

EMTA Africa Workshop Report

Financing African Development Post-HIPC: What Role for the Private Sector?

April 18, 2008

TABLE OF CONTENTS

Index of Abbreviations	1
Introduction	3
Summary of Findings	5
EMTA Africa Workshop Report	10
Section 1. Funding Strategies: Transitioning From Concessional To Market Finance	11
Section 2. Improving Debt Management And Risk Assessment Capacities	16
Section 3. Sovereign Eurobonds or Local Markets: "Sequencing" Considerations	22
Section 4. Sovereign Eurobonds: Additional Considerations	25
Section 5. Developing Local Markets	27
Section 6. Financing Infrastructure Development.....	33
Section 7. Private Sector Funding Of The Domestic Private Sector.....	38
Section 8. Improving Public-Private Sector Communication And Cooperation.....	44
Annex A.....	49
Acknowledgements	51

INDEX OF ABBREVIATIONS

ADB	Asian Development Bank
AFC	African Finance Corporation
AfDB	African Development Bank
CSD	Central Securities Depositories
DFID	Department for International Development
DSF	Debt Sustainability Framework
EAIF	Emerging Africa Infrastructure Fund
EMTA	Trade Association for the Emerging Markets
GEMLOC	Global Bond Fund for Emerging Market Local Currencies
GKO	<i>Gosudarstvennoe Kratkosrochnoe Obyazatelstvo</i> (domestic short-term government bond issued by Russia)
HIPC	Highly-indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International financial institution
IIF	Institute of International Finance
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
MTDMS	Medium Term Debt Management Strategy
OECD	Organization for Economic Cooperation and Development
SME	Small and Medium-sized Enterprise

OPIC	Overseas Private Investment Corporation
SSA	Sub-Saharan Africa
STABEX	<i>Système de Stabilisation des Recettes d'Exportation</i>
UST	United States Treasury
WB	World Bank

INTRODUCTION

The EMTA Africa Workshop (the "Workshop"), *Financing African Development Post-HIPC: What Role for the Private Sector?*¹, was convened at the behest of the private sector which wished to commence a dialogue both with the public sector² and with African representatives³ about the opportunities for, and consequences of, private sector investment in Africa. The Workshop took place against a back-drop of private sector enthusiasm for assets from emerging Africa, and public sector concern that this over-exuberance could lead to another round of unsustainable indebtedness.

The objectives of the Workshop were to:

- Provide a forum for an exchange of views among the public sector, private sector and African representatives;
- Facilitate a change in perceptions and build confidence between the private and public sectors generally;
- Clarify each sector's positions on key issues; and
- Identify recommendations for re-defining roles in recognition of each sector's strengths, weaknesses, and goals with respect to their engagement in Africa.

This Workshop report (the "Report") seeks to distill the Workshop discussions and present the exchange of views between participants in a way that can facilitate future dialogue. Therefore, while we recognize that there is a spectrum of views within each of the sectors, and not all perspectives could be voiced, the points of view are attributed to the "public sector" or the "private sector" (or some combination of "participants") throughout the report, without further description of the type of representative or specific number of representatives within each sector that shared that view. The meeting took place subject to the Chatham House Rule, and views expressed were personal and not institutional.

¹ Private sector participants (referred to throughout the Report as the "private sector") included traders and originators from sell-side institutions and brokerages; debt, equity and private equity investors ("foreign investors"); sovereign advisors; rating agency and trade association professionals; and research analysts specializing in Sub-Saharan Africa (SSA), from the UK, US and Europe.

² Public sector participants (referred to throughout the Report as the "public sector") included representatives from several international financial institutions (IFIs), including the IMF, World Bank and African Development Bank, a representative from the Bank for International Settlements, representatives from development agencies such as DFID, and from Finance Ministries of certain G7 countries, including Germany, France, the UK and US.

³ African representatives included officials from the Central Banks of Nigeria, Kenya and Zambia, and an advisor to the Finance Ministry of Ghana.

While not all issues were developed to the same extent, participants found many areas of consensus and identified a number of areas where better cooperation or coordination between the sectors would maximize effective engagement. There remain, of course, areas where the sectors do not see eye to eye. These issues will hopefully be discussed in future encounters.

The main areas of focus of the three sectors were, broadly, as follows:

Participants in the private sector focused on the real and perceived impediments to increasing their role at a time when Africa faces acute funding needs. While acknowledging that there will continue to be areas where public sector concessional lending is still the most appropriate alternative, private sector participants stressed that in many cases a market solution is often faster and more effective (if also more costly), and that African governments must be allowed to *"take risks with private finance or no progress will ever be made."* Private sector participants volunteered many suggestions on how the public sector can better target aid to facilitate a greater role for the markets.

Participants in the public sector focused on the responsibilities that come with an increasing private investor role in Africa, particularly at a time when debt management capabilities in most African governments are not sufficiently strong to cope with large foreign inflows. The public sector strongly advocated for a greater private sector role in promoting "responsible lending," particularly in the sphere of the international capital markets, and maintained that ensuring the proper use of funds was necessary for debts to be properly serviced. In essence, the public sector concern was that it has committed a great deal of time and granted a great deal of debt relief to many African countries, and does not want to be left to "pick up the pieces" if they permit the private sector unfettered opportunity to lend.

African representatives acknowledged that the transition away from primarily public sector support to mixed sources of funding presents many opportunities to match development needs with the most appropriate funding sources. This transition, however, also presents challenges, particularly in the area of debt management. As government's take more responsibility for funding strategies, the question was posed as to how investment opportunities appropriate for the private sector could best be identified.

The Report includes a Summary of Findings, followed by Sections in which the discussion surrounding each issue is developed. Annex A provides specific comments about the WB/IMF Debt Sustainability Framework.

SUMMARY OF FINDINGS

1. FUNDING STRATEGIES: TRANSITIONING FROM CONCESSIONAL TO MARKET FINANCE

The availability of market finance is providing African governments with the opportunity to transition away from concessional finance and match funding needs with more varied sources of finance. This transition has exposed tensions between competing lenders, and raised questions about how concessional finance and market finance can coexist more efficiently. (See Section 1.)

- 1.1 There is consensus that African governments need funding flexibility that allows them to match financing sources (including bi-lateral and concessional loans, access to international capital markets and local currency financing) with needs.
- 1.2 The public sector view is that although market finance is becoming available to some African governments, it is premature to contemplate the end of concessional finance for some time.
- 1.3 The private sector believes that African governments must be allowed to "take risks" with market finance or no progress towards self-sufficiency will be made.
- 1.4 The private sector further believes that policies limiting non-concessional external borrowing have in the past blocked their attempts to provide a market solution to a specific funding need.
- 1.5 The private sector is also concerned that there is no policy transparency with regard to what is permitted in terms of non-concessional external borrowing.

* * *

2. IMPROVING DEBT MANAGEMENT AND RISK ASSESSMENT CAPACITIES

As African governments transition from predominantly public sector support to mixed sources of funding, they must improve their debt management and risk assessment capacities. The public and private sectors can each assist African governments to improve capacity in these areas. (See Section 2.)

- 2.1 There is consensus that debt management should be interpreted in the widest sense to encompass external and internal liabilities as well as monitoring the use of proceeds in project contexts.
- 2.2 There is a clear mandate for the public sector to provide technical assistance to improve debt management capabilities, but this is a long-term enterprise.

- 2.3 The public sector would like the private sector to complement its efforts in this area by: (i) demanding more transparency from countries; (ii) differentiating between and rewarding countries that are making this a priority; and (iii) understanding the risks associated with the environments into which they are lending.
- 2.4 The private sector can also assist African governments with risk management through the introduction of hedging instruments to guard against certain risks. Contingent liability assets, which shift risks from the borrower at times of vulnerability, should also be given greater consideration.
- 2.5 There is consensus that African governments should immediately invest in improving investor communications and transparency, which go hand in hand with debt management. The public and private sectors can support these efforts.

* * *

3. SOVEREIGN EUROBONDS OR LOCAL MARKETS: "SEQUENCING" CONSIDERATIONS

There is firm consensus amongst all participants that developing liquid, deep and efficient local markets is a valid policy goal for all governments in Sub-Saharan Africa. However, there was not consensus as to whether they should seek external financing before local markets are developed. Noting that they now also have the option of issuing local currency assets off-shore, a key question was how African sovereigns "sequence" their engagement with foreign investors. (See Section 3.)

- 3.1 One view is that African governments are best advised to focus on local currency financing (be that on-shore or off-shore) in order to limit currency liability mismatches and shield against the effects of procyclical foreign investor behavior.
- 3.2 Another group argued that, on the contrary, there are valid reasons for and even benefits to be gained by sovereigns who seek external currency financing, and that the sequence with which sovereigns engage foreign investors is very important.

* * *

4. SOVEREIGN EUROBONDS: ADDITIONAL CONSIDERATIONS

In view of weak debt management capability, the public sector urges the private sector, particularly advisors and lead managers, to encourage African governments to exercise prudence when issuing (hard-currency) Eurobonds, particularly as regards the timing, purpose, size and structure of deals. The private sector maintains that issuances must, first and foremost, be liquid, or there will be no appetite for the bond. (See Section 4.)

* * *

5. DEVELOPING LOCAL MARKETS

Local markets that are deep, liquid and efficient attract stable foreign inflows, and provide governments with a viable financing alternative to external financing. Furthermore, the issuance of long-term fixed rate instruments governed by local law in local currency shields economies from turbulence in international markets. However, the development of local currency markets that can properly absorb foreign inflows takes time. African governments are encouraged to step up efforts at market reform, while investors are urged to be patient in their demands for liberalization. (See Section 5.)

- 5.1 African governments are encouraged to issue longer-term securities to create benchmarks which facilitate trading in the secondary market in order to attract stable foreign inflows.
- 5.2 Barriers to entry that discourage investment in local markets include: (i) lack of competitive custodial services; (ii) lack of transparency and poor data dissemination; and (iii) tax issues.
- 5.3 Sub-Saharan African local markets would also benefit from: (i) a more robust legal and regulatory regime; (ii) timetables for the development repo and derivatives markets; and (iii) a stronger domestic investor base.
- 5.4 Skills and technology are needed at both government level and within local financial institutions in order to service the growing local capital markets.
- 5.5 A regular forum for dialogue between local market regulators and private sector participants with cross-market experience would be desirable.
- 5.6 International financial institutions (IFIs) can play a direct role in supporting development of local currency markets by catalyzing private funds through targeted programs.

* * *

6. FINANCING INFRASTRUCTURE DEVELOPMENT

Better coordination between the public and private sectors in the area of infrastructure finance, particularly at the planning stage of new projects, should be developed urgently to maximize the benefits of cross-sectoral cooperation. Innovative funding packages are needed that: (i) combine public and private funds; (ii) utilize local and external currencies; and (iii) allocate risks appropriately. (See Section 6.)

- 6.1 There is consensus that there are areas of infrastructure development not suitable for private sector investment, particularly in "social" areas such as education and health.

- 6.2 The public and private sectors must improve coordination to maximize benefits of public-private partnerships to fund infrastructure projects in areas such as energy, transport, water and telecommunications.
- 6.3 Local bond markets can provide a financing solution for projects, most of which produce revenue in local currency.
- 6.4 More efforts are needed to boost skills within African governments to pick and plan projects, which also link private and public sector investors.
- 6.5 The domestic private sector must be better equipped to identify and originate bankable projects that also draw on foreign capital.
- 6.6 Public sector initiatives which facilitate public-private partnerships for financing African infrastructure are to be encouraged.

* * *

7. PRIVATE SECTOR FUNDING OF THE DOMESTIC PRIVATE SECTOR

While much of the focus of the Workshop was on the financing options available to African sovereigns, the importance of the concurrent development of the domestic private sector cannot be overstated. The domestic private sector of individual African countries will ultimately be the engine of sustained economic growth. As a priority, capacity in local financial institutions and banks must be built up through skills and technology transfer to permit these entities to assume their proper role as the driver of this engine. It is also essential that conditions be in place to attract foreign inflows – both debt and equity – to fund this important sector. (See Section 7.)

- 7.1 Within the domestic markets, "*banks must act like banks.*" Local institutions must assume the responsibility to actively cultivate the local economy, including funding small and medium size enterprises.
- 7.2 Local banks and financial institutions need both technology and skills transfer in order to compete adequately with international banks and service the growing local capital markets.
- 7.3 Very targeted practical skills training for local firms would be beneficial.
- 7.4 Domestic corporate bond markets provide alternative funding sources for local firms and opportunities for infrastructure finance.
- 7.5 Foreign investors can play an essential role in financing the domestic private sector through the capital markets (via debt or equity instruments), or through private equity.
- 7.6 Weaknesses in disclosure and accounting standards, the legal framework, and capital markets infrastructure prevent full-scale engagement of foreign funds.

- 7.7 Opening channels of communication between foreign investors and domestic market participants will assist in encouraging investment.
- 7.8 The public sector can support the African private sector by: (i) using funds in innovative ways to leverage private capital into the private sector; (ii) supporting listings of African companies on developed stock exchanges; (iii) on-lending in local currency to stimulate liquidity in the local economy; and (iv) supporting government reforms.

* * *

8. IMPROVING PUBLIC-PRIVATE SECTOR COMMUNICATION AND COOPERATION

African economies' transition from concessional finance to the opportunities presented by private sector financing can be facilitated by better communication and cooperation between the public and private sectors. However, opportunities for improving communication and cooperation are currently limited. Furthermore, perceptions of mistrust still inhibit public-private sector relations, impeding information sharing and, ultimately, policy transformation. (See Section 8.)

- 8.1 Existing channels for the discussion of debt relief between creditors and countries (*e.g.*, the London Club for commercial creditors and the Paris Club for bilateral creditors) work, if imperfectly; however, more effective dialogue as between creditors would be useful.
- 8.2 More regular forums for communication between the public and private sectors would allow the two sectors to trade concerns and update one another on activities in order to build trust and improve policy transparency.
- 8.3 Regular or *ad hoc* forums in which private sector knowledge and expertise can be shared with the public sector would be useful for both technical assistance and policy design.
- 8.4 The Debt Sustainability Framework design process would benefit from public-private sector dialogue at the framework level.
- 8.5 A mechanism to coordinate participants and facilitate public-private partnerships as between the public and private sectors, and in coordination with African governments, needs to be developed.
- 8.6 A formal process through which the private sector and African governments can interact and seek approval from the IMF for non-concessional financings is needed.

EMTA Africa Workshop Report

**Financing African Development Post-HIPC:
What Role for the Private Sector?**

SECTION 1. FUNDING STRATEGIES: TRANSITIONING FROM CONCESSIONAL TO MARKET FINANCE

The availability of market finance is providing African governments with the opportunity to transition away from concessional finance and match funding needs with more varied sources of finance. This transition has exposed tensions between competing lenders, and raised questions about how concessional finance and market finance can coexist more efficiently.

INTRODUCTION

- While the public and private sectors agree that concessional financing in Africa will one day be replaced by market financing, there was no indication as to when concessional financing might begin to be scaled down or phased out. The continuing role of concessional financing and the conditionalities that come with it (in particular, limitations on external borrowing and the IMF's on-going role in policing these limitations): (i) necessarily impact each African government's ability to determine its own funding strategy; and (ii) in some cases limit the ability of the private sector to provide a market solution to meet financing needs.
- Based upon the Workshop's discussion of these issues, it appears that the public sector remains largely of the view that it should stay in the picture for some time as advisor, enabler and lender, particularly with regard to the sub-set of African countries outside the scope of private sector interest. To the extent that the private sector does step into the more developed African markets, it should do so carefully, and actively encourage "responsible" borrowing. Public sector hesitation to embrace full scale engagement of private sector funds hinges on the fact that debt management capacity throughout Africa needs improvement before private funds can be used effectively and debts properly serviced. In short, the public sector does not want to see a build up of commercial debt before appropriate borrowing practices are in place.
- Broadly, the private sector believes that the public sector must actively transition away from lending (and from essentially competing with the private sector in the provision of finance) towards enabling countries to access more private finance. In essence, the private sector believes that until African countries are permitted to take risks with private finance, no real progress towards self-sufficiency can be made. Further, many in the private sector expressed frustration at what they perceive to be a lack of transparency in IMF/WB policies with respect to non-concessional borrowing, and argued that while concessional finance was necessary in many cases where the market could not provide a solution, at times the policy itself prohibited the markets from providing a solution.
- In terms of assets, from the private investor side, there is interest in both local market and hard-currency assets, and the Workshop entertained a pointed

debate on the advantages and disadvantages of local versus external finance. (This latter point is taken up in Section 3.)

- With these various considerations in mind, there was agreement, at least in theory, that African countries should be allowed to determine their own funding strategies and assume responsibility for these, and that these strategies will include some combination of commercial and concessional finance for some time in the future. As was pointed out, the rise in democracy across Africa means political accountability has increased considerably in many African countries, which puts pressure on governments to make the proper choices and deliver needed infrastructure and services to their constituents.
- For African governments, however, there is no obvious single path to be followed in establishing a funding strategy. Consequently, African governments are encouraged to evaluate what their needs are, what different methods have to offer; what the risks, rewards, and consequences are for each method; and how different methods might be deployed concurrently. The continuing engagement and evolving role of the IFIs, and the increasing participation of the international private sector offer valuable resources and opportunities. However, African governments can only avail themselves of these if cooperation between themselves and these sectors is robust and transparent.

DISCUSSION

1.1 There is consensus that African governments need funding flexibility that allows them to match financing sources (including bi-lateral and concessional loans, access to international capital markets, and local currency financing) with needs.

1.1.1 African governments need to be allowed flexibility to appropriately adjust their financing to today's realities. They should have available to them concessional finance, bilateral loans, international capital markets (international bonds) and local markets. There is no one-size fits all approach, but African countries should determine (and assume responsibility for) their funding strategies.

1.1.2 African governments must work with the public and private sectors to decide what needs to be done and what roles each party will play. Privatization, public-private partnerships, and government interventions may be more or less appropriate for different funding requirements. The sectors must work together to determine what the needs are and what kind of financing will best meet these needs. This assessment includes an analysis of who is best-placed to accept what kinds of risk.

1.1.3 With the rise of democracy and political accountability, African governments are under pressure to deliver. Each financing source has advantages and

disadvantages. *"Bilateral lenders such as China can deliver in size but often with low documentation, often raising questions. Donors can provide concessional financing but it comes with other costs that are non-monetary. Markets can deliver quite expediently but at a higher cost. An optimal solution must be a balanced approach where there is a little bit of each [source] targeted at what the African government needs."* It is very much in the interest of the African governments to realize that there is a great opportunity to consider all of these varied financing sources in order to get the best outcome possible.

1.2 The public sector view is that although market finance is becoming available to some African governments, it is premature to contemplate the end of concessional finance for some time.

1.2.1 In recent years, patterns of concessional finance have been changing as new bilateral lenders are entering the picture, including China, India and Brazil. Private sector participants have also emerged as willing investors, challenging the view that the IFIs must compensate for a market failure in Africa and provide concessional finance. In spite of these developments, as private sector participants noted, most of the recent African Debt Sustainability Framework (DSF) analyses, published by the IMF and World Bank, include as a baseline assumption the continuation of concessional finance for onwards of 20 years.

1.2.2 The public sector acknowledged that it will continue to provide concessional loans to a number of African countries because the markets are still not able to offer the right solutions. This is true both in terms of the type of assistance provided (including blanket budget support) and in terms of what countries receive it (including a number of African countries that fall outside of most private sector investment horizons). Therefore, the public sector insisted, *"it is premature, probably, to talk of an official sector 'exit strategy' in the realm of concessional finance"* particularly because *"there are far more instances of the market failing than the market working."*

1.2.3 Weakness in debt management capacity across the board in Africa makes an increased role for private sector funding a worrying prospect for the public sector. To the extent that African governments turn to market finance, they are encouraged by the public sector to look to the local markets first to mitigate against the risk of currency mismatches. The public sector also urged the private sector to play a role in promoting improved risk and debt management in their engagement with African sovereigns.

1.3 The private sector believes that African governments must be allowed to "take risks" with market finance or no progress towards self-sufficiency will be made.

1.3.1 All participants agreed that African governments will have to borrow from the private sector at some point. As one private sector participant remarked *"you are not going to build an entire country over twenty/thirty years just on the basis of*

concessional borrowing." Furthermore, *"market discipline as opposed to donor conditionality will be a stronger incentive for countries to follow sound economic policies over the long term,"* declared a public sector official.

- 1.3.2 The private sector view was that the IFIs should let African governments take risks with private sector finance. As one private sector participant explained, *"multilateral creditors should not be afraid to let African countries try private sector borrowing. If they do well then they will get the reward in terms of lower risk premium, if some don't do well, then they will borrow at a more expensive rate."* Another market participant concurred, *"We have to accept that we cannot get any returns and we cannot make any progress unless we are willing to take chances. Maybe we should support the countries that are willing to take these steps forward and step in and provide them with assurances."*
- 1.3.3 A private sector representative pointed out that the public sector's focus on risk management / risk mitigation, while important, could be paralyzing at best, and destabilizing at worst, based upon experiences of the public sector itself. (STABEX, a system designed to mitigate against commodity price volatility, which actually exacerbated price swings due to the delays in payments, was provided as an example of a risk mitigation tool having destabilizing consequences.)
- 1.3.4 Examples of countries "taking a leap" despite reluctance from the IFIs, and making huge strides forward were also provided: *"[When] Uganda liberalized its foreign exchange markets back in the early 90s, this was significantly resisted by the multilateral agencies particularly the IMF who felt that the capacity of the government to manage this major liberalization was not there. In fact the liberalization went ahead at the will of the government and was a very considerable success. Ghana's decision to go forward with its bond issue is another example."*
- 1.4 The private sector further believes that policies limiting non-concessional external borrowing have in the past blocked their attempts to provide a market solution to a specific funding need.**

- 1.4.1 Private sector participants discussed the situation of one African country to illustrate the point. In that case, a sovereign was told: (i) they had to pay off World Bank arrears before a new IMF program would be put in place; (ii) that they could not borrow on a non-concessional basis outside of the country to pay this off; and (iii) that they could, however, borrow in local currency from domestic markets to pay off the amount due.
- 1.4.2 In this case, the private sector expressed frustration at being "blocked" from providing a solution to this specific cash flow problem, even though the market was willing and able to provide financing in this case. Although the country was allowed to seek funding in the local markets, the local markets were not sufficiently developed to be able to deliver the amount needed. Therefore, as of

the date of the Workshop, the problem had not been resolved and no new IMF program had been rolled out.

1.5 The private sector is also concerned that there is no policy transparency with regard to what is permitted in terms of non-concessional external borrowing.

1.5.1 From the World Bank perspective, *"the question of non-concessional finance must be judged on a case-by-case basis."* There is no "blanket ban" on non-concessional finance. From the private sector perspective, the lack of policy transparency with regards to who can and cannot borrow on non-concessional terms is frustrating, in particular for market participants whose role it is to advise sovereigns on funding strategies.

1.5.2 The private sector explained that it cannot effectively advise African governments on their funding strategies if the policy relating to non-concessional funding approvals is not more transparent. The private sector also noted that there is currently no formal process in place for the private sector and African country governments to interact and seek approval from the IMF for non-concessional financings. *"If we could get feedback from the IMF that said, 'sorry, ... borrowing is not possible for this country' it would vastly improve our ability to do our jobs and also the ability for many African sovereigns to predict what is or isn't feasible in terms of debt raising ability."*

SECTION 2. IMPROVING DEBT MANAGEMENT AND RISK ASSESSMENT CAPACITIES

As African governments transition from predominantly public sector support to mixed sources of funding, they must improve their debt management and risk assessment capacities. The public and private sectors can each assist African governments to improve capacity in these areas.

INTRODUCTION

- With macroeconomic reforms on track and clear balance sheets, many SSA economies are attracting foreign inflows at unprecedented levels. In the face of these foreign inflows, it is imperative that these governments continue their reform agendas. The area in need of the most attention is debt management at the sovereign level, both in the broad policy sense (that is, in terms of how African governments determine their funding strategies and ensure efficient use of resources) and in the technical sense (in the daily operations of debt management offices, which centralize the monitoring and servicing of sovereign debt). As one participant observed, the need to develop *"risk management, debt management – they're almost synonyms here – ... is absolutely acute."*
- There is little history of African debt management. With the IMF/WB and bilateral creditors providing concessional finance for most of Africa's history, there has been little need to develop liability management expertise. As a result, a 2007 IMF report concluded that most SSA countries *"have at this point weak debt management"* and, as one participant stated, *"rely arguably too much on organizations such as the World Bank and IMF to do their debt analyses."* The task of building debt management capacity requires targeted technical assistance, but also wide-sweeping, cultural change – away from a culture in which the lenders are the *de facto* debt managers, towards a culture in which the borrower must assess and assume risk.
- Greater technical capacity in debt management offices will help countries deal with lenders on a more equal footing and will allow African policy makers to make more informed borrowing decisions. Improvements in this area are also critical for markets to be used effectively.
- Building debt management capabilities is a long-term enterprise. While the public sector has a clear mandate to step in and provide technical assistance in the area, African governments can address shortcomings by promoting investor communications and transparency. There are also steps the investment community can take to encourage proper risk management, including rewarding countries for transparency and introducing African sovereigns to a larger array of hedging products. Contingent liability instruments were discussed as a direct way for the private sector to assume risks from borrowers at times of

vulnerability. Although there is currently not demand for contingent liability instruments, some private sector participants suggested that demand *"could perhaps be created if such instruments were provided and well disclosed and well managed by countries."*

DISCUSSION

2.1 There is consensus that debt management should be interpreted in the widest sense to encompass external and internal liabilities as well as monitoring the use of proceeds in project contexts.

2.1.1 Several participants expressed the view that debt management capabilities should be interpreted to include the whole range of liability management for the government, encompassing both external and domestic liabilities, and even to some extent, ways and means for the debt management team to monitor the effectiveness of the use of the debt proceeds in project management. *"To be truly useful for these countries, debt management capabilities should be interpreted in a wider sense rather than the usually narrow focus on when and how to issue international bonds."*

2.1.2 Several participants agreed that there should be a project dimension to debt management: *"If we are attracting private investment into these countries, ... debt management capability is important [in order] to know when you have reached borrowing limits, but project identification will help in directing funds in ways that they can be paid back."*

2.2 There is a clear mandate for the public sector to provide technical assistance to improve debt management capabilities, but this is a long-term enterprise.

2.2.1 As one private sector participant expressed, *"African governments need to borrow and everybody has agreed that they will have to borrow. ... Give them the right tools to do so."* Indeed, there is consensus that the IFIs must play a role in building debt management capacity, and efforts to do so are being stepped up.

2.2.2 While the public sector acknowledged its role in strengthening debt management capacity, it stressed that there is *"no magic bullet on the capacity building side."* It is *"a very long-term enterprise and we are very realistic about the amount of payback that one could get over a short horizon. The challenge in low income countries is that debt management is done in a fiscally more vulnerable and volatile environment and it is done with less capacity...and with a narrower span of control in the debt management office than you would find in a typically more developed country."* Therefore, lenders should be realistic about the institutional environment into which they are lending.

- 2.2.3 The Medium-Term Debt Management Strategy is a new major initiative through which the IMF and WB will be working with five or six countries a year on these issues. The G8 Initiative on Good Financial Governance in Africa was launched in 2006 and lays out a series of recommendations for reform that would enable governments to develop public finance capacity that accounts for aid flows, debt relief and revenues from natural resources.
- 2.2.4 Meanwhile, Nigeria, Ghana, Kenya, Uganda and Mauritius have benefited from targeted assistance from the United States Treasury (UST) Office of Technical Assistance, including implementing best practices in debt management. The UST advisors are professionals with significant experience in either debt markets or state government debt offices. This program was held out as an example that other national governments could emulate.
- 2.2.5 It was noted that the Francophone countries of Africa have not benefited from any assistance in this specific area. While there has been work done on procurement related issues and budget management, debt management itself has not been addressed. A suggestion is for francophone development agencies, such as *Agence Française de Développement* which has debt management agencies elsewhere, to create the same in Africa.
- 2.2.6 The public sector was asked to extend the type of technical assistance that it has offered to other emerging markets, particularly in Latin America, to Africa, *"including direct assistance for the debt management teams, and to help them devise debt management strategies and valuation strategies."* While networks to provide this kind of assistance are in place, the public sector acknowledged that *"so far not much work has been done in [parts of] Africa."*
- 2.3 The public sector would like the private sector to complement its efforts in this area by: (i) demanding more transparency from countries; (ii) differentiating between and rewarding countries that are making this a priority; and (iii) understanding the risks associated with the environments into which they are lending.**
- 2.3.1 Given that private money is now flowing into Africa, the public sector believes strongly that the private sector should share responsibility for improving debt management.
- 2.3.2 The public sector believes that the investment community can actively encourage progress in this area. And, *"given the newness of these issues for so many of these countries, [the private sector can] be a bit more proactive and cautious than they have been in the past and urge countries to move more quickly forward with risk management, and more clearly reward countries for risk management."* (This was a message imparted to investors, the sell-side and the lead managers, and is further developed as it relates to external borrowing in Section 4.)

- 2.3.3 The private sector should demand more transparency and reward countries for becoming more transparent. On a number of occasions, the private sector mentioned that the IMF Article 4 confidentiality requirements limit private sector access to country data and make it difficult to properly assess country borrowing profiles. It was noted that the countries themselves can waive this confidentiality requirement and provide more data to the private sector. By encouraging greater transparency, the private sector will also have access to the information necessary for them to stress test IMF/WB Debt Sustainability Analyses.
- 2.3.4 Investors must continue to differentiate between countries in Africa and regard each as an individual investment opportunity based on the policy environment, the cash flows from the individual projects, as well as the legal and regulatory safeguards that are provided. Leaders in the private sector should step forward to create the right incentives and rewards for governments that demonstrate strong risk management, particularly through pricing mechanisms.
- 2.3.5 When making decisions about lending into countries, the private sector should take account of the efforts of the public sector in connection with Highly Indebted Poor Country Initiative (HIPC) and Multilateral Debt Relief Initiative (MDRI) programs. Indeed, one of the objectives of these programs was to clean up the balance sheets of low income countries so that they could once again issue commercial debt. In connection with the MDRI, the IMF/WB analyze all aspects of public financial management, including proper budgeting, proper screening of investment projects, procurement procedures, and everything that concerns the appropriate use of public resources whether from revenue or aid.
- 2.4 The private sector can also assist African governments with risk management through the introduction of hedging instruments to guard against certain risks. Contingent liability assets, which shift risks from the borrower at times of vulnerability, should also be given greater consideration.**
- 2.4.1 All participants acknowledged that the government revenues of many African economies are tightly connected to climate conditions and commodity prices. In light of this, the public sector believes that African governments need more access to borrowing that takes these contingencies into account, and encouraged the private sector to give greater consideration to contingent liability instruments. It was argued that *"lending contingent on commodity prices gives investors a better chance of internalizing the prospects of being repaid while making explicit the circumstances in which you wouldn't be repaid."*
- 2.4.2 The private sector expressed a preference to provide more hedging instruments to African governments to permit them to manage fluctuations in commodity prices and improve payment performance, rather than bundle risk into bonds. It was suggested that the private and public sectors should address African governments jointly to discuss some of these issues.

- 2.4.3 While the private sector acknowledged that there are examples of instruments which bundle risks, or provide up-side to creditors at times of windfalls or improved economic fundamentals (such as Nigerian and Venezuelan oil warrants or Argentine GDP-linked bonds), these types of instruments are often difficult to value and trade in the secondary markets.
- 2.4.4 There was some discussion about whether or not the inefficiencies of bundling two types of risks in one instrument created a "second-best alternative" or would indeed detrimentally impede liquidity. Although private sector demand for contingent liability instruments is currently limited due to the perceived liquidity constraints, it could perhaps be created if *"such instruments were provided and well disclosed and well managed by those countries."* Participants noted that greater empirical work on this issue would be helpful.
- 2.4.5 A private sector participant suggested that African governments should consider issuing more instruments in line with economic fundamentals in the local markets. Inflation-targeting instruments, it was suggested, would provide countries with incentives to reduce inflation very quickly and create a win-win situation for countries and investors alike. However, several participants highlighted the "serious obstacles" to proper valuation of these types of instruments due to poor data quality.
- 2.5 There is consensus that African governments should immediately invest in improving investor communications and transparency, which go hand in hand with debt management. The public and private sectors can support these efforts.**
- 2.5.1 African governments should immediately invest in improved investor communications, which would assist all parties. On the country level, the websites of Turkey, Mexico and Brazil were held out as benchmarks in this area, and provide examples of the type of information investors are looking for. Assistance from IFIs in this area, participants noted, would be beneficial. Countries are also encouraged to provide information to market data service providers such as Bloomberg.
- 2.5.2 On the regional level, the African Development Bank (AfDB) was asked to consider developing a resource similar to the Asian Bond Fund website administered by the Asian Development Bank (ADB). The website includes information on the tax framework and the legal environment for investors. It includes daily market quotes, and permits investors to track a country's yield curve. It also allows the private sector to track the macroeconomic factors that the ADB feeds into the website. A similar website listing all African bonds or loans, market information and macroeconomic information would be extremely useful to the private sector. However, the challenge of obtaining accurate data across the board in SSA at this moment was cited as an impediment.

2.5.3 Private sector organizations such as the Institute of International Finance (IIF) are playing a role in helping countries build debt management capacity and improve investor relations. The IIF has a program to help sovereign borrowers to improve their investor relations programs by analyzing and ranking the efficiency and usefulness of their investor relations efforts, including their websites. (The IIF releases a ranking report once a year to help investors.)

SECTION 3. SOVEREIGN EUROBONDS OR LOCAL MARKETS: "SEQUENCING" CONSIDERATIONS

There is firm consensus amongst all participants that developing liquid, deep and efficient local markets is a valid policy goal for all governments in Sub-Saharan Africa. However, there was not consensus as to whether they should seek external financing before local markets are developed. Noting that they now also have the option of issuing local currency assets off-shore, a key question was also whether it matters how African sovereigns "sequence" their engagement with foreign investors.

INTRODUCTION

- Different regions of the world offer different examples of how countries transform from low-income or developing countries to "emerging markets." Workshop participants tried to extrapolate from the experiences of various emerging markets – in Latin America, Eastern Europe and Asia – and apply that wisdom to Africa.
- One issue that attracted extended debate was the question of whether governments should seek to draw foreign investor flows through the local currency markets, or whether they should access foreign flows through the issuance of hard currency bonds in the international markets. The possibility of issuing local currency Eurobonds (that clear and settle at Euroclear/ Clearstream), was also discussed. Africa presents unique challenges for these issues because the funding requirements are large and imperative. Building a local market that can absorb foreign inflows takes time. Furthermore, debt management capacity needs to be improved so that the decision of whether to access local or external borrowing can be properly analyzed.
- The public sector expressed a strong preference for African governments to seek financing in local currency – in the local market or via local currency Eurobonds - to the extent possible, citing currency mismatches as a cause for virtually every debt crisis since WWII (the Russian GKO default being the one exception). Views on issuing in external or local currency were mixed in the private sector, although compelling arguments on both sides were provided.
- It was pointed out that previous experience in issuing in external debt rather than local currency debt *"took place in a marketplace where the demand base was very different. Nowadays there is that much more demand, not just to take on risk at a fund level in local currency, but also to take that risk on in terms that are comparable with [hard currency] Eurobonds by way of size and duration."*
- Several participants also noted that the choice of whether to access hard-currency over local currency financing, or vice versa, is sometimes imposed

externally. The local markets in Kenya and Zambia were held out as examples of markets that have developed out of necessity in the face of public sector-imposed limitations on external borrowing.

- Brazil and Egypt were cited as examples of countries pioneering the local currency Eurobond trail, although several market participants argued that long-term local currency financing in the international markets should only follow after countries have developed strong local markets.

While there was no resolution to these questions, some arguments are presented below.

DISCUSSION

3.1 One view is that African governments are best advised to focus on local currency financing (be that on-shore or off-shore) in order to limit currency liability mismatches and shield against the effects of procyclical foreign investor behavior.

3.1.1 A group of public and private sector representatives cited concern about the ability of SSA governments generally to manage foreign exchange rate risk, amongst other macroeconomic management challenges, and pointed out that every debt crisis since WWII, with the exception of the Russian GKO crisis, resulted from currency mismatches brought on by financing in hard currency. It was suggested that as between a SSA government borrower and a major investment fund, the latter was better placed, at present, to hedge against FX risk.

3.1.2 Taking some lessons from Asia, this group emphasized that developing a robust local market in the first instance could shield countries from volatility caused by procyclical foreign investor behavior.

3.1.3 Recognizing that foreign investors might be wary of local market risks, be they legal or custodial, public sector participants recommended that African governments consider the option of issuing local currency bonds off-shore so that custody and settlement issues are handled through international systems like Euroclear and Clearstream.

3.2 Another group argued that, on the contrary, there are valid reasons for and even benefits to be gained by sovereigns who seek external currency financing, generally, and that the sequence with which sovereigns engage foreign investors is very important.

3.2.1 This group believed that Latin American countries provided a good model for engaging foreign investors: first, borrow in external currency and develop a visible benchmark. Local markets can then thrive with the help of stable foreign

inflows. Then, having established robust local markets, these countries can access long-term local currency funding off-shore, following the model of Brazil.

- 3.2.2 This group argued that even the more developed local markets in SSA cannot meet their countries' funding needs, and that developing a thriving local market takes time. This group maintained that issuing hard currency bonds in the international markets provides needed financing most expediently and even has intrinsic value in that: (i) the process of issuing compels improved disclosure and debt management; (ii) the bonds establish a sovereign yield curve, which ultimately facilitates corporate funding; and crucially; and (iii) the process engages the sovereign with the international financial community.
- 3.2.3 They also pointed out that certain types of investors, in particular pension funds, which represent long-term stable flows, often want sovereign credit risk without currency risk.
- 3.2.4 With respect to foreign exchange risk, this group suggested that foreign investors could implant severe FX shocks upon nascent local markets, which sovereigns can do little to insure against, if there is a sell-off of a large local currency position, whether that exposure is on-shore or through synthetic exposure off-shore.
- 3.2.5 As one private sector participant explained: *"If I hold [Zambian] Kwacha in my portfolio, if I don't like this Kwacha anymore I am going to sell that portfolio and that's going to implant a FX shock on to the local country in question – that could be immediate – the FX market moves very quickly. If I instead lend money to Zambia in dollars that FX volatility is going to be much less important to me. I'm going to take a long-term view on Zambia and I'm going to say "do I like this credit or not"? and the short-term volatility is not going to make much of a difference to me. That is why I think currency volatility is of key vulnerability for local market investors."*
- 3.2.6 Significantly, this group contended that accessing long-term funding *exclusively* in local currency should only occur once local markets are robust. For example, it was noted that Brazil issued externally in local currency *only after* having (i) cleaned up its balance sheet, (ii) developed a very strong external curve, *and* (iii) put in place a number of reforms that allow the local markets to thrive, including developing a local investor base (in the form of a pension system). In this way, this group explained, countries could best shield themselves from procyclical foreign investor behavior.

SECTION 4. SOVEREIGN EUROBONDS: ADDITIONAL CONSIDERATIONS

In view of weak debt management capability, the public sector urges the private sector, particularly advisors and lead managers, to encourage African governments to exercise prudence when issuing (hard-currency) Eurobonds, particularly as regards the timing, purpose, size and structure of deals. The private sector maintains that issuances must, first and foremost, be liquid, or there will be no appetite for the bond.

INTRODUCTION

- In the absence of strong debt management capabilities, the public sector urges caution, and sees a role for the private sector to act as "responsible lenders" as SSA sovereigns begin to tap international markets. Generally, the public sector believes that risk of future debt crises can be lessened if the private sector would take the lead in encouraging African governments towards greater prudence and improved risk management in their borrowing strategies. In particular, the public sector would like African governments to be more discerning about the timing, purpose, size, and structure of deals. This includes giving greater consideration to issuing: (i) contingent liability assets (as is further developed in Section 2); and (ii) local currency assets, including in the international markets (as further discussed in Section 3). (This Section focuses on hard-currency Eurobonds, only).
- Generally, the private sector view is that African governments have acute financing needs, and that if the private sector is willing to play a role in funding, including buying Eurobonds, then African governments should consider this option. While the private sector clearly does not want another debt crisis, it sees the public sector focus on risk mitigation, particularly relating to use of proceeds, structures, etc. as either unworkable or so fundamentally impacting liquidity, that it defeats the appeal of investing in African government assets.
- There was concern expressed among some public sector participants that pressure has been and/or would be exerted on SSA countries looking to access the capital markets to re-size and re-structure bonds in a particular way to meet market demand, without regard to the risk management issues. Some in the private sector expressed the opposite worry that the IFIs might be the ones exerting the pressure to advance their own policy goals, without regard to how markets work.
- There must be more interface between the public and private sectors to further address these issues. (See Section 8.)

DISCUSSION

- 4.1.1 **Timing and Use of Proceeds.** At the time of the Workshop, there was a great deal of investor demand for African assets, and very little supply. The public sector questioned whether African governments should be encouraged to borrow externally to meet this investor demand, even if debt management capacity is not in place. Further, it questioned whether countries should come to market if there is not a clear use of proceeds.

Several private sector representatives expressed the view that, aside from there being acute financing needs in Africa that could be met in part through external finance, the process of issuing Eurobonds compels improved disclosure and debt management. Furthermore, the bonds establish a sovereign yield curve, which ultimately facilitates corporate funding; and crucially, the process engages the sovereign with the international financial community. In other words, it is a key step to integrating countries into the international financial system. Therefore, if there is investor demand, and the time is right for the country to come to market, then it should be allowed to make that choice.

- 4.1.2 **Size.** The public sector voiced concern that countries might be encouraged to issue larger sized deals than is necessary to meet their funding needs in order to promote market liquidity. They questioned whether the size of borrowing shouldn't be more closely related to the use of proceeds, and whether larger deals are always necessarily cheaper for the issuer.

The private sector view is that liquidity is key to determining whether an asset is worth buying in the first place. Therefore, the size of deals is very important as it directly relates to liquidity (smaller deals are harder to buy and sell). Therefore, it did not agree that size should be limited by immediately identifiable use of proceeds if the result was a bond that did not trade.

- 4.1.3 **Structure.** The public sector view on structures was that amortizing structures rather than bullet payment structures might be appropriate for new borrowers in SSA stating that "*small occasional issuers tend to get in trouble because they have large payment hubs, whether due to their own bad luck or to external conditions.*" They questioned whether efforts should be made to reduce these payment hubs through amortization structures and whether there is any evidence that markets penalize countries which reduce risk by using amortization structures.

The private sector noted that amortizing bond structures are often more costly for the issuer, and are generally associated with borrowers with poor track records and not necessarily new issuers. This might make a deal harder to sell in the market, and again impact liquidity.

SECTION 5. DEVELOPING LOCAL MARKETS

Local markets that are deep, liquid, and efficient attract stable foreign inflows, and provide governments with a viable financing alternative to external financing. Furthermore, the issuance of long-term fixed rate instruments governed by local law in local currency shields economies from turbulence in international markets. However, the development of local currency markets that can properly absorb foreign inflows takes time. African governments are encouraged to step up efforts at market reform, while investors are urged to be patient in their demands for liberalization.

INTRODUCTION

- SSA countries must develop local markets that are deep, liquid and efficient, and expand domestic yield curves to attract stable foreign inflows. However, the development of local currency markets that can properly absorb foreign inflows takes time. Local markets development is part of a larger reform agenda, and while there is agreement that liberalization and deregulation should be prioritized, participants from all sectors observed that over-rapid market liberalization can lead to financial instability.
- That said, foreign funds are already flowing into the government securities markets in certain SSA countries. These flows are putting downward pressure on yields and making borrowing cheaper for governments in some of those countries. However, massive foreign inflows can push up exchange rates and create market volatility in new markets. African governments need time to prepare for the consequences of increased foreign flows. Therefore, as several participants remarked, investors must be realistic in their demands for increased market liberalization in order to allow the markets to develop in a robust and sustainable manner.
- There is clear consensus on the many actions that African governments should take to address barriers to entry that deter investors. Issuing benchmark securities to build out the yield curve, providing a robust regulatory framework and trading infrastructure, addressing issues of taxation, and improving transparency and predictability will all go a long way towards attracting long-term stable investors. The development of repo and derivatives markets must also be considered as these products help investors manage risk, promote trading in the secondary markets, and minimize volatility. Clear signals from regulators as to their intentions with regards to market liberalization and deregulation are very highly valued by the investment community.
- The public sector can contribute to the development of local markets by providing necessary technical capacity-building assistance and helping governments establish timetables for the sequencing of market developments. The public

sector can also play a direct role in supporting development of local currency markets by catalyzing private funds, for example through initiatives like the WB Global Bond Fund for Emerging Market Local Currencies (GEMLOC) program.

- Regular information exchanges between local market regulators and foreign investors will also help align expectations and expertise.
- This discussion focuses on developing the local currency and government securities markets. Additional local markets-related issues focusing on equities and corporate bonds are addressed in Section 7.

DISCUSSION

5.1 African governments are encouraged to issue longer-term securities to create benchmarks which facilitate trading in the secondary market in order to attract stable foreign inflows.

5.1.1 Increasing secondary market liquidity is seen as a key component to developing markets generally. Building long-term liquidity should be a priority, with governments looking to issue longer term paper.

5.1.2 One route to building longer term issues is reopening issuances rather than having new auctions of short term paper that cannot provide liquidity and *"leave investors stranded in a fragmented yield curve."* A five-year bond that is re-tapped every month and is clear and transparent will provide more liquidity than many small issues with differing issue dates and maturities. It may be that procedures within certain countries' Central Securities Depositories (CSDs) must be revised to permit the re-opening of issuances to permit this building out of the yield curve.

5.2 Barriers to entry that discourage investment in local markets include: (i) lack of competitive custodial services; (ii) lack of transparency and poor data dissemination; and (iii) tax issues.

5.2.1 **Custodial services.** The lack of custodians in SSA local markets is a major bottleneck for foreign investors. There are very few custodians – only two to three – operating in many SSA markets, and several markets have only one. As private sector participants noted, in cases where only one custodian is handling all foreign inflows, particularly in the larger SSA local markets, the risk implications are worrisome. Lack of competition amongst custodians also means that custody fees are very high compared to international standards. And, lack of custodial services has led some foreign investors to seek to invest through synthetic products that clear and settle in Euroclear.

Although private sector participants brought this issue to the attention of the public sector, there was consensus that the private sector, both foreign and

domestic, is best-positioned to address the lack of custodial services. Banks – either foreign or local – should be actively encouraged to set up robust custodial services and enhance competition. At the same time, African governments must implement reforms in the local regulatory regime to underpin robust custodial services.

A private sector participant indicated that there are encouraging signs that local participants are moving into the custodial services area, and suggested that foreign investors "*should be prepared to work with these local banks*". This causes some anxiety as described by another private sector participant to the extent that an investor buying a sovereign bond that is held in custody by a local bank implicates not only sovereign risk but also risk on a local bank for which there is no additional compensation. It was further noted that foreign investors might be deterred from investing in markets where regulations require that custodians must be local banks.

5.2.2 Transparency and Efficient Data Dissemination. Lack of transparency about government auctions and lack of market data were raised as deterrents to investing in some SSA markets by foreign investors. Investor relations can be improved by encouraging transparency and the timely dissemination of information. Private investors would like issuing authorities to provide more information, particularly relating to governments' borrowing strategies in the domestic market, as well as access to specific and time-sensitive data including auction schedules. IFIs could play an important role in providing necessary technical assistance in these areas.

The publication of auction calendars setting out what is intended to be issued was given great importance by the private sector. Market participants explained that market credibility is lost if issuances are seen as opportunistic and it was noted that some issuers have walked away from auctions. Private investors therefore would like information about the timing of auctions to be made available, preferably six months ahead of time, as well as auction results. Some participants suggested that African governments consider following the Dutch auction process for treasury bills.

On the national level, the websites of Turkey, Mexico and Brazil were held out as examples of best practices in this area, offering the kind of information that investors seek. Governments are also encouraged to provide information to market data service providers such as Bloomberg.

On the regional level, the AfDB was asked to consider developing a resource similar to the Asian Bond Fund website administered by the ADB. It was suggested that a similar website listing all African bonds or loans, market information and macroeconomic information would be extremely useful to the private sector.

5.2.3 **Tax Issues.** Private sector participants noted that several tax-related issues were perceived to be barriers to entry to greater foreign investment. In particular, several private sector participants stated that equality of treatment between different types of investors, including between foreign and domestic investors was key.

Private sector participants further noted that some SSA countries have cumbersome, multiple tax systems applied to single transactions. There is a clear preference among private sector participants for a single clear tax on investments rather than a number of different taxes.

It was also pointed out that withholding tax can be relatively high in certain SSA countries; the amount of tax is as relevant as the existence of the tax. As a private sector participant explained, high withholding tax can distort yields by causing mispricing of bonds. For example, if investors are seeking a certain yield they will build the cost of the withholding tax into their yield calculations, and demand an adjustment to the coupon as necessary.

Certain participants from the private sector suggested that capital gains tax would be a better taxing solution as opposed to withholding tax to encourage holding on to bonds especially where sovereign bonds were being funded. Other means of taxing were discussed, including an exit tax on gains to be disclosed by custodians.

African regulators' concern was that the tax system must be easy to administer, and explained that private investors should not assume that the local market regulators are aware of everything that private investors are doing. For example, in a certain country, there are two custodians but they do not inform the central bank of individual trades. As such, there is no ability to tax investors directly, making an exit tax difficult to administer.

Private sector participants and African regulators suggested that the IFIs can play an important role in surveying different governments to establish best practices in relation to taxation.

5.3 **Sub-Saharan African local markets would also benefit from: (i) a more robust legal and regulatory regime; (ii) timetables for the development repo and derivatives markets; and (iii) a stronger domestic investor base.**

5.3.1 **Robust Legal and Regulatory Regime.** Governments should focus on legal reforms which underpin the financial sector. As further developed in Section 7, these include, *inter alia*: establishing a framework for the recognition and registration of security interests; reforming bankruptcy procedures; and opening access to the courts. Providing regulatory frameworks for repo, securities lending and derivatives transactions would also assist in market development.

Many African local markets are small. In order to make investment easier, African governments are encouraged to look for regional harmonization in the areas of

regulation and market practices. IFIs (or perhaps local trade associations) could provide a coordination function in the harmonization of domestic laws and market practices for trading local currency instruments.

5.3.2 **Repo.** As expressed by one private sector participant: *"If we want to see less choppy local markets then we have to use the means that are being used everywhere else to produce a two-sided market, [like] repo. A repo is the fundamental element of a reasonable hedge, a market neutral hedge position."* SSA countries were urged to adopt international standard documentation to support the development of repo markets, as part of a larger strategy of market reform. Private sector participants asked IFIs to encourage this.

5.3.3 **Derivatives.** Derivatives are attractive to foreign investors wishing to manage their local currency exposure. Private sector participants suggested that developing the derivative markets in the FX context – permitting forward and swap transactions – will improve liquidity in a domestic foreign exchange market. The perception among the private sector is that if African authorities do not embrace regulating derivative products on-shore, these products will develop off-shore and may not easily come back on-shore, if at all.

5.3.4 **Selling restrictions and minimum hold periods.** Regulators see selling restrictions and minimum hold periods on local currency denominated investments as tools to limit speculation and prevent "hot money" from leaving the country too swiftly, thereby minimizing volatility. The private sector's view is that these restrictions have an additional effect of restricting an investor's ability to reduce their exposure on one asset in order to invest in another, and thereby act as a barrier to entry.

5.3.5 **Local investor base.** All participants agreed that a strong domestic investor base is necessary to underpin the market. Local investors such as pension funds are necessary in the event of a flight to quality. These local investors provide both stability and an exit route for foreign investors. While in some SSA countries there is strong or growing local demand, a focus on further developing local appetite will contribute to the development of a robust local market.

5.4 Skills and technology are needed at both government level and within local financial institutions in order service the growing local capital markets.

5.4.1 Many local African banks have neither the IT capacity nor the professional risk management capacities for their banks to compete adequately and service the growing local markets. IT capacity is necessary for information sharing and transparency. The lack of easy access to data was cited as a significant impediment to foreign investors.

5.4.2 The UST Office of Technical Assistance was again held out as an example of a successful technical assistance program that other governments can replicate in terms of the assistance it provides in the area of market development such as

building out yield curves, establishing a primary dealers system, and creating predictable auction systems.

5.5 A regular forum for dialogue between local market regulators and private sector participants with cross-market experience would be desirable.

5.5.1 A gap exists between experienced international investors and "local players" who may not realize *"what the global competition for capital is like."* Regular dialogue would allow all participants to discuss market developments and impediments.

5.5.2 A private sector organization such as EMTA or the IIF could serve as a conduit for information sharing, for example, keeping a list of issues raised by foreign investors and directing specific questions to the relevant African countries.

5.6 IFIs can play a direct role in supporting development of local currency markets by catalyzing private funds through targeted programs.

5.6.1 In October 2007, the World Bank Group announced the GEMLOC project, which intends to invest US \$5 billion in local currency bonds while simultaneously establishing an "investability" index. This index is meant to both provide benchmarking for the fund manager and determine how World Bank technical assistance could be placed. No SSA countries were included in the GEMLOC fund at the time of the Workshop.

5.6.2 One private sector participant applauded the GEMLOC initiative to the extent that it might encourage sovereign wealth funds to diversify out of G3 government securities and into emerging markets. However, other private sector participants expressed skepticism as to whether the investability indicators truly reflect the needs and experiences of market investors; whether the index would be useful, considering the "off-market pricing;" and whether there was a conflict of interest involving fund sponsors and recipients.

SECTION 6. FINANCING INFRASTRUCTURE DEVELOPMENT

Better coordination between the public and private sectors in the area of infrastructure finance, particularly at the planning stage of new projects, should be developed urgently to maximize the benefits of cross-sectoral cooperation. Innovative funding packages are needed that: (i) combine public and private funds; (ii) utilize local and external currencies; and (iii) allocate risks appropriately.

INTRODUCTION

- Africa has substantial infrastructure financing needs. The UK's 2005 Commission for Africa report stated that Africa currently needs US \$10 billion a year in financing for its infrastructure requirements, and subject to review, US \$20 billion a year after 2010. Energy, transportation, water and telecommunications, for example, are large investment opportunities but they are also challenges.
- Success in meeting Africa's infrastructure development needs will require the combined strengths of the public and private sectors, and benefit from greater participation of the domestic banks. The horizons for private sector financing in Africa are expanding in terms of both duration and currency, and there is an appetite in this sector to engage in public-private partnerships to facilitate infrastructure financing. Each sector has much to contribute and much to gain through cooperation.
- There are certain needs in the area of "social" infrastructure (*i.e.*, health or education) where the public sector is best-placed to provide funding. In many other areas of the economy, however, and particularly in the areas such as energy, transportation, water or telecommunications, public-private partnerships will provide the most effective solution for getting projects off the ground faster and more efficiently.
- However, it is in this financing area more than any other that the private sector perceives itself to be competing with the public sector. While the public sector maintains that there are not that many "bankable" projects coming on line that would be of interest to the private sector, the private sector's experience is that they are not aware that projects are being developed until the financing has already been earmarked for a multilateral agency. As a private sector participant pointed out, the current practice inhibits *"potential transaction opportunities in which there is scope for risk sharing, for genuine public-private sector partnership, because they don't fit the funding allocations of the IBRD, the IFC, or the African Development Bank."*
- Without reiterating all of the points and counterpoints in this debate, the positions are broadly as follows:

- Many in the private sector, particularly those who do origination on the project side, believe strongly that they are being "crowded out" by the public sector because the information flow with respect to project implementation favors the public sector, even though private solutions are available and might often be more effective and quicker off the ground. Furthermore, as one participant described, because of IFI strategic sectoral policies, even in cases where the private sector is in early, as soon as a MDB or agency arrives, *"boom, it goes silent."*
- There is also a perception amongst private sector participants that the public sector is "pre-screening" projects to determine whether they are "bankable," even as there are no mechanisms in place to permit professional investors to undertake independent analysis of the potential opportunities for themselves.
- The public sector view is that the private sector is not being crowded out, and that the issue is much more complicated than simply putting projects out to tender. For example, the skills needed to identify and originate bankable projects are lacking at the African government level. Moreover, the public sector believes that it is naïve to think that just because there are funding needs, that there are investment returns to be made.
- Clearly, better communication and coordination is needed to address these perceptions. Better coordination between the sectors and the African governments originating projects at the planning stage may help. Formal mechanisms to bring the private sector into the tendering process sooner, or through which the public and private sectors work together to develop instruments to match funding needs and investor demand, could be developed. Methods for allocating risks and responsibilities between the parties in the best position to assume those risks should also be considered.
- Areas of focus for technical assistance include improving capacity to identify and originate bankable projects at the African government level and within the domestic private sector.
- Local bond markets could provide another avenue for infrastructure financing, so efforts to boost the efficiency of those markets will be beneficial.

DISCUSSION

- 6.1 There is consensus that there are areas of infrastructure development not suitable for private sector investment, particularly in "social" areas such as education and health.**

- 6.1.1 In virtually all of Africa there are very large needs in the health and education sector that must be addressed. According to a public sector official, *"the public sector is best-placed to provide assistance to low income countries in the form of grants or extremely concessional loans so that the resources are there to feed and educate children, to prevent illness and to diagnose and treat those who are sick."*
- 6.1.2 Meanwhile, the private sector is very willing and able to participate in a number of infrastructure projects where the rates of returns are readily identifiable.
- 6.2 The public and private sectors must improve coordination to maximize benefits of public-private partnerships to fund infrastructure projects in areas such as energy, transport, water and telecommunications.**
- 6.2.1 Participants agreed that as there is an urgent need throughout Africa for infrastructure financing, the private sector must become integrated into the process in a way that it is currently not. Generally, more thought must be given to coming up with new financial instruments and new investment opportunities which match funding needs and meet investor appetite.
- 6.2.2 Funding should be diversified in ways that play to the strengths of each sector. Projects seeking funding should not look only to sole sources such as the IBRD, IDA, IFC or the private sector, but should instead consider a combination of sources when appropriate. For example, it was suggested by a private sector participant, that if the World Bank has chosen a project in which it can provide comfort to the private sector, it should introduce the private sector into the projects; the same applies to the IFC. Where the private sector initiates a project, mechanisms to involve the public sector should be available.
- 6.2.3 As one participant suggested, *"I would like to see a lot more happening with the multilaterals in terms of making a broader range of instruments available ... and providing financing and value-added in areas where the commercial market will not and assuming risks [(e.g., political risk)] that the commercial market will not take."* Public sector assistance in the form of extensions of the maturity profile or credit enhancements were provided as examples.
- 6.2.4 In determining financing structures, participants pointed out that all projects will require substantial local currency funding (for salaries, procurement, taxes, etc.) and most will generate returns in local currency. As a result, funding a substantial portion of these projects directly in local currency should be considered. Local currency funding would both meet the financing needs without introducing exchange rate risk, and would benefit local financial markets.
- 6.2.5 As one participant noted, *"Ideally, project bonds, collateralized by identifiable revenues, managed with proper discipline, and providing proper transparency, could be an objective of public-private cooperation."*

6.3 Local bond markets can provide a financing solution for projects, most of which produce revenue in local currency.

6.3.1 As discussed above, the local market can play a critical role in funding infrastructure projects. Accordingly, boosting the efficiency of the local markets is a priority to permit these markets to contribute to the infrastructure needs. The public sector can play a role in stimulating liquidity in the local bond markets and provide credit enhancements and maturity extensions to add value to local market project bonds.

6.3.2 Local currency project bonds would provide another set of investable assets for local investors as well as foreign investors.

6.4 More efforts are needed to boost skills within African governments to pick and plan projects, which also link private and public sector investors.

6.4.1 A private sector participant suggested that it is necessary to have "on the ground" cooperation and expertise to be able to identify at a national level what the strategic priorities are and where there would be scope for co-financing of infrastructure projects. However, as one public sector participant explained, *"the skill base is a constant concern, not just in originating bankable projects but also on the part of governments in sifting through those projects and seeing which of those one should possibly finance."*

6.4.2 In order to address what appears to be a lack of coordination between parties originating projects and those who are willing to finance them, a mechanism to link the sectors could be put in place to facilitate direct dialogue among African governments, IFIs and the private sector at the planning stage. The IFIs may be best placed to develop this mechanism or facilitate this dialogue.

6.4.3 Due to the scale of funding needs, African governments are urged to consider creating dedicated teams to assess projects.

6.5 The domestic private sector must be better equipped to identify and originate bankable projects that also draw on foreign capital.

6.5.1 As one public sector participant explained, banks in even the most advanced economies in Africa *"are still finding it difficult to be able to come up with package projects that they can support on the ground and also sell to the international community. What is needed is to be able to build the capacity of some of these institutions to be able to come up with bankable projects that may be risky, but the adjusted risk will still be able to achieve a high level of return."*

6.5.2 The establishment of the Nigeria-based African Finance Corporation (AFC), a private-sector led investment bank and development finance institution created to help mobilize and channel required capital towards driving Africa's economic development was seen by participants as a positive step in this direction, as risk

capital is contributed from the domestic private sector not from the donor community or the IFIs. (*For further information, see <http://www.africafc.org>*)

6.6 Public sector initiatives which facilitate public-private partnerships for financing African infrastructure are to be encouraged.

- 6.6.1 It was noted that the United Kingdom has its own emerging Africa infrastructure fund designed to combine public and private funds for Africa infrastructure projects. The Emerging Africa Infrastructure Fund (EAIF) is a public-private partnership providing long-term hard-currency denominated debt or mezzanine finance on commercial terms to finance the construction and development of private infrastructure in 45 countries across sub-Saharan Africa. The EAIF is involved in financing projects across a wide range of sectors including telecoms, transport, water and power, amongst others. (*For further information, see <http://www.emergingafricafund.com>*.)

SECTION 7. PRIVATE SECTOR FUNDING OF THE DOMESTIC PRIVATE SECTOR

While much of the focus of the Workshop was on the financing options available to African sovereigns, the importance of the concurrent development of the domestic private sector cannot be overstated. The domestic private sector of individual African countries will ultimately be the engine of sustained economic growth. As a priority, capacity in local financial institutions and banks must be built up through skills and technology transfer to permit these entities to assume their proper role as the driver of this engine. It is also essential that conditions be in place to attract foreign inflows – both debt and equity – to fund this important sector.

INTRODUCTION

- The private economy is taking on a greater role in much of SSA as privatizations, which both stimulate and are facilitated by capital markets developments, continue within African economies. These privatizations will have the longer term beneficial effect of moving more business out of government hands, thus lessening the need for large amounts of sovereign borrowing. Private sector firms are now also taking on a greater role in infrastructure development and the provision of needed services, and are often better placed to deliver more efficiently than governments.
- In order for African domestic private sectors to thrive, capacity-building must be addressed in a range of ways. Local banks must develop the ability to lend on assessed opportunities and take on a greater role in funding small and medium sized enterprises in the local economies. To this end, addressing the lack of risk management skills in the historically conservative banking industry in many SSA countries is crucial. Providing skills training and IT capacity to bring this sector in line with international standards is also necessary. All of these improvements would support continued growth, and permit local institutions to properly service the growing local capital markets.
- Foreign investors can play an essential role in financing the private sector through the capital markets (via debt or equity instruments), or through private equity. However, a number of obstacles prevent full scale engagement of foreign funds at the private level, including weaknesses in disclosure standards, the legal framework and capital markets infrastructure. Furthermore, investable assets are currently very limited and liquidity constraints in the secondary markets for corporate bonds remain an obstacle.
- There are a number of specific ways that the public sector can catalyze foreign investor funds into the African private sector or otherwise support growth of the private sector.

DISCUSSION

7.1 Within the domestic markets, "*banks must act like banks.*" Local institutions must assume the responsibility to actively cultivate the local economy, including funding small and medium size enterprises.

7.1.1 The activity of local financial institutions in the area of credit extension both in the areas of consumer lending and loans to small and medium enterprises (SMEs) varies by country, but there was broad agreement that improvement is necessary across the board. Banks "*must learn the hard task of lending on assessed opportunities*" and develop a "credit" culture.

7.1.2 Several reasons were given for the lack of capacity in the area of risk assessment within the banking sector, including: (i) the historical economic framework in most SSA countries which has been dominated by government; (ii) the fact that banks can survive and even thrive by purchasing and holding government fixed-rate debt; (iii) a preference for raising equity in some markets; and (iv) a focus on collateralized lending that does not require an examination of risk levels or tolerance, nor require rigorous diligence.

7.1.3 As a result of this lack of risk management capacity, some participants explained, domestic banks are failing to provide adequate financing for SMEs. Meanwhile, foreign investors are already investing in large public sector entities, multinational subsidiaries, and banks.

7.1.4 Domestic banks are best-placed to provide this SME funding, although there was also a suggestion that domestic institutional investors (e.g., pension funds) which are also currently only investing in government securities could also be incentivized to invest in SMEs.

7.1.5 Several recommendations for stimulating a "credit" culture in the banking sector and /or incentivizing banks to finance SMEs, were provided:

- Implement government policies that discourage banks from investing in safe government securities: "*by starving the banks of very attractive fixed rate government instruments ... the banks are going to be forced to look for and actually build a loan portfolio.*"
- Put in place programs to educate banks about debt financing.
- Stimulate increased competition amongst banks, which could be achieved through consolidation, which has been successful in Nigeria.
- Consider changes in banks' capital structures: including raising the minimum capitalization requirements in order to develop new, higher

capital market niches that could lend at a larger scale. (This has proven politically sensitive in at least one country.)

7.2 Local banks and financial institutions need both technology and skills transfer in order to compete adequately with international banks and service the growing local capital markets.

7.2.1 Local financial institutions need to improve their risk management and credit analysis capacity. IT capacity is necessary for information sharing and transparency. The lack of easy access to data is a significant impediment to foreign investors and inhibits local institutions from being able to fully support the development of the local capital markets.

7.3 Very targeted, practical skills training for local firms would be beneficial.

7.3.1 Participants suggested that very targeted, practical skills training for local firms, for example, in "how to draft a business plan," or "how to submit a credit application to a bank," would benefit private sector firms.

7.4 Domestic corporate bond markets provide alternative funding sources for local firms and opportunities for infrastructure finance.

7.4.1 While some banks and corporations have been able to access foreign capital in the international capital markets, participants recommended that developing the domestic corporate bond markets should be a priority. Developing domestic corporate bond markets provides local firms with alternative financing options (to the banking sector) and provides foreign investors with assets. Robust local bond markets could also provide a local currency alternative for project financing.

7.4.2 Impediments to the development of African corporate bond markets must be addressed in order for their full potential to be realized. These include:

- (a) **Regulation and tax.** The approval process for issuing corporate bonds is complex, lengthy and very costly, especially in East Africa. In some countries, a bank guarantee is required to issue bonds. Tax discrepancies between government bonds and corporate bonds are seen as hindering the growth of the corporate bond market.
- (b) **Culture.** Many SSA corporates are not culturally attuned to debt financing on the capital markets and still see bank loans, rather than bonds, as the preferred means of raising money. There is also skepticism about the sustainability of financing on these markets. A cultural change is needed to alter these preferences and address this skepticism.
- (c) **Liquidity constraints.** Foreign investors need greater liquidity in corporate bond markets. One suggestion for stimulating liquidity in the on-shore markets was to develop a cross-currency off-shore market in the same assets thereby creating arbitrage opportunities wherein the "two

pools of liquidity could feed off of one another." International banks can encourage these onshore/offshore flows through structured note programs that would also offset the limitations of small transactions.

7.5 Foreign investors can play an essential role in financing the domestic private sector through the capital markets (via debt or equity instruments), or through private equity.

7.5.1 The point was underscored several times during the Workshop that debt and equity instruments have different risk-sharing characteristics and different costs, which should be considered by those in the domestic private sector seeking financing.

7.5.2 Re: debt: There was some concern amongst participants that debt investors are viewed as "hot money speculators" and discouraged in certain markets (in favor of equity investors). They suggested that lack of liquidity in the corporate bond markets made nearly all debt investors in Africa "buy-and-hold" investors, and the return expectations of debt investors are more modest. Again, more education about debt markets was proposed as a solution for addressing this bias.

7.5.3 Re: equity: It was noted that equity markets are attracting foreign investors, in particular as corporate accounting and disclosure standards in many SSA countries are improving. However, as one participant observed *"most African equity markets are still small and illiquid."*

7.5.4 Re: private equity: Several participants underscored what they considered the appropriateness of private equity investment in the African context for providing *"risk properties that actually match the circumstances of investing in a high risk environment, and make that risk explicit."* It was further suggested that the model provided by venture capital funds, which take substantial direct equity stakes in African companies, is a good one to follow, to the extent that they feel a responsibility to be involved in management.

7.6 Weaknesses in disclosure and accounting standards, the legal framework, and capital markets infrastructure prevent full-scale engagement of foreign funds.

7.6.1 The Workshop participants identified several obstacles to investment in the private economy from their perspective:

- (a) ***Standards of disclosure, due diligence and accounting must be improved.*** Although several private sector participants pointed out that there have been many improvements recently, for the most part, disclosure, accounting and due diligence standards of domestic institutions are not up to international standards. It was noted that in many cases these were designed to satisfy local auditors and not foreign investors. Asset-based (collateralized) lending has also not resulted in a

culture of disclosure within local firms. As such, local accounting practices and lower disclosure standards remain major obstacles for international investors investing in Africa.

Workshop participants largely agreed that African governments and IFIs should focus on policies to promote improved accounting and disclosure standards for local companies and banks. (In relation to this point, it was noted that further, "...*improved disclosure and due diligence standards will foster a more transparent system and eliminate the procurement policies that often play into the hands of a small group of banks and 'connected' parties, stifling competition in the local banking sector.*")

- (b) ***A legal framework that protects investors is necessary.*** Legal reforms underpinning financial sector reform are necessary to gain foreign investor confidence. There should be a focus on improving and developing further the investment environment, including (i) prioritizing corporate governance issues, (ii) increasing recognition of creditor's rights, (iii) opening access to the courts, (iv) addressing land tenure/title issues, (v) outlining efficient bankruptcy procedures, (vi) establishing a framework for the recognition and registration of security interests, and (vii) developing tax incentives to promote investment via the market.
- (c) ***Market infrastructure and transaction costs.*** As discussed in Section 5 (Local Markets), it is important to improve capital markets infrastructure, in particular as regards custodial services, in order to support increased foreign sector investment in the domestic capital markets. It was noted that more competitive custodial services would also reduce capital market transaction costs.
- (d) ***Lack of sovereign benchmarks; corporate ratings.*** Participants pointed out that the lack of sovereign benchmarks, coupled with a lack of corporate ratings across the board in Africa, may hinder investment in African corporates as investors often gauge corporate pricing using a sovereign benchmark. However, in a few cases (Nigerian banks, for example), it has been the private entities that have accessed international capital markets ahead of the sovereign. While this "tail wagging the dog" has worked in these limited cases, participants were not sure of what the implications of this would be for attracting foreign funding of the corporate sector more widely.

7.7 Opening channels of communication between foreign investors and domestic market participants will assist in encouraging investment.

- 7.7.1 One participant pointed out the need for and benefits to be gained from improving communication between international investors and local investors and actors. The African Venture Capital Association was raised as a model initiated by the private equity community to help bridge the information gap between

international and potential local participants. It was suggested that creating an "African Capital Markets Association", through which local and international investors could liaise, would boost awareness about local capital markets within the investment community and facilitate information exchanges.

7.8 The public sector can support the African private sector by: (i) using funds in innovative ways to leverage private capital into the private sector; (ii) supporting listings of African companies on developed stock exchanges; (iii) on-lending in local currency to stimulate liquidity in the local economy; and (iv) supporting government reforms.

7.8.1 The public sector can introduce private funds into the domestic private economy by developing innovative mechanisms to support these investments. The Overseas Private Investment Corporation (OPIC) initiative to provide financial support for private equity funds focused on Sub-Saharan Africa is a good example of this. (*For further information, see <http://www.opic.gov>.*)

7.8.2 In addition, governments in the developed markets could support listings of African companies on their stock exchanges. Developed country regulators could play a role in assisting African companies by ensuring they do not encounter insurmountable regulatory burdens if they wish to list on developed country equity markets. As one public official stated, *"It remains exceedingly difficult for companies from less developed countries to tap capital markets in more developed countries. A possible model to follow would be the London Stock Exchange Alternative Investment Market. That allows smaller companies to list shares under terms and conditions less strict than other securities markets. This would provide equity investors in Africa with more opportunity to exit which for the majority of lenders is just as important as being able to enter."*

7.8.3 IFIs can stimulate liquidity in the local economy by on-lending in domestic currencies (the Eichengreen-Hausmann proposal). Both the IFC and AfDB have begun to on-lend in local currency, but noted that a challenge to on-lending is having readily-identified investments that the funds can be placed towards.

7.8.4 The public sector can support government reforms. For example, it was noted that Kenya and Ghana were among the "Top Ten Reformers" in the WB *Doing Business* indicators in 2007. This WB initiative is useful as it helps African governments identify what specific area of reforms can be targeted for improvement. Furthermore, as Ghana and Kenya are acknowledged for their reforms and become increasingly attractive places for foreign investors to do business, they exert peer pressure on other countries to also introduce reform.

SECTION 8. IMPROVING PUBLIC-PRIVATE SECTOR COMMUNICATION AND COOPERATION

African economies' transition from concessional finance to the opportunities presented by private sector financing can be facilitated by better communication and cooperation between the public and private sectors. However, opportunities for communication and cooperation are currently limited. Furthermore, perceptions of mistrust still inhibit public-private sector relations, impeding information sharing and, ultimately, policy transformation.

INTRODUCTION

- Negative perceptions amongst private and public sector participants and a general lack of trust continue to impede cooperation between the private and public sector. Cooperation is essential for establishing new roles for and relationships among the sectors that are necessary for an effective engagement of private funds. At present, there is little opportunity to improve perceptions as there are few avenues for communication between the private and public sectors, let alone frameworks for cooperation. Overcoming these negative perceptions is imperative to moving forward in partnership effectively.
- While of course not every member of the private sector or public sector shares every complaint that was raised during the Workshop, examples of the negative perceptions that trouble public-private sector relations are provided throughout the Report. Below is a synopsis of these frustrations and concerns from the perspective of the private sector, on the one hand, and the public sector, on the other.
- **Private Sector Perceptions.** The private sector raised several points of contention with the public sector during the Workshop, particularly with respect to: (i) the lack of transparency in the way the public sector works, generally; (ii) the perception that its attempts to finance African sovereigns are viewed with suspicion; and (iii) the perceived competition in the provision of finance, particularly in the area of infrastructure.
 - *Lack of transparency in the way the public sector works.* Lack of policy transparency was raised in several contexts during the Workshop, including: (i) Paris Club deliberations and decisions about debt relief and burden sharing; (ii) decisions about what is permitted in terms of non-concessional borrowing for African governments; and (iii) Debt Sustainability Frameworks, generally. A central problem, from the point of view of the private sector, is the perception that the private sector does not have access to the policy processes through which concessional finance ceilings are established and debt management frameworks designed, or to the data upon which Debt Sustainability Analyses are produced.

- *Suspicion.* There is also a perception that the public sector views private sector motives with suspicion, more so with respect to Africa than other parts of the world, and that some policies are aimed at limiting private sector activity rather than facilitating it. As one private sector participant noted, *"financial market liberalization and the growing role of the private sector present policy risks and challenges, and legal and regulatory risk, in any emerging market anywhere in the world, but the off-shore private sector in Africa in particular raises eyebrows and suspicions."* The very time-consuming public sector policy focus on the activities of a few distressed debt funds, or vulture funds, which most in the private sector view as "bit players", also perpetuates the belief that the public sector is only focusing on a few controversial aspects of private sector involvement rather than fully engaging with the private sector.
- *"Crowding out."* As discussed in Section 6 (Infrastructure Finance), there is also the perception that the public sector, which is better placed to receive information due to its double role as advisor and lender, is at worst, competing with the private sector, or at least missing potential opportunities to partner with the private sector in the area of infrastructure finance.
- **Public Sector Perceptions.** The public sector side also voiced frustration and concern. There is a great deal of worry that investors' search for yield is drawing them towards Africa without regard to the realities on the ground, and a suggestion that it is the commodity price boom and excess liquidity, rather than the desire to make a long term investment commitment to Africa, that is driving the current interest. The public sector has spent a great deal of time and granted a great deal of debt relief to many African countries, and does not want to be left to pick up the pieces if they permit the private sector unfettered opportunity to lend. There is concern that *"too much money is chasing too few opportunities,"* a scenario that has led to debt crises in the past. The public sector's lack of confidence in the private sector stems in part from the private sector's lack of clear leadership.

It was noted that the private sector, although notoriously heterogeneous and difficult to organize, can coordinate itself through organizations such as EMTA or the IIF. However, general obstacles to discussing issues directly with the public sector include the lack of adequate formal forums for communication and the absence of vehicles for cooperation.

DISCUSSION

8.1 Existing channels for the discussion of debt relief between creditors and countries (e.g., the London Club for commercial creditors and the Paris

Club for bilateral creditors) work, if imperfectly; however, more effective dialogue as between creditors would be useful.

8.1.1 The IIF has in the past played a role in coordinating dialogue between commercial creditors and the Paris Club on issues of comparability and burden sharing. This kind of dialogue is useful, but as one participant mentioned, *"There is a feeling that the sort of semi-annual meetings that the Paris Club organizes have perhaps become a little tired in their format."*

8.1.2 A forum to bring commercial creditors into discussions about additional debt relief and commercial buy-backs of remaining commercial loans at risk of litigation does not currently exist and could be useful.

8.1.3 Greater policy transparency in the operation of the Paris Club with respect to how determinations on debt relief are made was requested by a number of private sector participants.

8.2 More regular forums for communication between the public and private sectors would allow the two sectors to trade concerns and update one another on activities in order to build trust and improve policy transparency.

8.2.1 Participants observed that there were few contexts in which the private and public sectors could meet and agreed that more were needed, noting that current frustrations stem from lack of dialogue. Creating opportunities for more regular meetings between the sectors could improve perceptions and over time build trust.

8.2.2 It was noted that MDB annual meetings are underutilized by the private sector to meet with public sector representatives as part of the larger private investor community (and not just as representatives of their individual institutions) and bring issues of substance to the table.

8.2.3 One suggestion was that private sector participants themselves, or private sector organizations such as EMTA or the IIF, could coordinate dedicated private-public sessions to be held around the annual meetings of the AfDB.

8.3 Regular or *ad hoc* forums in which private sector knowledge and expertise can be shared with the public sector would be useful for both technical assistance and policy design.

8.3.1 Participants agreed that there is ample scope for dialogue and cooperation in the area of technical assistance and in some cases, policy design. Currently no vehicle or mechanism exists to facilitate regular cross-sectoral exchanges and robust cooperation.

8.3.2 The Workshop discussion of the obstacles facing development of SSA local markets was highlighted as an example of private sector experience and

perspective that could be useful to public sector policy makers. The Workshop presented an opportunity for public sector representatives to hear private sector concerns and to carry them to their own institutions. This type of exchange could be useful in other areas.

8.3.3 A public sector participant noted that the World Bank has considered assembling a private sector advisory group through which information could be shared. This advisory group was envisioned as being "informal but organized", and meeting periodically. Participants suggested that more thought should be given to developing this type of mechanism.

8.3.4 It was also suggested that the public sector could use the websites of organizations like EMTA or the IIF to communicate with the private sector, for example, to send invitations to participate in advisory groups, or to provide information about and seek feedback on current public sector programs.

8.4 The Debt Sustainability Framework design process would benefit from public-private sector dialogue at the framework level.

8.4.1 Private sector-public sector dialogue at the framework level is necessary in order to address the assumptions implicit to the financial models that inform Debt Sustainability Framework (DSF) assessments at the country level.

8.4.2 There was also agreement that having a public forum to explain the DSF to investors would be helpful to both the IMF/WB and the private sector as it would provide the opportunity for the groups to discuss/debate: (i) whether the assumptions that are made in the baselines are always the right assumptions; (ii) if market participants in general find this kind of analysis to be useful to them in their information searching and pricing of markets; and (iii) how the analysis is done and for what purpose it is used.

8.5 A mechanism to coordinate participants and facilitate public-private partnerships between the public and private sectors, and in coordination with African governments, needs to be developed.

8.5.1 There appears to no framework in which to coordinate participants and design public-private partnerships, either between the public and private sectors, or in coordination with African governments. A public sector participant accepted that the private sector was often invited to participate in financing opportunities "*late in the process, and often only on partial information*", and acknowledged that more information sharing is in order.

8.5.2 At the transaction level of private-public partnerships, a participant acknowledged that what was needed was not for each sector to bring the other into existing transactions, but instead as discussed in Section 6 (Infrastructure Finance) to have sufficient "on the ground" cooperation and expertise to be able to identify at a national level what the strategic priorities are and where there is scope for co-financing of projects.

8.5.3 A meeting dedicated to developing a mechanism to facilitate public-private partnerships in the infrastructure context would be useful.

8.6 A formal process through which the private sector and African governments can interact and seek approval from the IMF for non-concessional financings, is needed.

8.6.1 No formal process for seeking approvals with respect to non-concessional transactions currently exists. As a result, it appears from the perspective of the private sector that *ad hoc* and arbitrary decisions are made from country to country and that the decision-making process lacks both consistency and transparency.

ANNEX A

More exchanges between the private and public sectors on the use, applicability and relevance of the IMF/WB Debt Sustainability Frameworks would make that tool more useful in preventing an unsustainable debt build-up.

- The IMF/WB DSF is designed to help ensure that public sector lending does not negatively impact debt sustainability. The DSF provides a forward-looking assessment on the risk of debt distress in low income countries and offers insights into the risks of new borrowing and lending.
- The IMF/WB have already started outreach on the DSF with export credit agencies from OECD countries and with emerging markets countries like China, India and Brazil, who are entering the picture as bilateral lenders in Africa. The IMF/WB also encourage African governments to make sure that they consider any assistance that comes from China and any other emergent lenders in the context of the sustainability framework.
- With respect to outreach to the private sector, there was clear consensus that more promotion of the DSF generally is needed, and more candid exchange is needed about the usefulness or relevance of the DSF from their perspective. Currently, to the extent that private sector participants are aware of the DSF analyses prepared by the IMF/WB, opinion is divided as to their usefulness or relevance.
- There is a view that *"the DSF is a bit controversial but ... it is very sensible, it is very flexible, it is very useful, however it ought to be marketed better, it ought to be promoted very highly. ... [M]ore clarity with regards to how it is applied will be very welcome and would help capital markets desks across the Street and across the City to do their jobs more effectively."* Others explained that they had only very recently become aware of it, echoing requests for better marketing of the product.
- The controversy with respect to the DSF stems from the fact that the baseline assumptions do not reflect any transition away from concessional lending over a very long period and therefore do not anticipate any role for private sector financing.
- An example was given of a DSF report for an African country that has as its premise an *"unchanged fiscal deficit financed by an unchanged assumption about the pace of concessional financing for the next 20 years."* The private sector participant mused that the private sector reads the DSF report *"in the context of gradually destabilizing a central assumption of the report"* and further explained *"if we are precluded from the assumption from playing an integral role*

over the next 20 years, it is difficult then to expect us to be paying serious homage to these analyses however useful they are as a research exercise."

- It was also remarked that debt sustainability was but one area of concern, and not the priority of investors when analyzing whether or not to invest *"as compared to things like political risk, financial stability in a broader context, commodity markets and so on."*
- Another criticism stemmed from the private sector's inability to independently stress test the DSAs due to lack of access to the underlying country data: *"we can read the conclusions and enjoy the prose but we can't do our own analysis of the same underlying data."* The constraint in this regard is the IMF's confidentiality agreements with governments; however, it was clarified that *the release of data is at the discretion of the country who supplied that data.* Therefore, the private sector can insist that countries become more transparent and share the same information with them (most usefully on a site like Bloomberg, as some countries like Ghana are doing), which would allow the private sector investors to do their own analysis. It was further pointed out that the private sector should demand this level of transparency and reward countries for cooperating.
- Finally, there was clear consensus that public-private sector dialogue would be quite helpful at the Framework level, generally. There was also agreement that a public forum to explain the DSF to investors would be helpful. (See Section 8.)

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