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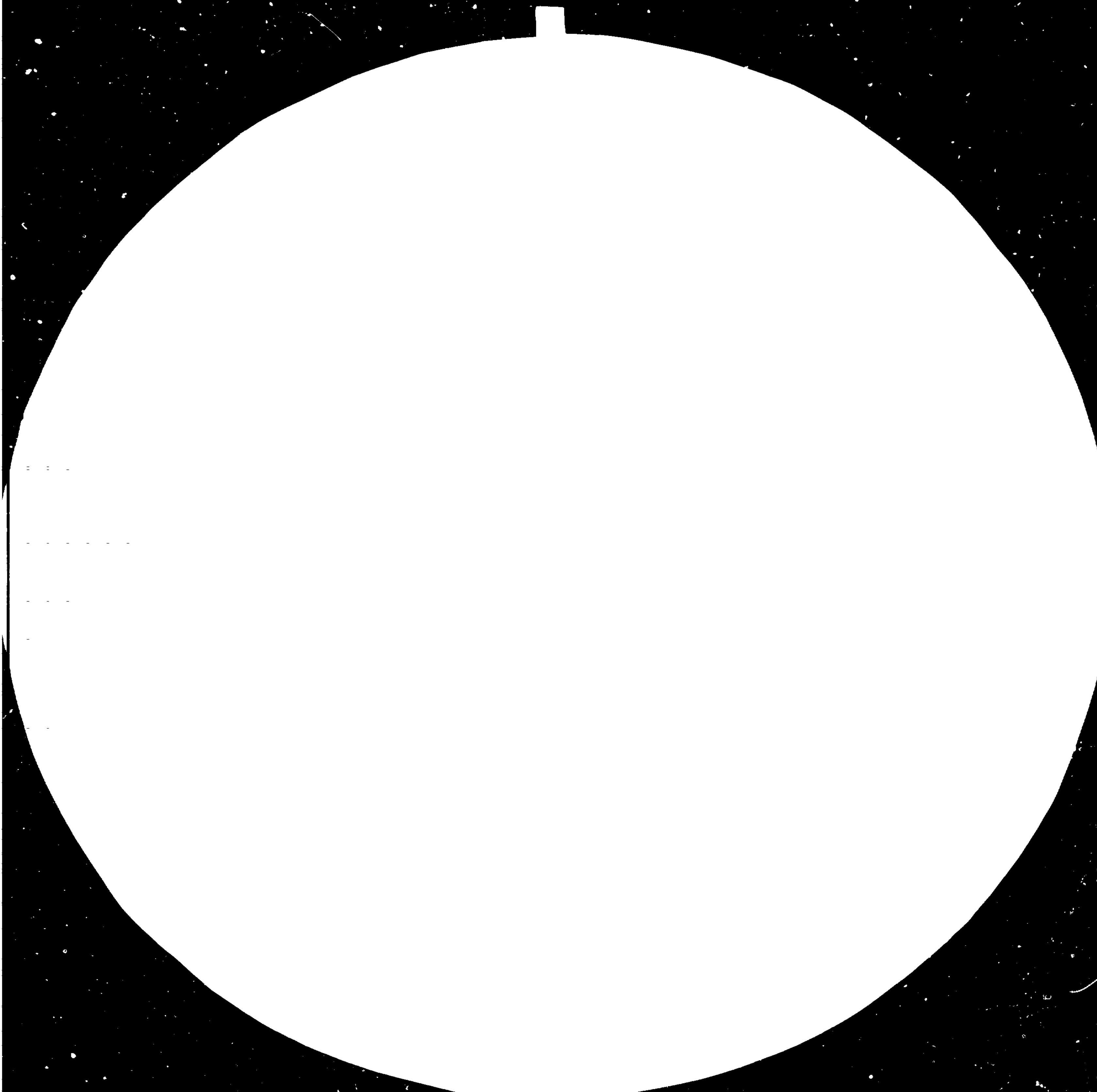

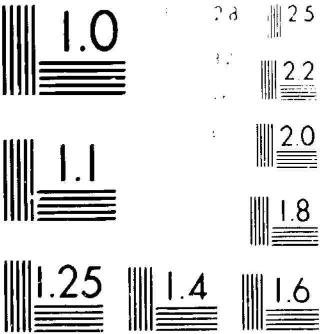
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The Inter-American Development Bank and its Activities in Latin America's Industrial Sector *

by

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** IDC: Institute for Developing Countries.

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The Inter-American Development Bank (IDB), established in 1959, has for many years been a major source of external public financing for most of the countries of Latin America.

The Bank's main functions are: to promote the investment of public and private capital in Latin America and the Carribean for development purposes, to use its own capital funds raised by it in financial markets and other available resources for financing high priority economic and social projects in the region, to encourage private investments in projects, enterprises and activities contributing to economic development, to supplement private investment when private capital is not available on reasonable terms and conditions and to provide technical co-operation for the preparation, financing and execution of development plans and projects, including the study of priorities and formulation of specific project proposals.

The Bank is owned by its 43 member countries. Twenty seven of these countries known as the regional members, are located in the Western Hemisphere, and sixteen known as the non-regional members are in Europe, Asia and the Middle East. The latter group was admitted to membership in 1976. The entry of non-regional countries has not altered the provision in the Bank's charter which preserves for Latin America and the Caribbean, as a group, the position of majority shareholder.

The entry into the Bank of non-regional countries capped more than a decade of joint experiences and consultations on financial and economic matters of mutual interest. Participation in the IDB affords a variety of reciprocal benefits, both tangible and intangible, to all of its member countries. On the one hand, the loans, technical co-operation, equity financings and small-scale financings represent an important flow of new resources for the borrowing countries. On the other hand, the non-borrowing countries benefit from the procurement derived from the execution of those projects.

The Bank relies on several sources of funds to finance its lending and technical co-operation activities. The subscriptions, paid-in and callable, of the member countries, which are increased periodically, constitute a principal source. Another is the world's capital markets, which the Bank taps through bond issues and other capital-raising arrangements, backed up with the callable portion of members' subscriptions. The third consists of several trust funds which the IDB administers on behalf of several countries. The fourth source is the flow of repayments. The Bank's authorized resources at present stand at US$ 27.3 billion, of which US$ 2 billion is paid-in. The total includes US$ 19.6 billion in member countries subscriptions to the Bank's capital resources and US$ 7.7 billion in contribution quotas to the Fund for Special Operations. The trust funds alluded to above amount to US$ 1.2

billion. The capital subscriptions of Latin America and the Caribbean represent 55.3% of the total, those of the United States and Canada 39.1% and those of the non-regional members 5.6%.

The Bank makes loans only for specific projects designed to meet high priority national requirements, in the framework of a coherent national development effort. Projects presented to the Bank for possible financing must not only meet this overriding purpose, but also have been subjected to initial feasibility studies and planning. Once selected by the Bank as a candidate for financing, the project is subjected to a detailed and thoroughgoing scrutiny on the part of the professional staff of the Bank, covering all of its technical, financial, economic, administrative and legal aspects. Only loans which survive this kind of careful review and which, moreover, are shown to yield a high rate of return, are presented to the Bank's Board of Directors for authorization, to provide financing only to cover a part of the project's total costs.

Loans which have been authorized usually do not become effective until important preconditions are met, often including the adoption of measures by the government to enhance and ensure successful completion of the project. Thereafter, the actual work on the project is closely monitored and superivised on the spot by the Bank's own technical staff resident in each of its borrowing member countries. Loan disbursements are made only as the project progresses, and usually extend over a period of years.

In consideration of the long-term development objectives foremost in the Bank's lending, the Bank provides the bulk of its loans on a long-term basis, with grace periods suited to the necessary project execution period, and with a fixed rate of interest. The Bank's typical loan is for 2o years, with an average life of perhaps 12 or 13 years.

There are several manners in which the IDB mobilizes resources additional to its own, most of them grouped under the label of co-financing. The general term "co-financing" applies to any case where the Bank arranges for participation by other sources in addition to its own. Amongst those co-financing formulas the Bank has used are: joint financings, parallel financings, export credits and complementary financings.

In a joint financing, the Bank first identifies a co-lender that is acceptable to the ultimate borrower. The IDB than works with him in the preparation and appraisal of the proposed project along the lines outlined earlier. The IDB and co-lending institutions then grant separate loans. However, the Bank is responsible for the administration of both loans as well as over the supervision of the execution of the project.

This formula has proved viable with such multilateral financial institutions as the International Fund for Agricultural Development (IFAD), the Commission of European Communities (CEC) and the Organization of Petroleum Exporting Countries (OPEC).

The parallel financing formula is a more independent way of co-financing. Under this scheme, each lender undertakes its own evaluation of the project and administration of separate loans. Notwithstanding this independence, co-lenders maintain close coordination and consultation during the project execution phase. This formula has proved fruitful in co-financing with the World Bank.

The export credits are granted or insured by specialized national agencies in the industrial countries. In these cases, the IDB's role is to provide assistance when its borrowers request it. The borrower itself is responsible for negotiating terms and conditions ruled by international agreements. In addition, the use of export credits is usually "tied" to goods and services from the respective country. These three formulas: joint financing, parallel financing and export credit, contain a subsidy element which usually takes the form of lower than market interest rates and extended maturities, which in turn are important for the viability of some projects.

The last of the four techniques is called complementary financing at the IDB. Its basic objectives are:

- to assist borrowers in gaining access to international capital markets or to help borrowers to improve and diversify the forms and scope of such access;
- to reduce the risk in credit operations and thus improve the terms and conditions of such credits,
- to enhance the economic effectiveness and the financial soundness of the external borrowing programs of Latin American member countries.

The formulation of this was based on two consideratons:

the need of the borrowers in Latin American member countries to obtain funds on more favorable terms and conditions than they could obtain directly from commercial credit sources; and the possibility that borrowers which might have difficulty in securing loans for their development projects in capital markets might do so more easily through the Bank.

In implementing this scheme the Bank usually grants two loans to the prospective borrower: the first, chargeable to its own resources, with a fixed rate of interest; and the second, a "complementary" loan, with a variable interest rate and other conditions (amortization and grace periods, fees, and the like) suitable for mobilizing resources from various segments of the international capital markets, such as commercial banks and institutional investors from the industrialized countries.

Once a number of steps have been fulfilled, the Bank invites a number of private financing institutions to submit proposed terms and conditions for the complementary loan. These institutions compete on the basis of their respective offers with regard to the interest rate, amortization period and other terms. After the Bank analyzes those offers, it submits them, with its evaluation, for the borrower's consideration. Once the borrower (and the guarantor), in consultation with the Bank, has selected the best offer, the Bank approves two separate loans: one with its own resources and the other, a complementary loan with funds obtained in the international capital market.

The problems facing industrial development in Latin

America are not unimportant, particularly in those countries which are not amongst the newly industrialized countries. The IDB does not believe that co-financing is the panacea for solving these problems; what it does believe is that co-financing can be a useful tool, particularly if it can channel additional resources for sectorial financing.

There is also a lateral approach to industrial development where co-financing can play an important role, whilst at the same time satisfying the need for additionality. This approach covers the whole area concerned with the financing of infrastructure projects. Industrial development in Latin America is not limited to the financing of new manufacturing plant and equipment and transfer of technology; it also relies heavily on infrastructure and market access. A number of these projects, which at first sight are not necessarily prime candidates for co-financing, have nevertheless been co-financed and have been well received by the international capital markets.

The Bank's action in Latin America's industrial sector has developed along five lines: 1) direct loans, 2) global loans, 3) technical co-operation for preinvestment and institutional support, 4) support to technology research, and 5) loans for exports of manufactured goods.

From the time it was founded up to and including 1981, the Bank has granted 219 loans to the industrial sector, amounting to nearly US$ 3 billion to finance projects representing an aggregate cost of more than US$ 2o billion.

Of the 1,1o8 loans granted by the Bank since it was founded, the industrial sector has accounted for 19% of both the number and amount of the loans. Taking into account the overall cost of these projects, the industrial sector programms in which the Bank has participated represent more than 30% of the total amount. This is indicative of the large extent to which financial resources from sources other than the Bank have been mobilized on behalf of this sector. For reasons of a practical nature, the Bank only considers direct financing in excess of a certain amount, which varies according to the country but is rarely less than about US$ 5 million at present. When smaller amounts are needed, financing is channeled by the IDB through local and regional development banks which in turn grant credit to medium- and small-scale industrial enterprises.

The Bank has financed direct loans totalling US$ 1.8 billion in the industrial sector. These loans went to both public and private industry. Financing in the form of direct loans tends to support basic industry and large-scale projects which national efforts are not, as a rule, sufficient to cover.

In some cases, the size of the project has allowed the Bank to underwrite a significant portion of a financial package made possible by a combination of public and private sector efforts and IDB participation. However, particularly during the seventies the growing cost of industrial projects investments led the Bank to seek alternatives that would allow financing to keep pace with spiraling costs.

If the Bank had limited its action to financing large industrial projects, it would have neglected the great majority of projects - those of intermediate and small scope, primarily funded by the private sector. This was not the case and in its very first year of operation, the Bank started to grant global industrial loans to national and regional development institutions. These in turn used those resources, together with their own funds and financing from other sources, to grant some 11,5oo loans by 1981 for the expansion, installation or modernization of industrial companies, practically all of them in the private sector. The global industrial loans granted by the Bank through 1981 amounted to a total of about US$ 1.2 billion. Based on these figures, the average subloan has amounted to about US$ 1oo,ooo.

Various types of mechanisms have been used in the above case. In some instances, the intermediary institutions lend directly to the end beneficiaries. In others, this is done through private or public banks, both development and commercial, which act as intermediaries.

Thus far, this paper has focused on what might be called the Bank's traditional forms of financing and co-operation. However, changing international conditions and the awareness of new and different needs for development action have led the Bank to propose, experiment with and implement new ways of supporting economic development, particularly after the mid-seventies. This paper will now address the new mechanisms having a special impact on financing to the industrial sector that have already been adopted or are being used on a trial basis.

In 1975, the Fondo de Inversiones de Venezuela signed a trust contract with the Bank for the administration of a fund of US$ 500 million in dollars and bolivars. Its purpose is to help finance projects and programs with a significant effect on the development of the Bank's relatively less developed member countries and those with limited markets or in the intermediate stages of development through improved utilization of their natural resources and promption of their industry or agribusiness.

Thus far the Bank has used these resources to finance eligible projects, primarily in the form of loans on terms similar to those for the ordinary capital. However, operations are now under way using the method of equity financing. It should be noted that since the financing in these cases is granted for the purchase of shares. the resources may be used interchangeably to cover costs of external or local origin, which in many cases offers a flexibility that is not available with the Bank's other resources. A further advantage of this type of operation is the possibility of obtaining a better credit rating the capital/indebtedness ratio improves. Also, in the case of large scale projects in small countries, the system allows for control of the companies by the countries which own the natural resources and whose budgets might not suffice to implement the projects with their own funds, much less to maintain control of the company.

In June 1978, the Bank established a new system, the Small Projects Financing Program, as a means of helping low-income individuals who had no access to conventional credit systems.

To do so, the Bank channels these operations through intermediary institutions which may be either public sector or private nonprofit agencies. To be eligible, projects must benefit marginal groups with no access to credit, create job opportunities and utilize a high percentage of raw or semiprocessed materials of national origin.

The loans for small projects have an amortization period of 40 years and 10 years of grace and an interest rate of 1% to the intermediary institutions. As a rule, the funds are transferred to the end beneficiary in local currency on terms similar to those prevailing in the market for such activities. A number of operations have been carried out, principally for the production of rural craft work or in the field of agriculture.

The spiraling demand for investment will place the less developed countries within the region at a disadvantage since their relative contribution to industrial production in Latin America has declined over the years, thus widening the gap separating them from the more developed countries whose relative share has continued to rise. This explains the preferential attention given by the Bank to the less developed countries with limited markets, where its investment efforts represent an attempt to help overcome the present imbalances.

In the field of basic natural resources, investment will have to be focused on those located in developing countries, where exploitation may prove less costly than in industrialized countries and where as yet undiscovered reserves are to be found. This will require the development of new mechanisms allowing a gradual stream of investment in the form of technical and financial support to those countries and the establishment of conditions that will attract capital.

Finally, the Bank must not only maintain but intensify its action on behalf of the medium and small-sized industrial sector enterprises, both through continual review and improvement of technical co-operation and credit mechanisms and by stimulating activity under its new equity financing program.