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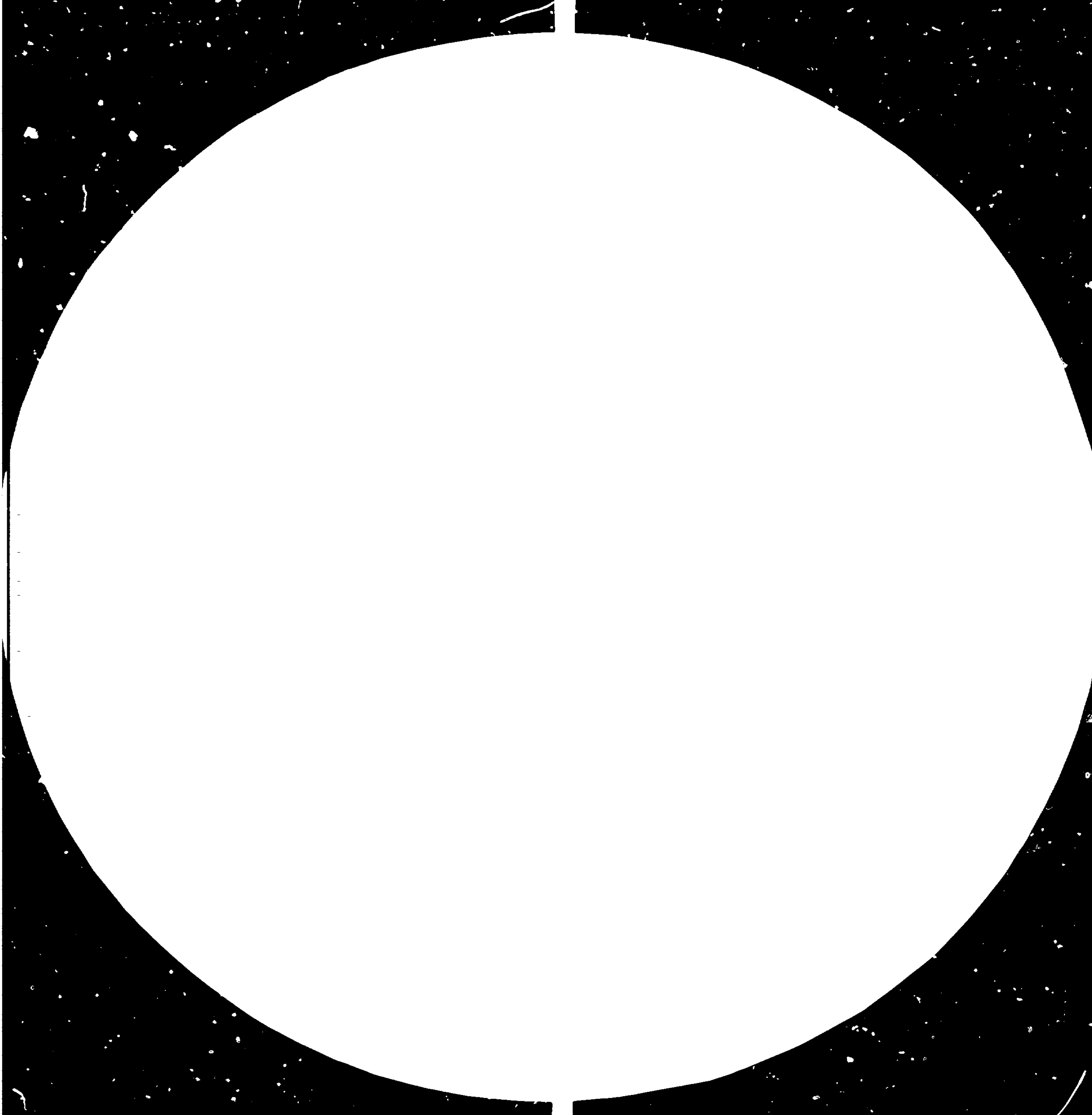

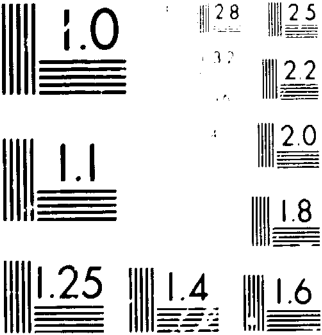

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POSITION PAPER ON INDUSTRIAL FINANCING*

prepared by
the secretariat of UNIDO

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Introduction

Results of Consultations which have taken place in various industrial sectors within the UNIDO System of Consultations, underscore the fact that industrial financing is an indispensable element of industrial development. The difficulty of obtaining reasonably-priced funds with realistic maturities has been identified time and again as a major constraint in the industrial development of Third World countries. It is therefore of prime importance that the forthcoming Consultation on Industrial Financing should result in meaningful developments which would alleviate this difficulty.

The Scenario as perceived by the Secretariat

1. While internally-generated funds will continue to provide the bulk of industrial financing in developing countries, there can be no significant advance in industrial development without a substantial flow of external resources. External funding is especially required by the heavy reliance by most developing countries on imported capital equipment and technical know-how.

2. Industrial financing is just one of several components of the persistent current account deficits of most developing countries which have so far raised these countries' external indebtedness to levels heretofore unknown. These deficits are attributable principally to two main factors, namely: the deterioration in terms of trade, i.e., steady rise of world prices of manufactures in relation to primary products and to higher debt service obligations due to rising debt levels as well as higher interest rates. Industrial development of any consequence would therefore render necessary, external flow of resources of a greater magnitude than so far witnessed.

3. Concessional and semi-concessional borrowings are becoming less and less significant as sources of external funding required by developing countries. The ODA (Official Development Assistance) sector overall is projected to increase by only \$2-3 billions a year in the next few years. The inevitable consequence of this is an unprecedented expansion of borrowing by developing countries in international markets, particularly the Eurocredit markets.

4. The international banks which comprise the corps of Eurocredit lenders shall forever seek to maximize profits and minimize losses. In the process of minimizing losses, acceptable levels of risk are established formally or informally both with regard to the merits of the project (project risk) and the existing conditions in the country where the project is to be implemented (country risk).

5. There is a marked tendency on the part of private international financial institutions as well as the official export credit agencies to apply country risk analysis more and more exclusively when allocating loanable funds. Even the World Bank's recent campaign to increase co-financing arrangements with private lenders appears to be based on 'project suitability' which refers to projects in higher income developing countries. This tendency adversely affects the chances of low-income (below $400 per capita) developing countries to obtain financing for their industrial projects.

6. While there is general agreement that economic and industrial development prospects of low-income developing countries are bleak, no definitive solutions have been recognised so far. If present trends continue, these countries will be left farther and farther behind as more developing countries join the ranks of the newly industrialized.

7. The current state of affairs and its ramifications are of such urgency and vital concern that the job of finding solutions cannot be lodged exclusively with any single institution or group of institutions. The situation demands no less than the concerted best efforts of all concerned.

Salient concepts of Consultants' proposals

A. Intervention of developed countries

Developed countries, taking advantage of their generally higher-than-average credit rating will borrow in the Eurocredit market at relatively favourable terms. The borrowed funds shall then be relent to developing countries at subsidized terms to finance industrial development. The cost of the subsidy and of insurance to cover defaults shall be financed by a portion of the intermediating country's ODA budget. This approach has the added benefit of simplicity of execution since the intermediating country can act unilaterally and would therefore not entail modification of existing schemes.

B. Re-examination of industrial project evaluation guidelines

This proposal is directed against traditional cost-benefit analysis as applied by financial institutions in industrial project selection. A developing country, for example, desiring to establish a T.V. plant, may not be able to obtain the necessary financing if analysts decide that television sets would be cheaper to import. This conclusion would of course be normally based on traditionally projected costs of production related to perceived benefits which would be simplistically presumed to be the enjoyment by the population of television. It is quite conceivable that the analysts would ignore the long-term benefits accruing to the country through the diversification of its manufactures mix. A programme as opposed to project approach to financing is clearly implied by this proposal.

C. Expansion of infrastructure financing

Bilateral and multilateral financing institutions, particularly the World Bank, might be called upon to give priority to the financing of infrastructure which would directly benefit an industrial project and/or a string of small and medium-size projects, i. e. an industrial complex or programme.

D. Extended co-financing

Since the early seventies, international development banks, in particular the World Bank, have been promoting credit arrangements with export credit agencies and/or private financial institutions to finance industrial projects. These arrangements can greately enhance both the quantity and the quality of financial flows to industry through more equitable risk sharing and the optimal utilization of the capabilities of each type of financial institution.

E. Improvement of market assessment and loan negotiation skills in developing countries

The lack of formal controls in the Eurocredit market has no doubt been the most important factor in its legendary growth. It is also the primary reason for its complexity and often erratic behaviour. To say that marketplace participants have been inventive with regards to margins, types of instruments, fees, etc., may be an understatement. There is a great variety of combinations of terms and the innovation process is far from over.

Consequently, borrowers need to keep up with their market assessment and loan negotiation skills if they want to obtain the most favourable terms possible. These skills must be backed up with solid information on current loan pricing policies, currency fluctuations, contract conditions, capital equipment pricing practices, etc.. Some developing countries may very well require assistance in sharpening their available skills as well as in gathering and synthesizing relevant information.

Given the initiatives expected of multilateral finance institutions and the relationship of these institutions with co-finance partners, burdening them with the task of providing this type of assistance, might lead to conflicts of interest. New arrangements must therefore be sought to help these countries cope with the complexities of existing schemes and of the expanded types mentioned above.

Conclusion

While being fully aware of the general exigency of increasing capital flows on appropriate terms to developing countries, the primary concern of the UNIDO secretariat is to assure that an adequate portion of these flows is effectively channelled to industry and that the poorest of developing countries should receive a sufficient portion of the industrial financing flows. The above-enumerated concepts are calculated to have this effect once refined through the present advisory proceedings and subsequently in the Consultation Meeting.

As previously pointed out, the task at hand requires the concerted best efforts of all concerned. It is hoped that all the parties concerned will heed the call. For its part, the UNIDO secretariat stands ready to maximize the effectiveness of its technical assistance to industry in the Third World by integrating industrial financing support more fully into its normal activities. Additionally, UNIDO shall encourage and facilitate co-operative undertakings of developed and developing countries with a view to improving, on mutually beneficial terms, the latter's access to available industrial financing.