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SYSTEM OF CONSULTATIONS IN THE FIELD OF INDUSTRY:
REPORT ON INDUSTRIAL FINANCING*
(April 1978 to March 1979).

Report by the UNIDO secretariat

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REPORT ON INDUSTRIAL FINANCING

I. Introduction

1. The Second General Conference of UNIDO held in Lima, Peru, in March 1975 recommended that UNIDO should include among its activities a system of continuing consultations between developed and developing countries among developing countries themselves. The objective of these consultations would be to assist the developing countries in achieving their industrialization goals, which include in particular the goal of producing at least 25 percent of world industrial output by the year 2000.

2. Initially, in accordance with the directives of the policy-making organ of UNIDO, the Industrial Development Board, consultation meetings have been convened in the following sectors: fertilizers, iron and steel, leather and leather products and vegetable oils and fats during 1977 and 1978. Preparations on five other sectors are continuing. One of the conclusions of these consultations has been that certain issues are common to all sectors, such as financing and the training of industrial manpower. The Industrial Development Board recognized this and recommended that industrial financing should be dealt with on the following basis:

"The Secretariat, gathering all the necessary information should examine the requirements for the financing of industrial development in developing countries; the Executive Director should report to the Board at its thirteenth session on the results of this examination in order to enable the Board to consider the convening, at an appropriate time, of a Consultation Meeting on the financing of industrial development in developing countries" (ID/B/212, para 169(b))

3. The problems of financial industrial development projects are being considered by UNIDO as transactions between entities in developed and developing countries. However, the objectives of each party to the transaction may differ considerably; for the Third World countries this objective is to gain access not only to the financial resources which may be available in developed countries, but more importantly to the technological know-how and other knowledge and experience accumulated by those countries. This transfer of know-how depends equally on the absorptive capacity of developing countries. The acquisition of equipment, engineering and other services, training, technical assistance need to be purchased by developing countries if they are to accelerate their

industrialization process and achieve the Lima Target by the year 2000. An Expert Group Meeting on Industrial Financing^{1/} met in Vienna on 6-8 December 1978 to discuss firstly the financial resources required to pay for the acquisition of such knowledge, know-how, plants and equipment, and secondly to discuss the present and possibly improved terms and conditions applied to loan and equity financing.

II. Activities undertaken by the UNIDO Secretariat

4. In accordance with the mandate given to it by the Industrial Development Board at its twelfth session, and in addition to organizing the above-mentioned Expert Group Meeting, the UNIDO Secretariat has gathered information on the activities of financial institutions in order to:

- (i) review their lending policies and practices with regard to the industrial sectors of developing countries;
- (ii) ascertain that the issues which might be discussed at a possible Consultation Meeting are not being dealt with in any other global forum in which all members of the United Nations are able to participate on an equal basis.

5. Some of the activities of UNIDO on the problems related to industrial financing are reflected in 12 of the documents presented at the above-mentioned Expert Group Meeting. They have included an investigation of the investment credit policies of selected financial institutions with regard to industry in the developing countries; in order to highlight the real obstacles to the mobilization of industrial finance, an attempt has been made to review the present and future policies of selected financial institutions; attention has been focussed on the process of financial intermediation for industry through banking institutions and on the past and expected future volumes of industrial finance and technical assistance; the statutory provisions and actual practice with regard to industrial finance; banking policies, i.e. standard operations and new designs and methods; normal and innovative board and management decisions of development finance institutions; other ways of increasing the share of industrial finance, funding and supporting activities.

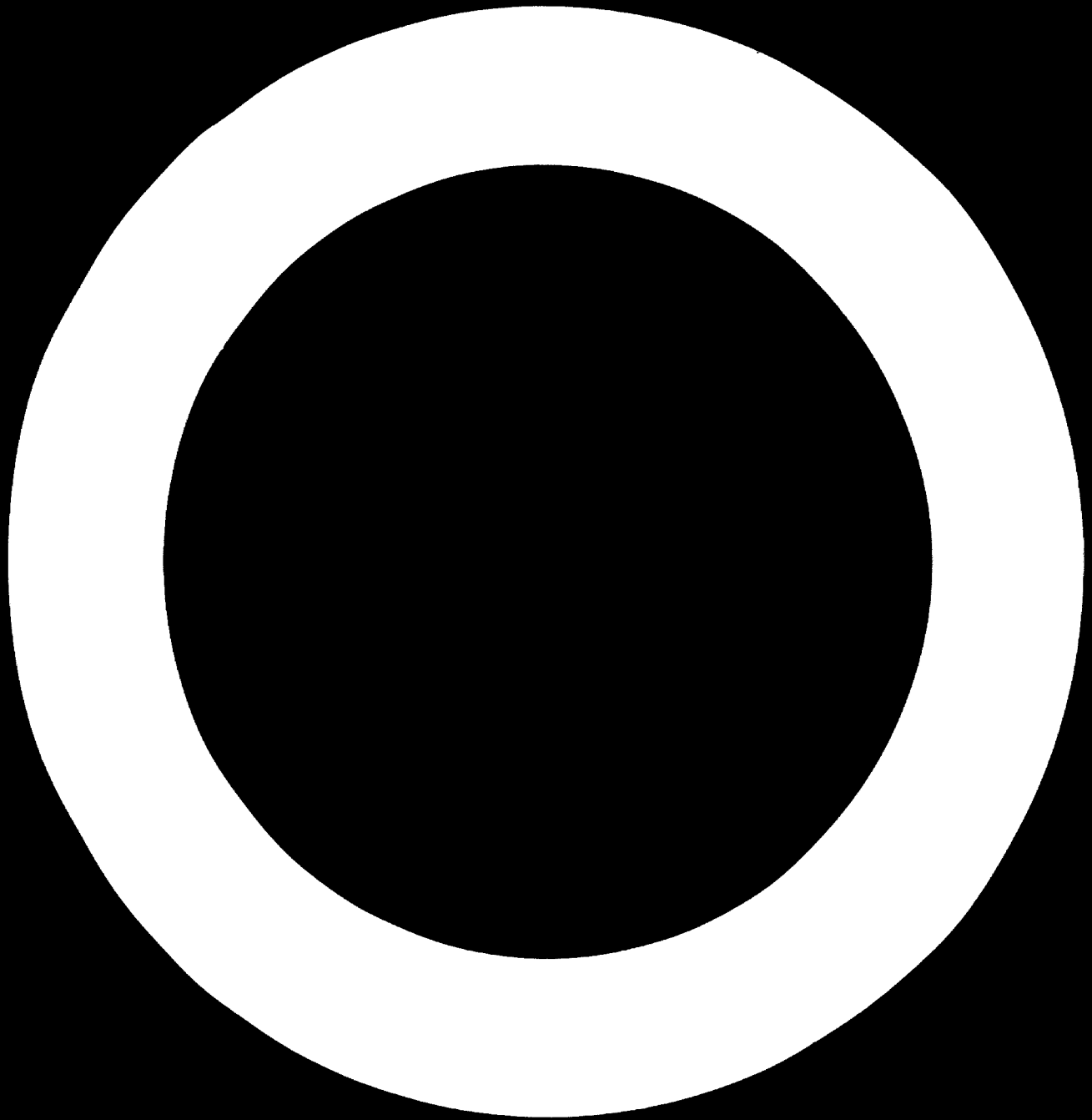
6. It is important to note that the Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries (Development Committee) recognizes the importance of clear procedures to be applied by host countries to direct foreign investment even in a case-by-case approach; such procedures are desirable in order to minimize uncertainties to both

^{1/} Final Report, ID/WG.287/10, 8 December 1978.

partners in industrial co-operation. Of equal importance is the recognition by the Development Committee that improved mechanisms for information, consultation and monitoring are desirable, and particularly that no global forum exists today where the developing countries generally can exchange information, consult and follow-up on agreed policies concerning inter alia, direct foreign investment with the industrialized countries. It consequently appears that UNIDO could provide the desired global forum.

7. In carrying out its activities on industrial financing, collaboration with the World Bank has been secured through the Investment Co-operative Programme Office - World Bank/UNIDO Co-operative Programme; a world-wide symposium on "Development Banking in the 1970s" is being organized jointly by UNIDO and the World Bank in June 1979. UNIDO has been in contact with UNCTAD through participation in the meeting of the "Group of High Level Experts on Finance for Development" in August 1976. Additionally, contact with FAO has taken place through regular participation in the annual meetings of the FAO/Bankers Programme. UNIDO has been collaborating with OECD in the field of tripartite co-operation, involving Arab sources of finance and developed countries' technology and equipment for the industrialization of the Third World. It should also be stressed that considerable efforts have been made by UNIDO to promote closer collaboration with the state investment and development banks of the socialist countries, such as the International Investment Bank (Moscow), FINCOM (Iraq), the State Development Bank (Budapest), etc.

Annex 1: Summary on Institutional Policies for Industrial Development Financing of International, Regional and National Development Banks.



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SUMMARY ON INSTITUTIONAL POLICIES FOR
INDUSTRIAL DEVELOPMENT FINANCING
OF INTERNATIONAL, REGIONAL AND NATIONAL DEVELOPMENT BANKS

1. In compliance with the recommendation of the Industrial Development Board (ID/B/212, para.169(b)) that "The Secretariat, gathering all the necessary information should examine the requirements for the financing of industrial development in developing countries" this annex to the Executive Director's Report summarizes the activities of other development institutions concerned with industrial financing.

INTRODUCTION

2. Most industrial development financing institutions in developing countries are between 10 and 20 years old and many in the industrialized countries are only a few years older. Some of them are of rather recent establishment like the Caribbean Development Bank (1970); the West African Development Bank (1973; 1976 first operational year); Arab Fund for Economic and Social Development (1968); Abu Dhabi Fund for Arab Economic Development (1971); or the Islamic Development Bank (1975). By experience it takes 3-5 years to get a bank fully operational and even a few years more before they enter industrial lending operations because of the high degree of financing expertise and technical know-how required.

3. National development banks become faster operational; however, their preparedness to undertake sizable industrial investments during their infant years is limited, due to the accumulation of various industrial investment risks. However, their importance in mobilizing financial resources to invest in industrial development projects is unquestionable but their effectiveness may have been lessened by the general lack of information about their policies, objectives and potential for providing funds. It is important to note that this applies as well to institutions in industrialized countries as to those in developing countries.

a) FINANCIAL TERMS AND CONDITIONS

4. Information on international terms and conditions for financing industrial projects, the activities of industrial development finance institutions, their lending criteria and eligibility for preferential

industrial financing, the resources available in individual institutions, all these data have been compiled in UNIDO's publication PI/61, "Financial Resources for Industrial Projects in Developing Countries", March 1978, and made available to interested members of delegations to the Industrial Development Board at its twelfth session, to more than 2000 development finance institutions, commercial bankers, industrial firms and government departments.

b) DEVELOPMENT BANKING STRUCTURE

5. During the past year, ICPO's investigation revealed that industrial development finance institutions take a very broad variety of forms:

- Governmental aid agencies and international banks (such as the World Bank Group, Washington, or the International Investment Bank in Moscow);
- Regional development banks (such as the Asian, the African and the Inter-American development banks);
- National development banks of mixed ownership between private shareholders and governments (such as the Cyprus Development Bank, the National Development Bank of Congo, the Colombian Financieras, the Development Finance Corporation of Sri Lanka, etc.);
- Private development banks in developing countries;
- State investment corporations (such as the Algerian Development Bank, the State Development Bank of Hungary, or the Union Bank of Burma).

There are many highly specialized industrial development banks of mixed ownership in developing countries, but also private investment houses, parastatal corporations and semi-commercial financing companies, mixed local and foreign partnerships in development finance companies, etc.

6. Such institutions become more numerous since the developing countries' need for industrial financing is actually growing. In addition, the opportunities increase for combining different types of industrial financing:

- a) on short-, medium- and long-terms;
- b) by several project sponsors;
- c) with ownership shared between local and foreign partners; and
- d) co-financing between public and private institutions.

7. It has been observed by UNIDO that such co-operation arrangements are often the only means of fulfilling financing requirements; hence, there is an upward trend for national and international joint ventures and closer co-operation among industrial development finance institutions themselves. As a result, industrial financing has become more international.

c) INDUSTRIAL FINANCING POLICIES

8. However, when contacting individual institutions, be it an international, a regional or a national financing agency, UNIDO's investment co-operative programme and related technical assistance projects are first of all confronted with the policies and management decisions of these particular institutions. Their investment and lending decisions are based on very different statutes and organizational charters for financial institutions. Therefore, an attempt was made to assess the institutional policies of industrial development finance organizations by a questionnaire action involving approximately 350 financial companies. It was checked whether their legal statutes and charters allow industrial investments and financing. It was asked which approximate amount of financing was earmarked or available for industry. We inquired whether financing is available for industry on special terms, what is the number of industrial projects financed in the last fiscal year and how many applications for industrial projects were received in the last fiscal year, etc.

9. The response to UNIDO's questionnaire action was overwhelmingly positive. However, after a careful analysis, it proved that particularly those questions related to the prospects for increased industrial finance and expanded investments which are required to accelerate the industrialization process in order to achieve the Lima target by the year 2000, were either unanswered, not yet considered, or the answers provided highly uncertain estimates.

10. Among bankers there appears to be a general tendency to be conservative towards industrial lending and investment because of the high risk component which is imminent to most industrial financing operations not only because of the production process but also because of the industrial products prices, uncertainties in market forecasts, quality aspects, change of fashion, and currency

fluctuations. There is hardly information traceable from international banks or aid-giving institutions on the number of applications for industrial projects financing they receive, which is an essential data for comparing offer and demand in national and international capital markets. A few quotations might illustrate the qualitative aspects of the future orientation in industrial financing, notwithstanding the fact that the current practices and policies might seem to be sufficient to meet the present requirements.

11. Formal agreements of co-operation have been concluded by UNIDO with the World Bank Group, the Inter-American Development Bank and the African Development Bank. A note of co-operation was signed with the West African Development Bank. Further arrangements are envisaged for example with the Islamic Development Bank and other institutions.

I. INTERNATIONAL DEVELOPMENT FINANCE INSTITUTIONS

THE WORLD BANK GROUP

While the Bank has traditionally financed all kinds of infrastructure facilities, such as roads, railways and power facilities, its present development strategy places more emphasis on investments which can directly affect the well-being of poor people by making them more productive and by bringing them into the development process. This strategy is most evident: in 1977 loans approved for industrial projects (including development financing companies) amounted to US\$ 1,451.5 million. Although there is no financing available for industry on special terms, it should be noted that in fiscal year 1978, as a result of a stepped-up effort and changes in sectoral composition, 36 loans were approved for a total of US\$ 1.457 billion: US\$ 910 million for 25 industrial development and finance projects, (including small scale industries), US\$ 392 million for 8 major industrial and mining projects, and US\$ 155 million for three programme loans by the World Bank. IFC commitments reached US\$ 338.4 million in fiscal year 1978. IFC contributed 18% of the total cost of the projects it helped to finance; the balance was mobilized from the developing countries (65%) and from capital exporting countries (17%). The sectors of particular emphasis were manufacturing, development of earth resources and food/agribusiness.

EUROPEAN INVESTMENT BANK grants and guarantees long-term loans to enterprises, public authorities and financial institutions, to finance investments furthering the development of less advanced regions. The Bank's activities were initially confined to EEC, but have gradually been extended on an ad hoc basis under various agreements, conventions, and decisions to associated states and to the signatories of the Lomé Convention, states in Africa, the Caribbean and the Pacific. However, there is no approximate amount of financing earmarked for or available to industry for the years to come.

12. The conditions on which EIB conducts its industrial financing operations outside the European Economic Community are governed by the agreements and decisions in force. However, "Lomé II" is under negotiations and most of the existing "protocols", defining framework and scope of industrial financing for a four to five-year period, will terminate in 1979/1980.

II. REGIONAL DEVELOPMENT BANKS

The AFRICAN DEVELOPMENT BANK in a communication to the Executive Director of UNIDO dated 13 December 1978 states: "As indicated by the Vice President Mr. Kerdoudi to your group of experts, the African Development Bank, to date, contributed to the development of the industrial sector 16% of its lending, either directly or by way of credit lines to the national development banks of its member countries. In the five-year programme 1982-1986, an increase to 20% is envisaged. The engagement of the African Development Fund whose loans are at the most favourable conditions, is nil in the industrial sector, because its lending policy gives priority to the sectors of agriculture, health, education, roads and public services."

The ASIAN DEVELOPMENT BANK informed UNIDO that its financing earmarked or available for industry "depends on the projects requiring financing. So far, on an average between 15 and 25% of the bank's lending has gone to the industrial sector inclusive of lending to development banks." The scope and extend of the ADB's assistance is confirmed by its sector paper on development finance institutions.

"As of 31 December 1977, the Bank's financial assistance to development finance institutions cumulatively amounts to US\$ 717.2 million made available to 20 institutions in 14 DMCs, comprising US\$ 684.6 million in credit lines and US\$ 32.6 million as project-tied loans. At US\$ 717.2 million, the financial assistance to development finance institutions represents 17% of the total gross loans approved by the Bank up to 31 December 1977." ^{1/}

"Out of the total credit line approvals of US\$ 684.6 million for development finance institutions to 31 December 1977, US\$ 486.7 million (or 71 percent) has been approved and/or authorized for withdrawal from the respective loan accounts for a total number of 2,045 sub-projects, of which US\$ 367.1 million (or 75 percent) having been disbursed. It has been estimated that the total fixed cost of these 2,045 sub-projects amounts to US\$ 1,479 million of which the Bank financing represents 33 percent."^{2/} The Asian Development Bank does not have a rigid pattern of lending to individual economic sectors; in the first ten years' lending 23% of total lending went to industry, including development banks representing US\$ 772 million. UNIDO assisted in appraisal of HETAUDA cement project in Nepal, and in a Fertilizer project in Sri Lanka.

The INTER-AMERICAN DEVELOPMENT BANK has not specified the terms and conditions for industry. However, many lending operations are channelled through industrial development financing institutions in Latin America, for sub-lending to a broad variety of industrial ventures. It is hoped that a special agreement between the Inter-American Development Bank and UNIDO will increase the number of industrial projects financing through technical assistance arrangements.

^{1/} ADB Sector Paper on Development Finance Institutions, page 7, para. 19.

^{2/} ADB Sector Paper on Development Finance Institutions, page 8, para. 20 Asian Development Bank Publication, April 1978.

The CARIBBEAN DEVELOPMENT BANK and CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION (CABEI) report in some detail and it appears that they have come to grips with industrial financing, particularly on the basis of small-scale industries and joint ventures. For larger scale industrial projects, however, these banks are lacking the required capital funds and the broad economic base, so far.

It appears that ARAB FUNDS continue to receive a remarkable large number of applications for industrial projects finance. Industrial finance is requested for rather large scale industries. However, managerial capacity and information gaps and lack of technical know-how within the respective institutions, prevent them - for the time being - to respond efficiently to loan applications and industrial investment opportunities. UNIDO co-operated with the Islamic Development Bank in staffing an evaluation mission on industrial projects to Syria and for the OPEC Special Fund in a mission to Mali for studying the construction industries.

III. NATIONAL DEVELOPMENT BANKS

UNIDO has also established co-operation with some of the major development finance institutions in European countries for developing countries: Société Belge d'Investissement International, Belgium; Industrialiseringsfonden for Udviklingslandene, Denmark; Caisse Centrale de Coopération Economique, France; Deutsche Gesellschaft für wirtschaftliche Zusammenarbeit (Entwicklungsgesellschaft) mbH, Federal Republic of Germany; Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden, Netherlands; Commonwealth Development Corporation, United Kingdom; Overseas Private Investment Corporation, U.S.A. (OPIC finances part of the cost for the UNIDO Investment Promotion Office in New York).

These member institutions have considerable funds available for industrial finance, which, in compliance with an established code of practices, is expected to be increased, particularly by channelling funds through national industrial development financing institutions in developing countries. The German Development Corporation (DEG), for example, has an authorized capital of 700 million DM. As of February 1978, DEG shared with a total of DM 128 million in 29 development banks and funds, of which 33% was invested in the so-called

"least developed countries". UNIDO has, consequently, established an investment promotion office in Cologne, FRG. With a similar objective, a UNIDO investment promotion office was established in Bruxelles previously, in order to co-operate, inter alia, with the Société Belge d'Investissement International and with the Caisse Centrale de Coopération Economique, France.

13. Economic development depends, to a large extent, on the creation of an adequate financial infrastructure to promote industrial production. The financing system in developing countries is primarily structured according to national and local needs with a major proportion of domestic private and public funds. The domestic capital formation is based on private savings, taxation, or other budgetary allocations of the developing countries themselves. The mobilization of national resources is usually considerably higher than it might appear at a first glance. The external component is usually provided by governments of industrialized countries and international agencies. However, the mandate of international organizations gives stronger impetus to the mobilization of foreign exchange and additional capital funds on terms and conditions acceptable to developing countries. Therefore, the necessary measures ought to be taken to raise the flow of concessional capital.

14. The principle issues in regard to medium and long-term industrial capital flows to the developing countries are the uncertainty about the rate of growth of lending from private sources, namely commercial banks.

15. The rapid growth of those financial intermediaries which are now operating in the semi-industrialized countries, for example in Turkey, India, Brazil, Korea, Argentina, have - on the one hand - been able to cope with the demand for long-term credit and investment. On the other hand, it caused some financial problems, since the increased demand for working capital for industry, in few cases at a growth rate of 50% per annum, led to sharp increases in their debt service obligations and made the lenders particularly sensitive to unexpected developments. It was observed, however, that these countries were able to build a very sophisticated mechanism for

channelling industrial development finance. These national development finance institutions demonstrate a high degree of specialization and competence.

CONCLUSIONS

16. The problems of any of the above-mentioned countries could easily affect the willingness to lend to lesser-developed countries, in particular the least developed of them, and the potential of the projected rapid growth of the industrial sector might be hampered by the lack of financial liquidity as well as by the accumulation of risks. The second problem is the instability created by the gross disbursements from commercial banks and the re-financing of short-term funds on the so-called euro-markets, leading to high amortization requirements which must be financed by additional gross borrowing.

17. "The World Development Report, 1978", published by the World Bank in August 1978, states on page 24, "Finally, how far the banks will increase their exposure in developing countries over the next several years depends on the adequacy of their capital base, and the maintenance of a regulatory environment conducive to continued active lending to the developing countries. Much of the increase in lending to the developing countries over the past few years has been handled by a relatively small number of banks. Well over half of all outstanding claims on developing countries are held by about 30 major banks."

18. It is concluded by the same report, "Diversifying the sources of lending would improve the prospect of a stable flow of commercial capital to developing countries. Mandatory diversification among borrowers, however, poses a potentially serious threat to the projected flows of commercial bank lending. In this connection, changes in the regulatory environment could be critical. The danger is that regulatory measures designed to assure the stability of the banks in industrialized countries could inadvertently cause abrupt changes in the availability of finance to individual developing countries, thereby triggering the sort of debt crises that the regulatory measures are intended to prevent."

19. For this very reason, it is believed that the global meeting of development finance institutions to be organized jointly by the World Bank and UNIDA, 11-13 June 1979, in Zürich, Switzerland, will also serve as a forum for the preparation of global consultations concerning mobilization of industrial finance. All interested bankers, governmental institutions, multilateral and regional banks, as well as private commercial banks, export-import banks and aid-giving institutions, as well as UN-specialized organizations will discuss in that symposium the prospects of development banking in the 1980s.

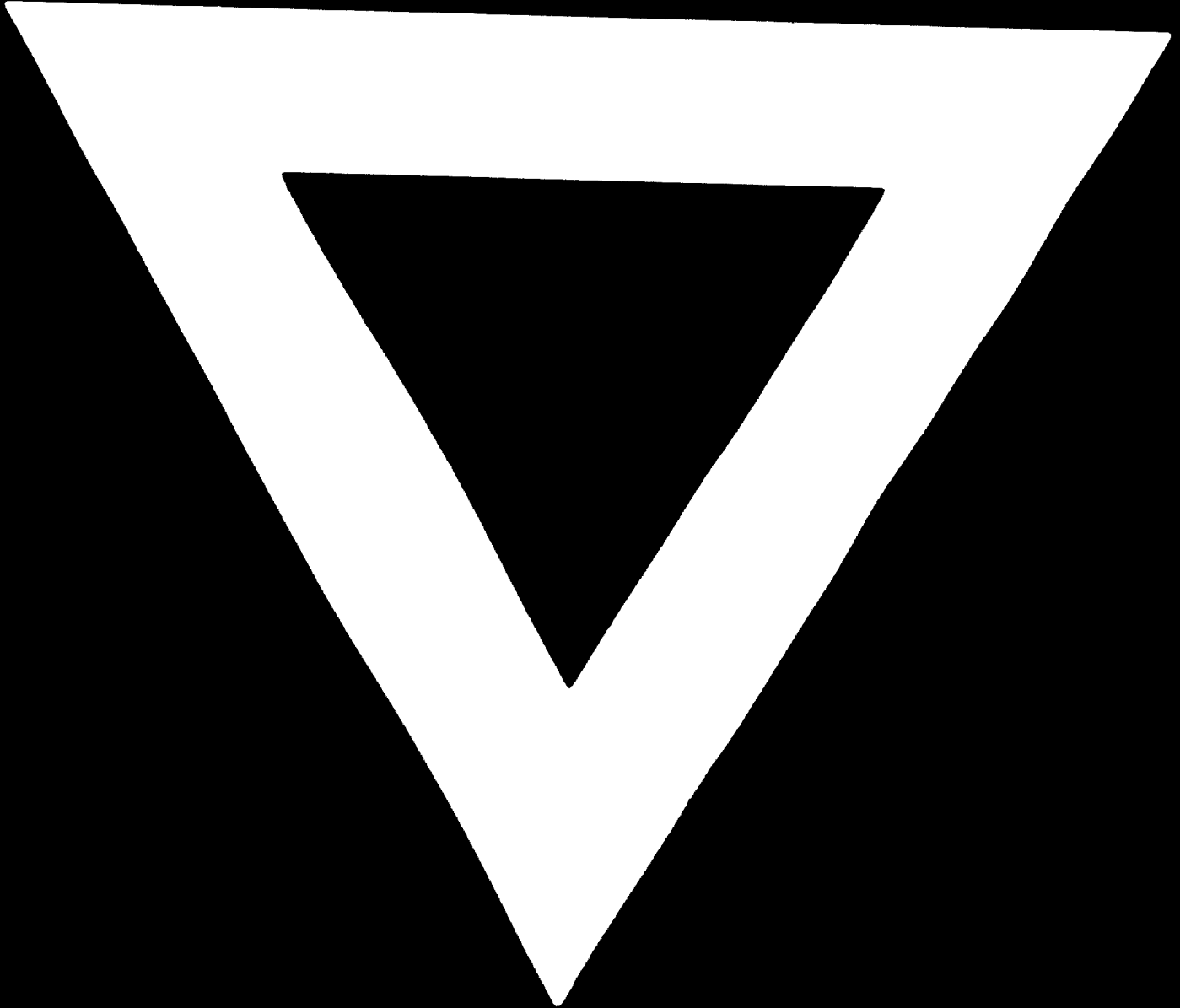
20. The agenda for this global meeting reflects the salient issues of development financing institutions in compliance with a questionnaire, which was sent out by UNIDO and the World Bank to approximately 300 finance institutions.

21. Consultations with governments are seen as not only being desirable, but essential for the wide variety of investment projects that increasingly need to rely on governmental co-operation with industrial financial institutions. In any event, since UNIDO has already promoted a supporting programme for development banking, for which world-wide annual conferences were organized in Paris, Copenhagen, Ottawa, West Berlin, Caracas, Tunisia, New Delhi, it is our experience that national and international industrial development bankers have always regarded their operations in a spirit of partnership with governments.

22. After having promoted a dense network of institutional relationships and an effective mechanism of communication with industrial development finance institutions, it should finally be emphasized, that numerous direct contacts and excellent personal acquaintances help considerably in UNIDO's day-to-day operation to accelerate the flow of domestic and external flow of finance to industry.



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