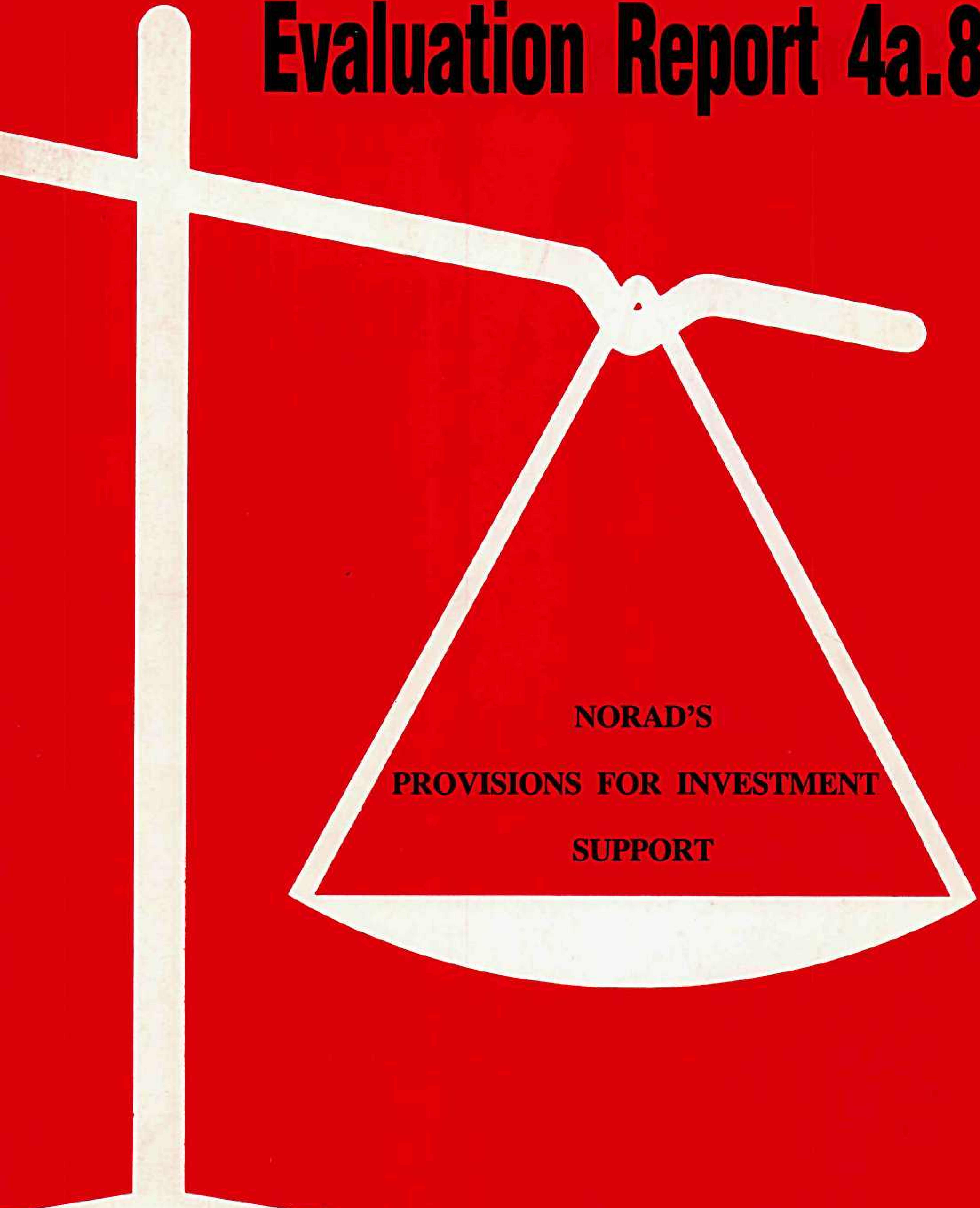
THE ROYAL NORWEGIAN MINISTRY OF DEVELOPMENT COOPERATION

Evaluation Report 4a.87



NORAD'S

PROVISIONS FOR INVESTMENT

SUPPORT

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EVALUATION
OF NORAD's
PROVISIONS FOR
INVESTMENT SUPPORT

REPORT PREPARED FOR

THE ROYAL NORWEGIAN MINISTRY OF

DEVELOPMENT COOPERATION

BY

CENTRE FOR APPLIED RESEARCH

THE NORWEGIAN SCHOOL OF ECONOMICS AND

BUSINESS ADMINISTRATION

FOREWORD

In March 1987 the Royal Norwegian Ministry for Development Cooperation gave the Centre for Applied Research at the Norwegian School of Economics and Business Administration the assignment of evaluating NORAD's provisions for investment support. The main points in the mandate for the evaluation, are as follows:

- Evaluate the provisions for investment support with a view to their effect and efficiency and to their agreement with the over-all Norwegian foreign aid objective.
- Evaluate the present plan for organising and administrating the existing provisions for investment support.
- Suggest any changes to the existing provisions and schemes based on the experience gained from terminated and ongoing projects.

The evaluation team's work can be divided in five phases:

- Preparations (collecting and interpreting background material as well as the development of a theoretical basis).
- Preparing three questionnaires (two forms to be completed by officials in the Department for Industrial and Commercial Cooperation in NORAD, the third to be completed by Norwegian firms that have received support under the current provisions).
- Personal interviews with the officials in the Department for Industrial and Commercial Cooperation and selected Norwegian business executives.
- Field work/visits at 10 projects in developing countries (Egypt, Kenya, Tanzania, Pakistan, Malaysia and Thailand. Two projects in Sri Lanka were visited in July/August 1986).
- Writing the report: presenting a draft report in September 1987, participating in discussions within the Ministry of Development Cooperation on the draft and preparing the final version of the report.

The evaluation team included:

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The evaluation team would like to thank Mr. Geir Asheim, associate professor, and Professor Kåre P. Hagen for having read and commented on parts of the report. We would also like to thank the secretariat at the Centre for Applied Research - the Norwegian School of Economics and Business Administration, particularly Ms. Vibeke Farestvedt and Ms. Anne Kristin Wilhelmsen for excellent writing assistance.

The evaluation team at the Centre for Applied Research would like to thank the Ministry of Development Cooperation for an interesting and stimulating assignment. We hope that our report will serve as a useful presentation of the provisions for investment support, and that it will stimulate discussion on important issues concerning foreign aid policies.

This report was originally written in Norwegian. It has been translated by Kontekst translatørbyrå, Bergen.

Bergen, December 12, 1988.

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ABBREVIATIONS

DAC	-	Development Assistance Committee (within OECD)
FINNFUND	-	The Finnish Fund for Industrial Development Cooperation Ltd. (Finland)
GDP	-	Gross Domestic Product
IFU	-	Industrialiseringsfonden for Udviklingslandene, Denmark (The Danish industrial fund for developing countries)
ILO	-	International Labour Organization
KL	-	Kenyan pounds
KSh	-	Kenyan shillings
LIC	-	Lower Income Countries (Countries whose GDP per capita was below USD 700 in 1983.)
LKR	-	Sri Lankan rupees
LMIC	-	Lower Middle Income Countries (Countries whose GDP per capita was between USD 700 and 1300 in 1983).
NOK	-	Norwegian kroner
NORAD	-	Norwegian Agency for International Development (Under the Ministry of Development Cooperation)
OECD	-	Organization for Economic Co-operation and Development
SADCC	-	Southern African Development Coordination Conference (Regional economic cooperation between the following nine countries in southern Africa: Angola, Botswana, Lesotho, Swaziland, Mozambique, Malawi, Zambia, Tanzania and Zimbabwe.)
SWEDFUND	-	Swedish Fund for Industrial Cooperation with Developing Countries (Sweden)

UMIC	-	Upper Middle Income Countries (Countries whose GDP per capita exceeded USD 1300 in 1983.)
UNIDO	-	United Nations Industrial Development Organization
USD	-	US dollars

CHAPTER 1:
SUMMARY OF PRINCIPAL RESULTS AND RECOMMENDATIONS

This chapter will outline the main issues that the evaluation team has been addressing, as well as the results and recommendations that this work has yielded. Our theoretical basis will also be briefly sketched out.

1.1 Central Issues

First, the evaluation team sought to outline the history of the Norwegian provisions for investment support, and how Norwegian industry has made use of these provisions.

Second, the team evaluated a number of aspects related to current provisions for investment support. The principle questions were:

- Are the investment incentive schemes satisfactorily administered today? The team focused its attention on the interpretation and application of current guidelines, and on certain aspects relating to the efficiency of the decision-making process. In this connection the team evaluated a number of projects that have benefited from the provisions for investment support.
- Are the current regulations and guidelines working according to their objectives?
- Do investment support represent a rational way of distributing foreign aid?

Third, in the light of the relevant evaluations, the team sought to find out how the current provisions for investment support could be improved.

1.2 Outline (cf. part 1, chap. 2-5)

Table 1.1 illustrates the investment support paid out annually as distributed among the various schemes.

Only two payments have been made under the special scheme for investment guarantees. Both of these payments were compensations covered by the Norwegian Guarantee Institute for Export Credits and did not involve the foreign aid budget.

Table 1.1: Annual investment support as distributed among the different schemes. (Amounts in NOK, current prices).

Year	Support for feasibility studies	Soft Loans	Support for initial training schemes	Support for investment in basic infrastructure
1976	159,232	-		-
1977	770,115	-		-
1978	1,036,710	-		372,000
1979	3,005,472	-		194,000
1980	782,330	-		6,076,000
1981	481,870	10,750,000		2,798,800
1982	1,292,296	33,910,500		802,500
1983	683,945	56,190,000	-	1,563,154
1984	1,952,767	46,600,000	-	1,486,913
1985	3,879,083	27,306,000	1,583,462	-
1986	3,353,095	55,130,000	3,788,559	1,875,000

Source: Compiled on the basis of statistics from the Department for Industrial and Commercial Cooperation, NORAD

The investment incentives' share of total official Norwegian development assistance has shown a clear increase since the mid 1970s. In the period between 1976 and 1981, support for investment accounted for less than 0.5 % of the annual total. In the period between 1982 and 1986 (with the exception of 1985) this figure rose to between 1.0% and 1.4%. Payments made under investment incentive schemes were not substantial until the provisions for loans and guarantees were introduced in 1979. In the period between 1976 and 1986, payments under the provisions for loans and guarantees accounted for 86% of all investment support.

Today, the executive officers' area of responsibility is primarily related to firms, with secondary emphasis on geographic area. Applications for loans are subjected to a preliminary financial assessment. The Norwegian commercial bank, Den norske Creditbank (DnC) carries out the technical part of this analysis. The assessment of the project's contribution to economic and social development is somewhat more discretional, but it is based on certain defined criteria. Most applications for support are settled by NORAD's Project Committee. Individual cases which exceed the maximum amounts, or which fail to be recommended by the Project Committeee, are to be submitted to the political leadership. Applications for loans are settled by the Minister. Accordingly, the executive work is extensive, as four levels are involved in the decision-making process (the Department for Industrial and Commercial Cooperation, the board of directors, the Project Committee, the political leadership).

1.3 Theoretical basis (cf. part 2, chap. 6-8)

As a first approach to the evaluation, the team outlined the ideal foreign aid administration, i.e. the planning and assessment of activities and projects. This ideal shows how a rational foreign aid organisation ought to allocate its means on various activities and countries in order to optimise their contribution to the organisation's objective (welfare in the receiving developing countries). In this connection it is indicated how restrictions, whether on types of activities or on amounts payable to individual activities and/or countries, will reduce the gains in the receiving developing countries.

The evaluation team shows how the Ministry of Development Cooperation's ultimate objective can be rationalised to the extent that the contribution of foreign aid activities or projects to the realisation of this objective, may in principle be measured by means of a social cost-benefit analysis. Investment support is considered development assistance on equal terms with other activities, and the Norwegian private enterprises are regarded as means used by the Ministry of Development Cooperation to achieve its general objectives. With the activity plan of the Department for Industrial and Commercial Cooperation as a basis, the main and partial objectives of the department are discussed, and it is demonstrated that these are, to a degree, in conflict with the ultimate objective of the Ministry of Development Cooperation.

All evaluations and recommendations are made in reference to this ideal.

1.4 Evaluations and recommendations (cf. part 3, chap. 9-11)

Are the current regulations and guidelines appropriate?

The evaluation team will heavily emphasize flexibility in an ideal investment incentive programme. A flexible system in which type of support, extent and conditions are decided in each case is considered the best system for administering the provisions for investment support. It is recommended that a social cost-benefit analysis of the individual project is used as a basis for the executive officers' negotiations with private investors. In these negotiations the officials should be relatively free in their attempts at putting together an optimal "support package". Ideally then, having as many provisions for investment and as few detailed regulations as possible seems advantageous. For such a flexible system to work satisfactorily, however, it is vital that the NORAD officials, or those who do the job on their behalf, are well versed in project analysis (particularly social cost-benefit analysis), as well as being competent negotiators. The team would therefore strongly recommend that systematic training in these areas be more heavily emphasized. Further, it is recommended that the provisions for investment support be considered in connection with other development assistance activities.

As long as the conditions for such a system do not exist, a relatively small range of instruments and a fair number of detailed regulations may be advantageous. The current regulations and guidelines will therefore be subjected to critical evaluation.

First, the common guidelines are discussed. These include a number of regulations which exclude potentially interesting projects on a formal basis. Consequently these regulations serve to reduce the value of the investment support as foreign aid.

The guidelines stipulate that a Norwegian enterprise with relevant production activities in Norway must be involved. This constraint can hardly be seen as anything but a restriction put on the use of foreign aid money out of consideration for Norwegian interests. Further, the guidelines seem to favour industrial undertakings at the expense of other types of business projects - a restriction for which it is difficult to find any plausible reason. Even if the guidelines seem to be applied flexibly, the team recommend that these restrictions be either altered or lifted. This ought also to be done with consideration to the regulations' signalling effects, so that potential applicants for support become aware of the possibilities that do in fact exist.

All guidelines concerning provisions for investment support seem to be tailored for new undertakings. In certain situations, however, it would make better sense to use foreign aid in support of on-going projects which may be closed down unless they receive support.

Further, the requirement that representatives of the host country (private or public) take a stake in the project seems to be a hasty decision, as the value of the project may well be higher otherwise. The evaluation team therefore recommend that owner interests etc. ought to be subject to negotiations between the Ministry of Development Cooperation/NORAD, the private investors and the authorities in the host country.

Second, the common guidelines include a set of criteria for finding whether a project deserves support (stimulates development). These criteria are difficult to apply and produce unreliable and ambigous results. Consequently, they are not working satisfactorily. The team recommend that these criteria be replaced with criteria of this kind:

> A project deserves support if it contributes to the increase of total welfare in the partner country of the Royal Norwegian Ministry of Development Cooperation.

In order to find out whether a project deserves support, a systematic use of social cost-benefit analysis is recommended. This approach will produce more reliable and unambigous results than the current criteria. Provided the officials receive training in this area, and provided information on the project and the host country has been systematically collected and arranged, these criteria will moreover prove to be relatively simple to use.

When the common regulations have been discussed, the special regulations related to the individual investment incentive scheme will be examined. It is maintained that some of these, related to the support for feasibility studies and the provisions for loans and guarantees in particular, are difficult to defend as foreign aid. The guidelines for support to feasibility studies ought to be altered so that studies carried out in Norway qualify for support as well. Secondly, the provision for repayment of the support if an enterprise is established, should be removed. Concerning the provisions for loans and guarantees, the team recommends that the collateral security required be reduced. This will imply a wider use of subordinated loan capital. At the same time it should be possible to use the foreign aid funding for equity capital. In this way NORAD would be sure to have a seat on the board and thereby gain insight into, and influence on, day-to-day operations. Any possible collateral security ought to be reserved for private lenders.

It is difficult to say anything about the relevance of the various financial instruments in general terms. Which instrument is the most appropriate in each case will depend on the nature of the project in question as well as possible financial restrictions in the host country. The provisions for loans and investment guarantees, and the support for initial training schemes and investment in basic infrastructure all seem to represent appropriate instruments. The evaluation team suggests the possibility for stipulating the loan in the local currency, so that the lender carries the risk of possible currency fluctuations. The team also suggests that the support for feasibility studies be discontinued. This support could not be considered development assistance even if the guidelines were altered in accordance with the suggestions above. It is the opinion of the evaluation team that far too many feasibility studies receive support, and that the Norwegian business community consciously uses the support for other purposes than those intended, such as export market research and promotion. An extensive inquiry carried out for NORAD in 1986 shows that very few projects receiving support for feasibility studies in the period between 1976 and 1985 were ever implemented (5%). According to the same inquiry, 70% of the enterprises that did implement their projects in the period between 1981 and 1985 responded that they would have conducted their feasibility studies even without support from NORAD. The evaluation team suggests that the Department for Industrial and Commercial Cooperation themselves, primarily in cooperation with other segments of the Ministry of Development Cooperation, identify good projects and then seek out companies that may be interested in implementing them, instead of financing Norwegian companies' search for projects in developing countries. Furthermore, perhaps investment guarantees should be taken over by ordinary insurance companies, with the premiums paid by NORAD.

Labour subsidies are proposed introduced as a new investment incentive measure. The use of this instrument will probably help make projects more labour-intensive than if the support was channeled through the provisions for loans and guarantees. As labour subsidies and support for initial training schemes are closely related intruments, linking the new instrument to the initial training support may be appropriate.

Is the present administration of the investment incentive schemes satisfactory?

The evaluation team concludes that the current guidelines are applied and interpreted relatively flexibly and pragmatically. This seems prudent in the light of our reservations concerning the guidelines, and the ideal administration of investment support outlined above. However, the team has two strong reservations concerning this approach. First, certain regulations ought to be applied consistently and similarly in all situations. In particular, this applies to the criteria for support, and the provision that projects that would be implemented without support shall not be supported unless important factors so indicate. Secondly, the ideal presumes that the executive officers share a useful set of references when designing the final "support package". Today, officials in the Department for Industrial and Commercial Cooperation share only a limited set of references. Consequently there is no guarantee that the current flexibility and pragmatism is advantageous from the point of view of foreign aid.

Today, executive officers' background, training and expertise vary. In many ways this may prove to be an advantage. As the guidelines are relatively vague on certain important points, however, and as no systematic project appraisal really exists, these variations may lead to systematic differences in the ways the officials consider applications. Training in social cost-benefit analysis would provide the officials with a common (and useful) set of references, and thereby make the consideration of applications more uniform and consistent.

The team recommends that the criteria for deciding whether a project deserves support (i.e. the extent to which it stimulates development) be interpreted on the basis of a social cost-benefit analysis. This type of project analysis ought to be in much wider use than at present. It should be used when appraising the projects at the time of application, as well as when following up the projects. Systematic use of social cost-benefit analysis requires that increased emphasis be put on regular collection and arrangement of information on projects and host countries. At the same time, the rule that projects can receive support only if they would not be implemented otherwise should be applied more strictly than today.

The actual course of events in many projects indicates that the commercial profitability analysis carried out during feasibility studies is generally too optimistic. It appears that the attitude in the Ministry of Development Cooperation/NORAD helps reinforce this trend. Problematic projects are undesirable, and consequently the need for the project to show a favourable financial result in the feasibility studies is emphasized. The prevalence of this attitude serves as an incentive for firms to produce overly optimistic calculations in the feasibility studies in order to increase their chances of receiving NORAD support.

The evaluation team recommends aiming at a more realistic appraisal of commercial profitability. In the current situation, in which DnC carries out the sensitivity analysis, the basic alternatives seem to be systematically too optimistic, whereas the risk is under-estimated by limiting the range of variables of the other alternatives.

Generally, the time used by the Department for Industrial and Commercial Cooperation in handling applications seems unreasonably long. In addition, many firms meet with unreasonably detailed requirements for preparation, and this adds unecessarily to their costs. The team recommends a number of simplifications in these areas.

A major problem is the complexity of the process of entering into an agreement, particularly in relation to the provisions for loans and guarantees. The strict security requirements posed by NORAD reduce the importance of this support as venture capital for top finance. It is recommended that the requirements for security be reduced, and that the documentation requirements be simplifed. In this connection it should be considered whether the Department for Industrial and Commercial Cooperation ought to employ their own legal expertise instead of drawing on the Legal Department in the Ministry of Development Cooperation.

The decision-making process can be very time-consuming, as it involves the board of directors, the Project Committee and the political leadership in the Ministry of Development Cooperation. The team suggests that the Project Committee, which in fact has no real influence on project planning, be eliminated. If the political leadership is to have a say, it must receive the application immediately after it has been considered by the board of directors.

Against the background of current project appraisal in the Department for Industrial and Commercial Cooperation, which heavily emphasizes microeconomic profitablity and uses unsatisfactory criteria for appraising macroeconomic profitability, the team recommends that the department officials be trained in social cost-benefit analysis. It is suggested that a computer based system for project appraisal and evaluation be developed. A prerequisite for proper project evaluation and both internal and external reporting, is that statistics and other information material be stored and systemized more properly than what has been the case to date in the Department for Industrial and Commercial Cooperation. Further, it is proposed that the current arrangements with the same officials working on both investment and export cases, be altered. The investment cases should receive priority.

Today the executive officers are required to have substantial in-depth competence in a wide range of fields. They are expected to function as business consultants, legal experts and specialists on developing countries. The evaluation team holds these requirements to be unrealistic. It is recommended that the officials concentrate on building up specialist expertise on developing countries. Based on this expertise investment handbooks containing relevant information for firms that want to consider investment projects in the developing countries in question should be written. Further, it is recommended that the executive officers be granted the opportunity to travel to the countries in question more often and to spend longer periods of time there. In this way they would be in a position to follow up projects over time and to identify desired projects and project participants. As for the budget, the team recommends increased spending on internal planning, administration and internal development.

Some of the projects that have benefited from investment incentives have been examined more closely. The project evaluations carried out by the team seem to indicate that most projects contribute to the increased welfare of the host country, at least according to the country's own evaluation, and assuming that the countries would neither receive foreign aid nor other foreign capital if the projects were not implemented. The value of the projects is drastically reduced if it is assumed that the countries would receive aid and/or other foreign capital even if the projects were not implemented. Generally, however, the welfare gains seem positive.

Despite these favourable results, however, the team does not conclude that the support received by the projects in question represents useful spending of foreign aid money. The main reason is that a great many projects are likely to have been implemented even without financial support. The fact that the firms ought to try to find alternative finance does not appear to be a relevant issue in the negotiations between the Department for

Industrial and Commercial Cooperation and the investors. In general, it is hard to accept that projects whose feasibility studies show high profitability and low commercial risk would have any problems at all in finding finance on commercial grounds, except when the political risk seems high. The fact that the largest and most prosperous firms are those who benefit the most from investment support today, increases the probability that the projects would have been implemented even without support.

Does support for investment represent a reasonable way of allocating foreign aid money?

As stated above, the evaluation team is sceptical to the use of foreign aid money within the present investment incentive programme. In the team's opinion it is probable that there are other ways of using these means that can produce higher welfare gains in the partner countries of the Ministry of Development Cooperation. This is partly due to the organisation and administration of the present system. Today there is no guarantee that the money is channeled into those projects which produce the highest welfare gains. In addition, it is probable that many projects that receive support would have been realised anyway.

The evaluation team emphasizes that if investment incentives are to be considered foreign aid, they must be subject to the same requirements as other foreign aid: the money must generate the highest possible marginal rate of return in the form of increased welfare in the developing countries. This means that the investment incentive programme can no longer be seen in isolation, but will have to be integrated in a total plan for development assistance. This plan's objective would be to identify the best ways of applying foreign aid money. Project identification would be a key issue, as well as the evaluation of whether private or public finance and operation would be preferrable. Applications from private firms should be approved only if this kind of support produces greater gains than alternative uses of the money, and it is essential that the support have the form which produces the highest possible welfare effect in the developing countries.

PART ONE:

THE HISTORY AND SCOPE OF
THE PROVISIONS FOR INVESTMENT SUPPORT

CHAPTER 2:
THE INTRODUCTION OF THE PROVISIONS FOR INVESTMENT SUPPORT AND OFFICIAL POLICY

Since the first systematic framing of Norwegian foreign aid policy in Report no. 23 (1961-1962) to the Storting Norwegian authorities have stressed that foreign aid should seek not only to grant traditional aid, but also to "contribute in meeting the developing countries' need for inflow of capital on commercial grounds"[1].

In accordance with this view, a set of policy instruments has been developed in order to stimulate Norwegian export to, and Norwegian private investments in, developing countries. The first investment incentive scheme, the provisions for investment guarantees, was introduced in 1963. In 1967 support for feasibility studies and support for investment in basic infrastructure was introduced. The provisions for loans and guarantees were introduced in 1979, after having been announced i Report no.94 (1974-75) to the Storting. The most recent scheme, support for initial training schemes in connection with Norwegian business ventures in developing countries, was introduced in 1983.

The introduction of the provisions for investment guarantees was proposed in Report no. 54 (1962-63) to the Storting, concerning Norway's commercial aid to the developing countries. In the same proposition the idea of support for feasibility studies and investments in basic infrastructure was introduced[2].

The Onarheim Committee's report and the subsequent Proposition no. 109 (1966-67) to the Storting contributed extensively to the development of the provisions for investment support. The committee proposed the following five measures:[3]

1. Improvements in the provisions for investment guarantees, for instance by extending the range of risks covered and lengthening the guarantee period.
2. Support for feasibility studies to Norwegian commercial projects in developing countries.
3. Fiscal measures, primarily agreements in order to avoid double taxation.
4. Direct financial aid in the form of long term loans for part financing of private investments.
5. Bilateral development assistance projects in connection with private investments, (meaning "various basic investments of economic and social character in order to improve conditions for private commercial activities").

When debating Proposition no. 109 (1966-67) to the Storting, the Foreign Affairs Committee stressed that Norwegian foreign aid is intended to further development and benefit the interests of the developing countries. These intentions are also meant to apply for aid channeled through the industrial schemes. However, designing the public aid programmes with a view to strengthening the international competitiveness of Norwegian trade and industry was also advocated.

> "However, when it comes to economic development, cooperation for mutual benefit is often a highly effective principle. For Norway's own part, it should be an objective to seek to stimulate commercial interest in activities in developing countries so that we will not lag behind developments in this field, which will presumably continue in an accelerating pace. The developing countries may undoubtedly become good export markets for Norwegian goods and expertise."[4]

In other words, the introduction of the industrial schemes was based on two diverging considerations: the developing countries' need for development and Norway's industrial competitiveness.

In Report no. 36 (1984-85) to the Storting, Report no. 34 (1986-87) to the Storting, and Recommendation S. no. 186 (1986-87), the wish to strengthen cooperation between development assistance authorities and the business community is further stressed. At the same time, though, there are signals indicating clearer limitations in the use of foreign aid money. This will inevitably affect the application of the industrial schemes.

In Recommendation S. no. 186 (1986-87), the Foreign Affairs Committee refers to the fact that in accordance with the objectives set for Norwegian foreign aid, a number of earlier reports have called for a clear distinction between measures whose main objective is to further the internationalisation of Norwegian industry, and measures which clearly seek to stimulate development in the developing countries (cf. Recommendation S. no. 225 (1980-81), Recommendation S. no. 137 (1981-82) and Recomendation S. no. 189 (1982-83), etc). The committee proposes the following guidelines as a basis for further development of the industrial schemes:

- The principle objectives for the provisions must be to create economically sound activities in the developing countries, thereby contributing to their social and economic development.
- The basis for the use of industrial incentives is found in the developing countries' own priorities and the call for stimulation of development in our over-all foreign aid objective. The criteria for evaluating whether the developmental effect of a project is good enough as compared to the support in question should be made clearer.

- Support may be issued to commercial projects in Norway's main partner countries, other partner countries and other developing countries within Norway's special cooperation areas. Support may also be granted to other countries which according to the OECD are classified as least developed countries (LDC), lower income countries (LIC) (close to 70 countries) and lower middle income countries (LMIC) (30-plus countries). The committee holds that countries with a higher income level (UMIC) should not benefit from industrial schemes financed by foreign aid money. At the same time the Government was asked, in connection with the announced revision of the provisions for investment support, to consider whether they ought to be reserved for a more restricted group of poor developing countries.

Further, the committee goes in for directing the industrial schemes towards Norway's partner countries to a greater extent:

> "The committee, would like to point out that if the investment and export incentives are not deliberately directed towards our partner countries, strictly commercial considerations will lead the companies to newly industrialised developing countries and other attractive markets to which private capital can be procured in any case."[5]

In accordance with this, the Minister of Development Cooperation has announced a more active approach towards the trades and industries in order to direct their interest towards the areas which have been given priority:

> "Bearing in mind the heavy emphasis put on main partner countries and special areas, it is particularly evident that the Ministry should take a more active approach towards the Norwegian business community, as we endeavour in relation to SADCC. To a lesser extent then, the Ministry ought to be handling applications which from the point of view of foreign aid may seem quite arbitrary."[6]

Concerning the relationship between foreign aid related industrial schemes and the internationalisation of Norwegian industry, the committee states in its report:

> "The committee affirms that the internationalisation of Norwegian industry is an important issue related to Norwegian trade policy. In accordance with foreign aid objectives, however, we wish to emphasize that measures meant to further this internationalisation cannot be financed by the foreign aid budget in cases where the measures do not clearly stimulate development in developing countries. "[7]

In the debate on Report no. 36 (1984-85) to the Storting and its Supplementary Report (Report no. 34 (1986-867) to the Storting) it was decided that provisions for investment support should be given priority over provisions for export in the allocation of foreign aid money:

> "Concerning the participation of Norwegian firms, the committee finds that investment incentives in developing countries are the more interesting, because they imply that private business

enterprises put capital, know how and other resources into the industrialisation of developing countries. When budgeted means are being allocated, it is evident that investment incentives ought to have priority over export incentives."[8]

According to the Minister for Development Cooperation, the industrial schemes' relation to foreign aid policy will consequently be geared more in the direction of development assistance policy, clearly distinct from the internationalisation of Norwegian business interests.[9]

CHAPTER 3:
THE OBJECTIVES, HISTORY AND DEVELOPMENT OF THE INDIVIDUAL INSTRUMENTS FOR INVESTMENT SUPPORT

3.1 Investment guarantees

Investment guarantees and special term guarantees for exports to developing countries are administered by the Norwegian Guarantee Institute for Export Credits (GIEK) under a joint scheme. This special scheme for guaranteed exports to and investments in developing countries was introduced in 1963. Since then it has been renewed and modified through various parliamentary resolutions.[1]

When this scheme was introduced in Norway in 1963, similar schemes existed in only three other countries: the USA, Japan and West Germany.

The conditions for granting investment guarantees were stipulated as follows in 1963 (cf. Proposition no. 108 (1962-63) to the Storting):

> "The Government may guarantee private Norwegian investments in developing countries if these investments contribute to or form the basis for considerable economic growth in the country in question."

In 1968 the expression "contribute to or form the basis for considerable economic growth" was changed to "are suited for furthering economic growth". This latter phrasing has been used in the special scheme's regulations since then.

The guarantee covers political risk only, meaning losses incurred through expropriation, confiscation, the destruction of property through actions of war etc. and blockage of payment on various grounds. The cover given by the guarantee is limited to 90% of possible losses within the first 20 years.

When introduced, the provisions for guarantees (including guaranteed export credits on special terms) had a budget of NOK 300m, of which investment guarantees were to be kept below an upper limit of NOK 50m. This limit on investment guarantees was lifted by a parliamentary decision in 1965. Subsequently, investment and export credit guarantees have been budgeted together. The guarantee budget reached a maximum of NOK 12 bn following the so-called "Ship export campaign" in 1982. Since then, the budget has been gradually reduced to NOK 6 bn in 1987.

GIEK handles applications for support under the special scheme, but NORAD evaluates whether the investment (or export) project "is suited for furthering economic growth in the country in question". If NORAD finds that an investment satisfies these requirements, it is normally recommended that guarantee be granted.

However, a positive recommendation from NORAD does not necessarily imply that guarantee is granted under the special scheme. The final decision depends on GIEK's evaluation of the risk involved, and if large amounts are involved, the application will have to be approved by the Ministry of Trade. In its recommendations NORAD clearly states that neither risks nor terms for the guarantee have been considered. Based on an evaluation of the risks involved, GIEK can reject guarantees for projects in particularly risky countries.

According to the rules in force, the Norwegian Ministry of Trade is authorized, in special cases, to approve applications for guarantee even if the Ministry of Development Cooperation/NORAD has turned them down. This "rule of exception" has been in force since 1977 and was introduced in connection with guarantees for export credits under the so-called ship export campaign.[2]

Until 1983 it was assumed that compensation was to be paid via the foreign aid budget and GIEK's risk reserves, with no distinction between projects recommended by NORAD and projects approved by the Ministry of Trade withouth NORAD's recommendation (cf. Proposition no.42 (1984-85) to the Storting).

In the 1983 Budget Proposal a distinction between NORAD-recommended projects and other projects was proposed, so that only losses incurred by NORAD-recommended projects were to be covered by the foreign aid budget. According to the proposals, losses on projects not recommended by NORAD would be covered by support that was not tied to foreign aid. In Report no. 34 (1986-87) to the Storting, it was suggested that all losses on guarantees under this scheme should be covered by the budget of the Ministry of Trade.

A new special scheme for developing countries is now on its way. The current scheme was discontinued at the end of 1987[3]. It is still not clear how the new provisions for investment guarantees will be designed.

3.2 Support for investment in basic infrastructure

Support for investment in basic infrastructure is based on Proposition no. 109 (1966-67) to the Storting, and Recommendation S. no. 167 (1967-68).

The objective is to assist Norwegian enterprises wanting to establish manufacturing plants in developing countries, in places were economic or social conditions or the lack of infra-structure makes such projects particularly difficult or expensive.

The support is meant to finance basic investments such as roads, wharfs, local power stations and vocational training for native workers; these are investments which in industrialised countries would normally have been made by the authorities. This support is required to have a reasonable magnitude in relation to the total investment. It must be demonstrated that the local population will benefit from the basic investments' positive effects and that the investments are essential to the establishment of the plant. Up to 80 % of basic investment costs may be covered by foreign aid.

Support can only be given if the developmental effect of the project which is dependent on the basic investment can be clearly identified and appraised.

Few projects have benefited from this support until now, and in Report no. 36 (1984-85) to the Storting, it is presumed that this trend will continue, as the provisions for loans and guarantees provide for basic investments as well.

3.3 Support for feasibility studies

This scheme is based on Proposition no. 109 (1966-67) to the Storting and Recommendation S. no. 67 (1967-68). The objective is to serve as an incentive for Norwegian firms to examine the possibilities for establishing firms in developing countries. Up to 50% of the total costs can be covered by support - in special cases even more. The feasibility study shall clarify conditions which are essential to deciding whether to establish a plant, such as market potential and technical, legal and financial conditions.

3.4 Provisions for loans and guarantees

The provisions for loans and guarantees are founded on Proposition no. 119 (1978-89) to the Storting and Recommendation S. no. 321 (1978-79). The guidelines were established in governmental resolution of 8 November 1979; supplementary guidelines were laid down in Proposition no. 84 (1982-83) to the Storting and Recommendation S. no 234 (1982-83).

The scheme's objective is to contribute to the development of trade and industry in developing countries. Under the provisions for loans and guarantees, partner companies may obtain loans, or guarantees for raising loans, in connection with investments in developing countries; these are investments in which Norwegian partners put up venture capital or make other contributions. Loans for investment in basic infrastructure may also be obtained. Normally, with the exception of investments in basic infrastructure, loans and guarantees covered by foreign aid shall not exceed 50% of total finance. The borrowing terms (repayment period, interest rate etc.) are modified according to the financial capacity of the individual project, but the loan will include a grant element of at least 25% calculated at a fixed 10% discount rate. Loans for investment in basic infrastructure may involve a grant element of 85%. All projects receiving support must have been appraised and found to stimulate development.

The provisions for loans and guarantees were first announced in Report no. 94 (1974-75) to the Storting:

> The Government will (...) promote the establishment of provisions for loans and guarantees financed by public means in order to launch projects given priority in developing countries for which Norwegian enterprises are specially qualified."[4]

In Recommendation S. no. 192 (1975-76) the majority in the Foreign Affairs Committee (the Labour Party, the Centre Party and the Christian Democratic Party) agreed on the intentions of the provisions for loans and guarantees proposed by the Government.

The Conservative members of the committee pointed out that Norwegian firms are generally small and indicated that the suggested instruments would probably prove inadequate. These members recommended stronger instruments, and suggested the establishment of a Norwegian Industrial Fund for developing countries. In addition to granting loans and guarantees, this fund, according to its proposers, should be used to provide share and stock capital to partner companies in developing countries.[5]

In Proposition no. 119 (1978-79) to the Storting the provisions for loans and guarantees were primarily proposed with reference to the developing countries' wish for more substantial transfers of private capital, in particular through direct investments.

The Foreign Affairs Committee in the Norwegian Parliament commented:

> "The committee refers to Recommendation S. no. 192, (1975-76), and to the various notes to the recommendation.
>
> The committee also refers to what was pointed out in the proposition: projects that receive loans shall have a clear stimulating effect on development, and projects which are in direct conflict with the criteria for development cooperation are not to be supported.

> The committee agrees with the Government in its view that in principle all developing countries can be eligible for loans and guarantees, as it is assumed that all countries and projects are evaluated on the basis of the statement above and the criteria which are stated in the proposition."[6]

In connection with the parliamentary debate on the 1983 foreign aid budget,[7] it was decided to extend the provisions for loans and guarantees so that venture capital in the form of subordinated loans could be provided for. The background was

> "that in some cases, e.g. when the risk relating to investments in developing countries is particularly high, public venture capital may be required in order to stimulate increased investments in developing countries. Subordinated lending will mean that security is not reqired in order to be granted a loan under the provisions for loans and guarantees. This will be the principal difference between ordinary loans and subordinated loans under the provisions for loans and guarantees".[8]

In Recommendation S. no. 234 (1982-83) specifies that most subordinated loans should be granted in connection with the establishment of businesses in the least developed countries and in our main partner countries.

3.5 Support for initial training schemes

This scheme is founded on Proposition no. 109 (1966-67) to the Storting and was introduced in its present form in 1983. Until 1983 training grants for newly established enterprises in developing countries were to some extent administered under the provisions for investment in basic infrastructure. To a limited extent support for training related to the individual business has been granted under the fellowship provisions as well.

The objective of support to initial training schemes is to assist Norwegian firms that establish manufacturing plants in developing countries in which a shortage of skilled local labour makes the project particularly difficult or expensive. In order to obtain support it is required that the investment project has a stimulating effect on development, and that this effect can be clearly identified and appraised.

Support for initial training schemes can be given to cover measures in connection with the training of local workers before and during the establishment of the business enterprise. Within the limits of an agreed maximum, up to 50% of total training costs may be covered by NORAD. To a great extent this support is used for the training of key personnel at middle and top management levels.

CHAPTER 4:
THE SCOPE AND DISTRIBUTION OF THE VARIOUS INSTRUMENTS FOR INVESTMENT SUPPORT

4.1 Annual investment support

Payments under the provisions for investment support make up a relatively modest part of total public expenditure on developing countries and international humanitarian aid. As illustrated in table 1, however, this share has clearly increased since the mid 1970s. In the period between 1976 and 1981 investment incentives accounted for 0.01 - 0.54 per cent of total annual publicly funded development assistance. In the period between 1982 and 1986, 1985 excluded, investment support amounted to 1.0 - 1.4 percent of the annual total.

Table 1: Investment incentives as a share of total public Norwegian aid, 1976-86. (Amounts in NOK, current prices).

Year	Total public aid	Annual investment incentive payments	Percentage of public aid
1976	1,191,300,000	159,232	0.01
1977	1,569,900,000	770,115	0.05
1978	1,860,700,000	1,408,710	0.08
1979	2,169,800,000	3,199,472	0.15
1980	2,330,600,000	6,858,330	0.29
1981	2,585,800,000	14,030,670	0.54
1982	3,603,400,000	36,005,296	1.00
1983	4,258,400,000	58,437,099	1.37
1984	4,431,700,000	50,039,680	1.13
1985	4,945,800,000	32,768,545	0.66
1986	5,890,800,000	64,146,654	1.09

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD and NORAD's annual reports.

Apart from the support for basic investments received by a project in Brazil in 1968, nothing but support for feasibility studies was paid out until 1978. In 1978 support for investment in basic infrastructure came into use again. However, table 2 indicates that it was not until the introduction of the provisions for loans and guarantees that support for investment reached a significant volume. In the period between 1976 and 1986 payments under the provisions for loans and guarantees accounted for nearly 86% of total payments of support for investment. Support for feasibility studies and investment in basic infrastructure accounted for 6.5% and 5.5% respectively, while support for initial training schemes, which was not introduced until 1983, accounted for 2% of the total investment support. No compensations have been paid out under the provisions for investment guarantees.[1]

Table 2: Annual investment support as allocated among the different schemes. (Amounts in NOK, current prices).

Year	Support for feasibility studies	Loans	Support for initial training	Support for investment in basic infrastructure
1976	159,232	-		-
1977	770,115	-		-
1978	1,036,710	-		372,000
1979	3,005,472	-		194,000
1980	782,330	-		6,076,000
1981	481,870	10,750,000		2,798,800
1982	1,292,296	33,910,500		802,500
1983	683,945	56,190,000	-	1,563,154
1984	1,952,767	46,600,000	-	1,486,913
1985	3,879,083	27,306,000	1,583,462	-
1986	3,353,095	55,130,000	3,788,559	1,875,000
Total	17,396,915	229,856,500	5,372,021	15,168,367

Source: Compiled on the basis of statistics from the Department for Industrial and Commercial Cooperation, NORAD.

Table 3 illustrates annual commitments as distributed among the various provisions for investment support (investment guarantees not included) in the period between 1976 and 86. There are considerable differences between some of the schemes. In part, this is due to the fact that commitments are retracted as firms fail to fullfil their obligations to NORAD (cf. the support for feasibility studies). In part, it is due to the fact that some firms never avail themselves of the promise, often because their projects never materialize. Besides, the decision-making process involves an extensive period of waiting between commitment and payment.

Table 3: Annual commitments for investment support allocated among the different schemes (investment guarantees excepted), 1976-86. (Amounts in NOK, current prices).

Year	Support for feasibility studies	Provisions for		Support for initial training	Support for basic invest.
		Loans	Guarantees		
1976	1,646,593	-	-	-	-
1977	1,608,875	-	-	-	-
1978	3,125,195	-	-	-	7,299,000
1979	1,307,342	-	-	-	-
1980	851,363	10,750,000	4,500,000	-	-
1981	1,662,460	5,197,500	3,465,000	-	7,189,000
1982	1,548,322	38,235,000	13,727,000	-	270,000
1983	3,100,000	81,138,000	5,794,000	2,172,000	-
1984	7,704,980	44,239,000	3,830,000	1,688,600	-
1985	5,902,208	21,184,000	-	8,538,400	2,500,000
1986	5,748,695	67,500,000	7,600,000	1,580,000	8,500,000
Total	34,206,033	268,243,500	38,916,000	13,979,000	25,650,000

Source: Compiled on the basis of statistics from the Deptartment for Industrial and Commercial Cooperation, NORAD.

4.2 Support for feasibility studies

From the time this support was introduced in 1966/67 and until the end of 1986, 406 feasibility studies had been promised support. In some cases the same project received more than one promise of support. Between 1968 and 1976 only 5-7 feasibility studies were promised support annually. As table 4 illustrates there was a considerable increase in this number as from 1976.

Table 4: Annual commitments of support for feasibility studies and average amount promised per project. (Amounts in NOK, current prices.)

Year	Promised amount	Number of commitments	Average amount per project
1968	10,000	1	10,000
1969	81,656	6	13,609
1970	116,500	6	19,417
1971	255,500	5	51,100
1972	152,500	5	30,500
1973	174,000	7	24,857
1974	171,470	6	28,578
1975	233,679	6	38,947
1976	1,646,593	33	49,897
1977	1,608,875	27	59,588
1978	3,125,195	40	78,130
1979	1,307,342	26	50,282
1980	851,363	14	60,812
1981	1,662,460	29	57,326
1982	1,548,322	26	59,551
1983	3,100,000	38	81,579
1984	7,704,980	56	137,589
1985	5,902,208	39	151,339
1986	5,748,695	36	159,686
Total	35,401,338	406	

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

Both the total amount promised annually and the average amount promised per project are increasing. This increase can partly be accounted for by the rise in prices, but even if the price rise is adjusted for, there has been an increase.

Support has been promised to 214 Asian projects (53% of the total number of commitments), and to 156 African projects (38% of the total number of commitments).

Table 5 shows that African projects received proportionally fewer commitments between 1981 and 1986, showing a clear decrease as compared to earlier periods, whereas there has been a clear increase in the number of commitments given for feasibility studies in

Asia. Commitments for projects in Europe and Latin America have accounted for a relatively modest part of the total number of commitments given in each period.

Table 5: Annual number of commitments of support for feasibility studies by continent in various periods. The figures in brackets indicate per cent of total for each period.

Continent	1968-75	1976-80	1981-86	Total
Africa	16 (38)	62 (44)	78 (35)	156 (38)
Asia	20 (48)	67 (48)	127 (57)	214 (53)
Latin America	5 (12)	2 (1)	16 (7)	23 (6)
Europe (Portugal and Malta)	1 (2)	9 (7)	3 (1)	13 (3)
Total	42 (100)	140 (100)	224 (100)	406 (100)

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD and NORAD's annual report.

As many as 248 commitments (61%) have been given for feasibility studies in lower income countries (LIC). This is clearly in line with Norwegian authorities' desire to stimulate increased industrial activity in the poorest developing countries. As illustrated in table 6, 65 feasibility studies (16% of the total number) have been promised support in lower middle income countries (LMIC). 93 commitments have been given to upper middle income countries (UMIC). As of July 1987 projects in upper middle income countries (UMIC) will no longer receive support.

The relative proportion of commitments given to projects in the different categories remained unchanged from 1976-80 to 1981-86.

Table 6: Number of commitments of support for feasibility studies as distributed among categories of countries[2] during different periods. The figures in brackets indicate per cent of total number of commitments for each period.

Country category	1968-75	1976-80	1981-86	Total
LIC	23 (55)	88 (63)	137 (61)	248 (61)
LMIC	6 (14)	22 (16)	38 (17)	66 (16)
UMIC	13 (31)	30 (21)	49 (22)	92 (23)
Total	42 (100)	140 (100)	224 (100)	406 (100)

Source: Statistics from the Department for Industrial and Commercial Cooperation, NORAD and NORAD's annual report.

The individual firm decides in what country it wishes to do its feasibility studies. Malaysia is clearly the most popular country, with as many as 53 commitments for support. This accounts for 13% of the total number of commitments. Most of these were given between 1981 and 1986 when Malaysia experienced an economic boom. Table 7 shows that in some of our main partner countries relatively many projects have received commitments. In India 34 feasibility studies were promised support, in Tanzania 33. In the period between 1981 and 1986 China also became a very popular country for feasibility studies.

Table 7: Number of feasibility studies as distributed among various countries during different periods. The figures in brackets indicate per cent of total number of commitments.

Country	1968-75	1976-80	1981-86	Total number	
Malaysia	3	15	35	53	(13)
India	2	10	22	34	(8)
Tanzania	-	16	17	33	(8)
Indonesia	7	2	19	28	(7)
Kenya	5	12	10	27	(7)
Sri Lanka	1	15	6	22	(5)
China	-	-	16	16	(4)
Pakistan	1	3	9	13	(3)
Portugal	-	10	3	13	(3)

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD and NORAD's annual reports.

Table 8: Annual commitments of support for feasibility studies as distributed among main partner countries and other developing countries. (Amounts in NOK, current prices. The figures in brackets indicate number of projects).

Year	Com.ments to main partner countries		Average amount promised to per project	Com.ments to other developing countries		Average amount promised per project
1968				10,000	(1)	10,000
1969	11,050	(1)	11,050	70,606	(5)	14,121
1970	25,000	(2)	12,500	116,499	(4)	29,125
1971	7,500	(1)	7,500	248,000	(4)	62,000
1972	7,000	(1)	7,000	145,000	(4)	36,250
1973	5,000	(1)	5,000	169,000	(6)	28,167
1974	26,250	(1)	26,250	145,220	(5)	29,044
1975	78,750	(3)	26,250	207,429	(3)	69,143
1976	721,035	(16)	45,065	925,558	(17)	54,445
1977	708,895	(11)	64,445	899,980	(15)	59,999
1978	1,803,095	(24)	75,129	1,322,100	(16)	82,631
1979	754,500	(7)	107,786	552,842	(19)	29,097
1980	64,000	(2)	32,000	787,363	(12)	65,614
1981	405,943	(6)	67,657	1,256,517	(23)	54,631
1982	471,103	(10)	47,103	1,077,219	(16)	67,326
1983	739,990	(10)	73,999	2,360,010	(28)	84,286
1984	2,050,713	(21)	97,653	5,654,267	(35)	161,550
1985	2,068,776	(18)	114,932	3,833,432	(21)	182,544
1986	1,172,865	(10)	117,287	4,575,830	(26)	175,993

Source: Based on statistics from the Dept. for Industrial and Commercial Cooperation, NORAD.

From the introduction of this support until the end of 1986, a total of 145 feasibility studies in main partner countries (36% of the total number) were promised support. The only difference between main partner countries and other developing countries in this respect, is that NORAD may cover more than 50% of the expenses if the project is related to measures that have been assigned priority in main partner countries. However, few firms have received more than 50 %. If we study the proportional distribution, there has been an increase in the number of feasibility studies in Norway's main partner countries during 1976-86 as compared to 1968-75.

Table 8 shows that the average amount promised per project in main partner countries is less than for projects in other developing countries (with the exception of 1977, 1979 and 1981). This may seem to indicate that the feasibility studies carried out in Norway's main partner countries are less extensive than in other developing countries.

Support is not paid out until NORAD receives a report on the implementation of the project, with bills verified by certified accountant. Support has not been paid out to 133 projects that were promised support. This accounts for 33% of the total number of commitments.

In a study from the Norwegian School of Management on "The relation between feasibility studies and the establishmnet of Norwegian enterprises in developing countries" (Akselsen and Trondsen, 1986), the writers distinguish between projects in which the feasibility study was never carried out in spite of commitment of support, and projects in which the feasibility study has been carried out, but for which no report was submitted to NORAD. The firms in the latter category have stated the following reasons for failing to submit a report:

- The enterprise was going to be established so soon that there would be no point in making use of the support
- Deficient internal routines caused the report and the bills not to be submitted
- Missing invoices
- It was held that the project was not qualified for receiving public funds. (In spite of having been promised public support!)

The 133 feasibility studies to which support was promised but never paid out, are distributed among the various country categories as follows:

LIC:	84 (63)
LMIC:	18 (14)
UMIC:	31 (23)
Total:	133 (100)

43 of these (32%) are feasibility studies related to projects in Africa. 73 (55%) are related to projects in Asia. 46 projects to which support was never paid out (32%) were located in Norway's main partner countries. These figures roughly reflect how projects that have received commitments of support are distributed according to country category and continent (cf. tables 5 and 6).

Grouping the firms according to type of business and country category has not seemed appropriate, as numerous trades and industries are represented, and there is little connection between line of business and country category. Some firms, however, clearly stand out as major "consumers" of support for feasibility studies. As table 9 illustrates, A/S Norcem/A/S Scancem comprises a group of its own, having been promised support for as many as 31 feasibility studies and having received support from NORAD for 17 of them. Business enterprises have been established in 5 instances. Dyno Industrier A/S has been promised support for 13 feasibility studies and has received support for 4 of them. Business enterprises have been established in 3 instances, whereas 4 projects may still be implemented. Norsk Hydro A/S has been promised support for 12 feasibility studies and has received support for 5 of them. Business enterprises have been established in 2 instances. Jotun A/S has been promised support for 5 feasibility studies, and has received support for 2 of them. 1 project has been implemented, whereas 2 projects may still be implemented.

During the period 1976-85 a total of 328 commitments of support for feasibility studies were made. Business enterprises were established in 16 cases only, i.e. a proportion of 5%.

Table 9: The major users of support for feasibility studies, 1968-86.

Company	Number of com.ments	Number of payments	Implem. projects	Abandoned projects	May still be impl.
A/S Norcem/A/S Scancem	31	17	5	17	2
Dyno Industrier A/S	13	4	3	5	4
Norsk Hydro A/S	12	5	2	9	-
Elkem Spigerverket	6	4	1	2	-
FORINDECO	6	6	2	3	1
National Industri A/S	6	2	2	2	1
A/S Elektrisk Bureau	6	5	1	2	1
Jotun A/S	5	2	1	1	2

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD. (Columns 3, 4, and 5 cannot be summarized to get column 1, as more than one commitment may have been given to the same project).

Some of the feasibility studies have resulted in licensed production, exports or consultancy assignments. However, according to the guidelines for the support for feasibility studies, the Department for Industrial and Commercial Cooperation cannot regard these as "successful projects".

4.3 Provisions for loans and guarantees

As illustrated in table 10, loan commitments for a total of NOK 268.2 m and guarantee commitments for NOK 38.9m were given in the 1978-86 period. A total of NOK 229,8m was paid out as loans during this period.

Table 10: Annual loan and guarantee commitments and annual payments. (Amounts in NOK, current prices. The figures in brackets indicate number of commitments).

Year	Loan commitments	Guarantee commitments	Loans paid out
1980	10,750,000 (2)	4,500,000 (2)	-
1981	5,197,500 (2)	3,465,000 (2)	10,750,000
1982	38,235,000 (4)	13,727,000 (2)	33,910,500
1983	81,138,000 (9)	5,794,000 (4)	56,190,000
1984	44,239,000 (5)	3,830,000 (1)	46,600,000
1985	21,184,000 (5)	-	27,306,000
1986	67,500,000 (6)	7,600,000 (1)	55,130,000
Total	268,243,500 (33)	38,916,000 (12)	229,856,500

Source : Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

From the time these provisions came into force in 1980 until the end of 1986, a total of 33 loan commitments and 12 promises of guarantees were given. The provisions for loans and guarantees include 29 projects in 17 countries[3] (cf. table 11).

Table 12 shows that a total of 21 loan commitments were given for projects in Asia, amounting to NOK 184.1m (current prices)[6]. Two of these commitments were never used because the projects, one in China and one in Malaysia, failed to be implemented. These commitments accounted for NOK 38m. 11 commitments, accounting for close to NOK 70m, have been given to projects in Africa. Loan commitments for 2 projects in Western Africa, accounting for a total of NOK 23m, have not been used. Further, a loan commitment has been granted to a project in Portugal.

Table 11: Provisions for loans and guarantees. Projects that have been promised loans from 1980-86, distributed according to country and country category. (Amounts in NOK, current prices. The figures in brackets indicate number of projects).

Country	Country category	Loan commitment	Trade/Industry	Notes
Sri Lanka (6)	LIC	2,000,000	Cultivation of green plants	The firm was promised a loan in 1980 and 1983.
		900,000	Production of wooden toys	The firm has been closed down.
		2,230,000	Production of fishing gear	The firm has been closed down.
		1,285,000	Production of steel tubes	
		1,000,000	Printing works	
		4,000,000	Production of marine electronic equipment	
Malaysia (4)	UMIC	13,057,000	Production of telephones	The project has been shelved and the loan was never paid out.
		3,500,000	Production of wheelbarrows	
		4,650,000	Paint production	
		1,500,000	Production of powdered varnish	
Indonesia (2)	LIC	30,570,000	Production of adhesives/formaldehyde	Guarantees for NOK 12,200,000 were granted in 1982. These were later converted to loans.
		11,100,000	Oil exploration lab services	
Thailand (2)	LMIC	10,955,500	Production of frozen fish/ industrial kitchens	The firm received loan commitments in 1981 and 1981[4].
		1,800,000	Explosives production	
Togo (2)	LIC	9,000,000	Marble/brickworks	
		3,300,000	Grain terminal	The Norwegian partner withdrew from the project and the loan was never paid out.
Tanzania (2)	LIC	630,000	Travel agency	
		6,100,000	Airport ground service	Swedfund and IFU participate with share capital.
Jordan (1)	UMIC	29,000,000	Shipowners	The loan was given to Jordan National Shipping Line Co.Ltd., a publicly-owned company.
China (1)	LIC	25,000,000	Oil exploration lab.services	The project has not been implemented and the loan was never paid out.

Table 11. (contd.)

Country	Country category	Loan commitment	Trade/Industry	Notes
India (1)	LIC	21,000,000	Fibreglass tube production	
Gambia (1)	LIC	20,000,000	Cement production	The project has not been implemented and the loan was never paid out.
Guinea (1)	LIC	18,000,000	Ship demolishing for the production of iron reinforcement	
Pakistan (1)	LIC	14,135,000	Production of powdered adhesives/ plastics	NOK 5,720,000 of the loan was earmarked for inv. in basic infratrstructure
Portugal (1)	UMIC	14,000,000	Production of fittings systems	The first loan commitment was given in 1980. In 1985 a NOK 4m guarantee from 1980 was converted to a loan.
Nepal (1)	LIC	6,500,000	Production of turbines	Part of the loan was earmarked for inv. in basic infrastructure. This part has later been converted to a grant.
Egypt (1)	LIC	5,950,000	Paint production	
Sudan (1)	LIC	5,754,000	Fishing project	The project has been closed down.
Kenya (1)	LIC	1,227,000	Cultivation of green plants	

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

Table 12: Loan commitments by continent, 1980-86. (Amounts in NOK, current prices. The figures in brackets indicate number of commitments).

Continent	Implemented projects. Loan commitments		Projects not implemented. Loan commitments	
AFRICA	46,661,000	(9)	23,300,000	(2)
ASIA	146,125,500	(19)	38,057,000	(2)
EUROPE	14,000,000	(1)	-	
Total	206,786,500	(29)	61,357,000	(4)

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

During the years 1980-86, 25 enterprises were established in developing countries, part-financed through the provisions for loans and guarantees. Table 13 shows that 18 of these enterprises are located in lower income countries (LIC). Of these, 3 entreprises have been closed down: 2 in Sri Lanka and 1 in Sudan. 2 enterprises are located in lower middle income countries (LMIC) and 5 in upper middle income countries (UMIC). The average loan commitment per project in upper middle income countries is somewhat higher than in the other country categories.

Table 13: Loan commitments to implemented projects by country category, 1980-86. (Amounts in NOK, current prices). The figures in brackets indicate number of projects[7]).

Country category	Implemented projects Loan commitments	Average commitment per project	Projects closed down Loan comitments
LIC	141,381,000 (18)	7,854,500	8,884,000 (3)
LMIC	12,755,500 (2)	6,377,750	
UMIC	52,650,000 (5)	10,530,000	
Total	206,786,500 (25)	24,762,250	8,884,000 (3)

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

11 projects in our main partner countries have been partially financed through the provisions for loans and guarantees. Of these, 6 enterprises were established in Sri Lanka. This must be seen in connection with the favourable investment incentives that foreign investors enjoy there. Today, 2 of the Sri Lankan enterprises have been closed down. 2 enterprises have been established in Tanzania, whereas Kenya, India and Pakistan host 1 enterprise each. Tables 13 and 14 show that the average loan commitment per project in our main partner countries is smaller than in other developing countries. The average loan commitment per project in Kenya, Tanzania and Sri Lanka is considerably smaller than the corresponding figures for other developing countries. The projects in these three countries may be characterized as export oriented.

The loan commitments to the projects in India and Pakistan, however, are considerably higher than the average loan commitment to projects in other developing countries. As compared to many other developing countries, the industrial sectors in both India and Pakistan are relatively well developed. In addition, these countries offer enormous domestic markets for the products in question. Both projects are import substitution undertakings.

Table 14: Loan commitments to implemented projects in Norway's main partner countries, 1980-86. (Amounts in NOK, current prices. The figures in brackets indicate number of projects).

Country category	Implemented projects Loan commitments	Average commitment per project	Projects closed down Loan commitments
Sri Lanka	11,415,000 (6)	1,902,500	3,130,000 (2)
Tanzania	6,730,000 (2)	3,365,000	
Kenya	1,227,000 (1)	1,227,000	
Pakistan	14,135,000 (1)	14,135,000	
India	21,000,000 (1)	21,000,000	
Total	54,507,000 (11)	4,965,182	

Source: Based on statistics from the Dept. for Industrial and Commercial Cooperation, NORAD.

4.4 Support for investment in basic infrastructure

Support for investment in basic infrastructure was first used in connection with a project in Brazil in 1968, after which it was dormant until 1978. 6 projects have been promised support for investment in basic infrastructure. In two instances basic investments were financed through heavily subsidized loans under the provisions for loans and guarantees. One of these loans, for a project in Nepal, was later converted to a grant. Both projects were included under the provisions for loans and guarantees in chapter 4.3. The support for the project in Nepal will also be included here.

For the years 1968-86 the amount promised for investment in basic infrastructure totalled NOK 26.7m (current prices). Total payments were NOK 16.1m. Annual commitments and payments are illustrated in table 15.

Table 15: Promised and paid out support for investment in basic infrastructure, 1968-86. (Amounts in NOK, current prices. The figures in brackets indicate number of commitments).

Year	Promised	Paid out
1968	1,000,000 (1)	1,000,000
1968		
-		
-		
-		
1978	7,299,000 (1)	372,000
1979	-	194,000
1980	-	6,076,000
1981	7,189,000 (2)	2,798,800
1982	270,000 (1)	802,500
1983	-	1,563,154
1984	-	1,486,913
1985	2,500,000 (1)	-
1986	8,500,000 (1)	1,875,000
Total	26,758,000 (7)[8]	16,168,367

Source: Based on statistics from the Dept. for Industrial and Commercial Cooperation, NORAD.

The 6 projects that have been promised support are located in 6 different countries, 4 of which are lower income countries (LIC). 2 of these projects are located in the main partner countries of Tanzania and Sri Lanka. The support promised for a project in Thailand in 1981 has not been paid out, as the firm failed to implement the measures for which the support was intended. Table 16 shows how projects to which support has been promised are distributed according to country and and country category.

Table 16: Investments in basic infrastructure. Distribution of projects according to country and country category, 1968-86. (Amounts in NOK, current prices).

Country	Country category	Loan commitment	Trade/Industry	Notes
Tanzania	LIC	12,581,000	Production of transformers and hot-plates	The project received support for basic investments in 1978 and 1981.
Guinea	LIC	8,500,000	Ship demolishing	Paid out in 1987 and/or later.
Nepal	LIC	2,500,000	Production of turbines	The amount was originally granted as a loan for basic investments under the provisions for loans and guarantees. Later converted to a grant.
Thailand	LMIC	1,907,000	Production of prefabricated houses	The amount has not been paid out as the firm has failed to carry out the measures for which the grant was intended.
Brazil	UMIC	1,000,000	Production of industrial machinery	The Norwegian partner has withdrawn from the project.
Sri Lanka	LIC	270,000	Production of woollen jumpers.	
Total		26,758,000		

Source: Based on statistics fom the Department for Industrial and Commercial Cooperation, NORAD.

Under the provisions for investment in basic infrastructure it has also been possible to part-finance vocational training programmes. The support may finance the establishment and, to a certain extent, the operation of technical schools, but training specifically related to production and processing cannot be covered through these provisions. 4 of the

6 projects that have been promised support under these provisions were wholly or partly related to training. This applies to the following projects:

- Brazil (1968): Technical college
- Tanzania (1977): Training centre
- Thailand (1981): Training centre
- Sri Lanka (1981): Knitting instruction

4.5 Support for initial training schemes

From the time this scheme was introduced in 1983 until the end of 1986, support for initial training schemes was promised for 16 projects in 10 countries.

The total amount commited for the entire period is NOK 13.9m (current prices), of which NOK 5.3m have been paid out (cf. table 17).

Table 17: Promised and paid out support for initial training schemes, 1983-1986, current prices. (The figures in brackets indicate number of commitments.)

Year	Promised	Paid out
1983	2,172,000 (1)	-
1984	1,688,600 (4)	-
1985	8,538,400 (7)	1,583,462
1986	1,580,000 (5)	3,788,559
Total	13,979,000 (17)[9]	5,372,021

Source: Based on statistics from the Department for Industrial and Commercial Cooperation, NORAD.

Table 18 shows the distribution of projects according to country and country category. 12 projects are located in lower income countries (LIC), and as many as 7 of these in main partner countries. Two projects are located in each of the country categories LMIC and UMIC. Given the guidelines for this scheme it is not surprising that most projects are located in lower income countries, for they may be expected to have a more acute shortage of qualified key personnel than other countries.

The average commitment per project is highest in lower middle income countries; it is clearly lower in the main partner countries than in other developing countries. This reflects a lowe average investment per project in these countries than in other developing countries.

Two commitments of support have not been employed: one for a project in Togo and one for a project in Malaysia. The project in Sudan which also received support for feasibility studies and support under the provisions for loans and guarantees, has later been closed down. The discrepancy between commitments and payments in some projects is due to the fact that some of the support will be paid in 1987 or later.

Table 18: Support for initial training schemes. The distribution of projects according to country and country category, 1983-86. (Amounts in NOK, current prices. The figures in brackets indicate number of projects).

Country	Country category	Promised amount	Amounts paid out	Trade/Industry	Notes
Sri Lanka	LIC (4)	59,000	59,000	Cultivation of green plants	
		358,900	358,900	Production of steel tubes	
		1,500,000	1,000,000	Printing works	
		160,000	-	Production of marine electronics	
Malaysia	UMIC (2)	57,600	57,600	Shipowners	
		1,452,500	-	Production of telephones	The projects has not been realised
Guinea	LIC (2)	5,000,000	1,250,000	Marine training centre	
		385,000	-	Ship demolishing	
Togo	LIC (2)	185,000	-	Grain terminal	Application withdrawn.
		250,000	-	Marble/brickworks	
Sudan	LIC (1)	1,250,000	1,250,000	Fishing project	Closed down
The Philippines	LMIC (1)	2,172,000	1,166,912	Shipowners	
India	LIC (1)	600,000	-	Fibreglass tube production	
Pakistan	LIC (1)	170,000	112,559	Production of adhesives/plastics	
Kenya	LIC (1)	117,000	117,000	Cultivation of green plants	
Thailand	LMIC (1)	262,000	-	Explosives production	
Total	(16)	13,979,000	5,372,000		

Source: Based on statistics fom the Department for Industrial and Commercial Cooperation, NORAD.

4.6 Investment guarantees under the special scheme

The level of liability under this scheme has remained moderate in the course of the 20 years of its existence. In part, this reflects the limited volume of Norwegian investments in developing countries during most of this period. In part, it also seems to reflect a limited interest for the scheme, as it only covers a very small part of the total risk involved when a business of primarily commercial nature is established in a developing country. As table 19 illustrates, current liabilities at the end of 1986 amounted to NOK 52,700,000. A major investment in Brazil was the main reason the liabilities reached their highest level during the years 1969-72.

Table 19: Investment guarantees under the special scheme. Current liabilities and annual changes in liabilities, 1964-86. (Amounts in NOK, current prices).

Year	Current liabilities as per 1 Jan	Increase in liabilities during the year	Decrease in liabilities during the year	Current liabilities as per 31 Dec
1963				
1964				6,750,000
1965	6,750,000	633,420	367,200	6,566,220
1966	6,566,220	0	1,890,000	4,676,220
1967	4,676,220	6,660,000	846,000	10,490,220
1968	10,490,220	83,000	630,000	9,943,000
1969	9,943,000	98,886,000	1,334,000	107,495,000
1970	107,495,000	2,871,000	1,335,000	109,032,000
1971	109,032,000	2,787,000	1,375,000	110,444,000
1972	110,444,000	3,150,000	2,337,000	111,257,000
1973	111,257,000	0	17,529,000	93,728,000
1974	93,728,000	3,708,000	3,839,000	93,597,000
1975	93,597,000	612,000	14,283,000	79,296,000
1976	79,926,000	1,468,000	8,636,000	72,757,000
1977	72,757,000	4,032,000	20,823,000	55,966,000
1978	55,966,000	365,000	7,629,000	48,702,000
1979	48,702,000	8,501,000	43,677,000	13,526,000
1980	13,526,000	24,200,000	1,600,000	36,100,000
1981	36,100,000	11,966,000	2,558,000	45,507,000
1982	45,507,000	3,000,000	2,300,000	46,200,000
1983	46,200,000	7,400,000	-3,800,000	57,400,000
1984	57,500,000	5,400,000	29,400,000	33,500,000
1985	33,500,000	-	5,900,000	27,600,000
1986	27,600,000	31,000,000	6,000,000	52,700,000

Source: The annual reports of the Norwegian Guarantee Institute for Export Credits, 1963-1986

Table 20 shows how effectuated investment guarantees are distributed according to continent and country category for the years 1964-86[10]. 13 of the effectuated guarantees have gone to projects in lower income countries (LIC) in Africa. Upper middle income countries (UMIC) and low income countries (LIC) in Asia host 9 and 7 guaranteed projects respectively. A total of 6 guarantees to projects in Latin America have been effectuated.

Table 20: Number of effectuated guarantees by continent and country category, 1964-86.

Continent	LIC	LMIC	UMIC	Total
Africa	13	6		19
Asia	7		9	16
Latin America		2	4	6
Europe			1	1
Total	20	8	14	42

Source: The annual reports of the Norwegian Guarantee Institute for Export Credits, 1963-1986

Compensations have only been paid out in connection with two projects under the provisions for investment guarantees. Both projects had been recommended by NORAD.

Table 21: Number of compensations paid out under the guaranteed investment scheme, 1964-86.

Country	Date of com.ment	Trade/Industry	Compensation	Date of payment
Zambia	5 Sept 68	Production of fishing vessels	248,877	10 May 84
Nigeria	6 June 76	Fish processing	14,200	20 March 86

Source: The Norwegian Guarantee Institute for Export Credits

The compensations were covered by the risk reserve of the Norwegian Guarantee Institute for Export Credits and did not affect the foreign aid budget.

CHAPTER 5: THE ADMINISTRATION AND ORGANISATION OF THE PROVISIONS FOR INVESTMENT SUPPORT

5.1 An historical perspective

The present Department for Industrial and Commercial Cooperation was preceded by the "Advisor for Trade and Industry". The "Advisor for Trade and Industry" gradually developed from a single position into a unit with several employees and an extensive administrative responsibility in connection with various industrial schemes.

The "Advisor for Trade and Industry" unit was established pursuant to Proposition no. 109 (1966-67) to the Storting and Proposition no. 1 (1968-69) to the Storting, supplement no.3. Page 2 of the supplement ("The development of the foreign aid administration)" states that:

> "Organising and furthering industrial and commercial activities in the developing countries has been assigned to the directorate as a task of special importance. The organisational plan therefore requires that the directorate employ an advisor/consultant with special qualifications and experience in private investments and industrial activities. This official should work closely with the Planning Department."

In 1968 NORAD was established with three departments: A Planning Department, a Project Department and an Administrative Department. The "Advisor for Trade and Industry" worked closely with the Planning Department up to 1971. From 1972 this unit was placed directly under NORAD's Director General. When the Ministry for Development Cooperation was established on 1 January 1984, the new Department for Industrial and Commercial Cooperation was temporarily placed under the Deputy Director General for NORAD[1]. The Department for Industrial and Commercial Cooperation received departmental status on 1 January 1986.

The "Advisor for Trade and Industry" had an "independent and in many ways somewhat isolated position within the NORAD organisation. This was primarily due to the fact that its work had little in common with the ordinary bilateral activity."[2]

The "Advisor for Trade and Industry" was not particularly affected by the restructuring of NORAD in 1976 and 1982, and no final decision concerning the organisational position of this unit was ever made. In spite of the fact that the Department for Industrial and Commercial Cooperation was granted full departmental status as from 1 January 1986, there is still uncertainty concerning both organisation and area of responsibility.

5.2 Brief survey of the current administration and organisation of the Department for Industrial and Commercial Cooperation

As per August 1987 the department consisted of 12 full-time posts. 10 are filled and 2, 1 Assistant Director General and 1 Head of Division, are being recruited. The other posts are: 1 Head of Division, 6 Senior Executive Officers, 1 Executive Officer and 2 Senior Clerks. All officials work on both investment and export cases.

The Department for Industrial and Commercial Cooperation is not formally divided into divisions, but to a great extent the current internal organisation model implies separate divisions. Until 1 September 1986 all activities were organized according to geographic area, and the officials were placed directly under the Assistant Director General. From the same date the organisation was changed so that an official's area of responsibility is now primarily related to firms and only secondarily to geographic area. A liason was also instituted between the Assistant Director General and the executive officers: a Head of Division with responsibility for investments and a Head of Division with responsibility for exports. The new organisational model is a trial project which will be evaluated in the course of 1988 in connection with the restructuring of the Ministry for Development Cooperation/NORAD.

The Imports Promotion Division (NORIMPOD) consists of 6 posts, and is administratively responsible to the Ministry of Development Cooperation and the Department for Industrial and Commercial Cooperation. The division has enjoyed a free position since its introduction in 1977, first under the Ministry of Trade, later under the Ministry of Development Cooperation. The organisational status of the Imports Promotion Division is also being evaluated.

5.3 The activities of the Department for Industrial and Commercial Cooperation

Through rotating activity plans for the Ministry of Development Cooperation, the individual departments work out plans for their aims, priorities and expected results for the planning period. The resources required for obtaining these results are also specified. In the activity plan for 1986 the Department for Industrial and Commercial Cooperation was assigned the following main tasks:

1. Cooperation with international bodies as well as the authorities and commercial interests in developing countries regarding the identification and organisation of activities with a view to Norwegian public and private participation.

2. Cooperation with Norwegian trade and industry concerning the financing of feasibility studies, investment guarantees, basic investments, training, or other financial participation in the industrial build up of developing countries.
3. Activities to increase trade between Norwegian firms and developing countries through support for export and import.

In the activity plan for 1987 the following measures were assigned priority:

- Assistance and counselling.
  The executive officers in the departments will continue to contact selected firms in order to provide assistance and advise on the possiblities for investments and financial involvement in the chosen areas. Delegations including representatives for various firms will travel to the developing countries.
- Product development.
  Suggestions for extending existing programes will be worked out. The introduction of new measures is required in order to stimulate the interest of Norwegian businesses for investments, especially in the SADCC region.
- Information.
  The department will produce information material on available provisions for support. The existing information material is inadequate and should be revised.
- Promotion.
  The department will more actively promote its advisory services and provisions for support.

The department's other activities include:

- The consideration of applications for loans, investment guarantees, and support for feasibility studies, basic investments and training in connection with potential investments in developing countries.
- The consideration of applications for mixed credit, training support and guarantees in connection with export.
- The preparation of project documents which will form a basis for further consideration of the applications at higher levels in the Ministry of Development Cooperation (the Project Committee, the directors and the political leadership.)
- The arrangement of debts and refinancing of projects.
- Administration of projects with parallel finance.
- Professional assistance to other units in the Ministry.
- Cooperation with other public bodies within the department's area of responsibility (Technical, Economic and Industrial Cooperation-agreements, the internationalisation committee etc.)

- Control and follow-up of ongoing projects.
- Preparation of budgets and reports.
- Organisation of joint administrative services and training.

5.4 Time utilization

The most recent activity plan indicates the following distribution of time resources within the department:

- Daily routines/follow-up. 50%
  This includes meetings, internal assistance, processing applications and following up projects.
- Planning. 10%
  This includes product development, reports, budgetting and system development.
- Information. 20%
  Advising and assisting Norwegian businesses accounts for a considerable share of the information activities, in addition to the promotion and preparation of information material.
- Internal administration. 10%
  This includes organisational development, in-house meetings and planning of internal routines.
- Personnel development.
  This includes seminars and further education for the employees in the department. 5%
- Miscellaneous. 5%

It is clear from the activity plan for 1986 that time and effort are distributed unevenly on investment and export; the administration and follow-up of decisions relating to export is by far the more time-consuming. It is estimated that administration and follow-up accounts for 70% of the time spent on projects with parallel finance. The corresponding figure for investment projects is 10-20%. Project evaluation accounts for 50-60% of the time spent on investment projects.

In keeping with the Ministry of Development Cooperation's objective of aid for self-supporting development, the activity plan for 1986 recommends that work related to provisions for investment support be given priority over work related to provisions for export, on grounds that the latter is assumed to be less effective in stimulating development (cf. Recommendation S. no. 186 (1986-87), p. 48).

5.5 The project cycle

The project cycle, beginning with the consideration of applications from Norwegian enterprises for support for investment and ending with a possible commitment of support, can be divided into four levels within the Ministry of Development Cooperation:

1: Consideration by the Department for Industrial and Commercial Cooperation.
2: Consideration by NORAD's directors.
3: Consideration by the Project Committee.
4: Consideration by the political leadership.

The project is examined and the project documents are prepared in the Department for Industrial and Commercial Cooperation. When required, the Department for Industrial and Commercial Cooperation may employ external consultants in connection with project appraisal and evaluation.

Applications for loans are submitted for financial appraisal to the Norwegian commercial bank Den norske Creditbank (DnC). On the basis of the budgets on which the firms base their applications, as well as information from the executive officers in the Department for Industrial and Commercial Cooperation, the bank carries out an economic analysis wich includes market appraisal and the preparation of financial key figures. The DnC-analysis represents an important part of the background information on which the Department for Industrial and Commercial Cooperation bases its own appraisal of the project. In addition, Dnc administers all loans on behalf of NORAD/the Ministry of Development Cooperation. Businesses in developing countries supported through the provisions for loans and guarantees must submit their accounts to the DnC every six months. The bank carries out an analysis of the business based on the annual accounts. In this analysis central financial key figures are included, as well as comments on the individual result and balance entries.

The Department for Industrial and Commercial Cooperation draws on the Legal Department in the Ministry of Development Cooperation for legal assistance and consideration. Special considerations related to certain projects may require that the Ministry of the Environment and/or the Ministry for Foreign Affairs be consulted.

In some cases NORAD's Board of Directors can make a direct commitment of support, based on recommendations from the Department for Industrial and Commercial Cooperation. This procedure may be used for applications for investment guarantees or for part finance of feasibility studies and training up to a maximum amount. To a certain extent, this upper limit for commitments by the Board of Directors may be exceeded provided the Project Committee recommends it.

The Project Committee is appointed by the Minister. This committee is assigned the task of discussing and possibly recommending the proposals submitted by NORAD's Board of Directors. Meetings in the Project Committee are called by the Board of Directors and are normally held once a month. Applications for support for investment in basic infrastructure shall be submitted to the Project Committee. If the project is recommended by the Project Committe, NORAD's Board of Directors may promise support for up to the stated maximum amount per project.

All applications for loans and guarantees under the provisions for loans and guarantees shall be submitted to the Project Committee for consideration. If the Project Committee's recommendation is positive, the Board of Directors may promise loans and guarantees for up to a stated maximum amount per project.

All applications for amounts exceeding the stated maximum amount shall be submitted to the ministerial leadership with the Project Committee's recommendation attached.

All applications which fail to be recommended by the Project Committee shall, unless they are withdrawn, be submitted to the ministerial leadership for decision.

PART TWO:

THE PROVISIONS FOR INVESTMENT SUPPORT AS PART OF THE FOREIGN AID ADMINISTRATION - A THEORETICAL EVALUATION

CHAPTER 6:
FOREIGN AID ADMINISTRATION AND PROVISIONS FOR INVESTMENT

6.1 Introduction

In our evaluation of the provisions for investment we need a set of references, an ideal to set the current provisions up against. In this chapter we will outline the main principles of what we see as an ideal for foreign aid administration in general, and we will comment briefly on the role played by the provisions for investment with respect to the total set of provisions for foreign aid. This will also require us to comment on the Ministry of Development Cooperation's objectives and budgetary restrictions.

Against the background of the ideal presented in this chapter, the next chapter will present a method for analysing various kinds of projects in developing countries. Chapter 8 discusses the provisions for investment more specifically.

In part three of the report we will draw on ideas from these three chapters in connection with our actual evaluation of the provisions for investment.

6.2 Foreign aid administration - an ideal

The planning and evaluation of foreign aid projects and activities ought to represent key elements in foreign aid administration. However, these tasks seem to have been carried out unsystematically and unsatisfactorily in the Ministry of Development Cooperation. Improvements in these areas have been called for in several reports to the Storting. Report no. 36 (1984-85) to the Storting examined these issues in some depth, and the views stated there were also put forward in Report no. 34 (1986-87) to the Storting. A good system of planning and evaluation is essential if the foreign aid is to be used efficiently. In this section we will outline a system for planning and evaluation which in our opinion may serve as an ideal for the Ministry of Development Cooperation. The approach recommended can be introduced gradually in the sense that its initial area of application may be limited to certain foreign aid activities and/or receiving countries. This approach could be particularly useful for the planning and evaluation of foreign aid activities whose consequences are primarily economic in nature (in the wide sense), such as activities in which business interests are involved. This is because consequences of an economic nature are easier to quantify than many other types of consequences. In the following discussion it may therefore be wise to bear in mind that foreign aid activities whose consequences are difficult to measure are not included. However, we are of the opinion that the approach outlined may help make such foreign aid activities more efficient as well. For the time being, it may also be wise to disregard typical staff functions of only indirect consequence to the receiving countries.

In outlining our main ideas, we assume that the foreign aid organisation has a certain amount of funds at its disposal, a *budget*, and an *objective* for its activities. This objective is operationalised in such a way that the "degree of attainment" during any period is quantifiable.

The general objective for the foreign aid organisation is to contribute to the increase of welfare in potential receiving countries. The funds at the disposal of the organisation are to be used in a way that provides for a maximum contribution to the realization of this objective. This means that the organisation shall use its means so that the increase in welfare in the receiving countries is as great as possible. Since the objective concerns welfare in the receiving countries, we will operationalise it by means of a so called *welfare function*. In general terms, this function gives the relation between the welfare level and its determinants. We will let the welfare in each country be defined as the welfare of all individuals or families, i.e. the present and future welfare of the population. It is reasonable to assume that the welfare which the foreign aid organisation wishes to maximise, is the sum of the welfare levels in potential receiving countries.

What factors determine people's welfare? This is an extremely difficult question which we will not try to answer fully; we shall simply assume that the level of consumption determines the level of welfare. The higher the consumption, the higher the welfare. To the extent that foreign aid activities affect people's level of consumption, then, they will affect the country's present and/or future welfare level. The number of factors that influence people's welfare may easily be increased by considering leisure time, working conditions etc., but the problems of quantification become greater the further we move away from purely economic factors. However, for our purpose most non-economic factors that influence people's welfare can be regarded as constants, i.e. they remain unaffected by the aid activities. In that case foreign aid organisations need not study anything but effects on level of consumption when considering the consequences of an aid project.

It follows from this discussion that the welfare the aid organisation wishes to maximise is determined by the present and future level of consumption for all individuals (or families) in all potential receiving countries. As both future and current consumption is involved, the long-term and often indirect consequences of aid activities will have to be outlined and evaluated as well as the short-term, direct effects. Evaluation of long-term, indirect effects will often involve great uncertainty.

Thus far we have discussed the aid organisation's welfare function for potential receiving countries and highlighted the organisation's budgetary constraints. In addition to the welfare function and the budgetary constraints, we need information as to the type of *foreign aid activities* concerned and the relationship between the contribution made by the various foreign aid activities and the welfare level in the various receiving countries. The concept of foreign aid activity may be given a narrow or wide interpretation, depending on the purpose of the analysis. Each foreign aid activity consists of one or more (closely related) *projects*. In this connection the concept of a project is interpreted very broadly. A project involving investment support may e.g. be a new business venture in a certain country, a capacity increase in an existing enterprise, refinancing, etc.

If the relationship between the level of an aid activity and the welfare level in a country is to be examined, this requires detailed information both on the aid activity concerned and on special features in the economy of the receiving country. According to our theoretical basis, these aid activities influence the country's welfare level through the welfare of the individuals (or the individual families), and it is the channels or mechanisms that link various kinds of aid to people's welfare that have to be examined.

Foreign aid cannot be administered rationally without such information, i.e without knowing what consequences various kinds of aid activities produce in the receiving countries. In this connection it is important to examine any relation between the welfare effects of one aid activity and the size of the contribution to other activities. This type of information is essential to the question of whether to link two or more foreign aid activities, such as the village development schemes and the commercial and industrial development schemes in Sri Lanka. Generally, linking two activities will be desirable if one of the aid activities simplifies the implementation of the other.

Figure 1 outlines how funds of the foreign aid budget are distributed among the various foreign aid activities in the various partner countries.

How, then, should a rational foreign aid organisation administer its grants to the various foreign aid activities and partner countries? In principle, the answer to this question is a simple one: in general, the foreign aid organisation ought to administer its means so that it is impossible to increase the total welfare level in the partner countries by redistributing the means, i.e. by transferring means from one activity in one country to the same activity in another country or to other activities. To overstate things slightly, we can say that the foreign aid organisation ought to administer its funds so that the expected marginal welfare gains are equal for all activities and countries.

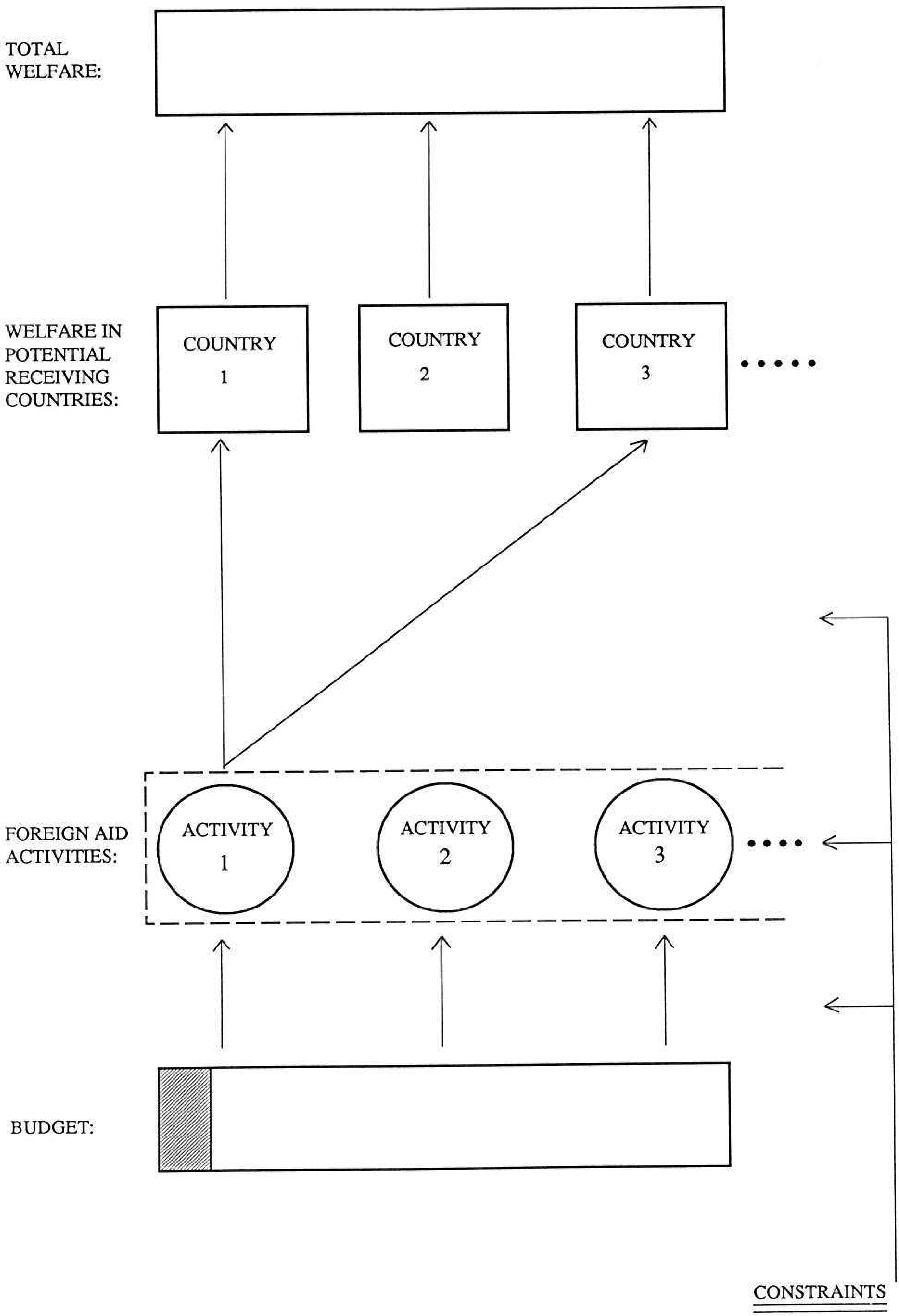
TOTAL
WELFARE:
WELFARE IN
POTENTIAL
RECEIVING
COUNTRIES:
COUNTRY
1
COUNTRY
2
COUNTRY
3
FOREIGN AID
ACTIVITIES:
ACTIVITY
1
ACTIVITY
2
ACTIVITY
3
BUDGET:
CONSTRAINTS

Fig. 1

If this is not the case, and if the budgetary restriction is binding, the total welfare will increase if the aid organisation transfers means from one activity in one country to another activity in the same country, to the same activity in another country or to another activity in another country in which the welfare gains are greater. Many countries and activities may then have to be eliminated, in the sense that they no longer receive any grants, because the funds can produce greater gains in other countries and/or on other activities.

A foreign aid organisation that has been in existence for some time, will probably have acquired special expertise on certain foreign aid activities and partner countries. Consequently, we can expect some concentration of both foreign aid activities and partner countries.

As long as the budgetary restriction isbinding, the expected marginal welfare gains from any activity in any country will be positive. This is due to competition for funds: a grant to one activity in a particular country is issued at the expense of another grant. If the budgetary restriction is not binding, there would be no competition for funds, and certain grants would not be issued at the expense of other grants. In this situation it is sensible to grant money to an activity as long as the grants seem to contribute to the increase of welfare, i.e. until the expected welfare gains of further grants disappear. The expected marginal welfare increase, then, will be zero for all activities and all countries.

So far we have taken a *planning perspective* in the sense that we have discussed how to determine the allocation of grants among various activities in various countries. We may imagine that these decisions are made once a year, for instance. They are of course based on the information available at the time of decision. This information must be continuously updated so that next year's grants are allocated on the basis of new information. We know that the information required by the foreign aid organisation is partly related to the aid activity itself and partly the economic conditions in the various countries. Continuous *evaluation* of the various aid activities helps increase our understanding of how various kinds of aid influence welfare in the receiving countries. At the same time it indicates how to design more efficient aid activities. Continuous monitoring of the receiving economies is also necessary in order to adapt the aid packages to each different country in the best possible way.

If the collection and arrangement of this type of information is carried out systematically, the informational base for the next period's allocations will not only be new, but also improved. Hopefully, this will effect an increase in the marginal welfare contribution.

The daily operation of foreign aid activities is effected by a number of departments, each with its own area of responsibility. Let us imagine that each department is responsible for implementing projects related to a certain type of aid activity in various countries. Alternatively, each department might be responsible for implementing projects related to various types of aid activities in one specific country.

In light of the planning perspective presented above, it is evident that the expected marginal welfare gains will be the same in all departments. If all information were perfect, so that the most profitable projects at the planning stage turned out to be the most profitable projects at the time their implementation was decided, the department's task would be relatively simple. However, new information affecting the profitability of planned projects will typically emerge, and new interesting projects may turn up. For these reasons the funding to the various departments should be regarded as framework funding, enabling the departments to change their priorities in connection with day to day operations.

Concerning these changes in priorities, we wish to emphasize one key principle (to which we shall return later): if a new project is approved, and if the budgetary restriction is binding, this project ought to be implemented only if its welfare gains exceed the welfare gains of the forgone project(s). The lost welfare gains constitute the opportunity cost of allocating funds to the new project. If the foreign aid is organised according to country, the forgone project would have been located in the same country. If the organisation is based on activities, however, the forgone project may very well have been planned for another country.

6.2.1 Tied foreign aid funding and/or activities

Untied aid, which according to our assumptions can be any one of the aid activities, is often presented as better than other kinds of aid. In this context untied aid will mean aid which is issued directly to the authorities in the receiving countries, who are free to dispose of these funds at their own discretion. There are two reasons for regarding untied aid the most sensible. First, the authorities in the receiving country are in the best position to know where the funds would produce the highest gains. And second, to the extent that the foreign aid organisation ties its aid to one particular project, for instance, funds are often released for the authorities to use for other purposes. In reality, then, the aid is used for these other purposes, and consequently, tying the aid is pointless. We believe these arguments to be valid in many cases. If they are correct, the amounts granted to all other activities in the planning problem presented above, will equal zero. In effect, all aid will be granted as *untied* aid. Moreover, the countries which are able to make the best use of the untied aid, according to the aid organisation's evaluation, will be granted the highest amounts. Many countries will probably be eliminated. If this line of reasoning is correct, aid administration in a rational aid organisation should be extremely simple. It would involve nothing but sending the granted funds untied to the authorities of a (probably) small group of countries.

However, most foreign aid organisations are subject to various kinds of political constraints in their administration of funds. Amounts may be specified for certain activities, for instance, or to certain countries, or to a combination of the two. If constraints of this nature affect the eventual grants, in the sense that the grant pattern deviates from that of a situation without constraints, the constraints will incur costs in the form of lost welfare. The total welfare gains of the aid will be lower than they would have been without the constraints. This is of course because the constrained grants produce lower gains than they would have if used optimally. They may even have direct negative welfare effects in a situation where the aid organisation's budgetary restriction is not binding.

The task of the foreign aid organisation will now be to allocate the grants so that they produce the greatest possible welfare gains given these constraints or ties.

It may also be worthwhile to calculate the costs of the various ties. As mentioned, these costs manifest themselves in the form of lost welfare in the recieving countries. If the losses are considerable, the calculations may be used in making the politicians loosen these constraints.

In addition to the conditions imposed on specific grants, there are many other kinds of constraints. Some types of foreign aid activities are politically acceptable whereas others are not, other activities are politically acceptable only if used in a certain way, etc. As for imposing conditions on certain grants, these other constraints are most likely to reduce the aid organisation's possibilities for using its funds efficiently.

In this context we have been using the term *constraint* or *tied aid* in a very wide sense. In Norwegian official documents, however, the same term is often used in a narrow sense which suggests that aid is tied only when linked to Norwegian exports. In our terms, this is in fact one out of several types of ties.

6.3 The Norwegian Ministry of Development Cooperation's objective and budgetary restrictions

Our evaluations will be based on the principles laid down for the ideal foreign aid administration outlined in the previous section. In this context we will consider the Department for Industrial and Commercial Cooperation a department whose task it is to administer the foreign aid activity called investment support by granting support to industrial schemes in various countries. Before looking into the situation of the Department for Industrial and Commercial Cooperation in more detail, however, it is necessary to define how the general objective of the Ministry of Development Cooperation can be used in order to give concrete expression to the welfare function introduced in the previous section. In addition, we will comment briefly on the Ministry of Development Cooperation's budgetary restrictions.

6.3.1 The general objective of the Norwegian Ministry of Development Cooperation

In our discussion of planning and evaluation in the previous section we assumed that the present and future level of consumption of individuals (or families) in the potential receiving countries is incorporated in the aid organisation's welfare function. This function will now have to be further specified. It must be capable of providing us with information as to the value of increased consumption for particular groups in particular countries at different points of time as compared to increased consumption for other groups in the same or other countries, at the same or other points of time.

Given our theoretical basis, we will make these comparisons based on the information provided by the objective of the Ministry of Development Cooperation, both regarding preferences concerning present vs. future welfare, and concerning the distribution of income and, consequently, consumption among individuals (or families).

In order to understand our way of measuring these factors, it is necessary to return to the relationship between individuals' (or families') welfare or utility, and their level of consumption. The welfare of individuals is determined by their consumption: the higher the consumption, the higher the welfare. Moreover, the higher the level of consumption at the outset, the less will the welfare gain from further consumption be. This means that if a poor person increases his consumption by a certain amount, this produces higher welfare gains than if a rich person increases his consumption by the same amount. The *elasticity of marginal utility* is a key variable in this context. It expresses the percentage reduction in the welfare or utility added by more consumption in response to a one per cent increase in consumption. The greater the elasticity, the stronger the preferences for equal income and consumption. Accordingly, high elasticity of marginal utility means that an income increase will be worth relatively less to a rich person than the same income increase given to a poor person, as compared to a situation in which the elasticity is lower. Once the elasticity of marginal utility is indicated, we will be able to compare the welfare effects of increased consumption for different individuals (or families).

We will express the preference for present welfare as compared to future welfare by means of *the rate of time preference.*

Is it possible to say anything about the elasticity of marginal utility and the rate of time preference based on the Ministry of Development Cooperation's general objective?

In Report no. 36 (1984-85) to the Storting, Report no. 34 (1986-87) to the Storting and in Recommendation S. no. 186 (1986-87), the general objective is worded as follows:

> "- to contribute to lasting improvements in the economic, social and political conditions for the peoples of the developing countries."

Further, it is stressed that:

> "Foreign aid shall be used in such a way that it produces a maximum developmental effect in poor populations. Preferably, it shall benefit the poorest developing countries, and be designed in such a way that it creates as little dependence as possible upon continued assistance. Foreign aid funds must be used as efficiently as possible in order to attain this objective."

In our perspective the strong orientation towards poverty in the phrasing of the objective means that a given increase in income and consumption for a poor individual will contribute to a welfare increase which is much higher than the welfare increase which results from a similar rise in income for a rich person. Consequently, we have an argument for stating that the elasticity of marginal utility is relatively high. At this point we will not consider how high it may be, but we are of the opinion that the Ministry of Development Cooperation should try to operationalise the poverty orientation by selecting a figure for the elasticity of marginal utility. The higher the figure (i.e. the greater emphasis placed on the orientation towards poverty), the greater the emphasis put on aid projects that help raise the consumption level for very poor people in very poor countries. If the Ministry can settle on a figure for the elasticity of marginal utility, the poverty orientation will be operationalised in such a way that it can be expressed in figures and therefore used consistently in all forms of foreign aid activities.

The Ministry of Development Cooperation ought to consider not only the elasticity of marginal utility, but also the extent to which increased future welfare should be emphasized as compared to increased present welfare, i.e., the rate of time preference. If future welfare is considered to be worth much less than present welfare (i.e. the rate of time preference is relatively high), this would result in greater emphasis on short-term projects which soon increase consumption, than in a situation in which the rate of time preference is lower. It is difficult to say anything about the rate of time preference based on the phrasing of the objective above. However, the provision that the aid is to contribute to "lasting improvements" and that it should be "designed in such a way that it creates as little dependence as possible upon continued assistance" may suggest that the rate of time preference is relatively low.

Once the elasticity of marginal utility and the rate of time preference are clear, the welfare function based on the Ministry of Development Cooperation's objective is operationalised. Provided the necessary information is submitted on the aid activities, the receiving economies and the budgetary constraints, the planning problem presented in the previous section, may be solved in principle. In our view, it is not necessarily required that the Ministry of Development Cooperation do this explicitly. However, we do believe that a systematic comparison of gains from alternative uses of foreign aid can start already now, and that this can be done in a relatively simple way. Over some time, then, money can be transferred from activities with low yields to more profitable activities and from countries in which the funds produce relatively low gains to countries in which the gains are higher.

Reservations

Before leaving the question of the Ministry of Development Cooperation's welfare function, we wish to make a reservation concerning our suggested operationalisation. We also wish to comment briefly on the extensive use of partial objectives which is in common use in the Ministry today. These objectives intend to put the general objective into more concrete terms and to provide the individual departments with aims of a more concrete character.

Our reservation concerning the welfare function is based on our concentration on people's income and consumption, i.e. their economic situation. We assume that most of the conditions relating to the improvement of economic and social conditions in the population, are included in our consumption concept. But what about the improvement of political conditions? To the extent that our information shows that aid produces political improvements which in turn increase people's income and consumption, welfare gains of this type will be taken into account. However, this is only appropriate as long as the political improvements can be considered instrumental to economic and social improvement. If political improvements are considered valuable in their own right, they are not taken into account.

Partial objectives of the Ministry of Development Cooperation

If the Ministry of Development Cooperation accepts an operationalisation of its general objective such as the one we have suggested, both joint partial objectives and strictly departmental partial objectives can to a large extent be dropped. This is because it is possible, in principle, to calculate a project's or an activity's contribution to the main objective directly.

Report no. 34 (1986-87) to the Storting, for instance, states:

> "The general objective . . . opens up for many different strategies and measures for our foreign aid. The guidelines provided for how to assign priorities are limited. Consequently, the Ministry wishes to stress the fact that there are several objectives for our aid. These objectives do not always coincide, and in practical work priorities will often have to be made, favouring certain objectives and considerations. These objectives should be noted:
>
> - Proper administration of natural resources and the environment
> - Economic growth
> - Improved living conditions for the poorest population groups
> - The safeguarding of human rights
> - Furtherance of peace between nations and regions
>
> It is important to emphasize that these objectives do not always coincide, and that the practical composition of foreign aid often involves a choice between objectives. It will be made clear that ... parallel work of several kinds is required, as well as the realisation of several part objectives. Practical work and priorities must reflect a balance between the different objectives and considerations."

The first three partial objectives are primarily of economic character, meaning that in our perspective they affect people's consumption directly. To the extent that the aid activities and projects have consequences along these dimensions, they will be considered and compared in the plan already discussed. Accordingly, these part objectives are redundant.

The last two part objectives are much more difficult to handle. They concern the over-all objective's provision for improvement of political conditions. To the extent that it is the economic consequences of improvements along these dimensions that are the most important, and provided that the aid activities' effects on them are known, we can say that these improvements are taken into account in our welfare function. As previously pointed out, however, we will be unable to account for the fact that political improvements may be valuable in their own right.

Partial objectives of the Department for Industrial and Commercial Cooperation

In the same way as the need to divide the general objective into partial objectives is reduced, the need for individual departmental objectives is reduced if the main objective is operationalised in the way we recommend. Different foreign aid activities represent different ways of contributing to the realization of the general objective, and it is the direct contribution to the realization of this objective which is calculated and which forms the basis for deciding whether to implement a project. Staff departments and departments administering activities whose consequences are difficult to quantify, may possibly represent exceptions. We will comment on this point on the basis of the partial objectives set by (and for) the Department for Industrial and Commercial Cooperation, more or less at the request of the Norwegian Directorate of Organization and Management (Statskonsult.)

The Directorate of Organization and Management seems to assume that the general objective cannot be operationalised (cf. Report no. 2/87, "The planning and organization of Norwegian foreign aid"), and that the various departments need partial objectives in a hierachy of objectives:

> "i.e. objectives are established at different levels. Attaining an objective on a lower level, then, represents a contribution towards attaining an objective on a higher level".

This principle may be reasonable in a bureaucracy where the results attained by one department represent the means by which a department at a higher level can attain its desired results. For certain staff departments this is probably also relevant in the Ministry of Development Cooperation. The Department for Industrial and Commercial Cooperation, however, is not subordinate to any other department in this respect. This department's activities contribute directly to the general objective of the Ministry of Development Cooperation.

At the request of the Directorate for Organization and Management the department has formulated its own objectives. In connection with the preparation of the 1986 activity plan the department's main objective was phrased as follows:

> "To contribute to increased production, economic growth and employment in developing countries."

The following partial objectives were formulated:

- Integrate support to trade and industry with other aid activities
- Assist in the internationalisation of Norwegian trade and industry
- Act as a catalyst between Norwegian trade and industry and developing countries.

The main and partial objectives were similar in the 1987 activity plan. In addition, a new partial objective was proposed:

- Work for increased and broader involvement by Norwegian firms in selected geographical areas, namely the SADCC region and India.

If we were to set up a welfare function for the Department for Industrial and Commercial Cooperation based on the department's main objective as presented above, this function would be far less oriented towards poverty than the function we set up on the basis of the Ministry of Development Cooperation's over-all objective. Even if the activities of the Department for Industrial and Commercial Cooperation were to give maximum results based on the department's own welfare function, their contribution to the realisation of the Ministry of Development Cooperation's general objective would be very low. Consequently, letting the individual departments operate with their own objectives that only partly coincide with the over-all objective is extremely unsatisfactory.

What status is attached to the partial objectives defined? Are they independent objectives, valuable in their own right, or are they meant as concrete expressions or implications of the main objective?

Integrating support to trade and industry with other aid activities and increasing the involvement in particularly poor regions seems sensible in the light of the Ministry's over-all objective and the reasonable assumption that there is complementarity between industrial development and other foreign aid activities. In that case, systematic appraisal of projects on the basis of their contribution to the realisation of the Ministry's over-all objective will mean that projects with precisely these qualities, will receive priority. Accordingly, partial objectives of this character are redundant.

The two remaining partial objectives are extremely dubious. To the extent that the internationalisation of Norwegian trade and industry and similar considerations are valuable in their own right, these kinds of objectives will reduce the value of the Department for Industrial and Commercial Cooperation's activities. In other words, they reduce the department's contribution towards the Ministry's general objective. If the Department for Industrial and Commercial Cooperation's activities help accelerate the process of internationalising Norwegian industry, this may be very well, but it is of no value in terms of foreign aid. This conclusion seems to be in line with the attitude of the Storting. For instance, Recommendation S. no. 186 (1986-87), p.47 states:

> "The committee affirms that the internationalisation of Norwegian trade and industry is important as regards Norwegian trade policy, but wishes to emphasize that the measures for furthering this internationalisation cannot be financed by the foreign aid budget, except in cases when the measures have a clear stimulating effect on development in developing countries, in accordance with the objectives for Norwegian foreign aid."

6.3.2 Budgetary constraints

We are often given the impression that the Ministry of Development Cooperation has more funds at its disposal than it is able to spend. If this is correct, it is probably because the foreign aid budget has grown very rapidly, both because of an increase in its share of GDP and because of rapid growth in the Norwegian GDP. An additional explanation is undoubtedly to be found in the heavy constraints put on the allocation of foreign aid. It will always be possible to use any amount of foreign aid if the money can be granted to the authorities of the receiving countries without restrictions. First, tied aid requires administration. Moreover, it can be difficult to find projects that meet the requirements. Loosening the constraints would simplify both the administration and the task of finding good projects.

In the previous section we pointed out that in a situation where the budgetary restrictions put no constraints on the allocation of funds, the costs of supporting a project are non-existent from the point of view of the foreign aid administration. As the resources are not scarce, the implementation of one project will not displace another project. Is this the actual situation in the Ministry of Development Cooperation?

It is difficult for someone outside the organisation to form an opinion on this matter. However, we wish to point out one argument for maintaining that the funds may have opportunity costs even though the situation in a certain year is like the one described above. We base our argument on the hypothesis that funds can be transferred from one year to the next. We assume that sooner or later the Ministry of Development Cooperation will experience that funds are getting scarce, both because the grants will no longer increase as fast as before, and because the organisation will become better at indentifying good projects. (The constraints might even be relaxed?) In this perspective we assume that the grants for one year are not affected by transfers from previous years. If this is correct, support for a project one year will be granted at the expense of a different project the following year, or the year after, even in a situation with seemingly superfluous funding.

There is yet another argument for maintaining that individual departments with available funds, in the sense that the entire grant is not used, (e.g. the Department for Industrial and Commercial Cooperation) ought to calculate the costs of foreign aid funds: other departments may experience scarcity, in the current period or later.

CHAPTER 7: SOCIAL COST-BENEFIT ANALYSES

7.1 Introduction

In the previous chapter the principles of foreign aid administration were discussed. We did not consider more closely how to measure the welfare effect of a project, or a foreign aid activity, which in our terms of reference is nothing but a group of projects. We will recommend using modern welfare theory as a foundation, especially as these theories are applied in social cost-benefit analyses. The social cost-benefit analysis we wish to recommend, is a method which has been developed partly at the initiative of organisations such as the UN (UNIDO), the World Bank and the OECD.

In this chapter we will briefly outline the main ideas behind this method. However, we would strongly recommend our readers to aquaint themselves even better with it. We regard the social cost-/benefit analysis to be essential in connection with any planning and/or evaluation activity in the Ministry of Development Cooperation. The ideas outlined in the previous chapter would therefore be difficult to understand unless the reader, to a certain extent, is familiar with this method. In the Ministry of Development Cooperation and many other circles which have specialized in development studies, there seem to be many misconceptions concerning this method. These misconceptions are probably rooted in a lack of understanding for, and scepticism towards, the practical usefulness of economic theory in general and specifically in connection with foreign aid. We would therefore like to demonstrate that social cost-benefit analysis can be an extremely useful tool, which, when applied pragmatically, will help produce a considerable increase in the welfare gains in the receiving countries, without entailing formidable increases in planning and evaluation costs. In chapter 10 we will use social cost-benefit analysis in our evaluation of the projects, and it is necessary to be aquainted with the main principles of the method in order to determine the validity of these evaluations.

Social cost-benefit analyses are in use in many developing countries in connection with the planning and evaluation of investment projects. The first part of this chapter, in which the main ideas are presented, will be based on the developing countries' perspective, i.e., we will describe how the developing countries ought to evaluate the projects themselves. We will then consider how social cost-benefit analysis may be used to solve planning and evaluation problems within the Ministry of Development Cooperation. In that connection we will briefly indicate how information derived from the planning and evaluation carried out in the receiving countries can be utilized by the Ministry in their own planning and evaluation. Further, the concept of receiver-oriented aid will be examined and interpreted in the light of probable conflicts between the Ministry of Development Cooperation's objective and the objectives of the receiving countries.

7.2 The developing countries' perspective

This analysis is based on the authorities' comprehension of total welfare, expressed by means of a welfare function. This is the same type of welfare function as the one assigned by the aid organisation to each country in our discussion in the previous chapter. This means that the present and future consumption level of the country's population is included in the function. The authorities' judgement concerning the distribution of income (the elasticity of marginal utility) and the value of an immediate welfare increase as compared to the value of a future welfare increase (the rate of time preference) may diverge from those preferred by the Ministry of Development Cooperation. We will return to this later on.

When calculating the welfare effect of a project, e.g. an industrial project, we do this by assigning prices to the project's inputs and outputs. These are what we call *shadow prices*.

The shadow price of a certain kind of output from the project reflects the change in society's welfare following the increased access to this commodity by one unit.

The shadow price of a certain kind of input to the project reflects the change in society's welfare following the rest of society's reduced access to this input by one unit. The concept of *opportunity cost* is also often used in this connection.

If we are to calculate the shadow price for all of a project's inputs and outputs, we need to know how the authorities' welfare function is formulated. In addition, we need information on certain features of the country's economy. Our intention may become more apparent if we formulate the relevant special features as constraints on the welfare level, measured by means of the welfare function. We will classify these constraints in three different categories:

I. First, there are fundamental constraints having to do with access to resources, technology, etc. These are the types of constraint that are usually pointed out when explaining the poverty of the developing countries: low capital stock (factories, roads, harbours, etc.), poor quality of labour (due to low level of learning, poor health or insufficient nutrition) and a low technological level. These are constraints which cause low levels of productivity and income, even when all accessible resources are employed in the activities which produce the highest gains from the point of view of society.

In a perfect market economy, in which the authorities may readily redistribute income according to their own wish, these constraints are the only relevant ones. It is a key principle of welfare theory that in such an economy, which must be considered a theoretical construction, the market prices will represent the shadow prices required to find the project's social value.

In this economy the market prices (representing economic signals according to which private firms and households adjust themselves) ensure that the private actors, when seeking to realise their own interests, also contribute to the maximization of welfare in society at large. Accordingly, the fact that the market prices and the shadow prices coincide helps make governmental checks on private firms' profitability appraisals redundant. Private and social profitability will coincide.

In an open economy, i.e. an economy which engages in international trade and exploits its comparative advantage, the domestic market prices, and consequently the shadow prices, of goods and services that are traded internationally, will under certain conditions be identical to the world market prices in foreign currency multiplied by the exchange rate. The exchange rate will be determined so as to create a balance between the supply of and the demand for foreign currency. In this situation the country would exploit its potential for international exchange of goods and services, so that the country's total income would be maximized. The world market prices determine the terms of the international exchange of goods.

II. We can find the background for another type of constraints on the welfare level if we set aside the condition of a perfect market economy but retain the assumption about perfect income redistribution possibilities. These constraints refer directly to the organisation of the economy, and prevent the welfare potential indicated by constraints of type I from being fully realised. This is because the economy's available resources typically fail to be used where they produce the highest return. This is related to the fact that the economic signals that private agents are faced with (the market prices) are such that the private agents, when they seek to realise their own interests, make choices that do not benefit society at large. The market prices and the shadow prices no longer coincide. Consequently, the total value added, and therefore the total income at the disposal of the members of society, will not be as high as if these constraints were not present. This gives us an argument for maintaining that a social check on private firms' profitability appraisals is required. Private and social profitability no longer coincides.

With economic theory as our frame of reference, it is natural to point out at least three types of problem that arise in this connection:

First, there are market failures of the kind that are often pointed out as the most important types of market failures in industrial countries, namely public goods, externalities etc. In such cases government action is required in order to improve allocation efficiency.

Second, there are the forms of market failure that are often identified as particularly common in developing countries: lacking or fragmentary markets and unfavourable patterns of organisation. Economic growth and development often go together with new and improved markets and patterns of organisation. In part this occurs automatically, and in part it occurs as a consequence of a government's deliberate economic policies.

Governments often try to compensate for the two forms of market failure that have been mentioned so far. However, it is clear that government policies often cause market imperfections and unfavourable allocation of the society's resources as well. The most important imperfections of this kind are probably price distortions caused by the government's trade policy, foreign exchange policy, employment policy, price policy for public services and policy on interest rates.

There may be many reasons why governments cause price distortions in these areas. Political pressure may be one of them, as well as insufficient awareness of the policy's unfavourable consequences, or perhaps the lack of better economic instruments.

Restrictions of type II are wide-spread in many developing countries. Consequently, the market prices will often be useless as shadow prices. The shadow prices will have to be calculated. When doing so, the world market prices of internationally traded goods and services are often used as a sheet-anchor for the shadow price system. These still represent the country's actual possibilities for exchange. Against this background foreign exchange is apt to be used as the unit of account, or numéraire, when the relevant shadow prices and the value of the project are being calculated.

III. The third type of constraints on the welfare level appears if we no longer assume perfect income redistribution possibilities. Welfare would increase if it were possible to effect a redistribution from rich to poor people and/or from the current generation to later generations (by increased savings and investments). These constraints are caused partly by political opposition to redistribution and partly by unfortunate consequences on the incentive system caused by redistribution. To the extent that the income distribution will be influenced by the implementation of the project, the shadow prices ought to reflect these distributional effects. Therefore, this is yet another argument for maintaining that market prices cannot be used as shadow prices.

We will now have to find out who will benefit from implementation of the project and who, if any, will lose. It is no longer sufficient to determine the effect on society's total income. Consequently, we can no longer use foreign exchange in general as a unit of account; we will have to say something about the receiver and the application of the relevant foreign currency. We will use untied foreign exchange in the hands of the government as our unit of account. All use of foreign exchange, then, will have to be considered in relation to this unit of account.

Against the background of this discussion, projects can (and should) be appraised in at least three ways:

I. At domestic market prices.
In this appraisal constraints of types II and III are not considered. The current market prices are observed quantities, but future market prices will have to be predicted.

II. At the efficiency prices.
In this appraisal constraints of type II are considered, but not those of type III. Efficiency prices are calculated quantities.

III. At social prices.
In this appraisal constraints of types I and II are considered. The social prices must be calculated like the efficiency prices. They are equal to the efficiency prices adjusted for distributional effect.

It is important to consider the causes of deviations between the different price systems in order to find the scope of the error made by not including constraints of types II and/or III (i.e. by settling for the market price).

We will illustrate our main points by studying the shadow price of labour - the shadow wage rate.

The shadow price of labour

The shadow price of labour reflects the loss of welfare inflicted on society if labour is transferred from any other activity to the project in question.

In a perfect market economy in which the government is free to redistribute income, i.e. an economy in which only constraints of type I are relevant, the market wage rate will express this loss of welfare. In an economy of this type the market wage rate will reflect the market value of a worker's production in the type of activity he abandons. If, for the sake of convenience, we imagine that the worker ceases to produce a commodity of which the country is a net importer, and which is freely imported, imports of this commodity will increase by a quantity which equals the loss in production. The market value of this import increase will equal the world market price in foreign currency multiplied by the foreign exchange rate, i.e. the currency cost which society incurs when the worker leaves his former eployment.

The currency cost, which in this case equals the market wage rate, is in fact the shadow wage rate estimate which ought to be used.

If competition is not perfect, i.e. if constraints of type II are also present, the market wage rate can no longer be used as the shadow wage rate.

With our set of references, however, the shadow price, i.e. the efficiency wage rate, will still reflect the currency cost which society incurs when the worker is transferred to the project in question. This, however, no longer equals the market wage rate.

A frequent form of market imperfection in developing countries is a market wage rate which is so high that it creates unemployment. We can illustrate the main point by looking at two extremes. One extreme which is often used in older economic literature on developing countries is an efficiency wage rate which equals zero. This is based on the assumption that a worker employed in the project is unemployed at the outset, and so does not contribute to the production of anything at the outset. Consequently, society does not incur any costs when the workers are employed. As long as costs attached to reduced spare time etc. for the workers are negligible, this line of argument is correct if we can be certain that the reduction in unemployment has no other relevant consequences. In order to illustrate the other extreme, in which the efficiency wage rate can be imagined to be very high, we will point out one type of consequence from reduced unemployment which seems be of importance in some places. If the project is planned for a region with a certain degree of unemployment, it is expected that unemployed people will be employed in the project. However, it may well be that workers in other regions react to the improved employment situation in the project region by migrating there in the hope of getting work. It may well be that these migrants were employed in productive activity in the regions they came from. If, for instance, three persons move to the region and become unemployed for every person employed in the project, society will incur very high currency costs as a consequence of employing that one person. The fact that he used to be unemployed, then, represents no argument for maintaining that the efficiency wage rate should be set at zero.

If the government cannot redistribute income without problems, constraints of type III must also be considered. The efficiency wage rate, i.e. the currency loss, must be adjusted for the distibutional effect and expressed in units of free foreign currency in the hands of the authorities. Free currency in the hands of the authorities has a value because it can be used for such puposes as investments producing welfare gains in the form of a future consumption increase for the country's population.

Workers employed in the project in question will receive higher incomes and consequently their consumption will increase. Disregarding the migration effect discussed above, we find the social wage rate by referring to the efficiency wage rate, i.e. the general loss of currency. Initially, the government will experience this loss as reduced access to foreign currency. In addition, however, the workers' consumption increase will tie up foreign currency. The import of some commodities will increase and the export of others will be reduced, the domestic production of a third commodity will increase, etc. This means that the amount of foreign currency which is at the free disposal of the authorities, and which can be used for investment purposes, is further reduced in relation to the efficiency wage rate. On the other hand, it is evident that the workers' consumption increase is valuable in its own right from the point of view of society. This will have to be expressed in units of free foreign currency in the hands of the authorities. This welfare gain contributes to reducing the social shadow wage rate. The poorer the worker is at the outset, the higher the welfare gain (and the lower the social shadow wage rate.)

The value of a project

Let us imagine that the project in question represents an investment in one period which will produce a stream of future welfare gains (the value of the stream of finished products less the value of the inputs, estimated at the relevant shadow prices). The difference between the future welfare gains and the initial investment (which will also have to be estimated using the same type of shadow prices) will then represent the total welfare gains. The future welfare gains are typically experienced later than at the time of the initial investment, and often at different points in time. When we are to set these gains up against the initial investment, it is the value of the gains as they are estimated at the time of investment which is relevant. We say that future gains must be discounted back to the time of investment.

If the discounted value of the welfare gains exceeds the initial investment, the *present value* of the project is positive and the project ought to be implemented. The project is profitable to society. If the present value is negative, the initial investment is higher than the discounted value of the welfare gains. Society is thus better off by not implementing the project.

In this perspective the initial investment reflects the loss of welfare which society experiences when means are tied up by the project. These costs, often called the opportunity cost of capital, consequently depend on the alternative application of the funds if the project is not implemented. If our underlying assumption is that the project is to be wholly financed by public means, we know that the money will be taken from a given investment budget, and thus from another public project which will not be implemented. The opportunity cost of capital, or the investment cost from society's point of view, will then be determined by the discounted value of the welfare gains that society forfeits as a consequence of the fact that the project in question is not implemented.

The simplest way to estimate this cost of investment is to use the *internal rate of return* (society's annual earnings from the invested capital, expressed as a proportion of the outlays) in the project that was forgone as the discount rate when the future welfare gains of the project we study are to be discounted to the time of investment. A positive present value, then, implies that the internal rate of return in the project in question exceeds the internal rate of return in the project that was forgone. A negative present value has the opposite implication.

Alternative finance

We assumed above that the project in question was to be financed entirely by public means, and that the means were to be taken from a given investment budget for the period of implementation. If this project is implemented, one or more other projects (preferably the least profitable one(s)) will have to be forgone.

However, there are other ways of financing a project. Domestic and/or foreign private agents may contribute equity capital, or loans can be raised in the domestic or foreign private sectors for part or total finance.

The required finance would then be taken from other sources than if the project were wholly financed by public means, and profit after taxes would be at the disposal of private shareholders, while private lenders would receive interest income.

The main principle remains the same as if the project were wholly financed by public means. The cost of investment reflects the welfare gains society forfeits as a consequence of using the means for the project in question, rather than for alternative applications. If the private means were taken from the domestic market, the alternative could be a private investment project within the country. The cost of investment would then constitute the welfare gains forgone by not implementing this project.

If the private means come from the international market, the alternative could, as is often the case, be investments in projects in other countries. The relevant cost would then under certain circumstances be zero: if the means are tied up in the project in question, this will not be at the expense of other projects that produce welfare gains in the country.

The welfare consequence from the shareholders' disposal of profits and the private lender's interest income will also have to be studied and appraised.

What about aid financing in this perspective? From the receiving country's point of view the most important question is whether the aid which may contribute to financing the project in question, would otherwise be used to the benefit of the country. If the answer is yes, and the alternative is untied means granted to the authorities, an implementation of the project in question will in fact take place at the expense of other public projects, and we return to the situation described in the previous section. If the answer is no, the aid is tied to the project and the money will not benefit the country unless the project is implemented. In this situation foreign aid financing implies no opportunity cost for the country. Under certain circumstances the cost of investment will thus be zero. As we will see later, foreign aid organisations ought to think along other lines. The aid could alternatively be used for a project in another country. Consequently, there is an opportunity cost: the welfare gains forfeited by the other country.

7.3 A foreign aid perspective

Thus far we have presented the main ideas of social cost-benefit analysis with a developing country's typical need for planning and project evaluation as our term of reference. We will now briefly outline how the Ministry of Development Cooperation can make use of some of the work carried out in developing countries in this field in their own planning and evaluation activities.

If we return to the planning model for the foreign aid organisation outlined in chapter 6, there is a clear need for much information on the economy of potential receiving countries in order to obtain a picture of the relationship between the effort applied in various aid activities and the welfare in these countries. In connection with the necessary gathering and systematizing of information the Ministry of Development Cooperation ought to make use of information which has already been collected and arranged by planners in the receiving countries (or possibly by other aid organisations). This applies both to general information of an economic nature and more specialized information concerning shadow prices etc. As this type of activities are poorly developed in some countries, it would probably be wise to use foreign aid in order to initiate or improve such activities.

When the Ministry of Development Cooperation makes use of information which already exists in the developing country, it is important to keep in mind that it should be adjusted somewhat before it is used in the Ministry's planning and evaluation system. This is the case for shadow prices in particular. A project is not necessarily of the same value to the Ministry of Development Cooperation as to the receiving country. There are two main reasons for this difference. First, the welfare function that the Ministry has assigned the country is not necessarily similar to the one that the government represents, implicitly or explicitly. Second, the Ministry ought to have a wider perspective than the planners in the receiving country, in the sense that possible welfare effects in other countries should also be considered when estimating the value of a project. This is the case both if the project to be implemented has a direct effect on welfare in several countries, and if a project in one country is implemented at the expense of a project in another country.

We will first comment briefly on the discrepancy between the welfare functions. These discrepancies are rooted in different attitudes concerning income distribution (cf. the elasticity of marginal utility) and/or the value of future welfare as compared to the value of immediate welfare (the time preference rate). There is reason to believe that the Ministry of Development Cooperation has a stronger preference for income redistribution than the governments of several potential receiving countries. The Ministry may also be more patient in the sense that the premium put on immediate welfare as compared to future welfare is relatively low. Discrepancies of this kind necessitate adjustment of the social shadow prices, even in situations where there is no need to compare the welfare effect in different countries, i.e. in situations with only one potential receiving country. The efficiency prices, however, need not be adjusted.

It is particularly the social wage rates that will have to be changed as compared to the receiving country's calculations. However, these adjustments are easy to perform. The values of the elasticity of marginal utility and the time preference rate which are used, and which are based on the government's preferences, will simply have to be replaced with new ones based on the Ministry of Development Cooperation's objective.

The other problem is rooted in the Ministry's need to compare projects and therefore welfare in different countries, a need which the individual governments do not share. Comparisons of this type will have to be carried out whenever several countries benefit from the same project. However, their particular importance is based on the fact that the alternative to supporting a project in one country may often be the supporting of a project in another country. Consequently, the welfare effects and shadow prices must be made internationally comparable.

7.3.1 Receiver-orientation

We have pointed out the possibility that when based on the authorities' own preferences, the welfare function of the receiving country may fail to coincide with that of the Norwegian Ministry of Development Cooperation. In addition, the Ministry and the receiving country may have diverging views on the opportunity cost of the aid.

What are we to understand by receiver-oriented aid in this perspective? On the basis of the planning perspective presented in chapter 6, we recommend that the Ministry of Development Cooperation choose to implement the projects that seem best in relation to the organisation's welfare function. Receiver-orientation can be catered for by introducing restrictions stipulating that projects shall be acceptable to the receiving countries, i.e. they shall contribute to the increase of welfare in the receiving country as evaluated by the preferences of its government. If the government concerned does not calculate the value of the project in this way, we recommend that the Ministry of Development Cooperation carry out these calculations on their behalf.

CHAPTER 8: INVESTMENT SUPPORT AS A FOREIGN AID ACTIVITY

We have previously indicated that we consider support for investment as one of the aid activities in the planning model outlined in chapter 6. The task of the Department for Industrial and Commercial Cooperation is to administer the money that the department has been granted as efficiently as possible. In doing so, the department is to support and contribute to the implementation of industrial and commercial projects in a number of countries. In this respect, then, Norwegian trade and industry are means used by the Ministry of Development Cooperation (through the Department for Industrial and Commercial Cooperation) in their administration of foreign aid.

In this respect the deliberations of the Department for Industrial and Commercial Cooperation are not in fact dependent on the basis for deciding the grant. If decisions are made on the basis of a rational planning system of the type discussed in chapter 6, the expected marginal return on the grants to this department, in the form of increased welfare in the receiving countries, will be equal to the marginal return on grants to other departments. If political constraints (or lack of planning) make the grant larger than it would have been under such a planning system, the return will be lower than in other departments. In that case it would be profitable to transfer means from the Department for Industrial and Commercial Cooperation to other departments. If the opposite is the case, it would be profitable to transfer means from other departments to the Department for Industrial and Commercial Cooperation. In our discussion we have maintained that the Department for Industrial and Commercial Cooperation ought to use the Ministry's objective as their term of reference, as we have operationalised it, and that the department ought to assume that the grants it administers are scarce, even in years with seemingly idle funds.

Until now we have used the concept of *return* from aid as if it were an unambigous and unproblematic concept. However, it is hard to operationalise this concept satisfactorily.

The rate of return is to be used for ranking projects according to degree of profitability in terms of foreign aid. It is supposed to help channel scarce means into the types of activities and projects that produce the highest welfare gains in the receiving countries. Both the net present value per Norwegian Krone granted to the project in question and the internal rate of return on contributions represent rates of return of interest to the Department for Industrial and Commercial Cooperation as well as for other types of foreign aid activities (even though there are objections to both of them). We recommend that the Department for Industrial and Commercial Cooperation choose a rate of return of this type when the projects are to be ranked. The number of projects to be supported will depend on the size of the department's grant, which in a rational plan will reflect the rate of return on other foreign aid activities.

So far we have considered as given quantities such project characteristics as the quantity of outputs, inputs, and amount of support. However, it is clear that these quantities and many other factors will be the results of negotiations between the private investors (in Norway and in the host country), the authorities in the host country and the Department for Industrial and Commercial Cooperation. In this connection it is not, from the point of view of the Department for Industrial and Commercial Cooperation, only the support amount, i.e. the <u>extent</u> of the support, that is relevant. The <u>type of support</u> and any <u>conditions</u> attached to it are also important factors, because they influence the return (measured in welfare) per Norwegian Krone granted in support of a project.

There are two factors of particular interest when considering various types of support. One of them is what kind of instruments are to be used in the various projects; the other is what regulations should be attached to these instruments. In addition to the instruments that the Department for Industrial and Commercial Cooperation administers today, we can envision a number of others, such as support for the use of (unskilled) labour.

The choice of instrument may be of importance to the project profile. If support is issued as loans on concessionary terms, this will probably effect an increased use of capital (machines etc.) as compared to labour. If on the other hand the support is issued in the form of labour subsidies, the opposite consequence is the more probable. If the Department for Industrial and Commercial Cooperation possesses the necessary information on the project and has calculated its value by means of a social cost-benefit analysis, the department ought to design various "support packages" with a view to finding the one that gives the highest return per Norwegian Krone granted in support. It is hard to come up with a general recommendation as to what this package should look like, i.e. which instruments ought to be used, and how the detailed regulations should be formed. The "support package" should be tailored for each individual project.

The main reason is to be found in the limited number of projects of very different nature being implemented in many different countries. If the projects were of a relatively similar nature and they were implemented in relatively similar countries, it would in principle be possible to design a good aid package to be used in all projects.

In the attempt to design the best "support package" the Department for Industrial and Commercial Cooperation ought to keep in mind that the private investors will not go through with the project if the return they receive on their investments is too low. At the same time the department ought to keep in mind that a project is to be profitable from point of view of the recieving country (the host country). These considerations will in the last instance be decisive for the extent of the support, i.e. the amount of foreign aid required for the project to be implemented.

To the extent that it is possible to attach conditions to the support, in addition to those implied by the incentives used etc., the task of the Department for Industrial and Commercial Cooperation ought to be to gear the project in the direction that maximises the social rate of return. If these conditions are to be meaningful it is evident that the projects must be followed up with a view to checking whether the conditions are met, and there must be possibilities for imposing sanctions.

If the projects that receive support for investment have consequences for the rate of return on other foreign aid activities, attempts should be made to integrate support for investment with the relevant activities.

PART THREE:

AN EVALUATION OF THE PROVISIONS FOR INVESTMENT SUPPORT, THEIR ADMINISTRATION AND RESULTS

CHAPTER 9:
THE CURRENT INSTRUMENTS AND THEIR GUIDELINES

9.1 Introduction

The guidelines for the five instruments covered by the provisions for investment support were revised in 1985 based on the realization that their earlier presentation made them difficult for users to understand. The revised guidelines, as presented in the publication "Guidelines for finance and support for undertakings in developing countries" from 1985 (cf. appendix), have never been formally approved by the senior officials of the Ministry of Development Cooperation, but the Department for Industrial and Commercial Cooperation regards them as being in force, based on the philosophy that silence is consent. The revision was primarily concerned with the form of presentation, seeking to present the various schemes as parts of a single programme.

The guidelines contain first a number of general regulations which apply to all five instruments, and then a number of detailed regulations concerning each individual instrument. In this chapter we will examine critically both sets of regulations, with the ideas and perspectives presented in chapters 6, 7 and 8 as our terms of reference.

9.2 General regulations

First, there are elements in the general regulations that formally exclude many interesting projects on formal grounds. With our set of references these must be considered as constraints or ties. Secondly, the provisions set out the criteria used to determine whether projects that are not excluded on formal grounds, deserve support. With our set of references this may be considered as a profitability test.

9.2.1 Regulations that exclude potentially interesting projects

We will first identify the regulations that exclude a number of relevant projects on formal grounds.

- A Norwegian firm must be involved and its involvement must be of decisive importance to the establishment of the enterprise (2.1 and 2.4). This regulation can hardly be seen as anything but a way of tying foreign aid out of consideration for Norwegian interests. It is therefore clearly in conflict with the stipulation that most of the Norwegian development aid shall be granted untied, and it reduces the value of the aid. If this stipulation were not there, foreign firms could apply on equal terms with Norwegian firms, and this would undoubtedly increase the number of good applications for support and consequently the value of the investment support in terms of foreign aid.

It is true that the guidelines state that "other foreign interests may participate in the finance and the implementation of the projects" (2.4), but this formulation does not open for independent foreign initiative.

- A Norwegian enterprise is further defined as an enterprise registered and established in Norway, but with the additional prerequisite that "the enterprise runs a business in Norway which is relevant to the objective of the establishment" (2.3). This stipulation represents further ties, and it cannot possibly be founded on considerations for foreign aid. The fact that the Norwegian firms operate their relevant activity abroad can hardly reduce the value of the project in terms of foreign aid.
- Further, it is clearly stated (2.4) that the provisions will primarily be used for the support of projects in the manufacturing industries. However, other undertakings may receive support, loans or guarantees if the Norwegian firm possesses special professional or commercial qualifications. This stipulation cannot possibly be founded on considerations related to foreign aid policy. Is it evident that undertakings whose activities are related to e.g. agriculture, fishing or service industries are of less worth than manufacturing firms? The answer is a clear "no", all undertakings should be weighed against each other on equal terms. There is no reason to discriminate against activities other than manufacturing.

It is difficult to see how these regulations can be founded on considerations for anything but the Norwegian business community, and Norwegian manufacturing industry in particular (cf. one of the previously discussed partial objectives of the Department for Industrial and Commercial Cooperation, chapter 6.3.1).

9.2.2 Criteria for deciding whether a project deserves support

In addition to these stipulations, which exclude many potentially relevant commercial projects on formal grounds, the general provisions set out certain criteria for deciding whether a project deserves support (2.5):

> In order for the Ministry of Development Cooperation/NORAD to grant support or loans, the undertaking to be established is considered technically feasible, financially viable and economically sound, and have a definite developmental effect. When evaluating the developmental effect of a project, emphasis will be placed on whether it:
>
> 1. contributes to the useful production of goods and/or services in the host country,
> 2. creates profitable jobs which improve the social and economic conditions in the host country,

3. is located in relatively poor areas,
4. involves necessary systematic training of local labour,
5. forms a basis for other economic activities,
6. uses and processes the host country's own raw materials,
7. contributes to the improvement of the host country's level of technological achievement,
8. applies a technology that is adapted to the needs of the host country,
9. contributes to the improvement of the balance of payments through reducing import or increasing export.

It is not required that each project fulfil all these criteria. Decisive emphasis will be put on the host country's evaluation of the project.

In the evaluation of undertakings it will be emphasized that the firm will offer the local employees working conditions in accordance with existing local regulations in force and also accepted international norms and ratified conventions.

The first sentence contains a collection of nice-sounding phrases that might just as well have been deleted. Is there such a thing as a financially viable project which is not technically feasible? Do the critera for developmental effects carry any meaning which is not covered by the concept "economically sound"?

When a project's value in terms of development assistance is assessed today, it appears that its various developmental effects are being considered. Other effects seem to be disregarded. In our perspective these criteria should help identify the projects, among those not excluded on formal grounds, which have the highest social profitability, i.e. have the highest value in terms of development assistance. It is essential that the Department for Industrial and Commercial Cooperation apply certain criteria for deciding whether a project is worthy of support, and it is reasonable to require the following of these criteria:

- They ought to be <u>reliable</u> in the sense that they actually contribute to measuring the value of the project in terms of foreign aid.
- They ought to be relatively <u>simple</u> in use, to avoid delays in the decision-making process.
- They ought to be relatively <u>unambiguous</u>, so that project appraisals are independent of the executive officer responsible.

In light of our terms of reference the present criteria used by the Department for Industrial and Commercial Cooperation seem to be neither reliable, simple nor unambiguous:

- They are not reliable because they are difficult to use for measuring a project's value in terms of foreign aid. For instance, it is impossible to compare the different criteria.

When it is impossible to measure the value of a project, it is also impossible to rank it meaningfully in relation to other projects.

- If taken seriously, they are not particularly simple to apply. Quite a lot of time will have to be spent outlining and assessing the qualities of a project along these dimensions.
- They are ambiguous. To a great extent the individual executive officer will have to use his/her own discretion, both concerning the operationalisation of each criterion, and, not least, concerning the comparison of the project's contribution along the various criteria.

The stipulation that "decisive emphasis will be put on the host country's evaluation of the project" is very reasonable against this background, since this will hopefully stop unfavourable projects which have been found worthy of support by the Department for Industrial and Commercial Cooperation based on their set of criteria. For this to happen, though, the potential receiving country's/host country's organizations for planning and project appraisal must be well developed. In many of the poorest countries, institutions of this kind function very poorly, and so even more importance is attached to the quality of the criteria used by the Department for Industrial and Commercial Cooperation for deciding whether a project is worthy of support. The department (and the rest of the Ministry of Development Cooperation) should strive to function as an ideal in this field.

Even though a project is not excluded on formal grounds or on the basis of the criteria for deciding whether it deserves support, it is not evident that it is eligible for support. Support is not to be granted if the project will be implemented even without support. This is not stipulated in the general regulations, but the principle is laid down in the special guidelines for support to investment in basic infrastructure, initial training schemes and in the provisions for loans and guarantees. Clearly, it should also to be included in the guidelines for feasibility studies (where the feasibility study is regarded as a project in itself) and in the provisions for investment guarantees. Consequently, this could be a general regulation. It seems reasonable to assume that support for projects which are commercially profitable without support, and therefore would be implemented without support, represents an outright waste of foreign aid money. The aid is transferred directly into the owners' pockets. This means that the concept "financially viable" in the criteria for deciding whether a project deserves support, must mean viable given that the project receives support, but not without such support. If the project is finacially viable without support, it is not eligible for support.

We have occasionally heard the following objection to our line of reasoning: "Support given to projects that would be implemented even without this support represents a rational way of administering foreign aid means. By receiving support the Norwegian firm will increase its total investment budget and thus more investments are realised than if the support was not granted". The fact that total investments increase may represent a valid argument (given that the whole amount is not used for dividends, etc.) but in that case we cannot verify the value of the project which is actually implemented by means of the support in terms of foreign aid. This may be a project implemented in Norway or in the US, or if implemented in a third world country, its value in terms of foreign aid may be negative. We therefore reject this argument.

However, there are arguments which indicate a need for exceptions from this rule. If the support can be used in order to effect a positive change of the project's profile in terms of foreign aid, it may be sensible to support it even though support is not essential to the implementation of the project. However, the motivation for making exceptions must be stated in each case.

From the point of view of the Department for Industrial and Commercial Cooperation, it is, of course, very difficult to determine whether a project will be implemented if the application for support is rejected. Applicants will always have an incentive for designing their budgets so that their projects qualify for support, no matter what the requirements are.

To the extent that it is impossible to discriminate between projects that will be implemented without support and projects that will not, we recommend that supported projects be required to yield a higher rate of return than other foreign aid projects. This is based on recognition of the fact that some of the support for business undertakings is wasted because it is given to projects that would have been implemented in any case.

A problem which is closely related to the one we discussed above, concerns interpretation of the concept "investment support". All the guidelines seem to be tailored for new undertakings. However, in some situations it may be wise to use the foreign aid in order to support projects that have been operating for some time, and that will have to close down unless they receive support. However, out of consideration for incentive effects these applications ought to be considered relatively restrictively. We do not wish to see that investors already at the planning stage count on support if problems arise at a later stage.

Further, the regulations stipulate (2.4) that : "It is a prerequisite that the host country is involved in the project". This stipulation is of such a general character that it is almost redundant. Is it possible to implement a project in any country without the country being involved? The stipulation probably indicates owner participation. For the host country the structure of ownership will affect the value of the project, as the opportunity cost of the capital, the application of profits and possibly other project qualities will depend on it. The investors' individual stakes etc. ought therefore to be part of the negotiations between the Ministry of Development Cooperation/NORAD, the private investors (from Norway and the host country) and the authorities in the host country. In this connection it seems inappropriate to require that the host country take a stake in the project, whether the investments are private or public. It may well be that the value of the project, from the point of view of the foreign aid organisation, would be higher without host country participation. The same applies from the point of view of the receiving country.

It should also be noted that stipulations of this nature provide unscrupuluos actors in the host country with opportunities for fraud and easy money. In some cases Norwegian investors looking for a local partner seem to have been easy prey.

The general regulations also point out that the actual conditions for support will be "set out in an agreement between the Ministry of Development Cooperation/NORAD and the receiver." However, this must be considered self-evident as the guidelines are relatively general. Above we maintained that the Department for Industrial and Commercial Cooperation ought to design an "aid package" in which the welfare gains per Norwegian Krone granted as aid are maximised, and the department's conditions implicitly require the projects to be acceptable to the private investors and the authorities of the receiving country. In that connection we assumed that the Department for Industrial and Commercial Cooperation could choose freely from a great number of different instruments. Ideally, it would be desirable to have other instruments at hand than the current five, and it would be desirable to design the detailed regulations differently from the current ones. To the extent that these possibilities are barred, in our perspective we are facing constraints of the type that reduce the value of foreign aid given as investment support.

In pursuit of the best "support package" we recommended that the Department for Industrial and Commercial Cooperation base its work on social cost-benefit analysis of the project. This analysis indicate the extent of the projects' contribution to welfare in all partner countries of the Ministry of Development Cooperation. To the extent that a project is planned for one particular country and will have direct effects on the welfare of this country only, other countries' welfare may be affected through the opportunity cost of the aid tied up in the project. Based on this assumption, the general rule will be that a project should be supported if its rate of return exceeds that of any forgone project.

We will strongly recommend that the Department for Industrial and Commercial Cooperation go over to using this criterion when allocating its means. This criterion is both more reliable and less ambiguous than the current criteria, and it can hardly be more difficult or more time-consuming in use. Moreover, all (meaningful) elements in the above list of developmental effects (and many more) will be integrated in the social cost-benefit analysis of a project. We therefore recommend the following operationalisation of the concept "developmental effect":

> A project has developmental effect if it contributes to an increase in total welfare in the Ministry of Development Cooperation's partner countries.

If we disregard the fact that the implementation of a project in one country may affect other countries, we may argue that this stipulation is covered by point 2: "... improve the social and economic conditions in the host country". This, however, must be the over-all aim for all foreign aid activities (cf. the above discussion on the Ministry of Development Cooperation's objectives). None of the other criteria can have a value in their own right. The fact that they are included, must be owing to the fact that projects' contributions to the improvement of "the social and economic conditions in the host country" have never been properly calculated the way a social cost-benefit analysis would allow. In the absence of such an analysis the other stipulations may possibly (?) be used as <u>indicators</u> as to whether a project contributes to the realisation of this objective. In the project appraisal method we recommend, all meaningful elements in the list of desired effects (and many more) would be integrated in such a way that different (and partly conflicting) considerations are implicitly compared. The outcome is therefore a relatively unambiguous measure of the project's contribution to the welfare of the population. In addition, possible consequences in other countries will be taken into consideration.

Let us systematically consider the eight remaining elements on the department's list of desired effects, in an attempt to find their contribution to the value of a project, as we have calculated it.

The point of reference for social cost-benefit analysis is the project's contribution to the net inflow of foreign curency (point 9). All costs and gains related to the project are calculated in foreign currency so that all direct and indirect currency inflows and outflows resulting from implementation of the project can be taken into account, also those caused by ploughing back profits and servicing loans. The higher the project's net foreign currency inflow, the higher the value of the project.

If the project is implemented in relatively poor regions (point 3), this means, among other things, that the workers are relatively poor and not particularly productive prior to the implementation. This means in turn that society incurs only a low direct cost of foreign currency when labour is transferred from other activities into our project. (If the workers used to be unemployed, this cost will be zero). In addition, society's assessment of these poor people's consumption increase will be high. Both of these conditions will push the shadow price of labour down (it may even be negative) and thus the value of the project will be increased.

Systematic training of local labour (point 4) can influence the value of the project in several ways. If, for example, this training implies that local labour takes over an increasing number of functions in the project, the gain will manifest itself through reduced spending of foreign currency on hiring foreign expertise etc. This will represent a positive factor in the appraisal if the saving (adjusted for any training costs) exceeds the shadow price of the domestic labour. If the training primarily benefits the rest of the economy, i.e. if the trained workers quit in order to take other jobs, this will be a typical example of external effects. The workers' increased productivity will now benefit the rest of society. This is a gain which will have to be estimated and incorporated in our present value estimates. It will of course enhance the value of the project.

What is intended by the stipulation that the technology applied shall be adapted to the needs of the host country (point 8)? All projects with a positive present value are profitable to society and, to a degree, use suitable technology. However, if different technologies could be used for implementing a particular project (technologies which can be classified according to the required quantity of the various inputs) the value of the project will have to be calculated for each technology. The technology which yields the highest project value must be chosen. In most cases this technology will require relatively low quantities of inputs with high shadow price (e.g. petroleum and skilled labour) and relatively high quantities of inputs with low shadow price (e.g. unskilled labour).

What is intended by the stipulation that the project should "contribute to the improvement of the host country's level of technological achievement" (point 7)? If it means that the project should have a high technological standard, i.e. contribute to the efficient transformation of inputs to finished products, this is catered for in the present value method we chose for our term of reference. If, on the other hand, it means that the technological level in the rest of the economy should increase, e.g. due to an increased store of knowledge and skill, we are again faced with an external effect which is very similar to (and related to?) the corresponding phenomenon in connection with the training of labour. In this situation the welfare effect of this externality should be estimated. It will help increase the value of the project.

What is intended by the stipulation that the project should "form a basis for other economic activities" (point 5)? One type of derived activity is the saving and investment of means generated by the project. The value of these investments must be estimated and incorporated in the estimate of the project's value. The same goes for the value of increased production in firms with idle capacity experiencing increased demand for their products following the implementation of our project. The higher the value society derives from this kind of activity, the higher, of course, is the value of the project.

What is intended by the stipulation that the project should exploit and process the host country's own raw materials (point 6)? It is difficult to see how this can form an objective in its own right. The question of whether such projects should be implemented depends on their social profitability. If special considerations indicate that such a project is particularly profitable, this will be reflected in the social cost-benefit analysis. If, for instance, the country experiences idle capacity in its production of raw materials because other countries put restrictions on their import of a certain commodity, its shadow price will typically be low. The value of domestic projects for processing these commodities will consequently rise.

The stipuation that the project should contribute to the "useful production of goods and/or services in the host country" (point 1) is difficult to understand. What is the difference between useful and non-useful production? This distinction would be meaningless in a social cost-benefit analysis.

In light of this discussion it seems quite evident that social cost-benefit analysis is not in conflict with the evaluation criteria currently used by the Department for Industrial and Commercial Cooperation. Social cost-benefit analysis is, however, more systematic and yields less ambiguous answers as to whether a project ought to be implemented. To an outsider it therefore seems that re-structuring departmental practice in this field will contribute significantly to making the administration of Norwegian foreign aid more efficient. If the host country undertakes this analysis, its own government will be able to turn down projects which are socially unprofitable, irrespective of the opinion of the Department for Industrial and Commercial Cooperation.

9.3 Some comments on the current instruments

As is made clear from the discussion of principles in the previous chapter, we recommend great flexibility in the choice of instrument in each case. It is impossible to determine once and for all which instruments are the best.

Out of the five current instruments, we would like to hold out the support for *initial training schemes* and *investment in basic infrastructure*. These instruments are closely related to other kinds of development assistance. The external effects of initial training schemes and investments in basic infrastructure are often positive; i.e. they generate more values than those which the private investors can acquire for themselves. From the point of view of society it is therefore often profitable to put a premium on activities of this type, thereby increasing the investors' interest for them.

The external effects from initial training schemes are primarily related to the fact that the productivity of trained workers will increase. To the extent that the workers leave the project after having completed training in order to engage in other activities, some of the gains will benefit others than those who carry the training cost. These externalities will depend on how project specific the training is. The more generally applicable, i.e. the less project specific, the greater the external effects. Perhaps the Ministry of Development Cooperation ought to restrict their support for initial training to schemes that provide training of a more general nature than what is strictly required from the point of view of the private investors.

In addition to the beneficial external effects, the support for initial training schemes will, from the management's point of view, contribute to reducing the price of labour as compared to the price of other inputs. Consequently, the use of labour will increase. This seems wise, especially if the workers were unskilled before the implementation of the project.

The external effects from investments in basic infrastructure are related to the fact that roads, wharves etc. built for the project can also be used by others, more or less at no expense to them.

It is reasonable to assume that the value of the training scheme or investment in basic infrastructure is lower to the host country than the value of other applications of public means within the country. Otherwise the government would probably have implemented the measures in question anyway. This means that if an amount equal to the cost of implementing these measures were given untied to the authorities, the money would most probably be applied differently. However, given that the money is tied to investment support, this does not mean that support given to relevant training schemes or investments in basic infrastructure represents unfavourable use of development assistance.

Under the *provisions for loans and guarantees*, the Department for Industrial and Commercial Cooperation grants loans on concessionary terms and guarantees for raising other loans. The guarantees must be intended to ensure better terms on commercial loans. Support given under the provisions for loans and guarantees consequently subsidises capital. On the basis of economic theory we would therefore expect a higher capital intensity and consequently a lower labour intensity than if other instruments were used.

The *provisions for investment guarantees* cover various forms of political risks; ordinary commercial risks are excluded. The intention is to increase interest in undertakings in politically unstable areas.

The political risk often seems a threat to private investors. But frequently, although effects of political actions such as expropriation will prove disastrous to the private owners, the project may continue producing goods and services of positive value to the host country even after the expropriation. The value of the project, seen on the basis of the host-country's or the Ministry of Development Cooperation's welfare function, will consequently be much greater than its value to the owners. Against this background the provisions for investment guarantees seem to represent a prudent instrument.

The *feasibility studies* are to contribute to the collection of information required to identify projects of positive value in terms of foreign aid, but which cannot be implemented because information is lacking.

We highly doubt the value of this scheme. In our view it is impossible to decide whether a project deserves support until the feasibility study is finished. The information required for deciding whether the project deserves support is in fact the information the feasibility studies are supposed to provide. Because it is so difficult to distinguish between good and bad projects, it is impossible to safeguard against misuse. Experience with the scheme seems clearly to confirm this (cf. chapters 4 and 11.)

9.4 The specific guidelines

Having critically examined the common guidelines and briefly commented on some special features in the present five instruments, we will now consider the specific guidelines concerning the individual instruments.

Most of the stipulations in the guidelines for the support for *initial training schemes* and *investment in basic infrastructure* are of such a general nature that they are difficult to comment upon. As we believe that support ought to be adapted and tailored in each individual case, this general nature seems sensible. However, we find it difficult to understand how the maximum amount of support is determined. The Ministry of Development Cooperation may cover up to 80 per cent of total investment in basic infrastructure and up to 50 per cent of total training costs "within the framework of an agreed maximum amount".

Further, the guidelines for the support for initial traning schemes include a special stipulation (5.1): "support can be granted to the training of local employees in connection with the establishment". This clearly indicates that the support is to be given at the date of investment. We have already pointed out that support to projects that have been operating for some time, may represent a good way of applying foreign aid if the alternative is for the firm to close down. Seen against the beneficial external effects of support for initial training schemes, this is a particularly weighty argument for this scheme (and for support for investment in basic infrastructure).

The stipulation that Norwegian firms must play an essential part in the undertaking is operationalised in the following way for the *provisions for loans and guarantees*: "Ordinarily the Norwegian firm's investment should comprise so much of the share capital that there is a basis for real control". We are not able to find justification for this stipulation in our terms of reference. If the Norwegian firm in a specific instance demands the majority interest, or if this distribution of ownership is supported by other specific considerations, the final agreement will reflect this situation. However, there are no reasons for stipulating this as a general requirement.

Further, the guidelines include a few constraints which, to the extent they are significant, reduce the project's value in terms of foreign aid:

- there must be no decisive industrial, commercial, or regional factors in Norway, or considerations of employment, which weigh against the establishment (4.1.).
- it is required . . . that there is a reasonable correlation between the investment and the Norwegian enterprise's potential deliveries to the project (4.2).

As for the support for initial training schemes and investment in basic infrastructure, we find it difficult to see a reason for certain detailed stipulations, e.g. that "the individual loan shall include a grant element of at least 25%" (4.1). This probably reflects the OECD's foreign aid requirements. If the Department for Industrial and Commercial Cooperation is relatively flexible, the executive officers will know that a large loan with a small grant element can be exchanged for a small loan with a large grant element. In a way, then, this can be made into regulation that exists only on paper, and this is at best redundant.

The stipulation that "ordinarily, collateral security is to be furnished for the loans and/or guarantees" (4.4) is a more problematic issue. Whether private finance companies will issue loans directly when offered security represents a key question in this connection. If the answer is affirmative, the involvement of the Department for Industrial and Commercial Cooperation is in fact unnecessary. To the extent that support is required, the department ought to subsidise interest rates instead of granting loans and guarantees.

In certain cases support is granted in the form of "subordinated loans", for which the requirements for security are much less severe than for ordinary loans and guarantees. "By a subordinated loan is meant a loan in which the lender has agreed to concede to all other creditors (secured as well as unsecured) so that these may have their claims fully recovered before the lender if the business is liquidated." These loans, then, will represent a type of top finance. This is precisely the kind of venture capital which the Department for Industrial and Commercial Cooperation ought to provide. As the willingness to accept risks increases, so will the number of defaults on loans and the size of losses.

The purpose of granting support for *feasibility studies* is to stimulate "Norwegian enterprises to explore the possibilities for business undertakings and other joint ventures of extended duration". What is intended by the expression "other joint ventures of extended duration" is not made clear from the guidelines, but we presume that it must apply to imports, exports, etc.

In our terms of reference this kind of support for the collection of information must, as already mentioned, be based on the assumption that there are potential projects of positive value in terms of development assistance, which are not implemented due to the lack of information.

The guidelines seem to indicate that only that part of the feasibility study which is carried out abroad is eligible for support (3.1a). This provides applicants with clear incentives for carrying out as much of the study abroad as possible. Accordingly, it seems reasonable to assume that feasibility studies generally become more expensive than if the part of the study carried out in Norway were eligible for support.

Granted, it is required that "information available in Norway be examined to the extent this is possible before the part of the feasibility study eligible for support is started", but it is difficult for the Department for Industrial and Commercial Cooperation to verify this.

However, the most unfortunate stipulation in the guidelines must be that "if the firm carries out or contributes to the carrying out of the project, the amount that has been paid out shall ordinarily be repaid to the Ministry of Development Cooperation/NORAD"

(3.2f). The feasibility studies that deserve support, then, are in fact those that do not lead up to an establishment, whereas those that do lead up to an establishment do not deserve support. Given that the undertaking in question is assessed as being sensible in terms of foreign aid at the outset, this means turning things upside down.

From the point of view of a firm that has carried out a feasibility study and obtained support, this stipulation represents an additional cost related to the undertaking. It is therefore perfectly conceivable that projects now remain unrealised that would have been implemented had the support for feasibility studies been real. If a project receives other types of support, the repayment in connection with the feasibility study may be compensated for by increased support under the other provisions.

The Department for Industrial and Commercial Cooperation evidently wishes to prevent the establishment of consultancy firms which specialize in seeking out projects in developing countries that might be of interest to Norwegian firms: "Part finance of consultancy fees may only be granted in those instances where the applicants themselves have initiated and headed the feasibility study" (3.1c). We find it difficult to understand the reason for this requirement.

In our terms of reference the provisions for *investment guarantees* can, as already mentioned, be based on the assumption that projects which are valuable in terms of development assistance, fail to be implemented unless investors are guaranteed against what they consider to be a high political risk. Investment guarantees "can be granted the investor against loss occasioned by:

- expropriation, confiscation or similar action from the authorities of the country concerned, or
- destruction of property as a consequence of war, rebellion or similar disturbance, or
- ban on payments, moratorium, currency restriction or similar hindrance to payment or transfer of capital, interest or dividend".

These stipulations seem to be prudent. The other detailed provisions are difficult to judge. Investment guarantees are administered by the Norwegian Guarantee Institute for Export Credits (GIEK), but losses on guarantees to projects recommended by NORAD are carried by the Ministry of Development Cooperation.

The issue of whether to let ordinary insurance companies give such guarantees represents an important question of principle. These companies would be in a much better position than the Guarantee Institute to spread the risk. From the point of view of the Guarantee Institute (and thus the Ministry of Development Cooperation) it is therefore possible that total payments of premiums to the insurance companies would be lower than total expected losses. In addition, the Guarantee Institute for Export Credits (and the Ministry of Development Cooperation?) would be able to save administrative costs.

Assuming that the project is desirable in terms of development assistance, support may be granted as a subsidy on the insurance premium instead of as a guarantee on concessionary terms if this is required for the implementation of the project. If the above arguments are correct, this arrangement would probably prove less expensive to the Ministry of Development Cooperation than the present one.

9.5 Proposed changes

In chapter 8 we maintained that the Department for Industrial and Commercial Cooperation, using a social cost-benefit analysis of the projects, ought to be very flexible concerning the type and extent of support. Their objective should always be to maximize the rate of return per Norwegian Krone granted as foreign aid. Against this background it is tempting to consider the present limitation of investment support to a small group of instruments, which are further restricted by a set of detailed regulations, as unnecessary constraints on this type of development assistance. The ideal therefore seems to be as many instruments and as few detailed regulations for each instrument as possible.

For such a flexible system to operate well, however, the executive officers in the Department for Industrial and Commercial Cooperation (or possibly those who do the job on their behalf) must have a good understanding of project analysis (both strictly financial appraisal and social cost-benefit analysis) as well as being competent negotiators.

To the extent that these conditions are not present, a relatively small set of instruments and a fair number of detailed regulations for each instrument may be advantageous. In our perspective such a system would represent a way of governing the executive officers. The set of incentives in question, however, must be well-chosen and the detailed regulations must be sensible. Based on our critical comments in the previous chapter we will therefore suggest some improvements in the present programme, both concerning the choice of instruments and the detailed regulations applicable to the individual instruments.

Concerning the general regulations we insist that all regulations that exclude projects on formal grounds ought to be eliminated. Further, the criteria for deciding whether a project deserves support should be operationalised by means of a social cost-benefit analysis. A project deserves support if its return per Norwegian Krone granted exceeds the return on the project forgone if the project in question is implemented. Once the type and extent of support is decided, the command of social cost-benefit analysis required for estimating this rate of return is not particularly high. The type and extent of support will, in the situation that we have in mind, to a great extent be decided by which instruments are at hand, and their set of detailed regulations.

Based on the current guidelines for *support for feasibility studies*, we would expect very few feasibility studies to lead up to actual undertakings. Chapter 11.1 confirms this.

If this instrument is to be retained in the future, the guidelines ought to be revised so that studies carried out in Norway also qualify for support. Moreover, the stipulation that support is to be repaid unless an undertaking is established, ought to be removed.

However, as already mentioned, we highly doubt the value of this instrument. We find it hard to defend in terms of foreign aid. Foreign aid currently used on feasibility studies, could alternatively be used for other types of aid where the welfare gains are higher.

The purpose of a feasibility study is to identify investment projects of positive value in terms of foreign aid. This is a very important task. We recommend that the Department for Industrial and Commercial Cooperation take on the role which at present is left to private firms. The Department for Industrial and Commercial Cooperation should identify interesting investment projects, possibly in cooperation with other segments of the Ministry of Development Cooperation (cf. the suggestion to integrate industrial support with other aid activities). The department ought, then, to seek out investors that might be interested in implementing the project, and that possess the required expertise.

In this connection the Department for Industrial and Commercial Cooperation ought not to limit its interest to Norwegian firms. In most cases there will probably exist foreign firms that are better suited for the task. Perhaps a number of firms could be invited to submit tenders for the project. The firm that submits the best offer, i.e. that will generate the highest welfare gain per Norwegian Krone granted in support, should be given the responsibility for implementing and running the project (assuming that its welfare gains per Norwegian Krone granted exceed those of the forgone project). It is even conceivable that the project might not need support at all; it might be profitable from the point of view of the private investors even without support.

Concerning the detailed provisions for *investment in basic infrastructure* and *initial training schemes*, we suggest no other changes than removing the categorical requirement that support for initial training schemes can only be granted at the establishment of an undertaking. In addition, the restrictions on the extent of support (up to 50 % of total training costs and up to 80 % of basic investments) seem somewhat categorical and unmotivated.

The support for investment in basic infrastructure and the support for initial training schemes seem to be sensible instruments. This is primarily due to their positive external effects discussed above. The value that the host country derives from training schemes and basic investments, exceeds the value which the actual project generates for its private investors. Through detailed regulations or conditions the Department for Industrial and Commercial Cooperation ought to help make both training and basic investments as little project specific as possible so that they are more applicable to the rest of society than what the project calls for.

Concerning the *provisions for investment guarantees*, we have no concrete suggestions for changes, but would like to recommend that insurance premium subsidies be granted instead of guarantees, provided that ordinary insurance companies are willing to sell the relevant insurance.

The scheme itself seems to represent a sensible incentive. Political unrest is great in many of the countries which presumably will benefit the most from the relevant projects.

Concerning the *provisions for loans and guarantees*, we recommend that all restrictive detailed regulations be eliminated. Further, we recommend that venture capital for top finance be stressed at the expense of collateral security. The possibilities for security that do exist, should be reserved for private lenders.

If necessary, the Department for Industrial and Commercial Cooperation may possibly subsidise interest on these loans. Projects that seem very risky to investors, but in which the potential (excpected) value to society is high, are precisely the kind of projects that the Department for Industrial and Commercial Cooperation ought to support through loans and guarantees. Consequently, the department must be willing to carry losses on their loans and guatantees to a greater extent than today. In this perspective the present "subordinated loans" seem sensible.

The step from subordinated loans to equity capital seems a short one. It is highly conceivable that the most sensible thing for the Department for Industrial and Commercial Cooperation to do is to provide equity capital for a project. In addition to providing venture capital, the department would then secure representation on the board and thereby insight in and influence on day-to-day operations. This approach would prove particularly important and sensible if the department's activities were integrated with other aid activities, and if the department assumed a more active role in seeking out and designing projects, as we recommended in our extended discussion of feasibility studies.

Further, the possibility for stipulating loans in local (the host country's) currency ought to be considered. NORAD would then have to assume the currency risk

As already pointed out, the provisions for loans and guarantees subsidise capital. Accordingly, we expect the capital intensity to become higher than if other forms of support were granted. When discussing the Ministry of Development Cooperation's objective we observed that an increase in income and consumption among poor people was heavily emphasized. Providing relatively well paid jobs for unskilled and/or unemployed workers would probably represent the best way of achieving this. If the Department for Industrial and Commercial Cooperation decides to grant support in the form of *labour subsidies*, we expect a higher labour intensity in the project and a higher rate of employment. Acccordingly, more workers will experience a rise in income and consumption than if support was granted in the form of capital subsidies. We therefore recommend that labour subsidies be introduced as a new incentive. As labour subsidies represent an incentive which is quite similar to the support for initial training schemes, the two schemes might preferably be administered together. Administrative considerations and considerations of incentive effects indicate that labour subsidies ought to be allocated as a specific sum at the date of investment.

In our comments we have tried to point out prudent alterations in the current provisions based on a foreign aid perspective. However, we believe that no rigid system of instruments and detailed regulations will ever work better than a more flexible system in which the executive officers, to the best of their ability, try to put together an optimal "support package" in each case. We therefore consider it very important that the executive officers are trained in the use of social cost-benefit analysis etc., as this will qualify them for such an approach. Of course, this recommendation does not apply only to officials in the Department for Industrial and Commercial Cooperation, but also to other executive officers in the Ministry of Development Cooperation. This type of analysis ought to be in wide use in all types of foreign aid administration.

CHAPTER 10: EVALUATION OF SELECTED IMPLEMENTED PROJECTS

10.1 Introduction

In chapters 6, 7, and 8 we presented an ideal plan, as we see it, for the planning and evaluation of foreign aid activities in general. At the same time we indicated the role of the Department for Industrial and Commercial Cooperation within the total foreign aid picture. If the current aid administration system in the Ministry of Development Cooperation, and in the Department for Industrial and Commercial Cooperation in particular, had been working according to our recommendation, our task of evaluating concrete projects would have been relatively simple. Much of the required information, concerning both the host country economies and the particular projects, would then already have been collected and many relevant estimates would have been carried out. In particular, many of the shadow prices would have been calculated in advance. As that is not the case, we have had to spend much time collecting and arranging information which should ideally have been available beforehand, and in the limited time at our disposal we could not look into as many projects as we would otherwise have been able to. In addition, some of the estimates are less reliable than they could have been.

Our project evaluations have all been based on the type of cost-benefit analysis presented in chapter 7. Most estimates are based on what we have called a *development country perspective*, i.e we calculated the projects' value to their host countries as the respective governments would do if they were to carry out a cost-benefit analysis. We have based our welfare function on the governments' own views (as we perceive them) on income distribution and preferences for immediate or later welfare. In addition, we have used the countries' own views on the opportunity cost of aid and other foreign capital inflows to the country if the project is implemented. Based on the assumption that the country will not benefit from the money unless the relevant project is implemented, the opportunity cost is zero. However, we have also examined how the value of the project is affected if, alternatively, the aid is granted en bloc to the government of the host country.

Some of our estimates are based on what we have called a foreign aid or development assistance perspective. In these cases we have operationalised the welfare function of the Ministry of Development Cooperation and used it instead of that of the receiving country.

Some of our project evaluations are based on the original project documents and thus represent evaluations of a type which ought to be carried out prior to the implementation of the project, i.e. while the project is at the planning stage. In our perspective this type of *ex ante evaluation* is used in order to say something about whether a project seems to deserve support at the time of initiation.

Other project evaluations are based on historical data. This type of *ex post evaluations* is used to check whether the project has in fact generated a welfare increase.

When choosing which projects to examine more closely, we emphasized that:

- different regions and important partner countries for Norwegian foreign aid were represented.
- different types of ventures in developing countries were represented.
- different types of Norwegian parent companies/partners were represented.
- we could benefit from earlier work carried out in the country in question, primarily bearing in mind calculations of shadow prices, carried out for instance by the World Bank. This would greatly simplify the project evaluations, and considering the limited time at our disposal, this was an important factor.
- we could make use of our own work carried out prior to receiving this evaluation assignment.

On this basis we decided to subject Green Farms Ltd. and AFI Ltd in Sri Lanka, Fairview Flora Ltd. in Kenya, and Frionor (Thailand) Ltd., to thorough analysis. Green Farms Ltd., AFI Ltd. and Fairview Flora Ltd. have received loans and support for initial training schemes from NORAD. Green Farms Ltd. has benefited from the provisions for loans and guarantees three times. Frionor (Thailand) Ltd. has also made extensive use of the provisions for loans and guarantees, and has been in close contact with NORAD throughout the course of 6 years.

In order to collect enough data on the projects, as well as to obtain an impression of their influence on the local environment, we visited these firms. The field work in Sri Lanka was carried out in July/August 1986, i.e. before starting to work on this evaluation report. The field work in Kenya and Thaliand was carried out in July 1987. In July we also visited other projects in Tanzania, Egypt, Pakistan, Malaysia and Thailand. These projects have been subjected to a less extensive, non-quantifiable economic evaluation.

The projects we have visited and evaluated are set out below:

Project	Country	Trade or industry	Kind of support
Green Farms Ltd.	Sri Lanka	Cultivation of green plants	Loan, support for init. training and inv. guarant.
Fairview Flora Ltd.	Kenya	Cultivation of green plants	Loan, support for init. training
Alloy Fabricators International Pte. Ltd.	Sri Lanka	Production of metal tubes	Loan, support for init. training
Frionor (Thailand) Ltd.	Thailand	Production of frozen fish/ industrial kitchens	Loan, support for init. training
Jupiter Associates Ltd.	Thailand	Production of explosives	Loan, support for init. training
El Mohandes Jotun Co.	Egypt	Production of paint	Loan, support for feasibility studies
Dahaco	Tanzania	Airport service	Loan
Dyno Pakistan Ltd.	Pakistan	Production of adhesives	Loan, support for init. traning, feasibility studies and inv. guarant.
Star-Block Co. Ltd.	Thailand	Housebuilding	Support for inv. in basic infra-structure and feasibility studies
Jotun (Malaysia) Sdm.Bhd.	Malaysia	Production of paint	Loan
Corro-Coat Sdn.Bhd.	Malaysia	Production of powdered varnish	Loan
Trallfa (Malaysia) SdnBhd.	Malaysia	Production of wheel barrows	Loan, support for feasibility studies

In this chapter, project evaluations will be presented in their order of appearance in the list, followed by a brief summary.

10.2 Green Farms Ltd. - Sri Lanka

Green Farms Ltd. was established in 1979 as a joint venture between one Sri Lankan and three Norwegian firms. The partnership deed stipulates that the local partner has a 40 % stake and that the rest of the share capital is paid in by the three Norwegian investors. The firm cultivates tropic plants for export.

The farm is located in Marawila, 65 km north of Colombo. It consists of five greenhouses (screen houses), offices and storage rooms, its own power plant and a laboratory. At the end of 1986 the company employed more than 200 persons. In addition, Green Farms was in the process of building up an extensive network of contract cultivators for the delivery of plants to the farm.

The production process involves using so-called stock plants for cultivating cuttings and trunks. The cuttings are rooted in netted pots and are then primarily sent to Western European greenhouses in order to be acclimatized for sale on this market. Unrooted cuttings, cut flowers and larger plants are also exported.

Green Farms operates under free trade area conditions. This means that the firm enjoyed exemption from tax from its first export consignment in 1980 until June 1987. From 1987 till June 1998 the firm will pay a 5 % tax on its turnover. From then on Green Farms will be taxed like any local firm.

In Green Farms' first operating year a number of problems arose causing unexpectedly bad results. These problems were primarily due to plant diseases, investments proving to be larger than estimated and the failure of the first product range to meet market demands.

As a result of these problems, in 1983 the company was refinanced and the share capital was raised. In this situation one of the Norwegian partners took over as sole owner. As part of the agreement with NORAD he promised to find a new local partner within two years. As per today Green Farms has no Sri Lankan partner(s). The firm therefore requires that its employees buy a total of 20 % of the share capital.

After the refinancing the company has shown a positive result. The plans that Green Farms presented to NORAD prior to its first operating year have been implemented to a great extent. Thus far, the financial appraisals for the 1983-1989 period have proved to be correct.

Green Farms uses the Norwegian parent company's existing network of distributors, based on one importer in each importing country. The customers are considered sound in their markets. 90% of all production goes to Western Europe, a proportion which is expected to remain constant until 1990-1992. In the following five years the European market for tropical plants is expected to increase by 5-10 % per year. The markets in the USA and Japan are also expanding. It seems as if Green Farms has established itself in the expanding market and that it is now in a phase of steady growth. For the time being, the company's own production capacity represents its limiting factor.

According to the terms of agreement with the GCEC the project was to be financed by foreign capital, except from the local share capital. The project is part financed by NORAD loans amounting to a total of NOK 4.2m, plus an NOK 1m guarantee. In addition, the firm received NOK 59,000 as support for initial traning schemes in 1986. In 1987 the company was promised another NOK 170,000 in support for training schemes.

The first NORAD loan of NOK 750,000, with an NOK 500,000 guarantee, was granted in 1980. The loan was paid out in 1981. When the firm was refinanced in 1983, NORAD granted an additional loan of NOK 1,250,000 and increased its guarantee to 1m. This additional loan was paid out in 1984. When expanding the project in 1987, Green Farms was promised a NOK 2.2m loan. The NORAD loans have been granted at an interest rate of 2.75 - 3% per annum, the principal is repayable after 3-5 years, and then repayment is to made over 3 years.

We estimated the social economic profitability of the project by finding its present value, PVS (Present Value of Shadow Prices). We arrived at the present value by discounting the welfare gains, measured as the difference between the streams of costs and benefits in each period, to a particular period, which we set to 1980 in this case.

We calculated the present value of the project at efficiency prices, the distributional considerations being left out (PVS_1), at shadow prices based on the Sri Lankan government's objectives regarding growth and distribution (PVS_2), and at shadow prices with greater emphasis on the distribution of income (PVS_3), i.e. more in line with the Ministry of Development Cooperation's objectives.

When estimating PVS_1 and PVS_2 we used a discount rate of 6%, while PVS_3 was based on a discount rate of 8%. The somewhat higher discount rate indicates greater emphasis on increased consumption for poor people today.

The results were:

PVS_1 = 3,567,000 LKR
PVS_2 = 3,139,000 LKR
PVS_3 = 4,548,000 LKR

These figures indicate that during its period of operation Green Farms Ltd. has been a profitable project to the national economy. There is only a small difference between the first two present values because the difference between the efficiency and the social wage costs, given the underlying parameters, is small. This is relaed to the fact that a considerable proportion of the workers at Green Farms are unskilled. Before they were employed by the company, their incomes were therefore relatively modest. Consequently, society assesses the rise in these workers' consumption so highly that by and large it makes up for the costs that society incurs by tying up the resources in increased consumption (cf. the discussion on the shadow price of labour in chapter 7).

If we base our calculation of the present value on an objective oriented towards income distribution, the social economic profitability of the project will clearly increase (PVS_3). This is because the social wage rate for unskilled labour will then be much lower. Society's assessment of the worker's consumption increase will rise.

To a great extent the positive present values can be explained by pointing to the inflow of foreign capital in the form of loans and share capital during the first years, and the assumption that the money would not benefit the country unless the project was implemented. This capital inflow, and the rise in turnover during the last part of the period covered by the analysis, together outweigh initial investments and operating costs. However, it is clear that this will have consequences for the future profitablity of the project, because interest rates, repayment and possible transfers of profits to Norway will represent outflows of foreign capital from Sri Lanka and accordingly be costs to the national economy.

The beneficial external effects from this project can be characterized as considerable. Green Farms was a pioneering project in Sri Lanka within the production and export of tropic plants. The company has exerted considerable influence on the development of this industry and has set the standard within this kind of plant cultivation in the country. In this way, Green Farm has made it easier, less expensive and less risky for other firms to apply the same technology.

Green Farms' research, and the spread of expertise as competitors directly copy technology and products, must be characterized as beneficial externalities. It is impossible to avoid these external effects through patent legislation, but company would not want this, in any case, according to its management. As a technological leader in Sri Lanka, Green Farms set the quality standards for other greenhouses. Part of Green Farms' production and market strategy is to establish Sri Lanka as a high quality producer in the international flower market. The long-term effects of these externalities for Sri Lanka's plant exporting industry may prove to be of considerable value to the national economy.

During the first operating years the use of chemicals and pesticides in production, and as disinfectants, caused allergic reactions, headaches and dizziness in the workers. Negative external effects of this kind generate a number of social costs in the form of production losses, heavier burdens on other household members and the public health system, as well as reduced welfare for the individual who suffers the pain. After the routines for the use of chemicals were altered, no allergic reactions have been registered. Besides, the company has introduced a free monthly medical examination for persons who employ chemicals in their work. Other workers are offered an annual medical examination. These examinations may themselves generate beneficial externalities, in that dangerous, possibly contagious diseases may be discovered at an early stage.

In our above calculations we have set no opportunity costs for the NORAD loans but have entered the whole amount as income to the project, representing an inflow of foreign capital. If the alternative application of these means were en bloc aid to the Sri Lankan government, the situation would have been different. As Sri Lanka is one of our main partner countries, this assumption may be reasonable. In that case the project's value to Sri Lanka's national economy would be considerably reduced. At a discount rate of 6% the present value of the project at efficiency prices, would be:

PVS_1 = 335,000 LKR.

At social prices based on the Sri Lankan government's objectives the present value would be:

PVS_2 = -94,000 LKR.

Disregarding the beneficial externalities, the negative present value means that in terms of social economy Green Farms has represented a net loss to Sri Lanka in its years of operation. However, if we base our shadow prices on NORAD's objectives, putting greater emphasis on income distribution, the present value will be positive.

There may be reason to ask whether NORAD support has been justified. The project would probably have been initiated even without this support. In connection with the refinancing in 1983, however, NORAD clearly played an important role in making it possible for the present owners to take over and to carry on the business. The present owners have undoubtedly contributed to the economic value of the project through their attitude to the spreading of technlogy and learning. Closing down Green Farms might have meant a loss to Sri Lanka's national economy as compared to a situation in which the company continued its business. However, there is more reason to ask whether the loan granted in 1987 represented a prudent way of spending foreign aid money. In our view the investments in question would have been made in any case. Consequently, the grant element of the loan represented a direct subsidy of the Norwegian owners, at the same time as foreign aid was taken away from other activities. The opportunity cost of this funding may therefore be considerable.

10. 3 Fairview Flora Ltd. - Kenya

Fairview Flora Ltd. was registered in August 1984. The company produces cut flowers, mainly roses and rosy veil (gypsophila paniculata).

The company is located in Kiambu, a typical agricultural district about 15 kilometres outside Nairobi. An area of 380 hectares within a coffee plantation has been leased for 15 years, with an option for renewed leasehold for another 15 years.

The establishment in Kenya was related to the spreading of a type of pest which represented an increasing problem to flower cultivators in other countries. Experience from Kenya showed that it was possible to fight the pest by means of strict control and a correct spraying plan.

The then production manager of the Norwegian parent company had formerly worked with flower cultivation in Kenya as a NORAD expert. Familiarity with local conditions, the favourable climate and ample local access to inputs like fertilizers and inexpensive labour, made the Norwegian investors assess the conditions in Kenya as being very favourable for this type of cultivation. It was also an important factor that the Scandinavian Airlines System (SAS) on its weekly flights between Johannesburg and Copenhagen, with intermediate landings in Nairobi, could provide for fast and safe transport of plants to Norway. These flights were later discontinued and transport to Europe was then taken over by Lufthansa and the KLM. 65% of the current production is exported to Norway. The remaining 35% is sold to florists in Nairobi, where the current demand is great.

It was the present Norwegian sole owner of Green Farms Ltd. that took the initiative for the establishment of Fairview Flora. This is an import and gardening firm for cut flowers and potted plants which also has a small production of turves. Today this firm is responsible for half the total flower imports to Norway. Its branches include a wholesale firm and a retail chain. It is this firm which now conducts the sale of the Kenyan flowers on the Norwegian market.

The Norwegian main shareholder visits the project 5-6 times a year, as this is considered less expensive and more cost efficient than permanent presence. Moreover, the Norwegian owners keep in touch by means of telephone, telex and mail. A Kenyan with agricultural training and a diversified agricultural background is employed as production and operation manager.

Today (August 1987) the project employs 70-80 persons. About 65 of these are workers and foremen. A little less than half of them are permanently employed, the others are day workers primarily recruited from the local community. Half of the workers are women whose alternative employment is seasonal work on the coffee plantations.

NORAD support of NOK 117,000 has part financed an initial training scheme for the employees. The scheme included a two week study tour to the Netherlands and Norway for the operation manager, and three 15 day introduction courses for foremen and workers in Kenya.

The project is part financed by an NOK 1,337,000 loan from NORAD. The repayment period is 7 years, the principal is repayable after 3 years and the interest rate is 3.5% per annum. The NORAD loan was promised in June, 1985 and paid out in 1986. In addition the firm has borrowed NOK 500,000 from Eksportfinans at an interest rate of 9% per annum. The principal is repayable after 1 1/2 years. Equity capital makes up a relatively modest proportion of total capital. All the same this gearing was accepted by NORAD, as the local partner and the owner of the Norwegian parent company both assumed marginal liability. The Norwegian partner holds the majority interest (50.025% of the shares).

During its first two operating years (1985 and 1986) the company was run at a considerable loss. In 1987 the result is expected to be positive. This is in keeping with the budgets that constituted the basis for the loan application to NORAD. These budgets estimate a payback period of four years. Until now the project development is in accordance with the financial appraisals on which NORAD based its decision to support the project.

A realistic and thorough pre-investment study represents the main reason that the project so far has developed according to plans. The Norwegian owners benefitted from their experience with similar projects in other developing countries. Sale of the products was secured in advance through sales agreements with the Norwegian parent company. Moreover, in the initial project phase it was of decisive importance that the local partner, through his contacts in the civil service, was able to obtain results in an often ineffective bureaucracy. Today, cooperation between the Norwegian and the Kenyan partners seems to work very satisfactorily.

The firm has experienced some problems with plant diseases, but these now seem to be under control. The biggest problem, however, has proved to be the transport of plants to Norway at the time of year when the Norwegian market is open. KLM and Lufthansa give lower priority to consignments to Norway than to consignments to the continent. Reloading in Amsterdam and Frankfurt adds an extra 36 hours before the plants arrive in Oslo. On an SAS flight between Nairobi and Scandinavia the time in transit would have been reduced to 12 hours. The prolonged transport reduces the quality of the flowers and makes the transport more expensive.

As Norwegian agriculture is protected, the Norwegian market for imported plants is closed parts of the year. It has caused the firm some difficulties to adapt its production to this situation. Attempts are now being made to reach an agreement with the Ministry of Agriculture in order to provide for a certain volume of exports from developing countries to Norway even during the periods of protection. Such an agreement seems realistic as there already is a certain volume of imports from countries like Israel and the Netherlands during these periods, due to inadequate Norwegian capacity.

Most of the ground that Fairview Flora leases is already under cultivation. Accordingly there is little room for expansion within the existing farm. The company is therefore considering building up a system of contract cultivators, similar to the system established by Green Farms in Sri Lanka. This system is based on small farmers using part of their fields for cultivating plants for sale to Fairview Flora. The plants will then be resold under Fairview's trademark. Fairview Flora will deliver cuttings to the farmers and provide guidance concerning cultivation methods.

In its project evaluation the Department for Industrial and Commercial Cooperation emphasized that from the plans and budgets submitted, the project seemed to have a good commercial profitability ("financial viability"). The risks identified were primarily related to the air transport of plants to Norway, and secondarily to plant diseases. These conditions were not considered critical to the project.

The Department for Industrial and Commercial Cooperation also referred to its positive experience with the Norwegian parent company in connection with Green Farms Ltd. in Sri Lanka. In its evaluation of the project's commercial profitability or financial viability, the Department for Industrial and Commercial Cooperation seems to have put great emphasis on the project's excellent earning power and the low risk involved. This must mean that the Department for Industrial and Commercial Cooperation regarded the project to be safe and that the low risk of losses was an important argument in support of this.

When assessing the project's developmental effects, the Department for Industrial and Commercial Cooperation emphasized the fact that the project was approved and given high priority by the Kenyan authorities due to the capital inflows and the increase in employment. Moreover, the Department for Industrial and Commercial Cooperation assumed that the project would help raise the technological level within this sector.

In our cost-benefit analysis of Fairview Flora we have quantified the developmental effects, or the economic profitability of the project. We base our calculations on the firm's accounting data for the first two operating years and its budgets up to and including the 1995/96 fiscal year.

As we presume that the foreign aid money would not have benefited Kenya unless the project was implemented, we have calculated three different present values, as we did for Green Farms Ltd.: PVS_1, where we disregard the distributional effects, PVS_2, which is based on our interpretation of the Kenyan government's view on distributional questions, and PVS_3, which reflects the Ministry of Development Cooperation's strong poverty orientation.

Expressed in fixed 1985 prices, the present values are:

PVS_1 = 16.01m Ksh
PVS_2 = 15.40m Ksh
PVS_3 = 15.90m Ksh

These figures indicate that in terms of national economy, Farview Flora Ltd. is a very profitable project.

As with Green Farms Ltd, there is little difference between the project's present values when calculated at efficiency and social prices respectively. This is because there is only a small difference between the efficiency and social wage costs. The economic implications of this situation are interpreted in the section on Green Farms Ltd.

All our calculations are based on a discount rate of 8%. A somewhat higher discount rate may be more in line with NORAD's objective that the consumption increase for the poor people of today is urgent. A discount rate of 11.5%, which represents the upper limit of the interval we regard to be realistic for the discount rate, would not seriously affect the present values.

In the above calculations we have set the opportunity cost of the NORAD loans to zero. This means that we assume that the NORAD money would not benefit Kenya unless the project was implemented. It would probably have been more correct to set a positive opportunity cost for this loan. As Kenya is one of our main partner countries it is reasonable to believe that the money would have benefitted Kenya in any case, as part of Norway's total foreign aid. If we assume that the alternative application of the money is an en bloc grant to the Kenyan government, the present value of the project at efficiency prices is 13.30m Ksh. Even if the present value becomes somewhat lower, the project still shows a positive result.

Fairview Flora seems to be a profitable project to the national economy, and consequently it deserves support according to some of NORAD's guidelines. However, based on the expected commercial profitability of the project and the low risks involved, there is reason to ask whether the subsidised NORAD loan was strictly necessary. A financially sound parent company with a commercially successful establishment in Sri Lanka could probably obtain finance from commercial banks.

Part of the reason for carrying out a thorough analysis of the Fairview Flora project was to compare it with the Green Farms project in Sri Lanka, drawing parallels between the two projects. This comparison may provide useful information on what conditions in different countries contribute to the increase of the economic profitability of a project. Our evaluation of Green Farms Ltd. is a strict ex post analysis, while the evaluation of Fairview Flora is primarily an ex ante evaluation. To a degree, this reduces our basis for comparison. Concerning Green Farms Ltd. unexpected events caused dramatic changes in relation to original plans and budgets. In particular, problems between the partners were of great consequence to the project. When this has been pointed out, however, there are some conditions that give Fairview Flora a much clearer positive margine than Green Farms. These are mainly related to the costs of the project. As compared to Green Farms, the Fairview Flora project imports considerably less of its inputs, having to a much greater extent made use of inexpensive and easily available local inputs. This may of course have been caused by better local access to these inputs in Kenya than in Sri Lanka.

In Sri Lanka more sophisticated solutions, mostly imported from Europe, were chosen. However, there is reason to ask whether the relatively extensively subsidised NORAD loans to Green Farms did in fact make the project more capital intensive than it would have been with ordinary, commercial finance. On the other hand, however, there are the considerable beneficial external effects from this project which contribute to the economic value of Green Farms beyond its present value. A conscious concentration on research and development and the spreading of technology and learning, has made Green Farms a leading project within its field in Sri Lanka. Corresponding external effects from Fairview Kenya are much more limited, which in part is due to the fact that the flower industry has been established in Kenya since the 1970s. Green Farms, on the other hand, was the first project of its kind in Sri Lanka.

It is difficult to come up with a clear recommendation to NORAD based on our comparison of these two projects. Despite many similarities, internal conditions in the host countries produce different project profiles (cf. the external effects).

10.4 AFI Ltd. - Sri Lanka

Alloy Fabricators Pte. Ltd. (AFI Ltd.) was established in 1984-85 in the industrial area of Ratmalana in Colombo's southern suburbs with the object to produce and export cunifer piping.

Cunifer is an alloy of copper, nickle and iron, which in the last decade has been in extensive use for sea water transportation piping on offshore petroleum platforms, being particularly suitable due to its light weight and resistance to corrosion.

AFI is very much a "one-man-project". The initiator, main shareholder and manager is a Sri Lankan. Having received training as an engineer in Scotland, he worked for 12 years in Phillips Petroleum Company, he had tasks involving considerable responsibility, and worked directly with issues related to piping and the use of cunifer.

In the first half of the 1980s it looked as if there was going to be a great expansion in offshore petroleum activities in a number of Asian countries. At the same time there were no manufacturers of cunifer piping in that part of the world. Consequently, the Sri Lankan saw a clear opportunity for returning to his home country and setting up a highly profitable manufacturing firm. As the production of cunifer piping is relatively labour intensive, the low wage costs in Sri Lanka also indicated an opportunity for a profitable establishment in the markets in Europe and the Middle East.

The Norwegian partners in the project are the main shareholders and managers of two of the member firms in Oil Industry Services (OIS). OIS is an engineering and contractor company owned by a number of Norwegian firms in petroleum-related activities. The Norwegian partners hold 30% of the AFI shares while the Sri Lankan initiator has a 51% stake. The National Development Bank of Sri Lanka holds 14% and a British engineer 5%. There have been many complications related to the 49% of the shares that the Sri Lankan does not hold himself. The original Norwegian initiator withdrew from the project at the last moment. The cooperation with OIS was established hastily following a request to the Norwegian Council of Export, first and foremost so that AFI would receive the loans and the NORAD support for initial training schemes applied for through the original partner.

In the autumn of 1984 the clearing of the site in Ratmanlana began, as well as the construction of the workshop. In the beginning of 1985 a 14 weeks welding course was held with two Norwegian instructors from OIS (TIG welding). Under the provisions for support for initial traning schemes NORAD contributed NOK 358,900.

The factory was ready for production in the autumn of 1985, somewhat behind schedule. The interest rate is 0.25% per annum and the loan is repayable over five years, the first year without repayment of principal. According to NORAD's method of calculation the grant element of the loan was then to be 25%.

The plan was to capture approximately 5% of an expanding world market, and the number of employees was expected to rise from 33 in 1985 to 76 in 1988. However, AFI has not been capable of getting any orders for their cunifer products. Up to the spring of 1986 the firm's income was virtually zero. A subcontract was then made for the delivery of steel pipe products to a Belgian/Sri Lankan company in the free trade area of Katunayake. This provided a basis for operation on a low level with 18 employees in August 1986 when we visited AFI. Since then a possibility has arisen for extending this agreement to include sub-deliveries to the Belgian parent company in Europe. In order to expand, however, more trained welders are required and AFI would therefore like to go through with a new training scheme supported by NORAD.

In other words, AFI's development has diverged considerably from the original plans. Both NORAD and the partners were well aware of the fact that the firm was aiming at a market on which it is difficult to establish oneself. Cartel-like cooperation is common and there is widespread scepticism as to whether new manufacturers in countries like Sri Lanka are able to comply with the strict quality requirements. However, the extensive experience of OIS and the Sri Lanka initiator was assumed to minimize these problems. When this has proved incorrect, a number of reasons may be pointed out, of both internal and external nature. However, two considerations deserve special attention. First, petroleum prices fell drastically in 1985, causing the rate of investment within petroleum activities to drop. Second, the firm's products were marketed rather haphazardly, and it was not until 1986 that agreements were made with agents in two of the potential markets (India and the United Arab Emirates).

The loan agreement between NORAD and AFI presupposed that documented agreements of this type existed. AFI's failure to comply with the terms of the loan agreement caused considerable friction in the relationship between AFI and NORAD. One of the consequences was that NORAD held back half the loan for some time. In the meantime AFI had to go to a local bank for intermediate finance, thereby making the project more expensive. The Norwegian partner's extremely passive role has represented another problem for the project. Beyond the training scheme and a few marketing drives, the Norwegian partner has had very modate contact with AFI and has exerted no direct influence on the company's operations. NORAD has pressed for a change in this situation.

When NORAD promised a loan and support to AFI, its high probability for outstanding commercial profitability was regarded an extremely positive factor.

There were three reasons why NORAD evaluated the developmental effects of AFI's planned operations as positive: AFI's production would mean that the technology and know-how required in modern mechanical industry would be transferred to Sri Lanka, AFI's production would be labour intensive, and AFI's export would provide for inflows of foreign capital to the country.

We based our ex ante evaluation of AFI's commercial and social economic profitability on the firm's budgets for the first four operating years, and an assumption that the budgets could then be drawn up unchanged until 2004. In our estimates, then, the company has a working life of 20 years.

In our calculations the company's commercial profitability in the form of the project's present value at market prices, is:

PVM = 184 591 593 LKR.

This corresponds to an internal rate of return of 150%. (LKR = Sri Lankan rupees). When calculating the project's social economic profitability, in the form of the present value at social prices, we based our work on our interpretation of the Sri Lankan government's preferences, provided the foreign aid money would not benefit Sri Lanka unless the project was implemented. The project's present value at social prices came out as:

PVS_2 = 148 610 110 LKR.

This corresponds to an economic rate of return just below 140%. Based on our interpretation of the Norwegian aid authorities' preferences, the economic present value came out as:

PVS_3 = 81 079 388 LKR.

Prior to its implementation, AFI seemed to be a project of very good profitability, both in terms of business and national economy. This conclusion would remain even if we assume that the foreign aid would have been granted en bloc to the Sri Lankan government if the project was not implemented. However, according to the company's own calculations the project's commercial profitability seemed to be so favourable that there should be absolutely no need for Norwegian foreign aid subsidies. With a profitability of that magnitude, which NORAD seems to have evaluated as reasonably realistic, AFI should have no difficulties in obtaining finance on commercial grounds. Moreover, our calculations show that neither the commercial present value nor the internal rate of return would be significantly altered if the project's loans were transferred from NORAD to a loan in the Bank of Ceylon at an interest rate of 10%. (AFI has already borrowed from the Bank of Ceylon at an interst rate of 10%. This loan is somewhat larger than the NORAD loan.) We have not seen any NORAD evaluation that discusses whether AFI's implementation depended on the NORAD loan. All evidence indicates that this was not the case. NORAD's support to the project therefore seems to be in conflict with NORAD's guidelines, which stipulate that loans can only be granted if the implementation of the project depends on finance on reasonable terms.

The development of the project shows that AFI's own ex ante evaluation was not all that realistic. The dramatic fall in oil prices and the ensuing global problems in the petroleum sector were a shock which could hardly be foreseen.

It is possible that AFI has survived thanks to the favourable NORAD finance. Even if AFI seemed to be a very profitable project in terms of national economy before implementation, it is hard to say for certain whether NORAD has consequently contributed to maintaining economic profitability.

If NORAD evaluated AFI's own feasibility study as unrealistic at the outset and assessed the risk related to the project to be very high, they may have decided to grant the loan and support to the project on that basis. If that is the case, this should have been made clear in NORAD's project evaluation. However, there are hardly any indications of this way of thinking in NORAD's project documents.

10.5 Frionor (Thailand) Ltd.

Frionor (Thailand) Ltd. is a manufacturing concern producing frozen foods. In terms of both volume and sales value the principal product has been and still is frozen filets of the fish "red snapper" for export to the USA. Various types of shrimps and prawns also used to represent an important product. Stagnation or reduction in the size of catches and harsher competition for the primary products have caused steep price rises for shrimps and red snappers. Production has become less profitable and the future supply of raw materials is uncertain. The company is therefore attempting to alter its production in order to concentrate more on processed products and to start processing other seafoods, especially certain types of squid and mussels. The long-term plans are therefore to boost the production of mixed products like "Marinara mix" and Kebab seafood skewers, while shrimps and prawns are only to be sold deep fried and in limited volumes. The company also sells other types of deep fried products such as fish fingers and chips, as well as frozen strawberries, but sales of these products are relatively modest.

The USA is and will remain the company's most important market. In addition, Australia represents a considerable market. However, sales to Europe (Switzerland in particular) are expected to rise considerably and so are domestic sales within Thailand.

The plant is located in the dock area of Bangkok, close to the poor, dilapitated residential area of Klong Toey where most of the production workers live. In the summer of 1987 the factory had a work force of about 130 permanently employed production workers and about 180 day workers (kilo workers). In addition, there was a staff of 27 foremen, production managers, technicians and office workers.

Frionor (Thailand) Ltd. was originally established at the end of the 1960s without the participation of Frionor and under the name "International Commerce Promotors (ICP) Bangkok Co. Ltd.". There were two Norwegian partners and one Australian partner, who was the chief executive. In 1972 Frionor Norsk Frossenfisk A/L took over a considerable share holding as well as the marketing of the products. In 1982/83 considerable losses were revealed following unfavourable arrangements and dishonesty in the management, and the company had to be refinanced.

Frionor then took over the entire share holding in 1983, and in 1984 the company name was changed to Frionor (Thailand) Ltd.

Frionor strongly considered withdrawing from the project in 1980, but partly due to discussions with NORAD they decided to start modernising the plant instead, aiming at a higher degree of processing. The expansion and modernisation started in 1981 and was completed during the spring of 1982. In this connection NORAD contributed a loan of NOK 4,297,500, representing 30% of investments, and an NOK 3,240,000 guarantee covering a bank loan.

In 1983 the choice was again whether to wind up the company or to provide fresh capital for refinancing. Again the activity was subject to in-depth discussions with NORAD, and a consultant was engaged in order to give a thorough appraisal of the plant and its operations. Again NORAD decided to contribute approximately 50% of the total capital required in the form of an NOK 6,658,000 loan and an NOK 4,400,000 guarantee for loans in one Norwegian and one Thai bank. At the same time the loan granted in 1981-1982 was made into a subordinated loan, as the debenture secured by machinery and equipment was transfered to the new loan. In this connection the Norwegian Industrial Fund also contributed NOK 10,000,000 to Frionor Norsk Frossenfisk A/L for its share capital increase and as a subordinated loan to Frionor (Thailand) Ltd. In addition, Frionor Norsk Frossenfisk A/L wrote down its claims on Frionor (Thailand), carried miscellaneous receivables from the then ICP to expense and granted an interest free loan.

In 1984/85 new problems arose as a result of the fact that the Thai currency, the Baht, is tied to the US dollar which in this period experienced a steep rise. Being an export firm, Frionor (Thailand) Ltd. was affected by this change. In November 1984 the Thai government devaluated the Baht by 17.3%, giving hopes of improvement. However, extremely unfortunate conditions produced the opposite result. The Bank of Thailand demanded that the so-called "Packing Credit" (i.e. credit on particularly favourable terms against the discounting of sales contracts) was to be exchanged at the old rate of exchange (i.e. the exchange rate which was in force when the contract was made). Following the devaluation the primary product price immediately rose by 15-20% (according to Frionor). Frionor has calculated "the total loss caused by the devaluation" relative to the ideal situation involving devaluation, but given that the packing credits were exchanged at the new exchange rate and that there was no price rise in the raw material. The result of this calculation was an estimated loss of 13,200,000 Baht, close to NOK 4,500,000, but the calculation must be said to be rather unusual as the alternative situation is utterly unrealistic. Furthermore, loans in foreign currencies (such as the NORAD loans) became more expensive in connection with the devaluation (whereas they were previously becoming ever cheaper). On top of this there were problems in finding sufficient raw material in Thailand for a time. Despite the fact that the operating result has improved since then, the company was unable to meet its financial obligations in a normal way when loans from NORAD and others were due for repayment.

Again Frionor Norsk Frossenfisk A/L discussed whether its activity in Thailand ought to continue. A prerequisite for continued operation was that debt could be renegotiated, and that at least a moratorium was achieved. It would of course be preferable if the lenders (i.e. NORAD) could be made to write off all or part of the debt. Again the activity was subject to in-depth discussions with NORAD, and again consultants were engaged and financed by NORAD, in order to carry out a thorough evaluation of the company.

In the summer of 1986, a moratorium was achieved for the bank loan by extending NORAD's guarantee from 1981/1982 by four years. Then, in November 1986, Frionor applied for NORAD to release them from all or part of their debt and to meet their guarantees for loans, worth a total of NOK 17,130,000 (of the NOK 18,220,500 which NORAD had granted the company in loans and guarantees). The deliberations in NORAD concluded that two guarantees for loans in a Norwegian bank worth a total of NOK 5,165,000 were to be made into one NORAD loan. The principal was to be made repayable after 3 years, and at the same time another three years of no repayment was granted for the other two NORAD loans, on which the first repayments were to be made in 1987.

NORAD has gone very far in complying with Frionor's wishes. The original intentions of the provisions for loans and guarantees, as these are laid down in the guidelines, can hardly be said to have been adhered to. All three NORAD loans were granted in connection with renovation, expansion or refinancing, not in connection with the establishment of a new undertaking. As a matter of fact, when considering Frionor's first loan application in 1981 NORAD had to clarify its own principles. It was suggested that "an expansion which only implies increasing the capacity for production of the existing range of products must be financed by the company itself...", and further: "the situation is different if the planned expansion of an existing firm implies the production of new products and/or the considerable use of new technology. In this context *new products* also covers products which are made from the same input of raw material as earlier products, but which are further processed. The fact that an expansion of this kind is physically related to an existing plant cannot be decisive. An investment of this nature will also meet the requirements for developmental effect as stipulated in the guidelines" (Note to the Directors from the Advisor for Trade and Industry, 6 July 1981). Furthermore, the company, which is wholly owned by Frionor Norsk Frossenfisk A/L, has never had any domestic owners. This is in conflict with the guidelines for the provisions for loans and guarantees. The extensive good will that NORAD has shown through refinancing and moratoriums has resulted in NORAD becoming the firm's only creditor of any consequence, apart from the Norwegian parent company.

It may be useful to compare NORAD's attitude to the assessment made by the Norwegian Industrial Fund in connection with Frionor's loan application in 1983. There is no doubt that the Industrial Fund has little faith in the commercial profitability of the operations of Frionor (Thailand) Ltd. Nor is there any doubt that they hold the firm to be of little value in terms of internationalisation based on purely Norwegian interests.

NORAD's basis shall be, and has been, completely different. There is hardly any doubt that they were already very much aware of the risks involved with the project when considering the application in 1981. It was therefore considered important to agree on a capital maintenance guarantee and a guarantee of completion obliging Frionor in Norway to inject extra capital if required for completing the new investments or to secure continued operation. NORAD required that Frionor in Norway ensure better control with the firm by putting its own people in the management. A Norwegian deputy manager was employed and the existing management's malpractice was soon revealed.

The fact that NORAD has given the company's applications for support sympathetic consideration, seems to have two reasons:

- NORAD held the company to generate highly developmental effects. This judgement was based on three criteria. First, its operations were labour intensive and the company employed a large number of women for whom prostitution was assumed to be a probable alternative. Second, the company used the country's own raw materials, processing them to a high degree, and third, the company was an export firm providing inflows of foreign capital to the country.

- The fact that Frionor in Norway seemed to be willing to back the project and inject money from Norway (and the USA) probably made a great impression. Heavy involvement by Frionor would secure the continued transfer of technology to the fish processing industry in Thailand.

In other words, NORAD's Department for Industrial and Commercial Cooperation here seems to be facing a situation that ought to be typical (although this is far from being the case): a risky project whose commercial profitability is extremely uncertain, and which could probably never have been implemented, nor could its operations continue, unless favourably supported, but which seems to be highly profitable to the national economy of the host country. NORAD's subsidies can therefore help a firm in a developing country continue its operations if its economic profitability is high, but its commercial profitability is weak. Whether this has in fact been the case with Frionor (Thailand) Ltd. depends on whether NORAD's evaluation of the project's developmental effects proves to be correct.

The cost-benefit analysis that we have performed in order to get an answer to this question, is based on the firm's accounting data for the period between 1981 and 1987 (i.e. from the time NORAD came into the picture till today), and estimates for the period between 1987 and 1997 (i.e from today till all NORAD loans are repaid in accordance with the current repayment plan). The economic profitability is calculated under the assumption that the foreign aid would not benefit the country unless the project received support. As before, PVS_1 represents the present value at efficiency prices, while PVS_2 is based on social prices and our perception of the Thai government's view on distributional issues. PVS_3 is based on a stronger preference for equal distribution of income, more in line with the Ministry of Development Cooperation's over-all objective.

The calculations gave the following results:

PVS_1 = 493,814m Baht
PVS_2 = 455,728 m Baht
PVS_3 = 1,709,201m Baht

These figures indicate that Frionor (Thailand) Ltd. is a very profitable company in terms of national economy. It is particularly profitable if the calculations are based on NORAD's preference for poverty orientation. If Frionor (Thailand) Ltd. would have been closed down without the NORAD support, these figures indicate that the NORAD money was very prudently applied.

There are three factors that make Frionor a highly profitable enterprise in terms of national economy:

- It is an (unprotected) export project.
- It employs relatively many workers for whom alternative employment is assumed to be poor.
- Thailand receives considerable resources from abroad, i.e from the Frionor group and from NORAD, which Thailand presumably would not have benefited from had Frionor (Thailand) Ltd. not existed.

The reduction in profitability is small even if the alternative application of the foreign aid was an en bloc grant to the Thai government.

Finally, we would like to mention what we regard to be the most important factors of uncertainty in our calculations of economic profitability.

- Firstly, there is great uncertainty related to the accounting and budgetary data on which we based our analysis. There is of course always an element of uncertainty in budgetary data set up as future estimates, and we have not had the opportunity to assess the realism in these data. The accounting data for the period between 1981 and 1987 are uncertain, partly because we have not had the opportunity to go sufficiently in depth regarding accounting details and therefore have been forced to make many assumptions. Partly, the fact that there has been considerable fraud during the period, and that the accounting year has been changed in the course of the period has complicated the situation.

- Secondly, it is not clear how the labour market should be evaluated and consequently the opportunity cost of labour is uncertain. Contrary to NORAD's opinion as maintained in the project evaluation we have considered it unprobable that prostitution would represent a likely alternative to very many of the about 300 women workers. In spite of this assumption, however, there is still some uncertainty connected to the opportunity cost, i.e what production is lost when a worker leaves another activity in order to work for Frionor. This is a very controversial question in Thailand and we have considered it further in an unpublished appendix.

- Thirdly, there is uncertainty as to how to estimate the shadow price of the raw material, i.e the raw fish. It seems that there is great danger of drawing too heavily on the fish stock in the Thai gulf, and this may imply that the shadow prices should have been considerably higher than we set them. The economic profitability is highly sensitive precisely to changes in shadow prices, and consequently this price could not be much higher before the economic profitability would become negative. In connection with its original engagement in 1981 NORAD actually seemed to emphasize the company's application of the country's own primary products as an extremely positive factor. However, stagnation in the fishing industry in the Thai gulf was clear already at that point, and it now seems to be an extremely poor argument for giving Frionor positive consideration in connection with its first loan application.

10.6 Jupiter Associates Ltd. - Thailand

Jupiter Associates Ltd. is a joint venture in which Norsk Hydro's Industrial Chemicals Division holds a 49% stake. The remaining 51% is owned by the Thai partner that ran a business under the Jupiter name prior to this venture, importing chemical products from firms such as Norsk Hydro. The import activity is now run by Jupiter Chemical Ltd. which shares Jupiter Associates' office premises in the centre of Bangkok.

Jupiter Associates Ltd. was established with the object of producing emulsion explosives for the domestic market in Thailand. The product is called Emex and is sold under Norsk Hydro's trade mark. The factory is located in Sara Buri, about 130 kilometres north of Bangkok. The Sara Buri area is meant to play a central role in providing relief to the overburdened Bangkok area as one of the central industrial growth areas in the country. Road connections to Bangkok are very good. Thus the question must be raised how NORAD's project document can maintain that this area is a typical economically weak region with considerable unemployment.

Of the company's original investments of about NOK 6m, NORAD loans provided approximately 30%. The rest was financed by equity capital. In February 1985 Jupiter Associates Ltd. was promised an NOK 1,800,000 loan and NOK 262,000 in support for initial traning schemes. However, the loan was not paid out till June 1987.

Construction work began in the course of 1985. Before that, market research work was carried out and potential customers were contacted. In February 1986 the factory manager, who incidentally has a Ph.D in chemistry from the USA, had a one-month stay in Norway in order to study similar production and to assemble and try out the production plant that accompanied him back to Thailand in containers. The production started in May, 1986, and the first year about 200 tonnes of Emex were produced. The most important buyers are the country's three cement factories, all located in the same area at Sara Buri. These factories use the Emex cartridges in their quarries. A potential major customer is EGAT's (Electricity Generating Authorities of Thailand) coal mines.

The company currently employs 19 persons, of which 5 work at the office in Bangkok and 5 are unskilled workers directly involved in production. In addition, the plant is continuously monitored by 2 policemen and 2 soldiers. If production increases as planned, a second shift will probably be introduced and consequently yet another 5 workers will be employed. In the long run continuous process production may be considered to replace the current batch production. However, having 46 employees as indicated in NORAD's project document lies far ahead.

The feasibility study shows a very good commercial profitability. Everything seems to indicate that the project would have no problem in finding alternative finance to the NORAD loan. It would probably have been implemented even without the support from NORAD.

All things considered, it seems as if Jupiter Associates Ltd. is not a particularly profitable project to the national economy, as it is allowed to operate under a degree of tariff protection. There is a 45% import duty on explosives. In addition, there is a 10% "business tax", and the cost of domestic transport and distribution can amount to 15-20% of the import value. On the other hand there is a 20-35% import duty on the production inputs (ammonium nitrate and various kinds of wax etc.), in addition to approx. 10% transport/distribution costs.

In NORAD's project documents the potential market protection seems to have been assessed as a positive factor. In terms of the firm there is hardly any doubt that protection is favourable, but in terms of national economy protection is usually unfavourable because imports could have been less expensive to society as compared to domestic production.

We have calculated the project's present value to the national economy at efficiency prices based on ex ante estimates and the assumption that the project has a working life of 15 years. The result:

PVS_1 = 14,918,400 Baht.

This corresponds to an economic internal rate of return of 30% plus. If we assume that the whole NORAD loan alternatively would have been granted en bloc to the Thai government, we find that the economic present value is reduced:

PVS_1 = 8,438,400 Baht.

Basing the calculations of social economic profitability on the social shadow prices causes little change in the present value, as the company employs few poor workers.

The external effects from the project seem to be considerable. Emex does not cause the same problematic working conditions as the traditional explosive, nitroglycerine. Quarry workers do not feel unwell anymore since they started to use Emex. This was made clear during our visit to one of Jupiter's most important customers, the Siam City cement factory.

Safety has also improved. Road transport of nitroglycerine from Bangkok to the Sara Buri area is avoided. Moreover, Emex is completely harmless when not attached to a detonator. The Thai government regards the project positively, not least because the domestic production of explosives is regarded important in case of war etc.

Our calculations are based on the company's pre-investment studies. On this basis Jupiter Associates Ltd. seems to be profitable in terms of national economy, even though the profitability is not as good as it would probably have been in a similar unprotected export project. In terms of business economy, however, the profitability seems to be good, and it is hard to see that this project required subsidies from Norwegian foreign aid.

10.7 El Mohandes Jotun for Paints and Coatings (Jotun Egypt)

Jotun Egypt was registered as a joint venture in 1983. Construction work was completed and production started in 1985. The company produces paints and paint related products for sale on the domestic market and to ships passing through the Suez canal. Sales to ships represent 15% of total sales and are paid for in foreign currencies.

The company is located near Ismailia on the Suez canal. An industrial area of 100 hectares with partly developed infrastructure and service industry was bought from the government.

The history of this Egyptian udertaking dates back to 1977 when the Jotun factory in Libya was nationalised. At that point the then Egyptian ambassador to Norway contacted A/S Jotungruppen to have them consider establishing an undertaking in Egypt as an alternative to the lost plant in

Libya. Some market research was carried out following this contact, but there were no concrete results. However, a feasibility study partly financed by NORAD was carried out in 1980, and this was followed by other studies. In June 1981 an agreement was signed between the Jotun Group and local interests. The final project analysis was finished in January 1982, and on this basis the decision to go through with the establishment was made.

The following factors were decisive to Jotun's decision:

1: Major domestic market for paint products.
2: Localisation at the Suez canal close to a major market for ship's paint.
3: Local partners that are also potential customers (the canal company which is responsible for operating and maintaining the Suez canal, and a local steel manufacturer).
4: Operation under the conditions of a free trade area, meaning privileges like tax excemption for 5 years after production has started, excemption from import duties on investments and inputs, permission to buy foreign currencies on a free market for the payment of foreign loans and any return of profits.

Production is based on a licensing agreement between Jotun Egypt and A/S Jotungruppen. According to this agreement, Jotun Egypt will be provided with research results from the Jotun group's R&D activities, and production will be subject to regular control by the parent company's laboratory in Sandefjord. This is also a condition for selling the products under Jotun's trade-mark.

Jotun Egypt is headed by a chief executive officer and a production manager from A/S Jotungruppen. The rest of the staff totals 34 persons, of which 20 are unskilled workers, half of whom were recruited from other industrial activities, half from agricultural work. 5 are skilled workers, 5 are office workers and there are 4 technicians/engineers. The project employs 2 women. The domestic employees are paid according to the local wage level based on the government's minimum wages. The workers are organised.

The raw materials are mostly chemicals of various types, primarily binding agents and solvents. Approximately 80% of the raw materials are imported. These commodities are purchased through A/S Jotungruppen's purchasing office. Packaging and some solvents are purchased locally.

The project is part financed by an NOK 5,950,000 loan from NORAD. The principal is repayable after 1 year, and then repayment is to made over 5 years. The interest rate is 0.25%. This loan provided for about 30% of original investments. Another 20% is provided by a commercial loan from a local bank. The equity capital accounts for 50% of total investments.

A/S Jotungruppen holds 25% of the shares and a Norwegian bank holds a 5% stake. The remaining 70% are held by five different Egyptian partners.

The company could register a profit already after its first year of operation - an outstanding result by both Norwegian and Egyptian standards. The budget on which NORAD based its loan commitment expected the first operating year's revenues to only just cover expenses. A profit and satisfactory liquidity were expected for the following years. Accordingly there seems to be reasonable correspondence between expected and actual project development.

Both A/S Jotungruppen and NORAD assessed the risk involved in an undertaking in Egypt to be considerable. NORAD's analysis shows that results are sensitive to fluctuations in both sales prices and the cost of raw materials.

However, the project's relatively high equity capital ratio (close to 50% of total investments) increases the company's ability to absorb minor fluctuations in income and expenses.

The unfavourable development in the exchange rate of Egyptian pounds in relation to Western currencies has increased the cost of imported inputs. At the same time the NORAD loan has become considerably more expensive than expected. The company will probably be able to cover some of these extra expenses by raising sales prices. With the explicit objective of capturing 20% of the domestic market, Jotun Egypt will probably be able to attain some market power and consequently be in a position to influence prices.

When evaluating the project's "developmental effect" NORAD emphasized the effects on the currency situation in the form of import savings and export earnings. NORAD also maintains that the project is probably desired by the Egyptian authorities because they would prefer the increasing Egyptian demand for paint to be met by domestic production. However, NORAD fails to discuss the economic consequences of potential market power.

Other factors that are held out as arguments for granting NORAD support to the project are the creation of new jobs and the transfer of expertise related to the operation and administration of modern paint production. Beneficial external effects from the project already seem to have manifested themselves in the form of transferred expertise. In fact, Jotun's quality requirements have now become the established standards for local suppliers of raw material to the paint industry. In this way international standards are complied with, and Egypt may establish herself as an exporter of such products.

However, a cost-benefit analysis of this project produces uncertain results. The following conditions count on the negative side:

- A considerable part of the total capital was taken from Egyptian sources. The opportunity cost of these funds may be great.
- A considerable proportion of investments and inputs are imported, implying currency costs to the country.
- Jotun's possible market power wihin the Egyptian paint market may be of considerable negative consequence to the national economy.

Factors such as these indicate that a project of very good commercial profitability is not necessarily profitable in terms of national economy. With the expected earning power of this project its chances of obtaining alternative finance on commercial grounds must be considered good. However, this issue does not seem to have been on the agenda in the negotiations between NORAD and the company. Nor is there any indication that NORAD has tried to influence the project profile in order to enhance the economic value of the project.

10.8 DAHACO - Tanzania

Dar Airport Handling Company (DAHACO) was established in 1984 as a joint venture between the Scandinavian Airlines System (SAS) and the state owned Air Tanzania Corporation Ltd. (ATC). The company is responsible for ground service at Dar Es Salaam international airport. Ground service includes the handling of cargo and baggage, passenger reservation and the operation and maintenance of airplane service equipment.

Until 1981 the ground service at the airport was handled by the ATC. During this period the airport service was characterized by delayed departures, food going bad and problems in providing spare parts.

The ATC's monopoly on servicing planes and passengers was broken in the 1970s when Swissair started to traffic the airport with planes that were too big for ATC's equipment. Swissair then took over the ground service for these planes and made an agreement with other foreign airlines that traficed the airport with large aircraft.

For the ground service to be taken over by Tanzanians again, it had to be extended and improved. ATC therefore took the initiative to found a new company. On a previous occasion a Scandinavian firm had been involved in the running of the airport, receiving finance from SIDA. In

1982 SAS was therefore asked by Tanzanian authorities to draw up a report on the conditions for a new company. This SAS study was completed in the autumn of 1983, and formed the basis for the establishment of DAHACO. Swissair was positive to this initiative and has now wound up its activity.

The Norwegian partner, Det norske Luftfartsselskap represented by SAS, holds 15% of the shares. In addition, IFU (Denmark) and Swedfund (Sweden) have contributed 10% of the share capital. Both institutions have also issued loans to the company. The remaining 65% of the share capital is held by ATC. Part of ATC's share capital was paid in in the form of used equipment from the existing business. The share capital comprises 31% of total investments of about NOK 25m.

NORAD has granted an NOK 6.1m loan to the project. The loan is to be serviced over 8 years, including a 2-year period of no repayment. The interest rate is 3.25% per annum. DAHACO is the only project which has been supported by three of the Scandinavian institutions granting subsidised loans for business undertakings in developing countries. In addition, the East African Development Bank has issued a loan of NOK 2,440,000. However, the management wishes to pay back this loan as they consider it to be unnecessarily expensive.

SAS is in charge of the day-to-day management of the company through a management agreement. The current management is Scandinavian, but in the course of a 2-year period SAS is obliged to find local managers. The Tanzanians are then to work together with the SAS managers for 3 years before they take over the management completely.

The company employs a total of 400 persons. Most of them were originally employed by the ATC. 370 employees work in the service department, while the maintenance and accounting departments employ 15 persons each.

The company considers good working conditions to be of great importance. We had the impression that DAHACO's personnel policy was worked out along the lines of the SAS-model, an impression which was confirmed by the Scandinavian management. All employees go through a relatively extensive training programme. Furthermore, a free pension scheme has been introduced as well as free medical service for all employees and their families. Every day all employees receive food coupons worth 45 TSh (Tanzanian shillings). Workers and the office personnel are organized. Wages are somewhat higher than the minimum wages for organised labour.

In order to make customer payments more efficient and at the same time meet the company's liabilities in convertible currencies, DAHACO has received permission to open an account with a Western bank. Thanks to SAS' involvement the company meets with relatively little bureaucracy in connection with the import of spare parts.

Based on a superficial evaluation this seems to be a profitable project in terms of national economy:

- A considerable share of total investments was financed by external funds for which the opportunity cost is zero.
- A great many workers were unskilled at the outset but have received vocational training through their work.
- The project provides for inflows of foreign capital through its service exports (services rendered to foreign airlines).

Presumably, the external effects from the project are quite extensive. Owing to SAS' involvement, the Dar es Salaam airport is considered one of the best functioning and most efficient airports in Africa. Improved ground service and investments in new equipment for the handling of cargo from larger planes have stimulated a certain increase in the airport activity. On this basis the loan granted by the Department for Industrial and Commercial Cooperation in support of this project seems to represent prudent application of foreign aid.

10.9 Dyno Pakistan Ltd.

Dyno Pakistan Ltd. was established in 1981 as a joint venture between Dyno Industrier A.S, holding 35% of the shares, and the Habib group, a major national company in Pakistan. The chief executive officer, who is in fact one of the partners, is the main driving force behind the project. No Norwegians are employed, but Dyno employees have spent longer periods with the company in order to establish efficient accounting and control systems in line with those used by the rest of the Dyno group.

The plants are located in Hub Chowski about 30 kilometres north of Karachi, just within the boundary of the Baluchistan province. The industrial area is intended to contribute to the development of this poor province and one of the requirements that the company has to comply with is that its workforce include a certain proportion of Baluchians. In return the company enjoys considerable tax relief. In reality the Hub Chowki industrial area is one of the country's most important industrial areas located in the immediate vicinity of Karachi, the biggest city in the country.

The factory was planned for the production of formaldehyde and industrial adhesives (urea-formaldehyde). Trial production began at the end of 1984 whereas the factory was officially opened in the autumn of 1985. It has proved difficult to sell the adhesives because of unforeseen events such as the sudden establishment of competing firms and delays during Dyno's own initial phase. In 1985 formaldehyde was thus produced at only 14% of maximum production capacity. In order to be able to utilise more of the formaldehyde internally, production of powdered base plastics was started. This production proved a success and brought a profit to Dyno Pakistan Ltd. as early as 1985. In order to further increase capacity in the formaldehyde factory, and in order to be able to supply a presumably fast growing base plastics market, the capacity of the base plastics factory is now being increased from 1200 to 3000 tonnes per year.

Dyno Pakistan has received extensive support fram NORAD:

- An NOK 8,415,000 loan promised in May 1982. The loan agreement was set up in February 1983 stipulating that the principal is repayable after 3 years, and that repayment is to made over 10 years. The interest rate is 4.5%. This loan represents approximately 25% of the original investment.
- An NOK 5,720,000 loan for investment in basic infrastructure - the construction of houses for the workers. The loan was promised in May 1982 and the loan agreement was set up in May 1984. The loan is serviceable over 50 years, including ten years of no repayment. There is an administrative charge of 0.75%. This loan accounted for about 17% of originally planned investments.
- Investment guarantees of NOK 5,254,728, covering 75% of the share capital, by agreement in October 1982.
- NOK 112,559 in support for initial training schemes, paid out in August 1986.
- An NOK 7,600,000 loan for expanding the base plastics factory in 1987. (Originally, in August 1986, a guarantee was granted under the provisions for loans and guarantees for the same amount, but this guarantee was converted into a loan commitment by approval of the Minister in November 1986). This loan was still not paid out in July 1987. The construction work had started, however, financed by the local partner's private means.

40% of the original investments in the base plastics factory were financed by an increase in share capital and through commercial bank loans guaranteed by the Habib group.

Dyno Pakistan Ltd. is a rather complex project which is hard to evaluate, particularly with regard to NORAD's support. We collected considerable data during our visit to the plant but unfortunately time has not allowed us to make use of it. Consequently, we are not able to draw any conclusions regarding the company's economic profitability.

However, we would like to draw attention to a few points:

- The company has achieved considerable tariff protection (the tariff rate on formaldehyde is 60%, the tariff rate on aminoplastics is 40%, and there is a purchase tax of 12 1/2%) and the import duty on inputs has been reduced. These conditions seem to indicate reduced social economic profitability.
- The residential area for the workers, called Jensen Village, was located some distance away from the factory, near Hub Chowki village. Jensen Village was an experiment which can hardly be said to have proved a success. The construction work was finished long ago, but in July 1987 very few people had actually moved in because the local authotities had failed to arrange for electricity and water supply. The heavily subsidised health center which is part of the residential area is staffed with one physician, but is in little use. The residential area is very pleasant and the flats are of high standard relative to the inexpensive rent of 300 PKR (about 100 Norwegian kroner) per month. However, unskilled factory workers earn 1000 PKR per month and cannot afford to live in them. The more well-to-do employees do not wish to live in Hub Chowki, but in Karachi, because their children receive better education there and because they are attracted by the other possibilities a metropolitan area can offer.
- Dyno Pakistan Ltd. seems to be a well-run company, and the management appears to be innovative and spirited. Our first impression is that the company seems to provide the Pakistani society with considerable values both through its production activities, through technology transfer and through the generation of down-stream activities. In Karachi and its near vicinity several hundred small firms producing various plastic articles with simple production equipment have emerged. In fact, there are more than a hundred small producers of electric switches etc. in the town of Sargoda in Punjab.

However, working conditions represent an unsolved problem both at the base plastics factory and to the small producers of plastic articles. A number of workers complained about waste gases from the production. However, when expanding the base plastics factory, the aim is to implement measures that can help solve these problems.

10.10 Other projects in Asia

Star-Block Co. Ltd. is a joint venture in Thailand in which G. Block-Watne A.S participates with 20% of the share capital. The local partner, Stramit Board Ltd., used to produce primarily partition walls from straw ("stramit"). The company produces fairly luxurious detached houses from standard drawings which may be modified according to the buyer's wishes. These are not really prefabricated houses as they are built relatively traditionally on the site. However, there is a certain degree of prefabrication, in that staircases, doors, roof trusses and other wooden elements are produced in the company's factory in Sampravi, approx. 10 kilometres outside the centre of Bangkok. The production of stramit partition walls also continues here. In addition to a certain degree of standardisation and prefabrication, the construction of small houses in Thailand has gained yet another enhancement: marketing. First, Star-Block sells prototype houses that potential customers can assess on the premises of the company's sales offices. Second, marketing has been decentralized to the various sales offices that have been established in different parts of Bangkok and throughout the rest of the country. These decentralized units enjoy considerable independent responsibility. This company structure is based on Block-Watne's experience from Norway. Supported by NORAD's scholarship provisions, several Star-Block employees have visited Block-Watne's plant at Jæren in Norway. The construction workers live under miserable conditions on the sites. Their skills as construction workers can undoubtedly be improved, and their working methods can be made more efficient. This was the objective in 1981 when Star-Block was promised nearly NOK 2m in support for investment in basic infrastructure. A loan application for the same purpose had previously been rejected. The plans were to build a training centre with three mobile units that could provide on-site vocational training. However, the support was never used. If Star-Block had developed according to the original plans, the company would clearly have been the biggest company ever, in number of employees, to be promised NORAD support, but the assumptions that these plans were built on were never realised. Today the company employs around 300 persons, but a substantial expansion is expected. For instance, the management would like to realise the planned training centre. For Thailand this centre seems to be a very profitable investment as it may effect considerable beneficial externalities. The construction workers do not work in one factory only, but circulate among various building sites and firms. The introduction of better and more efficient working methods would therefore probably generate a considerable spreading effect, and contribute to the increase of productivity within the entire construction sector.

At present, the applications for loans from two projects in Thailand are under consideration in NORAD. The applicants are Jotun Thailand Ltd., applying for a loan for the expansion of a 20-year-old paint factory, and Nobø Fabrikker A.S, applying for a loan for the establishment of an office furniture factory. There can hardly be any doubt that the first of these projects are in the category that would be realised even without a loan from NORAD. As a matter of fact, the construction of Jotun's new paint factory has already started, even before the loan application has been considered. There is therefore no reason for NORAD to support this firm with subsidised loans. If support from NORAD is to be considered at all, this support must enhance the project's value to Thailand's national economy. It is reasonable to believe that support for initial training schemes or support for investment in basic infrastructure would be most favourable.

In Malaysia we paid a short visit to Jotun's paint factory and to Corro-Coats powdered varnish factory, both located close to Kuala Lumpur, and to Trallfa's wheelbarrow factory not far from Penang. All three factories have received loans from NORAD. Jotun and Corro-Coats must be considered expansions of already established activities in Thailand and Singapore, and would probably have been realised without support from NORAD. Corro-Coats is doing very well, whereas Jotun has experienced problems both concerning commercial profitability and the local partner.

The evaluation of Trallfa is not all that clear. At first glance Trallfa's factory seems to be of greater value to the national economy than the other two projects, as it is an unprotected export project located in a relatively poor area. Originally a large number of Indian rubber plantation workers were employed. However, this led to the most substantial industrial conflict that has ever been registered at any NORAD supported project. According to management the problem was that the plantation workers had problems in adapting to the discipline required in a manufacturing plant. Today relatively few Indian ex plantation workers are employed. Trallfa is unique in several respects. It is the only wholly Norwegian owned enterprise for which NORAD has not required a local partner as a condition for granting the loan. Trallfa in Norway also had to find an institution to stand surety for the loan. The commercial profitability has been negative for Trallfa in Malaysia and in this connection the surety caused considerable controversy between NORAD and Trallfa, as Trallfa maintained that NORAD had taken on no risk at all for the project. For the sake of curiosity we would like to mention that Trallfa has started to use Corro-Coats' powdered varnish for its wheelbarrows and has thereby reduced the need for skilled labour and raised the quality of the products so that they are now able to compete. We would also like to mention that Malaysia's present level of income per inhabitant is so high that further NORAD support for private undertakings in the country is out of the question.

10.11 Summary

In this chapter we have presented the results of more or less thorough economic analyses of some of the projects that have received support through NORAD's provisions for investment suppport, mainly we have considered the provisions for loans and guarantees.

One of the central issues, has been whether the investment support has represented a prudent way of spending foreign aid money.

As long as the opportunity cost of the aid is zero, i.e. as long as we assumed that the countries would not benefit from the money unless the projects were implemented, almost all evaluated projects seemed to be profitable to their host countries. In this connection it is important to be aware of the fact that some of our calculations were based on the original project documents which, to a degree, are overly optimistic, and we have not always had the opportunity to find out what actually happened.

However, if we stipulate that the foreign aid money alternatively would have been granted en bloc to the authorities of the host countries, which is clearly a better assumption, the economic profitability is considerably reduced, but still seems to be fairly positive.

Our analyses also seem to indicate that the most profitable projects in terms of national economy were marked by the following characteristics:

- they produce for export markets.
- they are labour intensive with a considerable proportion of unskilled labour.
- they pay taxes to their host countries.
- they generate considerable beneficial external effects.

Despite the fact that our calculations show a fairly positive economic profitability most of the time, we are not immediately willing to conclude that the support granted has represented a prudent way of spending foreign aid money. This is because a substantial number of the projects that we have studied most probably would have been implemented even without support from NORAD.

This means that in our view it would have been to the benefit of the developing countries if the provisions for investment support had not existed. Many of the projects that have received support from NORAD would have been implemented even without it, and at the same time the transfers for other foreign aid activities would have been greater than today. This line of reasoning builds on the assumption that the total amount used for foreign aid would remain the same in the absence of the provisions for investment support.

CHAPTER 11:
EVALUATION OF THE ADMINISTRATION OF THE PROVISIONS FOR INVESTMENT SUPPORT

We choose to consider the problem of administration by focusing initially on four aspects of the present administration of the provisions for investment support, based on our observations:

- the interpretation and application of guidelines in force.
- time consumption and bottlenecks in the executive work.
- the tasks and competence of the executive officers.
- the placement of the provisions for investment support in the organizational structure.

Our observations are based on:

- Reading of project documents, as well as notes and letters of the NORAD files.
- A questionnaire, where Norwegian business executives and NORAD executive officers have answered questions in connection with the 37 business undertakings in developing countries which before the spring of 1987 had been promised loans and/or initial training grants and/or support for investment in basic infrastructure from NORAD. (The basis here is 26 questionnaires returned by the business executives and 29 by the executive officers).
- A questionnaire, where 9 employees of NORAD's Department for Industrial and Commercial Cooperation have answered questions in connection with their general experience from the department's activities. (All 9 questionnaires were returned).
- Personal interviews with the 9 NORAD employees, a selection of twelve Norwegian business executives, telephone conversations with a number of other business executives and our visits to 12 developing country undertakings (which also represent the basis for the project evaluations in chapter 10).

On the basis of these observations we will draw conclusions as to what administrative changes seems required, even if the essential features of today's system remain unchanged.

We will then, on the basis of earlier chapters, outline what role we think support for investment should play and what form it should have. On this basis we will draw conclusions regarding what administrative consequences should accompany a rearrangement of the provisions for investment support in line with our views. Finally, we will carry out a simple comparison of the Norwegian provisions with corresponding arrangements and evaluations in some other countries.

11.1 Interpretation and application of guidelines in force

The revised guidelines have been evaluated on the basis of principles in chapter 9. In the following we will take a closer look at how these guidelines have actually been interpreted and applied in connection with the projects the Department for Industrial and Commercial Cooperation has considered.

In chapter 9 the regulations which bar projects on a formal basis were discussed, and there some of these regulations were deemed unfortunate. However, we should point out that some of the regulations are applied particularly strictly. That applies first and foremost to the regulations requiring participation by a Norwegian enterprise that "runs a business in Norway which is relevant to the objective of the establishment," and stipulating that "the participation of the Norwegian enterprise must be decisive for the project to be implemented." The same is true of the regulations requiring that "the host country is involved in the project," in the sense that citizens, registered firms or institutions of the host country contribute share capital. And finally, the same applies to the regulations for the provisions for loans and guarantees which state that the investments of the Norwegian firm should normally "comprise so much of the share capital that there is a basis for real control" and that "there is a reasonable correlation between the investment and the Norwegian enterprise's potential deliveries to the project."

Among the 37 undertakings which have received loan commitments and/or initial training grants and/or support for investment in basic infrastructure, there is one instance where a Norwegian enterprise is not a joint owner in the foreign aid undertaking. The case in question is a shipowner in Jordan, where NORAD contributed the biggest loan ever under the provisions for loans and guarantees (NOK 29 million) to contribute to the finance of a Jordanian shipowner's purchase of ships from a Norwegian shipowner at prices above the world market price. The Norwegian shipowner contributed management, training, and share capital in a chartering firm, and also entered into agreements making the Norwegian shipowner liable for potential losses the first few years. In another instance (in India) the "Norwegian" enterprise is 90% American owned, but runs a relevant business in Norway and was previously Norwegian owned.

In the vast majority of undertakings the Norwegian partner runs a similar business in Norway. Exceptions are a tour operator in Tanzania, where the enterprise in Norway had to be set up for the occasion, a producer of wooden toys in Sri Lanka (no longer in operation), where the corresponding business of the Norwegian partner takes place abroad, and a metal producing firm in Guinea, where the Norwegian interests are very complex.

In the majority of cases the size of the Norwegian enterprise's share in the project is great enough to constitute a basis for real control. Moreover, as a rule the Norwegian enterprise exercises such control. 28 of the 37 projects under consideration are in operation, and of these 21 (as far as we know) have a "Norwegian" business executive on location, i.e. a business executive who is recruited from or by the Norwegian enterprise.

There is only one of the remaining projects in which NORAD has actively intervened and tried to make the passive Norwegian partner more directly involved and committed in the project (a metal pipe producing plant in Sri Lanka). In the other projects the Norwegian enterprise is represented on the board of the company, and both NORAD and the Norwegian enterprise seem to be satisfied with this situation. NORAD has been fully aware of the fact that the interest of Norwegian enterprises for participating in foreign aid projects in some cases is based first and foremost on their chances for deliveries of their own products to the project. For this reason, NORAD has tried to prevent such projects from receiving support. Thus the only blank rejection of a loan application that we know of (a fishing project in Costa Rica) was made on the grounds that the investment of the Norwegian enterprise was unreasonably low compared to the deliveries from the enterprise to the project. Similar considerations have entered in with regard to a project in India, which has been the subject of lengthy negotiations, but which eventually received considerable NORAD support.

The questionnaires returned by the business executives suggest that 85% of the Norwegian enterprises regard their involvement in the respective foreign aid establishments as long-term and binding. To the question of how much emphasis is put on the requirement that "the Norwegian partner's participation is of a lengthy and binding nature" in NORAD's project appraisal, most NORAD employees say that this requirement is heavily emphasized, a with view which most business executives also concur.

The responses also suggest that the requirement that "the establishment shall be made in cooperation with a local partner" is heavily emphasized. However, there are at present three projects which have received considerable support from NORAD, without participation by a local partner. Furthermore, there are several other projects where the local participation in terms of ownership is highly pro forma, and neither represents any form of local control or local involvement, nor contributes actively to the adaptation of the undertaking to the local conditions. Several business executives strongly voice their dissatisfaction with NORAD's relatively strict application of the requirement that the undertaking must be partly locally owned, because in many cases this prompts the Norwegian enterprise to establish connections which are of no value in the long run and which do not make a positive contribution to the undertaking. If anything this requirement has the opposite effect.

On the other hand there are also formal regulations which are not applied very strictly. The regulation stating that the provisions will primarily be used to support projects within the manufacturing industry, has been set aside in 9 of the 37 projects we included in the questionnaire. Crop cultivation, fish farming and fish processing are here classified as manufacturing industries. Of these 9, 4 are shipping projects, 2 are projects involved in geophysical activities, while one project sells airport services. All these projects seem to satisfy the stipulation that "support, loans, and guarantees may be granted for the establishment of firms within other activities where the Norwegian enterprise is particularly qualified." However, in the case of a tour operator in Tanzania and a grain terminal in Togo which have received loan commitments and initial training grants, such qualifications do not seem to be present.

The regulation under the provisions for loans and guarantees stating that loans can be granted "if there are no decisive industrial, commercial or regional factors in Norway, or consideration of employment, which weigh against the establishment," can definitely be called a sleeping regulation. None of the 9 NORAD employees express the view that very much emphasis is put on this regulation. Also, none of them indicate that they put very much emphasis on the regulation under the provisions for loans and guarantees which states that "the involvement of the Norwegian enterprise is assumed to come to an end after some time so that interests in the host country can take over the shareholders' funds and responsibilities, provided that this is in the interest of the host country."

This criterion is clearly subordinate to another criterion, which it also seems to be contradictory to, that the Norwegian partner's participation be of a lengthy and binding nature. To be sure, a definite majority of the enterprises which answered the question of whether there are chances for local interests to take over the project in the long run, answered in the affirmative. However, the question here is very hypothetical and non-binding, and the answers seem to form a direct contrast to one of the clearest results from the questioning of the Norwegian business executives, i.e. that the foreign aid undertakings form a part of the enterprises' long-term internationalization strategy. This regulation has in fact been relaxed in the revised guidelines compared to the earlier version. In the earlier version, which contained a subsection 3.14 stating that "regulations regarding cessation of the involvement should be included in the agreement which regulates the rights and duties of the Norwegian enterprise." Only two enterprises state that they have entered into agreements which open up for a takeover of the activity by local interests after a time, but even in those cases it seems highly unlikely that such a local takeover will actually be carried out.

A factor which has been given greater emphasis in the revised guidelines is the working conditions for the employees. The earlier guidelines for the provisions for loans and guarantees contain no regulations for this area, while the new guidelines for all provisions emphasize "that the firm will offer the local employees working conditions in accordance with local regulations in force and also accepted international norms and ratified conventions." On the questionnaires the business executives respond "yes" to the question of whether the workers are organized in trade unions for 7 out of 26 projects, while the NORAD executive officers answer "yes" for 4 of the 29 projects. Many respondents "don't know" anything about this. There is every reason to question the affirmative answers, because what is involved here is hardly what people in Norway would call trade unions, but rather committees among the employees, restricted to the firm itself. Moreover, the firms in question are mostly relatively small, with a weak basis for trade unions, and also, some of the host countries have little experience with trade unions. One can hardly find examples of workers being refused to form trade unions, not counting the instances where laws in the host countries prohibit trade unions in free trade zones. No doubt there are instances of working conditions which would not be acceptable in Norway. Examples of unskilled labour being paid less than the minimum wage also exist. However, there is no doubt that generally wages and working conditions at the Norwegian undertakings are better than what the "average firms" in the host countries can offer. A satisfactory investigation of these issues would, however, require a good deal from the executive officers in terms of concrete knowledge of the projects and local conditions in the host countries. A one-to-one comparison with corresponding conditions in Norway is of course totally irrelevant.

Chapter 9 expresses scepticism regarding the provision for support for feasibility studies. There arguments are put forward which suggest that if today's guidelines are maintained, we can expect very few feasibility studies to lead to concrete undertakings. This is confirmed in a comprehensive study carried out for NORAD/the Department for Industrial and Commercial Cooperation in 1986 by I. Akselsen and S. Trondsen: "The relation between feasibility studies and the establishment of Norwegian enterprises in developing countries"[1]). This study shows that very few of the feasibility studies which received promises of support during the period 1976-85, have resulted in establishments. In this period promises of support were granted to 328 feasibility studies (cf. chapter 4.2).

Establishments have taken place in 16 of these cases, representing a realization rate of 5%[2]). According to the same study 70% of the enterprises which have realized their projects after feasibility studies carried out in the period 1981-85, answer that they would have carried out the feasibility studies even without support from NORAD.

On the basis of the report by Akselsen and Trondsen and our own investigation we believe we can justify the assertion that too many feasibility studies are supported. Promises seem to be granted almost automatically, and industry consciously uses the scheme for other purposes than it was meant for. For instance, business executives who have benefitted from the scheme, admit having used the money for for export campaigns and holidays. If improper use is to be avoided, the guidelines may need to be changed so that the support for feasibility studies is dropped if establishment does not take place. However, such a change in the guidelines would, as we see it, be the same as eliminating this instrument (cf. the discussion in chapter 9.)

11.2 Evaluation of the economic profitability/the development stimulating effects

Both the earlier version and the revised guidelines make it perfectly clear that "in order for the Ministry of Development Cooperation/NORAD to grant support or loans, the the undertaking to be established must ......have a definite developmental effect," and that, when evaluating the development stimulating effects, emphasis will be placed on the requirement that the project satisfies 9 specified criteria, which are listed in chapter 9.

The responses of the NORAD employees regarding the weighting of the 9 criteria to evaluate the development stimulating effect, seem fairly random. One gets the impression that the NORAD employees put (or perhaps rather: want to put) "relatively great emphasis" on all 9 criteria, which seems to reflect the fact that the criteria are somewhat vague and difficult to apply and give the impression of being a wish list. It is therefore not surprising that most emphasis is put on the two criteria which can most easily be checked by the executive officer; i.e. that the project:

- includes systematic training of local labour.
- contributes to the improvement of the balance of payments by reducing import and increasing export.

When it comes to the application of this last criterion, we feel that it is here the executive work comes closest to considering the project in an economic context, since some NORAD employees maintain that attempts are made to set up so-called "currency accounts" for projects. (However, we have not yet seen any examples of these). There is a definite majority of export projects among the undertakings which have received loans commitments and/or support.

The answers indicate that relatively great emphasis is put on the first two criteria of the list of nine points; i.e. the project:

- contributes to the creation of useful production.
- creates profitable jobs.

We believe this can be characterized as an exaggeration. Normally, any project creates production and jobs, and we have not yet come across clear and unambiguous interpretations of the terms "useful" and "profitable" in this context. In one case, concerning the production of Christian literature, the Project Committee rejected an application principally because the production was not "useful." However, the Minister approved the project and it was realized with support from NORAD.

On the other hand it is a bit surprising that relatively little emphasis is put on two other criteria, i.e. that a project:

- is located in relatively poorly industrialized areas.
- contributes to the improvement of the host country's level of technological achievement.

One should think that the first of these criteria would be very important in light of the poverty orientation in the Norwegian foreign aid, even if it would be a practical problem to pressure the enterprises into such a localization. It is also questionable whether this criteria is a sensible one from the developing countries' point of view, since spreading the industry throughout the country may involve considerable costs in developing the infrastructure.

One should also think that the second criteria would be very important in light of the commonly held assumption that the transfer of technology is of particular importance in private foreign investments in developing countries.

The remaining three criteria; i.e. that a project:

- forms a basis for other economic activities,
- uses and processes the host country's own raw materials,
- applies a technology which is adapted to the needs of the host country,

are given relatively little emphasis according to the questionnaires, but the last two are accentuated in some project evaluations where this is natural in view of the nature of the projects.

An examination of the 37 projects which are our main point of reference, shows that many of the projects import a considerable share of the inputs in production. Even in the individual instances where projects make extensive use of local raw materials, e.g. in connection with fish processing, the utilization of the host country's raw materials does not always seem to be a very good argument for claiming that the project stimulates development, cf. the evaluation of a fish processing plant in Thailand in chapter 10.

If by technology "adapted to the needs of the host country" is meant "suitably" labour-intensive technology, calculations are made of invested capital per employee in many of the NORAD project appraisals, and a low ratio is systematically emphasized as a positive feature. In general, however, the conclusion must be that relatively few of the 37 projects in question are particularly labour-intensive. For example, loans and/or support are granted to a number of processing industry firms which have created relatively few jobs. (Here we exclude jobs created in spin-off activities making use of the processing industry's products, for example small scale production of plastics on the basis of the production of base plastics in Pakistan).

To the question of whether the nine criteria in use are good enough for evaluating the developmental effect, 5 of the 9 NORAD employees answer "yes," while 4 answer "no." However, two of those who answer "yes" are clearest in their criticism of the criteria. These two comment on their response as follows:

- "Yes, if quantified/qualified."
- "Yes, but as far as possible things must be quantified. Could start to use the World Bank method as an instrument.

Two of those who answer "no" would like to be able to evaluate the "socioeconomic effects" better, and underline the importance of including environmental issues, use of natural resources and the role of women. The other two are critical of the fact that almost anything can satisfy at least one of the criteria and thereby be considered acceptable, and the need for a method to rank the criteria is underlined by one of them.

It appears that the new formulation in the revised guidelines, that the project in question must be "considered to be technically feasible, financially viable and economically sound" can be interpreted as the expression of a certain frustration over the problems of applying the nine criteria in practice. We have earlier, in chapter 9, characterized this formulation as a collection of nicesounding phrases which might as well have been deleted. At the same time the use of the term "economically sound" can be interpreted as opening for the use of a profitability analysis based on social economics (i.e. cost-benefit analysis, cf. chapter 7) in the project apraisal and evaluation.

The answers to our questions regarding the new formulation show, however, that it is not understood in an unambiguous way, and it is clearly misunderstood or not understood by a majority of the 9 NORAD employees, as we see it. Only one third of the 9 NORAD employees interpreted the phrase "economically sound" with reference to the national economy. Moreover, 24 of the 26 business executives believe that the phrase refers to commercial profitability. (The Norwegian phrase used is clearly ambiguous, covering both "of value to the national economy" and "commercially sound"). These answers clearly show that "economically sound" needs to be specified, and we suggest that it be replaced by "profitable in an economic perspective." Furthermore, the answers indicate that the new formulation has been introduced without the executive officers who are to apply it having been brought into the discussion or briefed on what the new formulation implies. (Alternatively, it is possible that the person(s) who introduced the new formulation did not clearly understand what it implied).

Thus the interpretation and application of the criteria to appraise the developmental effects of the projects must indeed be characterized as random and unsatisfactory. This being the case, it is reassuring that the guidelines contain a rule providing that "decisive emphasis will be put on the host country's appraisal of the project." Accordingly, the responses to the questionnaire leave no doubt that this is the most important criterion in project evaluation. 8 of 9 NORAD employees express the view that this criterion is emphasized "heavily." This should help attain the objective of "receiver-orientated foreign aid". However, there is still no criterion which makes it possible to rank the projects, so that the best projects are given priority when there is competition for the grants.

11.3 Evaluation of commercial profitability/financial viability

The introduction to the specific regulations for the provisions for loans and guarantees states that "loans may be granted when a project is dependent on reasonable terms of finance." We interpret this formulation thus that NORAD loans cannot be granted to projects which would have been realized even in the absence of such loans. The purpose of the NORAD loans must, on the contrary, be to ensure that projects that are economically profitable are realized despite the fact that they initially, before the reasonable finance is taken into consideration, seem unprofitable in a strictly commercial context. However, our overall impression is that this interpretation <u>is not</u> used by

NORAD. The application of the guidelines gives priority to projects which have a good "commercial profitability " or "financial viability," two terms to which we attach the same meaning. The strong demands from politicians that NORAD avoid losses on loans and guarantees (cf. Recommendation S. no. 186 (1986-87)) support such an application of the guidelines.

In the questionnaire we posed a number of questions which touch on this problem. To be sure, there are only 2 of the 9 NORAD employees who answer that, in principle, the project has to be financially viable before NORAD support is taken into consideration, while 5 think it is sufficient that it is viable afterwards. However, in the evaluation of the projects in question we get a different picture.

29 projects were evaluated by the executive officers in the questionnaire. According to their answers 12 were "financially viable" before the NORAD support was taken into consideration, while only 3 projects were not.

The business executives answer in 10 of 26 cases that the NORAD support "was decisive" for the project's initial realization. However, we doubt that the NORAD support was decisive for all these 10 undertakings. It is significant that an enterprise which hardly received any support at all also answered that the support was "decisive" for the establishment to take place. If it is really the case that many of the projects would have been realized regardless, with or without support from NORAD, there is here, in the light of considerations in earlier chapters, a basis for maintaining that the value of the NORAD support as foreign aid has been minimal.

However, after the undertakings have been in operation for some time, it may seem as if actual developments in most realized projects indicate that the budgets for the commercial profitability in the feasibility studies are systematically too optimistic. On the basis of our knowledge of the 37 projects in question we would say that at least 23 of the 37 projects have had to reconsider their plans, sometimes drastically, because of various unexpected events. From the 26 questionnaires returned by business executives it is evident that only 3 projects have shown a commercial profit so far.

Because of the gap between the budgeted commercial profitability and the actual results achieved it is natural to focus on risk analysis in connection with the planning of a project. The business executives express the view, in the questionnaires, that <u>none</u> of the enterprises evaluated the risk as "very high," while as many as 12 of the 26 enterprises evaluated the risk as "low." Only 3 enterprises said that they made higher demands on the required rate of return (in the form of risk premium) at the foreign aid establishment than for projects in Norway.

These answers must be said to be sensational, because a part of the aim of the provisions (except for the provisions for investment guarantees) according to the guidelines, subsection 1.2, is "reducing the commercial risk." However, the responses are fairly concurrent with the answers from the executive officers of the Department for Industrial and Commercial Cooperation. Only for one of the undertakings was the risk considered as very high, while the risk was considered as "low" by the executive officers in 17 out of 29 undertakings.

All in all, it seems as if the planning of projects is generally far too optimistic, and that the risk involved is underestimated. It appears to us that the views in NORAD (and for that matter also among politicians) tend to reinforce this tendency. There is a desire to avoid problem projects, and therefore it is emphasized that the projects are to show good commercial profitability in the feasibility study before support can be granted.

When this view is widely held, it is of course an incentive for enterprises to submit optimistic estimates in the feasibility study in order to improve their chances for receiving considerable support from NORAD. The budgets which the Department for Industrial and Commercial Cooperation sends to the commercial bank, DnC, for analysis can generally be characterized as far too optimistic. In the sensitivity analyses which are carried out in connection with the pre-investment appraisals, there are very small deviations in the variables compared to what real life has shown us to expect.

Whether the projects have had access to alternative finance is difficult to evaluate. But the fact that only 10 of 26 business executives answer that the NORAD support was "decisive" for the implementation of the projects, may be interpreted as indicating that alternative finance was available. The most typical feature here is, however, that hardly any enterprise has had to try to provide alternative finance. In any case we have no indication that this has been an issue in the negotiations between the Ministry of Development Cooperation and the investors. Generally it is difficult to accept that projects with feasibility studies which show a very good commercial profitability and low risk would have problems in providing finance on commercial terms. If the feasibility studies are unrealistically optimistic, this is in itself a problem which may reflect a conception among the investors that a high commercial profitability is the key to obtaining support from the Department for Industrial and Commercial Cooperation.

As a natural consequence of the desire to avoid problem projects, we see the contours of a system which is particularly favourable for large, healthy Norwegian enterprises, where the probability of losses and problems for NORAD seems to be relatively very small, but where there is a very high probability that the projects would have been implemented even without support from NORAD. Several of these enterprises have been working systematically towards NORAD for many years. They are continuously in touch with their connections in NORAD. Knowing how modest NORAD's own visiting activity towards potential Norwegian enterprises is, and knowing the frustration a number of small and medium-sized enterprises experience in their first meeting with the bureaucracy partly strange and red tape in NORAD, the conclusion must be that it is only natural that these large, healthy enterprises gradually achive a unique position. This close contact may also result in unfortunate ties between the executive officers of NORAD and the business executives.

11.4 Risk evaluation and requirements for collateral security

The guidelines' provisions for loans and guarantees state that "collateral security is to be furnished for the loans and/or guarantees," and furthermore "the terms are to be set out in the individual loan and guarantee agreement." Our impression is that these conditions are interpreted and applied very strictly by the NORAD executive officers. In some cases the Norwegian enterprise has had to find institutions to stand surety for the NORAD loan. Buildings and machines are mortgaged as security, and guarantees for the completion of the establishment are required of the Norwegian partner. It is also required that the borrower produce a legal opinion from a local lawyer in the host country, a requirement which may cause considerable trouble to the enterprise.

The strict security requirements on the part of NORAD further weaken the role of the provisions for loans and guarantees' in providing top finance. In addition some business executives, who are dissatisfied with these requirements, point out that the corrupt conditions in some countries make it easy to produce almost any document, including a legal opinion, if you are willing to pay for it, but at the same time these documents have no particular value when needed. It is also emphasized that the costs involved in attempting to realize mortgage debentures, if that should be necessary, can far exceed the funds which can be transferred to Norway from a wound-up project. Furthermore, the fairly complex loan agreements, with extensive requirements regarding documentation and security, are the main cause for what we see as an unreasonable use of time in NORAD's executive work, a point we will comment on further below.

11.5 The composition of instruments applied in the projects

Before we have a closer look at the use of time, we will first consider the composition of instruments applied in the 37 projects in question. The first noteworthy point is that only 43% of the projects which have received promises of loans and/or support for initial training schemes and/or support for investment in basic infrastructure have made use of the NORAD support scheme for feasibility studies. A few projects have received promises of support for feasibility studies, but have not made use of them. The second point that stands out is that the provisions for loans and guarantees, after they were introduced, have become the decidedly most important of the four investment provisions proper.

The provisions for investment support in basic infrastructure were not used at all in the period 1981-1986. Instead, two loans were granted on concessionary terms for investments in basic infrastructure in Nepal and Pakistan. The loan to the project in Nepal has later been converted to a grant. (Besides, there now appear to be several new projects that are eligible for support for investment in basic infrastructure). About one third of the projects have made use of the provisions for investment guarantees, while some very few have received guarantees for loans under the provisions for loans and guarantees.

It is the subsidized loans that the enterprises are primarily interested in. This is often what they initially apply for. Through contact with NORAD the support is extended to include support for initial training schemes, loans/support for investment in basic infrastructure and guarantees for other loans or for equity capital. The only cases where support for initial training has been granted, but no loans, are three shipping projects. In all four instances where promises of support for investment in basic infrastructure were granted before 1986, the support was given for initial training schemes, in the two latest instances as the result of initial loan applications from the enterprises (Sri Lanka and Thailand). However, in 1986, for the first time, a promise of support for investment in basic infrastructure was granted for infrastructure purposes proper (ferry service in Guinea), and this is the only project which so far has made use of all five support schemes.

The basic rule for deciding the size of the NORAD loan is that the loan must not comprise more than 50% of the loan finance, and thus the initial investment is often financed by approximately one third equity capital, approximately one third NORAD loans, and approximately one third other loans from local or foreign banks or other sources. In a few instances NORAD has granted guarantees for the other loans, and in three instances where the projects have run into difficulties and NORAD has contributed to refinancing, these guarantees have later been converted to NORAD loans (projects in Thailand, Indonesia and Portugal). However, with regard to projects in some of the poorest countries a pattern seems to emerge where NORAD contributes loan finance of 50% of the initial investment, while the remaining 50% is equity capital.

In addition to the two loans mentioned earlier which were granted for investments in basic infrastructure, where the grant element is about 85% (incidentally, one of the loans has been converted to a 100% grant), a standard has been established that the grant element is to be 25%, which is the bottom limit for the loan to be accepted as public foreign aid by the OECD and thereby in international statistics. In those cases where periods of grace with no charge of interest have been given, the grant element has of course increased over time measured in NOK.

In the case of support for initial training schemes, a standard support of 50% of the training costs has been established. In connection with a project in India, however, a promise of 100% support has been granted for programmes especially directed towards women. In addition the NORAD scholarship scheme has been used for training purposes at a project in Thailand, while extensive support for imports has been granted a project in Tanzania.

In concluding this discussion we can maintain that to some extent today's guidelines are interpreted and applied in a relatively flexible and pragmatic way. This is apparently consistent with our ideal for investments in basic infrastructure as outlined in chapter 8. However, we have two very strong reservations about such a conclusion. Firstly, there are certain regulations which should be applied consistently to all projects. In particular this is true of the criteria for deciding whether a project deserves support and the regulation stating that support will not be granted to projects which will be implemented even without support, unless there are particular reasons for doing so. Secondly, the ideal is based on the assumption that the executive officers have a cost-benefit analysis of the project for reference when the final "support package" is designed. This package should then be consciously designed to maximize the welfare gains of the support. Today the officials of the Department for Industrial and Commercial Cooperation have such a reference only on a modest scale. Therefore we have no guarantee that today's flexibility and pragmatism are all to the good.

11.6 The time spent on executive work

The questionnaire and the interviews with Norwegian business executives give the impression that an unreasonable amount of time is used on executive work. This has caused numerous and strong expressions of disapproval.

To the question of whether executive work was unreasonably time-consuming, 12 of 26 business executives answered "yes," while 9 answered "no." The NORAD employees agreed that generally too much time is spent on executive work, 4 of 9 answering "yes," while 2 answered "no." What is meant by "much time" in this connection can be found in the executives' responses regarding how much time passed from the first contact until the loan or support was paid out. In eight cases this took more than two years, in one case between one and two years, and under no circumstances did it take took less than one year. The question was left unanswered in twenty cases.

The NORAD officials are particularly concerned about the time lapse between project appraisal and discussion in the Project Committee and by the NORAD directors, culminating in final approval by the Minister. The documents for the monthly meetings of the Project Committee are to be submitted three weeks in advance, so there may be a waiting period of almost two months before a case has passed the Project Committee. The executive work in this committee is often of pro forma nature and the committee members have no technical qualifications for appraising the projects.

The issue, then, is the amount of time used before promise of support is granted. The commitment itself may be the most important factor for NORAD's own statistics, but for the enterprises the time of payment is also of importance. When the commitment has been granted one should think that the remaining task would be fairly simple, because all fundamental considerations have been made. The real bottleneck, however, particularly when loans are involved, is no doubt the period between commitment and payment (also underlined by one of the NORAD officials). In several cases more than two years have elapsed between commitment and payment. Several business executives have in fact counted on the NORAD loans or support being paid out relatively promptly after commitment, and have had to resort to interim finance which has made the undertaking more expensive. The objection may be raised that with a letter of promise from NORAD there would be no problems obtaining interim finance. However, it is important to keep in mind that at the time in question the enterprises are in the hectic initial phase and have enough problems already. Many enterprises, especially intermediate sized firms with limited international experience, prefer to compare NORAD/the Department for Industrial and Commercial Cooperation to a bank, and are therefore of the opinion that the relationship between NORAD and the enterprise should be based on mutual trust more than on a series of documents whose practical value is questioned by many. In personal conversations two or three business executives firmly rejected the idea that they would ever apply for NORAD loans again, because they consider their expenses in connection with the time-consuming process of obtaining documents and administrative procedure to be so heavy that an ordinary commercial loan would actually have been more favourable than the subsidized NORAD loan.

The core of the problem is a complex loan agreement, where NORAD on the whole requires a very high degree of collateral security for the loan, and which requires collaboration with the Legal Department of the Ministry of Development Cooperation. We have a distinct impression that this collaboration does not function very efficiently. The executive officer who underlined the unreasonable time span between commitment and payment, also suggested separate legal expertise in the Department for Industrial and Commercial Cooperation as a solution to the problem.

The biggest problem related to the loan agreement may simply be a failure to communicate. In this field there is an abundance of English specialist terms of which business executives, and possibly also government executive officers, have an extremely vague comprehension. However, people are reluctant to ask about things they do not understand where they feel they are expected to understand. This may cause the process of obtaining information and documents to become unnecessarily complicated.

11.7 Data and information processing in the Department for Industrial and Commercial Cooperation

If we consider the Department for Industrial and Commercial Cooperation as an efficient finance institution, we should expect heavy emphasis concerning systematizing information on the institution's total activities, for example for planning purposes. The lack of such information has been conspicuous in the Department for Industrial and Commercial Cooperation, and the employees in the department admitted that mapping of the department's total activities had been neglected since 1980.

The material we collected from the files of the Department for Industrial and Commercial Cooperation when mapping the use of the provisions for investment support, proved to be fragmentary and not very systematized. Survey lists and aggregate data were also partly incomplete and inaccurate. Another problem was the terminology which differed from one chart to another, and which indicated inadequate internal reporting routines.

It proved difficult to produce copies of the enterprises' accounts from the Department for Industrial and Commercial Cooperation. This was partly due to the fact that accounts had not been received, even though according to the loan agreement all enterprises are to submit half-yearly and annual accounts to the Department for Industrial and Commercial Cooperation. Partly it is due to an unorganized and not very user-friendly filing system. Copies of the relevant accounts were therefore obtained at NORAD's bank connection, DnC.

The problems we met when collecting data and mapping the individual provisions, which caused a disproportionate amount of time to be spent on the tracing, collecting, systematizing, checking and aggregating data, may largely be ascribed to lacking routines for inter-departmental reporting. This problem is now being solved, it seems, as the Department for Industrial and Commercial Cooperation is currently developing a data filing system for the individual provisions. Information on the support for feasibility studies has already been computerized. The other provisions will, according to the plan, be computerized before the end of 1988. The new data filing system will probably also be able to function as a useful aid in the planning of the total activities of the department.

For an institution such as the Department for Industrial and Commercial Cooperation, external reporting is also of great importance. This applies to information to the users of the provisions, as well as to the public at large. In this connection it is natural to suggest that the Department for Industrial and Commercial Cooperation prepare annual reports of their activities. Such an annual report may also be published in the form of an information brochure, which may be used in marketing the department. An example of a good, informative annual account is the IFU's "Annual Report 1986."

11.8 The executive officers' competence

A clear majority of the business executives in the questionnaire feel that the executive officers' competence on the whole is "good" or "very good." It is first and foremost in questions related to the developmental effects and specific problems related to the establishment in the developing country that their competence is rated as "very good" or "good." However, we have documented the opposite in our study; the interpretation and application of the criteria related to the appraisal of the developmental effects of the projects can be described as haphazard and unsatisfactory (cf. chapter 11.2). The business executives' rating of the executive officers' competence seems to be the least positive when it comes to the knowledge of relevant industries/enterprises in Norway and commercial planning/analysis. On the whole a great majority of the business executives describe their experience with NORAD and the support for investments as "very positive" and "positive," while only two describe their experience as "negative."

There are two clearly conflicting views among the employees of the Department for Industrial and Commercial Cooperation as to what principles should be the basis for assigning cases to the individual employees, and consequently, in what areas the individual employees should specialize. The questionnaire shows that a majority of five think that the executive officers should be assigned to countries/regions, so that a knowledge of the local conditions in the relevant countries is developed as the special competence of the executive officers. Only one official maintains that the executive officers should be assigned to, and that each one of them should have a specific responsibility for, particular enterprises in Norway. Two officials maintain that job assignments should be based on both these criteria.

The demands placed on the executive officers are often very high. They are expected to act partly as business advisers and legal specialists, partly as economists and experts on developing countries. We are of the opinion that the executive officers' main task is to be experts on developing countries, i.e. specialists on local conditions and the host countries' economic needs, and we have the distinct impression that it is primarily in this area that Norwegian business executives expect to find expertise in NORAD. As experts on one or a few developing countries and their economies it should be possible for the executive officers to participate actively in shaping the project profile through negotiations with the business executives before support is promised, thereby maximizing the projects' welfare gains.

11.9 The executive officers' influence on project profiles

In our evaluation we have tried to visualize how NORAD officials attempt to influence the project profile in the period between the first contact with an enterprise and a possible loan or support commitment. According to the business executives, NORAD required changes to be made in only 3 of the 26 projects from which we have received completed questionnaires, before loans or support could be granted. Three business executives also acknowledge that the projects were altered to a certain extent as a result of the negotiations with NORAD, but none of the business executives consider the projects to have been changed dramatically. The NORAD officials are of the opinion that NORAD required and actually produced changes in a few more projects. Furthermore, it is evident from the NORAD employees' responses that the planning of the projects has reached an advanced stage when contact between the enterprise and NORAD is made. Obviously they are of the opinion that there is not much to be done about the project profile, except to ensure that a few standard requirements are met.

When NORAD actually requires changes to be made, what are the desired changes? The answers show that the executive officers put more emphasis on improving the projects' financial viability than on strengthening the projects' economic profitability and/or its developmental effects. In other words, once again a main impression of NORAD's work with the provisions for investment support is reflected: good commercial profitability is focused and this is what makes projects deserve support, though normally one should think that sound commercial profitability would make public subsidies superfluous. (To be fair, 2 of the 9 NORAD officials also mention training as an important aspect, and state that NORAD tries to strengthen the projects in this respect. In addition one official mentions a desire for greater involvement by the Norwegian partner.)

Four of the nine NORAD officials are of the opinion that NORAD's desire to change the project profiles generates, to a degree, conflicts between NORAD and the enterprises. Four officials think that this rarely happens, while one thinks it often does. This applies to the question of conflicting views between NORAD and the enterprise as to financial viability as well as on the relationship between financial viability and other factors.

Only two business executives are of the opinion that conflicts actually arose because of disagreement on the financial viability and disagreement on the emphasis on financial viability versus other factors in connection with specific undertakings. The executive officers feel that in two instances such conflicts arose because of disagreement on the emphasis on financial viability versus other factors, while at the same time they respond that any desires NORAD may have had for changes in the projects have never led to conflicts between NORAD and the enterprises.

When the questions have to be answered with "yes" or "no," it is evident that both the business executives and the executive officers feel it is not right to answer "yes" to whether there have been conflicts, for the word "conflict" does not correspond very well to the experience they have had. On the whole a picture emerges of a peaceful negotiating process where the issue of economic appraisal (i.e. the developmental effects) suffers eclipse.

11.10 The organizational situation of the provisions for investment support

A frequently discussed subject has been the question of who should have the administrative responsibility for investment support as a political instrument for subsidising the involvement of Norwegian trade and industry in developing countries. There have been weighty claims that the "industrial incentives" should be taken out of NORAD and the Ministry of Development Cooperation, because they have nothing to do with foreign aid, but are only a subsidy for the benefit of Norwegian trade and industry. The Ministry of Trade has been the most frequently mentioned alternative, and was particularly in focus in connection with an initiative taken by the Minister of Development Cooperation in the summer of 1986. Furthermore, it is a striking fact that Norway has chosen an organizational form for the schemes that differs from those in the other Nordic countries, where corresponding provisions for investment support are under independent foundations (see chapter 11.13). Such questions are naturally of great importance for the question of how the provisions for investment support can function and be administered. However, according to the Ministry of Development Cooperation these questions are outside the terms of reference of this evaluation. Nevertheless we found it interesting to map the views of the business executives and the NORAD employees on the organizational situation.

From their answers it is evident that four of the nine NORAD officials are of the opinion that the provisions for investment support should be transferred to an independent foundation (more or less following the pattern of the other Nordic countries), while four officials think they should be administered by a separate department in the Ministry of Development Cooperation. One official thinks the provisions should be part of an external directorate under the Ministry of Development Cooperation.

Those in favour of a separate foundation emphasize the potential provided by this form of organization for increased flexibility in executive work and staff policy, and also for participating in projects with share capital (although some feel that this would be possible also within today's system), as well as the possibility for being less at the mercy of political changes in the Ministry.

Those in favour of placing the provisions under the Ministry of Development Cooperation underline the need for the provisions to be administered from a foreign aid perspective.

Four of the twenty-six business executives are of the opinion that the provisions should be administered by an independent foundation. This is obviously a question that the business executives are not very preoccupied with, or they may feel that they do not have the necessary insight to express an opinion. Several of them underline the need for all provisions to be administered by the same body, but otherwise their opinions are not very strong. The business executives' chief preoccupation is that the activities must be exercised more quickly and less bureaucratically, more like a bank, regardless of what administrative placing is chosen.

11.11 Suggested changes to improve the present system

The suggestions we put forward in this section presuppose that the Department for Industrial and Commercial Cooperation continues as a separate department within NORAD, dealing with both investment projects and export projects. Moreover, it is assumed that the various provisions for investment support remain the same, except for the support for feasibility studies, which we suggest should be discontinued (cf. chapter 9.5). On the background of the observations we have accounted for above, we will relate our suggestions to four stages of the Ministry of Development Cooperation/NORAD's work on the projects:

1. The executive work until the project appraisal has been finished and a project document including a draft resolution has been made.
2. The executive work after the project document has been drafted until the final decision of whether to grant a loan or support.
3. The executive work from commitment until the loan or support is actually paid out.
4. The following up of the projects after support has been granted.

The main problem of the first stage is the project appraisal itself. If we accept that the provisions for investment support were primarily established in order to maximize our foreign aid, then the present project appraisal is not good enough. This is because it emphasizes commercial profitability and because the criteria used for appraising economic profitability are unsatisfactory. In this context it would be desirable that the employees of the Department for Industrial and Commercial Cooperation not only passively receive ready-made project proposals from the enterprises for appraisal, but that they actively identify and appraise projects, preferably in connection with other foreign aid programmes where it would be favourable to involve private enterprises.

Moreover, it may be added that these are conclusions which to a great extent are in accordance with considerations made in high political quarters. Reports to the Storting, recommendations from committees etc. have several times asked for more thorough economic project appraisals. Furthermore, on a seminar held by the Federation of Norwegian Industries in June 1987 the Minister of Development Cooperation announced that NORAD/the Department for Industrial and Commercial Cooperation will take a more active stance towards industry, especially with a view to activities in main partner countries and regions given priority: "Therefore, in the future the Department should be less occupied with considering applications which from the point of view of foreign aid may be fairly accidental." At the same time there is every reason to highlight the excessive optimism which systematically seems to make itself felt in the commercial appraisal of the projects.

Against this background we suggest the following measures:

- A more realistic pre-investment project appraisal with regard to commercial profitability. This is in order to improve the present situation where the basic variables in the sensitivity analysis carried out by DnC seem to be systematically too optimistic, whereas the risk is under-estimated by limiting the range of variables in the other alternatives.

- The employees of the Department for Industrial and Commercial Cooperation should receive training in cost-benefit analysis, and this method should be employed when the developmental effect of a project, or its value to the national economy, is to be calculated. Computer based systems should be developed for handling the project appraisals, preferably in cooperation with the rest of NORAD/the Ministry of Development Cooperation. This would gradually improve the present form of appraisal and evaluation. (Alternatively, one might rely on the services of external consultants, for example by developing some form of collaboration such as the present collaboration with DnC, cf. chapter 5.5, although this would hardly be as satisfactory.)
- A requirement for good project apraisal and for being able to make use of the appraisals over time, is that statistics and other information are stored and systematized in a completely different way from what has been the case so far (cf. chapter 11.7.) We recommend that the Department for Industrial and Commercial Cooperation prepare annual reports of the Department's activities. Such an annual report may also be published in the form of an information brochure, which may be used in marketing the department.
- The Department for Industrial and Commercial Cooperation should abandon the present system where the individual executive officer handles both investment and export projects. The export projects represent a distracting element in the long-term work with the investment projects, not least because a separate urgency routine has been established for export projects. Moreover, assigning a clear priority to the investment projects would be in line with the view expressed in Recommendation S. no. 186 (1986-87) from the Foreign Affairs Committee of the Storting (cf. chapter 2).
- The internal organization of the Department for Industrial and Commercial Cooperation should be changed so that the individual executive officer's field of responsibility is a specific developing country or a region. In this way the individual executive officer will be able to acquire a special competence regarding this country or region. He/she will be able to assume the responsibility for developing a satisfactory data base containing international statistics, etc., to be used as a basis for the project apraisals. He/she will also be able to participate actively in the identification of possible projects for Norwegian industry in cooperation with local authorities and other types of Norwegian foreign aid activities.

- We suggest that investment manuals be prepared containing relevant information for enterprises which want to establish themselves in selected developing countries, if desirable in cooperation with the Foreign Service. It would also be desirable to prepare lists of possible joint venture partners in the developing countries and in Norway, for use in an active process of identifying and initiating desired projects.
- Executive officers should travel to the relevant countries more often and study the conditions there more thoroughly. This would develop the individual official's expertise regarding a particular country or region, enabling him/her to identify desired projects and project participants and to follow up projects over time. Contact with NORAD's local representatives should be encreased.
- To strengthen cooperation with other foreign aid activities it would also be desirable for the Department for Industrial and Commercial Cooperation to be located physically in the same place as the rest of the NORAD organization, and in particular in the same place as the Country Programme Unit and the Project Department.
- In budgetary terms these suggestions imply a recommendation for increased emphasis on internal planning, administration, and internal development (cf. chapter 5.4).

The main problem of <u>the second stage</u> is a time consuming decision-making procedure where the NORAD directors, the Project Committee and the political leadership in the Ministry of Development Cooperation are to consider the projects. In our opinion the Project Committee is completely superfluous in this context. In actual practice the Project Committee has proved to be without real significance, acting as a mere rubber-stamp. The NORAD directors should be able to arrive at a decision independently on the basis of the project appraisal and recommendation from the Department for Industrial and Commercial Cooperation, possibly in consultation with the political leadership in the Department. If the latter are involved, the case should be submitted to them immediately after the directors have considered it.

The main problem of <u>the third stage</u> is the complex procedure leading up to the actual agreement. This applies to loan agreements in particular. In our opinion the NORAD loans should be in the form of top venture finance. Collateral security requirements should be reduced, and the same applies to the documentation required as a basis for the loan agreement.

Once again it must be emphasized that when a loan commitment, guarantee or support is granted, all fundamental considerations should be completed, and the drawing up of a loan agreement should be an easy task. It ought also to be considered whether the Department for Industrial and Commercial Cooperation should have their own legal expertise instead of making use of the Legal Department of the Ministry of Development Cooperation.

The main problem of the fourth stage is that there is no systematic programme for following up projects. This is partly due to capacity problems and partly due to the fact that support, in principle, is granted to new projects in which NORAD is not meant to play a part after their establishment. However, again and again we see that projects have problems in repaying the NORAD loans, and refinancing with assistance from NORAD becomes necessary. For a number of projects it seems desirable to follow up the support over some time. In particular this applies to the support for initial training schemes and the support for investment in basic infrastructure. This support may often prove to be of greatest value when the projects have already been established and the most serious problems emerge.

Besides, a more systematic programme for following up projects would be desirable in order to learn from experience and to be able to make use of the insight gained in considering new projects. To a higher degree than now, the executive officers should therefore keep in contact with the projects. They ought to visit the firms and follow up the project appraisals with evaluations when the projects have been in operation for some time.

11.12 The ideal and its administrative implications

The various provisions for investment support (and provisions for export support) have developed without a corresponding clarification of objectives, administration and organization. "Adviser to Trade and Industry" developed from an advisory position to become a unit with administrative responsibilities for the various provisions which were placed under it. The establishment of the various provisions must be regarded as a response to the needs of Norwegian enterprises in the internationalization process just as much as a response to the needs of the developing countries for economic growth and development (cf. chapter 2). Influential circles seem to have been unwilling to acknowledge that these two sets of needs may be conflicting in some cases.

The Department for Industrial and Commercial Cooperation was given its status as a NORAD department in 1986. Nevertheless this has not led to a clarification, neither organizationally nor regarding the objectives of support for investment. This uncertainty is partly evident in the activity plan of the Department for Industrial and Commercial

Cooperation, where the main objective and the partial objectives of the department are set out; these objectives are only partly in accordance with the over-all objective of Norwegian foreign aid policy (cf. the discussion on the Ministry of Development Cooperation's objectives in chapter 6). Partly the uncertainty is evident in the discussions on whether the provisions for investment support should be withdrawn from the Ministry of Development Cooperation, and placed under to the Ministry of Trade, for example, a discussion which was particularly topical after the Minister of Development Cooperation suggesting this course of events by in the summer of 1986. The issue is whether the provisions should be better integrated with the rest of the foreign aid activity, or if the provisions should have a freer status in order to be able to function on business terms.

A clarification of these issues is of decisive importance for the future form and administration of the provisions for investment support. The parliamentary debate on Report no. 36 (1984-85) to the Storting and Report no. 34 (1986-87) to the Storting in May 1987 may be an indication of such a clarification. Here reference was made to quotations from chapter 2 of the recommendation of the Foreign Affairs Committee. We believe this clarification must continu and be done in accordance with the analysis made in chapters 6, 7, 8 and 9 of this report. If support for investment is to be regarded as a foreign aid activity, the same requirements must be applied here as in other foreign aid activities: the money spent on foreign aid must give the highest possible return in the form of increased welfare for the developing countries. That is, any restrictions for the benefit of Norwegian industry will represent a cost in the form of reduced welfare for the partner countries of the Ministry of Development Cooperation.

This would mean that support for investment cannot continue as an activity isolated from other foreign aid activities; it should form an integral part of an over-all plan. The purpose of this plan would be to identify the best alternative use of funds. Project identification and evaluation of how the project would be financed and operated most favourably, whether privately or publicly, are key issues. Applications from private enterprises should be approved only if support for that project generates a higher yield than alternative applications. The support must be designed in such a way that its welfare effect in the developing countries is maximized.

- Such a plan requires a high degree of flexibility in designing the support and in principle, any type of support should be possible.
- Such a plan obviously requires a strong increase in funding for research, development and internal training regarding planning systems and project appraisal.
- Such a plan also seems to presuppose that the activity of the Department for Industrial and Commercial Cooperation is more integrated in the other foreign aid activities.

- The guidelines for granting support will disappear in their present form. All irrelevant and partly inactive regulations should be abandoned, as should the present criteria for appraising developmental effect, in keeping with the observations made in chapter 9 and in this chapter. The present strictly defined instruments will disappear.
- The activities can be based on a single rule: "A project in a developing country may be granted loans, guarantees or support if this use of foreign aid is considered to be the most profitable application of this capital in terms of national economy, and if the project depends on favourable NORAD finance in order to be implemented."

The administrative implications of such a plan will, in other words, be very far-reaching and impossible to predict in detail. Of course, a period of trial and error is required before a satisfactory system is arrived at.

11.13 Provisions for investment support in other countries

A number of OECD countries have established public or semipublic provisions for support which are comparable to the Norwegian provisions for investment support. We will in this connection confine ourselves to giving a brief survey of the various organization models employed in the Nordic countries. In addition we will give a short presentation of the criteria for "developmental effect" emphasized by some of the counterparts to the Department for Industrial and Commercial Cooperation.

We give primary emphasis to IFU and the Danish provisions for investment guarantees. IFU is the oldest institution of its kind in the Nordic countries and has achieved a size and position which in the smaller Western European countries is perhaps second only to the Dutch FMO. The Danish provisions for investment support were evaluated in 1983-84. We will present some conclusions from this report and compare these to our own conclusions. The report is chiefly based on information in Report no. 1006, (Report on provisions for support to private capital transfers to developing countries) Copenhagen 1984, and SOU 1977:77 (Sweden's development cooperation in the industrial field. Report on the industrial foreign aid evaluations of 1977).

IFU in Denmark is a self-owned public institution with the objective to promote economic development in the developing countries. IFU's Board is appointed by the Minister of Foreign Affairs, and among the Board members there are two representatives of the Ministry of Foreign Affairs/DANIDA. IFU can participate in undertakings in developing countries with share capital, ordinary loans, guarantees, and loans for feasibility studies. The fund consists of the initial fund capital augmented by revenue generated by the fund, as well as fiscal grants if needed. The fiscal grant amounted to about DKK 300 million in the period 1968-79. IFU has been self-sufficient since 1980. As there are no fiscal transfers to the IFU at present, no current IFU activities are reported as public foreign aid.

FINNFUND ("The Finnish Fund for Industrial Development Cooperation Ltd") in Finland is a joint-stock company where the State through the Ministry of Foreign Affairs holds 90% of the shares, while the rest is divided between the Finnish Export Credit, the Finnish Industrial Fund, and the Confederation of Finnish Industry. FINNFUND's objective is to promote economic and social development. The Board of the company is appointed by the annual general meeting. The Managing Director of Finnida is the chairman, while the Department of Trade, the Department of Industry, and the rest of the share capital are also represented. The fund consists of the paid-up share capital as well as later contributions from the foreign aid budget. FINNFUND can participate in undertakings in developing countries with equity capital, loans on concessionary terms, ordinary loans, and support for feasibility studies. Share capital and loans are reported as public foreign aid.

SWEDFUND ("The Swedish Fund for Industrial Cooperation with Developing Countries") in Sweden is a public foundation with the objective to stimulate and promote industrial undertakings in developing countries. The Board of the foundation is appointed by the Government and has representatives from the Ministry of Foreign Affairs, the Ministry of Trade, the Ministry of Industry, SIDA, and professional and industrial bodies. The foundation's fund consists of the initial capital and overheads. The foundation may raise loans guaranteed by the state. SWEDFUND can participate in undertakings in developing countries with equity capital, ordinary loans, guarantees, and support for feasibility studies. The share capital contributed is reported as public foreign aid.

This shows that the Department for Industrial and Commercial Cooperation in NORAD has a unique position compared to the structure in the other Nordic countries in that all loans and all support are granted via the foreign aid budget, and all transfers are reported as official development aid.

Furthermore, the four Nordic institutions mentioned above have an informal Nordic cooperation body, NORDACT, with regular meetings to exchange views and ideas. Other Nordic cooperation bodies, such as the Nordic Investment Bank and NORSAD (Nordic cooperation with SADCC), may further improve the support for investment as foreign aid, especially if the national industrial interests of the member countries are restrained.

Most other OECD countries also have public institutions with provisions for loans and/or support and/or guarantees in connection with private undertakings in developing countries. We have listed some of these institutions below, with comments on how they evaluate the projects' developmental effects in athe host countries, as this has been an aspect of particular interest in our study.

IFC ("International Finance Corporation") is a finance institution linked to the International Bank for Reconstruction and Development (the World Bank). The IFC emphasizes that the projects are in agreement with the host country's development plans as well as factors such as the creation of jobs, effects on the foreign currency balance, the utilization of local raw materials, training and education of local labour, and any effects on the physical environment. The IFC normally prepares a social economic profitability analysis, in the form of cost-benefit analysis, and is definitely the institution which comes closest to our recommendations in this report as regards project appraisal. However, the IFC does not normally consider the distributional effects in their economic analyses.

FMO ("Nederlandse Financierings-Maatchappij voor Ontwikkelingslanden"), The Netherlands, attempts to select the projects which contribute to in the fight against poverty and which create new jobs. Moreover, training and education of the work force is emphasized as well as the transfer of technology and expertise. Projects receiving support must provide good working conditions and terms of employment for the workers. Finally, the balance of payments is emphasized, for example through the utilization of local raw materials.

SBI ("Societe Belge D'Investissement International"), Belgium, places decisive emphasis on the fact that projects are of common benefit to the host country and Belgium, and that the activities should be in accordance with the host country's development plans.

CDC ("Commonwealth Development Corporation"), the United Kingdom, assigns high priority to the training and education of workers. Moreover, the CDC gives preference to projects which provide for currency inflows, or which represent foreign currency savings through import substitution. The CDC also emphasizes that projects contribute to local saving, create local jobs, contribute to the education of managers, transfer technical expertise, and promote an equal distribution of incomes.

DEG ("Deutsche Gesellshaft für wirtshaftliche Zusammenarbeit (Entwicklungsgesellschaft) mbH"), West Germany, emphasizes in its project appraisal the creation of jobs and the improvement of the host country's foreign currency balance through the utilization of local raw materials, export, or import substitution.

CCCE/PROPARCO ("Caisse Centrale de Cooperation Economique"), France, emphasizes the projects' importance for the balance of payments, employment, and the national budgets. In addition, high priority is given to the training and education of local labour.

OPIC ("Overseas Private Investment Corporation"), USA, emphasizes in its project appraisal the creation of jobs and the project's importance to the host country's foreign currency balance. However, there is a requirement that the project be in accordance with the USA's currency and employment policies.

CIDA ("Canadian International Development Agency"), Canada, emphasizes the projects' positive developmental effects in the host country, but their positive employment effect in Canada.

SWEDFUND, Sweden, emphasizes in its project appraisal the creation of new jobs, the training and education of workers, how well the project fits into the local economy, how well the project is technologically adapted to the local conditions, the transfer of technology, the utilization of local raw materials, a positive effect on the foreign currency balance, and a positive effect on the environment.

FINNFUND, Finland, emphasizes that the projects have a positive effect on economic and social development in the host country.

IFU, Denmark, considers both the commercial and economic effects of the investment projects. Decisive emphasis is put on the fact that the investments, on certain conditions, will be commercially profitable within a reasonable period. For IFU to participate in a given project approval by the authorities of the host country is required.

IFU also investigates, as a matter of routine, whether four basic ILO conventions (nos. 87, 98, 111, and 135) have been ratified by the host country, and how they are complied with in practice. Information on conditions in the labour market may be collected from the ILO in Geneva if needed.

IFU's collection and appraisal of information on the developmental aspects, have in recent years followed NORAD's set of recommended criteria. IFU's appraisal of a project's developmental effects is based on a total consideration of the various factors, and like NORAD, IFU does not require a project to meet all criteria. With a view to achieving further improvement and systematized analysis of developmental effects, IFU's partners, through short stays with IFU, have the opportunity to study the institution's methods of analysis.

Even though IFU rarely declines to participate in a project because the project's developmental effects are too insignificant, rejections on these grounds represent the fourth largest group (11 out of 114 rejections in the period 1968-83).

The 1984 evaluation of IFU (Report no. 1006, Copenhagen 1984) considers the basic principles of IFU's activities to a limited extent only, an aspect which we have given main emphasis in this report. There seems to be an underlying condition that Danish private investments in developing countries should be advantageous to both the host country and Denmark, and that favourable finance provisions will promote such investment activity. On this basis the report puts forward a number of suggestions for minor changes in the system. Some of the suggestions seem reasonable, others more speculative. We choose to start where the report ends, that is, with the project appraisal. Here the report recommends (on page 15) that NORAD's check list should remain IFU's basis for appraising the projects' developmental effects.

In other words, our evaluation concludes quite differently. However, it must be added that according to our impression IFU is the one Nordic institution which has most seriously considered making use of a cost-benefit analysis. For example, a seminar on this method was arranged in the autumn of 1986, where NORAD employees also took part.

In addition the report found (pages 13-16) that IFU's activity has stagnated in the past few years (1984), and that it is disappointing that IFU has not been able to place a higher proportion of its money in profitable projects. The report states that IFU's investment policy has been restrictive and cautious, and also emphasizes that only a negligible part of the investments has been made in the poorest developing countries (the LLDC countries).

In this connection the report recommends that IFU should conduct a more venturesome investment policy, especially in the poorest countries. The report suggests that IFU should actively try to encourage Danish enterprises to invest in developing countries by presenting of possible projects or by directly urging them to invest. Furthermore, it is suggested that IFU should have the opportunity to implement, and for a period to maintain, activities which are not immediately commercially justifiable if such activities imply a substantial increase in the project's development potential (if possible in cooperation with DANIDA). Moreover, the report expresses the view that these activities would have to be financed through contributions or non-interest bearing loans from other sources than the profits from the projects.

These conclusions from the Danish report seem to point in the same direction as our conclusions: a policy of active identification and implementation of the projects most favourable to the host country should be followed, and greater risks should be taken. However, if foreign aid activity assumes such a form, it is also evident that the organization model chosen in Denmark (and the other Nordic countries), where the operation is based on the commercial profitability of the project, is not particularly suitable. There is every indication that a high degree of integration with the main foreign aid organization is preferable in this context.

It is interesting to note that the Danish report, after having evaluated risks, observes that less than one third of the Danish partners in the IFU projects were small and medium-sized enterprises (less than 50 employees). This seems to correspond with our experience with NORAD: the large and healthy enterprises are preferred, enterprises which have established themselves in the system over time and which will probably not bring losses upon the activity. The Danish report expresses the view that where small and medium-sized enterprises master an interesting technology with considerable potential, IFU should be able to assume a higher proportion of the financial burden both in connection with the adaptation of the technology and in the investment itself.

From among the suggestions made in the report on how IFU is to assume higher risks, we will mention a few which seem reasonable and which also correspond to ideas that occurred to us during the evaluation, without believing that such measures are the most essential in order to improve the support for investment as foreign aid:

- IFU should continue to provide venture capital for projects, chiefly through share issues.
- When granting loans to projects in the LLDC countries IFU should be able to assume a certain percentage of the currency risk, as frequent and often comprehensive devaluations in these countries may entail that the repayment of loans to IFU becomes such a heavy burden that the projects' continued existence is jeopardized.
- IFU should to a greater extent advance loans in other convertible currencies than Danish kroner.
- For high-risk projects it may be to the purpose that IFU advances loans for which the interest rate is tied to the profits, or gives a period of grace regarding the payment of interest for a period fixed in advance.

However, NORAD's current practice in this area seems to be the most satisfactory way to handle this issue. The foreign currency risk should basically be the responsibility of the enterprises, but if enterprises find themselves in difficulties for various reasons, then

NORAD should consider the projects individually and contribute to refinancing where this is desirable from NORAD's point of view. And this is exactly what NORAD has done on a number of occasions. The enterprises also know that NORAD in many such cases has been favourably disposed because of the desire to secure the "developmental effects" of the projects and this is probably the most risk relieving factor in the NORAD support for investment the way the system is practised today.

Otherwise, the Danish report seems to be in line with our evaluation on the following points:

- The provisions should not only apply to new undertakings, but also to existing activities (p. 12 and p. 15).
- The provisions should not only apply to manufacturing, but to any type of project (p. 14).

The Danish report offers far more concrete and detailed recommendations than our report does. We do not regard it to be the purpose of this report to make such recommendations. In general there is hardly any doubt that the Norwegian provisions for investment support are far more favourable from the business enterprises' point of view, and a relatively flexible application reduces the effects of the most unfavourable or irrelevant formal regulations. The main problem concerning the Norwegian provisions for investment support, and we believe this applies to the Danish ones as well, is the lack of a clear objective. Moreover, it should be made clear how to arrive at a planning procedure and a project appraisal which ensures optimal fulfilment of the provisions' objective. This is the main problem which has represented the guiding principle in our evaluation.

Of course it is up to the Storting and the Ministry of Development Cooperation to make the final clarification. The parliamentary debate on principal aspects of Norwegian foreign aid, as expressed in Recommendation S. no. 186 (1986-87), seems, to some extent, to have contributed to such a clarification already, or in any case to have indicated the direction to be pursued.

NOTES

Chapter 2: The Introduction of the Provisions for Investment Support and Official Policy

1. Cf. Report no. 54 (1962-63) to the Storting, Proposition no. 109 (1966-67) to the Storting and later reports on the principles of Norwegian foreign aid: 1971-72, 1974-75, 1984-85 and 1986-87. Also cf. the reports from the Engen committee, the Rogstad committee and the Onarheim committee in connection with the reports in 1961-62 and 1962-63 respectively, as well as the proposition in 1966-67.
2. On investment guarantees: see pp.7-11 in particular. On feasibility studies and investment in basic infrastructure: see p. 11.
3. Proposition no. 109 (1966-67) to the Storting, page 18.
4. Recommendation S. no 167 (1967-68), page 352.
5. Recommendation S. no 186 (1986-87), page 146.
6. Minister Vetla Vetlesen's speech at a seminar held by the Federation of Norwegian Industries on 17.06.87, cf. pp.1-2.
7. Recommendation S. no 186 (1986-87), page 144.
8. Ibid., page 151.
9. Minister Vetlesen's speech on 17.06.87. Report p.3.

Chapter 3: The Objectives, History and Development of the Individual Investment Incentive Schemes

1. The parliamentary debate on the special scheme:

   Proposition no. 108 to the Storting, Recommendation S. no. 229, the Official Report of the Storting proceedings 3881-3889 (1962-63)
   Proposition no. 66 to the Storting, Recommendation S. no. 171, the Official Report of the Storting proceedings 3432-3434 (1964-65)
   Proposition no. 100 to the Storting, Recommendation S. no. 219, the Official Report of the Storting proceedings 4072-4105 (1967-68)
   Proposition no. 108 to the Storting, Recommendation S. no. 201, the Official Report of the Storting proceedings 2931-2933 (1970-71)
   Proposition no. 116 to the Storting, Recommendation S. no. 258, the Official Report of the Storting proceedings 3290-3307 (1973-74)
   Proposition no. 102 to the Storting, Recommendation S. no. 222, the Official Report of the Storting proceedings 2911-2912 (1975-76)
   Proposition no. 79 to the Storting, Recommendation S. no. 157, the Official Report of the Storting proceedings 2628 (1976-77)
   Proposition no. 156 to the Storting, Recommendation S. no. 399, the Official Report of the Storting proceedings 4271-4274 (1976-77)
   Proposition no. 152 to the Storting, Recommendation S. no. 272, the Official Report of the Storting proceedings 3017-3018 (1977-78)
   Proposition no. 91 to the Storting, Recommendation S. no. 239, the Official Report of the Storting proceedings 3206-3207 (1978-79)
   Proposition no. 95 to the Storting, Recommendation S. no. 251, the Official Report of the Storting proceedings 3175-3180 (1979-80)
   Proposition no. 118 to the Storting, Recommendation S. no. 225, the Official Report of the Storting proceedings 3616-3617 (1981-82)
   Proposition no. 100 to the Storting, Recommendation S. no. 226, the Official Report of the Storting proceedings 4636-4640 (1982-83)
   Proposition no. 59 to the Storting, Recommendation S. no. 78, the Official Report of the Storting proceedings 2333-2336 (1983-84)

Proposition no.1 to the Storting from the Ministry of Trade, supplement no. 5 and Recommendation S. no. 6 on the Budget, supplement no 1. The Official Report of the Storting proceedings 1869-1873 (1984-85).

Proposition no. 42 (1984-85) to the Storting on new provisions for guarantees on conditional terms for export to and investments in developing countries. Recommendation S. no. 293 (1984-85) to the Storting.

Report no. 55 (1985-86) to the Storting on the revocation of Proposition no. 42 (1984-85) to the Storting on new provisions for guarantees on conditional terms for export to and investments in developing countries. Recommendation S. no. 222 (1985-86) to the Storting.

Also refer to Proposition no. 1 to the Storting from the Ministry of Trade, 1985-86 and 1986-87.

Also refer to the Norwegian Guarantee Institute for Export Credits' annual reports for the 1963-86 period.

2. Cf. Proposition no. 156 (1976-77) to the Storting and Recommendation S. no. 399 (1976-77). The rule of excemption was introduced with reference to the need for quick decisions in export cases, but in the regulations they have also been made applicable to investment cases (cf. the Resolution of the Storting, s. 1).

3. Cf. report from Minister Vetlesen's speech to the Federation of Norwegian Industries on 17 June 1987, p. 2.

4. Report no. 94 (1974-75) to the Storting, page 72.

5. Recommendation no. 192 (1975-76), page 13.

6. Recommendation no. 321 (1978-79), page 2.

7. Cf. Proposition no. 1 (1982-83) to the Storting, Proposition no. 84 (1982-83) to the Storting, and Recommendation no. 234 (1982-83)

8. Proposition no. 84 (1982-83) to the Storting, page 3.

Chapter 4: The Scope and Distribution of the Various Provisions for Investment Support

1. Investment guarantees have been promised since 1964. Up to the end of 1986 only two compensatory payments had been paid out. None of these were financed via the foreign aid budget. See section 4.6.

2. LIC = Lower Income Countries. Countries whose GDP per capita was below USD 700 in 1983.
   LMIC = Lower Middle Income Countries. Countries whose GDP per capita was between USD 700 and USD 1300 in 1983.
   UMIC = Countries whose GDP per capita exceeded USD 1300 in 1983.

3. Some projects have been promised loans several times.

4. In November 1986 the Norwegian parent company applied for the remittance of a loan and the realisation of a guarantee for loan, totalling NOK 17,130,000. This resulted in two guarantees for loans with a Norwegian bank being converted into a NORAD loan of NOK 5,165,000. This amount has not been registered in table 11.

5. In August 1986 the firm received a guarantee for an NOK 7,600,000 loan in connection with an expansion of the factory. This amount was later converted to a loan commitment and has not been registered in table 11.

6. A project in Pakistan received support for investment in basic infrastructure through the provisions for loans and guarantees. A loan to a project in Nepal was later converted to a grant. None of the amounts have been registered as loans.

7. Some projects have received several promises of loans. The total number of projects is therefore lower than the number of commitments granted.

8. A project in Tanzania recieved two separate promises of support for investment in basic infrastructure.

9. A project in Sri Lanka was promised support for initial training schemes in both 1984 and 1985.

10. There are certain reservations concerning the figures in table 20. In some of the Norwegian Guarantee Institute for Export Credits' annual reports nothing but the number of effected guarantees are mentioned, their localisation having been left out. As far as possible we have tried to gather supplementary information from other sources such as NORAD's annual reports and from the Department for Industrial and Commercial Cooperation.

Chapter 5: The Administration and Organisation of the Provisions for Investment Support

1. Cf. Report no. 1 (1983-84) to the Storting, supplement no 1.

2. The organisation of NORAD. Report from the working committee, June 1982.

Chapter 11: Evaluation of the Administration of the Provisions for Investment Support

1. This report was written on assignment from NORAD/the Department for Industrial and Commercial Cooperation. Based on information gathered from Norwegian firms by post or phone during the summer of 1986, this report evaluates the provisions for support for feasibility studies.

2. According to the Report on feasibility studies 320 studies were promised support during the 1976-85 period. However, we found the correct figure to be 328. This figure is based on an examination of data printouts from the Department for Industrial and Commercial Cooperation and and on NORAD's annual reports.

APPENDIX:

GUIDELINES AND SUPPLEMENTARY REGULATIONS FOR THE PROVISIONS FOR INVESTMENT SUPPORT

GUIDELINES FOR FINANCE AND SUPPORT FOR UNDERTAKINGS IN DEVELOPING COUNTRIES

1. OBJECTIVE

1.1 The objective of the provisions for investment support is to contribute to the development of trade and industry in developing countries. They are based on the desire of the developing countries for a greater transfer of private capital for such development, and the desire of Norwegian authorities to provide support by encouraging Norwegian enterprises to participate in this development. It is considered important in this connection that the Norwegian participation occurs in cooperation with the authorities of the host country in accordance with the host country's own priorities.

1.2 The provisions aim at reducing the commercial risk and the costs in the initial period of establishment. In order to achieve this the following provisions for investment support have been established:

- support for feasibility studies, which aims at stimulating Norwegian enterprises to explore the possibilities for business undertakings and other joint ventures of extended duration,
- provisions for loans and guarantees, which aim at facilitating the establishment process by providing venture capital, necessary guarantees and assessments of the project,
- support for initial training schemes, which aim at relieving pressure on the enterprise where the lack of trained local labour hampers or raises the costs of the project, and
- support for investment in basic infrastructure, which aims at paving the way for the establishment of manufacturing firms in areas where infrastructure is lacking and conditions of an economic and social nature hamper or raise the costs of the project.

1.3 The provisions for support for feasibility studies, investments in basic infrastructure and initial training are founded on Proposition no. 109 (1966-67) to the Storting. The provisions for loans and guarantees are founded on Proposition no. 119 (1978-79) to the Storting and Proposition no. 84 to the Storting and Recommendation S. no. 234 (1982-83).

2. GENERAL REGULATIONS

2.1 Within the framework of these guidelines and the allocations, delegation of decision making and guarantee resolutions of the Storting, support, loans and state guarantees can be granted for business undertakings in developing countries if Norwegian enterprises are involved.

2.2 By undertaking is meant that the Norwegian partner shares the risk by investing capital, production equipment or services or by making other contributions of an economic nature.

2.3 By Norwegian enterprises is meant enterprises which are registered and established in Norway. It is required that the enterprise runs a business in Norway which is relevant to the objective of the new venture.

The enterprise concerned must be found to have a sound financial basis, and technical as well as managerial competence to be able to establish new ventures in developing countries in a satisfactory manner.

2.4 The provisions will primarily be used to support projects in the manufacturing industries. Even so, support, loans and guarantees may be granted for the establishment of firms within other activities where the Norwegian enterprise is particularly qualified.

It is a prerequisite that the host country is involved in the project. Other foreign interests may also participate in the financing and implementation of the projects, but the participation of the Norwegian enterprise must be decisive for the project to be implemented. Norwegian subsidiaries may also avail themselves of the scheme for support for initial training.

2.5 In order for the Ministry of Development Cooperation/NORAD to grant support or loans, the undertaking to be established must be considered technically feasible, financially viable and economically sound, and have a definite developmental effect. When appraising the developmental effect of a project, emphasis will placed on whether it:

- contributes to the useful production of goods and/or services in the host country,
- creates profitable jobs which improve the social and economic conditions in the host country,
- is located in relatively poor areas,
- involves necessary systematic training of local labour,
- forms a basis for other economic activities,
- uses and processes the host country's own raw materials,
- contributes to the improvement of the host country's level of technological achievement,
- applies a technology that is adapted to the needs of the host country,
- contributes to the improvement of the balance of payments through reducing import or increasing export.

It is not required that each project fulfil all these criteria. Decisive emphasis will be put on the host country's appraisal of the project.

In the appraisal of undertakings it will be emphasized that the firm offer the local employees working conditions in accordance with existing local regulations as well as accepted international norms and ratified conventions.

2.6 The terms for support with reference to the established provisions will be set out in an agreement between the Ministry of Development Cooperation/NORAD and the receiver.

2.7 Inquiries and applications should be addressed to:
The Ministry of Development Cooperation (NORAD)
Department for Industrial and Commercial Cooperation
P.O.Box 8142, Dep.,
0033 OSLO 1
Telex: 74256 NORAD-N
Telephone: (02) 31 40 55

3. SUPPORT FOR FEASIBILITY STUDIES

3.1 a) The feasibility study must be purposeful and well planned. It is required that information available in Norway be examined to the extent this is possible before the part of the feasibility study eligible for support is initiated. It must be reasonably likely that the feasibility study will result in implementation of the project.

b) The study may include those inquiries which are necessary in order to determine whether the enterprise should participate in the implementation of the project.

c) The study may be carried out by the applicants themselves or in cooperation with consultants approved by the Ministry of Development Cooperation/NORAD. Part finance of consultancy fees may only be granted in those instances where the applicants themselves have initiated and headed the feasibility study.

3.2 a) The Ministry of Development Cooperation/NORAD will, as a main rule, cover up to 50% of the total actual costs within the framework of an agreed maximum amount. In particular cases, involving undertakings given priority, particularly in main partner countries, the Ministry of Development Cooperation/NORAD may cover a higher percentage. The agreed maximum amount will be based on an itemized estimate, which may include:

- The enterprise's direct expenditure on wages for those who carry out the feasibility study (covered on the basis of annual wages).

- Travel and living expenditures in accordance with the national travel allowance scale.
- Consultancy fees.
- Other approved expenditure which is directly related to the feasibility study.

b) The Ministry of Development Cooperation/NORAD normally does not grant support for expenditure accrued prior to the date of the agreement.

c) Payment of expenditure in connection with a feasibility study will be made by the Ministry of Development Cooperation/NORAD on the basis of audited accounts for the study, including the necessary travel documentation, after the feasibility study report has been submitted to the Ministry of Development Cooperation/NORAD. Part payment may be made in particular cases.

d) The firm is to submit a final report to the Ministry of Development Cooperation/NORAD on the feasibility study within an agreed period after the field work is finished. If the field work stretches over an extended period of time, interim reports may be submitted. Information as to whether the firm intends to implement or participate in the implementation of the project is to be submitted to the Ministry of Development Cooperation/NORAD as soon as possible after the report is finished.

e) The applicant and the Ministry of Development Cooperation/NORAD may in joint consultation consider whether the feasibility study must be expanded with additional studies in order to provide the best possible basis for a decision as to whether the project should be implemented.

f) If the firm carries out or contributes to the project, the amount that has been paid out shall ordinarily be repaid to the Ministry of Development Cooperation/NORAD. If the project is not implemented, the Ministry of Development Cooperation/NORAD has the right to use the report for internal purposes without having to pay for such use. The use of the report for other purposes is not permitted without a separate agreement with the firm that carried out the study.

3.3 The application should be submitted one month before the planned initiation of the study, at the latest, and must contain the following information:

a) A description of the applicant's activities in Norway and of any international experience, as well as the firm's three latest annual reports.

b) The objective of and a description of the project which is to be the object of the feasibility study. The enterprise's qualifications for implementing the project, as well as the project's connection to the activities in Norway.

c) A plan for the feasibility study including a statement of the conditions to be studied.

d) A time schedule for the feasibility study, including the date when it is expected to be finished.

e) Information on who is to carry out the study and also the consultants to be used, if any, as well as a description of the consultants' qualifications for the contract and also the fee scale to be used.

f) An itemized estimate of the costs of the feasibility study.

g) Information on whether any other form of support for the project has been applied for or received.

3.4 The Ministry of Development Cooperation/NORAD's support for a feasibility study does not imply any obligation for further support if the project is implemented. Later applications for other forms of support will be considered on their own merits and on the basis of an independent appraisal.

4. THE PROVISIONS FOR LOANS AND GUARANTEES

4.1 Loans may be granted when a project is dependent on reasonable terms of finance and if there are no decisive industrial, commercial or regional factors in Norway, or considerations of employment, which weigh against the establishment.

The individual loan shall include a grant element of at least 25%, calculated on the basis of a fixed discount rate, at present 10%. The period of no repayment, the interest rate and the repayment period for the loan are to be adapted to the earning power of the individual project so that the required grant element is achieved.

4.2 The manifestations of the Norwegian firm's investments are described in subsection 2.2 of the Guidelines. Ordinarily the Norwegian firm's investments should comprise so much of the share capital that there is a basis for real control. Furthermore, it is required that there be a reasonable correlation between the investment and the Norwegian enterprise's potential deliveries to the project.

4.3 Guarantees for loans will normally be limited to those instances where the necessary commercial basic finance cannot be procured without guarantees. Guarantees are to be granted without any premium or other expense to the recipient of the guarantee.

4.4 Normally, the total loans and guarantees granted shall not exceed 50% of the total loan capital in the project.

Ordinarily, collateral security is to be furnished for the loans and/or guarantees. The terms are to be set out in the individual loan or guarantee agreement.

4.5 The involvement of the Norwegian enterprise is expected to come to an end after some time so that interests in the host country can take over the shareholders' funds and responsibilities, provided that this is in the interest of the host country. However, the participation of the enterprise in the project is expected to be maintained as long as the agreement between the Ministry of Development

Cooperation/NORAD and the recipient of loans and/or guarantees is in force.

4.6 Applications for support for undertakings in the shipping sector shall include a recommendation from the Ministry of Trade and Shipping.

A statement will be obtained from the Ministry of the Environment on projects which are judged to entail pollution of the environment.

5. SUPPORT FOR INITIAL TRAINING SCHEMES

5.1 Support may be granted for the training of local employees in connection with the establishment.

The support may cover these costs:

- Cost of labour in the training period
- Travel and living allowances
- Cost of courses, course materials and instruction
- Other approved expenditure

The size of a training programme receiving support must be reasonable compared to the total investments, and at the same time it must be necessary for the undertaking to be commercially profitable. The initial training scheme for which support is requested, must be a separate, identifiable part project.

5.2 The Ministry of Development Cooperation/NORAD will normally be able to cover up to 50% of the total initial training costs within the framework of an agreed total maximum amount.

It must be established that the total finance of the investment project as well as the initial training programme is secured.

The payment of the Ministry of Development Cooperation/NORAD's share of the initial training expenditure will be set out in the agreement between the cosigner and the Ministry of Development Cooperation/NORAD on the basis of submitted plans and budgets. Final settlement is made against the submission of a report on implementation of the training project including a summary of the accounts certified by the auditor of the Norwegian enterprise.

Normally, support from the Ministry of Development Cooperation/NORAD does not cover expenditure incurred before the date of the agreement between the Ministry of Development Cooperation/NORAD and the enterprise.

5.3 Support is granted on the basis of an agreement between the Ministry of Development Cooperation/NORAD and the Norwegian enterprise as the applicant. This agreement is based in turn on an agreement between this enterprise and the subsidiary/partner firm on behalf of which the Norwegian enterprise applies. The agreement may be terminated before the agreement expires if the requirements for support are no longer present or if other factors so require.

5.4 The application should be submitted as early as possible in the establishment period and must include the following points:

a) A description of the applicant and also the other partners.

b) A description of the total investment project (project study, investment and operating budgets are expected to be enclosed) or a summary of the project in case a detailed description has been submitted in another context.

c) A description of the initial training schemes, including plans and budgets for finance and implementation.

d) An account of the expected developmental effects of the investment project.

Information concerning the host country's attitude to foreign investments and who has approved the project in the host country must accompany the application in cases where this is not otherwise made clear.

6. SUPPORT FOR INVESTMENT IN BASIC INFRASTRUCTURE

6.1 Support may be granted to undertakings related to economic and social investments in basic infrastructure which in an industrialized country would normally be the responsibility of the public authorities to implement, for example roads, wharves, local power stations, power lines, etc, as well as vocational training, housing, institutions of education and health for local employees, etc. The extent of a training programme receiving support must be reasonable compared to total investments, and at the same time it must be necessary for the undertaking to be commercially profitable. The investment for which support is being requested, must be a separate, identifiable part project.

6.2 a) The Ministry of Development Cooperation/NORAD will ordinarily be able to cover up to 80% of the total investment in basic infrastructure within the framework of an agreed maximum amount.

b) It must be established that the total finance of the project as well as the investment in basic infrastructure is secured.

c) Payment of the Ministry of Development Cooperation/NORAD's share of the investment will be set out in an agreement between the cosigner and the Ministry of Development Cooperation/NORAD on the basis of submitted plans and budgets. Final settlement is made against the submission of a certificate of completion or the like, including a summary of the accounts certified by the auditor of the enterprise.

6.3 Support is granted on the basis of an agreement between the Ministry of Development Cooperation/NORAD and the applicant Norwegian enterprise/the local firm.

6.4 The application should include:

a) A description of the applicant and also the other partners.

b) A description of the total project (project study, investment and operating budgets are expected to be enclosed).

c) A description of the investments in basic infrastructure including a statement of why these are necessary and why they cannot be implemented by the authorities of the host country.

d) Plans for finance, implementation and maintenance of the investment in basic infrastructure.

e) An account of the expected developmental effects of the investment project.

Information concerning the host country's attitude to foreign investments and who has approved the project in the host country must accompany the application in cases where this is not otherwise made clear.

7. INVESTMENT GUARANTEES

7.1 Introduction

The most recent foundation for the guarantee provisions in connection with private investments in developing countries is a parliamentary resolution, Proposition no. 42 (1984-85) to the Storting.

7.2 General regulations

Investment guarantees are only granted in connection with private investments in developing countries. The investment may be made as share capital or other forms of equity capital. Under certain conditions long-term loans closely associated with ownership in the undertaking concerned, can be covered by the guarantee. In addition to investments in the form of liquid funds or securities, the guarantee may also include investments in new or used machines or other production equipment, as well as services and other contributions.

If certain requirements are met, reinvestment of profits from earlier guaranteed investments is covered by the guarantee, provided that the reinvestment contributes to further economic development of the undertaking. Guarantees can also be granted if the reinvestment is part of necessary preparations for the main investment.

Risk area

In connection with private investments in developing countries guarantees can be granted to the investor against loss occasioned by expropriation, confiscation or similar action from the authorities of the country concerned, or destruction of property as a consequence of war, rebellion or similar disturbance, or ban on payments, moratorium, currency restriction or similar hindrance to payment or transfer of capital, interest or dividend (political risk).

The rate of guarantee is limited to a maximum of 90% of losses covered by the guarantee with reference to the provisions stipulated in the policy.

Calculation of the premium

The premium, which includes a fee for administration, is normally fixed at 0.7% per annum of the maximum guarantee amount in force from time to time.

Other regulations

An investment guarantee policy also contains a number of other stipulations regulating the relationship between the Guarantee Institute and the investor, for example on the obligation to submit information and act with due care, regulations on scaling down and on liabilities, rules for assessing the loss and the amount to be paid out in compensation, etc.

7.3 Applications

Applications for investment guarantees in connection with Norwegian investments in developing countries should be addressed to:

The Norwegian Guarantee Institute for Export Credits
Dronning Mauds gate 15
P.O.Box 1756, Vika
0122 OSLO 1

A copy is to be sent to:

The Ministry of Development Cooperation/NORAD
Department for Industrial and Commercial Cooperation
P.O.Box 8142, Dep.,
0033 OSLO 1

The application must contain information on:

- the Norwegian participants.
- a description of the project.
- the project, capital required and financing, etc.
- which investments guarantees are sought for.
- the market.
- the developmental effects of the project.

Complete information facilitate more rapid processing.