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FINANCING THE INDUSTRIAL ACTION PROGRAMME FOR THE LDCS: A CHALLENGE FOR THE 1990s

Working Paper*

Prepared by
the UNIDO Secretariat

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PREFACE

In the face of a stagnant world economy and competing demands on a diminishing pool of financial resources, the group of Least Developed Countries (LDCs) must increasingly devise its own solutions to achieving industrialization. The Industrial Action Programme for the LDCs was drawn up by the First Ministerial Symposium on the Industrialization of the LDCs, held in Vienna in November 1991. The draft text was submitted for consideration by UNIDO's General Conference and adopted in its resolution GC.4/Res.10 of 22 November 1991.

Implementation of the Industrial Action Programme is regarded as the proper response to the challenges posed by the needs of the LDCs. Basic to that implementation is the targeting of sound channels of finance through which sustainable industrial development can be nurtured. With this in mind, the theme of this Second Ministerial Symposium on the Industrialization of the LDCs is "Financing the Industrial Action Programme for the LDCs".

This paper attempts to give a concise overview of the various channels of finance open to the LDCs - at a domestic level, through both the formal and informal sectors, and at an international level, through official development finance and the increasingly sophisticated mechanisms of the international financial markets. Special attention is paid to the particular problems of women entrepreneurs needing access to funds.

Each branch of finance offers its particular characteristics. For the small entrepreneur who finds the doors of the commercial banks closed in his face, the informal sector offers a lifeline but - as this paper points out - is not a really suitable vehicle for providing medium and long-term finance. Even the commercial banks in the formal sector face a similar dilemma when they must borrow short but lend long. One theme to emerge strongly is the vital role of the indigenous development finance institutions, some of which are now struggling to re-establish their reputations after many years of inefficient management, and injudicious lending, and many of which have been closed down, leaving a dangerous vacuum in the financial sector of some LDCs.

On the external front, an analysis of the statistics reveals all too clearly the overwhelming dependence of the LDCs on official development finance for promoting their industrial development. And this at a time when the less poor countries are also becoming more dependent on ODF, with the result that more countries are competing for a slice of the same cake. Yet alternative means of financing are available on the international markets. Some would-be borrowers in the LDCs are intimidated by these seemingly sophisticated mechanisms. But many of these funding techniques are accessible and can provide valuable alternatives to the traditional funding channels.

It is hoped that this paper will help to stimulate lively debate and an exchange of ideas on those financial instruments best suited to promoting the rapid industrialization of the LDCs. Where existing mechanisms prove unsuitable or inadequate, this symposium should act as a forum for identifying the funding gaps and for proposing modifications and innovations to overcome these shortcomings. The experiences of the LDCs and also, where relevant, of other developing countries have been drawn upon.

This paper contains an introduction on the evolution of industry in the LDCs, the main components of the Industrial Action Programme, the impact of structural adjustment and the importance of the SMI sector in the private sector in the LDCs. Chapter 2 reviews the role of the informal financial sector and Chapter 3 looks at credit via the formal financial sector. Chapter 4 assesses the problems of women and access to credit. Chapters 5, 6, and 7 turn to external sources of finance - official development finance, the international financial markets, and foreign direct investment. The final Chapter (8) of this paper gives a resumé of the various recommendations for ways in which the LDCs can improve their access to these various sources of finance for industrialization.

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1. INTRODUCTION

There can be no development without industrialization. The setting up of high added value enterprises enables the different actors on the economic stage to derive benefits vital to their performance and, at the same time, permits the developing countries to reduce their reliance on foreign countries. By transforming basic commodities on the spot, the industrialization process allows the Least Developed Countries (LDCs) to break away from the "cash-crop economy" which makes them overdependent on raw material price trends.

The evolution of industry in the LDCs

The 47 UN classified LDCs reported on average a manufacturing: GDP ratio of 10 per cent in 1990. This shows no advance over the 10 per cent ratio of manufactures recorded in 1980. Of these 47 countries, only one, Zambia, reports a manufacturing: GDP ratio above 15 per cent. Indeed, only nine LDCs report a rate higher than 10 per cent in 1990. Zambia's ratio of 43 per cent for manufacturing within GDP reflects the disproportionate contribution of the copper industry to economic activity and demonstrates that little has been done to diversify its economy and industrial base away from copper. Zambia thus remains classified as a LDC, despite its relatively large manufacturing sector.

In the majority of LDCs, and in many of those in Africa, the state for many years played the role of the entrepreneur. This was often justified by the argument that the indigenous private sector did not have the capacity, in terms of capital and skills, to bring about the rapid industrialization that was needed. In the case of Africa, the view that the continent suffers from a lack of indigenous entrepreneurs was also more or less accepted by donor organizations.[1] The policies that were followed by both governments and donors did not, therefore, give adequate attention or encouragement to private domestic investment. The focus was either on public investments or attracting foreign private investment and most industrial policies and incentive packages for investors reflected this bias.

When looking at industry, policy makers focused mainly on promotion of large-scale, wholly government-owned or joint venture industrial enterprises. These were deemed to be the hallmarks of development and were generously supported by public policy, also enjoying preferential access to credit, foreign exchange concessions and protection from competition through subsidies, tariffs, quotas and exclusive licenses.[2] Private domestic enterprises were accorded very little attention and in some cases completely ignored.

Over the last three decades, the overall economic structures and macro-economic policies of many LDCs have failed to provide a sufficiently conducive environment for domestic private investment. In the first place, many existing industrial entrepreneurs, who were largely foreign or non-indigenous, did not always provide sufficiently attractive examples or encouragement to potential local entrepreneurs. Foreign-owned extraction or manufacturing enterprises, often using imported sophisticated technologies, did not encourage linkages with local industry. Large- and medium-sized industrial enterprises came to be largely viewed as a preserve of foreign investors or government institutions, and out of reach of private individual investors.

The high profile of state-owned enterprises and foreign shareholders in large-scale industries in LDCs inhibited indigenous entrepreneurship in other ways. With greater experience and better access to sources of capital, large foreign-owned firms were usually more competitive than indigenous firms, enabling the former to take up most of the profitable economic opportunities. This, coupled with other problems, such as high levels of industrial protection, credit rationing and recession tended to push domestic entrepreneurs into peripheral fields including service industries, and, more particularly, into small- or medium-scale enterprises (SMEs). The participation of local private investors in industrial activities has thus been concentrated in small and medium industries (SMIs).

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[1] **Accelerated Development in Africa South of the Sahara**, World Bank, Washington DC, 1981.

[2] Ibid.

It was the international financial crisis in the 1980s that led most developing countries to rethink their development strategy with a view to stabilizing and restructuring their economies; this involved a large-scale withdrawal by the state and also activities aimed at mobilizing domestic savings given the scarcity of inflows from foreign capital. At the same time, the situation in the LDCs was characterized by a failure of the state in its role as entrepreneur. In fact, in an attempt to encourage development, governments assigned themselves tasks that they could no longer carry out.[3] The role of the private sector as a factor of growth has been reconfirmed.[4] Nevertheless, it must be recognized that the socio-economic environment of these countries, given their current situation, does not constitute a fertile soil on which to sow the seeds of private enterprise.

The Industrial Action Programme for the LDCs

In response to the special problems faced by the LDCs, an Industrial Action Programme (IAP) has been drawn up and adopted by the LDCs and the international community. This programme was designed to help the LDCs realize the goals set in the Substantial New Programme of Action (SNPA) reaffirmed in the Paris Declaration and Programme of Action. The main features of the IAP emphasize:

- Human resource development for the industrialization of the LDCs;
- Industrial development in rural areas;
- Macro-economic policies to create a favourable environment and basis for sustained growth and mobilization of financial resources for industrial development;
- Development of the industrial, services and technological base, with three components:

  a. Maintenance and upgrading of existing facilities;
  b. Expansion of production potential in line with dynamic comparative advantage;
  c. Availability of resources and internal and external market prospects.

- Putting in place a system of consultations at the international and regional level to promote industrial development in the LDCs;
- Industrial economic cooperation.

Strategies for the IAP

The main thrust of the Industrial Action Programme is to improve the efficiency of industry through appropriate policy and investment choices. Its emphasis on rural industry is thus well placed both because of its linkage with the large agricultural sector in the rural economy of the LDCs and also because rural industry is calibrated to the resources and demand potential of the LDCs. However, a policy designed to stimulate rural industry must be built upon a dynamic agricultural economy. Thus deceleration in investment and ODF flows to agriculture could end up by having a negative impact on the rural industrialization component of the IAP. Similarly, SAL-induced reforms which may initially harm farm production through reduction in input subsidies or expose weak rural industry to competition from imports under a policy of trade liberalization could undermine this component of the IAP.

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[3] **The State and the Crisis in Africa: In Search of a Second Liberation**, Dag Hammarskjöld Foundation, Upsala, Sweden, 1992.

[4] **Accelerated Development in Africa South of the Sahara**, World Bank, Washington DC, 1981.

The emphasis on human development to augment both managerial and technical skills is also well placed. However, it must be realized that a key element in promoting industrialization derives from the entrepreneurial resources at the service of a country. Such skills do not come out of management training schools but are accumulated over time, through experience interfacing with the policy, social and cultural inheritance of a country. Nor is it enough to develop technical skills if this supply is not calibrated to macro-economic policies, micro-economic demand for skills and the incentive structure of the economy and society.

The emphasis of the IAP on dynamic comparative advantage as a guide for investment choice and its focus on privatization as an institutional instrument for industrialization are also pertinent, particularly for countries which have made inappropriate investments in inefficient import-substituting industries and where state enterprise operates without accountability or commercial orientation. However, it should not be overlooked that import substitution has, throughout history -even in the export success stories of Japan, Republic of Korea and Taiwan Province - been an integral component of their industrialization strategy.[5] The question is thus how to make this process efficient and without prejudice to export promotion. Similarly, the public sector has played a necessary role in the industrialization of many countries.[6] The problem is how to make such policies efficient and flexible rather than to deny the public sector any role at all.

Evaluating the impact of structural adjustment reforms on LDC industrialization

The creation of an enabling environment is now part of the aid strategy of most DAC countries. The World Bank and the ADB have shifted emphasis away from public sector industrial loans to lending through DFIs and directly to the private sector. There is also a particular emphasis on human resource development (HRD). Between 1988 and 1991, the share of ODF going to HRD rose from 5 per cent to 8 per cent. Programme lending has targeted reforms in the industrial sector which are in conformity with the IAP strategies. What is, however, lacking both in the IAP and the lending strategies of the donors is any identification of the need and commitment for resource flows to the LDCS to fund the restructuring and reorientation of their industries. The presumption remains that private domestic and foreign investment will underwrite this redirection of the industrial sector in whatever configuration is appropriate for particular LDCs.

Unfortunately, as was seen during the 1980s and now into the 1990s, none of the LDCs has registered any noticeable output and investment growth. Most LDCs have put in place programmes of reform in the area of privatization, import liberalization and financial sector restructuring. Either the reforms have not gone far enough or remain inadequately implemented or there may be some design flaws and inconsistency in the reform agenda.

For example, these reforms take private entrepreneurship as a given standard. Other than suggesting more public investment as part of a programme of human resource development through management training, they assume that the right mix of policies will stimulate entrepreneurship in equal measure for all countries from Mexico to Bangladesh to Chad, to Laos. However, in the short/medium run, the supply of entrepreneurs may differ widely among different developing countries, so that the response to a common set of policies and even placement of investment funds through DFIs may invoke widely different management responses and varied degrees of efficiency in productive performance. Such variations may explain the widespread default in many LDCs on loans from the DFIs or the inability of entrepreneurs in

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[5] Amsden A., **Asia's Next Giant: South Korea and Late Industrialization**, Oxford University Press, 1989; Wade R., **Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization**, Princeton University Press, 1990.

[6] Martin B., **In the Public Interest: Privatization and Public Sector Reform**, Zed Press, 1993.

many LDCs to compete with imports and identify and avail themselves of export opportunities. Furthermore, the policy reforms take no account of the prevailing global market regime, the volume and sectoral imbalances of trade, or of the increasing use of non-trade barriers by the developed countries to contain the effects of their declining global comparative advantage in many areas vis a vis the developing countries. The policy reforms thus overlook the impact of macro-economic stagnation due in part to the differential impact of the structural adjustment reforms on many LDCs in creating market conditions designed to stimulate industrial enterprise.

Finally, by excluding any entrepreneurial role for the state in making the catalytic investments which stimulated the industrialization process in most developing countries and LDCs in the 1950s and 1960s, the reform strategy exposes LDCs with weak entrepreneurial capability for investing in particular sectors to the possibility that their industrialization process will be unbalanced and thus unsustainable.

The leading role of SMIs in the private sector in the LDCs

In several LDCs, a lack of entrepreneurial spirit[7] can be observed, together with an inadequate financial system and the absence of capital markets. In these countries, 90 per cent of private businesses are small and medium-scale enterprises (SMEs) within the household sector.[8] However, instead of stimulating these enterprises, governments, faced with the debt crisis, have striven to privatize state enterprises. It is evident that **any model for the industrial development of the LDCs based on growth via private enterprise must first and foremost use SMEs as its foundation.**

Small- and medium-sized industries (SMIs) include manufacturing, processing and maintenance (repairs), which can be distinguished from other activities such as services, transport and construction (building) that also belong to the SME sub-sector. In rural areas, the SMIs come under the heading of non-agricultural activities, while in the towns they form part of the services sub-sector.[9]

In low-income countries where a severe economic, financial and political crisis, linked with the problem of debt management, prevails, poverty is rife. Whether they belong to the formal or informal sector, whether they are urban or rural in nature, the SMIs play a major role in the economy of the countries concerned. They create jobs and offer income opportunities for women and for the poor. In fact, these labour-intensive SMIs generate more jobs per unit of capital than the larger units. They also produce goods consumed mainly by those in the low-income bracket; they are economical in their use of capital and foreign currency and they utilize less skilled labour. And yet they generate more profit per unit than large enterprises.[10]

More recently, SMIs have begun to get more attention in many LDCs because of the increasing recognition of their role in the development process of Newly Industrialized Countries (NICs). For instance, a major ingredient of the successful industrial development in East Asia, especially in Taiwan, was the active role of SMIs. SMIs are now said to have been "the source of dynamic entrepreneurship, the training ground of skilled workers, an efficient medium of diffusion of technology and know-how, and supporting actors in dynamic growth through division

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[7] **Sub-Saharan Africa: From Crisis to Sustainable Growth**, World Bank, Washington DC, 1989.

[8] **The Least Developed Countries**, UNCTAD Report, 1992.

[9] Chuta E. and Liedhom, **Rural Small Scale Industry: Empirical Evidence and Policy Issues**, Chapter 20 07 Eicher and Staatz, 1984, pp. 296-3 2.

[10] Due, J.M. et al., "Funding Small-scale Enterprises for African Women: Case Studies in Kenya, Malawi and Tanzania", **African Development Review**, Vol. 2, Nr. 2, 1990, pp. 58-32.

of labour with large firms". In other developing regions, however, although there have been numerous small, cottage-type industries, there are few strong medium-sized enterprises.

The SMIs, which have been the engine of industrial development in nearly all Asian NICs and even Japan, have thrived, firstly, because the NIC Governments were able to create relatively efficient and competitive financial markets; and, secondly and more importantly, because these Governments were able to create an institutional framework with a lesser degree of discrimination between large firms and SMEs. This was achieved through appropriate macro-economic policies which have ensured that most investments in industry were domestically financed.

Whereas indigenous entrepreneurs face the same problems all over the third world, the extent of the problems differs from one region to the other. A survey on problems confronting indigenous SMEs in Sri Lanka and Tanzania concluded that lack of access to finance was the most binding constraint for all sizes of firms in Tanzania, yet only for smaller firms in Sri Lanka. Regulatory and tax constraints were severe with small firms in both countries but increased with size in Sri Lanka and declined with firm size in Tanzania.[11]

In the face of bureaucratic regulations and harsh working environments in the formal sector, particularly in the African LDCs, burgeoning domestic entrepreneurs resort to the informal sector. This is a phenomenon which has emerged in virtually all developing countries. Informal firms, which are mainly domestically owned, operate with few workers, often in remote locations to avoid detection and harassment. They have hardly any access to formal credit, and generally rely on informal lenders and family savings. This significantly reduces the ability of these informal enterprises to expand. Yet the bias against SMEs has continued in spite of the fact that they are often more profitable than large private and state-owned enterprises, which are favoured in terms of access to credit and regulatory environment.

With regard to the specific difficulties faced by the SMIs, some of the particular problems[12] would seem to refer to entrepreneurial spirit (much lacking), management capacity (notably weak), diffusion of information (poor), access to finance and credit (virtually impossible in the formal sector) and access to technology.

Access to credit

In most developing countries, the financial scene is characterized by the co-existence and parallel functioning of two financial sectors, one formal and the other informal. The formal sector has proved inadequate in the face of development demands, while the informal sector seems to have been strengthened and stimulated by the financial crisis and also by the malfunctioning of the former. The growing interest in informal finance stems not only from the shortcomings of the formal system, but also from the potential and dynamism of the informal financial sector.

The banks in the formal sector refuse to grant credit to the SMEs/SMIs since they believe that there are insufficient guarantees, that the risks involved are too great, and that the costs of administration and recovery are too high. Under these circumstances, these enterprises are systematically resorting to the informal sector in order to meet their financial needs.

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[11] Levy B., "Obstacles to Developing Indigenous Small and Medium Enterprises: An Empirical Assessment", **World Bank Economic Review**, Vol. 7, No. 1, 1993.

[12] Due, J.M. et al, "Funding Small-scale Enterprises for African Women: Case Studies in Kenya, Malawi and Tanzania", **African Development Review**, Vol. 2, Nr. 2, 1990, pp. 58-82.

2. THE ROLE OF THE INFORMAL FINANCIAL SECTOR

Tontines, savings and credit cooperatives are expanding and strengthening their role in the financing of agriculture and small businesses. However, very little information exists about this means of financing industry in the Least Developed Countries (LDCs).

The informal financial markets comprise all financial transactions which take place outside classical banking procedures. A further feature of informal financial transactions lies in the absence of state control and intervention. The ease of the operations and the flexibility of lending conditions in the informal sector give it certain economic advantages over the formal financial sector.

Found in both rural and urban areas, the informal financial sector is characterized by the diversity of its actors. To this category belong friends, neighbours, relatives, traders, shopkeepers etc. There is also a group that is rapidly growing in number, that of the travelling bankers. Their activity consists of visiting clients regularly (every day) to offer them financial services. In the case of deposits, the banker and his client agree on a daily contribution rate which is entered on a membership card. When this matures, the banker returns the accumulated amount of money to the client, less a daily commission for his services.

These travelling bankers also grant credits or advances. Indeed, if at the outset the main task of the banker was to encourage saving, obliging his client to regularly put aside a certain sum of money to be placed, theoretically, into safekeeping, this profession, bending to pressure from the clientele and in the face of outside competition, has developed rapidly. From a simple "purse-keeper", the travelling banker has become a real banker, who collects savings and distributes loans. This evolution has necessitated proper management of the funds.

In both the rural and urban areas of the LDCs there are a great many mutual aid associations and savings and credit clubs. These associations can be subdivided into two main groups: those designed solely for saving, and those oriented towards saving and credit.

The first group centres mainly on collecting contributions and membership cannot be compared to the relationship between debtor and creditor. Here, the overriding principle is one of the safekeeping and redistribution of money among a group of members. These clubs are open to a wide variety of people who encourage each other to save in order to accumulate joint investments, particularly in the area of farming. But, increasingly, the savings accumulated through the regular paying-in of the contributions are being used to finance non-agricultural activities such as cottage industries.

In the group that deals with both savings and loans, the **Associations rotatives d'épargne et de crédit (AREC) or tontines** are the best known. These rotating savings and credit associations (ROSCA) exist in almost half the countries in Africa and in many other LDCs. They have a solid structure and can effectively compete with the formal institutions.[13]

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[13] Miracle M.P., Miracle D.S. et Cohen L., "Informal Savings Mobilization in Africa", **Economic Development and Cultural Change**, 28 (4), 1980, pp. 701-724.

There are three types of tontines:[14]

- **The mutual tontine** is based on the solidarity of its members who know each other well. It is a financial association set up among people who decide to pool their savings, which are then made available to members on a rotating basis. The amount thus accumulated benefits each of the participants according to a pre-fixed order which can, however, be changed. Each member can lend, borrow or substitute a credit for a debt. In theory, the debts are not subject to interest.

- **The commercial tontine** is administered by a treasurer (purse-keeper) who collects the contributions and grants advances and credits. In other words, it is a mobile bank.

- **The financial tontine** is characterized by the putting up for auction of the order of drawing down the accumulated sum of money. Here, the participants can influence the order of the rotation of funds according to their personal needs. Those who borrow before their normal turn pay interest and those who save are remunerated.

Tied to a rural environment in their early stages, the ROSCA are now widespread in towns, particularly in Asia and in Latin America.

Partnerships

Apart from the ROSCA and the individual lenders, there is a range of companies or societies which, despite the formality of their names, can be viewed as belonging to the informal financial sector: these are the "Financières" (financial companies) in Africa, the tontine banks (in Benin) and the "Chit Funds" (in India).

These financial companies have their roots in the mutual tontine (each member pays in a monthly contribution) and the commercial tontine (there is an accumulation of funds). The "tontine bank" is a new creation, emanating from the mutual and commercial tontines. Its main feature is that it remains in one place and it is, in effect, an agency that collects savings and distributes credits. The "Chit Funds" belong to the informal financial sector in India, a sector which consists of two distinct branches: a "non-organized" branch, which comprises indigenous bankers, pawnbrokers and partnerships; and an "organized" branch, which includes registered companies such as leasing societies, investment companies and "Chit Funds".

The informal financial sector in India is institutionalized to a high degree, with the result that it has been accorded a legalized "parabanking" status. The "Chit Funds" have evolved through the gradual process of transformation and adaptation of a traditional savings technique which is widespread throughout India and the whole of South-East Asia. Similar to mutual tontines at the outset, they have now developed into financial tontines and, today, they even feature managing directors and boards.

The Coopératives d'Epargne et Crédit (COOPEC) (Savings and Credit Cooperatives)

Although their place in the informal sector is debatable, they cannot be considered as belonging to the formal sector, given their specific nature. The situation, however, varies from one country to another.

In India, for example, the cooperative banks are wholly legal entities which are regulated by the government and can thus be viewed as part of the formal sector.

[14] Lelart M., "L'épargne informelle en Afrique", in colloque **Les politiques financières nationales et la formation du capital en Afrique**, Cairo, July 1984 and 1989; "Les tontines béninoises" in **Revue Tiers Monde**, nr. 118, April-June 1989.

Whether informal or semi-formal, the COOPEC are private, voluntary financial cooperatives which are owned and managed by their members. Their aim is to encourage their members, and also non-members, to save by offering them deposit facilities and by granting loans to members on the basis of their savings.

Although the AREC and other mutual savings and credit associations are today widespread throughout the LDCs, the COOPEC - if one takes into account the large numbers of people they serve, the volume of the savings mobilized and the total amount of loans granted - **are increasingly proving themselves to be the banking system best suited to the LDCs.**

Informal financial markets helping to promote the development of SMIs

When comparing the formal and informal sectors, the question of access to financial services is one of overriding importance. The success of the informal systems can largely be attributed to their adaptability to the socio-cultural environment in which they operate. Considerable information is available on the support provided by informal systems to the rural population and, in particular, to farming communities. Indeed, excluded as they are from the formal sector because they do not offer sufficient guarantees, small-scale farmers, rural and urban households, craftsmen and small and medium-sized businesses are increasingly resorting to informal credit.

However, although informal finance is unquestionably and increasingly being used to cover the financial requirements for working capital of craftsmen and small and medium enterprises (India, Thailand, Benin...), it is nonetheless ill-suited to large-scale investments. Indeed, in the case of the SMIs, apart from agriculture, where most of the loans can be made on a short-term basis, medium and long-term credit is required which, in the absence of adequate guarantees, entails high risks.

The informal sector has often been accused of negatively influencing growth and development because it diverts savings towards private consumption, non-productive use of the funds or towards investments of low productivity that are considered low priority from the point of view of development. Yet, the end use of funds in the informal sector is varied and often innovative. The capacity of this sector to adapt savings and credit operations to meet every type of requirement from its clientele is one of its fundamental features.

Since individual lenders give credit on a cyclical basis, in monthly or yearly instalments, the mutual associations would seem to be by far the best suited instruments in that they can respond to a whole range of potential requirements, such as consumer expenditure and the productive utilization of funds. For example, the ROSCA and, in particular, the fixed capital associations, often use part of the funds collected to finance large-scale investment projects which benefit the entire community (purchase of agricultural tools and machinery, processing equipment etc.).

All in all, although there are no empirical data on support to SMIs from the informal financial sector, it is clear from the different methods of finance outlined above, that it contributes towards covering the working capital requirements of small and medium-scale enterprises in both rural and urban areas. However, informal finance appears ill-suited (with very few exceptions) to a whole range of large-scale investments. The major constraint to the promotion of SMIs through informal finance derives largely from the nature of the resources available in this sector, since these are short-term and cannot, without entailing high risks, be put to long-term use.

The governments of the LDCs, assisted by donors, have already tried (unfortunately without great success) to induce the formal financial sector to participate in the establishment of small and medium-scale enterprises. Several approaches have been tried,[15] such as the provision of guarantees on high-risk credits, participation in the capital of these enterprises by setting up finance companies and by promoting the principle of risk capital through the Société d'investissement et de développement international (SIDI). Despite all these efforts, the small and medium-scale enterprises sector remains marginalized.

There are, however, some encouraging developments with regard to support for the small and medium industries in the LDCs. The COOPEC were created in the 1970s under a variety of names (People's Banks, People's Savings Banks, banks for the poor, solidarity loans). In the 1980s, following the financial crisis, there was a revival of interest in them on the part of the donors. In most of those LDCs where they exist, these savings and credit cooperatives have virtually broken free from state control and, contrary to the scepticism which reigned some ten years ago over the possibility of attracting cash savings from the low-income rural population, there has been spectacular expansion in savings: at a rate of 20 per cent and 25 per cent per year in Rwanda and Benin, for example.

As regards the internal policy of the COOPEC on granting credit, this is marked by a bolder approach towards its members, despite which a recovery rate of almost 100 per cent is still achieved. The Grameen Bank in Bangladesh, for example, had US$ 300 million of loans outstanding in 1992 to 1,170,000 beneficiaries, with a recovery rate of around 98 per cent.

The COOPEC, as well as the Partnerships, have an advantage over other institutions in the informal financial sector in that they play the role of financial intermediaries. From this role of financial intermediation, four characteristics emerge which make the COOPEC a potential source of support to the SMIs:

- a major savings function;
- links between savings and credit;
- surplus funds which can be re-injected in the economy;
- open credit which matches the needs of its members.

All things considered, the COOPEC are, without doubt, one of the most interesting developments in the field of financial markets during the past few years. They have shown that it is possible, by training their members and applying rigorous and healthy management standards, to mobilize large volumes of savings from both the rural and urban populations. Their main aim is to become a real local development institution. They have the means to do this, provided they draw funds from stable resources for medium and long-term investments aimed at financing SMIs. However, they cannot carry out this strategy on their own. Close cooperation with the cooperatives who are responsible for supplies, marketing, stocking and production will be necessary. They will also need the assistance of governments and donors in order to educate enterprises in the judicious utilization of the funds.

[15] Gentil D. and Fournier Y., "Les paysans peuvent-ils devenir banquiers?", **Epargne et crédit en Afrique**, Syros, Paris, April 1993.

Diagram: Structure of the informal financial markets in the LDCs

TYPES OF ACTORS	FINANCIAL CATEGORY	LENDERS	BORROWERS
Individual lenders	Non-commercial operations	Friends Relatives	Small-scale farmers small businesses household firms
	Commercial operations	Professional lenders Travelling bankers Traders Shop keepers Landowners	Shop keepers Small businesses Household firms Wage-earners
Mutual associations	Savings plan	Fixed capital associations Mutual aid associations Savings clubs	Small-scale farmers Small businesses Households
	Savings and credit plan	ROSCA and variations	Small-scale farmers Small businesses Households
Partnerships and tontines	Financial intermediaries	Indigenous bankers Finance companies Savings and credit agencies	Shop keepers Small businesses Households
Savings and credit cooperatives	Financial intermediaries	Savings banks or Local, regional or federal banks	Farmers Fishermen Craftsmen Small businesses Small traders Households

Source: Taken from GERMIDIS *et al.* (1991),[16] page 95.

[16] Germidis D., Kessler D. and Meghir R., **Systèmes financiers et développement : quel rôle pour les secteurs financiers formel et informel ?**, OECD, Paris, 1991.

3. CREDIT VIA THE FORMAL FINANCIAL SECTOR

The successful rasing of finance is dependent on a feeling of confidence between lender and borrower (credit - credere - confidence). In the LDCs, intervention by a bank on behalf of an enterprise comes up against certain constraints which should be spelt out before discussing the structures and systems involved.

The economic, political and legal background

It is clear that the instability and uncertainty prevailing in many parts of Africa and other LDCs today is not conducive to banking operations, which on the contrary, require maximum stability. In a fluctuating and unpredictable environment, two points should be made:

- Everywhere in the developing countries, there is talk of "support to the private sector". It is not a question here of disputing this attitude, which lies at the very heart of the policy of UNIDO as of other international institutions. But, just as some years ago it was assumed that development would be born out of enterprises in the public sector, nowadays there is an almost instant conviction that, because collectivism has failed, pure, hard liberalism will save the day. But this is not the case. There can be no efficient private sector without a strong public sector that is both healthy and credible. Yet how can the private sector be promoted and investments made in the climate of insecurity of goods and people which reigns throughout much of Africa and in many LDCs today? It is a mistake to reduce the number of civil servants and to cut their salaries. What can one expect from a customs officer or tax collector who has not been paid for eight months?[17]

The law must be respected

- Within the LDCs and despite the existence of a well-defined legal system, it often happens that the enforcement of rules and regulations encounters obstacles. Guarantees are rarely honoured and the debtor can, with impunity, continue to cheat suppliers and other lenders. Legal texts must be standardized, it is true, but, more important still, is the use that is made of these texts. Plans to set up a regional law school will be of no avail if judges do not receive proper remuneration for their services, thus precluding any temptation to distort their legal decisions. As concerns the financial institutions, special attention must be paid to collective procedures, guarantees, means of execution and debt recovery.

Not enough "bankable" projects

Another obstacle to the provision of bank loans lies in the companies themselves and the difficulties their managers have in submitting "bankable" projects - that is ones that are eligible for credit. A recent study carried out by the Association Professionnelle des Banques de Cameroun (APECEAM) showed that only one loan application in 100 can be viewed as "bankable". For 75 per cent of those starting up a business, advice is their first requirement[18] and credit takes second place. This need for advice concerns:

- market research,
- project feasibility studies,
- financial plans,
- business forecasts.

and these items constitute vital information for the lender in assessing the viability of the project.

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[17] Situation in the Central African Republic, June 1993.

[18] Seminar on the setting up of enterprises, Bangui, 7 to 11 June 1993.

The role of the central banks

Existing regulations and the phenomenon of withdrawal of governments from banking systems places the central banks in an increasingly important position. The reinforcement of their powers of control through the creation of banking commissions must be encouraged. Preventing the risk of bankruptcy protects the saver and inspires confidence: "the overriding aim is to ensure the protection of the depositors and, in so doing, preserve confidence in the currency and guarantee the efficiency of monetary policy....".[19]

Institutions for financing enterprises

Most LDCs have experienced severe financial crises over the past ten years and the banking sector has been one of the main victims. The extent of the damage has necessitated major restructuring programmes which have considerably changed the banking scene in place since shortly after independence. These programmes were largely based on the banking structures of the former colonial powers, particularly in the Franc Zone countries where the influence of the French banks has remained very marked. The state was usually a fairly large shareholder in the banks although to varying degrees according to the political régime in force at the time - wholly nationalized systems in countries of left-wing ideology (Benin, Guinea, Madagascar, Ghana, Portuguese-speaking countries), or joint ventures with the private sector elsewhere.

Apart from the Central Bank, there are two types of institutions, deriving from the Western distinction between investment banks and retail banks. These are the development banks and the commercial banks.

Development banks were set up to finance the social infrastructure (roads, ports, schools...) and economic infrastructure (business firms) which is vital to development. The state had a large share in their capital and there was also minor participation by bilateral institutions, such as the Caisse Française de Développement and the German KFW. They also had credit lines from other donors, both multilateral (World Bank, EIB...) and bilateral. Given their functions, there was nothing unusual about the fact that these banks were state-controlled, since it was the job of the state to define economic priorities and consequently it needed the means to achieve these objectives.

The commercial banks, on the other hand, were chiefly concerned with collecting savings (generally short-term), converting these savings into loans, and with services relating to the management of their clients' accounts. When they were not entirely state-controlled, the capital of these banks was generally shared between the state (sometimes the majority partner) and the foreign banks (often from the former colonial powers).

By virtue of their vocation, the development banks are even more exposed to economic crises than their counterparts in the commercial sector. The causes of the problems of the national development banks are both exogenous and endogenous. Development finance entails greater risks than financing the operations of an enterprise. The amount and maturities of the finance are greater, as are the uncertainties of the market[20] and the profitability of the investment. The reversal of the markets in the 1980s resulted in a rise in the number of company bankruptcies and had repercussions on the creditor banks. In a situation where the state was the principal actor in the development process, carrying out the role of both entrepreneur and banker (debtor and creditor), the development banks cou.. not avoid financing projects whose profitability was not assured.

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[19] Communication from the Banque des Etats d'Afrique Centrale, seminar in Yaoundé, October 1992.

[20] Must we be reminded that one company out of every two set up in Europe disappears within three years? In these circumstances, how can we pass judgement on the LDCs!

This system worked relatively well until the end of the 1970s. Lulled into a false sense of security by the ease of public financing, which was itself nurtured by the products of high commodity prices, the banks did not see the crisis coming. Generally very liquid, they made very little effort to search for new products or to diversify their clientele. On the contrary, they often made imprudent investments in sumptuous premises for themselves and recruited far too large a staff.

The problems confronting the development finance systems

The progressive drying up of public resources and the frequent drawings by the state on public enterprises or parastatals drained the liquidity of the commercial banks. Many of them became illiquid and had to close down, others have had to submit to large-scale restructuring.

Pressure exerted by government over the granting of finance, the designation by the state of chairmen and directors with little or no knowledge of the subject, the diverting of funds towards uses other than that of development (the Treasury was frequently tempted to draw down funds lodged with the banks), prestige expenditures, excessive overhead costs, lack of proper evaluation of the projects submitted - these are just some of the reasons behind the rapid downfall of the development finance institutions (DFIs).

While it is true that, in the 1960s and 1970s, national development banks contributed to the economic development of the LDCs, in recent years widespread suspensions of payments have necessitated their restructuring. Some better run banks have managed to escape this crisis (Burundi, Gabon, Burkina Faso, for example...), together with the regional development banks and, in particular, the Banque ouest-africaine de développement (BOAD).

The problems facing the banks[21] and their incapacity to serve the national economies led the state authorities, sometimes under pressure from the IMF and the World Bank, to carry out major restructuring of the financial systems as part of their structural adjustment programmes. These restructurings have generally shown positive results and the banking systems have again become healthy and liquid.

The emergence of new banks

Although there has not been a mass exodus from Africa of banks from the industrialized countries (with the exception of American banks which have completely withdrawn from Francophone Africa), various initiatives have been launched with the arrival of new partners. These include:

- initiatives by the North African countries: Morocco (in Mali, Guinea, and Central African Republic), Tunisia (in Niger and Senegal), Libya (in Senegal, Mali, Burkina Faso, Togo and Niger).

- regional African initiatives: the ECOBANK group, which operates in West Africa (Nigeria, Ghana, Côte d'Ivoire, Benin, and Togo).

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21 Within the Franc Zone alone, total bad debts, refinanced by the central banks, came to 750 billion CFA (15 million FF) at the end of 1988, with more than 30 banks officially "in difficulty", (statistics given by Pierre Servant in "Afrique Contemporaine" at the end of March 1991).

- private African initiatives: the MERIDIEN BIAO group, which is of Zambian origin and, after buying up the BIAO group, became a major shareholder in 20 African banks: 11 Francophone, 8 Anglophone and 1 Lusophone . The Bank of Africa group, funded by private African capital, is established in Mali and Benin; the CCEI in Cameroon and the Financial Bank in Benin and Chad.

Another trend is the movement towards the "universal" bank. The failure of the development banks led governments, encouraged by the World Bank, to transfer the management of credit lines financing investments to the commercial banks. The commercial banks have thus become "multipurpose banks".

Shortcomings in the existing structures

Lack of institutions specialized in development finance

The transfer of the financing of development projects to the commercial banks has proved to be a widespread failure: "The substitution of the development banks by the commercial banks can only act as palliative"[22] for the following three reasons:

1. Commercial banks are short-term banks. They collect short-term savings, generally in sight accounts (in other words, they can be withdrawn at any time) and can thus only grant short-term credits, i.e. cash loans financing the bottom of a company's balance sheet. To lend long with short resources would entail the risk of tying up assets for too long, and this would rapidly become unsustainable for the bank.

2. The main objective of the commercial banks is their profitability and the trend towards privatization referred to above only serves to highlight this aim. The financing of development projects, particularly those involving the establishment of high value added enterprises, carries such high risks that the commercial banks are unwilling to become involved. They prefer to place their surplus funds on the money markets rather than with the central bank, free from risk and assured of a positive real rate of return (around 10 per cent in the Franc Zone countries). It is unrealistic to expect private capital to invest in high risk credits.

3. Financing investments is a very different matter from financing the running of an enterprise: "to analyze a short-term risk and to analyze the economic feasibility of a project are two quite different tasks".[23] In the first instance, the credit is "self-liquidating", i.e. it is repaid through the conversion of the good which is being financed (merchandise, debt) into monetary assets. In the case of an investment credit, it is the profitability arising out of the good to be financed (its self-financing capacity) that permits the repayment of the credit, a prerequisite to which is an expert study of the feasibility of the project. It is, however, not the job of the commercial banks to undertake such studies and they do not, therefore, employ this type of expert, who must not only be financially competent but also possess technical know-how.

Shortcomings in the financing of industrial production

The lack of institutions specializing in long-term finance is, without doubt one of the reasons for the paucity of medium and long term finance in the monetary statistics of various LDCs.

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[22] Gauthier M., "Que faire des banques de développement ?" Marchés Tropicaux, 2 December 1988.

[23] Ibid.

Although caution should be exercised when interpreting monetary data (for one thing, the informal sector does not feature in the statistics), these figures nevertheless show that, on the one hand, there is a widespread decline in the amount of credits distributed through the official banking sector and, on the other, the share of investment loans appearing under the heading of "medium and long-term credits" is very small. Industrial development requires financing for at least as long as it takes to amortize the good which is being financed. This poor share of industrial finance cannot be attributed to the inflexibility of the banking structures alone (the economic crisis is the main cause) but this is certainly a contributory factor and, for this reason, it is vital to set up a financial system better suited to the economies of developing countries.

As it now stands, the banking system can provide finance for the running costs of enterprises and can deal with temporary (in principle) shortfalls in their cashflow. Short-term resources are generally used for short-term lending such as advances on stocks, crop funding, overdrafts, cash facilities and all forms of debt mobilization. However, as we have already seen, the financial systems emanating from bank restructuring offer few possibilities for the long-term financing that is vital to every form of investment.

Whilst it is true that the informal credit sector can, to some extent, fill this gap,[24] the creation of specialized institutions which alone are capable of satisfying the vast needs which accompany the industrialization of a country is still a priority and must be encouraged.

Faced with huge needs and the urgent task of satisfying them within the context of a market economy, Western countries established specialized institutions for this purpose at the beginning of the 20th century. Today, these establishments still co-exist alongside the commercial banks but play a complementary rather than a competitive role. The idea of a "universal bank" is debatable. "There is a major difference in professional approach towards collecting savings, attending to individual clients and servicing enterprises, and here we must make a further, important distinction between attending to the needs of SMEs and attending to the needs of large-scale enterprises. This separation of responsibilities even within (banking) networks would seem to indicate that they are increasingly being viewed as "different jobs", says Mr. Jacques Mayoux, European Vice-Chairman of GOLDMAN SACHS.[25]

What is true for Europe is even truer of the LDCs given the wide range of their needs.

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[24] This subject will not be dealt with in this paper.

[25] "La Banque Universelle en question", Revue Banque, June 1993.

4. FACILITATING WOMEN'S ACCESS TO CREDIT

In addition to the general problems of SMI in obtaining credit, women face specific and even more severe obstacles due not only to the general characteristics of their enterprises but also due to the criteria on which loans and finance are granted.

These problems may be summarized as follows:[26]

- Women's enterprises generally tend to be smaller in size and more temporary and informal in their organization: therefore the lending problems arising from the informal character of the enterprise and the small loan size affect them more seriously.

- In particular, the problem of collateral is compounded for women by the widespread custom of registering property in the names of male household members, as well as by systems of inheritance which distribute property to male survivors, making collateral requirements one of the most pervasive barriers to formal credit for women.

- The often lower educational level and limited access to general education and skill training of women in comparison with men also puts them at a disadvantage in applying for a loan from the formal banking sector. Women may thus have difficulty completing the complicated application forms and compiling financial statements that banks require. In some cases, literacy was found to be a precondition for loan access - which frequently constitutes a more significant problem for women than for men.

- Accounting methods employed by women in microenterprises are often weak and, frequently, they cannot produce the records required by the banks. Consequently, women are perceived by financial institutions as having enterprises that are not worthy of credit and lack absorptive capacity to utilize credit profitably.

- Formal banking procedures and regulations are often discriminatory against women entrepreneurs, as they often contain conditions, such as having the husband or another male relative co-sign for a loan. Sometimes, public financial institutions permit only one loan per household, even if family members engage in separate economic activities - a regulation which generally acts to the detriment of the wife.

- Such disadvantageous procedures are aggravated by outright discrimination and a negative attitude and bank managers' lack of faith in women's economic talents and ability to succeed. Women are therefore often regarded as higher risk borrowers - despite the proven fact that their repayment rates are remarkably better than those of men.

- Reduced mobility is another constraining factor for women, who, for example, are limited by socio-cultural norms and traditions in the distances they can travel or, in addition to their business obligations, have to bear the responsibility for family and household duties and therefore are confined to the village sphere.

- Formal lending institutions communicate information about their credit facilities through the media and other facilities to which women have little or no access. For instance, information conveyed through men's cooperative societies, farmers' associations, brochures or even daily newspapers does not reach most women entrepreneurs. Also, some institutions do not have adequate branch networks for out-reach to women in remoter areas.

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[26] Berger M., "Giving Women Credit: The Strengths and Limitations of Credit as a Tool for Alleviating Poverty", in **World Development**, Vol. 17, No. 7, 1989, pp. 1017-1032.

- Socio-cultural factors also influence women's access to credit. For example, it may be improper for women to deal unaccompanied with unknown men - restricting them in their transactions with male bank managers.

- A lack of self-confidence on the part of women, together with the discriminatory attitude of many bank managers against female loan applicants, constitute additional barriers for potential female entrepreneurs.

While various interventions and mechanisms have been developed to facilitate access to finance for SMIs, they do not generally take into account and address the additional and specific problems faced by women entrepreneurs, although exceptions do exist in some countries and regions.

While an overall increase in the flow of institutional credit to the SMI sector may to a certain extent improve the overall lending environment also for women entrepreneurs, this is generally not sufficient to respond to their specific problems and needs. To overcome women's problems of access to lending from commercial and development banks, specific programmes have been created by some commercial and development banks.

> *The* Banco Nacional de Méjico, *for example, has established a department specifically for women* - Banco de la Mujer - *providing loan services and investment advice. This has not only improved credit access for women, but has also boosted the bank's business with a new group of clients. The* Agricultural Development Bank of Nepal, *one of the country's two development banks, also has a department dealing specially with loans to women.*

A number of innovative financing mechanisms within the formal sector have recently been adapted to the needs of SMI lending in developing countries. Some of these approaches may be effective channels of credit to micro-enterprises without assets and collateral, including enterprises owned by women. Worth mentioning in this context in particular are leasing and hire purchase arrangements, as well as venture capital schemes.[27]

Women's World Banking (WWB) is the most important example of this credit model, and, with around 46 affiliates in 35 countries (more than 50 other affiliates are in the formation stage,[28] the most widely spread credit guarantee scheme for women. Since its establishment in 1979, WWB has provided more than 56,000 loans valued at US$ 11.5 million. WWB was founded to advance and promote entrepreneurship in women, particularly by facilitating their access to organized credit and thus ultimately proving their creditworthiness. The organization extends credit to women through commercial banks with the use of a partial loan guarantee mechanism. Under this scheme WWB guarantees 50 per cent of the principal amount, the local affiliate 25 per cent, and the remaining 25 per cent risk is borne by the bank. By spreading the risk among the three institutions, this formula creates an incentive for lending institutions to expand their pool of women borrowers. In addition, WWB affiliates have created other credit programmes, such as revolving loan programmes to provide business working capital etc. WWB also offers monitoring of loans as well as training programmes for women in technical and entrepreneurial skills .

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[27] Levitsky J., "Financing of Small and Medium-Scale Enterprises, UNIDO/IPCT.72(SPEC.), 1 November 1988; Levitsky J., **Innovative financing systems**, in Netherlands Development Cooperation: Small Enterprises, New Approaches; Proceeding of the Workshop "Small Scale Enterprise Development, in Search of New Dutch Approaches", The Hague, 6 and 7 March 1989; and Okelo M., **A Brief Guide to Women's Access to Credit in UNIDO Projects**, 1991.

[28] "Women and Credit", **Women and Development**, in INSTRAW News, No. 15, Winter, 1990.

In distinction to schemes targeting mainly women in micro-scale activities, WWB must be considered an approach which is also relevant to women entrepreneurs in organized manufacturing, and may also be a facility for upgrading women's production activities to the formal sector.

Women's World Banking may therefore be regarded as a very relevant and useful partner for cooperation in projects, particularly for the small- and medium-scale industry sector. Female project beneficiaries or clients can be made aware of the availability of this credit scheme and its services. At the same time, WWB can provide a feedback on assistance requirements of women entrepreneurs to the SMI project or the small industry development organization involved. If no such WWB affiliate exists in the country concerned, local women entrepreneurs' associations should be informed of the existence of the scheme, and encouraged to set up a local affiliate.

Poverty-focused banks have, with significant success, developed specific approaches to reach those groups of the economy which are usually left out of the mainstream of development and, in particular, out of institutional finance. They have targeted the urban and rural poor, those groups which, in general, cannot fulfil the collateral or accountancy requirements of formal sector banks, people involved in unregistered micro-scale enterprises and, in particular, they have focused on women involved in micro-scale activities. (Some of these schemes have targeted women exclusively, such as the *Bank of Poor Women*, set up by the *Self-Employed Women's Association, SEWA*, in Ahmedabad, India).

The best known bank of this type, and one which has been the guiding example for many similar efforts, is the *Grameen Bank* of Bangladesh. In October 1989, the Grameen Bank, which started as a small action-research project in one district in the late 1970s, was running more than 632 branches and had more than 630,000 active members (of whom around 88 per cent are women) organized into almost 25,600 borrower "centres".[29] The repayment record is an exceptionally high 98 per cent.

Women all over the world have been particularly active in developing a variety of indigenous financial associations, the most important being the rotating savings and credit associations (ROSCA). They have different names - *tontines* in West Africa, *arisan* in Indonesia, and *panderos* or *juntas* in Peru - and take slightly different forms according to the country or region. Each member regularly pays a certain amount into a pool, which is made available to members on a rotating basis. While these schemes are traditionally used to finance celebrations and other non-economic expenditures, they may also be transformed and used for productive purposes.

Various efforts have been undertaken by technical cooperation agencies to adapt revolving loan fund schemes and use them for productive requirements. In particular, the United Nations Development Fund for Women, UNIFEM, has implemented revolving loan funds in a significant number of its projects.

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[29] Hulme D., "Can the Grameen Bank be Replicated? Recent Experiments in Malaysia, Malawi and Sri Lanka", in **Development Policy Review**, Vol. 8, 1990, pp. 287-300.

5. EXTERNAL FINANCE - OFFICIAL DEVELOPMENT FINANCE

Trends in Official Development Finance (ODF) to the LDCs

The investment of external resources in the LDCs to promote manufacturing growth remains a critical element in their development process. The very nature of their least developed status presumes low levels of domestic resource mobilization in relation to GDP.

The overwhelming part of the LDCs' external resource gap is financed through ODF offered as concessional loans and grants, which for all LDCs averaged above 95 per cent of all financial flows in six out of ten years between 1981 and 1990. Adding in the ODF going to LDCs on non-concessional terms, then **official flows account for virtually 100 per cent of external resource flows to the LDCs (Table 1).**

ODF flows to the LDCs may be compared with the external resource inflows to all developing countries for which concessional ODF was below 40 per cent between 1981-84 but rose to 81.2 per cent by 1990. Indeed, ODF accounted for most of the net non-concessional inflows into all developing countries in 1990 so that ODF by 1990 had (with rare exceptions mostly in East and South East Asia), emerged as the principal source of external resource inflows for all developing countries, and not just the LDCs, although the large wave of interest from foreign private investors in Latin America has since moderated this trend.

This deceleration in non-ODF financing for the developing countries meant that LDCs were exposed to a more competitive environment for concessional ODF in general. The LDCs share of concessional ODF thus averaged 31 per cent between 1985 and 1988 but declined in every subsequent year to 26.9 per cent in 1991. This contraction was particularly evident in concessional flows from bilateral donors in contrast to multilateral donors who, every year since 1985, channelled above 40 per cent of their resources to LDCs rising to a high of 48.4 per cent in 1989.

The LDCs' limited access to non-official resource transfers only emphasized the critical role played by ODF in the financing of development in the LDCs. Consequently, **the overall increase or deceleration of ODF flows to LDCs assumes a disproportionate significance in their economic fortunes.**

Trends in financial flows and ODA

Total financial flows to the LDCs in constant 1980 dollar values rose by 27 per cent between 1981 and 1990, increasing to US$14.49 billion from US$11.39 billion. However, this increase barely managed to keep pace with population growth, with the result that, in per capita terms, inflows remained constant at $28.4 in 1981 and $28.5 in 1990. Nonetheless, the LDCs benefitted far more than the developing countries as whole who saw total financial flows (in constant dollars) fall from US$96.74 billion in 1981 to US$60.59 billion in 1990 and corresponding per capita falls from US$42 to US$21.3.

The ODA component of total financial flows to the LDCs has grown in importance over the last ten years, with concessional loans and grants representing 81 per cent of all flows in 1981, as much as 99.6 per cent in 1989, and 93.5 per cent in 1990. This growing dependence on ODA is illustrated in its ratios to the main macroeconomic indicators. Thus, between 1980 and 1985 and 1985 and 1990, the ODA: GDP ratio rose from 9.4 per cent to 10.9 per cent whilst the ODA:domestic investment ratio rose from 57.7 per cent to 79.7 per cent and the ODA: import ratio rose from 47.2 per cent to 63.5 per cent, reflecting the weakening economic performance of the LDCs.

Table 1 Composition of total financial flows to all LDCs in current and in constant dollars

Millions of current dollars

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Concessional loans & grants of which:	8 824	9 335	9 109	8 908	10 162	12 180	13 467	14 377	13 929	15 668	14 733
DAC	6 813	7 069	6 796	7 325	8 514	10 274	11 765	13 100	13 095	14 869	14 245
- Bilateral[a]	4 324	4 649	4 265	4 436	5 287	6 508	7 446	8 584	7 859	9 082	8 491
- Multilateral[b]	2 489	2 420	2 531	2 889	3 227	3 766	4 319	4 516	5 236	5 787	5 753
- Grants	5 195	4 972	4 834	5 096	6 236	7 118	7 792	9 181	9 324	10 997	-
- Loans	1 618	2 098	1 961	2 228	2 278	3 156	3 974	3 918	3 771	3 872	-
- Technical assistance	2 062	1 939	1 931	1 874	2 141	2 518	2 800	3 095	3 158	3 309	-
- Others[c]	4 751	5 130	4 865	5 450	6 373	7 756	8 965	10 004	9 937	11 560	-
OPEC	1 132	1 389	1 128	664	685	665	589	201	181	512	557
- Bilateral	887	1 164	952	567	613	585	522	177	165	498	573
- Multilateral[d]	246	225	177	97	72	79	67	24	17	14	-16
- Grants	255	710	397	414	430	385	448	135	92	481	503
- Loans	877	679	731	250	255	280	142	66	89	31	53
Non-concessional flows of which:	2 068	1 707	54	717	290	-200	-204	597	55	1 085	-
DAC	2 097	1 831	59	731	284	-173	-202	628	91	1 087	-
- Bilateral official[a]	499	382	370	1 156	446	461	465	450	100	589	-
- Multilateral[b]	136	134	128	94	267	90	77	52	3	58	-
- Export credits[e]	405	597	-405	-585	-385	-625	-545	-411	-142	-347	-
- Direct investment	562	543	90	-39	-84	-133	134	329	735	453	-
- Others[f]	497	175	-125	105	40	34	-332	209	-604	334	-
Total financial flows	10 892	11 043	9 163	9 625	10 451	11 980	13 262	14 974	13 984	16 733	-

Notes:
a. Excluding flows from Portugal and Spain, which became members of DAC at the end of 1991.
b. From multilateral agencies mainly financed by DAC member countries. Excludes flows from IMF (SAF/ESAF).
c. Grants (excluding technical assistance grants) and loans.
d. From multilateral agencies mainly financed by OPEC member countries.
e. Guaranteed private
f. Bilateral financial flows originating in DAC countries and their capital markets in the form of bond lending and bank lending (either directly or through syndicated "Eurocurrency credits"). Excludes flows that could not be allocated by recipient country.
g. The deflator used in the unit value index of imports (see table ii).

Source: UNCTAD secretariat calculations, mainly based on OECD DAC data. Taken from UNCTAD (1992) The Least Developed Countries, 1992 Report.

In a situation where the LDCs own domestic economic capabilities were deteriorating, the stagnation in external resource inflows merely compounded the weakened position of the LDCs, who demonstrated little resilience in adjusting to the unpropitious global climate for ODF.

Trends in ODF to the industrial sector in the LDCs

There have been strong indications in recent years of a crowding out of industry's share in ODF both to developing countries as a whole and to the LDCs. By 1988 for all DCs, ODF to this sector, which includes extractive industries and manufactures as sub-sectors, was down to 5 per cent of the total and, of this share, three-quarters was for manufacturing. By 1990, the share of industry in ODF was down to 3 per cent, of which two thirds went to manufactures (Table 2).

Within this overall deteriorating trend, the share of industry in ODF to the LDCs was 7 per cent in 1988, with manufactures representing six of the percentage points. By 1991, this industry share was down to 4 per cent, of which manufactures represented one half (two percentage points). Looking at absolute numbers, in 1988, US$ 924.8 million out of US$ 15.4 billion of ODF to the LDCs went into non-extractive manufacturing. By 1991, the flow of ODF into manufactures was down to US$ 375.6 million compared with total ODF of US$ 18.7 billion.

In the face of declining ODF to developing countries as a whole, LDCs are exposed to a now universal trend in the changing priorities of the donors in distributing their ODF. For most LDCs, ODF for industry has become minimal, as will become apparent in a review of the lending priorities of the World Bank and the Asian Development Bank, and the African Development Bank.

Moreover, in the last four years the flow of export credits to the LDCs has become negative; direct portfolio investments in 1991 were negative, whilst only US$ 103.8 million came to the LDCs as direct investment. It is thus evident that the negligible ODF going to the industrial sector in these countries has by no means been compensated by an acceleration of flows from the private sector. Indeed, it is likely that such private flows as there were may have gone to sectors other than industry. Thus the capacity of private foreign capital to stimulate industry in the LDCs may in this period have been even more minuscule than is apparent from the aggregate figures.

Multilateral institutions and their lending to industry

The deterioration in resource flows to industry in the LDCs may be more fully appreciated by looking at trends in three major multilateral institutions, the World Bank, the Asian Development Bank (ADB) and the African Development Bank (AfDB). World Bank lending strategies have, in particular, set the tone for the changing direction of ODF to the LDCs. Hence, an analysis of such strategies provides a broad insight into donor perspectives on ODF to industry in the LDCs.

In the setting up of the International Development Association (IDA) at the commencement of the MacNamara presidency at the World Bank in the 1970s, the Bank had come to recognize the special problems of the less developed of the developing countries. The IDA affiliate was designed to both target Bank resources to this less privileged category of borrowers and to do so on soft terms where the borrowing charge was as low as 0.75 per cent compared with the 8/8.5 per cent charged by the mainstream IBRD.

Table 2: Official Development Finance (ODF) to the industrial sector of the LDCs. (in $ million)

		Annual Average 1981-85	Annual Average 1986-90	1988	1989	1990	1991	Comments
A.	**Aggregate Flows to LDCs**							
1.	Concessional loans and grants	9 267	13 924	14 377	13 929	15 668		
2.	Non-concessional flows	967	267	597	55	1 085		
3.	Total financial flows, net (1+2)	10 234	14 191	14 974	13 984	15 753		
4.	Total financial flows, net (in 1980 constant prices)	11 264	13 720	14 459	13 024	14 492		
5.	Total ODF, gross			15 414	15 404	18 737	18 779	
6.	ODF to the industry sector			1 077	616	562	751	
7.	(6) as % of (5)			7	4	3	4	
8.	ODF to manufacturing sector			925	462	375	376	
9.	(8) as % of (5)			6	3	2	2	
B.	**% share of ODF to industry in selected countries**							
i.	Bangladesh			14	6	6	1	
ii.	Burkina Faso			5	4	1	1	
iii.	Chad			3	0	0	3	
iv.	Ethiopia			0	6	-	6	
v.	Guinea			6	0	1	40	extractive industry
vi.	Madagascar			9	2	1	5	
vii.	Mali			9	1	5	3	
viii.	Mauritania			6	1	-	77	extractive industry
ix.	Mozambique			5	3	2	0	
x.	Myanmar			3	2	1	-	
xi.	Nepal			0	-	1	0	
xii.	Niger			3	3	-	1	
xiii.	Rwanda			0	0	5	1	
xiv.	Somalia			4	-	0	20	
xv.	Sudan			2	1	-	-	
xvi.	Tanzania			6	4	1	4	
xvii.	Uganda			2	32	3	3	
xviii.	Zaire			15	4	1	2	
xix.	Zambia			3	4	16	4	

Source: A, 1-4: Least Developed Countries Report, 1992, UNCTAD.
A, 5-9 & B: Geographical Distribution of Financial Flows to Developing Countries, 1988-91, OECD.

However, unlike the UN classification of the LDCs, the World Bank determined eligibility for borrowing from IDA on the basis of per capita income and targeted what it defined as Low Income Countries (LIC), that is those countries with a per capita income below US$ 750. This categorization has made such large and more developed economies as Indonesia, India, China, and Pakistan eligible for IDA borrowing. Most LDCs thus remain as a sub-set of the LICs. (Botswana, Cape Verde, Djibouti, Yemen, Kiribati, Western Samoa and Vanuatu fall into the Bank's lower middle-income category). However, IDA lending provides a useful indication of lending to LICs since most LDCs are and have been borrowers from this facility and, unlike the more advanced LICs, rarely borrow from the IBRD affiliate of the Bank which lends on much harder terms than the IDA (the main exception being Botswana, an LDC until recently).

The IDA share of bank lending peaked in the early years of the MacNamara era when 29.4 per cent of all bank lending was channelled to the LICs. Yet this share then declined steadily in successive quinquenniums and stood at 24.6 per cent in 1986-92. 1993, however, has seen a revival in this share of total lending to 28.5 per cent. Yet, whilst the share of IDA may have declined in relative terms, more resources in absolute terms were going to the LICs, who in 1986-92 received US$ 34.4 billion of Bank funds compared with US$ 5.7 billion in 1971-75.

Industrial sector lending by the World Bank

For the purposes of this paper, the focus must be on industrial sector lending by the Bank. This broadly breaks down into a category defined as *industrial loans,* and one defined as *small scale enterprise* (SSE). It has somewhat arbitrarily been assumed that all bank lending under the heading of SSE went into industry so that industrial lending by the Bank reported in table 2 aggregates industrial sector and SSE loans. Bank lending to the development finance institutions (DFIs) of the developing countries forms another separate category. This facility, common to most developing countries, was designed to set up public sector lending facilities to channel term finance to the emerging private sector on the assumption that traditional commercial financial institutions, usually in the private sector, found such lending too risky. The World Bank, since followed by the regional multilateral banks such as the Asian Development Bank (ADB) and the African Development Bank (AfDB), has played a pioneering role in building up the DFIs and in the process promoting the development of private enterprise by channelling some US$ 24 billion to DFIs in the developing countries between 1971-92. This was slightly more than the US$ 23.7 billion it lent to the industrial sector.

Since, however, it is a fair assumption that a large position of DFI lending to the developing countries is invested in the industrial sector, an aggregate of lending to the DFIs and the industrial sector may be more accurate measure of the share of Bank funds going to industry. However, as some DFI funds have gone into areas such as financial sector adjustment and trade reforms (increasingly so under structural adjustment), there is obviously some overestimate in this categorization of loans to industry. Nevertheless, in the absence of a detailed sub-sector account of Bank lending, these estimates will have to serve in this paper as a proxy for industrial lending.

Under this redefined definition of the industrial sector, Bank lending to the sector varied between 16.1 per cent in 1971-1975 to 17.5 per cent of total lending in 1986-1992, so that between 1971-1992, US$ 47.6 billion of Bank lending went into industry. Thus Bank lending to industry in the developing countries came to constitute the principal source of ODF to that sector. The World Bank from the outset of its lending to developing countries has recognized that industrial development is an important component of the development process in order to stimulate growth, structural diversification and greater employment opportunities for the developing countries.

Most loans to the DFIs and to the small-scale enterprise sector went to finance private enterprise in the developing countries. As between 1970-1992, US$ 5.2 billion went to small-scale enterprise. If we add this to the US$ 23.9 billion which went to the DFIs is added to this, a total of US$ 29.1 billion or 10.1 per cent of bank lending went to private industry compared with 6.4 per cent which went to public sector industry. However, as the Bank shifted more into Multi-Policy-Based lending and structural adjustment loans (SALs) in particular, the share going to the private sector was effectively crowded out and lending for industry declined.

The gradual decline in the World Bank lending to industry in the LICs and, in particular, to public sector industry is made more explicit if Bank lending to the LDCs within the broader category of the LICs is analyzed. Table 3 shows that in 1974/75, 1.3 per cent of Bank lending, 3.9 per cent of IDA lending and 17.5 per cent of total industrial lending went to three LDCs (Bangladesh, Tanzania and Zaire). In 1980, 1.6 per cent of Bank lending, 4.7 per cent of IDA lending and 18.5 per cent of total industrial lending went to the LDCs. By 1985, lending to the LDCs had fallen to only 0.5 per cent of Bank lending, 2.4 per cent of IDA lending and 6 per cent of total industrial loans. In 1992, the Bank lent US$ 3.7 billion to the LDCs so that the share of lending to industry to the LDCs ($91.1 million) comes to 2.5 per cent. It is thus evident that very little Bank funding is currently going into industry.

There is a similar institutional shift in Bank lending strategy to the LDCs. Thus in 1974/75, all lending to industry in the LDCs went to the public sector. In 1985, four out of six loans, covering 79 per cent of the LDC total, went to the DFIs. In 1992, of the two IDA credits, one went to private banks in Bangladesh for on-lending to the private sector and another, for US$ 65.6 million, went to private enterprise development in Uganda.

Table 3: World Bank lending to LDC industrial sector
(in $ million)

	1975	1980	1985	1992
1. Total World Bank Industry + DFI loans to LDC	148.0	179.5	72.7	91.1
2. % share of total IDA loans	3.9	4.7	2.4	1.4
3. % share of total loans	1.3	1.6	0.5	0.4
4. % of share of total World Bank loans to Industry + DFIs	17.5	18.5	6.0	7.4

Source: World Bank Annual Report, 1970, 1975, 1980, 1985, 1992.

These trends appear to indicate that the World Bank is withdrawing increasingly from direct lending to industry for the creation of new capacity. At best, some funds may be extended for the balancing, modernization and expansion (BME) of a few extant public enterprises. What funds are being deployed by the Bank in the LDCs are largely designed to induce private sector promoting reforms where industrial investment can be expected to take place only as a by-product of the policy reforms. What direct lending is extended to industry will now go to the private sector either through DFI support or through private banks, or as equity participation through the IFC window of the Bank.

The African Development Bank

In common with the World Bank, the African Development Bank Group offers credits through the Bank itself, soft loans through the African Development Fund, and intermediate loans through the Nigerian Trust Fund (which is very modest in size). Cumulative lending by the Bank group at the end of 1992 totalled US$ 25.4 billion, of which the Bank lent $15.7 billion (62 per cent), the Fund $9.3 billion (37 per cent) and the Nigerian Trust Fund $282.6 million (1 per cent). Of this cumulative loans total, industry benefitted from 211 loans or grants, of an average size of $17.6 million, and the sector received 14.6 per cent of all group lending. The categorization of loans to industry by the AfDB group is facilitated by the fact that DFI lending is not treated as a separate category. Credit lines for industry are aggregated into the sectoral lending figures.

Looking at the individual lending arms of the group at sectoral level, industry received 20.9 per cent of cumulative lending from the Bank (compared with 22.2 per cent for agriculture and 25.7 per cent for public utilities), but only a minimal 3.6 per cent of Fund lending (compared with 32.4 per cent for agriculture and 19.9 per cent for transport) and 9.6 per cent of NTF lending (compared with 33.5 per cent for transport and 17.2 per cent for education and health).

However, looking at the more recent years, there is a clear pattern of the industrial sector being "crowded out" by the introduction of policy based lending, often for structural adjustment. In 1992, industry received only 10.5 per cent of bank group loan and grant approvals, compared with 21.6 per cent for public utilities and 19.4 per cent for multisector projects. In the four year period from 1989 to 1992, the Bank itself directed 15.6 per cent of its lending into industry (including lines of credit), compared with 25.9 per cent for public utilities and 20.25 per cent for multisector projects. At Fund level, industry received just 1.47 per cent of loan and grant approvals over the same period, compared with 26.32 per cent for social projects, 21.11 per cent for agriculture and 18.36 per cent for multisector projects.

Since again, and much in keeping with the World Bank group, access to the soft loans of the AfDF are based on criteria of GDP per capita, the African LDCs are borrowing mainly from the Fund and not from the Bank. The grant and loan statistics on Fund operations show that industry in the African LDCs receives only the most minimal funding from the regional development bank yet, as pointed out, these regional members are overwhelmingly dependent on ODF.

Nonetheless, there are some trends evident in AfDB lending which mitigate this rather negative picture. As some African countries progress in their structural adjustment programmes, multisector lending is shifting over from pure Structural Adjustment Loans to Sectoral Adjustment Loans (including industrial sectoral adjustment loans). In 1992, for example, sectoral adjustment loans totalled $457 million, compared with structural adjustment loans of $171 million. And at Fund level, the introduction of Poverty Alleviation loans and grants has spin-off benefits for industry when, for example, these loans have training components for small entrepreneurs. Another encouraging trend for industry was the establishment of the Bank's Private Development Sector Unit in 1990, which has, so far, lent mainly for manufacturing projects, although no LDC has yet benefitted. Hence, the African LDCs are borrowing almost exclusively from the Fund.

Yet despite indications that the "crowding out" of industry by policy-based lending is now past its peak, in the case of the African LDCs, another worrying phenomenon is the decline in GDP per capita incomes of the African non-LDCs, who are now finding themselves increasingly eligible for Fund money and, consequently, in competition with the LDCs. The solution is, of course, to increase the size of the Fund and the Bank group is hoping that the Fund donors will increase their contributions to the eighth replenishment, now under negotiation, and due to come into operation in 1994.

The Asian Development Bank

Soft loans by the ADB

The changing focus of World Bank lending to the LDCs is mirrored in the policies of the Asian Development Bank (ADB). Within the membership of the ADB there are, of course, far fewer LDCs than within the ambit of the World Bank or the African Development Bank. Most ADB lending goes to its LDC members through the soft loan window, the Asian Development Fund (ADF).

There has been a steady rise in ADF lending within the ADB. However, very little of this increased lending went to promote LDC industrialization, whose share of ADB lending contracted both absolutely and relatively, falling from 4.7 per cent of ADB lending in 1973-1977 to 0.6 per cent in 1988-1992. The changing direction of ADB lending is further emphasized in the move away from public sector industry towards lending to the private sector first through the DFIs and more recently through direct loan and equity support to the private sector.

Between 1973 and 1993, the ADB made 31 loans worth a total $611 million for industrial development to its LDC members. Of these, twelve went to the public sector, nine to DFIs, one for development of an industrial estate in Bhutan, six directly to the private sector (four in Bangladesh, two in Nepal) and three industrial sector programme loans. There is no time trend in this orientation to the private sector. It is, however, worth nothing that since 1987, the ADB has signed no new loan agreement for financing any public sector industry amongst the LDCs. It has, instead, initiated direct lending/investment in the private sector or directed funds through DFIs to private sector industry.

ODF for the private sector in the LDCs

Lending to the DFIs in the LDCs through ODF has been contracting. This trend originates in the problems of default to the DFIs and apprehension that, in a number of LDCs, the DFIs have become instruments of patronage of the government where inappropriate loans, compounded by lax enforcement of debt recovery, have reduced many of these financial organizations to a moribund state. The scope for reactivating DFI lending depends on whether the DFIs can indeed improve the quality of their loans.

The crisis in the DFIs has narrowed the scope for lending to private investors in many LDCs. In these countries, the weak entrepreneurial tradition and capability for risk taking had resulted in a disproportionate importance being attached to DFI loans. Moreover, the reduction in DFI lending has not been balanced by additional equity financing from abroad on private or ODF account. The World Bank, through the IFC and the regional development banks has opened up a very small alternative window for direct lending to the private industrial sector. These initiatives by the Banks consist of some equity financing and some direct lending to private borrowers. Loans to private enterprises do not carry government guarantees so the risk devolves on the IFC and the other lenders who thus have to fully satisfy themselves as to the financial credibility of the borrowers and the economic viability of the project. By definition, particularly in the LDCs, very few such private borrowers pass the rigorous scrutiny of these banks. It is hardly surprising that most such loans go to more developed developing countries.

Implications of the changing direction of ODF on LDC industrialization

Deindustrialization in the LDCs

This stagnation in the flow of ODF to the LDCs appears to have coincided with a deceleration in the industrialization process in the LDCs. On average, in the LDCs, the share of the manufacturing sector to GDP has remained unchanged at 10 per cent between 1980 and 1990. Of the 18 LDCs on which data exist going back to 1970, we find that between 1970 and 1991, no LDC except Lesotho made any significant advance in the share of manufacturing in GDP.

Most other LDCs have been caught up in a process of industrial atrophy, particularly in the 1980s. Of the 41 countries for which we have comparable information, only 18 registered a rise in their manufacturing/GDP ratio; and of these, only three had a rise of more than 4 per cent in the 1980's and two of these were really micro-economies. Thus, Zambia is the only case of a sizeable LDC which between 1970 and 1990 achieved a major structural shift towards the manufacturing sector.

Unfortunately, data do not exist to permit an analysis of the trend in investment in manufacturing in the LDCs. There is, however, aggregate data on investment in the LDCs which shows that this grew at 3.2 per cent per year in the 1970s, but in the 1980s registered negative growth of 0.3 per cent. In such an environment of weak growth in aggregate investment and low output growth in manufacturing, it would not be too inaccurate to assume that investment growth in manufacturing was also weak.

This assumption of weak investment is further supported by evidence of weak trends in growth in employment in the manufacturing sector of the LDCs. Nine out of 25 LDCs registered negative or zero growth in employment in the sector, seven registered more than 10 per cent growth over five years, and employment expanded by more than 20 per cent over five years in only seven.

It is a moot question as to how far sectoral reforms carried through without the backing of a substantial incremental flow of external resources to finance new investment to diversify the manufacturing sector can be expected to revive economic activity and reduce the vulnerability of LDC industry to exogenous shocks. Indeed it is arguable that in the contractionary environment initially created by stabilization measures, demand for domestic investment may itself weaken and make prospective entrepreneurs less liable to utilize credits channelled through the DFIs to set up new industries. The emergence of debt default due to a weakness in the debt servicing capacity of many borrowers from the DFIs in the LDCs has increasingly jeopardized these institutions themselves.[30] This, in turn, has led to a deceleration in ODF flows to the DFIs, further reducing the scope for investment in the manufacturing sector in the LDCs.

Given the slowing down of ODF to public sector industry, any weakening in the capability or willingness of domestic private enterprise to fill the investment gap left by the contraction of public investment in industry will correspondingly weaken overall performance in the manufacturing sector. Donor policy of giving priority in ODF to policy reforms may thus turn out to be internally contradictory. Ironically, policy reforms designed to promote the private sector may in fact in the short run weaken the incentive for investment and capacity utilization in the manufacturing sector. This can correspondingly deter foreign investment in economies with already weak manufacturing performance, resulting in a further deterioration in their capabilities due to the negative impact of the reforms.

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[30] Rehman Sobhan (ed), **Debt Default to the Development Finance Institutions: The Crisis of State Sponsored Entrepreneurship in Bangladesh**, University Press, 1991.

6. INTERNATIONAL PRIVATE SECTOR FINANCE

The LDCs have great difficulty in attracting private sector finance from external sources. In 1990, they received 12 per cent of all financial flows to the developing countries, but only 3 per cent of the private flows. Table 1 shows total financial flows to the LDCs. Direct investment and "other" (bond and bank lending) accounted for only 4.7 per cent of the total flows in 1990, and in some earlier years had been negative. It seems that the LDCs have negligible access to private foreign capital; indeed such lack of access could almost be used as a definition of the LDCs. Moreover, as private financial flows to the LDCs were lower in nominal terms in 1991 than they had been in 1981, it is clearly an uphill struggle to increase these flows.

Inevitably, many of the examples quoted in this paper come from higher income developing countries, as is many cases no LDC examples exist. This approach is necessary to show the way the LDCs may go in the future.

Perceived lack of creditworthiness means that LDCs have virtually no access to international bank lending, syndicated or not. The lack of creditworthiness is of course another way of saying that repayment prospects are poor. This in turn is caused by a variety of perceived risks - high existing debt, preferred creditors in the form of multilateral agencies, poor economic growth prospects, potential political instability and corruption, and in some cases risk of natural disasters. LDC access to bank borrowing declined strongly in the 1980s, in contrast to the competitive lending days of the late 1970s. Moreover their access has been restricted further by bank capital adequacy regulations, which give a high weighting to overseas lending.

Prospects for increased access by the LDCs to sovereign lending appear poor, in the next few years; however, this is regrettable only for those LDCs which can afford commercial borrowings and which can earn returns above the cost of borrowing.

Non-recourse financing

Prospects for commercial bank lending to individual projects (whether in the public or the private sector) would appear better than for sovereign risks. Banks can assess the risk of a project more easily than the risk of a sovereign loan, and if the project appears promising, then the risks are lower than on sovereign lending. This is especially the case if the output is exported, giving the opportunity for the bank to have a claim on the earnings (for example through an escrow account) before the earnings are repatriated. Banks have been more interested in non-recourse financing than in sovereign lending for some years now, a remark that applies also to many higher income developing countries. Projects such as mines and plantation crops, and perhaps some manufacturing projects may be able to attract non-recourse financing.

Export credits

Many LDCs are not regarded as creditworthy by official export credit and guarantee agencies, and therefore exporters cannot get official cover for these markets, although they may on occasion be able to arrange private export credits. Clearly this lack of officially guaranteed export credits is a substantial problem to be addressed.

Bond issues

Bond issues by developing countries rose sharply to US$ 10.7 billion in 1991 from US$ 6.6 billion in 1990, but were limited to 14 issuing countries, all relatively advanced.[31] Issues have been mainly sovereign bonds, although some Latin American corporations, both state owned and private sector, have issued bonds without sovereign guarantees. There may be certain corporations, both state sector and private sector, in the LDCs which could issue bonds without sovereign guarantees, but the views of the markets are still likely to be tainted by perceptions of country risk.

Portfolio investment

Portfolio investment in the emerging markets is rising strongly[32]. Yet by their nature the LDCs have only a few stock markets, and they are usually small and shallow. Persisting exchange rate controls also deter foreign investors. One case of portfolio investment in the LDCs is provided by the Himalayan Fund, one of the offshore funds through which foreign investors can invest in Indian stock markets. The Himalayan Fund has earmarked part of its US$ 75 million for India, and smaller amounts for Nepal and Sri Lanka. However, as the vast majority of LDCs do not possess stock markets, the potential is clearly small until they do.

Nevertheless, there is some embryonic interest in the African stock markets. Fund managers Genesis's Emerging Markets Fund also invests in Africa, and has investments in Zambia, (3 per cent of its portfolio), and Botswana (2.2 per cent). The International Finance Corporation (IFC) Board has approved an investment of US$ 7.5 million in an African Fund which managers EMIC hope will attract US$ 30 million. However, even in countries with stock markets, only three in Africa (Botswana, Ghana and Cote d'Ivoire) are reasonably open to foreigners, and others will need to be more accessible if portfolio investment is to flow in.

Build-Operate-Transfer (BOT)[33]

BOT has developed in recent years as a way of attracting foreign finance and management to development projects, especially infrastructure projects. Essentially a utility operator and a foreign company will set up a joint venture company (the franchisee) to build, own and operate a project. Outside shareholders may also be involved. The franchisee then seeks to borrow the bulk of the funds needed for the construction of the project, on the security of the assets and the income it expects to generate from the project (non-recourse financing). The project will aim to service its debt and pay dividends to the shareholders for a pre-determined period (say 15 to 20 years), after which its ownership may be transferred to the state.

The main advantage compared with traditional utility financing is believed to stem from the private sector nature of the project, bringing efficient management which will increase the likelihood of success. On the other hand, according to the British merchant bank, Schroder Wagg, funding costs a great deal more on a BOT - basis, perhaps as much as a premium of 4 or 5 per cent. Lending banks and export credit agencies may also have reservations about BOT financing, although some banks are pursuing it aggressively as a substitute for sovereign lending. Nonetheless, despite the fact that the debt is not sovereign in nature, banks may still set the lending against their loan quota for the country.

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[31] "International Capital Markets", **Developments, Prospects and Policy Issues**, IMF, Washington DC, 1992.

[32] Estimates by Amex Bank suggest the net portfolio flows to the developing countries doubled between 1990 and 1992, from US$ 4 billion to US$ 8 billion. In 1992 they accounted for 6 per cent of all net capital flows. Of course, very little of this portfolio investment goes to the LDCs. (Annex Bank Review 26 April 1993). According to Lipper Reports Inc (1990), the number of specialized developing country funds rose from 2 in 1984 to 120 by September 1990. By then, the total funds mobilized was US$ 8.9 million.

[33] There are a number of variants of the BOT model, such as "build-own-operate-transfer", "build-own-operate", "build-rent-transfer" and "build-own-operate-subsidise-transfer". For more details see **Industry and Development - Global Report**, UNIDO, 1992.

The supply of foreign debt has frequently been a stumbling block for BOT financing, partly because of commercial banks' current unwillingness to lend to developing countries, and because of the high gearing often proposed (90 per cent debt has been used in Turkish proposals). The involvement of multilateral financing institutions (MFIs), though, seems to make it easier to raise commercial bank debt.

Transnational venture capital

While the bulk of transnational venture capital flows have been between industrialized countries, there is now a growing flow to developing countries. During the 1980s, both multilateral and regional development finance institutions moved into investments in venture capital finds. The UK's Commonwealth Development Corporation (CDC) has invested in VCFs in Papua New Guinea, the Philippines, Ghana, and recently in Tanzania, an LDC (USAID is also involved). A small degree of interest has been shown by the private sector.

The main advantage of attracting transnational venture capital, for many developing countries, is that it is equity, or non-debt creating capital. Moreover, it has the "developmental" advantage of being direct investment, as opposed to portfolio investment which goes largely into the secondary market in existing securities. However, the conditions required to attract venture capital, especially from the private sector, are quite demanding. The two main conditions are opportunities for divestment and opportunities for repatriation of capital. In some countries, notably the LDCs, these conditions are still not widely met. Subsidies, or at least tax regulations which do not discriminate against venture capital, are also important.[34]

As with other forms of private sector financing, the LDCs find it difficult to attract private foreign capital, and it is likely that organizations such as the IFC, the ADB and the CDC will continue to have to take the initiative. Their past record has shown that they can act as catalysts in attracting further funding.

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[34] Kitchen R., "Venture Capital: Is It Appropriate for Developing Countries?" In Fischer Klaus P. and George J. Papioannou (eds), **Business Finance in Less Developed Capital Markets**, Greenwood Press, 1992.

7. FOREIGN DIRECT INVESTMENT

Introduction

Many LDCs, especially in Africa, have long been recipients of FDI, especially from their former colonial powers. Indeed, much of the manufacturing sector is wholly or partly foreign-owned (in the past often in the form of joint ventures with the government). To an extent, this reflects the shortage of indigenous equity capital in many LDCs. However, much of the FDI has come in behind protective barriers, and therefore has not been particularly economically efficient. The trend towards trade liberalization will result in more efficient FDI, and more outward looking investment.

FDI to developing countries as a whole has been growing rapidly and in 1990 accounted for over 10 per cent of private investment in developing countries, compared with an average of about 6 per cent during the period 1978-88. However, the record of FDI in LDCs since 1985 has been very mixed, as Table 1 shows. In both 1987 and 1989 figures for direct investment were substantially negative, indicating sales or closure of assets, or nationalizations. Even in years when FDI was positive, it accounted for a very small proportion of total capital inflows, for example 2 per cent in 1990. As we have seen, this is a much lower proportion than for all developing countries although the difficulty of gathering such data is such that they are necessarily far from reliable.[35] It is sufficient to say that FDI in the LDCs is at a very low level.

Recent developments

Debt swaps

FDI in developing countries has recently been stimulated by debt equity swaps (DES) in debt conversion programmes,[36] although these have not yet had any major impact in the LDCs. A debt-equity swap converts developing country debt into foreign held equity in a domestic firm. The swap serves as a vehicle for foreign direct or portfolio investment. For example, a multinational may pay cash for foreign debt, which it then redeems with the issuing state in exchange for local currency, to be used for investment purposes. The practice has now been officially sanctioned by a significant number of countries, but the details are technically complex, and vary from one country to another.

A debt-debt swap is a change of creditors holding developing country unsecuritized debt, typically commercial banks. Swaps may be undertaken by parties outside a country or by an outsider and an insider. They are a part of the secondary market which has arisen in third world bank debt, in which sovereign debt trades at a discount to face value of 20 per cent-90 per cent or more, depending on the perceived risk of the country in question. Its main importance in this context is that the secondary market provides a basis for, and opportunities for debt-equity or debt-local currency swaps, which are elements of new investment flows. The current objective of debt conversion programmes is to "capture the discount" visible in the secondary market.

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[35] This comment is made after discussion with an official at the OECD who is responsible for collecting FDI statistics. Data have become even more unreliable as exchange controls in industrialized countries have been removed and recording by central banks has ceased. For some countries, the official said, "FDI statistics are not worth the paper they are written on".

[36] Debt conversion programmes include a variety of possible debt swaps and debt for nature, education and health programmes. However, these are not relevant to FDI, so are not described here.

Debt-local currency swaps were designed to encourage the repatriation of flight capital. A resident or company of a country operating such a scheme can buy their country's sovereign debt (at a discount) in the secondary market with their overseas funds and then present the debt to their central bank for redemption (at face value) in local currency. In most countries the local currency must be invested. For example, Argentina requires that it is invested in export-oriented activities, and Jamaica in export oriented manufacturing and tourism. Some countries permit portfolio investment with the proceeds.

Superficially, at least, debt-equity and debt-local currency swaps have the attraction that they simultaneously reduce a country's sovereign external debt, and provide investment finance. However, the volume of deals done has so far not been very great.

Essentially, debt reduction is achieved by paying the debt, indirectly, in local currency, through taxation, the issue of bonds or the issue of new local currency. The latter may be seen as inflationary, which is one reason why some countries have put ceilings on the amounts to be converted. Swaps which are channelled into direct investment can be seen as providing an often welcome increase in economic activity rather than fuelling inflation. However, swaps which go into portfolio investment may merely increase share prices, giving existing shareholders a potential windfall gain, which might then be channelled into, say, real estate, which experiences a price boom in turn.

The extent to which DES provide new investment may also be questionable. Would the multinationals have invested anyway without the benefit of swaps? Does not the swap mechanism provide them with access to local currency at very low exchange rates, enabling them to squeeze out domestic firms? The extent of the additionality of DES funded investments is difficult to estimate, but even if no additionality is created, a country's external debt service burden is eased if interest-bearing debt is replaced by equity invested in foreign exchange earning (or saving) projects.

DES appear to have induced a substantial amount of investment in the industrial sector, particularly in Latin America.

Table 4: Proportions of DES going into the industrial sector between 1985-1989

Country	Proportion (%)	Period for which data available
Argentina	70	(1988)
Brazil	57	(1988)
Chile	61	(1985 - Sept. 1988)
Mexico	50	(1986 - June 1989)
Philippines	50	(1986 - June 1989)

Source: Derived from UNIDO, 1992.

Privatization

The vogue for privatising state enterprises in developing countries offers opportunities to attract foreign equity capital. Placement of shares gives the government the opportunity to bring in foreign investors while the conventional offer for sale, if advertised overseas and supported with credible assurances that proceeds of subsequent share sales by foreign investors can be repatriated in foreign exchange, might also attract both individual and institutional investors. The Government of Jamaica sold a significant interest in Carib Cement to a Norwegian cement company, prior to the general offer for sale. The foreign company has been brought in with a view to providing management, technology and marketing skills as well as equity finance. Malaysia's TELEKOM shares were also marketed overseas, and a listing obtained. Safeguards can be placed on the limit of foreign ownership, a practice which has been followed by the UK government in some of its privatization offers for sale.

Privatization programmes in the LDCs are generally in their early stages and are faced with the problems of little domestic private capital and reluctant foreign investors. However, there are possibilities. An interesting example is provided by John Moore, the United States entrepreneur who purchased several loss-making state enterprises in West Africa, including the steel mill in Togo, and who now runs a fast expanding group of industrial companies in West Africa. Tanzania's ambitious privatization programme is also attracting substantial interest from foreign investors.

Countertrade

Certain forms of countertrade, notably buy-back deals, provide opportunities for FDI. Although countertrade represents the oldest form of payment for trade, the modern version really dates from about 1980, and expanded rapidly in the first half of that decade. The sophistication of countertrade has also developed rapidly. The different methods, arrangements and terminology of countertrade can be confusing.

The main methods are:

- Barter, the direct exchange of goods between the importer and exporter without any exchange of money.

- Compensation agreements, which allow the full or partial payment for goods to be made in other goods. Unlike straight barter, compensation payment is usually staggered over an agreed period of time.

- Counter-purchase, or parallel trade involves two separate contracts, one for delivery by the exporter, the other for repurchase of the goods by the exporter. Such arrangements are sometimes made on a government-to-government basis, and the repurchase may in fact be made by a third party, or even a third country.

- Buy-back agreements (known also as industrial cooperation), whereby the exporter of machinery or a turn-key factory agrees to be paid, in whole or in part, in the goods produced by the factory. The plant exporter will usually arrange his own long-term financing for the plant in his own country.

- Offset arrangements. An exporter of goods agrees to make an offsetting investment in the importing country, to help increase financial flows of equity and to create employment. Offset has been used between developing country importers of aircraft and defence hardware, and exporting countries. governments are generally involved in the agreement.

- Evidence accounts are an extension of counter-purchase, whereby the exporter and importer maintain accounts of goods traded over a period of time, rather than entering into separate counter-purchase agreements for each transaction. The agreement, for example, may aim to maintain a balance in trade on a year-by-year basis.

- Switch trading is a triangular compensation arrangement between three countries, which is used to correct imbalances in bilateral trading arrangements between two of the countries. If country A has a trade surplus with country B, which is disrupting a bilateral agreement to achieve a trade balance, then A may purchase balancing goods from a third country C, which would buy goods to the same value from country B. When non-convertible currencies are involved the deals become complex, and usually involve a trade broker or agent.

Buy-back

Buy-back agreements usually involve capital equipment sales where the seller agrees to purchase a portion of the end product. The buyer's objective may be to re-coup part of his foreign exchange outlay, to develop his export market or to ensure an income stream which will be used to amortise the original investment. Buy-back deals can be high risk for the plant exporters. In addition to price problems, there may be difficulties arising from poor quality goods and low production levels, although management contracts may help to overcome these difficulties.

The dividing line between different forms of countertrade is often hazy, but all developed rapidly during the recession of the late 1970s and early 1980s, encouraged by the shortage of foreign exchange in developing countries and slack world markets both for their commodities and consumer goods, and for the capital goods of the industrialized countries. The governments of several countries such as Indonesia and Pakistan insisted on countertrade deals to pay for large import contracts. Indonesia has exchanged rubber, coffee, cocoa, and cement for fertiliser products; Iran has exchange crude oil for New Zealand lamb and wool, and Angola has arranged to use oil to pay Portugal for a hydroelectric project. There are many other examples to be found. However, government insistence on countertrade arrangements has perhaps been less successful than intended because of the difficulties in making trade arrangements, and the bureaucratic delays involved. Exchanging goods for money is much more straightforward.

Although barter, countertrade, and buy-back arrangements are essentially forms of international trade, they also represent substitutes for financial flows. Buy-back, off-set and compensation agreements involve the supply of capital goods which are 'paid for' over time, as with an export credit. However, they are not included in international statistics on the provision of export credits. What is more, these trading arrangements enable developing countries to maintain their investment programmes at time when finance is scarce, and to do so without increasing their financial indebtedness. Also, the division of risk is different. With, for example, a buy-back deal, much of the risk is borne by the plant supplier, in that he is responsible for marketing part of the output, and also faces some of the risk of poor plant performance and management. The buyer, on the other hand, has an assured market for part of his output. To that extent, it is more like FDI than an export credit although recent indications suggest that the boom in countertrade may have reached a plateau.

Repatriation of flight capital

The nature of capital flight means that data on its magnitude are very difficult to obtain. Capital flight is normally associated with attempts to avoid "exceptional sacrifices" on rates of return at home. The IMF[37] analyzes a number of individual studies which indicate capital flight ranging from US$ 200 billion to US$ 300 billion during 1974-85 for capital importing developing countries as a group. Equally, there is little doubt that capital flight was very largely attributable to government policies, whether political, fiscal, or monetary, which undermined confidence. As a rule, governments got the capital flight they deserved. As a corollary, government policies are equally important in tempting back flight capital, and we examine some of these below.

- **Amnesties**

Amnesties offer residents the opportunity to repatriate flight capital without fear of the consequences of earlier legal infringements, for example of taxes or exchange controls. Argentina, Mexico, Chile and Costa Rica have introduced amnesties, to some extent as part of debt swap programmes.

- **Capital account liberalization**

The abolition of controls on capital movements may discourage further capital outflows and at the same time encourage the return of flight capital, especially when combined with a market-determined exchange rate and credible anti-inflation policies. In Jamaica, Chile, Uruguay and Peru such measures have resulted in significant capital inflows; over US$ 1 billion in the case of Peru.

- **Financial instruments in foreign currencies**

A logical component of capital account liberalization is to permit residents to hold foreign currency instruments, such as bank accounts, and to permit companies (and government) to issue foreign-currency denominated bonds. Such instruments also impose a welcome constraint on policies which might be inflationary, as currency substitution can take place. Countries with access to international capital markets can also issue foreign-currency denominated securities abroad, to attract investments from flight capital. However, LDC governments and companies generally do not enjoy the creditworthiness to do this.

Liberalization of trade, investment regulations, exchange controls and exchange rates appear to have had a highly significant influence in countries such as Mauritius, and, more recently, Uganda and Tanzania. A liberal policy framework appears to reduce country risk (or, at least, some aspects of it) and thereby to encourage inward financial flows.

Yet micro-economic determinants such as relative costs, especially of skilled and white collar labour rather than unskilled labour, market size, the existing stock of foreign investment (which tends to encourage more, as in south China), the quality of infrastructure (especially transport, energy and communications), and the overall level of industrialization also exert strong influence. Country risk is acceptable if the expected returns are commensurate, especially if the industry is mobile (such as garment making), and can move out quickly in the event of risks materialising.

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[37] **Private Market Financing for Developing Countries and International Capital Markets**, IMF, Washington, DC, 1991.

Investment promotion

The legal framework for FDI is still inadequate in some LDCs despite recent attempts by some countries to liberalise foreign investment laws. LDCs start with many economic and natural disadvantages in competing with the rest of the world to attract FDI; it is important that they do not weaken their competitive position still further by maintaining legislative disadvantages.

Most developing countries, and especially the LDCs, have some way to go to reach that ideal. UNCTAD[38] reports that changes in regulations and legislation concerning FDI in some LDCs, including Burkina Faso, Central African Republic, Djibouti, Guinea-Bissau, Haiti, Lesotho, Malawi, Maldives, Niger, Sudan, Togo, Vanuatu and Samoa "have reflected a liberal approach in certain aspects, but were somewhat more selective in others". However, they still maintain discriminatory "privileged regimes" for investments in certain sectors, and impose conditions on issues such as the employment of local and expatriate labour, and limitations on foreign ownership.

Credit enhancement

One of the best ways to encourage private sector flows to the LDCs is through some form of credit enhancement, which shifts the balance of risk between borrower and the lender, and, frequently a third party. The ADB has a well-established, successful co-financing scheme. Between 1986 and 1991 co-financing amounted to US$ 10.8 billion, compared with total Bank lending and investment of US$ 37.8 billion. Of the US$ 10.8 billion, official sources contributed US$ 7.5 billion, and commercial sources, including banks, insurance companies and export credit sources, US$ 3.3 billion.

It is in co-financing with commercial sources that true additionality arises. Here ADB cross-default clauses and guarantees from the DFI can attract commercial finance which would not otherwise be attracted, and longer maturities and finer terms can be obtained on the commercial finance. The DFI is apparently taking a greater risk but, in effect, uses its position as a de facto preferred creditor to obtain the same status for the commercial component of the co-financing. Such co-financing, therefore, should be attractive to the commercial sources, as well as to the ADB and the recipient country (or company).

For LDCs, the ADB uses its Asian Development Fund in co-financings. In 1991 it co-financed projects in LDCs in Bangladesh, Lao PDR and Nepal. However all these co-financings were with public sector agencies, not commercial banks. Nor were they industrial projects.

The World Bank's schemes

The World Bank operates similar co-financing schemes which, too, are dominated by co-financing with official agencies. However, the World Bank's Expanded Co-Financing Operations (ECO) and Export Credit Enhanced Leverage (EXCEL) programmes are credit enhancement schemes which are worth examining, as is its Multilateral Guarantee Agency (MIGA).

The ECO programme is intended to support borrowers' attempts to raise commercial debt. The programme operates by offering partial World Bank guarantees on commercial loans.

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38 UNCTAD, **The Least Developed Countries**, 1992 Report, p. 65.

Nonetheless the impression remains that the ECO programme has not been a success. The most significant problem arose from the borrowing country eligibility criteria. The elimination of those countries which had undergone a debt scheduling exercise within the previous five years excluded many potential deals. Commercial banks, too, were disappointed that the World Bank could not support them (because of the eligibility criteria) in many countries where they would have liked to lend.

- **The EXCEL Programme**

The EXCEL programme was established in 1989 in collaboration with the Berne Union. The programme is designed to mobilise export credit packages for medium-sized private enterprises in selected developing countries where either the companies and countries would otherwise have difficulty in obtaining export credits.

- **The Multilateral Investment Guarantee Agency (MIGA)**

The World Bank established MIGA in 1988. Its mandate is to encourage equity investment and other direct investment flows to developing countries through the mitigation of non-commercial investment barriers. MIGA offers investors guarantees against non-commercial risks of currency transfer, expropriation, war and civil disturbance. As such, it is more a scheme of "equity enhancement" rather than "credit enhancement".

Companies have to register with MIGA and countries in which they invest must be a member of the scheme. So far 131 countries have joined. All member countries have to contribute financially. Companies will put pressure on individual countries to join so that they can get political risk insurance. The IBRD too will put together portfolios of investments which would proceed if the country in question joined the scheme, as occurred with Brazil for example. The scheme applies to the LDCs, but has worked predominantly with the more advanced developing countries. It would help the LDCs if their financial contribution to MIGA could be waived.

The IFC's schemes

- **The Multi-Currency Loan Facilities (MLF)**

This is an arrangement whereby the IFC links with commercial banks which use their branches to identify, appraise and co-finance projects in developing countries. So far the IFC has involved six commercial banks in the scheme (BNP, Crédit Lyonnais, Indosuez, ING (Holland), AB-Amro, and Bank of Austria), and does not plan to add more. The IFC considers the scheme to be generally successful, but implementation problems have risen in some countries due to financial sector, legislative and institutional weaknesses. Problems have been most acute in Africa, although the MLF has worked successfully in countries such as Indonesia, Pakistan, Turkey, Chile and Venezuela.

- **The Foreign Investment Advisory Service (FIAS)**

The FIAS is a joint facility of the IFC and the MIGA. Its purpose is to provide advice to member governments on procedures for the promotion, appraisal, approval and monitoring of foreign investment, and it can assist in implementing its recommendations. FIAS is a growing facility, and has been very helpful in least developed countries particularly.

- **Access to risk management techniques**

The IFC is now helping companies in developing countries to gain access to risk management techniques at a reasonable cost by arranging commodity, currency and interest rate hedging instruments for them and providing credit enhancement to market counterparts.

- **Leasing**

Leasing is a growing and profitable business in a number of third world countries and, contrary to the views of some commentators, does not derive its strength from tax advantages alone. Leasing companies provide medium term (typically five year) credit for capital goods, do not usually look beyond the leased item for security, provide 100 per cent financing, are more flexible than bank loans in structuring debt servicing and, in some countries, leasing may be treated as off-balance sheet finance. Leasing companies can therefore compete with a banking sector which provides little medium-term credit and which looks for security substantially in excess of the funds lent. However, leasing is likely to be more expensive than bank credit unless tax incentives are available.

In terms of international financial flows, a domestic leasing company which imports equipment and then leases it to domestic firms can provide an alternative to export credits. This can be particularly valuable in countries which are not regarded as creditworthy by export credit agencies, and which therefore do not have access to guaranteed export credits. Such a leasing company needs to be well capitalized, and needs to have access to foreign exchange through a liberal foreign exchange regime. Countries which have liberalized their foreign exchange regimes, such as Uganda and Tanzania, now have the potential to establish leasing companies, as do the Maldives.[39]

Leasing has become established in some LDCs, for example in Bangladesh (which has a notably dynamic leasing sector), Botswana and Malawi. It clearly provides a potentially important mechanism for industrial financing, and can be particularly important for small and medium enterprises which might find it impossible to obtain medium-term bank credits or to buy with an export credit. Development agencies have a role to play in encouraging and financing leasing companies in LDCs. It is also an acceptable Islamic financing technique.

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[39] In the case of the Maldives there may be significant potential in providing leasing finance for boats, especially for fishing and for a variety of other items from knitting machines and generators to photocopying machines. Given the uncertain nature of land as an asset which can be used as security, a leasing company would have a further advantage over the banks, which provide little term lending.

8. CONCLUSIONS AND RECOMMENDATIONS

Several themes have emerged from this review of the various sources of finance which, in practice or in theory, can be tapped to support industrial development in the LDCs. Looking first at the domestic sector, the crucial role of national development finance institutions has been highlighted, as has the plight of these institutions in some LDCs, particularly those in the Franc Zone. Equa_ _evident is the dynamism of the informal sector, which seems almost to have flourished in the face of economic adversity, evolving to meet the needs of its clientele yet, nonetheless, showing itself unsuited to provide the longer term capital needs of most SMI.

The potential now exists to refine and extend these domestic financing mechanisms with the double benefit of making the LDCs less reliant on external borrowing and, at the same time, creating multiplier effects on internal economic activity. The following are some suggestions as to how new and existing mechanisms could be harnessed to improve the mobilization of finance.

The formal sector

To the extent that the crisis within the DFIs is part of a wider crisis debilitating the industrial sector of the LDCs it would be appropriate to review the issue of such term lending and the reform of the DFIs within the proposed Industrial Rehabilitation programme proposed under the IAP. Reactivation of underused industrial capacity in the LDCs remains no less important than investment in new capacity in the LDCs. Thus, this programme for the rehabilitation of sick industries, should itself be situated in the broader review of the industrial policy reforms suggested for the LDCs and which must address the central issue of industrial stagnation in the LDCs since the 1980s.

From a technical point of view, while leaving the commercial banks to their job as short-term banks, we would propose the creation of specialized institutions which, for purposes of financing the industrial sector, could be the following:

- institutions granting capital equipment loans to the SMEs/SMIs (hereafter referred to as National Development Finance Institutes, NDFIs);
- risk capital companies (RCCs);
- stock exchanges;
- joint guarantee bodies.

Such institutions already exist in some countries and their success can serve as a benchmark. Their operations should complement not only the activities of the commercial banks but also those of the regional development finance institutions.

National Development Finance Institutes (NDFIs)

These institutes could replace those development banks that have closed down in order to meet the medium and long-term financial requirements of domestic enterprises.

Their functions would be:

- granting medium and long-term capital equipment loans. The joint guarantee bodies could play a role here in the case of high risk loans on which businessmen are unable to provide guarantees (see below);

- project evaluation, advice to businesses;

- under no circumstances would the NDFIs take in the savings of individuals.

They would thus not need to set up a network of branches and they would function with a minimal physical and material infrastructure. The staff would largely consist of professionals, who would act as advisors to the heads of companies, carry out project appraisals and follow up on the projects submitted.

- Their capital:

Given the risk involved in financing industrial investments, it would be unrealistic to envisage wholly private capital. Moreover, the state, which is responsible for defining priority economic objectives would have a share in the capital, provided this remained a minority stake to avoid the temptation of the sort of excesses that led to the downfall of the former development banks. Taking into account these considerations, the capital could be composed in the following way:

- State:	max. 20%
- AfDB, ADB, RDB:	app. 20%
- bilateral or multilateral aid institutions:	app. 30%
- national institutions representing economic operators (Chambers of Commerce, professional groups...) and local banks	app. 30%

This is the capital structure used in setting up the Banque de l'Habitat in Côte d'Ivoire[40] and also for the BNDE (National Economic Development Bank) of Burundi.

- Their resources:

Apart from the capital, long-term resources would be made up of credit lines provided by the customary international donors and by income-yielding investments of at least one year's maturity; as well as domestic institutional investors (insurance companies, pension funds, stabilization funds...). An obligatory investment of a fixed portion of the commercial banks' resources (reinvestment coefficient) could also be envisaged, which would constitute their contribution to development financing.

Risk capital companies (RCCs)

Risk capital is a vital part (or rather a pre-condition) of investment loans to SMEs/SMIs. The use of such resources ensures a sufficient amount of long-term capital, free from the burden of repayment. By increasing the firm's own capital, it reinforces the structure and solvency of the enterprise, thus facilitating its access to credit.

The creation and development of risk capital companies would be assisted by the establishment of stock exchanges (see below) which would facilitate the placing of shares on the market, thus avoiding the risk that the RCCs' capital is tied up for too long.

RCCs' function: Risk capital "provides an appropriate response to the needs of an enterprise according to its particular stage of development and its specific requirements".[41]

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[40] established in June 1993.

[41] Thieba P., TGF "Etude comparative du Capital Risque dans les pays Industrialisés" dans **Revue Epargne sans Frontieres**, March 1990.

Risk capital can comprise:

- start-up capital, which is needed from the very moment a firm is established. The founders of an enterprise do not always have sufficient capital of their own to give them the necessary presence in the market: the RCC meets this need.

- development capital which enhances the financial resources of an existing enterprise and facilitates the funding of its expansion.

Given the low potential for investment of domestic savings in enterprises, the privatization of companies in the public sector could be facilitated by the creation of risk capital companies which would ensure the necessary spread of shares.

Their capital: as their name indicates, risk capital companies carry risks that are often incompatible with the private investor's objective of a return on his money. Moreover, their role makes the presence of the state more difficult, which is why bilateral or multilateral donors generally provide the capital for these RCCs.

A case in point is PROPARCO, which was created in 1977 by the Caisse Française de Développement and which takes up to a 25 per cent share in the capital of industrial enterprises.

Further examples are the APDF (African Project Development Facility), set up mainly by the World Bank, and SIDI (Société d'Investissement et de Développement International) which was set up in 1983 by several French institutions. The activities of these RCCs, like those of the IFC (International Finance Corporation), are vital to the development of enterprises of a reasonable size.

Together with the creation of National Development Finance Institutions, it would seem advisable to encourage the establishment of national RCCs in order to facilitate the creation and development of national SMIs. There have already been some interesting developments in this respect, which can serve as case studies:

- an EC initiative **in MALI**
- a private initiative with FADI **in BENIN.**

Stock exchanges

If new life is to be injected into the stock exchanges, this is first and foremost in order to respond to the political and economic developments of the past few years.

The privatization of state-owned enterprises, currently numbering around 500 in French-speaking Africa alone, calls for private capital which would be all the easier to mobilize once its liquidity is ensured through the existence of an active secondary market. In this respect, it is to be feared that in a hasty attempt to change over from a system that has failed, "the horse" has, in fact, "been put before the cart" by the decision to privatize the state-owned productive sector without first putting in place the instruments needed for privatization.

A second reason to support the upgrading of stock exchanges in Africa and in LDCs in other regions is the need to **increase the amount of capital and reserves in enterprises.** The degree of indebtedness of enterprises is frequently disproportionate and this situation brings with it inevitable consequences in the form of financial overheads and structural imbalances in the balance-sheets. In addition, owing to the absence of development finance institutions, these debts are essentially short-term.

Added to these two reasons (privatization and boosting capital and reserves), there is also the need to **maximize savings** in the developing countries. To attain a satisfactory level of development in Africa, for example, the World Bank pointed out in a recent report that the investment rate should amount to 25 per cent of GDP, whereas the present rate of savings is, on average, only 12 per cent. **One of the most urgent priorities is, therefore, a policy for the mobilization of domestic savings.**

So, what form should these stock exchanges take ? Without going into technical details, the following five points should be observed:

1. All measures and incentives will be in vain if we do not reinstate that key-word in financial matters: **confidence**.

2. The next step would be to set up a financial market **of sufficient dimensions**. This is already being done in Abidjan, in order to turn the domestic stock exchange (which, after 15 years of existence, has only 24 companies quoted) into a regional stock exchange. It is surprising to note that UMOA has a regional central bank (BCEAO) and a regional development bank (BOAD), while the stock exchange has remained at a domestic level only. The stock exchange must be in the vanguard of economic integration within the CEAO.

   The same is true of other regional communities in Africa. An inter-state market would obviously be more effective since it would be better equipped than a national micro-market and thus more able to inspire confidence.

3. **Real attempts must be made to attract companies**, who are the leading actors in this market. With very few exceptions, enterprises in the LDCs are SMEs and, as in all SMEs the world over, the head of the firm is often unwilling to cede a share in his property to a third party, who is frequently unknown to him. These bosses need to be educated to understand the advantages of opening up their capital and the benefits of a partnership. While too much bureaucracy must be avoided in order not to discourage them, the basic rules of caution which accompany access to the market must be observed. Medium-sized enterprises should be allowed this access by means of an area specially reserved for them. Moreover, it is a good thing that some "engines of growth" exist - dynamic companies of an international dimension which can act as market leaders.

4. **Real attempts must be made to attract savers.** First of all, domestic savings must be encouraged. These are currently more oriented towards competitive products: bank deposits, investments in property or, more frequently, in the informal circuits and also overseas. It is not normal that short-term deposits, which are generally risk-free, should generate higher returns than long-term investments, which carry certain risks.

5. **An efficient and effective enabling environment must be put in place.** This would ensure maximum security for the saver and, at the same time, provide the enterprise with the best possible assistance. In an attempt, no doubt, to save money, the intermediaries on the stock exchanges in the LDCs are often the banks. Since they view stock market products as competition to their own products, they are not interested in motivating their clients to place their capital in bonds and shares. Consequently, intermediaries must be found who are completely independent.

Joint guarantee systems

The lack, or indeed the absence, of personal guarantees to be provided by the head of an enterprise, particularly during the start up phase, constitutes one of the main causes of difficulties in obtaining credit. The substitution of personal guarantees by joint guarantees can remove this obstacle.

Mutual guarantee societies

A mutual guarantee society is a form of partnership between banks and firms. The principle consists in creating, at a local, regional or national level, a professional group whose task it is to facilitate access to credit for its members. In fact, a mutual guarantee company acts as a complement to the intervention of a traditional credit institution. The former provides a guarantee in the form of an endorsement or bond, the latter provides the credit.

The decision of the mutual guarantee societies, taken independently of the lending institutions by an administrative board composed of professionals, is based to a large extent on the perceived capability of the head of a company and on the feasibility and potential of the project he submits. The guarantee of a mutual guarantee society is based on its own capital and reserves, often provided by business groups such as craftsmen's guilds and professional bodies, or even by the banks themselves. In addition to this capital and reserves, the mutual guarantee societies receive contributions from their members: between 0.5 per cent and 3 per cent of the guarantee, an amount which is reimbursed, less any deductions made to cover the losses of the society. A commission of 0.3 per cent to 0.5 per cent is added to cover the running costs of the mutual guarantee society. The guarantee enables small-scale enterprises not only to gain access to credit but also to benefit from advantageous rates and a number of services that only a professional body can provide.

In the present context, a mutual guarantee society must avoid falling into two traps:

- that of adopting an attitude of overbearing corporatism and of displaying ethnic or regional preferences. The standing of the applicant and the quality of his project must override considerations such as the risk of competition or his region of origin;

- that of taking on an excessive financial risk.

It could be tempting for a bank to put the entire risk onto a mutual guarantee society. To avoid such a trap, into which a number of African guarantee funds have already fallen, the society should only take on part of the risk (often between 50 per cent and 60 per cent). The applicant's project should be subjected to an in-depth appraisal by the society's decision-making body, assisted by organizations such as craftsmen's guilds and professional trade unions.

Of all the specialized institutions which can provide financial assistance to the SMEs, the mutual guarantee societies are, without doubt, the best placed. They have already proved their worth in more developed countries, so why should they not enjoy equal success as models of solidarity and cooperation in the LDCs?

Guarantee funds

National guarantee funds were established in several LDCs. Modelled on the national development banks, their failure can also be attributed to the same problems that caused the downfall of these banks. The funds ran into serious difficulties and had to close down.

Regional guarantee funds, such as FOSIDEC, an offshoot of the CEAO (OUAGADOUGOU), still exist but their activities are very restricted and their efficacy limited. Preference is shown for other funds which certain donors and the Caisse Française de développement in particular are trying to set up in many LDCs with the assistance of local banks. The involvement of the donors and commercial banks in the guarantee capital lends respectability to the undertaking. The decision to provide a guarantee should, however, take into account the attraction of the project for the national economy and for development, and not limit itself to purely financial criteria. The guarantee fund should provide a complementary function to that of the bank without, however, taking excessive risks which would quickly bring about its downfall.

The informal sector

As pointed out earlier, the informal financial markets are thriving. They are dynamic and diversified and strive to meet the needs of their clientele. Attention has also been drawn to the overwhelming number of SMIs belonging to the private sector of the LDCs. In addition, it has been emphasized that the major constraint with which they are faced lies in access to capital and that, as a result of their marginalization by the banks, they have systematically had to resort to the informal financial system.

The problem of mobilizing financial resources in the informal sector in order to promote the development of the SMIs is thus one of major concern. However, it must be recognized that medium and long-term credit needs, which are a typical feature of the SMIs, are not compatible with the short-term financial flows which characterize the informal sector. It is clear that recent developments such as tontines in which shares are sold off by auction, travelling bankers and others are not of any major benefit to the SMIs. In short, the "savings and credit cooperative" (COOPEC) model, which provides financial intermediation midway between the informal and formal sectors, seems to be the most appropriate method to mobilize the financial resources required for the development of the SMIs.

Emphasis has also been placed on the fact that easier access to credit on favourable terms for the SMIs must be accompanied by measures taken by the authorities to free the state from non-financial constraints. What is needed is to provide the enterprises concerned with technical, management and marketing assistance. The governments of the LDCs must also stabilize prices, reduce the tax burden and relax regulations on the SMEs, provide the necessary infrastructure and supply them with socio-economic information in order to create an enabling environment for their expansion.

As pointed out, access to suitable financial resources constitutes a prerequisite for the creation and continuance of the SMIs. To achieve this, efforts have to be made to:

- involve the informal financial sector;
- adapt credit terms to the needs of the SMEs and to the socio-economic capacity of entrepreneurs and enterprises;
- create complementary financial instruments (risk capital, share funds, etc...).

Improving women's access to credit

Since the formal financial sector will most probably continue to be the major source of credit in developing countries, policy level changes are vital for improving the volume of financial resources available to women. Women's access to credit hence depends on reforms in policies and laws on the part of governments.

At the same time, changes through the intermediary of credit projects, or components of projects, will also be important. Credit projects will have an impact on women's control over financial resources not only directly, through the numbers of beneficiaries actually reached, but also indirectly, through demonstration of women's demand for, and productive utilization of, credit when projects are designed to meet their needs. Such demonstration effects will ultimately feed back into the structure of the financial sector.

Policy recommendations

At the policy level, the development of intermediary credit institutions and programmes and legal reforms are likely to improve women's chances of obtaining financing.

- Policies should be adopted that create or strengthen credit sources that reach women entrepreneurs in a cost-effective manner and ensure payback for the lender with minimum inconvenience to the borrower.

- Provision of appropriate interest rate subsidies for credit to women and other low-income groups should be made.

- Intermediary credit institutions and programmes (e.g. management, marketing and entrepreneurship training and product quality standardization) intended to "graduate" women and other inexperienced borrowers into formal sector borrowing should be strengthened.

- Property laws should be reformed to widen women's access to credit. Legislation must require banks and other lending institutions to eliminate practices requiring the husband's consent or co-signature.

- Legal reforms should be initiated to remove inequalities between men's and women's status and rights.

Project recommendations

While access to institutional finance is a general problem for the small- and medium-scale industry sector, it must be kept in mind that it affects women entrepreneurs to an even larger and more pervasive extent than male entrepreneurs. Such credit problems of women entrepreneurs may also severely limit their capacity to benefit from projects. Access of women to finance (on both a start-up and continuous basis, i.e. for working capital and expansion of the investment) is equally an important basis for the sustainability of their entrepreneurial activity.

SMI projects should therefore aim at addressing these specific credit problems of women at different levels of intervention. Particularly at the policy level, UNIDO interventions can contribute to improving the overall environment for women entrepreneurs. On the basis of an analysis of country-specific problems, UNIDO should make the government aware of credit constraints faced by women and their impact on women's entrepreneurial activity. Changes at the policy and legal level may be advocated, and the establishment of specific programmes to facilitate women's access to credit be recommended.

In institution-building projects, cooperation with existing intermediary organizations, such as Women's World Banking, can assume a crucial role in facilitating women's access to credit and thus increase their overall benefit from the project. In particular, projects building up or supporting finance institutions or loan departments should establish or recommend mechanisms to facilitate women's access to credit. In small industry development organizations built up with UNIDO advice and comprising a credit scheme, provision should be made to ensure women's access or to earmark a specific credit line for women. SMI projects may also find it useful to set up a specific credit fund for women within a project.

External sources of finance - Official Development Finance (ODF)

Our review of external sources of finance for industry in the LDCs has demonstrated these countries' overwhelming dependence on ODA yet, at the same time, it also points to a seeming lack of enthusiasm among both multilateral and bilateral donors for providing direct funding to industry, particularly in the LDCs. Consequently, it would seem vital for the LDCs to engage - without further delay - in some form of lobbying activity, designed to raise the profile of the industrial sector within the donors' needs criteria.

Promoting intra-LDC procurements

At a practical level, the proposal under the Industrial Action Programme for joint action by the donors to tie some part of their ODF to LDCs to promote greater intra-LDC procurement may stimulate some of the industrial capacity lying idle in the LDCs. But such a proposal is not likely to find too many takers among those donors whose preference for open markets may come into conflict with the concept of tying their aid for procurement from possibly inefficient LDC enterprises. Thus any move for greater intra-LDC trade in manufactures is more likely to take place within regional trade cooperation agreements where donor funds may be deployed through export credits explicitly targeted to finance export of manufactures within the LDCs.

The case for a continuing role for the public sector

Paradoxically, despite the vogue for privatization in LDCs such as Bangladesh, no study has yet been undertaken on the outcome of privatization in the LDCs to see whether public divested enterprises do, in fact, perform better under private ownership in terms of factor productivity, profitability, generation and reinvestment of surpluses and contribution to public revenues. There exists little more than some casual empiricism and much *a priori* reasoning to guide what are major institutional decisions.[42]

To the extent that these *a priori* arguments in favour of privatization are now underwritten by donor investment decisions, cutting lending to the public sector and making programme lending conditional on greater efforts at privatization, donors appear to have ruled out the possibility of using programme loans to make more serious efforts to improve public enterprise performance in the LDCs and to use project loans to invest in new capacity in public sector industry, where private enterprise is not forthcoming.

International private sector finance

The LDCs have found it increasingly difficult to attract private sector financial flows over the past decade. This is in part because of the contractions of debt flows to developing countries in general in the wake of the debt crisis, and partly due to perceived lack of creditworthiness and economic weaknesses in the LDCs. Yet, simultaneously, the range of financial mechanisms in the international markets has evolved at a rapid pace, often stimulated by precisely the same sort of obstacles now faced by the LDCs. Non-traditional flows, such as debt-equity swaps, venture capital, leasing, countertrade, privatisation and various forms of credit enhancement all offer possibilities and the international community has a role to play in stimulating flows through these mechanisms, as well as in helping to reduce the barriers to traditional forms of financial flows.

The LDCs now have the opportunity to learn from and adapt many of these techniques to their own particular needs. Although the inflow of funds for industry from the international financial markets is currently minimal in the LDCs, lack of knowledge in this sphere should not be used as a pretext to overlook the potential which exists.

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[42] Shirley M. et al., **Privatization: The Lessons of Experience**, World Bank, 1992.

Countertrade

The attraction of countertrade for the LDCs arises from their limited access to export credit guarantees. Where such guarantees are not available, they should be prepared to use countertrade to obtain capital goods, or to set up buy-back deals.

Debt conversion and repatriation of flight capital

Schemes which are open to residents with capital abroad can play a significant role in negotiating flight capital, but they must be associated with an implicit or explicit amnesty. Also, participants need to have confidence in the government's macro-economic management. Debt conversion schemes generally permit participants to acquire domestic currency at very attractive exchange rates determined by the secondary market in bank debt. Although many LDCs do not have commercial bank debt which can be purchased for debt swaps, they have nonetheless experienced capital flight. They can attract it back by the combination of an amnesty (implicit or explicit), investment promotion to attract flight capital, and DES schemes.

Foreign direct investment

Even in the most favourable legal climate it is difficult for LDCs to attract FDI; obstacles such as restricting FDI to certain sectors, limitations on foreign share ownership and limitations on the employment of expatriates all discourage FDI and should be removed. In general, foreign companies and domestic companies should be able to invest under identical conditions. The provision of "incentives" for either FDI or domestic investment misses the point. It is far more useful to remove disincentives than to provide incentives. As a rule, any investor should be free to invest, subject only to obtaining the necessary physical planning consents.

Host governments can help to attract private foreign investment by ensuring the existence of efficient investment promotion agencies and by marketing the country's potential. The Uganda Investment Authority (UIA) is a good case in point. In is two years of existence, it has succeeded in bringing in a large number of manufacturing projects, although it has to be said that it has been assisted by the special circumstances which have brought back flight capital. Nonetheless, the UIA has also been instrumental in repatriating flight capital.

An important aspect of the planning of the UIA was an overhaul of the investment code, and the authorization of the UIA to issue or to obtain the necessary permits for investors. The UIA is a genuine one-stop shop and has done much to improve the investment code and the tax regime, and in opening borders to inward investment. It is a model which other LDCs may well study with benefit.

The various credit enhancement schemes promoted - mainly by the MFIs - in recent years offer considerable scope for the LDCs. In this respect, the World Bank needs to be persuaded to introduce more flexible conditions for ECOs with LDCs. The focus has been on the more advanced developing countries, and the Bank should try to extend the EXCEL programme to the LDCs, to operate with IDA loans.

Withholding tax on commercial bank interest

In co-financing with commercial banks, MFIs could negotiate the elimination of withholding tax on interest payments due to the commercial bank(s). This would be of obvious benefit to the banks, especially in countries where the bank's country of domicile has no double taxation agreement. It would remove a possible disincentive to the banks. Moreover the cost to the government in terms of tax revenue would be marginal.

Technical assistance

Technical assistance programmes should be developed to help the LDCs to develop comprehensive exchange and interest rate risk management systems; and help LDCs to gain access to hedging tools such as forward markets, futures, options and swaps.

Agencies might consider setting up a brokerage function to act on behalf of those LDCs which do not have access to such international hedging tools. Agencies could also help them to gain access to international markets by giving guarantees. This would be done for a limited period, to enable LDCs to establish a presence in the markets.

Project finance

The MFIs already have means to encourage commercial bank co-financing in non-recourse project financing. Offering the earlier repayments to the bank is one possibility; partial guarantee of interest and principal repayment another. A further possibility which may arise on occasion is to use commodity and stock markets to hedge risk.

Build-Operate-Transfer (BOT)

These schemes are proving increasingly successful in developing countries but not, so far, in the LDCs. Efforts should be made to adapt existing B-O-T techniques to industrial ventures in the LDCs.

Soft window loans

There is a possibility that the MFIs could use soft window funds as a means of enhancing commercial credits rather than for direct lending.

For borrowers which already have access to both commercial bank loans and soft loan resources, the use of these resources to guarantee or partially to pay commercial bank interest could generate a significant increase in commercial bank lending. For countries which do not have access to commercial bank loans, such a use of resources might encourage the banks to start lending to them. However, commercial bank loans have much shorter maturities than soft window loans.

Portfolio management

There is scope for increased portfolio investment in the LDCs, and the African Development Bank has an obvious policy and advisory role to play in opening up stock markets to foreign investors and improving the operations and transparency of African securities markets.

Trade barriers

Perhaps the greatest restraint on FDI in developing countries which originate in industrialized countries are barriers to developing country exports. The relationship is not unambiguous, but export oriented FDI in non-traditional products would surely be encouraged if trade barriers to these products in the industrialized countries were lowered,

Concluding remarks

The LDCs will face continuing difficulties in attracting private sector finance. Bond markets will remain closed to them, and commercial banks will be reluctant to lend, while the market to attract FDI will remain competitive. Portfolio investment is likely to remain low.

The best prospects of increasing flows of bank loans and export credits are through some form of credit enhancement with bilateral or multilateral agencies. FDI can be attracted by making the legal and economic environment more attractive to investors; LDCs still have significant scope to do this. In addition, debt equity swap schemes, venture capital, countertrade, privatization and leasing can all help to offset the likely continuing weaknesses in the more conventional forms of financial flows.