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Background paper

MEASURES TO INCREASE COMMERCIAL BANK FINANCING OF INDUSTRY IN DEVELOPING COUNTRIES 1/

by

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1/ The views and opinions expressed in this paper are those of the consultant and do not necessarily reflect the views of the secretariat of UNIDO.

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II. CENTRAL BANK ACTIVITIES TO INDUCE MORE LENDING TO INDUSTRY

11. Discount rates and reserve requirements are widely used by central banks to influence lending by commercial banks. These tools are used primarily for purposes of monetary policy. However, they can be adapted for use in assisting industrialization.

12. The level of the discount rate, the sector of the economy in which the discounted paper originated, the maturity of the discounted paper as well as the volume of the paper discounted can be used to channel more funds of the commercial banks into loans to industry.

13. However, reliance on the central bank discounting operations to channel more funds into industry may be of rather limited use in some countries. In a number of countries, commercial banks do not avail themselves of the discounting mechanism to any great extent. This may be due to policy on the part of the central bank which views unfavourably the extended use of its discount facilities. The relatively small use of such facilities may also be due to the high discount rate. Another factor may be the small amount of paper eligible for discount. That a change in the discount rate can be effective in developing countries in influencing borrowings from the central bank by commercial banks is illustrated by events in Nigeria. While those events relate to produce, not to manufactures, they do illustrate the effectiveness of the discount mechanism.

14. During the marketing season of 1963-1964, the Central Bank of Nigeria refinanced produce bills at 2 3/4 per cent. This was half the discount rate charged by the commercial banks. Thus, those banks had a strong incentive to refinance heavily throughout the season. During the 1964-1965 season, however, the central bank increased the refinance rate by 1 3/4 per cent to 4 1/2 per cent. But the commercial banks' discount rate for produce paper under the produce marketing scheme increased by only 1/2 per cent to 6 per cent. The smaller spread between the central bank's refinance rate and the commercial banks' discount rate induced the latter banks to hold bills to maturity. Thus, in the three months, October-December 1963, the Central Bank refinanced £15,872,000 of commercial paper. But in the comparable months a year later the refinancing dropped to £4,910,000.5/

5/ Including paper submitted by acceptance houses. (Central Bank of Nigeria, Annual Report and Statement of Accounts, for the year ended 31 December 1964, Lagos, 1965, pp. 47-48).

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15. To a considerable extent, in order to be effective, the discount mechanism depends on the initiative of the commercial bank. To bolster the discount mechanism, the central bank may take supplementary measures that do not depend on the initiative of the commercial bank. Thus, a preferential discount rate may try to pull a commercial bank's loans in a particular direction; central bank reserve requirements or credit guidelines may push those loans in the desired direction. Probably using a combination of different techniques available to the central bank, rather than using one device, would provide the best results.

Commercial bank discounting of paper at the central bank

16. As an inducement to lending to industry, the central bank can give preference to discounting of paper originating in manufacturing. The central bank's preference could take one or more of several forms. One form could be the imposition of a lower discount rate on paper originating in manufacturing. Another form of preference might permit discounted paper originating in the manufacturing sector to have a longer maturity than in the case of other paper ordinarily eligible for discounting at the central bank. Another type of preference might provide that, during periods of stringency, when the central bank refuses to discount paper, it might, nevertheless, discount paper originating in manufacturing up to specified limits.

Preferential discount rate

17. In many developing countries, the central bank imposes a different discount rate on different types of eligible paper, including industrial paper. The latter does not always receive a preferential rate. Indeed, in Colombia the central bank's discount rate on paper relating to some industrial purposes is the highest of ten rates. A preferential rate for industrial paper does not necessarily accomplish the purpose for which it was designed. The differential between the rate for industrial paper and other rates may be an important factor. The necessary spread between that rate and other rates in a country in order for the industrial paper rate to accomplish its purpose would depend on the situation in that country. The central bank can test for the optimum level by making

small changes in the rate over a period of time. The optimum rate would be the one that would result in the percentage of lending to industry by the commercial banks desired by the Government. The optimum rate would differ from country to country and probably from period to period.

Country examples of multiple discount rates

18. In India, the Reserve Bank makes advances to banks for marketing and production activities of cottage and small-scale industries at 1.5 per cent below bank rate.[6/] (The data in this section are summarized on the next page in table 1.)

19. The Bank of Thailand discounts to commercial banks at 5 per cent eligible paper arising from sales of industrial products by manufacturers, from the procurement of raw materials for industrial purposes (and also paper arising from export operations). For a number of years, that rate has been below the standard discount rate, 7 per cent, which, however, is only nominal since it actually has not been used for several years.[7/]

20. In Turkey in 1964 the central bank changed its monetary policy in order to ease further the availability of credit to those industries which had priority for economic development. For those branches of industry given priority by the State Planning Organization, the Committee for the Regulation of Bank Credits reduced from 10.5 per cent to 9 per cent the maximum rate of interest charged by commercial banks for industrial credits provided from resources obtained by rediscounting at the Central Bank. Simultaneously, the related rate of rediscount on industrial bills was lowered from 7.5 per cent to 5.25 per cent. But the credits which the commercial banks give from their own resources to the priority industries are subject to the normal rate of interest. Exports of manufactured goods are governed by the same interest rates as apply to priority industries. Maximum

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6/ International Financial Statistics, (Washington), May 1966, p. 162.

7/ Ibid., p. 278. See also Rodrigo Jaramilla, "Central Bank Discount Rates" in International Monetary Fund, Staff Papers, (Washington), March 1966, p. 117.

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Table 1

Central Bank Discount Rates to Commercial Banks, 1966

Country	Central Bank Discount Rate Relating to Industrial Paper Submitted by Commercial Banks	Other Discount Rates of Central Bank to Commercial Banks
El Salvador	4.00 per cent. (Same rate applies to agricultural paper.)	6.00 per cent (for commercial paper). (There is also a rate, 6.1 per cent, on advances to banks against securities issued or guaranteed by the central government. There is also a rate for bills resulting from credits granted against mortgage bonds and other rates for advances to banks under specified circumstances.)
Paraguay	4.00 per cent. (Same rate applies to cattle ranch paper.)	3.50 per cent (for agricultural paper). 6.00 per cent (for commercial paper).
Uruguay	4.00 per cent (for eligible commercial paper related to industrial equipment, raw materials and fuels; same rate for import bills for machinery, raw materials, fuels and other goods. Same rate for eligible commercial paper related to primary food products, agricultural equipment, fertilizers and others).	3.00 per cent (for meat packing). 6.00 per cent (for other commercial operations). (There are other rates against government securities and discounts of central and local government debt.)
India	1.50 per cent below bank rate. (This lower rate is for advances for production and marketing activities of cottage and small-scale industries. This lower rate also applies to medium-term loans for agricultural purposes.)	6.00 per cent. (This is Bank rate, the standard rate at which the central bank makes advances to scheduled banks against commercial paper and government securities.) 2.00 per cent below bank rate. (Used in advances to banks for seasonal agricultural operations and marketing of crops.) Treasury bills are discounted at a rate .031 higher than the average discount earned on the bill at the weekly auction.

Table 1 (continued)

Country	Central Bank Discount Rate Relating to Industrial Paper Submitted by Commercial Banks	Other Discount Rates of Central Bank to Commercial Banks
Thailand	5.00 per cent (for eligible paper arising from sales of industrial products by manufacturers, procurement of raw materials for industrial purposes. Same rate also applies to eligible paper arising from export operations).	7.00 per cent. (This is the standard discount rate. However, this is only nominal since it has not been used for several years. 3.62 per cent - 4.62 per cent (rates at which treasury bills which commercial banks bought directly from the Bank of Thailand can be discounted at that bank).
Turkey	5.25 per cent. (Same rate applies to agricultural and export bills.)	7.50 per cent. (This is the basic discount rate at which eligible paper is discounted.)
Colombia	7.00 per cent (for paper resulting from industrial "Development Loans". "Development Loans" also include agricultural and cattle raising loans. The rate on "Development Loans" is 2 per cent below that charged by the original lender). 9.00 per cent (on paper resulting from other industrial loans).	0-8.00 per cent. (Altogether the central bank quotes ten different rates: from no charge for financing of technical studies to the 9.00 per cent listed in the preceding column.)

Source: International Monetary Fund; Central Bank of the Republic of Turkey.

interest rate for credit in general is 10.5 per cent and the related rediscount rate is 7.5 per cent. In a related move at the same time, the Committee reduced reserve requirements based on time deposits from 20 per cent to 10 per cent in order to provide more funds for bank lending generally.[8/]

21. In El Salvador, the discount rate on industrial (and agricultural) paper has been 4 per cent since August 1964. This compares with the 6 per cent rate on commercial paper, which appears to be the only other type of paper eligible for discounting at the central bank. The one-third differential between the discount rate on commercial paper and industrial (and agricultural) paper represents the largest preference the latter has been shown in that country. Between 1948 and April 1957, commercial paper was apparently the only eligible type. During the period August 1957-August 1964, the discount rate on industrial (and agricultural) paper was generally 1 per cent less than the rate on other paper. However, for several years there was no differential in rate.[9/]

22. In Paraguay, since December 1953, the central bank's discount rate for industrial paper (and for cattle ranch paper) has been 4 per cent. This is considerably below the discount rate of 6 per cent for commercial paper but is not as preferred a rate as the 3.5 per cent for agricultural paper. Prior to May 1954, the discount rate was 3.5 per cent regardless of the origin of the paper.[10/]

23. In Uruguay, the Bank of the Republic discounts at 4 per cent eligible commercial paper related to industrial equipment, fuels, raw materials, primary food products, fertilizers, agricultural equipment and other items. That rate, the discount rate, is also used in the case of import bills for machinery, fuels, raw materials and other goods. The 4 per cent discount rate is a preferential rate compared to the one for other commercial operations (6 per cent) but is not as advantageous a rate as that for meat packing (3 per cent).[11/]

8/ Central Bank of the Republic of Turkey, Reports of the Board of Directors. (Ankara, 1965), pp. 62, 64-65; Central Bank of the Republic of Turkey, Bulletin Mensuel (Ankara), April-June 1966, p. 57.

9/ International Financial Statistics, May 1966, p. 113.

10/ Ibid., p. 236.

11/ Ibid., p. 303.

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24. In contrast to the above examples, of the ten different rates quoted by the Bank of the Republic in Colombia for its "ordinary quota" rediscount operations with commercial banks, the paper relating to some industrial purposes other than "Development Loans" carries the highest rate, 9 per cent. The central bank has ten different rates for these operations with commercial banks; these rates range from no charge for the financing of technical studies to the 9 per cent noted. Apparently, the most widely used rate is that for commercial paper, 8 per cent. Paper relating to "Development Loans" (industry, agriculture and cattle raising) carry a rate 2 per cent lower than the rate stipulated on the rediscountable paper. It appears that the rediscount rate on such loans has been 7 per cent since the last half of 1964. During approximately the preceding four calendar quarters, the rate apparently was 6 per cent. As an illustration of another rediscount rate, in July 1966 the rediscount rate on secured bonds (bonos de prenda) was 4 per cent; this was 1 per cent more than at the end of the preceding month.[12/] Aside from these rates on "ordinary quota" rediscount operations, on "special quota" rediscount operations the central bank charges the commercial banks the same rate as the commercial banks charge for loans.

Quotas and maturity of discounted paper

25. A number of countries regulate the volume of commercial bank discounting at the central bank through devices other than, or in addition to, the discount rate. Among these other techniques are ceilings on the amount a commercial bank may discount at the central bank and the maturity of the paper eligible for discounting. In some countries the amount that a commercial bank may discount varies with the type of paper submitted for discounting. Thus, in Chile and Spain, preference is given by the central bank to paper relating to particular types of exports.[13/] In Uruguay, a commercial bank may discount paper relating to agriculture and cattle raising up to 50 per cent of the bank's capital and reserves; this contrasts with a discounting quota of up to 30 per cent for commercial paper.[14/] With reference to influencing the volume of discounting by varying the eligible maturity of paper submitted for

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12/ Ibid., January 1967, p. 87; Bank of the Republic, Statement of Condition (Bogota), July 31, 1966; Bank of the Republic, Revista del Banco de la Republica (Bogota), July 1966, p. 865; August 1966, p. 1009.

13/ International Financial Statistics, February 1967, pp. 79 and 263.

14/ Ibid., p. 305.

discounting, Costa Rica, for instance, permits discounting of industrial and some other paper with a maturity of up to one year; but commercial paper is eligible for discounting only if the maturity is up to six months.15/

26. Similarly, in Venezuela, agricultural and related paper with a maturity of up to one year may be discounted; but here, too, commercial paper with a maturity only up to six months is eligible for discounting.16/ In Pakistan, commercial banks may discount at the central bank bills with a maturity of up to five years if the bills are drawn and issued for financing industrial and agricultural development. But paper for other purposes is eligible for discounting only if it matures within ninety days (government securities and trade bills; 180 days for foreign bills) or within fifteen months (for seasonal agricultural and crop marketing purposes).17/

27. The period for which central banks discount paper also varies among countries. In East Africa, for instance, commercial paper submitted for rediscounting may be rediscounted up to a maximum of five years, if the credits "are designed to finance investment projects included in the development plan of the interested member country or to promote the export of industrial products".18/

28. In France, paper may be rediscounted up to seven years.19/ In the United States, where paper is typically discounted for no more than fifteen days, it has been suggested that the period of discounting should be extended.20/

29. It would appear practicable for central banks to apply these techniques to encourage commercial bank lending to industry. Thus, quotas for discounting industrial paper may be made greater than for other types of paper. Similarly, in the many countries where discounting at the central bank is a privilege and not a right,21/ special quota preference may be provided for industrial paper. In terms of the maturity of eligible paper, industrial paper with longer maturity may be made acceptable. Conversely, central banks may rediscount industrial paper for longer periods than other paper.

15/ Ibid., p. 90.

16/ Ibid., p. 308.

17/ American Banker, (New York), 28 December 1966, p. 8A.

18/ "Comparative Digest of African Central Banking Legislation", (United Nations, E/CN.14/AMA/7, 15 December 1965), appendix II, p. 4.

19/ Conseil Economique et Social, Conjoncture Economique (Paris), Deuxième Semestre 1965, Rapports, p. 17.

20/ The New York Times, 1 September 1966, p. 47.

21/ International Financial Statistics, February 1967.

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III. RESERVE REQUIREMENTS

Reserve requirements according to type of asset

30. Some countries have successfully used reserve requirements to influence lending by commercial banks. Usually, the reserve requirements are based on deposits. However, in Rhodesia for example, the central bank may establish reserve requirements based on the total amount of loans and advances granted and bills discounted by the commercial banks and may also establish reserve requirements based on deposits.22/

31. For purposes of industrial development, a commercial bank could have a lower reserve requirement against deposits if its loans to industry equal or exceed a specified percentage of its assets for a specified period of time. Alternatively, perhaps, a bank meeting the prescribed conditions of a lower reserve requirement might be given the option, as in Mexico, of reducing its required holding of government securities.23/ In a number of countries, such as Brazil, Chile and Nicaragua, banks are required to hold specified amounts of such securities or may do so as a substitute for partially holding other types of required reserves.24/ For providing loans to industry above the minimum "reserve requirement reduction threshold", the bank could be permitted a further reduction in required reserves according to a schedule that would show how much reserve requirements could be lowered as the percentage of loans to industry increased.25/ To prevent a possible excessive amount of lending to manufacturers, the schedule could have a ceiling on the percentage of loans to industry; above the ceiling there would be no further reductions in the required reserves.

22/ "Comparative Digest of African Central Banking Legislation", (United Nations, E/CN.14/AMA/7), Appendix XII, p. 2.

23/ Robert L. Bennett, The Financial Sector and Economic Development, The Mexican Case, p. 50.

24/ Frank Tamagna, Central Banking in Latin America, (Centro de Estudios Monetarios Latinoamericanos, Mexico City, 1965) p. 162

25/ A somewhat similar suggestion, not specifically related to industrial loans, has been made for the East African countries of Tanzania, Kenya, and Uganda. (Donald C. Mead, "Monetary Analysis in an Underdeveloped Economy: A Case Study of Three East African Territories". Yale Economic Essays, (New Haven), Spring, 1963, pp. 66-67.)

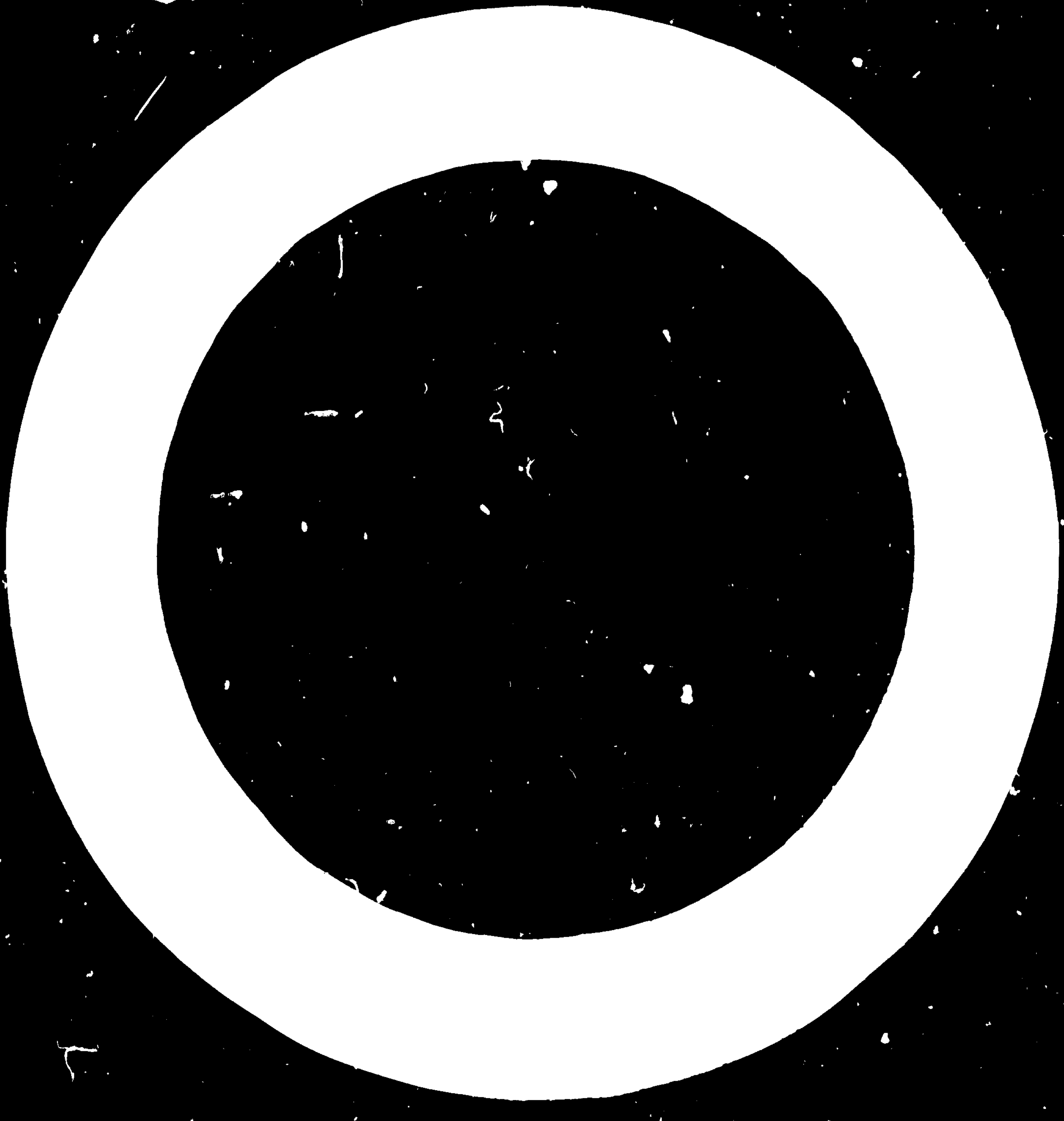
32. In some countries, such as Colombia, Greece, Israel and Mexico, guidelires have been set as to the type of lending a commercial bank should provide. The use of guidelines in these countries has been effective in shaping the direction that commercial bank investments have taken.[26/]

33. In Israel, the guidelines are combined with reserve requirements against deposits. The central bank requires the commercial banks to maintain reserve requirements of 65 per cent of deposits. However, 25 per cent of deposits may be released for purposes specifically approved by the central bank.[27/] Priority is given to export credits for industry and agriculture as well as tourism. Other approvals of loans to industry are based on such factors as employment expansion in development areas.

34. In Greece, banks with liabilities exceeding Dr 1,000 million (equivalent to $US33.3 million) are required to invest a minimum percentage of all drachma deposits of the private sector in medium and long-term loans to specified branches of the private sector: manufacturing, mining, handicrafts and tourism. The minimum required percentage rose from 10 per cent beginning June 1957 to 15 per cent in August 1959, at which level it has remained. A bank that does not fulfil the requirements must deposit an amount equal to the deficiency in a special account in the Bank of Greece. These special deposits earned 3 per cent annually prior to September 1966 and 2 per cent beginning 1 September 1966. However, prior to that date, if the deficiency was due to a shortfall in demand, a bank could invest in government treasury bills the amount equal to the deficiency. But, beginning 1 September 1966, this alternative was eliminated. The effectiveness of these regulations is indicated by the increase in long-term loans by commercial banks in Greece, as noted below under "Term loans by commercial banks", paragraph 50 and table 5.

26/ In Israel, the high liquidity reserve requirements have resulted, with the knowledge of the central bank, in circumventing those requirements to some extent. This is accomplished through "bill brokerage". Under this arrangement, the commercial banks do not lend funds but act as brokers between borrowers and lenders. The commercial banks guarantee that the borrowing firm will repay the bills and promisory notes. (American Banker, New York, 14 December 1965, p. 5A).

27/ Ibid., pp. 5A, 8A; American Banker, 28 February 1967, p. 55A.



35. In Colombia, beginning in 1951, the central bank required commercial banks to maintain, aside from the basic reserve requirement, a marginal reserve of 40 per cent; this marginal reserve was based on increases in deposits. As an alternative to maintaining the marginal reserve requirement, the commercial banks could hold half of those reserves in loans to industry with a maturity of up to five years; 20 per cent of the reserves could be in agricultural and cattle financing; the remaining part could be in other productive credits. From time to time, the marginal reserve requirement has been changed as well as the composition of the alternative loans.[28/] Beginning in February 1966, the marginal reserve requirements were eliminated. The February 1966 changes, made to channel increases of bank credit into development, also stipulated that in order to avoid penalties, a commercial bank is required to maintain in development credits a minimum of 36 per cent of its portfolio on 31 December of the immediately preceding year.[29/] As in the case of Greece, the central bank stipulations regarding the channelling of bank funds into long-term loans have been effective, as indicated below in paragraph 52.

Reserve requirements in Mexico

36. In Mexico, guidelines direct the banks as to what percentage of loans and investments are to be made in broad sectors of the economy. The Bank of Mexico has set reserve requirements of 100 per cent that commercial banks must maintain against new demand and time deposits. However, a commercial bank may waive these requirements if it invests its new deposits in loans, credits and investments in proportions established by the Bank of Mexico as indicated below in table 2. Thus, as of 30 April 1966, 12.5 per cent of new demand and time deposits in pesos could be invested in medium-term loans, 2.5 per cent in secured industrial loans, 5 per cent in industrial securities, and so forth. Approved percentages of investment were also applied to new deposits in foreign currency and to new savings deposits.

28/ F. Tamagna, Central Banking in Latin America, p. 167.

29/ International Monetary Fund, International Financial News Survey, (Washington), 18 March 1966, p. 91.

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37. The policy of prescribed loans, credits and investments, first authorized in Mexico in 1949, has been very effective in increasing the banks' investment in government securities, and fairly effective in increasing loan maturities. However, it does not appear that the banks' assets in loans, credits and investments in industry have significantly increased compared to financing of other sectors. For example, at the end of 1948, commercial banks held 564 million pesos (equivalent to $US82 million) in loans to industry and 5,514 million pesos (equivalent to $US460 million) in loans to commerce. At the end of 1965, those banks held 5,763 million pesos (equivalent to $US461 million) in loans to industry and 5,750 million pesos (equivalent to $US460 million) in loans to commerce. Thus, the increase between 1948 and 1965 in loans to industry, 5,199 million pesos, was almost the same as - in fact somewhat less than - the 5,236 million increase to commerce.[30] But the guidelines apparently were not drawn up with such fine distinctions of sectoral investment in mind except for the above-mentioned relatively small investment of new demand and time deposits in industry and the relatively small investment of new savings deposits in industry as shown in table 2. Since 1959, savings deposits have increased rapidly and substantially with the result that this investment requirement relating to savings deposits has become more important. Data relating deposits to investments in industrial securities are not available. Presumably, the guidelines could successfully put more emphasis on financing industry.

Mexican commercial bank holding of government securities

38. That reserve requirements tied to investments can be highly effective in a developing country is demonstrated by the increased holdings of government securities by the Mexican commercial banks. Prior to 1954, Mexican deposit and savings banks[31] bought only small amounts of government securities. However, during the years 1955-1959, those banks used one fourth of their new funds to buy those securities.[32] As shown in table 3 below, holdings of government securities fell

30/ Banco de Mexico, Informe Anual (Mexico City), 1965, p. 76 and 1950, p. 127.

31/ These are commercial banks; they have savings as well as commercial departments.

32/ R. Bennett, The Financial Sector and Economic Development. The Mexican Case, p. 75.

Table 2

Mexico commercial bank reserve requirements against new deposits, 30 April 1966[a/]

(per cent)

Type of required reserve	New demand and time deposits					New savings deposits				
	In domestic currency			In foreign currency		In domestic and foreign currency			In domestic currency	
	Circ. b/ 1389		Circ. 1470	Circ. 1493		Circ. 1310	Circ. 1287		Circ. 1469	
	Federal district	Other areas	All areas c/	On 8 Jan. '55 level	Above 8 Jan. '55 level	On 31 Aug. '55 level	On 36% above 31 Aug. '55 level	On additional deposits	On 50% above 1 June '63 level	On additional deposits
Credit Reserves										
Medium-term loans (up to 5 years)	12.5	12.5	15	-	-	-	5	5	5	5
Secured Industrial Loans	2.5	2.5	-	-	-	-	-	-	-	-
Production Loans	5.0	25.0	25	-	-	-	-	-	-	-
Credit for export of manufactures	-	-	-	-	20	-	-	-	-	-
Short-term loans (90 days)	-	-	-	-	-	-	10	-	-	-
Distribution of Consumer Goods	-	-	25	-	-		-	-	-	-
Low-cost Housing Loans	-	-	-	-	-	-	-	-	50	30
Securities Reserves										
Industrial securities	5.0	5.0	5	-	-	-	37.5	10	13	13
Federal Government securities	25.0	10.0	20	5	55	-	37.5	10	2	2
Other official securities	10.0	-	-	-	-	-	-	-	-	-
Cash Reserves										
On deposit in Bank of Mexico	15.0	15.0	10	20	25	10	10	10	5	5
Freely Investible	25.0	30.0	-	75	-	90	-	65	25	45

a/ Based on official sources.

b/ "Circ." refers to circulars of the Bank of Mexico.

c/ Applies only to time deposits over specified amounts and of more than ninety days which pay no more than 6 per cent interest.

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Table 3

Annual net increase in holdings of government securities by the Mexican "deposit and savings banks", annual net increase in demand plus time deposits in those banks, and the net increase in government securities, 1946-1948, 1961-1965

	1946-1948			1961-1965				
	1946	1947	1948	1961	1962	1963	1964	1965
A. Net increase of decrease in holdings of government securities (millions of pesos).	-13	25	-11	318	550	960	1,294	405
B. Net increase or decrease in demand plus time deposits (millions of pesos).	-165	-32	169	639	1,634	2,348	2,648	1,202
C. "A" as per cent of "B".	8%	-	-	50%	34%	41%	49%	34%

Source: Banco de Mexico, Informe Anual.

Note: Data are not available on distribution of assets and deposits according to location of banking offices in or out of Mexico City.

in 1946 and 1948. The decrease in the latter year occurred in spite of the net increase in deposits. (There were also decreases in holdings of government securities in 1951, 1952 and 1954. Those declines also took place despite increases in deposits.) But between the years 1961 and 1965, the smallest net increase was 34 per cent in holdings of government securities as a per cent of net increase in demand plus time deposits; generally the per cent net increase has been even higher. The interest yield on government securities has been considerably less since 1945 than the percentage yield on other assets. Consequently, the increased investment in government securities most probably has been primarily due to the high reserve requirements on increases in deposits.

Longer maturity of loans by Mexican commercial banks

39. The high reserve requirements also appear to have been important in channelling more of the "deposit and savings banks" funds into credits with longer maturities.

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Such provision of longer-term financing by banks can be of considerable importance to industry (chapter IV below deals with term loans). Table 4 below shows that in Mexico by 1964 loans with a maturity "over 360 days" had become the second largest category of credits to enterprises and individuals in contrast to being the smallest of five categories at the end of 1945. At that time, credits of "over 360 days" were slightly over 3 per cent of all credits to enterprises and individuals. At the end of 1965, credits of "over 360 days" were more than [illegible]1 per cent of all credits to enterprises and individuals. In fact, at the end of each year since 31 December 1951, credits of "over 360 days" have exceeded 10 per cent of all credits to enterprises and individuals. But it should be noted that as early as 1946 the share of loans with a maturity of "over 360 days" was already increasing prior to the imposition of high reserve requirements. So, while it cannot be stated conclusively, it is probable that those requirements were instrumental in influencing the banks to reach the high percentage of credits of "over 360 days" that they had at the end of 1965.

40. None of the other four categories of credit maturities increased as rapidly, in percentage terms, between the end of 1945 and the end of 1965 as did credits with a maturity of "over 360 days". Indeed, over that twenty-year period taken as a whole, the longer the maturity of the credit the greater the percentage increase in credit provided by the "deposit and savings banks".33/ However, on a year-to-year basis, longer maturities did not always show the greatest increase. In pesos, the increase between 31 December 1945 and 31 December 1965 in the "over 360 days maturity" was exceeded only by the increase in credits with a maturity of 91-180 days.

33/ Even if some different base year and final years are used to test the percentage of growth in the five different maturity categories, the credits for "over 360 days" increased faster than the others. Thus, the "over 360 days" category showed the most rapid percentage increase not only between 1945 and 1965 but also, for example, between 1945 and 1964, between 1946 and 1962, between 1947 and 1962, between 1948 and 1963, and between 1948 and 1964. However, as noted in the next sentence in the text, further testing of different base years and final years did not always result in credits of "over 360 days" growing faster than other credits.

Table 4

Mexico: "Deposit and savings banks'" credits to enterprises and individuals classified by maturity, year-end 1945-1948 and 1961-1965

Maturity	Credits to enterprises and individuals as of 31 December										
	1945	1946	1947	1948	Per cent on 31 Dec. 1948	1961	1962	1963	1964	1965	Per cent on 31 Dec. 1965
	Millions of pesos					Millions of pesos					
Over 360 days	32.4	37.2	67.2	89.0	6	902.7	774.4	985.3	1,936.7	2,938.6	21
Up to 360 days	81.7	84.3	106.0	131.1	9	720.1	834.7	970.2	1,210.3	1,616.0	12
Up to 180 days	511.5	568.3	638.2	821.8	55	3,668.4	4,215.5	5,048.5	6,158.2	6,772.1	49
Up to 90 days	357.9	313.3	379.3	422.1	28	1,162.1	1,388.4	1,685.1	1,792.8	2,287.5	17
Up to 30 days	35.1	38.9	33.9	35.9	2	76.4	73.6	81.1	83.7	75.6	1
TOTAL	1,018.6	1,042.0	1,224.6	1,499.9	100	6,529.7	7,286.6	8,767.2	11,181.7	13,689.8	100

Source: Banco de Mexico, *Informe Anual*.

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IV. TERM LOANS BY COMMERCIAL BANKS

41. The longer the term of the bank loan the greater the risk of default by the borrower, and the greater the problem of liquidity for the bank. In addition, in countries where prices are likely to rise rapidly, the bank must take into account the potential depreciation in the value of the currency, especially for long-term loans.

Term lending by commercial banks acceptable

42. Yet, as long-term finance is industry's greatest finance problem, it would be well to re-examine traditional thinking regarding bank term loans. Traditionally, there has been a strong and widespread - but not universal - feeling against long-term lending by banks. This opinion has been based on the fact that since the major part of a bank's liabilities are payable on demand or on short notice, correspondingly the assets should also be short term. But re-examination of the traditional thinking indicates that banks are capable of holding long-term assets.[34/] a re-examination of that traditional thinking seems particularly useful in connexion with changes that may occur over time in a borrower's capabilities, central bank actions, and in a bank's capital structure, deposit composition, asset liquidity and prospective inflow of funds from repayments of bank loans. In the early stages, when a bank is starting to make long-term loans, there will be little, if any, inflow from repayment of these loans. However, with the expansion of such loans and the passage of time, the repayment of loans becomes an important source of funds for the banks.

43. Even in countries with highly developed capital markets only larger enterprises have access to those markets. In many developing countries, there is no developed capital market. Thus, term loans by commercial banks may be even more important, relatively, in those countries than in developed ones.

34/ R.S. Sayers, Central Banking in Underdeveloped Countries. (Cairo, National Bank of Egypt, 1956) pp. 13-14; Robert W. Adler and Raymond F. Mikesell, Public External Financing of Development Banks in Developing Countries. (Eugene, Oregon, Bureau of Business and Economic Research, University of Oregon, 1966) p. 26; see also G.I. Williamson, The Role and Practices of Commercial Banks and Other Institutions Financing Development. (Cairo, National Bank of Egypt, 1965) pp. 9-10.

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44. Commercial banks in developing countries have dealt with the problem of providing long-term loans to subsidiary organizations in a variety of ways.[35] In some developing countries, banks have established subsidiary financing enterprises not subject to such strict regulation and control as the commercial banks themselves. In a few countries, as in Mexico, individual banks have organized their own individual subsidiaries which are permitted to provide long-term capital. In other countries, like the Republic of Viet-Nam and Brazil, groups of commercial banks have formed joint subsidiaries to provide long-term loans. However, loans provided by subsidiaries may result in interest and other charges that substantially raise the cost of credit.[36] A still different approach to forming specialized financial institutions capable of granting long-term loans has been taken by banks in several other countries. Among such countries, in Greece, for instance, such financial institutions have been established to provide long-term credit to industry with the help of financing provided not only by domestic commercial banks, but also by foreign financial institutions in developed countries.

45. Establishment of specialized financial institutions is not restricted to banks that are directly prohibited from making long-term loans. For example, in Greece, the two largest commercial banks have each set up, in combination with foreign financial institutions as noted, specialized financial institutions. Nevertheless, those two commercial banks also directly provide long-term loans to industry.

46. In many countries, even though loans may be nominally for a year or less, they are frequently renewed for another such period or more. This almost automatic "roll-over" of a loan makes it somewhat similar to a longer-term loan. But, of course, the basic feature of the assurance of a longer-term loan is missing. In the Republic of Viet-Nam, for instance, it has been suggested that it would be preferable for commercial banks to provide small industry with loans for a period of up to five years rather than to continue the present practice of providing short-term loans and then renewing them.[37]

35/ Commercial banks in developed countries, such as France and the Netherlands, have also formed subsidiaries to provide long-term loans. (Source: Henry Germain-Martin, "France" and A. Batenburg, S. Brouwer and D.W. Louman, "The Netherlands". Banking Systems, B.H. Beckhart, ed., pp. 249 and 622).

36/ "The Process of Industrial Development in Latin America", vol. 2. United Nations E/CN.12/716/Add.1, 15 December 1965, p. 76.

37/ Nguyen-huu-Hanh, "De l'élaboration d'une nouvelle politique de crédit", Bulletin Economique (Banque Nationale du Viet-Nam, Saigon), November-December 1965, p. 17.

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47. In many less developed countries it may prove inadvisable to change from the traditional thinking regarding the term of a loan. However, in a number of countries where long-held concepts about the place of industry have been revised, it may be appropriate to revise also, at least in part, the concepts regarding the appropriate term of loans to some industrial borrowers.

48. Where term loans to industry in a less developed country are deemed feasible, it may be appropriate to change the laws or regulations, if necessary, so that such loans may be granted.[38] It may be advisable to place a ceiling on the percentage of a bank's assets and deposits, or capital and reserves that a bank may make in term loans. It may also be advisable to place a limit on how much a bank may lend to any one borrower; such a limit may be in terms, for example, of the capital or net worth of the borrower. In Greece, as an example, the banks are allowed to invest up to 15 per cent of their total deposits in long-term loans. Beginning in 1962, the banks were also permitted to invest up to 5 per cent of their deposits in equities of new or expanding enterprises. This was in addition to previous investment in securities.[39]

49. There has indeed been widespread rethinking in recent years of the role of the commercial bank in connexion with long-term lending. This changed view, that the banks should provide such lending, has been accepted by many commercial bankers as well as by public officials. This acceptance has taken place in developed and developing countries. Furthermore, not only have term loans by commercial banks been deemed more acceptable but, as the following discussion shows, this view has been implemented by a substantial increase in term loans. Furthermore, such loans have increased not only substantially but rapidly. This indicates that in developing countries, too, the commercial banking system may be quite flexible and readily adaptable to new conditions and requirements. This has important and cautiously encouraging implications for industrial borrowers.

38/ "Proceedings of the Asian Conference on Industrialization". United Nations, E/CN.11/719, 10 January 1966, p. 77.

39/ Bank of Greece, Report for the Year 1962, pp. 76-77.

TABLE 5

Amount and per cent of loans and advances by commercial banks in Greece

31 December 1957-1958, 1962-1965

Amounts in millions of drachmas

	31 Dec. 1957	31 Dec. 1958	31 Dec. 1962	31 Dec. 1963	31 Dec. 1964	31 Dec. 1965
Loans of 5 years and more	18	153	1,378	1,965	2,493	2,437
Per cent of total loans and advances	0.2%	1.6%	7.7%	8.4%	9.7%	9.1%
Loans from 3 to 5 years	430	603	1,554	2,659	2,510	2,616
Per cent of total loans and advances	5.6%	6.4%	8.7%	11.4%	9.8%	9.8%
Loans from 1 to 3 years	1,516	2,136	3,788	5,259	5,779	6,144
Per cent of total loans and advances	19.8%	22.8%	21.3%	22.5%	22.5%	22.9%
Advances and loans up to 1 year	5,689	6,474	11,044	13,434	14,869	15,623
Per cent of total loans and advances	74.3%	69.1%	62.2%	57.6%	58.0%	58.3%
Total loans and advances	7,653	9,365	17,764	23,317	25,651	26,820

(Source: Bank of Greece, Monthly Statistical Bulletin)

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Recent growth in long-term loans in developing countries

50. In Greece, prior to 1957, the commercial banks gave no long-term loans to industry (nor, it seems, to any other sector). At the end of 1957, however, with the urging and indeed the pressure from the central bank,40/ the commercial banks held 18 million drachmas in long-term credits (five years and more). This, as shown in table 5 on the next page, was 0.2 per cent of all credits to all sectors by the commercial banks. Each year from 1957 through 1964 the percentage of the long-term loans of those banks increased. As a result, at the end of 1964, such loans accounted for 9.7 per cent of all credits by the commercial banks. As shown in table 7, long-term loans by commercial banks to "industry and mining" as a per cent of all loans by those banks to "industry and mining" also increased significantly between 1957 and 1964.41/ However, as shown in tables 5 and 7, at the end of 1965 there was a smaller amount of drachmas outstanding in all types of long-term loans than at the end of the previous year; the percentages outstanding were also smaller at the close of 1965 than at the end of 1964. This was also true of long-term loans to "industry and mining" as a per cent of total bank loans to that sector.

51. In the Republic of Korea, longer-term credits, called equipment loans, have been provided only since 1962 and are part of a drive to channel funds into industry. As shown in table 6 below, such longer-term loans increased rapidly after 1961 and by the end of 1963 accounted for over 6 per cent of commercial banks' total loans and discounts. However, by the end of 1965, the percentage had fallen to 3.4 per cent.

Table 6

Korea: commercial bank long-term loans for equipment funds, year-end 1961-1965

In million won

	1961	1962	1963	1964	1965
A. Long-term loans (loans for equipment funds)	0	1,194	1,384	1,378	1,269
B. Total loans and discounts	12,778	20,906	22,833	23,143	37,456
A as per cent of B	0	5.7%	6.1%	6.0%	3.4%

Source: Bank of Korea, Monthly Statistical Review.

40/ Bank of Greece, Report for the Year 1957, p. 61.

41/ The original data do not specify how many years "long-term" refers to with reference to loans to "industry and mining". They may be, perhaps, less than five years.

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52. In Colombia, at the end of 1953, long-term loans - those maturing in three years or more - by commercial banks were only 0.1 per cent of the total loans outstanding. Short-term loans, those maturing in less than 180 days, accounted for 90.0 per cent of the value of all loans held by those banks, and medium-term loans accounted for the remaining 9.9 per cent. In contrast, as shown in table 7, by the end of 1965, after a percentage increase in most of the intervening years, apparently at the urging of the central bank, holdings of long-term loans by the commercial banks comprised 7.2 per cent of all their loans; medium-term loans had declined to 75.8 per cent of all the banks' loans.

53. In Mexico also, as noted above in the section on "Longer Maturity of Loans by Mexican Commercial Banks" (paras. 39-40), credits of "over 360 days" provided by the "deposit and savings banks" have increased in recent years. The increase was from 3.1 per cent of credits to enterprises and individuals at the end of 1945 to 21.5 per cent at the end of 1965.

54. In Nicaragua, in recent years, loans for over eighteen months have accounted for approximately one third or more of commercial bank loans outstanding at year-end. At the end of 1965, long-term loans to "industry and mining" comprised somewhat over 7 per cent of all loans by commercial banks and almost 40 per cent of all commercial bank loans to "industry and mining".

55. In the Sudan, commercial bank loans for over one year ("medium- and long-term" loans) at the end of 1965 accounted for a smaller percentage of commercial bank loans than those outstanding at the end of 1961. At the end of 1965, loans for over a year comprised 15.0 per cent of all commercial bank loans outstanding. Complete data for "medium- and long-term" loans to industry are not available but it is clear that, at a minimum, such loans comprised at least 1.8 per cent of all loans outstanding by commercial banks and 9.5 per cent of all commercial bank loans to industry.

Reserve requirement according to type of deposit

56. Reserve requirements as related to a bank's asset distribution were discussed earlier. Along somewhat similar lines, reserve requirements could vary according to type of deposit. Thus, demand deposits, with a high rate of turnover, could have much higher reserve requirements than those relating to time or savings

Table 7

Recent growth of term loans outstanding by commercial banks in developing countries

	Maturity of "long-term" loan	Year-end	"Long-Term" Loans Outstanding: Amount Outstanding (millions)	"Long-Term" Loans Outstanding: Per cent of total credits outstanding by commercial banks	"Long-Term" Commercial Bank Loans to Industry as Per Cent of Commercial Banks: Total Loans	Total Loans to Industry
	(A)	(B)	(C)	(D)	(E)	(F)
Mexico	More than 1 year	1945	32 (pesos)	3.1%	N.A.	N.A.
		1964	1,937	17.3		
		1965	2,939	21.5		
Colombia	3 years and more	1953	1 (peso)	0.1	N.A.	N.A.
		1960	100	4.1		
		1964	297	6.7		
		1965	360	7.2		
Korea	N.A.	1961	0	0	N.A.	N.A.
		1964	1,378 (won)	6		
		1965	1,269	3		
Nicaragua 42/	More than 18 months	1961	24 (córdobas)	37.3	3.2%	18.8%
		1962	27	38.2	7.1	32.4
		1964	179	31.2	6.5	36.5
		1965	236	32.7	7.3	39.7
Greece 43/	5 years and more	1956	0	0	N.A.	0
		1957	18 (drachmas)	0.2		0.5
		1964	2,493	9.7		20.8
		1965	2,437	9.1		19.2
Sudan	More than 1 year 44/	1961	6.9 (LSd)	16.5	2.0 45/	17.3 45/
		1964	7.5	14.0	1.7 45/	11.4 45/
		1965	6.8	15.0	1.8 45/	9.5 45/

Source: Banco de la República (Colombia), Bogotá, Revista del Banco de la República; Bank of Greece, Monthly Statistical Bulletin; Bank of Korea, Monthly Statistical Review; Banco de Mexico, Informe Annal; Banco Central de Nicaragua, Informe Annal; Bank of Sudan, Economic and Financial Bulletin.

Note for statistics on India, see paras. 70-73.

42/ Columns "E" and "F": loans to industry include mining.

43/ Column "F": loans to industry include mining. The original data do not specify how many years "long-term" in column "F" refers to.

44/ "Medium and long-term" loans.

45/ These are minimum amounts. They are based on incomplete data relating to long-term loans to industry.

N.A. not available.

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deposits, which normally remain on deposit for considerably longer periods than demand deposits. Higher reserve requirements for demand deposits as against time and saving deposits is the normal[46/] country practice. However, it may be useful for central banks and the Government to review the spread in these requirements in the context not only of the monetary policy considerations with which they are usually connected, but also in the context of longer term loans to industry. The lower the reserve requirements, the greater the funds available for profit-making by the commercial bank. Furthermore, one of the basic criteria of the feasibility of longer-term loans to industry is the fluctuation in deposits in a bank. To protect its liquidity, and thus its ability to meet deposit outflows, a bank is able to lend with less risk on longer term if it knows with considerable certainty the maximum expectation of net withdrawals (new deposits minus withdrawals) that it can reasonably expect within a short period (of days or weeks).

57. Since time and savings deposits have a slower rate of turnover than do demand deposits, they can normally be expected to stay in the bank longer, thus enlarging the amount available for longer-term lending to industry. In Sweden, for instance, the ability of commercial banks to provide loans to industry without subjecting themselves "to undue liquidity risks, is very largely explained by the stability of deposits lodged with them".[47/] But increases in time and saving deposits will not necessarily assure increases in longer-term loans to industry. To increase the propensity of banks to make such loans, measures to encourage increases in longer-term deposits would have to be supplemented by other measures.

46/ This practice is, however, not always followed. For example, there were no reserve requirements in Palestine, and in Israel prior to November 1950 for banks. (Source: Meir Heth, Banking Institutions in Israel, Jerusalem, The Maurice Falk Institute for Economic Research in Israel, 1966, p. 93.) That is, all types of deposits had the same reserve requirements - zero. In Pakistan, reserve requirements against demand deposits and time deposits are 5 per cent. (American Banker, 28 December 1966, p. 8A).

47/ Lars-Erick Thunholun, Sweden, in Benjamin H. Beckhart, ed., "Banking Systems", (Columbia University Press, New York, 1954, p. 675).

Term of savings deposits in the Republic of China

58. In the Republic of China, for example, at the end of April 1966 there was a total of $NT2,193 million with a maturity of two years or more in savings deposits in banks.48/ The amount on deposit for two years or more had been increasing very substantially each year from at least the end of 1959 to the end of 1963. Since then, such deposits have been declining as a result of the decrease in deposits with a three-year maturity even though deposits with a two-year maturity have continued to increase. Beginning 1 July 1963, the interest rate on three-year maturities which previously was above that on deposits of shorter maturities was made the same as for the one-year maturity. At the same time, the interest rate on two-year maturities was also lowered to that available on the one-year maturity.49/ Depositors in Taiwan are apparently willing to commit more of their funds for two years at the lower interest rate. But savers are unwilling to commit them for longer periods at that rate when yields on competing investment outlets are considerably higher.

Term deposits and term loans

59. An important point to note is the substantial amount on deposit in Taiwan in long-term funds. This means that a pool of longer-term deposits is available for longer-term lending to industry.50/ In Greece, for instance, at the end of 1961, savings and time deposits of individuals and private enterprises held in commercial banks amounted to 10,765 million drachmas or 67 per cent of all deposits in commercial banks. It was on the basis of such a large proportion

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48/ Some of this was in savings banks. Not all of the savings were owned by individuals (Economic Research Department, the Central Bank of China, Taiwan Financial Statistics Monthly, April 1966, pp. 36-38).

49/ *Ibid*., p. 67.

50/ Financial institutions other than commercial banks also hold long-term funds. For example, the savings and loan associations in Latin America had a total of $132 million in savings at the end of 1965; this was primarily used to finance housing. (The American Banker, 11 August 1966, p. 18).

Loans by thrift institutions need not be confined to housing. In a number of countries savings banks, for instance, provide mortgage loans, even if in limited amounts, on industrial buildings and invest in stocks and bonds of industrial enterprises (see, e.g., "Savings Banks Association of New York State, Savings Banks Fact Book, 1965, New York 1965, pp. 44, 46, 47; also American Banker, 14 October 1966, p. 9, in connexion with savings banks in Canada).

that the authorization noted earlier was granted allowing the commercial banks to invest up to 15 per cent of their deposits in long-term loans.

60. There is, of course, no assurance in any country that deposits will continue to increase (as they have indeed in Greece and as they have with savings deposits in Taiwan with a two-year maturity) or even not decline (as with the savings in Taiwan with a three-year maturity). Radical shifts in the economy, such as a new sharp upward and prolonged rise in prices or a marked change in interest rates in various competing investment outlets, could result in declines in the total amount of savings on deposits in commercial banks. But barring such sudden changes, it would seem prudent - on the basis of experience in a country with the longevity of the available deposits and the anticipated cash flow from earnings on investments plus repayments of loans - for a commercial bank to make some term loans to industry.

Range in reserve requirements

61. Reserve requirements have ranged in recent years from zero to 100 per cent. In Israel, for example, prior to March 1961, there were no required reserves for amounts on deposit for fixed-term in excess of eighteen months.51/ Imposition of reserve requirements is not provided for in the Statute of the Banque Centrale des Etats de l'Afrique Equatoriale et du Cameroun, of the Malagasy Central Bank and of the banks of Sierra Leone, Mali and Guinea.52/ In a number of countries, such as Costa Rica, the Dominican Republic, Ecuador and Guatemala, there are 100 per cent reserve requirements on increases in deposit.53/ This wide range in reserve requirements would seem to offer the possibility of adjusting requirements to induce banks actively to seek time or savings deposits. If reserve requirements against those deposits are lower than against demand deposits, the banks presumably will have an incentive to seek time deposits more aggressively (without neglecting

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51/ Meir Heth, Banking Institutions in Israel, p. 96.

52/ "Comparative Digest of African Central Banking Legislation". United Nations, E/CN.14/AMA/7, 1965, p. 9.

53/ F. Tamagna, Central Banking in Latin America. (Mexico City, Centro de Estudios Monetarios Latino Americanos, 1965), p. 157.

demand deposits), not only from the existing market but also from the potential market that is rather removed from the money economy.

Changes in reserve requirements and changes in deposits

62. The significant effect that reserve requirements can have on the distribution of deposits is demonstrated by events in Israel. Prior to March 1961, fixed-term deposits in Israeli currency were an important source of funds for banks. In March 1961, however, these deposits were subjected to the same reserve requirements as demand deposits. Factors such as the development of bill brokerage and linking of the value of some types of deposits to a price index were important in causing a decline in the level of fixed-term deposits.54/ However, the upward revision in reserve requirements was also a significant factor in the decline from IL70.2 million at the end of 1960 to IL26.9 million at the end of 1964. (Indeed, as mentioned earlier, the higher reserve requirements were an important contribution to the development of bill brokerage.55/)

Government influence in term lending to industry

63. In Mexico, as indicated earlier, the commercial banks have been induced to change the composition of their assets through the use of reserve requirements by the central bank. In a number of countries, such as Argentina, Peru, Morocco and India, the Government has taken to a more direct approach in influencing the term of commercial bank loans to industry.

64. In Argentina, as in Mexico, reserve requirements have been used to influence the term of commercial bank loans. Thus, in 1961, a central bank regulation was issued permitting a small reduction in commercial banks' reserve requirements if the funds made available in this way were used for term loans for industrial (or agricultural) equipment.56/ More directly, though, the central bank provides

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54/ Meir Heth, Banking Institutions in Israel, pp. 128, 326.

55/ Ibid., p. 326.

56/ Arthur D. Little, Inc., Industrial Development in Argentina, Report to the Government of Argentina and the International Co-operation Administration, (Contract ICAC-1866, Washington, 25 August 1961, p. 113). Figures are unavailable on term lending by banks in Argentina; it is believed that such lending is not large.

financing for industry through special credit programmes that are made effective through the commercial banking system. Part of the funds from these special credits apparently is used for medium-term lending to industry.

Government funds to commercial banks via intermediary

65. Rather than having the central bank supply funds directly to commercial banks for lending to industry, in some countries, like Peru, India and Morocco, an intermediate institution channels funds from the central bank to the commercial banks.

66. In Morocco, the Banque Nationale pour le Developpement Economique (BNDE) discounts medium-term credits of commercial banks. If BNDE wishes, it may, in turn, rediscount this paper at the Bank of Morocco.57/

Indian Government refinances term loans to industry

67. In an effort to have more funds flow to industry, the Government of India, since 1958, has stood ready to refinance approved term loans made to industry by the major commercial banks. To provide this refinancing the Refinance Corporation for Industry Ltd. (RCI) was established that year.58/ The purpose of this new approach was to expand the funds going into industrial term loans beyond the level that the banks would ordinarily make available from their usual resources.

68. The IDBI, a wholly owned subsidiary of the Reserve Bank of India, may obtain funds from the central government, from deposits by the public, and the sale of bonds, and by borrowing abroad and from the Reserve Bank. The RCI funds came largely from government loans. The RCI, in turn, would provide the banks with the entire amount of refinancing required. Thus, the banks only distributed the amounts placed at their disposal. However, the banks did bear the full credit

57/ BNDE, an autonomous financial institution, was incorporated in 1959 with the Government providing 56 per cent of the authorized share capital. Since 1962, the Government has held 43.7 per cent of the share capital. International Bank for Reconstruction and Development, The Economic Development of Morocco (The Johns Hopkins Press, Baltimore, 1966), p. 182.

58/ In 1964, RCI was merged with the newly established Industrial Development Bank of India (IDBI).

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risk. With the establishment of the IDBI, only 80 per cent of refinancing has been provided; the commercial banks have had to supply the remaining 20 per cent of the credit from their own resources. However, in exceptional cases, in high priority industries the 80 per cent ceiling may be relaxed.

Eligibility for Indian refinancing

69. To be eligible for refinancing, loans by scheduled banks must meet the following conditions, which are summarized in table 8 below:

(a) The loan must be for a period of between three and seven years. This was modified in 1960 to allow a maximum term of ten years in exceptional cases.

(b) Originally, the largest loan to any one borrower could not be more than 5 million rupees (the equivalent of somewhat over $US1 million at that time). However, in cases where projects have already been assisted under the scheme, the IDBI raised the outstanding limit to Rs10 million (then equivalent to approximately $US2.1 million), and does consider requests for larger amounts. There is also a lower limit, Rs500,000 (equivalent to $US105,000), below which the IDBI ordinarily does not entertain applications. But this lower limit would be relaxed to Rs100,000 (equivalent to $US20,900), in the case of loans to small-scale industries covered under the Credit Guarantee Scheme.

(c) The borrower must normally be a medium-sized industrial firm with paid-up capital plus reserves between Rs500,000 and 25 million (equivalent to $US105,000-5,236,000 at the pre-June 1966 rate of exchange). However, loans to larger firms, depending on the merits of the case, are also eligible for refinance. Small-scale establishments with less than Rs500,000 in paid-up capital and reserves were brought under the scheme in 1960 if the loan was covered under the Guarantee Scheme of the Indian Government.

(d) The loan must have been granted by the commercial bank for increasing production in specified industries. The IDBI will normally refinance loans only for acquiring fixed assets. But loans eligible for refinance "may also include a portion of working capital, if such working capital is required on a term basis".

(e) The loan can be refinanced only if it is submitted within a year of the time the loan was granted by the commercial bank. Initially only fifteen major scheduled banks (and several government financial institutions) were eligible

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Table 8

Eligibility for refinance by the Industrial Development Bank of India of industrial loans by commercial banks in India, December 1965

Period of loan	Between three and seven years since 1960; maximum term of ten years in exceptional cases
Size of loan	Upper limit of Rs5 million to a single borrower (10 million for projects already assisted under the scheme). Lower limit of Rs500,000 (100,000 for small-scale industries under the Credit Guarantee scheme).
Size of borrower	Medium-size industrial firm; paid-up capital and reserves between Rs500,000 and Rs25 million. (Small-scale firms with less than Rs500,000 in paid-up capital and reserves brought under scheme if covered under the Guarantee Scheme. Larger firms, depending on the merits of the case, also eligible).
Purpose of loan	Loan must be disbursed by commercial bank for increasing production in specified industries. Normally for the purpose of acquiring fixed assets, but also for working capital if required on a term basis
Application conditions	Refinance provided only if applied for within one year of the issuance of the loan by commercial banks

Source: The Industrial Development Bank of India, Report of the Board of Directors for the Year 1964-65; L.C. Gupta, "Role of Commercial Banks in Medium-term Industrial Financing". Capital, Calcutta, Supplement to issue of 23 December 1965, Annual Review of Trade, Commerce and Industry.

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for participation in the refinance scheme. Those banks, however, held about 80 per cent of all deposits of all scheduled banks at that time. By the end of June 1965, the scheme had been expanded to include fifty-nine scheduled banks (and several government-financial institutions.59/ The same number of banks were eligible on 30 June 1966.60/

(f) Prior to 5 March 1965, the lending rate for refinance of industrial loans was 5.5 per cent. At that time it was raised to 6.5 per cent following the increase in bank rate from 5 per cent to 6 per cent in February 1965. In addition, since 21 December 1964, a commitment charge of 1 per cent per year is "levied on the amount of refinance remaining undrawn after a reasonable period". The purpose of this charge is to expedite the use of the refinancing funds provided to the financial institution.

Volume of term loans to industry in India

70. In the twelve months ending 30 June 1966, the IDBI sanctioned Rs155 million (equivalent to approximately $US31.5 million) of industrial loans to commercial banks for refinancing. This was 69.7 per cent of all industrial loans sanctioned for refinancing industrial loans. The following table summarizes the refinancing of industrial loans by IDBI and RCI from the inception of RCI in June 1958 to 30 June 1966:

59/ The Industrial Development Bank of India, Report of the Board of Directors for the Year 1964-65 (Bombay, August 1965), pp. 2, 4, 8, 9; L.C. Gupta, "Role of Commercial Banks in Medium-term Industrial Financing". Capital, (Calcutta), Supplement to issue of 23 December 1965, Annual Review of Trade, Commerce and Industry, pp. 99, 101.

60/ The Industrial Development Bank of India, Report of the Board of Directors for the Year 1965-66, p. 9.

Table 9

Industrial loans refinanced by the Industrial Development Bank of India, 1958-1966, by institutions

(in millions of rupees and percentage of total)

	1963/1964 (July-June)		1964/1965 (July-June)		1965/1966 (July-June)		Since the inception of RCI* in 1958 to 30 June 1966		
	Amount sanctioned	Amount disbursed	Amount sanctioned	Amount disbursed	Amount sanctioned	Amount disbursed	Amount sanctioned	Amount disbursed	Amount outstanding
Commercial Banks	178 (77.1)	148 (78.7)	205 (83.2)	182 (85.7)	155 (69.7)	144 (67.1)	846 (79.9)	642 (78.3)	485 (76.5)
State Co-operative Banks	2 (0.9)	6 (3.2)	28 (11.4)	6 (2.8)	0 (0)	20 (9.4)	50 (4.7)	46 (5.5)	36 (5.7)
State Financial Corporations	51 (22.0)	34 (18.1)	13 (5.4)	24 (11.5)	67 (30.3)	50 (23.5)	163 (15.4)	132 (16.2)	113 (17.8)
Total	231 (100.0)	188 (100.0)	246 (100.0)	212 (100.0)	222 (100.0)	214 (100.0)	1,059 (100.0)	820 (100.0)	634 (100.0)

Source: The Industrial Development Bank of India, Report of the Board of Directors for the Year 1964-65, p. 11 and Report of the Board of Directors for the Year 1965-66, p. 11.

* RCI is Refinance Corporation for Industry Ltd.

Figures for 1964-65 include operations of the RCI for the first two months; those for 1963-64 and prior relate entirely to RCI.

71. From table 9 above it is clear that refinancing of term loans to industry has by far been greatest through the commercial banks. Disbursements through those banks had been increasing until the latest fiscal year. The increase occurred not only compared to disbursement through the other two types of financial institutions, but also within the commercial bank sector, where there had been an acceleration of refinancing of industrial term loans: the Rs182 million (approximately equivalent to $US38.1 million), disbursed by IDBI to these banks in the one year 1964-65 was more than one third of the disbursements in the seven years 1958 to 30 June 1965. However, in 1965/1966 amounts disbursed and sanctioned for commercial banks were below the level in the preceding year although still more than double the disbursements and amounts sanctioned through the two other types of institutions.

72. As noted earlier, the purpose of the IDBI refinancing programme was to increase the amount of funds going into industrial term loans above the level that banks would normally make available from their usual resources. Indeed in 1962, the only year for which comparisons can be made, commercial banks' term loans (granted for periods exceeding one year) to industry were several times greater than the banks' term loans to industry under the RCI refinance programme. Thus, preliminary data relating to forty-three banks (including all Indian banks with deposits of Rs2.5 million or more) indicated that their outstanding term loans to industry amounted to Rs456 million (equivalent to $US95.5 million) or about 8 per cent of the banks' total outstanding credit to industry. Those terms do not include an additional Rs330 million (equivalent to $US69.1 million) of industrial credit which technically was short term. This, though, carried with it a specific understanding, formal or informal, between the bank and the customer that the short-term credit would be renewed beyond a year or that repayment of the loan, either in part or in lump-sum, would take place after one year. In contrast, at the end of 1962, the total amount of RCI's loans outstanding of all kinds to all institutions was Rs136 million[61/] (equivalent to $US28.5 million).

61/ Reserve Bank of India, Trend and Progress of Banking in India During the Year 1962, Bombay, 1963, pp. 33-34. Those institutions included fifty-six commercial banks, almost certainly including the forty-three banks mentioned above. Therefore, the Rs456 million in industrial term loans outstanding by the forty-three banks was even greater relative to RCI's Rs136 million outstanding to fifty-six commercial banks (plus other institutions).

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73. It would be very difficult to determine how successful the IDBI programme has been in terms of increasing the amount of funds going into industrial term loans above the level that banks would normally make available from their usual resources. That is, it may be that some of the financing under the IDBI programme may represent a shift from loans that would normally have been made.

Term loans in developed countries

74. The new widespread view that term lending is appropriate for commercial banks is not confined to the developing countries. This is quite apart from commercial banks in Sweden[62/] and the United States, for example, where, for many years, a large volume of term loans to industry has been provided. Indeed, in 1957, the latest year for which figures are available for the United States as a whole, the largest percentage of commercial banks' term loans, by value, to borrowers in "manufacturing and mining" was for the original maturity of five to ten years. Term loans comprised approximately 20 per cent, and even more, of all bank loans, by value, to "manufacturing and mining"; the number of term loans to "manufacturing and mining" was an even higher percentage of the number of all their bank loans. Term loans were not confined to large borrowers in "manufacturing and mining" nor were they made only by large banks: small manufacturers and mines (with total assets of less than $US50,000) held $76 million of such loans; term loans outstanding to all "manufacturing and mining" amounted to $6,533 million. Small banks, with less than $10 million in deposits held $585 million in term loans; banks with deposits of $10-$100 million held $2,069 million in term loans of the $15,421 million held by all banks.[63/] Term lending to industry has continued to be important: loans with a maturity of more than one year made by large New York City banks to manufacturers increased by a net amount of $1,264 million in the year ending 24 August 1966. This brought the total of such loans outstanding to $4,978 million. Both the net increase and the total outstanding were greater than those banks' net increase that year

62/ Lars-Erik Thunholm, "Sweden". B.H. Beckhart ed. Banking Systems, pp. 674-675.

63/ Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington), April 1959, pp. 354, 366, 363.

in industrial loans maturing in one year or less ($1,113 million) and the total amount outstanding with such maturity ($3,682 million).64/

75. In Australia, special arrangements were made in April 1962 by the Reserve Bank of Australia to enable the commercial banks to provide term loans for periods ranging from approximately three years up to about eight years for capital expenditure for production in industrial, rural and, to a lesser extent, commercial fields, and also to finance exports. At the end of June 1966, approximately four years after the banks were authorized to make such loans, total term loans outstanding amounted to $A207 million (equivalent to $US230 million); nearly one-half of all term lending was for manufacturing.65/

76. In Canada, the Royal Commission on Banking and Finance in 1964 suggested that it was "desirable from the point of view of the banks as well as of the smaller businesses which might benefit that banks continue to lend more freely on an explicit term basis".66/

77. In France, recent official actions - relating to acceptance of deposits of more than two years and to central bank discounting of paper with long maturities - have been taken to encourage the commercial banks to provide longer-term loans for equipment (and construction and exports).67/

78. In Japan, where the very rapid growth in manufacturing since the Second World War has been due to the driving force of the large commercial banks and the big industrial groups around them, industry is heavily dependent on the banks for long-term funds.68/

64/ Federal Reserve Bank of New York, Commercial and Industrial Loans Outstanding at Large New York City Banks by Industry and by Term, 26 August 1966.

65/ Reserve Bank of Australia, Report and Financial Statements, 1963, p. 18; Report and Financial Statements, 1966, p. 20.

66/ Quoted in Ronald F. Henderson, "Finance for Industry". The Role of Banks in a Rapidly Developing Economy. Melbourne, The Bankers' Institute of Australia, February 1965, p. 98.

67/ Conseil Economique et Social, Conjoncture Economique, second semester 1965, Paris, pp. 17-18; Federal Reserve Bank of New York, Monthly Review, November 1965, p. 245, The Economist (London), 26 November 1966, p. XIX.

68/ The Economist (London), 26 November 1966, p. XV.

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79. British banks have been officially urged to "be ready to offer term-loan facilities within reasonable limits, having due regard to their liquidity requirements, as an alternative to a ruining overdraft for creditworthy industrial and commercial customers".69/

69/ Committee on the Working of the Monetary System ("Radcliffe Committee"), Report, Cmmd. 827 HMSO, London, August 1959, p. 326; see also p. 320.

V. GOVERNMENT GUARANTEES OF BANK LOANS TO INDUSTRY

80. In addition to actions that the central bank may take to induce commercial banks to channel more funds into loans to industry, the Government itself may provide inducements for, and pressures on, banks to increase such loans.

81. Government guarantees of bank loans have been provided by a number of countries and have been in existence for many years in some countries covering a wide variety of loans, including those to industry.70/ An important inducement, provided in a number of developing and developed countries, is a guarantee by the Government that if a borrower defaults, the Government will reimburse the bank for at least part, if not all, of the unpaid balance of the loan and the unpaid interest. With such a guarantee reducing a considerable part of the lender's risk, the bank would be expected to expand loans to industry.71/

82. Since the purpose of the government guarantee is to increase the volume of loans, part of the guarantee programme may ordinarily include a stipulation (as in the Indian programme to guarantee loans to small-scale industries) that credit

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70/ For example: Canada (Report of the Royal Commission on Banking and Finance, 1964, Ottawa, pp. 223-224); India ("Industrial Development Bank of India: Scheme for Participating in Industrial Loans and Guarantees" in Reserve Bank of India Bulletin, March 1966, p. 264; Ministry of Industry, Financing of Small-Scale Industries in India, New Delhi, 1963); Philippines (Arthur I. Bloomfield, "Some Problems of Central Banking in Underdeveloped Countries"). The Journal of Finance, (New York), May 1957, p. 202; Japan (Small Business Credit Insurance Corporation, Present State of Small Business Credit Supplementation System in Japan - Tokyo, 1961); Bank - SBA Participation Loan Plans, Washington; United States Small Business Administration, September 1965. See also Organisation for Economic Co-operation and Development, Industrial Investment Policies (Paris, June 1965, pp. 46-48).

71/ In connexion with British foreign trade, for instance, "provision of credit insurance undoubtedly helps to bring forward finance for exports through the normal banking channels". (Export Credits Guarantee Department Services, London, July 1965, p. 18). Similarly, with reference to export credit insurance in general, "The banks' willingness to make advances or provide discounting facilities increases pari passu with their assurance that the supplier is protected (by insurance) against failure to pay on the part of his foreign customers". (Export Credits and Development Financing, part I, Current Practices and Problems. United Nations, E/4274; ST/ECA/95, 1966).

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standards should be liberalized for borrowers eligible for guaranteed loans.[72/] The United States extended-risk guarantee programme for investment in developing countries stipulates that loans will not be guaranteed if the needed private financing is available on reasonable terms without the guarantee.[73/] Whether the effective cost for any individual bank participating in the insurance programme would rise or fall would depend on the level of loan defaults before and after the insurance programme, additional costs, including insurance premiums incurred in participating in the guarantee programme, and how much of these costs were shifted to the borrower. If, as in the case of the guarantee programme in India, the lender shifts the insurance charge, the borrower may find his credit cost higher.[74/]

83. Nevertheless, another frequent aspect of bank loan guarantee programmes provides that interest charges to the borrower will be lower than such charges without the guarantee. For example, in Belgium, the Government, in effect, pays part of the interest to the lending institution which consequently lowers the rate of interest to the borrower. France follows a different procedure: the Government's payment may be either to the lender or the borrower. In both countries, as well as others, these types of guarantees have been applied to loans for creating new enterprises or expanding existing ones as part of regional development policies.[75/]

Guarantees by developed countries

84. Through liberalizing existing bank-loan guarantee programmes of their own, or by providing such programmes, the developed countries can help expand the flow of bank credit to industry in developing countries. In Denmark, the law provides for guarantees "to financial institutions whose object is to promote the economic

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72/ Financing of Small-scale Industries in India, p. 127.

73/ Aids to Business (Overseas Investment). (Washington, Agency for International Development, September 1965) p. 21. Among other criteria for determining if a loan is eligible for guarantee is the relationship between the project and the plans and programmes for development of the country in which the project is located, the priority of the project, and its effect (including the balance of payments effect) on the local economy. (Ibid., p. 20).

74/ Financing of Small-scale Industries in India. (New Delhi), 1963, p. 130.

75/ OECD Industrial Investment Policies, pp. 46-47.

development of developing countries". 76/ However, it has not yet been ruled whether commercial bank loans for direct investment in industry in these countries is included in the guarantees. A similar status exists in Austria. 77/ The United States, for example, since 1948 has provided a specific risks guarantee programme for U.S. business investment, including investment in industry, in developing countries. That programme covers the risks of inconvertibility of currency, as well as of appropriation and the hazards of war and revolution. The guarantees basically apply only to private U.S. new investments, including bank loans, in developing countries or new investments in existing enterprises in these countries. The term of the loan from the date of drawal and to the date of repayment must be at least three years. 78/ In a number of countries, export credit insurance programmes have been an important factor in the increase in the maturity of such credits 79/ presumably including those by banks.

88. In 1961, in addition to the specific risks guarantee programme, the United States extended-risk guarantee scheme mentioned above was introduced. This new programme very substantially broadened the coverage, including normal business risks. Among the investments in development countries covered by the United States extended-risk guarantees programme are term loans up to twenty years by banks. The financial guarantee facility of the British Government's export credit insurance programme has a number of features similar to those of the extended-risk guarantee scheme. 80/ Many other countries, too, have export credit schemes. 81/

76/ Act on Technical Co-operation with Developing Countries. (Copenhagen, 1962). Act No. 94, sections 7 and 8.

77/ Report on the Administration of Export Risk Guarantees for the year 1965 by Osterreichische Kontrollbank Aktiengesellschaft as Trustee of the Republic of Austria. (Vienna, 14 April 1966), part III, pp. 1-3.

78/ Aids to Business (Overseas Investment), pp. 14-16; Specific Risk Investment Guaranty Handbook. (Washington, Agency for International Development - March 1966, pp. 4-10).

79/ Suppliers' Credits from Industrialized to Developing Countries (Washington, D.C., International Bank for Reconstruction and Development - 20 January 1967), p. 6.

80/ ECGD Services, pp. 21, 49-52.

81/ Export Credits and Development Financing. Part I: Current Practices and Problems. (United Nations, E/4274; ST/ECA/95, 1966), pp. 17-22; Export Credit Insurance and Export Credit. Basle, Bank for International Settlements, March 1965.

[illegible] of developing countries provide insurance of export credits in connexion with sales of goods wholly or partially produced, processed or manufactured in those countries.[82] This can be important in expediting exports of manufactures and thus in aiding the development of industry. The U.S. extended risk guarantees programme, for instance, has a great potential[83] for inducing a larger flow of capital to industry in developing countries. Yet only five contracts, totalling $[illegible] million, have been issued under it in the five years the programme has existed, of the total, [illegible] $[illegible] million for [illegible] and a half years, [illegible] the only one with banks directly receiving the guarantee. That [illegible] States [illegible] goods and services, will assist in constructing a kraft paper plant in Thailand. The $[illegible] million understates the [illegible] equity and loan funds, largely from Thai investors, will amount to $[illegible] million. In addition, the U.S. Export-Import Bank has authorized a loan of $14 million to the kraft paper company for the purchase of U.S. materials for the plant.[84] The above illustrates the potential multiplier effect of a guarantee programme for increased investment in industry in developing countries: without the guaranteed loan, possibly a smaller plant would have had to suffice or, possibly, without the $[illegible] million from this or other sources, the plant would not have been feasible.

Developing countries' guarantees of repayment of foreign loans

[illegible] Guarantees by developing countries that foreign loans will be repaid are also important in inducing a greater flow of imports needed for the growth of industry. Such guarantees are long established procedures. For example, government guarantees of repayment of loans, such as those made - and fulfilled - by the International Bank for Reconstruction and Development for many years. It appears that in

82/ Encyclopedia of International Financing, John Morris Ryan, Editor, Santa Barbara, Calif., 1965; also G. T. Williamson, The Role and Practices of Commercial Banks and Other Institutions in Financing Development, p. 1[illegible].

83/ Total guarantees under the whole programme are authorized to be as high as $300 million.

84/ New All-Risk Guaranty Covers Thai Investment. Press release AID-66-177, Washington, [illegible] September 1966.

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I. INTRODUCTION, SUMMARY AND CONCLUSIONS

1. In many developing countries, commercial banks could potentially make significantly larger contributions to development[1/] - notably industrial development. This report, which essentially deals with developing countries with predominantly private enterprise economies, suggests that institutional changes can be made to induce banks to direct more of their resources to industry. Not only developing countries, but developed countries too, can change laws and regulations to accomplish this increased flow of funds to industry in the former countries.

2. A number of developing countries have made such changes with a considerable degree of success in achieving desired goals. Commercial banks in several developing countries have demonstrated remarkable ability to shift sizable proportions of their investments in rather short periods from non-industrial to industrial loans and from short to long-term loans; these rapid shifts have often been in response to official actions.

3. Measures effective in one country may not necessarily work in another. Before making possibly far-reaching revisions in legislation or regulation, it is advisable for a Government to analyse the probable consequences and effectiveness of the revisions in inducing the desired effect on banks and industry in the context of its own situation. Thus, among the topics covered in this report are the use of commercial bank reserve requirements and of central bank rediscounting of paper to influence commercial bank lending to industry. Depending on the level of development of the industrial and financial sectors, one of these techniques may be effective in some countries: in others both may be helpful. Many Governments will find it useful to have the advice of outside economic experts in determining what changes should be made in financial legislation or regulation.

1/ See for example Victor L. Urquidi, "Legislation for Economic Development". Latin America: Evolution or Explosion? Mildred Adams, ed. (New York, Dodd, Mead and Co., 1963), p. 156-157; John F. Due and Jean M. Due, "Some Observations on Economic and Political Development in Tropical Africa". Quarterly Journal of Economics and Business (Urbana, Ill.) August 1962, p. 39; "The Process of Industrial Development in Latin America", Vol. II. (United Nations, E/CN.12/716/Add.1, 1965), p. 169, Bank of Greece, Report for the Year 1964 (Athens, 1965), p. 83.

Argentina a large part of foreign credits granted industrial enterprises in recent years have been guaranteed by the Government-owned Banco Industrial.

87. In the Republic of Korea the Government has a repayment guarantee programme for foreign loans.85/ In some regions, such as Latin America, Governments have been reluctant to provide guarantees, and private business interests have been unwilling to seek them.86/ But guarantees of long-term loans need not be made only by Governments. In Brazil, for example, a commercial bank has guaranteed a $340,000 seven-year loan for the import of equipment for manufacturing metal products.87/

Evaluation of guarantee programmes

88. Given the reluctance of some Governments to provide guarantees, it appears useful for them to investigate the possibility of participating with domestic commercial banks in providing guarantees of repayment for imports needed for the growth of industry. Such participation could take the form of the Government and the banks each assuming a portion of the risk. Or the banks might provide the guarantee with the Government insuring part of the banks' risk in the event of default of the loans by the borrower. Through either approach, the Government's role would be less than if it alone provided the guarantee. Part of the suggested investigation would be to determine whether guarantees would indeed result in expanded imports needed for industry; possible balance-of-payments problems would also have to be considered.

89. It would be worth while for Governments that do provide insurance programmes to inquire as to the possibilities for improving them. The Indian Government,88/ for example, has investigated why the programme to induce more bank lending domestically

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85/ The Korean Reconstruction Bank, Its Functions and Activities 1966, (Seoul, 1966), p. 17.

86/ "The Experience of the World Bank Group in Financing Industrial Development in Latin America". (United Nations, ST/ECIA/Conf.23/L.58, March 1966), p. 3.

87/ Export-Import Bank of Washington, Quarterly Report, April, May, June 1966, p. 4. Banks in Spain and Thailand have also guaranteed foreign loans. (Ibid., pp. 14 and 18).

88/ "Financing Small-Scale Industries in India", pp. 129-130.

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as a result of guarantees did not reach its full potential. Similarly, in the United States, the reasons have been analysed why part of the guarantee programme to induce more lending to developing countries has not reached its full potential. Problems have arisen in administering the United States programme and in relation to conditions stipulated in the contract. Efforts have been made to overcome both sets of obstacles.89/ Suggestions have also been made to better the British export credits guarantee programme through simplification and improvement of forms and procedures.90/ After Governments have made improvements, it would be desirable to determine if the programmes can be expanded in terms of, say, risks covered, term of the loans, industries included, size of the borrower and number of banks participating. But such liberalization should also take into account the soundness of financed projects and possible balance-of-payments problems that may occur in developing countries.91/ Such inquiries would seem particularly useful in the light of guarantee programmes like those relating to housing in the United States, which have been highly successful; that is, programmes of government insurance of bank loans are not inherently unfeasible. It would be useful, although very difficult, for Governments, both developing and developed, to compare the costs and benefits that may be derived from such a programme as against the costs and benefits from other government programmes, like tax incentives, designed to accelerate industrialization in developing countries.

90. However, it is important to recognize that changes in formal aspects of the guarantee programme, such as improving the terms of the contract, can be helpful only to a degree. The investment yield available in one country as against another is a basic consideration in determining where investment will go. Unstable political and economic conditions are important deterrents to investment.

89/ Foreign Aid Through Private Initiative, (Washington, Agency for International Development, July 1965), pp. 16-18; World Business, (New York, The Chase Manhattan Bank, N.A., July 1966), pp. 4-7; Export and Import Procedures, (New York, Morgan Guaranty Trust Company of N.Y., 1965), pp. 63-64; The New York Times, 29 September 1966, p. 66.

90/ The Economist, (London), 18 February 1967, p. 641.

91/ Suppliers' Credits from Industrialized to Developing Countries. (Washington, International Bank for Reconstruction and Development, 20 January 1967), p. 25.

A borrower's inability to get sufficient foreign exchange to repay a loan may also act as a deterrent against lenders providing loans and against developing countries allowing them. Developed countries' liberalization of imports from developing ones would be helpful in this connexion.

91. With the widespread emphasis on increasing industrialization, it may be useful to investigate the possibility of establishing an international guarantee programme of bank loans to industry - not only international loans but also domestic ones. Such a programme might cover commercial as well as non-commercial risks. This programme may, perhaps, be integrated into, or broadly patterned after, the multilateral investment guarantees scheme suggested by the Organization for Economic Co-operation and Development,[92/] which has been followed by a draft scheme prepared by the staff of the International Bank for Reconstruction and Development.[93/] (Both the OECD and IBRD draft schemes relate only to risks of a non-commercial nature.) An international guarantee programme of bank loans to industry, if participated in by a large number of countries, may perhaps result in a smaller total administrative cost than if each country had its own programme. By spreading the risk among many countries, it may be possible to impose a lower insurance premium than if each country had its own programme. It is probably not feasible to establish an industrial loan guarantee programme in a sizable number of developing countries where industrialization is still very limited. Without going through the expense and effort of each establishing its own insurance programme, these countries could participate - and probably at considerable less cost - in an international insurance programme of loans to industry.

92/ "Report on the Status of the International Bank Studies on Multilateral Investment Guarantees - Note by the Secretary-General of UNCTAD." United Nations Conference on Trade and Development, TD/B/55, 3 February 1966.

93/ International Bank for Reconstruction and Development, Address to the United Nations Economic and Social Council by Mr. George D. Woods, (Washington, D.C.), 20 December 1966, p. 3.

VI. RELATIONSHIP OF COMMERCIAL BANKS AND DEVELOPMENT BANKS

92. There are a number of areas where commercial banks and industrial development banks can work closely together to mutual advantage. In many countries, shares in a development bank are held by commercial banks - not only domestic commercial banks but also foreign banks. In Colombia, bonds issued by development banks may be included in the commercial bank's minimum of 36 per cent of its portfolio required to be invested in development credits.94/ Some Governments require certain institutions, including commercial banks, to provide funds directly or indirectly to industrial development banks at comparatively low rates of interests.95/ Commercial banks also extend credit to development banks for lending to manufacturers.96/ In these ways, the commercial banks, even if indirectly, help expand loans to industry. Particularly for foreign banks, investment in industrial development banks would seem to be one simple way to provide some loans to industry in developing countries. Those commercial banks, especially foreign ones in many instances, could probably make a valuable contribution toward the improved operation of development banks in areas such as loan appraisal and internal administration.97/

93. One type of co-operation between a development bank and the commercial banks has been in the area of loan repayment. In Sierra Leone, the Development of Industries Board, a development bank for small industries, found that there were long delays in reporting the collection of loan repayments. The repayment

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94/ International Monetary Fund, International Financial News Survey, 18 March 1966, p. 91.

95/ Robert W. Adler and Raymond F. Mikesell, Public External Financing of Development Banks in Developing Countries (Eugene, Oregon, Bureau of Business and Economic Research, University of Oregon, 1966) p. 31 citing Antonin Basch, Financing Economic Development, and Robert W. Adler, The Financial Markets of Colombia.

96/ See, e.g., Banco Industrial del Peru, Annual Report Year 1964. (Lima 1965) p. 8.

97/ For an example of a contribution of this type by a foreign bank, see The Economist (London), 11 March 1967, p. 967.

system was handled by the government sub-treasuries. To cut this delay from five months to one month, it was decided to transfer the handling of accounts to the commercial banks.98/ In Greece, the central bank has urged the commercial banks and the specialized development financing institutions to collaborate. One benefit of such collaboration was expected to be a system of insurance of long-term credits. This insurance, in turn, was expected to increase the credit-worthiness of the borrowing enterprise.99/

94. Another area of co-operation that would seem to be of mutual benefit to both types of banks would be to eliminate duplication of effort and to strengthen the financial system through exchange of credit information on loan applicants and actual borrowers. It is likely that one type of bank or the other will already have information on the operations - actual or intended - of the applicant or borrower. If such information is exchanged among the appropriate institutions, this can help reduce costs by avoiding duplication of work. As new information is obtained during the period of the loan, this too can be shared with other lenders. Prompt sharing of such information may be important in assisting a borrower who is meeting financial difficulties. Indeed, the industrial development bank's attempt to speed up the reporting of loan repayments in Sierra Leone, mentioned above, was made to help borrowers in financial distress. A prompt system of reporting, it was felt, would enable the development bank to advise an entrepreneur in difficulty on how to rescue his enterprise.100/

Joint participation in loans

95. An additional area of co-operation between commercial banks and a development bank could be through joint participation in industrial loans. A loan could be divided into different parts, possibly according to term. The commercial bank or banks could provide the medium-term loan while the development bank loaned on

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98/ Philip E. Beach, Jr., "Industrial Development Banks: Operating Practices". Managing Economic Development in Africa, (Cambridge, Mass. M.I.T. Press, 1963) p. 119.

99/ Bank of Greece, Report For The Year 1962. (Athens, 1963), pp. 78-79.

100/ Philip E. Beach, Jr., p. 119.

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long term. Different interest rates could prevail for the different parts of the loan. For perhaps assuming the initial risk and for assuming the long-term risk, the development bank would, possibly, receive a special fee above the contracted interest rate.

96. By providing for participation by both types of banks, the risk that one lender would otherwise incur would be reduced. Also, a broader sector of the economy - not only the governmental or quasi-governmental development bank - could participate in financing of industry.

97. Ethiopia and India provide examples of a development bank and commercial banks jointly participating in loans to one industrial borrower. The Development Bank of Ethiopia in 1966 made a loan to a new pulp and paper company for machinery and equipment. At the same time, an Ethiopian commercial bank granted a line of credit for working capital.[101/] In India, the Industrial Development Bank of India participates in loans with commercial banks in order to reduce the risk the latter might incur in granting large medium-term loans.[102/] The above-mentioned proposed collaboration between development financial institutions and commercial banks in Greece was to take the form of joint financing of enterprises. The specialized institutions were to assume a greater part of longer-term credit.[103/] In Morocco, as indicated earlier, the development bank, Banque Nationale pour le Développement Economique (BNDE), indirectly participates with the commercial banks in financing approved projects. The BNDE discounts medium-term credits of commercial banks to such projects.[104/]

98. A variation of the joint approach could be an agreement in advance that the development bank make the long-term loan and that, as the time approaches for the start of repayment of instalments of the loan, the commercial bank assume that part of the loan due, say, in the next two or three years. The commercial bank would pay the development bank in advance the amount the latter would ordinarily collect in repayments of the loan in the forthcoming two or three

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101/ International Finance Corporation, Press Release 66/1, Washington, D.C., 14 January 1966.

102/ Industrial Development Bank of India, Report of the Board of Directors for the year 1965-1966, (Bombay, August 1966) p. 10.

103/ Bank of Greece, Report for the Year 1962, pp. 78-79.

104/ The BNDE may, if it wishes, rediscount the paper with the central bank.

years. The development bank would then be enabled to make other long-term loans to other industrial borrowers; the commercial bank would then be participating in the loans to industry. With the passage of the initial two or three-year periods, the process could be repeated until the last two or three years of the loan. At that time, the development bank would have had its loan, with interest, fully paid; the commercial bank would still have a loan outstanding. In this way, the development bank's revolving fund would have more funds available sooner for relending.

99. The examples of Sierre Leone and India given above demonstrate the need for changes in the relationship between development banks and commercial banks. In Mexico, too, a demonstrated need for change in the operation of a development bank was dealt with through tying in the activities of commercial banks with the development bank. Thus, at least in its earlier years, the Nacional Financiera, a development bank, did not solve the problem of credit for small and medium-size enterprises.[105] The Government handled this problem by establishing a "Guarantee and Development Fund for Medium and Small Industry". This fund, administered by Nacional Financiera, rediscounts loans made to industry by commercial banks. In India the question also arose of the proper relationship between development banks and commercial banks. The latter protested that they had difficulty in providing working capital to industry because of the State Financial Corporations. Those corporations denied such difficulties. Furthermore, they stated that with increasing economic activity, there was scope for both the commercial banks and the State Financial Corporation.[106] The above demonstrated needs for changes, or the possibility of such need for change, in the relationship of commercial and development banks in lending to industry, imply a need for more Governments to analyse this relationship in order to improve it, with the result that borrowing by industry should be facilitated.

105/ Stanford G. Rose and John B. Christensen, Tax Incentives for Industry in Mexico, (Cambridge, Mass. 1959) p. 37.

106/ Industrial Finance Corporation of India, Fifteenth Annual Report. (New Delhi, June 1963) p. 106.

VII. FURTHER ASPECTS OF THE ROLE OF DEVELOPED COUNTRIES' COMMERCIAL BANKS

100. Commercial banks with headquarters in developed countries have been important directly and indirectly in providing resources for industrialization in developing countries. These resources have been provided indirectly by investment in industrial development banks and in local commercial banks[107/] in developing countries, through investment in international financing institutions, and through subsidiaries of the banks with headquarters in developed countries.

Investment by subsidiaries

101. The significant investment such subsidiaries can make towards economic development in developing countries is illustrated by the £13.6 million (equivalent to $US38.2 million) in commitments for loans and investments by one subsidiary as of 30 September 1966. Of that amount, £3.9 million (equivalent to $US10.8 million) was for industry, which was £1.3 million more than the commitment for any other one sector. Of the total commitments of £13.6 million, £7.1 million or 52 per cent are for loans and investments of five up to fifteen years and £1.4 million, or 10 per cent, is for over fifteen years. (The time distribution of £1.6 million is unknown; some of this also may be in loans and investments of five or more years.) Of the total commitments, the £5,000 to £25,000 group accounted for the largest number of commitments, 105. But the commitments for over £100,000, while smallest in number (35), accounted for over half, £7.3 million, of all commitments. Of the total commitments, £7.2 million were for projects in East, Central and West Africa and £3.9 million were for projects in the West Indies.[108/]

107/ See, e.g., The Economist (London), 20 November 1965, p. xxxviii; American Banker, (New York), 28 February 1966, pp. 3A, 4A, 73A, 74A; Morgan Guaranty Trust Company of New York, Annual Report 1965, (New York, 1966), p. 9; First National City Bank, Annual Report 1966, (New York, 1967), pp. 23, 26-27; The Chase Manhattan Bank, N.A., Annual Report 1965, (New York, 1966), pp. 6, 14-15.

108/ Barclay's Overseas Development Corporation Limited, Report of the Directors for the year ended 30th September 1966, London, 1966.

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4. A number of development banks have performed markedly below the expected level. In several cases, revisions in the operations of those banks have included a joint working relationship with commercial banks. The demonstrated need for changes in policy of those development banks probably also indicates a widespread need for analysis, possibly with the help of technical assistance experts, of the policy and operations of development bank lending to industry and the likelihood that manufacturers would benefit from joint operation of development banks and commerical banks.

5. A shortage of long-term funds for industry is a major deterrent to faster growth of manufacturing although there is a shortage, also, of short-term funds. As the report demonstrates, in a number of countries, commercial banks do provide longer-term funds. To induce commercial banks to provide more funds of this type to industry, it may be helpful for the Government to guarantee or insure repayment of at least part of the loan. It may very well be that such guarantee or insurance may be less costly and more effective than other attempts, such as tax holidays, to foster the growth of industry. It would be very difficult, however, to measure the cost-benefit relationship of one programme as against another. Again, technical assistance experts could help Governments to determine whether an insurance programme would probably be effective in channelling more longer-term loans by commercial banks to industry and, if so, what kind of insurance programme would be most suitable. In connexion with such an analysis, it would be useful to determine whether laws or regulations are unnecessarily restrictive regarding the period for which they permit commercial banks to make loans.

6. The amount on deposit in a bank is, of course, a basic factor determining the volume of loans a bank can provide. It has been demonstrated in a number of countries, including developing countries, that institutional changes can have an important effect on the volume of personal deposits. In spite of low <u>per capita</u> incomes, more personal saving can be diverted into more productive channels, for example, via bank deposits. Among the methods for increasing saving in banks are: the provision of bank branches in more areas,[2] paying a competitive interest rate

2/ More branches in relatively remote areas may result in channelling funds to the larger urban areas where bank headquarters are. These large metropolitan banks are frequently reluctant to lend in the outlying regions. This may reinforce the tendency for industry to concentrate in larger urban areas. (See for example, "The Process of Industrial Development in Latin America", Vol. II. (United Nations, E/CN.12/Add.1, 1965), p. 77; A. Kafka, "Brazil". <u>Banking Systems</u>, B.H. Beckhart, <u>ed</u>. (New York, Columbia University Press, 1954, p. 70; <u>The New York Times</u>, 15 May 1966, Section 3, p. 1.)

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on deposits; assuring the depositer that his funds are safe (possibly through insurance); assuring the depositer that unauthorized persons will not learn of his account; and widely publicizing these developments.

7. Commercial banks with headquarters in developed countries have an important role to play in helping industry grow in developing countries. Such banks, through investment in commercial banks and development banks in developing countries, indirectly provide funds to industry in these countries. Similar indirect investments are made by commercial banks with headquarters in developed countries through the subsidiaries established to make investments that may be ineligible for the parent bank. Banks in developed countries also indirectly aid industry in developing countries through investments in securities issued by international financial institutions. Changes and improved administration of laws or regulations in economically advanced countries could facilitate increased investment in industry in developing countries by commercial banks from the former countries. By advising manufacturing enterprises on better ways of management, accounting, marketing etc., those banks, often among the few repositories of skilled manpower in developing countries, would make a valuable contribution to industrial development. Commercial banks with headquarters in developed countries could help provide more funds and advice to industry in developing countries by opening more branches in those areas. Foreign banks may help obtain more favourable terms for suppliers' credits to the private sector in developing countries. Foreign banks may also help increase the choices of imports that buyers have in those countries.

8. The more elaborate the laws and regulations governing banking (as well as, of course, other sectors of the economy) the greater the difficulty in administration by the Government. Thus, if inducements are given to commercial banks to provide more funds to industry, the government regulatory authorities should determine that the funds are indeed being employed in industry. Frequently, it may be difficult to determine this. Also, although this is only partly an administrative problem, it is well to note that with more funds available for industry, borrowers may merely shift to non-industrial purposes funds that previously might have been destined for industry. The more complex laws and regulations also put added burdens on the banks. As a result, both the Government and the banks need more skilled personnel to fulfil their roles.

9. Since this study focuses on industrial development, it deals only incidentally with other phases of economic development. As a result, some proposals in this report may, perhaps, be inconsistent with some other aspects of economic development - for example, the growth of sectors of the economy other than industry, economic growth with price stability, possible balance of payments problems resulting from the need to repay credits and investments of foreign banks. Another problem in some countries, not directly connected with economic development, relates to the proper role, if any, of foreign banks. Government policy makers must decide the priorities for those goals of economic development and others and reconcile inconsistencies, if any. Growth of the banking system through, for example, increases in deposits, would either allow an enlarged flow of funds to industry and other sectors or reduce the need for curtailing the flow to other sectors of the economy. Thus, to have a well integrated financial structure, it is important at an early stage of development to conceive that structure whole, as it is intended to be.

10. While change in the banking system may be a necessary condition to induce more rapid industrialization, it is not a sufficient one. The problems still remain of finding management skill in the industrial enterprise, markets for its output, and raw materials and technical capabilities for production. Thus, there is sometimes a dearth of qualified borrowers.[3/] Nevertheless, the potential for accelerated industrial development opened by changes in the banking system make it very worthwhile to try to effect such changes. These can induce growth in other parts of the economy which can in turn result in further useful changes in the financial sector. For example, during the years 1945-1959, the Mexican economy was changing from one of subsistence agriculture to an economy where

3/ See Sayre P. Schatz, "The Capital Shortage Illusion: Government Lending in Nigeria", Oxford Economic Papers (New Series) (London), July 1965.

rapid development was becoming self-sustaining. These rapid and far-reaching structural changes influenced and were influenced by structural changes in the financial sector.[4/]

4/ Robert C. Bennet, The Financial Sector and Economic Development. The Mexican Case. (Baltimore, The Johns Hopkins Press, 1965), p. 1. "...financial activities are not simply a mirror image of real activities. They can and do lead an independent existence; they can and do influence real variables." Source: Richard W. Hooley, "Implications of Saving Structure for Economic Development." Philippine Economic Journal (Manila), Second Semester 1962, p. 130. "Development involves finance as well as goods ... conventional theories of income, interest, and money have given insufficient attention to important reciprocal relationships between real development and financial development." Source: John G. Gurley and E.S. Shaw, "Financial Aspects of Economic Development." American Economic Review (Menasha, Wisconsin), September 1955, p. 515.

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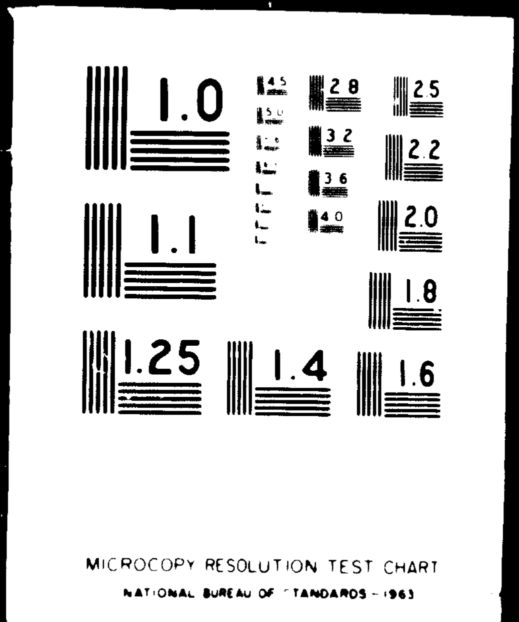
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MICROCOPY RESOLUTION TEST CHART
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102. In a number of developing countries, branches of commercial banks with headquarters in developed countries comprise the entire, or by far the most important part, in terms of resources, of the banking system. Those branches usually have been established to facilitate foreign trade; to the extent that this helped export of manufactures from developing countries and imports needed for development of manufacturing, this has been an important, even if indirect, aid to industrialization. In connexion with suppliers' credits, a study by the staff of the International Bank for Reconstruction and Development suggests that it might be useful to separate the financing, through greater use of foreign commercial banking facilities, from the sale of capital goods to buyers in developing countries. This separation might help buyers in developing countries by enabling the importers to have a wider choice of suppliers and countries among which to choose.109/ That study also suggests an increased role for branches of foreign banks in developing countries. In connexion with private external credits to the private sector in those countries, the study points out that "External credits contracted in large blocks are much more likely to have favourable conditions than numerous, fragmented credits for many small enterprises. In some cases, local branches of private foreign banks may be useful for this purpose".110/

103. More direct participation by foreign banks in the development of industry would obviously help. Such participation could take the form of more lending to manufacturing enterprises. In addition, as in France,111/ for example, banks could make equity investments in industrial firms. Legislation and regulation permitting, domestic banks in developing countries, as in Greece,112/ could also make equity investments in industry. If a Government deems it desirable to restrict the extent of such investment, an upper limit could be set in terms of the percentage of: (a) the capital and reserves, or the deposits or assets of the bank or of those balance-sheet items attributable to branches of the foreign bank in the country; and (b) the capital of the manufacturing enterprise.

109/ International Bank for Reconstruction and Development, Suppliers' Credits from Industrialized to Developing Countries, pp. IV and 32; International Monetary Fund, International Financial News Survey, 17 February 1967, p. 42.

110/ Suppliers' Credits from Industrialized to Developing Countries, Washington, IBRD, January 1967, p. 28.

111/ Henry Germain-Martin, "France". Banking Systems, B.H. Beckhart, ed., p. 238; The Economist, (London) 26 November 1966, p. XIX.

112/ Bank of Greece, Report for the Year 1963, p. 73.

Advice by banks

104. Frequently, banks are among the main repositories of rare skills in developing countries. Governments should urge those banks to advise industrial borrowers on proper accounting practice, investigation of market potential, and improved management of the enterprise. Indeed, those banks, individually or as a group, should, perhaps, be urged to advise also in matters of technology. For example, a foreign bank has recently engaged agricultural officers to work in the field in Africa.113/ In Panama, since approximately 1953, a foreign bank has been advising local ranchers on improving their herds, grazing land, etc. On the basis of this technical assistance, together with financing provided by the bank to participants in the programme, Panama has become a cattle exporter rather than an importer.114/ Thus the country, the cattlemen and the bank benefited from the programme.

105. Similar complementary interests may be served by banks helping to develop industry in developing countries. In effect, the banks would help create choice customers for their services. Indeed, the creation of such clients would be helpful to the banks in fulfilling obligations established under, for example, the reserve requirements criteria discussed earlier in this report. As in their home countries, the foreign commercial banks could perform an important service in encouraging the growth of industry through surveys of markets and feasibility studies to determine the possibilities of establishing new industries or the expansion of existing ones. This, coupled with bringing together likely investors - domestic and foreign, corporate and individual - could significantly help the development of industry.

106. In a number of cases, it may well be that foreign commercial banks would wish to pursue a more active role in industrial development. However, restrictive laws or regulations in the home country may prevent a bank from following such a policy. Such laws or regulations frequently were promulgated many years ago. It may be appropriate for developed countries to review that legislation and regulation in the context of the more recent interest in assisting the growth of developing

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113/ Barclays Bank D.C.O., Report and Accounts 1966, London, 1966.

114/ Unpublished material of the Chase Manhattan Bank, N.A., New York, 1966; Dun and Bradstreet, Business Abroad (New York) 12 December 1966, pp. 20-21.

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countries. Perhaps, as in other instances,[115] the legal and regulatory framework may be refined to permit greater freedom of activity in developing countries on the part of banks domiciled in developed countries.

107. On the other hand, of course, restrictive legislation in the developing countries may counteract such possible liberalization and inhibit foreign banks' potential more active involvement in industrialization. In Pakistan, for example, official policy suggests that foreign banks should confine their activities primarily to financing foreign trade and fostering foreign investment (presumably including investment in industry). An outgrowth of this policy is the restriction of new offices of foreign banks to port towns or large cities where substantial trade is carried on with foreign countries.[116] In Thailand, the Government does not encourage additional establishment of banks - local or foreign; however, branching by established banks is encouraged.[117] In the Republic of Korea, at least until early 1967, branches of foreign banks were not permitted.[118]

115/ Board of Governors of the Federal Reserve System, Federal Reserve Bulletin (Washington, D.C.), December 1965, pp. 1694-1696. This urges U.S. banks to curtail credits in developed countries but does not urge them to restrict credits with reference to developing countries. See also Federal Reserve Bank of New York, Foreign Activities of Member Banks and Edge and Agreement Corporations, Circular No. 5958, (New York, 15 March 1967). This permits U.S. banks to invest in stock of foreign banks or make loans or extend credit to them. These investments, loans, or credits may be made within the above guidelines to curtail credits.

116/ State Bank of Pakistan, The State Bank of Pakistan, Its Growth, Functions and Organization (Karachi, October 1961), p. 46.

117/ Paul Sithi-Amnuai, "Investment is Expected to Expand in Thailand". American Banker, (New York), 28 February 1967, p. 128.

118/ American Banker, 14 February 1967, p. 3.

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