: can the provision of (a) equity capital and (b) long-term loans act as a useful incentive measure? What is the respective role of each type? Are the two types complementary?

10. When a developing country embarks on a programme of industrialisation for the first time the existing institutional arrangements are usually not well adapted to supply these two important forms of finance. The commercial banks are used to finance trade and similar transactions

---

1) Measures to Facilitate Foreign Investment are discussed in a later issue paper (ID/WG/30/9).

which can be satisfied with short-term or revolving loans. Equity capital, if it is available at all, must result from the accumulation of profits derived from other activities such as agriculture, trade real estate, etc. The issue arises therefore: can new institutional arrangements to mobilise finance for the industrial sector in the appropriate forms result in the provision of finance as an incentive measure?

11. The Country Background Papers show that most of the developing countries whose experience has been studied have established at least one industrial financing institution to supply long-term loans; to a greater or lesser extent these industrial development banks are willing to provide some equity capital for new projects. A more limited range of countries has established a capital market or stock exchange to mobilise equity capital. Some countries (e.g. Iran and India) have used tax incentives to encourage a wider share ownership among the public. The issue arises therefore: can specially designed incentives be used to encourage share ownership and increase the supply of equity capital?

12. Besides these more traditional forms of institutional arrangements, other techniques have been devised to assist in the mobilisation of funds for the industrial sector. Turkey, for example, has found it necessary to establish a special institution to provide working capital for industrial enterprises; other countries have relied on government influence to persuade the commercial banks to invest a sufficient proportion of their resources in this way. In some countries commercial banks have been willing to provide some medium-term loans for industry; in others the rediscounting facility of the Central Bank has been required to encourage this form of lending. The issue arises therefore: to what extent can the adapting of institutional arrangements or other techniques facilitate the provision of assistance with financing as an incentive measure?

C. Improvement of terms and conditions

13. Industrial projects in some countries may be deterred not so much by the lack of availability of finance, but by the high cost, the short maturity period over which it must be repaid, and the security required by the lending agency. Assistance with financing can act as a useful incentive measure if these obstacles are overcome.

14. The high cost of finance, reflecting a general shortage of funds, means that the cheaper financing offered to selected enterprises serves as a powerful incentive. In the Republic of Korea, priority industries have been offered long-term loans at 12% instead of 24% charged by the commercial banks; in Argentina loans from the Industrial Bank have been at concessional rates and for longer maturities than otherwise available. In Turkey, loans to priority projects from the Government's Promotion and Encouragement fund will be at or below 9%, compared with 15% to 20% range applicable to bank borrowing. The issue arises then: to what extent can the Government use loans at favourable interest rates to divert investment into key industrial projects? What criteria should be used in setting the rate of interest charged?

15. For most lending institutions, the long-term type of finance required by an industrial enterprise is an unfamiliar type of financing. The Background Papers show that in most countries, the period for which loans are granted (5-10 years) is generally shorter than is normally the case in industrially advanced countries. This is particularly true in countries subject to chronic but variable rates of inflation. The issue arises: is this unwillingness to extend maturity dates due to unfamiliarity with the nature of the investment, fear of changing conditions, the threat of inflation or other factors? Where maturities are lengthened, is this a valuable incentive?

16. The nature of the risk of investing in a new or expanding industrial enterprise also seems to be exaggerated by some lending institutions in developing countries. The Country Background Papers give several examples of cases where security requirements prevent the financing of some projects by leaving too high a proportion of the funds required to be put up by the entrepreneur himself. The issue arises: can less strict security requirements in an institution's lending policy be a useful incentive in its own right?

17. Finally the role played by foreign sources of finance might be considered. Where finance is provided by an international institution (e.g. The World Bank, IFC or the Inter-American Development Bank) long-term loans are often available at a rate of interest much lower than that prevailing in the recipient developing country. Medium-term financing (up to 5-7 years) is also available under the export credit schemes of

many industrially advanced countries. The issue arises: can the Government (which usually has to guarantee and/or approve such loans) use such sources as an incentive resource to promote priority projects?

D. The selection of enterprises to benefit from this assistance

18. Some developing countries have consciously used assistance with financing as an incentive measure to promote the development of priority projects. In other countries the allocation of funds is performed by a financial institution controlled by the Government. In other cases the institution may be privately controlled. The issue arises: how does the Government ensure that the incentive effect assistance with financing is directed to priority projects[2] ?

III. SUGGESTED ISSUES FOR DISCUSSION

19. A wide range of issues have been raised in this paper. In order to make the session devoted to this subject of maximum value, it is suggested that discussion might concentrate on the following issues:

To bring out the experiences of the countries represented at the Seminar, participants might indicate:

a) whether an insufficient volume of funds for investment in their country has held back the rate of industrial development;

b) whether there has been a shortage of certain types of financing in their country;

c) what institutional arrangements have been made to attract more funds into the industrial sector;

d) which institutions or techniques offer assistance with financing as an incentive measure,

e) whether the incentive effect depends on i) the availability of funds, ii) their cost, iii) the maturity of the loan, iv) a relaxation of security requirements.

More general points which might be discussed are:

f) what role can assistance with financing play as an incentive measure?

g) what steps can be taken to make assistance with financing a more effective incentive measure?

---

2) The criteria for selecting priority projects are not considered here but in the Issue Paper Criteria for selecting industries qualifying for incentive benefits ID/WG/30/11.

20. I. 72