OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

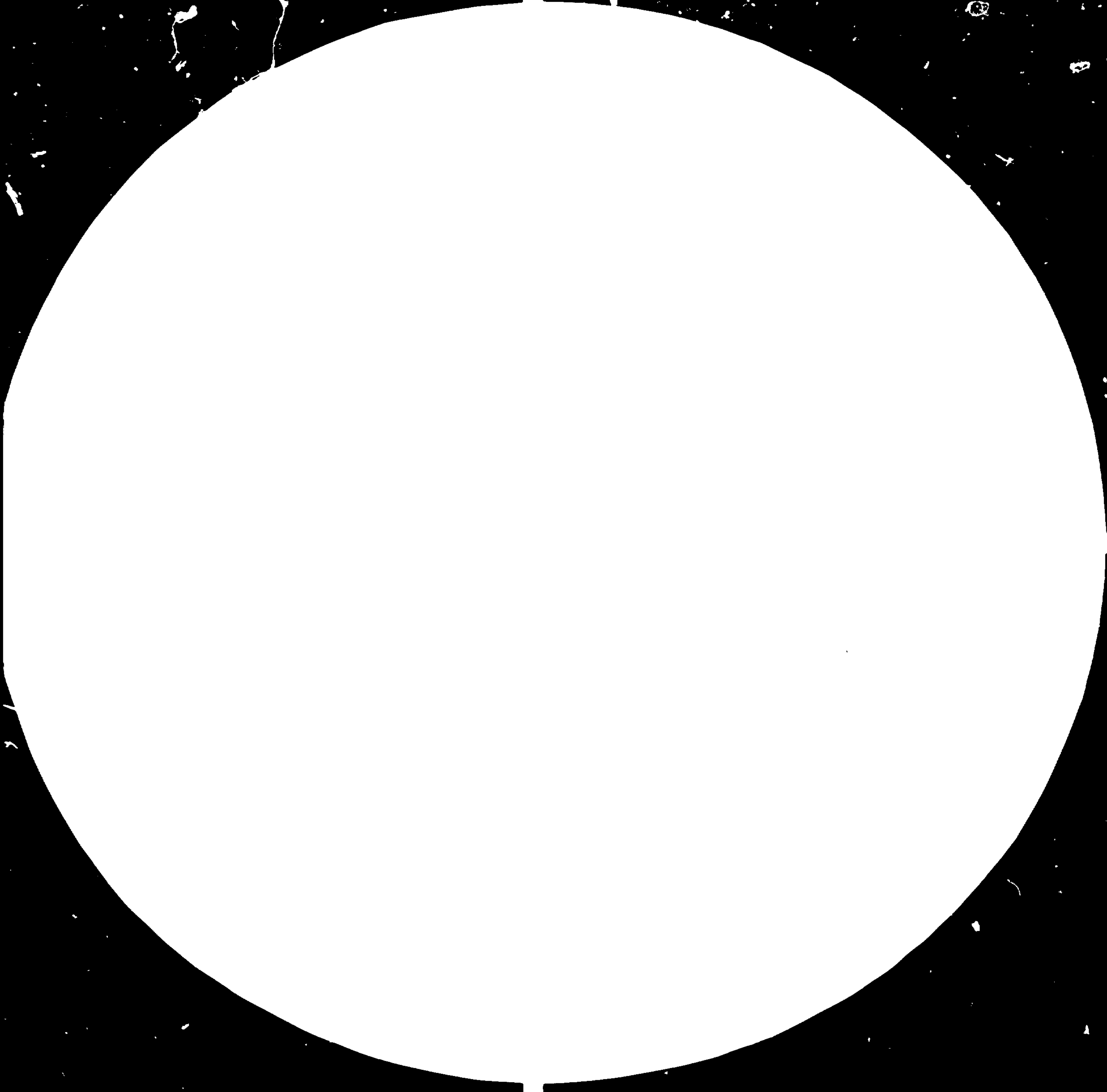
FAIR USE POLICY

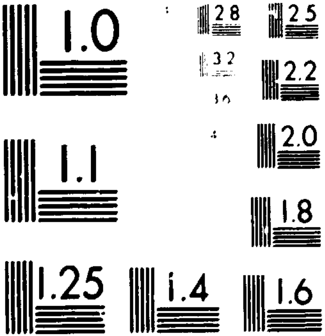
CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

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




1.0
2.8
2.5
3.2
2.2
3.6
4.0
2.0
1.1
1.8
1.25
1.4
1.6

09499

FOR PARTICIPANTS ONLY

ID/CONF.4/CRP.9
17 December 1979

ENGLISH ONLY

United Nations Industrial Development Organization

THIRD GENERAL CONFERENCE OF UNIDO

New Delhi, India, 21 January–8 February 1980

Agenda item 5

Industry 2000 - New Perspectives:*

PROPOSAL NO. 2:

GLOBAL FUND FOR THE STIMULATION OF INDUSTRY

Paper prepared by the Secretariat of UNIDO

000012

* The attached is an elaboration of the proposal described in ID/CONF.4/3, Part One, secion 2.2.3 and Part Two, section 5.4.2. It is available in English only.

id.79-10070

TABLE OF CONTENTS

GLOBAL FUND FOR THE STIMULATION OF INDUSTRY

1. INTRODUCTION

This proposal starts from a recognition of the crisis in the international economy: global recession coupled with global inflation and instability of the international monetary and financial systems. The Global Fund for the Stimulation of Industry seeks to make quick disbursing programme financing loans to developing countries, of extended maturities between 12-20 years, in significant amounts building up to an annual level of over $ 15 billion, with a total callable capital in the range of $ 75 - $ 100 billion. Finance would be obtained for the most part by borrowing on international markets backed by the latter guarantees of callable capital, such borrowed funds being onlent at commercial rates to developing countries, and at below commercial rates to least developed countries, the subsidy element being provided through an interest subsidisation account.

The rationale for the proposal which is summarised below, is that the expansionary impetus to be provided by the Global Fund to the economies of both industrialised and developing countries, would make the international atmosphere conducive both to the lowering of tariff and non-tariff barriers which discriminate against manufactured exports of the South, as well as to the restructuring of industry from the industrialised to the developing countries. It is against a background of a consensus on inflation and the limits beyond which existing multilateral financing institutions cannot extend, that the case for a separate programme financing mechanism for longer-term disbursements as envisaged in the Global Fund, is made.

It is recognised that the outline below merely summarises certain technical issues which would have to be resolved in an appropriate forum for negotiation. These issues include capital structure, guarantee arrangements and voting powers among member countries; the scale, distribution and terms of finance among members; relationships between the Global Fund and International Agencies, Central Banks, finance institutions; the conditionality issue, its mode of implementation; decision-making and management structure, and appropriate transitional arrangements. Detailed elaboration of these issues can be undertaken in subsequent negotiations. The crucial question, however, is whether the international community can agree in principle that the concept defined here would be a major step towards a solution of global problems of employment and investment, and reduction of current differences between industrialised and developing countries.

The Third General Conference of UNIDO is invited by the Secretariat to consider and approve in principle the concept of a Global Fund for the Stimulation of Industry, and to designate an appropriate agency or agencies to initiate consultations and negotiations among member countries, international organisations, and international and regional financial institutions on the setting up of the Global Fund.

2. BACKGROUND: AN OVERVIEW OF THE INTERNATIONAL FINANCIAL SYSTEM

The rationale for the proposal for a Global Fund for the Stimulation of Industry is as follows. The world economy has been sustained during the current prolonged recession by the buying power of the developing countries. Today the developing countries absorb about 25% of US exports and 40% of EEC exports. In 1975, a time when the European Community reached a low point in the recession, and its exports to other industrialised countries were declining - by 17% to the US and by 3.3% to other industrialised countries - it was exports to the developing countries which increased substantially by 25%.[1/] One result of this buoyancy of Third World purchasing power was that unemployment in the developed world was significantly less than it might have been; it is estimated that there would have been at least 3 million more unemployed in the Community area alone, if capital deficit developing countries had been obliged to cut their imports of manufactured goods by the amount needed to pay for the oil price adjustments after 1973. However, the level of unemployment has remained high, between 2.2% for Japan and 7.7% for Canada, with the EEC countries lying between this range.

Manufacturing capacity utilisation rates for 1977 have been calculated at below 85% for a number of the major market economy industrialised countries, and for all these countries, stand at levels significantly below average utilisation rates for the 1964-1974 period as shown in figure A. Accompanying this underutilised capacity have been the steep rises in prices which have occurred in the 1972-1977 period in certain major market economy industrialised countries, where the inflation rate has averaged about 10% p.a., with certain countries showing even higher rates, as indicated in table 1. Moreover, there seems to be every indication that these higher rates of inflation will continue for a considerable period.

Two sets of factors have thus recently dominated the international financial system and these are likely to continue in the foreseeable future; first, the above-mentioned continuing high rate of inflation and the pronounced underutilisation of human and productive resources; second, the accumulation of excess liquidity in the private banks of the North together with severe monetary and exchange rate instability.

There are complex interrelationships between the factors mentioned; taken together, however, their impact has been to make the International Financial System increasingly fragile. With growing interdependence of the world economy, this has generated a degree of uncertainty which has depressed incentives to invest in industry in both industrialised countries and the Third World. Stagnant growth rates coupled with historically severe inflation has led to increased protectionism in the North, tending to retard progress in the South.

1/ See Commission of the European Communities, Europe and the Third World. A Study of Interdependence, Brussels, 1978, p. 54.

The combination of rising prices, underutilised resources and slow growth which has been termed "stagflation" has been accompanied by extreme instability in exchange and interest rates, as shown in tables 2 and 3 respectively.

The factors identified have brought about a fundamental change in the international financial system, in so far as the economic health of the main industrialised market economy countries has been considerably affected. Change in shares of world official reserves is illustrated in table 4: in 1960 a group of eleven industrialised countries held 77% of IMF members' official reserves, while in 1977 the corresponding figure had fallen to 50%. As can be inferred from the table the relative positions of individual countries within the group of eleven have also undergone major changes.

The ability of the industrialised countries to enforce order in the financial system has been further weakened by the upsurge of the Eurocredit markets, in which the volume of deposits now exceed total official reserves, including gold and IMF reserves. Total deposits in these markets have grown from about $ 15 billion in 1964 to about $ 500 billion in 1979 as shown in table 5; these markets emerged in the 1950s and are based on currencies being held on deposit in bank accounts outside the country of currency issue.[1/]

Table 1: Seven Major Industrial Countries: Dispersion of Inflation Rates, 1960-1977

(per cent)

	Mean Rate of Inflation [a/]	Dispersion of Inflation [b/]
1960-1970 Average	3.6	1.5
1972	5.3	1.1
1973	8.6	1.9
1974	14.6	5.4
1975	12.9	5.5
1976	10.0	4.5
1977	9.8	4.5
1972-1977 Average	10.2	3.8

Source: IMF, International Financial Statistics.

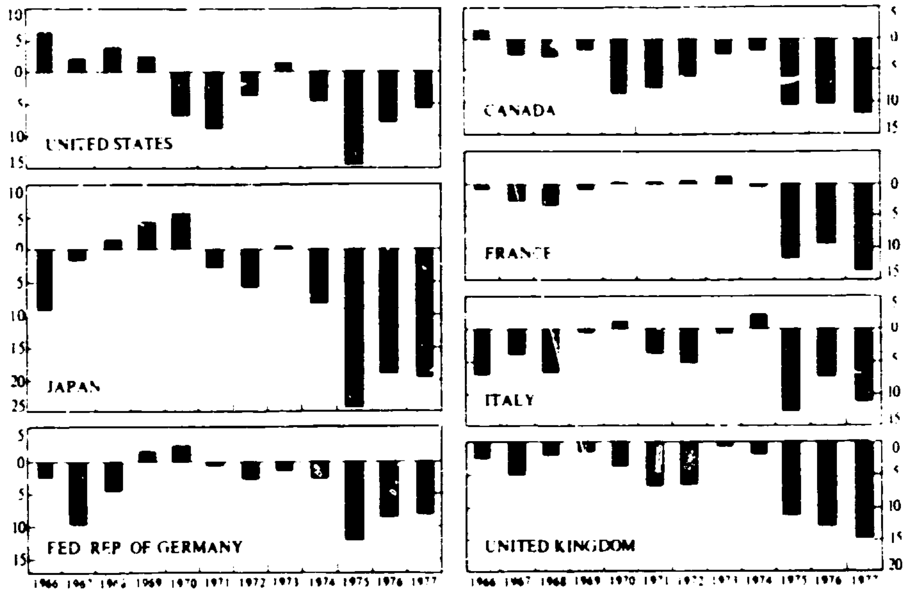
a/ The (unweighted) average annual rates of change of consumer prices for the United States, Canada, Japan, France, The Federal Republic of Germany, Italy, and the United Kingdom.

b/ The measure of dispersion used is the standard deviation of inflation rates among the seven countries.

1/ See the description of the operation of the Eurocredit Markets, pp. 108-109 in Industry 2000 - New Perspectives, ID/CONF.4/3.

Figure A: Major Industrial Countries: Output Gaps in Manufacturing, 1966-1977[1/]

(Percentage of potential output)



1/ Difference between actual and potential output.

Table 2: Index of Change in Major Currency Exchange Rates Against US Dollars 1975-1978
(First quarter 1975 = 100)

	DM	SwFr	Yen	FrFr	Stg	Lira
1975 (1st quarter)	100	100	100	100	100	100
1975 (2nd quarter)	99.3	98.9	100.2	[illegible]	97.3	101.4
1975 (3rd quarter)	91.6	93.5	98.4	98.4	89.1	96.0
1975 (4th quarter)	90.0	94.0	96.6	96.8	85.4	93.8
1976 (1st quarter)	90.8	96.6	97.0	94.8	83.6	83.8
1976 (2nd quarter)	91.4	99.8	98.0	91.1	75.6	74.1
1976 (3rd quarter)	92.3	100.5	100.7	87.3	73.9	76.0
1976 (4th quarter)	97.1	101.8	99.8	88.2	69.1	73.9
1977 (1st quarter)	97.6	98.9	102.7	86.0	71.7	72.2
1977 (2nd quarter)	99.0	99.1	106.5	86.5	71.9	72.0
1977 (3rd quarter)	101.3	103.0	110.1	87.6	72.6	72.3
1977 (4th quarter)	105.2	114.2	118.7	88.6	76.0	72.7
1978 (1st quarter)	112.6	129.2	123.5	90.1	80.6	74.0
1978 (2nd quarter)	112.8	130.0	132.9	93.0	76.7	74.0
1978 (3rd quarter)	116.4	148.8	152.2	97.6	80.3	76.1
1978 (4th quarter)	124.8	153.2	154.0	99.6	83.0	76.6

Source: International Financial Statistics, IMF, April 1979.

Table 3: Eurocurrency deposit rates, January to December 1978

(Prime Banks' bid rates in London, at or near end-of-month)

	1978											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
US DOLLARS												
One month	7.06	6.62	7.62	7.25	7.69	8.19	8.06	8.56	9.19	9.62	11.62	11.00
Three Months	7.25	7.19	7.50	7.62	8.00	8.69	8.50	8.87	9.44	11.37	11.56	11.69
Six months	7.62	7.62	7.81	7.87	8.44	9.19	8.81	9.25	9.69	11.87	11.87	12.31
Twelve months	7.87	7.94	8.00	8.00	8.56	9.19	9.00	9.25	9.69	11.87	11.62	12.00
DEUTSCHE MARK												
One month	2.87	3.19	3.31	3.31	3.44	3.31	3.44	3.31	3.31	3.12	3.37	3.19
Three months	2.94	3.19	3.31	3.31	3.44	3.37	3.50	3.44	3.56	3.50	3.69	3.31
Six months	3.00	3.19	3.31	3.44	3.56	3.50	3.75	3.62	3.62	3.56	3.94	3.69
Twelve months	3.19	3.19	3.31	3.50	3.69	3.69	4.00	3.87	3.75	3.75	4.12	3.81
SWISS FRANC												
One month	0.31	0.12	0.44	0.62	1.06	1.31	1.56	0.44	0.50	0.00	0.19	-.06
Three months	0.75	0.31	0.56	0.87	1.31	1.50	1.69	0.69	0.94	0.12	0.31	0.00
Six months	1.37	0.50	0.81	1.19	1.62	1.94	2.00	1.06	1.06	0.31	0.56	0.12
Twelve months	2.00	1.00	1.25	1.44	1.87	2.19	2.19	1.19	1.31	0.62	1.44	0.62
POUND STERLING												
One month	6.75	7.00	6.87	10.00	10.00	10.75	10.75	11.00	12.37	10.50	12.87	12.00
Three months	6.75	7.69	7.37	10.12	10.56	11.37	10.87	11.37	12.75	11.87	13.50	12.62
Six months	7.25	8.12	8.00	10.37	11.12	12.00	11.25	11.75	13.00	12.62	14.06	13.25
Twelve months	7.56	8.37	8.31	10.37	11.81	12.12	11.50	11.75	12.75	12.87	13.87	13.00
FRENCH FRANC												
One month	11.50	12.00	8.87	8.87	9.00	9.87	8.37	8.00	11.25	7.00	8.12	10.50
Three months	13.25	12.87	8.87	9.37	9.25	10.00	9.12	8.87	10.25	8.75	9.19	9.87
Six months	13.37	12.00	9.37	9.75	9.75	10.37	9.87	9.37	10.25	10.00	9.31	9.87
Twelve months	13.37	12.00	9.87	10.37	10.50	11.00	10.37	10.00	10.25	10.87	10.37	10.25
JAPANESE YEN												
One month	2.12	2.69	-.25	1.50	2.44	2.56	0.44	1.19	2.81	0.75	0.31	-.69
Three months	2.94	2.50	1.19	2.12	2.69	2.94	1.56	2.50	2.81	2.44	0.31	0.62
Six months	3.31	3.25	2.56	2.87	3.31	3.62	2.31	2.81	3.12	3.31	2.37	1.87
Twelve months	3.50	3.50	3.62	3.81	3.94	4.12	2.87	3.25	3.25	3.31	2.94	2.19

Source: World Financial Markets, Morgan Guaranty Trust Company of New York.

Table 4: Distribution of reserves of 11 industrialised countries, end of years 1960 and 1970-77
(billions of SDRs)

	1960	1970	1971	1972	1973	1974	1975	1976	1977
Industrial Countries									
Belgium-Luxembourg	1.5	2.8	3.2	3.6	4.2	4.4	5.0	4.5	4.7
Canada	2.0	4.7	5.3	5.6	4.8	4.8	4.5	5.0	3.8
France	2.3	5.0	7.6	9.2	7.4	7.2	10.8	8.4	8.4
Germany,Fed.Rep.of	7.0	13.6	17.2	21.9	27.5	26.5	26.5	30.0	32.7
Italy	3.3	5.4	6.3	5.6	5.3	5.7	4.1	5.7	9.6
Japan	1.9	4.8	14.1	16.9	10.2	11.0	10.9	14.3	19.1
Netherlands	1.9	3.2	3.5	4.4	5.4	5.7	6.1	6.4	6.6
Sweden	0.5	0.8	1.0	1.5	2.1	1.4	2.6	2.1	3.0
Switzerland	2.3	5.1	6.4	7.0	7.1	7.4	8.9	11.2	11.4
United Kingdom	5.1	2.8	8.1	5.2	5.4	5.7	4.7	3.6	17.3
United States	19.4	14.5	12.1	12.1	11.9	13.1	13.6	15.8	16.0
Total, ind. countries	47.2	62.2	84.8	93.0	91.2	92.7	97.7	107.0	132.7
Total, all IMF members	61.2	93.2	123.2	146.8	132.6	180.2	194.5	222.4	262.8

Source: IMF, International Financial Statistics

Table 5: Growth of the Eurocredit market, 965-1979
(US $ billion)

End of Period	Total	Percentage increase over prior year	US$ portion (per cent)
1965	15.1	-	77
1966	19.9	32	81
1967	24.5	23	81
1968	37.4	53	81
1969	57.8	55	82
1970	78.3	35	77
1971	100.1	28	71
1972	131.8	32	75
1973	187.6	44	70
1974	214.1	14	73
1975	258.1	20	74
1976	286.8	11	76
1977	321.0	12	78
1978	392.6	22	81
1979	500 (estimate)	n.a.	n.a.

Sources: 1965-1975, Part I, Table 1, P. A. Wellons, Borrowing by Developing Countries on the Euro-currency Market, OECD, Development Centre, Paris, 1977.

1976-1978, Calculated from Borrowing in International Capital Markets, EC 181/784, World Bank, Washington, D. C., 1979.

Table 6: Borrowing by Developing Countries on the Eurocredit Markets, 1973-1979

Year	Total Annual Borrowing (US $ Billion)	Developing Country Borrowing (US $ Billion)	DC Borrowing as a percentage of Total Borrowing (per cent)
1973	20.8	7.0	34
1974	28.5	9.7	34
1975	20.6	12.5	61
1976	28.7	17.3	60
1977	34.2	20.3	59
1978	71.6	37.9	53
1979	circa 100 (estimate)	n.a.	n.a.

Source: World Bank, Borrowing in International Capital Markets, various issues.

The purchasing power of developing countries derives from their export earnings and from their net international borrowings. In recent years, however, it was substantially increased borrowings which sustained their demand, especially as their export earnings had tended to suffer in a climate of international recession: thus, between 1972 and 1977, net external capital inflows increased from $ 20.4 billion to $ 57.1 billion, for the most part on non-concessional terms.1/ It is generally accepted that the present macro-economic equilibrium of the world economy depends significantly on developing countries' borrowings from the Northern private banking system, and borrowing must continue to increase if the momentum of world growth is to be maintained. For example, had nearly $ 40 billion not been added to world trade in 1978 through private bank lending to developing countries, recession in industrialised countries would have been more intensified. The dependence of some developing countries on access to the Eurocredit market is shown in table 6 above.

What is new in the present situation, is that doubts are being entertained about the ability of the private banking system to cope with the additional strains recently imposed upon it for recycling additional financial surpluses. Countries that have borrowed in the past are for reasons of prudent debt management cutting back on their borrowings significantly, while the short-term flow of funds into the private banking system threatens to increase substantially in the wake of recent oil price adjustments. The viability of private banks is threatened in such a situation of demand/supply imbalance for funds; also, unless an effective mechanism is found for rechannelling surplus liquidity, there is no alternative to an intensification of global recession, further aggravating protectionist tendencies.

1/ "The present equilibrium of the world economy depends to a considerable degree on a continuing flow of private lending to the non-oil producing developing countries (and to the Soviet Union and Eastern Europe) on a scale unheard of before 1974 and would be called in question by any impediment to that flow. This flow of lending is also of interest in the Community context - because a significant proportion of the loans has been made by banks resident in the EEC." Commission of the European Communities, Annual Economic Review 1978-1979, Brussels, 1978, p. 8.2.

What gives cause for concern is that additional strains imposed upon this market could have serious consequences. Deposits in the Eurocurrency market are primarily short-term, with upwards of 90% of deposits being for periods of much less than one year. The major private banks have been able to transform these liquid funds into medium-term lending. Problems are very likely to arise in this market because of the very considerable Interbank lending which supports the market, i.e. banks lending to one another in order to maintain the borrowing of their large customers. Problems could also occur, if one or a number of their large borrowers were to fail. In this connection, mention might be made of the banking crisis which occurred in the mid-1970s, when two not particularly large banks, one in the United States and one in the Federal Republic of Germany, failed. At that time it was thought by a number of observers that the private banking system as a whole could be considerably affected by the failure of these two banks.[1/] It should be noted, however, that while the repayment record of developing country borrowers in this market has been excellent, a measure of the potential problems that may arise from such borrowing by developing countries is reflected in the six-month interest rate (in US dollars), which had stood at about 6 1/2% p.a. in the last quarter 1976, but had risen to over 15% p.a. in the last quarter of 1979.

One of the significant results of the growth of the Eurocurrency markets in the 1973-79 period is that although developing countries are the major borrowers, direct access to these funds is limited to only a few developing countries, with six of them accounting for about three quarters of all Euromarket borrowing by developing countries.[2/] Although 50 to 60 other developing countries have had occasional access to these markets, to many developing countries the market is virtually closed. The essence of the solution is to channel these funds under a mechanism of collective guarantee of the international community to the widest possible range of developing country borrowers who, taken separately, might not otherwise have access to the private banking system.

3. THE PROPOSAL

One way of providing this collective guarantee is through the mechanism of a Global Fund for the Stimulation of Industry, with a modest initial paid-in capital[3/] contributed by industrialised and developing countries accompanied by substantial, say 90% to 95% callable capital which in effect would constitute a system of limited joint and several guarantees against which the Fund could borrow in the market place. Its functioning in this respect would be precisely analogous to the functioning of the World Bank which borrows in capital markets against its callable capital. The crucial difference, however, is that the total

1/ See Euromoney, 1974 and 1975 issues, London.

2/ World Bank, Borrowing in International Capital Markets, various issues, EC-181.

3/ The initial paid-in capital could range from 5% to 10% of the Fund's total callable capital of \$ 75 - \$ 100 billion; so that the paid-in amount would have a lower limit of \$ 3.75 billion.

amount to be raised by the Global Fund will be utilised for programme rather than project lending, so that the necessary momentum can continue to be imparted to the world economy in precisely the same manner in which private bank lending has been able to do in recent years. It goes without saying that such programme loans will be spent on industrial goods. A second crucial difference is that an interest subsidy element will of necessity have to attach to the Global Fund's lending operations, so that it can reach out to the least developed countries and the most seriously affected countries, whose overall circumstances require the resort to concessional finance.

One method of financing this subsidy element might be IC government contributions to an interest subsidisation account, evaluated as a small proportion of the value of incremental industrial exports from these countries to the DCs, financed from the proceeds of the Fund.

The Global Fund for the Stimulation of Industry has been drawn up on the basis of a number of common elements taken from several disparate earlier proposals which have called for a co-ordinated global stimulation programme.1/

It takes their positive elements and integrates these into a new conceptual framework of the mutual benefit of industrialised and developing countries. The Global Fund proposal contains the general outlines of a co-ordinated strategy, incorporating mutually supportive and reinforcing elements, which are designed to promote non-inflationary growth in both developing and industrialised countries, and thus lead to some reduction in unemployment and imbalances in international payments.

3.1 The International Consensus

In the essential respects described above, the Global Fund falls squarely within an International Consensus which has been gradually evolving over the past year or so, and which was further confirmed at UNCTAD V in Manila.2/ The proposal for a Global Fund represents a particular mechanism for bringing about what has been termed "the massive transfer of resources" which was the subject of a consensus resolution and which has also received the endorsement of senior officials of international institutions.3/ The consensus at UNCTAD V held that "substantially increased transfers of resources to developing countries are an indispensable factor for accelerating their pace of development

1/ Muller, R.E. and Moore, D.H. (TASC), A Description and Preliminary Evaluation of Proposals for Global Stimulation, consultant paper submitted to UNIDO for this study, March 1979. For a recent contribution to the debate, see Jayawardena, L., Towards a New Economic Order: Some Issues for Discussion. The Third World as an Engine of World Growth, Speech before Sri Lanka Association for the Advancement of Science, December 1978.

2/ Resolution 129 (V) Part IV, UNCTAD, Manila, 1979.

3/ See the statements of Mr. de Larosière and Mr. Ripert to UNCTAD at Manila, 1979.

and could help stimulate global economic activity, particularly in a medium- to long-term perspective". It further specified that operational proposals to give effect to such transfers should be formulated in time for decisions to be taken by the relevant bodies either before the next special session of the General Assembly or on that same occasion, and to take into account the possibility of interest subsidy mechanisms.

The consensus also specified a set of guidelines to be observed by proposals for substantially increased resource flows. Proposals should:

(i) be compatible with the development priorities of developing countries and should take due account of their debt servicing capacity over the longer term;

(ii) give special attention to all developing countries which depend primarily on concessional funds for external financing for their development, particularly the least developed among developing countries;

(iii) be largely raised in international financial markets for project development and execution and programme finance purposes.[1/]

The present proposal for a Global Fund for the Stimulation of Industry addresses itself to the programme financing aspects, as shown in this outline, as being the readiest way of accomplishing the global stimulus that is needed; a framework for industrial project development is elaborated in another proposal presented to UNIDO III, for establishing an International Industrial Finance Agency. The Global Fund also meets the requirements of these guidelines by incorporating an interest subsidy element representing the difference between the cost of funds in financial markets, and the terms acceptable to countries requiring concessional finance. What needs emphasising at this stage is that the innovative element in the proposal consists not so much in the idea of a massive annual transfer of resources, but in the fact that it is raised in the context of furthering the hope that the stimulus to industry in the developed world that would be created in the medium term, would both revive industry and maintain economic activity in a non-inflationary manner.

It is the aspect of inflation which requires to be frontally addressed in appraising the international consensus on proposals for massive resource transfers. This consensus appeers adequately summarised by Mr. de Larosière, the managing director of the IMF, in his UNCTAD address, where he argued that action extending beyond the scope of what may prudently be available through the International Monetary Fund was necessary in the case of "countries that are deeply embedded in underdevelopment". In his view, in such cases "domestic policy adjustments would not be sufficient, even if they are supported by

1/ Resolution 129 (V), UNCTAD, 1979.

considerable medium-term credits" through the IMF. He continued: "In such cases, monetary mechanisms must not be used alone, as there is the risk of their breaking down or causing members to endure intolerable levels of deflation. It is the transfer of greater real resources that is at issue. It is paradoxical that industrialised countries - most of which are not using their productive potential to the full - are hesitating to increase their financial a d to poor countries. This is despite the fact that such aid would result in increased global demand and thus contribute to a reactivation of world trade and a recovery of production. There is nothing in the present state of deflationary chain reactions in the industrialised world (stagnation feeding inflation) which would argue against such an increase in financial aid" (emphasis added).

3.2 Membership and Decision-Making

The founder members of the Global Fund would be governments of industrialised and developing countries, with a decisive role being played by the latter. Programme lending on a substantial scale would have to be accompanied by that degree of policy conditionality and forward planning necessary to enable countries to bring about the necessary changes in their economic structures. Conditionality as exercised by multilateral financing institutions is perceived by developing countries to be perhaps over-rigid, with the result that borrowing from private banks on arguably too permissive a scale has become an attractive proposition, to the point when private bank financing is sometimes held to have abdicated from the responsibility of imposing any conditions at all.

More specifically, it is perceived by a number of developing countries that the conditionality provisions imposed by the International Monetary Fund bring sudden changes in their domestic economies often accompanied by significant social unrest, and in the short run at least, sudden fluctuations in the disposable incomes received by different social classes. Moreover, the result of these changes has often been a significant degree of social and economic dislocation. Thus, for policy conditionality to be acceptable to the developing countries, the governing and management structures of the Global Fund must be seen to embody a decisive weight of developing country decision-making, for purposes of approving loans to developing countries. From the standpoint of raising money from the capital markets and for establishing the market standing of the Fund, a different voting structure can be resorted to for decision-making by the Governing Body of the Fund.

It is increasingly recognised that between Bretton Woods and the 1970s the international monetary system was designed and run by and for the OECD (and really the Group of Ten[1/]) countries, taking little account of the needs of developing countries. The fundamental issue is the proper relationship between the international monetary system and development, and the historical assumption that what is "good" for the North is also "good" for the Third World. The International Monetary Fund's role in the management of industrialised economies has been drastically reduced, with the advent of floating exchange

---

1/ Canada, United States, Japan, France, Federal Republic of Germany, Italy, United Kingdom, Belgium, Netherlands and Sweden.

rates, central bank swap arrangements, and most recently the European Monetary System. Somewhat incongruously, the IMF is now left with being predominantly concerned with the problems of developing countries, armed with policies and management dominated by the North and an apparently inflexible package of conditions which may be quite inappropriate and contrary to continued economic development: internal deflation, exchange rate devaluation and trade liberalisation.

It should be noted that important countries are not members of the Bretton Woods institutions. The Global Fund for the Stimulation of Industry should be fully universal and include as members the USSR, China, and other non-market economy countries; benefits of mutual experience and a large scope for international co-operation would flow from the participation of all countries.

The question of conditionality is indispensable in lending, but a source of difficulty has been its interpretation in the light of one particular view of the world. Thus technical solutions, while protecting creditors' rights, have to be found, so as to take into account the legitimate interests of borrowers. Conditionality at the level of country borrowing, which is inseparable from responsible economic management, can be acceptable only if, through the medium of the Global Fund, recipient countries are seen in effect to discipline themselves by having a majority of their representatives both on the governing body and at crucial levels of management. Precedents for a decision-making structure of this type already exist in the case of the International Fund for Agricultural Development (IFAD) and the Common Fund set up under UNCTAD's Integrated Programme for Commodities.

3.3 Capitalisation

The Global Fund for the Stimulation of Industry would need a sufficient capital base to be able to borrow in the market place, amounts of the order of $ 15 billion per year. While existing multilateral institutions are required by their statutes to keep the level of their outstanding loans below the sum of their capital and reserves, this is not the case with the European Investment Bank where the ratio of loan to capital is approximately 2.5 and which has secured AAA status in the market place. It is suggested that the Global Fund, while seeking AAA borrower rating, might work with an intermediate loan to capital ratio of 1.0 with a capital base of the order of $ 100 billion. As indicated earlier, only a small part of this sum would be paid-in capital, perhaps 5 or 10 per cent, with the remainder in the form of callable capital replicating in effect the system of limited joint and several guarantees used by the World Bank and the regional development banks.

3.4 Operations

It is envisaged that the global fund would have the necessary authority to lend and to guarantee loans to member governments and their private and public entities, as well as to other international organisations such as regional or subregional finance institutions. Such lending would be given only on receipt of government guarantees. Loan maturities, rates of interest, grace periods etc would depend on the economic prospects of the particular developing country as well as conditions on international financial markets and on the level of funds available to the interest subsidisation account; as indicated earlier, however, the global fund would pay due regard to countries which are in a specially disadvantaged economic position.

To the greatest extent possible, the global fund would seek to use the facilities of existing development finance institutions for the appraisal, administration, implementation and disbursement of its lending programme. However, there would be preference on promoting decentralisation and effectivity by entrusting regional and subregional institutions, as well as national finance institutions, with a graduated degree of responsibility for lending activities. It is recognised that programme lending on a significant scale would be a new departure for many lending institutions and a substantial technical assistance effort might be required in this direction.

4. RECENT PROPOSALS FOR INCREASED CAPITAL TRANSFERS

A number of proposals, some by governments and others by prominent public figures, have recently been advocated for increasing the flow of long-term capital to developing countries, primarily through borrowing from private sources of capital backed by a multilateral guarantee system. These proposals have for the most part been based on a recognition of growing interdependence in the world economy: more specifically, that unless developing countries have access to long-term finance, their capacity to purchase manufactures including capital equipment from the OECD countries will decline; also there has been the recognition that a continued reliance on the private banking system for recycling financial surpluses gives rise to a precarious debt structure which is vulnerable to shocks, and uncomfortable for both creditors and debtors. Lastly there has been a growing recognition of the need for programme finance in contrast to project finance which has been described above. A number of these proposals are described in the outline below.

The Venezuelan Initiative

A study was commissioned by Venezuela in 1977 which was discussed by ministers of a number of capital surplus developing countries; in December 1977 a press conference was held in Caracas, in which OPEC's interest and support for this idea was announced. The essence of the initiative was that a pool of OPEC and OECD funds, private as well as public, would be placed in a special trust fund of the multilateral and/or regional development finance institutions; a proportion of the financing would be raised from OPEC nations and private investment, through bond flotations in international capital markets, using the underwriting services of the private banking system; the bonds would be guaranteed by OPEC and by the World Bank family. It was envisaged that a proportion of the total funding agreed upon would be channelled to the least developed countries, and that \$ 10 to \$ 12.5 billion per annum with a maturity of 12 to 20 years could be raised in this way.

The financing arrangement envisaged would act as an international long-term credit mobiliser absorbing the underutilised savings of both OPEC, and OECD private investors now held in liquid short-term assets. It would employ the underwriting and intermediation services of the international private banking community, avoiding OPEC's technical and administrative involvement in the raising of monies but ensuring decision-making role on the end uses of funds.[1/] The involvement of the private financing institutions would allow a readily available secondary market in the bonds, and provide flexibility in bond purchases over time.

The Mexican Proposal

In the May/June 1978 meetings of the interim committee of the IMF in Mexico, the Mexican representative proposed the design and implementation by the World Bank of a long-term recycling fund of \$ 15 billion for the purchase of capital goods by developing countries. The proposal welcomed the past short-term recycling of international surpluses by the private banking system, but noted that the international community had not additionally faced the long-term structural problems that affect developing and developed countries: emphasis was placed on the establishment of a long-term recycling mechanism. The financial mechanism would be similar to the Venezuelan initiative, i.e. a World Bank facility operated as a managed trust fund using SDR denominated debt instruments to lenders with 15-year maturities at a market rate of interest, with the industrialised countries providing additional guarantees to the bond issues. In the original proposal no mention was made of the distribution of loans between different groups of developing countries. This proposal relies on the technical expertise of the World Bank in approving project loans and originally no mention was made of tripolar decision-making in the facility. However, as in the Venezuelan initiative, it was emphasised that the proposal would generate breathing time for developed nations to make necessary structural adjustments. It is understood that this proposal may still be under examination in the interim committee.[2/]

1/ For details see "A description of a preliminary evaluation of proposals for global stimulation" by Muller, Ronald E. and Moore, David H., specially commissioned by UNIDO.

2/ See Muller/Moore op.cit.

The OECD/DAC report

In May 1978 the Development Assistance Committee of the OECD released a draft report on "elements of a programme of investment in the Third World in the context of interdependence, key issues and choices". The objective of the programme proposed in the report was to initiate a major increase in investment flows from the OECD and OPEC countries in the short run for development within the Third World by stimulating demand and increasing production in both developing and industrialised countries. The time perspective of this global stimulation effort was envisaged to be 3 to 5 years, but implications were recognised regarding long-term structural changes in the world economy. Investment flows of some $ 10 billion per year were mentioned, facilitated through the use of various co-financing operations by the World Bank, the regional development banks and private commercial banks. Financing would be targeted to Third World projects in the field of energy, and non-energy raw materials and infrastructure. Third World manufacturing industry would not have access directly to these funds. While details on participation in management decision-making were not specified, the need was noted for a greater share of Third World responsibility in decision-making.1/

International Loan Insurance Fund

During the 1977 IMF/IBRD meetings, Prof. X. Zolotas, Governor of the Bank of Greece, suggested the creation of an insurance agency to provide guarantees for private bank lending to developing countries: an international insurance fund was necessary both to service longer-term needs of developing countries and to ensure financial stability in the Euromarket. The objectives of this proposal were to open the Euromarket to lower income developing countries, to assure continued access but with longer maturities and at lower cost to developing countries currently in the market and to insulate all developing countries from roll-over problems arising from short-term variations in Euromarket liquidity. While this proposal envisaged an independent agency, it was suggested that it would co-ordinate with the existing multilateral gencies, i.e. IMF and the World Bank. Among the features of the proposal was the suggestion that there would be superior risk assessment by the Agency which would be in possession of information, held by public agencies i.e. multilateral and developing country agencies, not normally available to the commercial banking sector.2/

1/ See [illegible]ller/More op. cit.

2/ See Muller/Moore, op. cit.

The Nakajima Proposal

This proposal "for the global infrastructure fund" made in August 1978 by Mr. Masaki Nakajima, President of the Mitsubishi Research Institute and former Managing Director of the Mitsubishi Bank, suggested the establishment of a new international institution investing $ 13 billion per year, contributed to by the USA, FRG, Japan and other industrialised countries and the surplus OPEC countries in major international projects of a pioneer nature. The proposal saw the need for "a global new deal" arising from both the failure of post-war Keynsian economic policy to prevent stagnation in the North and the urgency of eradicating poverty in the South. It emphasised global stimulation as the only viable means of sustaining growth in the context of continued technological progress, and recognised danger in the inflationary bias of strictly national deficit-financed stimulation efforts and the collapse of the Bretton Woods international monetary system. Funding would come from public sources requiring a 30 per cent increase in ODA from the industrialised countries, and the need for a new agency was placed in the context of outdated management and decision-making structures in the Bretton Woods institutions.1/

The Kreisky Proposal

This proposal was first outlined by the Chancellor of Austria, Dr. Bruno Kreisky, in 1976 as an idea for aiding growth in developing countries while stimulating the economies via the stimulation impact of the industrialised countries. Mr. Claude Cheysson of the EEC Commission, another early proponent, suggested a "new Marshall plan" for the Third World amounting to $ 10 billion per annum for 3 to 5 years, viewing this as a short-term anti-cyclical device based on traditional Keynsian theories applied on an international scale. The International Fund for Economic Co-operation and Structural Adjustment was developed from the original Kreisky proposal which aimed at directly matching Third World project financing to the use of excess industrial capacity in participating industrialised countries. The fund would get paid-in capital based on national quotas of participants, raise finance in capital markets, and the proposed initial $ 1 billion would be invested in projects primarily in industry and infrastructure.2/

The Swedish Initiative

In November 1978 Sweden and eight other nations held a "special meeting of the like-minded countries on transfer of resources" to discuss stimulation proposals. The meeting emphasised that the massive transfer concept was a means for inducing long-term non-inflationary growth for the OECD and the world economy, and as a means of avoiding intreasing OECD protectionism by addressing the problem of structural adjustment. The meeting took the view that a massive transfer could overcome the existence of excess capacity in OECD nations while decreasing poverty in the Third World.3/

1/ See Muller/Moore op. cit.

2/ See Muller/Moore op. cit.

3/ See Muller/Moore op. cit.

Other Proposals

The Commonwealth Governments at the meeting in London in June 1977, in reviewing a Commonwealth expert group report calling for a major increase in the transfer of resources, endorsed the report as a constructive contribution towards a specific action-oriented development programme. In 1978 Mr. Edward Heath, former Prime Minister of the UK, proposed that the EEC borrow substantial amounts from the OPEC countries, and use these funds in both industrialised and developing countries for general economic development and for mining and raw material expansion. In April 1978 Senator Jacob Javits and seven other US senators proposed the establishment of a capital pool of $ 50 - 100 billion for productive investment in developing countries as a means of stimulating world economic activity and achieving development objectives.1/

The Brandt Commission Proposal

The Independent Commission on International Development Issues (Chairman, Mr. Willy Brandt, former chancellor of the Federal Republic of Germany) consisting of a number of eminent persons from industrialised and developing countries, will reportedly propose2/ a World Development Fund to provide massive finance for a variety of purposes, including general and sector programme financing, energy and raw materials exploration and processing, agricultural investment and infrastructure development. The bulk of the funds would be raised on the international capital market, as well as from bilateral arrangements with capital surplus countries, and there would be an interest subsidisation account financed possibly through a number of "automatic" transfers such as royalties from the recovery of seabed minerals and taxes on the arms trade.

The Arusha Proposal

The Arusha proposal, contained in the Arusha programme for collective self-reliance and framework for negotiation was adopted by the Group of 77 at Arusha, Tanzania, in February 1979. This proposal was notable in that the call for massive transfer of resources to developing countries in the course of promoting global economic recovery ceased, for the first time, to be the exclusive concern of a few isolated individuals or countries, whether in the North or in the South. The proposal argued that in the restoration of full employment in the North, meeting the needs of the developing countries would have a decisive role to play, in a situation where purely domestic reflation in developed countries would be no substitute, since the existing production capacities for export markets had been developed over three decades of export growth. The proposal called for an additional financial transfer inthe range of $ 35 - 50 billion, in the context of a recognition that needed structural adjustments in the pattern of production

1/ See Muller/Moore op. cit.

2/ See the report in the International Herald Tribune, 10 October 1979.

and trade would be facilitated in both developed and developing countries by a climate of economic expansion rather than stagnation. It was noted that for the resulting revival in effective demand to lead to the restoration of investment and growth initially in the developed world, international monetary stability was an essential prerequisite. The proposal also suggested the mechanism of raising funds under the collective guarantee of the international community in international markets, and their disbursement to developing countries over a long-term period with an interest subsidy element as appropriate, in the form of both project lending and programme lending for structural change. The proposal urged inter alia the exploration of more "automatic" mechanisms than are envisaged today, e.g. a tax on exploitation on seabed resources, with a view to financing the interest subsidy element of the proposal. This proposal also expressed a sense of deep disquiet with the imbalance inherent in the decision-making and management arrangements of Bretton Woods institutions, between debtor and creditor, and between donor and donee. It was felt that there was a need for equality in decision-making.1/

5. PROGRAMME FINANCING AND CONDITIONALITY

It is recognised that two important elements in the Global Fund concept would eventually require adequate elaboration which is not possible in this present document. However, the outlines of these two elements, viz., programme financing and conditionality are provided below.

5.1 Programme Financing versus Project Financing

The financing activity which comprises programme lending provides financial support for the whole range of projects and investment activities carried out in developing countries. It assists in the implementation of these activities in the face of fluctuating foreign exchange earnings and government revenues. In contrast to project lending, programme lending can pay for imports unrelated to specific projects: developing countries have borrowing needs which cannot be satisfied by project financing. Unlike project loans, programme loans can be quickly disbursed and since the imports arising are sold domestically, local currency can be easily generated for the government: this regular stream of disbursements can provide not only support for the balance of payments, but can also help finance domestic costs including such costs on foreign financed projects. A shortage of local currency has been one major factor causing project implementation delays,2/ and programme financing can reduce losses arising from incomplete projects.

1/ UNCTAD, The Arusha Programme, TD/236, February 1979.

2/ See World Bank Annual Report 1978, page 9.

Some countries have substantial domestic industrial capacity so that foreign financing of capital equipment imports may be either unnecessary or of limited usefulness. Equally, some other developing countries have substantial excess capacity which cannot be operated fully because of a shortage of foreign exchange for intermediate goods, spare parts, maintenance, etc. These needs cannot be met by orthodox project financing. Similar considerations arise with respect to the financing required for working capital, especially in the export sector, an area which is crucial in many countries. Too great a reliance on project financing invoke two additional problems in investment programmes. First, large projects are often preferred to small projects, where bilateral and multilateral development banks perceive economies of scale in administrative costs; leading to an encouragement of capital-intensive projects and processes, Second, it is extremely difficult to bring about a structural diversification of an economy dependent on a limited number of raw materials without programme financing. The building of social, administrative and managerial structures required for such structural reorientation, of necessity depends not only on project lending but also on programme lending.

There is of course no firm dividing line between project and programme lending. Instead, there is a spectrum of financing needs, with general purpose loans at one end of the spectrum and with financing of foreign capital goods for a specific project at the other end. In between are sector loans, i.e. those tied to specific economic sectors such as industry, agriculture etc., and there are also various kinds of lending for imports which arise indirectly as a result of capital investment. What is being suggested here is not that project financing activities of the orthodox type carried out by the World Bank and regional development banks are inappropriate, but rather that there is a range of financing activities which is not covered by the existing multilateral finance institutions. Direct support for programme financing activities can be found in the concern expressed by the Development Assistance Committee that the disbursement problem faced by multilateral and bilateral agencies was a serious impediment to resource transfers. If continued, this trend will weaken the debt servicing capacity of developing countries and strengthen uncertainty concerning the adequacy of future capital availability to meet investment needs. In this, the IBRD and regional development agencies seemingly committed to these present procedures for project financing, are not in a position to pay a fully adequate role.[2/]

Table 7 below indicates the volume and type of capital flows to developing countries that had taken place in the years 1970-1975 and as projected to 1990 by the World Bank; the figure for projected requirements in 1990 amount to US$ 183.5 billion as against

---

1/ Indeed this experience led to the conclusion of the OECD Development Assistance Committee that the disbursement of "official capital has not kept pace with the rapid expansion of private capital". See Development Assistance Committee, 1978 Review, Paris 1978, p. 23.

2/ DAC 1978, ibid.

US $ 45.8 billion which had flowed in 1976. This table emphasises the growing importance of private financing as compared to multilateral financing. While these figures are based on a number of optimistic assumptions,1/ an earlier report notes that "uncertainty about the availability of capital from private sources and the insufficient maturities of these loans showed the importance of the growth of capital flows from the multilateral financing institutions and official export credit agencies".2/ As already demonstrated above, many developing countries have little or no access to the private sources of programme financing available on the Eurocredit markets. Programme lending on a relatively large scale would contribute to providing a better balance between private and multilateral project lending and would be mutually beneficial to industrialised countries which would gain through increased orders for exports, and to developing countries, since such lending would ensure that their growth objectives would not suffer where finance from private sources could not be obtained, or could be obtained only on inappropriate terms.

Table 7: Net Disbursements of Medium- and Long-term Capital to Developing Countries, 1975-90

	Billion Current UD Dollars				Average Annual Percentage Growth Rate (at 1975 prices)	
	1976	1980	1985	1990	1975-85	1980-90
Private Direct Investment	2.4	8.7	14.0	33.5	0.3	3.3
Official Development Assistance	13.1	21.8	37.9	57.9	1.9	3.6
Grants	5.9	9.7	18.0	28.3	2.7	4.5
Bilateral Concessional Loans	5.4	9.4	15.3	23.5	0.5	2.9
Multilateral Concessional Loans	1.7	2.7	4.6	6.1	4.5	1.9
Medium- and Long-term Loans at Market Terms	30.3	39.4	69.8	103.1	2.9	3.4
Private	26.0	30.0	55.1	82.6	2.4	3.9
Multilateral	2.4	6.1	9.9	11.7	6.4	0.2
Official Export Credits	1.9	3.3	4.7	8.8	3.3	3.7
Total	45.8	69.8	121.7	183.5	2.3	3.4
At 1975 Prices	44.4	46.0	57.1	64.4		

Source: World Development Report 1979, World Bank 1979.

1/ See pages 8-10, World Bank Development Report 1979.

2/ See page 24, World Bank Development Report 1978.

5.2 Conditionality and Decision-Making

It is recognised that programme lending on a substantial scale would have to be accompanied by a degree of borrower policy conditionality and forward planning to ensure that borrowed funds are productively used, i.e. policy conditionality would have to ensure responsible economic management by borrowing countries.

Since the Global Fund for the Stimulation of Industry would rely heavily on market borrowing, there would be no place for inefficient management in such a new institution nor could there be any complacency towards deficient economic management by borrowing countries. Thus the Global Fund would need to ensure that its lending activities contribute optimally to raising productive capacity and not to such activities as unnecessary consumption or expenditure on arms; all Global Fund loans would have conditions attached and monitoring provisions intended to assure the productive use of funds. These conditions would have to cover, *inter alia*, such questions as the size and composition of the investment programme, management of balance of payments and the efficacy of domestic resource mobilisation and savings efforts. Conditions would take into account the circumstances of each borrowing country, the short-term and long-term effects of its lending decision on economic growth, welfare, and the financial position of borrowers.

It is recognised that lending conditions may have a profound impact on domestic policy priorities, income and employment levels, and particularly on the income distribution. Therefore, in the setting-up of loan conditions it will be necessary for borrowing countries to participate fully in a co-operative manner. Such conditions of loan and monitoring would only be acceptable to developing countries if, through the medium of the Global Fund, developing countries are seen in effect to discipline themselves by having their representatives form the majority on the governing body and at crucial levels of management of the new institution.

Conditionality exercised by multilateral financing institutions is perceived by the developing countries to be perhaps overrigid;[1/] thus, the organisational and decision-making structure of the Global Fund would need to reflect to the greatest extent the equal participation of all members. This implies that the Global Fund would operate on the basis of interdependence reflected in a voting and management structure in which no particular country or group of countries dominates. Thus a structure midway between the voting system of the UN organisations, i.e. one state, one vote, and the system of the Bank and the IMF, i.e. votes weighted by the capital subscription of particular states, might be envisaged. A key principle could be equality between the industrialised and the developing countries as groups.

1/ See Outline for a Programme of Action on International Monetary Reform, The Group of 77 Position Paper presented at the Annual Meetings of the IMF and World Bank, Belgrade 1979, pp. 7, 11.

6. TRANSITIONAL OPERATIONS

Even with full guarantees from its member governments, it would be some time before the new Fund could establish that high standing on international capital markets which would allow it to obtain its financing on the most favourable terms. It is important, however, that programme lending begins fairly rapidly in amounts which go some way towards off-setting any reduction in financial flows from private banks, whether for the reason of reluctance on the part of lenders or prudence on the part of borrowers.

During this transition period of three or four years, a possible approach might be for borrowing to proceed on negotiated terms from countries with large reserves. Thus, it might be possible for about one half of the Global Fund's requirements during this period to be on the basis of negotiated loans from both capital-surplus industrialised countries and capital-surplus developing countries. In this connection, it is envisaged that capital-surplus developing countries might undertake to make negotiated purchases of bond issues or similar negotiated loan arrangements during this transition period, while similar arrangements might be possible with other countries with large reserves. If such a means of loan financing could be agreed during the transitional period, the Global Fund would be able more quickly to obtain the remainder of its needs in the international capital markets. At the end of the transition period of course, the Global Fund would obtain all its borrowings from the international capital markets.

It is to be noted that if those developing countries whose names are well known in the international capital markets, were also to associate themselves with the Global Fund from its inception, through their participation in a system of limited joint and several guarantees, this would enable action to be taken fairly rapidly. Thus the Global Fund could begin initially solely on the basis of interested countries; in other words, this phase can operate precisely in the manner envisaged by the Mexican Proposal[1/] without the formal paying-in of capital subscription for the reason that at a later stage the Global Fund could be negotiated on a universal basis.

1/ The Mexican Proposal placed before the Interim Committee of the IMF, May-June 1978, Mexico City.