INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

DEVELOPMENT LOANS TO PRIVATE ENTERPRISE IN
UNDERDEVELOPED COUNTRIES

A Progress Report on New Credit Institutions in
Ethiopia, Turkey and Mexico

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Economic Department
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DEVELOPMENT LOANS TO PRIVATE ENTERPRISES IN UNDERDEVELOPED COUNTRIES

A Progress Report on New Credit Institutions in Ethiopia, Turkey and Mexico.

Introduction

New institutions designed to overcome some of the obstacles to productive private investment have been in operation for approximately one year in Ethiopia, Turkey, and Mexico. These institutions were promoted by the governments of the countries, with the advice, encouragement and financial support of the International Bank for Reconstruction and Development, and, in two of the three cases, with the participation of commercial banks and other private enterprises. The institutions were to provide medium and long-term credits to private enterprise on reasonable terms and to supplement foreign exchange resources available for financing developmental imports. The Industrial Development Bank of Turkey and the Consortium of Mexican Banks were designed to serve the industrial sector, while the Development Bank of Ethiopia was to serve both the industrial and the agricultural sector. In both Turkey and Ethiopia technical and managerial assistance to private enterprise were to be provided by the development banks.

The IBRD took a special interest in the establishment of these institutions as an effective and efficient means of making IBRD resources available to private enterprises in underdeveloped countries. Domestic capital resources would be applied by the development banks in Turkey and Ethiopia and by the commercial banks participating in the Consortium in Mexico, and in all three countries by the ultimate borrower. Loan applications requiring the use of foreign exchange resources would be screened by the local credit institution before submission to the IBRD. After such loans were approved by the IBRD, the local credit institution would administer the individual loans. Thus, the IBRD could depend upon a local institution to assume, under its general surveillance, responsibility for detailed screening and administration of loans to private enterprise.

Prior to the establishment of these new institutions, the IBRD, at the request of the governments concerned, examined the particular problems facing private enterprise in each country. Both the IBRD and the government concerned felt that the new credit institutions would in each case make a direct contribution to the economic development of the private sector of the economy. At the same time they recognized that there were other obstacles, many less amenable to immediate corrective action, which were impeding the healthy expansion of the private sector. Some of these obstacles, such as the lack of adequate transportation, power, education, and other basic facilities, were being tackled by the governments, often with the support of the IBRD. The creation of new credit institutions to serve private enterprise complemented these efforts.
This report on the progress of these institutions during their first year of operations is based almost entirely on information secured within the Bank in Washington. No field work has yet been undertaken by the Bank to review comprehensively the activities of these institutions. In the case of Ethiopia, however, valuable information was secured from reports of, and interviews with the Manager of the Development Bank.
PART I

Development Bank of Ethiopia
The Development Bank of Ethiopia was created in March 1951 as an instrumentality of the Ethiopian government, with the technical and financial support of the International Bank for Reconstruction and Development. It was established to assist in the development of industrial and agricultural production in Ethiopia and to stimulate the use of private capital for productive purposes.

Ethiopian economic development has been impeded by the lack of institutions able to advance adequate loans on reasonable terms to agricultural as well as industrial enterprises. Capital was required for the establishment and expansion of manufacturing enterprises, for the processing of local raw materials and for the expansion and modernization of agricultural enterprises. Many small factories, which were being operated profitably, were believed to require capital to finance the procurement of additional equipment to enable them to use present capacity more efficiently, to use by-products now going to waste, and to replace worn-out or obsolete equipment.

At the time of the establishment of the Development Bank, there were two state-owned credit institutions operating in Ethiopia, the Agricultural and Commercial Bank of Ethiopia and the State Bank of Ethiopia. The former, which had extended small agricultural loans, was to be incorporated in the new institution. The latter, which had previously extended some medium-term credits for economic development, was to leave this function to the Development Bank.

Under its charter the Ethiopian Development Bank was authorized to make, guarantee, or participate in loans to industrial, agricultural, or commercial enterprises, to participate in such enterprises on an equity basis; and to develop enterprises on its own account. It was authorized to purchase, hold and sell stocks of enterprises and could also issue its own securities. The board of directors, the president, and the vice-president of the Bank were to be appointed by the Imperial Government. Under the terms of the Loan Agreement the management and staff of the Bank were to be approved by the IBRD.

The capital stock of the Development Bank was authorized at Eth$ 13 million (US$ 5.2 million) $11 million of which represented the ordinary capital stock subscribed by the Imperial Ethiopian Government. The remaining Eth$ 2 million in preferred stock were to be offered for sale for either public or private subscription then authorized by the Board of Directors. Eth$ 2 million of the capital stock subscribed by the Ethiopian Government were paid immediately in cash. Eth$ 3 million were to be payable upon call by the Board of Directors, and Eth$ 1 million were to be paid in the form of the capital of the Agricultural and Commercial Bank upon its merger with the Ethiopian Development Bank. The remaining Eth$ 5 million were to be treated as a counterpart of the US$ 2 million loan from the International Bank: the Ethiopian Government was to receive shares of capital stock in fulfillment of its subscriptions to an amount in Ethiopian dollars equivalent to the amount withdrawn from the IBRD loan account.

Under the Loan Agreement with the IBRD the equivalent of US$ 2 million
was provided to finance the foreign exchange required for projects supported by the EDB. Projects which required the use of the IBRD loan for imported equipment or services were to be presented to the IBRD for approval. After $1 million of this loan were utilized the IBRD could withhold funds if a proportionate amount of the subscribed capital was not paid in. The $2 million loan secured from the IBRD carried an interest rate of 4% (including the statutory commission) and was repayable over 20 years with amortization beginning after five years.

Thus, the EDB could have ultimately available Eth$ 11 million, of which Eth$ 5 million could be disbursed in foreign currency. For immediate placement, however, it had access only to that part of the capital subscription paid in cash - Eth$ 2 million and Eth$ 2.5 million representing the counterpart of the first $1 million of the IBRD loan. The Ethiopian Government assumed the foreign exchange obligation to the IBRD, the borrower from the EDB having an obligation in local currency only.

Scale and Character of Credit Operations

The Development Bank of Ethiopia opened for business on May 15, 1952 and the Loan Agreement with the IBRD became effective on June 1, 1951. During the first six months of the EDB's existence very few applications for developmental loans were received. In order to provide the Bank with some earning assets and in order to continue some of the functions performed by the former Agricultural and Commercial Banks, the EDB established the Ceres Company in October 1951. This company handles a commission and financing business in cereals, oilseeds and pulses. EDB provided the Ceres Company with Eth$ 300,000 in capital and a credit line of Eth$ 700,000. As the development functions of the EDB expands the management plans to sell its capital shares in this company, which is showing sufficient earnings to attract private capital. The commercial credits now provided by the EDB to the Ceres Company would presumably be available from the State Bank.

In the first 10½ months of operations the Bank approved loan applications amounting to almost Eth$ 2 million, excluding operations with the Ceres Company. It is also liquidating the small agricultural loans of the former Agricultural Bank. Loan contracts were concluded up to March 31, 1952 on loans amounting to some Eth$ 575,000. The largest single operation - amounting to Eth$ 1,300,000 for a cotton enterprise - was concluded on April 4, 1952.

As of March 31, 1952 the EDB also had done preparatory work sufficient to assess the merits and prospects of projects which would probably justify further credits of about Eth$ 1,500,000. Applications had been received, for which investigations had not been carried out, for credits amounting to about Eth$ 750,000. Applications for loans amounting to about Eth$ 1,700,000 had been rejected.

Excluding the operations of the EDB with the Ceres Company during the first year of operations, loan contracts may be concluded totalling about
Eth$ 2.5 to Eth$ 3.0 million. In view of the primitive state of the Ethiopian economy and the special difficulties which face a developmental credit institution in such an environment, the first year's operations can be considered an achievement. In general the investment projects financed by the EDB involve total investment expenditures of 2 to 3 times the amount of the credit granted; an investment of from Eth$ 5 million to Eth$ 9 million may thus be associated with the credits granted by the EDB during the first year. A substantial part of this total will be used in the industrial sector, in which employment may be expanded by from 5 to 10 percent through the projects supported by the EDE.

In a sense the EDB's greatest accomplishment during the first year of operation is to be found not in the scale of its credit operations, but in the mere fact that it has been able to establish itself as an active lending institution in the Ethiopian environment. The EDB is offering credits under procedures and terms which are almost unknown to the business community. Business men in Ethiopia are not acquainted with the technique of medium-term loans. They are used to short-term loans with fixed maturity, subject to prolongation, overdraft credit, and credit against goods and documents. The principle is now being established that a loan may be linked to a special investment program and proceeds disbursed only for agreed expenditure. Factory owners were not accustomed to planning their investments in a comprehensive way and occasionally they might buy machinery with no clear idea of how to use it. They are anxious to preserve their independence, and not to disclose what they consider to be business secrets. Bookkeeping systems are frequently primitive or non-existent. They consider any "end-use" procedure, "progress reports", "following-up", as unnecessary nuisances. The attitudes of entrepreneurs thus constitute a limitation, at least in the short run, on the functioning of the EDB.

The credit operations of the EDB up to March 31, 1952 are divided among three major fields (excluding relations with the Ceres Company) — agricultural development loans, industrial loans, and small loans for current agricultural operations, as follows:

<table>
<thead>
<tr>
<th>Type</th>
<th>Contracts Concluded</th>
<th>Other Loans Approved by Board</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>Amount Eth$</td>
</tr>
<tr>
<td>Agricultural development</td>
<td>10</td>
<td>91,200</td>
</tr>
<tr>
<td>Industrial development</td>
<td>17</td>
<td>384,400</td>
</tr>
<tr>
<td>Cotton enterprise</td>
<td>2</td>
<td>1,300,000 2/</td>
</tr>
<tr>
<td>Small agricultural</td>
<td>110</td>
<td>100,375</td>
</tr>
<tr>
<td>Total</td>
<td>139</td>
<td>1,875,000</td>
</tr>
</tbody>
</table>

1/ Though approved by EDB board it is not clear that borrower will actually sign a loan contract.

2/ Contract actually concluded in April.

Most of the Bank's loans carry an interest rate of 7 percent. The agricultural development loans are usually for about three years' term; the industrial
development loans are usually for a three to five years' term. All loans are repayable in installments.

Agricultural Development Loans. Agricultural development loans, totalling Eth$ 91,200 and averaging about Eth$ 9,000 per loan, varied in amount from Eth$ 3,000 to Eth$ 20,000. With the exception of one loan for the purchase of tractors for demonstration and resale, all other loans granted in this field were given to owners of agricultural property or holders of agricultural concessions. The object of most of these loans is to bring additional land under cultivation. There is an abundance of land in Ethiopia and many agricultural properties are still uncultivated. The task of getting it ready consists mainly in clearing and tilling, and tractors are sometimes used. In most cases, however, no change of method of agricultural production is involved. Usually owners of land prepare the land for cultivation and try to attract farmers to produce on a share-cropping basis. An exception to this pattern is found in two loans, one for replacement of old coffee trees by new trees and the other for an increase in pork and milk production. Modern methods of production are involved in these two projects. The contribution of the agriculture development loans granted to date for modernizing Ethiopian agriculture is thus quite limited. The low level of education in the agricultural field, the lack of research, and the non-existence of extension services are not conducive to the submission of true development projects for financing. In addition, the limited experience of the EDB's own staff in this field may have made it difficult to exploit the limited opportunities present. Legal difficulties also severely limited the scope of operations in the agricultural field. There are many regions of the country in which no individual property in the western sense exists. In rural districts in the North the family or clan is the property owning entity, and in the South grants of a feudal character still exist. Under these conditions it is extremely difficult to establish firmly the debtors' legal obligation for a credit granted by the Bank.

The most significant application from an agricultural development point of view was for the improvement of coffee forests. This application was approved by the Board but on terms not acceptable to the borrowers. About three-quarters of Ethiopian coffee, the major export crop, is grown not in plantations but in coffee forests, where coffee trees grow wild among other trees and shrubs. The application in question involved the improvement of six coffee forests of this type, where currently no work is undertaken except to harvest the beans. Because of unfavorable conditions (too much shade, which causes coffee trees to grow too high; too dense, too sparse growing of coffee trees, shrubs and weeds competing for nourishment) output per tree and hectare is very small. The applicant started improvements on one of his properties by felling big trees which were over-shadowing the coffee trees, clearing ground, etc. To improve the land properly, the coffee trees would also have to be pruned and unnecessary ones eliminated. Upon investigation by the EDB it was found that the improvements contemplated by the borrower would result in a great increase in output, and that the proceeds from the sale of additional crops would amortize the loan in a matter of a few years. However, the applicant was unwilling to accept a credit which was to be disbursed gradually as actual work on the project progressed.
Industrial Loans. Seventeen industrial loans amounting to Eth$ 384,000 were extended by the Bank up to March 31; in addition two loans to a cotton enterprise amounting to Eth$ 1,300,000 were concluded early in April. The industrial loans, ranging in amount from Eth$ 3,500 to Eth$ 1,300,000, are distributed by fields as follows:

<table>
<thead>
<tr>
<th>Type</th>
<th>No.</th>
<th>Amount (in Eth$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sawmills</td>
<td>4</td>
<td>139,500</td>
</tr>
<tr>
<td>brick</td>
<td>2</td>
<td>35,000</td>
</tr>
<tr>
<td>Paint factory</td>
<td>1</td>
<td>35,000</td>
</tr>
<tr>
<td>Grain cleaning</td>
<td>1</td>
<td>30,000</td>
</tr>
<tr>
<td>Glass factory</td>
<td>1</td>
<td>20,000</td>
</tr>
<tr>
<td>Soft drink bottling</td>
<td>1</td>
<td>15,000</td>
</tr>
<tr>
<td>Small flour mills</td>
<td>4</td>
<td>29,200</td>
</tr>
<tr>
<td>Blacksmith shop</td>
<td>1</td>
<td>5,000</td>
</tr>
<tr>
<td>Short-term prior to investment loan</td>
<td>2</td>
<td>75,000</td>
</tr>
<tr>
<td>Cotton</td>
<td>2</td>
<td>1,300,000</td>
</tr>
</tbody>
</table>

17                          384,000
19                          1,684,000

The loans granted in the industrial field have been used to facilitate the establishment of new enterprises, to expand capacity of existing enterprises, or to finance a modernization program. The largest number of loans have been granted for new enterprises; the largest volume for the expansion of capacity in existing enterprises.

The cotton credit, which will provide for the company's working capital needs as well as expansion of capacity, is the largest operation in which the EDB has engaged. It is intended to increase the number of spindles from 11,000 to 21,000 and to permit production of 2/3 of Ethiopia's yarn requirements at lower production costs. Employment will be created for 300-400 additional workers. (Total industrial employment in Ethiopia is estimated at 10,000 to 15,000).

All of the other industrial credits heretofore granted by the EDB were on a more modest scale, ranging from Eth$ 3,500 to Eth$ 90,000. None of the industrial credits have been used for the establishment of enterprises in fields entirely new to Ethiopia, although one credit has been approved by the Board which might conceivably be used for a large project including the establishment of meat packing for export in Ethiopia. The few applications received requesting credits to start enterprises in new fields have been so poorly presented that adequate appraisal by the EDB has been impossible. The EDB management is eager to support sound, new ventures but it cannot under these conditions.
Small Agricultural Loans. The small agricultural loans extended by the EDB are a continuation of the activities of the Agricultural Bank. These loans are granted to farmers only in the Shoa province where the laws of land ownership make possible a satisfactory guarantee. The loans are not supervised, in contrast with the agricultural development loans previously described. Nevertheless, the EDB feels that even unsupervised loans of this type can make a limited contribution to agricultural development. Borrowers ordinarily employ the proceeds for the purchase of livestock or tools, and the repayment experience of the Agricultural Bank has been very good.

In addition to the new small agricultural loans amounting to Eth$ 100,375, the EDB also administers the collection and renewal of similar loans previously granted by the Agricultural Bank. About Eth$ 500,000 in such loans were outstanding upon the merger of the Agricultural Bank with the EDB.

Applications for Credits Rejected.

Up to March 31, 1952 the EDB rejected 45 applications for credits amounting in all to over Eth$ 1,650,000. These figures do not include cases in which applicants approach the Bank with projects and after discussion do not make a formal application. On the other hand, the volume of loan applications rejected is not strictly comparable with the volume of loans approved, since the latter figures represent the volume of credits granted after screening and not the amounts originally requested for approved projects.

In many cases preliminary examination of applications submitted with supporting documents led to a definitive rejection of the applications. In such cases, technical investigations either of an engineering or economic character were not attempted, and it is impossible to say whether these considerations might also have led to rejection of the application. Thus, the data derived from the EDB's administrative review of applications are only suggestive of the relative importance of the different obstacles to the financing of sound development projects. Nevertheless, the experience gained by EDB in rejecting applications during this early stage is highly instructive. Rejected applications may be classified in five major groups:

1. Short-term commercial credits - 10 applications totalling Eth$ 127,000 were rejected because they were designed to finance commercial transactions without relation to any new investment project. One such application was referred to the Ceres Company. The EDB, it should be noted, is willing to consider applications for credits to provide for working capital needs only when such applications are associated with new investment projects.

1/ The decision to reject applications on the basis of data and information contained in the application itself was made with respect to applications totalling over Eth$ 1 million, two-thirds of the total of rejected applications.
2. Credit risk too great - 16 applications amounting to Eth$ 695,000 were rejected because of the unfavorable reputation of the applicant as credit risk, inability of applicant to fulfill requirements with respect to collateral, inability (because of lack of accounts) or unwillingness of applicant to reveal true financial position, or doubtful legality of concession on which enterprise is based.

3. Excess capacity - 4 applications amounting to Eth$ 103,300 were rejected because the proposed investment was designed to increase capacity in fields which, in the view of the EDB, already suffered from excess capacity.

4. Unfavorable technical report - 6 applications amounting to Eth$169,000 and one of undetermined amount were rejected because of an unfavorable technical report based on field investigations by the staff of the EDB.

5. Rejected on preliminary examinations of project merits - 8 applications amounting to Eth$ 561,000 were rejected because the project as described in the loan application and verbally by the applicant was too vague, obviously unworkable, or inadequately formulated for some other reason. This group also includes an undetermined number of applications in which the borrower was unwilling to state how much of his own funds he would employ in the project, as well as applications in which the borrower was unwilling to allocate a sufficient volume of his own resources to the project.

This tabulation of rejected applications reveals the relatively large volume which were rejected because of the credit risk involved. Five of these rejected applications amounting to Eth$ 227,000 involved agricultural development projects of the conventional type in which more efficient production methods were not proposed. In the case of another application of this type which was rejected, the applicant had actually misinformed the EDB on the validity of the title of the property which was to be put up for collateral. In the case of the largest (Eth$ 300,000) credit application rejected, the problem was not collateral but rather the difficulty of determining the financial position of an applicant.

The applications rejected on the ground that excess capacity already existed in a field where additional investment was proposed required a quite difficult judgment. Projects which would add flour milling capacity were, in fact, at first rejected and later approved. In the case of flour milling, loans totalling Eth$ 23,000 were refused to three applicants. At first the EDB continued the Agricultural bank's policy of refusing to grant such loans on the grounds that the mills already had excess capacity. Later it was decided that while excess capacity existed in the case of big commercial mills producing flour for sale, small mills which process small quantities of cereals brought to them by the local population, and whose income is derived from the charge made for this service, competed not with the commercial mills but rather with the home milling of grains in mortars. It was decided that small mills to replace milling of grains in mortars, where there are no other mills of the same character in the vicinity, represent a good investment.
The other case involving the question of excess capacity was in the field of coffee bean cleaning. In this instance the enterprise applying for a loan for an expansion of facilities for cleaning coffee beans showed an excellent profit record, despite the excess capacity generally prevailing in the field, because of prohibitions on the export of uncleaned coffee from one province in which the company operated. Because the monopolistic position of the enterprise was not based on any economic considerations but on arbitrary decisions of a provincial government, the request for a loan was denied.

Applications which were rejected on the basis of an unfavorable technical report had passed the preliminary examination of the merits of the application, including the credit standing of the borrowers. Details on all of the applications rejected in this group are not available. In the case of one application, which proposed the exploitation of Sanseviera (a plant similar to sisal), substantial technical difficulties were encountered relating to the type of equipment required for decortication, the quality of the fibre which might be obtained, and the price prospects for the product. The difficulties could not be resolved because EDB lacks facilities for studying such problems. It was further discovered that transportation problems posed by the project presented insoluble difficulties. The other projects in this group posed technical problems which either could not be solved or required modifications which the prospective borrower was loath to consider.

Applications rejected on the basis of unfavorable technical reports and applications rejected because preliminary examination of the merits of the project was sufficient for rejection raise the question of the extent to which the EDB should actively assist the applicant in preparing a sound application. Even in those cases where an applicant comes with an unrealistic proposition, it might be possible for the EDB to direct the applicant's attention to more fruitful fields, if the applicant has managerial talent and some resources of his own. The EDB has been reluctant, however, to take such initiative if its own staff would have to assume any substantial responsibility for working up a project. This decision has resulted partly because of EDB's limited staff, but primarily because the EDB management believes that it is not wise for a developmental credit institution to make the kind of an advance commitment which the assignment of its own staff might imply. Although this is a sound policy it raises a serious problem in a country where small entrepreneurs have great difficulty in securing access to technical advice.

Use of Foreign Resources

During the first 11 months of operation the EDB signed loan contracts committing the equivalent of about EthS 1,350 million of the IBRD loan. This represents over one-half of the foreign resources immediately available for use by the EDB and an even greater percentage of the total credits placed by the EDB during the period. However, these figures give a misleading impression of the relative ease which the EDB has had in utilizing the foreign exchange made available under the IBRD loan. Almost the whole of the commitment under the loan account arises from one operation, the recently concluded cotton enterprise
loan. On all of its other operations the Bank has had great difficulty in utilizing the resources made available by the IBRD. The agricultural investment projects financed by the EDB involve little, if any, disbursements for imported goods and services. The industrial investment projects financed by the EDB, while having a substantial import content, pose special problems in utilizing the foreign exchange made available through the IBRD loan. Often the imported goods consist of second-hand equipment or new equipment to be purchased from local merchants. In other cases the applicant may already have secured the imported goods and services before applying to the EDB by using his own funds or by contracting short-term credits. He then applies to the EDB for the financing of local purchases, or for a consolidation loan. The IBRD is currently considering some liberalization of its provisions governing the use of funds from the loan in order to facilitate financing.

However, it should be recognized that the problem which has been encountered here is indicative of a substantial change which took place in the Ethiopian exchange position since the time when the EDB was originally conceived. The Ethiopian exchange authorities have been much more liberal in granting licenses for the importation of equipment and other materials needed in investment projects. Given the difficulty which prevailed in past years in securing exchange for such imports, it was only to be expected that entrepreneurs would immediately take advantage of the facilities offered by the exchange authorities. As the facilities offered by the EDB become better known, it can be expected that entrepreneurs will come to the EDB at an earlier stage in their investment operations so that the utilization of foreign exchange resources will be easier to arrange. Whether the foreign exchange resources under the IBRD loan thus utilized are a desirable supplement to the foreign resources available to the Ethiopian economy will depend upon whether the economy is enjoying, partly as a result of the EDB's own operations, a more satisfactory rate of development.

Availability of Investment Funds

During the initial period of the EDB's operations covered in this study, the business class in Ethiopia enjoyed an unusually high degree of liquidity and volume of business profits. Moreover, there has been an influx of entrepreneurs with capital from other countries. From one point of view this gave the EDB greater opportunities, since with their assets in unusually liquid form and with high current profits businessmen would presumably be particularly interested in seeking out new investment opportunities. In this way more investment projects might have been developed. On the other hand, the greater availability of funds in the hands of entrepreneurial groups reduced their need to turn to the EDB for financing. The latter effect may well have

1/ In Ethiopia this difficulty has not arisen because the borrower assumes the risk of exchange devaluation. As observed above, the EDB's borrower assumes only an obligation in local currency, not in foreign exchange.
offset the former, since most of the investment projects formulated by the entrepreneurial class at the present stage of development in Ethiopia are relatively small projects requiring little if any supplement to the resources already available to the entrepreneur.

In the judgment of the management of the EDB the loans which they have made to date in no case have led to the establishment of an enterprise or the expansion of capacity which would not otherwise have been created at some point in the not too distant future. However, by supplementing the resources otherwise available to entrepreneurs the EDB has somewhat accelerated the rate of private business investment, having made it possible for many entrepreneurs to undertake projects this year which might otherwise have to be postponed several years until sufficient funds had been accumulated.

However, if the Development Bank had not made credits available, its borrowers probably could have been served to a considerable extent by the State Bank of Ethiopia. During the first year of its operations the EDB was dealing primarily with businessmen who had well developed contacts with the State Bank. The loans of the State Bank to the private sector declined substantially during this period as a result of the high degree of liquidity prevailing in Ethiopia. Under these conditions the State Bank and the EDB found themselves competing for the limited demand for credit. Since there are many borderline cases in which developmental credit requirements can be met equally well by renewable commercial credits or by medium-term loans, many cases arose in which the State Bank could have provided at least a portion, and in some cases a substantial portion, of the loan actually secured from the EDB.

EDB-State Bank Relations

Although it was intended that the EDB should be self-supporting, it was also recognized that this might be impossible during the first few years. The general expenses of the EDB are estimated at about Eth$ 300,000 annually. To cover these expenses it must have outstanding loans of about Eth$ 4,500,000. The management of the EDB does not feel that this level can be reached until about April of 1953, and then only if the EDB continues its relationship with the Ceres Company.

In view of the difficulties encountered by the EDB in becoming self-supporting, the question arises whether it might not have been wise to strengthen the State Bank, assigning to it the extension of developmental credits rather than creating a new institution. This argument has dubious merit, even in the short run. The State Bank in Ethiopia has both central banking and commercial banking functions. Neither of these functions require the kind of technical staff which must be established for development banking. Thus, even from a strictly financial point of view, the economies that can be secured from a consolidation of these functions are small. More important, however, is the fact that the problems of policy which arise in development banking are substantially different from those which arise in central and commercial banking. To these problems must be applied a quite different mentality and spirit. For this
reason, it is wise to establish an independent directorate and management to carry out development banking, even if overhead costs are higher.

External Limitations

The experience of the EDB during its first year of operations points strongly to the importance of many factors external to the EDB itself which limit its scope. It is frequently asserted that countries in Ethiopia's stage of development have vast opportunities for investment, but lack capital. The experience in Ethiopia would indicate, rather, that while private investment capital is available there is a definite scarcity of clearly located and demonstrable investment opportunities.

This situation is partly a reflection of the extremely limited results so far achieved in expanding public facilities such as transportation, communication and education. It may also be possible that substantial opportunities for investment exist even under present conditions. To determine whether this is so would require that Ethiopian entrepreneurs engage in more intensive exploration and experimentation.

A development bank can act as a stimulant to such efforts, but it is doubtful that the stimulus thus provided is sufficient. Although the EDB can be expected to become increasingly more successful in the discovery of real investment opportunities as its own staff develops, it will always be limited by its mandate to be a self-supporting institution. Often the exploratory work that is required to determine whether a real investment opportunity exists is beyond the capacity of the EDB just as it is beyond the capacity of the private entrepreneur. The EDB finds itself in a vicious circle: it depends on the finding of suitable loan and investment opportunities, but until such opportunities are discovered and made the object of the EDB's credit operations, it is unable to finance exploratory and experimental efforts.

This vicious circle might be broken if the budget of the EDB were supplemented by annual grants, at least during the first few years. Such grants would permit the EDB to take a more active role in finding investment opportunities. 1/ When an investment opportunity is found, the EDB could then decide whether it would be desirable to exploit it by establishing an enterprise on its account, by taking an equity participation in a private enterprise, or by lending to a private enterprise.

The establishment in Ethiopia of research and extension agencies to promote agricultural and industrial development would also contribute greatly to a generally more favorable environment for the EDB's operations. 2/ Such agencies could directly stimulate private enterprises, and could also provide, on a contract basis, services to the EDB which might be difficult for it to secure in an economical manner through its own staff.

1/ The manager of the EDB has already initiated discussions with Ethiopian and international agencies along these lines.

2/ The U. S. Technical Cooperation Administration is embarking on a technical assistance program in agriculture, including sponsorship of an agricultural college and related research and extension services.
PART II.

Industrial Development Bank of Turkey
INDUSTRIAL DEVELOPMENT BANK OF TURKEY

The Industrial Development Bank of Turkey was established on June 2, 1950 as the result of joint efforts by private business interests in Turkey and the Turkish Government to promote the industrial development of Turkey and to encourage private capital investment.

In mid-1949, these two groups asked the IIBRD to assist them in working out the means of stimulating private investment in Turkey. Both groups felt that private industrial investment was inhibited by the lack of long-term money at moderate rates of interest; by the lack of experience in mobilizing capital; by the lack of technical and managerial knowledge; and by the lack of foreign exchange. As a result, the Government had been compelled directly to undertake many industrial enterprises. Given the limited financial and managerial resources available to it, the Government was unable to secure a proper balance in its economic development effort. It was generally believed that the International Bank might help as a catalyst for the combination of local capital, foreign exchange, and experience required for the stimulation of private enterprise.

The IIBRD therefore sent a consultant to Turkey in the Fall of 1949 to discuss the issue with all interested groups. As a result of his visit, a plan was evolved for the establishment of an institution which would be privately owned, and which would be directed by competent management advised by a technical staff qualified to analyze investment applications and assist the institution’s clients in carrying out projects. A second visit by IIBRD representatives early in 1950, resulted in the working out of details and was followed by the formal establishment of the Industrial Development Bank of Turkey.

The IDB was to assist in establishing new private industrial enterprises and to help in the expansion of modern and existing ones; to stimulate the investment of private capital both foreign and domestic in Turkish industry; and to develop a market for industrial securities in Turkey. To accomplish these objectives the statutes of the Industrial Development Bank empowered it to grant medium- and long-term loans, to help capitalize new industrial undertakings, and in exceptional cases to establish and operate enterprise of its own. The Development Bank was to provide management and technical aid to the enterprise it finances. Under its agreement with the IIBRD, the Bank was to have available foreign exchange resources with which to finance the foreign exchange cost of investment projects.

The capital stock of TL 12½ million was subscribed by a group of 18 private institutions including 13 banks, both Turkish and foreign, and two industrial enterprises. It was envisioned that the shares of the new bank would later be placed among a much larger group of shareholders. In view of the IDB’s public responsibility to promote industrial development, a 12% maximum was imposed on dividends and a minimum dividend of 6% was guaranteed by the government. A TL25 million loan in foreign exchange secured from the IIBRD was guaranteed by the Republic of Turkey and the Central Bank of Turkey agreed to purchase the securities of the Industrial Development Bank to the amount of TL 12½ million.
Soon after its establishment additional funds in local currency, the counterpart of Marshall Plan assistance, were made available to the IDB under an agreement with the Turkish Government and the Economic Cooperation Administration of the United States Government. These additional resources, amounting in all to TL 54.5 million, were to be used by the IDB in extending credits to private industries under an agency arrangement. Part of these funds (TL 17.9 million) were already committed for loans by the Government prior to the conclusion of the agreement with the IDB. The IDB’s responsibilities were limited with respect to these funds to the administration of loan agreements. The bulk of the counterpart funds (36.6 million lira) were to be placed by the IDB in credits to private industry on the basis of certain standards and priorities specified in the agency agreement with the Turkish Government and the ECA. Under this agency agreement the IDB secured access to a substantial addition to its lira resources on terms which could yield a considerable income without incurring any risk should its debtors default on loans extended from counterpart funds.

Thus, the Bank had available to it TL 79.9 million in local currency, TL 17.8 of which was committed, and TL 25 million in foreign exchange. The foreign exchange resources, provided by the IBRD for a 15-year period at an interest rate (including commission) of 3 3/4%, were available for projects specifically approved by the IBRD. The total resources available to the IDB amounted to the equivalent of TL 104.5 million, of which TL 86.6 million were available for placement. These resources were distributed as follows:

<table>
<thead>
<tr>
<th>Sources of Funds</th>
<th>(Million of TL)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions to capital stock</td>
<td>12.5</td>
</tr>
<tr>
<td>Paid in</td>
<td>6.25</td>
</tr>
<tr>
<td>On call</td>
<td>6.25</td>
</tr>
<tr>
<td>Sale of bonds to Central Bank</td>
<td>12.5</td>
</tr>
<tr>
<td>IBRD loan (foreign exchange)</td>
<td>25.0</td>
</tr>
<tr>
<td>&quot;Own&quot; resources</td>
<td>50.0</td>
</tr>
<tr>
<td>Counterpart funds</td>
<td>54.5</td>
</tr>
<tr>
<td>For placement by IDB</td>
<td>36.6</td>
</tr>
<tr>
<td>Special account 2/</td>
<td>17.9</td>
</tr>
<tr>
<td>Counterpart</td>
<td></td>
</tr>
<tr>
<td>Grand Total</td>
<td>104.5</td>
</tr>
</tbody>
</table>

1/ TL 2.80 = U.S. $ 1.00

2/ Represents funds committed for loans by government prior to conclusion of agreement with IDB. Administration of loan agreements under IDB.
Scale of Credit Operations

The IDB began its actual operations on March 1, 1951, when its loan agreement with the IBRD came into effect. In the first year of its operations loan applications amounting to TL 30.6 million were approved; loan contracts were concluded for credits amounting to 22.1 million. These loans, which exclude the 17.9 million of loans from counterpart funds previously committed, were distributed by source of funds as follows:

<table>
<thead>
<tr>
<th>Credits denominated in TL</th>
<th>Applications approved (In millions of TL)</th>
<th>Contracts concluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counterpart funds</td>
<td>9.7</td>
<td>5.6</td>
</tr>
<tr>
<td>Other</td>
<td>15.7</td>
<td>14.3</td>
</tr>
<tr>
<td></td>
<td>25.4</td>
<td>19.9</td>
</tr>
<tr>
<td>Credits denominated in foreign currency (IBRD)</td>
<td>5.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Total</td>
<td>30.6</td>
<td>22.1</td>
</tr>
</tbody>
</table>

The volume of loan applications approved during the first year constitute about 35% of the total resources available for placement by the IDB. An even larger percentage of the IDB's lira resources were assigned to approved loans. In fact, setting aside the counterpart funds, which did not become available until August 1951, over 60% of the lira resources available for placement were assigned and almost 60% were placed under loan contract during the first year of operation. Only about 9% of the IDB's foreign exchange resources were placed under contract.

The IDB credit operation of TL 30.6 million compares with gross investment by the government in 1949 in industrial establishments of about TL 40 million and gross private investment in industry of TL 25-40 million. The IBRD sponsored mission to Turkey 1/ envisaged for the future a level of private industrial and mining investment of about TL 80 million. The 30.6 million in loan applications approved and 22.1 million in contracts concluded thus represent significant sums. The credits made available by the IDB gave rise to investments which are more than double the amount of the credit extended because borrowers have been utilizing other funds equivalent to the credits received. 2/ Over TL 60 million in private industrial investment have been generated by the IDB

1/ The Economy of Turkey: An analysis and Recommendations for A Development Program, 1951.

2/ Based on special tabulation prepared by IDE.
from its first year's operations. Including the investment which was associated with the TL 17.9 million financed from previously committed counterpart funds, total industrial investment related to IDB operations amounts to over TL 90 million. The IDB estimates that when all these projects are realized in full annual industrial production will increase by TL 170 million, an increase of almost 7.5% over the 1950 level. The value added by these projects represents over 10% of the value added by industry in 1950.

The loans extended by the IDB were available at 6% and for types of enterprises, new and old, which previously had access to medium- or long-term funds, if at all, only at extremely high interest rates. The commercial banks in Turkey were not accustomed to lend to industrial enterprises, although working capital was available through 90-day commercial rediscounts to well established enterprises. Medium-term credits - up to 12 years - as provided by the IDB at moderate interest rates, coupled with technical and managerial assistance, constituted new elements in the Turkish industrial environment.

It is, of course, difficult to determine to what extent the investment generated by the IDB represents a net addition to private industrial investment; some part of this investment would no doubt take place in any case. Moreover, it should not be assumed that the apparent increase in private industrial investment over 1949 levels is attributable solely to the IDB. During 1951 many new forces were at work in the Turkish economy which might, even in the absence of the IDB, have given private industrial development a new impetus. The great progress made in the expansion of Turkish agriculture, particularly cotton, provided additional raw materials for a wide variety of industries and gave rise directly and indirectly to savings which might anyway have found an outlet in industrial investment. The ease with which foreign exchange could be secured from the Central Bank for financing the importation of capital goods from EPU countries also contributed, as did a generally more favorable attitude of the Turkish Government toward private industrial development. Under these circumstances, it is difficult to isolate the contribution of the IDB and the encouragement which it provided to the private investor, both of a financial and technical character. The real contribution of the IDB during its first year may well have been more fully to exploit new forces as well as previously existing elements favorable to private industrial development.

Character of Credit Operations

During its first year of operations, ending February 29, 1952, the IDB considered 747 applications for loans, 489 under the Marshall Plan Private Enterprise Fund and 258 under the Bank's own resources. Applications rejected amounted to about 40% of the total; applications approved amounted to about 12%, the remaining 48% being in various stages of processing. Loan contracts had been concluded on 75% of the approved loans in number and on 73% in value.

Although detailed information is not available on the credit applications which were rejected, it is known that some were rejected because they originated in certain fields of enterprise, such as mining, which in the judgment of the IDB's Board, the institution was not created to promote. Although
it is not known to what extent applications were actually rejected because of inadequate guarantees from the borrower in the form of collateral, the IDB during its first year did require substantial guarantees from borrowers. Borrowers were also required to put up funds of their own; working capital in particular had to be independently secured. In all cases, the business experience and technical knowledge available to the applicant, and the previous financial record of the applicant, were important considerations.

The loan applications approved, grouped by major fields, are shown in Appendix I and II. The detailed information necessary for appraising the impact of the IDB's operations on each of the major industrial fields is not available. We do not as yet know to what extent credits were extended for new enterprises, for expansion of existing enterprises, or for modernization of existing enterprises. The fields already included in the IDB's credit operations cover a fairly broad range. A superficial appraisal indicates that the sectors to which credits have been granted represent for the most part fields well suited to Turkey's needs. Cotton ginning, vegetable oil factories, construction materials, pharmaceuticals, small metallurgical plants and food processing fall in this category. These sectors were noted by the IBRD survey mission as promising fields for development or expansion. It is not known to what extent the IDB was simply responding to the preferences of its borrowers in extending loans in these fields, and to what extent the IDB played an active role in inducing entrepreneurs to focus their efforts in these fields. It is probable that the responsibility which had to be assumed by the IDB in this respect was not substantial in these initial stages.

The industries benefiting from Marshall Plan funds, as shown in Appendix II, fall within the priority categories for loans from the Fund under the IDB's agreement with the ECA and the Turkish Government. This agreement set forth certain general criteria and listed 20 specific industries as priority claimants. (See Appendix III). About 60% of the loan applications approved under the Fund were made by two of these industries, merchant shipping and cotton carding and spinning.

With respect to its own funds the IDB is not limited to the 20 industries, although the approval of the IDB must be secured when foreign exchange provided by the IBRD is to be utilized. 1/ The two major fields receiving credits from the IDB's own resources are construction materials and textiles, (see Appendix I) the former having received 20% of the credits extended and the latter 40%.

The most difficult decision that the IDB has had to make with respect to the allocation of credits has arisen in the case of textiles. By the end of 1951 the IDB had received 64 applications from the textile industry involving credits of over TL 62 million. Substantial investment had been made in textiles by the Government in the postwar period under the industrial investment program of the Sumerbank. The IBRD survey mission, viewing the situation

1/ See Appendix IV for criteria adopted by IDB in processing loans from its own resources.
early in 1951, was fearful that while cotton textiles would ordinarily constitute an almost ideal field for development in Turkey, it may already have been expanded far enough for the time being. The mission advised a careful survey to determine the priority of need for additional capacity in textiles.

The IDB determined that some expansion of textile capacity was justified. By the end of February 1952 it had approved applications amounting to over TL 8½ million. Although the IDB's decision was based on an analysis of the current level of domestic output and imports in relation to probable future demand, the IBRD, which has assisted in the financing of textile expansion, has advised a more careful appraisal of this field before the IDB grants additional credit for textiles. As the IDB expands its operations, the timing of additions to plant capacity in other fields in relation to market prospects will probably become an increasingly important question.

Role of Foreign Credits

The foreign exchange resources available to the IDB under its agreement with the IBRD were intended to supply the foreign exchange requirements of projects which the new Bank would finance in its initial stages. Foreign exchange had not generally been available on an adequate scale for the importation of capital and other goods needed for private industrial investment. The loan agreement of the IDB with the IBRD was designed to correct this situation. In actual fact during the first year of its operations under this loan agreement the IDB requested the commitment of only about $800,000 of the $9 million credit (TL 25 million), although it had approved for submission to the IBRD loans which would involve an additional commitment of about $1 million.

The slow rate at which the IDB requested use of the funds provided for under the loan agreement stands in striking contrast to the rate at which lira resources were committed. As noted above, almost 60% of the Bank's lira resources, excluding ECA counterpart which did not become available until August, was placed under loan contract during the first year of operation, as compared with only 9% of the IDB's foreign exchange resources.

The failure of the IDB to call upon the foreign exchange resources available to it to any appreciable extent during the first year of its operation can be primarily explained by the availability of foreign exchange from other sources. As a result of the import liberalization procedure established upon

The Bank's foreign exchange resources were to be supplemented through an agreement with the Government under which the Government would convert into foreign exchange the Turkish lira payments of principal, interest and other income received from investments which the Development Bank made in foreign exchange. Since the Development Bank's loans were to be for shorter periods than the International Bank's loans the foreign exchange provided by the Government could be used for additional investment or for other operations until the exchange was needed for the repayment of the IBRD loan.
Turkey's adherence to the EPU in August 1950 during 1951 EPU currencies were freely made available for liras in payment for capital and other developmental goods needed by private industry, including borrowers from the IDB. Most of the developmental goods desired by Turkish industry are purchased in European countries. The IDB, under its agreement with the Turkish government and the ECA with respect to the use of counterpart funds, adopted the policy of a uniform 6% rate of interest on its loans, regardless of whether the borrower assumed an obligation in local currency or foreign currency. Prospective borrowers from the IDB, given the transferability of liras into the currencies of the countries providing capital goods, preferred to borrow liras at 6% to borrowing foreign exchange at 6%, since in the latter case they would be assuming the risk of exchange devaluation.

This preference led initially to an unbalanced use of IDB's resources. Under IBRD practices, foreign exchange provided by it is to be used only to finance the import cost of projects. With the IDB's lira resources being used to cover the total cost of projects, the use of IBRD resources would have to be postponed until local currency investment funds available to the IDB were exhausted. In that case the IDB would find itself without funds to finance the domestic costs of projects. If it were to try to correct this situation by securing additional local currency resources the situation would not be corrected, for again a systematic preference on the part of borrowers for lira funds would prevent use of the institution's foreign exchange resources. Under these circumstances, the IBRD would not effectively supplement the investment funds and foreign exchange resources available. The IDB could make either local currency loans or foreign exchange loans; it could not do both during the same period.

A complementary use of domestic and foreign exchange resources might have been secured by inducing clients to accept a foreign exchange obligation. From the point of view of the IDB's profit and loss statement there was little to be gained from inducing clients to accept a foreign currency obligation. The IDB does not have to pay a commitment charge on its loan to the IBRD until amounts are credited to the loan account for projects specifically approved by the IBRD. Lira funds were available to the IDB from the Central Bank of Turkey at a rate only slightly more than the rate under the IBRD loan (4 ¾% rather than 3 3/4%).

Moreover, there were many problems in inducing clients to borrow foreign exchange under the circumstances prevailing in Turkey. By refusing lira credits the Bank could probably have induced many of its clients to accept a foreign obligation, but it is difficult to see on what basis this refusal could be justified so long as it had ample lira resources and the exchange control permitted conversion of lira into foreign exchange for the purchase of capital goods in EPU countries. It would have been difficult equitably to determine which clients should be induced to accept a foreign exchange obligation. If all clients were required to accept a foreign exchange obligation for a fixed percentage of their requirements (or requirements in foreign exchange), the administrative burden that would be involved in securing IBRD approval for a much larger number of small loans would be magnified.
Under these conditions it is understandable that during the first year of its operations the IDB placed a relatively small part of its foreign exchange resources. Recently, the IDB has been able to increase utilization of the IBRD loan. In the past two months the IBRD has received additional requests amounting to about $1 million for purchases by IDB's borrowers in EPU countries.

The reason for the recent increase in the use of IDB's foreign exchange resources appears to be a change in the conditions noted above. Turkey's position in EPU has shifted so that current deficits must now be covered by dollar payments. Although there is no indication that the import liberalization procedure has been modified making capital goods imports subject to more stringent exchange allocation, the Turkish authorities may have persuaded the IDB management or the IDB's prospective borrowers to favor foreign exchange loans rather than lira loans. The IDB, itself, now has a more obvious interest in placing its foreign exchange resources. The counterpart fund, under agreement with the ECA and the Turkish Government, is not freely available for the extension of credit in all fields. Under the priority list for the use of counterpart funds, several important sectors of Turkish industry are excluded, including most of the textile field, construction materials, flour milling, and some metallurgical fields. Many of the loan applications which have been received by the IDB fall in these excluded fields. Since almost 55% of the IDB's own lira funds (excluding the unpaid portion of capital) were committed by approved applications at the end of February, it is probable that the IDB is becoming progressively more interested in the utilization of its foreign exchange resources. The IDB's management may be reluctant to call the remaining TL 6.25 million of the capital subscription as long as the equivalent of 22.9 million lira is still available from the IBRD, since the IDB is committed to pay a 6% dividend on the paid-in portion of the stock subscription.

Thus, many prospective borrowers may be faced with the prospect of accepting 6% foreign exchange credits from the IDB or paying much higher interest rates for medium-term lira credits outside the IDB. Moreover, even though we have no evidence of any actual modification in the "liberalized import list" which would make more difficult the conversion of liras into EPU currencies for covering capital goods imports, informal measures may have induced borrowers to seek loans denominated in foreign exchange rather than liras. The immediate problem of placing credits denominated in foreign exchange may under these conditions be resolved without shifting the burden of the foreign exchange risk from the ultimate borrower. However, so long as borrowers have a preference for lira loans, any increase in the IDB's lira resources will again prevent utilization of its foreign exchange resources, or will require the IDB to discriminate against some borrowers by offering them only loans denominated in local currency. The IDB is currently negotiating with the Turkish Government for an agreement under which the central bank will absorb the foreign exchange risk for a small fee. All of the IDB loans would then be denominated in local currency.

1/ Of the two projects approved by the IBRD, the first involved dollar purchases. The second, the larger of the two, involved primarily the use of British currency.
APPENDIX

I. Credit Applications Approved for Its Own Account

II. Credit Applications Approved for Account of Fund

III. Criteria for Counterpart Loans

IV. Criteria for Loans from IDB's Own Resources
I. Credit Applications Approved by IDB for Its Own Account, by Industries, to February 29, 1952

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number</th>
<th>Value (In lira)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cotton gin and decortication</td>
<td>6</td>
<td>1,685,000</td>
</tr>
<tr>
<td>Textile industry</td>
<td>7</td>
<td>8,763,816</td>
</tr>
<tr>
<td>Construction material</td>
<td>11</td>
<td>5,166,860</td>
</tr>
<tr>
<td>Food industry</td>
<td>7</td>
<td>2,979,000</td>
</tr>
<tr>
<td>Metallurgical</td>
<td>7</td>
<td>1,482,000</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>1</td>
<td>800,000</td>
</tr>
</tbody>
</table>

Total: 39

20,876,676
II. Credit Applications Approved by IDB for Account of Marshall Plan

Private Enterprise Fund, by Industries, to February 29, 1952

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number</th>
<th>Amount (In liras)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cotton carding and spinning</td>
<td>2</td>
<td>2,372,000</td>
</tr>
<tr>
<td>Fruit and vegetable processing</td>
<td>1</td>
<td>125,000</td>
</tr>
<tr>
<td>Manufacturing of agricultural equipment and irrigation facilities</td>
<td>1</td>
<td>214,500</td>
</tr>
<tr>
<td>Repair of agricultural equipment</td>
<td>16</td>
<td>207,450</td>
</tr>
<tr>
<td>Oil factories</td>
<td>5</td>
<td>772,000</td>
</tr>
<tr>
<td>Cotton gin</td>
<td>4</td>
<td>746,000</td>
</tr>
<tr>
<td>Agricultural insecticides</td>
<td>1</td>
<td>150,000</td>
</tr>
<tr>
<td>Cold storage warehouse</td>
<td>1</td>
<td>335,000</td>
</tr>
<tr>
<td>Freighters</td>
<td>5</td>
<td>3,500,000</td>
</tr>
<tr>
<td>Small power plants</td>
<td>1</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>38</td>
<td>9,703,650</td>
</tr>
</tbody>
</table>
III. Criteria for Counterpart Funds

The standards established for loans from the counterpart fund are as follows:

"1. Loans shall be made only to enterprises which are 100% privately owned.

2. They shall be for the purpose of securing rapid and sound development of industries processing primarily Turkish raw materials, particularly agricultural products, and especially those which promise most rapid and most largely to increase Turkey's foreign exchange earning.

3. The greatest possible emphasis shall be placed upon loans which will tend to increase the productive efficiency of Turkish labor and of facilities already installed in Turkey.

4. Emphasis shall also be placed upon enterprises which will tend to increase the supply of and to maintain productive equipment required in agriculture, manufacturing, and road building.

5. Projects are to be favored which look toward increasing the marketability of Turkish products through reduction in costs and improvement of quality, grading, packaging, and standardization."

The following specific industries have so far been selected as priority claimants for loans from the fund under the above criteria.

1. Preparation and processing of cotton fibers.
   (a) cotton ginning
   (b) cotton-yarn combing

2. Wool washing and combing.

3. Vegetable oil processing and refining, particularly olive oil and cotton seed processing, including the production of linters and cake as well as oil.

4. Fruit and vegetable processing of all kinds.

5. Valonia processing and extraction.

6. Cold storage for foodstuffs.

7. Sponge fishing.

8. Manufacture of agricultural equipment including animal drawn machinery and spare parts for all such machinery.

9. Repair shops for agricultural equipment.

10. Preparation of insecticides and pesticides.
11. Recapping of automobile, truck, and tractor tires.

12. Fishing and fish canning.

13. Egg preservation and packing.


15. Manufacture of metal and wooden containers such as tin cans, drums, and boxes.

16. Pharmaceutical production and processing of medicinal plants.

17. Small electric power plants.

18. Hemp and flax fiber processing, combing, whitening, dyeing, spinning of rope and twine, preparation of fabrics.

19. Mining. (The Bank shall not make any loans to a mining enterprise, where the necessary financing can be provided by SCA under its deficiency materials program.)

20. Merchant Shipping. (Since the cost of individual units is high, it seems appropriate to note that it is understood that the Bank shall exercise due caution to prevent too large a proportion of the Fund from becoming tied up in shipping enterprises.)
IV. Loan Standards for IDB’s Own Funds

The standards applicable to loans of the IDB for its own account are grouped under four headings: "character of product, viability of industry, efficiency and magnitude of project, and simplicity of industrial process." The Assistant Director General of the IDB has stated 1:

"Applications to the Bank should be classified in accordance with the above four groups and degrees of priority shown under each group should be applied to the projects. Projects that do not meet most of the priorities listed under the above four groups are not financed.

Classification of Priorities

A) Grouping from the point of view of products.
   1. Products that have their essential raw material in raw or semi-manufactured form in Turkey and also have or can have a market for the finished goods in Turkey or abroad.
   2. Industries that will raise the value and also exportability of goods already exported.
   3. Industries that produce goods where there is a big difference between the value of raw material and the finished product by importing the raw material or a part of the finished product, and in this way meet a necessary consumption demand in the country.

B) Grouping from the point of view of viability.
   1. Industries whose products can compete in markets abroad.
   2. Industries whose products do not need artificial protection such as custom duties, tax exemptions, import restrictions.
   3. Industries that can live by themselves but a tariff protection could increase their profitability.

C) Grouping from the point of view of efficiency and magnitude.
   1. Projects that are simple but on the other hand the results of which can be obtained at a short time should be preferred to giant projects.
   2. No distinction should be made between small and large industries.

1/ In lecture presented in Ankara on Dec. 21, 1951 before Mediterranean Training Center on "Economic Development and Industry and part of the Industrial Development Bank of Turkey in Economic Development." (mimeograph)
D) Grouping from a simplicity point of view. The principle of beginning from the simpler and less expensive industries and moving towards the more complicated ones should be adopted. Therefore:

1. The modernization of the existing industries and in this way increasing their productivity or preventing a fall in their productivity.

2. Development of the existing industries.

3. Establishment of new industries which have relatively simple production methods and whose products can be exported or meet essential consumption needs in the country."
PART III

Mexican Industrial Development Line of Credit
(Consortium of Mexican Banks)
In October of 1950 the International Bank for Reconstruction and Development extended a loan of $10 million to assist in financing private enterprise in Mexico. This loan originated in an understanding between the President of the International Bank and the Secretary of the Treasury and Public Credit of Mexico. The Secretary requested the bankers attending the 1950 Annual Meeting of the Mexican Banking Association to suggest how they might cooperate in securing effective use of an IBRD loan for private enterprise. On the basis of discussions among the Mexican Government, the Bank of Mexico, private bankers, and representatives of the IBRD, it was decided to make the loan through a line of credit to a Consortium consisting of eight of the principal Mexican commercial banks together with Nacional Financiera, the official financing agency of the Mexican Government. It was to be used to finance the cost of imports for specific industrial development projects submitted by Mexican firms and approved by both the Consortium and the IBRD.

The major purpose of the line of credit was to apply some of the IBRD's resources to the financing of a broad cross-section of private industrial enterprises in Mexico by taking advantage of the experience and facilities of the private banks. The advanced stage of development of the Mexican banking system appeared to make it inadvisable to set up a separate institution. The purpose of the loan was in line with the aims of the system of qualitative credit control established by the Bank of Mexico to channel commercial bank resources into the industrial sector. It was felt that small and medium-sized private enterprises in Mexico did not have adequate access to medium-term credits at reasonable rates of interest, and that the Mexican economy would achieve a more balanced development if such credits were made available through private credit institutions rather than official agencies.

The procedure established under the line of credit was for individual members of the Consortium to sponsor specific applications by Mexican firms which were to be scrutinized by the Consortium as a whole, and, if approved by a minimum number of participants and by Nacional Financiera, submitted to the Bank. When the Bank in turn approved a project, it was to grant a loan to those members of the Consortium who wished to participate; the banks were to relend the proceeds to the applicant. In order to insure adequate screening of loan applicants, not less than five members of the Consortium were to participate in each loan; and participations were to be not less than 5% and not more than 40% of each loan. Nacional Financiera would have the right to sponsor projects and to participate in loans on the same basis as the commercial banks in the Consortium. It was also empowered to grant the Government's guarantee. This mechanism was designed to enable the IBRD to delegate to the Consortium the greater part of the detailed screening of the numerous projects, while at the same time retaining power to insure that the loans conformed to its general standards and objectives.

Individual loans were normally to range from $25,000 to $1,000,000. The maximum maturity on these loans would be five years, in view of the re-
strictions imposed by the Mexican Banking Law, but it was expected that Nacional Financiera would take up longer maturities when required. A maximum interest rate of 6% was to be charged the ultimate borrower. The IBRD was to receive 3½%, the Nacional Financiera 1½% for its guarantee, and the members of the Consortium participating in individual credits, 2½%. Loans extended by the Consortium were to be denominated in foreign exchange, but arrangements were made with the Bank of Mexico whereby the borrower could be insured against the risks of exchange devaluation occurring during the latter half of the period of the credit. The borrower would pay a commission to the Bank of Mexico equivalent on the average to about .7% of the amount of the loan for this guarantee. Thus, the effective interest rate would be about 6.7% to the ultimate borrower, who would also have to assume the risk of exchange devaluation during the first half of the period of the credit.

Although formally executed in October 1950, the line of credit did not become effective until July 20, 1951. The administrative difficulties involved in working through a loose confederation of private banks were already evident in the initial stages. The execution of certain legal formalities was very slowly accomplished, and some modifications in the Loan Agreement with the IBRD had to be made. It was also apparent in the initial stages that the various interested parties did not feel an urgent need to utilize the credit facilities available under the Loan Agreement.

Activity Under Line of Credit

From July 20, 1951, when the Loan Agreement became effective, to the end of May, 1952, participating banks presented to the Consortium 21 applications amounting to $3,304,000. Twelve of these applications, totaling $2,076,000 were withdrawn by the applicant before action was taken by the Consortium. In over half of these cases no reasons were specified by the applicant for the withdrawal; in the others procedural complications and delays in processing were cited as major reasons. In one case an application was rejected because Nacional Financiera refused to grant its approval. Three applications, amounting to $590,000 were denied because applicants failed to meet procedural requirements.

Only three credits amounting in all to about $270,000 were extended by the Consortium, as of May 31, 1952. All three of these credits were extended during the month of August, 1951. Two of these credits ($50,000 and $114,500) were for textile machinery, the third ($73,550) for machinery for the manufacture of gas stoves. Each of these credits mature in five years. One additional credit was approved after August 1951 but was later cancelled. At the end of May 1952 the Consortium had only two applications under consideration totaling $190,000. Over $9,700,000 of the $10 million loan was still unutilized.

Neither the Mexican participants nor the IBRD see any reason to expect greater activity under this line of credit. The Mexican Government has not indicated a desire to renew the credit beyond June 30, 1952, the latest date for IBRD's approval for loans under the present Loan Agreement.
Reasons for Inactivity

Many possible reasons have been cited in banking circles in Mexico for the inactivity under the line of credit. The reasons include: (1) lack of experience of Mexican commercial banks in financing industrial development; (2) rigidity of the Mexican Banking Law in the field of industrial financing; (3) inflexibility of the National Banking Commission in the administration of the Banking Law; (4) reluctance of ultimate borrowers and banks to assume one-half of the foreign exchange risk; (5) reluctance of participating banks to submit customers' affairs to the scrutiny of competitors; and (6) documentation required of loan applicants by IBRD. It is difficult to determine the relevance of these factors without a detailed investigation in Mexico, but the main fact seems to be that neither the participating banks nor the ultimate borrowers had a real interest in utilizing these new credit facilities.

Under the qualitative credit controls established by the Bank of Mexico in 1949, the commercial banks in Mexico had already been provided with a strong incentive to extend medium-term credits to industrial enterprises. Under these controls commercial banks can increase their earning assets when their deposits increase only by extending medium-term loans to industrial enterprises and by other specified developmental credit operations. The effects of these controls were not very strongly felt at the time the Consortium credit was first conceived in Mexico. During the latter part of 1950, however, when bank deposits in Mexico began to expand at a rapid rate, the banks found themselves in possession of cash reserves which could not be converted into earning assets by expansion of their conventional lending operations. Moreover, they could earn a much higher return by placing medium-term peso credits than by placing the dollar funds provided under the line of credit. During 1951 the banks expanded their medium-term credits, but not to the extent permitted under the controls. Since the commercial banks did not fully exploit all of the opportunities to extend industrial credits under qualitative credit controls, they had little incentive to utilize the IBRD credit. The fact that foreign exchange was made available by the IBRD constituted no additional incentive, because pesos are freely convertible into foreign exchange in Mexico.

To the extent that the commercial banks did not have a strong interest in utilizing the IBRD credit simply because they had ample peso resources during the past year, it might be argued that this was only a temporary impediment. As commercial bank deposits decline, or as the banks fully exploit their capacity to extend peso industrial credits under the controls, their interest in utilizing the IBRD credit might increase. There are, however, more basic limitations on the Consortium device for securing effective use of IBRD resources. The Consortium was a loose confederation of private banks without staff of its own. Although with strong leadership the participating banks might be induced to take a greater interest in Consortium activities, the return accruing to the participating banks offered little inducement for them to extend operations in fields where the administrative costs of placing funds and the risks assumed are greater. Even the qualitative credit controls, which offer a much greater incentive to the banks, have not been very effective in
inducing the commercial banks to extend medium-term industrial credits. The only new element introduced by the Consortium was the opportunity it offered for a wider distribution of risks on individual loans. The banks participating in the Consortium did not apparently attach much significance to this, perhaps because loans of the magnitude contemplated under the line of credit do not pose risks beyond the capacity of an individual bank.

So far as the ultimate borrowers are concerned, those who would ordinarily qualify under the credit standard utilized by the commercial banks may have preferred to secure peso credits even at somewhat higher nominal rates of interest rather than assume a foreign exchange obligation which poses the risk of loss should the peso be devalued. Delays in processing of applications resulting from the lack of interest of the participating banks and the documentation required by the IBRD of loan applicants may also have reduced the interest of the commercial banks' ordinary industrial borrowers, accustomed as they were to less formal practices and to speedier action.

The relatively small number of applications presented to the Consortium, and the fact that so many were withdrawn on the initiative of the borrower, suggest that the participants in the Consortium loan may have overestimated the need for additional sources for medium-term industrial credits. If the need had been general, delays in processing of applications and documentation requirements would not have had such a deterrent effect. According to Mexican sources the earnings of medium and small-sized industrial enterprises in Mexico are sufficiently high to provide a large proportion of funds needed for further expansion; their own resources are supplemented by medium and long-term loans from commercial banks and the Financieras. To the extent that small and medium-sized enterprises have further needs for credit, it is doubtful that these needs can be met by the commercial banks, operating singly or as a group.