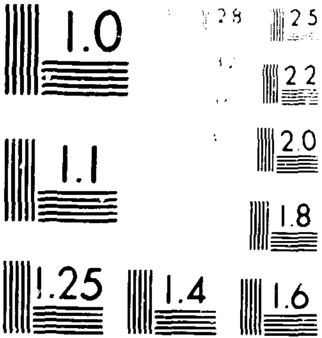
UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org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Financial Co-operation for Industrial Development of Developing Countries *

By

Augustin Papic

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** IDC: Institute for Developing Countries.

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1. Introduction

1. The Tenth Round Table of Developing Countries takes place in the period described as the gravest economic crisis for Developing Countries (DCs) since the Great Depression. Last years have been characterized by deterioration in the international economic environment, requiring urgent action in fields of trade, commodities and international finance.

2. Within such unfavourable environment the industry in DCs showed a bit better results in production and in faster rate of growth of exports of manufactures than that of primary commodities. Particularly important was the fact, that the prices of internationally traded manufactures in latest 30 years (1981 compared to 1950) grew faster than that of primary commodities (excluding crude oil). All that supports the orientation of DCs to more rapid industrialization, in spite of all obstacles faced in international economic environment.

3. However, the industrialization became more and more dependent on foreign financing. Due to growing difficulties in this field, decreasing contribution of developed world, particularly when compared to the needs, DCs are faced with

stronger orientation towards more self-reliance in the financing of their industry. The paper is aimed at offering some solutions in this field. They are general, however, within which the industry could find its place.

2. Gap in External Financing of Industry

4. Unfavourable external position primarily of oil importing DCs has been result of several factors, like:

- Rapidly growing current account balance of payment deficit (from US $ 11,5 billions in 1973 to US$ 99,o billions in 1981) *.
- External debt grew from US$ 96,8 to US$ 436,9 billions. Value of debt service payments increased from US$ 15.3 to US$ 92.3 billions. Only interest payments jumped by more than 7 times (from US$ 4.6 to US$ 37.5 billions)* . (Comparisons are made between 1973 and 1981).
- Floating interest debt grew from 7.9 per cent in 1972 and 9.o per cent in 1973 to 18.o per cent in 1981 ** .

5. Total resources flow to DCs declined in volume in 198o compared to years after 1976**. In almost 2o years (between 196o-62 and 1978-8o) the real value (in 1978 prices) of net capital flow to DCs grew only by 3 times (from US$ 25 to US$ 76 billions***. Within total flow, the share of:

- Official development assistance declined from 59 to 34 per cent.

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* "World Economic Outlook", International Monetary Fund, 1982, Washington, D.C.p.161,172,173.

** "1981 Review DEVELOPMENT CO-OPERATION", OECD, 1981,p.6o and 7o.

*** "World Development Report 1982", Published for the World Bank by Oxford University Press. p. 29.

- Private, nonconcessional flow grew from 34 to 53 per cent. Financial flow (eurocredits, etc.) increased substantially from 7 to 26 per cent, taking thus in 1978-8o more than 1/4 of all net capital flow.
- Direct private investments, which are considered by USA to be the main factor in financing DCs, dropped from 2o to 14 per cent.

In such development, particularly hardly hit were the least developed and most affected countries.

6. Worsening of external position of DCs have had negative effects on foreign financing of industry in DCs. Industry became shorter not only of imports of investment goods, but also of imported raw materials, components, parts, etc.

7. The future is not bright either, with regard to reaching Lima target for the DCs' share of world's industrial production. If projections of "World Bank Development Report 1982" proved to be essentially correct, then there are poor chances for bridging DCs' external financial gap.

8. The vigorous actions need to be oriented in two directions: the efforts to improve and expand the financial contribution of developed world, and substantial expansion of mutual financial co-operation among developing countries.

3. Financial Co-operation Among Developing Countries on Business Basis

3.1 The Parties and Motivation for Mutual Financial Co-operation

9. While all DCs could be interested in financial co-operation for industrial development, one can detect three

groups among them, having specific interest, like:

(a) Great majority of DCs having some natural resources and unskilled labor are short of technology, capital, machinery and equipment, oil, skilled labor and management. Importing the lacking factors of development they could offer available natural resources processed as rapid as possible.

(b) The more developed, newly industrialized DCs need capital, first of all, some natural resources and oil in particular, special technologies and markets for their products. They could offer to other DCs technology, machinery and equipment, investment services, management and marketing skills in many fields. Though deficient in capital, they are obliged to finance exports of machinery and equipment, mainly by export credits, or by participating in joint ventures.

(c) The capital surplus oil exporting countries have capital, oil and some other natural resources, which they could offer to other DCs. They import technology, capital goods and investment services, some of them need management and even labor force. They are interested in diversification of their production structures and other DCs could contribute to the process more.

All that offers broad scope and motivation for mutual economic and industrial co-operation, where financing in many cases is essential.

3.2 The Sources of Financing

10. Main sources of financing could come from capital surplus oil exporting countries, while more industrialized DCs

could finance part of exports of their technology, capital goods and services.

11. With regard to current account balances of the oil exporting countries, the situation is not favourable at this stage. Current account surplus of OPEC reached the peak of US$ 115 billions in 1980, declining to US$ 71 billions in 1981* while the estimates for 1982 are very contradictory: from surplus of US$ 25 billions (International Monetary Fund and Citybank), or US$ 12,5 billions (UN) to deficit of US$ 15 billions (First National City Bank of Chicago), US$ 27 billions (AMEX) and even US$ 66 billions (Daiwa Securities)**. In 8 years (1974-1981) total current account surplus of oil exporting countries amcunted US$ 433 billions of dollars. According to UNCTAD Secretariat*** identified investible surplus in the same period amounted US$ 362.5 billion out of which short term investments accounted for 43.7%, and long-term ones 56.3%. In the same period concessioral assistance of OPEC to other DCs amounted US$ 55.5 billions.

12. A more detailed analysis of the deployment of investible surplus, could give more concrete ideas as to redeployment some of surplus to DCs.

13. More developed, newly industrialized DCs are already some source of financing of other DCs. The amount has been rather small, though. The characteristic of that financing

* "World Economic Outlook", International Monetary Fund, Washington, D.C.p. 165.

** "Deficit Forecast in OPEC Current Account", OPEC Bulletin, August 1982, p. 8

*** "TRADE AND DEVELOPMENT REPORT 1982". UNCTAD Secretariat, Vol. II. 28 July, 1982. p. 194 and 196.

have been its tying to exports of capital goods or services, in the form of export credits or some joint ventures. There is no reason to doubt, that under more organized conditions, the contribution of these countries could increase.

3.3 Forms of Financial Co-operation

14. There already exists a number of financial institutions of DCs which finance other countries on bilateral or regional level. Here one should call the attention to various funds or banks created by OPEC and first of all by Arab countries, including in particular OPEC Fund for Economic Development, which became important source of concessional financing. Regional development banks, combining resources of developed and DCs played significant role in financing DCs.

15. As to the forms of financing, the rest of the paper concentrates on its nonconcessional forms based on business principles. It is because of the fact that only in such a way one could mobilize additional resources, and because it suits many industrial projects.

3.4 The Bank for Developing Countries

16. For the long time it was considered the Bank for DCs could give special impetus to their mutual financial co-operation. It was pointed out that the main function of the Bank should be the financing of development projects/joint ventures including export credit. That seems to be the only realistic approach. Within these functions, particularly in the field of joint ventures, industry could take the most important share.

17. It is important to emphasize that the scope of mutual financial co-operation, including the Bank for DCs is not supplementary, but complementary to financial contributions of developed world. In fact the Bank could create additional impulses for some specific contribution of developed world, for co-financing and tripartite co-operation.

3.5 Joint Ventures Among Developing Countries

18. In analysing various forms of financial co-operation among DCs, including particularly the Bank for developing countries, a lot of preference has been given to joint ventures. Various advantages have been attributed to them for both capital exporters (home countries) and capital importers (host countries):

(a) For capital exporters, particularly under current inflationary trends, the transfer of money deposits, or bonds into equity in joint ventures would mean protection of real value of its capital, provided adequate rate of return and security against risks is guaranteed.

(b) Joint ventures bring to host country foreign capital combined with enterpreneurship, i.e. technology, capital goods, management, marketing, industrial and technical co-operation including possibility for mutual deliveries of goods and services.

(c) Joint ventures are not dependent on the level of indebtednes of individual country if invested in profitable, balance of payments active projects.

(d) Sharing responsability not only for the financing but for project as a whole, in the process of investment as well as in the management of new firm, joint ventures could contribute much more to the success of co-operation, than credit operation alone usually does.

19. It is of special importance joint ventures among DCs be based on the mutually beneficial economic interests and sovereignity of countries involved, avoiding exploitation to which DCs were exposed by foreing direct private investments including joint ventures coming from developed world, and transnational corporations in particular.

2o. The enumeration of advantages of joint ventures, should not ignore its complexity, need for solid preparation and implementation, where promotional activity is of paramount importance. That is why great expectations are put on future Bank for Developing Countries, which could organize special window, devoted to joint venture operations.

3.6 Profitability and Security in Financial Co-operation

21. The financial co-operation among DCs and creation of the new bank, could be successful only if based on business principles, offering mutual economic benefits to parties involved. Saying that, the importance of financial aid and concessional financing among DCs, is not minimized.

22. In order to attract capital surpluses or already invested stocks of oil ecporting countries, the projects in DCs should offer comparable rate of return, taking into account risks involved. For this purpose it is of interest to analyse the rates of return of OPEC countries' investments abroad. According to an UNCTAD analysis:

(a) The average annual rate of return on money market investments in the major convertible currencies in the period 1974-1979 was about 7.7 per cent. At the same time annual increase of UNCTAD price index of OPEC countries' imports was about 1o.3 per cent. That implies an erosion of 2.4 per cent annualy in the purchasing power of such assets.

(b) Similarly, investments in the United States taxable bonds in mentioned period must have suffered an average erosion of 3.4 per cent of purchasing power.

(c) The equity investments, as indicated by the movement of the New York Stock Exchange,common stock price composite, which achieved an average annual appreciation of 7.9 per cent over the 1974-198o period, also failed to appreciate as rapidly as import prices advanced.

(d) Even high interest rates in Eurocurrency market during past two years, in all likelihood, were inferior to the appreciation of the value of oil conserved in the ground.

(e) The average rate of return on OPEC direct investment in USA (which are rather small) was on annual basis in 1979 -12.7 per cent and in 198o -1o.4 per cent*. But an advantage of direct investment lies in the fact that the value of invested assets being in real terms, appreciate.

23. As to the average rates of return obtained by US capital in DCs, they were, in the 1976-8o period, double as compared to that obtained in developed countries; the rates

* "Foreign Direct Investment in the United States, 198o". Survey of Current Business, US Department of Commerce, August 1981, p. 11.

of return in petroleum werevery high, while those in manufacturing used to be almost half of the average.

24. Foreign financing based on business, commercial condition is not suitable for low profitable industrial projects with long gestation period. A combination of concessional and nonconcessional financing could be solution for them.

25. Security of investments is fundamental condition for success in financial co-operation, and for joint ventures in particular. Normally, foreign investors would avoid high profitable but risky projects in favour of lower (but acceptable) rate of return offering security. The establishment of guaranty scheme against risks (commercial and political), where Bank for DCs could play some role, deserves to be elaborated.

3.7 Promotion of Investments

26. It is not easy to identify and construct projects in DCs which could obtain adequate rate of return and offer security against risks. That is why there is broad scope for activities in:

- Exchanging information on possible projects, on economic, legal and institutional matters of parties involved in financial co-operation.
- Pre-project technical assistance and project identifiation, appraisal and development, and
- Brockerage facilities to bring together potential investors with sources of funds and supplier of technology, investment goods and services.

UNIDO, with new "Project Preparation facility" could play a great role in these fields.