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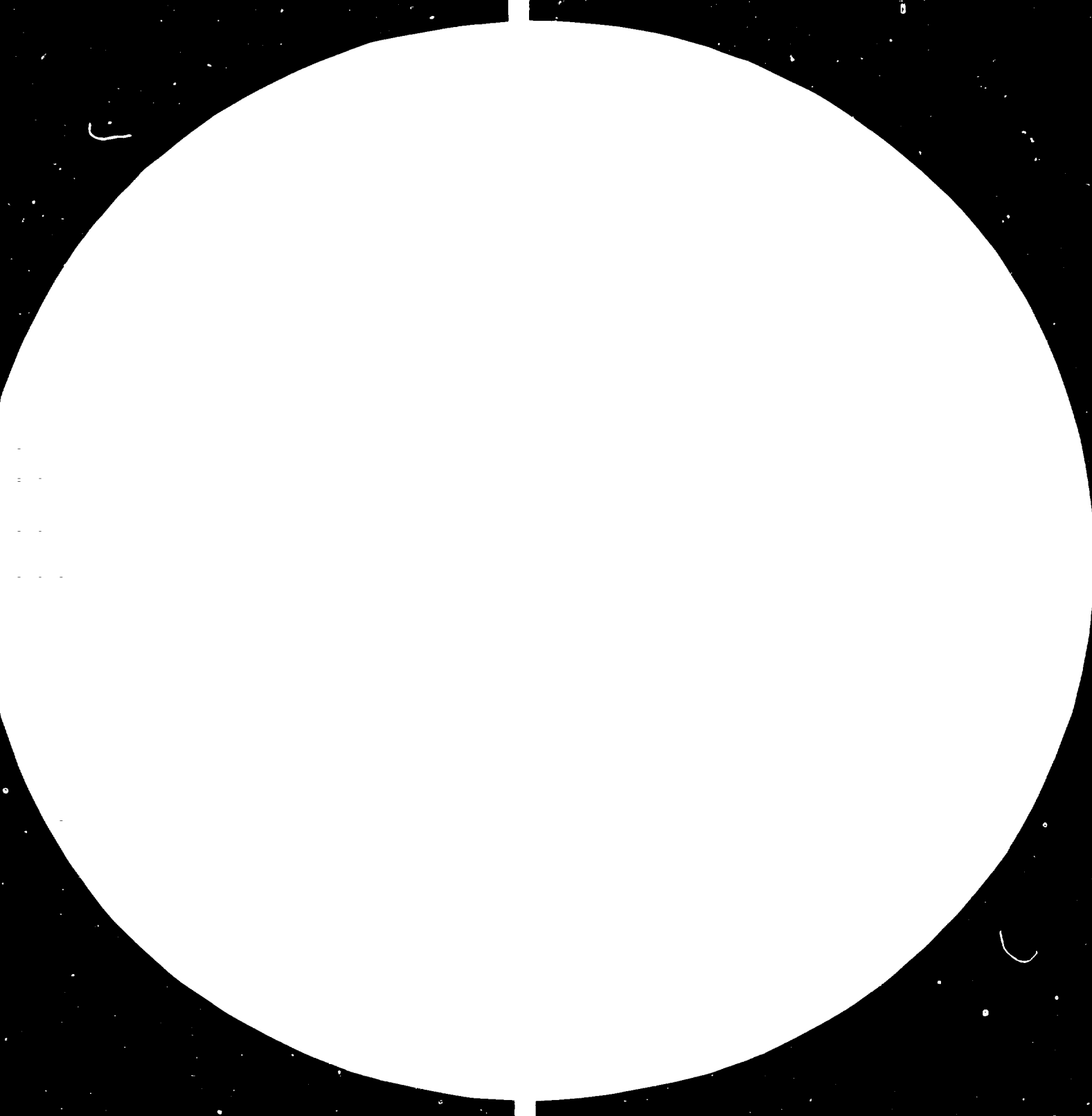
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Global Preparatory Meeting for the First
Consultation on Industrial Financing

Vienna, Austria, 23-25 March 1981

REPORT *

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PREFACE

The Second General Conference of the United Nations Industrial Development Organization (UNIDO), held at Lima, Peru, in March 1975, recommended that UNIDO should include among its activities a System of Continuing Consultations between developed and developing countries with the object of raising the developing countries' share in world industrial output through increased international co-operation. The General Assembly, at its seventh special session in September 1975, endorsed the recommendation, requested the Executive Director to ensure UNIDO's readiness to serve as a forum for consultations, and invited the Industrial Development Board to draw up rules of procedure under which the System would operate.

The System is being implemented under the guidance of the Industrial Development Board.

In May 1980, the Board decided that:

- (a) The System of Consultations shall be an instrument through which the United Nations Industrial Development Organization (UNIDO) is to serve as a forum for developed and developing countries in their contacts and consultations directed towards the industrialization of developing countries;
- (b) Consultations would also permit negotiations among interested parties at their request, at the same time as or after consultations;
- (c) Participants of each member country should include officials of governments as well as representatives of industry, labour, consumer groups and others, as deemed appropriate by each government;
- (d) Final reports of Consultations should include such conclusions and recommendations as agreed upon by consensus among the participants. The report should also include other views expressed during the discussion;
- (e) The System of Consultations with its main characteristics as described above is established on a permanent basis. Rules of procedure for the System are expected to be adopted at the fifteenth session of the Board in 1981. 1/

1/ Paras. 153 and 154, Report of the Industrial Development Board on the work of its fourteenth session, ID/B/243.

In the period 1977 to 1980, eleven Consultations were convened consisting of the First, Second and Third Consultation on the Fertilizer Industry, the First and Second Consultation on the Iron and Steel Industry, the First and Second Consultation on the Leather and Leather Products Industry, the First Consultation on the Vegetable Oils and Fats Industry, the First Consultation on the Petrochemical Industry, the First Consultation on the Agricultural Machinery Industry, and the First Consultation on the Pharmaceutical Industry. One conclusion of these Consultations was that certain issues were common to all sectors, for example, financing and the training of industrial manpower. The Board recognized this at its twelfth session 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". 2/

The Board, at its thirteenth session in May 1979, decided that preparations should continue for the convening of the First Consultation Meeting on Industrial Financing to be held during the biennium 1982-1983. 3/

2/ Para.169(b), Report of the Industrial Development Board on the work of its twelfth session, ID/B/212.

3/ Para.34(d), Report of the Industrial Development Board on the work of its thirteenth session, ID/B/232.

I. AGREED CONCLUSIONS AND RECOMMENDATIONS

1. When considering the three issues suggested by the secretariat, the Meeting agreed on the following:

Issue 1: The nature and conditions of access to international industrial financing in developing countries

2. Although there was some agreement on the topics raised, it was felt that a number of important questions remained to be discussed at the First Consultation on Industrial Financing:

(a) Is the present and future supply of funds adequate to meet the industrial financing requirements of developing countries?

(b) Sophisticated financial expertise is required for access to international capital markets. Since this does not exist in most developing countries, how can developing countries acquire this expertise?

(c) Although all industrial projects which have external financing carry with them elements of both project risk and country risk, how can country risk be faced in order to ensure the financing of projects?

(d) How can the terms of external financing for industrial projects be liberalized?

(e) What is the present and future role of private external capital and of the multilateral and bilateral institutions?

(f) What are the possibilities of introducing mechanisms for co-financing export credits with bilateral and multilateral aid agencies?

Issue 2: Economic and financial criteria used by finance agencies in financing industrial projects and the implications of applying such criteria

3. Concerning Issue 2, it was agreed that it could be more fruitfully discussed as part of Issue 1, since it represents a principal allocation criterion for external financing of industrial projects in developing countries. In this context, the implications of existing investment criteria in terms of access to external finance and the formulation of more appropriate criteria in accordance with industrialization objectives in developing countries need to be examined.

Issue 3: Prospects for co-operation of small and medium-scale industry in both developing and industrialized countries

1. It was agreed to have a working paper prepared for the Consultation on the experience and requirements for co-operation of small- and medium-scale industry in both developing and industrialized countries which could identify the position, mechanism and framework in order to recommend possible actions for the benefit of participants in such activity.

II. ORGANIZATION OF THE MEETING

5. The Meeting was convened in Vienna on 23-25 March 1981 as part of the preparations for the First Consultation on Industrial Financing. It was attended by 23 participants from 21 countries, representatives of a number of multilateral institutions, and a representative of the UNIDO Working Group on Scenarios of the Iron and Steel Industry's Development.

Opening of the Meeting

6. The Meeting was opened by E. Becker-Boost, Chairman of the UNIDO internal Task Force, responsible for preparations for Consultations on Industrial Financing. The UNIDO Task Force had considered a number of issues and selected three for presentation to the Meeting.^{4/} Participants were expected to discuss those three issues, and any other issues that they choose to consider, and to decide which issues should be given priority; the suggestion of the UNIDO secretariat was that the First Consultation Meeting should consider preferably one or two issues so that these could be discussed in depth.

7. The Global Preparatory Meeting was also addressed by the Head of the Negotiations Branch of UNIDO who described the System of Consultations.

Election of officers

8. John E.N. Scoon (Trinidad and Tobago) was elected Chairman, John D. Bierman (United States of America) and Václav Zahalka (Czechoslovakia) were elected Vice-Chairmen.

Adoption of the report

9. The draft report of the Meeting was adopted by the Meeting at its afternoon session on 25 March 1981.

^{4/} Issue 1, ID/WG.334/6
Issue 2, ID/WG.334/4
Issue 3, ID/WG.334/5

III. SUMMARY OF DISCUSSIONS

Issue 1: The nature and conditions of access to international industrial financing in developing countries

10. The secretariat introduced the issue by identifying three main features of the present situation:

- (a) The increasingly high dependence of industrial financing on private sources, particularly on private bank lending and on a fluctuating interest basis. This is due to the relative stagnation of official development assistance, and the limited number of industrial projects financed by multilateral institutions, and to the relative lack of long-term savings on a fixed interest rate basis available through bond markets.
- (b) The increasing budget and balance of payment deficits industrial countries are not only taking up the limited investment funds of the bond markets but also substantial amounts from the Eurocurrency market. Although a larger number of developing countries has recently gained access to international markets, it is only a limited number of them, and in relatively small amounts. On the Eurocurrency markets, the bulk of funds continues to go to a limited number of developing countries.
- (c) The unsuitability of funds available to meet the specific requirements of industrial development; this is mainly due to the potential crowdingout of marginal borrowers, and to unpredictable changes in maturities, amounts, spreads and interest rates.

11. The secretariat also underlined the fact that in the future financial resources for industrial investment might even be more restricted for the following reasons:

- (a) Developing countries will have to obtain external finance in the first place to cover increased payments for essential imports and increasingly to service external debt, mainly as a result of increased volume and increasing interest rates.

- (b) Risks attached to the financial intermediation process increase with the deterioration of the external position of borrowing countries, with the increasing concentration of financial resources among a small number of depositors, and with the erosion of the capital to assets and liabilities ratios of the major lenders.

12. The secretariat concluded that in the present institutional context, a continued deterioration of financing terms can be envisaged, thereby substantially increasing the share of industrial investments which cannot be suitably financed. This would lead to an increased rationing which would affect types of industrial investments and borrowing countries unevenly.

13. The Meeting considered the secretariat's presentation and a variety of views were expressed.

14. Participants from developing countries expressed the view that already today finance was not always readily available. In contrast, some participants from developed country lending institutions were of the opinion that it was possible to rely increasingly on some of the already existing sources of finance, such as export credits and various co-financing arrangements. Due to the need for sustaining economic activity in developed countries through exports, some countries might resort increasingly to export credits.

15. However, several participants from developing countries stressed that export credits are tied, which limited their capacity to benefit from bidding from suppliers. In this connection, it was pointed out that co-financing arrangements between export credit agencies and multilateral institutions may relieve the tied element of export credits by allowing for competitive bidding; moreover, new co-financing arrangements appeared to many participants to provide additional sources of finance.

16. In discussing the range of financial instruments available to developing countries, participants noted that borrowers were often disadvantaged by lack of information as well as with insufficient acquaintance with the complex techniques involved. One participant suggested that to overcome this problem, developing countries might consider the use of a national development institution having the technical knowledge and access to information required to establish appropriate links between domestic users of funds and foreign lenders. Moreover, this suggested solution would emphasize the importance of providing finance to countries' industrialization programmes rather than to individual projects.

17. In the debate that followed over the relative importance of country and project risk, participants from developed countries noted that project risk was an important criterion; however, they also noted that country risk considerations may dominate in the case of serious balance of payment difficulties. Furthermore, there may be too much tendency to take a short-time view of country-risk, given that industrial projects involve long-term investments.

18. This led to a related topic: how to define a "bankable" project. Some participants from developed countries considered that bankable projects would always find financing. However, the investment climate, notably fiscal and foreign exchange policies, was not always favourable for foreign investment. One of the participants stressed that the problems of what to finance and the criteria used in financing an industrial project should not be dealt with separately. Other participants emphasized the difficulty of selecting the criteria which could be accepted by both developed and developing countries and of applying these criteria in conditions of great uncertainty. Some participants concluded that the application of these criteria could result in the allocation of financing in such a way that some developing countries may increasingly face problems in financing their industrial projects.

19. A participant suggested that for the iron and steel industry in developing countries during the period 1980-1990, project financing constituted the major obstacle, and indicated that the secretariat should consider the results of Sectoral Working Groups in its preparations for the Consultation Meeting on Industrial Financing.

Issue 2: Economic and financial criteria used by finance agencies in financing industrial projects and the implications of applying such criteria

20. (a) The issue was posed by the secretariat by pointing out that existing criteria are somewhat arbitrary in so far as they involve a series of assumption of a political nature. In particular, the use of international prices presupposes the maintenance of the status quo in international trade and in the pattern of the international division of labour. These prices may be unacceptable to many developing countries seeking external industrial finance: these countries may be trying precisely to break away from that existing pattern.
- (b) The secretariat emphasized that many of the crucial parameters like discount rate or "shadow prices" for crucial inputs cannot be uniquely evaluated without definite assumptions. On the other hand, complete reliance on "market prices" begs the question of supporting a development programme.
- (c) The secretariat indicated that such arbitrariness in underlying political assumptions make "cost-benefit" analysis a technique of limited applicability: it may be more helpful to accept the limited scope of the technique by restricting it to evaluating alternative methods of production within an industrial branch than to push the analysis beyond its legitimate limits leading to decisions on the inter-sectoral pattern of investment. In brief, the purpose of the cost-benefit technique was suggested as being restricted to decisions on how to produce a given commodity, but not what commodities to produce which is determined in accordance with a country's development objectives.
21. A wide-ranging discussion followed in which divergent views were expressed.
22. There was some support from developing country participants for the position presented by the secretariat. It was stated that funds need to be allocated, according to national objectives and priorities, not merely on financial and economic criteria alone. The view was expressed that many financing agencies, both private and public, have been perceived to evaluate projects "purely on a numerical basis". National development objectives and economic linkages between projects need to be taken into

consideration when viewing a project. In particular, it is considered undesirable to view an individual project as isolated from the infrastructural support needed for its operation. It is necessary to consider how the project fits into a government's overall industrial strategy, and even with the international trading environment. For example, the view was expressed that less protection on the part of developed countries might improve the viability of industrial projects in developing countries.

23. Moreover, a dynamic rather than a static view needs to be taken of a project. This applies equally to the place of a project in the overall industrial development of a country as well as to such micro-economic considerations as shadow prices and international prices. One participant suggested that there was scope for the use of international prices on the grounds that use of domestic prices was open to the same objectives as use of international prices. Further, financing institutions were recommended also to appraise the managerial aspects of projects, and a study on this subject was suggested.

24. As regards the provision of finance based on project criteria, a view was expressed that while finance may be generally available in sufficient amounts, it does not appear to be available for all government borrowers who wish to finance what they consider to be sound projects. Developing countries were often placed in the position of promoting those projects which satisfy the criteria of external financing agencies.

25. By contrast, several participants from developed countries stated the case for conventional project appraisal criteria. Projects should be seen to have an acceptable rate of return, to be able to service debts out of cash flow; to have sound, tested technology and adequate entrepreneurial and managerial skills.

26. Opinions were expressed that there may well be conflicts between the project selection criteria used by some developing country borrowers and external financing agencies, even when the latter were government agencies. A call was made for new criteria. What criteria should be applied? Could UNIDO make proposals? Perhaps greater weight should be given to criteria of developing countries, whose needs are greatest. A participant called for such criteria to be incorporated into the international codes of conduct, negotiations of which are taking place within the United Nations System.

Some preference was expressed for the use of integrated national economic plans rather than appraisal of industrial projects on an individual basis.

27. The question of criteria for small projects was raised, and opinions were expressed that conventional criteria could be used safely. Lines of credit could be given by external financing agencies to development banks who could then on-lend on small projects. Experiences were quoted on this practice leading to national development banks attempting to emulate the project appraisal procedure of their foreign lenders. Some external financing agencies, however, expect national development banks to use simpler project appraisal criteria under such circumstances.

28. Developing country ignorance of financial sources for projects and the requirements of financing agencies were perceived to be a problem especially for smaller developing countries. Sources of good, impartial advice are needed.

29. A view was expressed that new financial mechanisms are needed which will allow sufficient scope for criteria of national sovereignty. The suggestion was made and generally accepted by the Meeting that Issue 2 might usefully be incorporated within Issue 1

Issue 3: Prospects for co-operation of small and medium-scale industry in both developing and industrialized countries

30. In view of the importance of medium-and small-scale industry for industrial development in the industrialized as well as the developing countries (particularly in the smaller countries) co-operation of small and medium-scale industry in both developing and industrialized countries is considered to be of mutual interest. However, the question arose, whether the discussion of industrial financing should concentrate on medium-and small-scale partners in industrialized countries or also on large companies undertaking medium-and small-scale projects which usually have a larger potential for investments in developing countries (financial, management, marketing).

31. For clarification the secretariat stated that it had in mind the small-and medium-sized project (SME) with a local promoter in a developing country which could benefit from the experience and support of the industrialized countries partners. Furthermore, it was stated that governments of developed countries could support their own small industrial enterprises going abroad, thereby increasing their production, marketing and earning potential.

32. In view of the large potential development contribution, it was generally accepted that SME's on both sides may need technical and financial assistance for their intended collaboration. It appeared that, so far, co-operation has mainly been on larger-scale projects as sub-contractor or as supplier of services or of handicraft. The co-operation potential as co-venturer, partners or small entrepreneurs has not yet been utilized to a meaningful extent.

33. The Meeting generally concurred on the need to stimulate small firms to co-operate. However, the experience in some developed countries seemed not too encouraging due to lack of information and perceived high risks. Small firms are inward looking and with limited management capabilities.

34. On the other hand it was noted that there exists "an endless stream of visitors from small business" looking for opportunities, inquiring about investment conditions and incentives, proving their outward-looking approach. It was also stressed by a representative of an industrialized country that the progress on SME co-operation was very slow.

35. Commercial and political risks determine largely the investment decision of SME joint ventures. There was much support for the view that one might distinguish more clearly between the large multinational companies and small-or medium-sized partners in joint business ventures of developing and industrialized countries. To some extent, investment codes and tax laws have been oriented towards multinational corporations and this was considered as too restrictive and cumbersome for smaller companies.

36. The participants noted with interest the different mechanisms which were established in developing countries such as, for example, in Mexico, the Dominican Republic, Trinidad and Tobago, the Philippines and Yugoslavia in order to attract small-and medium-joint ventures. In all instances, the offer was made to report on these experiences in more detail, in order to give SME guidance, information and comparative advantages. It was stated that these mechanisms could usefully be examined by other developing countries at a Consultation. Common features of these schemes appear to include active exchange of information and promotion, temporary tax and duty incentives, attractive investment legislation and financing.

37. The Meeting has been aware of the existing, normal disadvantages for SME's in any foreign country with an alien environment, information gaps, management problems, specific fiscal and monetary measures etc. However, particular concessional terms could be provided in both developing and industrialized countries for qualified SME projects which generate additional employment, use local raw materials, transfer technology, and are directly productive industrial investments, be it by means of import substitution or for export markets. It was, however, stressed that these international joint ventures should use advanced technology and have a direct capital participation.

38. Additional points were considered, taking into account generally accepted needs and possibilities have been as follows:

- What can financial institutions do in order to promote and assist in the increased establishment of viable joint venture SME's?
- How can the disadvantages for SME's be overcome?
- How to adjust industrial financing methods for SME's in industrialized and developing countries?

- Which are appropriate and generally accepted financial instruments for promoting small-and-medium industrial enterprises, and how can these be improved?

39. In that context it was considered important to have a clearer definition of the small-medium sized industrial enterprise, including a common understanding on the motivations for co-operation, advantages of partnership agreements, and the possible set of preferable incentives for all partners involved (local and foreign sponsors as well as governments providing support).

40. It was emphasized that it would be desirable to have a secretariat study reviewing the prospects for co-operation of small- and medium-scale industry in developing and industrialized countries describing both the existing framework on the one side and the actions to be taken on the other side.

41. It was therefore suggested to have a working paper prepared for the Consultation Meeting on the experience and requirements for co-operation of small- and medium-scale industry in both developing and industrialized countries which could identify the position, mechanism and framework, and recommend possible actions for the benefit of participants in such activity.

Annex I

LIST OF PARTICIPANTS

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* * * * *

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Annex II

LIST OF DOCUMENTS

Information documents

Aide-mémoire

List of participants

List of documents

Main working documents

Suggested issue no.1

The nature and conditions of access to international industrial financing in developing countries

ID/WG.334/6

Suggested issue no.2

Economic and financial criteria used by finance agencies in financing industrial projects and the implications of applying such criteria

ID/WG.334/4

Suggested issue no.3

Prospects for co-operation of small and medium-scale industry in both developing and industrialized countries

ID/WG.334/5

Background documents

Impacts of terms, interest and exchange rate fluctuations of debt and equity financing on industrial investments

ID/WG.334/1

The influence of the variability of exchange and interest rates on industrial development

ID/WG.334/2

Cost-benefit analysis for project evaluation and structural changes in a developing economy

ID/WG.334/3

International co-operation for small and medium-scale enterprises in industrialized and developing countries: a socio-economic perspective

ID/WG.334/7

Papers presented in the course of discussions

Finance for steel and supplementary report, British Steel Corporation (Overseas Services) Ltd.

Joint banks as upgraded form of interbank co-operation, M. Zecević

Note on the establishment of joint investment funds in Mexico, C. Quintana G.D.

