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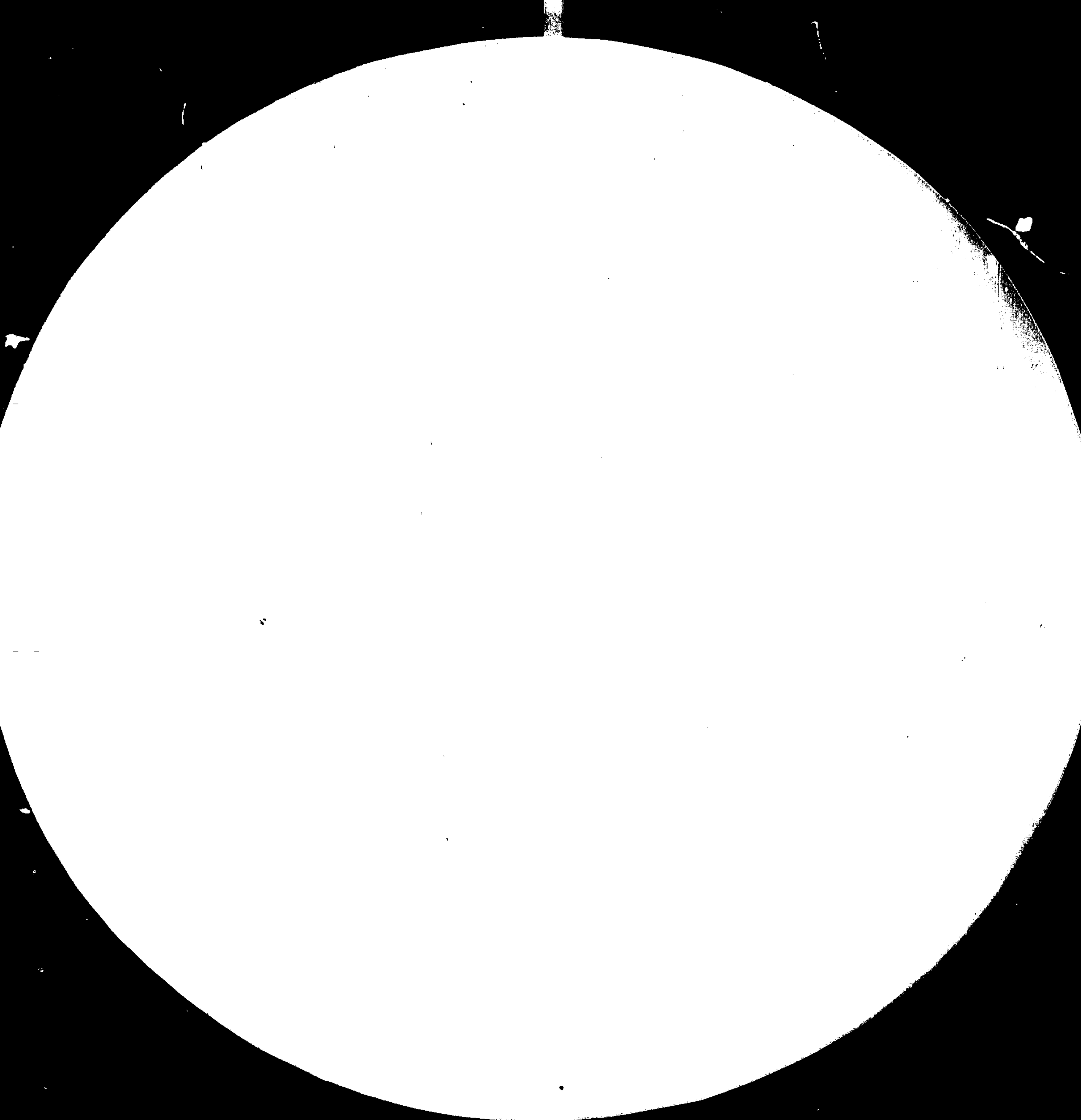

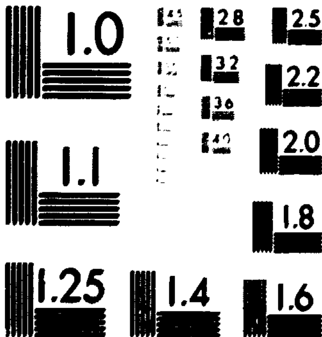

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DEVELOPMENT BANKING IN THE 1980s

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UNITED NATIONS

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna

DEVELOPMENT BANKING IN THE 1980s

Selections from the proceedings of the UNIDO/World Bank Symposium, Zurich, June 1979

UNITED NATIONS
New York, 1980

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Foreword*

The role of industrial development finance institutions in the years to come is one of the most crucial within the industrial development process. For what they have achieved so far, and what they intend to do for industrial financing in the future, we owe industrial development bankers a debt of gratitude - for contributing their ideas and dedicating their indigenous efforts to accelerating industrial development both in their own countries and in others.

This Symposium might well turn out to be a starting point for a new concept and new dimensions in industrial development financing. Each one of us present here is conscious that the restructuring of the world economy must, in fact, coincide with both the restructuring of world industry and its financing.

In considering the challenge that international organizations as well as the international financing community face as they enter the 1980s, it is necessary at the outset to appreciate that the group of institutions represented here is not homogenous. Industrial development finance institutions take many forms: governmental and international aid agencies, development banks of mixed ownership, state investment corporations and private investment houses, parastatal corporations and semi-commercial companies. As such institutions become more numerous and the developing countries' need for financing grows, the opportunities increase for combining different types of industrial financing by several project sponsors. Indeed, such arrangements are nowadays often the only means of fulfilling financing requirements; hence, the increase of national and international joint ventures and co-operation among industrial development finance institutions. As a result, the approach to financing has become more international.

For the future we expect a more widespread application of new industrial financing methods, for example for international subcontracting, export leasing, compensation and buy-back arrangements. These non-conventional banking techniques will be a new challenge for the industrial banker; they will diversify the scope of traditional development banking activities, and they will require a considerable personal capacity for judging risks and implementing innovative ideas.

Most industrial development finance institutions in developing countries are between 10 and 20 years old, and many in developed countries are only a few years older. Their importance in mobilizing financial resources to invest in industrial development projects is unquestionable. Nevertheless, their effectiveness may have been lessened by the general lack of information concerning objectives for development and conditions for providing funds. The subject of financial co-operation among industrialized and developing countries has, therefore, been under discussion in successive forums over a number of years. Indeed, there are few subjects which have such a massive mandate.

But while there is no lack of desire on the part of the developing world to co-operate financially with the industrialized countries, and while resolution upon resolution of the developing world speaks of the paramount significance of mobilizing industrial finance for their economic development,

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* Excerpted from the opening address by the Executive Director of UNIDO.

what has been lacking so far is a concrete plan of action - something based on the shrewd judgement and understanding of individual industrial development financiers and their professional associations.

In various United Nations General Assembly resolutions, it has been urged that steps be taken to enable the developing countries to locate and invest financial resources on terms and conditions acceptable to them for carrying out their industrialization programmes. To meet the need for comparable, basic information on various industrial development finance institutions, UNIDO was the organization with the commitment to design a programme in industrial development banking. Under the General Assembly resolutions providing for the establishment of UNIDO, one of the terms of reference was that UNIDO should provide "... assistance at the request of Governments of developing countries in obtaining external financing for specific industrial projects, by giving guidance in the preparation of requests, by providing information on the terms and conditions of the various financing agencies and by advising the financing agencies on the technical and economic soundness of the projects submitted for financing".

In compliance with that mandate, the work of UNIDO in connection with financing institutions has been comprehensive. UNIDO has executed several technical assistance projects with industrial development finance institutions, and it has trained industrial development bankers in modern banking techniques. From 1970 until today, a series of seven world-wide meetings of development bankers were held.

We hope that this Symposium will aid us in the elaboration of more sophisticated, flexible financial and institutional arrangements and that it will suggest terms and conditions suited to the requirements of developing countries. For international organizations, this Symposium may indicate new approaches to giving assistance. In general, it is intended to help to make industrial financing easier and more practicable.

With the dramatic changes taking place all over the world, the developing countries have tended to exercise ever greater control over foreign-owned banks operating within their borders; in many cases they have nationalized them. On the other hand, many banks have set up operations abroad, both in the leading financial centres, and also, where possible, in developing countries important to them for trade or finance. Likewise, many industrial firms, the banks' customers, have themselves moved around the world. They too needed a new range of financial services.

In most major financial centres, for example Zurich, international banks are also requested to provide industrial finance. Such large industrial credits are now demanded, banks need to pool their risks, and they are becoming used to forming international consortia or entering into joint lending agreements. This, in turn, requires all of us to be aware of modern industrial development banking techniques.

There are also great advantages accruing from the immense investment opportunities now arising. The System of Consultations - unique in adding the weight of practical experience acquired by industry to the knowledge needed for the decisions facing the world - has brought some assessment of the huge requirements of the third world. At meetings on iron and steel, fertilizers, leather, vegetable oils, and petrochemicals, it has been agreed that if global requirements are to be met, the 25 per cent Lima target is not an ideal but a necessity. Investments worth many billions of dollars have been identified; codes to ensure fair treatment for all partners are being drafted to help dispel fears of risks.

In UNIDO - an international organization concerned with the industrial development of the developing countries - we are conscious of the growing internationalization of banking. We are consequently considering holding a Consultation on Industrial Financing within the framework of the system of industrial consultations, which the Second General Conference of UNIDO and the United Nations General Assembly requested us to launch. This Consultation may take place in 1982, subject to the final decision of the Industrial Development Board. However, we have already been requested to make the necessary preparations for it.

In this context, it should be borne in mind that:

(a) Considerable financial resources are required for industrial development, if the targets provided for by the Lima Declaration and Plan of Action are to be achieved. A conservative estimate of the foreign exchange requirement over the six-year period ending in 1985 would be in the order of $20 billion per annum in constant terms, as compared to about $10 billion per annum during the past few years;

(b) Industry is not the only sector calling for additional financing; agriculture, infrastructure, transport, education and health also require a considerable increase in capital investment, since industry itself cannot grow in isolation;

(c) The social obligation of development banking is one of the new dimensions that has to be added when considering the overall volume of mobilizing development financing nationally and internationally.

From this brief enumeration, it is seen that the crucial question is how to fill the gap between present and expected levels of financial requirements and how to obtain suitable terms and conditions for financing industrial projects in developing countries.

Because of the very close relationship between industrialization and development banking, virtually every item on the agenda for this Symposium is of considerable interest for the industrial development banking community and the international organizations. We will review the lending policies and practices of a broad variety of financial institutions always with regard to the industrial sectors of developing countries. We will follow these deliberations with great care and inform the Third General Conference of UNIDO of the views expressed here. We are convinced that the discussions following the plenary sessions and panel meetings will provide a significant contribution for the next development decade and the promotion of new forms of international financial co-operation.

Abd-El Rahman Khane
Executive Director, UNIDO

WELCOME ON BEHALF OF THE WORLD BANK

(Excerpt)

David L. Gordon, Director

Industrial Development and Finance Department, World Bank

The World Bank has been associated with the creation, reinforcement and financing of DFIs for nearly 30 years - over 100 institutions in 73 countries, and gross financial commitments of some $6 billion. We are continuing to provide finance to most of these at a current rate of nearly $1 billion a year. We take pride, however, in the fact that a number of the institutions which we helped to get started no longer need our financial support - although we still consider them members of the family, a family that continued to expand rapidly.

The DFI mechanism has proved to be a highly efficient means of assessing investment needs and proposals and of allocating investment resources - mainly to industry, but increasingly in other sectors as well. It permits a flexibility in the administration of block funding, and an adaptation to local needs and changing conditions that national plans and international project financing are often incapable of achieving. If used as a channel for international finance, the DFI helps to enlist local initiatives and reinforce local criteria for decisions regarding use of these external funds. They also reassure foreign lenders or donors that the resources made available will be used rationally - under proper supervision - toward agreed objectives.

Although most DFIs have dealt primarily with manufacturing industry, other lines of economic activity are increasingly benefitting from this mechanism: construction companies, tourism, agri-business, wholesale and retail trade, municipal works and services, and so on - any area where there is need for entrepreneurial initiative and for systematic assessment of financial and economic returns. These activities need not all be profit-making. Subsidies may be justified for social reasons, but the anticipated costs and returns can be quantified and weighed in the balance; the analytical discipline embodied in the DFI's appraisals constitute one of their major advantages as instruments of public policy.

Nevertheless, as the mission of DFIs expands and diversifies, it may also become blurred and confused. Social policy obligations may appear to conflict with the needs to maintain financial viability and to mobilize investment resources. The more diverse patterns of financing and loan administration may have a similar effect by increasing staff costs in the early stages.

Even more serious problems are posed by changes in the economic environment that are beyond the DFI's control. Inflation and currency fluctuations erode their equity base, complicate their access to capital markets and expose their clients - and ultimately themselves - to heavy risk. Abrupt shifts in government investment policy and legislation that profoundly change these premises and the environment in which they must operate have become more common.

The need and opportunities for effective DFI operations are thus expanding enormously; at the same time the conditions requisite for their effective operation are becoming more uncertain. This predicament, in all its ramifications, is the occasion for our Symposium.

WELCOME ON BEHALF OF THE HOST COUNTRY

(Excerpt)

Klaus Jacobi

Delegate of the Federal Council for Trade Agreements
and Governor for Switzerland of the Asian Development Bank,
African Development Fund and Interamerican Development Bank

The majority of topics of the Symposium focuses on industrial development and on technical issues relevant to the management of development banks. The knowledge of management techniques and their application is an absolute prerequisite for the development of efficient financial practices. However, as important as the banking aspect might be, we should not lose sight of the equally important goal of generating genuine development. Resources need to be equitably applied, in order to benefit the most needy sections of the population.

Given the diversity of problems and needs of the third world countries, the instruments used must be appropriate to the various constraints hindering the development process. Development banking must therefore be flexible, adapting its instruments and techniques to the diverse and changing needs of its beneficiaries. With activities ranging from financing of projects at very concessionary terms to joint or parallel financing with private funds there is a wide field for these institutions to cover. This diversity and flexibility of development banking is the central theme of the Symposium.

By providing resources for investment in infrastructure, agriculture and industry, development banks play a major role in correcting the lopsided structure of the economy. Increasing diversification will make developing nations less vulnerable to internal and external economic disturbances and allow them to benefit fully from their integration into the world economy. Fortunately over recent years considerable progress has been achieved by numerous countries in this respect.

The choice of Zurich for this Symposium is not accidental. We might recall that Swiss capital markets are a major source of finance for the development banks.

In recent years, the contribution of the Swiss capital market to development banks and developing countries has grown considerably. In 1978 the World Bank alone borrowed SwF 1.7 billion, 180 million went to the Asian Development Bank and 80 million to the Interamerican Development Bank. This trend has continued in 1979.

As of March 1979, notes and bonds of development banks totalling SwF 6 billion were outstanding. This included 3.6 billion for the World Bank, 1.3 billion for the European Investment Bank, 530 million for the Asian Development Bank and 500 million for the Interamerican Development Bank. In addition SwF 1.3 billion went to a number of individual developing countries.

Thus, the borrowing in the Swiss capital market by developing nations and development institutions rose from 24 per cent in 1977 to 28 per cent in 1978.

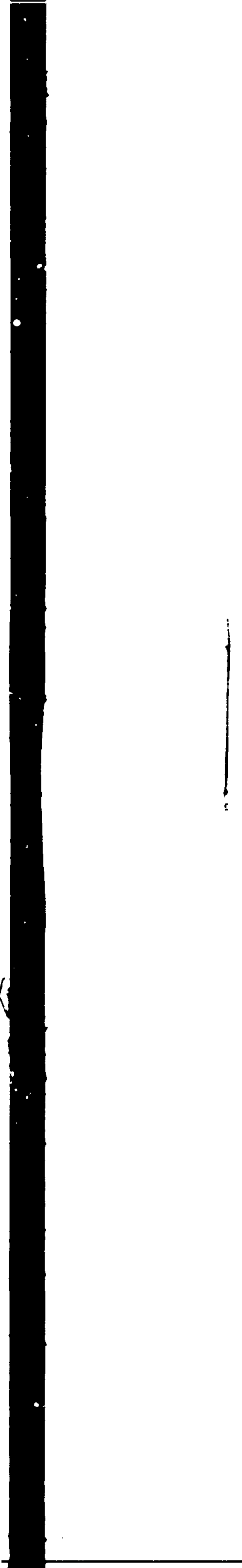
Latest available figures for 1977 show that total net flows of capital - including export credits as well as direct private investment - from Switzerland to developing countries and development institutions amounted to SwF 4.8 billion which correspond to 3.14 per cent of the Swiss GNP, i.e. somewhat better than our official development aid performance.

The importance the Swiss Government attaches to development banking is not limited to providing funds through the Swiss capital market to the major financial intermediaries. As a member of the regional development banks, Switzerland also subscribes to their capital stock and provides resources at concessionary terms for making soft loans. Furthermore, we have begun to co-operate with subregional development banks as well as national development banks. These institutions are often particularly well suited to adapt their lending to specific local circumstances, making use of local talent and initiative. Such industrial development financing institutions are essential tools that complement the work of the larger development banks.

In concluding, I would like to express again to you my best wishes and sincere hope that this Symposium may be a rewarding experience for you and that you will enjoy your short stay in Switzerland.

Part one

INTER-RELATIONSHIPS BETWEEN GOVERNMENT POLICY AND INDUSTRIAL DEVELOPMENT BANKING



A. *Plenary Sessions*

PRINCIPAL PROBLEMS THAT INDUSTRIAL DEVELOPMENT BANKS ARE LIKELY TO CONFRONT IN THE 1980s

Olivier Giscard d'Estaing, *President*

European Centre for International Co-operation (CECI)

The economic objectives are clear: feeding a fast increasing world population; organizing work so that there will be employment together with the necessary goods for everyone, drastically reducing the present inequalities in standards of living; bringing each state's trade and financial balances into equilibrium; and providing each of the world's regions with infrastructures and facilities worthy of the modern world.

With regard to industry, we should bear in mind the target set forth in the Lima Declaration and Plan of Action on Industrial Development and Co-operation in 1975: industrial output in the developing countries to be raised from less than 10 per cent of world production as at present to 25 per cent. Arithmetically, this will mean:

(a) An annual average industrial growth rate of 10 per cent for 25 years in the developing countries. At that rate by the year 2000 they will have reached the present production levels of the industrialized countries;

(b) Annual industrial growth in industrialized countries kept at an acceptable level of 5 per cent;

(c) World growth to be maintained at a rate slightly above 6 per cent - the minimum necessary to make such an evolution possible.

Can this be achieved? It means a substantial and steady increase in world industrial production - justified by consumer needs and made possible by modern productivity and technology, but which has to face serious obstacles of a material, human and structural nature. These obstacles need to be well weighed. The potential remedies involve, inter alia, the fundamental role of development banks.

The obstacles

The principal material obstacle concerns energy - its high cost and shortage of supply. The size of the problem is indicated by projecting current growth rates in consumption (in terms of equivalent tonnes of petroleum (ETP)):

	1950	1970	2000 (estimated)
World consumption (billion ETP)	1.7	6	14
Consumption per head (ETP)	0.7	1.7	2.25

The estimate of 14 billion ETP in 2000 is conservative. It corresponds to a population growth and a world consumption increase of 3.5 per cent annually (i.e. not 6 per cent as assumed in the Lima target). It is also far from certain that it will be possible to double present energy production that even these figures would require. This factor alone could bring about a crisis of unprecedented scale and a dramatic increase in the income gap between the oil-producing countries and the rest of the world. Indeed, if the market is given free rein - that is to say if supply shortages result in a continuous and unrestrained rise in the sales price of crude oil - the world economy may well be faced with an apocalyptic situation.

The second material obstacle concerns availability of finance in terms of present indebtedness and savings possibilities. Globally the figures are very high: more than F 1,000 billion (i.e. more than $230 billion) for developing countries and F 200 billion (more than $45 billion) for the East European countries.

However, compared to the GNP of the developing countries, the amount only comes to one seventh of their total combined GNP; the debt per head is F 37.50, which is bearable. The burden is also bearable for the lending countries. Certain countries will nevertheless not be able to cope indefinitely with the balance of payments deficits resulting from the debt-servicing burden.

The principal problem for the developing countries is therefore to break the cycle - from which there appears to be no excape - described by Franklin Root as follows:

> "Productivity is low because investment is low; investment is low because savings are insufficient; savings are insufficient because incomes are low; incomes are low because productivity is low."

Another material obstacle is the lack of infrastructures. Industrial development demands modern infrastructures, which in turn often call for substantial investment. The direct short-term returns on such investment is difficult to estimate, but the lack of it prevents the functioning of a growth economy.

In this context, infrastructure embraces transport, telecommunications and the necessary supplies of energy and water.

The human obstacles involve tradition, nationalist and protectionist sentiments, a lack of vocational training and unfamiliarity with the requirements of industrial production. This does not mean that industrialization is in conflict with culture, religion, collective spiritual and traditional aspirations. But it does mean additional requirements regarding organization, methods, timetables and regular working habits to which not everyone is accustomed. These constitute constraints which, under conditions of freedom, are only surmountable through economic motivations sufficiently powerful to engender individual and collective effort in the interests of production and productivity.

Every region, every nation has established institutions and the international organizations contribute additional competence and resources. It would thus appear paradoxical to classify these various institutions as institutional obstacles to development, when in fact they are contributing to it.

Nevertheless, their authority and their resources cannot guarantee that the objectives will be attained. Evidence is in both the present international monetary chaos and the lack of a world energy policy. The blame does not lie with these institutions but with human beings, their traditions, collective egoism, fears, public opinion. Fear of supranationalism, the burden of cumbersome national or international public administrations and the attendant dangers of a slowing down or even paralysis of initiatives, the difficulty of bringing about international agreements - all are factors whose effects should not be underestimated.

The remedies

All these obstacles need remedies and they do exist. Some can and must be supplied by European enterprises on the one hand and by multinational financing and credit institutions on the other.

The European Centre for International Co-operation (CECI) tries within its modest means to bring about concrete conditions for implementing projects in developing countries. It is as a result of its four years' experience that the following convictions are offered.

The role of European companies consists in actively participating in the growth of industrial production in the countries of Africa, Asia and Latin America. The objective is not so much to devise a new distribution of wealth as to contribute to increasing its production.

If the wealthier countries were to transfer 20 per cent of their *per capita* consumption to the poorer countries - which admittedly would be politically, economically and socially impracticable - there would be little change in the wealthier countries' consumption. Assuming, for example, a growth in production of 5 per cent in the industrialized countries and 10 per cent in the others, the consumption rate of both would rise rapidly; and the wealthier countries would make good their transfer within five years.

Index of *per capita* consumption

Country group	Population (per cent)	Consumption (per cent)	Today a/	After consumption transfer b/	After 5 years	After 10 years
Wealthier countries	20	60	3	2.4	3.8	4.9
Other countries	80	40	0.5	0.65	0.88	1.43
Ratio	0.25	1.5	6	3.8	4.3	3.4

a/ Ratio of per cent consumption to per cent population.

b/ 20 per cent transfer of per capita consumption.

This growth would require careful selection of projects, a choice of technologies allowing good rates of productivity, and the accelerated training of the workers, foremen, senior staff and management of enterprises. Western experience in these fields is useful and transferable.

We, in Europe, are conscious of this growth potential. One example: annual world requirements of cement will grow from 840 million tonnes in 1978 to 1,250 million in 1990, and 90 per cent of the new requirements will be outside the industrialized countries.

European companies can and must play a part in this effort, but it must be subject to certain conditions and with certain limitations.

The conditions involve a spirit of international co-operation that facilitates the movement of men, techniques, products and financial resources; administrative relationships must be based on confidence and not on mistrust; and the policies of the Goverments concerned must give due weight to the need for a return on investment and for investment guarantees.

The limitations involve the availability of human and financial resources. They vary according to sector, company and country. Such resources are plentiful and still inadequately utilized. Nevertheless, sectoral studies and feasibility studies are necessary so that the costs and potential markets can be assessed to provide guidance for the huge efforts to be undertaken.

Companies can perform this function without attempting to dominate markets or to impose a Western model which is often ill-adapted. They should do so in a spirit of partnership and imaginative effort so as to take local realities and traditions into account.

Development banks have a major role in contributing to the establishment of essential infrastructures - something that private capital is not in a position to do. They look after the long term to avoid crushing States under excessive financial burdens. But they can discharge other important functions: instituting complex financial arrangements in which resources varying in national or institutional origin are combined; financing feasibility studies which will be paid for after the projects studied have been implemented; contributing to vocational training efforts; playing a promotional role by participating in semi-public or private projects regarded as having priority. In this way financing from private and public, national, foreign and international sources can go hand in hand.

Governments also have their part to play, and they could do more. A decisive gesture is indispensable. Spectacular political action on a global scale is required to respond to the anguish and aspirations of the world's peoples. A new type of plan inspired by the following four principles must be devised:

Massive aid, expressly contingent on a pause in the rise of petroleum prices

Material aid in the form of food and equipment

Temporary aid on condition of accelerated social progress in the recipient country

Selective aid - selective in its application and multilateral in its origin

Such aid has to be on a large scale: if it does not go beyond a certain critical threshold, it is ineffectual. Its volume will play a decisive role both for the subsequent development of the recipient countries and for effective economic recovery in the donor countries. Official assistance today is insufficient - witness the inadequate results attained. The new assistance proposed should be at least equal to the assistance now being given; it would double the sums contributed at the moment and more or less make it possible to attain the target for official assistance of 0.70 per cent of the GNP of the contributing countries. A doubling of the aid flow would represent an additional F 100 billion per year, i.e., less than 5 per cent of the sum which it is planned to devote to energy investment. A reduction of 10 per cent in the world's military expenditures, agreed upon by the leading nations, would be sufficient to achieve this objective.

Credit for purchases would be provided to allow temporary utilization of the assistance. This credit would permit carefully defined supplies of food products to ensure the survival of the countries concerned, and equipment to stimulate the creation of new wealth. Following the salutary example of the Marshall Plan, this proposal would absorb food surpluses and would encourage both agricultural production and the recovery of the capital goods industries in the West - thereby contributing to its industrial activity as a whole. There would be no further justification for criticism regarding waste or improper utilization. The systematic organization of needs forecasting and supply possibilities would be instituted, bringing into being a new world model for co-operation and progress. It would become the source of a colossal transfer of agricultural and industrial technologies, and should be accompanied by a huge management training effort.

The time allowed for this aid could be approximately five years. The effort demanded of the contributing states would thus be of predetermined duration. The psychologically disagreeable situation of countries being perpetually assisted would thus become acceptable for a period limited in time.

The social programming, of equivalent duration, included under this plan, would ensure that the effort benefited the population concerned. Wages and social benefits would be rapidly increased, and new social legislation would consolidate this progress, so as progressively to bring about more humane conditions of work and social welfare. Future international competition would be on a sounder footing. It would, therefore, be possible to move towards an equitable and stimulating liberalization of trade.

Unfortunately, this plan necessarily calls for selectivity as regards the countries that will benefit. The problems of world poverty cannot be solved in five years. In addition to the present efforts on behalf of the most disadvantaged - which would be maintained - those proposed here would concentrate on countries offering the most promising prospects for the utilization of assistance.

At the conclusion of the proposed plan the economic results achieved would make it possible to re-examine the problem - this time in the interests of the poorest countries.

There are at the present time a certain number of countries, perhaps about 20, where the economic and political situation offers a climate providing the necessary guarantees for the success of such a plan. A selection should be made among Andean Pact countries, the countries of South-East Asia, certain African states, and the oil-producing countries. The latter could be included as both givers and beneficiaries under this plan. The basis would be objective criteria of economic efficiency, political stability and potentially rapid social progress, that would ensure the necessary focus of the project on attainable objectives. Subsequent stages would respond to the aspirations of other countries within the framework of a plan which could continue up to the year 2000.

The source of such aid would be multilateral, thereby increasing its potential. The European Community could play an important part in the plan, the scope of which would be still greater if it included all the member countries of the Development Aid Committee. This group could even be joined by additional countries adhering to the common political will directed towards helping countries that aspire to become developed and are within reach of that goal.

An intergovernmental agency could be set up to establish and administer the programme. It would work closely with existing organizations such as the OECD, the EEC Commission, UNIDO, and the World Bank and its subsidiary, the International Finance Corporation (IFC).

The example and support of these existing multilateral organizations would help implement the plan rapidly. But it would be desirable that representatives of the private sector also co-operate with the representatives of states and international organizations for the purpose of studying and implementing the plan.

Parallel to this public effort, companies and corporations should try to multiply their activities on the African, Asian and Latin American continents by a factor of ten. This presupposes the Governments concerned adopt a favourable attitude. For the entrepreneurs it implies a will to accept risks, and needs their unrelenting efforts in the direction of training and the application of techniques and selective investment. Both transnational corporations and existing or new local enterprises would be involved.

Some may fear that these new efforts called for may be onerous. Let them rest assured: their economies will benefit along with their material security and their moral conscience.

The real problem lies in the sphere of political will.

Absorbed as they are by their concerns at home, will there be enough heads of state of contributing countries with sufficient vision to subscribe to this plan? Will they be able to convince public opinion in their home countries?

Will the heads of state of the beneficiary countries be ready to undertake the economic and social commitments required on their side? Will they be capable of persuading their populations to co-operate? Will they show sufficient liberalism to make their implementation possible?

If the responsible political authorities accept this new orientation for their economic and social effort, the mechanisms will be set up and companies will commit themselves, finally and completely, to energetic action for world industrialization.

PRINCIPAL ELEMENTS OF GOVERNMENT POLICY WHICH AFFECT DEVELOPMENT BANKS

Cesar Virata, *Minister of Finance*

Philippines

Looking back on developments over the last 50 years, it is now clear that what the colonial relationship and administration brought about was the development of plantation agriculture, mining, ports and railroad systems, communications, water supplies and energy facilities. These projects were financed by Governments, trading conglomerates, multipurpose financial institutions, or merchant banks. The degree of development in any particular country provided different starting points when these countries became independent.

Aware of the high degree of economic dependency, the first national leaders want diversification of the economic base - emphasizing industrialization and diversification of markets as well as diversification in sources of technology and capital. At this stage of development, many institutions are set up: government development companies, central banks or monetary authorities, development banks and private companies are encouraged and a securities market is established.

This period after independence also creates import substitution industries under the aegis of import licensing, exchange controls, tariff protection, and tax incentives. The traders and traditional distributors become the industrialists and the multinationals enter with packaging operations or light manufacturing industries, basically to protect their markets. As can be expected the traders-turned-industrialists need financing by their commercial banks, unless by this time development banks are already utilized to fund or guarantee equipment imports. The multinational corporations either finance themselves or seek local partners at an early stage.

This is a typical market-oriented approach to development and we know by now the limitations of this type of industrialization. Linkages are difficult to establish because of the great variety of products that were assembled. Backward integration of industry is therefore hampered until some of the companies close because of competition - thus permitting to others a wider market base. We also find that foreign exchange is not really saved by establishing import substituting industries when they are allowed to grow under protective devices. Because of this experience, there is now greater emphasis on export-oriented manufacturing enterprises - especially those featuring non-traditional labor-intensive products.

At the other end of the spectrum are the extractive industries that export most of their products in raw form or after slight processing. There is an urgent need to expand these industries in order to earn foreign exchange for the import substitution industries. Again, the commercial or development banks become involved, especially in ventures financed by advances from commodity buyers.

Countries at this stage of development must consider their industrial projects carefully because they require intensive capital investment and highly developed technological know-how. The multilateral banks, the

export-import banks and the national development banks also have to work in close co-operation on such major projects. The national banks usually provide equity capital and guarantees, and they extend loans in domestic currency. The foreign exchange is usually supplied either by the export-import banks, or the multilateral development banks. Nevertheless, on the different experiences in setting up these types of industries, countries are nowadays more careful in planning such industrial projects. Development banks should support this trend to avoid repeating the investment mistakes of the past.

In agriculture, the push is towards self-sufficiency of the basic staple foods. At the same time there is the natural expansion of plantation crops. Expansion of the area in agriculture reflects both population pressure and the fact that forest exploitation enables conversion of hillsides to agricultural and livestock production. Agrarian reform is also another aspect of development requiring banking services for both the farmers and the former land owners need investment guidance in business and industry so they may transfer their assets.

As soon as uncultivated agricultural land is exhausted, the drive for intensive agriculture begins - with irrigation and drainage systems, high yield crop varieties, fertilizers, pesticides, processing equipment and storage units all needed to keep up production. Again the development banks are called upon to assist. They are likewise called on to finance projects of the co-operative movements, for example warehousing and equipment pools.

In the 1980s, Goverments will continuously reassess the gaps - areas that have been neglected - so there will be some re-orientation of the programmes. There will be greater emphasis on medium- and small-scale industries that link to agriculture and other industries and to export. It is necessary to disperse industries in the rural areas to provide employment and to keep the people from moving to the cities. The cost of urbanization is so high that greater attention must be given to broadening economic opportunities in the rural areas. Industrial estates are particularly helpful for small- and medium-scale industries, for example. On the other hand the urban poor and unemployed will need similar treatment. Capital ventures requiring low capital investment, e.g. in the service areas, hold considerable promise for the urban sector.

In a world where oil supply does not meet current demand and the price of energy is definitely going up, many countries are implementing energy diversification programmes. But unless there is a stable energy source it will be difficult to industrialize further. Major investments will therefore have to be made in the energy field. Financing of exploration and development of fossil fuels, construction of hydroelectric or geothermal plants and various forms of non-conventional energy will require greater participation by development banks. The World Bank, regional banks, eximbanks, national development banks as well as commercial banks will have to be mobilized to fund such projects, whose costs are two thirds in foreign exchange and only one third in domestic currency. Only by facing this problem squarely, can we assure stable economic growth.

While there is a great need for development financing, the existing financial systems are based towards short-term maturities, especially in developing countries where there is a general lack of savings. Relatively high inflation rates further accentuate the shift towards short-term operations. For the sake of long-term industrialization, greater efforts should therefore be made to control inflation. At the same time we should not fail to modernize our incentive schemes in order to meet industry's longer-term financial requirements. In the Philippines, for example, we are now studying with the World Bank the feasibility of reforming the Philippine financial system in order to utilize a greater proportion of the financial resources for medium-term, and hopefully long-term, lending.

Since a large proportion of export earnings go to finance our industrial development, a number of stabilization measures for commodities will have to be undertaken in the 1980s. By means of export earnings stabilization under the Lomé Convention, the compensatory financing facility of the IMF, and the

International Commodity Agreements, it is hoped both that the earnings of developing countries will be more stable and that their terms of trade will improve.

We can only project the needs on the basis of what is presently lacking, and what could be done in the face of increasing constraints. As stated earlier, there will be emphasis on basic needs; food; domestic energy sources; labor-intensive, medium- and small-scale industries; industries linked to agriculture; and those that generate export earnings.

As we enter the 1980s, there is above all a greater awareness of the trend to equitable growth rather than plain economic growth. Projects have to be considered by the development banking system in terms of socio-economic benefits.

But, while there is a greater realization that countries are highly interdependent we nevertheless cannot remove the desire for self-reliance. These parameters govern our actions.

INSTITUTIONAL RELATIONSHIPS BETWEEN GOVERNMENTS AND DEVELOPMENT BANKS

J. S. Raj, *Chairman*

Industrial Credit and Investment Corporation of India

By and large, Governments of developing countries have viewed raising the level of living standards as their benevolent duty. The focus in economic management has therefore been on accelerating the pace of development rather than playing a dominant role in the economic activity itself.

Many Governments have adopted economic planning as a strategy for growth. The exercises in planning have been undertaken however with a view to mapping economic resources and directing their allocation: planning was not conceived as an instrument of rigid control.

In this framework, development banks, like other financial agencies set up to help develop sectors such as agriculture and trade, have been agents of development. As such they have been regarded benignly by Governments.

There has been an understandable desire by Governments of developing countries to diversify into industrialization, moving away from traditional agriculture. Apart from being a symbol of modernity, industry-oriented strategies appeal to Governments of developing countries on several scores.

Agro-based industries have been seen as means of upgrading agricultural productivity and incomes by enlarging markets for agricultural produce. Industries processing minerals have had the advantage of augmenting domestic value added.

Even though low per capita incomes restricted local markets for industrial products, a further point in favour of industry-oriented development strategies has been the fact that the developing countries almost wholly depended on imports of industrial goods. Import-substitution industries provided a natural area of viable growth.

Development banks in turn were perceived as instruments for attaining the objectives of rapid industrialization. In this context, the World Bank has played an important role in establishing the credentials of private enterprise. Not only did it stress the need for setting up development banks exclusively for assisting private enterprise. It also insisted on private ownership of such banks.

The private DFI model of the World Bank was designed against a backdrop of the developing countries' underdeveloped capital markets. Investable resources were as limited as domestic savings were meagre. And even these meagre resources were often siphoned off into non-industrial assets such as real estate. But not only was risk capital for industry shy, much of the equipment and know-how for import-substitution industries also had to be imported from abroad. Development banks assisted by the World Bank and other international financing agencies were therefore the specialized institutions ideally suited to play the role of purveyors of foreign exchange.

Governments have not overly interfered with the management of development banks. For instance, in the case of The Industrial Credit and Investment Corporation of India (ICICI) the Government of India appointed one director to the board. But looking back over the early years, neither the financial

support of the Government nor the presence of this senior government official on the board infringed, even in the slightest manner, the autonomy of ICICI.

The prerogative of accepting or rejecting a project rested solely with the board of directors. Only projects which satisfied the multiplicity of criteria evolved by ICICI itself qualified for assistance. A large number of DFIs, assisted by the World Bank and with financial support from Governments, have experienced similar institutional relationships during their formative years. Today this could well be the pattern of relationships between development banks and Governments in the least industrialized countries. Purveying foreign exchange loans would presumably be a primary function of development banks in these countries.

Diversity in the pattern of relationships

Starting from a position of autonomy in formative years, the government-development bank relationship evolves in different ways in different countries. In some developing countries the autonomy of development banks has been considerably eroded. In others, notably the high growth economies of the Far East, South-east Asia and Latin America, development banks have exhibited remarkable vitality - despite their late entry to the family of development banks.

There has also been no uniformity in the matter of government ownership of development banks' equity capital. Nevertheless, the common feature of the high growth economies is openness of their financial markets and liberal government policies regarding the inflow of foreign capital and know-how.

The inflow of foreign saving to the semi-industrialized developing countries has acted as a catalyst to mobilize domestic resources, both human and financial. Governments of developing countries have often insisted on indigenous participation in industrial ventures. Development banks in these countries have therefore been called on to raise local resources.

With the development of an indigenous industrial sector, the need for local currency resources steadily increases. To meet this challenge, development banks in several developing countries have become mobilizers of primary saving, i.e., in addition to agencies for purveying long-term credit to industry. Development banks have also set up subsidiaries such as unit trusts and banking companies to mobilize domestic capital. They have further diversified into activities such as leasing companies, merchant banking etc. From purveyors of foreign currency credit, development banks in several semi-industrial developing economies have thus emerged as significant promoters of financial institutions.

The rapid growth of development banks is facilitated by an appropriate interface between the managers of development banks and government agencies. The ideal relationship is based on mutual trust and respect for autonomy. Top management in development banks is given representation in government bodies which are responsible for investment planning. Besides ensuring viability of industrial investment, this involvement of development banks has ensured efficient implementation of government industrial investment programmes.

In contrast, Governments in some developing countries decide to assume detailed responsibility for controlling the economy. In the process, the autonomy of developmental agencies is curtailed, particularly in those developing countries where Governments own and control an overwhelming portion of the financial intermediaries that act as primary mobilizers of domestic savings. Development banks in these countries have had no option but to seek government support for raising funds from domestic capital markets. However, international agencies such as the World Bank and foreign commercial banks have also insisted on government guarantees for their lending to development banks.

Financial dependence does not wholly explain the infringement of autonomy of development banks. In developing economies that feature national planning, popular thinking has generally veered towards increased government intervention and direct ownership of industrial capital in order to expedite the process of development. Development banks in developing countries that also pursued restrictive economic policies have generally experienced greater erosion of their autonomy than their counterparts in other countries.

To a certain extent, the infringement of autonomy is a consequence of the widening gap between actual growth performance and what is required to alleviate poverty and unemployment. In several developing countries the pace of economic advancement has barely exceeded the rate of growth in population. Improved public health services have dramatically reduced the death rate whereas no perceptible impact has been made on birth rates. Consequently the process of development has remained a struggle even to maintain the same standards of living. Governments in such slow growth developing countries, whether of dictatorial or democratic varieties, have often become desperate to produce results out of sheer desire to survive. The consequence has been the tightening of government controls in all spheres.

The international agencies that were instrumental in setting up private sector DFIs now perceive development of agriculture, small industry, housing, public water supply and other public utilities as the main areas worthy of their support. On their part, the Governments of several developing countries have set up development banks, wholly owned by them, with a view to regulating the flow of capital to these industries. As a result international financial agencies such as the World Bank have begun to channel funds through these Government-owned development banks. Such changes in attitudes and policies of donor agencies have considerably influenced the development of relationships between Governments and development banks.

The 1980s

The scenario for the 1980s for developing countries as a whole is encouraging. According to World Bank projections, growth performance of low-income developing countries during the decade 1975-1985 should be considerably better than the past decade and a half.1/ In terms of basic requirements such as a developed industrial structure, a supply of skilled labour, cadres of technicians and professionals, and a financial institutional structure, developing countries are in a position to perform better than in the past. What is needed is an appropriate framework of government policies.

The liberalization of economic policies by many developing countries is also an encouraging sign for development bank operations in the 1980s. But in order that these countries continue to pursue liberal economic policies, it is essential they continue to have access to foreign capital.

For example, many Governments of developing countries, emboldened by their improved foreign exchange resources position, have lowered their tariff and non-tariff barriers. Development banks in these countries could now provide, as they did during the 1950s and 1960s, a channel for inflow of investment capital on reasonable terms. In the 1950s and the 1960s, the sources of funds were the official international agencies. In the 1980s, it could be commercial sources. The international private capital market is increasingly being tapped by middle income non-oil exporting countries to finance their development needs.

According to other World Bank projections, domestic savings in low income countries of Asia and Africa are expected to register significant increases in 1985 compared to their levels in 1975. The share of foreign resources in the financing of investment should thus decline. Mobilization of domestic resources therefore poses a major challenge to developing countries in the 1980s. In particular financial institutional structures will have to

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1/ World Development Report, 1978 (Washington, World Bank, August 1978).

be diversified and strengthened. This means that development banks in both the low-income semi-industrial countries and in least industrialized countries can play a crucial role in setting up a framework of suitable financial institutions to accelerate the flow of industrial capital.

In the final analysis, the crux of the institutional relationship between Governments and development banks is the rapport between managers of development banks and government officials at all levels. However the creation of many interface relationships, with the Government taking the driver's seat, would clog the process of development. However many Governments might like to have their representatives on management boards of financing institutions, the temptation to centralize decision-making will have to be avoided. Thus, in addition to professional competence, top management of development banks in developing countries must have developed strong personalities to meet the challenges of the 1980s.

RELATIONS AND INTERACTIONS IN A CENTRALLY PLANNED ECONOMY

B. Belghoula, *Chairman and Director-General*

Banque Extérieur d'Algérie

Direct state intervention occurs more and more frequently for a variety of reasons: to safeguard certain vital sectors of the economy; to support employment levels and avoid social disasters; or to promote and develop public service activities or strategic sectors in which private enterprise is loath to participate, either because of the large capital investment required or because of the non-existent, or at best very long-term, returns.

It may also be observed that, even in free-market economies with very high levels of development, state interference in economic decisions is extremely frequent.

At the same time, many developing countries have turned to national development banks to stimulate their economies, these banks being regarded by some as an ideal, effective instrument for the rapid achievement of development objectives.

Obviously the efficacy of these institutions is not to be judged by their degree of independence from or their dependence on the central authority, but rather from their capacity to play a useful part in the development effort.

It is none the less a fact that their role and importance depend both on the resources they are in a position to supply for the needs of development and on their economic and financial organization.

In a developing country with a liberal régime, where industrial policy rests essentially on the initiatives of domestic and foreign private capital, the role of the development bank is of prime importance as an instrument for guiding, selecting, financing and promoting investment. Nevertheless, when such a bank enjoys complete management autonomy it is bound to look primarily for safe and profitable investments.

In developing countries of socialist pattern where economic decisions are generally taken within the framework of a centralized plan and the activities of private capital are severely controlled (and often quite marginal), the stimulus for development comes from the central authority. The plan represents a political decision of a binding nature for all the actors on the economic stage responsible for its implementation.

Considerable effort and great sacrifices are required to make up a lag of several decades of underdevelopment and to bring about radical changes in economic structures that were conceived to originally suit the needs and interests of the former colonial authorities. In these circumstances it is understandable that the state should play a major part in the eonomic process as the nation's principal investor.

Deciding on investments then becomes a political rather than a technical problem, in which it would be inappropriate to dwell on considerations of risk, security of employment and financial returns. The purpose is to establish the basis for a truly national industry that will ensure the country's economic independence and raise the people's standard of living and social well-being.

In the final decision-making stage, the economic and social effects of intended investments are a criterion that cannot be ignored. The banking system - and the financial organization as a whole - then take on the role of providing technical and financial support for the investments they have to finance and whose implementation they have to supervise.

In schematic form, this is an outline of the relations which would seem desirable between the financial system and the government in a centrally planned economy The experience of Algeria illustrates this type of relationship with the role of the Development Bank in the Algerian financial system.

First steps toward a national financial system

On gaining independence, Algeria's financial system was adapted to the economic and financial organization bequeathed by the colonial power - a ramified extension of the structures existing in France.

The economic environment was that of a market economy dominated by foreign interests:

(a) Natural resources, the country's main source of foreign exchange, were in the hands of foreign corporations;

(b) Industrial organization, still in its earliest stages and highly disorganized, was largely controlled by foreign private capital. It was not designed by the country, nor did it aim at satisfying its needs;

(c) The banking network consisted of branches or subsidiaries of foreign banks whose interests were far from coinciding with Algeria's development imperatives.

Under these conditions, the socialist and planned development for which Algeria had opted was quite a distance away. This made it all the more necessary for Algeria to hasten the process of recovering the attributes of economic sovereignty:

(a) By recovering sovereignty over its natural resources;
(b) By developing the state's means of production;
(c) By setting up a financing system to suit development needs.

In this context, the creation of the Algerian Development Fund was an answer to the authorities' immediate concern to fill a void left by the French institutional structures responsible for financing productive investments, e.g. the Crédit national and the Caisse d'équipement pour le developpement de l'Algérie (specially set up to implement the Constantine Plan, 1959). The continued existence of these bodies was considered no longer compatible with the country's sovereignty.

At the same time the Algerian Development Fund became the State's first instrument for achieving its development objectives. It was the institution responsible for helping finance productive investment and for implementing investment programmes and plans.

The development fund's field of activity

The Algerian Development Fund was to play a part in many areas: firstly, it was a source of credit in the pure tradition of the financial institutions from which it had taken over. As such it participated in financing of all forms of investment, either from its own resources in the case of long-term credit, or by guaranteeing medium-term loans granted by commercial banks. It also provided all kinds of credit to help execution of contracts concluded by the Government and other public authorities and institutions. Like its predecessors, it was also to be one of the instruments for monetary stabilization, responsible for moderating inflationary pressures at commercial bank level.

The Algerian Development Fund also promoted industry creating or encouraging establishment of enterprises and assisting in their expansion, transformation or modernization.

An auxiliary of the Government and an instrument of the latter's economic policy, the Algerian Development Fund could be made responsible for:

(a) Implementing the national capital development programme;

(b) Participating in the capital of enterprises on behalf of the Government and representing it in the governing bodies of enterprises;

(c) Carrying out credit operations on behalf of the Government and facilitating such operations;

(d) Providing guarantees on behalf of the Government.

Acting as an orienting and selecting instrument for private investment, the Fund was to judge the soundness and financial aspects of projects submitted to the National Investment Commission, in the context of its functions as the secretariat of the Commission. Its various activities were exercised within the framework of policy defined by the governing board, among whose duties were:

(a) Annual determinations of the economic sectors to be encouraged by the Fund, the financial effort needed and the objectives to be attained in each case, as well as the orders of priority to be observed;

(b) Decisions on which enterprises were to be set up, the equity participation and the credits to be granted.

The clear political composition of its board, which included the Prime Minister and all the ministers responsible for economic sectors, gave the Algerian Development Fund considerable autonomy in its activities and enabled it to exert useful influence on the country's economic choices and decisions.

Seen in that light the Algerian Development Fund could be regarded as a genuine instrument for co-ordinating the country's economic actions. The conditions for socialist development were, however, still lacking and the Algerian Development Fund had to operate under two unfavourable circumstances:

Dominance of the private foreign sector

A banking system outside state control

The economic structure had not yet developed and the methods of financing were still those of a market economy.

The financing system

Until the creation of the National Corporations, financing problems were relatively simple and easy to cope with.

The budget covered working expenses and non-productive investment. Productive investment, not very substantial at that time, was taken care of either through loans from abroad, mostly governmental or by private initiative.

The saving-investment equilibrium in general was a responsiblity shouldered, within the limits of its capacities, by the banking system.

Thus, there were two sources of financing:

(a) The Government, with the support of the Treasury;

(b) Enterprises, which were dependent on the banking system.

The banking system determined its financing policy by making choices between the various possibilities for the placing of funds (e.g. capital investment, short-term financing and subscription to Treasury bonds). At the same time it eliminated investments which did not conform to its own criteria and it oriented savings to purely profitable uses.

Communication between the banking system and the budget system was established through the Treasury, which sought to mobilize savings by issuing interest-bearing bonds to cover its temporary needs. But apart from the obligatory quota of Treasury bonds, the requirements of the Treasury were subject to the same rules of selection as those of enterprises. In other words, the banking system only transferred to the Treasury funds which had not found other uses.

At the time, monetary pressures were relatively moderate in the light of:

The rigid budget regulations
The conservative line taken by the primary banks towards industrial financing problems
The comparatively low level of investment

The picture changed with the introduction of the triennial programme in 1967 and the development of an increasingly important public sector. The extent of the public sector's financing needs called for total mobilization and rational allocation of savings. Most savings, however, were still handled by a banking sector that was still dominated by foreign interests and the banks' selection criteria automatically excluded any financing of the nascent public sector.

In the circumstances, the Government had no other recourse but to concentrate the financing of productive investment in the only financial instrument controlled by the Government, namely the budget.

As it then existed, the banking system functioned counter to planned economic development. Its modes of operation left the choice of investments to the laws of the market, and called in question the implementation of central investment decisions. In contrast, financing problems should have been approached in terms of planning, and it was for that reason that the 1971 reform was introduced, the Government having meanwhile taken over the entire banking system.

The role of the banking system in Algeria's planning

It should be understood that planning is an inevitable consequence of the socialistic organization of society. It constitutes the appropriate instrument for controlling the economy, and contrasts with capitalistic organization which leaves the implementation of economic decisions to the laws of the market.

In a socialistic economy the reinforced role of the state appears to be a necessary condition for achieving a fair and equitable policy. It is up to the state to take the appropriate decisions and to adopt the most efficacious measures for achieving a harmonious and coherent development.

The state sets out its priorities through the plan, is responsible for co-ordinating the various economic measures and adjusts means to objectives within the overall circumstances.

In this way the plan, centralized in its conception, constitutes a guideline for economic development. It is the expression of the political will of the state and its general strategy for development.

The activities of the various economic agents must therefore follow these planning guidelines, and it is important they be synchronized and rationalized to ensure optimum implementation of the plan.

It was this overall objective which made the 1971 reform necessary - to adapt the financing system's methods of intervention to the imperatives of planning.

Financing after 1971

Far from overturning the financial structures of the time, the procedure established in 1971 restricted itself essentially to bringing about better utilization of existing agencies with a view to controlling the allocation of resources and securing strict control over monetary and financial flows.

It should be recalled that the two sources of financing (the Treasury system and the banking system) were completely independent of each other up to 1971. The banking system, even after being completely nationalized, had retained broad freedom of decision regarding how to utilize its resources, i.e., essentially on the basis of criteria of profitability and security.

This resulted in a poor utilization of savings, particularly of savings drained off by the banking system and allocated to non-priority operations.

Two basic principles lay behind the 1971 reform, the purpose of which was to put the banking system at the service of planned development:

(a) The financing of productive investment in the public sector is henceforth ensured by temporary inputs (i.e. total financing by credits);

(b) Allocation of resources is centralized in the interests of better utilization through redistribution in accordance with the objectives assigned to each sector of the economy.

The aim, therefore, was to channel available resources of all kinds into development operations by giving the banking system an obligation to finance productive investment.

The collection of resources, however, continues to be the task of the two networks that existed at the time:

(a) The Treasury system, which, in addition to budget (Caisse nationale d'épargne et de prévoyance, insurance companies, pension funds, social security organizations) and the savings collected by its correspondents (in particular the Centre des chèques postaux). This network covers long-term investment needs;

(b) The banking system, which takes deposits from individuals and client enterprises. It provides financing for the medium-term needs of public enterprises in addition to operating credits granted in the context of their current activities.

The picture is completed by external credits which are mobilized to help pay for imported goods and services.

In this system, the Issuing Institute has to take care of the liquidity of the economy either by rediscounting or by taking in short-term credit papers, and by granting advances to the state to satisfy temporary cash needs.

In view of the high capital investment outlays demanded for the accelerated development of the economy, the strains on the currency depend on the country's ability to accumulate capital and the possibilites for mobilizing resources by the banking and financial systems.

From a financial point of view the programming of investment is a means of ensuring equilibrium with regard to currency, the balance of payments and foreign indebtedness.

The financing plan: a factor in financial planning

When the Algerian Development Fund became the Algerian Development Bank in 1971 there were changes in the statutes. The governing board was replaced by a board of directors, essentially made up of technicians from the Ministries of Finance and Planning and the banking apparatus.

In addition to its administrative powers, the board of directors has to supervise credit operations within guidelines and instructions issued by the Ministry of Finance.

After the changes in the statutes and powers of its administrative organs, the Algerian Development Bank in fact became both a purely technical executive body and at the same time a co-ordinating centre for creating financial coherence in investment.

Also since 1971 the Development Bank has become the starting point for procedures for financing productive investment. For implementation of an investment project in the production sector two pre-conditions must be satisfied: it must be individualized and accompanied by a financial plan.

The individualization decision, the approval of a project at a given cost, is taken by the central planning body. The financing plan is established by the Development Bank in the context of the principle of centralized allocation of resources and is formally adopted by the Minister of Finance.

The prime aim of the financing plan is to ensure the project's financial equilibrium. This means that the combination of various types of credit (long-term, medium-term and external loans) is subjected to careful study

with reference to the goods financed and the borrower's foreseeable capacity or repayment. This ensures that once a projected unit starts to be implemented, there should be no difficulties with regard to its financial structure.

The financing plan is also the guidance for the financial aspects of the investment. Spread over a number of years, it sets forth the funds to be mobilized by type of credit in terms of the physical planning of project implementation. It thus means that the project should not suffer any financial constraints during the course of implementation.

By collating the financial plans it is possible to project the financing needs for investment in the entire production sector.

A synthesis between the financing plans, the status of the physical implementation of the projects and the forecasts for the mobilization of resources enables the Government to decide on the definitive global amount to be set aside annually for each branch of production. It is thus in a position to arbitrate between the various priorities and decide on the levels of the different equilibria to be attained.

This of course is a deliberate simplification of the requirements for financial programming of investments. The reality is in fact more complex, if only because of possible divergencies, e.g. delays, re-estimating of costs, or growth being slower than foreseen.

The financing plan is thus not always of optimum efficacy. In particular it depends on the degree of reliability of the financial data derived from the techno-economic study of the project. Nevertheless, based on experience gained so far, it is always possible to bring about substantial improvements in this efficiency.

Starting up and controlling the implementation of financing plans

As noted, the Government sets aside each year a credit allocation in accordance with the needs of the production sector.

The board of directors of the Algerian Development Bank uses this as a basis of establishing a schedule of credit provisions by type and by enterprise, the schedule being approved by the Minister of Finance and communicated to the banks and enterprises.

The credits are then mobilized in accordance with the outlays provided under the framework of multi-year agreements set up for particular projects, e.g. between the Algerian Development Bank and the enterprise (in the case of long-term credits financed from Treasury funds), and between the primary home bank and the enterprise (in the case of medium-term credits).

The enterprises themselves, generally with the assistance of their banks, are responsible for mobilizing supplementary external credit, either from their suppliers or from the international capital market. However, it has to be demonstrated that the credits mobilized are really for expenditures on projects approved under the Plan; enterprises are no longer free to make decisions on their financing. The banking system, and particularly the primary banks, constitute the sole channel for financial flows. It is thus up to the banks to make sure that enterprises are spending the money in accordance with the decisions taken by the planning authorities.

Financial control only operates with maximum effectiveness if enterprises carry out their operations in conjunction with a single bank. The bank is then in a position to watch over the cash flows of the client enterprise.

Expenditure is therefore only authorized by the banks if the planning formalities have been fulfilled (i.e., the project is individualized and accompanied by a financing plan), and if the expenditure comes within authorized cost and if payment credit is available.

The centralization of an enterprise's cash flows through a single bank has the further advantage of avoiding interference between operating credit and investment credit.

As the sole financial partners of enterprises, the banks are also responsible for periodically reporting to the central authorities on the financial implementation of investments and the progress of projects.

Conclusion

The Algerian banking system, generally speaking, is a faithful, integrated instrument in the service of planning and has the task of attending to the financial needs of productive investment. It is at the same time a unit for financial planning, a centre for supervising conformity with government decisions and a reporting body.

Quite clearly, its role cannot be conceived in a framework of independence vis-à-vis the Government, in the light of the imperatives of centralized planning.

However, it must be in a position to throw sufficient light on the financial aspects of the investments in order for the Government to be able to evaluate the impact on the economy and the various national equilibria.

In other words, the intervention of the financial system aimed at improving the reliability of financing plans should be directed towards fuller knowledge of the projects to be financed, in order to ensure better control over costs.

This can be achieved by co-ordination between enterprises and the banking system in the stages of project preparation and finalization.

An evolution in this direction seems to be well under way. The Development Bank in Algeria is endeavouring to set up a service for evaluating projects, which will help local authorities to start up small and medium-sized enterprises. The planning authorities, for certain major projects, are more systematically submitting their files to the banking system for examination before deciding on the individualization of the project.

The dimensions of development problems are steadily increasing everywhere. The attempt to rationalize financing methods for investments deserves to be pursued. But we have to be aware that this is a long-term task, the achievement of which will undoubtedly encounter all manner of difficulties, particularly in this rather disturbed period when inflationary pressures and monetary instability are becoming daily more critical.

NATIONAL AND INTERNATIONAL SUPPORT FOR DEVELOPMENT BANKS

B. Knapp, *former Senior Vice President, World Bank*

Development banks are taking on an increasing variety of forms and functions. Among them are the promotion of the modern sector in the economies of developing countries, i.e. fostering the development of enterprises in the field of industry, commerce and finance, and extending in some cases to agri-business and commercial agriculture.

The proposition is that such development banks, which have generally been launched with funds provided largely or entirely from local governments and international public institutions, should constantly evolve as they mature in the direction of raising their resources in the domestic and international capital markets. Each of them should establish for itself the goal of achieving, over a period of time suited to its present stage of development, full independence from reliance upon governmental and intergovernmental financial support.

This evolution would provide an important stimulus to the healthy growth of the development banks themselves, and of their contribution to their local community.

This proposition is based upon three premises:

(a) Both domestic governments and international development institutions face severe problems in allocating their investment resources between the wide spectrum of capital requirements in developing countries;

(b) Any investment activity that can command resources in the capital market should be expected to do so;

(c) The financing of the modern sector in developing countries, if conducted in an appropriate manner, should be able, in due course, to stand on its own feet and command the confidence of investors in the capital markets.

Furthermore, to the extent that dependence on direct government support brings a risk of political influence in the day-to-day conduct of a development bank's business, freedom from reliance upon such support will enable the development bank to better discharge its responsibility for promoting sound economic development.

This is not to depreciate in any way the responsibility of Governments for establishing objectives and priorities to which development banks should adhere. Development banks are a vital bridge between the broad development plans and macro-economic policies of Governments and the day-to-day application of these policies to the productive enterprises with which development banks deal. It is indeed that relationship which justifies the support national banks and international development institutions have long given, and continue to give, to the development banking business.

All the foregoing remarks are meant to apply to both publicly-owned and privately-owned development banks, since it is assumed that public development banks will be equally guided by professional, economic and business principles.

So far as local funds are concerned, it is fully realized that any exhortation to development banks to tap local resources other than government appropriations presupposes an environment in the country concerned conducive to the functioning of an effective local capital market. Here the

main responsibility lies with the Government to foster such a market through appropriate institutional, legal and administrative policies. But development banks themselves can and should make an important contribution to this process. Furthermore, international development institutions should devote more time and attention to assisting Governments in this task.

It is indeed one of the prime economic functions of the Government of any developing country to stimulate the flow of domestic savings and to see that these are mobilized through appropriate institutional channels in order that they may be harnessed to the country's development needs. For such effort to be effective the Government must also pursue appropriate macro-financial policies including, in particular, the adjustment of interest rates to levels corresponding to market forces. Artificial ceilings on interest rates for example are likely to frustrate a development bank's efforts to find its own sources of local funds and to force its financing requirements back on the Government's already over-loaded budget.

But, as noted, development banks themselves should be part of the process of creating an active and responsive local capital market, and they should regard this as one of their high-priority functions. They can themselves promote portfolio sales to local investors, underwrite and distribute local security issues, offer their own paper with maturities and other features designed to elicit local support, and assist the Government in designing and creating local capital market institutions. And, at least in the case of privately-owned development companies, they can sell their own shares to a widening public, thus, among other things, obviating criticism that they are themselves too closely held.

In this connection a further prerequisite for achieving meaningful financial independence by a development bank, whether privately or publicly-owned, is its capacity to build up an adequate equity base to sustain its borrowing activities both at home and abroad. This means, among other things, that Governments and international development institutions must recognize the need for development banks to realize net earnings (after all appropriate provisions) in amounts adequate to sustain their operations. Here again artificial ceilings on lending rates and lending spreads may frustrate a development bank's sound evolution, especially at a time when such banks are often being pressed by Governments and international development institutions to take on new functions and responsibilities which, although entirely desirable and even necessary in terms of the promotion of sound economic and social development, do impose additional costs on the development bank's budgets.

So far as external financing is concerned, the stage is well set for increased access by development banks to the immense resources of the private international capital market. This remains very important in most developing countries because of the substantial foreign exchange component in investments financed by development banks.

The private international market already is supplying very substantial funds to developing countries. The circle of countries regarded as creditworthy by this market is gradually extending, and although lenders are increasingly seeking to "projectize" their operations rather than to disburse general purpose funds to borrowing Governments, their maturities have been lengthening to a point where they are well suited to the requirements of industrial investment. Investment by foreign investors in the form of lending to an active and enterprising development bank offers opportunities for establishing business contacts and brings collateral advantages.

From the point of view of the international development institutions such as the World Bank and the regional banks, there is, as suggested earlier, a severe problem of allocating resources to competing investment requirements in developing countries. There is therefore a natural tendency for them to concentrate increasingly on those sectors of investment that are less likely to command the confidence and support of private capital sources. They are at the same time - and quite properly so at this stage in the development process - seeking to re-direct their efforts into a more sharply focused attack upon the roots of poverty in the developing countries

and toward the satisfaction of basic human needs.

None of this means that the international development institutions should discontinue their lending operations in support of development banks that need such support. The international institutions still find that loans to these banks are among the most productive ones in their portfolios in terms of the stimulus that they give to economic and social development. Their long record of association with many of the leading development banks around the world provides a source of great pride and satisfaction.

The World Bank alone has provided assistance in the amount of some $6 billion to over 100 development banking institutions in some 73 countries, and indeed this activity has represented a very important segment of its entire operations. Nonetheless, new priorities are always in the making and the resources of these institutions are never unlimited. Hence, within the field of development banking itself, the international institutions are likely to concentrate increasingly on the promotion of new development banks, especially in countries which hitherto have still not been able to develop effective agencies of this kind, and toward helping more mature development banks to improve their access to the domestic and international capital markets.

The immediate responsibilty for this new drive in the direction of financial independence must lie with the development banks themselves. Indeed, many have already embarked upon such a course with gratifying results. This new dimension in their activities requires both top management involvement and the acquisition of new skills in fund-raising operations. None of this, of course, should be at the cost of maintaining the highest possible quality of lending operations, especially since it is the quality of a development bank's portfolio which will be the primary determinant of its own creditworthiness in the eyes of domestic and international investors.

It is hoped that the international development institutions will also actively take up this cause. They could lend it great support by making special efforts to assist Governments - indeed, to press Governments - to formulate positive programmes for the creation of active and efficient local capital markets, and to pursue macro-financial policies conducive to mobilization of local savings and their application to priority development purposes. They can also provide important assistance to development banks in their approach to the international capital markets; one of the most effective ways to accomplish this purpose, as has already been demonstrated on several occasions, is to arrange co-financing from private sources in conjunction with World Bank and regional bank lending to development banks.

B. Working Panels

Group I — Government/development bank relationships in semi-industrial developing countries

GOVERNMENT/DEVELOPMENT BANK RELATIONSHIPS IN SEMI-INDUSTRIAL DEVELOPING COUNTRIES

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Historically, the financing of industrial and economic development in Europe and North America has been a function of the growth of capital formation. It was assisted by the banking system and, consequently, not directly linked with government. This was probably due to the slower growth experienced by the countries involved in the Industrial Revolution and the minor role played by the public sector at that time. Even where the financing of major public works was involved, the role of government remained indirect.

The devastation of the Second World War and the resulting need for very large finances to restructure and rehabilitate damaged economies made it necessary to form new financial institutions, even in European countries. Their role was to provide finance for small-, medium- and large-scale industry, for regional and sectoral development, and for development for social purposes. This led to a development-oriented outlook requiring the more direct intervention of Governments. Imbalances in the distribution of development and wealth also necessitated specialized institutions backed by public funds to develop less advantaged areas.

In the early 1940s the need to reduce the gap between the standards of living of the developing countries in Africa, Asia and Latin America on one hand and those in Europe and North America on the other, brought about more conscious promotion of economic development by means of development financing institutions.

This move received unusual impetus from the establishment of the International Bank for Reconstruction and Development in 1945, from World Bank involvement in setting up such development financing institutions, and from its provision of much-needed specialized lines of credit. World Bank involvement also brought about closer involvement of Governments in both the formation and evolution of development financing institutions. This was due not only to the World Bank's need to be assured of Governments' support for the development process but also to the belief that the participation of Governments would strengthen the status and stability of fledgling development financing institutions.

The steady evolution of development banking since 1945 is evident in an analysis of 139 DFIs, which discloses that no less than 67 per cent have more than 50 per cent government ownership and that 46 per cent are entirely government-owned (see table).

The period 1945-1975 can be considered a period of establishment. Progressive evolution of development banking as a distinct profession is evidenced by the fact that 82 per cent of the development financing institutions were established after 1950, 41 per cent between 1961 and 1970, and 19 per cent after 1971 (see table). One question for the 1980s is whether the bulk of the development banking community has now reached a stage of maturity sufficient to presage a change of relationship with Governments.

PROFILE OF DEVELOPMENT FINANCE INSTITUTIONS

By government ownership

Percentage of government ownership	Number of DFIs	Percentage of total
0	23	17
1 - 10	5	4
11 - 20	-	-
21 - 30	4	3
31 - 40	4	3
41 - 50	9	6
51 - 60	9	6
61 - 70	3	2
71 - 80	5	4
81 - 90	1	1
91 - 99	10	7
100	64	46
Unknown	2	1
Total	139	100

By age

Year of establishment	Number of DFIs	Percentage of total
Before 1920	3	2
1920 - 1925	-	-
1926 - 1930	1	1
1931 - 1935	2	1
1936 - 1940	2	1
1941 - 1945	6	5
1946 - 1950	11	8
1951 - 1955	12	9
1956 - 1960	19	14
1961 - 1965	35	25
1966 - 1970	22	16
1971 - 1975	24	17
1976 - 1980	2	1
	139	100

Source: Financial Resources for Industrial Projects in Developing Countries (PI/61)

The main aspects of the relationships of DFIs with Governments for the period 1945 and 1975 may be summarized as follows:

(a) Government participation was required not only to provide needed capital but also to lend strength and stability and to impart status;

(b) The participation of Governments in the ownership, and sometimes management, of DFIs was justified on the grounds that they could ensure the proper development of such fledgling instruments of growth;

(c) Both formal agreements - sometimes engendered by the World Bank - and verbal understandings helped ensure government respect for the independence of DFIs, both public and private. Governments also recognized that DFIs could best fulfil their function when left free to operate with the least possible interference;

(d) The links between Governments and DFIs also assisted DFIs to fit their operating policies more accurately into the national economic development framework and gave them better access to the national planning process. This in turn enabled the more vigorous DFIs to play a part in the shaping of development policy;

(e) It had been argued that DFIs could not function in isolation and that, since their primary function was that of a catalyst for development, they could only profit from close linkages with Governments. Completely independent DFIs would quickly be isolated and rendered obsolete by government policies and such government participation and influence was considered a form of insurance. Nevertheless, even when the best intentions prevailed, the possibility of government influence remained a matter of concern for the development banking community. The fears were exacerbated by the tendency of some Governments to seek to increase their share holdings and thus pressurize the management of DFIs to influence the flow of lending towards enterprises that under normal criteria did not qualify;

(f) As a consequence, the prevailing view was that the mobilization of scarce resources towards productive and profitable economic development would not be successful unless the DFIs pursued a policy of vigorous independence despite their links with Governments. The difficulty lay in the fact that DFIs were hampered by dependence upon Governments for allocation of funds. As long as the DFIs depended on government fund allocation, the quality of their performance could therefore only be judged by the flexibility and independence of their decisions. In turn this was made possible by their outstanding professional expertise, integrity, initiative, sound judgement and respect by Governments. The objective in the short-term was to ensure that the management of DFIs would be as free from undue pressure as possible;

(g) It was thus widely regarded as quite proper for development financing institutions to minimize the dangers of government influence by:

(i) Adopting Charters with precise terms of reference that restricted the areas of government influence;

(ii) Adopting policies that insulated the declared functions of DFIs from the need to finance projects or become involved in areas of development that had political rather than economical implications;

(iii) Ensuring that, as far as possible, the bulk of the share capital of DFIs would be in private hands;

(iv) Insisting on government guarantees for investments that satisfied socio-economic rather than the normal economic criteria;

(v) Raising their own funds and thus gradually lessening the strength of the links between Governments and themselves.

In the 1980s it may be assumed that development banking will move rapidly into a more mature and competitive phase. This would be due not only to the longer experience of the DFIs themselves but also to the more rapid rate of development of the economies in which they operate and the emergence of competition from banks, merchant banks and other specialized financial intermediaries.

The rapid escalation in the cost of economic and industrial development in recent years and the continuation of this trend is bound to escalate the costs of future project and infrastructure development to such high figures that no single DFI will be able to marshal the capital required. The escalation in development costs will also require capital of longer duration and at more competitive rates. This may only be available in sufficient quantity in future when backed by government guarantees.

The provision of credit lines in foreign currencies also demands backing with government guarantees, and this trend itself will require the support of Governments.

The rapid development of the economies of the developing countries will itself engender imbalances in the distribution of development and wealth within national borders. Special arrangements will therefore have to be made between DFIs and Governments to provide capital for developing such lesser-developed and riskier areas. To be able to move into such new areas of financing, suitable sources of funding at below market rates would be required - and this would be unavailable without government support.

The flow of funds through the banking system of developing countries would thus increasingly require government intervention. If the linkages between Governments and the DFIs were to lessen, it may be doubtful that the DFIs would be able to procure sufficient funds at appropriate cost. In such an event, the future of development banking may be a move in the direction of reduced profitability and performance as the scarcity of capital and its higher cost push the development banks into the position of marginal lenders. They could become increasingly squeezed by operating in the capital market at high cost and having to offer narrower spreads on their interest rates in order to compete with other institutions.

One possible conclusion is therefore that the more complicated the nature of funding, the higher the costs of development, the greater the competition, and the newly developing ethos of spreading development more justly and equitably within developing countries as rapidly as possible will require that the linkage between Governments and development banks be increased during the 1980s. The alternative is that the tradition of development banking is progressively adulterated and lost as the development banks metamorphose into marginal financial lenders as a consequence of normal competition.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN SEMI-INDUSTRIAL DEVELOPING COUNTRIES

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Development agencies and economic development

Development banks made their appearance in most developing countries of Latin America in connection with industrialization objectives. They were regarded in particular as suitable instruments for creating conditions of sustained growth, thus raising standards of living.

The subsequent development of these institutions has enabled them to provide financial support for their countries' infrastructure and for the development and promotion of new enterprises to balance the industrial structure. The resulting combination of financial and production experience has given the development banks significant capacity for implementing industrial policy.

Economic development was seen, however, as an integrated process. Long-term objectives were set for the economic system and these institutions became directly responsible in their role as financial intermediaries. This accounts, in turn, for the growing state participation in the ownership or supervision of the development banks.

Such participation by the state naturally becomes more extensive in countries like Mexico with a mixed economy.

Mexico's Nacional Financiera, S.A. (NAFINSA) was founded in 1934 as a state bank designed to promote the economic development of the country. By 31 December 1978 total assets were valued at 191,464 million pesos. 1/ The country's largest financial institution, with only the Central Bank holding greater assets, Nacional Financiera is the Government's principal instrument for financing the economic infrastructure and promoting industrial development. It provides credit to industry and to the Government and its enterprises and organizations and guarantees loans, principally those contracted abroad. It buys industrial and government bonds and invests in industrial undertakings. It raises funds from the domestic market by issuing its own paper. It negotiates for and obtains financing from abroad on its own account and as financing agent for the Government.

To promote new industrial enterprises, it contributes risk capital and encourages participation by other sources of capital, and solicits technology for the enterprises. It participates in industrial planning of basic sectors of the economy, especially sectors with priority for economic policy, e.g. food and fertilizers, small-scale and medium-scale industry, capital goods, secondary petrochemicals and other basic industries. It takes on the task of co-ordinating the development of trusts, mainly in connection with the industrial and tourist sectors.

1/ With the exchange rate at $1 = 22.80 pesos, this amounts to about $8.4 billion.

In summary, as a financial intermediary, Nacional Financiera, S.A., fulfils two basic functions: as financing agent for the Government and as development bank for the country.

Role as financing agent for the Government

From the start, the role of financing agent for the public sector has been one of the institution's most important functions. In the past 45 years its activities have expanded at both national and international levels. At national level it acted as financing agent and as adviser for issuing, placing and other operations connected with public paper; it has sought to develop the private stock market, starting with mortgage bonds and later going on to support the purchase of shares in industrial enterprises; it has become a major support for public issues. Intervening when needed, it helps stabilize stock exchange quotations so as to attract a larger number of investors and savers. It helps the formation of companies by means of a special support fund and an instrument known as the Co-Investment Fund.

Since 1941 NAFINSA has obtained financing from abroad either in its position as financing agent of the Government or for its own development purposes. On 30 June 1978, credits contracted with the World Bank and the Inter-American Development Bank stood at some $5 billion.

It has been the institution's policy to diversify the sources of financing under conditions suitable to specific programmes or projects, assuming responsibility for the servicing of such financing and its use for productive purposes within the limits of the country's ability to pay.

Its credit operations therefore cover public, private, bilateral and multilateral bodies. In its search for appropriate mechanisms it has drawn up a plan of global lines of credit and introduced the use of parallel credits and the Co-Investment Funds system at the international level, making it possible to obtain resources from abroad at low rates. In the one case, it facilitated the transfer of technology; in another it organized participation of foreign capital in new undertakings which had to be set up in even more complex sectors, such as capital goods and the secondary petrochemical industry.

Mention should also be made of the activities of NAFINSA in international capital markets. At a time when only institutions from developed countries had access to those markets, NAFINSA succeeded in introducing itself - thanks to its serious approach and reputation for fulfilling its obligations. These gave it an image of solvency and trustworthiness which it still enjoys in international banking circles today.

The sophistication of international financial operations has reached a point where the usual practice is for loans to be obtained from banking syndicates grouping a number of creditors from various countries. The markets approached which included the Euromarket, the oil-producing countries, Japan and other dollar markets has led NAFINSA to set up branches in Washington, New York, Tokyo and London.

Role as a national development bank

There is no doubt that NAFINSA has been a powerful instrument supporting Mexico's national development policy. The broad diversity of uses for its funds and of the instruments used to raise them at home and abroad enables it both to support the Government's priority development areas, and at the same time to act as a development bank. The financial results have been positive - without any fiscal subsidies, except in the case of its trust funds.

Over these 45 years, the role assigned to the state as prime mover of the economy has changed. This is reflected consequently in the role assigned to the development bank, and a wide variety of instruments of economic policy that are utilized. However, in accordance with NAFINSA's charter, in

force since 3 January 1975, its traditional tasks have been added to. In addition to taking on the functions of a multiple bank and offering integrated banking services, the work of planning and promoting the country's industrial development is now one of the institution's prime duties.

In the light of its new charter, the institution can regard itself as the financial body responsible for the country's industrial planning and programming. To this end the institution has organized itself into five departments under deputy directors to carry out more specific functions:

(a) Industrial programming, promoting new enterprises and encouraging private sector participation in them;

(b) Obtaining resources for carrying out such programming;

(c) Channelling these resources into sectoral programmes, existing enterprises or new projects;

(d) Permanent and systematic managerial support and technical assistance for companies borrowing from or associated with NAFINSA; supervision of trust funds set up by the Government as support bodies for the function of industrial programming;

(e) Internal administration of the institution, involving the management of its human resources and the establishment of controls to ensure efficiency.

Current activities

The overall performance of the institution is illustrated by the following figures:

Currently NAFINSA investments in its group of affiliates amount to 14,056 million pesos ($9.62 billion). These enterprises have a total paid-up capital of 43,169 million pesos ($1.89 billion) and assets of 210,071 million pesos ($9.21 billion). They employ 115,628 persons and maintain a sales volume of 83,156 million pesos ($3.65 billion).

During the period December 1977 to December 1978, 38 (out of a total of 79) enterprises showed profits of 2,940 million pesos, producing a return of 10 per cent for the institution. Studies of the problem enterprises are being made to find ways of improving their operations and to determine how they should operate in order to be profitable. At present 43 enterprises have plans for projects and extensions aimed at a wide range of objectives; the combined investments required amount to 55,371 million pesos ($2.43 billion).

Relations with the Government

Formal co-ordination of the objectives of economic policy and the functions and tasks of the state development banking system is carried out at the highest level of the institution, the governing board. Those participating include the Ministry of Finance and Public Credit, the Ministry of Public Property and Industrial Development, the Ministry of Commerce and the Bank of Mexico (the country's central bank). Three representatives of the private sector, representing the interests of private bankers and industrialists, reflect the institution's status as a limited company in a mixed economy.

The economic policy of the present government stresses the goal of lowering the rate of inflation and unemployment. To that end an "alliance for production" has been formed between the public and private sectors. This alliance is reinforced by administrative and political reforms, the planning of urban and rural settlements (National Urban Development Plan), and sectoral plans in line with the country's Global Development Plan. The role of the institution in national economic activity is thus reflected in guidelines derived from the Global Development Plan, the Industrial Plan and the National Urban Development Plan; the functions assigned to the institution through its charter allow it, in fact, to adjust to the guidelines of these programming instruments.

NAFINSA, in co-operation with the Ministry of Public Property and Industrial Development and in accordance with the guidelines set by the Ministry of Finance and Public Credit, implements its programme of support for the industrial sector by providing resources to a very large number of enterprises and semi-state bodies while at the same time promoting strategic sectoral programmes. To that end the Ministry of Finance and Public Credit has announced that the national banking system will provide support in the form of loans for active programmes of structural change and promotion, particularly in relation to the fishing and farming sectors, small- and medium-scale industry, the manufacture of capital goods, exports, tourism, and agreements concluded with the alliance for production. NAFINSA's function of industrial promotion follows the guidelines laid down in the National Industrial Development Plan. It thus contributes to the objectives of the Plan in various ways: with its industrial programming work, by its participation in the National Industrial Development Commission, with its Integrated Support Programme for Small and Medium Scale Industry, through the Co-ordinating and Financial Evaluation Committee for the Development Programme for the Capital Goods Industry, and by a Programme for Direct Promotion in the Capital Goods Sector.

The challenge of the future

The strategy of the Government provides for three stages of development. Each consists of a two-year period, the first (1977-1978) being aimed at achieving internal price stability and a floating foreign exchange rate. The second period (1979-1980), the so-called consolidation period, aims at eliminating bottlenecks in the existing economic structure and in the area of financial resources, so as to consolidate the accelerating economic growth rate. The third period (1981-1982) is geared towards real development with an annual growth rate of at least 10 per cent from 1981 through to 1990.

For the institution, such explosive growth implies an important role in the direct creation of enterprises (especially in the capital gooods sector), greater channelling of resources through its development funds, and, extremely important, emphasis on industrial development programming. This includes participation by the country in financing and investment schemes in other Latin American countries, together with rational and coherent management of its traditional financing schemes using resources from abroad and transfer of technology (Co-Investment Funds).

This means that in the area of financing, the institution will have to provide for a reorientation of its traditional patterns of international financing, moving from a basically debtor orientation to the establishment of financing mechanisms that will allow Mexico's exchange surplus - stemming from petroleum exports - to be appropriately channelled.

Such financing schemes will have to be integrated in industrial programming policy, and the generation and expansion of projects and enterprises will be of even greater importance if projected growth rates of 13 per cent for the industrial sector are to be achieved.

Looking ahead, the institution, together with other teaching institutions, will have to make greater efforts, especially in the field of human resources, to train managerial staff for the enterprises to be formed and to introduce new management techniques in the public sector corporations. Only in this way will it be possible to achieve adequate levels of efficiency and profitability in public enterprises set up in the capital goods sector, the secondary petrochemical sector and other industrial sectors of national priority.

Currently the institution is carrying out a programme of immediate action in the capital goods sector. This involved investments of 22,000 million pesos in 1978 and 1979, the creation of some 23,000 new jobs and the replacement of 17,000 million pesos' worth of imports.

The success of the institution's direct promotion work is geared to the use of the instruments now at its disposal plus increasing transfer of technology and participation in the risk capital of new enterprises by foreign suppliers of technology. This will mean combined participation by the state, national investors and the foreign suppliers of technology in the priority industrial projects required for the development of the country. We are thus conscious that the targets planned for 1990 imply significant participation by the national and foreign private sector within the guidelines and framework of the National Industrial Development Plan.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN SEMI-INDUSTRIAL DEVELOPING COUNTRIES

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The need for a close relationship

In the initial phase of industrialization Governments promote numerous new projects - fertilizer and pesticide plants to increase agricultural productivity, cement plants for construction, electric power plants for industrial use, transportation facilities and communication networks etc. These new projects require huge amounts of borrowed capital - from abroad as well as from local resources.

The technical limitation in financing these projects and the financial supervision needed during their construction and operation make necessary a suitable financial institution, such as a development bank - even where foreign and domestic resources for the projects are mobilized entirely by the Government.

The distinction between Government-owned development banks and private DFIs set up to do this became clear as the industrial sector developed. Government-owned development banks are concerned mainly with large government projects: the private DFI is more involved with the relatively small private industrial sector even where there is no clear demarcation between the two.

The concept of a private DFI favoured mainly by the World Bank particularly proved its effectiveness in directing the financial assistance of the Bank to support the private industrial sector of developing countries.

As industrialization advances, the need for investment increases and with it the need to mobilize long-term domestic savings resources expected to become the main source of loanable funds for DFIs. While their financial strength and reputation for effective service remain high, private DFIs are thus beginning to find that external credit sources are becoming increasingly uncertain and access to domestic savings resources is limited.

The concept of the private DFI is an attempt to avoid excessive government interference: they can bypass direct government interference thus allowing them to deal more effectively with the private industrial sector. Because of this underlying principle, private DFIs have operated as independent institutions making their own decisions except when government guarantees are required for borrowing from external sources.

One problem with complete independence from government, of course, is the inability of some DFIs to mobilize sufficient domestic resources. This partly reflects high market interest rates. Because of inflation, these often range between 20 and 30 per cent per annum in developing countries, and the resulting high cost makes it difficult to finance long-term (6- to 10-year) investment projects. The gestation period for factory construction and machinery installation is often between 2 to 3 years, and by the time plant construction is completed, the cost of the plant, including interest, is 60 to 90 per cent higher than starting cost.

Development economists nevertheless insist that unrealistically low official interest rates should be adjusted upwards to reflect realistic market rates, thus making it possible to mobilize domestic financial resources for development projects. However, while accepting this rational concept of interest policy, the high cost of financing still creates many problems for industrial plant construction because of the long construction period. Until an industrial project starts operating, a long installation period has to be allowed for with an appropriately long grace period. In addition, there are high costs for working capital, but these might be acceptable if passed on to the consumer.

One possibility for mobilizing domestic resources through DFIs is for the margin between the cost of resources mobilized at the market rates of interest and the relatively acceptable rates of interest on a loan, to be subsidized by the Government at least during the plant construction period. The experience of semi-industrialized countries indicates therefore that partial rather than total government assistance in savings resource mobilization by subsidizing interest costs might be the best solution for DFIs. It would also minimize government interference.

The idea of self-reliance and autonomy with no assistance from the Government should therefore be examined in the light of the relationship between the Government and the DFI. DFIs should weigh the cost of interference and the benefits to be derived from close relationships with the Government - for example accepting linkages through ownership, resource allocation, some forms of subsidy and tax concessions.

Problems of relationships and co-operation

Any link between the Government and development banks can be interpreted as one-sided interference by the Government. And certainly, if the link is ownership, government control of the development bank and the DFI can be tight.

One reason is that during the initial phase of industrialization, development banks and DFIs are often perceived by Governments as reluctant participants in the national economic development effort. On one hand they are regarded as conforming only under pressure to government directives. On the other, these directives ignore the fact that the habit of obedience often leads to institutional inertia with initiative, innovative ability and, professionalism being lost altogether when interference is strong. DFIs effectiveness can thus be impaired when the Governments intervene to the extent that their autonomy, professionalism and objectivity in decision-making are removed or thwarted.

Notable pressure can also result from an ownership link - for example where the Government appoints directors to the board of the DFI or appoints the president of the institution. However, if directors coming from the Government retire from office on their appointment, they become private directors acting in the own institution's interests even though their watch-dog status remains. And if the president is chosen from among professional banking institutions and has experience in finance, the DFI would be even more likely to be a sound organization, even if the institution is partially or fully owned by the Government.

But even when such DFIs are effectively managed as private enterprises, conflicts can still arise, since private enterprise is profit oriented while public interest is considered to be the objective of government policy. If DFIs consider they have been established as instruments for long-term investment for national economic development, managerial effectiveness could to some extent be subordinated to the public interest. But if pressures are brought to bear that affect individual investments without an open Government-board decision, they might cause misallocation of resources or even failures of projects. Such interference usually does not stem from Government-board

decisions but from individuals in positions of power. Bringing pressures to a DFI over recruitment or the promotion of individual staff members is one type of action that can destroy professionalism. Were it owned by the Government, the development bank might also come under pressure to conform to government salary scales, which are usually low compared to those in private business. This problem is serious for holding staff losses to a minimum and attracting new people. One solution is for the Government to permit higher salaries for DFI and Government-owned development bank staffs than for civil servants.

Too much stress laid on public interest aspects of a DFI's lending policy can cause loss of income, and that in turn causes problems in raising further capital. Even where Government-owned development banks are non-profit institutions, a deficit could affect their reputation and reduce their creditworthiness at home and abroad. Even if private shareholders in DFIs voluntarily limit direct return to a modest level, they must earn some profit.

It is accepted that adhering to profit standards alone makes it impossible to achieve national economic development goals. But at the same time, if profit potential is not taken into account in financing development projects, it might also interfere with the policy goal of overall industrial development. Joint efforts and consultation between the DFI and the Government when financing important projects can thus be decisive factors in the success of individual development projects.

The expectations of the Government and the DFI often differ greatly nevertheless. While the Government has long-term policy goals in mind when appraising investment projects, the DFI is more interested in the immediate prospects. Some Governments try to promote projects which would be ineffective for some years but promise to be ultimately successful - whereas the DFI's management may be aiming at early returns on its investment. Projects can even fail because - despite government pressure to carry them to completion - they may be premature for the stage of the economy.

To minimize such possible conflicts between Governments and DFIs it might be suggested that large public sector projects are carried out, through a Government-owned development bank with heavily subsidized resources - leaving private sector projects to operate through privately owned DFIs.

Such a two-tier system for development financing would have the merit of easing tension that might build up between the two. According to the experience of semi-industrialized countries, government financial interference in the public and the private sector can make them both ineffective. Dispersal of scarce resources among too many individual projects can cause inefficiency, for example. At an advanced stage of industrialization, the Government would be wise to act more as an overall guide rather than issuing directives on individual projects. In this way the development banks and private DFIs would have more leeway in selecting the individual projects. They would still qualify for development financing in compliance with government policy for project diversification, which would then lead to industrial diversification.

In such circumstances, the relationship between Governments and development institutions in semi-industrialized countries could become co-operative rather than interfering.

SUMMARY OF DISCUSSION

During the discussion, a representative from the Philippines discounted the fears voiced by previous speakers on the consequences of development banks' dependence on government for its funding needs. Quoting from the experience of the Development Bank of the Philippines (DBP), he asserted that his institution had to follow nationally accepted priorities and objectives of development. Thus, DBP activities were geared to objectives such as creating employment acceleration of economic growth, more equitable distribution of wealth and income, and regional industrial development. DBP had also been actively involved in promotion of regional and rural development banks.

While his bank did not face any problems of government interference he wondered if any development bank could afford to insulate itself from linkages with its Government. The real issue was to define how best the backstopping role of the Government could be blended with the catalytic role of the development bank in achieving mutually shared objectives.

Looking ahead, the working panel felt that the institution of development banking was at the crossroads. Developing countries were becoming more industrialized and their economies more diversified. But if development banks sought to move away from government support as a result, they might have to diversify into areas of activities that would bring them into competition with other financial institutions. In this, reference was made to the example o the Development Bank of Singapore. While some development banks might be able to pursue such a policy successfully, the danger was that those institutions would alienate themselves from the mainstream of developmental activities and hence forfeit their claims as developmental institutions. The other path for the operation of development banks was to come to terms with the Governments.

It was observed that though in the past the linkages between development banks and Governments arose out of funding support - including guarantees for foreign loans - in the 1980s the nexus of interaction was bound to be deeper and diversified. The development banks, whether privately owned or Government-owned, had to work in close co-ordination and co-operation with the Government to achieve socially accepted economic objectives.

It was questioned if the discussions concerning the differentiation between the privately-owned and Government-owned development banks were not wrongly directed. The more important point seemed to be the objectivity of decision-making and the capacity of management to stand up to pressures running counter to its considered operational decisions.

Questions concerning the relationship between Governments and development banks need not be posed in the context of perpetual confrontation. They should be conceived rather in a framework of positive co-operation with each party being conceded the right to its own convictions.

It was stressed that a development banking institution should be considered essentially as a gap filler. It should perceive institutional or other gaps in the economy impeding industrial development and take over that function so that it could effectively fill the gap. For example, the Singapore Development Bank (SDB), identified and sought to fill up gaps by undertaking commercial banking, merchant banking and issue-house operations in competition with the existing commercial banking institutions - mostly foreign owned. This was the only way SDB could achieve its developmental obligations of attracting overseas entrepreneurs, foreign technology and

management know-how and developing indigenous small-scale enterprises. What was important to realize was that there was no divergence between government policy and SDB activities.

There was no unanimity among delegates regarding the exact definition of a development banking institution. Some believed that privately-owned development banks did not merit the title because they were conservative in taking risks and their motive was maximizing their returns. They disagreed with the analysis of B. Knapp (former World Bank official) that in the 1980s development banks might have to be increasingly independent of Governments regarding their resources if they were to maintain their operational autonomy. Many observed that development banking institutions might well have to depend increasingly on Governments in one way or the other, and that so long as those institutions kept their developmental obligations to the country in view, the linkages with the Government would grow, and rightly so.

The discussions revealed that in the 1980s the interface between development banks and governments will be diversified and that the distinction between privately-owned and government-owned development banks would tend to be increasingly blurred, at least operationally.

Group 2 — Government/development bank relationships in less industrialized countries

GOVERNMENT/DEVELOPMENT BANK RELATIONSHIPS IN LESS INDUSTRIALIZED COUNTRIES

G. F. Mbowe, *Chairman and Managing Director*
Tanzania Investment Bank, United Republic of Tanzania

Origins of development banks

The genesis and growth of DFIs together with their government links in less industrialized countries can be historically traced from the Latin American countries. A few were established during the depression of the 1930s and during the Second World War when these countries were hard hit by deteriorating prices of their primary goods exports, shortages of consumer goods, lack of foreign private capital for new industrial ventures and inadequacy of foreign exchange to promote domestic private investment.

These economic hardships compelled the Governments of Latin American countries to pursue a policy of aggressive industrialization through import-substitution. The promotion of this policy was implemented parallel with the establishment of industrial DFIs which channelled funds to the private industry. The period, therefore, witnessed the birth of the Nacional Financiera in Mexico which started business in 1934; Corporación de Fomento de la Producción, Chile, in 1939; Instituto de Fomento Industrial, Colombia, in 1940; Banco Industrial de la República, Argentina, in 1943, and Corporación Venezolone de Fomento, Venezuela in 1946.1/

The emergence of DFIs and their growth in African and Asian countries in the period 1950 to 1975 was associated with the political independence of those countries. Their DFIs wre established on social, political and economic grounds, and the principal factors motivating the Governments to create them focused on the need for sound financial infrastructures for mobilizing domestic and external resources for accelerated industrial development. The establishment of the DFIs in the Middle East in the same period was connected with the exploitation of natural resources there.

In the United Republic of Tanzania, the establishment of the major DFIs followed a rationalization policy for the public sector after the 1967 Arusha Declaration defining the country's economic objectives. The importance of the Tanzanian Government's action in directing the activities of the economy followed a systematic establishment of the direct productive sectoral parastatals, on the one hand, and specialized sectoral financial institutions, including service-oriented parastatals, on the other.

1/ Bureau of Business and Economics Research, Public External Financing of Development Banks in Developing Countries (Oregon, University of Oregon, 1966), pp. 6-23.

In all these cases, the decisive intervention by the Governments signified the need for links between these DFIs and their respective Governments.

The motivation for creating the DFIs stemmed from certain unfavourable circumstances prevailing in these countries. These were:

(a) The absence of private markets for raising equity and long-term loan capital;

(b) The unwillingness of existing commercial banks, which were oriented towards trade financing, to provide even short- and medium-term loans to any but well-established foreign and domestic firms;

(c) The relatively low rate of profits in relation to risk in the field of industrial investments compared to alternative uses of financial capital such as construction, land speculation, trade and loans for consumptive purposes;

(d) An unfavourable climate for foreign investments;

(e) Limited markets and high production cost as a consequence of a shortage of skilled labour, technicians and managerial competence;

(f) The need for pre-investment surveys and adequate assessment of industrial ventures;

(g) For at least some countries, the inability to obtain foreign exchange for imports of industrial equipment and materials.2/

A quick glance at the design and framework of DFIs in varying environments such as fully socialist, centrally planned, indicatively planned and market economies indicate that their rationale and role do not differ significantly. Their common characteristics are summarized under the following headings.

The catalytic function

In order to enhance their harmonious development, most developing countries have formulated development plans with objectives such as:

Accelerated industrial development

Increased value of agricultural production

Creation of new employment opportunities

Assistance in promoting public enterprises

Help for private and social interest institutions in promotional activities

The basic function of DFIs, therefore, is to act as a catalyst in promoting these objectives through the facilities of financial assistance for specific projects and also to render technical advice in carrying out feasibility studies and project implementation. Where Governments are the prime movers, the DFIs are obliged to work hand in hand with them to promote these objectives.

Technical assistance

Of vital importance to industrialization is the DFI's contribution in terms of technical assistance. As specialists in resource mobilization, resource management, resource allocation, project appraisal and project supervision, public and private DFIs are constantly expected to render technical assistance to Government-sponsored projects. The extent of this contribution depends on how close working relationship is between the Governments and their respective DFIs.

2/ Bureau of Business and Economic Research, op.cit.

Resource mobilization

The basic reason for setting up DFIs is not to act only as custodians of exchequer funds or channels for official development grants and credits, but to act as mobilizers of domestic and foreign resources needed in economic development. The importance of this function makes close links with the respective Governments inevitable since Governments determine the extent, pattern and timing of resource mobilization.

Economic development

The motivation for establishing DFIs is to promote social and economic development - not necessarily profit maximization. With regard to public DFIs, this objective is normally stipulated in the statutes. Their lending activities must therefore be aligned to national objectives. Nevertheless, this does not mean wholesale involvement even in the promotion of projects of purely social character, such as the construction of football stadiums. DFIs, whatever the nature of their ownership, are not - and should not become - mere administrative conduits for lending, but rather institutions capable of using capital effectively in achieving their Governments' development objectives.

Strategic function

Industrial self-reliance is very often associated with promotion of certain strategic industries such as iron and steel, pulp and paper and fertilizers. These activities normally involve an outlay of enormous resources. Nevertheless, DFIs are expected to give preferential assistance to such activities of national priority and strategic importance. Again, this function calls for close working relationships with the Government.

Regional co-operation

Regional industrial co-operation, promotion of multinational industries, joint technological research activities, joint financing of regional strategic industries and the like, are some of the issues that are facing developing countries. Both national and regional DFIs are expected to shoulder this responsibility together with their respective Governments.

Commercial function

Most of the DFIs in the less industrialized countries have been established or promoted as a means of channeling exchequer funds and private domestic savings into industry. In order to attract external capital for industrialization, DFIs have to be creditworthy and operate on a sound commercial basis. As commercial entities, they are expected to operate profitably, pay corporation tax and declare dividends to their Governments and other shareholders, as well as borrow from overseas. In most cases, foreign loans are guaranteed by Governments, but it follows that DFIs should also be capable of meeting the foreign obligations from their operations without ever having to invoke the guarantee provision.

Transfer of technology

Many of the tasks of industrialization are probably beyond the ability of the DFIs to tackle. Nevertheless, these institutions play a significant role in assisting Governments in providing some of the answers. The issue of transfer of technology therefore concerns DFIs also.

Many DFIs have established technology departments solely charged with providing advice to clients on appropriate technologies. Because of the national interest in technology issues, Governments have worked closely with DFIs to expand the facilities and research programmes for these technology wings.

By definition, the basic functions of DFIs discussed above cover areas of essential interest to Governments in their efforts to promote growth and development. Especially in the less industrialized countries with a scarcity of institutions, training and education facilities, entrepreneurial talent and low living standards, Governments have of necessity assumed active participatory roles in the development process, and particularly in the industrial sector.

International co-operation

The foregoing is, however, only one side of the complex story of the Government-DFI relationship. There are other indirect forms and natures of co-operation which involve international and bilateral institutions.

The current availability of resources of DFIs can be classified into three categories: local capital, external capital and technical assistance.

Governments of less industrialized countries receive substantial development assistance for industrial and other types of activities from international institutions such as the World Bank, United Nations Development Programme (UNDP), Economic Commission for Africa (ECA), Asian Development Bank (ADB), European Investment Bank (EIB), European Development Fund (EDF) etc. Enterprises seeking financial assistance from these organizations must, therefore, have links and co-operation with their own Governments. By virtue of this basic requirement, DFIs must have working relationships with their respective governments. This is a prerequisite for financial and technical assistance from the international organizations. Loans to DFIs from the World Bank and the European Investment Bank, for example, require guarantees from their Governments. Technical assistance from UNIDO to DFIs is normally processed through ministries of finance, planning and manpower development. Recognizing the need for channelling some of this assistance directly to the DFIs from these international organizations, Governments have, on a number of occasions, been closely involved in the discussions concerning the national development schemes, particularly in the less industrialized countries where these institutions intend participating and assisting in investment programmes in the industrial, agricultural and basic infrastructure sectors.

Bilateral co-operation

Bilateral financial and technical assistance to the less industrialized countries is also another focus of co-operation between Governments and DFIs. The major sources of bilateral assistance to these countries are the United States Agency for International Development (USAID), Swedish International Development Authority (SIDA), Norwegian Agency for International Development (NORAD), Canadian International Development Agency (CIDA), Danish International Development Agency (DANIDA), Financial Management Office (FMO) of the Netherlands and Deutsche Entwicklungsgesellschaft (DEG) of the Federal Republic of Germany, to mention only a few. These institutions provide

very substantial assistance to countries like the United Republic of Tanzania for specific productive sectors. Their assistance to industry, agriculture and forestry has invariably been routed through the Governments to the financial institutions for allocation and disbursement to projects. The routing of these funds through DFIs makes it essential that there be strong co-operation between Governments and DFIs.

One key attribute for efficient operation of DFIs is an ability to act as a link between the productive public sector, the private sector, the Government and the donor institutions. Through this process of co-operation, DFIs are able to assist their Governments not only in vetting projects, but also in stimulating new approaches to development.

The interlinkages of DFIs

In the light of both this broad perspective and DFIs' role in development strategy, it is important to stress that DFIs must serve the macro-economic objectives of their governments. They need close relationships with their Governments both because of their historical links and the purposes for which they were created.

It is precisely because of this close relationship that Governments provide DFIs with substantial assistance: exchequer, bilateral and international funds, and multilateral and bilateral technical assistance. As channels of official aid to direct productive activities, DFIs are frequently invited by Governments to participate in discussions with bilateral and multilateral development agencies. Sometimes they are called upon to suggest areas deserving financial assistance or to give their opinion on certain projects.

Because of their specialized functions and expertise developed over the years, DFIs often are the first focal point in the process of economic and technical evaluations undertaken by international and bilateral organizations. Such consultations assist in assessing the content and volume of aid to the less industrialized countries. Their intimate relationship with Governments can, therefore, be very influential in the evaluations made by these international and bilateral institutions. The technical information that international organizations are keen to obtain includes policies on various problems, levels of industrial activity, industrial data, national priority of industrial projects, the bankability of projects in the pipeline, and the health of both the business sector and the economy in general.

Organization and institutional arrangements

For a number of reasons one cannot expect uniform legal forms and managerial structures common to all DFIs. For example, the legal and managerial structure should be directly related to the local environment in which a DFI operates. At the same time, it is generally accepted that the legal and managerial framework of a DFI should be flexible enough to give it sufficient autonomy to discharge its responsibility with the highest possible degree of efficiency.

The acts establishing DFIs should be as comprehensive as possible. They should cover their objectives, appointment of top executives, the board of directors and their detailed responsibilities; capital structure; accounting and auditing requirements; investment and financial policies and any other matters relating to their links with government resource contributions, the administration of special funds, raising of external resources, and guarantees of loans.

For supervising DFI activities, there can be four levels of control: ministerial, board, external auditing and parliamentary committee. Although this arrangement should be encouraged, in practice there is a need to define clearly the objectives of DFIs and to develop tactical systems of control and co-ordination without stifling their operations.

Conclusion

One of the most important considerations in broadening co-operation between the Governments and DFIs is a better understanding of the Governments' practices, their expectations and their influence on the working environment of the DFIs. This influence is pervasive and no institution can claim to be insulated from it. In other words, there is no such thing as sovereign immunity of a DFI. The extent of influence varies from country to country, and it is the quality of management of a DFI that determines whether the DFI is a robust instrument of government development strategy or a weak handmaiden of political whims.

In view of the identity of intentions and objectives, particularly of the public DFIs and Governments, there is hardly room for conflict. Fears are sometimes expressed that too much government influence can impair the business efficiency of DFIs. The advocates of this fear suggest that while DFIs should maintain some links with the Governments, they advise that DFIs should keep themselves at arms's length lest their business ethics are submerged in the government bureaucracy and political expediencies. The extent to which government influence can cripple the efforts and efficiency of DFIs depends very largely, however, on the degree of co-operation and extent of linkages between the DFIs and the government ministries and how well they are maintained.

Governments do not have a monopoly of all good ideas, nor are they impermeable to rational arguments originating from DFIs. Persuasion and logic are basic tools in dealing with Governments. On sensitive issues with broader national significance, such as determination of interest rates, the views of the Government often prevail. This is an area in which figures speak louder than words. A simple quantitative analysis is likely to be more convincing to the Government than a theoretical argument in abstract. Interest-rate questions are vital - they determine whether and how a DFI can mobilize resources, the risks to which it exposes itself and the level of administrative costs it can beat.

The areas in which DFIs can promote smooth working relationships with Governments are several. Their advice could be in areas of management of foreign exchange risks, transfer of technology, interest-rate policy, investment priorities, incentive schemes, and several others. Where there is a harmonious working reltionship, it is uncommon for the Government to meddle in the affairs of the DFIs. Apart from information which the Governments can obtain directly, information on the performance of DFIs comes also through the government representation on the board of directors.

Co-operation between DFIs on the one hand and the Government on the other hand is vital and should be cultivated. A collective approach by DFIs on matters of national importance can have a better impact on the Governments than individual efforts. In particular, what is recommended is a union of DFIs in each country to meet regularly with officials from the Government to review aspects of policy affecting their general performance and the well-being of their clients.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN LESS INDUSTRIALIZED COUNTRIES

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National Investment Bank, Ghana

With attainment of independence by many developing countries after the Second World War, the need to accelerate the process of economic development became more prominent and pressing. Emphasis was placed on industrialization as a means of achieving faster economic growth. However, the necessary ingredients of development were absent: capital, information on investment opportunities, and local entrepreneurs with the requisite managerial and technical skills for industry and agriculture. These lacks inhibited private initiative in new areas of economic activity that appeared risky and required medium- and long-term capital.

The commercial banking system with only short-term funds to offer concentrates on giving support to the trading sector, which appears to be a highly profitable and relatively safe investment. But with the commercial banks concentrating on trading, there was a growing need for specialized institutions to identify investment opportunities, appraise projects, and mobilize local and external finance and management to implement the projects. Thus the establishment of development banks was seen by Governments as an instrument to support their newly-won political sovereignty through mobilizing medium- and long-term capital, transfer of technology and management skills.

In many developing countries the private sector has not taken the initiative in creating development banks because there were other highly profitable investment opportunities with relatively short gestation periods. Governments have therefore had to be actively involved in setting up such institutions. Development banks have therefore tended to be wholly Government-owned - at best with minority private participation.

Governments did not merely initiate the establishment of development banks, but also financed them with equity and long-term loans at concessionary rates of interest. Guarantees, where necessary, were provided to enable them to raise additional capital from both local and external sources. Governmental financial support to a certain extent thus determined the important role that development banks were to play in the economic development process of a less developed country. For this reason, the factors that led to the creation of development banks and the role of Governments in getting them established usually determines the relationship of Governments and development banks. The closer the link to the Government through ownership and management, the greater the likelihood of government influence on the activities of development banks. There are nevertheless wide variations in such relationships.

Where the institution has some private participation, a Government may limit itself to the appointment of the chief executive and one or two directors to serve on the board. Management is then relatively free to exercise control within the broad framework of government economic development policies. In such circumstances, the degree of government interference depends largely on the competence of management and quality of the board.

However, if a development bank is made an extension of a government department or ministry, as in the pre-independence industrial development countries, government directives may be frequent and specific. Here management may be exposed to direct political interference and even appointments may change with a change of government.

Whatever form development banks take, they cannot operate in isolation and they require government support and encouragement to function effectively. Over the years, development banks have evolved special working relationships with Governments towards achieving the objectives for which they were set up. The relationship is institutional and is reflected through exchange of information and consultation on various development policy issues. Since the relationship is mutual, management staff of development banks are often appointed to serve on inter-ministerial and national economic committees. Through this, development banks participate in the policy-making process of the Government.

Where there is a healthy institutional relationship, Governments are co-operative in solving the operational problems of their development banking institutions.

Conversely, due to the strict methodology development banks exercise in handling projects, they earn the Government's confidence and reciprocate by making their services readily available to the Government. As a result of this working relationship, development banks are looked to for advice on various investment proposals submitted to the Government. Thus, in the less industrialized countries, although development banks may be susceptible to government action and control, the control can be reduced, but not eliminated entirely.

In summary, the extent to which development banks maintain a healthy institutional relationship with the Government and the confidence the Government has in the management of the bank determine the degree of the bank's control.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN LESS INDUSTRIALIZED COUNTRIES

G. Raynor, *General Manager*

Investment and Development Bank of Malawi Ltd.

Between the Malawi Government (through its Treasury, Reserve Bank, and Ministry of Trade, Industry and Tourism) and the Investment and Development Bank of Malawi, known more popularly as Indebank, there is what might be described as a model relationship.

Indebank is the only development bank operating in Malawi, and this possibly is a significant factor in the development of a harmonious relationship. Indebank commenced operations on 1 January 1973 as a partnership between a Malawi statutory corporation, the Agricultural Development and Marketing Corporation, and three well-known international institutional development organizations, the British Commonwealth Development Corporation (CDC), the Netherlands Financial Management Office (FMO) and the Deutsche Entwicklungsgesellschaft (DEG) of the Federal Republic of Germany. In 1978, the original sponsors of Indebank were joined as equity shareholders by the International Finance Corporation. Indebank is also supported by lines of credit made available by DCD, the European Investment Bank (EIB) and the World Bank, the latter two lines of credit being guaranteed by the Malawi Government. Available resources total $27 million, projects total 44 in number and commitments $19 million. Since inception the bank has been modestly profitable.

Indebank is registered in Malawi as a private company and under its Articles of Association each partner may appoint two directors to the board. This provides the Malawi partner with two directors, one of whom is the non-executive chairman of the company. The relationship between Indebank and the Malawi Government is, however, formally regulated by a finance and co-operation agreement between the Government, the sponsors and the company, signed shortly before the Bank commenced operations. Apart from the usual undertakings to provide exchange-control consents to facilitate the remittance of funds, payments of dividends etc., the most important aspects of the agreement are its investment policy principles and operating procedures, which may not be changed without the written agreement of each of the five shareholders. Inter alia, these principles define:

Investment sectors of primary emphasis for further economic development of Malawi

Project Clearance in Principle procedure

Criteria to be met by all applications for Indebank participation

General terms and conditions on which Indebank will consider investing in projects

The most important single factor controlling the investment portfolio of Indebank, however, is the Clearance in Principle procedure. Under this procedure, an outline summary of the project proposals, with management's confirmation that they are within the investment policy principles, is circulated to the directors before a project is investigated in depth. Within 30 days the directors must indicate their agreement or otherwise to a full investigation of the project; the veto of one director will prohibit

detailed investigation until the matter has been discussed at the next board meeting. This situation has never arisen but it is doubtful if the board would authorize management to proceed with a project investigation against the wishes of one of the sponsors.

It can be seen from these procedures that the Malawi Government, or in fact any sponsor through its directors on the board of Indebank, can stop further investigation of a project it does not consider desirable. In practice, since the inauguration of Indebank no veto has ever been imposed by any director under the Clearance in Principle procedure. Only on one occasion has a project been rejected on advice of the Government - on grounds which were later discovered to be related to currency infringement proceedings pending against the project sponsor, of which Indebank was, of course, unaware at the time.

In practice, the Malawi Government relies entirely on the judgement of the Chairman of the company to decide whether projects are in support of its economic strategy. If in doubt, the Chairman has direct access to the Minister of Finance for guidance. The Chairman is also supported by an experienced development-oriented board, with strong representation from the international development organizations that support Indebank.

Since inauguration, there have been only minor changes in operating principles, mainly in connection with increase of investment limits. Agreed investment principles notwithstanding, it could be possible for a Government to bring pressure, either directly or indirectly, to persuade its development institutions to support its policy by investing in those projects which it considers to be in the interests of the country. In Malawi no such pressures exist, or if they do, they have been so subtle as not to have been noticed by management. The relationship between the Government and Indebank, although formally documented, in practice is one based on mutual trust and understanding.

Indebank recognized its role in the promotion of commercially viable medium-scale development projects and co-operates closely with the Government and statutory corporations in order to identify projects suitable for development bank finance. There are of course large projects like sugar schemes, cement and fertilizer plants etc. While accepting the limitation of the contribution that can be made by a development bank oriented towards financing medium-scale agricultural and industrial projects, the Government welcomes Indebank's co-operation in the promotion of these projects. Where major projects are beyond its scope, there is an understanding that Indebank will concentrate on identifying, promoting and financing the peripheral service projects that inevitably emerge.

The co-operation between the Government and Indebank in project participation is a two-way business and there are many instances where Indebank has been able to fill finance gaps in projects it is promoting by approaching statutory corporations for their participation. The co-operation has been of particular value in projects with economic and social consequences, for which the goodwill of the Government was essential.

The Government's reliance on the common sense, practical policies of the board has continued, even though in the last two years the Government has guaranteed lines of credit from EIB and the World Bank and there is no direct government representation on the Indebank board. The relationship with the Reserve Bank of Malawi is again one of mutual respect and understanding. Indebank is not registered as a bank in Malawi and therefore is not required to comply with banking restrictions, including the usual deposit restrictions placed on commercial banks.

The role of the Malawi Government has been protective and understanding. As a consequence, no projects have failed and because of this the response of Indebank's sponsors has been equally co-operative. Funds from the sponsors have always been available to meet the Bank's investment requirements, in particular for its agricultural investments - a sector for which it is notoriously difficult to find medium-term international finance.

In summary, the main factors contributing to an ideal relationship are as follows:

(a) Initial detailed and comprehensive discussions between all parties leading to full agreement on the investment principles and operating procedures of the board;

(b) Clear, concise legal documentation setting out the obligations of the Government, sponsors and company to each other;

(c) Precise and careful implementation of the agreed policies and operational procedures by the board through management;

(d) Freedom of the development bank to choose viable commercial projects in the economic interest of the country and for which finance is most suitable;

(e) Interest on the part of the development bank in implementing government policy.

SUMMARY OF DISCUSSION

In discussing the relationships between development banks and Governments, a staff member of the World Bank, speaking from his personal experience of DFIs from the African continent, confirmed the "symbiotic relationship". He was wary of prophesying the direction the future relationship might take in different countries, given the wide range of economic and social situations in these countries and the diversity underlying the DFIs themselves. However, he thought that there was need for greater co-operation between Governments and DFIs regarding identification, preparation and implementation of viable projects of all sizes and of relevance to the economy of the country. Development banks in the 1980s would be called upon to diversify their activities; they might be called upon to engage, to a greater extent than today, in project identification and development of feasibility studies and to specialize in financing specific sectors, which had been neglected until then. In that process, the World Bank realized that the contact points of DFIs within the Government were likely to enlarge and might include, in addition to ministries of finance, industry and planning, those concerned with public works, construction and education.

Participants observed that the nature of the relationship between the DFI and the Government was determined by the structure of the economy concerned. In particular, the relationship was likely to vary depending on whether the economy was a centrally planned one, a mixed one or a market-oriented one. Also, the relationship was different depending on whether the DFI concerned was substantially privately owned, or entirely Government-owned. A third factor was the composition and structure of management of the DFI. Government-DFI linkages needed to be understood against the background of those factors.

The economic and statistical adviser to the Industrial Finance Corporation of India observed that development banks, being only one of several instruments engaged in industrial development, could not be expected to perform the whole range of activities involved in fostering industrial development in a country. It was therefore important to divide the functions among different institutions engaged in the common task of industrial development and assess the performance of development banks against the framework of the tasks expected of them.

It was concluded that most industrial development finance institutions had in fact established excellent relations with their Governments, whether they were federal or central Governments, irrespective of the specific functions within the economy or the ownership of the banks' capital.

Group 3 — Government/development bank relationships in centrally planned economies

GOVERNMENT/DEVELOPMENT BANK RELATIONSHIPS IN CENTRALLY PLANNED ECONOMIES

M. Radosavljevic, *President*

Yugoslav Investment Bank

Investment planning and financing in Yugoslavia have been influenced by institutional changes and the development of productive resources. The system evolved effectively in three phases - periods of central economic planning, global proportions planning and self-management planning.

Central economic planning

The first period started immediately after the liberation of the country and lasted till the end of 1950. The planning and financing system in general, and investment planning and financing system in particular, were characterized by central decision-making and physical allocation of production factors according to centrally established priorities. An investment plan was subsequently implemented in the form of centrally decided programmes based on priorities set for constructing the necessary facilities. These programmes took the form of lists of key projects with basic data such as type, size and industrial value of the project, breakdown of capital investments, length of construction period, time needed for start-up etc.

The national economy being devastated by war, the urgent need for fast development of productive resources called for strict control over the means of finance and their allocation to investment projects defined in the Government's overall social plan.

In this period, investments in the entire territory of Yugoslavia were financed from the budget, without any obligation for repayment. The Government's planning authorities decided on the necessary funds and sources. Their utilization and control over their correct and meaningful application were entrusted to the only development bank in Yugoslavia at that time - the Yugoslav Investment Bank. Thus, the operation of the development bank depended directly on the Government's planning and budgetary authorities.

Global proportions planning

In the period beginning in 1950 a process of self-management was initiated in enterprises and in some areas of public services. It called for the introduction of a new economic system whose main feature was to narrow the central planning domain, and to give larger decision-making powers to enterprises and communes.

Further new incentives were legislated in the mid-1950's when a number of large industrial projects were put into operation. Following liquidation of the state-controlled economy and the take-over of management in enterprises by workers, new investment finanancing measures, applied over the period lasting till 1960, were as follows:

(a) A long-term financing system comprising investment funds set up at different levels, i.e. at Federal Republic level and at that of other socio-political organizations;

(b) Introduction of a lending mechanism - long-term credits replaced budget financing, and introduced the idea of credit repayment with accrued interest;

(c) Introduction of economic criteria for selecting investment projects (e.g. profitability).

The role of the development bank in this period was more active since it operated more independently than previously. For development of individual branches of the economy, the system of global proportions required overall quantifications, but avoided the need to specify individual projects and their locations. Resources to meet the requirements - globally defined in the plan over a given period of time (for instance, 1 million tons of steel, 100 thousand tons of aluminium, 50 thousand cars etc.) - were provided from special investment funds formed for the purpose. The bank's role was to select within the globally determined capacities, the most eligible projects for financing, up to the limits of available resources. Project selection was made on the basis of public bidding by Yugoslav enterprises applying established economic criteria.

In this way, the bank was given an exclusive right to choose eligible projects and to enter into contractural relationships.

Self-managing socialist planning

Although the first lending mechanism represented an improvement compared to the state-controlled system of budget formation and allocation of investments funds, there were increasing problems in carrying out investment plans at the industrial project level.

Firstly, the required investment structure could not be sufficiently determined. In many cases directly productive investment in industry required a supporting infrastructure that was not available. The question also arose: Can profitability be distinguished from the benefits derived from centrally planned public investment structure?

Secondly, there was a strong tendency to concentrate investment funds in the bank. In this way, huge reserves called state capital were built up.

Eliminating these reserves was one of the main aims of the economic reform in 1965. This introduced direct participation of Yugoslav enterprises in decision making and in formation and allocation of investment funds. After the constitutional amendment of 1963, the principle of self-management was applied at the basis of the entire social system.

In order to satisfy market requirements while simultaneously maintaining optimal progress, both workers in economic enterprises (through mutual self-management agreements) and citizens in socio-political communities (through social contracts) harmonize and direct their social and economic development taking into account their own priorities and joint interests. Economic enterprises subsequently became the exponents and activating forces in social economic planning, operating either individually or together with other, related enterprises.

It should be underlined here that basic principles in the system of self-managing planning, particularly those relating to economic development, are the principles of social contracts and self-management agreements. The purpose of these contracts and agreements is to replace the states' role in resolving social contradictions and to ensure co-operation and solidarity in the economic and other spheres of life. It is thus possible to co-ordinate development plans based on objective inputs such as scientific research data, social parameters and statistical indicators.

In investment financing, this period has been characterized by increasing decentralization of financial sources with the aim of strengthening the financial position of the economic enterprises themselves. Economic enterprises thus become not only the exponents of the economic planning but also the exponents of investment financing. The introduction of social contracts and self-management agreements constitute an innovation in economic planning. The concurrent innovation in the investment financing system was a shift towards self-financing and pooling of funds of the enterprise. Bank loans and other sources are used only as sources of additional funds.

It should be added in conclusion that a federal fund for financing less developed areas in Yugloslavia has existed for many years. It specializes in financing projects to accelerate development of industry and uses special resources allocated to it by economic enterprises and the commercial banks.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN CENTRALLY PLANNED ECONOMIES

A. Olteanu, *Member of Administration Council*

Investment Bank of Romania

Economists and politicians the world over appreciate that underdevelopment and deepening of economic gaps between countries adversely influence not only the less developed countries but also the social and economic evolution of the whole world, including the industrialized countries.

As a socialist developing country, Romania considers eradication of underdevelopment and reduction of gaps between countries should constitute a major preoccupation both of individual countries and of the international community as a whole.

Romania's experience and that of many other countries as well demonstrates that the decisive factor in the process of social and economic development is the domestic effort of each country. In our opinion, the key lies in successful mobilization of the whole potential of materials and financial and human resources. But parallel to the domestic efforts, an important role devolves on intensified co-operation between developing countries and other countries.

The basis of Romania's achievements is a policy of establishing the social and economic strategy for development. During 1976-1978 the average annual growth rate of Romania's industrial output was 11 per cent - one of the highest in the world.

This rapid development of the country is in fact the outcome of steady implementation of large investment programmes - allocating a large share for development without in any way restricting programmes for increasing standards of living. During 1966-1977, for example, when the investment rate was 33.4 per cent, national income increased by an average annual rate of 9.5 per cent, compared to 7.9 per cent during 1956-1965 when the allocation for investment was only 22.4 per cent national income.

The high rates of economic growth have led to increases in Romania's per capita national income, thereby reducing the gap compared to the economically developed contries from 8 to 10 times in 1960 to 3 to 4 times by the end of 1975.

A major part in the country's economic development is played by the Investment Bank of Romania, the specialized state institution responsible for financing development and managing the financial resources allocated for implementation of investment programmes.

The Investment Bank finances 80 to 85 per cent of the total investments implemented in all sectors of activity except agriculture and food processing. These are separately financed through the Bank for Agriculture and Food Industry.

As a state body, the Investment Bank implements state policy related to raising and administration of funds for development, as established by the national plans and state budget. It also credits and controls the economic enterprises' use of these funds.

Because the economy is developing on the basis of five-year plans and annual plans, the Investment Bank works directly with the planning and finance bodies to establish the investment projects to be implemented within the respective programmes, supervising individual growth rates and the relative growth needed to modernize economic structure and induce harmonious and balanced development of all regions of the country.

One of the important responsibilities of the Bank is to appraise prior to any investment decision the economic efficiency of projects from technical, economic and financial points of view.

Within this activity, there is particular stress on savings investment funds - by establishing minimum expenditures per unit of product assuming use of advanced technology by demanding high profitability and productivity, and by encouraging high rates of return on the use of development funds.

There is accordingly a close relationship established between the general interests of the Government and the responsibilities of the Investment Bank. The bank is requested to furnish its competent opinion for each project based on inputs by a staff of financial analysts, economists and engineers.

In all cases, the approval of techno-economic documentation for each investment is based on the advice of the Investment Bank on the economic efficiency of the project including both production and sales. The only exceptions are projects of national importance, which are approved by the Government and for which the initial advice is given by the bank together with other government bodies.

The support of the Bank is also extended to industrial investors, with a view to improving their investment projects, especially with regard to the technology, construction and production costs.

Any investment programme has to be supported by the corresponding financial resources. Here the Bank plays a decisive role in assisting the principle of self-management and self-financing of the economic enterprises. It helps mobilize the industries' own financing resources, co-ordinating them with contributions from the state budget.

In addition to these basic resources for financing investment, the Bank contributes foreign credits obtained from international bodies.

Parallel to investment financing, for which long-term credits are extended, the Bank carries out credit and financial operations during construction and start-up periods.

One of the Bank's responsibilities is to monitor the implementation of investments with reference to legislation in force. It is assigned extensive investigation rights - from the stage of a project's introduction in the economic plan, to its commissioning and final evaluation of performance. It supervises the way the human, financial and material resources are managed and determines measures for achieving targets and improving project efficiency.

The Investment Bank also participates in the information system organized within the economy - reporting to the Government and requesting its intervention to settle cases in dispute.

GOVERNMENT / DEVELOPMENT BANK RELATIONSHIPS IN CENTRALLY PLANNED ECONOMIES

Secretariat of UNIDO

Distinctions in Financial Intermediation

The institutional role of an industrial development bank is defined, not only by the financial system - which is the entirety of banking organizations, capital markets and industrial financing instruments in a country - but also by the policy of the bank's own management, the economic and financial policy of the government or both. The question is what this organizational relationship is in the countries with centrally planned economies and how it compares with practices elsewhere.

In seeing useful criteria for systematically grouping the different banking systems of the world, UNIDO finds that neither the banking structure nor its degree of concentration, nor the character of banking activities nor even specialization in industrial financing provides clear-cut divisions for systematic analysis. Whether development finance companies have a private or public function, it need not make any difference who has the majority in the board of management and what the other criteria related to ownership, financing activities or financial resources are. Nevertheless, there do exist liberal versus centrally conducted systems of financial intermediation.

Under any economic system there are households, productive units, public organizations, and private individuals, who at certain times have financial resources temporarily available. This is a result of the seasonable nature of production, time-lags between expenditure and income, and the accumulation of funds, profits, reserves or budgetary advances. The predominant criterion in industrial banking is whether decisions on investment and finance are made centrally or individually.

Mono-bank system

In centralized economies, surplus funds of industry and state organizations have to be surrendered to Government-appointed public financial institutions. Credit operations are therefore planned in a way to re-distribute money resources in the economy in accordance with official plans for investment and production processes.

The most striking characteristic of financial intermediation in centralized economies is of course the state monopoly. Financial institutions are completely in the hands of the state. In theory the economy functions thus with a mono-bank system. There is only one bank where all financial settlements are concentrated and it combines all central commercial and investment bank functions. In practice, however, the banking structure and the functioning of financial intermediation is often very sophisticated.

China has a typical mono-bank system. The principal domestic financial institution is the People's Bank; there are no separate savings banks, consumer credit does not exist, and financial instruments such as cheques, bonds and shares are not used. The well-known Bank of China is a foreign-exchange bank managed by the People's Bank.

As is the case within China, financial resources for investments in equipment and construction derive from the state budget. Sums are allocated in accordance with the national plan in the form of grants and credits. Only state enterprises or public communes can obtain credits. They are restricted to certain operations and have a limited maturity. The People's Bank has the task of controlling the correct use of funds in accordance with purposes envisaged in the plan. It supervises wage payments and payments to other enterprises and plays a permanent role in managing overall liquidity.

In practice, one of the main functions in the organization of industrial investment finance is carried out by the Construction Bank. This, in fact, is not a financial institution, but a part of the Ministry of Finance, an executive organ of the Government.

In the Union of the Soviet Socialist Republics, the economic reforms of the 1960s laid emphasis on self-financing of enterprises. Since then, credits have played a somewhat greater role as additional sources of finance for industrial modernization. Financing of investments through the state budget has been replaced as far as possible by attempts to make enterprise expansion depend on the realization of economic surpluses.

Although Gosbank (the USSR state bank) has a wide range of special tasks, as an organization it cannot be compared with any financial institution in a market economy. It is a government agency, a fact illustrated by the direct subordination of its board of directors to the Council of Ministers of the USSR. However, its resources consist of balances on current account, deposits of savings banks and state insurance companies, deposits from other banks, budget reserves of the USSR and other administrative entities.

Unlike the mono-bank structure of China, Gosbank provides long-term credit for agriculture and consumer co-operatives and medium-term loans for the financing of non-centrally planned investments.

Under the economic reform of 1965, measures were taken to boost the role of credit and to apply interest charges. This was to encourage the wider application of credits in the economy. Instead of relying on the state budget, industrial enterprises are expected to self-finance both their fixed and working capital from their own resources, from capital surpluses and depreciation allowances. Subsidies from the state budget were to be reserved for a limited number of big projects, for developing production of energy, for establishing new plans based on advanced technology etc.

The system of the USSR has served as a basic model for the majority of other centralized economies - particularly the socialist countries of Europe - but also many developing socialist countries, such as Algeria, Burma, Ethiopia, Iraq and the Syrian Arab Republic. In several of these countries the special role of credits is to provide additional finance geared to productivity improvements and better export performance.

Given the aims of the economic reforms, it would be highly debatable to regard banks in socialist countries as administrative institutions - as passive bureaucracies charged only with the distribution and control of investment finance. Their role is a wider one:

(a) Many institutions have supplementary functions in the financial structure of the socialist economy. They are in a privileged position since they provide long-term credit to finance not only centrally-planned investments in all branches, but also where no contributions from the budget have been reserved and neither the enterprises in question nor their respective ministries have any other financial resources available;

(b) The socialist banks' activities abroad include financing of the international trade (especially East-West trade), and transactions in foreign currency, gold and deposits;

(c) Socialist banks are highly developed in their capacity to intermediate on international capital markets, where they operate in both European and Asian currencies;

(d) Socialist banks in Western market economies enjoy the same rights as private banks;

(e) International financial co-operation is a socialist tradition.

The trend to nationalization

Against the background of industrial banking in centrally planned socialist economies, one must be aware of a trend to nationalization in a number of developing countries. This, however, has to be differentiated. In some cases it means the expropriation of private banks by bringing them into state ownership. In others, the banking structure was previously dominated by foreign banks, and this was often found insufficient for the basic requirements of centralized, socialist developing economies. Therefore, foreign banks in developing countries were obliged to become incorporated in the country itself instead of abroad. However, in both cases this does not necessarily result in monostructured banking systems, even though it helps establish national majority positions. Central banks, development banks and other state-owned institutions continue to fulfil their specific roles.

The question arises to what extent nationalization influences the financing of industrial investments. According to UNIDO experience, the foreign banks in former colonies were mainly concerned with financing foreign trade, harvests and raw material supplies and carrying out foreign exchange business, and export-import transactions. Industrial development, particularly as far as indigenous small and medium-sized industries were concerned, did not have their primary attention. UNIDO therefore concentrated its support on national industrial development banks, particularly those that were Government-owned and expected to play an important role in the industrial development plans of their country.

With many national development banks just beginning to establish their banking business, the UNIDO programme in industrial development banking has faced many practical constraints on its activities the past 10 years. The aim has been to help build up the reputation and international credit standing of the banks. That could have best been achieved by joint action and international co-operation among themselves.

The World Bank has already financed some large state-owned development banks (in India, the Philippines and the Republic of Korea), and has evaluated and financed government institutions that have public sector industrial activities as their targets (Algeria and the United Republic of Tanzania). Co-financing with commercial banks and official aid-giving institutions (e.g. regional development banks) is also of increasing interest.

Relevant in this context is the establishment of the International Investment Bank 1/ in Moscow by the Governments of Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland and the USSR - later on joined by Cuba, Romania and Viet Nam. Article II in the basic agreement provides for the following:

> "The fundamental task of the Bank shall be to grant long-term and medium-term credits primarily for carrying out projects connected with the international socialist division of labour, specialization and co-operation of production, expenditures for expansion of raw materials and fuel resources for the members' collective interest, and the

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1/ Agreement on the Establishment of the International Investment Bank - Statutes of the International Investment Bank (Moscow, 1971).

construction of projects for development of national economies of the countries and for other purposes, established by the Council of the Bank and consistent with the aims of the Bank."

The International Investment Bank establishes contacts and business relations with international and other financial and credit institutions and banks.

The International Investment Bank has also created its own Special Fund to finance programmes for rendering economic and technical assistance to developing countries. Article V in this later agreement indicates the intention to mobilize additional capital resources through national banks for industry - public or private - in developing countries:

"1. The Bank grants loans from the fund for the construction of new enterprises, reconstruction and modernization of acting ones in industry, agriculture and other branches of economy of the developing countries,...

"2. Loans from the resources of the fund may be made to:

(a) central and other banks of developing countries;

(b) enterprises and economic organizations in public and co-operative sectors of developing countries.

"In certain cases, on decision of the Council of the Bank, loans may be granted to private firms and organizations in developing countries."

Conclusion

Even though based on different economic systems, all financial intermediation is predominately aimed at mobilizing financial resources for industry and distributing them in optimal fashion in the interests of the population as a whole. Whether central planning or a market-economy approach comes nearer the optimum is not for debate here. What is confirmed by UNIDO experience in daily co-operation with bankers from all over the world is that their spirit and motivation have much in common. The borderline between "centralization" and "freedom of decision" are seldom clearly defined in any system. Industrial bankers in both planned and market economies can be in a position to apply personal judgements and employ programme funds to a large extent at their own discretion.

In international banking there is also an important and growing area of institutional initiative and decision making. This does not necessarily imply free disposition of the bank's own resources nor does it mean that investments that are not centrally programmed need not to be approved and controlled; but the managers involved do have increased freedom of choice. Generally speaking, almost all industrial financing institutions - even where they maintain close relationships with the Government - co-operate with capital markets abroad and are active in international money markets. If they were to apply strict instructions emanating from a domestic bureaucratic system, they would be unable to exercise any flexibility. Quick decisions, personal motivation and creativity along with professional ability are prerequisites.

In summary, as far as Government/development bank relationships in centrally planned economies are concerned, there are many reasons for optimism in the 1980s. However, the international banking systems, whether centrally planned or not, should much more effectively use their potential for enlarged co-operation - to pool the required investment funds for industry and ensure finance for the developing countries.

SUMMARY OF DISCUSSION

A representative from Czechoslovakia observed that until around late 1970, his country did not have a development bank for promoting industrialization within the country, but had set up a foreign trade organization called Fincom and the Czechoslovak Commercial Bank for collaborating with other developing countries on a bilateral basis. The partners from developing countries were normally foreign trading coprporations. Financial partnerships in joint projects took the form of equity contribution or loans with equity features, or assistance in obtaining financial aid from international agencies.

The Czechoslovak Government did exert its influence on the operations of these institutions particularly in regard to the scope and direction of their activities. In fact, all projects for assistance above certain investment limits have to have the approval of the Government. The institutions also influence government policies by providing economic intelligence on various aspects of recipient countries' economies and policies.

A participant from the Industrial Development Bank of the Ivory Coast wanted to know how centrally planned economies reacted to currency fluctuations and inflation rates experienced in industrialized countries and what counter-measures development banks in these countries had instituted to protect their operations from the deleterious effects of inflation, unemployment, recession etc.

In reply, the panellists stressed that exposure to external factors such as inflation and currency fluctuations was marginal since transactions with the external industrialized world were not based on free-market monetary terms. It was further emphasized that centrally planned economies did not have the problem of unemployment.

To a query from international bankers about access to investment resources other than contributions from the state, it was observed that finance was provided mainly from four sources. The first was internal accruals of the banks themselves; second came repayments of loans from enterprises; the third consisted of lines of credits from international lending institutions; the fourth was in the nature of government budget allocations.

More clarification was sought from South American bankers on the role of state investment banks in setting investment priorities and selecting and financing industrial projects. They also wanted to know the mechanism for channelling national savings to the banks in centrally planned economies.

In reply, the Chairman said that the long-term national development plans, usually the five-year plans and the annual plans, contained projections made by each enterprise as to its future demands. These projections and enterprise plans were submitted for scrutiny to the investment bank. The investment bank submitted its evaluation reports on each enterprise's plans to the Government, which incorporated these in an integrated plan. Reviews of performances were undertaken and, based on these evaluations, the individual enterprise plans might be modified. The bank had the right to refuse permission for implementation of the plans of an enterprise.

Answering a related question on the mechanism for channelling national savings to the banks in centrally planned economies, the Chairman stated that household savings were deposited in special savings banks, which made the accumulated funds available for investments.

The panellist from UNIDO drew attention to the fact that private saving did exist in the USSR and other centrally planned economies. That meant that individuals had to decide on spending or keeping savings accounts. Given the size of those economies, the accumulated private savings were substantial. Government regulations and interventions did not necessarily mean a change of ownership of the funds. Furthermore, in quite a number of countries with planned economies, centralization measured did not affect all banking operations.

In view of the relative size of the industrial banking business, even taking into account the need for managerial flexibility, it was often judged sufficient if the central bank and the major institutions were state-owned. Partially nationalized systems in banking were known, for example in Argentina, Austria, France, India, Indonesia, Italy, Peru and Sri Lanka. Therefore, it was not easy to define clearly the field of industrial development banking operations to which different types of institutions should confine themselves without overlapping each other. In recognizing that fact, the industrial development bankers had been able to co-operate internationally with an astonishing spirit of understanding.

Group 4 — Technological choices and information sources for development banks

TECHNOLOGICAL CHOICES AND INFORMATION SOURCES FOR DEVELOPMENT BANKS

J. C. Caruana, *General Manager*

Investment Finance Bank Limited, Malta

The choice of economic activity in Malta has been mainly governed by its strategic position in the centre of the Mediterranean Sea. Malta has attracted the attention of many nations for the past 2000 years, during which time the island was dominated, and its economy shaped, by the military and defence needs of those countries. It is no wonder, therefore, that Malta became known as "the fortress island" and that until a few years ago industry was non-existent. The one exception was the dockyard, and even this was geared to defence needs rather than to commercial activity.

Therefore, when in the late 1950s the United Kingdom of Great Britain and Northern Ireland gave clear notice that its military presence in Malta was to be drastically reduced, it presented the Maltese Administration with the tremendous problem of finding jobs for thousands of workers who were to become redundant. This had to be done in the quickest possible time. The Administration however readily recognized that to attain its aim of creating work in a short span it had to base its programme on three pillars - tourism, shipbuilding and ship repair, and manufacturing.

For tourism it more or less had the necessary ingredients: sun, sea and an equitable climate all the year round. Tourism has been a real success story; in 1978 the number of tourists visiting Malta exceeded the local population by almost 50 per cent.

The dockyard was a more difficult problem. In the early 1960s strenuous efforts were made by the Maltese Administration to convert the yard into a commercial venture. The workers in the dockyard had acquired considerable skills in engineering and metalwork, and in a few years it became a force to reckon with in the Mediterranean for ship repairing. More recently, Malta Drydocks took a bold step forward into building. Last year it delivered - ahead of schedule - its first two product carriers, and its building activities included a floating dock, repeat orders for single-point mooring buoys, and other steel fabrications. For the last five years the dockyard has achieved increasing turnover and operating surpluses - consequences of greater labour involvement, favourable repair rates, and above all an aggressive and determined marketing effort.

The third pillar, however, was the most difficult to build. The manufacturing industry had to start from scratch, and it faced four difficulties:

(a) The Maltese were not familiar with the process of production;

(b) There was no knowledge of buying or maintaining machinery and equipment, no know-how, and no entrepreneurial skills;

(c) There was no infrastructure able to cater for the needs of industrial activity;

(d) Although capital had always been abundant, the Maltese had no propensity to invest locally.

The Administration therefore undertook a vast programme in the late 1950s and early 1960s to provide the necessary infrastructure. Industrial estates were built and harbour facilities improved. By means of investment incentives it sought to encourage local and foreign investors to come to Malta and to promote the transfer of technology.

Malta, with a population of 320,000, provides no real market for local production, and cannot boast of natural resources other than its people. Labour is abundant and easily trainable. The target therefore was to attract industry that was labour-intensive and export-oriented. And, as happens in almost every developing country, textile manufacturing industries were the first to come. Being labour-intensive and interested in low labour costs, they were also the least likely vehicles to transfer technology to Malta. And because they were mostly foreign-owned they were not likely to encourage competition.

The choice of industries was therefore governed by the past and by the immediate needs at the time. But these pioneers served other useful purposes. Above all they created among the Maltese an industrial environment, a mentality geared to mechanization, production processes, marketing, and contracts with the industrialized world.

The dangers were always appreciated that, for the same reasons that the textiles and clothing industries were attracted to Malta, they could be attracted away to other developing countries. And although textiles and clothing still constitute over 50 per cent of the manufacturing industry, an intensive effort is under way to continue diversifying the industrial activity.

Thus the Government's Development Plan for 1973-1980 lays great emphasis on the development of light engineering and metal industries. The Maltese have traditional skills in these sectors. In such skills, also, the servicing industry is making encouraging progress. Ventures are set up to service aircraft engines for companies operating in the Mediterranean area, equipment for the oil exploration companies, and electrical and mechanical plants. Again, the success of these efforts at industrialization is demonstrated in export figures: $27 million in 1968 and $356 million in 1978.

With its very limited resources, Malta cannot hope to be a leader in technology. But some local firms have recognized the need to innovate and to adapt imported techniques to local means. Research and development occupy a considerable part of the resources of a number of firms today. Many are able to produce their own designs, find their own suppliers, and markets, and produce high quality goods. The education system has also been overhauled, and the aim is to develop skills most in demand in accordance with those activities indicated in the Malta Development Plan.

Like most banks in developing countries, it is a difficult task for the banks in Malta to analyse the viability of a project. With technology still relatively in its early stages of development, they do not have the required range of technicians who can assess the up-to-dateness, capacity, capabilities, value etc. of machinery and equipment in all the various sectors of industrial activity. Nor is it an easy matter to assess for a particular venture the future availability and prices of raw materials, the salability and marketability of products, and above all the know-how, skills and capability of the entrepreneur. Often it has to rely on the advice of friends or imported experts. But this is not always available, and when it is it is expensive and sometimes serves as a deterrent to the fruition of the project.

It is for these reasons that one would like to see developing countries have easier and less expensive access to a bank of technological expertise set up by international organizations.

TECHNOLOGICAL CHOICES AND INFORMATION SOURCES FOR DEVELOPMENT BANKS

Secretariat of UNIDO

Two basic issues face development banking in the 1980s:

(a) Their role is not merely the provision of finance; it is also to influence and promote technological capacities and to build a base for indigenous technological development;

(b) Development banks should themselves build, or have access to a bank of critical technological information, not only to reduce their own risks, but also to help them play their proper role in promoting the process of development.

Both points were emphasized in replies to questionnaires circulated to senior officials of development banks.

Questions have also been raised as to how development banks can ensure that the technology chosen is appropriate in the light of development goals, resource endowments and specific product situations, and how they can ascertain that the equipment chosen and prices paid are reasonable, i.e., based on detailed examination that itself requires considerable resources. Questions such as these indicate that development banks do have a role to play in the appropriate choice of technology, in technology absorption, its adaptation and perhaps innovation.

But while technology has also been accepted as the main element of the development process, there is a tendency to aggregate it too much - to discuss it divorced from the actual production process. Technological development has unfortunately been bracketed with the establishment of research and development institutes, institutes that are often insensitive to the requirements of industry and the production process. As a result, much money has been spent on developing skills without direct links to the actual work performed.

Unless technological development is viewed at the micro level in terms of specific projects and products, and unless the necessary capacity is established for absorbing, adapting and innovating technology, the developing countries will not make much progress in building a viable production base and consequently simultaneous technology base. The stress should therefore be, not only on the production of goods and services, but also on the building of engineering, design and innovative capacities, both to respond to the changing needs of the market and to make best use of available raw materials and human resources.

The question is, then, how can the development banks ensure that these capacities are built - and can operating procedures be established for use by development banks in this task? The question is posed in the hope that the development banks not only agree in broad terms as to their role in promoting development of technological capacity at the project level, but also translate it into their systems of project evaluation, disbursement of funds for specific items and monitoring procedures.

The other aspect raised earlier, the information requirements to enable development banks to be satisfied that the technology or the process chosen is suitable and that the terms and conditions agreed between the buyer and seller of technology are reasonable and equitable, is a formidable problem,

particularly when the investment is large and the technology or production process sophisticated.

The problems are no less serious with small and medium-size industrial units. The alternative technologies available are not adequately documented and proper methodology has not been developed for evaluating alternatives. Information on terms and conditions is also considered confidential, even though both are part of the overall commercial information. UNIDO, through its newly established Industrial and Technological Information Bank (INTIB), has compiled some data on technology alternatives. It has also developed the Technological Information Exchange System (TIES), whose purpose is to systematically collect information on critical elements such as royalty rates, duration of agreements, licensing and know-how fees, payments for technical assistance and managements etc. The development of TIES was primarily the result of some 15 countries getting together to exchange information among themselves on terms and conditions of contracts. Based on such information, UNIDO has prepared guidelines for evaluating transfer of technology agreements which will be published shortly.

Using INTIB and a question-and-answer service, UNIDO might also be able to help interested development banks should they wish to take advantage of it. Since the basic orientation of INTIB is to provide such a service, it would be necessary to have continuous dialogue to ascertain the nature of the information required. INTIB, through its network of other information banks and technical correspondents, might then be able to obtain the specific information needed for development banks.

It is also suggested that development banks themselves get together and examine if their information requirements could be provided either by a large development bank with several years of experience, or by a group of them establishing a small unit for information gathering and analysis. The subject is wide and needs further discussion. However, the comments and suggestions of this group would set the basis for further work in the two areas outlined.

TECHNOLOGICAL CHOICES AND INFORMATION SOURCES FOR DEVELOPMENT BANKS

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Firstly, there is the issue of the technological choice itself, often termed as appropriate or alternative technology. Technology, however, is constantly changing as a result of technical and scientific development. Although users of technology are confronted with several choices of technology, be it production technique or choice of equipment or type of management, it cannot be assumed that the choices before them will remain the same for all time.

Secondly, there is the related issue of collecting, storing and disseminating information - how it can be organized to promote the diffusion of technological knowledge. The paradox is that while knowledge about most advanced technology is quickly transmitted throughout the world - millions of people hear about moon landings, jumbo jets and nuclear bombs - the knowledge concerning low-cost technology often takes years to travel a few miles.

Definition of technology

In the broadest sense technology is a method of applying science to give practical results. It therefore relates to the choice of production systems, the design of equipment, engineering, marketing and of management system - all contributing to the material betterment of mankind. However, society also depends on several other environmental factors:

Government policies reflecting the social values and the aspirations of the society

The technological gap between the recipient and the donor of technology

The absorptive capacity of the recipient

The latest, most automated technology need not necessarily be the most appropriate. The choice open or offered to development banks, industrialists or government planners is not one or the other, but rather a whole spectrum of technologies, ranging from the small and simple to the large and complex.

The difficulty is not only in the choice of technology but also in the terms under which that technology is made available. This includes such things as know-how and technical fees, royalties, selection of suppliers, guarantees of performance and post-commissioning technical assistance. Any assistance that the other development banks can provide on the basis of their own experience with their clients provides us with a suitable base for adaptation and negotiation.

The choice of technology is a decision normally taken at the level of the business enterprise. This is where development banks can play their proper role in passing on their experience to assist clients to select not only the latest but also the most appropriate technology. There are some development banks that have been co-opted as consultants to the Government in drawing long-term plans. They can also influence decision making at the highest

level. Development banks have to be constantly familiar with what is the latest, the best and the most appropriate. In short, what they require is a good information system.

Sources of information

Information is a major production factor as well as an important resource, but it is far from clear how it can best be organized and exploited to promote diffusion of new innovations. The problem of technological choices is partly solved if the information collecting and disseminating system is efficient. Many attempts have been made with various technological information clearing houses. But these have been organized primarily on a national basis, either by government organizations or by private institutions. There are of course multinational organizations dealing with the diffusion of information on technology and the promotion of local enterprises. Unfortunately, nearly all these multinational organizations originated, and are still based, in the industrialized countries. The choice confronting the developing countries is whether to utilize existing information systems of the multinational groups or to build up their own systems.

Access to foreign technology and the cost of its acquisition have often been described as major difficulties for developing countries. The experience of various documentation centres and technology transfer centres shows that information is a very expensive commodity since three cost elements are involved: collection of information, its classification and storage, and finally its diffusion. The cost of collecting information on technology is definitely higher in the case of developing countries. Storage and retrieval costs are also high. More important, information becomes obsolete as time passes. To be of much use the information service must be able to collect and store substantial information (maybe 50 to 80 per cent of all information concerning a particular technology). On the other hand, the users are few.

Important as the costs of collection and storage may be, the biggest difficulty is that of diffusing information. The real problem lies in the ability of users to gain access to the information stored. In other words, any new system should start with a clear assessment of its potential users and recognize the fact that the various users do not have the same need. The delivery system should not be rigid. A small-scale entrepreneur for example will not take the initiative and go to the information system and the information has therefore to be passed to him through an extension service. Large firms in contrast will be active users, since they know what they need.

Flow of technology

Today, technology transfer is a one-way road. Information on technologies moves from the developed or industrialized countries to the developing countries but rarely between developing countries. In the 1980s we would see development banks play a more meaningful role as agents in transferring technological information between the developing countries themselves. The development banks must be active in this. If necessary they must undertake or initiate their own research programmes in conjunction with already established local research institutions such as universities and research stations. In terms of scope, the development banks' functions should include identifying local or foreign technologies and developing them even up to a commercial stage.

Another area where development banks can use their influence is to stimulate local innovative forces. One side-effect of industrialization has been to paralyze these forces. There are many economic activities in developing countries where local talents can be developed and upgraded. This approach enables a larger number of people to participate in the development process.

Problems in the flow of information

The problems encountered in obtaining technological information are illustrated by the Bank Pembangunan Malaysia's experiences in starting up a local food processing industry. The amount of time taken and the number of people consulted, institutions visited, machinery suppliers contacted, and market investigations conducted were just enormous.

The flow of information within developing countries is also far from satisfactory. To cite another example in Malaysia, there are a number of research institutions in both the private and the public sector undertaking technological research. Unfortunately, their findings, innovations and information are not yet systematically transmitted to potential users in the country. One suspects this holds true in many other countries. Of course the same can be said of the multinational organizations in terms of diffusing information to the developing countries.

Conclusion

To overcome these problems some intermediary exchange centres should be set up at the international level, preferably on a regional basis, under the auspices of the World Bank or UNIDO to act as clearing houses on technological information. The idea of an international technology bank has long been proposed but nothing has materialized so far. At the national level there should be technology extension centres. The object is not just to introduce new technology, but to try to identify within each community the social mechanism of change to stimulate the internal innovativeness and inventiveness of the community.

SUMMARY OF DISCUSSION

It was generally felt that industrial development banks had an important role to play in the appropriate choice of technology, its absorption, adaptation and, perhaps, innovation. Their role consisted not only in promoting development of technological capacity at the project level, but also in translating this into their own systems of project evaluation, disbursement of funds for specific items and monitoring procedures.

However, while recognizing the important role played by industrial development banks in selection of technology, one panellist observed that the dichotomy in functions - between engineers who selected the technology and economists who thereafter were asked to assess the economic rates of return - was not conducive to selection of technologies really reflecting the socio-economic environment and the needs of the society.

A representative of the Industrial Finance Corporation of India said that the UNIDO technology information exchange has been found to be of great use to the development banks. However, he felt that it was only the larger development banks that used these services. He suggested that an intermediate linkage to disseminate this service among the relatively small development banks should be evolved. In case UNIDO itself might not be able to directly reach these smaller development banks, he suggested that some institutionalized arrangements be evolved whereby the larger development banks would act as links between UNIDO and the small development banks.

A delegate intervened to say that development banks faced two types of constraints in their role as agents for selection and transfer of technology. One of these related to factors external to, and the other to those internal to, the development banks. External constraints arose because the market for technology was imperfect and monopolistic. This prevented free access to technology. A related problem was inadequate flow of information on international experiences in regard to the use of specific technologies.

The internal constraints arose out of the inability on the part of development banks themselves to mobilize resources of the magnitude called for in developing technologies relevant to environments of their operations. The delegate thought that some of these problems could be overcome by closer and more effective co-operation between development banks and international organizations.

One banker added that the problems of adaptation and development of technology indigenously cannot entirely be left to development banks alone. In some countries solutions to the problem were sought by setting up research and development units in universities and technological institutes. Perhaps development banks could make a modest beginning by associating themselves with those efforts. It had also to be remembered that most development banks were still in their teens and had yet to build up expertise in the art of technology utilization. Lack of industrial management skills in most developing countries compounded the problem.

The President of the Caribbean Development Bank informed the delegates on an experiment concerning gathering and utilization of information on appropriate technology by his institution in its day-to-day operations. Funded by an international donor agency, the technology unit had two wings: one for gathering information from both supply sources and those who had practical knowledge of using the technology; the other wing of the unit was concerned with identifying technology research and development institutions and encouraging indigenous research and development work. He added that the

process of choosing technology in the bank would be totally integrated with that of project preparation and evaluation. This would be achieved by bringing about close co-ordination in the work of project and technology staff right from the beginning. Intermediate technologies of use to developing countries were to be found not only in developing countries such as Brazil, India and Mexico but also in developed countries such as the Federal Republic of Germany, Italy, Japan and to some extent the United Kingdom.

The Managing Director of an Egyptian bank referred to the need for information on the cost of technology transfer. This, he said, would enable them to conduct negotiations with the technology donors in an informed manner. He urged the World Bank and UNIDO to evolve a system whereby the development banks could be provided with such information on a continuing basis.

Referring particularly to information requirements of smaller development banks, a representative of the World Bank suggested looking beyond the framework of development banks and helping to build local technical extension capabilities to which the development banks and their clients could look for assistance. He felt that whatever the effective international network, it should be supported by a national network that would be in a position to provide the necessary technological follow-up. It would be difficult indeed for an international institution like the World Bank to provide information on costs of technology relating to the thousands of cases handled by development banks.

A representative of UNIDO outlined two specific situations for industrial development banks concerned with selecting appropriate technology. The first is where a development bank could do little, because the project promoter had already tied up all facilities and requirements of the project - including process, technology, plant and machinery and even suppliers - before approaching the financing institution. In the second situation, the development bank was itself involved in project promotion activities. In such cases it could definitely play an important role in searching out, advising on and selecting the appropriate technology. This would help minimize banking risks, but also require more readiness for additional responsibilities.

It was concluded that an industrial development bank should not necessarily have the capability to analyse the technology from various angles, within its own organization. In this connection, reference was made to the example of India, where development banks had helped set up a number of technical consultancy organizations. These organizations rendered useful services in matters of analysing, selecting and, in some cases, adapting appropriate technologies at the project level. The industrial development banks worked closely with those institutions. It was envisaged that the 1980s would see more industrial development finance institutions emulating that example.

Group 5 — Industrial redeployment and the role of development banks

INDUSTRIAL REDEPLOYMENT AND THE ROLE OF DEVELOPMENT BANKS

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The term "international division of labour" means nowadays that labour in the developing countries would be concentrated on those industries they specially need, whereas developed countries would change to a system of planned leisure based on high technology industries. Ironically, leisure has indeed increased in the industrialized world - but only because of unemployment born of the unforeseen recession.

Today this beautiful strategy lies in tatters. Millions are spent to keep labour-intensive industries in being and to protect their jobs. Advances in technology that do not provide employment during the development phase are held back for fear they will cost further jobs in future. Instead of adjustment assistance, once intended to complement the transfer of industries, there is now protective aid - maladjustment assistance - undertaken in the absence of any coherent strategy.

Misguided action is not, however, confined to these measures alone. Their rationale is that they need to be backed by tariff and other terms of protection. A measure of the diversion of resources in this area was given by Robert McNamara, President of the World Bank, in his address to UNCTAD V in Manila this year. Quoting a recent study that showed the effects of protective measures imposed by the United States of America between 1975 and 1977, he noted they resulted in a cost to consumers of $600 million in sugar, $1.25 billion in carbon steel, up to $800 million in meat, $500 million in television sets and $1.2 billion in footwear. It might be added that this constitutes some 8 1/2 per cent of the total official development aid provided by all donor countries put together over those same three years.

A further indicator of this lamentable trend is the European Economic Community's trade statistics. While the index of exports to the developing countries in 1978 relative to 1977 stood at 197.66, that of imports from them dropped to 94.65. In other words, the promise of progressive complementarity between the economies of developed and developing countries is receding. At the same time, instead of having labour-intensive products made in the third world and imported for consumption in the industrialized world, more and more high technology industry is being exported to the developing countries, especially in Asia. The system is thus fast becoming competitive instead of complementary.

In itself this is clearly no bad thing. What it is essential to realize is that the world has moved beyond the original simplistic strategy. What should now form the basis for the transfer of industry is not only the labour potential of developing countries but also their potentially immense resources

of hydro and other alternative energy supplies which will soon be ever more decisive. Harnessing such energy will require a massive technological input - but this is precisely what the industrialized world now has to offer.

Furthermore, there are new opportunities for complementarity by matching northern technology to the products of the southern world. Equipment made in India is in many fields, for instance, much better adapted to the needs of developing country conditions for which it was designed. What it often lacks is the sophisticated quality control devices manufactured in the developed countries. Together they could provide highly saleable products as well as offering new scope for co-operation between their separate manufacturers.

If these new opportunities exist, the problem remains how to provide the necessary bridges to enable them to be realized. In my opinion, this could be one of the domains of the industrial development banks. New ways must be found for them to reach the real candidates for co-operation in the developed countries. This has traditionally been a problem; and to the extent that more sophisticated industries are now required, the problem may well grow in complexity. Certainly one route will be to go beyond the present institutions in industrialized countries concerned primarily with overseas development and seek out those in industrialized countries who are doing the same job as the development banks in developing countries.

Since the problem has acquired a new technical aspect, it has also moved on to a different economic and political level. Within Europe the structural problems of industry have moved beyond the national boundaries and become subject to policy developed at the European Economic Commission's headquarters in Brussels. Since few developing countries individually offer the conditions for high technology industries, regional economic integration and co-operation is also required. Such identity of purpose provides for a programmed and systematic approach to the problem of industrial transfer of benefit to both sides.

From these considerations it is possible to draw several conclusions. During the past decade relations between industrial development banks have been characterized by a search for technical assistance and experience - a process which the annual meetings organized by UNIDO have done much to foster and systematize. The task for the 1980s is surely for a similar system of co-operation between industrial development banks in the third world and those institutions in the developed countries responsible for national industrial financing programmes, e.g. Britain's Finance for Industry, the Canadian Federal Business Development Bank and many others. The object, however, should no longer be the old-fashioned forms of assistance but the organized transfer of industries from one area to another.

Such a programme can, however, succeed only if it is based on parallel co-operation on the regional level. Regional groupings such as the Association of South-East Asian Nations (ASEAN), the Caribbean Community (CARICOM), Latin America Free Trade Area (LAFTA) etc. need to reconsider their own industrial location policies if their members are to be effective partners in this process. Few individual countries are in a position to carry through their own convictions or offer the market potential to implement their ideas.

Clearly, it is in this area that the industrial development banks and their regional associations will have a particular role to play, and this constitutes their new challenges for the 1980s. The EEC is ready to support other regional integration efforts, and the financing institutions of its members have declared their willingness to be involved in those developmental initiatives. In the same way it is hoped that one of the major roles of national development banks in developing countries will be to promote closer regional co-operation and ensure that this effort meets with responsive partners in the third world. The well-tried and tested partnership between industrial development and finance institutions on both sides can then take on new and more powerful dimensions in the redeployment of industries - a wide field so far not effectively covered by them.

INDUSTRIAL REDEPLOYMENT AND THE ROLE OF DEVELOPMENT BANKS

Secretariat of UNIDO

Introduction

The political term "new international economic order" has a more progressive economic and pragmatic connotation than usually implied by industrial bankers. The classical model of international trade relationships, the present interdependence of world-wide industrial production, need not necessarily conflict with a modern interpretation of the theory of the terms of trade. The new international economic order is basically an internationally accepted target but not a prescribed method. The international flows of goods and services and specialization according to comparative cost advantages within the world economic system will continue to prevail. However, the new international economic order will have to achieve a planned objective, namely to accrue - by increased and accelerated industrialization and with the help of a stable international trading system - income and benefit for the world population as a whole.

The existing disproportions in income and unequally distributed social welfare have become unacceptable not only nationally but internationally. The required international adjustment process will have to involve a reconciliation of costs and benefits of industrial production that, with growing specialization, ought to improve the terms of trade for many countries.

In a climate of growth and business confidence, with equal access to natural resources, or with different economic systems being in equilibrium, one could possibly trust that market mechanisms would ensure efficient realization of this objective. Since this is clearly not the case, one might conceive a new structure - to be set up by a planning authority, which would work out a detailed programme of action. Or, one might believe in a mathematically designed production and distribution process that would more precisely achieve the economic and social objectives. Unfortunately, there is no such phenomenon as "balanced economic growth". If this were in fact possible, the problem of underdevelopment would not exist; neither would we have economic crises, recessions, balance-of-payment problems, inflation, unemployment, obsolete industries. Nor, on the other hand, would there be innovations, advanced technologies, entrepreneurship, social and economic progress.

And yet the restructuring of world industry will be necessary if developing countries are to achieve the Lima target, the means _inter alia_ being improved market access and the adjustment of industrial policies. Countless economic factors and a great variety of political ideologies - an extremely wide spectrum when the 150 States Members of the United Nations are taken into account - determine the extent the adjustment processes will have to be organized. So far, the consensus is to reach this target with a minimum of disturbance and to involve the industrialized countries to the same extent as the developing countries.

Industrial redeployment

One method of international restructuring that has received special emphasis in international discussions in recent years is the concept of redeployment of industries. The United Nations Conference on Trade and Development (UNCTAD) in its resolution 131 (V) on protectionism and structural adjustment and the General Assembly in its resolutions 3362 (S-VIII) and 31/163 urged developed countries to encourage redeployment of certain industries to developing countries. In the same resolutions, UNIDO was requested to prepare studies including policy recommendations for promoting redeployment. It should be stated at the outset that the redeployment of industries does not necessarily imply the dismantling of non-competitive industrial capacity in one country and its re-establishment in another.

Recognizing that the concept of redeployment is capable of a wide range of interpretations, it is pointless - even dangerous - to describe the process in absolute terms. "Relocation", for example, may or may not refer to "transfer of technologies" or "redeployment" which may be understood as being close to "unemployment" in industrialized countries - but not necessarily.

Some examples illustrate the breadth of interpretation by various Governments and companies that were asked to give their opinion concerning redeployment. Many thought it was the establishment of industrial subsidiaries in developing countries; others think in terms of transfer of technology and know-how or selling equipment, including used equipment. It was also misunderstood as training of nationals of developing countries or the provision of management services to the developing countries. The transfer of existing plans or pure capital investments appears to be the typical interpretation of bankers.

In UNIDO so far, a very broad definition of "redeployment" is used: "a form of international industrial co-operation for resource transfers aimed at establishing productive capacities in the developing countries, with a view to increasing these countries' share in total world industrial production on the basis of each country's factor and skill endowment, development objectives and other socio-economic considerations" (ID/B/199, para. 35). Accordingly, redeployment would mean the transfer of capital, technology, know-how, plans and other resources by an operating industrial enterprise in a developed country to a developing country, in order to establish a manufacturing capacity in that country (ID/B/222, para. 6).

The role of industrial development banks

Generally, redeployment involves decisions by the entrepreneur of the developed country, the company or partner in the developing country, the Government of the developing country and the Government of the developed country. The intermediaries will, as usual, be industrial development finance institutions.

UNIDO has undertaken surveys at enterprise level in a number of developed countries to ascertain industrial entrepreneurs' interest in and motivation for participating in redeployment activities. The surveys reveal that significant interest and motivation exist for redeployment of certain industrial capacities to developing countries. In practically all industrial subsectors companies indicate that they consider redeployment as a means of rationalizing their production or making better use of existing resources.

The question arises whether there is a mandate for development finance companies regarding their involvement in the redeployment process. The following is a brief summary of the possible scope of their activities:

(a) To assist in financing redeployment projects wth equity participation and with loans, to participate in joint venture investments, and to guarantee loans from external financial sources;

(b) To finance redeployment projects through non-conventional financing methods such as leasing, buy-back agreements or to guarantee buy-back and compensation deals;

(c) To finance the marketing of manufactured goods of developing countries in export markets;

(d) To inform, and possibly assist, through UNIDO, interested firms in industrialized countries of the investment opportunities in developing countries, and also inform sponsors in developing countries about their potential partners;

(e) To initiate redeployment of industries among developing countries, including intensified regional co-operation;

(f) To invite developing country participation in investment promotion meetings being organized by UNIDO that have a strong redeployment component, as was the case in investment promotion meetings held at Brno (Czechoslovakia), Budapest (Hungary), Helsinki (Finland), Montreux (Switzerland) and elsewhere;

(g) To participate in international consultation and negotiation meetings organized by UNIDO for specific industrial sectors such as the steel industry, fertilizer industries, leather manufacturing, fats and oil production, pharmaceuticals etc.

Conclusion

Issued in connection with the Third General Conference of UNIDO (New Delhi, 21 January-February 1980), the publication Industry 2000 - New Perspectives discusses the Lima Target and the necessary restructuring and redeployment, and suggests recommendations for supporting programmes. These proposals are relevant not only as guiding principles for future co-operation among development financing institutions, but they also identify the constraints in developing countries in absorbing and reaping the benefits of redeployment. Some problems likely to confront industrial development banks in the 1980s might come to a large extent in the areas of redeployment and restructuring.

SUMMARY OF DISCUSSION

Providing the framework for discussions, the Director of the Investment Co-operative Programme Office of the World Bank/UNIDO Co-operative Programme reminded delegates of the huge foreign exchange gap likely to be faced by the developing countries in their bid to achieve the target of industrial growth. Some possible means available to fill this gap were:

(a) Increasing official development aid;

(b) Increasing the share of industry in current total flow of aid;

(c) Compensatory financing;

(d) Increasing the investment resources of foreign private investors so that the share of redeplcyment could be increased in future.

Redeployment was defined as "transfer of capital, technology, know-how, plants and equipment and other resources by an operating industrial enterprise in a developed country to a developing country in order to establish a manufacturing capacity in that country".

An official of a development bank in Argentina, quoting from the experience of his institution, observed that there had been good as well as bad examples of redeployment. While their experiences had been good with regard to a cement plant and another chemical plant, the same could not be said of their experience with automotive plants. While the former were operationally successful, the latter involved his institution in tremendous financial loss and dissatisfaction to consumers in terms of higher unit cost, out-moded models and lower quality. Worse still, the redeployed automotive enterprises effectively led to protectionist laws in his country.

A bank director from the Ivory Coast mentioned that all redeployment projects in his country were screened by the Industrial Promotion Office, set up with the assistance of the UNIDO. This body not only scrutinized the terms and conditions for the redeployment of plant, but also the relevance of technology and the possibilities for its re-adaptation to suit local conditions.

They expected, however, the redeployed plants to farm out manufacture of unsophisticated items to local enterprises. They also encouraged redeployed enterprises to be owned and managed as joint ventures.

While the terms and conditions, along with the technological aspects of all redeployed projects, were examined by governmental authorities, the Development Bank scrutinized the techno-economic and financial viability of only those projects and enterprises which sought the Bank's assistance. The Industry Promotion Office came into the picture in regard to small and medium-size projects only.

A participant from the United Republic of Cameroon felt that it was essential to insist on the participation of local entrepreneurs and arrangements for associating and training local counterparts in the management and operation of redeployed enterprises. Many redeployed enterprises were reluctant to concede these two pre-conditions. He also pleaded for close regional co-operation in exchange of experiences and information with regard to operation of redeployed plants.

An official of a Belgian investment company reported on the successful experiences of his company in organizing visits for officials of development banks and planning organizations to Belgian enterprises and meetings with Belgian entrepreneurs. The results had been highly encouraging in terms of crystalizing project ideas on the spot and firming up of business deals then and there. They also took an active interest in training Belgian technicians

in setting up and managing redeployed enterprises in recipient countries. He mentioned several successful examples where his company had been involved in smooth redeployment of plants, particularly in Ecuador, Tunisia and the United Republic of Cameroon.

The speaker concluded by supporting the suggestion of a participant from the United Kingdom for co-ordinated endeavours on the part of development banks in developing countries to establish effective operational rapport with similar agencies in developed countries to foster industrial redeployment.

An official of an industrial finance corporation in India observed that developing countries should be cautious of importing second-hand plants in the name of industrial redeployment. Care should be taken to guard against obsolete process, out-moded plants or plants with capacities that could not be sustained by local markets. Also provision for training of local technicians should be involved. He thought that one way of ensuring satisfactory performance and viability of the plant in the local conditions could be to insist on equity participation of the donor firm.

Another bank official from India observed that in selecting redeployment plants only those with potential long-term multiplier and linkage effects to the local economy should be preferred. He also suggested that the foreign promoters of redeployed plants should as far as possible reinvest their profits in the growth of the enterprises, rather than remit the entire income back home. This would be greatly appreciated by the developing countries.

A representative of the Swedish International Development Authority (SIDA) mentioned that his organization was engaged in fostering the type of grass-roots level co-operation discussed by the panel. For example, SIDA provides financial assistance to a local small industry promotion organization in an African country for identifying potential small-scale projects to be set up through joint ventures of Swedish and local entrepreneurs. The scheme had been highly successful.

Group 6 — Role of development banks in upgrading accounting and auditing standards

THE ROLE OF DEVELOPMENT BANKS IN UPGRADING ACCOUNTING AND AUDITING STANDARDS

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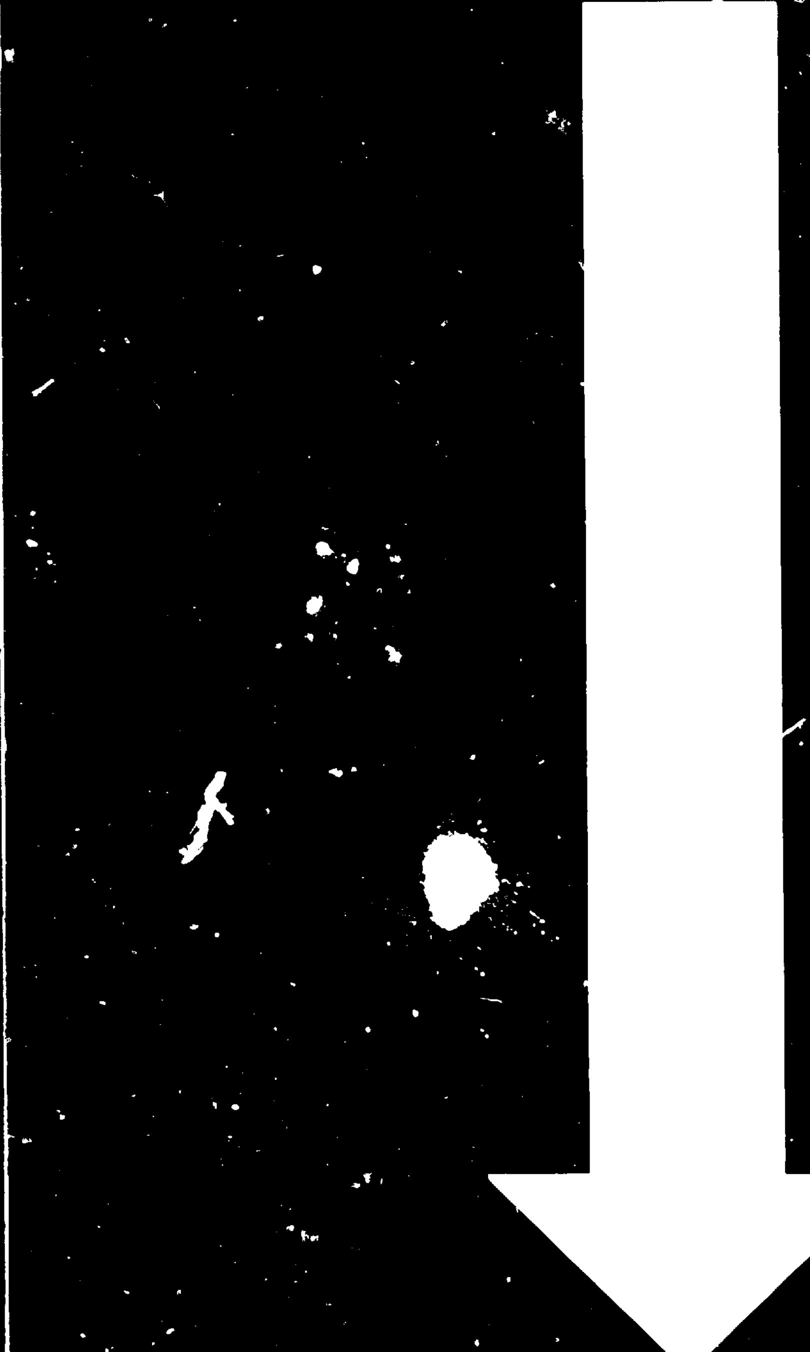
Our subject deals with the scope and methods for improving accounting and auditing in the context of (a) development banking activities (internal and external) and (b) the economy at large; these two are interwoven. The significance and potential role of good financial management (accounting) for development banking and economic activities is generally poorly recognized in third-world economies.

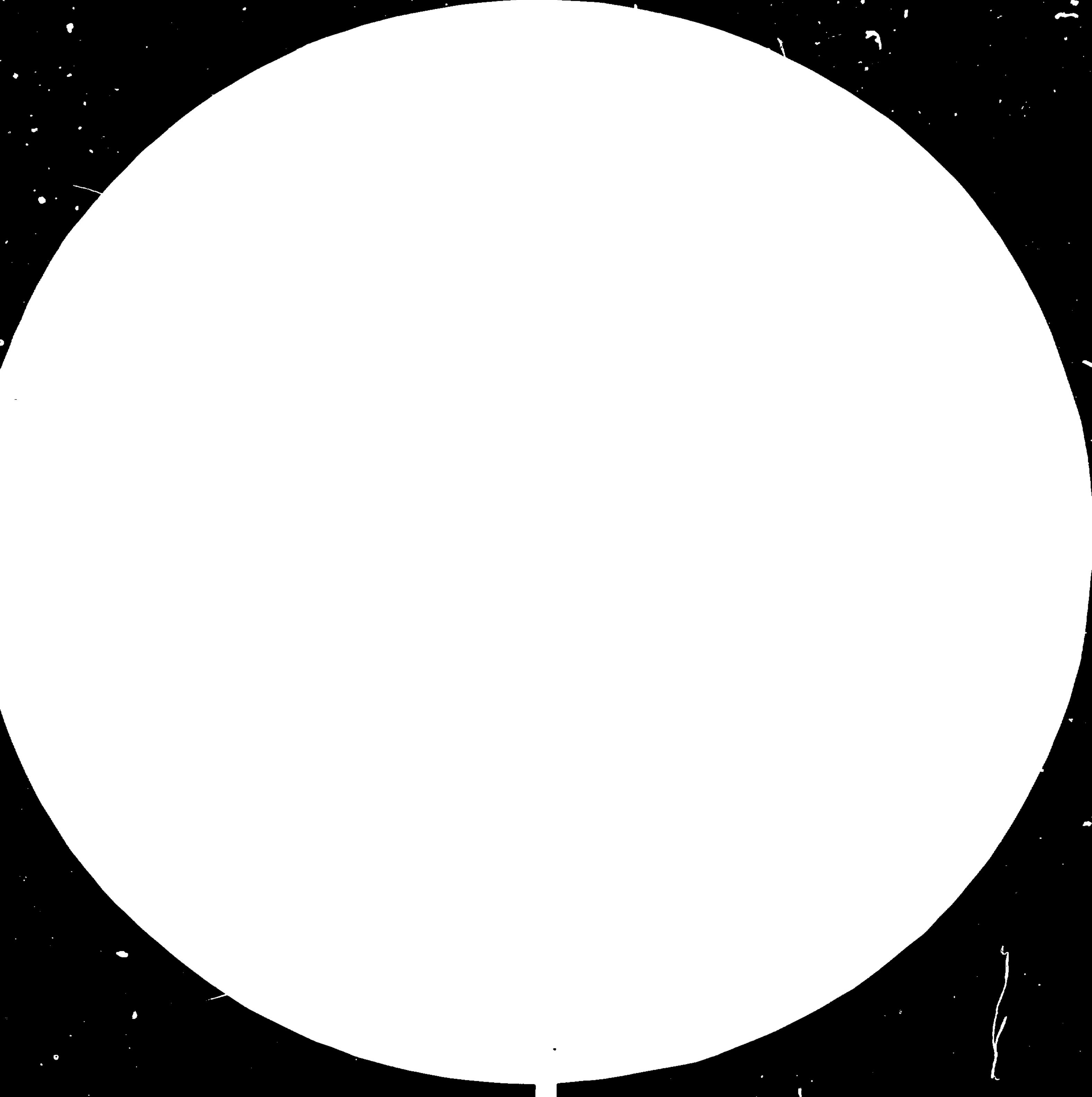
The framework of accounting

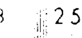
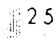
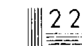
Accounting is conceived and practiced as an information measurement system dealing with the generation, verification and reporting of relevant data for micro and macro-economic activities and resources.

The accounting system consists of three subsystems, which in turn have a series of sub-branches or versions. The three subsystems are: (1) enterprise accounting, (2) government accounting, and (3) macro or national accounting. Auditing may be considered a separate branch although permeating each of the subsystems. Enterprise accounting is composed of financial accounting and managerial or cost accounting. Government accounting splits up into government administration, budgeting, and taxation. Macro accounting consists of the national income, input-output, balance of payments, flow of funds, and national balance sheet account. All these subsystems and branches are related; this has an impact on the development of accounting systems, methods, practices, and education.

Accounting also has its impact on capital formation and the capital market mechanism. Financial statements have to be reliable and relevant, and need to be internally or externally audited. Good management accounting assists in the optimum evaluation and allocation of resources. Thus, good accounting and auditing help in generating sufficient investor confidence to stimulate the flow of capital and to measure the efficient use of capital. To improve capital formation and the proper channeling of funds, adequate accounting of a micro and macro nature is required; changes or improvements may also be warranted in an accounting institutional, professional, legal, technical, educational, and certification content.





A greater degree of accounting harmonization or standardization is desirable to improve the reliability and consistency of information for internal and external enterprise operations, for sectoral and national accounting, and for other socio-economic purposes. Valuation of data, i.e., historical versus current, is another accounting issue which requires attention in most countries to facilitate better analysis, evaluation and decision making. Current values tend to reflect more relevant costs and benefits to maintain capital intact and to enhance capital formation.

Accounting in third-world countries and its scope for improvement

Accounting in most countries has emerged from an obligation for accountability based on law, economic, political, or religious power.

Enterprise accounting and auditing methodology and practice have been strongly influenced by foreign company acts and by legal and tax decrees and have been geared toward custodianship. Accounting may lack consistency and relevancy in both its practice and theory, making it difficult to compare financial statements, pinpoint capital and finance needs, measure efficiency, prepare feasibility studies (product appraisals) and construct budgets. Limited focus is given to accounting systems and procedures. Professional accountants may be hired for tax computation or bookkeeping purposes only. Auditing may be subject to extensive and detailed checking, largely due to the absence of good internal control and check systems.

Government accounting (e.g., public enterprise) is often seen solely as an accountability device for public receipts and expenditures. Methods are frequently antiquated without enough attention to sound estimation procedures and budgetary controls. Effective auditing standards and practices are not sufficiently stressed for government accounts, programming and performance activities, and public enterprises.

Macro accounting often lacks a good data base (e.g., quantification and valuation). Accountants may not be aware of the macro accounting requirements, e.g., value-added measurements, imputations, current valuations.

Education and training also has a strong accountability orientation, while management accounting, systems and procedures, cost-benefit analyses, feasibility studies, controls, government accounting and budgetary review, and "economic development accounting" are not getting due attention. Specialized accounting training may not be offered, and often one general accountant is produced. Institutional training for chartered (certified), cost and governmental accounting may be hampered by a shortage of good teachers, materials, and teaching aids. Many professional institutes have no training programmes at all. Vocational training also may be equally neglected. Accounting generally has a low status and accountants may be poorly paid.

Improvements in the accounting "infrastructure" are required. The aspects that warrant improvement are:

(a) Professional and institutional. A well-functioning institute with related professional activities is needed to evaluate the status of accountants, to establish and maintain accounting (e.g., auditing) standards and to disseminate information. An institute is also needed to develop accounting and auditing standards, codes of conduct, professional training and updating, research, reading materials, and clearing-house activities. Development banks can effectively stimulate professional and institutional progress, both directly and indirectly;

(b) Legal and statutory. These must be clearly spelled out. A company or an accounting act should set forth the economic significance, scope and content of financial statements, and the classification, valuation, and other measurement procedures to be applied. An accounting act may outline the qualifications and tests, registration requirements, accounting and auditing norms, required reporting to the Government etc.

(c) Adherence to accounting criteria and standards. Development banks (DBs) may use their leverage to ensure that accounting standards, methods, and practices are soundly conceived and followed. They can influence the financial planning and control systems of the firms they finance or are in contact with and secure adequate audits. DBs may well create separate "accounting development units" to serve present and prospective clients and other outside parties.

Underlying these requisites for potential improvements is the need for an "accounting inventory", covering manpower aspects by sectors and functions, and related legislative, institutional and educational elements. The inventory and layout of requirements serve as a basis for "accounting planning", covering educational, institutional, legal and professional aspects. It will be necessary to specify the respective training needs and developments by levels, functions and types, including upper, middle, and lower levels. Test and certification requirements must be delineated. The various forms of training should be spelled out, i.e., academic, institutional, technical and vocational. Institutional training demands a sound institutional (professional) setup covering the various fields of accounting. "Accounting development centres" to impart theoretical and practical knowledge for the private and public sector should be promoted. Such centres may be set up by country or broader region. These centres also should cover developmental aspects of an administrative, research, publication and information dissemination nature.

The role of accounting in development banking

To be distinguished are (a) internal accounting at DBs, (b) accounting at enterprises financed by DBs, and (c) general accounting tasks in the economy. Accounting at DBs would require:

(a) Clearly laid out accounting policies and procedures. These must cover financial accounting, budgeting, managerial and systems aspects. Guidelines should be harmonized. Adequate "development banking accounting manuals" need to be prepared, preferably with regional assistance and co-ordination;

(b) Training of own personnel in accounting systems and methods. It is desirable to conduct, on a local or regional basis, 3 to 6 weeks of condensed courses on accounting (financial management) for development banking. Such courses should include: feasibility studies and cost-benefit analysis; financial measurement and reporting; computer accounting and auditing; controllership, budgeting, regulatory aspects, international and regional accounting developments; professional enhancements etc. Regional development banks and international organizations may carry out or support such programmes. Upgrading and updating of accounting personnel may also be undertaken at accounting development centres.

Accounting at enterprises financed by DBs

A financial-administrative well run DB will set an example for enterprises it finances, while DB personnel can assist clients' accounting personnel in improving their accounting structures and practices. DBs could prepare standard accounting forms and procedures for enterprises, covering financial and managerial accounting, budgeting, accounting systems and methods etc. Such efforts may be part of the pre-financing (feasibility) study, as a technical assistance project, or as part of the project financing itself.

A well operating accounting system facilitates the auditing task, and helps reduce audit costs. An inverse relationship tends to exist between the accounting system and the audit scope. The audit should also result in a "long form" report, DBs may insist upon an adequate system of accounting control and check and the preparation of sound financial and cost statements covering past and projected (pro-forma) data and statements.

Project feasibility studies of a standard layout nature are warranted. These studies need to convey systematically and quantitatively the (direct and indirect) costs and benefits regarding projects. A macro or sectoral economic-accounting analysis will be an integral part of such project studies. These studies should be tied into input-output analysis. All these activities belong to the accounting sphere of operations.

The technical assistance function of DBs

The technical assistance function of DBs has internal and external components. Externally, they may require that adequate systems are installed, audit reports submitted etc. DBs may keep a record of accounting firms that can grant such services, while they also may set up their own accounting service units to cover local and regional assistance requirements.

Nationally, the main thrust will be to spur an accounting/auditing profession, accounting institute, legislation, training and education, clearing-house and research and developmental activities. DBs can become directly involved in the development and financing of such activities or act indirectly, as a vehicle or catalyst, to spur such implementation. International and regional development institutions have extensive clout in these matters. DBs may want to set up appraisal teams to determine the best ways to develop a useful accounting infrastructure in countries. They may help assess the accounting and auditing standards, accounting acts, and the reporting system. DBs may work closely with regulatory agencies and educational institutions; accordingly, they can function as catalyzers for change.

Ways and means for improving accounting in the third world

Accounting improvement efforts by DBs should be actively spurred. The required improvements are of a methodological, professional, and educational nature, and may comprise internal, external and joint elements. Internal supporting elements cover a layout of an accounting inventory and plan, professional and institutional enhancements, governmental support, and development of norms, practices and training. The internal elements may require external and joint means of the following nature: accounting development centres of a regional or international nature, accounting service corps, support for foreign accounting institutes and firms, exchange of technical personnel, teachers and materials. A need exists to upgrade all sorts of financial management personnel.

Better international and regional co-ordination should be sought and may warrant setting up an international institute for development accounting to function as a clearing-house or association for eco-accounting development purposes. Financial support for such programmes may come from international development agencies, regional and local development bodies, accounting institutes, government agencies and foundations.

Conclusion

Accounting and auditing in many third-world economies have not received the attention they require. These economies may not have been adequately exposed to current and relevant know-how practices and developments in the various systems, methods and practices of accounting, auditing, and related educational elements. A need exists to spur developments at three levels: DBs, clients of DBs and national. An adequate accounting planning framework may have to be installed, covering the whole accounting infrastructure, e.g., education, administration and accounting development.

DBs can influence improvements as follows:

(a) Install good financial and cost accounting systems and practices at their own units and at units they contact;

(b) Require effective accounting and auditing methods and procedures at firms they finance;

(c) Serve as an agency to spur national and regional accounting systems, auditing norms, institutional and professional aspects, educational developments etc.

Development banks should carefully appraise their direct and indirect functions from an enterprise and national point of view, and take steps accordingly. DBs can and should play a very effective role in spurring accounting progress at all levels and sectors of the economy. Their ways and means should be carefully set forth by them with the assistance of regional and international development organizations.

Part two

DIVERSIFICATION OF ACTIVITIES OF DEVELOPMENT BANKS

A. *Plenary Sessions*

PROJECT IDENTIFICATION, PREPARATION AND PROMOTION

Baldev Pasricha, *Chairman*

Industrial Finance Corporation of India

The countries whose development banks are represented in this Symposium have diverse characteristics. History, culture, stage of industrialization, level of economic development, natural resource endowments, and a host of other features distinguish one from another.

The development bank's internal environments is as varied as its external. Therefore, no two development banks are alike. Still, all development banks are looked upon as engines of economic development and their common endeavour is to accelerate the pace of economic growth in conformity with national objectives, plans and priorities; hence their vital interest in project identification, preparation and promotion.

The project seeking assistance from a development bank is both a business risk and a step towards the accomplishment of desirable socio-economic goals. Apart from the macro angle, the development bank examines the project in question, keeping several factors in mind, such as its technical, financial and economic viability; the experience and integrity of the promoters as well as their own financial contribution to the project cost; the quality, adequacy and competence of management; the socio-economic spin-off expected from the project, its contribution to the development of a culture; its employment potential; its contributions to an improvement in the balance of payments; its demands on scarce domestic capital, scarce foreign exchange resources or infrastructure facilities; its linkages with other sectors of the economy, its contribution towards development of local skills and use of indigenous technology or absorption of foreign technology; its potential for future diversification; its resistance to adverse market developments resulting from changes in consumer preferences, governmental policies, international developments, emergence of substitutes etc. A project which scores high in this long list of attributes should be called a good project.

Improving the quality of projects before their presentation to a development bank is an important contribution. Once it is possible to discern what the features of a good project are within the context of the environment in which it functions, one is then prepared to make a proper evaluation of the project. This is particularly true in the case of projects sponsored by entrepreneurs entering industry for the first time and not familiar with the requirements of development banks.

One might ask how a development bank can best use its knowledge, experience and resources to spawn a number of good projects. The first step towards meeting this challenge lies in surveying and evaluating the adequacy and effectiveness of measures already taken to promote industrialization. The next step would be the clear identification of critical gaps.

Before the promotion of industrial projects, infrastructure facilities should be provided. When developed land, water, power, transport and communication facilities and industrial training institutes are taken into account, a congenial climate for the promotion of industrial projects is created. Specialized institutions and what are called "promotional activities" are also necessary in the field of finance.

The need for broader industrial promotion strategy and the importance of providing physical and institutional infrastructure facilities should be emphasized; with the understanding that project identification, preparation and promotion activities cannot be undertaken by a development bank in isolation.

The question becomes: How should a development bank go about the task of Project Identification? These are some answers:

(a) Import substitution is perhaps worth exploring at the outset. Not all products which are imported will be worth substitution by indigenous manufactures. There might still be a good number of products that are actually imported which could well be manufactured indigenously, based perhaps on the import of necessary capital equipment, technical know-how, and raw materials;

(b) Export-oriented projects could also be identified by scanning the list of exported raw materials. Here the endeavour should be to export semi-processed or finished goods instead of raw materials, or to improve the value added component of exports;

(c) Growth in the size of the domestic market for many consumer goods determines possibilities for increased manufacturing or processing. Here, identification of the project idea must be followed by a market survey. A preliminary study is necessary only in those cases where market prospects appear to be promising;

(d) Another approach is to study promising project possibilities through industry sector studies. Long-range availability of indigenous raw materials, market prospects, technological aspects, performance of existing industrial units in the sector, plant and equipment availability as well as costs of manufacture could be studies in an integrated manner and new investment possibilities thus identified;

(e) A conscious effort should be made to identify projects which can be set up quickly. When a few are identified at an early stage, such projects guarantee the continuation of the more ambitious project identification efforts.

The funds expended by a development bank in a systematic effort at project identification are in the nature of an investment which promises good dividends. By the same token, the expenditure on project identification exercises including staff salary costs should be carefully evaluated and progress closely monitored.

On the other hand, project preparation represents an activity resulting in the conversion of a project idea into a bankable project. It requires professional skill in a variety of disciplines, such as engineering, market research, finance and economics.

The progression from a project idea to a bankable project is gradual. Project ideas do not necessarily result in bankable projects. One must proceed through pre-feasibility studies, techno-economic studies, feasibility studies, and detailed project reports.

As the task of project preparation is considerable, it makes sense for the development bank to seek assistance from consultants and industry specialists. But, in order to best use these consultants, the development bank needs experienced, professional personnel.

Where consultancy firms are not readily available, the development bank may consider organizing its own division, specializing in technical consultancy for selected industries. However, a development bank which successfully undertakes project preparation could find itself a way off its original course and its own assigned function; such neglect could prove to be a costly mistake. Further, the development bank could well experience a loss of objectivity in appraising the preparation of its projects.

The next concern becomes project promotion. A healthy industrial enterprise such as a development bank aims to achieve has two prerequisites: a good project and a good promoter. A good project in the hands of a second-rate promoter is as apt to fail as a good promoter trying to implement a

poorly conceived project. The essence of project promotion, therefore, lies in bringing together a good project and a good promoter and keeping them together. The binding force is finance, post-finance supervision and guidance.

One should look for a promoter who is enterprising and enthusiastic and who has the relevant business background or considerable managerial competence. It is understood that the project promoter should have a financial stake in the project. It is possible for the development bank or an interested agency to provide seed-capital assistance, which might induce entrepreneurs of relatively modest means to enter industry as promoters of projects, thereby enlarging the entrepreneurial base.

There are several ways for development banks to encourage new promoters. Counselling and advisory services could be provided, free of cost, funds for project preparation could be provided on soft terms, and equity investment could be offered to increase motivation. Besides the usual assistance, e.g., loans in foreign and local currencies, underwriting and guarantee facilities, development banks can attract promoters by offering special services. For example, Merchant Banking services could be made available for mobilizing local-currency resources and arranging foreign-exchange loans. Assistance could be offered for obtaining government approvals and agency co-operation.

There is even a more direct way of assisting the prospective promoter. In India we call it the joint sector. Organized by the development bank, it is a project in which the development bank and the private promoter are more or less equal partners, together holding 51 per cent of the equity. The balance of 49 per cent is subscribed by the public. It is understood that the day-to-day management of the project lies in the hands of the private promoter, a fact determined by the joint sector agreement made between the development bank and the private promoter. Though his share in equity is only 25 per cent, the private promoter retains control of the project. This is a much lower investment in equity than would be necessary to retain control if the development bank were not his partner.

The joint sector concept has helped spawn a number of medium-sized projects in India. Its success depends on the careful selection of private promoters as partners. If in a joint sector enterprise, the private promoter fails to do his part, the development bank has no alternative but to try to effect a change in the management by bringing in another private promoter.

Another aspect that should be considered is the viability of the development bank itself. If a development bank launches several projects on its own and these run into troubled waters, the financial viability and hence the resource-raising capability of the development bank itself is likely to be impaired.

If a development bank assumes the role of promoter it should be as a separate legal entity with a clearly defined financial and managerial setup. Its industrial enterprise becomes a separate undertaking, managed by the development bank until it is functioning. Then the possibilities are twofold: find a private promoter who will take over the project entirely or agree to manage it as a joint sector project.

Development banks can play similarly important roles in the promotion of small-scale industries. Approaches to project identification and preparation are much the same. The number of entrepreneurs to be identified will be much larger for the development of small-scale enterprises. The logistics may have to be slightly altered as the organizational structure might have to be largely decentralized. Here, the institution of entrepreneurial development and training programmes by development banks all over the world is especially promising. The aim should be to identify target groups of entrepreneurs and use organizations at the grass-roots level to deliver specially designed entrepreneurial development and training programmes.

The various stages of the project cycle discussed here, namely project identification, preparation and promotion, are integrally bound by the logic and objectives of industrial enterprise. The line of approach to be adopted,

its selection from available alternatives and the paths chosen at different stages of the project cycle can lead to desired results only if all the interrelated aspects are kept in view.

DEVELOPMENT FINANCING INSTITUTIONS AND MULTIPURPOSE BANKING

P. Mistry

SGV Group, Philippines

The thrust of contemporary development financing can be traced to the early 1950s, when the World Bank made loans to two institutions in Ethiopia and Turkey. By the late 1950s, the World Bank had become an enthusiastic proponent of the private development finance institution (DFI). It saw the potential for promoting growth of new enterprise in the industrial sector and, to a lesser extent, in the transport, tourism and mining sectors of developing economies. It also saw DFIs as catalysts for capital market development in the third world.

During the First Development Decade in the 1960s, a large number of private DFIs were established and supported in Asia, Europe, Latin America and the Middle East.

By the end of the 1960s, it was realized that it would be limiting to channel resource transfers only through private DFIs. They alone would not be able to meet the long-term funding needs of an increasing segment of eligible and deserving borrowers in the developing countries. And, it had not yet been proven that private DFIs would promote capital development in the third world.

The Second Development Decade in the 1970s saw an increasing proportion of the resources of multilateral financing institutions being channelled to large public development banks in Asia, Europe and Latin America. It also saw the establishment of many new institutions, public and private, in Africa. This increased flow of funds resulted in making more resources available to a wider range of industrialists and business enterprises in the developing nations. However, it did little to further the development of the capital market or financial sector.

At the outset of the Third Development Decade, it seems that large public institutions with government backing will stay alive. The survival and growth of the smaller private, vulnerable institutions as well as the mature public institutions depend on their ability to confront the following pressures:

(a) Other sources will become attractive or necessary as they are weaned away from traditional sources such as the World Bank, regional development banks and bilateral aid institutions;

(b) They must expand their range of financial services in order to remain competitive with other financial institutions and meet the increasingly complex financial needs of their own borrowers in a world of floating exchange and interest rates;

(c) Their financial institutions are offering competitive financial services to meet the increasingly complex needs of their borrowers;

(d) A greater diversification of the various financial instruments and assets, which are available in the capital markets of developing countries, will become necessary in order to meet the different needs of savers.

Obviously, not all DFIs will face these pressures to the same degree. Many may not encounter them until the next decade. But the responses of the more mature DFIs, especially the private DFIs, in the middle income and poorer

but semi-industrialized countries will provide the examples and establish the precedents.

The need for further diversification of fund raising efforts and financial services offered by the more mature DFI in Asia, Europe and Latin America is not disputed. A large number of DFIs have instituted programmes of operational diversification over the past three to five years with varying degrees of success.

In South East Asia most mature private DFIs have affiliated financial companies specializing in: leasing, investment services, mutual fund and unit trust operations, merchant banking, industrial estate and factory development, securities brokeraging, and management consulting. In Singapore a small DFI has become, in only ten years, a formidable financial force providing a wide variety of banking and financial services. In South East Asia and a few other areas, DFIs are also taking the lead in establishing housing and mortgage finance institutions.

The continued financial diversification of DFIs is inevitable. The question therefore is not whether DFIs will diversify but how they will do so and when?

Core institutions, whether commercial banks, development banks, investment banks or finance companies are all potential candidates for forming the nucleus of major financial agglomerations. Such agglomerations could become cohesive, monolithic universal banks. Specialized units could retain separate operational identities and operate as a conglomerate under a single corporate flag.

Relative to other types of indigenous financial institutions in the developing countries, DFIs are in a better position to anticipate and respond to evolutionary forces and competitive pressures. They have a skilled staff capable of long-term planning and are likely to have a better appreciation of the linkages between the various institutions in the financial sector.

At another conference last month in Asia, I implied that some of the managements of older established DFIs had become older and established themselves. I wanted to suggest that there was no room for complacency when it came to understanding developments in financial technology.

Their internal capability to anticipate and diversify gives DFIs an edge but they are at a decided disadvantage when it comes to financial resources. Even mature DFIs are overly dependent on concessionary sources of long-term funds or the foreign side of their operations. These account for between 70 per cent and 90 per cent of the total. Several Asian, European and Latin American DFIs have the capability to borrow foreign funds on commercial terms. But, without government guarantees it is unlikely they will be able to raise purely commercial resources with the same maturities, at the same costs and in the same quantities. Assuming total substitution of commercial for concessionary funds were possible, the fact that most DFIs operate under conditions of a constrained interest rate, would make total substitution financially unattractive.

Domestically, DFIs have raised the bulk of their borrowings at market rates. Public DFIs have had a real advantage over their private counterparts. They've had access to long-term domestic resources, frequently with longer maturities and at a lower cost. Still, they are considered to be secondary mobilizers of local funds. And so, neither the public nor the private DFI gets as much attention as other claimants.

Multipurpose banking seems inevitable in the light of the following assumptions:

(a) For mature DFIs, access to concessionary foreign funds is going to be curbed during the 1980s;

(b) Total substitution by foreign commercial funds will neither be possible nor financially feasible for most such DFIs;

(c) The resulting shortfall in resources and operations will not be made up by domestic financing operations if DFIs are constrained to being secondary mobilizers of funds in the local market.

Therefore, many DFIs will be faced with one of two possibilities: either their total operational base will start shrinking or they turn to raising other kinds of funds from foreign and domestic sources as primary rather than secondary mobilizers of funds.

In short, to survive, to grow and to make good on the expectations of their shareholders, mature DFIs will be faced with no choice but to go into the commercial banking business.

Up to now, with few exceptions such as in Singapore, DFIs have not generally diversified into banking. They have instead diversified into non-conventional financing.

There are several reasons for this, the first being that numerous governments have discouraged DFIs from going commercial. In many developing countries today, it is difficult for financial institutions to obtain a commercial banking license or even a license to take deposits. The second reason is that DFIs may have been reluctant to encroach on the territory of the commercial banks when they themselves already had a monopoly at the long-term lending end. The banks' reaction would have been harsh and perhaps uncontainable. However, mature DFIs in middle-income countries no longer have this monopoly. And for those that still do, it is not likely to last long. Once major international banks, or money centers entered the regional markets of Asia, Europe, Latin America, the Middle East and a few countries in Africa, the competitive impact became pronounced. These major internationals have excellent project-financing capabilities. While they continue to be collateral conscious, they are speedier in their decision-making, more responsive to client needs, less rigorous about discipline in the client relationship, and more capable of providing a total package of client services, from overdraft facilities to asset insurance. Besides sometimes outclassing the DFIs, the presence of the internationals has spurred domestic commercial banks to respond. Once content with a co-operative relationship with the long-term lending institutions, domestic banks have strengthened their own long-term lending capabilities and are aggressively going for project financing and total package approaches. In terms of their staff capabilities and their collateral orientation, they do not yet represent a real threat to DFIs. The third reason is that the intensive association between most mature DFIs and their traditional concessionary creditors (such as the World Bank) may work against developing a commercial banking orientation. Somehow, being developmental became much nicer than being commercial.

The development bankers supposedly:

(a) Did all the hard work in identifying good projects;

(b) Took risks and did not insist on too much collateral;

(c) Supported the client, regardless of the circumstances;

(d) Concerned themselves with economic impact, exchange earnings and employment effects.

The commercial bankers:

(a) Took deposits from the poor and made loans to the rich;

(b) Were not overly concerned about project merits so long as they had collateral,

(c) Did not pay much attention to financial discipline;

(d) Made loans at excessive spreads and only to prime clients;

(e) In the event things went wrong, the commercial banks foreclosed and took the profits.

It seems that one should start out developmental only to become totally commercial in the end. And it is desirous to become commercial as quickly as possible. A fourth reason is that at an earlier stage in their evolution, and in some cases later, a number of mature DFIs found that in order to achieve rapid growth in the banking business they seriously lacked internal managerial and staff resources. Their capacity to hire and absorb large numbers of staff, and to successfully control and manage a burgeoning commercial banking operation was limited.

The establishment of a direct banking link with a broad domestic deposit base is a functional imperative for the future viability of DFIs. In most developing countries DFIs should consider the merger or acquisition route.

Private DFIs in many middle-income countries are good targets for take-overs by larger, strong commercial banks in their respective economies. This is especially the case if they specialize in conventional long-term lending, or if they diversify into non-conventional activities but concentrate on the long-term financing aspect. The only barrier to this aggressive behaviour would be the introduction or enforcement of legislation. For a sound development of the financial sector in many of the third world nations such legislation may be neither desirable nor practicable.

DFIs can still be successful by anticipating these possibilities earlier and by responding accordingly. They do have the option of being active agents in the financial sector. Mature, private DFIs in the industrializing countries of South East Asia, in some Southern European countries and in Latin America should begin seriously considering the possibility of merging with or acquiring small commercial banks or larger savings/thrift banks in their respective economies.

Many such DFIs already perform deposit-taking functions, but their activities are confined to accepting only large institutional and personal deposits. With an expanded and stable primary deposit base of smaller individual savers, DFIs would need to provide essential services to meet the financing needs of the depositors. The deposit base must allow for a prudent level of term transformation and the ability to meet the short and medium term financing needs of traditional clients, i.e., medium-sized business clients. Access to such a deposit base would enable DFIs to provide a complete package of financial services and banking facilities to smaller business enterprises, a market which many DFIs are striving to service more effectively. The acquisition/merger route also has the advantage of being associated with an established management structure and institutional mechanism for attracting deposits and undertaking short-term loans.

Initially, at least, DFIs going into the banking business should build on their existing operations and provide clients with additional services. These might include:

Current account and overdraft facilities for daily working-capital needs

Specific-purpose short-term loans for packing credits, import credits, export bridging finance and LC facilities

Trust receipt and acceptance financing

Inventory financing against raw materials, work-in-progress and finished goods

Short- and medium-term lease finance facilities or hire-purchase facilities for small equipment items on a medium-term basis

Payroll-clearing facilities

Clearing-house facilities for inter-firm credit financing arrangements

Pension-fund planning and management facilities on a trust basis

Trust services for corporate portfolio management

Foreign-exchange hedging facilities and currency-exposure management services

These specialized banking services would be coupled with efforts to attract corporate accounts on a stable long-term basis. The aim of DFIs would be to provide a full range of financial assistance to medium-scale corporate clients who are forced to manage the financial pressures of expansion and diversification. That orientation would appear to be a natural extension of the present medium- and long-term financing activities of DFIs.

There is also the prospect of similar affiliations with insurance companies offering a full range of insurance services to meet the needs of business enterprises. Many DFIs in Asia have already entered the insurance agency and broking business, which provides them with another source of commission revenues. Direct participation in the insurance business on a managed-risk basis is always a possibility. Such an association would also enhance DFI access to long-term domestic resources for business financing.

Addressing the critical shortage of long-term funds for development oriented investments in the third world is a critical and significant task. However, DFIs which are devoted to that, and only that, task are likely to be doing their clients, their economies and themselves a disservice. It seems to be a dead-end for mature private DFIs in middle-income countries to concentrate only on term-financing.

For many DFIs, contemplating an entry into multipurpose commercial banking, the following constraints and risks should be anticipated:

The need to push already exhausted management capabilities

The realization of limited staff capabilities

The effort to combine at top management level the quite different perspectives of commercial and development bankers

Disputes with Governments and at times international creditors on major policy issues and regulations which would inhibit entry into short-term financing

Competitive reactions from commercial banking counterparts and the loss of their market share of the long-term financing business

The inability to cope with the transition period and the threat of competitive setbacks

Inadequate net earnings and dividends for a period two to three years before stability and growth can be achieved

Untimely upheavals in the financial sector and consequent repercussions

These risks are real and nearly impossible to avoid. But the potential rewards are substantial.

Finally, mature DFIs, especially private ones, cannot rely on concessional assistance and direct or indirect government support. They cannot expect to be given special treatment and favored status within the financial community simply because they carry the word development in their corporate title. Their justification is to become totally self-sufficient and yet retain their developmental identity.

The entry of DFIs into multipurpose banking must be seen as a service-oriented developmental response to the needs of an ever-widening clientele. These needs increase as financial and business environments become more sophisticated. They usually grow more rapidly than does the ability of enterprises and entrepreneurs to cope. Providing multipurpose banking services is one way in which DFIs can help their clients better cope.

Such service capabilities should also enable DFIs to address the legitimate financing needs of business enterprises in the services and construction sectors where the need for various forms of short-term working-capital support far exceeds the need for fixed-asset financing. These sectors have been ignored by the development finance community for too long and for the wrong reasons. They offer solutions to problems of low-cost unemployment and access. It is important that their potential be recognized.

In closing, it is as well to recognize that the last 20 years have seen rapid strides in the progress made by individual DFIs. They have also seen a massive increase in the contribution made by the development financing community to economic growth in the third world. Of course, development priorities, strategies, and approaches to problem solving have changed over the last two decades. Indeed the structure of the world economy and the international financial system have changed in ways that I suspect are not yet fully understood. It is in the context of such changes that DFIs must strive to maintain their relevance to the needs of their communities.

It is inevitable that Governments, creditors and clients will disagree about what DFIs should do to remain relevant. And, it is the business of DFI management and boards to read the signals and make the appropriate decisions about the future.

NON-CONVENTIONAL METHODS OF FINANCING

R. W. Richardson, Director

Development Department, International Finance Corporation

Non-conventional methods of financing could broaden the horizon of development banking and make more significant their developmental contributions in the years ahead. Before a discussion of these methods, it might be helpful to consider the pre-conditions and problems. The environment, politics, developmental goals and basic economic structure characteristic of the different countries determine the success or failure of financing. The staffing capacity, and the mixture of talents available to DFCs, are variables which also must be considered. The differences make it possible for one country's DFC quickly to staff a new operation with well trained people, while in another country such training may be scarce and make the performance of a DFC impossible.

However, the future of the DFC in the development process should be considered productive. A DFC should be primarily concerned with problems of transition. The DFC, in the best sense, represents and symbolizes the developing economy itself. As development proceeds and the economy evolves, the demands placed upon the economy, and therefore on the DFC, change.

Changes occur at different stages of development. Some goods and services with high economic productivity at an early stage will lose their importance, while other activities will emerge in the course of development.

Institutions dedicated to accelerating development should understand that expansion is only possible if they are constantly on the alert to provide services appropriate to the needs of the community. One such service, which is of real interest to the developing world, is the leasing company.

Though the industrial world originally became interested in leasing for purposes of avoiding taxes, this service has become an increasingly effective vehicle for development. It broadens financing options available to enterprises that are short of capital, therefore contributing to the process of industrialization. A lease is a contract between a lessor and a lessee for a specified period of time. Payments become due at regular intervals in exchange for use of a particular asset. Therefore, most of the economic value associated with ownership is contracted for, while the actual title and any benefits derived from tax considerations and the residual value of the asset at the end of the contract are retained by the legal owner.

A lease should not be confused with an ordinary debt security, where the borrower undertakes an absolute obligation to repay the principal at a specified time in the future. A lease, on the the other hand, represents a conditional contract because it depends upon the future use and condition of the asset that is leased.

Leasing is attractive because it is a source of long-term financing for firms seeking expansion which are otherwise unable to raise capital in the marketplace or for firms whose scale of operations would not justify outright purchase of costly equipment. Capital is freed for other uses.

There are obvious drawbacks and they must be carefully examined. Leasing companies rely heavily on well-trained, highly skilled personnel. Company management must have a sound operating knowledge of financial analysis, the technical nature of the equipment being leased, tax law and marketing. It is, in short, a technical business involving high risks.

Economically, it is important to determine that the use of the leasing instrument is appropriate to the stage of development. The country must have a reasonably sophisticated tax system, and standard accounting procedures must be widely practiced. The legal basis for such arrangements must be well established, since the process of leasing normally involves extensive negotiations and documentation resulting in highly complex contractual agreements.

It should be kept in mind that a principal objective for the introduction of leasing arrangements, from the social point of view, is to stimulate the growth of the capital goods sector. Leasing may stimulate the demand for capital goods before the economy is in a position to increase its supply of them. In such circumstances, the primary burden may fall on imports and foreign exchange reserves and be seen as economically inopportune.

In each case, it is essential to assess the appropriateness of an innovation to the time and the place. One should not be persuaded that a leasing company or some other instrument will solve all problems.

Another possible area of innovation that DFCs might explore, one that is not as fashionable as leasing companies, is the field of business insurance. The cumulative risk of loss associated with business activity in terms of transportation, maintenance of inventories, ownership of capital assets etc. can always be measured and is frequenty quite high. Creation of a business insurance facility distributes business risk and is a vehicle for the mobilization of savings, with positive implications for economic growth. It should be borne in mind that this type of activity is appropriate in some circumstances and not in others. But in every instance it would seem a sensible initiative for DFCs to undertake an analysis of both the need and the feasibility of such insurance facilities in their own community.

DFCs may profitably explore new involvement in the area of engineering services. Here again, the stage of development and the structure of the private sector will determine the potential success of such enterprises. Small and medium-size enterprises may not be internally capable of maintaining the necessary engineering services. In such cases engineering and technical consultancies can efficiently provide services in economically sized packages so long as they are staffed with professionals familiar with local conditions and requirements. This means that such firms from the outset should be well staffed with nationals, besides the foreign talent.

This concept could include the whole range of financial services such as controllership, accounting and computer services. When offered on a consulting basis to small and medium-size enterprises they are likely to produce excellent economic results.

The exchange of knowledge and information which should be characteristic of engineering and financial management service firms is especially important where industrial activity is concerned. It is essential to the growth process, but is extraordinarily difficult to develop. Proprietary secrecy and technical or educational inadequacy are attributed to the poor information flow in industrial activity. It is possible and would be significant if the DFC were able to establish an information clearing centre which would make available to interested parties the current state of knowledge in technical and commercial matters, as practiced in the domestic economy and abroad.

The DFC could easily co-ordinate knowledge of its own projects and activities with its understanding of the greater community to which it has access. How such information would be made available is yet to be determined. Perhaps the DFC would wish to absorb a negative return, considering the social overhead nature of the service, as well as the need to convince the community of its usefulness.

The International Finance Corporation has been discussing the creation of a national technology development and financing function which would promote appropriate linkages within industry and between industry and agriculture. This would be accomplished by the identification and development of products and technology that could be widely used to increase productivity. In the case of India, the objective of such a new institution is an increase of agricultural productivity and an improvement of rural income. And if viable, its application for a developing economy would be a natural extension of the activity of a DFC, to either promote the creation of a wholly new institution for this purpose or to begin more modestly by organizing a separate department within the DFC to consider this activity and nurture it to maturity.

Domestic and foreign scientific and technological research institutions have attempted to find lower-cost solutions to consumption and investment requirements in developing countries. They have developed economic modes of transportation and energy, simple building materials, uncomplicated power-driven agricultural equipment and protein-enriched supplements. However, with very few exceptions these initiatives have remained on the shelves of R & D institutions and have not been commercially produced or marketed. An institution which could identify products that are technologically appropriate, test their use and applicability on a selected basis, promote the necessary industrial capacity to produce these products on a mass basis, and help to organize their marketing, would be making a great contribution to the national development effort.

The idea is to bring together in one place the whole range of activity, from initial product identification, to commercial development, through to effective marketing. The new function goes beyond being a co-ordinating body. The aim is to become an investment bank with a strong technology development orientation and the capability to test and appraise products developed by domestic and foreign R & D institutions for local suitability, and for commercial development.

Ideally, the operations of the technology banking function would fail into two distinct but complementary categories. The first would be the identification of specific technological products or projects needed to accelerate economic activity. This would mean conducting a micro-level market research for the identification of commercially viable product lines and at the same time a search for appropriate products or processes not currently in development or unavailable. The job then is to locate potential markets, test the acceptability of such products and, if necessary, introduce modifications to suit local conditions. This phase involves the upgrading, adopting or improving of the existing technologies rather than the development of new ones.

The other phase of the bank's operations would be to act as an entrepreneur. Following the project identification studies, it would prepare detailed feasibility studies, locate potential partners, obtain required approvals, and arrange the financing. Needless to say there are many obstacles. DFCs and the talent available to them have the advantage for this kind of venture. It has the particular advantage of being able to be launched on a small scale as a new department within DFC, thus minimizing the chance of failure and maximizing its flexibility for experimentation.

FINANCING OF EXPORTS FROM DEVELOPING COUNTRIES

Helmut H. Haschek, *Chairman*

Österreichische Kontrollbank Aktiengesellschaft

The world economy has been regarded with increasing pessimism over the past few years. "Scenario" has become a fashionable term used by economic futurologists who base their projections on exponential growth patterns that can't help but lead to explosion. The question becomes, when will the explosion take place, which once again depends on the inserted rate of the growth factor.

There is a basic disequilibrium between surplus and deficit regions in the world, and the challenge for some time to come will be to find ways to transform financial assets into a real transfer of goods and services. The establishment of integrated export financing and insurance agencies in the less developed countries (LDCs), intended to achieve both increased foreign exchange earnings and diversified, self-liquidating financial assets aiding the reinvestment of accumulated foreign exchange surpluses, would be a significant contribution.

One of the sources for optimism is the development of world trade. Since the Second World War world trade has grown as never before and to a certain extent developing countries participated in its growth.

There is a complaint that the existing economic order did not allow the LDCs to participate in the prosperity of the industrialized developed countries (DCs).

As prosperity itself is no way to measure progress and achievement, it is held that it is the result of political exploitation by economic means. The gap between the rich and the poor has been widening and the terms of trade for the LDCs has a persistent tendency to deteriorate.

The third world, however, is a much more heterogeneous group of countries than the world of the industrialized countries. Apart from the rich oil countries, officially classified as LDCs, there is the large bloc of relatively advanced LDCs (Argentina, Brazil, Republic of Korea, to name a few) at the one end of the spectrum and the very poor countries, the so-called least developed countries at the other. There is no single gap separating the LDCs and the DCs; on the contrary there are a number of gaps between smaller groups of countries and between individual countries, LDCs as well as DCs. Some of these gaps have grown, others have gotten smaller. And it is not difficult to find gaps between individual countries which have reversed themselves.

As far as the foreign trade of the LDCs is concerned, the post-war development has been satisfactory. The terms of trade have exhibited cyclical fluctuations but it is as yet not established that there is a secular trend for the group to deteriorate.

Exports of the LDCs (exclusive of the oil-exporting countries) increased during the post-war period according to International Monetary Fund statistics from $15.9 billion in 1952 to $118.2 billion in 1976. Even though LDC exports are hampered by protectionist policies of the DCs, their exports of manufactured goods have expanded rapidly, increasing from 10 per cent of

total non-oil exports in 1925 to 41 per cent in 1977. About 80 per cent of the LDCs' manufactured goods exports go to Western industrial (OECD) countries and Middle East oil-exporting countries. Of the remaining 20 per cent, the largest part is accounted for by intra-LDC trade and only an insignificant fraction goes to the centrally planned economies.

Little has been done to organize export development from the LDCs. There is no problem with developing countries borrowing capital abroad, provided it is used for productive purposes. However, they must be prepared for the problem of maturity as well as the size of indebtedness.

Export financing for trade promotion is based on present-day export credit insurance systems. These were created at the turn of the century to help diversify credit risks of suppliers in international trade.

Exchange restrictions were chiefly used for financing in international trade. The exporter became the main creditor in international exchanges. The banks' role was reduced to providing financial assistance by refinancing the exporter, who then also became the main debtor. Credit was, therefore, nearly always a domestic operation in the country of the exporter.

At first, the main purpose of export financing was to bridge the financial requirements of the exporters when they sold on extended terms (terms were extended to allow the importer to reimburse the exporter after he sold the goods). It was the financing of the distribution of goods over national boundaries. The additional risk was the political risk of increasing exchange difficulties and was assumed by the various Governments involved.

In the early 1960s export financing took on another function. Export credits were used as investment credits in project financing. It worked like this: Buyer credit formula and credit insurance were no longer offered to exporters but were being offered by banks lending to importers. From an institutional point of view, the administration of the credits and the insurance was handled mostly by commercial banks and the already existing credit insurance organizations.

This represents the first stage in development for dealing with export financing from developing countries. Current international discussions, for instance in the realm of the OECD, are concentrated on long-term financing and interest subsidies. It would simplify matters if we were willing to agree to make a distinction between export financing of the distribution of goods and project financing.

The development of LDCs as future importers depends on whether they will be able to increase their export earnings and narrow the existing imbalances between the world trading regions. In the industrialized countries export financing will continue to assume a more prominent role in long-term project financing. Export financing in the LDCs must be developed in the short and medium term to secure increased foreign exchange earnings. This is a re-distribution of roles which requires restructuring of the industrialized world's economies and which calls for sacrifices that are only possible in an atmosphere of growing world trade where all partners benefit from the international division of labour.

Unfortunately, this has not been the case. Surplus in one part of the world has been used for the acquisition of financial assets. The growing deficit in other parts of the world limits the volume of financial assets to invest.

And so, the creation of viable export financing, organizations in the developing world using the industrialized countries experience of 50 years could serve a double purpose:

(a) To positively influence the growth of export earnings of the developing countries;

(b) To create new borrowers in international markets with diversified, self-liquidating assets expressed in foreign exchange with maturities on short and medium term, which would form an ideal basis to be internationally re-financed in markets in which short-term and medium-term funds are abundant.

LDCs mainly export raw materials, agricultural products and, increasingly, light manufactured goods. For obvious reasons they are not exporting fuels, the buyer market being what it is at present.

Because raw materials and agricultural products are sold on cash or near cash basis, rather than credit, one sees that export financing for trade promotion relates almost exclusively to the sale of manufactured goods. The problem in the field of raw materials and agricultural products is not one of financing the distribution of the sale of goods but that of price stabilization.

It is quite different with the sale of manufactured goods. Extended terms have been established. The traditional forms of financing have not been maintained and the use of confirmed letters of credit has been widely discontinued.

It is clear that export promotion as proposed presupposes a certain commodity structure. If this structure exists, it can be used as a strategy. But, export promotion also presupposes a certain commercial and banking infrastructure, as it is a device to assist exporters.

As more and more LDCs enter the international markets, the political risks involved in export transactions rise. As trade expands, the political risk of non-payment due to exchange difficulties and currency fluctuations are of real concern to exporters.

The risks vary with the direction of trade. Exports to industrialized countries and to some oil-exporting DCs almost always involve commercial risk. The LDCs have a comparatively favourable position vis-à-vis their potential buyers as far as the foreign trade risks are concerned, for example, the various self-supporting schemes provided by export credit insurance.

This is also true as regards the risk of currency fluctuations when exports of LDCs are involved. The inflation differential between the contract currencies and the local currency is usually in favour of the former.

Export financing requires the creation of an export insurance scheme. Its primary function is to protect the exporter from additional risks he faces when selling across national boundaries, not to create additional competition between the exporter and the domestic entrepreneur.

The funds can be made available to the export community at lower rates without redistributing national income to the exports (i.e., subsidizing exporters). The lender assumes only the risk that the exporter performs accordingly. The foreign risk is excluded. An effective export insurance scheme allows a far better diversification of risks by using as frequently as possible the law of large numbers rather than that of thorough examination of the credit risk involved.

It should be noted that selling goods abroad on extended terms puts an initial strain on the balance of payments of the exporting country. It is not so apparent because in most cases trade balances show the physical exchanges of the goods rather than foreign exchange flows.

The question is whether the total volume of exports can be increased in the long run with a positive growth effect. Provided the export financing schemes are operated on a self-supporting basis, this growth effect can be achieved. The temptation is to use export insurance and export financing to subsidize export which in effect is a misallocation of resources. In any case, there is the funding problem, but that can be resolved by attracting international finance.

Looking ahead to the day when export promotion is accepted as beneficial for the economies in question, consideration of the required organization structures seems appropriate.

Export financing and insurance is strictly divided in most countries. Institutions which handle both in a more or less integrated fashion are the Export Finance Institute Corporation in Australia, the Osterreichische Kontrollbank (OKB) in Austria, the Export Development Corporation (EDC) in Canada and the Export-Import Bank of the United States of America for the industrialized countries, and the Export-Import Bank of the Republic of Korea among the LDCs. There is, however, a tendency towards centralization which which can also be seen in the new organizational structure of the Societá Assicurazione del Credito Esportazione (SACE) in Italy.

Export insurance schemes have been created in a number of LDCs (Argentina, Hong Kong, India, Malaysia, Mexico, Pakistan, South Africa, Venezuela and, most recently, Sri Lanka). Their purpose is to provide insurance for the commercial and political risks involved in handling export on extended terms.

Through their ministries of trade and connection with the central banks, Governments provide funds for financial resources. These funds are mostly channelled through the existing commercial banking system.

From an administrative point of view this organizational division is neither particularly useful nor logical. Export financing requires two decisions: one on the export risk, be it commercial or political, and one on the availability of funds at given cost. These decisions are interrelated. The required credit period influences the risk involved and the cost at which funds can be provided. If these decisions are handled by two different agencies, further decisions must be taken on the essentials of the total contract on a provisional basis as the authority to decide is reserved for the other agency. Administrative expenses and serious delays in the decision-making process result.

In both cases it is likely that supervising committees have to be consulted. Therefore, two judgements are being made on the transaction when only one is necessary. The commercial banks handling the transactions are required to take a share in the risk which requires a third decision.

This procedure can be further complicated by the fact that export transactions involving extended terms are frequently handled by exporters unused to international financial transactions. Potential exporters must be given simple and fast working procedures involving as little administrative expenses as possible so as to find foreign markets attractive.

Logically, the commercial banking system should handle both the insurance and the financing of the export transactions. The commercial bank should not be involved in sharing in the foreign credit risk because this requires another decision and the prospect of more delays.

A normal case in an integrated system should qualify for financing at the same terms for which the credit risks are covered. The next decision concerns the interest rate and other fees. The risk should be shared only between the insurer and the exporter. And, once the decision on the risk is rendered, the rest should be triggered automatically.

An integrated system is preferable for another reason: its funding procedures. An integrated system requires that export financing is made available on insured business only. The financing agency would acquire insured assets through commercial banking and carry the commercial bank's guarantee regarding the risk of the exporter concerned. The financing agency must have the assets available upon the due date regardless of whether the foreign buyer defaults and the insurance is called or not. This is a good reason why the commercial bank should be used as an intermediary.

While the speed and flexibility of the organizational framework is of paramount importance, these detailed considerations should have a promotional effect for another very important reason.

It has been indicated that export promotion on extended terms initially puts a strain on the foreign exchange resources of a given country. This strain can be avoided by funding export receivables internationally. Moreover, in today's international markets it is increasingly difficult to find suitable borrowers. Though the LDCs have penetrated the international markets there is a growing concern among lenders as to the type of financing which should be made available. General balance-of-payments loans are looked upon as being particularly hazardous. Project financing requires long-term funds.

In one corner of the world, surplus accumulates which cannot be transformed into real transfers of goods and services but is used to acquire financial assets. This process is going to continue for some time to come. It involves the transformation of risks and maturity. The burden of this transformation is carried by the banking system, but there is a limit to its capacity for performing this task.

The creation of export financing institutions in the LDCs as described would mean new borrowers in the international markets. These organizations would have comparatively diversified and self-liquidating assets in foreign exchange maturing on short and medium term. The financial assets would be guaranteed by the Governments involved. There should be no additional cost or additional risks for the Governments' making the guarantees also to the funding operations. Instead of providing foreign-exchange risk guarantees on individual export transactions a foreign-exchange risk cover could be extended to the financing agency, allowing it to pay the exporter in local currency, diverting the foreign-exchange risk through the funding operations.

In recent years export financing organizations from Austria, Canada, Finland, Norway and Sweden have entered into the market. Together they have borrowed the equivalent of $2.5 billion in more than five currencies and have furnished these funds to markets in Asia. In fact, the Austrian organization was the first to develop the proposed formula and is the largest single user of international markets, having borrowed more than $3 billion in recent years.

In past development strategies, special attention has been given to creating development banks because they provide the organizational financial infrastructure needed to produce goods and services. It would seem that the creation of export financing institutions should receive the same attention as the development bank programme. It may be an organizational and economic argument for certain development banks to add export guarantee and finance to their functions (the Industrial Development Bank of India provides an example) or to promote the establishment of a specialized institution for those purposes.

B. Working Panels

Group I — Project identification, preparation and promotion

PROJECT IDENTIFICATION, PREPARATION AND PROMOTION

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Turkiye Sinai Kalkinma Bankasi

One of the most important functions of a development bank is the appraisal projects submitted to them for finance. A careful study of each phase of industrial project implementation, together with a review of the promotional work, is necessary. In countries with no industrial experience where a small entrepreneurial class is mainly interested in trade and real estate, the development bank's operation is complicated by many restrictions. Still, it is fully engaged in making surveys, identifying projects, formulating projects, providing finance for and establishing the enterprise, and, in some cases, in managing the enterprise itself. If project appraisal is considered an essential function for project promotion (and the aforementioned are considered essential functions), it can be said that there are several additional promotional activities in which development banks could play a role. The degree of their involvement depends on a number of things. For example, entrepreneurs are needed to exploit investment opportunities and to look for finance; otherwise, the development bank must do the project identification on its own.

Regardless of the possibility of investment ideas coming from the business community, the development bank still has to identify the projects that meet their specific developmental objectives.

One of the most significant areas in which technical assistance and advisory services is needed is in the area of project preparation. Clients of the industrial development banks simply need more technical assistance than those of commercial banks.

Promotion of entrepreneurships should next be considered. A reasonable way to extend technical assistance and services to entrepreneurs is to prepare the projects for them. In this way a development bank could participate as a "co-promoter" jointly with other entrepreneurs and help to launch the enterprise.

A convincing financial instrument for motivating entrepreneurs would be an equity participation by the development bank in the project, which in many cases is more important for entrepreneurs than the actual extending of loans.

Needless to say, a development bank cannot provide all the financing needed for an industrial project. Its own resources, as well as risk limitations often imposed by its charter, prevents it from doing so. A project

needs additional financing from other financial institutions or through capital markets. In this regard, a development bank could play an important role by promoting "package financing". The development bank would be providing risk capital, long-term finance and a certain proportion of the working capital.

The cost of promotional activities is high. Staffing the bank for promotional work is expensive, as is outside consultancy. Development banks should be enabled to mobilize resource funds from domestic financial markets and international capital markets. The importance of financial supports from Governments and financial institutions for their total resources would ideally be in decline sometime in the 1980s.

In fact, expectations from development banks will increase. The more developed the country, the more complex, difficult and ambitious developmental functions should be expected.

PROJECT IDENTIFICATION AS THE FIRST STEP TOWARDS PROJECT PROMOTION AND INNOVATION

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Industrial Development Bank, Kenya

When a DFI undertakes project identification, it is taking its first step towards project promotion and innovation. Its experience as an investor should enable a DFI to identify any number of projects by itself. In fact, the search for project possibilities should be an institutionalized DFI activity involving senior staff members whether or not their principal role in the bank is project appraisal.

The development bank's knowledge of the economy, its continuous contact with the enquiring public and its consultations with government departments put it in an excellent position to undertake prima facie studies. The next step should be to undertake in-depth preparation of one or more of the projects selected through prima facie studies.

The question of whether the bank can raise grants from the Government or from technical assistance sources will undoubtedly be raised. Therefore, when seeking external investment, the project studies should be accompanied by information about the possibility of investment supports or incentives being provided by the Government.

The biggest problem the DFI will face is its lack of competent technical staff to undertake the project identification and preparation. This may lead to the problem of credibility and could prove to be an inhibiting factor.

Given these difficulties, the Industrial Development Bank of Kenya has tried during the five years of its existence to make innovations in the processes of product identification and preparation.

Three years ago, the Industrial Development Bank (IDB) of Kenya identified a project for the manufacture of polypropylene bags. It was a relatively straightforward project, and all the initial studies were carried out within the Bank. This was followed by a prospectus for investment. We managed to get investors to take up 70 per cent of the equity. IDB took 30 per cent. The Bank played a leading role in the implementation of the project including land acquisition, selection of machinery, appointment of manpower. The cost of the consultant employed from the beginning and all other costs of the Bank were reimbursed as pre-investment costs. Finances were syndicated by IDB. The company is now in commercial production and shows every sign of success.

IDB has recently undertaken a complete feasibility study for a new hotel in Kenya. It appointed assistants for the project and obtained all government and Central Bank clearances for an investment. The capital cost of the project is about $6 million. Having prepared a prospectus, IDB has brought together a number of local and external investors. Construction of the hotel was to begin in September 1979.

IDB has organized a new department called Research and Promotion. A manager and three staff members, representing about 15 per cent of our professional staff, have been assigned to it. In the 1979 budget, funds were provided for the first time for research and development. Government grants for consultant studies and applications for bilateral aid are being requested to reinforce funding for this activity.

The main challenge of the 1980s will be to discover whether the development banks in the less developed countries are going to be able to cope with the considerable cost and risk of innovation. The ability to bear the responsibility for project initiation, staff competency, and the availability of government assistance will be important factors of success.

PROJECT IDENTIFICATION, PREPARATION AND PROMOTION: A MODE OF INNOVATIVE BEHAVIOUR

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Philippine Investments Systems Organization

There are certain impediments to direct institutional entrepreneurship. For some development banks, financial entrepreneurship offers a viable alternative for innovative action.

To determine the potential of a project the identifier must be analytical, have a good head for business, the ability to define and present the reasons for a project, and the skill of mediation necessary to act between investor groups, local and foreign. The establishment of a project's configuration with the various governmental agencies is as important as the ability to guide a project, objectively but persuasively, through the hierarchichal structure of a DFI. These are marketing skills that all project development people should have.

Naturally, conflicts do arise when there are so many considerations. Certain conflicts arise out of the need to develop the following skills:

(a) A solid business sense and entrepreneurial drive for projects which meet defined economic and commercial norms;

(b) The specialized technical, market, financial, and managerial skills to focus on a project's weaknesses and provide appropriate remedial measures;

(c) The analytical and promotional ability to undertake the preparatory groundwork and provide the impetus to forge a logical unity to the various project elements and satisfy the different regulatory considerations;

(d) The objectivity needed to distinguish the role as promoter from the potential participation as creditor;

(e) The ability to recognize divergence between expectations during project development and results as established during project supervision.

Bankers tend to be wary of risk. They may be operationally aggressive but are necessarily financially prudent. Non-financial entrepreneurs are different from innovators within the financial system. The financial innovator is known to have fall-back positions or cushions to liquidity and solvency, while the non-financial entrepreneur, particularly in capital-starved countries, is inclined to optimize capital leverage.

Direct entrepreneurial activities of a financial institution make it essential to avoid potential areas of conflict of interest. To understand a financial institution is to be aware of its commitment to its corporate objectives and their own connection to government programmes and its responsibility to the interests of its shareholders and the community that it is there to serve. Where the financial institution itself is a potential investor in an entrepreneurial project, there is the difficulty of striking a delicate balance between the creditor position of the institution and its role as an equity investor.

Direct institutional entrepreneurship can be seen as posing a psychological threat to the bank's clientele. In some cases, successful entrepreneurship leads to the so-called creative destruction of existing enterprises in related lines of activities. Once it is understood that the degree to which an institution participates in direct entrepreneurship is a function of the state of development of its country and the institution itself, the situation of direct institutional entrepreneurship can be put in perspective.

When a DFI subcontracts project study preparation work to an external consultant, there can be mutually reinforcing business flows between the consultant and the DFI. The consultant may refer some of its clients to a DFI for the appropriate financial inputs. Objectivity can be maintained by the DFI through the use of a management consultant.

A dynamic DFI will find out that the cost of preparing project studies would normally be far greater than the consultant's remuneration. Substantial fees can be generated from syndications, underwritings and related work which flows from project development by a DFI or merchant bank. It is important to not involve more staff than necessary in project development as they may be needed for other fee-generating activities.

Mergers and acquisitions have not been pursued with vigor by DFIs. When and if they occur, the immediate and long-run rewards can be significant. The fees that can be generated from mergers and acquisitions add to the revenue stream of a merchant banking institution.

Entrepreneurship as internalized in a financial institution can involve the development of new delivery systems. In the 1950s, 1960s, many DFIs assumed the likeness of an original model, one that conceives of the institution principally as a source of long-term finance. Financial entrepreneurship can be pursued by seeking new forms and ways of financing and assisting projects. Examples of these activities which have recently developed are leasing, syndications, consultancy, investment management, and variants of short-term finance. Financial inputs include local and foreign currencies of different maturities.

The development of new delivery systems is closer to a financial institution's overall direction and work and is, therefore, within its distinctive competence. The technical knowledge and support of new delivery systems may be less hazardous than would normally be the case when one ventures into a new entrepreneurial undertaking. The strengthening of a country's financial infrastructure which this might accomplish would contribute to the financial institution's relevance at all stages of development.

Stimulating, co-operating, and assisting existing entrepreneurial groups can be a promising medium for the innovative energies of a financial institution. An institution's shareholder groups involved in various non-financial economic activities may be equipped in terms of experience and access to expertise and resources supportive of new undertakings. On occasion a financial institution can rely on the expertise, perceptions, and potential pioneering efforts of its enterprising shareholder groups, without prejudice to considering other business groups, as circumstances warrant.

In a number of developing countries, government planning and project identification, as instituted by their boards of investments, have set guidelines for prospective activities on the part of private sector. These government activities also relieve development banks of the bothersome work of conducting aggregative and sectoral surveys and reviews as a prelude to project identification. Working with government, DFIs can hasten the integration and nationalization of industries which offer significant local raw material and labor contributions.

DEVELOPMENT BANKS AND PROJECT PROMOTION

S. S. Nadkarni, *General Manager*

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Development banking has come a long way over the past three decades. It is finally clear that there is more to development banking than the provision of term finance. The field of development itself has changed. Development banks (DBs) have reviewed and adopted policies, procedures and activities and widely varying forms. The more classical ones among them relate to a more positive role in project improvement, providing guidance during the construction period and seeing the assisted units through difficult times. Other DBs have diversified their activities and have become involved in merchant banking, multipurpose banking, real estate and housing development.

The activity of project promotion covers conception and identification of a project and the identification and initiation of an entrepreneur.

It also could involve participation in project management during the construction and the operating period. The environment may demand a DB to be involved in all or most aspects. There have been times when DBs managed projects on their own either because there was a complete lack of entrepreneurs or because special social objectives required it.

It is often argued that there is but only a thin line between providing project finance and project promotion. There could not be a more unrealistic statement. Project promotion requires an involvement of an entirely different nature. Here there is no well established set of procedures as in the case of project appraisal. There are no comforting yardsticks of comparisons with similar past projects. Project promotion requires much more than the coolness of a banker, namely the quality and ability of entrepreneurship. Institutional entrepreneurship entails anxieties and conflicts which also beset individual entrepreneurs. However, the psychological and real rewards the individual experiences are not available to the DB entrepreneur.

DBs are called upon to take up project promotion in places where entrepreneurial initiative is lacking or inadequate. The opportunity for or the availability of special financial incentives does not create entrepreneurs. DBs usually have to demonstrate that it pays to set up an industrial unit and show how it can be successfully done. In this way DBs play an important role as development entrepreneurs.

There are many developing countries where a substantive nucleus of entrepreneurs is already available and the individual and corporate initiative at hand. This initiative comes from the trading community, from the established manufacturing fields and other traditional economic activity. This initiative becomes a reason for DBs not to enter the field of project promotion in these environments. Considering the fact that DBs in these countries have played a vital role in contributing to the industrial growth, it is interesting to note that this same growth has caused them problems. The DBs must now adjust their policies and actions to meet these new challenges through the 1980s.

A changing context requiring DBs to take up project promotion relates to the need for the regional dispersal of industries, a broader entrepreneural

base with restrictions on monopoly and large houses, the encouragement of small-scale enterprises and the development of appropriate technology, and the filling in of gaps in the industrial structure by taking up the manufacture of basic, intermediate and ancillary products.

Existing entrepreneurs tend to prefer the most favourable and fully developed locations. Successful attempts have been made to lure them away from these locations through the placement of zonal restrictions and the provision of fiscal and tax incentives. There are also many examples of DBs who without any assistance had to take up the promotion of projects in backward areas and underdeveloped states.

Big projects necessitate funds for promotion but also for the substantial managerial efforts required for promotion. The newer, smaller entrepreneurs find it difficult to meet these requirements. This in turn leads to the expansion and strengthening of the large industrial houses. So in a few cases these big projects encourage monopolistic trends. One of the answers to this problem has been the business association between DBs as institutional entrepreneurs and a new individual partner.

Consequent widening of the industrial base creates new gaps in the industrial structure and demands for newer products. A DB is often able to predict such needs, identify the projects, prepare project details and arrange for its preparation. Otherwise, its involvement in promotion may be limited. This naturally depends on the environment of the particular country.

The need for all DBs to take up project promotion work becomes increasingly important in the context of new developmental objectives. The managements have learned by now to deal with the contradictions inherent in the association of private profitability and social gains. Balancing financial security and risks in development projects has become a matter of course. Such will be the case with striking a balance between providing finance and undertaking project promotion.

The subject of project promotion was discussed at a conference of DBs arranged by the World Bank at Washington in October 1965. At the time it was stated:

> "Those who were most reluctant to take the lead in promoting enterprises were from countries in which there was already a large and active entrepreneurial class. ... Yet even the managers of companies (DBs) in the more underdeveloped countries considered that the primary function of their institutions was to provide finance. ... There was a general reluctance to take the primary responsibility for the formulation and execution of a project".

A decade and a half have gone by since the date of that conference. It is hoped that this Symposium, held on the eve of the march of DBs into the 1980s, is able to arrive at a different conclusion.

SUMMARY OF DISCUSSION

Throughout the discussion it was maintained that promotion should be considered in the context of total development potential. Therefore, linkages of individual projects with the environment of the industrial sector were desirable. Most agreed that as development banks become more experienced, they should make greater contributions to the formulation of economic policies in their own countries.

Reactions from the floor indicated a wide range of problems facing DFIs in individual countries. A representative from Bangladesh talked about his institution's problems with inadequate information about existing capacity, difficulties in assessing the availability of raw materials, lack of information regarding the future demand of individual products and the corresponding gaps in demand, scant information about the choice of technology, the dilemma of whether to develop indigenous technology or to import technology from abroad, and finally how to go about finding sources of technical assistance abroad. He concluded by suggesting that the World Bank prepare a paper on this subject, on the choice of technology, and on building up technical consultancy service centers to prepare feasibility reports. He also called for the creation of training facilities for DFIs in both industrialized and developing countries.

The representative from Portugal felt that developing banks should resist duplication and seek to fill in the gaps in project identification and promotion left by others. In this way he established the principle of consistency in project planning and promotion: There should be consistency with markets, with economic plans, with current investment and financing activities so as to avoid overcapacity in certain sectors. He suggested a service-oriented approach for DBs. For promoting projects he suggested DBs should undertake pre-investment studies and reconversion studies. The latter would aim to change the structure of individual sectors in accordance with comparative advantages offered by the country.

The discussion moved on to consider two specific questions: that of finding the resources to fund pre-investment and promotional work, and the organization of promotional work.

One speaker outlined three formulas to cover the cost of promotion: the charging of fees, the inclusion of the cost of promotion in the interest rate, and the tapping of special resources for promotional work.

The DFI representative from the Philippines said that his bank defrays the cost from its budget. It charges a fee to customers when the project comes to fruition.

State institutions do most of the promotional work, according to the representative from India. They can raise the necessary resources by issuing bonds at subsidized rates of interest.

Another representative from a development bank in India explained that his bank had a method for reallocating part of its profits for promotional work. His bank had access to a fund from the Kreditanstalt für Wiederaufbau (Federal Republic of Germany). This was provided through the interest differential between the borrowing and onlending rates, at a zero per cent interest rate. These resources were used to sponsor a venture capital organization, which made a significant number of investments and increased the total value of projects.

The Industrial Finance Corporation of India had no machinery for follow-up. In order to promote the development of the projects which had been identified and to lay the ground work for follow-up, technical consultancy organizations were founded on a non-profit basis. The costs were mostly assumed by the all-India DFIs. The completion of area surveys, the establishment of industrial profiles and the sudden availability of technical services to the small enterprise sector represented the co-operative effort of local institutions, regional and commercial banks and the technical consultancies.

It was finally suggested that DFIs could promote a project, receive outside financing and complete their work only to discover it was a failure. Besides the financial implications, the concluding concern was for the risk to the reputation of the DFI, and the further suggestion that perhaps the DFI should become even more involved with a project's promotion to ensure its success.

In response to this issue the representative from the Philippines suggested two procedures which his institution found helpful: the use of disclaimer statements in loan agreements and, more important, the practice of adopting the policy of explaining to clients the strengths and weaknesses of the project.

Group 2 — Financing small-scale enterprises

FINANCING SMALL-SCALE ENTERPRISES IN CANADA

G. A. Lavigueur, *President*

Federal Business Development Bank (Canada)

The Federal Business Development Bank was created in 1944 by the Government of Canada to assist in the development of business enterprises within Canada, with particular emphasis on small businesses. It was originally called the Industrial Development Bank, and 1944 legislation confined the Bank to the financing of projects in the manufacturing sector only.

The Bank was established as a provider of capital where the financing could not be obtained under reasonable terms and conditions in the private sector. Commercial banks in Canada are not restricted from making term loans to small-scale enterprises; however, only recently have they been permitted to make commercial mortgage loans. Many commercial banks have set up small business divisions to emphasize service to the small enterprise. This indicates a turn-about in Canadian commercial banks' assessment of small-scale enterprise as a viable partner. Canada in the 1970s has experienced a high savings ratio which makes funds for this type of loan more available than ever before.

As in the case in several other countries, the Government guarantees some of the small business loans. What has been to date a modest programme is growing rapidly. This is also the case with regular-bank term loans.

Thus far, the Federal Business Development Bank has not had any restrictions on how much lending it can do. It has been able to concentrate on assessing the viability of each enterprise or business proposal approaching it for financing and has not had to choose between larger or smaller ones.

Through decentralization the Bank has minimized the average cost of transaction and improved service. It has grown from four branches in the early 1950s to twenty branches in the mid-1960s and now has 100 branches and sub-branches scattered across Canada.

As a Government-owned corporation, the Bank receives overall budgeting and legislative direction from the Government of Canada. The 15-member Board of Directors carries out its mandate within the existing legislative and financial framework. In order to assist co-ordination with other government agencies, four of the members of the Board are senior civil servants.

As large as Canada is geographically, the Bank's programme of decentralization brings it closer to the customer. This helps in analysing the business proposal and administering the account once the Bank has provided a loan. A great deal of the authority for loan approvals has been delegated to local managers, which speeds up the decision-making process. Using local managers also makes for a less formal atmosphere, eliminates unnecessary duplication of efforts (e.g. paperwork) and a reduction in information requirements, particularly as concerns the smaller loans.

Therefore, the Bank has always made a small profit on its lending operations. During its 35 years of existence it has operated in a growing economy. This fact, the style of its organization and the attention it pays to minimizing transaction costs has enabled it to specialize in small-scale enterprises; 87 per cent of the clients have less than 20 employees.

Less than 1 per cent of the outstanding loans are represented by write-offs of business enterprises that have failed. This figure is increasing, and the Bank is trying to continue its lending policies on the same basis while operating its financial services on a cost-recovery basis. It is true that there are more losses on the smaller loans than the larger ones. For example, loans of under $Can 25,000 have represented less than 15 per cent of the total amount of the Bank's lending in recent years. Still, these loans represent 36 per cent of the write-offs arising from bad loans. At the other extreme, loans of over $Can 250,000 represented about 12 per cent of the total amount of lending, but only 5 per cent of write-offs.

The Bank has attempted to be less conservative in lending in the 1970s, as already mentioned. Moreover, it provides advice and counselling to borrowers who may encounter problems and gives them time to recover from their financial difficulties. In this sense the Bank is more flexible than a commercial bank, and this obviously is the role of the development bank.

The Bank's role in the economy and as a development bank is significant. To all appearances 5 - 8 per cent of all Canadian businesses currently use the Bank for financing. These firms employ about 350,000 workers or 31/2 per cent of the Canadian work force. The Bank's loans and investments last year assisted in the initiation of about 2,000 new Canadian small enterprises.

The recruitment and development of high-quality credit officers and branch managers has been extremely important. Specialists are made available to field staff when required, people with experience in equity investment, engineering, training etc. In the 1980s the Bank hopes to improve its strength in these areas without reversing its accessibility. It is essential to continue to recruit, train and develop a staff of professionals and to draw on their expertise without obliging the customer or his application to be lost in a bureaucratic maze.

Over the years, the Bank has been keen to share ideas and experience with other national and international agencies in the business-development field. In the process, the Bank has advised many other development banks on methods and training programmes in response to enquiries from all over the world. In co-operation with the Canadian International Development Agency, the Bank will be investing considerably greater resources in the field of international technical co-operation and training programmes in the 1980s.

FINANCING SMALL-SCALE ENTERPRISES

V. S. Raghavan

World Bank

Existing small-scale enterprises (SSE) and those in development are recognized by their many contributions in the areas of employment and production as well as by the logistical problems they pose. There are varied social and economic implications involved with the development of small-scale enterprises but the chief concern are the regional disparities and the need for creating a new entrepreneurial class. Still few development banks (other than those specifically created for that purpose) are prepared for financing SSE.

The Development Bank of Mauritius (DBM) operates, among others, a programme directed to such small-scale enterprises which are otherwise untouched by the rest of the banking sector. These enterprises are engaged in tailoring, garment making, furniture making, shoe making, metal works, jewelry, fishing, pig and poultry farming, printing and service-related activities such as garages, repair shops and small construction. Typically, the owner is by necessity the principal worker, assisted by some other members of the family or a few employees (less then five in 90 per cent of the cases). Rarely does the capital investment exceed Rs 25,000 (about $4,000). The average size of DBM's loans (which carry interest of 6.5 per cent for loan amounts up to Rs 15,000, or $2,500) is about Rs 5,000, or $830. DBM's loans normally cover about 80 per cent (though in rare cases it covers up to 95 per cent) of the expenditures on the acquisition of fixed assets which in most cases are machines and tools or a simple shed for the workshop.

The programme of assistance to these very small enterprises started in 1966 and was administered by the Small-Scale Industries branch of the Government. Until 1970, only some twenty loans had been sanctioned. DBM took over the scheme in 1971 and, within six years, granted funds to over 1,600 enterprises. All loans are guaranteed by the Government; similarly, all administrative and legal expenses incurred on the programme are reimbursed by the Government. Less than 1 per cent of the portfolio was in arrears in 1977 and not one cent had been written off in six years. This is even more impressive since the loans are made at a high interest rate with a built-in subsidy element which is hardly an incentive for repayment. It would seem that "small is not necessarily risky".

The administrative costs for the informal sector financing programme in Mauritius amounted to 13 per cent of the portfolio, a seemingly high figure, but a quite reasonable one when compared to similar programmes directed to the informal sector in other countries. With a handful of exceptions, the entire portfolio of DBM could be described as small-scale enterprises. The administrative cost of the entire portfolio worked out to 1.2 per cent, a figure DMB could live with even if the Government had not reimbursed the expenses of the informal sector financing.

The Industrial Development Bank of India (IDBI), which is the apex institution for term finance, uses financial intermediaries like state financial corporations, regional development banks, and commercial banks to reach a large number of units. A major portion of IDBI's assistance to the small-scale sector is by way of refinance of term loans granted by the primary

lending institutions. The minimum amount of loan eligible for IDBI refinance is Rs 10,000 (approximately $1,250) and the facility covers 100 per cent of the loan for amounts up to Rs 0.5 million, 80 per cent in other cases. The interest rates are fixed in such a way that the primary lender gets a spread of 3.5 per cent. IDBI has issued guidelines on eligibility criteria. For loans up to Rs 0.5 million fulfilling the criteria, the facilities are automatic. Nearly 90 per cent of the loan assistance in terms of numbers and 60 per cent in terms of the amount are covered by this automatic procedure.

The IDBI has taken initiatives in setting up technical consultancy organizations in the industrially backward regions of the country. The main objective of these organizations is to provide small and medium-size entrepreneurs a package of services, ranging from project identification, preparation of feasibility reports, training of entrepreneurs and technical and management services in implementing and operating the units. There are ten technical consultancy organizations which have been in existence for one to seven years. While it is too early to judge whether they have been successful, it should be mentioned that they have thus far prepared more than 1,000 project reports, provided training facilities to some 200 entrepreneurs, and identified as many as 1,000 new entrepreneurs to take up the projects they have surveyed.

Since the financial services required of the SSE sector are radically different from those for units in the large-scale sector it would be useful for this work to be undertaken by a specialized organization. This organization could be located either in existing institutions or in a specialized institution organized for this purpose. It is essential to develop a network of local offices which can reach the large number of clients in the SSE sector. Therefore, in countries covering a wide geographical area, commercial and co-operative banks with their extensive branch office networks may be better for SSE financing than the development banks. There are several reasons for using commercial and co-operative banks. They provide integrated banking facilities that meet fixed capital and working capital requirements of SSE. This avoids the need for small clients to deal with more than one institution for their meagre requirements. Using local institutions which have an intimate knowledge of the clients results in a gradual reduction of transaction costs of SSE lending. It does not follow that development banks should not involve themselves in SSE lending. It does seem that the finance role of the development bank should be limited to one of refinancing and supervision.

In order to retain greater objectivity in its lending programme it might be sensible to separate the banking and promotional functions into two agencies. This would serve to check on the system as well as necessitate the creation of separate bureaucracies which might find it easier to co-operate with each other for the successful promotion of SSE.

Whatever the organizational decision, it is necessary to simplify the requirements for reporting and application. Proper accounts can often be resolved in small workshops while the notional accounts can be generated by the lending officers themselves. Larger enterprises keep accounts, but the reporting requirements should not be time consuming. Requirements for authorized clearances and certifications should be kept to a minimum. As it is, they rarely affect the viability of the loan but occasion much cost and time on the part of the entrepreneurs.

The smaller entrepreneurs are frequently discriminated against when demands for guarantees and collateral are made because of few assets or fewer influential friends. Most varieties of SSEs involve little fixed, but substantial working, capital. The banks have the greatest difficulty financing these enterprises; it is difficult to find the appropriate collateral. On the other hand, some forms of secured small-scale business finance such as hire-purchase, lease of equipment, factoring, or accounts receivable finance provide a fairly easy way of relieving SSE needs. They frequently remove the factor of the lending agency and speed up the flow of funds to the SSE sector.

With the simplification of information and security requirements, it will become even more important to exercise careful, subjective judgement about the reliability of SSE debtors. Much can be learned from informal credit markets. Informal market credit sources have close and continuous involvement with their clients in the market. In a supervisory capacity it may be appropriate to use the informal credit sources as brokers or intermediaries. The shroffs (bankers) in the unorganized sector in India, for example, have traditionally lent their funds to SSE and rediscounted their bills with the commercial banks. The smaller, very successful Philippine banks, are dominated by local magnates comparable to the bankers in the unorganized sector in India, and can refinance themselves with the central bank.

A development bank's participation in SSE developments necessarily varies according to the country and the environment. Where existing arrangements for work space, extension facilities, marketing arrangements and various other services required by the SSE are inadequate, the development bank will have to organize those services. It may even be necessary for the financing agency in the interim to undertake these functions, and become both financer and promoter of the project.

SMALL ENTERPRISE ASSISTANCE: THE INTEGRATED PROJECT CONCEPT

Ernst Löschner, Executive Secretary

Österreichische Kontrollbank Aktiengesellschaft

In countries of the developing world 85 to 95 per cent of all enterprises are classified as small in terms of asset size or employment. This classification has become useless as a basis for determining how much operational support should be given to an enterprise.

In a consideration of smallness it is worth noting Fritz Schumacher's book Small Is Beautiful. When the book first appeared, he was ridiculed by the industrial world as a social romantic and harshly criticized by many developing countries for prescribing a medicine that would perpetuate backwardness. Schumacher invited such criticism when he oversimplified and underestimated the political dimensions of his message. However, at the same time he rightly focused attention on the political and social dimensions of massive unemployment. Our concern is his basic message to the task of development banking. He speaks of technological choice, the search for alternatives and analysis of these alternatives. Resource endowment, input supply, managerial know-how, linkage effects, marketing and finance are involved. These would originate from various sources and lead to the integrated project concept.

Three types of integrated projects can be distinguished:

- Industry-specific support schemes
- Regional schemes for dispersed small enterprises
- Support schemes for small service enterprises.

The integrated single-industry approach is appropriate whenever there is a high degree of regional concentration of many small companies and where sector-specific support institutions exist. Typically, these institutions must deal with fragmented producers who are trying to reach different markets. They require joint raw-material supply, production facilities, marketing or technological assistance. In order to meet these conditions, the single-industry approach provides an effective and low-cost means of assistance as well as infrastructural support to help small enterprises compete effectively and attain long-term viability.

For example, the shoe industry in India (concentrated mostly in Agra) supplies close to 60 per cent of the requirements of the whole subcontinent. Significantly, an overwhelming proportion of output is produced by small enterprises, the economic backbone of the mohallas, which are small physical and sociological units of work and life. Most small enterprises have depended on middlemen. This brought about a hand-to-mouth existence and catered only to the closest markets. They were lacking the capital, know-how and organization necessary to upgrade design, sales promotion and outlets; they could not provide for bulk raw material, storage and transport. However, already established industry-specific support institutions offered prospects which would benefit these informal industries. The goals were the joint

organization of integrated support services, and the provision for overhead costs over a large number of decentralized production units. The joint linkage of small units with stable markets would naturally mean better credit risks for the banks.

A regional support scheme is more difficult to organize and administer than an industry-specific support scheme. It can also be effective when distances from markets or services create economies of scale in raw-material purchasing, collection points of finished products, storage, transportation and marketing. Critical to the success of this scheme is the availability of skilled extension workers in the support organizations.

The design of integrated projects will be easier conceptually and administratively if a combination of industry-specific and regional support schemes can be devised. A number of countries organize subcontracting with large firms.

The leather industry in India is another example of an industry-specific support scheme. There is a high degree of regional concentration and specialization: over 90 per cent of all tanning and finishing is carried out in the States of West Bengal and Tamil Nadu. Given the international markets for their products, the potential increase in value added is equivalent to an increase in foreign exchange to be secured by many small, labour-intensive units.

Service industries like commerce, local transport and repair require a different kind of institutional support. Nearly all service industries cater to local markets. They require few raw materials, and benefit from flexible, autonomous organization. Here, access to working capital and investment credit is most crucial. Co-operatives and associations provide savings to consumers, broaden distribution of earnings, and offer the possibilities of increasing services (e.g. auto repair co-operatives).

A recent World Bank project in Upper Volta provides an interesting example of integrated support to small service firms. The project assigns a key role to the development bank in linking financial and non-financial assistance to road equipment and civil works. The integrated project concept works at three levels: as a corollary to ongoing projects, for meshing financial with technical assistance, and in providing subcontracting arrangements for feeder roads.

In the context of integrated support schemes for small enterprises, two points regarding development banks and credit deserve mention.

There is the viewpoint that small enterprises are poor credit risks. A comparison of development banks assisting large and small enterprises in the same countries showed that the small enterprises suffered from greater arrears problems, relatively speaking. It would be false, however, to conclude that small enterprises are worse credit risks. In fact, it was found that the development banks assisting small firms had inferior appraisal capabilities and supervision practices. Furthermore, comparative data on income and equity returns show that small enterprises tend to show yields that are just as attractive as those of larger enterprises.

One should instead consider the poor credit argument as a perceived risk. Therefore, the introduction of a credit guarantee scheme can foster the development of a lending component.[1/] Whereas in some countries, e.g. Nigeria, such a scheme has apparently not been successful, in the majority of cases financial assistance to small enterprises by development banks and commercial banks has increased following introduction of a credit guarantee scheme.

1/ The lending component may be more important for working capital purposes rather than for investment finance. A World Bank study undertaken in Colombia in 1974 showed working capital constituting 74 per cent of project cost for small enterprises compared to 18 per cent for medium/large firms.

The other point concerns the social obligations of development banks. Small enterprise assistance is associated with the need to farm out work to poor people in less developed countries. Such employment frequently has a bad reputation and negative side effects. Workers may be paid exploitation wages and be exposed to unhealthy working conditions where noise, smoke, chemical pollution and inadequate protection are serious concerns.

Family enterprises, and those in the informal sector, typically exploit their workers with long hours, low wages and poor working environments. Many established small firms do likewise. They have alleged that they could not otherwise compete with the medium- and large-scale firms which have more modern, capital-, intensive facilities. Insofar as this is true the alternative to substandard employment conditions may be an absolute loss of jobs.

Minimum wage, safety and environmental health standards established by Governments to protect workers from abuses are frequently not enforced when it comes to the small enterprises. Administrative, political and economic problems are involved. The question is should the development banks, in setting conditions for use of their loans, be more demanding? They are not police and to prohibit them from extending loans to enterprises already violating the legal regulations may be self-defeating, considering the original function of the development bank. However, it is clearly not in their interest to be associated with enterprises, large or small, that violate the most basic norms of health, safety and treatment of their workers. By and large it must be left to the development bank's discretion. But they can and should include in their policy statements and operating rules a policy to critically examine the working conditions maintained by borrowers, and to seek to upgrade them as far as possible.

When one is identifying projects in the small enterprise area and looking for the required mix of financial and non-financial assistance it is helpful to remember the following items:

(a) Multiplier effect. In view of the vast number of small enterprises in the developing countries, it would be naive to expect that more than a small fraction of them could be directly assisted. This is Schumacher's message. But the chief selection criterion for small enterprise projects should be seen in its potential. Therefore, small enterprise projects should deal with entities in the same sector or with those who have closely related needs. An organizational base to reach dispersed entities is essential for regional support schemes. Here, a co-operative movement may be most useful. This would provide an organizational base to promote communication and provide a means for channeling assistance. Overhead costs would be spread and the administrative burden of technical assistance reduced. And, it would prove a better credit risk for the banks;

(b) Individual initiative. When designing technical assistance components for projects, a maximum degree of individual initiative is necessary. Here the bank's role is truly one of promoter. It can afford to do no more than assist. In fact, this is a problem and too many small enterprise programmes today are being designed to force the bank to get more involved. This would be counterproductive. One should instead be assured of the existence of individual initiative before considering assistance. Many projects with co-operative components have failed because there was not enough initiative on the part of the small entrepreneur;

(c) Accountability. It is essential to separate the various cost elements within the different forms of assistance. This is not only important for determining the appropriate spread to be retained by development banks, but, more generally, it is necessary for the achievement and maintainance of accountability and cost consciousness.

Not every development bank can and should be a promoter of small enterprise assistance. But those that contribute to meeting the needs of small enterprises will find abundant and rewarding opportunities.

FINANCING SMALL-SCALE INDUSTRIES IN THE PHILIPPINES

Rodolfo D. Manalo, *Manager*

Trust Department, Development Bank of the Philippines

Small-scale industry financing has existed in the Philippines since the Second World War. At the time there was no conscious effort to develop small enterprises because the sector was not recognized. The predecessor of the Development Bank of the Philippines (DBP), the Rehabilitation Finance Corporation, served the credit needs of industry and agriculture. Lending to agriculture was considered more important as the Philippines was a primarily agricultural economy. However, a national industrialization scheme was conceived about 1973. And, small and medium-size industries (SMIs) were considered to be most beneficial to the economy.

In launching the campaign to promote SMIs, the Government considered the area of finance as critical. Financial institutions were reluctant to participate in SMI financing because of the basic risks and relatively high administrative costs involved. It was found that monetary incentives such as subsidized interest rates and liberal rediscounting facilities would need to be extended to the banking sector so as to stimulate lending to SMIs. Commercial banks tended to cater to high-yield, low-risk investments, which made an institutional framework for SMI promotion and development essential.

In 1974, the Commission on Small and Medium Industry was created to bring together the resources and facilities of these member agencies:

Ministry of Industry
Ministry of Local Government and Community Development
National Economic and Development Authority
Ministry of Agriculture
Ministry of Natural Resources
Ministry of Trade
National Science Development Board
Central Bank of the Philippines
Development Bank of the Philippines
University of the Philippines Institute for Small-Scale Industries
National Manpower and Youth Council
Bureau of Small and Medium Industries

These responsibilities were in the areas of technological, training, financial and marketing assistance.

There is a particular need for a responsive financing programme. In the six years that DBP has been involved with small enterprise financing, several material characteristics peculiar to small enterprises have surfaced:

(a) They have little access to commercial credit as often they have no "track record";

(b) They have problems with raising equity;

(c) They lack adequate project experience;

(d) They experience a critical period in their second and third years;

(e) They underestimate the possibility of going overbudget;

(f) They frequently suffer from insufficient collateral.

All these characteristics should be kept in mind when designing a financing programme responsive to the needs and aspirations of the small industry entrepreneur. DBP's lending programmes have taken into account as many of the problems facing small enterprise development as possible. Therefore DBP's lending programme contains the following features:

(a) Working-capital financing. Working capital needs should be packaged into all small enterprise loans to provide for peaks and lows of working capital requirements. Disbursements of loan proceeds must be closely managed to avoid the diversion of funds which is common to small enterprise projects. These projects are typically run as self-employment schemes and can involve the entrepreneur's family and personal finances. DBP has considered the establishment of credit lines instead of direct loans to finance working-capital requirements of small firms. One may question the validity of providing short- or medium-term financing when this is the realm of commercial banks. On the other hand, when a small enterprise pledges its property to secure the loan, it usually is not left with any other acceptable collateral with which to secure loans from commercial banks;

(b) Equity financing. The problem of equity appears to be a formidable problem and DBP has not to date found a solution. In evaluating projects where equity poses a problem, the Bank has asked other institutions to participate in the project. However, DBP feels that a separate organization should be formed to provide risk capital to small enterprises. It is significant that in some DBP-financed small enterprises which are distressed and come to DBP for restructuring their loans, the Bank has tried, whenever it made sense, to convert part of its arrears, particularly the non-out-of-pocket portions (interests and other charges) into equity;

(c) Collateral requirements. DBP's lending programmes have been tailored so that in appropriate cases loan values get as high as 90 per cent or even 100 per cent of market values. This seems to ease the collateral requirements of our loans. When highly desirable projects beset with collateral problems come to DBP for financing the Bank sometimes looks to the Philippine Industrial Guarantee and Loan Fund to guarantee the uncollateralized portion of such loans;

(d) Loan processing time. The current DBP lending system requires a comprehensive evaluation of the project proposed for financing. This entails time to process. In order to simplify matters DBP has defined priority investment areas based on viability and economic desirability. Projects belonging to industries previously ascertained to be desirable are appraised to determine viability. This cuts processing time considerably.

(e) Contingency allowances. DBP has initiated a contingency programme whereby there is speedy approval of cost-over-run loans up to a maximum of 15 per cent. The aim is to facilitate project implementation. Therefore, the contingency loans are approved at the time the original loans are sent to decision-makers for final action. The implementing department determines whether such loans are appropriate and should be disbursed.

Since 1973 DBP's financing programme has responded to the needs of the SMI sector. To date, DBP, with its network of 40 branches, 10 sub-branches and 8 agencies, through funding from the World Bank, has financed over 5,000 projects involving over $80 million. In addition the Bank provides consultancy services to its financed SMIs through its programme of project supervision. From time to time, management audits, project visitations and management training seminars are conducted for the benefit of the small entrepreneurs.

In the early years a project's viability was considered enough to insure the project's success. Six years and more than $80 million in loans later, DBP discovered that apart from an analysis of the project's feasibility, management by the project's proponent is an area of major concern. Ninety per cent of DBP-assisted projects in distress suffer from management problems. This is largely due to the fact that in a small enterprise the entrepreneur himself handles all aspects of the business.

DBP-assisted SMI projects are closely monitored under the supervised credit programme. Requests for additional financing or restructuring are closely studied. Deficiencies are identified and certain conditions imposed to seek expert advice in the critical areas of project management. Along the same line, accounting manuals and management brochures are freely provided to assist the SMIs.

New projects seeking DBP financing are evaluated on both project viability and management ability, with increasing emphasis on the latter. The assessment of the applicant, however, is not limited to his apparent knowledge of the business operations, but includes an evaluation of his credit standing, his past performance, training and experience. In the same manner, evaluation of expansion projects includes an extensive review of past performance.

SUMMARY OF DISCUSSION

A development banking expert from the United Nations Development Programme (UNDP) said that for the next decade social aspects were more important than increase of GNP. He took the view that small business development was important for both developing and industrialized countries if there were to be significant contributions to the welfare of people. He felt the offering of finance was too narrow a concept. Advice, promotional activities, and consultancy services were equally important.

The need for intensive agricultural development and the simultaneous expansion of small-scale agro-business due to expected birth growth rates was reviewed. The expected population explosion and the relatively low investment cost for job opportunities in small-scale industries support the idea to make more public finance available to small-scale industries of all sectors.

The question arose to what extent subsidies for interest rates or infrastructure were necessary. The representative of the World Bank emphasized that incentives for interest-rate differentials, special procurement, tax incentives etc. could often lead to inefficient types of production. Each industrial project would have to be appraised in the light of the economics of small-scale production.

A Latin American development banker stressed more efforts were needed for financing small-scale industries in the metropolitan areas, which would also enable the unemployed urban masses to find work.

A development banker from western Africa said that none of the African countries were yet at a stage in development which could be called industrially dominated. In his view broader solutions were required for the financing of small-scale industries which considered the whole economic environment and the frequency of substantial national changes.

A representative of the Economic Development Fund of the European Economic Community mentioned that under the Lomé Convention there were two methods of promoting small-scale industries. The first was to subsidize technical assistance, training, consultancy, institution building etc., the second to provide finance directly to small-scale industry through loans, grants or credit lines. The question arose, particularly with regard to the capacity of development banks in Africa, to what extent they could use, administer and repay those funds. One participant said that a possible solution could be to create specialized agencies for promoting small-scale industries or, as an alternative, Governments could make a joint political effort in centralizing, possibly through the African Development Bank, small-scale industry lending.

Group 4 — Project monitoring and after-care

PROJECT MONITORING AND AFTER-CARE

I. Simba

African Development Bank

The African Development Bank has found it difficult to determine which department should handle project monitoring. There are arguments in favour of this being the responsibility of the operational departments or those departments concerned with industrial project appraisal. But some bank managers feel that staff members who were responsible for project appraisal should not bear the responsibility for following up on these projects. They might not be able to identify their own mistakes.

There are others who felt that project follow-up belongs to those who are responsible for committing funds, in many cases the treasuries or finance departments. Some DFIs appoint directors to the boards of companies which they have financed, hoping they will be able to follow closely what is happening there. A close liaison between the enterprise and the bank's representatives in managing, or with the supervising organs of DFIs, should enable the identification of problems before they actually exist. A great deal depends on the experience of the particular DFIs.

PROJECT MONITORING AND AFTER-CARE

D. P. Gupta. *Managing Director*

Development Bank of Mauritius

Project monitoring goes way beyond conventional following-up: it implies looking for any signs of approaching danger to investments, credits or industrial loans. It is not easy for a local DFI to organize effective monitoring systems. The lack of experienced personnel and accumulated knowledge in industrial financing techniques poses serious problems. The lack of experience is the chief concern; new financing methods can be applied temporarily, but experience is demanded and must be gained throughout the life of the project. Imagine the following situation: A foreign holding company plans to implement an industrial project in your country so as to support their subsidiary in another country or in two other countries, one for supplying raw materials, the other for marketing. If something should go wrong with one of the foreign subsidiaries and it should close down, the investment in your own country is substantially endangered regardless of whether you own the majority or a substantial proportion of the securities.

Such defaults will become typical in the 1980s because of the growing internationalization of the industrial and banking business. Inexperience and neglect in international monitoring demands the close co-operation of industrial development financing institutions and the commercial banking system. And, there is a need for a better understanding of legal systems. Sometimes the law prevents action, even when it comes to changing local managements. The question is how can an effective system of international monitoring be organized?

CONTROL AND FOLLOW-UP OF PROJECTS IN DEVELOPMENT BANKING

L. Baez. *General Manager*

Corporación Financiera Nacional. Ecuador

In order to facilitate the understanding of the practical methods and criteria for the supervision and follow-up of projects, it is important to talk about the nature of development banking. Basically, industrial development banking differs from traditional banking in the following ways:

(a) Its principal objective is to promote the social and economic progress of a region, country or group of countries, by providing financial resources;

(b) Decisions regarding credits take into account the guarantees provided, the financial returns that may be offered the client, and the social effects of improving the employment situation while utilizing national raw materials, consolidating the balance of payments etc.

Bearing in mind both the lack of financial resources, the minimal generation of domestic savings and the enormous collective needs of the developing countries, control of projects is essential to development banking. When exploring controls they should keep these goals in mind:

(a) Funds loaned should actually be an investment in the items specified by the project, and approved by the lending agency with the aim of benefitting the country;

(b) Recovery of the loans so as to pursue further activities for the promotion of development;

(c) Gathering of data and experience so that conclusions can be drawn to effect the success of future decisions.

Experience of the Corporación Financiera Nacional

Organic and functional structure

The Corporación Financiera Nacional (CFN), established in 1964, finances the growth of Ecuadorian manufacturing and the exportation of goods not previously sold by the country in foreign markets.

Follow-up and control of projects is carried out by several administrative units. Supervision is their specific duty, and other units collaborate to complement this task.

Top management units as well as those from the Loan and Investment Control Department are involved. They are also there to insure that the financed projects accomplish their specific objectives. The complementary actions are performed by the following units: the Legal Bureau, which determines the execution of policies and procedures; the Enterprises Bureau, which analyses and participates in the management of those enterprises within which the CFN participates as a shareholder; The Economic Research Bureau, which carries out the ex-post evaluation; and the Accounting Department, which reports on current loan portfolios and recoveries.

Human resources

Trained personnel from a variety of backgrounds are available. For example, the Loan and Investment Control Department comprises 16 members whose fields of expertise are related to mechanical and civil engineering, economics and management, besides those specifically related to control techniques.

Records

In order to cope with the many clients the Loan and Investment Control Department keeps records to provide an up-to-date and objective image of each organization. These records include loans, work schedules, loan-insurance policies, shareholders' equity, endorsements and counterguarantees, and financial statements. The information is systematized through electronic data processing.

Bases for the control of each project

The procedures for evaluation of industrial projects are usually those followed by all development financing agencies, adapted to the special conditions of the country involved.

The evaluation report schedules such activities as production, input, work-force, sales, pro-forma statements, rates of solvency and ability to pay etc. It also makes recommendations as to the execution of the project and the expectation of benefits.

An agreement of approval specifies the contractual provisions and terms of the loan to be fulfilled by the beneficiaries. A formal acceptance by the borrower is required to make it legal. Once the conditions of operation have been agreed upon, the Loan and Investment Control Department makes its verification regarding requirements prior to disbursement, the status of execution of the project, the initiation of operations, the fulfillment of the pledge of industrial security, and the follow-up during the repayment period.

Management of control systems

During the past years, 279 visits were made to enterprises working with CFN, either in the promotion, execution or operation phases of the projects. As a result 801 reports on the control of the securities pledged, the initiation of production, the observance of contractual obligations, and the status of the portfolio of the institution were prepared. These were to look for existing problems, determine the attainment of objectives and recommend actions to guide the development of enterprises.

Special visits were made in accordance with the decision of CFN directors to supervise enterprises showing financial difficulties as reflected by the accounting reports submitted every six months.

Throughout 1978, CFN representatives acted on the Board of Directors of 29 enterprises in which CFN held stock and contributed towards solving the problems arising in the development of industrial activities. To obtain reliable and up-to-date information, the borrowing firms were also obliged to submit regular reports as required by the control systems.

To keep proper control of the borrowing enterprises, information was collected from other sources and cross-checked with the data provided by the clients. The Central Bank, the Ministry of Industries, Commerce and Integration, and other administrative units within CFN have been participating.

Every month the Loan and Investment Control Department analyses the current and due portfolios, studies the cases of enterprises evidencing problems with regards to the fulfilment of their obligations and then makes

suggestions pertaining to the objectives of the evaluation studies, to safeguard the interests of the investors and of CFN.

The systems of ex-post evaluation of financed projects

All work which has been programmed must be later evaluated to determine its final results. According to the Ecuadorian experience, the subject may be considered from two points of view:

(a) A final appraisal resulting from use of its own resources. When projects are directly financed with institutional funds, the ex-post evaluation centers on the period of repayment. Of the 837 reports submitted during 1972-1978, the most significant indicators obtained were the changes in programmed investments, evolution of proprietorship, the degree of compliance with contractual obligations, and the administrative features of the enterprises. Recommendations are sent to the borrowers so that they might improve their management, financing, marketing, personnel and production methods, either through their own efforts or through specialized consulting agencies;

(b) Appraisal as a result of using external resources. To determine the effect of the use of external credit in Ecuador, an ex-post evaluation of the programme and of the different projects included was undertaken. Such aspects as total investments made in the country, the distribution of investments between fixed assets and working capital, their effect on the balance of payments situation and the increase in internal demand due to the acquisition of national goods and services were considered especially important.

The Corporation is considering the adoption of new ex-post control and appraisal methods in order to make CFN financial policies more efficient for the industrial development of the country. Most important would be a manual for project supervision and follow-up and the preparation of a report immediately following the total recovery of the loan.

General suggestions for development banking

Based on CFN experience, it is possible to give some general opinions on the specific problems of control. When organizing a development bank, it is necessary to provide for reliable control of business activities involving the client. This demands the availability of suitable elements to execute control, co-ordination of efforts and prompt analysis and solution of the difficulties involved. From an organic point of view, the following aspects should be indicated:

(a) An appropriate number of administrative units with ranking are necessary for the execution of control. The structure of these units must conform to the different financial policies of the various agencies involved. The decisions must also conform and be able to function within the institutional hierarchy. A framework of general lending policies, financing norms and appropriate operating manuals should be required;

(b) An efficient multi-disciplinary team needs to be created within the control unit. Accounting, top management and control units representing civil works, marketing, production processes, should participate;

(c) Guidelines for controlling construction and financing programmes should be determined, with provisions for constant on-the-job training;

(d) Assistance from complementary control units, such as a legal department for the analysis of the loan; an economic research department for the definition of policies; a data processing department for systematizing information.

Definite provisions must be made for alternative means of gathering information. It is essential to receive enough information to determine whether or not funds are being used appropriately. The client cannot usually be depended on to supply this information, therefore, the following suggestions might prove helpful:

(a) The loan contract should specify all the important conditions according to which operations must definitely be carried out and the necessity of the periodic submission of financial statements and progress reports;

(b) Adequate records should be maintained to ensure control and to communicate the information required by the contract;

(c) Regular visits for purposes of assessing the project's progress should be made;

(d) There should be participation on the project's board of directors;

(e) Recommendations should be made, when necessary, about the use of consultants;

(f) Accounting and auditing systems, procedure manuals, management information systems and administrative control methods should be established for maximum efficiency to benefit the investor, the credit agency and the country.

CFN experience with almost a thousand private, mixed and public enterprises shows that excessive involvement with the difficulties and administrative decisions of clients promotes inefficiency and the risk of losing scarce resources. Therefore, it is important to consider carefully the reasons for intervention and to turn the occasions for intervention into periods of co-operation.

PROJECT MONITORING AND AFTER-CARE

M. R. B. Punja, *Executive Director*

Industrial Development Bank of India

Experience in development banking over the last 25 years has reinforced the belief that no development bank could be effective without the machinery for effective follow-up of assisted projects. Because of the problems of industrialization and the fact that a goodly number of projects already show signs of failure, the follow-up function has become a basic activity of development banks.

Over the years, development banks have gone from being mere purveyors of term credit to being the instruments for achieving rapid industrialization and the agents for removal of regional imbalances. Earlier there was an emphasis on the economic standing of the promoter; nowadays the emphasis is on project viability. The promoter is considered the entrepreneur and project manager. Previously, recovery by foreclosure in the event of default was stressed, while today's concern is for project nurturing, problem solving and rehabilitation.

The follow-up concept has undergone major changes in recent years. This is greatly due to the widening objectives of the banks. Before, they were confined to inspection and verification of assets. "Follow-up" has come to mean monitoring and constant re-evaluation of management's performance. It takes the form of assisted concern through this process of monitoring and real help in order to assure the successful implementation and operation of the project.

As far as project financing is concerned, development banks have become major partners in the projects assisted by them because of their substantial contribution, which can go over 85 per cent of the project costs. This contribution can increase if there is an over-run in the project cost, which occurs frequently in present inflationary situations.

Development banks ought to give industry and industry's management confidence and the feeling that development banks are as much interested in the everyday stability and prosperity of the enterprise as they are in financing it when it is in trouble. A relationship of trust and understanding between development banks and their clients is invaluable. Confidence makes for co-operation, which is the means for the communication of vital information.

In India, development banks recommend that the boards of directors of assisted industries should consist of persons with industrial, financial and commercial backgrounds. Invariably, development banks appoint their nominees or representatives on the concern's boards of directors right from the start. Nominee directors are expected to ensure the application of sound business principles, keeping the interest of the development banks and the shareholders in mind, and to see to it that everything remains within the framework of government policies. It is just likely that the nominee director would also participate in a management committee where senior executives and other directors deal with the most important matters of the enterprise.

A basic organizational structure must be set up for implementation of the project. Its objective should be the provision of professional expertise in technical, financial, commercial and administrative fields before the assistance is disbursed.

In some cases consultants are appointed by the bank to report on the implementation of projects. Auditors are also appointed if the case so warrants. With the additional information gained, development banks should be in a position to undertake intensive monitoring of projects. Intensive monitoring should be done on a selective basis for high-cost projects or projects promoted by new, inexperienced entrepreneurs.

Situations do exist in countries such as India where development banks, against their best judgement, must accommodate a class of promoters with a proven record of delinquency. In such circumstances, one would adopt a cautious but hopeful attitude and resort to depending on a much more rigorous follow-up.

Delinquent managements may have to be regarded as a separate category and dealt with in a suitable manner. It should be remembered they do not represent the majority of clients.

The lack of requisite information can be somewhat resolved in the following ways:

(a) The management and professional staff of development banks should adopt a helpful, co-operative and problem-solving attitude;

(b) Information systems should be devised so that they may be of practical use to the project management;

(c) The management and professional staff of development banks should be concerned with their reputation. They should be in a position to influence sister institutions, government and other agencies, and help projects to solve their problems;

(d) The development bank should make a conscious effort to have communication at all levels.

There should be a spirit of mutual trust, understanding and appreciation of each other's points of view between the development bank and the client corporation.

An efficient and effective monitoring system would depend upon such factors as the effectiveness of the follow-up, size of operation, type of industries and segments of economy financed, geographical coverage and the resources in terms of finances and manpower at its disposal. Otherwise, the objects of follow-up seem to be common for all development banks. Even though it may cost much in terms of time and money to set up an efficient follow-up department, it is a long-term investment.

There is the question of whether a development bank should be involved in helping the assisted concerns in their problem-solving activities. Next, and more important, it should be decided to what extent a development bank is justified in concerning itself with the management affairs of the assisted units. Should their participation go so far as intervention? The two issues are interrelated. The case for extending assistance at the stage of project implementation or at the operational management stage rests, finally, on the enlightened self-interest of the development bank involved. The development bank's changing mode of operation has effected its operational flexibility on several fronts: the quality of entrepreneurship, a competitive market situation, problems of supplying essential equipment, intermediate goods and raw materials, troublesome bottlenecks in transportation, contending with government policies regarding imports, exports, taxation, pricing and credit policies. Therefore, the development bank must keep a close eye on the flow of additional, unanticipated benefits from the project, assuring the speedy implementation of the project and its efficient and profitable performance thereafter, in order to recover its investment. These considerations could be termed the "enlightened self-interest" of the development bank.

It becomes necessary to distinguish between situations where the development bank is merely concerned with the affairs of industrial management and where it is actively involved. While a development bank can legitimately be concerned, its active involvement should not be the rule.

From the Indian experience, the management of assisted enterprises can be categorized as dependable, deficient and delinquent. The first category of management does not call for any involvement in their affairs. In the case of deficient management, the involvement of the development bank in the affairs of their management will be acceptable provided the development bank has established its credibility. It is only delinquent management that may interpret the concern of the development bank as constituting interference. Such cases are few. Therefore, the development bank is justified in rectifying the delinquencies.

It is not unlikely that development banks in the 1980s will have occasion to be increasingly concerned. Problems of management must be solved, and follow-up efforts must be made keeping in mind that each issue and each enterprise must be examined in terms of the overall operational context of the development bank.

SUMMARY OF DISCUSSION

In discussing the relationship between appraisal and follow-up, a number of representatives mentioned that their banks had found it necessary to combine both functions. The representative of the Caribbean Development Bank explained how his bank had found project officers to be more interested in appraisal than follow-up, considering it to be a more glamorous activity. The bank had therefore decided to assign both functions to project officers and placed a senior officer in charge of both appraisal and follow-up. While the bank seemed satisfied that it would be wrong to separate appraisal from supervision, they did not consider the combination of functions an ideal solution.

The representative from the Belgian Investment Bank mentioned the favourable experience his bank had had because of combined functions. He suggested that DFIs share their various experiences in this regard. It was felt that outside consultants were occasionally needed to fulfill the combined function.

A number of other representatives said that according to their experiences it was absolutely essential to separate appraisal and supervision within the organization. it was indicated that supervision teams that had not been involved in the process of appraisal had been found to be more critical. It was stated, however, that a different type of training was needed for supervising officers. They had to be capable of exactly defining what information was needed and of analysing the environment in which the project was operating.

A representative from Mali talked about how his bank decided three years ago to separate the appraisal and follow-up functions within the organization. So far the results had been excellent. In spite of the separation, the appraisal and supervision teams had to co-operate.

The Moroccan representative discussed his bank's decision to separate the functions. His institution found that in many cases supervision officers were not of a high enough calibre. A further difficulty was indicated: the insufficiency of information flows and feedback on project progress between appraisal officers and the supervision department.

One development banker who thought it was not necessary to separate the appraisal and supervision functions maintained that projects frequently failed because events could not be correctly anticipated. He felt that the appraisal process could be improved significantly on the basis of experience gained in follow-up. In conclusion, he felt that it was more important for DFIs to gain experience than to be overly concerned with impartiality.

A representative from the United Republic of Cameroon cited two problems his bank faced in follow-up. One concerned technical problems and the other, management problems. Because of the smallness of their staff, the institution had to resort to hiring independent consultants when technical difficulties arose. The managerial problems most frequently encountered were in the areas of financial management, accounting and budgeting. The bank, therefore, decided to create a special assistance division to specialize in those areas. It had achieved favourable results so far.

At the close of the meeting a representative from OPEC voiced his agreement with the panel members who felt that DFIs should not as a rule get involved in the actual management of firms.

It was also suggested that international organizations should discuss the problem of project appraisal and follow-up and offer training seminars on the subject.

Group 5 — Operational and institutional self-evaluation

INSTITUTIONAL SELF-EVALUATION OF DEVELOPMENT BANKS IN CHANGING ENVIRONMENTS

T. Y. Hahm, *Senior Vice President*

Korea Development Finance Corporation

Many development banks (DB) successfully fulfill their roles in the development of a national economy. However, it should be observed that some DBs fail to perform their role and remain stagnant.

A DB with a declining role can usually be found in the transition period toward an industrialized economy rather than in the very early stage of industrialization. By and large, stagnation occurs when a DB fails to adapt itself positively to the rapidly changing economic and social environments. However, healthy DBs manage to make the adjustments and continue to play important roles in the economy.

It is helpful to look at the environments and priorities of the stages of industrialization:

Stage	Environment	Priorities
Initial	Limited financial resources	Inducement of foreign capital
	Poor domestic savings mobilization	Identification and promotion of projects
	Lack of entrepreneurship	Managerial and technical assistance
	Inexperienced managerial staffs	Creation of job opportunity
	High unemployment with affluent unskilled labour force	DB's own institution building
	Limited economic statistics	
Semi-industrialized	Increased mobilization of domestic savings	Inducement of new financial methods
	Few opportunities for new business	Mobilization of domestic savings
	Heated competition	Promotion of new industries
	Surge of labour problem	Management consulting
		Active industrial research

Stage	Environment	Priorities
Fully industrialized	Excessive savings over demand Technological development Active production of capital goods Surge of pollution problem Emphasis on social welfare	Overseas economic co-operation Deepening of industrial structure Support of public-oriented industries, such as pollution control

So much depends upon the specific environment in which the DB operates. Nevertheless, the above illustration may help explain what is expected of a development bank at a given stage of economic and social development.

It is unlikely that a DB operating in the initial stage of industrialization can raise a large portion of the required investment funds in the domestic market. It is also unlikely that it will be able to promote highly technology-oriented industry. Investments in pollution control industry may also be too costly at this stage.

However, DBs which rely on foreign capital while the domestic market allows fund mobilization will quickly experience shortages of available fund resources and a decrease in business. The future of the development bank itself and its ability to compete depends completely on its perception of changing environments and its talent for evaluating its institutional surroundings.

Its self-evaluation should have institutional and operational aspects. In assessing the institutional aspect, a DB needs to be concerned about the following economic and social factors:

Change in the industrial structure

Change in distribution of labour-intensive, capital-intensive and technology-oriented industries

Movement of interest rates, inflation and savings ratio

Financial market structure and fund-raising abilities.

Awareness of changing industrial structures will enable a DB to promote projects in the leading industrial sector and provide a basis to contribute to the industrial structure of the national economy.

Industrialization necessitates a gradual shift of investment from labour-intensive industry to more capital-intensive industry, the goal being investment in highly capital- and technology-oriented industry. There may always be some exceptions. Therefore, DBs must continually be prepared to meet the changing requirements.

It is necessary for DBs to adopt policies to maximize the mobilization of funds in given local market situations. In the absence of a workable capital market many DBs rely on government funds for local currency financing. A DB usually needs a longer term capital to provide equipment financing. It should not allow itself to be discouraged by the high inflation and low savings potential in its domestic market. The close observation of changing interest rates, inflation and savings serves as a basis for future fund mobilization.

As the economy moves towards maturity, more diversified financial services are required. A DB must diversify its activities or anticipate the creation of new financial institutions to handle newly required financial services. This could be a joint effort or something it pursues on its own.

The four factors mentioned above are significant for assessing a DB's position at any stage. Close observation of these factors should eventually suggest two aspects of self-evaluation: how to assess and remove the obstacles preventing the optimum performance of the present activities and how to prepare for the next stage.

In the evaluation of a DB's operation special emphasis needs to be placed on the quantitative analysis of its contribution to the national economy. Such analysis will provide the basis for maintaining its status as a DB and make for the establishment of operational strategy. It will also contribute to improving its relationship with the Government and the general public.

HOW THE DEVELOPMENT OF THE INDUSTRIAL SECTOR LEADS TO CHANGES IN THE OBJECTIVES AND STRATEGIES OF DEVELOPMENT BANKS

Harry M. Osha, *Managing Director*

Nigerian Industrial Development Bank Ltd.

Upon examination, one notices an amazing degree of uniformity when it comes to the industrial objectives and strategies of the developing countries. Nearly all of them, regardless of their stage of development, have adopted import-substitution and export-creation strategies. Some have graduated into intermediate and capital goods production, but most are still at the consumer goods stage. Brazil and India have been quite successful in the creation of industrial export. But, in most developing countries the search for appropriate technologies that would both reflect their relative factor endowment and alleviate the problem of unemployment has not been successful.

On the whole, the underlying structure of the economies of developing countries has not changed, and industrial production still accounts for only a negligible part of GDP. Moreover, because foreign capital dominates the industrial sector in many of these countries, control and management continues to remain in foreign hands even though considerable progress has been made in achieving indigenous ownership. The reasons are the shortage of entrepreneurial ability and skilled manpower and the unwillingness of expatriate managers to relinquish control.

Government is the major promoter of industrial development in most developing countries. Since development banks in these countries tend to be Government-owned, they are usually involved in the implementation of their respective aspects of development plans. Indeed, they are even involved in the formulation of development plans. With such a relationship between the Government and development banks, it is inevitable that the objectives of the banks should change not only with development but also with changes in national economic policies and objectives.

Nigeria's efforts at industrialization date back to 1946, when the Ten-Year Development Plan was launched by the colonial Government. In that year the Nigerian Local Development Board, the forerunner of Nigerian development finance institutions, was established. It may not have achieved a great deal but it set the course and set it in the right direction. Nigeria's First National Development Plan was initiated in 1962. One of the objectives was the organization of a development bank for the mobilization of funds. The establishment of the Nigerian Industrial Development Bank (NIDB) in January 1964 was the result.

The major industrialization objectives of Nigeria, as contained in the First National Development Plan (1962-1968), the Second National Development Plan (1970-1974) and the Third National Development Plan (1975-1980), are these:

Promotion and expansion of industrial output and diversification of the industrial sector

Industrial employment opportunities

Creation of increased indigenous participation in the ownership, direction and management of industry

Promotion, development and fair distribution of industry.

Despite the rapid growth of the industrial sector in Nigeria, it has yet to meet expectations because of its slow start from a very small base. Nigeria continues to find it necessary to import a wide range of manufactured goods.

Many industrial objectives and strategies are carried over from one Development Plan to the next. Unless this is to continue, the country must address itself with renewed vigour to the following issues:

(a) The virtual non-existence of vertical industrial diversification and the linkage effects that go with it. Considerable progress has been made with the expansion of import-substitution consumer goods output, but little progress has been made with industrial diversification. The country's iron and steel industry is still being implemented. Apart from petroleum refinement, there has been no forward integration from crude oil production to petrochemicals. The munufacturing sector continues to be heavily dependent on imported intermediate goods and components. Export-oriented industries, essential if Nigeria is to diversify her source of export earnings, are almost non-existent;

(b) the industrial sector is a negligible employer of labour when compared to the primary sector. Because of the capital-intensive nature of industrial technology, industrial employment has not been able to keep pace with the industrial growth.

The concentration of industries in a few urban areas remains a marked feature of economic development in Nigeria. The goal is the even geographical distribution of industries. But, the inadequacy of infrastructural facilities in the less developed parts of the country stands in the way. It should be noted that the Government is at work to remove the barriers and facilitate the geographical distribution. At present, the Government and the Central Bank of Nigeria account for a combined share of 99.5 per cent of NIDB paid-up share capital. Prior to 1976, a total contribution of 74 per cent of NIDB risk capital was made by the International Finance Corporation (25 per cent) and private, foreign institutions in Nigeria (49 per cent). The remaining 26 per cent was held by the Central Bank of Nigeria (25 per cent) and individual Nigerians (1 per cent).

Many of the original operating policies of NIDB did not conform with national industrial objectives because of its involvement with private and foreign industry. For example, NIDB was to assist all enterprise operating in Nigeria, regardless of whether it was indigenous or foreign. It was forbidden from investing in Government-controlled projects. However, as the needs and circumstances of the economy changed. NIDB operating policies and strategies were reviewed. There have been modifications, even though its basic objective of providing finance and technical assistance to industrial projects remains unchanged.

In fact, to date NIDB has sanctioned a total of N 311 million (approximately $190 million) to 349 projects and disbursed N 190 million (approximately $120 million). The investment strategy has closely followed the national strategy of import substitution.

Textiles accounted for the largest share of NIDB sanctions in the earlier years of its life. However, food and beverages (mainly beer and soft drinks) and cement have taken priority in recent years. The Bank has formulated a subsectoral investment programme to guide its operations until 1981, primarily in response to the recognition of the subsectoral composition of manufacturing output, the availability of manufactured items and the recent intensive import restrictions. NIDB has also considered the following factors in designing the programme: the deteriorating external payments position, the emphasis on the use of local raw materials and the intensified programme of import substitution.

Because the Government is the chief promoter of industrial development in Nigeria and because of the relationship of NIDB with the Government, the operating policy of NIDB has been reviewed so as to enable it to assist Government-sponsored projects. The Bank is, therefore, contributing to the realization of the Government's industrialization objectives.

Indeed, prior to the promulgation of the first Indigenisation Decree in 1972, NIDB had reviewed its policy in this regard. Up until 1970, most NIDB sanctions and disbursements went to foreign-controlled projects. For example, only 27 per cent of the value of 1969 sanctions went to indigenous industrial venture. After the 1970 policy revisions, indigenous enterprises have consistently accounted for the greater portion of the Bank's investment. This portion has exceeded 90 per cent in each of the last three years. This commitment has necessitated an increase in the Bank's promotional activities, as well as its loan and equity stake in the projects assisted. Therefore, it has had to step up its technical and managerial efforts to ensure that the projects are run efficiently. NIDB has been making efforts to guarantee the fair distribution of its projects throughout the country. At first, its projects were concentrated in a few urban areas. In 1964, as much as 46 per cent of its sanctions went to Lagos. In 1970, the figure was 30 per cent, in spite of the fact that the inadequacy of infrastructural facilities in the rural areas worked against the Bank's efforts. There has been progress in this regard.

It is also possible that the inadequacy of suitable financial intermediaries could hinder industrial development. As industrialization progressed, the existing banks and financial institutions found themselves operating at full capacity and nearing the breaking point. Commercial banks listened to the complaints of indigenous businessmen who wanted more support. NIDB responded by helping to found a merchant bank. It also set up a stock-broking subsidiary which has helped the development of the Nigerian capital market. Recently it acquired a 60 per cent participation in Commonwealth Development Corporation (Nigeria) Ltd., a step that is bound to add further strength and resilience to Nigeria's financial system.

Development banks have excellent potential for influencing the course of industrial development. In Nigeria, they have influenced the policies of both the Government and private investors. This is an indication that their influence and the process of interaction and change is not restricted to one point of view or one direction. This is a fact that Governments should understand as they accept the role of developing banks as agents of change.

PROJECT SUPERVISION AND EVALUATION

G. B. M. Renger

World Bank

Project evaluation has two basic objectives: the measurement of how fully and how efficiently operational programmes and activities are producing the desired results and the feedback of information for the purposes of anticipating and augmenting new directions, policies and procedures. If one agrees with the principle that the function of evaluation should be performed by those directly involved in the operations, it should hold true that most of the evaluation activities are of a decentralized and self-evaluative nature.

About eight years ago the World Bank established a separate Operations Evaluation Department whose Director-General is responsible for appraising the operation evaluation system and reporting on its adequacy. He is also responsible for conducting selective, independent reviews of operational programmes and activities to determine whether objectives are being realized and how programmes might be made more effective and responsive to the needs of the member States.

Some initiatives have recently been taken to establish the function of evaluation at the outset, as the projects themselves are developed and financed. We are also trying to encourage and institute immediate project supervision within member States.

While evaluation is an integral part of supervision at all stages of a project's development, the World Bank believes that a more formal evaluation exercise should be instituted at a project's completion. At the conclusion of active project supervision the World Bank is required to prepare a project completion report. This is done by the responsible operating departments, normally within six months of the completion of disbursements. Lately, we have agreed with our borrowers that they should prepare this report themselves.

In some ways, the report represents the culmination of our regular supervision. It comprehensively reviews the extent to which the objectives and expectations have been achieved. The report examines reasons for deviations from plans and tries to assess their significance. It is not intended to record the history of the project but to consider whether the project was worth doing.

Some of the principal questions, which of course are also asked during project supervision, are the following:

On implementation: Were the project and its principal components fully completed, on time, within cost estimates, and were final costs reasonable? What changes were made during implementation? Why?

On financial performance: Have the targets and projections, including the self-financing of investments, been fulfilled?

On institution building: Were project management arrangements satisfactory? Have agreed or expected reforms in policies and structures been carried out? Have such reforms been successful?

On efficiency: Could some of the projects be prepared, appraised, and implemented more quickly or economically in the future without undue risk to project or sector objectives?

On economic impact: Is the economic return of the project likely to reach expected levels? If this question cannot be answered or if the report cannot offer meaningful comments on the likely benefits so soon after completion, when can economic evaluation of the project be scheduled?

On other considerations: Did the project have unintended effects? Where relevant, was the distribution of benefits of the project as expected? How does the borrower perceive the World Bank's involvement in the project? Was our original diagnosis appropriate in that respect? Have we learned the lessons of our experience with this project, whatever its degree of success?

There are questions to be answered regarding the quantitative impact of development bank financing. The World Bank has sought to put their answers in understandable terms and has introduced the Subproject Data System through the clients' own development banks. It provides for the standardized compilation of appraisal data for subprojects financed by the Bank or IDA and for their systematic assessment at a later date, when the financed project is in operation. This would not be later than the third complete financial year of operations.

The System involves recording data about key indicators of anticipated costs and benefits on a standard one-page form at the time of appraisal, as well as other data which would be routinely available from the time of appraisal. At a later date it would involve recording on the same form the very same indicators for the same subprojects, thereby reflecting actual performance once the project has been implemented and is presumed to be in full operation. Needless to say, we have sought to minimize the administrative burden on the development banks by limiting the information called for to that which is normally available at the appraisal stage and checked in the course of supervision.

Benefits to the DFI would include the following:

A better ability systematically to evaluate and justify any contribution to economic development

A definite framework for the collection of subproject data, recording for follow-up on subproject implementation and the assessment of subprojects' actual performance

A more streamlined process for Bank processing of subprojects and the later preparation of the project completion reports would be available to DFI borrowing from the World Bank

The Subproject Data System also facilitates matters for the World Bank. It provides it with the following:

Procedures for evaluating and demonstrating the overall contribution of development bank lending financed by the Bank

A uniform presentation of key appraisal data

A consistently defined set of appraisal expectations on which to base the justification and approvals of subprojects

A mechanism for checking on the actual performance of subprojects

An accumulation of the data needed for the project completion report in a standardized, easily accessible form.

As stated before, we have only just introduced this system and have introduced it in two forms. The Long Form is for larger subprojects and the Short Form for the smaller subprojects. This should minimize any additional administrative burden. It will be necessary to fill in the data twice, once at appraisal and again on the same form when the project starts operation. This process will consist of key indicators such as:

Total cost of the subproject
Time required to complete
Capacity utilization
Employment creation
Investment per job created
Value of total output
Value of exports
Domestic and import components of inputs
Value added and value added as a percentage of output
Gross earnings as a percentage of net fixed assets

It may sound formidable, but, in fact, it is rather simple. The most difficult calculation may be the economic rate of return, but this item appears only on the Long Form. In other words, it is only required for the larger subprojects and then only when a meaningful calculation can be made.

This system is required only for subprojects that benefit from World Bank financing. However, some of our client development banks have indicated interest in extending it to each of their subprojects. Therefore, these forms will become available to any interested banker.

FONEI:
A CASE OF INSTITUTIONAL SELF-APPRAISAL

J. Villaseñor, Director

Fondo de Equipamiento Industrial, Mexico

Unlike most other central banks, the Banco de México has actively participated in promoting the economic development of its country. One way has been by channeling credit through legal reserve requirements to priority areas. Another has been the administration of trust funds that finance development.

One of these trust funds is the Fondo de Equipamiento Industrial (FONEI). It is engaged in financing exports of manufactured goods. It was observed that a number of industries were not able to fill export orders due to insufficient production capacity. In order to improve this situation and grant credits for purchasing better machinery and technology for export industries, the World Bank, in October 1971, approved its financial support to the Banco de México and the creation of FONEI. By mid 1973, FONEI had begun operations.

The first years were difficult. Most Mexican industrialists were accustomed to using the banking system for credit purposes which required only the backing of collateral. The FONEI requirement of a pre-investment study was something new. FONEI found itself having to formulate the ideas that industrialists had loosely presented into a useful pre-investment study. During this stage, FONEI tried to offset the resistance of the industrialists to drawing up and presenting useful pre-investment studies by offering them attractive credit terms, especially where the interest rate was concerned.

FONEI, like all other trust funds for financial development administered by the Banco de México, makes use of the national Mexican banking system. As an incentive to act as intermediaries in the granting of Fund credits, they are offered a differential that is intended to offset their costs and give them a reasonable profit. In the beginning, the Fund's promotional strategy was to attend to the entrepreneurs directly, evaluating their investment projects and backing them in the search for a credit institution that would be willing to act as an intermediary. Up until that moment, the role of the banking system behind the Fund was basically a passive one.

FONEI had attempted, without much success, to induce banks to take charge of evaluating the projects applying for the FONEI rediscount. By the end of 1978, however, the Fund had established an incentive for banks, which consisted of their receiving a greater differential for their intermediation. This and the January 1979 change in banking legislation, which said that banks were first and foremost to take into account the viability of the investment projects, awakened the banks' interest in evaluating projects themselves. All this led FONEI to design a training programme to teach bank officers to accelerate the process. Finally, it is the intention to acquaint all Mexican credit institutions with the concept of active development banking.

Once the Fund had achieved the necessary maturity to define its objectives more precisely, the step was taken in 1978 to set up a system to finance national programmes for adapting, integrating and developing industrial technology. The country was at a point of development where it was

possible for Mexicans to assimilate technology quickly from third-party countries and adapt it to the Mexican reality. At the same time they were capable of developing new processes or products and solving problems of manufacture or quality control through their own efforts.

The industrial development of Mexico was geared to the substitution of imports. Little attention was paid to other qualitative aspects, and so it had largely been concentrated in the metropolitan areas of Mexico City and Monterrey. The majority of the industries developed without the realization of problems which would eventually result from the industrial waste. This and the increasing number of vehicles in circulation have made Mexico City one of the most polluted cities in the world.

Recently the authorities enacted a law, with many regulations, to control the various types of pollution. While serious measures have been taken to ensure that it is observed, industrialists have resisted making the necessary investment and consider it unproductive. This situation has led FONEI to pursue the possibility of obtaining financial support from the World Bank. The idea is to establish a new programme for the preferential financing of investments in pollution-control equipment.

FONEI supports projects in which it takes into account not only the possibility for the generation or net saving of foreign exchange, but also the number of jobs that would be created and the kind of contribution that would be made to regional development. In 1978, the FONEI Technical Committee authorized credits totalling about $US 100 million, almost double the amount granted in previous years. As a result of the credits granted in 1978, the Bank has calculated that approximately $US 790 million in foreign exchange will be generated or saved (computed at current values) during the first five years the projects are operating. About 6,500 new jobs will be created. The fact that 70 per cent of the credits authorized by FONEI during 1978 were to companies established outside the zones of industrial concentration gives some indication of its contribution to regional development.

SUMMARY OF DISCUSSION

The consensus was that operational and institutional self-evaluation would be crucially important for the next decade. At the same time it was felt that there had been little progress in the area of self-evaluation and that there was an urgent need for guidelines.

The representative of a DFI in Malaysia conceded he had not been able to arrive at a satisfactory solution, but he suggested that it would be helpful to consider three stages of evaluation. The first might consist of setting targets for achievement in key areas. The comparison of targets with actual achievements should lead into a second stage in which the DFI's contribution to its environment would be examined. In this stage the DFI would analyse its role and ascertain whether it in fact had the appropriate criteria for judgement. For instance, questions concerning measures of profitability and the optimation and adoption of standards would be raised. In the third stage it would be asked if the DFI was capable of efficiently accomplishing its tasks and how it should be compared with other financial institutions operating in the same or similar environments.

A second speaker from Malaysia expressed disappointment that the question of how development banks should evaluate themselves had not been answered. He questioned the fulfillment of plans and meeting profitability targets as accurate measures of success. He pointed to the dilemma of measuring success qualitatively and quantitatively.

This dilemma was highlighted by a representative from a public development bank in India. He suggested that the question of self-evaluation could be rephrased by asking whether the development bank had been developmental in meeting the objectives laid down by the Government. He conceded, however, that the quantitative measures of growth rate and profitability could be less important than the quality of a DFI's work. As examples of quality he mentioned responsiveness to clients' needs, the quality of services rendered, efforts to simplify forms and streamline procedures, improvement of follow-up techniques etc. These considerations would lead to answering the question of how to quantify the quality of service.

The representative of a DFI in Nigeria characterized the issue of self-evaluation as a dilemma when a Government-owned development bank had not received clear objectives from the Government. He suspected that there were several cases where DFI had found their shareholders to be reluctant or unable to spell out the tasks they would like to see accomplished. Therefore, the DFI had to be prepared to rely on its own judgement, and in any case to seek the closest possible relationship with government authorities.

Reliance on the DFI's own judgement was the essence of the statement made by the representative of the private DFI in the Philippines. "Evaluation" was prefixed by "self", so as to stress that the DFI must judge for itself whether or not it was making relevant goals in its country. If a DFI was not able or willing to critically evaluate itself as regards the extent and quality of its own progress, suggestions for outside evaluation and guidance seemed almost irrelevant.

In this connection he felt that the panel had made some useful suggestions. It was important that DFIs should set their own standards of expectations and that there should be an effort to ensure that the process of self-evaluation would be institutionalized and carried out once a year, helping the DFI to remain constantly responsive to its country's needs. He did feel that too little attention had been given to the dichotomy between

ex-ante planning and ex-post control and was convinced that programming and planning was more important than ex-post control. For this reason it was held that regular self-evaluation was absolutely necessary for the DFI to mobilize its potential, according to the changing expectations and needs of its environment.

Group 6 — Social obligations of development banks

SOCIAL OBLIGATIONS OF NATIONAL DEVELOPMENT BANKS

I. Shihata, *Director-General*

OPEC Special Fund

Development is a comprehensive process which transcends economic criteria and objectives to include social considerations and even social objectives in its scheme. The social element is composed of factors that directly improve the quality of life, although they may also contribute economic benefits, however indirectly. Economic and social objectives are therefore frequently interlocked. They are seldom mutually exclusive. If they seem at times to be contradictory, they should be more closely examined to see if this is actually the case. Economic growth in the narrowest perspective, i.e. without social considerations, would make no sense. Problems do arise at the early investment and decision stages, when trying to determine the social and economic objectives. This is the case because of financial resource constraints and alternative demands which are competing for available resources. This is not a problem of reconciliation between social and economic objectives for the government planners. It is instead a question of exchanging short term for longer term benefits within the overall ranking of development priorities which are, of course, largely influenced by the availability of financial resources.

As catalysts for development, development banks face problems similar to those of the government planners with their project promotion and financing activities. The difference is that the greater their accountability, the more constraints on their resources.

As their name suggests, development banks are both development institutions and banks. As banks, they are obliged to pursue profit motives to the extent to which they are not compensated for by direct government aid or by interest-rate subsidies. This is because of their accountability to those whose money they manage and who are, in essence, their performance auditors. These include the external lenders of development banks, the shareholders and the depositors. Therefore, as banks they are obliged to apply sound financial criteria in their activities. But, as development institutions they share in the responsibility of the country's development effort, both social and economic. It is the fulfillment of this role which places unusual demands on the project promotion and financing activities of development banks. Yet, without fulfilling this role, a development bank would lose its reason for existence.

If social and economic objectives converge, their union also converges with long-term financial objectives. One of the basic reasons for overall financial viability (besides providing for the future) is the ultimate pursuit of a development objective. Otherwise, financial viability becomes solely a matter of individual gains and has no positive impact from the standpoint of general or collective welfare. Therefore, objectives of financial viability

are important for the long run only to insure the achievement of the higher socio-economic objective of development. Insuring the future of the concern can only be done by way of such financial incentives as profit and remuneration. By this method both parties, the development bank (DB) and the enterrise, can expect a fair return on the invested capital.

The typical investor, promoting a project, is rarely concerned with socio-economic considerations beyond those implicitly involved in the profit motive of his investment proposal. However, in the case of DB, the financial return objective should not take precedence over socio-economic considerations. Nor should commercial ends be sacrificed altogether, as DBs could not continue to play their fundamental role in a market-oriented or mixed economy.

For purposes of discussion, the social development responsibilities of DBs can be divided into three areas: project design and appraisal, institutional building, and target groups and sectors.

An investment which may be financially viable may not necessarily be socio-economically desirable from a resource allocation viewpoint, i.e., in terms of employment generation, value added, profit plow-back, linkages, and induced incremental socio-economic benefits. It is a DB's responsibility to screen out potential investments without such benefits from their scope of activities.

On the other hand, there are projects which may be of dubious or marginal financial merit but are nevertheless socio-economically desirable. Often, such projects are the result of inadequate project preparation or the result of over-emphasizing social considerations during project preparation. Cases of public amenities financing by DBs may be a good illustration of this latter situation. In such cases, the justification for DBs' promoting and financing such non-revenue earning components as pollution abatement equipment, software or items otherwise unrelated to the revenue-earning capacity of projects, is no different from the justification for legislation or institutional mechanisms dictating the need for such components. The problem is that the benefits of these socio-economic considerations (improved quality of life and lower environmental costs in the example of antipollution components) are often long term, aggregate and difficult to measure for the typically small project considered for DB financing. Consequently, in these cases the problem is not one of contradiction between financial and socio-economic objectives but rather one of quantification.

Another case involves public entities such as the utilities companies which do frequently receive financing from DBs and which more often than not attain low rates of both financial and economic return. In such cases, financial objectives are difficult to reconcile with development objectives because of difficulties in quantifying social benefits that bridge the difference.

Where social considerations make economic objectives seem dubious, Governments and DBs should define the threshold below which a project should not be financed by a DB. Such purely developmental projects as basic infrastructure, education etc. cannot be suitable for DB financing if, as mentioned earlier, the DB must withstand the scrutiny of its creditors and shareholders. It is quite clear that Governments do not substitute their budget for those of the DBs in projects of unquestionable financial and economic merit. However, there are borderline cases, thin lines or areas outside the traditional government sphere of responsibility which find themselves merging with those traditionally outside of the DB sphere. Appropriate incentives to DBs are important. In such situations, institutional building activities can be seen as important to the DBs.

There is no doubt that staff training in financial analysis, accounting and management, involvement in the preparation of general sector studies, or assisting in project feasibility studies and project preparation, and their ability to provide technical assistance to borrowers in the developing countries is an important role of DBs. While the short term return on these activities is low or negative, the long term benefits are encouraging. These include an improved DB performance and capability resulting in the more efficient allocation of resources, contributions towards creating a good

climate for investment, improvements in the client/DB image made possible through experiences with successful projects, and finally the development benefits of well-conceived and well-appraised projects.

The question becomes, how can these activities be carried out by DBs without resulting in an excessive drain on their resources for other, immediately productive activities?

Before answering this question, there is yet another social obligation of DBs which finds its rationale in the very reason for institutionalizing credit, i.e., to make it available to those who could not otherwise obtain it. This, of course, refers to such groups as farmers and small investors who could not otherwise obtain credit from commercial banks because of the risks and relatively high administrative costs involved. This also assumes promoting productive investments in the agricultural sector, the rural and other economically depressed areas in order to complement the infrastructure and other investments of Governments.

DBs must be prepared to make the commitment to assist these target groups and sectors which would otherwise be neglected for reasons, respectively, of credit and productive investment. Beyond their own institutional building efforts, DBs obviously need help from essentially two sources, their Governments and external lenders.

Governments can assist development banks in two ways: directly, with financial aid and interest-rate subsidies or rebates and, indirectly, through investment-code provisions responsive to the obligations of DBs and the needs of their clients. Such assistance, however, must be reserved for occasional fine-tuning of the investment climate when there are socio-economic considerations. Care should be taken to avoid excessive incentives such as the misallocation of resources or forgone tax revenues, serving simply to promote financial rewards for both DBs and their clients. The responsibility for monitoring the investment climate, its ills, its probable cures, and its direction rests to a large extent with DBs and their activities. Governments should benefit from DB's experiences by giving DBs a role in the discussion of a country's development plans and orientations and in the elaboration of investment codes.

External lenders that assist DBs by extending them lines of credit can also do much to assist. They could show greater sensitivity to the social obligations of DBs in orienting their portfolio to certain sectors and target groups as well as in the review of subprojects appraised by DBs. It is possible for them to tailor their onlending terms (for those institutions which extend their lines of credit through Governments) to enable DBs to meet the unconventional demands on their resources that do not yield adequate financial returns but nevertheless are necessary for the development process.

SOCIAL OBLIGATIONS OF DEVELOPMENT BANKING

S. A. Dave, Executive Director

Industrial Development Bank of India

As with developing countries, there are many differences between development banks. it is especially important to understand these differences when discussing matters of policy. However, development banks do have these common characteristics:

(a) Their financial involvement includes the mobilization of resources and the lending and allocation of funds to all projects;

(b) They not only provide term finance but also take up developmental activities such as project identification, promotion and reformulation; i.e., they are active in all stages of the project;

(c) Their lending operations, by and large, are not guided by profit motives only; socio-economic objectives set by their Governments are included in project appraisal and constitute part of the developing banks' goals.

The objective of any development strategy is to optimize the use of the country's scarce resources for achieving long-term socio-economic objectives. It is an enormous task to formulate this kind of proper development strategy. It must involve a large number of people and institutions at the time of formulation so as to be realistic and appear acceptable. The main task we should be considering is the removal of poverty in the next decade. This is quite impossible unless it is known what needs to be done and what can be done from the first and with what available resources. There must be priorities and target solutions for the future. A time schedule for accomplishments should be devised. From the moment the strategy is formulated, local people and institutions should become involved. Its wide acceptance is essential.

Development banks are institutions whose activities have to be geared towards achievement of national economic objectives in all countries undergoing a planned process of economic growth. Objectives, and organizational and policy frameworks, may differ from country to country, but the institutions have to work to achieve them. Within the limitations of its statute, each development bank has to translate these individual objectives into its own objectives. It should be aware of its own domain and therefore aim for excellence in performance within that domain.

The main business of development banks is to raise and to disburse finance, a scarce resource in any developing economy. Finance should not be considered a resource but a spectrum set in which all other resources are expressed. Therein lies its weakness and its strength. The mobilization and disbursement of financial resources without an eventual corresponding creation of goods and services is inflationary. At the same time, development banks are not and should not be reduced to functioning exclusively as resource-raising and finance-disbursing agencies. Finance has the strength to command all resources and direct their flow in socially desirable directions.

Within the framework of its traditional lending activities, a development bank can play a significant role in optimizing the use of available resources and in achieving a socially desirable product-mix. They are useful for stepping up the pace of industrial growth and for promoting industries to

development in otherwise industrially backward regions. The development bank can prevent the concentration of economic power and be successful in promoting the indigenous growth of small entrepreneurs. As soon as the objectives are clearly defined, the operational policies and procedures must be geared towards their realization.

There is no scientific way of translating these objectives into organizational objectives. They require value judgements and predictions. Nevertheless, they must be clearly defined. Otherwise, the development banks may find it very difficult to set priorities, prepare medium-term plans, formulate annual performance budgets, and apply the appropriate appraisal criteria.

The development bank's method for project allocation of resources should lead to a greater contribution to social purposes. Appraisal of any project, large, medium-size or small, has to be conducted from several interdependent points of view: commercial, technical, managerial, financial and economic. However, these four points should not be considered by a possible project as the only conditions which must be satisfied to be deemed and selected as a worthwhile project. They are necessary and important criteria to satisfy, but when resources are scarce and several competing projects are likely to satisfy these criteria, one must decide which project would make the best use of scarce resources and benefit the greatest number of people.

This is where the more challenging developmental role of the development banks comes in. The concept of financial institutions as term-lending agencies assumes that all other resources needed for investment are available and that finance is the only limiting factor,and that the borrowers will successfully carry out the projects as soon as the financial resources are made available. This assumption is not valid for developing countries, where the process of industrial growth is constrained by varying shortages. Most of them are characterized by shortages of some of the inputs and skills needed for a successful project. Apart from scarcities of physical inputs such as machinery, materials, fuel, power and infrastructure facilities, these countries do not have a sound enough entrepreneurial base to take up new projects. They are also lacking the competent technical and managerial personnel to run their projects efficiently. What happens at odd times is that there are few, if any, viable projects to pursue.

Obviously a development bank in these countries must do something more. It can look at itself as a catalyst, co-ordinating the efforts of some government agencies and institutions, while fortifying the efforts of others. It is very difficult to surmount the problem of rigid restrictions through international trade when the need for supply is critical, particularly when some of the shortages are non-tradable factors. And, international markets are not sources or outlets for production. If that were the case they could earn valuable foreign exchange. Because the problems created by the inadequacy of infrastructure, capital and resources are essentially multi-dimensional, no institution is capable of solving them alone. It is a joint task which can perhaps best be implemented by the catalytic development bank. In these special cases it is up to the development bank to build up the weaknesses and remove anything that stands in the way of industrial growth.

Development banks have no limitations when it comes to fulfilling their social obligations, so long as their activities pertain to servicing industrial activities. However, they must be innovative. The initial transformation of ideas into projects can usually be accomplished more effectively through the assistance of a consultant or professional not too closely involved.

Their modus operandi may be more noticeable through their implementation of individual projects and with individual entrepreneurs. However, development banks have to keep the overall industrial development and economic objectives of the nation in perspective and see to it that all parts operate harmoniously.

THE SOCIAL OBLIGATIONS OF THE IVORY COAST INDUSTRIAL DEVELOPMENT BANK

A. Diby, Director-General

Ivory Coast Industrial Development Bank

The fundamental obligations of the Ivory Coast Industrial Development Bank (BIDI) are described in its constituting convention. They are to encourage the development of industrial private enterprise and invite the participation of foreign investors in the development of the Ivory Coast. Domestic investments from Ivory Coast industry are also suggested. No effort should be spared when it comes to learning about financing new industrial enterprises. Most important is the financing of projects approved by the Government.

BIDI is also obliged to provide technical and professional training with the goal of creating a skilled indigenous work force. Citizens of varied abilities are to receive training, though there should be emphasis on training individuals for financial and general management of BIDI.

The Bank's directors perceived that the fulfilment of these obligations was of primary social importance. Therefore, the Bank set itself the objective of successfully promoting the Ivory Coast national. It has taken an active part in setting up promotional bodies aimed at training Ivory Coast businessmen, as follows:

(a) The National Office for the Promotion of Ivory Coast Enterprise was established in July 1968 for the purpose of devising and implementing studies and actions to be pursued in the Ivory Coast. It is designed for the creation and development of truly national commercial, industrial and agricultural enterprises, the organization of collective professional branches and improving efficiency and productivity within the business sector. Towards that purpose, it conducts a wide range of studies and arranges their implementation to benefit enterprises, groups of enterprises, firms and professional unions;

(b) The Guarantee Fund for Credits to Ivory Coast Enterprises was instituted in July 1968 for the purpose of guaranteeing credits granted by banking institutions to Ivory Coast nationals or companies where at least 50 per cent of the capital is nationally owned. In its first 10 years the Fund has helped raise over 3 billion CFA francs (CFAF 217 = $1) in loans, benefiting 160 enterprises, thus helping to provide more than 2,000 jobs;

(c) The Special Fund for Small and Medium-Size Enterprises is managed by the National Financing Corporation. It was founded in October 1970 to make up for the shortfall in capital investment for small and medium-size Ivory Coast companies. It was a matter of making them self-financed. This Fund contributes up to 15 per cent of the funding for a project, thus lowering the promoter's share to 10 per cent. This may be accomplished either by participating in the business by means of a buy-back clause in the promoter's favour, or through a long-term loan which is not due until the repayments of normal bank loans. The Fund's support has made possible 34 projects and investments totalling CFAF 400 million.

BIDI itself participates directly in business promotion. This began as a supplementary effort to assist the small and medium-size Ivory Coast

enterprises whose action through their own special fund was limited. The Fund's resources could not exceed CFAF 60 million over a period of five years. The number of projects permitted was limited due to the Fund's own restrictions of a ceiling of CFAF 50 million on project expenditures.

The Bank's participation was aimed at making up the promoter's investment or at making it possible for Ivory Coast nationals to become shareholders. To date BIDI has helped some 27 projects and invested approximately CFAF 900 million.

BIDI set up promotion and guarantee funds. These were made possible because of interest monies returned by foreign agencies that had granted loans to the Bank. Since its establishment in 1980 the Promotion Fund has supported 20 projects, and on 30 April 1979 its balance was CFAF 90 million.

The Guarantee Fund has, to date, a balance of CFAF 134 million.

Impressive as this may be, there is a great need for the Bank to extend its scope and become better able to respond to the needs of Ivory Coast entrepreneurs. The entrepreneurs lack financial and technical resources and adequate management experience. Industry is still very young in the Ivory Coast. The experience is in the less complex fields of agriculture, forestry, cattle raising, extraction of building materials, handicrafts, bakery, minor commerce, transportation etc. To extend its activities on behalf of Ivory Coast enterprise and to increase the level of experience, the Bank has helped to finance these sectors and assisted 35 enterprises with over CFAF 1 billion in the past 10 years.

It can be estimated that the 255 firms helped by BIDI have created 100,000 new jobs. Without the Bank's assistance some 20,000 of these would have never existed. The Bank's staff is entirely composed of nationals, totalling 56 persons, 23 of whom are at executive level. Besides training senior staff for its own purposes, BIDI is training employees for its clients. In this way it hopes to contribute towards creating the possibility for local management in the private sector.

SOCIAL IMPACT OF THE ACTIVITIES OF THE INDUSTRIAL DEVELOPMENT BANK OF EGYPT

A. H. Kabodan, *Chairman*

Development Industrial Bank, Egypt

The greatest achievement of the Development Industrial Bank of Egypt (DIB) has been the creation of new jobs at a low investment cost per capita. Since its establishment in August 1976, the DIB has provided employment for approximately 100,000 new workers. It accomplished this by focusing on labour-intensive projects and by supporting small industries, artisans and co-operatives. This actually means that it has helped to improve the chance of over half a million Egyptians to participate in development.

Egypt's greatest national resource is its people. The people may also be the biggest problem. Egypt is already one of the most densely populated countries. Population is increasing by about one million each year. The country runs the obvious risk that the hard-won gains of development will be diminished or even cancelled unless things change. Therefore, the reduction of the birth rate in Egypt is a social goal.

Industrialization is one of the chief factors contributing to a decline in the birth rate. There is a prevailing desire for smaller families and the effectiveness of family planning programmes is greater among that segment of the population associated with modern industrial activities. The increased standard of living should reduce birth rates and an increase in social securities would make children unnecessary as a means of security for old age.

DIB activities in long-term and medium-term financing have helped to accelerate the process of industrialization in the country. It has concentrated its operations in the most populated areas of Cairo and Alexandria where, contrary to the generally held view about the impact of urbanization on population growth, the growth rate is, in fact, higher than in the provinces. The geographic distribution of the loans approved by DIB from 1 August 1976 to 30 April 1979 was as follows:

Area	Number of loans	Percentage of total	Value of loans (thousands of Egyptian pounds)	Percentage of total
Cairo	1 053	48	6 430	60
Alexandria	708	32	2 120	20
Lower Egypt	102	5	1 040	10
Upper Egypt	323	15	960	9
Canal zone	19	1	210	2
Total	2 205		10 760	

The particular strategy of DIB has tended to reduce the negative social effects of advanced technology such as long working hours, fatigue, mental stress, environmental pollution and increased risks and accidents. It discourages the use of sophisticated imported machinery if it might entail

psychological stress and prohibits the introduction of second-hand machinery that might cause health and safety hazards. DIB is equally concerned about environmental stress.

The achievement of DIB technical assistance objectives will have a significant social impact. Better income can be obtained through improved performance. Finally, better nutrition, health, education and increased access to such luxuries as electricity and entertainment will be realized.

DIB has allocated a significant share of its resources to finance medical and dental equipment. The Bank has also contributed to the establishment of hospitals for purposes of rehabilitation.

Hunger is a key problem for developing countries. The poor quality of the food produced is as much a problem as the insignificant quantity. DIB has been effective in promoting food industries and the optimum use of Egypt's available agricultural products.

OPEC and the World Bank have created special funds and extended lines of credit to DIB. This assistance provided facilities with which the DIB could, in turn, assist the small firms in Egypt. The programme consists of four parts: (1) a technical assistance service organized and implemented by the Engineering and Industrial Design and Development Centre; (2) a programme for upgrading skills implemented by the same institution; (3) an accelerated training programme for unskilled or semiskilled workers from small firms implemented by the Productivity and Vocational Training Department of the Ministry of Industry; (4) a management development programme to be carried out by the Federation of Egyptian Industry.

DIB has encouraged projects with high social impact. Two outstanding examples are the sand-brick and plastics factories. Both projects employed prisoners and ex-prisoners, who would otherwise not have found work, in the production process. More projects of this kind are planned.

SUMMARY OF DISCUSSION

There were diverging reactions from the panellists discussing the social obligations of DFIs. Those representing Government-owned DFIs naturally mirrored the policies of their Governments, while executives of privately-controlled DFIs stressed the importance of freedom in project selection and promotion and they asserted that this freedom enhanced the viability of the industrial environment as such.

This dichotomy characterized the responses to the question of the extent to which development banks can or should consider questions of worker safety, health and environment in project promotion and appraisal. In particular, it was asked whether DFIs should support alcohol and luxury goods projects in their countries. The general question asked was whether a DFI should refuse assistance to a project on other than financial economic grounds?

A statement from the floor addressed the public development banks in particular. Since most DFIs were characterized by either total or majority government ownership, it was expressed that all public banks should have social obligations which match those of their respective Governments. It was felt they should give the same priority to that matter. However, the speaker was of the opinion that private DFIs should also have social obligations and not just social objectives.

The distinction was made between financial and economic project analysis and the analysis of social benefits. it was conceded that social benefits were at best difficult to quantify. However, the need for establishing guidelines was considered urgent. It was felt that project analysis could safeguard against pollution and that possibilities in this area should be explored. It was generally felt that environment should be explicitly included in an integrated approach of cost-benefit analysis for project preparation.

The two opinions concerning the priority of social obligations also characterized the panel's response to the following question: should a specific investment/employment ratio be a criterion for project analysis?

The representative from the public Egyptian development bank cited the favourable experiences his bank had had in assisting projects in the area of small enterprise. In his country, project assistance to small enterprises had proved to be an important vehicle for the creation of a large number of jobs. It had been achieved with a relatively modest investment which averaged out to costing about $4,000 per job.

On the other hand, the representative of the private DFI from the Ivory Coast reflected his bank's belief that a specific investment/employment ratio should not be a criterion for project selection and promotion. He stressed that freedom of choice was most important for project promotion, though the ability of projects to show adequate financial and economic returns had to be a condition for project acceptance.

In conclusion, the chairman of the panel voiced some concern over the statements made by representatives of the World Bank during the Symposium. These statements had characterized self-reliance as a primary goal. He expressed the fear that the pursuit of that goal would lead to the commercialization of development banks, which would in turn lead to problems for DFIs in meeting their social obligations.

In that context, the chairman mentioned that the OPEC Fund had been developing a new policy. As credits were made available to development banks at an annual interest rate which reached a maximum of 4 per cent, the Fund decided that the interest differential to the onlending rate of the DFI would be passed on to the DFI, allowing it to meet social obligations in specific priority areas.

Part three

PLENARY SESSIONS ON MOBILIZATION OF FINANCIAL RESOURCES

DEVELOPMENT BANKS AND THE MOBILIZATION OF DOMESTIC FINANCIAL RESOURCES

Vincente R. Jayme

President, Private Development Corporation of the Philippines and Chairman of the Management Committee, Association of Development Financing Institutions in Asia and the Pacific

The international economic order of the future must evolve from a system that has been largely shaped by the needs of industrialized countries into a system in which developing countries have a voice in the direction it should take. But greater participation in shaping a new world order requires developing countries to be increasingly responsible for and reliant on themselves. It also means that the economic development of developing countries should derive its momentum from co-operation and understanding, not only from developed countries but also among developing countries themselves.

It is in this spirit that development finance institutions (DFIs) must confront the challenges of the 1980s. One such challenge is an increased need to mobilize domestic financial resources.

Given the diversity of character, operations and operating conditions of DFIs throughout the world it is perhaps appropriate to outline the problems that appear to be common to most DFIs in mobilizing domestic financial resources.

Significance of the problem in the coming decade

The demand for resources in the world will continue to expand in the 1980s both in real and current terms. While much progress has been made within the third world in the last two decades in raising *per capita* income, much remains to be done.

Despite programmes to reduce population growth the dynamic implications of the present demographic structure in much of the world will strain resources in the coming decades. It will be necessary to sustain high levels of savings and investment to meet this challenge.

Mobilizing resources to sustain the momentum of structural change in the economies not only of developing countries but also of developed countries is another challenge that will probably encounter greater difficulties in the coming decade.

This structural change is reflected in the increasing share of the industrial sector in the gross domestic product (GDP) of developing countries and in the share of manufactured exports in their overall export structure. In the last two decades developing countries as a group have begun to account for an increasing share of world trade in manufactured exports.

The momentum of this transformation of the structure of production and trade, especially in developing economies, will have to be sustained and accelerated in the coming decade.

Such a transformation will require larger capital investments over longer periods of time to finance the purchase of equipment, the setting up of necessary infrastructure as well as the current supplies needed by an expanding

industrial sector. To finance this kind of transformation, the economy will need financial intermediaries who can match the requirements of lenders with the needs of borrowers. The problem of mobilization is twofold: generating enough resources and matching requirements with needs.

Changing directions in external flows

In view of their own capital needs, external flows of capital from industrialized countries may in real terms be insufficient to help the developing world. Moreover, the slow recovery of industrialized countries from recent economic crises has made the extent, terms and stability of these flows uncertain. The 1978 World Development Report of the World Bank indicates that in the coming decade the growth rate of industrialized countries will be slower than in the last two decades. This situation would make external mobilization of capital by developing countries more problematic. Slower growth in industrialized countries would mean not only slower growth in external flows, both commercial and concessionary, to developing countries but also slower growth in the exports of the developing countries to the developed countries.

In the face of these problems developing countries will have to make greater efforts both to mobilize resources and to diversify their sources of capital. Consequently DFIs must take an active part in this effort if they are to fulfil their function.

Domestic resource mobilization

Difficulties in mobilizing external resources will mean making a greater and more efficient effort to mobilize domestic resources.

As pointed out above, the problem of capital, in developing countries especially, is twofold: mobilizing sufficient resources and matching saver needs with investor needs. The first component involves saving and not consuming resources; the second involves a process of creative transformation.

Mobilizing adequate resources

In the first case, there is the problem of scarce domestic capital. This seems to be the chief problem in low-income countries, as is suggested by the high rate of private consumption, which increased from 79 per cent of GDP in 1960 to 81 per cent in 1976, and by the lower share of gross domestic savings in GDP in relation to gross domestic investment. In 1960 the median share of domestic savings in GDP in these countries was 9 per cent as against domestic investment of 12 per cent. In 1976 the share of domestic savings declined to 8 per cent and the resource gap grew larger as domestic investment reached 15 per cent.

Apparently where income is barely sufficient to pay for basic needs there is little saving and little capital formation.

The problem of mobilizing domestic savings begins with the problem of raising income levels because either income or saving for capital formation can be the cause or the effect of the other. While it is possible to create various financial instruments and introduce various financial intermediaries into the economy, the larger effort of raising income levels will have to be sustained if not accelerated to generate the savings needed to make such instruments and intermediaries purposeful. Raising the savings rate results from raising income levels and represents a truly national effort. This highlights the economic importance of projects financed by DFIs from scarce savings. Such projects must help create employment and raise income if they are to contribute to national development.

In connection with the problem of raising income levels, especially in the lower-income countries, it should be noted that while official sources with concessional funds or any other form of foreign capital will continue to stimulate economic growth, their role will be confined to supplementing domestic savings. Current developing country experience and the historical experience of developed countries indicate that domestic savings finance the bulk of domestic capital formation (more than half of the gross domestic investment of low-income countries and more than 80 per cent of middle-income countries). Developing countries can and should finance the greater part of their development effort by mobilizing domestic savings.

With effective support from government, DFIs should be able to mobilize private as well as public savings for industrial development through appropriate arrangements with existing intermediaries. Insurance companies, government social security institutions and commercial and savings banks, which usually are the first types of intermediaries to be established in an economy, not to mention wealthy individuals, can provide funds for long-term investment to DFIs by loans and by buying shares in DFIs.

Where commercial banks dominate the financial system, it may be possible to work with several of them. They can provide the working capital for the DFI's clients. Commercial banks can also devote part of their assets to relatively long-term obligations and the DFI can issue fixed-yield securities suited to this purpose.

Households in developing economies are usually oriented towards savings deposits as the traditional form of financial savings because they have immediate access to and are familiar with this form of financial asset. This apparent limitation in the savings behaviour of households can be used to mobilize household savings further by appropriate innovation and variation of traditional savings deposits. In the Federal Republic of Germany, for example, the introduction of interest-accumulating savings certificates or securities has proved to be a growing success although a few years ago a similar scheme was introduced to the Philippines with limited success.

The idea behind this innovation is that people tend to hold on to their deposits without immediately collecting the interest due. At the same time, the fact that deposits can be withdrawn at any time makes this kind of savings attractive. The interest-accumulating certificate combines these basic features with the idea of saving in an instrument whose interest rate is such that on due date the accumulated interest payments have doubled or even tripled the initial investment. Variations of this idea can be made by varying the interest rate and maturity of the instrument so that doubling or tripling the investment by retaining the instrument until due date is guaranteed.

Government savings can also be channelled to DFIs through subsidized loans, outright grants and direct equity participation, if not necessarily full ownership. These possibilities have been explored in Africa, Asia and Latin America. A number of DFIs in India received extended government loans which were subordinate to other debts and sometimes even to capital. Some countries in Latin America, for example Argentina, Brazil and Venezuela, have Government-owned development banks. In Asia and the Pacific, almost all member countries of the Association of Development Finance Institutions in Asia and the Pacific also have Government-owned development banks. The Korea Development Bank, for instance, in addition to having its capital fully subscribed by the Government, receives not only fiscal funds from the special account of the government budget but can also borrow from another government entity, the National Investment Fund.

Other countries have development banks with mixed ownership, that is, both public and private sector participation. Mexico and Peru are examples in Latin America; Tunisia, in Africa. In still other cases Governments have set

up rediscounting facilities for DFI loans and thereby enable DFIs to generate new liquidity from their portfolios. The Government of Colombia, for instance, has extended discounting facilities to several Colombian development banks.

While government participation is one way to mobilize national domestic savings for private sector use, there may be both economic and non-economic issues which a DFI and its Government must resolve before taking it. The possibility of political influence on the use and disposition of funds is one issue that must be dealt with. A DFI with mixed ownership must resolve the difficult issue of what rate of return on investment is optimal and acceptable to the Government and to the private shareholder. The larger issue of governments in less developed countries not possessing sufficient resources to satisfy the claims made on them will also have to be considered. If such an issue actually becomes a problem, a DFI may have to seek other forms of government assistance.

DFIs, especially if Government-owned, may seek government guarantees for the bonds and other debts instruments they issue to mobilize domestic savings. The Government could guarantee repayment of the principal to holders of DFI debt instruments. For example, bond issues of the Development Bank of the Philippines are guaranteed by the Philippine Government. Another form of government assistance might be granting tax exemptions or tax incentives. Holders of DFI instruments could be exempted from the usual taxes on securities investments. If this is not possible, a DFI might request the Government to offer tax incentives such as a graduated income tax structure providing lower tax rates for longer-maturing instruments. These possibilities may be more easily explored by a DFI if it is Government-owned but private DFIs should not ignore them. A DFI can justify such preferential treatment by referring to the resulting development of the country's capital markets and the consequent reduction of the DFI's dependence on the Government.

Development of capital markets

The median rates of savings and investment (20 and 24 per cent of GDP respectively in 1979) of middle-income countries are higher than those of low-income countries, and these rates compare favourably with the median rates of savings and investment of the industrialized countries (24 and 23 per cent respectively in 1976). Nevertheless, because of higher rates of investment relative to savings, the resource gap in the middle-income countries is still large and will still have to be met.

There are other possible solutions to the problem of mobilizing resources. In some middle-income countries there are sufficient savings but they are either short-term and require term transformation to match investors' requirements or they are in non-financial forms. The problem of mobilization is not so much the problem of creating or generating savings but in monetizing them or increasing the share of monetary savings in aggregate domestic savings. If savings are already monetary, then savers must be induced to choose long-term instead of short-term savings forms. When the problem of mobilization also includes matching savings terms with investment needs, the need to diversify sources of medium and long-term funds becomes critical.

There are various methods by which a DFI can prompt the transfer of savings from non-financial to financial forms. Encouraging the use of such savings for long-term investments involves other factors in the institutional framework in which savings take place and may require structural reforms.

One such factor is the interest rate structure in the country and the Government's policies on it. In many countries the Government sets a ceiling on effective interest rates which often is below the real cost of capital in the economy. This situation makes it difficult for DFIs to coax savings out of non-financial forms of saving such as real estate, jewelry and consumer durables. When the economy suffers from chronic inflation it is also difficult to persuade savers to make long-term monetary investments.

Taxation on interest earnings or dividends paid can also affect the availability of monetary savings for investment. The under-assessment of land values for taxation purposes can also create a preference for real estate as an outlet for savings as against other forms of savings.

There may be other structural deficiencies which hinder DFIs from engaging in adequate and diversified mobilization of domestic resources; but in resolving such deficiencies a DFI can demonstrate its contribution to the financial development of the economy.

The experience of DFIs in the Republic of Korea and Singapore with problems of this kind suggests a new approach to capital markets development. This approach calls upon a DFI to join with its Government to identify, study and perhaps implement reforms of institutional and policy framework to help accelerate the financial development of the economy. Such an effort might involve restructuring interest rates to reward long-term savings with a higher rate of interest. It might also involve setting up institutions to provide liquidity and working capital to stock brokers and underwriters and enable them to create both primary and secondary markets. A plan of this kind is now being studied in the Philippines.

In addition to active collaboration with its Government a DFI can help expand the market for securities by introducing new services, expanding current services or setting up subsidiary entities.

In terms of operations a DFI can help formulate and underwrite debt instruments to compensate holders with rewards other than interest. This is attractive when the existing scale of interest rates produces a lower return than is acceptable to savers on long-term investments. Variant bond issues, for example, might provide holders with some form of participation in profits. This could be effected by selling bonds and common stock as a unit with the price of the bond adjusted to reflect the participation of the holder in ownership. As an added feature, bonds or debentures might also be convertible into stock at specific price and date. Other features and variations may be offered as local laws permit.

The same kind of variations may be used in equity issues. Giving equity holders options or pre-emptive rights to purchase succeeding equity issues of the company may also attract potential investors and may in fact help expand the secondary market for securities by creating a sub-market for such options and rights.

In addition to the problem of enhancing the real and potential return on investment to investors, there is the problem of enhancing the marketability and liquidity of the securities issued or underwritten. This is especially serious if the economy in which a DFI operates is inflation-prone and the capital markets are relatively undeveloped. The marketability of such instruments can be increased by properly selecting collateral. Instead of issuing notes and debentures without collateral a DFI might issue bonds which, depending on market preference, could be collateralized with receivables, chattel mortgages or real estate. To enhance liquidity securities might be sold subject to repurchase agreements specifying term and price. An agreement permitting the holder to redeem his investment on demand at an appropriate discount might also enhance the marketability and liquidity of securities.

In the Philippines, where the secondary market for long-term debt instruments is not yet fully developed, some investment banks and DFIs (including the Private Development Corporation of the Philippines (PDCP)) are trying to establish a network of dealers to provide secondary or liquidity support for it. Under the proposed arrangement, each member of the network is committed to buy a specific proportion of secondary sales of such instruments at an appropriate discount. This commitment is in addition to whatever inventory of such instruments the member institution may already hold.

At the same time the Philippine Government and the International Finance Corporation (IFC) are investigating the establishment of a government entity to provide liquidity support to the securities industry by standing ready at all times to purchase securities at an appropriate discount. Meanwhile the Central Bank of the Philippines has announced plans to provide a rediscounting service for stockbrokers as an additional aid to the securities industry.

A DFI can in a limited way marshal equity resources for its own operations by drawing up a stock participation plan which would allow staff to acquire its own stock. Sales from its own portfolio would be another way for a DFI to raise resources. Moreover, since a DFI is presumed to hold a high quality portfolio, this measure might help the DFI to expand and improve the quality of its country's capital markets over the long term.

A DFI could also adopt an institutional approach to capital market development by setting up a mutual fund company or similar entities to promote and develop closed or open-end investment trusts for small savers. With the active support and assistance of IFC the Industrial Finance Corporation of Thailand, for example, established a mutual fund company to broaden the country's capital markets and engage a larger segment of the economy in those markets. Similarly PDCP, in collaboration with IFC and the participation of other domestic financial intermediaries, is establishing a mutual fund company as a means of enlarging its contribution to the fuller development of Philippine capital markets. Other DFIs might pursue a similar policy with the active help of IFC and the full support of their respective Governments.

It should be clear at this point that DFIs in the 1980s will have to take a twofold approach to the problem of mobilization. They will have to make a long-term effort to persuade Governments to reform the structural deficiencies that hinder the full development of capital markets and, while working within the limitations of the status quo, they will have to innovate and expand their own operations.

Agenda for DFIs in the 1980s

Much of the discussion so far has been addressed primarily to the situation of the developing countries. That is not to say that the problem of mobilization in the developed countries in the coming decade will be any less difficult. It does seem, however, that the developing countries merit special concern because of the greater steps they must take to bridge the widening gap between them and the developed countries.

It should also be clear at this point that DFI efforts to mobilize domestic financial resources in the 1980s will have to go beyond official, concessionary sources and tap hitherto unused sources. In many economies DFIs are often but a part, sometimes insignificant, of the total mobilization process; they can therefore reinforce their impact on this process only by thinking broadly and relating their efforts to the efforts of other sectors. They cannot, given the conditions foreseen in the 1980s, single-handed and in isolation find solutions to the problem of financial development. The problem is intersectoral.

How will domestic financial resource mobilization efforts in the 1980s look? In particular, how can DFIs harness financial capital to meet development needs?

The first step in such a programme might be for DFI management to develop the ability to diagnose the investment needs of the economy and impediments to funding. It might even be necessary to define specifically the nature and magnitude of the investment requirements of the private sector. Having estimated aggregate funding needs, it may be necessary to analyse the requirements of various sectors and reassign priorities within the sectors.

A DFI may have to collaborate with its Government, the rest of the financial sector and even with multinational agencies such as the IFC to arrive at a consensus on how best to approach the problem of mobilization. The DFI must then help work out a programme of financial development to parallel the programme for overall economic development.

To carry out such programmes in the 1980s, DFIs will have to diversify their operations, expand their institutions and create new ways and means of overcoming traditional obstacles to domestic resource mobilization.

MOBILIZATION OF FINANCIAL RESOURCES

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This paper deals with mobilizing domestic resources. However, development requires external resources as well and it is assumed that a sufficient inflow of loans, grants and private investments will be available. Financial resources alone, whether foreign or domestic, will not contribute to economic development unless the other factors of production are also available. The most important of these other factors is an adequately trained and well-disciplined work-force.

The principal problem of resource mobilization in developing countries is the low level of incomes. To mobilize domestic resources there must be adequate savings in the country. However, in most developing countries, where the standard of living is low, the ability to save is considerably less than in affluent countries. Therefore, the first step that developing countries must take is to increase the ability to save. To do this it is necessary to raise income levels and growth rates through better use of land and labour. Until income levels in these countries are high enough to provide for both consumption needs and savings, the ability to save will not exist. The starving do not save for the future.

Low incomes, lack of savings and lack of investment constitute a vicious circle which developing countries must break. This will no doubt require massive doses of foreign and local capital.

For developed countries, this implies a substantial increase in concessional aid. The flow of foreign aid to low-income countries has fallen below the expected level of 0.7 per cent of GNP. Only a few rich countries have contributed more than 3 per cent of GNP. Unless there are substantial increases in aid, which are also sufficient to keep pace with inflation, no real economic growth among the poorest nations can take place.

The slow growth rate of most industrialized economies and the consequent slow increase in <u>per capita</u> income may reduce assistance to less developed countries still further unless the rich countries make a genuine effort to increase it. The restrictions on free markets for developing country exports create further problems for those needing external resources for development and hence impede the improvement of the physical quality of life in developing countries. Developed countries should therefore consider removing protection barriers, particularly non-tariff devices such as quotas and marketing arrangements. If this is not done, third world countries will have to find their own solutions to the problem, such as increased trading and greater co-operation among themselves.

Rich countries should also permit some part of the aid given to developing countries to be used to meet financing of cost incurred in local currencies. Investment in plant, machinery and equipment, including spare parts, requires foreign exchange in substantial amounts. At present, the aid granted by industrialized countries flows back to the donors in the form of payments for these imports.

Developed economies should also consider writing off old debts, particularly of developing countries with balance of payments difficulties. They should also grant increased commodity aid which can achieve both: stabilization of the international price level and mobilization of national resources.

International organizations should allow part of their funding to be utilized to meet domestic currency expenditure. This necessity should be recognized by the World Bank, regional development banks and other international organizations providing assistance which can now mainly be used for importing capital goods. Due to the lack of local funds, some projects in developing countries cannot be implemented or even assisted by development finance institutions (DFIs). This serious handicap to the development of industry must be recognized and understood by international organizations if they are to play a useful and effective role in developing the economies of the developing countries.

The efforts of the World Bank, the Inter-American Development Bank and the Asian Development Bank to help the rural sector by allocating resources for integrated rural projets aimed at improving the productivity of the rural sector should be welcomed. These efforts will increase incomes and savings in the rural sector, which represents the larger part of the population in most developing countries. A substantial volume of domestic resources will thus be created which can be tapped if appropriate mobilization measures are adopted.

Meeting the challenges of the 1980s will change the role of developing countries. The flow of external aid from developed countries to developing countries will fall far short of the need, particularly where the export earnings of developing countries have to be used to repay old debts. There is also no guarantee that the present flow of aid will be maintained. Developing countries must therefore be more self-reliant and give their attention to mobilizing domestic resources. They must force the pace of development to meet their own needs and ensure that all available domestic resources are fully used.

Mobilizing domestic savings

Mobilizing domestic savings is the task of savings banks, insurance companies, provident funds, building societies and commercial banks. Part of these funds can be used for direct investment by the Government; the balance, by the private sector to create employment and earn foreign exchange.

Specific action to help mobilize domestic savings might include:

(a) Reforming or restructuring taxation policy to improve tax collection, to eliminate tax evasion and to increase the number of taxpayers;

(b) Amnestying tax-evaders: declared funds could be placed in fixed interest or savings accounts and earnings would be taxed at a declared low rate;

(c) Improving the efficiency of government corporations to cut losses and, where desirable, converting them into joint ventures with the private sector;

(d) Allowing only efficient government corporations to continue operations so that they contribute to the national exchequer instead of being burden to it; efficiently managed and financially successful government corporations should be allowed to operate autonomously and have the authority to determine realistic price and wage levels;

(e) Initiating savings programmes providing realistic interest rates, permitting withdrawals and offering loans against deposits at only 1 or 2 per cent above the savings rate;

(f) Granting tax exemptions on savings;

(g) Publicizing the advantages of saving;

(h) Creating saver confidence by ensuring that money deposited is safe and by guaranteeing attractive rates of return after allowing for inflation;

(i) Providing a practical legal framework for the operation of capital markets.

Implications for DFIs

In the 1980s mobilizing domestic resources will probably be a major problem of DFIs. External funding, particularly from international organizations and the development banks of industrialized countries, will no doubt be forthcoming, but domestic resources will become scarce because of other investment possbilities.

It is important that DFIs maintain their ability to mobilize resources independently because this is a fundamental requirement for maintaining the autonomy that permits DFIs to allocate funds on strictly economic criteria. DFIs should diversify their resources, both domestic and foreign. Development banks should not depend too heavily on a few sources because this makes them vulnerable to political interference. In this context DFIs should have some assurance that international organizations which provide resources will permit their use for local currency as well. Otherwise, development banks may be forced to ask their respective Governments for help which they may not be able to give because of budgetary limitations.

DFIs should also explore the possibility of attracting funds from commercial and savings banks by the issue of debentures, bonds and preference shares.

In the 1980s a gradual integration of development banking and commercial banking may very well take place. More and more development banks may accept deposits and commercial banks may engage in investment banking. Commercial banks, which usually do not participate in equity, should in any case allocate a portion of their total resources to development banks and support their industrial development role of sharing risks with entrepreneurs.

MOBILIZATION OF FINANCIAL RESOURCES

E. Keller, *former President*

ADELA Investment Company, Peru

The 1960s saw the emergence of national, subregional and regional development banks throughout the developing world, some owned by the public sector, some by private investors, some jointly. While concepts, policies and operating methods may have differed, all pursued the same basic objective: to be effective catalysts for socio-economic progress by contributing to economic development.

Within the broad context of development objectives and policies, development banks must perform these functions:

Identify development opportunities
Develop and structure them into viable projects and proposals
Mobilize resources for implementing projects

The effectiveness of development banks depends on how well they perform those three specific tasks and of course, on their own economic performance and success. Clearly, development banks must be more than providers of money. They must be capable of providing a broad range of development services, either alone or in conjunction with others.

Mobilization of financial resources

Plainly the mobilization of financial resources is an important part of the development banking function. Mobilizing them from abroad, at terms and conditions viable for successful implementation of development projects, is often a crucial requirement of major projects.

The significance of external financial resources is likely to increase in the 1980s since in most developing countries there are mounting pressures for accelerating the development process. In most countries internal generation of resources is insufficient to achieve this. Moreover, inflation will sharply increase funding requirements in the 1980s. Mobilization of external financial resources had already become more complex in the 1970s and will continue to become more complex in the 1980s for a number of reasons:

(a) Demand for long-term, low-cost funds suitable for development projects is likely to exceed supply by far;

(b) Conditions in major capital markets are likely to change frequently and perhaps radically, partly because of continuing economic and monetary instability, partly because of probable structural shifts;

(c) The number and the diversity of sources will continue to grow, particularly for debt financing, and more particularly where foreign procurement is involved;

(d) The frequent shortage of funds suitable for project financing will increase financing costs, at times to a point where basically viable projects may become economically marginal or unfeasible.

Structural shifts in sources of external financing

Changing conditions in capital markets will coincide with some structural shifts in the 1980s. One shift may concern public sector sources including the resources for concessionary financing.

Despite the continuing agreement of donor nations that development aid and concessionary financing should be augmented, the prospects for this increase in the 1980s are not good. The wealthy nations have not reached the overall target of 0.7 per cent of GNP for aid to developing countries. This is largely the result of rising domestic opposition in industrialized countries to aid to developing countries because increased government spending means higher taxes. Consequently, in the 1980s aid funds may become scarcer rather than more plentiful. They probably will be sufficient to replenish the capital of the world's major development institutions, which have increasingly become the conduit for development financing to developing countries, but they may not be adequate for bilateral aid programmes and concessionary financing.

Another structural shift in sources of external financing could occur in the at present uncontrolled major financial markets. The Euromarket with its 600-800 billion dollar funding is by far the world's biggest free financial market. Will it remain free and uncontrolled or will Governments attempt to regulate it? If they do so, massive amounts of funds now seeking employment through the Euromarket would shift to other financial markets or to new money centers elsewhere. Some re-orientation will probably result from a change of the principle depositors, some will result from the tendency to diversify risks.

A third structural change could take place among the major banks which now handle the bulk of funds channelled through private markets. The large international banks, the universal banking institutions on the European continent, the clearing banks in the United Kingdom, the money-centres in Canada and the United States, and the major Japanese banks will no doubt continue to serve as the most important conduits of funds between depositors and borrowers. But with current price increases for oil and possible price increases for other scarce commodities in the years to come, some producing countries may generate huge financial surpluses. Many oil-exporting nations have already established themselves as bankers or direct lenders and there are indications that they intend to expand their activities in the future. Thus development bankers seeking to mobilize external resources will have to be on the watch for newly emerging investment institutions.

Prerequisites for mobilizing financial resources

The fundamental principles of mobilizing money will not change significantly in the 1980s. Institutions wanting to mobilize funds will need to be creditworthy and of good standing, and most investors or lenders will expect to recover their money, normally with a profit.

The most important factor in mobilizing financial resources from others will continue to be the reputation and creditworthiness of the borrower. The business standing of a borrower is of course measured in terms of capital and sponsorship as well as by performance. Even in today's fast-moving world it takes years to establish good standing, but it takes only weeks, possibly one bad decision, to lose it for good. The keys to the good standing and creditworthiness of an industrial development bank are the quality of its leadership, its entrepreneurial ability, and its skill in managing its assets and liabilities.

Development banks cannot avoid taking risks. Their success does not depend on whether they will encounter problems but on how soon they detect them and on how well they cope with them.

Excellence in performance depends equally on the opposite side of the ledger, on liability management. This means keeping the institution well financed and highly liquid; taking advantage of optimum investment opportunities; meeting consistently and beyond doubt all obligations; and mobilizing the right type of resources, namely, those resources best suited for respective purposes.

Borrowed money should not be used to finance equity investments or make long out or short in debt-financing. In a world of monetary instability it is not prudent to assume exchange risks. Sound liability management means matching currencies and maturities. As in asset management, there are no short cuts. It pays to follow sound banking principles. This may sometimes be more costly and more difficult, but it is the way to survive in a basically unstable world.

Development banking institutions, whether publicly or privately owned, cannot afford to compromise on excellence in management. They also should not be subjected to pressures from owners and directors to compromise on the quality and viability of projects. Assets and liabilities should be used to mobilize external financial resources so that an institution can stand on its own and not depend on the support of others.

Uncontrollable factors

Institutions mobilizing external financial resources may be confronted with factors beyond their control which make their work difficult and unpleasant and can impair their efforts.

One obstacle of this kind may be the creditworthiness of the country or region where a bank is operating. Irrespective of how well an institution may be managed, changes in government economic policies, poor economic performance and balance of payments and lack of foreign exchange can all represent severe impediments to mobilizing external resources.

Funds from abroad may become too expensive. At present international financial markets are quite liquid. It is relatively easy to raise money. While funds are not cheap at present, they are plentiful. The market is predominantly a borrower's market. This will no doubt change as market conditions change and for the following reasons:

(a) Accelerating inflation may sharply increase demand for credit unless it is counteracted by recession. Demand could soon exceed supply;

(b) As in 1974/75 industrialized countries may again incur increasing payments deficits and try to finance them in international markets. This would further increase demand in already tight markets. Prime borrowers, that is, low-risk developed countries, would be assigned priority;

(c) The supply of funds may contract, principle depositors may hesitate or deposits may become concentrated in fewer prime banks;

(d) Developing countries, especially the less and least developed of them, and their institutions may not be considered preferred borrowers in tight markets;

(e) External financing may not only become inaccessible; it may become too costly, and the risks of projects may reach a point where the implementation of projects becomes marginal.

Sources of external financing

Mobilizing external financial resources is a continuous process requiring steady efforts to gain access to the broadest possible range of sources.

Large development banks such as the World Bank and its affiliates, regional development banks, the national development banks of industrialized countries and some newly industrializing countries, and the major international and national private institutions all have access to nearly all the financial sources they wish. They also have the means and organization to tap them systematically and the knowledge to make decisions at the right time.

The smaller public and private development banks in developing countries, however, can hardly tap all these sources. They also do not have access to all sources and types of funds even when they have the organizational facilities to approach them. To some funds they must seek indirect access by borrowing from the principal multilateral development institutions and the major private financing institutions. Nevertheless, development banks in developing countries must develop permanent relationships with a wide range of potential resources. Some of these relationships will become very close; others will remain more distant but permanent. Still others will be good for one or two transactions. The foundation of a good relationship with these sources is keeping in constant touch and establishing a continuous flow of information about the institution and the country or region in which it operates. Smaller development banks in developing countries should join forces to mobilize external resources. One way to do this would be to appoint a joint representative in the financial centres to procure financial resources.

Whatever method or organizational form is chosen to mobilize external financial resources, final responsibility always rests with the management of the bank seeking funds. There is no more effective way for an institution to raise money than to have the chief executive officer visit the principal financial markets once or twice a year to maintain present contacts and make new ones. The chief executive officer must provide information on the charter, organization and activities of his institution and let the business world and government departments know what his institution is trying to achieve, what its opportunities are and what kind of problems it faces. Mobilizing external financial resources means inspiring confidence in a region, in a country and in an institution and its management.

Concluding remarks

Industrial development banking is a highly challenging activity. Whatever other changes the 1980s will bring, industry will require more capital. A highly unstable world economic and monetary situation will be a dominant feature of the years to come, and in an ever more interdependent world this instability will bring developing countries many problems. One such problem will be growing uncertainty as to sources of funds; rapidly changing conditions in financial markets is another.

The 1980s will greatly accentuate the need for development bankers with these qualities: common sense, shrewd judgement of opportunities and people, imagination, ability to act and react quickly, and tenacity in the pursuit of objectives. In a word, development bankers must be excellent managers. Those who fear turbulence will find the 1980s troublesome, but those who thrive on challenges, and that is what development banking is about, will find the 1980s stimulating and profitable.

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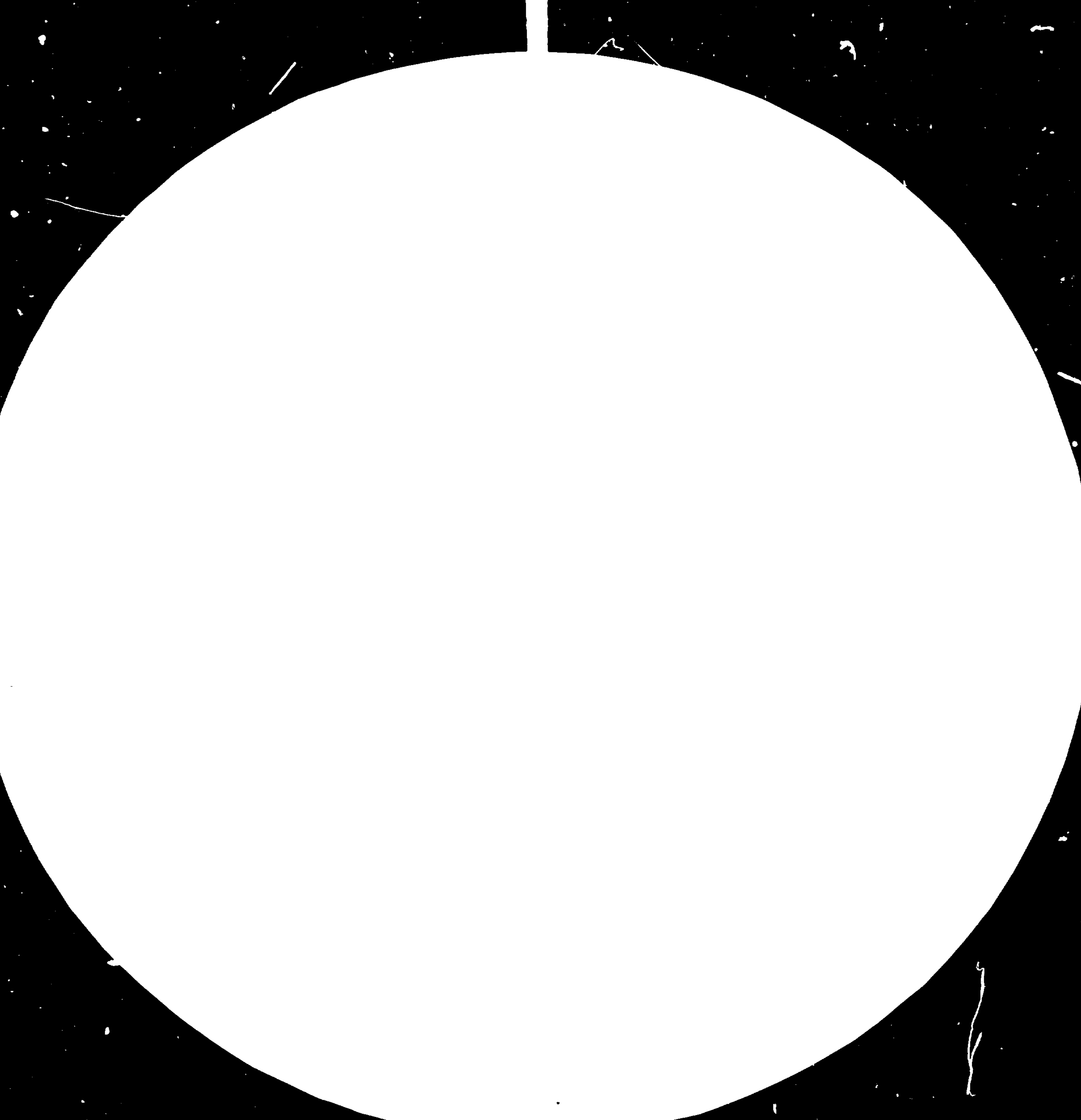

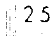
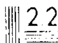
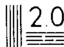

EXTERNAL FINANCING FOR DEVELOPMENT BANKS: SOME COMMENTS

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Orion Bank Ltd., London

What role can the international commercial capital market play in satisfying the requirements of development banks?

The development and size of the international capital market requires little comment. The total of reported bond issues and Eurocurrency bank credits rose from approximately $36 billion in 1974 to more than $100 billion in 1978. The dynamics that led to this growth have never been satisfactorily explained. Indeed the confusion in this area may very well have stimulated the current debate on whether regulations are required to control the Euromarkets and, if so, how they should be implemented.

It suffices to say that a continuing balance of payments deficit by the United States, a concomitant build-up of funds elsewhere, the very rapid growth rate of foreign exchange reserves held by the world's central banks, and the capacity of the many banks involved in the market to create credit have all played their part in this development.

The world's development banks have been responsible for 5 to 10 per cent of total borrowing on the international market over the past few years. This figure includes the borrowings of the major international banking and aid-giving institutions such as the World Bank, of the regional development banks such as the African Development Bank, and of all national industrial development finance institutions including those of the Organization for Economic Co-operation and Development (OECD) countries as well as those of socialist countries and developing countries.

Particular attention should be focused on the non-OECD national development banks, since their requirements are pressing and funds are not always available to them.

For the last few years borrowing by the non-OECD development banks has averaged 32 per cent of total development bank borrowing. The volume has increased from the equivalent of $0.3 billion in 1974 to $2.6 billion in 1978. However, the figures understate the foreign currency receipts of the non-OECD countries from development banks in general since they also received funds borowed, in the first instance, by the international development banks such as the World Bank and the regional development banks which were subsequently passed on to them.

The borrowing may conveniently be broken down into two distinct types: Eurocurrency borrowing and bond issues. Eurocurrency borrowing from banking institutions has normally been denominated in United States dollars and to a lesser extent in marks of the Federal Republic of Germany, with the possibility of drawing in other currencies from time to time subject to availability. These loans normally have a variable rate of interest, with maturities varying from 5 to 15 years.

The volume of such financing ought to be regarded favourably by the world's development banks. While there may be cases of disappointed borrowers who could have demonstrated their need for larger loans, they are few and far

between except perhaps among some of the poorest countries. More often limitations on borrowing have been set by the Governments of the countries concerned than by the lenders. Such indeed is the competition among lending institutions that the Euromarket banks have been criticized for lending incautiously and in larger amounts than normal banking practice would allow.

The bond market is important to development banks for several reasons. The proportion of total international market borrowing accounted for by bond issues now averages 40 per cent. Accordingly, as a source of funds bonds are important to borrowers who want to maximize their borrowing possibilities. In principle the bond market can provide funds on longer term than is normally available from banks and at fixed rates of interest. These characteristics are often attractive to development institutions because they permit funding at predictable cost projects requiring longer periods of time to show a return on investment.

The volume of funds made available by bond markets to non-OECD development banks, though rising, has been extremely small in relation to funds obtained by way of bank credits.

Doubtless non-OECD development banks would like to use bond markets to a greater extent than they have been able to do up to now. The reason for the shortfall and some possible courses of action to increase the volume of funds available from bond markets are examined below.

All commercially based lending depends on the acceptability to lenders of the perceived risks of lending. Bank credits have accounted for such a large proportion of non-OECD development bank borrowing because the international banking community is capable of analysing the credit risk of a given borrower. Banks in particular have been prepared to do this for developing countries and their development banks. As a perhaps cynical aside, there are those who claim that present liquidity has dulled the banks' perception of risk, to the benefit of marginal borrowers. Once risks have been analysed and deemed acceptable, a relatively large volume of loans can be and is arranged by the international banking community. Development banks in particular have benefited from this since international commercial banks have made an effort to understand development projects and the revenues likely to accrue from them. They have also tried to understand the relationship of the respective development bank with its Government.

The nature of bond markets, however, is that the subscribers are ultimate asset holders or investors rather than the international banking community. Investors' decisions have been characterized as being both more conservative than those of the banks and more subject to personal and political feeling. There is perhaps some truth in this analysis. Investors do tend to be more conservative than banks, partly because they do not have access to some of the information which banks have and partly because they lack the solidarity and bargaining power of the banks in relation to the borrowers. Note-holders' meetings are a clumsy way to negotiate with a borrower. Investors consequently avoid all situations which they believe might lead to the necessity of negotiating with the borrower during the lifetime of the bonds they are purchasing.

At the same time investors are indeed more emotional than banks. They are governed by knowledge of given names and by a feeling, based on long experience, as to the certainty with which payment will be made on time. This is not to say that bond investors are an unsophisticated group of lenders. They are, however, disinclined to take risks and are subject to inertia when they lack familiarity with given names.

The question therefore arises as to how the resistance of bond investors can be broken down to enable non-OECD development banks to tap them as a source of funds. Five possibilities come to mind.

1. To establish his name a borrower should first take funds from a group of banks. Such bank credits are normally publicized and discussed. Gradually, knowledge of successful borrowing operations is acquired by investors who are seeking profitable investment opportunities in bonds. This is a policy which has been understood and followed by many development banks.

2. The international bond market is extremely vulnerable to vacillating investor confidence in different currencies. This may be used to the possible advantage of would-be bond borrowers. During the last two years, for example, Swiss-franc denominated assets were much sought after by investors. It was therefore possible to tempt investors to accept less familiar names by offering them debt denominated in Swiss francs, and private placements were arranged for credits in the following non-OECD countries: Algeria, Ecuador, Mexico, Thailand, and Trinidad and Tobago. A number of the borrowers were in fact development banks. These operations would probably not have been possible for some of the borrowers were it not for the tremendous international demand for Swiss-franc denominated assets. Kuwait provides another example: the demand by Kuwaiti and Gulf investors has led to the issue of bonds denominated in Kuwaiti dinars by borrowers, including development banks in Algeria, Brazil, Mexico, Morocco, Panama, Philippines, Republic of Korea, Sudan, Tunisia and Yugoslavia.

Of course the very fact that these currencies were of interest to investors could involve exchange risks for the borrowers. Many would argue that when the Swiss franc had an exchange rate of 1.50 for 1 United States dollar and when the differential between rates of interest payable on Swiss-franc bonds compared to dollar bonds was between 6 and 7 per cent, the risks had to a large extent been discounted. It is generally true that the currency-play approach could lead to an unbalanced liability portfolio with a larger than prudent amount of currency risk, but this is on the whole well understood by individual borrowing countries.

3. Recently, excellent opportunities have arisen for new borrowers to enter the bond market by issuing floating-rate notes. Investors have been keen on such instruments because of their concern with future levels of interest and because short-term returns exceed returns on fixed-rate bonds. Great support has been given to floating-rate notes, particularly those of developing countries, by the increasing interest of commercial banks in purchasing paper of this sort. When the margins available on the interbank market are under pressure, the marketability and net return of floating rate paper have led commercial banks to purchase such investments. Such banks are prepared to take a less emotional attitude toward lending to untried borrowers. Thus they have been of particular importance to launching floating-rate bonds for developing countries. The purist argument which claims that bonds are for investors and bank credits are for banks cannot be justified. The fact is that in the absence of bank support many such floating-rate bond operations would not have taken place. More importantly the issuance of floating-rate bonds has helped make the names of the borrowers familiar to investors. In a sense banks may be regarded as long-term underwriters of this kind of paper which they are holding until traditional investors become interested in taking it up. This interest is developing and an increasing number of mainly institutional investors has become willing to buy the paper of developing countries. Developing countries may be well advised to use the present liquid market for floating-rate notes because if interest rates begin to fall or if, for other reasons, such instruments cease to interest the banks, they may have missed a useful opportunity to enter the bond market.

A second possible instrument is the private issuance of bonds to specific investors. There have been many, largely unreported, transactions of this type where the investors' motives have been sometimes political and sometimes strictly commercial, since yields on such transactions are normally high.

4. Investor support for given countries has increasingly come from areas which are close to them either geographically or politically. The political factor referred to above applies here and can sometimes be used by borrowers to their advantage. Arab developing countries, for example, have issued bonds in the capital markets of Kuwait and, to a lesser extent, of Saudi Arabia. Increasing wealth is available from investors in Latin America and South-east Asia, and borrowers in these areas can benefit from it by offering bonds to

investors in their own areas rather than relying on the older established money markets of Europe and the United States. The development of the Asian-dollar market, for example, is presenting increasing opportunities to regional borrowers.

5. In the past some developing countries have tried to enter traditional markets by forming themselves into larger groupings whose status and size were sufficient to overcome investor resistance. This has benefited the member countries of, for example, the Inter-American Development Bank, the Asian Development Bank, the African Develoment Bank, and the Central American Bank for Economic Integration. It is possible that further regional groupings would be appropriate for countries, such as some Mediterranean countries and the islands of the Pacific, which have not yet joined an existing grouping and which may not realistically be able to tap the international capital market alone. A possible extension of the grouping idea might be the establishment of a jointly owned subsidiary which could borrow under the explicit guarantee of its parent Governments or development banks. The objectives of the subsidiary would be limited to borrowing for projects in the countries of its owners; it would therefore have a more limited role than a regional development bank as such. Conceivably the formation of subsidiaries of this type would have fewer political overtones and be simpler and less expensive to operate than the creation of regional development banks.

THE MOBILIZATION OF EXTERNAL FINANCIAL RESOURCES

P. Galicia, General Manager

Nacional Financiera, Mexico

In the decade of the 1970s there were drastic changes in the international economic system that considerably affected the volume and composition of the external indebtedness of developing countries.

Although the economic recession and the rapid inflation experienced by the world economy developed before the so-called petroleum crisis, the latter constituted an aggravating factor in the economic recession, intensifying the effect of other factors such as the monetary crisis, the instability of exchange rates and cyclic fluctuations in the economies of the developed countries.

In that situation, the petroleum exporting countries obtained considerable balance of payments surpluses on current account, which estimated at $32 billion for 1979, whereas persistent deficits appeared in the balance of payments of the developed petroleum importing countries. However, the worst situation was that experienced by the developing countries which do not export petroleum. These countries were confronted not only with increased fuel prices but also with the restrictive foreign-trade policies of the industrialized countries and with the rising costs of goods and services purchased from the latter.

Nevertheless, developing countries have managed to sustain rates of economic growth that are higher on the average than those of the industrialized countries, but at the price of growing external indebtedness; for example, the public external indebtedness of 96 developing countries rose to $227 billion in 1976.

External indebtedness has become a highly important mechanism in designing the economic policy of developing countries. On the other hand, there has been a relative decrease in official assistance so that indebtedness has become concentrated to a growing extent on international markets for private capital.

The growing participation of commercial banks in lending to developing countries raises the question of the willingness of banks to raise the level of gross lendings to the less developed countries to maintain a net flow, since any attempt to reduce or diminish the rate of lending without alternative financing would have negative effects on the liquidity of the less developed countries.

However, even if banks expand their lending activities, it is highly probable that their conditions will become harder. Short- and long-term loans are not the most appropriate form of development financing and a hardening of conditions will only aggravate the problem of indebtedness.

Two facts are evident: Compared with other payments external borrowing has played a major role in financing the current-account deficit, and loan conditions have considerably hardened. These considerations lead to the conclusion that in recent years the problem of indebtedness has originated in the incompatibility between the nature of loans from commercial banks and the long-term capital requirements of developing countries.

In recent years the development of developing country indebtedness has given rise to a disproportionate increase in debt-servicing payments. This has led to uncertainty in international financial circles about the ability of developing countries to pay.

According to estimates of investment and domestic savings for the year 1985, it is clear that participation by external capital in the financing of investment programmes will diminish in the coming decade. In any case developing countries will have to obtain more external resources, particularly to finance their debt servicing. These countries will have to amortize approximately 60 per cent of their indebtedness in the early years of the coming decade and so will probably experience a high degree of economic, political and social pressure.

The deficit on current account of developing countries that do not produce petroleum is expected to increase because of their imports of capital goods and fuels and also because of the import restrictions currently imposed by industrialized countries. These payments plus the necessary disbursement for debt servicing provide the basis for predicting that in 1985 developing country financing needs will amount to $276 billion at current prices as compared with $63 billion in 1975.

An effort should be made to find appropriate solutions to this situation and to introduce changes in development financing that will make it possible for these countries to increase the flow of resources on terms that will not be detrimental to their economies in the long term and that will help improve the living conditions of more than 60 per cent of the world's population.

Among other measures, the following could be mentioned:

(a) Increasing official development assistance from industrialized countries;

(b) Stimulating the growth of a market for bond issues by developing countries with a maturity of 15 or more years;

(c) Encouraging the flow of capital to developing countries by making joint productive investments in priority sectors;

(d) Increasing the resources of international financing agencies such as the World Bank and the regional banks to enable them to play a more active part in providing funds to developing countries on advantageous terms.

Mexico, for example, proposed to the Development Committee of the International Monetary Fund and the World Bank the establishment of a fund, fixed tentatively at $15 billiion, to grant financial aid to developing countries, both for investment projects and for the acquisition of capital goods. This fund would be empowered to obtain long-term loans from countries with surplus capital and from international capital markets. The fund would be administered by the World Bank or some other international institution. The advantages of setting up such an additional source of financing for developing countries would include greater growth rates, improved debt structure and hence improved borrowing capacity. Such a fund would also provide industrialized countries with the opportunity to invest safely while generating higher levels of economic activity and employment.

Nevertheless, whatever financial arrangements are set up, the fundamental problem remains: Developing countries will not be able to meet their commitments unless they are paid adequately for their products and have access to stable markets and unless the protectionist barriers of industrialized countries are eliminated. A debtor country which cannot transfer real resources abroad will have difficulty in paying its debts and carrying out its development programmes. Both of these problems are matters of concern in a world economy which is increasingly based on interdependence and which affects more than two-thirds of the world population.

COMMENTS ON THE MOBILIZATION OF EXTERNAL FINANCIAL RESOURCES

W. D. Melzer, Director

German Development Corporation (DEG)

Financing industrial projects has no doubt become more problematical in recent years. This may be due to the fact that setting up industrial facilities requires substantial amounts of foreign exchange to buy capital goods and specific services. Even if the project itself will ultimately earn the necessary foreign exchange, the country as a whole may face balance of payments problems and therefore wish to utilize these funds in other sectors of the economy. Similarly, financing local investment costs with hard currencies often imposes an unduly heavy burden of interest and redemption payments both on the project and on the country.

There are three chief sources of external financing: foreign private investment and multilateral and bilateral financial assistance. The extent to which these sources can be tapped depends on different factors. The flow of private capital is above all stimulated by profit incentives which may in turn be influenced by appropriate policies of the recipient countries. Nevertheless, the identification of sound industrial projects is a major condition for attracting foreign capital and it is often the lack of sound projects rather than a shortage of funds which explains why private capital is not forthcoming.

A development bank will naturally focus on the economic development of its own country. Since no individual development bank will be able to provide the full range of services required to do this, all development banks ought to work toward economic development by co-operating to secure the technical and managerial knowledge about the market and to ensure a steady flow of capital from both multilateral and bilateral sources.

The German Development Bank (DEG) believes that the readiness of development banks to co-operate with shareholders from a wide range of financial institutions in different countries constitutes one of the most promising approaches to this problem. These shareholders may be public financial institutions or commercial banks. In DEG experience, the strength of a development bank depends essentially on the volume of own funds. These are the reasons:

(a) Development banks can promote economic development only if they are willing to make equity investments in projects receiving assistance. Such equity investments should not be refinanced through loans granted for a limited period of time only;

(b) Paid-in capital, including the capital provided by foreign shareholders, should not be subject to any currency risk;

(c) Equity investments in a development bank ought to be made available to the bank for, practically speaking, an unlimited period of time and should not be repayable at fixed maturities;

(d) By tying other financial institutions to it as shareholders, a development bank establishes a stable realtionship with them. The share of these institutions in equity capital should not be so small as to make them lose interest and not so large that the shareholders cannot effect the periodically required capital increases;

(e) The establishment of a shareholder relationship with other financial institutions affords a development bank the opportunity to receive loans from them for specific projects. The bank should explore with the shareholders to what extent such loans may be granted and on what terms. Should, for example, the rate of interest be profit-making or should it be comparatively low and subsidized by a bilateral aid programme? Relationships with foreign financial institutions can also be used to establish contact with commercial banks in those countries.

Borrowing will always have a number of disadvantages as compared to financing from own funds: loans have to be repaid at fixed maturities and foreign-currency loans are subject to currency risk. If possible, development banks ought not bear the currency risk themselves; they should pass it on either to the Government or to the borrower. Currency risk can never be assessed or calculated in advance and a bank cannot protect itself against it by charging the borrower a correspondingly higher rate of interest.

The mobilization of financial resources for a specific project need not affect the development bank's balance sheet; it can also be effected, especially for large projects, by forming a syndicate with external fund sources for the given project. Here, too, a development bank can fulfil its mediating function much more effectively if it can rely on a large group of shareholders. The long-term advantages to the project will be great if additional donors of equity capital support the project.

It is very important that development banks themselves should seek to identify economically sound and attractive projects. They should not wait until investors apply for loans. Development banks should be actively involved in developing ideas for new projects.

Feasibility studies can be financed, for example, with funds from the Centre for Industrial Development of the European Economic Community (CID) for the African, Caribbean and Pacific (ACP) countries, from the study funds of bilateral aid programmes and, on a very large scale, from UNIDO. The potential of these funds is by no means always fully utilized and development banks could make more effective use of these possibilities than they have to date.

If studies show that a project is feasible, co-operation with development banks in industrialized countries and, where appropriate, with the shareholders should be initiated to locate and recruit a technical partner from an industrialized country who is willing to provide the technical and managerial knowledge needed for the project. At the same time, the partners should plan the complete financing of the project.

MOBILIZATION OF FINANCIAL RESOURCES: A SUMMARY

Secretariat of UNIDO

Cost of domestic financing

In the 1980s the need for local currency will double and local currency will most likely become scarce. There appear to be two ways of dealing with the problem:

1. Internal methods of mobilizing local industrial financing

Of possible economic and policy measures these appear to be most promising:

(a) To increase domestic savings and channel them into domestic production;

(b) To intensify co-operation between commercial banks and DFIs, although there appears to be strong competition due to the different interest rates offered by DFIs and commercial banks;

(c) To liberalize interest rates.

As an alternative to liberalizing interest rates Governments might consider subsidizing savings. Governments might also consider guaranteeing industrial bond issues. Industrial finance evidently requires term transformation (long-term borrowing for short-term needs or short-term borrowing for long-term needs), for which there may well be a need to create new public or semi-public debt instruments. Secondary capital markets need to be expanded and additional capital markets may have to be created.

2. External methods of mobilizing local industrial financing

The World Bank might allow the use of its foreign exchange lending to finance local currency. The Regional Associations of Development Bankers might serve as an information exchange, particularly about available instruments for mobilizing local resources.

The foreign currency problem

Conditions in currency markets change very frequently. In the 1980s changes will probably occur more often but the number of financing sources will also multiply. Whether this increase in sources will increase and make money cheaper or increase costs because of increased overhead is unclear.

Developing country access to international industrial bond markets is a question not only of the credit standing of a given institution but also of a given country or region. Donor-countries are perhaps less interested in the repayment of principal than in receiving regular interest payments. If all accumulated debts, say $227 billion, were repaid in the next few years the result would probably be a catastrophe for bankers.

World-wide control of convertible currency markets is not possible. Even if such control were possible, the experience of the non-OECD countries, particularly the CMEA countries, has shown that Euromarkets are used by all countries as essential instruments for refinancing.

Industrial development banks feel hampered by Governments insisting that DFIs use official currency for loans rather than permitting them to lend in any available currency as their clients need.

The regionalization of currencies, banking facilities and capital markets can be advantageous, as has been demonstrated by the Latin American and South-east Asian countries as well as by the European Common Market and Currency Fund. Joint industrial development banking activities supported by government guarantees and as part of economic integration schemes might also prove to be advantageous.

Is a net flow of additional industrial investment capital possible considering the enormous outstanding debt of $227 billion? Based on an average of concessionary and commercial terms, estimated annual interest would amount to $10 billion. Since that is approximately equal to the amount of capital needed for industrial financing, the banking system could very well create more liquidity. A proposal was made to the Development Committee that a new lending facility with $15 billion funding be created, which is exactly in line with the findings of the plenary session.

Donor countries should open their markets to the industrial products of developing countries to help increase the foreign-exchange resources of these countries.

MOBILIZATION OF FINANCIAL RESOURCES BY SWISS BANKS

R. E. Gut, *Member of the Executive Board*

Credit Suisse

Switzerland provides a practical example of successful development. Switzerland is a rich country today which makes an important contribution to financing economic development in other parts of the world. It is, however, generally forgotten that 100-150 years ago the situation was different. Shortly after the destruction and the turmoil of the Napoleonic Wars, Czar Alexander I of Russia, one of the vanquishers of the great Corsican, sent 100,000 silver roubles to Switzerland to relieve the plight of the starving population. Since then, despite its lack of natural resources, the poor developing country of the early nineteenth century has become the modern industrial nation of today. Above all, this prosperity has been built upon the hard work of the Swiss, but to a considerable degree it is also the result of their thriftiness which helped the Swiss banking system to finance the rise of modern industry and trade.

Actually, every Swiss bank can be considered a development bank. The job of the banking system has always been and still remains channelling the funds entrusted to it into projects holding promise of productive development. A typical example of this is the Credit Suisse which was founded 123 years ago as a development bank to finance large-scale infrastructure projects such as railroads and hydroelectric power systems. In time Credit Suisse established a special institution to promote hydroelectric power systems which has developed into the present Electrowatt Ltd., Zurich, one of Switzerland's largest engineering and holding corporations. Like present-day development banks both institutions could not rely on domestic savings alone but also had to attract foreign capital.

In the meantime the role of the major banks has changed; with the economic rise of the country they have grown out of their earlier function as development banks and become full-fledged international banks. Swiss banks continue to serve as channels for the international flow of capital importers, Swiss banks have developed into major capital exporters and, on the basis of long experience in financing international projects and trade, they have also become administrators of large pools of international capital.

However, some basic elements in the activity of Swiss banks have not changed at all. Today as heretofore funds are entrusted to them because they guarantee the constructive and project-related use of those funds. In the past, foreign customers deposited funds with Swiss banks because they provided the necessary assurance that these funds would be directed into clearly defined projects of fundamental importance to the Swiss economy. Today their reputation is also based on the fact that they use their funds only to finance domestic and foreign projects that appear to be sound and constructive. These principles of successful banking are fundamental and will remain unchanged in the 1980s.

The evaluation of projects by modern development banks plays a vital role in foreign financing. The record of development banks to date has on the whole been excellent and has decisively helped to make the astonishing growth of their borrowings in international finance markets, including Switzerland, possible. The World Bank, for example, has mobilized 6.5 billion Swiss francs in Switzerland and has thereby become the largest single foreign borrower in the country. Swiss banks and investors have also placed themselves liberally at the disposal of the Inter-American Development Bank: At the end of 1978 more than a fifth of its total borrowed funds was derived from loans raised in Switzerland. Recently the Asian Development Bank has also made use of the Swiss capital markets. Formerly, the Swiss capital market was accessible only to international development banks, but it has now begun to accommodate national development banks as well. In recent years Swiss banks or their international banking affiliates have also participated substantially in the sizable borrowings made by development banks in the Eurodollar market. While third-world nations absorbed only 7 per cent of all syndicated Euroloans and Eurobond issues in 1970, their share has now risen to more than 50 per cent.

Thus Switzerland has channeled and continues to channel, largely through international and national development banks, substantial and increasing amounts of funds for development into other countries. Switzerland therefore renders a notable financial contribution to the economic development of other nations, especially the third world. Unfortunately, this contribution is often underestimated both at home and abroad. Switzerland will do its best to maintain or even increase its role in development banking during the 1980s. However, to reach this goal many technical and political impediments will have to be overcome. For example, the present bipolar cliché of industrial nations facing a block of developing countries is no longer useful. Future banking policy must be based on a more diversified system of classification. On the one hand the market economies of the industrial countries are supposed to co-operate with the centrally planned economies, a fact which will continue to pose economic and political problems during the coming decade. Moreover, the task of integrating the newly rich oil-producing countries into the world financial system must be continued and consolidated. In addition, differences between rapidly developing third-world countries such as Argentina, Brazil, Ivory Coast, Philippines, and Singapore and the least developed countries will have to be considered more carefully.

There are other difficult financial problems. According to all indications the world supply of capital will probably be sufficient during the 1980s. Available funds, however, will increasingly be of a risk-averting character and this does not facilitate financing inherently risky development. Government policies promoting investor confidence will therefore be even more important for economic growth and prosperity in the 1980s than they have been in the past. For this reason the rejection by many Governments of foreign financial participation and direct foreign investment creates additional financing difficulties. In fact, this attitude not only unduly hampers the transfer of managerial, technical and commercial knowledge but it also limits the inflow of risk capital.

Monotonous financing techniques often deter investors from participating in new issues because they like to diversify their portfolios not only with regard to country and borrower but also with regard to type of paper. The issuing houses try to overcome this difficulty by various devices, but an increased variety in the type of paper offered would stimulate investor interest. However, financing technique and project quality are not the only considerations in international financing. They are of course essential to maintaining confidence. Swiss banks like any other banks are working with funds that have been entrusted to them by other people, and the possibilities open to international banks in general and the Swiss banks in particular for tapping new sources of funds for financing development projects are a function

of investor confidence in the soundness of their lending policies. This applies particularly to Swiss institutions because the export of capital from Switzerland is not cushioned by the export trade of a large nation. Consequently, Swiss bankers cannot rely on the political influence of a big power and must evaluate their foreign exposure very carefully.

Country risks have grown substantially since the oil crisis of 1973. International indebtedness, estimated at roughly $200 billion, is approximately three times higher than it was at the end of 1970 but in spite of this sharp increase has hardly assumed dangerous proportions in the aggregate. In the case of some individual nations, however, indebtedness has already reached the point where restructuring is probably inevitable. Moreover, aggregate international indebtedness continues to increase. Should present trends persist, it is estimated that the developing countries, whose debt servicing cost $20 billion in 1978, will have to spend ten times this amount or roughly $200 billion for this purpose annually by the late 1980s. This amount could not be defrayed without seriously straining the international financial system. Such estimates need not be regarded as infallible predictions; they do point, however, to possible sources of problems which could destroy the confidence of the international financial community. The elimination of such dangers is not a task for bankers but for Governments. The only solutions are improvement of development aid and increasing efforts by industrial nations to open their markets to the products of the third world. Switzerland has traditionally adopted a pronouncedly liberal attitude toward imports from developing countries.

Difficulties and problems will not prevent Swiss banks from placing their experience at the disposal of development banks. The major Swiss banks regard their part in financing development as a challenge. They must of course continue to consider the risks involved carefully. To reduce risks in international financing the most valuable contribution of development banks in the 1980s will remain sound evaluation of development projects, unbiased by politics or ideology. However, financial institutions alone cannot assure the continuous and steady flow of funds into the countries that need them. To do this, they require above all the support of government policies which assure a reasonable degree of economic and political stability and encourage the confidence of the domestic business community and foreign capital. Stability may not be everything, but without stability, everything is nothing.

Part four

PLENARY SESSION ON ACTIVITIES AND PROSPECTS OF THE REGIONAL ASSOCIATIONS OF DEVELOPMENT BANKS

ACTIVITIES AND PROSPECTS OF THE REGIONAL ASSOCIATIONS OF DEVELOPMENT BANKS: INTRODUCTION

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Banco Arabe Latinoamericano, Peru

Co-operation among development financing institutions means identifying existing and possible future problems, outlining solutions to them and helping to translate those solutions into action.

The task of development financing is determined by the internal efforts of developing countries themselves, by their institutions and by the actions they perform in support of one another. International co-operation is essential to obtaining the financial and technological resources needed to accelerate industrialization and must be encouraged.

Information about development financing - existing organizations, institutional development, technical experience gained, prospects for helping other countries - is transmitted through regional associations in a continuous flow between the associations themselves and their member institutions. This creates a suitable environment for both maintaining and strengthening national identities and regional communities and for trying out new forms of co-operation. This co-operation is also supported by the financial and technical resources of institutions in developed countries and of international organizations.

Three regional associations - for Africa, Asia and the Pacific and Latin America - have been established in the last 10 years. Their activities are described elsewhere in this volume. International co-operation in development banking should be oriented toward creating similar associations in Europe and the Middle East.

International co-operation should also be directed toward co-ordinating the activities of regional associations; sharing information and human and technical resources; and mobilizing internal and external financial resources - in short, to new methods and forms of co-operation in the service of member organizations and their countries.

The regional associations of development financing institutions established to date provide advantages for their members and opportunities for multinational co-operative action. These advantages and opportunities should be extended to regions not enjoying similar associations. Relations between the African, Asian and Pacific, and Latin American associations have demonstrated the need to establish regular and continuing communications if activities are to be effectively co-ordinated. It is also becoming obvious that the establishment of a world association or federation of industrial development financing institutions would have advantages.

The major objectives of a world federation would include the development of its members both individually and as a group, encouragement of international development banking, collection and dissemination of comprehensive information on international development banking, and

maintenance and development of training facilities. A world federation would also take all necessary steps to help development financing institutions carry out their work with the greatest degree of efficiency in the interest of developing countries.

National institutions within the framework of their regional associations supported by international organizations such as the World Bank and UNIDO could realize such a federation during the 1980s. The agreement to create a world federation of development financing institutions is a first step in this direction.

ACTIVITIES AND PROSPECTS OF THE ASSOCIATION OF AFRICAN DEVELOPMENT FINANCE INSTITUTIONS

Moncef Maoui

First Vice-Chairman,

Association of African Development Finance Institutions

and Deputy General Manager, Société Tunisienne de Banque

Creation and objectives

The preliminary stepts for creating the Association of African Development Finance Institutions (AADFI) were taken at an assembly convened by the African Development Bank on 5 March 1975 at Abidjan, Ivory Coast. It was legally established on 2 May 1975 at Dakar, Senegal, and is the regional body representing the development banks of Africa. Its permanent headquarters is at Abidjan.

The objectives of AADFI are as follows:

(a) To stimulate co-operation for financing the economic and social development of Africa;

(b) To establish a mechanism for systematic exchange of information among its members;

(c) To encourage research on problems of common interest;

(d) To accelerate African economic integration.

In accordance with its charter, the AADFI has ordinary, special and honorary members. The membership now comprises 82 development banks, 63 of which are ordinary members, 4 are special members and 15 honorary members.

The constituent bodies of AADFI are a general assembly, an executive committee, and a general secretariat. The general assembly is composed of the heads of development finance institutions which are ordinary and special members of AADFI; it elects, from ordinary members, a chairman, a first vice-chairman and a second vice-chairman, for terms of two years. The executive committee is composed of the chairman, the first and the second vice-chairmen, and four members of the general assembly, representing the four subregions of the African continent. The general secretariat is responsible for routine administration to ensure co-ordination among all members; managing the association's finances under the supervision of the executive committee; organizing meetings, study groups and other activities.

The need to create associations of development banks became evident in the course of bilateral contacts between finance institutions.

The Latin American Association of Finance Development Institutions (ALIDE) set the tone for Latin America. In Africa, before the establishment of AADFI, banks hardly knew one another and maintained far closer relations with American or European banks. A few isolated cases like that of the

Société Tunisienne de Banque (STB), especially in Niger and in Mauritania, did however show that African banks could help one other and that they could benefit from the fact that their socio-economic context was relatively similar.

All African countries have experienced the vicissitudes of colonialism. The economies of these countries have much in common; nearly all are based on agricultural production and have an industrial sector still in its infancy.

Development banks need to work together on joint projects such as the search for external lines of credit or for the best policy to be applied in financing small and medium-scale enterprises. It was therefore necessary for African banks first to get to know one another, and then to survey existing banks before drafting a programme of activities. There had in fact been an earlier attempt in Africa to form an association of development banks with the Union Africaine et Mauricienne de Banques de Développement but this association did not meet the needs of all African countries. At the Fifth Meeting on Co-operation among Industrial Development Financing Institutions at Tunis in June 1974, STB suggested setting up an association of all interested development banks.

The new association quickly planned practical measures, emphasizing questions of training and exchange of information among African development banks. These activities and co-ordination with associations of development banks in other areas of the world are to be implemented in the 1980s.

Training banking personnel

AADFI tries to satisfy the training needs of member banks by organizing seminars. These seminars are intended to encourage participants to reflect on both present problems and future prospects of development banking. AADFI's simultaneous concern with examining urgent topical questions and making plans to deal with them in the future is a dynamic feature of the association.

The seminars have coincided with meetings of the Association's executive committee and have always been organized on the principle of decentralization that is a feature of its member banks. To date these topics have been the subject of AADFI seminars:

The effect of the present economic crisis on development banking activities in Africa (Nairobi, Kenya, January 1976).

The enabilization of financial resources (Kinshasa, Congo, April-May 1976).

Technology suited to small-scale industries; and the promotion of small and medium-scale enterprises (Port Louis, Mauritius, April 1977).

Information: a vital resource for development (Tunis, Tunisia, November-December 1977).

Training personnel for development banks (Libreville, Gabon, April 1978).

Industrial development in rural areas (Abidjan, Ivory Coast, May 1979).

The topics dealt with in these seminars have often been based on the experience of member banks. Such exchanges of experience have been developed further by training in a given financing technique provided by a bank with successful experience in the field. AADFI asked the African Development Bank (ADB) and the Economic Development Institute of the World Bank (EDI) to help it set up training programmes. ADB, AADFI and EDI have designed a joint training programme for the personnel of development banks which is initially to extend over a three-year period. A first training session on small and medium-scale enterprises will be held at Abidjan.

Information exchange

The executive committee of AADFI tries to participate in international meetings and act as spokesman for African development banks.

With the support of ADB, which provides the AADFI secretariat, information about resolutions adopted by various international bodies dealing with development financing and AADFI's own resolutions are distributed regularly to member banks.

In 1976 AADFI published the Yearbook of African Development Institutions. Widely distributed, the book has helped member banks to learn more about one another.

Because AADFI is well informed about the structure of its member banks, it can effectively co-ordinate joint undertakings and exchanges of information. Member banks can consult each other about specific matters and exchange views on various questions. Through AADFI, for example, STB has placed its 20 years of experience at the service of member banks in the form of training programmes and consulting activities. Since 1971, 71 staff members of development banks in Mauritania and Niger have been trained in Tunis and STB senior staff members have visited these institutions on mission. STB plans to continue activities of this kind.

Prospects

AADFI is a young organization and its first task is to carry out the basic objectives set by recent general assemblies. Accordingly, AADFI wishes to increase its membership. Its success to date should encourage more institutions to join it and also encourage the establishment of regional associations in America, Europe and the Arab world.

AADFI must ensure that regular consultations between members take place at both regional and continental levels and encourage co-operation between member institutions to find common solutions to common problems.

In the forthcoming decade AADFI must examine the desirability of becoming an economic and social council for Africa.

AADFI can also play an important role in helping Governments and financial institutions to solve specific problems of development financing: as arbiter, adviser, co-ordinator, and centre for collecting and disseminating information.

Co-operation with ALIDE and with the Asian development banking association will grow steadily. In the past few years, AADFI has drawn on the methods of ALIDE, while paying due regard to the needs of the African environment. Liaison between associations of development banks will increase in the 1980s and they will be able to adopt common standpoints in the face of the world economic problems.

ACTIVITIES AND PROSPECTS OF THE REGIONAL ASSOCIATIONS OF DEVELOPMENT BANKS

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Latin American Association of Development Financing Institutions

Co-operation between development financing institutions at the regional level

The increase in the number and capacity of development financing institutions in the developing countries underlines the fact that these institutions have steadily and inevitably taken on greater importance as a result of their nature and functions, the permanent need for resources on reasonable terms, the expansion of the institutions' areas of activity, the deepening complexity of the economic systems in which they function, and the pressing need for expansion or adaptation to new realities with the attendant requirement for new organizational and management techniques. The development financing institutions of the developing countries have evolved from a philosophy of isolation, which characterized their activities over a relatively long period, to one of greater involvement and communication, and have demonstrated through this evolution the advantages of communication as an avenue towards mutual co-operation. At the present time, financial contacts and exchanges of experiences are recognized as tools for the dissemination of mutually beneficial information that may be used for the common good, and the promotional institutions of the developing countries are sharing in the advantages of integration.

For a long time the developing countries themselves took the view that their development problems were specific in nature and could only be attacked through reliance on each country's own resources, perhaps with bilateral assistance if available. Today, there is a recognition that through co-operation and complementation of interests on the broadest possible basis greater dynamism and efficiency can be achieved, and there is an awareness of the importance for each country to take its place in the family of nations. Seen from this perspective, the advantages of regional associations of development financing institutions as a tool for the realization of co-operation and the exchange of experience are obvious.

The function of the regional associations within the new international economic order

For the financing institutions at both the regional and global level to be able to play an effective role in the establishment of a new economic and social order, what is needed is a new institutional framework. This concept has been studied at various meetings and by different organizations in both an international and a regional setting.

Among the most pressing concerns bound up in this concept one may mention the reform of the international monetary system, the mutually advantageous and equitable regulation of trade and economic relations, the rational distribution of centres of industry throughout the world, the protection of the

environment through the adoption of non-contaminating technologies, the conservation of non-renewable natural resources, the reform of the systems of transport and insurance, and the elaboration of an equitable system of tariff preferences.

In the face of the current disarray in the system of international financial flows, the crisis that has overtaken the Bretton Woods policies, the instability of the exchange markets, and the radical changes that have occurred in the balance of payments of the developed nations, the efforts of the development banks to establish a new order take on particular relevance.

One of the direct and immediate tasks of the development financing institutions is the promotion of new forms of regional co-operation. Whatever the outlook in the world crisis, regional solidarity provides an important and accessible instrument for coping with it.

What a regional association can offer depends entirely on the wishes of the institutions comprising it. The decision to form and join such an association requires an attitude of confidence and active interest in joint management, a sizable effort in terms of time and dedication, a modest economic contribution, and an unalterable commitment to co-operation. To the degree that the association can or cannot draw on these assets as provided by its membership, the united will and capacities of its members will find expression either in vigorous concerted action or in weakness.

The provisions for the establishment of the organization, the drafting of which is a basic responsibility of the promoters, define the possibilities for reducing or prolonging the initial period of stabilization, consolidation and growth. In the planning of the association, objectives, structure and functions are of fundamental importance, considering that the association is to operate basically as a mechanism for concerted action for co-operation and co-ordination of efforts among developing countries.

In regional associations, co-operating institutions enjoy all the rights of active members except the right to vote and to guide the institutional life of the association. They are free to express their views and may serve the association through their special capabilities and, just as they have an opportunity to make a contribution in the interests of the association and its members, they in turn have an opportunity for contacts and exchanges of all kinds, and can benefit from reports etc.

Within a structure of this kind, all the member institutions and their officials and representatives have the benefit of regular and frequent contacts.

Activities of existing regional associations

Three regional associations of development financing institutions (DFIs) have been established so far: the Association of African Development Finance Institutions (AADFI), the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), and the Latin American Association of Development Financing Institutions (ALIDE).

The Latin American Association of Development Financing Institutions (ALIDE)

At a meeting organized by the Inter-American Development Bank in late 1963 in response to a call by the DFIs of Latin America for the setting up of a formal system of reciprocal information and co-operation, a firm conviction emerged that, whatever form of institution was established, it should spring from an initiative of the development banks themselves, be oriented and administered by these same institutions, and be supported through a system of economic and technical contributions to enable it to perform its mission of information and co-ordination. In January 1968 the Latin American Association of Development Financing Institutions (ALIDE) was founded.

Its objectives are:

(a) To foster co-operation among its members;

(b) To maintain a systematic flow of information between them;

(c) To promote the preparation of studies on problems of common interest as a means of strengthening and binding together the membership;

(d) To encourage contributions by its members to the Latin American integration process;

(e) To improve the individual and collective action of its members.

The Association performs the following functions:

(a) Promotes the effective use of experience through exchanges of specialized personnel and other means;

(b) Circulates among the members information on the standards and practices of the development institutions of Latin America and other regions;

(c) Publishes for its members information on the procedures and facilities offered by national and international agencies in the areas of financing, promotion, technical assistance and personnel training;

(d) Administers an exchange of information among the members regarding investment projects;

(e) Establishes technical committees for special purposes;

(f) Organizes, promotes and sponsors sectoral, regional and subregional meetings and seminars.

The members of ALIDE consists of:

(a) Active members: development financing institutions of the countries of the region;

(b) Associate members: international or national organizations from outside the area which contribute to the economic development of the region;

(c) Co-operating members: financial or related organizations of countries of Latin America and the Caribbean and of other regions which express their solidarity with the objectives of the Association and indicate a desire to support its activities.

The organs of the Association are the General Assembly, the Executive Committee, the Consultative Board and the Secretariat.

The following services and technical assistance programmes are provided by ALIDE:

Inter-institutional co-ordination

An active programme of inter-institutional co-ordination is pursued at the regional or international level for the purpose of systematically extending the covering and range of action of ALIDE through the inclusion of new member institutions and the conclusion of co-operation agreements with Governments, international organizations and extra-regional bodies with an interest in contributing to the efforts of the development banking community on behalf of the development of the region.

Financial affairs, projects and investments

Under the guidance of a technical committee on financial affairs, studies are made into possibilities, standards and procedures in connection with facilities offered by national and international organizations as regards financing, the mobilization of resources and the setting up of national or multinational financing institutions and machinery for the distribution of new and increased resources and the analysis of realistic alternatives, such as co-financing and other financial instruments, for the development banking community.

Technical co-operation and assistance

A third service offered by ALIDE concerns technical co-operation and assistance either through the dispatch of experts to the headquarters of a member institution in response to a specific request, through the co-operation of other member institutions of the Asociation, or through the assistance received from international organizations or specialized agencies with which the Secretariat has concluded agreements. The purpose of this assistance is to meet specific needs and help in the solution of critical situations that may arise in the work of the development banking system, whether in respect of the adoption and introduction of new administrative procedures, the modernization and streamlining of operational systems, or the provision of human and technological resources to improve efficiency of its work.

Training

The services offered in training are based mainly on the inter-institutional co-operation of ALIDE members, together with the support and participation of international organizations and other extra-regional agencies and specialized centres, within the framework of the First Five-Year Training Plan (1977-1981). These services include the following activities and programmes:

(a) On-the-job training programme: fellowships offered by member and non-member financial institutions to the professional staff of member organizations of the Association;

(b) Courses: designed to impart the most important theoretical and practical skills required in development banking;

(c) Seminars: on various subjects in the area of development financing for managerial, executive and technical personnel of Latin American DFIs;

(d) Training support activities: upgrading the qualifications of the training staff and establishing and expanding training units.

Studies and research

In compliance with the objective of maintaining a reciprocal flow of information and experience between the DFIs, studies are prepared and research is conducted on the problems of common concern to the development banking system of the region. The priorities for the studies and research are generally based on the recommendations of ALIDE technical committees, its General Assembly, and the technical forums in which ALIDE is invited to take part in its capacity as the representative international organization of the development banking community of Latin America and the Caribbean.

Information and documentation

The ALIDE Documentation Centre (CEDOM) organizes the collection, processing and distribution of documents of interest and utility to the development banks of the region, as well as instructional material for use in the skill-improvement and training programmes organized by the Association and its member institutions.

Co-operation between DFIs

Exchange of experience

One of the principal functions of a development bank is to provide not only financial but also technical assistance to its borrowers, these for the most part being enterprises giving products a high added value and having significant economic potential for the developing country concerned.

Co-operation between development banks has a vital function to perform and takes place through the dissemination of experience and know-how relating to the mechanics and operational aspects of financial and assistance activities, and through specific modalities involving technology exchanges, the supply of information, training, and the provision of the services of technical experts etc. In addition, co-operation between DFIs plays an important role in the strengthening of the participating institutions themselves.

More detailed knowledge of national and international financing sources could prove very useful to DFIs experiencing difficulties in securing adequate funds. An understanding of the procedures to be followed in applying for external aid could well provide new sources for these institutions, which might likewise be able to improve the terms of their own loans if they were informed of the conditions applied in other cases.

Through co-operation it is also possible for one DFI to gain access to non-traditional funding sources by working together with another DFI of larger size or greater experience.

A knowledge of the experience gained by DFIs as regards means of access to different sources of finance and investment-funding instruments is of great value in the effort to seek out, secure and use available resources. Under this heading, therefore, belong the problems and technical aspects of bond issues, deposits, savings, stock exchange operations, the money market, subscriptions, loans, partnerships, renting, leasing-sale etc.

These subjects can be jointly studied at seminars, courses etc., and the related techniques can be developed by the more experienced DFIs through the system of on-the-job training and direct advisory services to other DFIs.

It is very hazardous to establish a new development financing institution without first taking into account the experience gained by the existing institutions of the same type. The same applies to situations in which DFIs lend their assistance in the establishment of specialized institutions, such as consultative bodies, training institutes and finance companies or agencies.

Co-operation between DFIs in training is possible in a number of ways: through personnel exchanges, delegations of staff for training and consultancy, training courses, and conferences and seminars. To some degree, these forms of information exchanges are already taking place at the intra-regional level, but they should be intensified. Similarly, the geographical coverage of these exchanges should be extended so that, for example, staff members of African DFIs might have the opportunity to train at Asian institutions, and senior officers of Latin American institutions to teach or act as advisers at African institutions.

The training of professionals for development banking should not concentrate exclusively on the subjects and practices traditionally associated with classical, commercial banking or on administrative matters, but should be expanded to include subjects which are of direct relevance to development banking and relate to the use of financial practices and techniques to replace, as far as possible, the subsidy criteria normally applied, the aim being to enable the development banking system satisfactorily to perform its role as a promoter and financer of development.

Financial co-operation

Through their financial operations the DFIs have come to realize that the problems of under-development can be more effectively addressed by joining forces, with bilateral assistance where appropriate.

As regards capital, for example, it is highly desirable for DFIs to co-operate in order to secure additional resources, at national, regional and international level, perhaps in the first instance in the joint negotiation of loans, particularly in view of the fact that the demand for financial resources in the developing world exceeds the amounts that are available internally. Some of the possible areas of financial co-operation are given below.

Capital markets are a highly effective instrument for economic development. Although in certain regions, Latin America among them, the emergence of these markets has been a relatively slow process localized for the most part in only a few countries, there has been a gradual growth of awareness of their importance and potential impact.

Two possibilities exist in this connection. The first is the market for short-term and medium-term debt instruments, which seems to offer excellent immediate prospects. The second, which is clearly more complicated and would require longer to realize, is the securities market.

It has been demonstrated that when adequate paper exists it is possible to mobilize internal resources in the developing countries and even to attract large sums from abroad.

Development financing institutions can lend their support to integration through their efforts to increase and facilitate trade between our countries.

Although there normally exist special mechanisms for the financing of trade, the development banking system is, in one way or another, involved in many of them. Trade promotion, moreover, is not merely a question of credit for exports or imports; also of very great importance is the provision of finance for export-oriented projects. In several Latin American countries the development banks have been financing service enterprises with the aim of streamlining trade.

The need for an efficient allocation of resources becomes more manifest in the light of problems encountered at the level of investment projects, which rarely meet the strict technical requirements for profitability of investment or financing, so that capital is not used when its opportunity cost is very high. What is more, this need becomes very clear when, in the case of integration projects, it becomes essential to develop new and more dynamic criteria for the evaluation and classification of projects involving some form of joint investment.

Co-ordinated action will be absolutely necessary when the development banking system, pooling its efforts and resources, decides to support projects of regional or subregional scale involving joint enterprises. Because such projects will require unknown quantities of financial resources, it may very well be that the development banks will seek to strengthen their position by negotiating with the international organizations the new and more flexible terms and conditions that these undertakings will require. Co-ordination will also be indispensable when entrepreneurs and financiers from more than one country enter into arrangements and associations.

The obvious advantage of co-operation between development banking institutions is the establishment of sufficiently solid security for these banks to become excellent candidates for credit, both because of the assurance that their project evaluations will be technically sound and objective, and because of the implicit commitment on the part of the Governments and the economies involved.

Many of the joint-enterprise projects in Latin America have been funded with resources made available by the DFIs of the region and by regional or subregional financial organizations working in this area, such as the Inter-American Development Bank, the Central American Bank for Economic Integration and the Andean Development Corporation

Nevertheless, so far there has not been adequate co-ordination and co-operation between the national financial organizations, between the regional, or between the regional and the national organizations to promote these and other new projects, especially during the stages of promotion and technical assistance in the preparation of pre-investment studies, and even the execution of the projects themselves. The participation of development banks in the execution of joint projects is one of the challenges facing the region as it seeks to multiply ties between its national organizations.

AN AGENDA FOR THE 1980s: A PROGRAMME FOR THE ASSOCIATION OF DEVELOPMENT FINANCING INSTITUTIONS IN ASIA AND THE PACIFIC

Vincente R. Jayme

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Introduction

The Association of Development Financing Institutions in Asia and the Pacific (ADFIAP) is a group of DFIs committed to promoting development in their respective areas of operation.

Never in the history of development financing has there been so much pressure to re-think the nature and task of DFIs. Never before has a group of DFI representatives, as a body, confronted the reality that to become truly relevant and attuned to the needs of the 1980s, DFIs must develop a new and wider range of capabilities.

To deal with the complex world of the 1980s the Second General Assembly of ADFIAP, held at Manila from 7-8 May 1979, drew up a broad programme for diversification based on the conviction that DFIs can only meet the challenges of the next decade by using new methods of funds sourcing, promoting new activities and providing new services.

It should be emphasized, however, that medium- and long-term lending will remain the basic responsibility of DFIs. Although the membership of ADFIAP is varied, the organization aims to foster economic growth in Asia and the Pacific. Indeed for some time to come many DFIs, especially those serving less developed economies, will continue to operate with traditional concepts of development financing.

Let me now elaborate on specific issues raised at the Second General Assembly of ADFIAP. In particular, I shall outline the changes in the environment in which DFIs operate, and the expectations of DFIs for the 1980s. I shall also discuss the specific role that ADFIAP will play in response to the needs of its members.

The beginning of transformation

The DFIs which comprise the membership of ADFIAP can be classified as large, medium-sized or small on the basis of their assets, or they can be classified according to ownership: government, private or mixed. Another way to classify DFIs is according to their stage of development, that is according to the degree to which they have developed various financial services.

Admittedly, government priorities differ from one economy to another but DFI operations in the 1980s will generally continue to support activities they now support. Thus, Government-owned development banks will continue to support large capital-intensive industries and will expand financing of small and medium-scale industries and agriculture-based industries. Nevertheless, these DFIs will have to innovate and diversify their services.

For DFIs in small developing economies such as Fiji, Nepal, Papua New Guinea and Sri Lanka, it would, perhaps, be premature to provide new services before strengthening their capabilities to provide traditional services. Hence, in the 1980s these institutions should continue to improve their internal operations in such areas as staff capabilities, project appraisal, and assistance to clients. In addition such DFIs operating in economies burdened with balance of payments and unemployment problems must continue to finance projects in key areas of development, projects which earn or save foreign exchange, and projects which generate employment and promote the development of entrepreneurial skills.

Notwithstanding, DFIs in small developing economies will probably start thinking about diversification by the mid 1980s. Possible activities would include the development of domestic capital markets comparable to the establishment of the Unit Trust and Stock Exchange in Fiji and the provision of management services for the Stret Pasin Stoa Scheme in Papua New Guinea.

Other DFIs are privately owned institutions created in the early 1960s. In Asia, private DFIs constitute a fairly large community. The private DFIs are faced with the biggest challenges in the 1980s. They are now beset with a great number of competitive problems as well as with the mobilization and allocation of their resources. The role of this group in the 1980s must be clearly defined.

With the sudden increase in the number and types of financial institutions in Asia, not to mention the entry of international financial institutions into Asian economies, the financial scene became altogether different, too. Not only did financial intermediation become more complex, but also users of funds and sub-borrowers became more sophisticated, pitting financial institutions against each other and calculating foreign-exchange risks.

It is not therefore surprising that financial markets in Asia have become more sophisticated, with different types of financial institutions introducing highly attractive and innovative services. At present foreign currency resources are easily available to creditworthy borrowers; indeed in some countries domestic currency resources seem to be the scarcer resources.

In addition, international institutions such as the World Bank and the Asian Development Bank have taken a new view of private development banks. Many long-term lending programmes formerly considered beyond question have been scrutinized and found wanting. The international institutions are now strongly recommending that well-developed DFIs actively seek out funds from other commercial sources.

Responsiveness

The responsiveness of DFIs to new conditions and new requirements will inevitably spell the difference between mere survival and success.

Several DFIs have already attempted to respond to the changed needs of the societies in which they operate. For example, the Development Bank of Singapore (DBS) has become a multi-service financial institution, the Korea Development Finance Corporation (KDFC) has ventured into leasing and short-term money market operations, the Malaysian Industrial Development Finance Berhad (MIDF) has gone into industrial estates, the National Development Finance Corporation (NDFC) (Pakistan) has assumed commercial banking operations and the Industrial Credit and Investment Corporation of India (ICICI) is now engaged in housing finance with the assistance of the International Finance Corporation (IFC). The Private Development Corporation of the Philippines (PDCP), for its part, is closely affiliated with stock brokerage and management consulting firms.

DFIs must take the decision to venture into other types of services and operations in the course of next decade, but better endowed DFIs must accelerate the process.

Developments in the 1980s will continue and DFIs must keep one step ahead of them if they influence economic development significantly.

Diversification

Funds must be generated with greater vigour and the sources of funds diversified. Both foreign and domestic capital markets offer potential resources waiting to be tapped. Innovative methods of raising foreign currency resources from international and regional agencies will need to be developed, including consortium financing, regional financing schemes or both. Many private Asian DFIs can tap the international capital market for funds; a few, in fact, have already tapped Middle Eastern and Eurodollar markets.

Domestic resource mobilization offers even wider leeway for innovation in financial intermediation. Such possibilities as acceptance of term deposits and recourse to government guarantees for bond issues which might thus become eligible for classification as reserve assets of commercial banks would allow Asian DFIs to draw funds from commercial banks.

In line with this diversification of fund sourcing, private DFIs would also have to adopt a developmental orientation toward the financial requirements of borrowers. More Asian DFIs will have to study and venture upon new operations such as securities brokerage, merchant banking, leasing, housing finance, industrial estates, regional investment financing and venture capital financing.

Fundamentally, the concept of development banking remains unchanged. The deep commitment to promote development remains and precisely because of this some DFIs in the 1980s must be able to function as multipurpose financial institutions. They must provide services suited to the specific needs of development in the areas they serve. No longer need they be simply mediators of long-term financing, although this will remain their major concern.

ADFIAP in the 1980s

In the 1980s ADFIAP will uphold its commitment to the development of its members, varied and diverse as they and their programmes may be. More particularly, it will work to support not only the traditional role of development banking but also the trend of many DFIs toward productive diversification. Furthermore, in addition to representing the interests of its members with international agencies, ADFIAP aims to promote the interests of its members in the wider context of regional and world-wide development.

The functions of ADFIAP will include collecting, analysing and disseminating information to its members, initiating and supporting research and manpower development programmes for their benefit and representing their interests in negotiations or joint undertakings with subregional, regional or international organizations. ADFIAP will actively pursue these programmes:

(a) Information. ADFIAP has published a newsletter since September 1977 as a medium for sharing information among member institutions. The newsletter reports developments and activities of ADFIAP members such as capital mobilization, loan syndication and project financing, as well as external developments affecting member operations. To meet the long-felt need for a professional journal of development banking, ADFIAP has decided to publish a journal on development finance in Asia and the Pacific. The journal will contain articles and papers based on research or on the experiences of development bankers in the region. It is hoped that the journal will help ADFIAP members to broaden their knowledge and enhance their practice of development banking;

(b) Research and development. One of the continuing aims of ADFIAP is to provide members with the results of research on development finance. Research reports on the effects of inflation and recession on the operations of DFIs, training and manpower development of DFIs in the region, and small enterprise financing by DFIs have been completed. Two additional reports, a study of the organization and management practices of DFIs in the region and a study of project appraisal procedures, are in preparation. Appropriate studies will be made to help DFIs plan their development in the 1980s;

(c) Professional development. One of the major tasks of DFIs in less developed economies is to improve manpower skills. The ADFIAP professional development programme aims at upgrading the skills of management and staff of member institutions. The more developed DFIs have provided training for staff members of less developed DFIs both within and without Asia and the Pacific. In particular, a number of Asian DFIS have provided experienced staff to other DFIs in an advisory capacity;

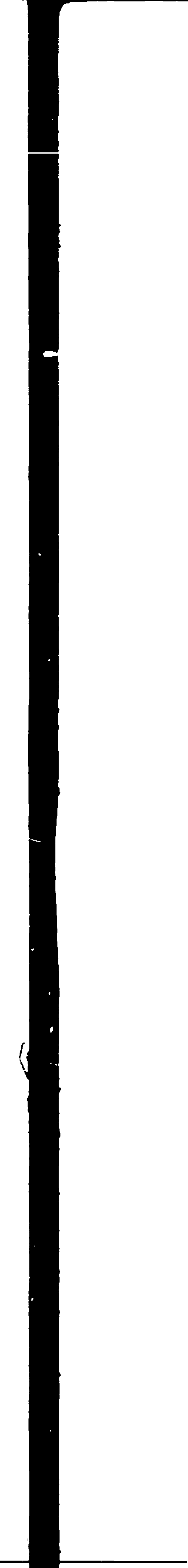
(d) Policy modification. In the coming decade ADFIAP will continue to speak for its members on important policy issues with other development-oriented institutions. In 1978 ADFIAP persuaded the World Bank to modify its standard currency disbursement practices on DFI loans by which sub-borrowers bore the full currency risks. As the result of ADFIAP representations, the World Bank has considerably reduced foreign exchange risks for sub-borrowers by agreeing to disburse 50 per cent of the loan in United States dollars with the balance in marks of the Federal Republic of Germany, Japanese yen, and Swiss francs;

(e) Regional, subregional and world-wide co-operation. Through its regional co-operation programme ADFIAP has submitted 23 projects received from member institutions to the Economic and Social Commission for Asia and the Pacific (ESCAP) for possible inclusion in its regional co-operation programme. Apart from assisting ESCAP to implement approved regional projects, ADFIAP will help assess regional projects in the countries of member institutions. ADFIAP will thus help DFIs to accelerate their efforts to diversify by identifying regional investment opportunities.

Like other regional associations ADFIAP hopes to see the establishment of a world federation of development financing institutions to provide guidance and direction for effective development banking around the world as well as liaison between regional groups of DFIs.

Part five

CLOSING SESSION



FINAL SUMMARY

D. L. Gordon, Director

Industrial Development and Finance Department, World Bank

For three days the Symposium on Development Banking in the 1980s discussed intensively, in plenary sessions and smaller panels, a very wide variety of questions of common interest to DFIs in developing countries.

The Executive Director of UNIDO, in his opening remarks, stressed that the Lima Target (i.e. for the developing countries' share of industrial output to reach 25 per cent by the year 2000) was "not an ideal but a necessity". It would call, however, for the mobilization of vast sums of capital - as a conservative estimate about $20 billion per year (in current terms) in 1980-1985, or double the amount obtained in recent years.

The keynote speech by the President of the European Centre for International Co-operation outlined the critical imbalance between the industrial North and the less developed South in productivity, financial resources and living standards. He presented quantitative projections of investments and financial transfers and suggested the kind of institutional changes that would be required to achieve the industrialization goals set by the Second General Conference of UNIDO, held at Lima in 1975. He considered those goals attainable despite numerous obstacles. He proposed a massive, temporary, selectively focused, multilateral programme of material assistance to developing countries. He averred that such an intensive effort could, over a five-year period, bring about a breakthrough for the more advanced of those countries and lay a solid base for more rapid progress in the less advanced ones. He concluded that his proposal was financially manageable, given the long-promised commitment of 0.7 per cent of GNP of rich countries to development assistance.

These opening speeches set in broad perspective the objectives and operations of the World Bank and UNIDO as potential collaborators in the implementation of a global programme for industrial development and those of DFIs in managing the practical allocation and supervision of investment resources in their respective countries.

The basic decisions on such proposals, however, are the responsibility of Governments; many of the issues involved are under active consideration by the World Bank/IMF Development Committee and by the Brandt Commission, whose report is expected in late 1979 or early 1980.

Issues of public development stategy and policy were further explored by the Minister of Finance of the Philippines. He reviewed the experience of developing countries during the last 30 years. Many of them have progressed from simple import substitution to more sophisticated export-oriented industrial activities. He stressed the need for careful, professional screening of projects and hence the important role of DFIs, especially in view of the increased recent emphasis on dispersion of industrial activity and helping smaller enterprises.

The Chairman of the Industrial Credit and Investment Corporation of India saw a link between high-growth economies and liberal government policies and financial systems in which DFIs had major scope for initiative. The President of the Banque Extérieur d'Algérie pointed out that while Algeria was not centrally planned in the COMECON sense, political decisions outweighed purely

technical considerations and that institutional performance in carrying out government decisions efficiently was the main criterion. In that context project-by-project rate of return or risk analysis of the kind espoused by most DFIs is less relevant than in more market-oriented economies.

The discussion then focused on the functions, problems and potential of DFIs. The dramatic expansion of DFI activities and the major changes in their character were repeatedly emphasized. Those changes had involved substantial diversification into new economic sectors, into novel institutional forms or financial instruments, into small-scale enterprises and into underdeveloped regions.

There was consensus that one classic concept of a private or mixed DFI, essentially providing term loans to large- and medium-scale manufacturing enterprises, no longer fully described DFIs; nor was the other classic model, a Government-owned institution charged with implementing specific investment projects, adequate. Evolution and mutation of the species had resulted in many new types of DFI.

Nevertheless, it was agreed that DFIs have certain common characteristics. They are financial intermediaries, mobilizing and allocating resources for productive investment and have a development purpose transcending but not inconsistent with profit making. They have discretion in selecting and approving projects; their investment objectives and criteria are defined in advance but the specific objects of investment are not. In exercising this discretion they follow strict standards of project appraisal and supervision and develop methodology and professional staff accordingly. They need reliable long-term financial resources, whether from equity subscriptions, budget allocations, domestic borrowing from public or private sources, or external credits. A DFI may be restricted (or restrict itself) to a particular sector, a particular size or a particular kind of operation; or it may be multipurpose. The choice depends on specific local conditions and needs.

By the same token some common opportunities, problems and preoccupations were noted. Because they can effect rational, flexible allocations of resources and systematically appraise and supervise investment projects, it was generally agreed that DFIs in most countries would be called on, both by their national Governments and by external financing agencies, to continue expanding the volume and range of their activities.

This progressive increase in the demands made on DFIs and in their own initiatives will inevitably impose strains on their financial resources and their administrative capacity. These strains are aggravated by domestic and international inflation. Inflation erodes the equity of DFIs and their borrowers, reduces lending margins, raises the cost and may affect the viability of projects, aggravates repayment problems, increases the amount of borrowing required, and generally increases financial uncertainty and risks.

One consequence is that DFIs have to a greater degree than formerly become dependent on government funding and must compete with other budgetary claims. Indeed, in most countries government resources have been made available to DFIs in encouraging amounts, but concern has been expressed that this increased dependence on government funding might tend to prejudice the autonomy and objectivity of DFIs in selecting and appraising projects. The discussion indicated that this has not in fact occurred on a wide scale and the existence of various countervailing tendencies and measures was noted; some speakers felt it was not currently a real issue.

Nevertheless, it was emphasized that it was important for DFIs to expand their independent mobilization of funds to meet the growing demands on them, to allow public funds to be used for other high-priority purposes, and to improve the security of their financial position. Possible sources of domestic and international finance were described and discussed in considerable detail and a number of possibilities were suggested for further exploration, including lending by the World Bank and regional banks in DFIs' domestic currencies. This possibility depends on agreement by the Governments of the countries in question. A proposal to issue bonds in foreign currencies, perhaps a mix of such currencies, would also require government authorization.

Closer co-operation with commercial banks, including improved access by DFIs to their deposit resources with effective, prudent term transformation arrangements, was recommended.

The need to maintain and reinforce the equity base of DFIs to strengthen their borrowing power was particularly emphasized. In most countries recent conditions have not been propitious for sales of capital stock in DFIs. If DFIs were permitted to increase their profit margins, the potential for such sales would be enhanced.

DFI profit margins depend chiefly on public policy and regulations on interest rates. There was a consensus that interest rates should be allowed to reach levels that, after allowing for inflation, would encourage institutional saving both in form of public deposits (and bond purchases) and of reserve accumulation. These considerations would seem to apply to DFIs whether privately or publicly.

Pressures on and incentives for DFIs to diversify their operations were cited by several speakers. In part these pressures stem from the need to improve profitability and to multiply sources of funds. It was noted that the access of mature development banks to concessional financing from international institutions might well be restricted, that foreign commercial funding could not entirely replace domestic funding, and that domestic resources were unlikely to fill the gap if the DFIs were limited to being secondary mobilizers of such resources. Hence, it was agreed, they must either restrict or reduce their activities or move into primary funds mobilization and increasingly provide such varied banking services as bridging finance, medium-term lease/hire-purchase funding, inter-firm clearing arrangements, trust facilities for pension funds and corporate portfolio management, and foreign-exchange hedging and risk management.

The potential DFI roles in business-risk insurance services, in consultancy and in more active entrepreneurial involvement were also discussed. Necessary conditions and risks were recognized, but these activities were seen as future possibilities for DFIs in countries at a relatively advanced stage of development. It was argued that DFIs should, by definition, be pioneers of institutional development.

Pressure to diversify DFI operations also arises from the need to compete with other institutions, especially commercial banks, that are moving into term financing for industry and to meet the increasingly sophisticated requirements of clients for a wide range of banking service.

One of these requirements is financing exports. It was noted that although aggregate exports from developing countries had grown substantially in recent years, growth was uneven. Little had been done to provide those countries with an effective organizational framework for export development. The need for and potential advantages of establishing integrated export financing and insurance facilities were noted. Meeting this need would provide DFIs with the opportunity to contribute to the development of marketing operations.

The notion that international institutional financing for mature DFIs should be phased out was disputed by some on the ground that those DFIs still had a major role to play in industrial development, and because they were efficient channels for and allocators of external funds. The truth of that was recognized and the continued need of mature DFIs for external resources was acknowledged, but given the competing claims of other, including new and weaker, institutions for scarce resources it seemed clear that they could not expect to continue receiving the same proportion of international institutional support as in the past and must accordingly look for supplementary sources of funds.

Small enterprise development is an area in which important new initiatives are being taken. The panel discussion on the subject considered the special characteristics and needs of small enterprise techniques, problems and costs of assisting small enterprises effectively. The importance of equity and working-capital financing and of credit guarantees was stressed.

Unfortunately, there was insufficient time to explore this complex subject in depth. The experience of the Federal Business Development Bank of Canada was cited as evidence that in favourable circumstances "financing small-scale enterprises appears to be possible on a cost-recovery basis".

The session on technological choices and information emphasized that appropriate technology refers not only to simplified or intermediate technology but encompasses the entire spectrum of available technology. It was noted that the concept had to be applied in two different contexts: in national planning and in project design and selection. The latter is particularly relevant to the work of DFIs. They need to be able to turn to knowledgeable local technical units which can interpret, apply and adapt foreign technical information.

Technological transfers were discussed in a somewhat different context in the session on industrial redeployment. Industrial redeployment means the shifting of product lines or processes that have become too costly for industrialized countries, given their high wage rates, to less developed countries, sometimes by physical transfer of production plant, more often by establishing incremental production in the more favourable developing country environment. UNIDO sponsors discussions of redeployment possibilities and advocates establishment of an equity fund for this purpose. DFIs could become channels for such funding and could also help by financing lease arrangements. DFIs can also provide advice on investment conditions, marketing and possible joint-venture partners in their countries. It was noted that some phases of high technology industries are increasingly recommended for redeployment. Production in developing countries would compete with, as well as complement, production in industrialized countries. While this seems a natural and appropriate development, it may stimilate protectionist reactions in industrialized countries.

The importance of sound accounting and auditing policies and procedures was highlighted in another panel discussion, and many useful suggestions were made for expanding the role of DFIs in this area. DFIs can promote fuller financial disclosure, improved management information systems, and upgraded professional standards. The achievements of the Korea Development Bank during the past 20 years exemplify this.

The importance of systematic self-evaluation by DFIs was acknowledged by all, especially in view of fluid politico-economic circumstances and the new challenges and pressures cited earlier. Changed conditions, demands and opportunities need to be reviewed continuously and the DFI's own objectives, strategy and mode of operations should be assessed in the light of these changes. The ways in which several DFIs, in diverse environments, were seeking to meet this need were discussed. The World Bank project evaluation system was also discussed. It was noted that the Subproject Data System recently introduced by the Bank should provide useful information for evaluating project effectiveness.

It was generally recognized that DFIs had social obligations above and beyond those of other financial institutions. Nonetheless, projects receiving assistance must satisfy financial and economic criteria as well as social criteria. Balancing financial economic feasibility with social objectives constitutes an essential element of the art of development banking. Governmental and international assistance and preferences make it feasible, in a financial sense, to carry out many social programmes.

The ultimate purpose of development banking is to identify and assist productive projects. These are, on the one hand, business risks for the DFI concerned and, on the other, the means to realizing its socio-economic goals. The essential contributions and advantage of the DFI mechanism is to permit systematic analysis of the technical, financial and economic viability of projects. DFIs can increase the number and quality of projects in several ways: by examining current imports to see if some may be susceptible of efficient substitution; by examining raw material exports for possible ways of adding value; by examining natural resources for possible exploitation; by making industrial sector studies; by cultivating promotionally-minded businessmen and encouraging their participation in joint ventures with Governments, foreign partners or both.

A recurring theme was the complex and shifting relationship between government strategies and policies and the operating policies of DFIs. Several specific country situations, in both market and centrally planned economies, were discussed. It was recognized that DFIs must operate within the national policy frmework but should retain discretion in day-to-day decisions. A number of areas in which DFIs might take initiatives to inform and influence government decisions were suggested. DFIs should formulate clear policies and prepare periodic statements of evolving operational strategies.

The Symposium provided a unique opportunity for DFI managers to learn about Swiss financial interests and Swiss potential for aid and credits to the developing world.

During the Symposium officials of the three regional organizations of DFIs worked out a framework for global collaboration. The World Bank and UNIDO welcome this development and hope that the new World Federation of Development Finance Institutions will take the initiative for convening and organizing future global gatherings of DFIs.

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