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ISSUES IN THE FINANCING OF INDUSTRIAL DEVELOPMENT

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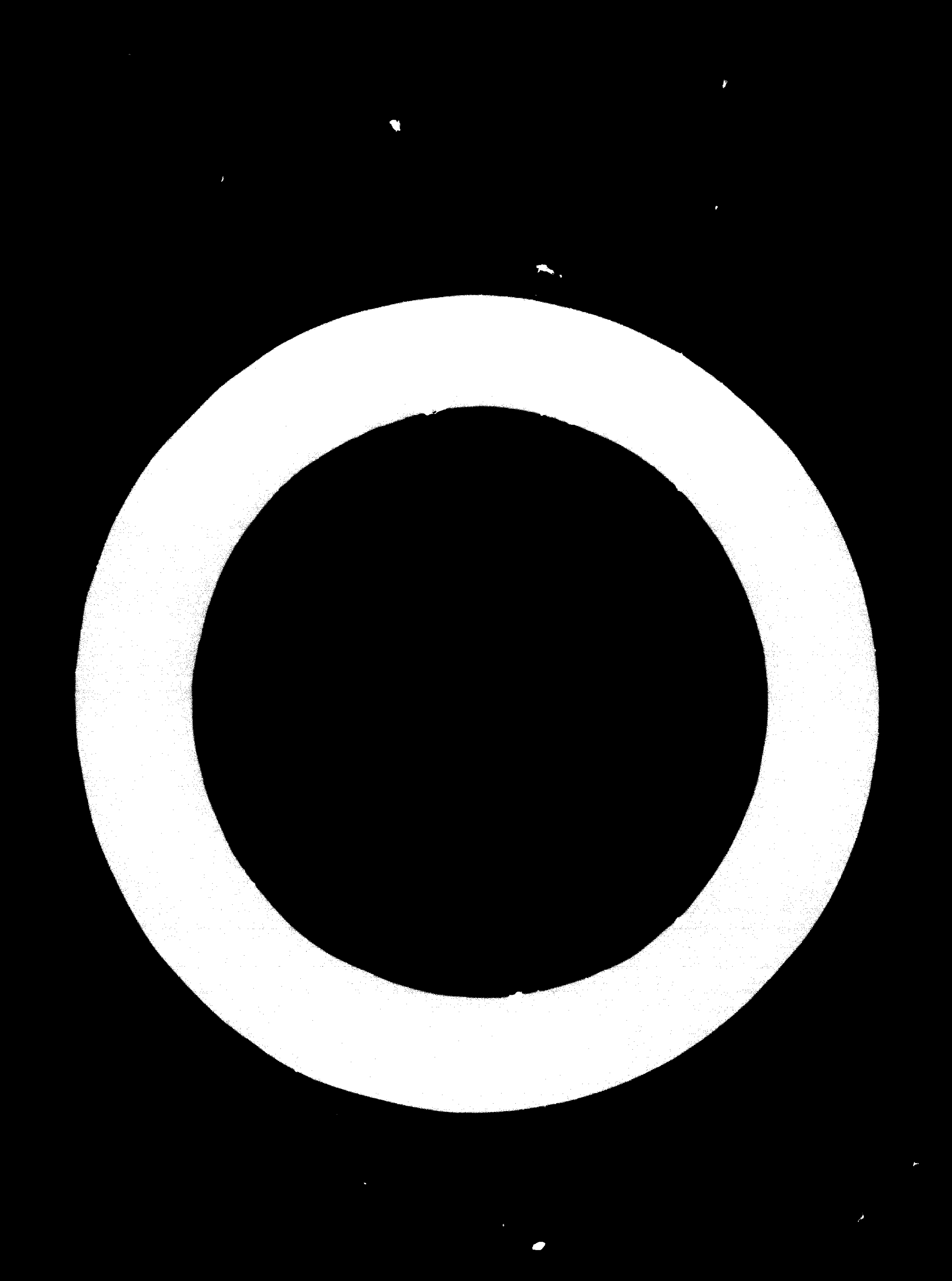

ISSUES IN THE FINANCING OF INDUSTRIAL DEVELOPMENT

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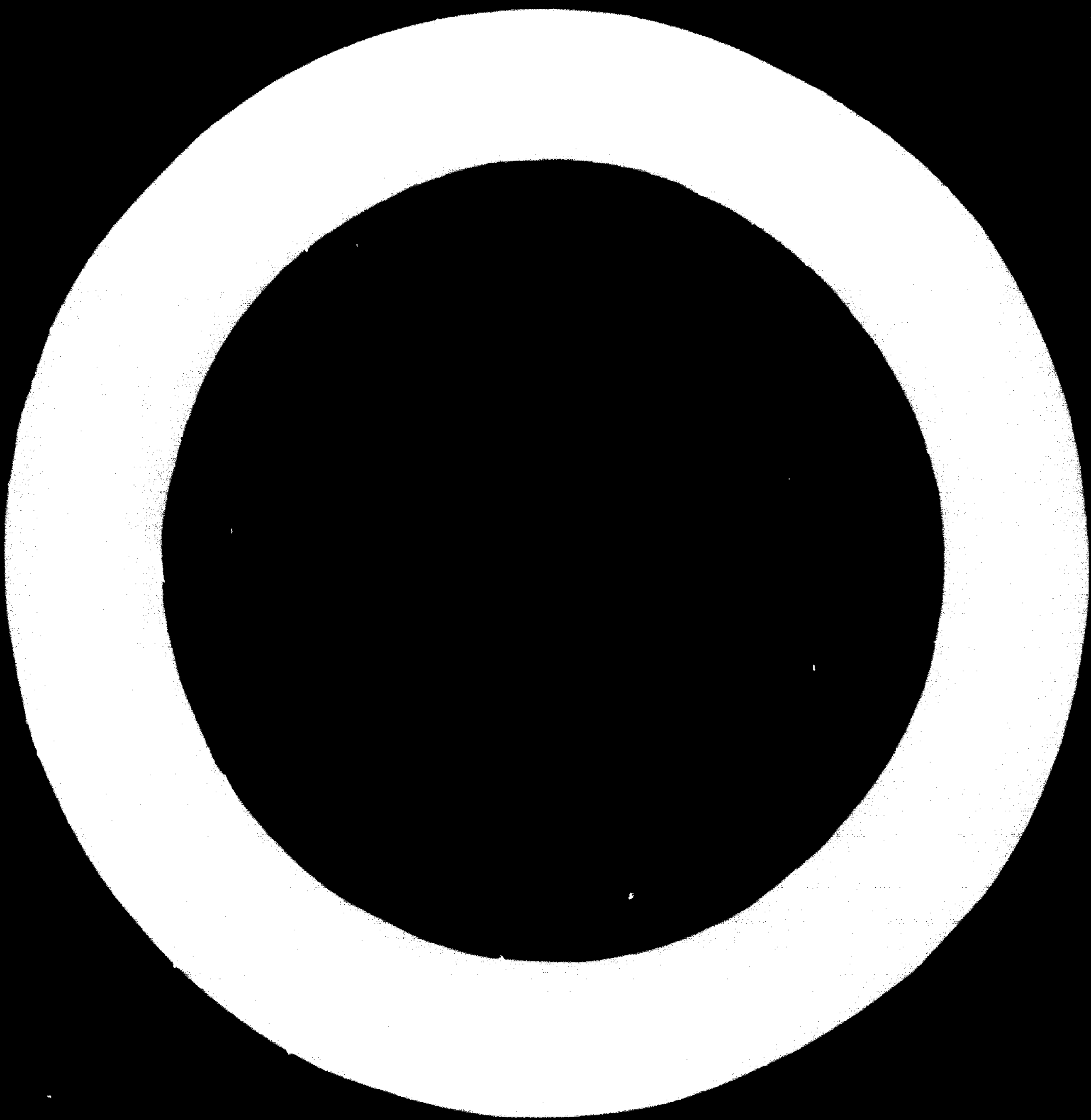

A. DOMESTIC SOURCES OF FUNDS

Introduction

Industrial development in most of the less-developed nations suffers from lack of funds (capital) in general, a feature which is common to all fields of economic activity. However, the situation for industry is different from that, for example, in agriculture; in the latter, investment can be carried out without resorting to outside finance in such a way which makes its volume difficult to assess. For industrial development, financial capital is required. Leaving aside the cases where new enterprises are established by a person or persons having the needed capital themselves or by borrowing from their friends, financial means are obtained from lending institutions and in a more advanced stage of development, from capital markets directly.

As industrialization represents a higher stage of economic development, it can succeed only if financial organization develops pari passu. This refers to the organization and operations of the various financial intermediaries and eventually the establishment of a capital market. (Australia, Japan and more recently Mexico can be referred to as examples).

Proper functioning of such institutions presupposes that there will be a continuous flow of savings - transferred from savers to users either directly or through financial intermediaries. With regard to the need of channelling savings into investment, there is basically no difference between private or public industrial enterprises.

First, the various financial intermediaries and their relative roles as suppliers of funds to industries will be reviewed.

1. Financial Institutions as Sources of Funds for Industrial Enterprises

In most of the developing countries commercial banks are important institutions for industrial financing. Called also "exchange banks", commercial banks in the former British dependent territories have taken, historically, care of the current credit needs of enterprises related particularly to foreign trade, but gradually they have been expanding into supplying working capital credit. In the case of enterprises in good standing, such credit becomes revolving and is then considered as part of funds available to the enterprise permanently. With the progress of industrialization the banking system is bound to develop and adjust to serve the needs of industry; this can be illustrated by examples in a number of countries. In a few countries commercial banks have established close associations with industrial groups following the example of the commercial banks on the Continent of Europe.

However, commercial banks cannot be regarded as a source of long-term loans.

In some countries refinance corporations have been set up to take over medium-term credits from the commercial banks. The role of central banks which, in a number of countries have agreed to rediscount industrial credits extended for a period of more than one year, is very important.

Insurance companies, especially life companies, are also an important source of loans for industries. However, this applies to countries which have already reached a somewhat higher stage of industrial development.

While provident funds and social security schemes have been accumulating a growing volume of savings (contractual savings), they are in general not permitted to lend to industries. Their funds are more or less earmarked for investment in government securities or for mortgage loans. This is generally true of public and private pension funds in the developing countries. (UAR and Singapore are among the few exceptions where the pension funds are allowed to invest in industries.)

After the war, there has been expanding development of the industrial finance corporations, development banks, development-finance corporations, etc. These institutions are now so numerous and so different in their structure and operations that it is not easy to classify them into simple categories. We are going to distinguish here between the government-owned and the privately-owned corporations.

The case of the government-owned development corporations is relatively simple, both as to their capital structure and operations. It should be pointed out, however, that some of the institutions have been reported to be dominated by political consideration in the making of loans or have not been equipped to prepare appropriate project evaluation and as a result have become involved in bad loans. In many cases remedial measures have been taken. The capital of these institutions is normally supplied by governments and additional funds, when needed, are obtained from government loans and through the issue of bonds. These bonds are purchased usually by central banks and only exceptionally sold in the market. These corporations make medium-term and long-term loans to industrial enterprises and with a few exceptions do not engage in acquiring equity in industrial corporations. In some cases, however, the scope of the operations is broader. An important example is the Pakistan Industrial Development Corporation (PIDC). This corporation also makes loans to newly established enterprises, but in addition acquires a majority of the share capital. The corporation is supposed to sell the shares to private investors as they are found and eventually to transfer to them the majority of the capital of the corporation. In this, the corporation has been moderately successful.

More complex are the operations of Nacional Financiera in Mexico, which is publicly-owned but enjoys complete autonomy in its administration and operations. The success of Nacional Financiera in supplying funds to industry has been great indeed, but it would be necessary to give here a brief history of the Mexican financial institutions and the capital market in the last thirty years to understand why Nacional Financiera has developed in such a way and been successful beyond any expectation. This success can be measured by the fact that at present Nacional Financiera is in a position to borrow in a number of foreign-capital markets, including important markets in Europe.

There are two reasons why industrial finance corporations have been set up and controlled by governments. Firstly, because private capital for financing industries was not available at all or not on what might be considered reasonable terms; and secondly, the governments wished to control industrial development through the provision of finance, often pointing out that only in that way could satisfactory terms be offered to new industries.

Since the middle of the 50's a trend has developed towards the establishment of private industrial finance corporations which, in a number of cases, were set up under IBRD sponsorship and more recently under IFC. Perhaps the best example of the organization of such an institution is the case of the Industrial Credit and Investment Corporation of 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 private foreign, mostly institutional, investors. The Government of India made the corporation a substantial non-interest bearing loan (Rs.75 million), repayable beginning the sixteenth year from the date the loan was made. The World Bank agreed to an initial loan of $10 million. Since then, the amount of World Bank loans has increased to $140 million in 1965 and the Government of India supplied additional loans carrying a four per cent interest.1/ In a similar way, this type of private institution was established in Pakistan, Ceylon, the Philippines, Malaya, Thailand, Nigeria and Venezuela. The government loans enabled the Corporations to operate at a profit, by investing mostly in government securities, such funds as were not yet needed for lending, and before interest on loans made by them could be received. In that way it was also possible to pay dividends on the subscribed capital.

The activities of the Indian Corporation (ICICI) consisted primarily of making loans to private industries. However, the corporation also engaged in underwriting new issues of capital and even in participations in new issues. (In 1963, eleven underwriting operations totalled Rs. 18 million.)

1/ The amount of government loans reached Rs.275 million at the end of 1964. Total net operations sanctioned by the Corporation since its inception until end of December 1963 aggregated Rs.832 million to 248 companies of which 105 were new enterprises - (Source: Report on Currency and Banking 1963-64, page 65, Reserve Bank of India, Bombay, 1964)

In recent years when the IFC has helped to organize development finance institutions it has frequently succeeded in bringing together a number of foreign financial institutions which have participated in the capital of the new corporations from the outset. Perhaps the largest number of participating foreign financial institutions was in the case of the Philippine Development Corporation established in 1963.

Assuming the projects to be financed are available, the Corporation's financial position depends on the amount of original capital, loans from governments, loans from international agencies and the participation of foreign banks in financing the projects. The local funds as needed are replenished sometimes through new government loans and in some cases through the issue of debentures in the market.

While the effect of these institutions on the financing of new industries can be important if general conditions are conducive to industrial development, it has to be stressed that the creation of new institutions by themselves does not provide either the needed funds or the expertise required for industrial development. Setting up an industrial bank does not guarantee that new industries will be developed. In a few cases, the governments have pressed for the establishment of new specialized banks which were not properly financed or organized and such banks have not proved to be very helpful in promoting industries.

The case of private financial institutions for industrial financing in Mexico is very interesting. These are called "private financieras" and while they are often associated with leading commercial banks, they have been exempt from various restrictions imposed by the Central Bank to which commercial banks are subjected (such as regulations governing the level of the rate of interest charged on loans or paid on deposits). Allowing the free-market forces to operate, these institutions have been surprisingly successful in mobilizing, within a short period, very large amounts of savings on which a rate of up to 11 per cent was paid. At the same time, they charged up to 13 to 14 per cent on loans. These "financieras" have become a very important source of medium-term credit for industries. Since 1961, the Central Bank directed the financieras to obtain growing amounts of funds through the issue of financial bonds. The amount of the bonds issued also has been expanding rapidly. Their total stood at pesos 4,255 million at the end of 1964, an increase of P.1,389 million in that year. Their deposits from the public reached P.7,674 million at the end of 1964, an increase of P.1,273 million during 1964.2/

2/ Informe Anual 1964, Banco de Mexico, pages 109, 126

The role of the private financieras in relation to industrial financing can be compared with that of the European continental commercial banks, but the financieras in Mexico have gone further with regard to the life of the loans they extend. One-third of the loans has been for more than one year and loans up to five years are no exception. Since 1964 the rates of interest paid on deposits (loans) have been declining and so have the rates charged on loans to industries.

[It can be assumed that a comprehensive information on development finance institutions and their operations will be provided when a major study initiated by the OECD Development Center is completed. This study will establish a list of institutions which can be regarded as development finance institutions, including many with similar names, but not falling under this type of financial enterprises.]

2. The Role of Transferred Savings in Institutional Financing

The ability of financial institutions to supply funds to industries depends, of course, on their receiving savings from the public. The question of government loans to institutions or to industries will not be discussed here in detail; this would involve an analysis of the government financial situation, particularly of the possibility for and the size of government savings. The importance of government savings which would help to finance investment programmes has been recognized by governments and experts everywhere. But, because of the race between rising recurrent expenditures and increasing revenues, government savings available for financing investment has provided in most countries only a marginal amount. There is need everywhere to supplement government savings from private savings available for investment.

The flow of private savings depends on a number of factors, such as confidence in monetary and political stability, and what is very important, on the habits of saving in the form of money deposits. An educational campaign is needed in many countries to change the pattern of saving, to induce the people to save by investing not in silver, jewellery or real estate, but in savings deposits. In a number of countries incentives to promote savings by individuals have been introduced: interest on post office savings bank deposits is tax free and very often interest on other savings bank deposits and time deposits at commercial banks is tax exempt up to a certain amount (for example, in Pakistan up to Rs. 500 yearly). Interest on government savings certificates issued mostly in small denominations is also tax free. A tax exemption on life insurance premiums and dividend income, up to a certain amount, could also be included here.

Improvement of banking facilities and particularly increasing the number of bank branches in the rural areas can also encourage savings habits and expand the monetized economy. In a number of countries such as India, the government has concentrated on a small savings drive which has been successful 3/. In a few countries the flow of savings has been expanding and the saving income ratio has gone up, i.e. Mexico and the Philippines.

The role of the rate of interest has been discussed in connexion with savings deposits. Very often the Governments would like to keep it low in order to have access to cheap credit for the Government. It has been pointed out that the rate of interest has not been very instrumental in increasing the flow of savings. On the other hand, it can be shown from experience in recent years in some countries such as Thailand, the Philippines, Mexico and Peru that higher rates of interest have contributed to a growing volume of savings 4/. Recently, interest rates have been gradually raised in nearly every country 5/ (The yield on government bonds rose between 1960 and 1964, for example, from 4.05 per cent to 4.82 per cent in India; from 3.56 per cent to 3.90 per cent in Pakistan; from 3.53 per cent to 6.49 per cent in the United Arab Republic; from 2.9 per cent to 5.22 per cent in Ceylon). 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.

Not all savings transferred to the financial institutions are available for industrial financing. Where postal savings, savings banks, savings and loan associations exist, the savings collected by them are usually available only to the governments or for mortgages. The same applies to funds accumulated in Social Security schemes and provident funds. All these savings can be regarded as captive savings.

3/ Some success has been obtained also by the Caja Agraria in Colombia in its savings drive which was extended particularly to the rural areas.

In 1963-64 a total of Rs.1,2[illegible] million (net) of small savings was collected which represents nearly one per cent of national income. In the four years, 1960/61 - 1963/64, about Rs. 4 billion was collected (approximately $830 million) from small savings, of which National Defense Certificates accounted for Rs. 2,06 billion and post office savings deposits for Rs. 1,27 billion. (Source Report on Currency and Banking 1963/64 (Reserve Bank of India), page 83)

4/ There has been a rapid increase in time deposits at the commercial banks in Thailand after 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 5,4[illegible] million at the end of 1964 (from US $70 million to about $260 million. (Source Bank of Thailand, Monthly Reports).

5/ In 1965 the rate on fixed deposits for 6 months paid by commercial banks in India has been raised from 3.75 per cent to [illegible] per cent.

However, to the extent that the requirements of the public sector and house construction are satisfied from the funds accumulated at the above-mentioned institutions, it might be expected that other savings are made free which can then be used for industrial finance. Furthermore, governments might be in a position to make loans to industries directly or through development finance corporations.

3. Self-financing

At the start of a venture the entrepreneur is expected to provide part of the necessary capital, whether the enterprise would be a private company or a corporation. In the circumstances prevailing in most of the developing countries, special incentives are regarded as necessary to induce entrepreneurs to invest in industrial ventures because of the often unknown risks inherent in such enterprises. For that reason higher yields are usually expected from industrial enterprises than from investment in fields where the risk is less (such as real estate).

In the majority of cases, the capital invested by the entrepreneurs will not cover the working capital requirements for which credits from banks or other sources are expected. Frequently, a part of the imported equipment is financed through suppliers' credits.

Self-financing of industrial enterprises from retained earnings and depreciation is very important in all countries, but particularly in the developing nations because of the limited access to the capital market.

Retained earnings as a proportion of total profit varies from country to country and from enterprise to enterprise. Where corporations are closely held, no great importance is attached to the payment of dividends (in some of the known cases the proportion of retained earnings reaches 80 per cent). But, where attention has to be paid to dividends to satisfy shareholders, the proportion of retained earnings hardly reaches 50 per cent, such as is the case of most corporations in India. In recent years in a number of countries, foreign firms, because of foreign exchange difficulties, were practically compelled to reinvest a larger portion of their earnings.

In newly industrializing nations, support is given to new enterprises to supply them with more funds through so-called accelerated depreciation. In some cases, equipment can be fully depreciated in five years, and in others the corporations are allowed to write off 125 per cent of the value of their equipment.

Also, to strengthen the capital basis of new enterprises, tax holidays are introduced according to which the firms would not be subject to any tax on their profits during the first five years of operations (e.g. Malaya). Such devices can certainly help enterprises in accumulating funds for expansion and new investment, always assuming that the tax exemptions are administered properly and not in a wasteful manner. It has been pointed out that, theoretically, all such measures might direct investment into [illegible] profit, [illegible] in the interest of the [illegible] economy. However, this objection should not be applied to most of the developing nations. Because of the over-all shortage of capital, whatever can be done to increase the flow of funds into investment will eventually benefit the economy. Another objection to tax exemptions is that the tax basis is being eroded. This is, however, a static concept because tax proceeds will rise as production expands and eventually the tax basis will be broadened.

Sometimes it has been attempted to draw distinctions between self-financing used for new investment or as funds for working capital. This distinction is not really relevant but, when talking of working capital requirements, it should be made clear that these requirements are obviously higher in the developing than in the advanced nations. This is particularly true of inventories. Because the supply of inventories, whether manufactured locally or imported, is not always regular or certain, the careful enterprises are bound to keep larger inventories than is the case in countries where there is no doubt as to the regular supply of raw materials, spare parts, etc., in standard quality, and where no foreign exchange difficulties exist for imports of these commodities.

Often, in the investment planning in developing countries, the working capital requirements were over-looked with the result that the enterprises are compelled to work the expensive imported machinery below capacity unless they are bailed out with the help of maintenance import credits or by a development bank.

4. Funds Obtained in Capital Markets

As industrialization progresses, development of an organized capital market - stock exchange - in countries with the private enterprise system, becomes important. The governments will support the development of such a market with a view to enlarging the possibility of marketing government bonds, and the corporate sector will welcome the organization of a capital market because it will facilitate the sale of corporate shares. One important difference exists between the bond and the share market. Private investors as a rule represent only a small portion of government bond holdings. By far the largest part is bought and held by institutional investors, even in the advanced countries 6/, and here again, unless financial institutions have a regular flow of savings, they are not in a position to buy any significant amount of government bonds. The problem is inter-connected. Some countries have tried to establish markets for government securities but have failed in the absence of financial institutions which could invest in such securities.

6/ In the U.S. individuals owned only about ten per cent of the government bonds held by the public (end of June 1965). The proportion is about the same in the UK and smaller in Australia. In most of the developing countries it is estimated that private individuals hold only about one per cent of government bonds. In a number of these countries substantial efforts have been made to channel private savings into government securities through the issue of savings certificates in small denominations. Interest on these certificates is usually tax free and sometimes lottery features are added to these certificates.

The creation and operation of an organized market for common shares is not an easy task either. In a number of countries, such markets have been set up but little has been achieved because the ground was not prepared. Private investors are also in need of education. They must be induced to buy shares and this requires time. Those investors must be attracted by the quality and yields of the investment and must have confidence in the orderly operations of the market as well as in the standing of the corporations. The process is complex. As a market develops, it becomes clear that it is necessary to have an agency which will supervise the operations of the market in order to avoid malpractices and undue speculation. Further, it will also be necessary to supervise the corporations through a properly established agency. to require disclosure of important data and proper auditing procedures. The institution of stockbrokers and, later, underwriters, will be a part of the whole process. The financial press can be very helpful in these matters. All this will require the creation of an atomsphere which will be conducive to attract private investors to the purchase of common shares.

Developing countries could benefit from a close study of a well-functioning stock market such as in Bogota, where an excellent supervisory institution has been established (Superintendencia de Sociedades Anonymas) the same is true of the progressive development of the stock exchanges in India. 7/ Technical assistance among the developing nations themselves could be very helpful in this field.

It is suggested that a survey be prepared of the existing organized capital markets in the developing countries and of their operations including their importance in the raising of capital for corporations.

In some instances, shares have been sold privately even in the absence of a well-operating stockmarket - for example, in Pakistan. In several Latin American countries, during a period of high inflation, a subsidiary of a US company (Deltec) succeeded in selling a new issue of shares through local agents working from house to house. But even in countries where stock exchanges exist, the sales of shares outside the market has been substantial, in some instances exceeding the sales on the stock exchange (e.g., in Mexico).

At an early stage of industrialization, however, not too much should be expected from raising capital by placing shares on the market. At a later stage when market operations become well-known and a class of private investors develops, institutions will also be set up which should help in spreading the ownership of shares. Such institutions, called unit trusts, operate like mutual funds and exist, for example, in Colombia, Mexico, India, Malaya and Pakistan. In India and Pakistan a unit trust was established by the governments 8/.

7/ The capital raised (paid-up capital) by non-government companies in India amounted to:

Rs.	1,119	million in	1960
"	1,215	"	" 1961
"	1,417	"	" 1962
"	926	"	" 1963

8/ A unit trust was established in India on 1 February 1964. By the end of June 1965 the aggregate amount of shares subscribed by individuals was Rs.177 million.

In Pakistan the National Investment Trust set up by the Government started its 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.

B. [illegible]

In all developing countries a great need exists for the inflow of foreign funds in order to [illegible] the resources available for development. Various series of data exist giving information on the total yearly flow of funds from the [illegible] to the less-developed countries, but there are substantial difficulties in establishing data on foreign financing of industries. For instance, the annual review of the Development Assistance Committee (DAC) of the OECD contains data on private direct foreign investment, but new inflow is not always separated from reinvested earnings. Reinvested earnings resulting from domestic production can hardly be regarded as inflow of new funds. Moreover, these data, in addition to investment in manufacturing include also investment in oil, mining, banking and other activities. With regard to the government-to-government aid, it would be necessary to have the detailed analysis of the transactions in order to determine the size of industrial financing. Therefore, we shall, for the time being, abstain from trying to present data or even estimates on the size of external financing of industries.

Following are the main sources of the inflow of foreign funds:

Private foreign direct investment - (Portfolio investment is rather the exception in the developing countries);

Loans from international and inter-regional agencies or from government-financed institutions;

Assistance from government to government;

Suppliers' credits or export credits in general;

Inflow of resources under PL-480 or similar transactions which make possible granting domestic credits for industrial development; and

Loans issued on foreign markets (a potential future source).

1. Private Foreign Direct Investment

Private foreign direct investment was not a large source of industrial finance even before World War II. Firms from the United Kingdom, France, the Netherlands and Belgium established factories in their dependent territories, very often in the field of exporting industries or where danger of losing markets existed. This applies to jute and cotton mills of India and sugar and vegetable oil plants in Indonesia. The United States firms set up some factories in Latin America such as the meat packing plants in Argentina; but on the whole, factories were established where danger of losing markets was apparent.

Since the war, the situation has certainly not improved. The climate for private investment has not been favourable in a number of countries. The reasons for this are manifold: lack of confidence by investors in political and financial stability, fear of nationalization (in some countries most of the industries were nationalized), lack of incentives; foreign exchange difficulties have hampered imports of the needed raw materials and components, and transfer of profits. Moreover, restrictive measures exist in many countries with regard to the ownership and management of industrial enterprise. Perhaps in some instances the barriers to foreign private investment are more imaginary than real.

Despite these difficulties, private direct foreign investment for manufacturing has been going to developing countries - from the United States mainly to Latin America, from the United Kingdom to the Commonwealth countries and in recent years, such investment was undertaken on a small scale by German, Swiss, Dutch, Belgian and also French and Italian firms.

There are difficulties in obtaining data on private direct foreign investment in industries. In recent years the Organization for Economic Co-operation and Development (OECD) has been publishing annually a review of total funds flowing from the DAC countries to the less-developed nations. According to these data, the total private foreign investment for the three years 1961-1963 amounted to $4,649 million. These figures include reinvested earnings and investment in oil which was very substantial. The figures of the United States private investment (excluding reinvested earnings) for these three years were $1,795 million. These figures include also investment in oil, mining and other activities. Data for the U.S. investment in manufacturing are also available. Of the U.S. total investment in manufacturing of $16,861 million (end 1964) investment in developing countries amounted to only $2,678 million (book value) of which $2,340 million was in Latin America. Total new capital outflow for private foreign investment to all developing countries amounted to $275 million in 1963 and $347 million in 1964. Of this total the net outflow for manufacturing was $140 million and $142 million respectively. The share for Latin America was $120 million and $93 million, with more than half of the amount invested in Mexico.

Assessing the data for the last few years, one arrives at the conclusion that direct private investment did not play a major role in developing industries in the less-developed world. The countries are becoming aware of the contribution which private direct investment can make to their industrial development, and gradually some of the obstacles are being reduced. As foreign firms show more willingness to accept local business partners and as the various restrictive measures are mitigated, an increase of this source of funds might be expected. The arbitration machinery established recently by the World Bank, the Convention on Settlement of Investment Disputes, might also prove to be helpful. However, on balance, developing countries cannot rely on private foreign investment to provide the major part of the funds needed for their industrialization. 9/

9/ Mexico can be regarded as an exception. The flow of funds for direct private foreign investment in Mexico totalled:

($ million)
83.1 in 1964
76.9 in 1963
81.8 in 1962
62.5 in 1961

Source: Informe Anual 1964, Banco de Mexico, page 92

2. International, inter-regional and Government lending agencies

(i) The World Bank (IBRD) Group: The World Bank has made direct loans to industries in the less-developed countries totalling about 280 million as of the end of June 1965. (Of that amount 159 million were loans to the two private Indian steel companies). In addition, the World Bank made loans amounting to 309 million to development finance corporations which indirectly were used for financing industries. The total amount of loans made to industries in the developing countries by the World Bank was only about 10 per cent of the Bank's total lending to these countries as of the end of June 1965. No loans were extended to government-owned industrial enterprises, and loans to private enterprises must be guaranteed by the government in whose territory such enterprise is located.

The International Finance Corporation (IFC) - As of 30 June 1965, total operational investments of the International Finance Corporation amounted to 130.45 million (original amount) plus 16.55 million of standby and underwriting commitment. Of the total investment, developing countries accounted for 112.7 million, of which 9.2 million was to development finance institutions and the rest to industries. It has been the policy of this institution to associate private foreign financial institutions with its operations, a policy which has been largely successful. No government guarantee for IFC lending operations is required.

The role of the IFC as the World Bank Group's instrument for industrial development will be greatly enhanced when the amendment of the Articles of Agreement of both the Bank and IFC - which was recommended at their 1964 annual meeting - is made effective, which is expected to be soon. According to this amendment, the Bank will be allowed to lend to IFC up to four times the Corporation's capital and surplus without government guarantee. This will add about 400 million to IFC's potential resources for lending to private industry in the developing member countries. Consequently, it may be expected that IFC will extend much larger loans to industrial enterprises than it was able to in the past.

The International Development Association (IDA) - IDA had supplied to industries only 6.5 million of development credit, but it had provided 190 million for the financing of various industrial imports to India (by the end of August 1965) 1/.

1/ The 190 million credit extended by IDA to India in August 1965, was to be made available for imports of materials and components for manufacture of capital goods by the automotive, electrical, industrial machinery and construction industries. (Source: IDA Press Release, 12 August 1965).

All together the World Bank Group made available a total of about $900 million to industrial projects.

(ii) Inter-American Development Bank (IDB) - The total amount of loans made by IDB for industry and mining was nearly $299 million up to 31 December 1964. Of that amount $248 million came from the Bank's Ordinary Capital Resources and $51 million from the Fund for Special Operations. About one-half of the loans of this Bank was made directly to industrial enterprises and the rest to development banks, industrial banks or even central banks to be re-lent to industries. In the case of loans to non-governmental entities, the Bank may require that the member in whose territory the project is located guarantee the servicing of the loan. The Bank succeeded in establishing close working relationships with Development Finance Corporations 11/.

(iii) The African Development Bank (ADB) - Loans to industries in African member countries may be expected also from the recently established African Development Bank.

(iv) European Investment Bank - This Bank, which was organized by the Common Market countries, made loans for industrial projects in South Italy and Sardinia. More recently the Bank extended its operations to Turkey (acting as an agent for the Common Market countries) so that it can be regarded as supplying industrial finance also to developing **nations**.

(v) Central American Bank for Economic Integration - This Bank has been providing increasing amounts of finance for industrial development. Its resources have been augmented by loans of $14.2 million from the Inter-American Development Bank (from the Bank's Fund for Special Operations), for industrial projects, the products of which are to be sold in the markets of two or more countries located in Central America. 12/

11/ "All of the Bank's Latin American members have received development loans which were allocated entirely or partially to finance industrial projects" (Source: Activities 1961-1964, Inter-American Development Bank, 1965 - page IX).

12/ Recently a $42 million Fund for Economic Integration was established to advance Central America's balanced development. The U.S. Agency for International Development (AID), will provide $35 million for the Fund and the five member countries will contribute $1.4 million each. The Fund will be administered by the Central American Bank for Economic Integration.

(vi) Government Finance Institutions - The largest of the Government agencies is the Export-Import Bank in Washington. Its lending operations exceeded $1 billion in 1963, and amounted to more than $500 million per annum in recent years. It is practically impossible to determine the amount of loans made by the Bank for financing industries. The Bank has made only a few development loans in which industries are also included. However, every year the Bank has extended a large number of export credits for capital goods, mostly at the request of U.S. suppliers or U.S. banks. Such credits can be considered more as suppliers' credits than development loans. One has to add, however, that a part of these credits might be regarded as revolving credits going to a large extent to developing nations.

The Commonwealth Development Corporation has made loans within the Commonwealth on a rather small scale. Its contribution cannot be regarded as a major one.

An Arab Development Fund has been established in Kuwait to make loans to government and enterprises in the Arab States. Most of the loans were for infrastructure and agriculture.

3. Government to Government Assistance

Inflow of foreign funds through government to government assistance has been larger than the supply of foreign funds from other sources. As shown in the table below, the total annual bilateral net assistance from the advanced countries (members of DAC) exceeded $5 billion in each of the three years 1961-1963 and was at about the same level in 1964.

	1961	1962	1963
		($ million)	
Total Bilateral Assistance by DAC Countries	5,214	5,334	5,679
of which:			
U.S.A.	3,208	3,391	3,627
U.K.	410	377	370
France	870	856	831
Germany	303	325	396
Japan	203	155	159
Canada	45	42	90
Belgium	69	65	75
Netherlands	69	91	38

The share of the United States was more than 60 per cent of the total during this period. Two-thirds of the U.S. assistance was provided in the form of grants or loans repayable in local currencies of the receiving countries. Next to the U.S. the largest contribution came from France, whose aid was directed mostly to the former French dependent territories.

No information is readily available as to how much of this official bilateral assistance was for industrial projects. Only if the data of the donor countries classified by the purpose of the assistance were released could an indication be obtained of the extent to which bilateral Government to Government assistance was used for industrial projects. It can be assumed that the situation varies from country to country. Whereas, financing of industrial projects has accounted for a large part of the German assistance, the share of industrial financing in the French assistance undoubtedly has been small.

A substantial amount of funds (economic assistance) has been committed by the centrally-planned economies. It has been estimated that these commitments exceeded $4 billion from 1955 to 1962 and increased further since then. It can be assumed that a substantial part of the assistance has been committed for industrial projects. The centrally-planned economies do not provide any free funds as aid, but their assistance consists of equipment and technical services. In view of their industrial development these countries, particularly the Soviet Union, are in a better position to offer equipment for heavy rather than light industries. Since many countries wish to have heavy industry established, it is not surprising that the share of manufacturing assistance provided by the centrally-planned economies has been high 13/. Moreover, it is their established policy to assist industrialization.

4. Suppliers' Credits - Deferred payments imports have been used rather often because it was thought that the establishment of industries could be accelerated by postponing the payments; frequently the suppliers would offer such credits in order to obtain contracts and it was also indicated that repayment of these debts should not be too difficult once the enterprises begin to produce. Only partial data on the total amounts of suppliers' credits are available.

Although it might be argued that suppliers' credits make it possible to erect a factory which otherwise could not be set up, they aggravate the debt burden of the receiving countries which, instead of incurring long-term debts, are obliged to repay short or medium-term credits. Moreover, the prices charged for equipment financed in this way have been found to be high in a number of cases.

It can be said that nowadays suppliers' credits do not offer on balance any advantage to developing nations and as they are excessive in a number of countries and the need of consolidating them into long-term debts has become pressing.

13/ A case in point is India where practically the whole of the aid provided by centrally planned economies consists of supplying equipment for and building of heavy industries including steel mills, heavy machinery, heavy forge, etc.

5. Maintenance Imports Credits - In recent years developing countries have stressed the importance of the so-called maintenance imports credits which have been granted to them by the AID, the IDA and the Export-Import Bank. Such credits are needed to enable the newly-established industries to operate at a relatively satisfactory, although not full capacity 14/. In establishing such industries, several important countries had not taken into account the foreign exchange (import) requirements resulting from their operations. By now it has been found more important to supply the existing industries with spare parts, components and also raw materials than to continue to erect new plants which would suffer from the shortage of foreign exchange.

6. The Debt Servicing (Transfer) Problem - It has been stated repeatedly that foreign funds can only supplement local funds - savings available for investment, although the role of this supplement is often crucial. A rough calculation shows that in recent years foreign funds financed about 20 per cent to 25 per cent of the total (real) investment of the developing countries. This proportion was substantially higher in some countries: in Pakistan it accounted for between 45 per cent and 50 per cent during the second Five Year Plan; in India for between 25 per cent and 30 per cent, and a high proportion also in the United Arab Republic.

In connexion with the future of external assistance, the terms on which such assistance is granted must be mentioned. In various studies, especially those prepared by the World Bank, attention has been drawn to the rapidly increasing burden on the balance of payments of many countries arising from servicing of their external obligations 15/.

The yearly service of foreign debts has been absorbing a growing proportion of debtor countries' export earnings so that justified doubts exist as to the countries' ability to service their debts from their foreign exchange earnings. Therefore, the donor countries have been urged to change the terms of their assistance; to extend loans on lenient terms.

14/ The $90 million credit made to India in June 1959 resulted in an increase of foreign exchange allocated for commercial imports in 1964/65, for the first time in four years. This then made possible better production planning and inventory control and high utilization of capacity. (Source: IDA Press Release, 12 August 1965).

15/ It has been estimated that the outstanding public and publicly guaranteed debt of developing countries with a maturity of one year or over amounted to $32 billion at the end of 1964. For the developing countries as a whole, total service payments on public and publicly-guaranteed debt with a maturity of one year and over are estimated at $3.5 billion in 1964. (Source: Annual Report IBRD, 1964-65, p. 9).

Loans made by the orld ank, Inter-merican evelopment ank (from its ordinary ca ital resources) and by the xport-Im ort ank are all made on the so-called conventional terms (hard loans).

A new type of loans on lenient terms was introduced by IDA. These credits are repayable in forei n exchange in fifty years, the repayment starting in the eleventh year. A commitment fee of 3/4 of 1 per cent - no interest - is charged. The funds available to IDA for lendin are limited. The loans extended by the Social Pro ress Trust Fund, which obtains its funds from the U.S. Government and is administered by the Inter-American Development Bank, are repayable in local currencies and carry low rates of interest. AC has repeatedly recommended to its members to ease the terms of its loans 16/. lthough pro ress in easin the terms of ublic (government) loans has been made by a number of DAC countries, the problem of credit worthiness remains and clouds the prospect of a number of countries as to their ability to incur additional external debt.

T e fact remains that forei n funds can in the long run sup ly only a relatively small proportion of the needed investment with regard to industrial financing in general, and particularly in the private sector, except in the case of a few countries such as Mexico, where private direct foreign investment has continued to flow in on a large scale. This situation is not likely to change in the near future because o the large ca ital requirements for infrastructure in most countries and of ro ing importance bein attached to aid to the agricultural sector and in the Latin American countries also to housing 17/.

16/ At the annual meeting of DAC held in Paris in June 1965, it was recommend d that DAC members who do not provide at least 70 per cent of their official assistance in the form of grants should endeavour to provide 80 per cent or more of their total official assistance at favourable terms - either as grants or as loans with long maturities (25 years or more) at low rates of interest (3 per cent or less) and with an average period of grace of seven years.

The 1964 UN Conference on Trade and velopment recommend d that at the request of any developing country a reement should be secured in co-operation with the creditor countries on the reschedulin or consolidation of debt, with appropriate periods of race and amortization and reasonable rates of interest. (Source: Final ct, nnex A.IV.5).

17/ This can be illustrated by the erformance of the orld Bank and IDA. Of a total of 7,667 million (this excludes Australasia and Europe except Yugoslavia and Turkey), IBRD loans and IDA credits as of 30 June 1965: 2,633 million was for electric ower; 2,8 2 million for transportation; 653 million for agriculture and forestry; and a total of about 50 million for industry (o that about 3 million to development finance companies). All the fi ures include loans to Japan.

[illegible] financing [illegible] self-financing and [illegible] entrepreneurs [illegible], it [illegible] level [illegible] Some assistance can also [illegible] especially in countries where [illegible] generated or where funds can be borrowed in the market.

It should be noted here that although a great many gaps exist in the financing of industrial development, the governments paid more attention to improving the financing of this sector than to the financing of agriculture and housing.

In summing up, the following are the prerequisites (needs) for an adequate financing of industrial development:

a. Capital contribution by entrepreneurs when an enterprise is set up. This applies also to direct government investment in the public or semi-public industrial sector, such investment can best be financed from government savings or loans raised in the market;

b. The existence of financial institutions which would provide short-term and working capital credit;

c. The development of institutions for supplying of long-term credit. The lending by financial institutions presupposes a steady flow of savings to them;

d. An adequate rate of self-financing;

e. The government's ability to make available loans to industries directly or indirectly; and

f. The eventual development of organized capital markets.

Supplementary resources are coming from foreign funds and take various forms, from private direct foreign investment to soft loans and grants.

The situation varies from country to country according to their stage of development. On one side of the ledger is Mexico whose companies have been recently able to borrow in the New York market through the issue of debentures and on the other are some countries, particularly in Africa where commercial banks have not yet been properly developed and where the monetized sector is not large.

As experience has shown, there is no easy and quick way to organize the financing of industrial development, just as there is no short-cut in the establishment of a manufacturing sector. These two problems are inter-connected and should be treated as such.

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It would be very useful to have some case studies on the financing of industrial development prepared, showing how industrial development has been financed in the last few years and indicating the sources of the funds. Such studies would deal also with the institutional framework and include government measures which relate directly to the financing of industry, such as suitable legislation, tax measures, etc. In addition to some of the developing countries, a study of the financing of industry in Australia would be instructive.

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