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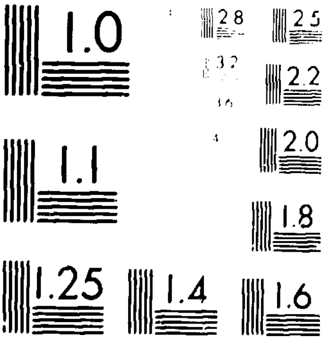

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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

FIRST CONSULTATION ON INDUSTRIAL FINANCING

v.l 3478

Madrid, Spain, 18–22 October 1982

REPORT.

(1st consultation on industrial financing).

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.1/

The General Assembly, at its seventh special session in September 1975, in its resolution 3362 (S-VII), decided that a system of consultations as provided for by the Lima Plan of Action should be established at global, regional, interregional and sectoral levels.2/ UNIDO, at the request of the countries concerned, should provide a forum for the negotiation of agreements in the field of industry between developed and developing countries and among developing countries themselves.

Sixteen Consultations have been convened since 1977 covering the capital goods, agricultural machinery, iron and steel, fertilizer, petrochemical, pharmaceutical, leather and leather products, vegetable oils and fats, and food processing industries.

In May 1980 the Board established the System of Consultations on a permanent basis, and in May 1982 it adopted the rules of procedure3/ according to which the System of Consultations was to operate, including its principles, objectives and characteristics, notably:

> 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;4/
>
> The System of Consultations would also permit negotiations among interested parties at their request, at the same time as or after consultations;5/

1/ Report of the Second General Conference of the United Nations Industrial Development Organization (ID/CONF.3/31), chapter IV, "The Lima Declaration and Plan of Action on Industrial Development and Co-operation", para.66.

2/ Official Records of the General Assembly, Seventh Special Session, Supplement No. 1, para.3.

3/ The System of Consultations (PI/84).

4/ Ibid., para.1.

5/ Ibid., para.3.

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;6/

Each Consultation Meeting shall formulate a report, which shall include conclusions and recommendations agreed upon by consensus and also other significant views expressed during the discussion.7/

The Board at its fifteenth session, held in 1981,8/ decided that the First Consultation on Industrial Financing should be held in the biennium 1982-1983.

6/ *Ibid*., para.23.

7/ *Ibid*., para.46.

8/ *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 16* (A/36/16), para.171.

CONTENTS

INTRODUCTION

First Consultation

1. The First Consultation on Industrial Financing was held at Madrid, Spain, from 18 to 22 October 1982. The First Consultation was attended by 180 participants from 65 countries and 16 international organizations (see annex I).

AGREED CONCLUSIONS AND RECOMMENDATIONS

Issue No. 1: Is there a quantitative and qualitative gap in external financial flows for industrial investment in developing countries?

Conclusions

2. Although there is wide recognition of a shortfall between funds available and funds required for industrial financing in developing countries, there is great uncertainty surrounding the estimates of the quantitative shortfall due to the difficulty of assessing the relative importance of the availability of funds and the availability of bankable projects, and the extent of the impact on project viability of terms and conditions of finance, in view of which the problems of financing the industrialization of developing countries need to be better analysed and better documented.

3. Nevertheless it is established that there is a serious problem of external financing for industrialization in developing countries that is expected to be aggravated if all present conditions affecting financing prevail.

Recommendation

4. In view of the above conclusions, UNIDO, in co-operation with the other institutions concerned, should continue to analyse the problems of financing of industry in developing countries; in particular, it should analyse the basic reasons and present mechanisms and practices used that make it difficult for the developing countries to obtain financing and that impair the viability of their projects, and disseminate the results of this analysis to member countries in preparation for subsequent relevant meetings.

Issue No. 2: How and to what extent can existing mechanisms and institutions provide additional industrial financing to developing countries?

Conclusions

5. There exists a serious information gap concerning the opportunities and needs for investment in industry in the developing countries reflected in the lack of liaison between development finance institutions, banks and other potential investors and project sponsors and enterprises capable of participating in the project. Small and medium-sized enterprises in both developing and industrialized countries suffer most from this gap.

6. Multilateral financial institutions, including the regional banks, that are currently a major source of industrial financing in developing countries, are facing serious constraints in increasing their lending, including that to industry. Given the restrictions in increasing their borrowings, an important way of increasing multilateral and bilateral financing appears to be greater co-financing with commercial banks, national export credit agencies, and other institutions capable of co-financing and of promoting, and sustaining or improving viable projects. This may in turn assist the commercial banking system to raise their lending.

7. Direct investment by foreign enterprises could also offer the possibility for increasing financing. This, however, depends on mutual understanding and agreement between foreign investors and the recipient country, as well as on mutually attractive investment conditions.

8. With the present deteriorating economic situation, it is recognized that projects that are entirely viable on their own may be denied financing because they are located in countries with serious balance-of-payments problems. In such cases the assessment of country risk is at variance with project risk.

9. New investment guarantee or insurance schemes have long been under consideration, primarily in relation to large-scale projects. There is a greater need for such protection to encourage co-operation and partnership between small and medium-sized enterprises in industrialized and developing countries. Some systems of guarantees would enable multilateral institutions as well as other specialized development finance institutions to expand

the innovative practice of providing equity or long-term loans convertible to equity to small and medium-sized enterprises through national development financing institutions.

10. Designing the financing package or "financial engineering" is as important as arranging the financing itself; special knowledge and skills are required to ensure the blend of terms and conditions (such as fixed-interest rates) most appropriate to the particular project. Small and medium-sized enterprises in developing countries particularly need assistance in this respect.

11. Industrial project identification, preparation, evaluation, financing and implementation are important elements of the project development cycle. Quality of management is equally important. Serious deficiencies still exist at all stages of project development, making it difficult for developing countries to submit well-prepared investment proposals for financing. A standardized methodology for project preparation covering markets. human resources, technical, financial and economic aspects would facilitate project evaluation. Early association of local and foreign project sponsors is lacking, which makes it difficult to arrange the financing package at the earliest possible stage. Inadequate implementation planning and administrative delays lead to cost over-runs, shortage of project liquidity and often to project failure. Project management covering the entire project development cycle and training in all aspects of pre-investment, investment and post-investment work are all required.

Recommendations

12. UNIDO, in co-operation with other interested United Nations bodies, should:

(a) Encourage the flow of information on industrial investment opportunities between financial or development finance institutions, other specialized financial institutions and other potential investors and sponsors by such means as organizing periodic investment promotion meetings, making available periodic information on existing financial or other specilized institutions, their facilities and conditions, and encouraging the establishment of focal points in developing countries, perhaps in development finance institutions;

(b) Make a detailed analysis, taking fully into account work being done in other institutions, of possible net increases in the flow of funds for industrial financing that might result from greater use of co-financing and partnership, and suggest ways to multilateral, regional and other institutions to improve and increase such arrangements in order to expand the funds for equity and long-term capital to developing countries;

(c) Strengthen its existing activities to promote direct foreign investment in developing countries, especially by small and medium-sized enterprises, making use of financial agencies in those countries, and taking especially into consideration the interests of developing countries;

(d) Encourage the dissemination, to all interested parties, of information on the nature and availability of investment guarantee and insurance mechanisms to facilitate investment in small and medium-sized enterprises in developing countries, and encourage or prepare whenever appropriate the creation or expansion of such mechanisms for small and medium-sized enterprises in developing countries, in collaboration with other appropriate agencies if necessary;

(e) Provide assistance to small and medium-sized enterprises in developing countries in designing and obtaining equity and loan financing on optimal terms and conditions;

(f) Explore ways and means of overcoming or reducing the country risk problem for individual industrial projects that are in themselves viable and could contribute to economic progress;

(g) Assist developing countries:

(i) To improve the quality of feasibility studies and the preparation of good projects with appropriate economic and financial effects through the provision of an impartial evaluation of studies;

(ii) To standardize the preparation of feasibility studies with a view to facilitating their evaluation;

(iii) To introduce integrated project management covering the entire project development cycle within the framework of the industrial development programme of the country;

(h) Undertake preparations in the event that the Industrial Development Board decides that a Second Consultation on Industrial Financing should take place.

Issue No. 3: Can the possible industrial financing gap be overcome by the elaboration of innovative concepts leading to the acceptance of new mechanisms and/or institutions?

Conclusions

13. Although the following conclusions apply to all developing countries, it is felt that there is a practical need to grant the least developed of the developing countries priority in the implementation of the recommendations.

14. Relatively small amounts of financial resources can be highly effective in many developing countries in bringing about a higher degree of utilization of existing industrial capacity. Financing of repair and maintenance imports is a particularly critical problem capable of speedy resolution. Working capital needs for other imports may also become critical.

15. Careful preparation, planning, evaluation and implementation of industrial projects and programmes, in particular financial planning, are important.

16. Also of great importance is the sustained development of small to medium-scale industries in developing countries, and in order to encourage this aspect of development, the problem has to be tackled not only on the financial level but also on the technical and related-skill levels, such as engineering and marketing, technical assistance and suitable technology transfer.

17. Investment in human capital formation and industry-linked infrastructure are pre-conditions for promoting industrial development and the financing of these two key inputs should be formulated within the financing package so as to attract finance on subsidized terms whenever possible. Furthermore, the financing allocated to these inputs should be separately considered when the commercial return calculation is undertaken.

18. There is an inadequate information flow between developing and industrialized countries in industrial financing in areas such as volume of credit by types of potential lenders and the quality of credit with respect to interest rate, maturity, exchange rate arrangements and other conditionalities. Information should be disseminated on the sources of risk capital needed for equity funding and the volume of such capital and the conditions attached.

Recommendations

19. UNIDO, in co-ordination, whenever necessary, with the appropriate financial agencies should use its best endeavours to promote:

(a) The use of programme lending on a wider and more imaginative sectoral basis, including financing of related services, pre-investment work, and repair and maintenance;

(b) The adoption of more flexible rules and regulations to make possible the supply of risk capital and/or more effective lending to small and medium-scale industries on a broader sectoral basis by channelling external finance through national development finance institutions, recognizing that the growth and stature of these institutions provide the opportunity for relaxing conventional requirements such as the taking of collateral security and the monitoring of disbursement procedures, thereby also recognizing that it is in the nature of small-scale industry that its collateral normally can have limited value;

(c) The creation of new mechanisms to strengthen the links between training and the setting-up of industrial plants, for example, by linking the financing of training operators and management personnel for industrial plants to the financing of hardware and machinery cost;

(d) The provision of financial support as well as technical assistance in order to supplement the domestic efforts of developing countries in building their industry-linked infrastructure;

(e) The adoption of project and programme appraisal techniques, separating industry-linked infrastructure and training costs from the calculation of financial returns;

(f) The use and increase of pre-investment funds for financing studies on pre-feasibility, marketing, finance, planning, etc., particularly for the least developed of the developing countries, and use, where appropriate, UNIDO arrangements for the financing of technical assistance;

(g) The study of combinations of different forms of financing and other measures that may lead to a general softening of the conditions of supplying risk capital and/or loans;

(h) The continuation of dissemination of information on industrial financing, in accordance with paragraph 18 above.

I. ORGANIZATION OF THE CONSULTATION

Opening of the Consultation

20. The First Consultation on Industrial Financing was opened by the Executive Director of UNIDO in the presence of His Excellency, the Vice-President of the Government for Economic Affairs. The Executive Director thanked the Vice-President for the hospitality extended by the Government of Spain, and recalled that Spain had hosted the First Consultation on the Vegetable Oils and Fats Industry in 1977.

21. Since 1977, 16 Consultations had been held involving over 2,500 participants and covering 9 industrial sectors. The sectoral Consultations had clearly demonstrated the importance of certain horizontal issues such as industrial financing, the subject of the current Consultation.

22. The Executive Director noted that the First Consultation was taking place during the most serious economic crisis the world had faced for 50 years. That had caused high unemployment and negligible economic growth in the industrialized countries; inevitably, such factors had severely impaired the economic situation of developing countries. Despite the gloomy financial and economic situation, it was felt in UNIDO that it was the right time for the industrialized and the developing countries to co-operate in measures to raise global industrial capacity utilization and to take decisive steps towards industrialization of the developing countries. Indeed, the growth markets of the future were in the third world, and their development could not but benefit the industrialized countries. In that connection, he noted that if the absolute size of economies rather than per capita income were considered, several developing countries were among the largest economies in the world in terms of total GDP. The growth of those economies would greatly benefit the world economy as a whole.

23. Accelerated growth, however, would need new investment from the North in the form of capital goods and services. That, in turn, depended on foreign exchange financing being made available to the importing developing countries on terms that would not cripple their growth.

24. In that context, three issues had been identified and documented for the Consultation. The Executive Director commented that any substantial progress towards the industrialization of the developing countries would require a huge investment, and he felt that the Consultation would make its own evaluation of whether that would leave a qualitative and quantitative gap between the needs and availability of finance for third world industrialization. Furthermore, he suggested that the Consultation might consider the special initiatives that would be required in order to provide seed money for project preparation and evaluation.

25. He considered it important to examine the extent to which existing financial mechanisms could provide additional industrial financing to developing countries and to review the possibility of greater direct foreign investment in the developing countries. He also thought the Consultation might consider the need for new financial mechanisms or institutions; it might also formulate practical means for eliminating constraints in order to meet the financial needs for industrial infrastructure, industrial training, and the industrialization of the least developed of the developing countries.

26. Finally, he recognized the considerable expertise and wealth of experience in industrial financing of the participants, who included practising bankers.

27. His Excellency, the Vice-President of the Government for Economic Affairs, on behalf of the Government of Spain, welcomed the participants to Madrid. He expressed his country's faith in the System of Consultations as a suitable means of promoting the industrialization of the developing countries, and said it was a critical moment in its history which was, for the first time, taking up problems that were not sectoral but horizontal in nature.

28. He recalled that the recent meeting of the International Monetary Fund and the World Bank had highlighted the fact that the current international economic crisis was coupled with a financial crisis that was manifested in acute form in several developing countries. That added particular importance to the current Consultation.

29. The Vice-President felt that all countries had an inescapable obligation to make maximum use of the limited resources available and to simplify all existing methods of financing. In that connection, it was necessary to promote a search for ways of ensuring a greater volume of financing through more fluid channels, for example: the establishment of multilateral guarantee schemes and trust funds for investment in private industrial undertakings; the improvement of national planning processes; the institutionalization and strengthening of South-South co-operation; and the expansion of mechanisms for co-financing, especially with export credit institutions, and other mechanisms enabling resources for industrialization to be extended to as many countries as possible.

30. The Vice-President hoped that the First Consultation would help to solve the problems that currently faced the developing countries.

Election of officers

31. Alberto Cerrolaza Asenjo (Spain), Director del Servicio de Estudios e Información, Bolsa Oficial de Comercio, was elected Chairman.

32. Four Vice-Chairmen were elected as follows:

Raymond Hemen Ihyembe (Nigeria), Controller of Investment Promotions, Nigerian Bank for Commerce and Industry

Robin S. Martin (United Kingdom of Great Britain and Northern Ireland) Standard Chartered Merchant Bank

Devendra R. Mehta (India), Joint Secretary (Industrial Finance), Department of Economic Affairs, Ministry of Finance

Jiri Vetrovsky (Czechoslovakia), Director, Department for Foreign Relations, Ministry of Finance.

33. Pablo Andrade (Ecuador), Commercial and Economic Counsellor of the Embassy of Ecuador in Madrid, was elected Rapporteur.

Adoption of the agenda

34. The Consultation adopted the following agenda:

1. Opening of the Consultation
2. Election of Chairman, Vice-Chairmen and Rapporteur
3. Adoption of the agenda
4. Presentation of the issues by the UNIDO secretariat

5. Discussion of the issues
6. Recommendations for future action
7. Adoption of the report of the Consultation

Establishment of a working group

35. The Consultation established an open-ended working group to discuss Issue No. 2 and to propose conclusions and recommendations for consideration by the plenary.

36. Devendra R. Mehta (India) was elected Chairman of the working group.

Documentation

37. The documents issued for the Consultation are listed in annex II.

Adoption of the report

38. The report was adopted by consensus on Friday, 22 October 1982, at the final plenary session of the First Consultation. Alfredo Rambla Jovani, Subdirector General de Relaciones Industriales Internacionales, Ministerio de Industria y Energía, Madrid, read a statement on behalf of the Minister of Industry of Spain before the Consultation was closed.

II. REPORT OF THE PLENARY SESSIONS

Introduction by the UNIDO secretariat

39. A representative of the UNIDO secretariat made a general introduction to the three issues to be discussed by the Consultation. He stated that current investment in manufacturing industry in all developing countries amounted to approximately $55 billion,[1/] of which foreign exchange was approximately $22 billion. Various estimates, including those based on the Lima target, indicated that by 1990 between $41 billion and $52 billion would be needed, equivalent to approximately half of the total external resource flows projected for that year. If industry continued to receive approximately 20 per cent of the total flows, there would be a gap of at least $40 billion annually. It was stated that those estimates were given only to indicate the order of magnitude of the problem and the opportunities for those countries that would supply the necessary equipment and services purchased with such funds.

40. The representative stated that the total industrial investment could be broken down by size of industry. Large-scale industries, such as iron and steel, fertilizer and petrochemical, accounted for approximately one quarter of developing countries' investment in industry. One question to be discussed in that context was how the financial and economic viability of projects could be improved by separating indirect investments in infrastructure from financing the projects proper. Medium-sized industries, such as metal-working, electrical and agro-based, accounted for approximately another quarter of developing countries' industrial investment. The financing of those projects required a substantial proportion of risk capital; since foreign partnership primarily related to those types of industries, problems related to direct foreign investment and to co-financing needed solutions. Buy-back arrangements could be one of the innovative means to finance that group of industries, including large-scale plants. Small-scale industries accounted for the balance and played a key role in most countries' industrial structure and in job creation. Programme lending on a sectoral basis might prove to be an appropriate means to channel funds available for those industries, mostly through national development finance institutions. A considerable portion of total industrial financing would be needed for engineering and other services, as well as for repair and maintenance.

1/ The figures are given in 1975 US dollars.

41. The representative of the UNIDO secretariat then gave some sample questions and possible answers relating to each of the issues to be considered by the Consultation. He recalled that for many industrialized countries the export of manufactured goods required the markets of developing countries. The latter, however, could not repay principal and interest if the markets of industrialized countries were not accessible to them. It might therefore be beneficial to both developing and industrialized countries, if the latter were to structure their industry in order to provide the hardware and services needed to complete industrial plants in developing countries.

Issue No. 1: Is there a quantitative and qualitative gap in external financial flows for industrial investment in developing countries?

42. A representative of the UNIDO secretariat introduced Issue Paper No. 1 (ID/WG.377/4) by explaining that external industrial finance should be examined in the context of total external financial flows to developing countries. Although some 80 per cent of the value of developing country industrial programmes were financed from domestic sources, external sources were of strategic importance. They represented some 50 per cent of the foreign content of industrial projects. Starting in 1973, there had been a marked switch from public to private sector financial flows to developing countries, and the commercial banks had played the important role of recycling oil surpluses for developing and industrialized countries. The magnitude of the switch was apparent from the fact that the proportion of the current account deficit of developing countries financed by Official Development Assistance was some 90 per cent in 1973, but by 1980 that had fallen to 28 per cent. That trend in terms of the availability and conditions of lending had had significantly unfavourable consequences.

43. The cost of the current international financial crisis was high in the industrialized countries, but was much more severe in the developing countries where the possibility of downward adjustment was much more limited. The capital markets had moved steadily to shorter term lending, which was not suitable for industrial investment. The capital markets provided finance, in order of preference for (a) industrialized countries; (b) non-growth needs of the developing countries; (c) debt servicing obligations of developing countries; and (d) growth needs of developing countries.

44. Finance for projects, and especially for industrial projects had suffered because of the high level of interest rates. Consideration of project risk had become subordinate to country credit-worthiness, and financial flows had suffered from the constraints in lending by commercial banks, which was due to the inadequacies of their capital/assets ratios and the extent of their exposure.

45. The figures for 1990 and 2000 quoted in Issue Paper No. 1 should be seen as indicating orders of magnitude only. Nevertheless they demonstrated a substantial and increasing quantitative gap between future needs and availability of finance for industry in developing countries. The Consultation had to consider what changes might be necessary if the current financial system could not provide the necessary quality and quantity of funds.

Issue No. 2: How and to what extent can existing mechanisms and institutions provide additional industrial financing to developing countries?

46. In introducing Issue Paper No. 2 (ID/WG.377/2), a representative of the UNIDO secretariat recalled that Issue Paper No. 1 had examined the demand for and supply of industrial financing and the extent to which a net demand would remain unsatisfied by the market without intervention or special measures. In the past, capital surplus had flowed from command over technology and industry; recently, however, there had been a fundamental change: a capital surplus had been generated by oil-exporting countries that did not command technology or industry. The financial markets reacted to that shift not by structural change but by a heroic re-cycling of funds by commercial banks. The question was whether the market could continue to cope with the changed situation: that depended upon the extent to which there was further pressure on the markets. The new mechanisms or institutions called for in Issue Paper No. 3 (ID/WG.377/1) should be considered in the light of the conclusions reached on Issue No. 2.

47. The advantages and constraints of four sources of industrial financing were discussed in the Issue Paper: Official Development Assistance, multilateral financing institutions, direct foreign investment, and commercial banks. Multilateral institutions had three important constraints: a limited capital base, a limited capital borrowing ratio (gearing ratio),

and a limit to the financing of the foreign exchange component of an industrial project. Those could be overcome by an increase in capital base, an increase in the gearing ratio, and co-financing. With respect to the latter, the questions to consider were how effective co-financing arrangements could be designed and the extent to which co-financing would generate additional funds. Direct foreign investment provided a useful package of inputs (technology, training, marketing, management), but must be reconciled with national development objectives. There was too, a question of generating additionality. Commercial bank lending was constrained by the capital/assets ratio requirements of banks and the limits to the country risk exposure that individual banks could accept. It should also be noted that commercial bank lending was confined to a relatively small number of developing countries. Such financing might be expanded through greater co-financing, the intermediation of industrialized countries, the promotion of risk capital instruments and the greater use of buy-back arrangements. The representative of the UNIDO secretariat suggested that the discussion should give particular attention to co-financing and direct foreign investment.

<u>Issue No. 3</u>: <u>Can the possible industrial financing gap be overcome by the elaboration of innovative concepts leading to the acceptance of new mechanisms and/or institutions?</u>

48. In presenting Issue Paper No. 3 (ID/WG.377/1), a representative of the UNIDO secretariat stated that the current world financial situation was seen as the context for questions on that issue. The short- and long-term components of the current economic crisis had to be recognized. The long-term structural component related to the changing pattern of comparative advantages and disadvantages in the industry of both the industrialized and the developing countries. Equally important were short-term cyclical problems causing lack of effective demand in export markets and a very severe cash flow or liquidity problem at enterprise and national levels.

49. It was recognized in the UNIDO secretariat that even with the best allocation and management in the use of the foreign exchange currently available to developing countries, the various components of the crisis could not be overcome successfully. An important part of that issue focused on the most effective way of allocating scarce foreign exchange. However, it had been recognized earlier that that was not enough; the question of allocation was only part of the problem. There was also a gap

between the total amount of foreign exchange available and the total amount required for industry that had to be met. Thus the allocation of foreign exchange and the total available of foreign exchange should be examined together, and not separately as is usually the case.

50. Foreign exchange could be used for the import of capital equipment and expanding industrial capacity, or for the continuous import of manufactured goods; textiles and clothing imported in the long-term rather than textile/clothing equipment in the short-term.

51. There might be a need for changes in arrangements to assure a greater allocation of finance to industry in developing countries as well as for changes in the terms and conditions of finance. However, apart from the quality of finance, there was the more basic question of access to finance, particularly from commercial sources. Thus attention had been drawn to the financing of industry in the least developed of the developing countries.

52. There was enough circumstantial evidence that current arrangements for industrial finance had favoured not only a handful of countries, but also a particular mode of industrialization in almost all of those countries. That had resulted in a de-emphasis of some of the most crucial areas of industrialization in developing countries. Thus, formation of industrial skills in developing countries had been neglected. In Issue Paper No. 3, attention was drawn to the financing of training programmes as an integral part of financing industrial programmes and complexes.

53. Moreover the development of industrial skills and industrial infrastructure were preconditions for viable industrialization; thus emphasis was placed in addition on the financing of infrastructure related to industry.

54. The very depth of the current economic crisis had forced the recognition that apart from all the problems related to establishing new industries there was a pressing need to sustain utilization of existing industrial capacities and enterprises in developing countries. The whole issue of industrial programme lending not just for small-scale industry but also for imported spare parts, intermediate and raw material input, etc., that is, "maintenance" imports, had to be viewed in that context. Industrial reconstruction through adequate programme lending could no longer be avoided.

Summary of discussion

Issue No. 1: Is there a quantitative and qualitative gap in external financial flows for industrial investment in developing countries?

55. In referring to Issue Paper No. 1 (ID/WG.377/4), many participants agreed that there was a large quantitative gap in industrial financing, and some pointed out that the technical problems involved in estimating it should not be allowed to detract from its magnitude and importance. One participant described the UNIDO estimates of the gap that were based on the Lima target as being modest and having failed to take account of outflows from transnational corporations.

56. Many participants expressed reservations to the estimates, and one described them as equivocal, while another said that it was difficult to talk of a gap as there was no absolute limit to the funds that could be borrowed.

57. One participant stated that his country intended to place at the disposal of developing countries up to 0.7 per cent of GDP and that demonstrated its intention to increase official funds.

58. One participant queried certain points concerning the estimates, and the basis on which they were made. He was particularly interested in the volume of flows to industry, and to know what might be the contribution of the existing institutions. In that connection, one participant thought there was scope for improving the estimates, and another said that UNIDO should continue to review and analyse the financing problems.

59. One participant requested that multilateral banks revert to their philosophy of encouraging development.

60. In the context of the financial gap, some participants drew attention to the impact of the current international economic crisis on the availability and terms of finance for developing countries. In order to improve the position it was stated that it was essential that the industrialized countries should reverse their current macro-economic policies. One participant said that financing organizations were discriminating against countries that had centrally planned economies, and that could have negative implications for providing assistance from them to developing countries.

61. One participant mentioned the possibility of acquiring inputs to implement an industrial project on a compensation basis while recognizing that that practice posed great problems.

62. Some participants stressed the importance of domestic savings for industrial investment; however, they also underlined the importance of external financing. A few participants pointed out that most countries had needed capital imports during the industrialization process, a significant part of which was financed by borrowed funds. One participant noted that concessional finance went to other sectors on the assumption that industry could attract private funds. That assumption, however, was no longer valid, particularly in the case of the industrialization of developing countries.

63. The representative of UNCTAD stressed the strong interdependence of the economies of developing and industrialized countries as indicated by the high cross-elasticity of growth between the two groups of countries. In view of the poor external environment, attempts by developing countries to accelerate the growth would lead to substantially greater current account deficits. The severity of the impact of the deficits on the external financial position of developing countries needed to be taken into account, and called for innovative financial schemes supported by measures in the trade and monetary spheres.

64. The representative of ESCAP drew attention to bootstrap elements in the process of financing industrial development, which policy, if adopted, would lead to economizing on investment and credit requirements. Among others, it was pointed out that as far as possible duplication of industries and establishment of industries operating with under-utilized capacity should be avoided.

65. In the discussions on the supply and demand for finance, several participants stated that if a project were sound then finance for it would be available from the capital market. However, one participant said that it was one-sided to take the view that the quality of projects did not matter, but that it was equally one-sided to say that whenever good projects were prepared, then funds would be available for them.

66. A few participants from borrowing countries stated that they had good projects but that finance was not available for them. Two participants expressed the view that a country's criteria might differ from a bank's and that it was consequently difficult to mobilize funds for industrial projects. One participant said that as a development banker, he was conscious of a shortage of good projects. Another said that project viability depended on financing terms.

67. One participant said that consideration of project and country risk could not be separated. Another participant disagreed with that view. He added that the main problem was country risk, and therefore a solution needed to be found.

68. Several participants spoke of the problems of quality of finance. One participant said the Issue Paper had neglected the qualitative aspects of finance. In that connection, several participants expressed concern at the high level and fluctuation of interest rates although it was pointed out that interest rates had recently declined. It was suggested that UNIDO study the effects and perspectives of that decline.

69. The short-term nature of much industrial project finance was of concern to several participants, although one participant expressed the view that with roll-over and revolving mechanisms the only difference between long-term and short-term was the certainty that there was money available.

70. A participant on behalf of a group of Latin American countries drew attention to the need to discuss industrial financing within the context of the current economic situation. He stressed that high and fluctuating interest rates often rendered good projects non-viable two or three years after their execution and suggested that financing on the basis of fixed rates of interest should be considered in financial packages with variable interest rates. He also requested that official bilateral and multilateral assistance be increased, and noted that the financing terms of the multilateral agencies had become harsher and that concessional finance had been virtually frozen. The same participant continued by recognizing the importance of direct foreign investment but suggested that capital repatriation periods should be lengthened. Finally, he recommended that UNIDO, when requested, should provide technical assistance to developing countries in the areas of marketing, engineering, technology and finance.

71. Still on the subject of the quality of financing the following needs were mentioned: more equity finance; improved access to capital markets; guarantees for commercial bank lending; variable interest rates to be converted to fixed rates; and appropriate financing for small and medium-sized projects.

72. Some participants pointed out that industry might not always be given the highest priority in development, and hence in financing. For example, agriculture might be considered more important. Other participants, however, underlined the very strong linkages between industry and all other sectors.

73. In order to improve the quality and increase the quantity of financial flows to industry in developing countries, the need was mentioned by a few participants for new mechanisms, and some participants said that it might help to increase the financial flows if more assistance were provided to prepare projects.

74. One participant said that a second Consultation on industrial financing should be convened at a future date, subject to the decision of the Industrial Development Board; he was supported by many participants. Other participants however considered that time to reflect upon the issues was required before a further Consultation was convened.

Issue No. 3: Can the possible industrial financing gap be overcome by the elaboration of innovative concepts leading to the acceptance of new mechanisms and/or institutions?

75. Although in its presentation of Issue Paper No. 3 (ID/WG.377/1), the UNIDO secretariat had emphasized four specific topics, namely, programme lending, infrastructure, training for industrial development and financing of industries in the least developed of the developing countries, the discussion had a wider scope. That was partly because some of the participants from both lending and borrowing countries elaborated their country or institutional experiences beyond the initial presentation of issues.

76. Describing specific country experiences, a number of participants from the developing countries emphasized the existence of a quantitative and qualitative gap in industrial finance. There was some discussion on

the importance of domestic savings and foreign financial flows, but all participants from developing countries felt that even with effective mobilization of domestic resources, an identifiable foreign exchange gap persisted. One of those participants suggested that greater co-ordination should be established between lending commercial banks and national development-investment banks in reducing the gap.

77. Some donor and lending institutions from industrialized countries also recognized the existence of that gap and described their ef[illegible] to bridge it. In particular, there was extensive discussion on the spectrum of types of credit available. At one end of the spectrum development bankers explained the nature of special facilities created by them for the financing of industrial projects in developing countries, including co-financing arrangements with multilateral institutions and public guarantee schemes. At the other end, more conventional credit instruments in the form of direct foreign investment and export credits were extensively discussed. Suggestions were made for possible credit-mix arrangements that might lie between the two ends of the spectrum, particularly for financing infrastructure relating to industries. Although some participants from developing countries questioned the suitability of export credit as an appropriate instrument for industrial development financing, partly on grounds of its tied nature, that view was not generally shared by participants from industrialized countries. At least one of those participants argued that the large subsidy element in export credit made it the second most important source of concessionary finance for industrial development.

78. Several participants from both developing and industrialized countries drew attention to the importance of training and infrastructure particularly in the least developed of the developing countries. Suggestions were made as to how technical assistance programmes in such countries could be made more effective. National educational and finance institutions and training programmes in industrialized countries, as well as UNIDO, could help in that regard.

79. The use that could be made of programme lending for development of industrial branches rather than particular projects was discussed, particularly with regard to maintenance, imports, working capital requirements, and cash flow problems of existing industries. However, many participants considered it more relevant for the development of small-scale industries; and some participants, from developing countries, considered it to be one of the vehicles of the transfer of technology. While several participants recognized the importance of timely programme lending even on a small scale to make more effective capacity utilization in industries in developing countries, other participants suggested more novel schemes of life-time approach to joint project planning. Freer and speedier availability of foreign exchange through programme lending was recognized by most participants as critical in bridging some of the gaps in industrial financing. All participants agreed that greater co-operation between developing and industrialized countries, particularly in exchange of information on availability of resources and investment opportunities, was needed.

III. REPORT OF THE WORKING GROUP ON ISSUE NO. 2: HOW AND TO WHAT EXTENT CAN EXISTING MECHANISMS AND INSTITUTIONS PROVIDE ADDITIONAL INDUSTRIAL FINANCING TO DEVELOPING COUNTRIES?

80. In the course of the debate on Issue Paper No. 2 (ID/WG.377/2), participants discussed multilateral financing institutions, direct foreign investment notably by transnational corporations, and the commercial banking system. In addition, a number of problems were discussed that concerned the evaluation by participants of the overall outlook for industrial financing and topics common to the three types of sources of financing.

81. Some participants stressed the danger of considering the setting up of any new institutions or suggesting formal changes in the structure of existing institutions. It was felt that efforts should be made for the optimal utilization of existing institutions. Several participants mentioned the spread of new financing institutions, both intergovernmental and private, that had emerged during the last decade. To others, however, there appeared to be a need for restructuring existing mechanisms and improving their functioning. One participant from an industrialized country referred to his Government's call for an international state conference on the current world financial situation.

82. Co-financing was considered by many participants to require further clarification. One participant said that UNIDO should provide detailed information on the practice of co-financing and on its potential. It was felt by some participants that co-financing arrangements between multilateral institutions, commercial banks in the industrialized countries and, whenever possible, local financial institutions in the developing countries would improve the quality of financial flows. To one participant, co-financing had a potential to increase actual flows whereas another participant expressed doubt as to the readiness of commercial banks to enter into further co-financing arrangements. One participant from a developing country expressed concern over the determination of the interest rates at which co-financing could be made available owing to the different lending policies of co-operating institutions. A participant from an industrialized country warned against studying a subject that was under active consideration in the World Bank.

83. Concerning direct foreign investment, one participant stressed that the role of transnational corporations should not be concentrated on exclusively, but that all sources needed consideration.

84. To several participants, proper estimation of the magnitude of direct foreign investment flows to the developing countries appeared to be increasingly difficult to make. The increasing importance of new forms of investment adapted to the requirements of developing countries made the monitoring of flows particularly difficult. One participant felt that flows originating in his country were generally underestimated.

85. The question of whether direct foreign investment resulted in a net capital inflow to developing countries was debated. As to the origin of capital invested by transnational corporations, several participants, referring to paragraph 14 of the Issue Paper, argued that large corporations were better placed than individual developing countries to obtain funds at favourable conditions from the international capital markets.

86. In the framework of the debate on direct foreign investment considerable attention was given to the issue of risk and more particularly to its effects on the small- and medium-scale investor. It was felt by several participants from the industrialized countries that country risk was crucial in determining international investment. Country risk was seen by one participant as a major slowing-down factor for direct foreign investment in the light of the current specific liquidity problems of some countries and the general overhang of existing debt. The risk factor made it particularly difficult to reach the small potential investor in the industrialized countries.

87. It was felt by many participants that direct foreign investment offered a considerable potential for expansion and could provide for additionality; one participant however felt that it was of the utmost importance that foreign companies be encouraged to reinvest the benefits in the developing country and to subcontract locally in order to create a wider industrial structure.

88. One participant from a developing country said that special efforts should be made to remove the country risk factor for direct foreign investment, and that UNIDO should participate in the search for new guarantee

mechanisms. To another participant guarantee funds to minimize risks were certainly important but the best guarantee would be the projects' capacity to pay back its debts. Currently, the World Bank was considering multilateral insurance schemes, complementing the insurance schemes of the countries of the Organisation for Economic Co-operation and Development.

89. One participant, referring to the work undertaken by a task force of the Development Committee of the International Monetary Fund/World Bank on an independent partial guarantee framework stressed the negative reaction of bankers to such a new scheme.

90. Some participants felt that it was necessary to help increase the efficiency of local savings mechanisms in order, inter alia, to improve the developing countries' capacity to assemble capital inflows.

91. One participant suggested that developing countries should envisage drafting, under UNIDO auspices, a code of conduct adapting their legislation to the requirements of foreign investors to improve investment conditions; to another participant negotiations for such a code would be extremely difficult, UNIDO not being the proper forum. On that issue, another participant mentioned the existence of a considerable network of bilateral agreements and instruments regulating foreign investment.

92. A number of participants, notably from financing institutions in the industrialized countries, were in favour of involving small and medium-sized enterprises of both industrialized and developing countries in the international investment process.

93. A subject of major concern to many participants from both developing and industrialized countries was project preparation. In the opinion of one participant there was both an information and a communication gap that prevented proper project preparation, particularly concerning the increasingly sophisticated financial engineering and the presentation of industrial projects to the appropriate financing sources. UNIDO, in addition to its investment promotion activities, should act as a clearing house for information on investment.

94. Adequate project preparation was, in the view of a participant from a developing country, an increasingly difficult task; help from UNIDO in the standardization of feasibility studies would contribute to strengthening the developing countries' abilities to adequately present industrial projects for outside financing.

95. Reference was made to the need for the training of national staff in the identification, preparation, evaluation, financing and implementation of pre-investment studies.

96. Another participant believed that UNIDO should work on a review of the investment climate in the developing countries.

97. In the context of investment information, several participants suggested that UNIDO should update the Financial Resources for Industrial Projects in Developing Countries 2/ and consider issuing it in the form of a monthly newsletter on the changing lending conditions of financing sources. Also, assistance should be given to developing countries in the setting-up of investment information centres.

98. The issue of industrial financing by the commercial banking system was not discussed as a separate item by the Working Group. However, it was stated by one participant that overall lending by banks began to slow down in 1979, and that the trend continued. Another participant stated that private financing had disappeared since 1980/81. That was contradicted by one participant who stated that net bank lending had increased in 1981. A representative of a bank added that in his opinion, most banks were close to their limits on international exposure: however, the strength of the commercial banking system lay in their flexibility and any improvement of the country risk situation could bring about a resumption of large-scale lending. Another participant pointed to the fact that export credits provided by the industrialized countries constituted a form of bank lending, a cheap source of financing being one of the major ingredients for the industrialization efforts of the developing countries.

99. In conclusion, many participants stated the need for further clarification and consultation at various levels of problems related specifically to foreign investment and capital flows to the developing countries. To one participant, the issue of industrial financing was the challenge of the 1980s.

2/ Financial Resources for Industrial Projects in Developing Countries, Industrial and Financing Series, 2nd ed. (PI/61/Rev.1).

Annex I

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Annex II

LIST OF DOCUMENTS

Official documents

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