A. The scope of development banking

The subject “development banking” is wider in scope than the concept of a development bank. A development bank is a financial institution with the scope that can be more precisely delimited with regards to its functions and operations. The field of development banking goes beyond the scope of the development bank proper. It deals with the number of areas that extend beyond the functions and operations of a development bank as an institution. Development banking, in addition to the functions and operations of a development bank, also covers the relations of these institutions with national and local governments, with national planning agencies, the link-up with national development programs and with industrial, agricultural, infrastructure, social and other development processes. Development banking deals also importantly with the appraisal and evaluation of projects. In addition, development banking requires a certain knowledge about financial markets and international finance. The above illustrates how development banking is wider in scope than the more direct concerns of the development bank as a financial institution. In this text, development banking will be discussed by using the concept “development bank”, or, the more general and for purposes of this text, more precise term, “development finance institution”, as the central core around which other pertinent development banking subjects will be grouped. It should be noted that the term “development bank” is not as precise as the term “development finance institution”, as will be explained below.
"Development finance institution" is the more precise term for the following reasons: A "bank" in the majority of cases is a privately-owned institution, licensed by a government financial authority to engage in the business of banking with the public. In many countries, however, the financing of development projects is carried out by government-owned financial institutions. While a private bank has a corporate charter, a government financial institution may not be incorporated. It may have been created by law, or it may only exist in the form of a special account of the Central Bank or the nation's Treasury or Finance Ministry. When the legal form adopted for a development financing mechanism is only a special bank account, then it is normally called a "development fund".

To include all the development finance institutions with different legal forms and with private, public or mixed ownership characteristics under one common denominator, the term "development finance institution" is used. But since the term "development bank" is a close synonym to development finance institution" and represents simpler language that is more easily understood, I will use it to stand in general for "development finance institution".

B. Concept of development bank

To analyze the nature of a development bank, we can start by asking: "What is a development bank? "What makes it different from other types of banks?" The differences with other banks help us to understand and to define the "development bank" concept. The type of bank we know best is the "commercial bank", and the "investment bank". "How do they differ from a development bank?" As you may know, commercial banks provide short-term credits, which are re-payable in 30 to 90 days. Most of the commercial bank loans are for period of less than one year. Short-term loans are normally defined as credits with a maturity of up to one year. Investment banks in Great Britain and the Anglophone countries commonly are called "merchants banks". These banks specialize in raising long-term funds through the underwriting and issuing of securities - stocks and bonds - or other financial instruments. These financial instruments are issued normally for already established enterprises, or for governments or public entities. As we shall see, development finance institutions, like investment banks, also operate in the field of long-term financing, but mainly through extending long-term loans for development project financing. In this respect, investment banks share some common characteristic with development banks, but in other respect they are quite different. One basic difference is that investment in banks do not make it their policy to give priority to mobilizing long-term financing for development projects,
nor do they attempt to estimate the economic benefits that a project is expected to generate.

1. Projects that contribute to development

A development finance institution is set apart from the other financing institutions, such as commercial and investment banks, by two important operational policies. These policies establish the following requirements for the approval of any loan for the financing of a project: (a) an economic appraisal of a project; and, (b) to observe the principle of acting as a lender of last resort, that is, to provide financing only when not available from any other source on reasonable terms.

a. Economic project appraisal

Before a project is financed, in addition to requiring an acceptable financial rate of return, a development bank makes an economic appraisal of the project. An economic rate of return is estimated as an important criterion for judging the development contribution of the project. Those of you, who have already taken a course in cost benefit analysis will know that economic and social cost-benefit analysis is a relatively new field in economics that continues to be developed with the objective of arriving at generally-valid and universally-accepted economic and social project appraisal methodologies. Some of the literature on this subject deals only with the economic appraisal of projects, other publications deal with social project appraisal and income distribution aspects. Economic cost-benefit analysis examines whether the project that is being considered for financing will make a significantly positive contribution of benefits to the economy or the society as a whole. Economic cost-benefit analysis measures the value of the economic benefits of a project’s expected contribution to the economy overall, to specific sectors, or to the welfare of individuals or groups within society. Economic cost-benefit analysis may also attempt to examine whether a specific project will increase employment and personal income. Social cost benefit analysis attempts to estimate whether a project will improve income distribution or contribute to the betterment of other social indicators. These questions are addressed in the economic and social appraisal of projects and unless significant positive economic benefits can be expected from a project, a development bank will not approved the financing of the project.
b. Lender of last resort

The second operational policy which makes development banks different from other types of banks, is that development banks normally, as a matter of principle, operate as lenders of last resort. Only if other private or public lending is not available for a project should the development bank use its own scarce long-term resources for the financing of that project.

In this sense, the function of lender-of-last resort is to serve the need of promoting new activities involving normally an above-average investment risk. The private banking sector which is not specialized in development finance will refrain from financing these projects because of their relatively high inherent long-term risk. The high risk may include the market risk and the term transformation risk (particularly in the case of a project with a high economic rate of return which has a long payback period). But, as we shall see in our further discussion, there are also many other aspects that reflect a basic difference between development banks and the private, or government owned, commercial and investment banks.

C. Evolution of development banks

1. Evolution before World War II

The questions that need to be asked is: “How did development banks emerge all of a sudden after World War II when there were none before?” “Were they not needed before?”

The answer to these questions is: They have existed all along, but in some other form and under some other name. More than hundred years ago, in the nineteenth century, the United States is already industrialized, and even earlier, Great Britain and a number of Central European countries developed their own industrial base. These industrial countries reached their level of industrialization through the long-term investment financing of banks that at that time performed the entrepreneurial function of taking on the risk of entering into new fields of production. In the nineteenth century, these institutions had different names and were known as “industrial banks“. The industrial banks of the last century provided primarily “risk” or “equity” capital for the projects which promised to yield a high profit from the exploitation of new productive activities. One example of this type of financing was the construction of the railroads in the United States, which goes even back to the 1700s.
When providing long-term capital for new innovative types of productive activities, the industrial banks performed, in essence, the function that today is being performed by the development banks. Later, around the turn of this century, many fortunes were made in the United States and in Europe in the stock markets until it collapse in 1929. There was a thirty-to-forty-year period between the end of the nineteenth century and 1929, when the investment banks became large and powerful financial institutions. They sold stocks and bonds all over the world and through these financial resource mobilization activities provided the critically needed long-term financing for the expansion of industrial activities in the leading industrial countries. Thus, through the underwriting of securities issues and the contribution of their special expertise to the creation of new industries, investment banks performed the kind of development banking functions which we attribute to development banks today.

This type of financing, however, was severely curtailed at the time of the great depression, from 1929 to 1932. The world economic crisis of the 1930's, which was brought on by the international financial crisis, had the effect of increasing the risk of long-term venture capital financing far above the level which the older industrial banks and the investment banks that survived the recession considered acceptable.

We can view this situation of new investment financing during the 1930's depression also in terms of the impact it had on savers. Many of the individual and institutional savers who lost their savings during the great depression decided not to buy ever again another bond or share of stock from an investment bank. During the years immediately following the great depression, a period of transition in investment financing started, during which governments and governmental institutions in the countries committed to industrial development started to use public credit to fill the acute shortage of long-term funds for investment financing. As a result, in the 1930's, the first public development banks were established in the Western Hemisphere: Nacional Financiera in Mexico, CORFO in Chile and CAVENDES in Venezuela.

2. Evolution after World War II

After the end of World War II, the Marshall Plan made possible the financing of the re-industrialization and reconstruction of the European economy. And after World War II also a new economic world was emerging. The United Nations was
established as the successor to the League of Nations. The formation of a world community started within which the developing countries, in sheer numbers, were four times as numerous as the industrial countries. In the 1980s, the Organization of Economic Cooperation and Development (OECD), which represents the Western industrial countries, had a total of 17 members (if Ireland, Luxembourg and Iceland are not included), while the total number of countries that were members of the United Nations was over 150. By adding the East European countries and the USSR, but not China, to the industrial countries, about 25 countries will be classified as "industrialized". That leaves the number of developing countries still at about 125, of which 100 have a population of more than 1 million.

After World War II, a major task that the world started to face was the problem of how to develop the non-industrial world. One of the critical problems was that many countries had insufficient savings for financing their development. In these countries not enough domestic savings were generated to provide the investment capital for the industrialization they aspired to. One of the major related problems was to find ways for effecting the transfer of external capital - of channeling funds from the countries that had a surplus of savings to countries that had a shortage of savings. In confronting this problem, the idea of the development bank as a suitable transfer mechanism for the external financing of development projects emerged. The older form of development bank as mentioned before, was the government-sponsored development bank that had emerged in countries like Mexico, Chile, Venezuela and others in the 1930s. Both types of development banks faced the need to make their institution an effective investment financing mechanism that could strengthen the development financing process in their countries. This situation, which was very common in developing countries after World War II, was the motivating factor behind the evolution of the new development banks at that time.

a. Development finance companies

In 1946, the World Bank had started operations. At the World Bank in the early 1950's, one of the principal promoters of development banking concept was William Diamond who headed the Development Finance Companies (DFCs) division. This function is now located in the Industry Department of the World Bank. However, in the late 1940s and early 1950s, the idea behind the "development finance company" concept was the one promoted by William Diamond in his 1957 book entitled Development Finance Company.
To explain this early "development finance company" concept, a hypothetical example will be used. For instance, if a private development finance company in Colombia was able to obtain funds from the World Bank in the form of a loan (line of credit) for $50 million for the financing of industrial projects, then this development finance company had to have the capability to make project loans to industrial enterprises, that is to re-lend this $50 million for development projects, distributing this amount over say 250 project loans of an average value of $200,000 and thus providing financing to 250 industrial corporations through its lending operations and following the policy orientations for the use of this resources agreed on with the World Bank. This approach implied that the development finance company would function as a recipient of large loans from the World Bank and act as a distributor of these long-term investment funds to Colombian private sector industrial enterprises.

This approach reflects the early development finance company concept that emerged after World War II. In some cases, the creation of new development finance companies with the support of the World Bank resulted in the creation of quasi-local subsidiaries of the World Bank in developing countries as locally incorporated legal entities. This also occurred in some industrial countries which needed to mobilize external funds for the development or reconstruction of their own industrial enterprises, as was the case in Austria, Finland, Ireland, Israel and Spain. These countries also established development banks. Now these institutions are engaged in substantial exports financing operations.

This early concept of a development bank, however, viewed retrospectively, was rather narrow and limited. Over the years, through the accumulation of experience, countries recognized that a finance institution, which was only a distributor of credit was not a viable financial intermediary for the longer term. A critical element in the institutional context of the development bank is to have sufficient capital of its own to back its operations and, over the long run the institutions also must able to mobilize domestic resources to become an integral part of the domestic financial system. If the loans from the World Bank to the development finance institutions are discontinued, then the development banks that depended for their operations on external funds almost exclusively would not be able to continue doing business without access to domestic financial resources raised in their national financial markets.

Consequently, the early "development finance companies" concept that placed principal emphasis on the distribution of external credits, was modified to include more emphasis on other functions that are critical for making the development finance institutions an autonomous financial intermediary, such as the integration
into the domestic financial sector, the appraisal of projects and the efficient management of their investment portfolios.

b. Development banks

The amended development banking concept increases the similarity of the development finance institutions with other types of banks and financial intermediaries. A genuine and viable financial intermediary, forming part of the domestic financial sector and part of the national institutional panorama, has to be able to depend on its own initiative and policies to extend long-term financing for development projects. With emphasis on the domestic mobilization of resources, a development bank would also more effectively contribute to national economic and financial development by stimulating a higher level of financial savings.

As a prototype, the early “development finance companies” were financial institutions that distributed external lines of credit for private sector development projects. Until 1967, it was a World Bank policy that only privately owned development finance companies qualified for a global development bank loans. As a result, the countries that had only public development finance institutions did not qualify for receiving this type of World Bank loan, while other countries, which had private development finance companies or created them in the 1950’s and 1960’s, were able to strengthen the financing of private enterprises through external lines of development bank credit. While so far, regarding external development banks credits, only the example of the World Bank was used, it should be pointed out that the national and sub-regional development finance institutions also received external financing in the form of bilateral aid funds and from other multilateral sources, such as the United States Agency for International Development (USAID), the Canadian Agency for International Development (CIDA), the Swedish International Development Agency (SIDA), the German Kreditanstalt fuer Wiederaufbau, and from the Inter-American-Asian and African-regional development banks. A large volume of the other external resources available to development came from the bilateral agencies, which also discovered that channeling external funds through development finance companies to private and public enterprise in developing countries was an effective way of reaching the private enterprise sector in these countries.

It was only in the late 1960s that the definition of the concept of development bank was modified by the World Bank for external financing purposes to include public sector institutions as eligible entities for World Bank financing, e.g., publicly-owned development banks or government finance institutions financing pri-
vate or public development projects. The Inter-American Development Bank, starting operations in 1960s, from the start provided global lines of credit to public development finance institutions in Latin America. The World Bank officially modified its policy to permit lending to publicly owned institutions in 1968.

c. Development funds

Throughout the 1950s and 1960s, there remained a number of countries where neither public nor private development finance institutions existed, while the need for financing industrial development or agricultural development in these countries constituted a high priority. In some of these countries, a special mechanism was created to overcome this deficiency. The mechanism created took the form of a "development fund" for industrial or agricultural development. This type of "fund" was normally given "in administration" to an already established and renowned financial institution which then "administered" the development financing funds received in the form of a development trust, but the risk of lending remained with the government. The resources available were loaned by this "fund" to private banks or other financial institutions for development projects when this institutions submitted eligible projects for financing. The financing was approved whenever the project met the criteria established for the use of a particular fund's resources.

Most development funds serve a special purpose. Development funds are mechanisms, which perform development banking functions but, which in most cases, are not legally constituted as corporate entities. Development funds are mechanisms for financing development programs or projects. They may perform a long-term investment financing function. However, some may have been created only for a limited period of time to accomplish, for instance, the implementation of a special program to be completed, for instance, within the span of a three or five year development plan.

d. Long-term investment financing

The long-term financing function of development banks is critically important. Commercial banks make short-term loans. We say therefore, that commercial banks lend money, because money market operations have a maturity of less than one year. Institutions that lend funds for periods exceeding one year are considered to lend "capital" for fixed investment. Capital-type lending can be medium-term or long-term. By "medium-term" we usually mean 2 to 3 years (or
up to 5 years). But “medium-term” is not a concept which has been defined with precision by the financial community. Depending on the type of financing or type of institution involved, the period will vary. There is no general agreement on exactly were medium-term ends, whether it ends with three years or five years and when long-term starts. But there is agreement that medium-term represents maturities exceed in the period of one year.

When discussing long-term financing, we need to differentiate between two types of “long-term” - namely long-term private lending and long-term public lending. Private lending is provided principally by investment banks and large international commercial banks, or in many cases, by private bank consortia. Investment banks will underwrite and place stock and bond issues, and international commercial banks may make long-term loans with a maturity of 5, 7, or up to 10 years. The maturity of the international bonds may extend up to 15, 20, or 25 years.

In inflationary times, the period of private long-term lending is usually shortened to a range of only 2 to 5 years. When the rate of inflation increases, longer-term instruments cannot be marketed anymore because investors become unwilling to assume the increased risk generated by high rates of inflation over the longer run, unless these instruments are being indexed.

Public long-term lending normally extends beyond the maturity periods of private long-term lending. Public development loans have maturities of from 10 to 45 years-and there are International Development Association (IDA) loans with a maturity of 50 years. This is where the concept of “lender of last resort” is applicable again. Development banks extend infrastructure loans, social sector development loans, and finance other development projects that have a long gestation period and long payback period. Therefore, financing is provided for maturity periods of 10 to 45 years, which is two to three times the length of loans available from private banks. Soft loans normally have the longest maturities and are granted for the financing of social development projects.

3. Development banks today

When discussing development banks as they function today, the question that needs to be asked is: “What is the present situation of development banks around the world?” A survey would show that practically every developing country, and some of the industrial countries, as mentioned before, have development banks now. There are government-owned, or public, development banks; there are private development banks, and there are mixed ownership institutions. If we want
to know their importance and start to count their numbers, we will find that there are about half as many mixed ownership institutions as publicly-owned institutions and there are about twice as many private institutions as public institutions. But, measuring their importance with respect to financing, around two thirds (or 65 percent) of financing comes from public institutions; about 15 percent comes from mixed ownership institutions, and the remaining 20 to 25 percent of the financing is being provided by privately-owned development finance companies. These rough proportions are averages observed in 1970s and may have changed during the 1980s & 1990s. Statistics with greater detail on individual regions and countries are available from the regional associations of development banks in Asia, Africa, Latin America and the Middle East.

a. Regional distribution of development bank financing

Analyzing the importance of development finance institutions on a regional basis, surveying their number in Asia, Africa, Latin America, Southern Europe and the Middle East, in terms of amount that are being invested annually in development projects, Latin America is the region which has been investing about half the total funds lent by national development banks in developing countries. Also for other countries posting an impressive growth record - South Korea, Singapore, the Philippines and Indonesia - the volume of development bank financing has been important. In these countries, development banks are providing a critical and strategically important amount of development project financing. Then, there are the countries with the giants among the development banks - India, Pakistan, Brazil, Mexico and China. Both India and Pakistan have old development finance institutions. However, to a degree, the nature of development banks in Asia when China is expected, is different from the nature of development banks in Africa and Latin America. Development banks in Latin America, except for the cases of Colombia and Ecuador, finance almost exclusively long-term investment. In Asia, which accounts for about 25 to 30 percent of the total number of development banks, these institutions are now adding commercial bank operations to their long-term investment financing operations. Development banks in East Asia have the objective to finance all the financial needs of industry, that is, to provide enterprises with both long-term investment capital and short-term working capital at the same time.

Africa has a lower level of development and has a lower level of development bank investment than Asia and Latin America. Therefore, Africa accounted in the early 1980s for only about 15 percent of development bank financing, most of it
supported by the World Bank, but with a trend to a substantial increase in the years ahead.

In Europe and the Middle East there are several countries with development banks (Austria, Cyprus, Egypt, Greece, Ireland, Spain, Turkey, Finland, Jordan, Portugal), which account for another 10 percent of development bank financing. These proportions provide a rough indication of the regional distribution of development project financing provided by development banks around the world.

b. Number of development banks

It is difficult to provide accurate statistics for the numbers of development finance institutions now in existence because of their differing operations in the different countries. Brazil differentiates between “pure” development banks and other private and state development banks. Taking those with a substantial proportion of operations in development financing, the worldwide total may reach about 750 institutions, with about 40 percent of them in Latin America. In South Asia, India has a long list of development banks - both industrial and agricultural. Pakistan has also a number of important development banks. Most of the other Asian countries have strong government and private development banks. In Africa, practically every country has a young development bank that started operations in the 1960s or 1970s. These new institutions, to some extent are still learning their business. In Southern Europe, some development banks have been absorbed into the public sector by the government for the financing of exports and have been fully integrated into the domestic financial system. They have developed beyond the function of the pure development banks, which focus only on industrial development. They are diversifying into many other types of financing that strengthen the economic development process.

c. Differences among development banks

Regarding the differences in the characteristics of development banks, private development banks normally makes somewhat shorter-term (shorter maturity) loans than government development banks. This is parallel to the differences in financing between private and public development finance institutions in general. Private development banks place often more weight on the financial rate of return. A high financial rate of return on a project implies also a higher expected rate of profit for the development finance company involved in financing the project. In the case of mixed ownership institutions and public development finance insti-
tutions, the economic rate of return may be given a heavier weight.

This is the case in Brazil, for instance. The federal and state government of Brazil is the major shareholder in most development banks. But, although government may be the "major" shareholder, it is not necessarily the "majority" shareholder. The government or the public sector may hold less than 50 percent of the capital but still have the predominant influence on the board of directors. In the case of this mixed ownership institutions, the public has an interest in having them managed on a private business basis to increase their efficiency. However, the number of mixed institutions has been declining, because over time mixed institutions either become public or the government sells its share in them and they become private. Therefore, we can observe a relative reduction in the number of mixed development banks in the last ten years.

Coming back to the question of how many development finance institutions exist, reference can be made to the OECD Global Directory of Development Finance Institutions in Developing Countries (1967), which contained the first comprehensive list of development banks. In the meantime, development banks have organized themselves into regional associations. In Latin America there is the Association of Latin American Development Finance Institutions (ALIDE) in Lima, Peru, with about 250 members. And there are other development banks in Latin America that have not yet become members of ALIDE.

In Asia there is the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP) in Manila, the Philippines. There is also an Association of African Development Finance Institutions (AADFI), in Abidjan, Ivory Coast. The Association of National Development Finance Institutions in Member Countries of the Islamic Development Bank and the European Development Finance Institutions.

These associations, like the American Bankers Association, represent the interests of their members and act as a technical secretariat for their members, providing technical assistance, training, and other advisory and support services. Their activities range from annual meetings where the chief executives of development banks get together to exchange experiences and talk about their common problems, all the way to organizing exchanges of professional staff between institutions and countries and cooperating in the fields of training, exchange of information on technology and industrial processes. Overall then, depending on the orthodoxy of the definition used for the development banks, a conservative estimate may yield a total of around 750 institutions worldwide, with 300 in Latin America, 200 in Asia and the Pacific, 150 in Africa and 100 in Southern Europe and the Middle East.
d. Importance of development banks in the national economy

The importance of development banks within a country and within the financial sector of the country may be approached by considering the role of long-term financing they provide. The questions that needs to be asked are: “Of the total amount of long-term financing in a country, what proportion is being provided by the development banks?” “Does the contribution to investment financing by development banks in the country represent a large proportion of total investment? On the basis of the proportions of financing provided, the answer to this question is that the proportions of finance provided is not very important. On a worldwide basis for the developing countries, the proportion of investment financing provided by development banks is probably only about 5 to 10 percent of long-term financing. But for the poorer countries - the countries with a low-per-capita income - this proportion is substantially higher. It may reach 30 to 35 percent of long-term financing.

But analyzing the importance of this financing from the quantitative point of view does not fully reveal its significance. Proportions do not necessarily reflect the strategic importance and qualitative significance of this financing. The importance of development bank financing lies in the critical role it plays in the development of a country. If, for instance, this financing succeeds in adding to a country’s productive capacity 5 percent of new industrial activities each year, producing goods that have not existed in the country before, this net addition of 5 percent of something new constitutes a critical and important contribution to the country’s future and its development. Therefore, the small proportion of 5 percent, in terms of the benefits that development bank financing is capable of creating for years to come, can be very important for a country. The benefits of this financing can be optimized particularly when economic project analysis is applied, which when it is used in the selection of projects, ensures a positive contribution to the development of a country.

Also, although the financing provided by the development finance institutions may be a small proportion of the total investment in a country, this financing when coming from a lender of last resort, plays a critical role in creating those types of productions that otherwise would not be not be undertaken by private initiative, but nevertheless are very important for the development of the country.

The above illustrates another role of development banks: to act as a lender of last resort in the development of new productive capacity. Later on another development bank function, namely the function of a catalyst will be discussed. A “catalyst” in this context may be a development bank, which acts as financial
agent that brings external capital into the country. Development banks may also fulfill the function of providing borrowers with another critical ingredient of development, or with adding a missing part that permits the initiation of new productive activities which otherwise could not be started. This ingredient is the selection and transfer of technology and adoption of new industrial processes.

e. Financial sector and development banks

The question that needs to be asked is: “What are the links between development banks and other financial institutions within a country?”

An overview of the financial sector in a country will show that normally between 30 to 60 percent of financial assets are held by commercial banks. Another important category of financial institutions are investment banks. In some countries the commercial banking and investment banking functions are found within the same institutions, as is the case in Central Europe and Switzerland. One also finds savings banks and savings and loan associations, which collect long-term savings and channel them into the housing sector through the granting of mortgage loans. There are also mortgage banks and finance companies, which in most countries operate as consumer finance companies, financing consumption in general and such items as automobiles and other durable goods. Regarding the term “finance company” it is important to note that although many private development banks are called “development finance companies” they are an entirely different type of institution than a “finance company”, which finances consumer loans. The “development finance company” provides long-term investment financing and the consumer finance company” provides short-term consumer financing. Insurance companies and pension funds are also a part of the financial sector. Also, credit cooperatives and other even more specialized financial institutions form part of the financial sector.

After identifying these different financial institutions that make up the financial sector, “What then is the relationship of the development banks with the other institutions of the financial sector?”

Commercial banks are under the supervision of the central bank. The central bank, therefore, plays an important role in the financial sector. In some countries, the central bank has authority extending beyond the money market, including capital market institutions, such as investment banks, development banks, insurance companies, leasing companies, venture capital companies and others. In most countries, however, the task of controlling capital market institutions is the responsibility of the “securities commission”. In the United States, a substantial
part of this authority is held by the Securities and Exchange Commission. At this point, it is important to recognize that the range of activities permitted to develop banks and other intermediaries operating in long-term finance depends on the government agency which controls capital market policy and supervises capital market operations. Therefore, it is the central bank, with its monetary policy authority, and the Securities and Exchange Commission, with its capital market policy authority that may impose limitations on, or extend privileges to, development banks. The Central Bank, or Securities and Exchange Commission, may also grant special preferences and incentives to development banks. To ensure that development banks become viable financial institutions, special privileges may not be desirable, except, possibly, during their start-up period. But, if a development bank receives sufficient public support and assistance during its initial period of operations, then even during the start-up period, no privileges should be granted.

\[ f. \textit{Mobilization of financial resources} \]

In most countries, development banks are given the authority to issue their own bonds, certificates of deposit or other types of long-term financial instruments. In most countries, they are also not permitted to hold checking and savings deposits. In order to issue bonds, development banks normally have to resort to the assistance of investment banks. But, development banks can also obtain funds from commercial banks, insurance companies, pension funds, mortgage banks or savings banks. Therefore, one important relationship that development banks have with the financial sector is that they will delegate part of the task of mobilizing domestic resources to other financial institutions that may have a cost advantage, or another advantage in mobilizing savings. The advantage that commercial banks have is that they are specialized in accepting money on deposit in the form of checking (demand) and savings (time) deposits. This gives them a special or privileged access to capturing savings. But, there are also economies of scale involved for commercial banks, due to their specialization as deposit institutions, which gives them a cost advantage in the mobilization of personal and corporate savings.

A development bank will be financially viable if it can pay a sufficient interest on deposits to mobilize private savings in the domestic or international capital market and if it can re-lend these savings at a rate which covers its costs and allows for the accumulation of reserves. Many public development banks are not obliged to make a profit, but they have to earn sufficient revenue to recover their
costs and provide for contingencies. Their revenue has also to be sufficient to compensate for the cost of inflation in order that the real value of their capital is maintained.

As the above illustrates, one of the most important relationships between development banks and other financial institutions is that development banks may have to rely on the entire spectrum of financial institutions to raise funds, if they themselves cannot go directly into the financial markets with bond issues or other debt instruments to mobilize financial resources. On another level, the relationship between development banks and commercial banks may also be competitive. Commercial banks make loans to individuals and corporations, as do the other major financial institutions. Development banks make loans to large corporation and medium and small enterprises. The policy of lender-of-last resort implies that development banks loans should not be a substitute for, or compete with, loans available from other financial institutions. If this principle is observed, then development bank lending will be a “net addition” to the credit provided by other financial institutions. This is called the “additionality” in development bank financing. Commercial bank financing should be supplementary, complementary, or parallel to development bank financing.

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g. \text{ Co-financing and parallel financing}
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In development financing, a term has evolved to describe the supplementing of development bank loans with loans from other sources. This term is “co-financing”. “How do we define co-financing?” Co-financing is an arrangement whereby the development bank loan may amount to $100 million and where private banks may join together to lend another $100 million for the same project, creating a “loan package”. In this case, if the project costs $200 million, the maturity of the two $100 million loan components may differ. The development bank may lend for 20 years and the private banks may lend their $100 million in a variety of ways, possibly half, or $50 million for 10 years, and the other half for five years. In co-financing, it is customary that the shorter maturities are financed by private institutions (because of the lower term risk) and the longer maturities are financed by the development bank. Also, the interest rate of the various components of the co-financing package will differ in most cases.

During recent years, co-financing has been growing significantly on an international scale. Co-financing, as presently defined by the World Bank, may be provided by three major sources: (a) governments administering bilateral development programs, and multilateral financial institutions, such as regional
development banks and funds; (b) export credit agencies, which either lend directly or provide guarantees or insurance for export credits; and, (c) commercial banks.

Co-financing offers several advantages. It combines professional development expertise and well-conceived and appraised projects. The underlying quality of the projects as well as close supervision of project implementation, reduce the risk of the project. Borrowers also find that co-financing gives them assurance that high-priority investments can be financed on the best terms available. In addition, co-financing can establish access to new potential sources of financing: official loans, export credit and commercial bank loans.

D. Development banking theory

1. Objectives and functions of development banks

To discuss the theory of development banking, first the objectives and functions of development banks will be analyzed. Then an overview of development banking theory will be provided and an explanation of their policies and operations will be given.

   a. Financing of development projects

Development banks differ from commercial banks and other private financial institutions in that they do not extend credit to an enterprise solely on the strength of the financial position of the enterprise, but also base their financing on the appraisal of the nature and quality of a specific project. By undertaking a comprehensive appraisal of the project, development banks also reduce the risk of financing a specific project. Project financing is an approach for minimizing - through careful appraisal of every aspect of the project - the risk on a specific project loan. Project appraisal is carried out to ensure that all aspects of the project are technically viable and economically and financially efficient. This procedure, which is at the core of development banking policy, permits the financing of longer term and riskier investment in new productive activities without a substantial increase in the investment risk. This policy is what makes development banks the most effective instrument for the financing and execution of development projects.
b. Promotion of development projects

Another major function of development banking is project promotion. In the context of development banking, the meaning of the word "promotion" is not the same as when used in advertising or sales. Project promotion in the development banking context has the meaning of acting as a promote of activities for achieving innovation, of acting as an entrepreneur who will take the risk to invest in new types of productive activities, often involving strategically important and technically-daring projects. Project promotion is particularly critical in the case of projects that have not been tried before and that promise to yield an attractive financial rate of return. The innovative nature of the project also contains the promise of a high economic rate of return.

c. Long-term financing and capital market development

Another major function of development banks is to provide long-term fixed-asset financing for development projects. This involves the willingness to assume the risk of financing long-term projects and to contract long-term funds. Here a note about the development of domestic financial markets and capital markets in developing countries is in order. The poorer a country is, the lower will be the level of saving it generates and the less likely it is that this country will have a developed capital market. If a country’s capital market is only in an infant stage, then no supply of long-term funds will exist, or the long-term component in this country’s financial market will be missing. Therefore, another important function of development banks is to contribute to an increase in the supply of long-term investment funds and, through its activities aimed at the achievement of this objective, also to contribute to a more rapid development of the domestic capital market. In order to increase the supply of long-term funds, development banks become promoters of capital market development.

d. Financial agents and catalysts

Development banks may also perform the function of acting as financial agents, bringing private, official, external and domestic financing together to construct a financial package, particularly when the amount of funds needed for a project exceeds a development bank's financial capabilities. Through co-financing, development banks also combine different types of loan into one package, such as multilateral loans, suppliers credits, bilateral loans and private bank credits. De-
velopment banks also acts as “catalytic agent”. They act in “catalytic role” when they assist potential borrowers in finding new sources of financing and helping them to gain access to external and international financial markets. Through their endorsement of a project, development banks may facilitate co-financing arrangements, or help find a new lender altogether. Development banks may also play a “catalytic role” in the selection and transfer of technology. They may assist in finding the appropriate technology for introducing new production processes to a country or for removing critical bottlenecks. In order to fulfill this function, development banks also need to have some competence in the selection and transfer of technology or they need access to the pertinent information on technology.

e. Technical assistance function

One of the characteristics of the institutional panorama in developing countries is that certain specialized technical services required in modern production processes are scarce or lacking. When such technical services are needed, it becomes the responsibility of the development bank in financing development projects to bring them into the country, or to assist in their creation within the country. Development banks fulfill this function primarily by providing technical assistance. The fulfillment of the technical assistance function may prompt the creation of domestic research institutions, the creation of consulting firms, the creation of the capacity to carry out studies, and the development of the advanced domestic training capacity. Development banks also include in their project financing funds for direct technical assistance providing advisors and consultants with special expertise, both domestically and from abroad. The provision of technical assistance represents another important difference between development banks and commercial banks. Through the inclusion of a technical assistance component in a project, development banks can substantially improve the quality of a project and increase its expected rates of return.

2. Development banking theory today

In development banking, the concept of “development” is combined with the concept of “banking”, to achieve the construction of a mechanism for the financing and implementation of development projects, which has been named “development bank”. The mechanism has the double objective of implementing projects that make a contribution to the development of a country and that earn a return sufficient to preserve or increase the country’s scarce financial resources.
The question that needs to be asked is: "How will development banks assure that the projects they finance will make their contribution to development?" Most countries have a development plan. This development plan has a definition of development priorities. The development plan may identify a specific sector as the main bottleneck to the development of the country. Therefore, a high priority is assigned to the development of this sector. Consequently, financing channeled into this sector should make the greatest contribution to accelerating development, and to increasing income and employment. Increasing the level of income is a quantitative contribution to development. Through their financing, development and banks can also make a qualitative contribution to development. For example, by eliminating bottlenecks in specific sectors, the efficiency of all enterprises in the country may be increased.

In measuring the contribution of development banks to development, both the qualitative and quantitative aspects of their contribution need to be considered. When a commercial bank considers a loan application, it normally does not examine the economic aspect of the expected benefits from a project, while a development bank in principle, may not start to process a loan application unless it already contains an attempt to estimate the expected economic benefits to be generated by a project. The requirement to estimate the expected economic contribution of a project is a key difference between development banking policy and banking policies, in general.

Development banking theory continues in evolution. In this text, the attempt is made to describe this evolution and to illustrate how, within the diversity of development banking institutions and financial and development policies in the different countries, the basic theoretical principles of development banking theory remain applicable. What is described as development banking in the foregoing and following parts of this text is considered to constitute the present state-of-the-art development banking theory.

3. Role of capital in development

Since part of the process of economic development consists of increasing the supply of capital in the economy, the role of capital in economic development in terms of factor proportions. Capital, labor and land (which includes natural resources), constitute the classical factors of production. Entrepreneurship, management technology are often called "invisible capital" and added as another factor of production. Others have called this factor "social overhead capital". According to Herrick and Kindleberger, the difference between industrial coun-
tries and developing countries can be determined by observing the relative factor proportions in each country. A country with abundant capital is normally an industrial country. A country where capital is scarce is normally a developing country. Exceptions are countries that are rich in natural resources and export these, such as the petroleum exporting countries. These resource-rich countries may have an abundance of capital without having reached the stage of development of an industrial country. When natural resources are not taken into consideration in the analysis, the process of development can be reduced to consisting of an increase in the availability of capital. This is a way of viewing the development process in terms of the role played by investment in this process. An increase in the supply of capital is also called “capital deepening”. If a development bank contributes to increasing the supply of long-term financing, then the development bank will help to increase the availability of capital. But the effect of achieving an increase in the supply of capital will also have its repercussions on labor.

Labor is relatively expensive and scarce in industrial countries. In a developing country, labor is normally cheap and relatively abundant. Hence, the repercussions of the activities of development banks when the supply of capital increases can be seen: capital becomes more abundant and less expensive relative to the cost of labor. If labor becomes relatively more expensive, then the level of per capita income increases and development progress is achieved. Therefore, development banks, by increasing the supply of long-term capital, indirectly also contribute to development by assisting in the creation of conditions leading to a rising level of personal income.

4. Role of financial intermediation

One way of increasing the supply of long-term capital is by expanding the scope and volume of financial intermediation. This function is fulfilled in the following manner: The party that provides funds is a saver. It can be an individual, a corporation, government or public institution. The party that needs funds is an investor. It can be an entrepreneur who creates additional productive capacity, a corporation, government or public entity. There may be many more savers than investors. When many savers pool their savings, it may add up to a large amount of funds which, for example, maybe sufficient for building an automobile factory. Here is where the role of the financial intermediary enters. The intermediary institution may capture many small amounts of savings and pool them to obtain a large sum of capital for investment, or it may obtain a large amount of funds and divide it up for the financing of many projects. A financial
intermediary may also raise funds on a short-term basis and lend them over the long-term. For example, it may obtain funds for six-months and lend them for three, five or ten years.

As these examples show, a financial intermediary may effect a transformation in the characteristics of funds, both in terms of volume of funds and also over time - the latter is called the "term transformation function". This relates to the "golden rule of banking". The rule states that: "if you borrow short-term and lend long-term, you are increasing the risk of going bankrupt". For example, if all funds mobilized for 30 days are withdrawn while part of these resources are tied up in 10 year loans which cannot be recalled, then the financial intermediary may become illiquid and face bankruptcy. If a bank cannot meet its payments when they come due, then the bank's creditors can obtain a court ruling declaring bankruptcy, thus putting the bank out of business.

Financial intermediaries are very much aware of the term transformation risk, which arises from borrowing short-term and lending long-term. But they also know that by transforming six-months funds to 5 years loan, they will increase they net return, because the interest rate on long-term loans is normally higher than the interest rate on short-term loans. If a financial intermediary can count on resources not being withdrawn, except for a moderate percentage representing a normal turnover of funds, it can afford to effect a lengthening of the period of commitment for a substantial proportion of its funds. This term transformation is particularly feasible in the case of institutions, which have a steady increase in resources. During expansion, the risk of illiquidity stemming from term transformation will be reduced, but during periods of recession this risk increases substantially.

When development banks act as financial intermediaries they may sell development bonds with a maturity of 5 years to the savers and use the proceeds for making 15 year loans for which they charge a higher interest rate than they pay on the bonds. When successfully effecting term transformation, development banks are establishing their viability as financial intermediaries in the domestic financial markets. Their viability as financial intermediaries is only assured if they are able to raise private savings in the domestic market and are able to maintain access to this market on a permanent basis. This implies that they are able to pay an interest rate which is high enough to attract these savings and that the safety, liquidity and yield associated with the development bank bonds is perceived to be sufficiently high to obtain a AAA credit rating in the United States, as established by the leading bond rating and credit appraisal agencies, such as Standard and Poors, Moodys, and Dun and Bradstreet.
5. Role in the mobilization of financial resources

As financial intermediaries, development banks increase the level of mobilization of financial resources in a country and contribute to capital deepening. This is an important role of development banks. In the lower income countries, a substantial part of savings takes place in the form of accumulation of physical asset - gold, coins, other precious metals, jewelry and real state. These form of savings, as well as cash horded in domestic or foreign currency, do not increase the capacity of the country to invest. When $100 is deposited in a bank, the capacity of the bank to lend for the expansion of industrial capacity increases. Any increase in the amount of savings provided to a bank will increase the ability to invest of the country and increase its degree of “financial deepening”. The financial deepening means that the amount of savings per capita held by financial institutions increase or that the level of financial assets as per cent of gross domestic product held by financial institutions increases. With a higher level of “financial deepening” the basis is provided for a higher level of “capital deepening”. When the relative level of investment increases, also the relative level of investment can increase. If banks provide incentives to their clients to liquidate savings held in real estate and convert the proceeds obtained into bank deposits, this contributes to the mobilization of domestic savings. An increase in savings, with the help of financial intermediaries, will increase a countries’ ability to invest. It also permits an expansion of production and an increase in the rate of economic growth.

6. Financial development

The mobilization of domestic financial resources is important for economic development and financial development. The theory of financial development addresses the questions: “How to increase the level of savings and the level of financial intermediation?” and, “How to increase the level of development of financial institutions and how to increase the supply of capital?”

The development of economic infrastructure is a pre-requisite for the development of an economy. The availability of financial services and of credit is another form of infrastructure. The existence of financial institutions is not in physical infrastructure, it is service infrastructure. To exploit opportunities in the market to invest when they arise, having access to financing is critical. These questions relate to the theory of financial development, which is part of the theory of development banking.
7. Ex-post evaluation and performance evaluation

In ex-post evaluation, results are measured in comparison with originally established objectives and estimated benefits. This is done after the completion of a project by comparing actual outcome against the expected benefits.

The performance evaluation of a development bank is made annually in its annual report. However, for an in-depth analysis of the development contribution of a development bank, it is more appropriate to examine its performance record over a three, five or ten-year period.

8. Economic cost-benefit analysis

In assuring the development contribution of development banks economic cost-benefit analysis becomes a critical tool. The purpose of economic cost-benefit analysis is to ensure that the project will generate adequate economic benefits. The application of cost-benefit analysis will lead to an estimated economic rate of return for a specific project. For example, if a project has an economic rate of return of 10 percent, this means that the value of economic benefits it is expected to generate annually exceeds its cost by 10 percent. When the economic rate of return is 15 percent, or a 20 percent, this means that the economic benefits generated will be 50 percent greater or twice as high as those of the project with a 10 percent rate of return. The economic rate of return is a relatively accurate indicator of differences in the flow of expected economic benefits. The methodologies for calculating the economic rate of return have advanced considerably during the 1970s. The economic rate of return for a project will differ only slightly when different methodologies are used. Shadow prices or accounting prices are used as a basis for obtaining the economic rate of return.

9. National economic parameters

National economic parameters can be calculated on the basis of priorities established in the national development plans. Large countries may establish different priorities for different geographical regions. High priorities may be assigned to outlying and remote regions due to their relatively lower level of development. Benefits from projects in those regions will be weighed more heavily. They will be measured with a different yardstick than benefits from projects in the central or most advanced regions of the country.
The question that needs to be asked is: "What are the problems in the use of national economic parameters?" Problems may arise from the need to find the appropriate parameter value for a specific community within a specific geographic region. To achieve this, agreements are needed in the weights to be used for priority sectors to which investment is to be channeled. Through the appropriate weighting procedure, an integrated calculation of the expected economic benefits of the project can be obtained and projects can be selected for financing with national development priorities having fully been taken into account.

10. Relation of private and public development banks

There are some countries where the so called "two-step procedure" is used in external development financing. If, in a specific case, the World Bank is the principal source of external funds, it may make disbursement to the Central Bank of, for example, the Dominican Republic. In turn, the Central Bank of the Dominican Republic will disburse financing for development projects to commercial banks which have established a long-term financing window to be able to lend for the long-term investment needs of private industrial enterprises. In the two-step procedure, financing is passed down from the Central Bank to a commercial bank and from the commercial bank to the industrial borrower. Two-step lending, in this example, involves the Central Bank lending to a commercial bank and as second step the commercial bank lending to the ultimate borrower. Where similar procedures are used in other countries, the Central Bank or National Development Bank, respectively are called "apex bank". Such a bank provides funding for the development projects to secondary level banking institutions. In most countries where this two-step procedure exists, it came about because strong, autonomous, public or private development banks that could have raised external funds directly and could have lend them for projects, did not yet exist. This shows one form of relationship between public and private development banks and it illustrates that in some cases private development banks may be dependent on public development banks for funds for long-term lending. There are also other relationships, like in the case of Mexico's Nacional Financiera, a giant public development bank, which in the 1960s and early 1970s was strong enough to issue its own Nacional Financiera bonds and to sell them to investors from all over the world at an attractive interest rate. This is an example of a public institution that is able to lend directly to the optimal industrial borrower in Mexico, regardless of whether the borrower is a publicly, or privately-owned enterprise. However, relation between a public development bank in Mexico and other institutions sub-
stantially differ from those followed by a public development bank in Brazil, or from those of a public development bank in Korea or India. This shows that development banks differ from country to country. Development banks are not homogeneous institutions when legal and institutional characteristics are compared, while their functions are the same across the world. The major differences derive from the national legal, economic and financial systems governing their domestic financial sectors. Development banks need to be integrated into the respective national legal and institutional system. This requirement has resulted in the creation of development finance institutions with different characteristics in different countries. However, they all perform the same development banking functions.

II. ADMINISTRATION OF DEVELOPMENT BANKS

A. Financial administration

One of the main tasks of any financial institution is the management of its funds. This involves the raising of financial resources as well as their lending or investing.

There is a distinction between lending and investing. Lending is the provision of capital through a loan, while investing is the participation in ownership or risk capital. Depending on economic and financial conditions and the state of the economic cycle, either raising, lending or investing funds may be more difficult.

In lending, the principles of sound portfolio management apply to development banks as they apply to other banks. Among the most important conditions that need to be taken into account are the following: (a) diversification of the portfolio; (b) the relative scarcity of long-term capital and the need to allocate it efficiently; (c) complete freedom in setting interest rates and charges on loans; and, (d) the control of costs.

The soundness of the financial position, or solvency, of a development bank depends on the management of its financial resources. A development bank must be able to earn a return on its portfolio which is high enough to pay for the cost of the funds it has raised as well as for covering its costs of operation and to compensate for the effects of inflation. The finances of a development bank must be managed in a pragmatic and orthodox manner, but with enough flexibility to permit a quick adaptation to changing economic conditions.
B. Organizational structures

A development bank carries out a number of activities that other financial institutions do not perform. Besides the financial administration of a development bank - which has the raising, lending and investing of funds for the implementation of development projects as its main activity - a development bank performs a number of other tasks which call for separate departments in the bank's organizational structure. One of these activities is project appraisal. Therefore, there is normally a project appraisal department in each development bank.

Since five types of appraisals are commonly carried out, development banks must develop the technical capacity to perform the appraisal of projects in these fields. They are: (a) economic appraisal; (b) financial appraisal; (c) technical appraisal; (d) institutional, managerial and organizational appraisal; and, (e) legal appraisal.

C. Management of loan and investment portfolio

When external financial resources are used for development project financing, often a two steps approach of lending is adopted. There may be an apex bank that raises external resources and guarantees their repayment. On a lower level, a development bank may receive resources from the apex bank. The apex bank, when transferring funds to a second story financial intermediary, may disburse funds that have been provide exclusively for specific priority investments. An apex bank may also finance projects directly. This will occur when a project is large enough to require a substantial appraisal apparatus and a loan of a magnitude, which exceeds the financial capacity of a second story development banks. One apex development bank that operates in this way is Nacional Financiera of Mexico.

A financially-viable project may be defined as a project which generates sufficient net revenue to pay back the original investment cost and to yield a return not lower than the opportunity cost of capital (i.e., a return not inferior to that obtainable through alternative investment opportunities).

Due to their dual objectives of contributing to development and earning a financial return on investment, there is an inherent conflict in the operational objectives of development banks. They finance projects which generate significant economic benefits. To estimate the value of the expected economic benefits of a project, the economic rate of return is calculated.
Development banks have to limit their lending to financially-viable projects, with an acceptable financial rate of return. Obviously, not all of the projects with an estimated significant development contribution will also have an acceptable financial return. Projects must meet both requirements to qualify for development bank financing. Depending on the maturity of the loan, the interest rate will differ. Long-term loans represent a higher level of uncertainty and will have higher interest rates than short-term loans.

Another risk factor that must be taken into consideration in lending is the market risk. This risk varies according to the type of business involved. Mining is riskier than manufacturing. Also the size of the borrowing firm influences the risk inherent in a loan. There is an inverse relationship between the size of the firm and the level of risk. Larger firms are more creditworthy than smaller firms.

Some development banks will only provide funds in the form of a loan. Others will also acquire shares, (i.e., provide risk or equity capital). In any event, development banks must assure the soundness of their loans and investments.

Portfolio management in development banks follows two basic rules: (a) to diversify risk, which means to lend and invest in different sectors of the economy and in different industries within the same sector; and, (b) to select quality projects, which means to lend or to invest only in projects that will generate the minimum acceptable economic and financial returns.

The administration of the loan and investment portfolio in development banks extends beyond the approval of loans. It requires control and supervision of loans outstanding to ensure their repayment. In some cases, it may become necessary to revise a part of the project to cover increased costs, which may be due to inflation, or to other unforeseen circumstances. Another important aspect of the management of loans and investments is to ensure a smooth cash flow. For this, a sources and uses of funds projection is prepared together with a time profile of funds required to honor lending commitments.

D. Mobilization of domestic and external financial resources

Mobilizing financial resources is the ability of a development bank to raise the funds it needs for making loans. A development bank may apply to the World Bank or to the regional development banks to obtain external funds. It may also obtain funds from its apex bank, or it may sell its own bonds or certificates of deposit to raise financial resources.

Financial resources may be obtains from either official or private sources, and each of the sources may be either external or domestic.
1.1 Domestic official sources

The sources of domestic official financial resources are:

a. Ministry of finance and central bank;
b. State, provincial, municipal and other local government entities;
c. Public development banks and development-related ministries and government entities.

1.2 Domestic private sources

The sources of domestic private financial resources are:

a. bond issues and sales of other financial instruments;
b. direct placement of loans;
c. private direct investment; and,
d. private portfolio investment.

2.1 External official sources

The sources of external official financial resources are:

a. foreign government loans and grants;
b. national development banks and official export-import banks.

2.2 External private sources

The sources of external private financial resources are:

a. commercial bank loans;
b. international and foreign bond issues;
c. direct placement of loans; external private direct investment;
d. private external portfolio investment.

A more functional classification of sources in the mobilization of funds for development banks is shown in Table II.1.
It is important to understand that “hard loans” are obtained on terms determined by market conditions, reflecting market interest rates, while “soft loans” are provided on concessionary terms, containing a “grant element” with interest rates below market rates and maturity periods exceeding those in private financial markets. For the private commercial banks, the greatest concern in making a loan is the “creditworthiness” of the borrower, or of the institution or government that guarantees the repayment of the loan. In appraising creditworthiness, consideration is given to the availability of foreign exchange, to the solvency of the borrower and the guarantees provided and, in the case of development projects, also the quality of the project and the expected return will be considered.