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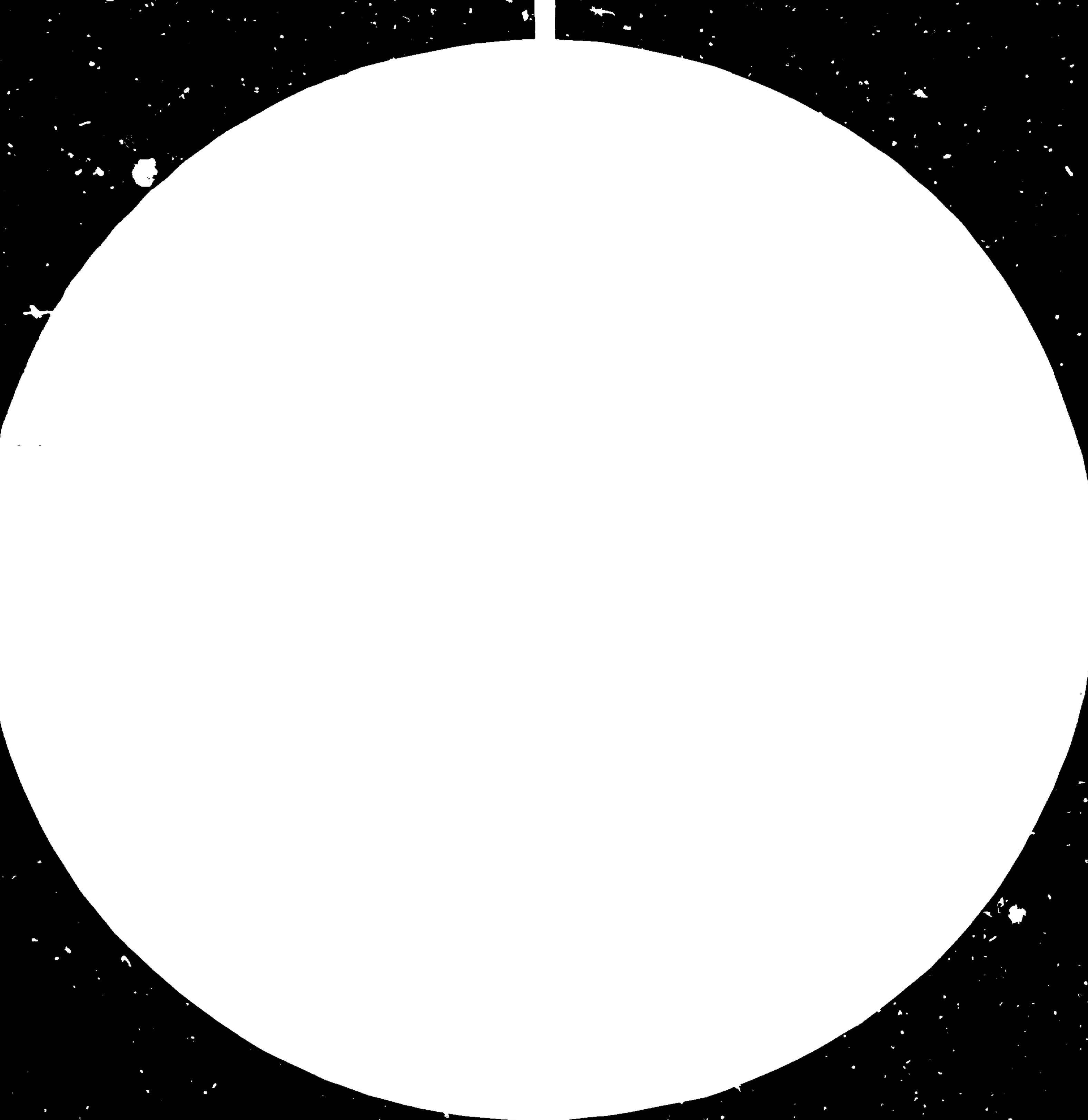

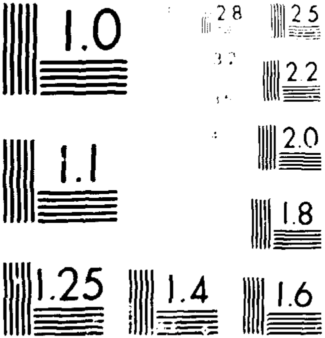
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OVERVIEW ON ARAB DEVELOPMENT FINANCE INSTITUTIONS AND FUNDS *

Prepared by

the Investment Co-operative Programme Branch

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UNIDO's estimate of the share of developing countries in world manufacturing value added stood at about 11% in 1980, as compared to about 65% for developed market economies and 24% for centrally planned economies. Of this 11% share of developing countries, Africa's share was less than 1%, Asia's share was slightly less than 4%, and Latin America's share was a little more than 6%. The developing countries account for about 48% of total world population. It is this world situation which led to the adoption, in 1975, of the goal of increasing the share of developing countries in world manufacturing value added to 25% by the year 2000.

Reaching, or even approaching, this level of 25% requires close co-operation between the developing countries and the industrialized countries, both market and centrally planned economies. This close co-operation cannot be simply interpreted to mean increasing the exports of machinery, equipment and services by the industrialized countries to developing countries. Innovative forms of co-operation appear to be required, but this issue will be dealt with later on in this paper.

With the limited resources at its disposal, UNIDO has been assisting developing countries in their efforts to reach this level of 25% share. Within UNIDO, our programme, which is known as the Investment Co-operative Programme, has been assigned the overall responsibility for assisting developing countries in converting industrial projects ideas and studies into operating factories.

This responsibility is carried out by assisting developing countries in locating sources of the various inputs required to bring about the implementation of viable industrial production facilities. These inputs may include technology, management, marketing or financing. Our programme, therefore, seeks to keep itself as well informed as possible of sources of financing available to developing countries. In this respect, Arab Funds are becoming increasingly important. A recent OPEC Fund publication lists six Arab countries amongst the top ten official development aid donors in 1980. The state of Qatar tops this list with net disbursements representing 4.5% of GNP.

This paper will seek to present to you an overview of Arab Development Funds and Finance Institutions and their role in industrial project financing. I shall not attempt to cover all Arab financing institutions, because this will require a great deal of time. Suffice it to say, that a large variety of Arab and Arab joint-financing institutions emerged during the past few years. These vary in ownership structure, area of coverage, capitalization, policies and conditions. I shall concentrate on a selected number of Arab development finance institutions, whether wholly Arab of jointly owned. Let us look at a group of nine institutions which are perhaps quite important for industrial project financing. These nine institutions closely co-ordinate their operations. They fall into three categories:

1. The first category comprises five National Institutions, which are wholly funded by their governments. These include The Abu Dhabi Fund for Arab Economic Development, The Iraqi Fund for External Development, The Kuwait Fund for Arab Economic Development, The Libyan Arab Foreign Bank and The Saudi Fund for Development.

2. The second category comprises two multilateral Arab institutions, namely the Arab Fund for Economic and Social Development and the Arab Bank for Economic Development in Africa.

3. The third category comprises two multilateral institutions with mixed Arab and non-Arab participation. These are the Islamic Development Bank and the OPEC Fund for International Development. I have included these two institutions because Arab participation in the capital of IDB amounts to about 85% and in the OPEC Fund to about 50%.

The combined authorized capital of eight of the institutions I have just mentioned amounts to some $22 billion and their lending capacity is at least twice this amount, i.e. $44 billion. Cumulative loan committments by these institutions at the end of 1980 amounted to about US$ 14 billion. During 1981, the total value of financing operations agreements concluded by these same institutions amounted to US$ 2.5 billion. Of this amount, only about 7% related to industrial projects, which included a US$ 7 million loan to a sugar project in Burundi. The loan was for 20 years with 5 years grace period and no interest except for 0.75% service charge.

Industrial lending during 1981 also included a US$ 15 million Line of Credit to the Moroccan National Development Bank. This loan was also for 20 years, with a 5 years grace period and 2.75% interest rate. Both the Burundi and the Morocco loans were extended by the OPEC Fund.

It may also be useful to note the geographical distribution of 1981 financing operations of these nine institutions. Asian countries received 40% of the total amount, Arab countries 34%, African countries 23% and Latin American countries about 3%.

The oldest and the largest of these institutions is the Kuwait Fund for Arab Economic Development. This Fund was established in 1963 to extend loan only to Arab countries. In 1974, its authorized capital was increased by a factor of five and its coverage extended to all developing countries. KFAED's authorized capital, at the end of 1980, was US$ 7.3 million. One example of a Kuwait Fund industrial loan extended in 1981 was for a fertilizer project in Pakistan. The loan amounted to about US$ 12 million for repayment in 20 years after a 5 year grace period of 4% interest. This project involved joint or co-financing by several other sources including the World Bank, Creditanstalt für Wiederaufbau, U.S. AID and the governments of Denmark and Italy. Although the Charter of the Kuwait Fund was recently amended to allow it to participate in equity developing countries' projects, to my knowledge no such participation has yet taken place and no guidelines have been made public.

The Kuwait Fund may, according to its charter, extend:

- direct loans;
- it may extend grants to finance sectoral studies, feasibility studies, training and other types of technical assistance;

- it also can provide advisory services relating to any aspect of development projects as well as institution building; and
- it may provide guarantees for the obligations of governments and corporate entities.

However, of these four types of assistance, only the first three are reported to have so far been provided.

The Charter of the Kuwait Fund precludes it under normal circumstances, from financing more than 50% of the total cost of any project, and also from financing the local cost component of any project. With regard to financial terms and conditions, there appears to be a large measure of flexibility in the hands of the Fund's management. In this respect, the Charter's only requirement is the imposition of a service charge of one percent annually on the amounts withdrawn from the loan and outstanding, to cover administrative expenses and other costs incurred in the execution of a loan agreement. The Kuwait Fund favours participation in joint or parallel financing with other bilateral or multilateral aid agencies. With regard to allocation of aid among recipient countries, the Fund's policy is very flexible, but emphasizes political and ideological neutrality. However, the Kuwait Fund is more selective with regard to economic criteria, such as per capital income, overall development performance, and access to foreign exchange. Electricity, transport, agriculture and industry have been the main sectors for Kuwait Fund operations, with the share of industry amounting to about 19% of total lending up to mid-1980.

At the end of 1980, cumulative loans extended by the Kuwait Fund stood at US$ 2.5 billion. By comparison, the figure for the Saudi Fund was about US$ 4 billion, even though the Saudi Fund commenced operation only 1975. The Abu Dhabi Fund's cumulative total on the same date stood at below US$ 1 billion. These three Funds cover all developing countries and their terms and conditions are somewhat similar. The Arab Fund for Economic and Social Development, differs from these three national Funds, in that it is owned by all Arab countries, and its operations are restricted to these same Arab countries. Whereas, the Arab Bank for Economic Development in Africa, known as ABEDA (or

BADEA for francophones) is owned by Arab countries, but its operations are restricted to non-Arab African countries.

The Arab Fund seeks to identify and lend to Arab projects, with more emphasis to multinational Arab projects. In this respect, the Fund itself undertakes to prepare studies, e.g. during 1980 two studies covering Arab countries were completed, one on the pesticides industry and the other on the iron and steel industry.

The cumulative amount of Arab Fund loans at the end of 1980 was about US$ 1.25 million, of this amount, about 15% went into industrial projects. One example of an industrial loan, extended by the Arab Fund in 1981, was that to Syria for the establishment of a garbage composting plant. The total cost of this project is about US$ 28 million. The Arab Fund's loan covers 28% of this total cost. The OPEC Fund and The Islamic Development Bank also extended loans covering 53% of total cost, and the Syrian Government will provide the remaining 19%. The Arab Fund's loan is for 14 years with a four year grace period and 6% interest rate. Interest rates on loans to poorer countries, such as Yemen, are lower by 2%.

ABEDA's authorized capital stands at US$ 738 million and was subscribed by Arab League member countries. As mentioned before, ABEDA's operations are restricted to non-Arab members of the Organization of African Unity. The terms of ABEDA's loans vary depending on the recipient country and on the nature of the project. The rate of interest ranges between 3 and 7 %. The grace period can vary from 3 to 5 years and repayment period from 15 to 20 years. In general, ABEDA finances up to a maximum of 40% of the total project cost. The bank is showing increasing interest in industrial projects which accounted for about 19% of its total cumulative amount of loans. ABEDA extended lines of credit to industrial development banks in countries like Kenya and Zambia and to the sub-regional Development Bank of Central African States. A recently approved loan to Mauritius Island will provide US$ 8 million which represents 25% of the total cost of a flour mill. The loan is repayable over 15 years, including three years of grace, and bearing interest at an annual rate of 8%.

The Islamic Development Bank (IDB) is of special interest for industrial projects financing. About 44% of its project financing goes to industry and mining. IDB commenced operations in 1975 with the declared purpose of forstering the economic development and social progress of member countries and Islamic communities in accordance with the principles of Shariah which is Islamic law. Its authorized capital is two billion Islamic Dinars which is equivalent to the International Monetary Fund's Special Drawing Rights(SDP). Forty one countries are members of IDB. Keeping in view the principles of Islamic law, the Bank does not charge any interest or commitment fee on any of its financing operations. Dividend earnings from equity participation, and income from profit sharing operations, constitute the major source of income to the Bank. The Bank provides:

1. interest free loans to infrastructure projects, and borrowers pay a service fee to cover the Bank's administrative expenses. Loan repayment periods vary from 15 to 20 years;

2. the Bank also provides interest free loans or grants for technical assistance primarily for feasibility and engineering studies;

3. IDB also provides financing through equity participation in industrial and other projects. Total equity participation since the commencement of IDB operations amounted to about US$ 181 million. During the year 1980-81, equity participation in six industrial projects was approved. The Bank's participation in these six projects amounted to US$ 25 million. These included textiles, fertilizers, sugar, and cement projects. The Bank's equity participation is normally limited to a maximum of one third of total equity. This one third should not be less than 2 million Islamic Dinars or more than 20 million Islamic Dinars for any one project. However, in order to assist member countries in the financing of smaller projects, IDB extends lines of equity to national development finance institutions. The same one third maximum in equity applies to each project financed from these lines of equity. The lower and upper limits of this one third are ID 100,000 and ID 2 million. So far, IDB has extended 12 lines of equity to national development banks. These lines of equity amounted to about US$ 76 million, and were extended to member countries in Africa, Asia and Europe.

4. IDB may also provide financing through leasing. Fourteen leasing operations have so far been approved by the bank, involving a total of US$ 142 million. In 1980-81 3 leasing projects were approved and 2 of these were for industrial plants: a urea fertilizer project in Bangladesh and a cement factory in Turkey.

5. Lastly, the IDB extends financing for foreign trade operations to utilize its funds in short term profit earning operations since the bank cannot accept interest on depositing such funds in banks.

The IDB's Sixth Annual Report covering the period 1980-81 reported a decrease in project financing in comparison to the preceding financial year. This decrease was attributed to "the insufficient number of projects suitable for financing in the form of equity participation." The management of IDB also reported the slow utilization of the lines of equity extended to national industrial development banks because of lack of suitable projects. This phenomenon leads me to recall the comment which I made earlier on, regarding the need for innovative approaches to co-operation between industrialized and developing countries, in the identification of industrial investment opportunities and the preparation of bankable industrial projects. The expertise required for this task is in the hands of operating industrial enterprises in industrialized countries. This expertise can be combined with information and expertise from developing countries to generate an increasing number of viable projects, and thereby ultimately lead to increasing industrialized countries' exports of machinery, equipment and services to developing countries. The number of industrial projects jointly generated by a developing and an industrialized country should be used as a more important measure of successful economic co-operation instead of the traditional use of the value of exports. UNIDO's Investment Co-operative Programme can facilitate such co-operation for the purpose of increasing the number of jointly identified industrial investment opportunities.

There are many other Arab financing institutions which take equity and/or extend loans to industrial projects. These include KFTCIC, ADIA, the Arabian General Investment Co. There are also large private companies which are active in industrial investments in both developing and developed countries. Other joint Arab financing institutions were established specifically for the purpose of acting as the arm of Arab financiers in regions not well known to the Arabs. Such institutions include the Arab Latin American Bank and many others. I should also mention the Inter-Arab Investment Guarantee Corporation in Kuwait. This corporation was established to provide insurance for Arab investments in other Arab countries against non-commercial risks such as nationalization and inability to obtain foreign exchange. Several joint Arab and non-Arab financing institutions are now eligible to obtain this insurance. A similar agreement for the promotion, protection and guarantee of investments in member countries of the IDB has been prepared and submitted to member countries for ratification.

A more recent development is the establishment of a joint Arab-French holding type of an investment company to seek to identify operating small and medium size industries in France, and possibly in other European countries, for equity participation by Arab investors. The technology and management of such industries should be already tested and should have future potential for introduction into Arab and other developing countries. The equity participation sought should be large enough to enable the Arab investors to become fully acquainted with the industry but need not be a controlling interest.