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RESOURCE FLOWS TO INDUSTRY IN  
THE FACE OF THE DEBT CRISIS

JUNE 1989

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## RESOURCE FLOWS TO INDUSTRY IN THE FACE OF THE DEBT CRISIS

### 1. Introduction: The Impact of External Debt on Development Finance

1.1 Foreign Exchange Availability. The availability of foreign exchange in a single period can be expressed as:

Available foreign exchange (ArE) = capital inflows - capital outflows, assuming no change in reserves.

This may be expressed in more detail as

$$\text{ArE} = \text{Grants} + \text{new borrowings} + \text{other capital inflows} + \text{exports} - \text{imports} - \text{factor payments abroad} - \text{repayments of principal on debt} - \text{other capital outflows}.$$

The impact of the debt crisis has been to increase directly factor payments abroad (through interest charges), and the repayment of principal on debt, to the extent that it is repaid.

The debt crisis has had further indirect effects on ArE. The main item affected is new borrowings, which have sharply diminished in view of the reluctance of the commercial banks to lend further to highly indebted borrowers, and the similar reluctance of export credit agencies to guarantee new export credits. Other capital inflows, mainly direct foreign investment (DfI), appear to have recovered somewhat since the early 1980's (see Annex 1), but the unfavourable macro-economic climate, caused by tight monetary policies and negative net transfers, leading to low or negative growth in GDP, is not conducive to increased DfI. "Other capital outflows", notably capital flight, also diminish ArE.

All these trends have tended to diminish the AFE, out of which the foreign exchange component of investments would be financed (assuming reserves are not diminished).

1.2 Domestic Finance Availability. Here the focus is on domestic savings. The impact of negative real transfers abroad has been to use national savings to service debt, rather than making it available for investment. The deflationary macro-economic measures adopted in many countries, either as a direct result of the debt crisis or through adjustment programmes inspired by the IMF and World Bank Structural Adjustment Loans, have led to declining GDP growth, and declining savings ratios. Both these effects combine to reduce the amount of domestic savings available for investment, and may lead to negative investment in the form of corporate failure.

1.3 Net Financial Transfers. There has been a marked fall in net financial transfers to developing countries since 1982. The fall has been sharp in volume terms, and of course much sharper in real terms. Table 1 shows the impact on different groups of countries; some have experienced negative real transfers, notably the western hemisphere group. This fall has imposed a direct and substantial constraint on new investment and working capital for the industrial sector.

**Table 1 Net Financial Transfers**  
Current \$ billion

	Average						
	1979	1980-82	1983	1984	1985	1986	1987 <sup>p</sup>
Sub-Saharan Africa	12	12	10	8	10	13	16
North Africa and Middle East	16	9	5	7	8	6	4
Asian LICs	10	12	12	14	17	17	22
Other Asia	5	6	9	1	-3	-2	-2
Western Hemisphere	28	30	-8	-6	-15	-10	-4
Other and adjustments <sup>a</sup>	7	8	-2	5	3	3	-2
<b>Total LDCs<sup>b</sup></b>	<b>78</b>	<b>77</b>	<b>27</b>	<b>27</b>	<b>20</b>	<b>27</b>	<b>34</b>
For reference:							
Least Developed Countries	9	10	9	9	10	12	13

a) Europe, Oceania, unallocated and other adjustments.

b) Excluding Gulf countries and Taiwan.

p) Provisional.

Source: OECD (1988)

## 2. Foreign Capital Inflows

Statistical data on financial flows to the industrial sector are thin on the ground, and those that are available are aggregated with other sectors, and/or of limited accuracy. Moreover, the well known problem of fungibility limits the utility of sectoral analysis anyway.

Annex 1 shows total net resource flows to developing countries, over 1979-1987. Of the major categories, data on flows to the industrial sector are available only for ODA, and these data are fragmentary. They are shown in tables 2 and 3. Of the other categories, direct investment can be presumed to flow mainly to the industrial sector but it is not possible to allocate export credits, bank lending or other items by sector.

Since 1981, total net resource flows have declined strongly in money terms, from US \$ 138 billion in 1983 to US \$ 29 billion

in 1987. The decline is much sharper when measured at 1986 prices and exchange rates. Export credits and bank lending have shrunk to negligible amounts, and tables 1 and 2 and Annex 1 suggest that the proportion of bilateral ODA flowing to the industry, mining and construction sector has tended to decline. As ODA has declined in real terms since 1981, the value of bilateral ODA going to industry has probably declined more sharply.

Only direct investment appears to offer substantial external finance to the industrial sector, and that declined sharply from 1981 to 1985. Only in the last two years has it approached its former levels in real terms. The sharp increase in DfI in 1986 and 1987 is probably largely attributable to the growth of debt-equity swaps. However, it should be remembered that the figures include flows to offshore financial centres in the third world, which may or may not remain there.

The data suggest that the volume of net external flows to the industry, mining and construction sector in 1987 were of the order of:-

	<u>U.S. \$ billion</u>
Bilateral ODA	2
Multilateral finance	1.5
Export credits	negligible
International Bank lending	negligible
Direct Investment	15 <sup>a</sup>

a) Assuming 75% goes to industry, mining and construction.

The overall picture is one of an industrial sector whose access to external finance was sharply reduced after 1931, a state of affairs which has been partially corrected only in 1936 and 1937 with the recovery of DrI.

OECD (1983) expresses the views that "there is clearly very considerable dynamism in foreign direct investment flows to (and among) Asian developing countries in particular" (p.53). The same source identifies Mexico as an important recipient of investment directed towards producing for the U.S. market, and debt-equity swaps schemes as generators of DrI. However, "there does not seem much chance of significant flows of foreign direct investment to [Africa] in the foreseeable future without a major effort to stimulate it through an active strategy based on appropriate fundamental policy conditions and far sighted measures to encourage OECD investors to become involved" (p.54).

**Table 2 Sector Shares in Allocatable Financial Commitments (%)**

	1975/76	1980/81	1982	1983	1984
Industry, Mining and Construction					
(a) Bilateral ODA	11.0	8.0	8.2	7.2	6.2
(b) Multilateral Finance	n.a.	n.a.	n.a.	n.a.	n.a.

**Table 3 Allocatable Sector Shares of Total Financial Commitments (%)**

	1980/82	1985/86	1987
Industry, Mining and Construction			
(a) Bilateral ODA	4.2	5.6	5.6
(b) Multilateral Finance	n.a.	7.5	9.3

Source: Tables 2 and 3: OECD, Development Cooperation: Annual Report (various issues).

### 3. The Impact of Debt on Investment

3.1 Trends in Investment since 1980. Table 4 shows trends in consumption (private and government) and trends in investment for the periods 1965-80 and 1980-86. Apart from China and India, all groups of countries showed a sharp reduction in the growth of both consumption and investment over 1980-1986, compared with the earlier period. The decline in investment was most marked in the highly indebted countries, and in Sub-Saharan African (SSA) countries.

Table 4 Growth of Consumption and Investment (%)

	General Govt. Consumption		Private Consumption		Gross Domestic Investment	
	1965-80	1980-86	1965-80	1980-86	1965-80	1980-86
Low Income Economies	5.7	5.4	3.8	5.4	7.4	13.2
China & India	6.1	6.1	4.0	6.2	8.3	14.9
Other Low Income	4.1	1.7	2.9	2.7	3.7	0.4
Middle Income	7.9	1.8	6.5	2.0	8.9	-2.3
Lower-middle Income	6.7	2.2	6.0	2.4	9.2	-3.4
Upper Middle Income	7.6	1.6	6.9	1.8	8.7	-1.9
Developing Economies	7.3	2.7	5.7	2.9	8.5	2.4
Highly Indebted Countries	7.0	0.0	6.0	0.7	8.4	-6.3
SSA	6.1	-1.0	4.9	0.7	8.8	-9.3

(Annual weighted average growth rates)

Source: World Development Report 1988.

### 3.2 The Effect of "Debt Overhang"

Debt overhang is the term used for the disincentive effect that a heavy debt service burden has on economic activity and new investment. The explanation is that any increase in output or exports merely enables higher debt service charges to be paid, the benefits thereby accruing to the creditors rather than to the country concerned. Debt overhang, therefore is a disincentive to investment, at least by governments.



The foreign private sector, too, is likely to be deterred from investment in highly indebted countries. The risk is that any guarantee of repatriation of dividends may be overtaken by the demands which government's debt service requirements place on the available foreign exchange. Repatriation of dividends in the form of foreign exchange may be impossible if the government simply does not have the foreign exchange available.

Investments requiring imported materials or components to function (as do many industrial investments) may also be deterred for the same reason, namely that the demands of debt service may mean that the government is unable to make foreign exchange available for imported materials, components, spares and parts.

In investigating the debt overhang problem, the IMF (1989) provided some illuminating data. All but one of the 15 "Baker countries" had a lower ratio of investment/GDP over 1982-86 than in the previous six years<sup>1</sup>. The second piece of empirical data shows that for 73 countries which have experienced debt problems, the investment/GDP ratio fell from 27% in the late 1970s to 18% in 1988. For developing countries without debt problems, the ratio rose from 26% to 28% over the same period. If non-borrowing countries are eliminated from the latter group, the investment ratio shows a small fall, from 29% to 26%. Therefore this is further evidence that low investment rates tend to occur in countries with substantial debt service problems.

### 3.3 The Impact of Structural Adjustment Programmes (SAPs)

A frequent, almost obligatory component of World Bank SAPs appears to be the reform of industrial incentives (Mosley 1987).

The component usually includes tariff reform, notably the elimination of quotas and the reduction of tariffs, the elimination of price and margin controls, and the reform of investment codes. The aim is to make the manufacturing sector more internationally competitive, and therefore increasing its economic value to its country. The measures are designed to reduce the protection offered to economically inefficient enterprises, and to encourage new investment in local resource based, export industries, partly through the elimination of anti-export bias. Such measures are often a major component of SAPs<sup>2</sup>.

The long-run impact of such SAP measures cannot readily be assessed yet. While in principle they should be favourable they depend upon the assumptions that import substitution industries can make themselves more efficient, and that the industrial sector will respond by directing new investments to the export sector. While these things may happen in the long term, the short term impact on manufacturing output, employment and investment may be negative, as enterprises find themselves unable to compete against imported, lower priced imports, and lack the confidence or the know-how to invest in local resource based, export industries (see Annex 2).

#### **4. Some Responses to the Debt Crisis**

It is clear that the debt crisis has been prejudicial to investment in general and to industrial investment in heavily indebted developing countries. We will now look at some of the innovative financing techniques which have developed for the

industrial sector in response to the debt crisis. The main emphasis is on external financing, which is logical given that the nature of the debt crisis is external.

Two significant trends have become evident in the responses discussed below. The first is the switch from debt financing to equity financing. The second is the shift of risk from the developing country to the financing agency, notably through the use of equity rather than debt, through the move away from sovereign risk to project risk (non-recourse financing), and through the increased availability of external guarantees.

#### 4.1 Venture Capital in Developing Countries<sup>3</sup>

Only in a handful of developing countries has any progress been made in establishing venture capital companies. The easy way to establish a venture capital company is for development banks to set up independently managed specialised funds or subsidiaries, as the functions of development banks are generally very similar in principle to those of venture capital companies. However, some may prefer to take smaller, higher risk, equity investments through a specialised subsidiary rather than through the mainstream development bank activities. This route has been taken, for example, by the state-owned National Development Bank in Brazil, which has established a venture capital subsidiary, BNDESPAR. However, the unsatisfactory performance of development banks (and other financial institutions) has been highlighted in World Bank (1989).

Specialised, independent venture capital companies are few in developing countries, and several of those which do exist have

been developed as joint ventures with the IFC since 1978, notably Sofinnova (Spain), VIBES (Philippines), Brasilpar (Brazil), IPS (Kenya), KDIC (Korea), and SEAVI (South East Asia). Although the IFC has helped with the development of these enterprises, its financial contribution has been limited, varying from 10% to 25% of the total initial capitalisation. OECD (1986) has details on the structure of these enterprises, but it is too early to make a full assessment of their performances. The main characteristic of these enterprises, though, is their diversity.

It should not be thought, though, that participation of the IFC is a necessary condition for the successful establishment of venture capital companies. Brazil has a number of other companies apart from those mentioned. Taiwan too has had venture capital companies for some years, the Development Bank of Malaysia has a venture capital scheme<sup>4</sup>, and Malaysia Ventures Sdn. is a private sector VCF, set up in 1984. Korea is particularly noteworthy, with a number of companies having had their origins in the Korea Technology Advancement Corporation (KTAC) venture capital group set up to invest in high-tech fields in 1974. KTAC was set up to commercialise R and D results from the Korea Advanced Institutes for Science and Technology, (UNIDO 1987). The Korean Technology Development Corporation, the private sector Korea Development Investment Corporation and the Korea Technology Finance Corporation also provide venture capital. The Asian Development Bank has made direct equity investments in the latter two (ADFIAP 1987), and the Deutsche Entwicklungs Gesellschaft in KDIC. Venture capital is developing in India, also. All the countries mentioned, significantly, have

active stock markets.

Taiwan has attracted a number of foreign venture capital firms as well as local ones since the initiation in 1983 of policies to encourage venture capital growth. The government sees venture capital investment as a means of encouraging the growth of a high-tech industry, thereby upgrading its industrial structure from reliance on traditional and labour intensive manufacturing. It has invested in venture capital funds through the development banks. However, progress to date has been slow, with a reluctance among Taiwan's entrepreneurs to take on board outside, and expensive equity. Moreover, the requirement that they should invest only in high-tech firms has made venture capitalists cautious. One interesting aspect has been the export of venture capital to small U.S. businesses, with a view to attracting them to invest in Taiwan when they want to expand. In this way, the funds hope to bring new technology to Taiwan<sup>5</sup>.

A significant aspect of venture financing in developing countries is the paucity of funds set up by development banks. These institutions do on occasion make equity investments, but they can hardly be considered to be entrepreneurial, venturesome, institutions. India is a notable exception, as numerous state-owned DFI's provide venture capital, even seed capital. But Wall (1986) noted that some schemes have performed disappointing, partly because of poor investment appraisal and lack of entrepreneurial spirit among technicians and managers. Islamic development banks, too, with their preference for providing equity rather than debt, also provide exceptions, as does the

Development Bank of Malaysia, which is something of a special case. The Industrial Finance Corporation of Thailand (IFCT), acts as a venture capital organisation, with investments in some 40 manufacturing enterprises. IFCT is now considering whether to set up a special unit within the organisation to deal with venture capital, or whether to set up an entirely separate entity. Either way, it envisages stepping up its appraisal capacity to 300 projects per year. However, these cases seem to be among the few development banks with serious involvement in venture capital.

Commercial Banks have been active in setting up VCr's. In Argentina, the S.A. Inversiones de Capital de Riesgo was set up in late 1986 by a leading bank, insurance company and two large diversified industrial holding companies. In 1986, Philippines had 16 VCr's, all "closely affiliated to commercial banks" (Wall 1986). In India, Grindlays Bank has a VCr, and in Spain the Bank of Bilbao is a partner alongside IFC in SEFINNOVA.

While a venture capital sector may be desirable, it may be difficult to stimulate it. We take the view that governments and government owned institutions are generally not a suitable base for venture capital funds although there may be exceptions. Civil servants and government employees are unlikely to possess the entrepreneurship, flexibility and managerial skills needed in a venture capital firm. This view is shared by Miller and Cote (1985) who state that government sponsored venture capital funds "have a dismal record in first round financing".

But while direct public sector involvement may not be desirable, governments have a crucial role to play in creating

the right commercial, financial and social environment for venture capital to be successful. Here we return to the discussion of capital markets in the first part of the paper. In terms of finance, perhaps the most important thing government can do is reduce financial market imperfections, both government-induced and "natural" imperfections. Ideally, venture capital firms should be able to survive in financial markets on "level playing fields". Should a government feel that special encouragement should be given for the financing of SMEs, (in our analogy that venture capital firms should be allowed to play downhill), then it may provide incentives.

More specifically, OECD (1986) identifies three areas where government action may be required. There are, in ascending order of difficulty, tax policy, divestment avenues and attitudes towards risk. "In a general sense, governments and societies should not discourage an investor's ability to profit and accumulate wealth". (p.32). We believe that care and skill is needed in developing tax incentives. What works in one country may not work in another. In particular, tax incentives may not be effective if the marginal tax rates are low. The question of avenues of divestment is important, and we take it up in our discussion of securities markets, below.

Few developing countries provide specific incentives to VCs. This is in marked contrast to industrialised countries where incentives are frequently encountered. Moreover, several developing countries discriminate against VCs, as their tax laws favour debt rather than equity. This applies, for example, where

there is double taxation of dividends, or where there is no indexation of capital gains for tax purposes. Both these factors have been identified by Wall (1985) as acting as disincentives in Colombia, which has no VCs. Brazil, on the other hand, provides tax concessions on both dividends and capital gains for venture capital investment, and Korea gives exemption from capital gains tax. In India, a third country where venture capital is well developed, the legislative and tax framework for VCs is apparently unclear.

By far the most difficult environment to create is one of risk taking. Risk averse individuals will not be attracted to high risk/high expected return investments, whether physical or portfolio in nature. High risk taking investors are generally ambitious, or hungry, or gamblers, with perhaps a touch of all three. The attitudes are societal, and not ones which governments can develop by decree. Exhortation, and tax policies which give incentives may help, but do not guarantee the right attitudes.

#### 4.2 Securities Markets in Developing Countries.

Should developing countries governments encourage securities trading? In an earlier work (Kitchen 1986) I have analysed the advantages and disadvantages, and much of the available evidence. Without going over the same ground again, my conclusion is still the same, that I am substantially in favour of encouraging stock markets in developing countries, within a sound regulatory framework. Considerable detail of the operations of securities markets in several developing countries is given in van Agtmael



(1984). Currently, some 40 developing countries have active securities markets.

Of more importance to this study is the use of securities markets for industrial financing. It is natural that organised stock exchanges should attract listings from the larger enterprises; but it is doubtful if stock exchanges should encourage listings by small and medium enterprises until the regulators and investors have acquired several years experience of trading in the stocks of major companies. It would be unwise of the authorities to rush into the establishment of second or third tier markets which are designed for smaller, riskier businesses. If things did not go well, such stocks could easily give a stock market a bad name before the market became well established. Nonetheless, the provision of organised markets for smaller companies should be seen as a long term aim of a stock exchange. To date, Nigeria and Thailand are the only developing countries with second tier markets, although the idea has also been discussed in India.

This leaves an OTC market as the only possibility in many countries. As we have seen already, OTC markets, taking a global view, have a mixed record. The objective, then, must be to try to capture the good points while excluding the bad. It seems that this can best be achieved by government approval and regulation of the market makers, and setting minimum qualifications for companies whose stocks are to be traded. Rules on disclosure of information and reporting should also be established. The Singapore SESDAQ may be worth examining in some detail, although it is very computer-intensive.

In many developing countries, development banks are the best placed organisations to operate an OTC market. Indeed they are often seen as the main alternative to an organised stock exchange. However, conflict of interest can arise when the development banks take shareholdings in client (or other) companies. Therefore what appears to be the current practice in Saudi Arabia, that commercial banks (as well as brokers) are permitted to sell stocks, providing an informal OTC market, but are forbidden to buy and sell stocks for their own portfolios<sup>6</sup> has much to recommend it.

The encouragement of unit trusts and investment trusts (we prefer the latter)<sup>7</sup>, with approval to invest a proportion of their portfolios in the shares of unquoted companies, can also help SME financing. Shares in investment trusts or units in unit trusts may be particularly convenient instruments for Islamic banks to offer in return for deposits.

#### 4.3 Franchise Financing ("Build-own-Operate-Transfer" - BOT)

Franchise financing 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 income it expects to generate from the project. The project will aim to service its debt and pay dividends to the shareholders for a pre-

determined period, (say 15 or 20 years), after which its ownership may be transferred to the state.

For the host country, the technique has the advantage that foreign debt can be raised without adding to sovereign borrowing, which may already be up to or beyond its serviceable limit. The lender is apparently exposed to pure project risk - on a project he thinks is sound - rather than sovereign risk. The foreign partner, usually a contractor or capital goods supplier, receives the initial orders, a management contract and a stream of dividends on the equity. The local partner(s) get a project, and a dividend stream.<sup>8</sup>

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, Shroder Wagg, quoted by Tyler (1986), it costs a great deal more to fund projects on a franchise basis. According to Shroders, it might be a premium of 4% or 5%. Lending banks and export credit agencies may also have reservations about franchise financing, although some banks are pursuing it aggressively as a substitute for sovereign-lending. But although the debt is not sovereign in nature, they may still set the lending against their loan quota for the country.

Turkey has been the main pioneer of build-own-operate schemes to date. Eximbank of the USA has lent US\$400 million for a conventional power station, being built by a US\$200 million joint venture company of international contractors with the Turkish electricity authority. The Swiss have also backed

another coal-fired power station. Malaysia has franchised an existing container terminal at Port Kelang, and Hong Kong has traditionally franchised its transport projects. (Tyler 1986). Currently the Thai government is selecting a consortium to build, finance, operate and maintain a mass rapid transit system for Bangkok. The successful consortium will form 75% of a company set up to build and operate the mass transit system with the Thai authorities taking the other 25%. They will have the right to set fares. After 30 years the ownership of the system will revert to the Thai government (Matthews, 1988).

A more radical, and potentially replicable scheme has been devised to finance a new power station in Pakistan. Costing £200 million, the power station will be owned and operated by a joint venture company with £50 million of equity. The shareholders will be local Pakistani investors and foreign suppliers, and the project may obtain a listing on the Karachi Stock Exchange. The major equipment supplier, Hawker Siddeley, will have a licence to operate and manage the project for between 23 and 25 years, while the financing is repaid. The station will sell electricity on a "take-or-pay" basis, which means that the Pakistan Government will in effect under-write the project. Provision is also included to allow price increases in the event of devaluation, to enable foreign debt to be serviced.

The supply of foreign debt has frequently been a stumbling block for franchise financing, partly because of commercial banks' current unwillingness to lend to developing countries, and because of the high gearing often proposed (90% debt has been

used in Turkish proposals). In the Pakistani project, prospects may be better for raising commercial debt, because of the lower debt/equity ratio and because the World Bank will contribute about £60 million from its new 'private sector window' in long maturing (23 years) debt, with an eight year grace period, thereby taking the later repayments. The financing and pricing arrangements should be attractive to foreign banks. (see Montagnon 1988a and 1988b).

Pakistan is reviewing a number of other energy projects which may be similarly financed. The involvement of the World Bank breaks new ground, and there would seem to be potential to involve multilateral and bilateral agencies increasingly in such schemes.

Although franchise financing has been limited to infrastructure projects so far, there seems to be no reason why it should not be extended to industrial, agricultural and service sector projects.

#### Transnational Venture Capital

While the bulk of transnational venture capital flows have been between industrialised countries, there is now an embryonic flow to developing countries. An important catalytic role is being played by the International Finance Corporation (IFC), with the Asian Development Bank (ADB) also involved. The IFC had invested in seven venture capital funds (VCFs) by 1986<sup>9</sup>, in Argentina, Brazil, Kenya, Korea, Malaysia, the Philippines and an ASEAN regional fund, the South East Asian Investment Company (SEAVIC). The ADB has invested in two Korean venture capital

funds, and one in Thailand. The Deutsche Entwicklungs Gesellschaft has also invested in a Korean VCF and in one in Kenya. A small degree of interest has been shown by the private sector. The ASEAN regional VCF was established by A.T. Associates, the Netherlands' Orange Nassau Group, while American Can and Credit Agricole have both taken a stake in the Korean Development Investment Group (Wall, 1986). A British-based group, African Permanent Investment Corporation has established a US\$10 million fund for venture capital in Zimbabwe (Financial Times, 3 May 1989).

Taiwan has attracted a number of foreign venture capital firms as well as local ones since the initiation in 1983 of policies to encourage venture capital growth. One interesting aspect has been the export of venture capital from Taiwan to small U.S. businesses, with a view to attracting them to invest in Taiwan when they decide to expand. In this way, the VCF's hope to bring new technology to Taiwan.<sup>10</sup>

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 many countries, these conditions are not met.

#### 4.4 Debt Swaps

Widely referred to as debt-equity swaps, debt swaps also occur in the forms of debt-debt swaps and foreign debt-local currency swaps.<sup>11</sup>

A debt-debt swap is a change of creditors holding developing country unsecuritised debt, typically commercial banks. They 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%-90% or more, depending on the perceived risk of the country in question.<sup>12</sup> Typically a secondary market swap is done to reorganise the debt portfolios of the participants, and although straight sales of debt are made, much market activity is of the "two cats for a dog" swap variety. This activity in itself does not lead to higher investment. However, its main importance from our point of view 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 several developing countries is to "capture the discount" visible in the secondary market.

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,<sup>13</sup> but

the details are technically complex, and vary from one country to another.<sup>14</sup>

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 in the secondary market with their overseas funds and then present the debt to their central bank for redemption in local currency. In most countries the local currency must be invested. For example, Argentina requires that it is invested in export-orientated 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. Roberts and Remolona (1987) estimate that between 1983 when schemes first started, and the end of 1986, about \$5 billion of debt-equity conversions took place. Although the pace has probably increased subsequently, as people become more familiar with the schemes, and more countries introduced schemes, the figure has to be seen against total developing country debt in excess of US\$1000 billion, and commercial bank debt of the 15 Baker Initiative countries in excess of US\$300 billion. However, external, foreign currency debt is certainly reduced by the scheme.

Essentially, this is done by paying the debt, indirectly, in



local currency, through the issue of new local currency. This in turn may be seen as inflationary, which is one reason why some countries have put ceilings on the amounts to be converted. (Chile, for example, has restricted debt-local currency swaps to US\$50 million per month). 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 again, which might then be channelled into, say, real estate, which experiences a price boom in turn. However, sensible limits on swaps should ensure that monetary policy does not become unmanageable.

The extent to which debt equity swaps 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? This question of additionality of investments is ultimately imponderable, 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. Dividends are paid only if the investments are profitable.

A number of interesting possibilities are emerging from debt-equity swaps. Philippines, which had experienced strong demand for debt-equity swaps, to an extent that the value of Philippines debt has risen sharply in the secondary market, has

offered banks the option of converting part of the interest payments due into Philippine Investment Notes (PINs). These would be US\$ denominated negotiable government securities which would trade, presumably at a discount, and which could be bought by multinationals and other direct investors who need Philippine pesos. (Kaletsky, 1987).

Privatisation issues could also be sold in part through debt-equity swaps. This could be done by governments offering shares in direct exchange with creditor banks, or by accepting debt acquired on the secondary market or through debt-local currency swaps as payments for privatisation issues.

A further variation on the theme arose when the IFC swapped its 28.7% equity stake in a Brazilian company, Papel e Celulose Catarinense for \$25 million of bank debt, presumably at a substantial discount to face value. (Lascelles, 1987). The practice could be repeated by IFC and by other development banks from industrialised countries who hold equity stakes in third world projects. The process can also work in reverse; industrial country development banks can use the debt-equity swap arrangements to purchase local currency to finance new investments.

Debt Conversion. An alternative to converting debt to equity or to local currency is to convert non-negotiable bank debt into long term bonds, of say 20-50 years' maturity. The bonds could then be sold on the market by the banks at a discount. The banks could take a loss, but would clear their balance sheets of the debt, which could be sold on the retail as

well as the wholesale market if the price (and yield) were sufficiently attractive. Debtor countries would have the maturities of debt significantly extended, but would not avoid the obloquy of default, so long as they maintained interest payments.

This scheme was first proposed by Kitchen (1985) and a version was subsequently implemented by Mexico in 1983, with a US\$10 billion bond exchange offer for bank debt. Banks were invited to bid by tender for the new bonds. The tender was only a limited success, but the Mexican government was able to capture some of the secondary market discount and thereby to reduce its bank debt.

#### 4.5 Portfolio Investment

Fund managers in the USA and Europe have become increasingly interested in diversifying into third world stock markets. Several unit trusts and investment trust (open and closed ended funds) have been set up to invest in countries such as Korea, Thailand, Taiwan, Mexico and Brazil. The IFC has established an international third world fund. A variety on the theme is provided by debt-equity conversion funds, in which creditor banks can exchange debt (at a discount) for equities. Such a fund has recently been set up to invest in Brazilian equities, following similar schemes in Chile and the Philippines, but the latter has suffered from delays caused by constraints on the range of permitted investments (Nicoll and Dawney, 1988).

Portfolio investment in existing stocks does not provide new investment directly. However, by increasing stock market

activity and prices, it helps firms to raise new funds through rights issues and flotations and reduces the cost of capital. To the extent that foreign portfolio investors take up rights or subscribe to new issues, portfolio investment provides new funds for investment.

#### 4.6 Capital Restructuring

Rehabilitation of third world enterprises is now attracting increasing attention as an alternative to new greenfield projects. Rehabilitation often requires capital restructuring, which presents opportunities to invite new foreign direct investment. Where foreign equity is already in place, the opportunity arises to increase it. Also foreign debt can be converted to equity, thereby reducing the debt service liability of a country.<sup>15</sup>

#### 4.7 Privatization

The vogue for privatizing state enterprises in developing countries offers opportunities to attract foreign equity capital.<sup>16</sup> Placement of shares gives the government the opportunity to bring in foreign investors<sup>17</sup> while the conventional offer for sale, if advertised overseas and supported with credible assurances that proceeds of subsequent sales by foreign investors can be repatriated in foreign exchange, might also attract both individual and institutional investors. 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.

#### 4.8 The Guaranteed Return on Investment Principal (GRIP)

In 1986 the IFC launched this scheme to encourage direct foreign investment in developing countries. The IFC takes on deposit the investment sum from the foreign investor, and acts as trustee, giving a guaranteed return for a specified time period. At the end of the period the investor can receive his investment and disengage from the project, or convert his investment into true equity, or extend the GRIP arrangement. The IFC takes the commercial and political risk, while the investor has a form of secured convertible loan stock. It appears that little if any use has been made of GRIP to date.

#### 4.9 The Multilateral Insurance Guarantee Agency (MIGA)

This scheme, set up by the World Bank, insures foreign investors in developing countries against four main classes of risk:

- Non-commercial risks arising from administrative actions by the host country, such as the imposition of exchange controls.
- Legislative actions by the host country.
- Repudiation of contracts, in cases where there is no competent forum to provide legal redress, or where a judgement in favour of an investor cannot be enforced.
- Risk arising from armed conflict and civil war.

Rather than providing finance, the MIGA is an attempt to reduce the risk of finance, and thereby to encourage its flow. As it expected to start operations only in mid-1988, it is impossible to assess how successful it will be. Moreover, it is

not clear how much additionality it will provide, as some risks are insured already by organisations such as the UK's Export Credit Guarantee Department and the Overseas Private Investment Corporation in the USA. Moreover, the private insurance sector is becoming increasingly interested in insuring such risks.

## 5 Countertrade

The major development in trade and payments arrangements in recent years has been the growth of countertrade in its various guises. Debt service difficulties, problems with international borrowing, and the limited domestic export credit schemes have all made a contribution to the growth of countertrade. The principle of countertrade is to ensure that an import is balanced by an equivalent export, although the timing of the two may be different. Thus firms wishing to export to developing countries have frequently become involved in negotiations with governments and companies with goods to export in order to stitch together a deal. Countertrade has arisen largely to finance the import of capital goods by developing countries.

Although countertrade represents the oldest form of payment for trade, the modern version really dates from the 1970's, and rose rapidly in the first half of this decade in response to the debt crisis. The sophistication of countertrade has developed rapidly. The different methods, arrangements and terminology of countertrade can be confusing. The main methods are barter, compensation agreements, counter-purchase (or parallel trade), buy back agreements, offset arrangements, evidence accounts and switch trading.<sup>18</sup>

Eastern European countries have traditionally been the main parties involved in countertrade. It arises when the initial importer is short of foreign exchange to pay for the goods, but has a surplus (or surplus capacity) of another good which it wishes to sell on the international market. In many cases the second good may be in excess supply on the world market, so that it is difficult to get sales, or good prices. Countertrade may offer opportunities to sell at better than world prices. Barter has recently produced examples such as the exchange of Russian machinery for Algerian wine and other goods in the 1960s. Buy-back deals sprang into prominence in the 1970s, particularly between the West and Eastern Europe. The West's process plant producers sold numerous chemical and petro-chemical plants to Eastern Europe and arranged to be paid in the products of these plants (see *The Economist*, 10 February 1979). They then had to dispose of the products on the world markets, at a time when those markets were already suffering from excess supply. Consequently they received lower prices than anticipated, and also angered western-based chemical producers. Therefore 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. Other examples of buy-back agreements in recent years have been the supply of a jeans factory to Hungary and a tractor factory to Poland. In 1984 Russia agreed to provide about one-third of the financing for an alumina plant in Greece, and to buy back two-

thirds of the annual output for the first ten years (The Economist, 14 July 1984). Bulgaria is supplying a tomato concentrate plant to India, with a guarantee to buy back 50% of the output.

The dividing line between different forms of countertrade is often hazy, but all developed rapidly during the recession of the late 1970s and the debt crisis of the 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 industrialised countries. The governments of several countries such as Indonesia and Pakistan insisted on countertrade deals to pay for large import contracts (Walsh, 1983). Indonesia has exchanged rubber, coffee, cocoa, and cement for fertilizer products; Iran has exchanged 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 matters of international trade, they also represent substitutes for financial flows. Buy-back or compensation agreements can involve the supply of capital goods which are 'paid for' over time, as with an export credit. However, they are not included in the international statistics of the provision of export credits. (They also tend to cut out the banks, who



normally provide the finance for export credits, which has led banks to set up subsidiaries to handle barter, countertrade and buy-back arrangements.) What is more, these trading arrangements enable developing countries to maintain their investment programmes at times when finance is scarce, and to do so without increasing their financial indebtedness. Also, the division of risk is different. With, say, 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.

Recent indications suggest that the boom in countertrade may have reached a plateau. A study by Produce Studies (1988), reported by Montagnon (1988c) indicates that countertrade involving at least one developing country peaked in 1985, when over 300 deals were recorded. Since then, it seems, a degree of disenchantment with countertrade has set in in the developing world, although the bubble cannot be said to have burst. The main area of decline since 1985 has been a fall in the number of deals between developing and industrialised countries from 136 in 1985 to 110 in 1987. Deals with Eastern bloc countries have also declined slightly, while intra-third world deals have remained fairly steady. Produce Studies expects North-South countertrade to follow a more erratic pattern in the future.

It is, of course, difficult to put values on countertrade as much of it is of the "two cats for a dog" variety. Of the 1358 deals analysed by Produce Studies, the average (one way) value

was \$143 million. This figure falls to \$57 million, however, when 56 exceptional deals of over \$500 million are excluded. If the 141 deals between \$100 and \$499 million are excluded, then the average falls to \$18 million.

If we take an average of 120 deals per year between North and South, with an average value of \$60 million per deal this gives a very crude estimate of \$7,200 million for North-South countertrade.

Major developing country imports and exports involved in countertrade deals, ranked in order of value, were:

<u>Import</u>	<u>Export</u>
1. Crude oil	1. Crude oil
2. Cereals	2. Cereals
3. Vehicles and parts	3. Clothing and textiles
4. Construction projects	

Although the number of construction projects rose from only 6 between 1980-83 to 101 between 1984-87, the picture of countertrade is that developing country imports are dominated by raw materials/consumer goods, rather than capital investment projects. Its role as a new form of investment therefore, has been limited. Likewise, exports have been dominated by raw materials, although the trend over the last five years has been an increase in the manufactured exports from developing countries in countertrade deals. Vehicles and parts, for example, have risen to sixth place in the export list from being vitually negligible over 1980-83.

Third world countertrade deals are centred on Asia, simply

because a number of large countries in the region have introduced policies of countertrade deals. Notable among countertraders are China, Indonesia and India, followed by Pakistan, Iran and Malaysia. However, countertrade involving China and Indonesia is declining, as it is in Brazil, which has also flirted with countertrade. Nigeria's attempts to use countertrade as a solution to its balance of payments difficulties, rather than having recourse to the IMF, was not a success.

Further evidence of trends in US countertrade is provided by Korth (1987). He reports that in 1972 only about 15 countries were involved in countertrade. These were mostly non-market economies. By 1979 the number had increased by 12, with the additions coming from South America and the Middle East. Much of the trade involved the purchase of defence equipment under offset programmes. According to a survey of US exports conducted in 1984, more than 88 countries were requesting some form of countertrade before agreeing to buy US exports. The spread of industrial products involved was widely diversified, with exporters of capital goods, oil field goods and aerospace products being heavily involved. The principal reason behind the rapid expansion was found to be the debt crisis, which sharply reduced many countries' ability to pay for imports by conventional means.

## **6 Mixed Credits**

These involve the addition of a tranche of official aid to a conventional export credit in order to reduce the cost and extend the maturity of export credits for capital goods or construction

contracts. Originally developed by the French and the Japanese, the scheme has been imitated by most other industrialised countries. It has though, been a contentious subject, as subsidised export credits, beyond the limits permitted in the Concensus, are disapproved of by some industrialised countries, notably the United States<sup>19</sup>. Nor is it clear that individual developing countries benefit. It probably does not create any additionality in aid received by an individual country, and merely directs aid from other projects. A mixed credit effectively acts as a subsidy to a capital goods exporter<sup>20</sup>.

Following mixed credit "wars" in the early and mid 1980s, an agreement has been reached through the OECD which now sets guidelines to the proportion of aid which can be used in a mixed credit<sup>21</sup>.

## **7 Conclusions**

The debt crisis has clearly led to a sharp fall in investment in developing countries, including industrial investment. This has been brought about by reduced economic growth and saving internally, the imposition of debt service on foreign exchange earnings, and sharply reduced external financing in real terms.

In response to these changes, new industrial financing mechanisms have evolved. These mechanisms include venture capital, build-own-operate, debt-equity swaps, countertrade, privatizations, and capital restructuring. However, these measures tend to be marginal in quantitative terms, and do not have the prospects of offsetting the quantitative reduction in

earlier financing mechanisms. However to the extent that the newer methods increase the share of equity in total financing, shift more risk to financing agencies, and do not depend on sovereign guarantees, they represent an improvement in the quality of industrial financing.

The best prospects for improving the flows of finance to the industrial sector probably lie not with new mechanisms such as those described above, but with some form of substantial debt relief which will ease the pressure of debt service. Apart from making more finance directly available, the reduction of the debt service constraint would have the secondary effect of increasing the confidence of investors.

Following the failure of the Baker plan, the best prospect now seems to be the Brady plan. This involves substantial IMF and World Bank lending which will be used to service commercial bank debt in exchange for some measure of commercial bank debt cancellation. While the IMF and the World Bank have approved the scheme, the commercial banks are clearly reluctant to go ahead, as they would have to carry all the burden of the debt relief, and the official creditors none.

The Brady plan, however, takes no account of easing official debt which is the major constraint in many countries, notably in Sub-Saharan Africa. Here the Lawson/Mitterand cancellation proposals hold out the greatest prospects. But again no account is taken of multilateral debt, which cannot be cancelled or even rescheduled. This form of debt is likely to remain a binding constraint, and the Brady plan would have the effect of replacing

reschedulable bank debt for non-reschedulable multilateral debt,  
much of which (IMF and IBRD) is at quasi market interest rates.

ANNEX 1 Total net resource flows to developing countries

	Current \$ billion									Percent of total		
	1975	1980	1981	1982	1983	1984	1985	1986	1987	1980	1985	1987
I. OFFICIAL DEVELOPMENT FINANCE (ODF)	31.9	45.1	46.6	44.0	41.8	47.1	48.5	56.2	59.9	35.2	57.7	70.6
1. Official development assistance	31.1	37.3	37.9	33.7	33.3	34.4	36.9	44.4	48.9	29.1	43.8	57.6
of which:												
Bilateral disbursements	24.9	29.5	30.0	26.2	25.7	26.7	28.5	34.9	39.0	23.0	33.5	45.5
Multilateral disbursements	6.2	7.8	7.9	7.5	7.6	7.7	8.4	9.5	9.9	6.1	10.0	11.7
2. Other ODF	5.8	7.8	8.7	10.3	8.5	12.7	11.6	11.8	11.0	6.1	13.6	13.0
of which:												
Bilateral disbursements	1.6	3.0	3.0	3.7	1.3	4.5	3.7	4.1	4.5	2.3	4.4	5.3
Multilateral disbursements	4.2	4.8	5.7	6.6	7.2	8.2	7.9	7.7	6.5	3.7	9.4	7.7
II. TOTAL EXPORT CREDITS	13.5	17.0	17.2	13.6	7.4	7.1	4.6	-0.3	-0.7	13.3	5.5	-0.8
1. DAC countries	13.2	15.9	15.8	12.6	6.7	6.1	4.0	-0.5	-1.0	12.4	4.8	-1.2
of which: Short-term	1.7	1.8	2.9	3.0	-0.7	0.5	3.0	2.6	3.0			
2. Other Countries	0.3	1.1	1.4	1.0	0.7	1.0	0.6	0.2	0.3	0.9	0.7	0.4
III. PRIVATE FLOWS	54.0	66.1	74.5	58.4	48.0	33.5	30.9	26.1	25.7	51.6	36.8	30.3
1. Direct investment (OECD)	13.4	11.2	17.2	12.8	9.9	11.4	6.7	12.2	13.2	8.7	6.0	15.5
2. International bank lending	35.9	49.0	52.0	37.6	34.1	17.4	13.6	5.2	8.0	38.2	16.2	9.4
of which: Short-term	16.0	26.0	22.0	15.0	-25.0	-6.0	3.0	-7.0	n.a.			
3. Total bond lending	x	1.5	1.5	5.0	1.1	1.0	4.8	1.6	-3.0	1.2	5.7	-3.5
4. Other private <sup>a</sup>	2.7	2.0	1.8	0.7	0.6	1.1	2.9	3.8	4.0	1.6	3.5	4.7
5. Grants by non-governmental organisations	2.0	2.4	2.0	2.3	2.3	2.6	2.9	3.3	3.5	1.9	3.5	4.1
TOTAL NET RESOURCE FLOWS (I + II + III)	104.4	128.2	138.3	116.0	97.2	87.7	84.0	82.0	84.9	100.0	100.0	100.0
Related data:												
Use of IMF credit, net	x	2.6	6.1	6.2	12.5	5.4	0.8	-1.4	-4.7			
Net capital outflows by LDCs <sup>b</sup>	-10.0	-10.9	-14.6	-10.5	-6.6	-10.1	-9.8	-8.8	-7.6			
Flight capital (estimated) <sup>c</sup>	n.a.	-27.0	-36.0	-31.0	-24.0	-16.0	-14.0	-12.0	-9.0			
Net investment income paid by LDCs <sup>b</sup>	-26.0	-39.0	-50.0	-63.0	-60.0	-61.0	-64.0	-55.0	-55.0			

At 1986 Prices and Exchange Rates

Total net resource flows	130.9	146.7	164.1	140.5	118.1	108.8	103.1	82.0	74.1
Total official development finance	46.3	51.6	55.3	53.3	50.8	58.4	59.5	56.2	52.3
Total ODF receipts from all sources	39.0	42.7	45.0	40.8	40.4	42.7	45.3	44.4	42.7
Total DAC ODA (bilateral and multilateral)	28.6	31.2	30.3	33.6	33.5	35.6	36.1	35.6	(36.1)

a. Including estimates of unreported bond lending and direct investment.

b. Excluding Gulf countries and Taiwan.

c. Excluding Europe, Oceania, North Africa and Middle East and China.

Note: 1987 data include negative net flows of \$8 billion from Korea, Rep. and exclude over \$10 billion of short-term inflows into Taiwan.

n.a. = not available  
 x = negligible  
 ... = OECD estimate

Source: OECD (1988).

## Annex 2

### A Note on the Impact of Debt on Corporate Failure

Although little systematic evidence is available, there is abundant anecdotal evidence and press reporting that foreign exchange shortages, and subsequent devaluations, have led to many corporate failures in the third world. trade liberalisation policies may have contributed also. For the purpose of this paper we may regard corporate failure as negative investment.

The causes of such corporate failure may lie in a recession consequent upon a debt crisis in a country; in the unavailability of foreign exchange to import materials and spare parts; and in the increased foreign exchange cost of corporate foreign debt following a devaluation. The latter risk may be experienced by manufacturing firms directly, or, where they are financed by a development bank with a line of foreign credit, by the bank if it carries the foreign exchange risk. For example, in Ghana, Development Banks and their corporate clients are exposed to substantial losses consequent upon devaluations.

Such corporate failures amount in fact to negative investment. Moreover, in an economy where failure is widespread, even the rumour of the possible failure of a firm can become a self fulfilling prophesy, as credit and orders are then withdrawn from the firm in question.

In order to try to reduce the problem of corporate failure, or to give firms a chance to recover, there is much to be said in favour of some form of protection from creditors, along the lines of the USA's Chapter II protection, or the similar mechanism



operating in France. Few developing countries appear so far to have introduced such provisions. A notable exception is India, which introduced a Sick Industrial Companies (Special Provisions) Act in 1985, and the establishment of the Board for Industrial and Financial Reconstruction in 1987. The role of the latter is to rehabilitate and reconstruct financially the sick industries through certain financial reliefs and concessions (Pahwa, 1988). By contrast, it is interesting to record that one of the smaller developing countries, Barbados, is considering the introduction of a U.S. style Chapter II.

## Notes

1. The exception, Colombia, had not needed to reschedule any of its debt.
2. Mosley (1987) records that removal of import quotas was a condition in 57% of SAPs and tariff reduction a condition in 24% of SAPs. On the other hand, measures to improve export incentives were recorded in 76% of SAPs.
3. Wall (1986) provides substantial descriptive material on risk capital (defined more broadly than venture capital) in Argentina, Brazil, Colombia, Greece, India, Indonesia, Kenya, Korea, Malaysia, Mexico, Philippines, Portugal, Singapore, Spain and Turkey. Not all these countries have venture capital funds yet. Several industrialised countries are also included in the survey.
4. The Development Bank of Malaysia (Bank Pembangunan Malaysia) set up a Venture Capital Loan Scheme in 1981 which provides "financial assistance in the form of soft loan, equity loan and equity participation to a project with the objective to get the project on, which in terms of quantum and evaluation criteria transcend normal banking risk". (Salim bin Dato Osman, n.d.)
5. See Far Eastern Economic Review, 5 November 1987, for further details.
6. The Middle East, May 1985.
7. Investment trusts are generally more transparent than unit trusts. Managers of the latter have all sorts of opportunities of abuse open to them, which act to the detriment of the unit holders. On the other hand, quoted investment trusts need a set of regulations to limit gearing and "pyramiding", which gave them such a bad reputation in the Wall Street crash of 1929. Venture capital companies, incidentally, are really a form of investment trust, but play an active part in the direction of their client companies. They are not usually subject to investment trust regulations.
8. The absence of sovereign risk may be illusory, especially with projects which do not earn foreign exchange. The ability to service foreign debt and repatriate dividends depends on the ability of the Central Bank to provide the foreign exchange. In times of crisis, even with the best will in the world, the Central Bank may not have the necessary foreign exchange available.

9. These are, with IFC's share of the equity:

Sofinnova, Spain	15%
VIBES, Philippines	25%
Brasilpar, Brazil	10%

Industrial Promotion Service

Kenya	15%
KDIC, Korea	12.5%
SEAVI, South East Asia	About 10%

Source: Wellons, Germiddis and Glavanis (1986).

10. See Moore (1987) for further details.

11. In this section we have drawn significantly on Roberts and Remolona (1987).

12. The prices below give an indication of the price at which \$100 of certain countries' debt has traded recently in the secondary market. They are not necessarily a good guide, as trading is thin, with few final buyers other than some Latin American banks and companies wanting to make debt-equity swaps.

<u>Country</u>	<u>Secondary Market Price</u>
Argentina	30
Bolivia	12
Morocco	51
Peru	8
Brazil	54
Mexico	53
Chile	62
Philippines	53
Ivory Coast	32
Ecuador	32
Uruguay	61
Colombia	68
Nigeria	30
Venezuela	55
Yugoslavia	46

Source: The AMEX Bank Review, Vol. 15, No. 5, May 1988.

13. Countries which have sanctioned debt-equity swaps include Mexico, Brazil, Chile, Philippines, Costa Rica, Ecuador, Venezuela and Jamaica. Other countries which are studying schemes include Uruguay, Peru, Colombias, Morocco, the Dominican Republic of Nigeria.

14. See for example, de Svastick (1986); French (1987); Orme (1987); Gardner (1987); Kaletsky (1987); and Schubert (1987; and Davis (1988).
15. An example is provided by the capital restructuring of Serge Island Dairies in Jamaica in which the Commonwealth Development Corporation converted its sterling debt into new ordinary and preference shares. Domestic creditors also converted their (Jamaican dollar) debt.
16. For a discussion of various aspects of privatisation policy in developing countries, see Cook and Kirkpatrick (1988).
17. 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.
18. This discussion draws on Kitchen (1986) which contains details of the different methods. See also OECD (1985).
19. In 1986 the US Congress approved a 'war chest' for the US Export-Import Bank of \$300 million to use in mixed credits selectively against European bidders, in order to persuade the European parties to accept limitations on mixed credits.
20. Mosley (1987) finds that mixed credits are not necessarily harmful to developing countries, but that they are an inefficient way of subsidising exports and employment.
21. For details, see OECD (1988). For least developed countries, mixed credits must have a minimum concessionality level of 50%, for others the figure is 35%.

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