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D01858

Distr.
GENERAL

ID/CONF.1/7
27 April 1967

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

INTERNATIONAL SYMPOSIUM ON INDUSTRIAL DEVELOPMENT
Athens, 29 November-20 December 1967
Provisional agenda, Item 3 (d)

DOMESTIC FINANCING OF INDUSTRIAL DEVELOPMENT

Prepared for the Symposium

Presented by the Executive Director of the United Nations Industrial Development Organization

67-09363

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commercial banks, through the expansion of their network of branches in the rural areas, are mobilizing money which was previously hoarded, and are thus bringing it into better use in the market. In this respect the State Bank of India has been very successful.

20. Tables 2, 3 and 4 below show the increase in time and savings deposits at commercial banks between the period 1958 and 1964. Of the Asian countries the largest relative increase has been in Thailand and the Philippines, and a substantial increase in India. In Latin America increases have been recorded, particularly for Peru and Mexico. In these tables, the countries which went through a high degree of inflation are not included; this relates to Argentina, Brazil and Chile. If deflated by the rate of exchange in 1964 as compared with 1958, the figures except for Chile, would show a decline in the value of time and saving deposits.

21. In Africa, substantial increases have taken place in the UAR, Ghana, Ethiopia and Nigeria.

22. It should be restated here that the flow of savings requires monetary and political stability.

23. In 1962, a Deposit Insurance Corporation was established in India which insured deposits up to Rs.1500 per depositor. This measure was introduced after the default of a number of small banks. At the end of September 1964, the total number of deposit accounts with insured banks was 9.8 million, of which 77.5 per cent having balances not exceeding Rs.1,500 each were fully insured.[6/]

24. The role of the rate of interest must be discussed in connexion with savings deposits. Governments would often like to keep the rate low in order to have access to cheap credit.[7/] While it has been pointed out that the rate of interest has not been very effective in increasing the flow of savings, experience in recent years in some countries, such as Mexico, Peru, the Philippines and Thailand, shows that

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6/ From its inception up to 31 March 1965, the Corporation has met the claims of nine banks with respect to insured deposits. (Report on Currency and Finance 1964-1965, Reserve Bank of India, p. 58)

7/ In this connexion it is interesting to compare the yields on government bonds in some developing and some advanced countries. See Table 4a.

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Table 2

Data on time and savings deposits in commercial banks from 1958 to 1964

Africa

		1958	1964	1965	1958	1964 Exchange $US	1965
Ghana	(Ghana pounds, in millions) Time and savings	9.3	35.2	86.9	2.80	2.80	1.17
Nigeria	(Nigerian pounds, in millions) Time and savings	17.8	56.6	70.3	2.80	2.80	
Ethiopia	(Ethiopian pounds, in millions) Time and savings	3.7(1960)	68.6	71.4	2.484	2.500	
Sudan	(Sudanese pounds, in millions) Time and savings	1.00	4.94	6.36	2.872	2.872	
UAR	(Egyptian pounds, in millions) Time and savings	68.3	179.2	200.5(Nov)	2.30	2.30	

Source: International Financial Statistics, August, 1965.

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Table 3

Data on time and savings deposits in commercial banks from 1958 to 1964

Latin America

		1958	1964	1965	1958	1963 Exchange $US	1965
Colombia	(Pesos in millions) Time deposits	448	1,255	1,473(Nov)	7.22	9.00	13.51
Ecuador	(Sucres in millions) Time and savings deposits	285	544	604	15.15	18.18	
Mexico	(Pesos in billions) Time deposits	1.85	5.75	6.70 (October)	12.49	12.49	
Peru	(Soles in billions) Time and savings	2.83	8.46	10.34	24.49	26.82	
Uruguay	(Pesos in millions) Time and savings	846	3,404	3,956	2.10	16.40	24.65

Source: International Financial Statistics.

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Table 4

Data on time and savings deposits in commercial banks, 1958-1964
(in national currencies)

Asia

		1958	1964	1965	1958	1964 Exchange Rate to $US
Ceylon	(Rupees in millions) Time and savings deposits	253	509	545	4.775	4.775
India	(Rupees in billions) Time deposits*	9.21	14.18	15.92	4.795	4.795
Malaysia	(Malaysian dollars in millions) Time deposits	227	690		3.06	3.06
Pakistan	(Rupees in millions) Time deposits	695	2,936	3,495	4.785	4.785
Philippines	(Pesos in millions) Time and savings deposits	777	2,368	2,449	2.004	3.91
Thailand	(Baht in billions) Time and savings	1.77	7.15	8.47 (Nov.)	21.1	20.84

* Savings deposits (included in time deposits) rose from Rs.2.8 billion end of March 1961 to Rs.5.8 billion end of March 1965 or more than doubled.

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Table 4a

Yields on Government Bonds

	Per Cent			
	1958	1964	1965	Feb. 1966
Ceylon	2.91	4.53	4.45	
India	4.18	4.73	5.33	5.47
Pakistan	3.20	3.93	3.90	4.48
Peru	9.36	7.14	7.23	
UAR	3.52	4.89	5.43 (Cot.65)	
Uruguay	6.18	6.43		
Australia	4.97	4.72	5.21	5.25
United Kingdom	4.98	6.03	6.42	6.50
United States	3.43	4.15	4.21	4.61
Canada	4.22	5.19	5.22	5.62
Germany	6.8	6.2	7.0	7.6
France	5.68	5.08	5.32	5.30
Mexico - market discount rate				
Discount	10.62	11.66	11.32	

Source: International Financial Statistics.

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a higher rate of interest has contributed to a growth in the volume of savings.[8] Recently, interest rates have gradually risen in nearly every country. Even in India, the rate on fixed deposits for six months or longer paid by commercial banks was raised from 3.75 per cent to 5.5 per cent in 1965. It must be emphasized however that in the promotion of savings an educational campaign is at least as important as the level of the rates of interest.

Savings bank and similar institutions

25. Savings banks proper, such as mutual savings banks, municipal savings banks or government savings banks, have been developed only in a few of the developing nations, as for instance in Colombia, Mexico and Thailand. This is true also of loan and savings associations and building societies, which have been established in only a few countries and have not succeeded in mobilizing savings. In recent years some progress has been made in organizing, with the help of technical assistance under the "Alliance for Progress", loan and savings associations in a number of countries in Latin America.

26. It is interesting to note that in the less developed countries no movement has been started by the people to organize such savings institutions, as has been the case in most countries in Europe, Australia and the United States. Perhaps as development proceeds and a new middle-class emerges, one might expect that a similar drive will be initiated and more will be done by the people themselves to organize savings banks and to entrust their savings to them.

Contractual savings

27. Contractual savings have assumed growing importance in the developing countries. They are voluntary life insurance and mandatory savings - social security and provident funds.

8/ There has been a rapid increase in time deposits at the commercial banks in Thailand since the rate of interest on deposits held for more than six months was raised to 7 per cent in May 1962. The amount of these deposits held by private residents rose from Baht 1,485 million at the end of 1961 to Baht 5,423 million at the end of 1964 (from $US70 million to about $260 million). **Source:** Bank of Thailand Monthly Reports.

28. Life insurance: Table 5 below shows that life insurance in force as a percentage of national income increased in a number of developing countries between 1958 and 1963; it has nearly doubled in India and Israel; the movement of assets of life insurance companies between 1958 and 1963 is given for some of these countries. It shows that in India the assets of the Life Insurance Corporation (which is publicly owned) have risen by more than $US760 million, whereas in Mexico by somewhat less than $100 million. To promote the life insurance business in many of these countries, the premia paid on life insurance are, up to a certain limit, exempt from income tax. Of course, the life insurance business can expand only in countries where stable monetary and financial conditions exist.

29. Social security: In a number of countries in Asia, provident funds, which are a form of social security, have shown marked progress. This applies to Ceylon, India, Malaysia and the Philippines. In Malaysia, the yearly fund accumulation at provident funds exceeds 100 million Malaysian dollars (about $US33 million); and it reached 1 billion rupees annually (about $210 million) in India, excluding the provident funds for Government servants; in Ceylon the annual accumulation is about 200 million rupees ($US42 million) and in the Philippines, a minimum of 115 million pesos (about $US30 million). As the coverage of labour expands and wages go up, a further increase in the annual accumulation of funds may be expected. In Latin America, social security systems have been introduced in most countries. However, in countries with a high rate of inflation, accumulated funds became eroded, except where they were invested in real estate. In 1959, savings of social security funds in Mexico amounted to about 510 million pesos ($US40 million); in Ecuador 220 million sucres ($US12 million); in Uruguay 141 million pesos ($US12 million). The increase of savings in social security funds in a number of countries has been unfavourably affected also by very high administrative expenditures. As stable conditions are restored and the social security systems made more economical, one may hope that in Latin America more savings will be available through social security schemes. It is estimated that in India currently 1 per cent of the national income (or about 2 per cent of the non-agricultural national income) is utilized for contractual savings, divided equally among the life insurance and provident funds payments. In the Philippines, the contractual savings-income ratio was of the order of 2 per cent on the average during 1954-1959.[9]

9/ Contractual Saving in Urban India, National Council of Applied Economic Research, New Delhi, July 1963, p. 4.

Table 5

A. Life insurance in force as percentage of national income

	1958	1963
Chile	2	2
Ecuador	4	4
Israel	8	15
India	12.8	23.5
Mexico	10	13
Peru	8	9
Pakistan	3	6
Philippines	17	20
Thailand	6	7
Puerto Rico	39	53

B. Assets of life insurance companies

	1958	1963
Chile		
Millions of escudos	12.24	15.70
India		
Billions of rupees	4.83 ($US1.1 bil)	8.47 ($US1.8 bil)
Mexico		
Millions of pesos	3.273	4.327
Ecuador		
Millions of sucres	110.8	197
East Africa		
Millions of E.A. pounds	30.8 (1960)	32.9 (1962)

Source: Life Insurance Fact Book 1965, Institute of Life Insurance, New York, p. 106.

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II. Channelling of savings into industrial investment

30. We shall now examine the question of channelling into industry funds accumulated at financial institutions. Not all savings collected by the various institutions are available for lending to or investing in industry. A part of the savings are "captive savings" which are reserved mostly for the use of Governments. This is true of nearly all mandatory savings and postal saving bank deposits. However, the use of these savings augment government funds and this should help in the financing of infra-structure and in providing means for financing Government-owned industries. Moreover, it may be possible that the Government will be placed in a position to extend direct loans to private industries or contribute to the capital and resources of development finance institutions.

31. With regard to other transferred savings, the Government will be faced with a difficult problem. In some countries the demand for funds for industries will be urgent; but the savings to be used for this purpose will also be claimed for other lines of activity, such as agriculture or housing. Should the Government introduce measures assigning priority to industries for the allocation of funds available at financial institutions? Such measures might lead to a lopsided development and eventually industries might be jeopardized because other sectors would be lagging behind. Thus the best way of providing more funds through loans from financial institutions to industries is a continuous increase in the volume of transferred savings. Only if the total volume of savings continues to grow will it be possible to satisfy adequately the various needs of the national economies.

Commercial banks

32. In most of the developing countries, commercial banks are a very important source of industrial financing. Called also "exchange banks", commercial banks in the former British dependent territories provided current credits to enterprises engaged in foreign trade, but as industrialization proceeded they gradually expanded their lending to industries. As a rule, such loans were short-term, but in a number of countries the banks began to provide credits also for working capital. In the case of enterprises in good standing, such credit became revolving and could then be regarded as a part of the funds available to the enterprise permanently.

33. A common feature of industries in the developing countries has been that, more often than not, when estimates of investment for new industries were prepared, adequate provision for working capital was not made. A part of the working capital should also be covered from at least medium-term funds. This is particularly important for industries in the developing countries because their working capital requirements are higher than in the developed economies; they have to import a much larger part of components, spare parts and even raw materials, and for this and other reasons they have to keep larger inventories than in countries where these items are readily available.

34. With the progress of industrialization, the banking system is bound to develop and adjust itself to serve the needs of industry. Table 6 below gives the proportion of loans to industries of the total lending of the commercial banks in various countries. In a number of countries the commercial banks have been in a position to rediscount the loans with the central banks. However, commercial banks cannot be regarded as a source of long-term loans. The reason for their lending limits is the source of their funds. These consist, in addition to their own capital and reserves, of demand deposits, time and savings deposits. It is not considered prudent for the banks to extend medium-term loans in excess of their time and savings deposits, although it can be pointed out that a part of the demand deposits will always remain with them and therefore to that extent they could enlarge their medium-term lending.

35. Views have been expressed that additional expansion of credit is needed to support accelerated economic growth, including the development of industries. It is true that as total national production expands, the volume of credit can be expanded accordingly, although the time element involved should be considered.

36. Arguments have also been advanced in favour of financing development through what might be called controlled inflation. As experience shows, it has not been easy to control inflation and often moderate inflation was transformed into a higher degree of inflation.

37. In a few countries in Latin America large credits were supplied (as the table below shows) by commercial banks to the private sector during a period of high inflation. There is no doubt that manufacturing benefited from this huge expansion of credit, but the high rate of inflation had many unfavourable effects.

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Table 6

Share of loans to industry of the total loans extended by commercial banks

	Total loans	Loans to industry	Percentage of industrial loans
Latin America			
ARGENTINA (pesos in billions)			
1962	168.9	76.9	45.5
1964	278.8	116.2	43.0
BRAZIL (cruzeiros in billions)			
1960	386.0	138.2	35.8
1964	2,272.6	949.9	41.8
CHILE (escudos in millions)			
June 1965:			
Loans for more than 3 months			32.3
Loans for a longer term		1,268.0	28.7
COLOMBIA (pesos in millions)			
1960	2,453.5	590.0	24.0
1965	4,996.7	1,504.6	30.11
ECUADOR (sucres in millions)			
1961	2,643.3	283.7	10.7
1964	4,611.3	444.5	9.6
GUATEMALA (quetzales in millions)			
1960	708.4	74.5	10.5
1963	948.6	163.5	17.2
MEXICO (pesos in billions)			
1960	9.5	2.8	33.076
1965	20.1	5.8	34.67
PERU (soles in billions)			
1960	6.8	1.8	27.1
1965 (September)	14.0	3.4	24.4

Source: Taken from official statements.

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Table 6 (continued)

	Total loans	Loans to industry	Percentage of industrial loans
Asia and the Far East			
INDIA (rupees in millions)*			
1960 (October)	11,000.0	5,628.0	51.2
1964 (March)	18,647.0	11,044.0	59.2
* figures include mining and utilities			
PAKISTAN (rupees in millions)			
1960	1,797.0	604.3	33.6
1964	5,479.9	1,959.9	35.8
THAILAND (Bahts in millions)			
1960	3,809.3	402.6	10.6
1964	7,401.8	1,099.9	13.5
1965 (June)	8,082.2	1,317.0	16.3
MALAYSIA (Malayan dollars in millions)*			
1960	416.6	53.3	12.8
1964	895.0	150.4	16.8
* figures include rubber products			
PHILIPPINES (pesos in millions)			
1963	5,002.1	1,558.5	11.2
1964 (September)	5,551.3	1,681.1	12.3
Middle East and Africa			
JORDAN (dinars in millions)			
1964 (December)	29.27	3.33	11.4
LEBANON (Lebanon £ in millions)			
1964 (December)	1,881.1	236.0	12.5
SYRIA (Syrian £ in millions)			
1960	668.0	126.1	18.9
1964	816.7	204.6	25.1
EAST AFRICA (EA £ in millions)			
1960	75.7	13.3	17.6
1963 (September)	95.8	12.9	13.5

Source: Taken from official statements.

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Credit to private sector	1958	1964
Argentina (billions of pesos)	74.4	338
Brazil (billions of cruzeiros)	211	3,070
Chile (millions of escudos)	226	1,370

The cost of living index rose by 500 per cent in Argentina in this period, by 1,170 per cent in Brazil and by 300 per cent in Chile. Shortage of foreign exchange made it difficult for industries to import needed components, spare parts and raw materials, so that the factories had to operate at low capacity. Not enough attention was paid to agriculture and Brazil and Chile had to depend on large imports of food. As inflation accelerated, economic growth slowed down and stopped and these countries have been going through very costly economic readjustments in order to achieve more stable conditions. By now this type of financing of industries is no longer recommended. Mexico can be cited as a country which managed to expand its industrial production under stable conditions. The amount of bank credits to industry rose from 2.8 billion pesos in 1960 to 5.8 billion pesos in 1965, but the cost of living index went up by only about 4 per cent in the last four years. Industrial production increased by 65 per cent, but Mexico has succeeded in expanding agricultural production during the same time and has been able to export cash crops and also wheat and meat.

38. There have been widespread requests that commercial banks increase their lending, particularly term lending to industries.[10/] There may be some legislative or administrative obstacles and regulations of the central banks limiting the

10/ At the Latin American Symposium on Industrial Development (Santiago, Chile, 14 to 25 March 1966), the view was expressed that, "it was deemed advisable to reform the banking system and to adapt it to the needs of an accelerated industrial development process". "International Symposium on Industrial Development - Reports on the Regional Symposia", E/C.5/135/Add.3, p. 17. The Report does not offer any suggestions as to how the banking systems should be changed.

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commercial banks term lending to industries.[11/] This matter will be dealt with in a special paper.

39. In principle, however, the capacity of commercial banks to lend to industries will depend on the flow of savings to them, especially in the form of time and savings deposits, because in addition to industries, commercial banks are also an important source of credit to commerce. In India in 1958, a Refinance Corporation was established to take over medium-term loans from commercial banks. This corporation obtained its funds from the PL 480 (United States) counterparts. In 1964 the functions of this corporation were taken over by the newly established Industrial Development Bank of India.[12/]

40. In a few countries, commercial banks have followed the example of commercial banks on the continent of Europe (Banque d'Affaires) and established close associations with industrial groups. This has resulted in active promotion of industries and also in underwriting new issues of industrial securities. In some instances it could be said that, in addition to the function of the commercial banks, these banks have also assumed the function of an investment bank. But first a higher stage of development would have to be reached which would make possible the establishment of organized capital markets (stock exchanges).

11/ The Argentine commercial banks are authorized to make medium and long-term loans which would not exceed 35 per cent of time and savings deposits. In Brazil commercial banks are not allowed to make loans for more than 180 days. In Mexico, commercial banks are allowed to extend credit to one to five years, the amount of which is determined by total demand and time deposits (usually it should not exceed 15 to 25 per cent of such deposits). Source: "El Credito para financiamiento de la industria de bienes de capital en algunos paises de América Latina". (Prepared for the ECLA Symposium) ST/ECLA/CONF.23/L.41, pp. 11-13.

12/ "With a view to encouraging commercial banks to grant adequate credit to indigenous machinery manufacture, the growth of which is essential in the context of rapid industrialization, the Industrial Development Bank of India introduced a scheme for rediscounting of bills of exchange/promissory notes arising out of sales of indigenous machinery on deferred payment basis discounted by approved banks and other financial institutions and having a maturity of six months to five years. The facilities are at the moment restricted to cotton textiles, silk and art silk, jute, cement, sugar and paper machinery manufacturing industries. Under the scheme, limits aggregating RS.7.95 million crores ($17 million) were sanctions to seven credit institutions." Source: Reserve Bank of India, Annual Report for the year ended 30 June 1965, p. 20.

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Life insurance

41. In the advanced countries life insurance companies are a very important source of investment in industrial securities. For instance, in the United States, of the total assets of life insurance companies, amounting to $149.5 billion in 1964, nearly $40 billion or 27 per cent was invested in industrial bonds and shares. In the United Kingdom in 1962, of the total assets of life insurance companies, £7.9 billion, 27 per cent (£2.09 billion) was invested in shares and 14 per cent in bonds.[13/]

42. As previously discussed, the life insurance business has been growing gradually in the developing countries but has been negligible in countries which went through major inflation. Substantial progress in this field was achieved in India, where the amount of life insurance in force reached Rs.40 billion ($8.4 billion) in 1964. In 1963, the total assets of the Life Insurance Corporation of India amounted to 8.6 billion rupees ($1.8 billion). Of this total, little over 15 per cent was invested in shares (Rs.1,440 million = $300 million at the end of March 1964). The Corporation is allowed to invest in industrial securities up to 16 per cent of its assets. With assets expanding at a high rate, the Corporation's investment in securities is bound to increase steadily.

43. The total amount of life insurance in force in Pakistan was about $320 million in 1964 and only about $200 million in Thailand for the same period.

44. In Latin America, the total life insurance in force in Mexico amounted to about $1,900 million in 1964. The technical reserves of life insurance companies were calculated at 3.66 billion pesos, of which about 9 per cent was invested in industrial securities.

45. In Colombia, life insurance has been expanding; the total life insurance in force has nearly doubled between 1960 and 1964, reaching almost $1 billion. But the increase in assets has been little more than $10 million annually and the share of investment in industrial securities was very small. Elsewhere in Latin America, life insurance has remained very limited. For example, in Ecuador the total assets were less than $10 million in 1962.[14/]

13/ Life Insurance Fact Book 1965, Institute of Life Insurance, New York.

14/ In Brazil, of the total investment of life insurance companies, amounting to Cr.16,268 million, about 17.6 per cent (Cr.2,987 million) was in company shares. Conjuntura Económica Internacional. March 1965, p. 37.

46. The lesson of the last decade with regard to the life insurance business shows that stable conditions are needed for this type of business to take root. Moreover, publicity is required even more than in advanced countries, but the example of India and Mexico proves that there certainly is enough scope for expanding life insurance in every developing country once it reaches a somewhat higher stage of development. As this business expands, there should be a possibility of channelling some of the funds accumulated at life insurance companies into industry.

Social security

47. Provident Funds, as mentioned before, must invest their reserves in Government securities and only as an exception are they allowed to make loans on mortgages. Therefore, these funds are not a source of direct financing of industry. Social security schemes suffered from inflation in a number of Latin American countries and the value of their accumulated reserves has been greatly depreciated. But even in the more stable countries the contribution of social security to industrial financing has been small. In Mexico, for example, as of the end of 1958, the Social Security Institution invested in industrial securities only P.47.8 million of its total assets of P.1.44 billion, and in Ecuador only Suc.61.4 million of total assets of Suc.2 5 billion were invested in such securities as of the end of 1959. In Latin America, social security institutions prefer to invest their funds in hospitals, laboratories and also housing, but are not attracted by investment in industrial securities.

48. It is possible that as economic and financial conditions in these countries stabilize and the operations of the social security schemes are made more economical, greater attention will be given to financing industries; it may be expected that the demand for this will become vocal because industries are expanding in most of these countries.

48. Pension Funds (except for Government officials) have not assumed any importance in the less developed countries and any contribution to industrial financing by them has been negligible.

49. It can be concluded that contractual savings, with few exceptions, are not an important source of industrial financing at present, but there are some possibilities of tapping this source, particularly when, as can be expected contractual savings grow throughout the less developed nations. This applies in the first place to the life insurance business.

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Development finance institutions

50. In recent years, development finance institutions have been considered very important institutions as a source of finance and also for promoting industry. Since World War II, there has been a steadily increasing number of such institutions (industrial finance corporations, development finance corporations, development banks etc.). They are now so numerous and so different in their structure that it is not easy to classify them into simple categories. They take various forms: fully Government-owned or fully privately-owned or jointly Government-privately owned.

51. These corporations have been set up by Governments because private capital for financing industry was not available, but in a number of cases, also because Governments wished to control industrial development through the provision of finance.

52. The objectives of industrial finance institutions, in whatever forms they exist, are very similar: to provide medium and long-term loans to industries; to underwrite issues of corporate securities; to make available technical assistance and often to initiate new enterprises. Many of these institutions have become an important channel for directing foreign funds into domestic industrial investments.

53. It has been reported that some of the institutions have been dominated by political considerations in their operations, have not been equipped to prepare appropriate project evaluation and follow it up, and as a result have become involved in bad loans. This is true especially when the corporations are managed directly by Government departments.[15/]

54. It should be pointed out that not all of the private institutions were fully successful.

55. The capital of the Government-controlled institutions is normally supplied by Government funds, and additional funds when needed are obtained from Government loans and through the issue of bonds. These bonds are mostly purchased by central banks or other official institutions and only in exceptional cases sold in the

15/ An example of such corporations was given in a report by J.T. Simpson, "Financing of Industrial Development with Particular Reference to Africa", presented at the African Symposium, CID/SYMP.B/11. In this paper he compared the poor performance of a corporation in Ghana, managed by a government department, with a corporation in Uganda which operated as an autonomous entity and has been successful.

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market, where capital markets exist. Often, it was believed that once an industrial bank or a development finance corporation was established, industries would benefit from obtaining finance from these organizations; but in many cases the new institutions suffered from a lack of capital which cannot be easily supplied from sources other than Governments. This confirms once more that only in countries where transferred savings flow to the financial institutions or capital market, can somewhat adequate financing be provided. Where development banks depend entirely on Governments, difficulties often arise in the early years of their operations.16/

56. The question might be explored whether development finance institutions could not obtain access to transferred savings, i.e., whether they could accept deposits from the general public. So far this has been the case only of a few institutions, such as the Industrial Finance Corporation in India and the Industrial Bank in Argentina. This, of course, might reduce the flow of savings to other financial institutions, particularly if higher rates of interest were offered; but it might be argued that development finance institutions would accept, in principle, only term deposits which could be used for medium and long-term loans. More study is needed in various countries to arrive at a conclusion or recommendation.

57. Of the publicly owned institutions, the most important is Nacional Financiera in Mexico. Also important has been the role of the Pakistan Industrial Development Corporation, which was instrumental in establishing a number of industries, but with the intention of selling their shares to the public as soon as practical.17/

16/ As an example, an industrial bank in Sudan, established in 1962, can be cited. The Government of Sudan subscribed to £500,000 of shares and made available to the Bank an interest-free loan of the same amount. By the end of 1963, after sixteen months of its operations, the Bank had available for new loans only an amount of £162,000. The need for new funds became imperative and the only source apparently was the Government. R.M. Meagher, Public International Development Financing in Sudan, Columbia University School of Law, 1965, p. 45.

17/ This Corporation was divided in 1962 into the West Pakistan and East Pakistan Development Corporation.

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58. Since the middle of the 'fifties, more emphasis has been placed on setting up private industrial finance corporations. The World Bank was instrumental in establishing the Industrial Credit and Investment Corporation in India (ICICI). When this Corporation was set up in 1955, 70 per cent of its capital was subscribed by private Indian investors and 30 per cent by foreign, mainly institutional investors. The Government of India extended to the Corporation a non-interest bearing loan, repayable beginning the sixteenth year from the date the loan was made. This Corporation has become very important in financing industries in India. In a similar way, this type of private institution has been establsihed in Ceylon, Malaysia, Nigeria, the Philippines, Thailand, Venezuela and elsewhere.

59. These private corporations obtained their funds from subscribed capital, and very often at the beginning from loans from Governments on easy terms. Later on some of them were able to issue bonds in the market and to obtain additional loans from Governments.18/ Many of them have become an important channel for directing foreign funds into industrial investment in their countries. The World Bank Group has been leading among the foreign lenders. The very active Industrial Credit and Investment Corporation in India (ICICI) has engaged in underwriting new issues of securities and helping to improve the capital market in India.

60. In recent years the International Finance Corporation (IFC) has been very active in helping to organize private development finance companies, and as of 30 June 1965 it was a shareholder in fourteen of these companies in twelve countries. In their operations, IFC, very often succeeded in associating foreign financial institutions with the national development finance corporations through equity participation. Furthermore, it arranged lending to them and took part in underwriting the issues of new shares.

18/ The following is the comment of the Inter-American Development Bank on the instruments which development banks can use for the strengthening of the capital market, which are generally known: "They consist mainly of: sale of securities from the development bank's own portfolio, underwriting new issues, sale of the bank's own obligations and encouragement of investors to participate in new ventures together with the development bank. For instance, Mexico's Nacional Financiera sells as its own obligations 'participation certificates' which are issued against a designated block of securities in its portfolio, consisting half of industrial shares and half of fixed-yield obligations. Not all of the instruments, available to development banks, are equally applicable, and underwriting new issues has only a limited scope in under-developed countries".

Source: "The Role of Development Banks in the Process of Latin American Economic Integration", First Latin American Meeting of Development Financial Institutions, Washing, D.C., 29 November to 2 December 1964.

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61. The importance of these institutions has been repeatedly stressed becaus through them, direct channelling of funds into industries is assured.
62. The operations of these institutions and their experience have been reviewed by international bodies; a list of development finance institutions is being prepared in a study for the Organization for Economic Co-operation and Development (OECD).

Private "Financieras" in Mexico

63. The case of the private financieras in Mexico is especially interesting. These were introduced in the late 'thirties as private development banks with the following functions: (a) to promote the organization and expansion of industrial enterprises; (b) to subscribe to equities and other securities issued by industrial or commercial enterprises; (c) to subscribe to, and sell, obligations of private enterprises, and to guarantee such obligations with regard to interest and amortization; (d) to make loans to manufacturing enterprises; (e) to act as a common representative of bondholders; (f) to issue their own bond; and (g) to receive time deposits (loans) for periods of not less than 180 days. Usually established by small groups of industrialists looking for funds with which to finance their own ventures, some financieras associated themselves with important industrial groups and were able to obtain the backing of leading commercial banks. Substantial funds were transferred from the commercial banks to the financieras, especially through the trust departments of the commercial banks.
64. However, the growth of the financieras since 1959, was based on the inflow of savings from the public. The banking authorities, aware of the importance of this type of investment banking for industrial development, did not subject the financieras to the same rigorous investment requirements as were applied to the commercial banks. The banking community realized that there was greater freedom of action and profit possibilities in the private financieras than in other branches of the banking business, and the financieras grew rapidly in size and number.
65. The financieras have been successful in mobilizing, within a few years, very large amounts of savings (in the form of loans), on which they paid a rate of interest up to 11 per cent. At the same time they charged up to 13 per cent and 14 per cent on loans to industries. In 1960 the financieras were directed to raise

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CONTENTS

	Paragraphs
Introduction	1 - 11
A. THE ROLE OF FINANCIAL INSTITUTIONS AND CAPITAL MARKETS	
I. Mobilization of savings - Financial institutions	12 - 29
Postal savings system	13 - 14
Small savings drive	15 - 18
Commercial banks	19 - 24
Savings banks and similar institutions	25 - 26
Contractual savings	27 - 29
II. Channelling of savings into industrial investment	30 - 133
Commercial banks	32 - 40
Life insurance	41 - 46
Social security	47 - 49
Development finance institutions	50 - 68
Capital markets (stock exchanges)	69 - 80
Latin America	81 - 91
Asia (India, Ceylon, Malaysia, Pakistan, Philippines)	92 - 118
The Middle East	119 - 128
Conclusion	129 - 133
B. SELF-FINANCING	134 - 148
Depreciation	136 - 139
Reinvested profits	140 - 148
C. GOVERNMENT SAVINGS	149 - 164

/...

growing amounts of funds through the issue of financial bonds in the market; the rate of growth for short-term liabilities was fixed at 12 per cent per year. This policy was intended to compel the financieras to depend more on the sale of their own medium and long-term obligations and less on short-term deposits. The amount of the bonds issued reached P.4,255 million ($US340 million) at the end of 1964, which was an increase of P.1,389 million in that year. The amount was only P.373 million in 1959. At the end of 1964, deposits from the public reached P.7,674 million ($US615 million), an increase of P.1,273 million during that year. They were P.1,216 million in 1959. One-third of their total loans has been for more than one year and loans up to five years were no exception. Since 1964, the rate of interest paid on deposits (loans) has been declining and so have the rates charged on loans to industries.

66. The role of private financieras can be compared with that of the commercial banks in Europe. They have become investment banks playing a very active role in the expansion of the most important Mexican industrial enterprises, through the provision of loans up to five years, their guarantee of private industrial bonds and their facilities for placing such securities on the market.

67. The experience of these financieras indicates how financial institutions can adjust to the requirements of industries assuming that market forces are allowed to operate and that the general financial, economic and political situation is relatively stable.

68. The following is a statement included in the report of the ECLA Symposium on "Credit for industrial expansion".

> "Mexico's experience in that field was interesting, although probably unique in Latin America. That country's representative said that Mexican industrial enterprises effected considerable savings and had access to other and abundant sources of funds through their operations on the free stock market. Issues of industrial shares (and bonds) had at all times received the firm backing of the Nacional Financiera and the Bank of Mexico. Moreover, the shares put out by the Nacional Financiera, that paid a high rate of interest and commanded a ready market, had been widely bought, not only in Mexico itself, but in the last few years outside the country as well, thereby enabling the Nacional Financiera to make a substantial volume of personal savings available to enterprises." 19/

19/ "Credit for Industrial Expansion", ST/ECLA/Conf.23/L.66, p. 87, paragraph 295, presented at the Latin American Symposium.

Capital markets (stock exchanges)

69. As industrialization progresses, the development of an organized capital market - stock exchange - in countries with a private enterprise system, is considered important. Corporations will look to such a market as a source from which they can obtain funds through the issue of shares and bonds. The creation and operation of an organized market for corporate securities is not an easy task. In a number of developing countries such markets have been set up, but little has been achieved because the ground was not prepared. In addition to various legal and administrative measures, it is necessary to educate private investors. They must be induced to buy shares and this requires time. Also, they must have confidence in the companies whose shares they would buy, and be attracted at the same time by the expected earnings. Often, dividends are paid to maintain the confidence of investors.

70. As a market develops, it becomes clear that its organization requires a number of legal and administrative provisions and regulations, such as provision for a listing of securities, and an agency which would supervise the operations of the market in order to avoid malpractices and undue speculation. The disclosure of significant data and proper auditing procedures of the corporation is very important. Eventually it will be necessary, also, to supervise the corporations through a properly established agency. A part of the whole process will be the institution of stockbrokers and, later on, of underwriters. The financial press can be very helpful in these matters. All this will be needed in order to create an atmosphere which will induce private investors to purchase common shares. The same applies also to the issue of industrial bonds which are expected to be purchased by the public.

71. A brief review of the existing stock exchanges will be given here and some of them will be discussed in the paper in more detail. In a number of Latin American countries, stock exchanges have existed for some time. In countries which have experienced a high rate of inflation, the operations of the stock exchanges have been affected by the inflationary situation. This is the case of Argentina, Chile and Brazil, where conditions have been improving recently.

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72. On the Mexican stock exchanges, the largest volume of transactions is in fixed interest securities, which is the consequence of the public's preference for liquidity.

73. In Asia, the most important stock exchanges are in India (Bombay and Calcutta), some of them having been established in the 1880's.

74. In the Philippines, a stock exchange was established as early as 1927. It was organized in Manila as a voluntary non-profit organization.

75. Stock exchanges also exist in Pakistan, but their operations have not been extensive.

76. A stock exchange operates in Singapore, and recently one was established in Kuala Lumpur, Malaya. A stock exchange was also organized in Bangkok but only small operations are taking place there. The stock exchange in Ceylon records greatly reduced activities in shares in the recent years.

77. In the Middle East a stock exchange was organized in Tel Aviv, Israel, in 1953. An active stock exchange exists in Beirut, Lebanon.

78. One comment should be made here. Savings in financial assets have been rising in a number of developing nations where relative monetary stability has been maintained and the savings-income ratio has been going up. In Mexico the amount of transferred savings increased from 2 per cent of the national income in 1956 to about 3.5 per cent in 1960 and has been rising further since then.

79. In India in ten years, from 1950/1951 to 1960/1961 the amount of savings transferred to financial institutions increased more than four times. The amount was equal to about 2.8 per cent of the 1960/1961 national income; adding to it the annual investment of individuals in securities, the ratio would be more than 3 per cent. A corresponding figure for Malaya is about 4 per cent and nearly 4 per cent for Peru.

80. Similar trends can be observed, also, in other countries. This development indicates that growing amounts of savings are collected by financial institutions or invested in capital markets, thus making more funds available for investment and providing for greater flexibility in the capital markets.[20]

20/ Source: A. Basch, Financing Economic Development, Macmillan, New York, 1964, pp. 137, 138, 205.

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Capital markets (stock exchanges) in Latin America

81. As will be shown, very few capital markets in the developing countries can be considered satisfactory, fulfilling the expected functions. One would assume that capital markets would be more developed in Latin America than in other less developed areas, but even there most of them do not function properly. As shown in table 7 below, the ratio between transactions in industrial shares and industrial production was small in every country, the highest being in Colombia, 2.6 per cent, and Chile 1.9 per cent. Only in Colombia and Chile did transactions in industrial shares represent more than one third of the total stock exchange transactions. In other countries, including Mexico, the largest part of stock exchange transactions consisted of fixed-interest securities.

82. This situation is surprising because some of the institutions are old establishments. For example, the stock exchanges in Buenos Aires and Rio de Janeiro began operating officially in 1854 and 1876 respectively. Among the factors underlining their unsatisfactory performance must be mentioned the absence of any regulations governing the operation of the stock market, or where such regulations exist their failure to adapt to a changing situation.21/ However, this situation is not the same in all countries.

21/ The organization and operation of the Rio de Janeiro stock exchange are, in essence, based on a law adopted in 1895, and to date there is no public institution that can certify the integrity of enterprises whose shares are in the hands of the public, even though all such companies must register their shares on the stock exchange. "The Process of Industrial Development in Latin America", Vol. II, p. 86, prepared for the Latin American Symposium. ECLA/Conf.23/L.2 and E/CN.12/716.

The turnover on the stock exchange in Rio de Janeiro was about 250 to 300 million cr., monthly. The new issue of paid-in capital amounted in the first half of 1964 to 131.5 million cr. This is usually only a very minor part of capital increases, the larger part consists of readjustment of value of the existing fixed assets. <u>Source</u>: <u>Conjuntura Economica</u>, November 1964.

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Table 7

INDICATORS OF EXCHANGE ACTIVITY IN EIGHT LATIN AMERICAN COUNTRIES, 1962

	Argentina	Brazil	Chile	Colombia	Mexico	Peru	Uruguay	Venezuela
1. Number of stock exchanges	3	21	2	2	3	1	1	1
2. Number of registered companies								
(a) Total	552		372	107	350	115	...	91
(b) Industrial	351		150	63	138	20	...	30
3. Relative importance of volume of transactions (percentages)								
(a) Ratio between total transactions and gross domestic product	1.5	1.2	0.8	1.1	10.9	0.7	1.3	1.1
(b) Ratio between transactions in shares and gross domestic product	1.4	0.4	0.7	0.6	0.1	0.4	0.1	0.1
(c) Ratio between transactions in industrial shares and the industrial product		0.9	1.9	2.6	0.2	0.1		0.3
4. Ratio between transactions in industrial shares and total transactions (percentages)	30	15 a/	35	40	0.5 b/	10	6.5	6

a/ In 1960 the corresponding ratio was 50 per cent.

b/ In 1961 the corresponding ratio was 6.3 per cent.

Source: The Process of Industrial Development in Latin America, Vol. II, p. 78, prepared for the Latin American Symposium, ECLA/Conf.23/L.2, E/CN.12/716.

83. A well-functioning stock market exists in Bogotá and also in Medellin in Colombia. Colombia has a very good supervisory institution (Superintendencia de Sociedades Anonimas). It also has strict stock listing requirements which are bei kept. The number of shareholders was reported to have been 442,000 at the end of 1962, as compared with only 36,000 in June 1947. The yearly turnover on the Bogot stock exchange in the first ten months of 1965 was 430 million pesos of which one-half was in industrial shares. In addition to shares, bonds issued by industrial corporations are also quoted. The yields on shares as well as bonds ha been between 10 to 13 per cent in recent years. Other countries in Latin America could certainly benefit from a close study of the organization and operations of the stock markets in Colombia.

84. On the Mexican stock exchanges, the largest volume of transactions is in fixe interest securities, which is the consequence of the public's preference for liquidity. The number of shareholders is smaller than in Colombia, which can be explained by a number of large, closely held corporations. Of the total turnover of the stock exchange in Mexico in 1964, operations in shares represented only about 6 per cent. There is a large market in securities outside the stock exchange but here too, shares represent a small portion. In recent years great efforts have been made by the stock exchange, commercial banks and stockbrokers to enlarge the number of shares which could be traded on the market.

85. As pointed out in a report prepared for the Latin American Symposium on Industrial Development, entitled "The Process of Industrial Development in Latin America", more important than the existence and the effectiveness of the regulation concerned seemed to be the factors relating to the actual structure of Latin American industry. In the first place, most enterprises are so largely family-owned or closely held, that there is little incentive to place their shares on the market, except for a proportion small enough to ensure that the existing control is not affected. Even in Colombia, out of sixty-three enterprises registered, shares are traded in only forty-eight, and of these, six account for 82 per cent of all transactions.

86. This ownership situation explains why the dividend rate of industrial corporations is not always closely related to their actual earnings. Therefore, the price of the shares, linked to the dividend rate rather than actual earnings or

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total assets, has no real meaning. One consequence of the situation has been that, since 1957, apart from Venezuela, in most Latin American countries the unit prices of the shares quoted on the stock exchange have been declining in terms of constant prices. This is true also of industrial shares.

87. This situation is one that must discourage the flow of savings into ownership of shares and securities that do not provide a fixed yield. The sharing out of profits by channels other than dividend distribution, and limited to a few persons, discourages the small shareholders who are sometimes unable to get back even the current value of their investment.

88. The result of these factors, also, is that even though in some cases the total number of shareholders is rather large, there is a high concentration of shares in the hands of small groups. In Colombia, for example, it is estimated that 1 per cent of the shareholders account for 70 per cent of the total volume of shares. This also explains why most enterprises prefer to place their shares with small groups of people (often members of a family) on a direct basis, and refrain from operating on an established stock exchange which offers no great prospect of obtaining additional funds. The above-mentioned report concludes that a study is needed covering the operations of the stock markets in the Latin American countries, both from the standpoint of the institutional framework and legal provisions in force and of the structural factors which affect the workings of the market.

89. One comment must be made here. In a number of these countries the volume of transactions in shares outside the markets has been increasing. In Mexico, private banks and prominent stockbrokers have been promoting such sales and trying to induce the closely held companies to sell a larger amount of their shares in the markets. Some success has been obtained in this field. Another example of such activity has been the operations of the United States firm, Deltec, which through its subsidiaries in a number of countries succeeded in selling even new issues of shares outside the exchange by promoting the sales through local agents, from house to house. Following is a statement concerning the operations of the company: "The local agents are not merely selling securities, however; they are teaching the lesson of free enterprise, helping to bridge the considerable gap that exists today between the few who have and the many who have not; they are, in short, bringing the opportunity of ownership to the great majority of people who in the

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past have not cared what happened to private enterprise and to whom it did not matter at all whether ownership was in the hands of the privileged few or in the hands of the Government."22/ Deltec Company started this operation first in Brazil and, later on, in Argentina, Peru, Chile, Mexico, and Venezuela.23/

90. To spread the ownership of shares, mutual funds have been established in Colombia and Mexico, both with the help of United States companies.

91. Various attempts have been made recently to broaden the ownership of shares by the Inter-American Development Bank,24/ stock exchanges, banks etc. It is also difficult sometimes for small companies to obtain listings on the stock exchange.

Stock exchanges in Asia

India

92. Among the Asian countries, the best organized are the stock exchanges in India. There are at present seven exchanges, the most important of which are in Bombay (established in 1875) and in Calcutta (established in 1908).25/ With activities expanding in the securities markets, the Government of India thought it necessary to introduce comprehensive legislation to control transactions in securities and

22/ Financing International Operations, American Management Association, New York, 1964. Chapter on "The Latin American Capital Market and Its Development" by Ulloa, pp. 146-147. In 1965 Deltec was able to underwrite and sell to the public at large, several good-sized stock issues of Brazilian companies. Among them was the offering of 600,000 shares of the first privately held company to go public there in the last ten years, which was a huge success. (Statement by G. Dauphinod, Jr., Chairman of Deltec, New York World Telegram, 8 February 1966.)

23/ The company underwrote an issue for Willeys-Overland in Brazil, of 2 billion cruzeiros. It took two years to sell this issue. The agents made about 400,000 calls and secured some 40,000 new Willeys-Overland stockholders.

24/ "One of the conditions usually included in loans made by the Bank to private enterprises is the obligation to permit within a reasonable period of time the participation of other investors in the capital structure of the companies" - from an address delivered by T. Craydon Upton, Executive Vice-President of I.D.B. in Caracas, on 26 October 1965.

25/ Other stock exchanges are in Madras, Delhi, Hyderabad, Indore and Ahmedabad.

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to regulate stock exchange practices. This was done by "The Securities Contract (Regulations) Act of 1956", which lays down the broad framework of control, regulation and supervision of stock exchange activities by the Central Government. The Act applies to all transactions other than spot delivery contracts.26/

93. Only those exchanges are permitted to function which are recognized by the Central Government. Furthermore, the Act provides for the listing of securities on the stock exchange. Only a company which has offered at least 49 per cent of each type of its securities for public subscription and made the allotment fairly and unconditionally, is eligible for listing on a stock exchange.27/ Detailed provisions deal with information which a company must submit at the time of application, including copies of balance sheets and audited accounts for the last five years. After listing, a company must furnish from time to time information pertaining to various matter, such as circulars sent to shareholders, annual reports and accounts. A stock exchange may prescribe additional terms and conditions for listing of securities. The by-laws and rules of stock exchanges mention in detail the manner in which an application for listing has to be made as well as subsequent conditions to be satisfied by listed companies in this respect.

94. Finally, the Government has the power to compel any public company to have its securities listed on a recognized stock exchange by complying with the necessary requirements for this purpose.28/

26/ Spot delivery contracts provide for the actual delivery of securities and the payment for them either on the same day of the contract or the next day. Such transactions are normally not expected to involve any large-scale speculation.

27/ In general, companies which were registered before 21 February 1957 and did not initially offer shares to the public and have at present concentrated shareholdings, are required to create public interest to the extent of 25 to 40 per cent in order to be eligible for listing.

28/ Under the Indian Companies Act, a joint stock company may be organized as a private company or a public company. A private company is one which: (a) restricts the right to transfer shares; (b) limits the number of its members to fifty; and (c) prohibits any invitation to the public to subscribe to its shares or debentures. All other companies are public companies.

95. Industrial production has been expanding in India ever since 1950, and this required increasing amounts of capital on the part of manufacturing companies. The paid-up capital of joint stock companies rose from Rs. 5.7 billion in 1950-1951 to Rs. 8.8 billion in 1960-1961. The total number of companies whose securities were listed on stock exchanges as of February 1961 was 1,203, with a total paid-up capital of Rs. 6.7 million.

96. No data are available on the volume of trading in securities. A rough estimate, based on collections of stamp duty, gives the annual turnover of securities in Bombay at about Rs. 15 to 20 billion. But this estimate is not very helpful as the trading in shares represented only a small proportion of the whole turnover, the largest volume being in Central Government and State Government securities. Although it is known that the ownership of shares has been broadening in India, precise information on the total number of shareholders is not available. The estimates vary from 100,000 to 500,000. The broadening of ownership can be seen in the number of shareholders of the prominent companies. The number of shareholders of the Tata Iron and Steel Company increased from 28,210 in 1952 to 70,000 in 1960 and during the same period the shareholders of Associated Cements increased from 25,415 to 44,067. The same is true of a number of other companies.

97. Until the conflict with China in 1962, there had been good response by the public to new issues of capital. Evidence indicates that an increasing number of persons belonging to the middle classes are becoming interested in shares as a form of investment (independent businessmen, doctors, public servants and retired persons). Table 8 below gives the amount of issues of different types of corporate securities for a number of years. The issue of shares and preference shares rose from Rs. 390 million in 1958 to Rs. 830 million in 1962; but declined then to Rs. 670 million in 1963, and did not recover in 1964. It should be pointed out here that under the Capital Issues Control Act, all issues of capital by Indian companies exceeding Rs. 1.5 million require the consent of the Government.

Introduction

1. Methods of financing industries will vary according to the stage of economic development of a country. On one side of the ledger will be a country where industrialization is only beginning and the financial organization for it has not yet been developed. It will be the innovator who will set up a factory, venturing his own funds and the funds of his family and friends, not being sure from what sources future requirements will be met.

2. On the opposite side will be a corporation establishing a factory. It will have its own subscribed capital and be assured of long-term loans, suppliers' credits and a new issue of capital. This presumes that along with the development of a capital market, financial institutions will gear their operations to the needs of industries.

3. Between these two cases there are other situations in which industrialization is being assisted by development banks, foreign loans, foreign private investment, private subscription of shares and financial aid from the Government.

4. It would be presumptuous to start with an easy generalization, for each developing country presents, in reality, a special case. However, one could draw the following conclusion: the less developed countries should pay attention to those countries which have succeeded in setting up the institutional framework for industrial finance. In this way they would learn what is required in order to have the financial mechanism developed, including, particularly, a steady flow of transferred savings which can sustain accelerated industrialization.

5. Domestic sources of funds for financing industries can be divided into three groups: (a) self-financing, (b) loans and other financial assistance from financial intermediaries and funds raised in capital markets, and (c) financial assistance from Governments.

6. In group (b) transferred savings hold a very important role. Among the financial intermediaries are some which collect savings but do not extend loans to industries, and others which are established for financing industry but as a rule do not collect savings from the public.

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Table 8

Issues of different types of corporate securities

(public companies only)*

	Ordinary shares	Preference shares	Debentures	Total
5 years, 1957-1961	1,952	284	489	2,725
3 years, 1961-1963	1,635	96	632	2,363
1963	465	21	220	706

*Source: Report on Currency and Finance 1963/64 and previous years. Reserve Bank of India, Monthly Bulletin. IBRD, "A review of the capital market in India", 1962.

98. The shareholders pay great attention to the standing of the companies and also to the yield on shares. The average yield on shares in India was:

- 4.88 per cent in 1960/1961
- 4.85 per cent in 1962/1963
- 6.59 per cent in October 1965

India has a well developed institution of stockbrokers and also a good financial press. The underwriting business has been developed in recent years. It was promoted by the ICICI, but later other institutions joined in. In the five years, 1956-1960, of the total new issues amounting to Rs. 1,974 million, Rs. 337 million was underwritten.

Table 9

Underwriting of new capital issues of non-government non-financial public companies*

(Rs. millions)

Year	Total amount of new issues	Amount underwritten by: ICICI	LIC	IFC	Banks	Brokers	Others	All under-writer
1956	344	8	-	-	8		1	17
1957	248	9	1	-	-	15	1	26
1958	311	18	12	7	19	11	8	75
1959	540	15	4	9	28	33	19	108
1960	531	10	13	2	50	22	14	111
Total 1956-60	1,974	60	30	18	105	81	43	337
1961-65		82		136				
Grand Total		142		154				

* Source: IBRD, "A review of the capital market in India", 1962.

99. However, except for the Life Insurance Corporation, there are hardly any othe institutional investors in India. The Life Insurance Corporation invests about 16 per cent of its assets in equities. About Rs. 1.5 billion was invested in that way by the end of 1963. It may be expected that this corporation will become the largest single shareholder of various important companies in India. In February 1964, the Central Government organized a Unit Trust with the object of broadening the ownership of shares. By the end of January 1965 the aggregate amount of shares subscribed by individuals was Rs. 177 million.

100. Although the stock exchanges in India are well established institutions, corporations which need funds cannot rely on them to obtain new capital. Very muc depends on the actual situation in the capital market, which in India is very sensitive to changes in domestic and international conditions. As the following figures show, in the five years, 1956-1960, newly paid-up capital supplied about 11.3 per cent of the total new funds and slightly over 12 per cent in the two years 1961-1963.

101. In the five years, 1956-1960, total new funds amounted to Rs. 11.07 billion of which paid-up share capital and debentures supplied Rs. 1,261 million - about 11.3 per cent.

102. In the two years, 1961/1962 - 1962/1963, total new funds were Rs. 6.8 billion of which paid-up capital provided Rs. 851 million or over 12 per cent.[29/]

Managing agents in India

103. The special institution of managing agents in India which has played an important role in the promotion, financing and management of industries must be mentioned in connexion with the capital market. Were it not for the initiative taken by managing agents many of India's important industrial enterprises would not have been established. Managing agents can be a firm, a private company or a public company appointed to manage a company.

104. Managing agents take up a substantial part of the capital of the companies managed by them. In a number of cases involving large companies, they provided a substantial part of the capital at the time of promotion and sold a part of their shareholdings to the public later on. They also used a part of the funds of companies under their management, to subscribe to the capital of new enterprises. In addition, the managing agents secure capital from their friends, relatives and associates. The association of managing agents, of good standing and reputation, attracts support from the investing public to new concerns. A managing agency also performs the function of an underwriter, because it takes up a part of the capital not subscribed by the public.

105. In the process of management, managing agents extend loans to the companies managed by them and also guarantee loans made by financial institutions.

106. Although no official data are available, estimates on the role of managing agents in financing industries were made. According to such estimates, 1,340 managing agents managed 720 companies, subscribed 13.58 per cent of the total paid-up capital of these companies, and loans made or guaranteed by them represented about 24 per cent of the total loans and advances as of 1951-1952. During the

29/ Report on Currency and Finance 1963-1964 and previous years. Reserve Bank of India, Monthly Bulletin. IBRD, "A review of the capital market in India", 1962. Paid-up capital includes capitalized reserves and premium on shares.

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'fifties the Government of India became concerned about the role of managing agents becoming too great in India's industries. Although seventeen managing agencies managed only ten or more companies each, these were the most important of India's industries. In August 1960, under the Companies Act, managing agencies were limited to managing not more than ten companies. At the same time restrictions were introduced with regard to remuneration tenure and operations. Despite these limitations, important managing agencies have continued to play a major role in the promotion and organization of companies and their management, especially the larger ones.

107. The nearest comparable type of institution may be the European commercial banks which combine the role of investment banking with supervising management of industries closely associated with them, but even so these banks have not become so well cognizant of the situation of particular industries as has been the case of the managing agents in India.30/

Pakistan

108. A stock exchange was set up in Karachi in 1949 and another in Dacca in 1951. The number of shares quoted on the Karachi exchange was 160 in 1965, of which only about 35 to 40 were actively traded. The daily volume of business in Karachi was estimated at about half a million rupees.

109. So far the market in Karachi, and even more so in Dacca, has been a narrow one, which is surprising if one considers the extent of industrial development in Pakistan, since say 1951. The total amount of sanctions for the issue of new capital which was about Rs. 4 billion during the period 1951-1964 can be considered as evidence of industrial expansion, but many of the large corporations are family concerns.

110. The Government of Pakistan has arranged several expert reviews of conditions in the capital market in Pakistan with a view to finding out through what legal, administrative and institutional provisions the market could be improved. Apparently more will be needed than legal or administrative reform. The investors will have to get used to the purchase of industrial securities. In a few instances

30/ S.L.N. Sinha, The Capital Market in India, Bombay 1960, pp. 111-123.

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it was possible to sell, privately, large amounts of shares outside the market, particularly in connexion with transferring shares from the Pakistan Development Finance Corporation to private hands. Furthermore, in Pakistan the National Investment Trust, set up by the Government, started operations in January 1963. At the end of 1964, it had over 10,000 unit holders who purchased units valued at about Rs. 70 million.[31]

Ceylon

111. The Colombo Stock Exchange organized by the members of the Colombo Brokers Association, was established before World War II. The turnover of commercial and industrial shares continued to rise until 1957, when it reached about Rs. 40,000 per day. In the following years it declined, which can probably be explained by the changed political situation. The nationalization of various financial institutions and pressure for the Ceylonization of the tea gardens made investors reluctant to enter the market. This has been reflected, also, in the movement of prices of quoted shares. Recently, after the change in Government, prices went up again, but the market has remained narrow.

Malaysia, Singapore

112. The stock exchange of Malaysia is an association of twenty-five stockbrokers in the States of Malaya and Singapore. The market is a small but growing one. Until recently, there has been substantial trade in the shares of the British-owned rubber plantations because of a strong tendency towards taking over these plantations through the purchase of shares. New industrial enterprises, established in the last few years, have attracted the attention of investors towards these new ventures. A number of newly formed companies have resorted to seeking capital in the market by the issue of shares and the sale of debentures. Usually a prospectus is submitted to stockbrokers or groups of individuals who take up all or a large part of the issue of the company and offer them to the public at a fixed price. In this way, thirteen companies raised $M65.7 million in 1964 and eleven companies

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31/ The aggregate value of ordinary shares amounted to Rs. 1.87 billion at the end of 1960 and to Rs. 2.72 billion at the end of November 1965. The value of industrial shares was about one-half of the value of all shares. Source: State Bank of Pakistan, Bulletin, December 1965.

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an amount of $M43.8 million. With present conditions prevailing in Malaya and with the Central Bank paying greater attention to possible improvements in the money and capital market, it may be expected that the stock exchange in Malaysia will develop further.[32/]

The Philippines[33/]

113. The Manila stock exchange, incorporated in 1927, was organized as a voluntary, non-profit organization. The legal and administrative framework for the stock exchange was provided by the Securities Act of 1936, which established a basis for setting up a Securities and Exchange Commission. The Act was amended and the Commission was patterned after the U.S. Federal Securities Acts. The Act and the rules and regulations prescribed the procedure for the offering of securities to the public, including the principle of "full disclosure". There are also stock listing requirements which include the publication of annual financial statements and obligations on the part of corporations and their officers to supply pertinent information on demand.

114. However, this comprehensive legal framework was not enough to create a broad market of securities; the more so because for some time there was a lack of securities in which the public could invest. The number of firms operating on the exchange was 29 in 1963, the same number as in 1939. In 1964 the total number of listed shares was 59, of which 25 were shares of industrial and commercial companies. No underwriting of securities was developed. The Manila stock exchange was exposed to speculation and booms originating in such speculation. The first such boom developed in the middle 'thirties in gold mining shares after the devaluation of the US dollar. A rise in copper prices created another boom in 1954-1955. Around 1958-1959 investors were impressed by the growth of industrial shares outside the mining and oil exploration; but even during the booms the total value of transactions was small as table 10 shows.

32/ "Country Study on Malaysia", prepared by the Government of Malaysia for the Asian Conference on Industrialization (Manila, Philippines, 6 to 20 December 1965) I&NR/Ind.Conf./C.17.

33/ "The Securities Market in the Philippines" by Antonio V. Roxas in The Principal Stock Exchanges of the World, edited by David E. Spray, Washington, D.C., 1964. Annual Reports of the Central Bank of the Philippines. Statistical Bulletin issued by the Central Bank of the Philippines.

Table 10

Total peso values of transactions

(in P million)

1952	23.4
1955	166.4
1956	257.2
1958	244.7
1962	118.9
1963	185.7
1964	148.8

115. The booms were reflected in the movement of the stock price index shown in the table below, which also indicates that the movement of mining shares had a dominating influence on the movement of stock prices.

Stock price index in Manila

1955 = 100

	All items	Mining	Commercial and Industrial
1955	85.9	73.1	
1956	174	182.8	
1957	133.2	135.5	
1959	101.8	94.3	152.9
1963	96.6	89.6	
1964 (December)	88.9	81.5	

116. The market value of listed shares on 30 June 1963 was:

	Pesos (million)
Total	1,346.9
Commercial-industrial	736.9
Mining	519.4
Oil exploration	90.6

Of the listed shares, only about 50 per cent of companies were paying dividends which exceeded 10 to 11 per cent of the quoted price.

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117. The Investment Company Act of 1960, was enacted to regulate the activities of mutual funds which started operating in 1958. For some time it was assumed that these funds would result in growing activities of the Manila stock exchange. No data are available on the total amounts collected by the mutual funds, but looking at the over-all situation and investors preferences, these figures are probably not very high.

118. The case of the Manila stock exchange may perhaps show that it is not enough to provide a legal framework for the operations of a stock exchange, including supervision and disclosure. More is needed to develop a climate which would attract the public to invest in shares, and this apparently has not yet happened in the Philippines. Moreover, there are various closely held companies in the Philippines which are not willing to place a major part of their shares in the market.33/

Stock exchanges in the Middle East

Israel

119. A regular trade in local securities began in Palestine after 1933 in the wake of the middle class emigration from Germany and Central Europe. In 1935 regular meetings of representatives of banks and brokers, were organized in order to fix prices for the securities available at that time. The Tel Aviv Stock Exchange Limited was organized in 1953.

120. After 1948, activities in the market were dominated by the issues of government and government-guaranteed loans, which were to a large part so-called "linked loans". These were dollar linked or index linked bonds.

121. Towards the end of the 'fifties, trade in equity securities grew as companies resorted to the issue of shares to obtain the needed funds. Table 11, below shows that the market value of securities listed on the Tel Aviv Stock Exchange and the volume of trading have been steadily increasing. The boom in equity securities is indicated in the movement of the index of shares.

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Table 11

Market value of securities listed on the Tel Aviv Stock Exchange
(in £I million)

	1959	1960	1961	1962	1963
Bonds	336	363	501	707	755
Shares	35	130	209	331	848
Total	371	493	710	1,038	1,603

Of the £755 million bonds issued, only £57 million were not linked bonds.

Volume of trading on the Tel Aviv Exchange
(in £I millions)

Equity Type Securities

1960	1961	1962	1963
38.2	46.5	68.3	241.9

Debt Securities

23.5	41.3	54.1	45.3

Indices of share prices
(1958 = 100)

1960	1961	1962	1963	1964
267	324	350	512	504

122. In 1963 the exchange membership consisted of forty-one members of which twenty-four were commercial banks. There are no hard and fast rules regarding the listing of securities on the exchange. Usually a listing will be made if the following criteria are met: that the public interest and widespread ownership of shares would warrant orderly trading; that a minimum of 25 per cent of the stock has been sold to the public or that of the stocks offered a minimum of 30 per cent must be publicly offered and no more than 70 per cent privately placed. Finally,

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that the amount of stock available for listing should be at least above the nominal value of £I 500,000.

123. In 1959 the Minister of Finance appointed a public committee known as "The Securities Commission", whose main task is to examine and approve all public issues and securities The number of companies whose stocks were quoted on the exchange reached seventy-nine at the end of 1963. During this year, the new issues offered were estimated at £I 180 million as compared with £I 34 million in 1962 (calculated at offering prices). During 1963, twenty-two new companies went public by offering their stock publicly. Family enterprises were reluctant to become public companies as long as there was some hope of raising investment funds outside the capital market. When the market became more active, industrialists who needed more funds to expand their business had to apply to the capital market.

124. One feature of the share market in Israel is the public preference for companies which regularly distribute relatively high dividends. Because of this mentality of investors, Israeli companies distribute most of their proceeds to shareholders The Government, through various tax measures and other means, has been trying to induce the investing public to realize more readily the importance of growth as against high dividend distributions. Institutional investors play an important role in the share market in Israel. In 1964 of the total amount of shares registered on the Tel Aviv Stock Exchange, investors abroad held £I 247 million or more than one-fourth; of the amount of shares held by investors in Israel, £I 728 million, institutional investors accounted for about 45 per cent (£I 315 million), of which £I 193 million was the share of public investment companies.34/

125. Between 1958 and the end of 1965 the cost of living index rose by 46 per cent. These inflationary conditions may have contributed to the growing investment by the public in shares.

126. It should be mentioned that Israel maintains free convertibility of currency and that it is assumed that foreign investors will become buyers of Israeli securities.

34/ The Stock Market in Israel, by Shalom P. Moron in The Principal Stock Exchanges of the World, edited by David E. Spray, Washington, D.C., 1964.
Statistical Abstracts of Israel 1965, p. 524/5.

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7. This paper will deal first with the role of financial institutions, although, in fact, as will be shown, financing from depreciation and retained earnings has been the most important source of funds in many countries. First, the setting up of new industrial enterprises by private investors will be discussed briefly.

8. At an early stage of industrial development, a private investor starting a new industrial enterprise can be regarded as an innovator who is taking on unknown risks inherent in such enterprises.[1/] He will have to provide at least a part of the needed capital, the rest often being obtained from relatives and friends and also from moneylenders.[2/] It will require various incentives to induce investors to start such a venture. Fiscal incentives will not be very important at an early stage of development. Most effective might be direct financial and other assistance by Governments. As industrialization proceeds, fiscal incentives may play a greater role; but this will be true of countries which have good tax administration, such as India, and more recently, Mexico. Where tax administration and collection are not adequate or the rates of direct taxes are low, tax incentives do not prove to be really helpful in promoting new industries. New industries everywhere will ask for protection against imports, which is usually assured from the start but often granted in excessive measure. Assurance will be needed that raw materials, public utility services, and labour, will be available on a sufficient scale and at reasonable rates.

1/ "As the field of industry is new in this country, it is very difficult for the people to venture in a field which they have no experience in before. They prefer to stick to their old trade, e.g. commerce, agriculture or real estate are all fetching quick and sizable returns as opposed to industry which requires money to be allocated for, e.g. research, development, apart from either incurring losses in its initial stages of development or if it succeeded to make profits they are very small." Regional Symposium on Industrial Development in Africa. (Cairo, 27 January to 10 February 1966) "Industrial Development in the Sudan" (submitted by the Republic of the Sudan), E/CN.14/AS/I/7, p. 19.

2/ "From their savings, individual businessmen have set up one-man industrial ventures; and in some cases, there have been a pooling of several individual savings to set up partnerships, private companies and co-operative societies, all engaged in setting up and financing one type of industrial project or the other." African Symposium Report on Nigeria (presented by the Federal Republic of Nigeria), p. 12, E/CN.14/AS/I/6.

Beirut, Lebanon

127. Elsewhere in the Middle East, the only stock exchange on which industrial shares are traded is in Beirut. Of the forty-seven joint stock companies quoted on the Beirut stock exchange in 1965, only thirteen were engaged in industry. Transactions in industrial shares in 1965 amounted to £L 12 million, or about 15 per cent of the total transactions (it was 4 per cent in 1960). In Lebanon, as in other Middle Eastern countries, a general tendency for "closed" companies prevails. Founders of new companies tend to provide most of the capital required, or at least enough of it, to retain control of the company. The submission of shares for public subscription is usually done as a matter of formality.35/

128. The stock markets in Cairo and Alexandria, UAR, lost their importance for trading in shares as practically all important industrial companies have been nationalized.

Conclusions - capital markets

129. Reviewing the situation of the stock exchanges in the less developed countries, it can be concluded, then, that in general they have not yet reached the stage of development which would assure enterprises that they could raise the required funds through issue of corporate securities. Furthermore, this is not limited to periods when the market had become less absorptive, because of a tight credit situation. An exception exists, perhaps, in Mexico, but mainly for fixed interest securities, and, not as yet for the issue of shares; the situation in Israel is also promising.

130. It must be realized that in most of the developing countries there is not much expectation that capital can be raised by selling shares until the process of industrialization progresses. Only when market operations become well known and a class of private investors develops, will stock markets gain more in importance. It can be said that the requirements are: a new approach of investors, to investment, a new psychology, and development of a middle class attitude.

35/ "Financing of Manufacturing Industry in Selected Countries of the Middle East", A/IV/UN-7, prepared for the Conference on Industrial Development in the Arab Countries. Kuwait, 1-10 March 1966.

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131. The reasons for the situation vary from country to country. Only when the conditions prevailing in each country are examined further can suggestions be made on how to improve the situation on the stock exchange. No simply formula to be applied to every country can be recommended.

132. For most countries information is not available on that part of the needed funds which has been obtained through the issue of securities in the capital markets An exception is India. As mentioned previously, data for 1,333 public non-financial companies in India indicate that in recent years paid up capital supplied about 12 per cent of the total funds available. (Paid up capital includes capitalized reserves and premium on shares.) But similar information is not available even for Mexico.

133. There is one interesting feature of the development of stock markets in less developed countries in recent years. Whereas stock prices in most of the advanced countries have risen substantially since 1958, they have remained stagnant or even declined in the less developed countries, as table 12 shows.

Table 12

Market prices of industrial shares

Index numbers: 1958 = 100

	1962	1964	1965
Ceylon (1952 = 100)	70.9	71.5	78.9
Colombia	101	113	107
India	139	125	114
Mexico	83	108	124 (November)
Peru	89	85	86 (November)
Venezuela	64	76	81 (August)
Australia	149	168	153
Germany	221	243	216
Netherlands	230	233	228
United Kingdom	158	192	181
United States	133	175	190

Source: United Nations Monthly Bulletin of Statistics, March 1966.

B. SELF-FINANCING

134. Self-financing from depreciation and retained earnings is a very important source of funds for the modernization and expansion of industries. This was recognized at the meetings of the three Regional Symposia and properly stressed. The Proceedings of the ECAFE Symposium on Industrialization include the following statement:

> "Corporate savings in the form of retained earnings have become more and more important for providing finance to the industrial sector, as they constitute the most direct means of capital formation and enable existing enterprises to mature into more economical units and at the same time to be in a position to assume greater risks." 36/

The African Symposium stressed the need for the promotion of a system of plowing back profits for the financing of industries for purposes of industrial development.37/ Finally, the summary report of the ECLA Symposium states that it was agreed that the industrial development of the Latin American countries had been limited by insufficient capital formation in the industrial sector. That, in turn, was due to insufficient re-investment of the funds generated by the industrial enterprises. It was recognized that depreciation reserves, considered as an internal source of funds for industrial enterprises, were generally lower than those of the enterprises in the more developed countries, and where there was inflation, the reserves were sharply reduced by the depreciation of the capital. In addition, the percentage of total profits invested was low and was often only sufficient to offset, in part, the inadequate depreciation reserves, without contributing much towards capital formation or expansion of capacity.38/

135. It has often been pointed out that self-financing is especially important for countries where enterprises cannot rely on capital markets for their needed funds. However, self-financing plays a major role in financing industries also in the

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36/ Proceedings of the Asian Conference on Industrialization, E/CN.11/719, p. 73.

37/ Report of the Symposium on Industrial Development in Africa (Cairo, 27 January to 10 February 1966), E/CN.14/347, p. 13.

38/ "Summary Report of the Latin American Symposium on Industrial Development", ST/ECLA/Conf.23/L.66, p. 87.

advanced industrialized nations. Table 13 shows the amount of self-financing of United States corporations for the period 1960-1965. Self-financing provided around 70 per cent of the total required capital during this period, while dividend payments amounted, on the average, to about 45.3 per cent of profits after taxes. A similar situation exists in Canada, the Federal Republic of Germany, the United Kingdom and elsewhere. This perhaps illustrates the role which self-financing should play in aiding industrial development in the less developed nations.

Table 13

U.S. corporate profits after taxes

($ billion)

	Total	Dividend payments	Undistributed profits	Deprecia-tion
1960	26.7	13.4	13.2	24.2
1961	27.2	13.8	13.5	25.4
1962	31.2	15.2	16.0	29.2
1963	32.6	15.8	16.8	31.0
1964	37.2	17.2	19.9	32.9
1965	44.5	18.9	25.6	34.9
Total	199.4	94.3	105.0	177.6

During 1960-1965 depreciation and retained profits totalled $282.6 billion, ($60.5 billion in 1965). Total amount of funds needed during 1960-1965 was $399.1 billion and $86.7 billion in 1965. Thus self-financing supplied around 70 per cent of total requirement of funds during this period. Dividend payments equalled about 45.3 per cent on the average during 1960-1965, but only 41.8 per cent in 1965.

Source: Annual Report of the Council of Economic Advisers, Washington, D.C., 1966, p. 284.

Depreciation

136. The purpose of depreciation is to enable the enterprise to accumulate funds adequate for the replacement of the investment when necessary. It may be expected that the cost of investment at the time of replacement will be higher than was the original cost because of price increases and also because, often, more modern and more efficient equipment is installed. It is therefore justified that Governments

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of developing countries establish provisions for an accelerated depreciation and allow the enterprise to depreciate 125 per cent of the original cost. Depreciation within five years has been permitted in a number of countries.

137. Special cases of depreciation arise in countries which have gone through a high degree of inflation. If depreciation rates are applied in these countries to a book value of the capital, it becomes more and more meaningless in relation to the real replacement value of the assets in question. This situation has prevailed in a number of countries in Latin America, especially in Brazil, Chile and Argentina. Although the Governments issued special provisions relating to the revaluation of assets, the real objective has not been achieved. This is reflected in the following statement of the paper prepared for the ECLA Symposium.

> "... the relative smallness of the contribution made by sinking funds to the financing of the expansion of manufacturing activity is attributable mainly to the undervaluation generally implicit in the book value of industrial capital. The corrective measures adopted do not seem to have been sufficiently efficacious for the following reasons: they have, as a rule, lacked continuity, being mainly in the nature of sporadic expedients, whereas the problem is perennial; in some cases, they have been linked exclusively to devaluations in the exchange rates, taking no account of fluctuations in internal price levels; and they have sometimes evaded overt recognition of a de facto situation, merely mitigating its adverse effects by authorizing the constitution of special sinking funds." 39/

138. To illustrate the situation: In Brazil depreciation amounted to only about 8 per cent of the total sources of financing during 1959-1960. The percentage was 10 in Chile during 1949-1961 and also in Colombia for 1958-1962. These countries could benefit from the experience of several European countries after World War I.

139. In Austria, Czechoslovakia and Germany, laws were introduced allowing a complete revaluation of fixed assets, thus providing a new basis for depreciation - a rather simple measure which resulted in a substantially higher investment than before these laws were passed.

39/ "The Process of Industrial Development in Latin America", Volume II, p. 64, ST/ECLA/Conf.23/L.2/Add.1.

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Reinvested profits

140. The reinvestment of profits is important, particularly for new enterprises, to make possible the strengthening of their financial base. For that reason, in a number of countries grace periods of five years after the beginning of operations have been introduced during which the new enterprises are exempt from the payment of income (corporate) taxes. In a number of countries, reinvested profits up to a certain limit are also exempt from taxation. The proportion of reinvested earnings to total profits varies according to the structure of the ownership of a company. Usually in family-owned or closely held companies no great importance is attached to the distribution of profits. However, where shares are quoted on the exchange, consideration is given to the market and the shareholders, and a higher proportion of profits is distributed. Data on the proportion of undistributed profits in total profits are not readily available for a large number of countries. The limitations in obtaining sufficient quantitative data on this item are also mentioned in the ECLA Report.[40/]

141. There is another factor which has to be taken into account with regard to undistributed profits in Latin American countries. The high rate of undistributed profits was to offset the low rate of depreciation. In recent years the ratio between undistributed and total profits has been rising in Mexico and Peru (it has been very high in the closely held companies in Mexico), and reached about 58 per cent in Colombia by 1962 and about 60 per cent in Argentina in 1960-1962. As the ECLA Report brings out clearly, this amount must be taken into consideration. with the low rate of depreciation in order to arrive at a total figure of self-financing.

142. Table 14 below shows the share of self-financing of industries in the total needed funds in some Latin American countries. The column headed "Other sources" includes also suppliers' credits and foreign loans.

143. For India, data are available for 1,333 joint stock companies representing about 90 per cent of the total capital of companies of this type. As table 15 shows, retained profits represented, on the yearly average, for 1960/1961 to 1963/1964, 36.8 per cent of profits after taxes. It is reported that this ratio has

40/ *Ibid.*, p. 62.

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risen in recent years. During this period depreciation and retained profits financed about 79 per cent of fixed investment, amounting to Rs. 2,327 million yearly (about $US490 million).

Table 14

Sources of funds for financing industrial expansion in Latin American countries

	Internal sources*			External sources		
	Total	Not Distributed profits	Deprecia-tion	Total	Capital	Other Sources
Argentina (1960-61)	40.0	14.0	26.0	60.0	9.0	51.0
(1952-55)	60.0	47.8	12.2	40.0	9.4	30.6
Brazil (1959-62)	43.2	36.4	6.8	56.8	8.2	48.6
Colombia (1958-62)	51.8	27.8	24.0	48.2	16.4	31.8
(1953-58)	48.7	11.3	37.3	51.3	25.7	25.6
Chile (1949-61)	52.3	42.3	10.0	47.7	4.5	43.2
Ecuador (1953-57)	56.5	22.7	33.8	43.5	12.6	30.9
Uruguay (1960)	42.0	...	...	58.0	16.0	42.0
Venezuela (1961)	50.5	21.3	29.2	49.5	10.6	38.9

Source: The Process of Industrial Development in Latin America, Volume II, p. 52, ST/ECLA/Conf.23/L.2.

*The terms "internal" and "external" mean internal and external to the firm.

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Table 15

India - 1,333 Joint Stock Companies

(Rs. millions)

	1960/1	1961/2	1962/3	1963/4
Profits after taxes	1,322	1,306	1,197	1,394
Dividends	801	832	800	857
Retained profits	520	474	398	537
Percentage of profits after taxes	39.4	36.1	33.2	38.5
Depreciation	962	1,037	1,124	1,288
Depreciation and retained profits	1,482	1,511	1,522	1,825
Borrowing from banks	506	521	686	334
Other	156	153	167	694
Total borrowing	662	674	853	1,028

Source: Reserve Bank of India Bulletin, November 1965.

144. At times arguments have been advanced against incentives for self-financing. One argument points out that such incentives tend to reduce tax revenue. This is true, but only for the first years. As the economic base grows because of new industrial development, revenue will automatically expand.

145. The second argument points out that if reinvestment of profits accumulates in enterprises which do not expand, it might lead to an undesirable consumption and prevent the new resources from going into manufacturing activities not connected with them. It can be pointed out that enterprises which do not intend to expand are, in most developing countries, exceptions. Furthermore, the benefit of channelling the resources into other manufacturing activities depends upon the efficacy of other instruments through which the transfer of savings is facilitated, a case in point being that of the capital market. Of course, tax incentives would not be very effective in countries with poor tax administration and collection, or with a low rate of direct taxation.

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9. Above all, a climate conducive to industrial development is necessary. This relates to many factors, such as confidence in general stability and social order, fairness in taxation, a feeling of security by the entrepreneurs, an expected rate of growth of the economy, a sufficient domestic market etc.

10. While tax incentives are being discussed in a separate paper, the most common will be mentioned here. They are accelerated depreciation (in India the new enterprises are allowed to depreciate 125 per cent of the value in five years), a grace period for the payment of income taxes extending for a number of years after the completion of the project, and an assurance that import duties will not be collected on raw materials, machinery and components. Systems of tax incentives have been operating throughout developing nations.

11. It should be pointed out here that the Governments in some countries doubted that private investors could be induced to set up industries, and therefore took it upon themselves to establish government-owned enterprises, at least at the onset.

A. THE ROLE OF FINANCIAL INSTITUTIONS AND CAPITAL MARKETS

I. Mobilization of savings - Financial institutions

12. Industries will need credits for at least a part of their working capital, in addition to credits for current purposes. The source of these credits will be financial institutions and these, in turn, will depend in their lending capability on the inflow of transferred savings. A regular and growing flow of savings requires savers' confidence in monetary and political stability. But, in addition to these basic prerequisites, in most developing nations, continuous education of people will be required to save in this form instead of investing in gold, silver, jewelry, real estate or hoarding money. Although it is often pointed out that such an educational process takes a very long time, experience has proved that the time can be shortened and that a basis for the people to save in the form of financial assets can be established. But as a report prepared for the ECAFE Symposium stated, "whether individual savings may be accumulated into sizable funds depends on whether there are proper institutions so that such savings may be concentrated and channeled into proper usage".3/ What is needed everywhere is to organize institutions which are in a position to collect savings and properly administer them. Such institutions will be discussed here and possible measures to be taken indicated. Not all of these institutions, however, extend credits to industries.

Postal savings system

13. Postal savings systems have been developed in all former British dependent territories and some other countries; but they do not exist in Latin America. A postal savings system can be effective especially in the rural areas where commercial banks seldom operate. Table 1 below compares the movements of postal savings deposits during the period 1958-1964. As the table shows, the largest

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3/ Asian Conference on Industrialization (Manila, 6-20 December 1965) "Sectoral Study. Industrial Credit and Finance." Prepared by a Group of Experts, p. 42 I and NR.IND.CONF./S.7. "The establishment of an official institutional mechanism is a prerequisite for mobilization of savings and their allocation in accordance with national priorities."

increase occurred in India (more than $50 million annually; in 1965, however, they increased much more - by $162 million). Much slower progress has been achieved in Pakistan, although the postal savings system is the same as in India. India recently raised the rate of interest on postal savings to 4 per cent, which might help to increase the volume of savings.

14. It would be useful for the developing countries to study the postal savings system and its performance in India, and even more so in some European countries. It should be possible to attract growing numbers of savers and in that way collect increasing amounts of savings.

Table 1

Postal Savings Deposits

A. Increases (in millions of $US)

	1958 $US	1964 $US	% Per cent
India	472.5	856.8	+81
UAR	98.76	157.09	+59
Pakistan	101.85	121.38	+19
Iraq	78.4	100.80	+28
Ceylon	61.74	82.53	+33
Malaysia	41.83	56.35	+34
Sudan	8.009	21.56	+161

B. Decreases (in millions of Pounds)

	1958	1963	Per cent
East Africa (E.A. pounds)	12.9	9.6	-39
Kenya " "	8.7	5.6	-36
Tanzania " "	2.2	1.6	-27
Uganda " "	2.1	1.2	-43
Ghana (Ghana pounds)	12.1	10.1	-16.5
Nigeria (Nigerian pounds)	4.0	2.9	-28

Source: International Financial Statistics, August 1965.

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Small savings drive

15. In some countries, Governments have attempted to collect more savings from the general public by selling government certificates in small denominations. Here again, India has made perhaps the strongest effort. During the four years 1960/1961 to 1963/1964, the total amount of small savings collected was more than $800 million. The main instruments were National Defense Certificates on which interest goes up according to the length of time the certificates are held. Interest on small savings and on postal savings is exempt from income tax.

16. Pakistan also endeavoured to mobilize small savings through the issue of various certificates. The most important are the National Development Savings Certificates which were introduced in 1958. By September 1965 the total outstanding amount of these certificates was Rs.576 million ($121 million).4/

17 While India is given as an example of a country trying to increase the flow of small savings, various measures of a similar kind have been taken also in other countries. Some countries have tried to induce people to save by issuing bonds (prize bonds) which have a lottery feature.

18. It can be concluded that wherever conditions are favourable for savings, a determined drive by the Government can help very much in inducing people to save in the form of financial assets.

Commercial banks

19. As stated in a recent ECAFE report:5/ "Commercial banks represent the most developed and effective mechanism for the mobilization of savings and their direction into productive channels by virtue of their access to all classes of savers through the network of their branches." Commercial banks collect savings in the form of saving deposits, but a substantial part of time deposits can be considered also, as available for the banks' term lending. In some countries, commercial banks have started a savings drive spread over the country to increase the amount of savings (for instance in Colombia, India and Mexico). Furthermore,

4/ State Bank of Pakistan, Statistical Bulletin, December 1965.

5/ *Ibid.*, p. 43.

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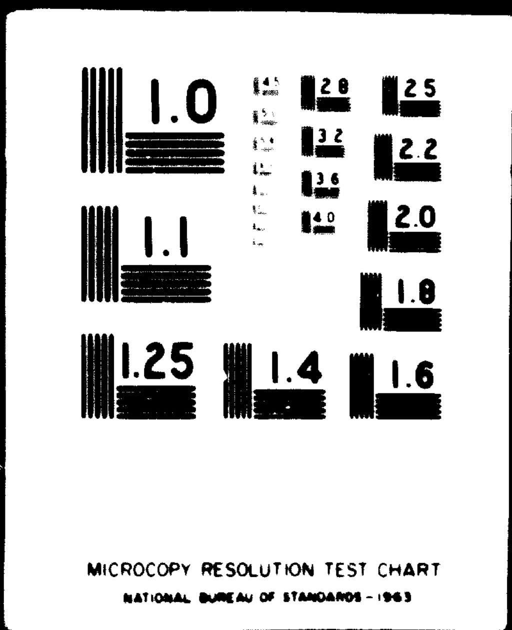
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MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS - 1963

We regret that some of the pages in the microfiche copy of this report may not be up to the proper legibility standards, even though the best possible copy was used for preparing the master fiche.

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146. Despite some arguments raised against it, the case for incentives for increased self-financing remains very strong, and countries would be well advised to examine what the best devices of such incentives would be. One could illustrate this with the example of Australia, a newly industrialized nation. During the five years 1959/1960 to 1963/1964, depreciation provisions averaged $1,330 million and undistributed company profits about $390 million annually. These two items provided the chief source of funds for capital expenditure by private business, which amounted to $2,518 million per annum.[41/]

147. During this period, Australian companies listed on the Australian stock exchanges have raised, on the average, $430 million per annum by new issues of shares and fixed interest borrowing. This shows that the high rate of self-financing did not prevent successful operations of the Australian capital market. On the contrary, the one goes in hand with the other, and only when a capital market is developed will the companies begin to depend on it for their financial needs.

148. In the less developed countries industries could hardly obtain from domestic borrowing or from security issues in the markets the funds which they generate through self-financing.

41/ Reserve Bank of Australia, Monthly Bulletin.

C. GOVERNMENT SAVINGS

149. The importance of government savings, which are defined as surpluses of current revenue over current expenditure, is widely recognized. The Proceedings of the Asian Conference on Industrialization include the following statement: "The need for public savings becomes more important as there are increased requirements for general infra-structure to promote further industrialization."42/ The report on "Industrial Credit and Financing", prepared for the meeting, elaborates on this point in more detail:

> "As to the public savings, it is suggested the fiscal and taxation policies should be formulated in such a way so that it /sic/ will stimulate further industrialization with some reference to curtailment of unnecessary consumption. Care should also be exercised in the attraction of public savings so that it will not compete too strongly with the private sector. As to the public enterprises, retention of earnings should certainly be encouraged so that they compete efficiently with the private enterprises and be given the opportunity to plan ahead according to their own projections." 43/

150. The Report of the African Symposium44/ includes the following statement among the points which received general recognition:

> "There is need of the manipulation of fiscal policy in various forms, as a device to promote and generate savings and new forms of revenue and to improve existing tax systems; a number of African countries were doing this: of particular interest was the experience of one country in imposing a tax on sugar to finance the building of a new dam." 45/

151. As government participation in industrial development has been expanding, either directly or indirectly, government savings are required to meet this particular need too.

42/ E/CN.11/719, 10 January 1966, p. 75.

43/ Report of the Expert Working Group on Industrial Credit and Financing, I&NR/IND/S.7, 31 August 1965, p. 181.

44/ Report of the Symposium on Industrial Development in Africa (Cairo, 27 January to 10 February 1966), E/CN.14/347.

45/ Ibid., p. 56.

152. To obtain sizable government savings is no easy task under the present circumstances in the developing countries, although their increase is considered possible.46/ Government expenditure has been rising everywhere, not only on the administration proper but also on what might be called social welfare, which includes health, education and housing. There has been a race between increasing expenditure and rising revenue. Often the recurrent expenditure rose faster than the current revenue. Many countries have attempted to increase tax revenue through the introduction of new taxes and more important, through improvement of tax administration and tax collection. Under the technical assistance provided by the "Alliance for Progress", substantial progress has been made in this field in a number of Latin American countries, especially with regard to tax administration and tax collection. As table 16 shows, a number of countries recorded public savings during the years 1961-1964; the highest rate of public savings, over 9 per cent of GNP, was in Venezuela in 1964, based on large revenues from oil. There was a steady rate of public savings in Mexico, around 4-1/2 per cent of GNP, and also in Ecuador. Chile shows government savings rising from 3.38 per cent in 1961 to 5.20 per cent in 1964, but this has to be reconciled with the large increase of claims on Government by the Central Bank. These claims have risen from 384 million escudos in 1961 to 1,473 million in 1964.47/

153. In India the percentage of government savings to national income more than doubled (from 1 per cent to 2.6 per cent) during the period 1950/1951 to 1962/1963. In Pakistan during the Second Five Year Plan (1960/1961 to 1964/1965), government savings amounted to nearly $800 million. In the four years, 1960/1964, government savings in Thailand exceeded $260 million. Government savings have been rising

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46/ "There would, in particular, appear to be scope for expanding public savings. The tax structures prevailing in developing countries have generally been such that tax revenue has not been strongly responsive to the growth of income and output".

Source: UNCTAD document, TD/B/C.3/4, Note by the Secretary-General of UNCTAD. Consideration of the Adequacy of the Rates of Growth Achieved by the Developing Countries: Problems and Issues.

47/ Alliance for Progress, Weekly Newsletter, 18 April 1966. It is reported that tax collections in Chile rose 26 per cent in real terms in the first half of 1965. Much of the increase is credited to more efficient accounting methods, more vigorous auditing of returns, and the entirely new threat of penalties for evasion.

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also in the United Arab Republic, mainly as a result of growing revenue from Suez Canal dues. Surprisingly small government savings, despite large oil revenues, were shown in Iran and Iraq.

Table 16

Public savings as a percentage of gross domestic product in Latin America 1961-1964

	1961	1962	1963	1964
Argentina	3.7	0.1	2.0	1.0
Bolivia	-	-3.3	-3.7	-0.8
Brazil	2.6	1.1	2.4	2.9
Chile	4.38	4.30	5.07	5.20
Colombia*	2.27	0.60	1.31	1.84
Costa Rica	1.64	2.61	1.33	-
Ecuador	4.21	3.40	5.09	5.48
El Salvador	0.46	1.16	1.45	2.78
Guatemala	1.52	1.32	1.66	1.37
Honduras	1.65	1.28	1.34	1.98
Mexico	4.53	4.26	4.41	4.33
Nicaragua	2.12	3.21	3.98	4.00
Panama	2.39	2.40	3.07	2.49
Paraguay	2.57	3.76	1.91	1.92
Peru	2.21	3.74	2.60	2.03
Uruguay	2.50	-1.80	-0.56	-
Venezuela*	7.24	5.90	4.91	9.06

* Only for the Central Government.

Source: Social Progress Trust Fund 1965. Annual Report Inter-American Development Bank, p. 101.

154. Recommendations to improve the financial situation of a country can hardly be made here, even in general terms. Financial policy is an integral part of a Government's policy and as conditions differ from country to country, any

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recommendations would have to be adjusted to the special situation of each particular country. The Governments must decide how much of the resources has to be assigned to financing infra-structure, social capital, industry or agriculture always assuming that they have surpluses or can raise the funds through the issue of government securities.

155. To obtain funds by issuing government bonds in the market is of course possible only where capital markets exist and government securities are traded. It must be pointed out, however, that in general the public (individuals) hold only a very small proportion of government securities. India, where an active market in government securities exists, can be given as an example. In 1963, of the total Central and State Government securities amounting to Rs. 32.1 billion, individuals held only Rs. 0.7 billion or 2.2 per cent of the total.48/ The situation is similar in other countries. The main investors in government securities are financial institutions, among which commercial banks occupy a prominant role. Important investors are also provident and pension funds, social security institutions, life insurance companies and savings banks. The marketing of government securities depends to a great extent on the flow of savings into financial intermediaries. In addition, central banks usually hold a sizable part of government securities.49/

156. Thus, in the present situation in the developing countries, as a rule industries cannot rely on government savings as a source of direct or indirect financing - there are too many claims on these funds and industry will obtain preferential treatment only exceptionally and only in a few countries.

157. Finally, the problem of government-owned enterprises in general, and industrial enterprises in particular, must be discussed. In a number of development plans,

48/ Management of Public Debt in India, National Council of Applied Economic Research, New Delhi 1965, pp. 28-29. In Ceylon, of a recently issued loan of Rs. 35 million, individuals, clubs and institutions subscribed 1.7 per cent of the total. Central Bank of Ceylon Bulletin, December 1965, p. 9.

49/ Even in the United States, individuals hold about 10 per cent of government securities owned by the public, not including the non-marketable savings bonds. The largest owners are commercial banks, accounting for more than one-fourth of government securities owned by the public. Federal Reserve Bulletins. The situation in the United Kingdom and the Federal Republic of Germany is similar.

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including the Five Year Plans of India, large surpluses were expected from publicly owned industrial enterprises to flow into the Treasury. However, the performance of such enterprises has not been encouraging. Very often deficits were incurred, which caused a drain on public finance.

158. Criteria for the operations of publicly owned industries should not differ in principle from the criteria under which private enterprises must operate, unless there are special reasons - social, political or economic.

159. This implies that publicly owned industries must provide for adequate annual depreciation. They must pay taxes the same way as private industries do. They must be able to plow back part of their earnings and finally to contribute from their surpluses to the government budget. It would be useful and instructive to have a comparison of the performance of publicly owned industrial enterprises and publicly owned enterprises in general. From this some conclusions could be drawn. The situation might be different in cases where private interest could not be found for establishing industries considered necessary for the national economy, as distinct from cases where such industries were established by the Governments on the basis of principles of policy. In the latter case, if it were found that such enterprises could not be operated efficiently, remedial measures could be suggested to improve the situation. Consideration should be given to whether they should continue to be owned publicly or transferred, in the interest of the economy, to the private sector. Policy is often obstructed by psychological difficulties where questions of changes from public to private ownership of industrial enterprises is involved. Only a thorough examination and a comparison of their results between various countries could show the reasons for the poor performance where it has persisted. This could initiate remedies and eventually lead to the improvement of the financial situation of the Governments. To take such an inventory might be considered as an important step towards the clarification of the whole problem and eventually might strengthen the economic basis of various economies.

160. It would be helpful if a few case studies could be prepared showing how industrial development was financed in a number of countries at various stages of

development. Some information was given on the financing of private sector industrial development in India during the Second Five Year Plan (1955/1956-1960/1961).50/ The figures are:

	(Rs. millions)
Total financing	8,500
Internal resources	4,000
New issues	1,500
Institutional agencies	800
Direct loan participation by Central and State Governments and other assistance	200
Direct foreign credit participation (including suppliers credits)	2,000

161. These figures indicate a high proportion of self-financing in the total outlay (about 47 per cent); domestic loans accounted for only about 11.7 per cent, while foreign credits for 23 per cent, the remainder being new issues of securities.

162. For information, a table is given below on "Sources of finance for private investment in Mexico in 1959" which was prepared in the IBRD Report, "A Review of the Capital Market in Mexico".51/

163. The report points out that it was extremely difficult to identify the sources from which the private gross investment was financed. Of the total of P. 13,955 million, the amount of self-financing was given as P. 9,157 million. For lack of any other information, about 65 per cent of the total was lumped under "self-financing". The other important items accounted for the following proportion of the total gross investment:

	Per cent of total
Long-term bank credits	about 12.5
Fixed interest securities	" 11.2
Private foreign investment	" 7.2

50/ Country Study on India prepared for the Asian Symposium JAMR/Ind.Conf./C.4, p. 32. According to a survey of 1,333 joint stock companies in India in 1962-1963 depreciation supplied 28.5 per cent of the needed funds and reserves and surpluses (including retained earnings) 13 per cent, or the total for self-financing was 41.5 per cent (it was 45.4 per cent in 1961-1962).

51/ Report is dated 31 January 1962, p. 30.

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Table 17

Sources of finance for private investment in Mexico

(M$ million)

	1959
Foreign direct investment	820.0
Reinvestment by foreign companies	202.3
New long-term banking credit	1,749.0
New mortgage loans from insurance companies	24.9
Banking investments	343.7
Insurance companies' investment	92.8
Fixed interest private securities held by non-financial private sector	1,414.2
Fixed interest private securities held by bail companies	2.2
Fixed interest private securities held by government agencies	148.4
Self-financing	9,157.0
Total	13,954.5

164. The share of self-financing, although high, might not be very much out of line because the Mexican companies have been reinvesting a large part of their profits. But no figure is given for raising new capital through the issue of shares. The share of bank credits, while somewhat higher, is not too different from that in India.
