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Financing for development: hearings with the business community, 11 and 12 December 2000

Summary of panel presentations and discussion

Summary

In its resolution 54/279, the General Assembly decided that the Preparatory Committee for the High-level International Intergovernmental Event on Financing for Development would hold two sets of hearings with civil society organizations and the business community to consider their views on areas of the financing for development agenda. On 11 and 12 December 2000, business hearings were held in New York; the present document summarizes the presentations made by 17 senior business representatives, and provides a synopsis of the dialogue among delegations, speakers, international agencies, civil society and other business representatives.

The main areas of discussion were:

(a) Mobilizing domestic financial resources for development (sect. I);

(b) Foreign direct investment, project finance and venture capital (sect. II);

(c) Other private capital flows (sect. III);

(d) Trade, systemic and other issues (sect. IV).

The statements made at the hearings are available on the Internet at:

http://www.un.org/esa/ffd/NGO/1200hear/panel_list2.htm

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I. Mobilizing domestic financial resources for development

Moderator:

Jørgen Bøjer (Denmark), Co-Chair of the Preparatory Committee

Panellists:

John de Wit, Managing Director, Small Enterprise Foundation, Northern Province, South Africa

Chulakorn Singhakowin, Chairman of Thai Bankers Association and President/CEO of Bank of Asia Public Company Limited, Bangkok

Victor Valdepenas, President, Union Bank of the Philippines, Manila

Hernan Somerville, Managing Director and Shareholder of Fintec, Santiago

Supportive regulatory policies for microcredit

1. Mr. de Wit presented recommendations on government policies that are supportive of the development of microcredit. His discussion was based partly on the experience of South Africa, and more specifically on the experience of the Small Enterprise Foundation. The Foundation is a South African microcredit organization targeting the rural poor, focusing on financing microenterprises, with a mission of eradicating poverty. Only about 10 per cent of clients expand beyond the microenterprise level and leave the informal sector.

2. His first recommendation highlighted the importance of relaxing general restrictions on lending activities and raising interest rate ceilings on microcredit loans. The latter should be permitted to be 75 to 100 per cent above the prime lending rate. Protection of borrowers from exploitative charges can be accomplished by instituting consumer protection measures. At issue here is the sustainability of microcredit organizations, which depends on the ability to charge interest rates that are adequate to cover high operating costs and provide a small profit.

3. The second recommendation stressed the development of savings and insurance services for the poor, which are needed to reduce their vulnerability to shocks and large life cycle expenditures, such as weddings and funerals. In many countries, savings services for the poor are provided by postal savings system. This function should be preserved while other institutional arrangements are being developed.

4. Mr. de Wit also emphasized that the Government needs to implement policies to create a supportive environment for the development of microcredit. These should be based on a long-term strategy, with a time horizon of 10 years, which recognizes the need to develop the requisite skill. The strategy should aim to strengthen existing microcredit organizations and create a number of new institutions so as to establish a critical mass of viable institutions that can produce large-scale delivery of services. The process should be free of political interference or politically driven delivery objectives. The Government should also provide funding for the development and expansion of microcredit institutions and accord priority to such expenditure.

5. Mr. de Wit underscored the fundamental difference between the business of commercial banks and that of extending microcredit. Therefore, he cautioned against pressuring commercial banks to enter the microcredit field. Rather, he favoured focusing on facilitating alliances between banks and microcredit agencies, with an emphasis on developing transparency and strong governance of the latter to make them good clients for commercial banks.

Dialogue

6. In response to questions from participants, Mr. de Wit attributed the disincentive for commercial banks to be involved directly in microcredit to the lack of collateral and formal accounting records in microenterprises, which increases their riskiness as clients.

7. On the desirability of government funding of microcredit organizations, some participants differed from Mr. de Wit, pointing out the risks of corruption and government and/or Central Bank restrictions on operations. Participants also discussed the possible role of donor Governments and international organizations in the development of microcredit. Mr. de Wit alluded to a loan that the Small Enterprise Foundation secured from a Dutch bank with a foreign exchange risk guarantee provided by a Dutch government-funded organization. In addition, he cited successful cases of direct funding by bilateral donor agencies, where they identified and funded local microcredit organizations perceived as potential “leaders” or “winners”.

Financial restructuring in Thailand

8. Mr. Singhakowin's presentation focused on the progress of financial sector restructuring in Thailand and further measures that are necessary to expedite the process. The financial crisis, which erupted in 1997, was the result of a long period of high investment and rapid economic growth, supported by strong expansion of lending by domestic banks and offshore borrowing. Some of the easy financing fuelled speculation in real and financial assets, resulting in a sevenfold increase in the stock market index and a quadrupling of real estate prices in the decade preceding the crisis.

9. As a consequence of massive deposit withdrawals and loan defaults in the wake of the financial crisis, the share of non-performing loans in the banking sector increased to 48 per cent of all loans by mid-1998. A large number of non-bank financial institutions and a number of commercial banks failed. In response, the Government committed to a market-led strategy to restructure the sector. This involved efforts to assist financial institutions in restructuring, including the strengthening of regulations; reform of institutions and the legal framework for settling insolvency and bankruptcy; creating an agency to assist in debt restructuring; and tax adjustments to enhance the process. Bank regulations were tightened to force recapitalization of the remaining institutions. Restrictions on foreign ownership of Thai banks were eliminated to allow full foreign ownership in order to facilitate the inflow of capital to the sector.

10. These measures have resulted in consolidation of the sector and greatly reduced the likelihood of more bank failures. However, lending activity in the sector has not been revived because of the need to increase provisions for a still very high level of non-performing loans (30 per cent). The slow pace of clearance of non-performing loans can be attributed to the still inadequate institutions and legal framework for resolving problem loans or preventing new defaults, which has in turn deterred prospective domestic and foreign investors from placing new capital in the sector. Further strengthening of the institutions and legal framework to resolve bad loans in a manner that creates a better balancing of risk-sharing will be needed to promote the recapitalization of banks.

11. In response to the slow progress in recapitalization of banks, there has been increasing support for greater intervention by the Government through the creation of a national asset management company that would purchase bad loans from the banks. However, there are the issues of the fiscal burden and moral hazard that such a measure can generate.

12. In addition, Mr. Singhakowin pointed to the need for further consolidation of the sector through market-based mergers and acquisition, including by foreign banks, which would entail the revision of current regulations that are restrictive in this regard.

Dialogue

13. Participants discussed the dominant role of bank financing in Thailand and the prospects of enhancing other financial institutions for financing, such as domestic bond and stock markets. Mr. Singhakowin indicated that the stock market in Thailand is currently moribund, while the bond market is still insignificant in amount of funds raised but is growing rapidly.

14. There was also discussion of whether the large-scale entry of foreign banks could transfer technology and introduce a different culture of risk management to domestic banks. Because the presence of foreign banks is still small — about 10 per cent of the sector — it is too early to judge their impact in this regard since technology can be transferred quickly but corporate culture only gradually.

New dimensions on the Asian financial crisis and lessons for domestic policy makers

15. Mr. Valdepenas highlighted the differences between the underlying risks in the Asian financial crisis and those in previous financial crises. He then drew lessons for policy makers with regard to the financial policies and mechanisms needed to manage the new risks.

16. He identified exchange rate risk and interest rate risk as the new financial risks that emerged in Asia in the 1990s. He attributed their origins to trade and capital account liberalization in the regional economies and financial globalization, which resulted in increasing international borrowing by corporations and banks in the region. Consequently, these new risks in addition to credit risk became concentrated in the private sector. Once the crisis erupted, analysis and response was full of flaws. The lack of instruments to confront it also became evident.

17. In the aftermath of the crisis, the framework for resolution of the debt overhang in the private sector is still being worked out since the issues are fundamentally different from those of balance of payments crises emanating from the public sector. The damage was deep, and countries are still coping with corporate bankruptcies and a massive debt overhang. In addition, monitoring for early warning of impending crisis under these circumstances was more difficult because of a lack of certain financial data, particularly at the sectoral or firm level.

18. Mr. Valdepenas underscored the need, therefore, for new data and analytical tools to improve the understanding and management of these new risks, including management of international reserves and monitoring of corporate debt structure. He also emphasized the need for strengthening financial mechanisms for better risk management, such as improvement of the hedging instruments for foreign exchange risk. Management of international reserves should look farther than import financing requirements to include capital account consideration. During crisis, discouraging short-term capital, particularly foreign exchange speculation (transactions that are not the counterpart of trade or a required payment), is essential.

Dialogue

19. There was discussion of the effect of "herd behaviour" among international investors on the massive withdrawal of capital from Asia. There were differing views on whether even with the appropriate information there would have been a more orderly exit of investors.

20. Participants also raised questions about the deep impact of the crisis on unemployment and poverty and the need for social safety nets. There was discussion concerning the institution of a foreign exchange transaction tax that could be increased in a crisis. There were differing views on its effectiveness as a deterrent to volatile international financial flows. Some participants believed that only a very significant tax rate could effectively change risk assessment by speculators.

Pension reform in Chile

21. Mr. Somerville presented the experience of pension reform in Chile, which was instituted after the collapse of the previous publicly administered "pay-as-you-go" social security system in the late 1970s.

22. In the previous system, the level of funding was dependent on the ratio of contributors to beneficiaries. Moreover, there was no relationship between contributions and benefits. As this ratio deteriorated rapidly in the 1970s, owing largely to demographic factors, funding declined sharply.

23. The basis of the new system put in place in 1980 is the privately administered compulsory individual contributory account, with a government guarantee. This guarantee provides a minimum level of pension to individuals with 20 years or more of contributions if their account collapses. The Government is also responsible for supervision of the system and providing incentives for savings in the voluntary account, which augments the individual's pension fund. There is, however, individual choice of the agent administering the account, the form of benefits — as an annuity or a defined schedule of payout — and age of retirement. The system currently covers 60 per cent of the workforce, with coverage of 95 per cent of employees but only 10 per cent of the self-employed.

24. Funds in the pension have grown rapidly to $35 billion, equivalent to about 50 per cent of gross domestic product (GDP), with 322,000 pensions paid out by the end of 1999. The investment allocation of the pension fund is regulated by the Government, with a substantial proportion invested in bonds issued by banks and Central Bank notes. Funds from the system have enabled banks to finance long-term loans for mortgages. A minority of the funds is invested overseas and in domestic private bonds and stocks. Returns on investments averaged over 11 per cent in real terms annually until the end of 1999. The cost of managing the funds is about 1 per cent of funds under administration. While the number of administrators is limited by regulations to eight, they are not a cartel but are regulated by the Central Bank.

Dialogue

25. There was discussion on the transition to the current system, when the Government had to take over the obligations of the previous system, which amounted to about 7 per cent of GDP and represented an onerous burden on the budget, particularly in the early 1980s when the deficit was large. Some wondered whether many developing and transition economies could

handle the demand on fiscal resources of such a transition.

26. Some participants raised questions about why the system had to be privatized and whether a restructured publicly funded system could have worked just as well. Concerns were expressed about the limited coverage of workers in the current system.

27. There was also discussion of the benefits of the new pension system. Mr. Somerville emphasized its positive impact on savings mobilization and economic growth in Chile; he attributed a large part of the rise in savings rate in Chile in the 1980s and 1990s to the implementation of the new system. He also indicated that the system has effectively channelled domestic savings to investment in domestic companies. In addition, a good working social security system is the best safety net. A similar system has been adopted or in the process of being adopted in many Latin American countries and other countries, such as Poland.

II. Foreign direct investment, project finance and venture capital

Moderator:

Asda Jayanama (Thailand), Co-Chair of the Preparatory Committee

Panellists:

Kenneth Rind, Founding General Partner, Israel Infinity Venture Capital Fund, New York

Andre Van Heemstra, Director, Unilever, Rotterdam

Beatrice Rangel, Senior Adviser to the Chairman, Cisneros Group of Companies, Caracas

Rodney Harper, Director, Alcatel, Paris

Thomas Marshella, Managing Director, Project/Infrastructure Finance, Bank Loan Ratings, Moody's Investors Services, New York

Encouraging venture capital in developing and transition economies

28. Mr. Rind outlined the growth of venture capital in the United States of America and Israel, identifying specific benefits from the industry and drawing lessons for other countries. Between 1979 and 2000, United States venture capital operations went from a $1 billion activity managed by 25 funds, with $0.6 billion invested in 300 companies, to a $120 billion industry managed by over 1,000 venture funds, holding $110 billion in 7,000 companies. The United States promoted this growth by lowering taxes on long-term investments; permitting pension funds to invest; facilitating market exits for shareholders; offering technology incentives; cutting down military spending and taxes; opening up university laboratories to collaborative research; and welcoming foreign entrepreneurs.

29. In 1986, Israel had two venture capital funds worth $30 million operating amid state socialism, government hostility to business and brain drain to the United States. It had world class military technology but just one world class commercial firm and a handful of foreign-owned research and development groups. By 2000, there were 150 venture groups managing $6.5 billion through 4,000 new companies, over 100 with international portfolio offerings overseas. The vitality of Israeli firms was reflected in acquisitions by dynamic multinationals, such as Microsoft, Cisco, Intel, Siemens and Marconi, and in investments from premier sources, such as Telecom Italia, Credit Suisse, Ericsson, Singapore and Hyundai among others. The Government promoted this expansion by directly stimulating the development of Israeli high-technology firms. Measures ranged from up-front repayable funding for new research and development, United States-Israeli seed funding for industrial projects and government start-up support for technology incubators to tax holidays and avoidance of double taxation on outside investors. The immigration of highly skilled citizens from abroad (especially the Russian Federation and the United States) was a significant boost. The important messages for Governments in other countries were: build strong educational infrastructure, encourage university-industry collaboration, promote foreign research and development activities, attract corporate strategic investors and establish policies allowing entrepreneurs to thrive.

Dialogue

30. Participants asked whether the inflow of capital from United States markets and the influx of skilled human resources from the United States and the Russian Federation did not make Israel a special case. What, in the absence of such atypical assets, would an Argentina, a Brazil or a Chile have to put in place to

jump start venture capital? In addition, was the case of India and its software industry not more relevant for developing countries? Mr. Rind acknowledged that the Russian Federation in particular had provided a rich flow of human resources, but Israel's two world class universities had also played a key catalytic role. Countries should promote university-industry partnerships and offer qualified expatriate nationals incentives to return, including research and development support, tax breaks and capital equipment support. He thought such countries as India had made considerable progress in encouraging investment in new economy industries and could do more with better incentives, for example by eliminating confiscation policies.

31. In response to questions about how activist venture capitalists are as shareholders, Mr. Rind pointed out that, typically, a venture capital fund would take a board seat on the basis of investing between one sixth and one third of equity in a firm.

Corporate criteria for investing in developing country markets

32. Mr. Van Heemstra profiled his company's business policies and criteria for investment. Unilever is a multinational, multi-local company, with deep roots in the societies in which it operates, dedicated to conducting business in a responsible and sustainable way, including stimulating local employment, helping to raise levels of education and upholding environmental and labour standards in line with global corporate policies provided that countries enforce such standards fairly.

33. He stressed that Unilever appreciates the role foreign direct investment (FDI) plays in economic development. With 95 per cent of future population growth projected to take place in developing and emerging markets, along with 70 per cent of consumption increase, the company was expecting to see up to 50 per cent of future sales and investment concentrating on developing and emerging economies. As a long-term resource, FDI creates a stable virtuous circle of wealth, by supporting jobs (directly and indirectly), building local skills, injecting technology into the supply chain and catalysing local economic activity. For example, the company employs some 6,000 people in four South-East Asian markets through operations that indirectly support another 45,000 jobs. It provides skills and sets quality standards for local managers, employees and suppliers. By focusing on its core business, Unilever increasingly outsources non-core functions to local firms, providing them in the process with technology inputs and strengthening their competitive position. Yet FDI has its limits. It can neither compensate for a weak national education system nor supply more than a relatively small proportion of gross fixed capital formation in the economy.

34. Unilever, like other companies, invests in markets which exhibit (a) political and economic frameworks conducive to efficient business, and (b) good governance and political stability. Companies expect a level playing field and fair treatment from public authorities before the law, including through strengthened intellectual property rights. They look at progress in removing impediments to effective operations (tariff and non-tariff barriers) and restrictions on ownership and trading rights. They value markets that are open and regionally integrated, with skilled workforces. They count on countries to invest in good basic infrastructure. China's forthcoming accession to the World Trade Organization (WTO) will be a critical test of how the business and developing worlds can meet on new common ground. Ultimately, however, the right political and economic framework is a necessary but not sufficient condition. What firms most closely look for are growth potential and good rates of return. International investors will go where the balance between risk and return looks best.

Dialogue

35. It was suggested that the speaker had portrayed investment decisions as they might apply to doing business in, for instance, the Netherlands. Are investors prepared to go further to increase the scope for investing in developing and emerging markets? What extra steps would they take to develop host economies? A second participant asked whether a company could be a good corporate citizen alone in situations where its competitors were less constrained by their corporate ethics. Is it not time to consider some standard codes of conduct and international investment agreements to make good corporate citizenship more than voluntary? A third participant agreed that Unilever is known for its ethical business vision but asked to what extent the company institutionalizes its vision in the investment guidelines of its pension funds, which account for tens of billions of dollars in investment.

36. Other participants observed that the most critical determinant of FDI is often sheer market size, as illustrated by investor concentration on such countries as China and Brazil. It was asked under what circumstances Unilever invests in small markets. One or two commentators returned to the point that investors appear largely preoccupied with the supply side of FDI. FDI levels had increased but only for a few countries. For the more than 50 poor developing nations with good track records in economic reform and governance yet without significant FDI, the issue is how to shape the supply side to strengthen their absorptive capacity and thus increase demand. How, for example, could poor countries invest in infrastructure to attract investors in the absence of resources and available official development assistance (ODA)? Some way to break this vicious cycle and deepen the investment process must be found.

37. Mr. Van Heemstra underlined that Unilever does not take the hospitality of host developing countries for granted, illustrating his reply with reference to recent company activities in Viet Nam. Unilever remains committed to maintaining a positive dynamic with local small and medium-sized enterprises and to displaying corporate social responsibility in respect of local training, skills development and technology diffusion, as well as in matters of public safety, health and environmental standards. The motive for this approach is not charity but the practical recognition that businesses prosper in societies that prosper. On the question of widening corporate citizenship, the answer does not lie in restrictions imposed from outside. Social responsibility has to be an internal ethic voluntarily adopted by firms and discharged with conviction.

38. On guidelines for pension fund investments, Mr. Van Heemstra observed that such funds have only recently been liberalized and are still evolving their own investment criteria. Fund managers have different responsibilities and it is not possible to enforce a corporate vision on them. Market size, he acknowledged, is often a key factor for investors, and by going into large markets, such as Indonesia, Unilever captures economies of scale, leading to cheaper products for more people. Some small markets are attractive for other, operationally oriented reasons, and more could become so through policies of regional or subregional integration. In terms of deepening the investment process, Unilever does not consider the 7,000 jobs created in Viet Nam or 13,000 in Indonesia to be negligible for the people concerned. Nor should the other stimuli to local economies he had mentioned be overlooked. There is, however, a central challenge for the global community to address in helping poor countries to participate more equitably in globalization and its benefits, including FDI. This is a challenge that all sectors must consider and address together.

39. Lastly, one participant noted that while Unilever advocates good governance for countries, it apparently prefers self-regulation for corporations. What criteria does the company apply to social or environmental impact assessment, what auditing practices does it follow and how does it independently verify that community and shareholder interests are served?

40. Mr. Van Heemstra replied that when a company generates internal enthusiasm to live up to social and ethical responsibilities, the results are more effective. However, Unilever does actively underwrite its financial, social and environmental accountability through independent audits and through community-oriented thematic projects around the world in sustainable fisheries, sustainable agriculture and clean water development. It has also convened an internal environmental council and published occasional studies on its web site of how the company is living up to its statement of purpose.

Attracting FDI in developing countries

41. Ms. Rangel addressed what it takes to succeed as a private direct investor in emerging markets and what conditions facilitate FDI. Host country markets demand choice, quality, consumer rights protection and technology innovation. They expect products relevant to their needs and attuned to local markets. New investors should conduct a comprehensive dialogue with employees, stakeholders and society at large to explain their goals, opportunities, costs and time frames. Realism is important in clarifying expectations to partners. Employee incentives should be provided in the form of stock options, bonuses and most of all training, which is critical in the service sector.

42. Companies should listen to communities, allay their fears about change, and help them gear up to cope with the new economy. Education, especially in information technology (IT) skills, is a major popular priority. Business-government partnerships could help communities to catch up.

43. Outside investors expect macroeconomic stability, chiefly a stable currency and labour market, strong, effective government, competition policies ensuring a level playing field, evidence of institutional development, peaceful solutions to social challenges, and laws protecting consumers and investors. Investors look for good human capital and knowledge, which could be developed by building up local IT structures and deepening Internet penetration. The experience of the Cisneros Group of Companies shows that education is the most effective investment that both companies and Governments could make, and Ms. Rangel called on the World Bank, the Inter-American Development Bank and Governments to form partnerships for human resources development.

Dialogue

44. A number of questions were posed, including how decisive it is for developing countries to have competition policies given that some investors seek monopoly positions in local markets; how could FDI contribute more to the global financing for development agenda, especially in smaller countries, considering that today some 12 countries receive 80 per cent of all inflows, with more than 50 per cent going to only two big players, China and Brazil. The former had neither a competition policy nor significant consumer protection; how does the Cisneros Group define labour market stability? A free environment for trade unions? Dialogue with stakeholders?

45. Participants noted as well that while market size was evidently important, some smaller markets receive more FDI per capita. The challenge is to use technical assistance through intermediaries with proven private sector development experience in smaller countries, such as the International Finance Corporation (IFC), to build up their attractiveness to investors. It was pointed out that local human capital is essential to the quality, as well as quantity of investment. Participants also asked whether the Cisneros Group could illustrate some of the qualitative gains in terms of education, human rights and public freedoms, and whether increasing national capacity to manage local domain registrations for Internet expansion is a top priority in helping countries to benefit from the information revolution, which is changing the nature of property and wealth.

46. In response, Ms. Rangel replied that competition is key to protecting consumer choice and building local equity and trust, noting the long-term benefits of a country being able to choose, for example, between land-based and satellite telecommunication installations. She admitted that size undeniably makes China an attractive self-contained market, but felt that smaller countries could also earn their way by providing goods and services for the global economy. She stressed that a stable labour market is one where countries do not change the rules every day and companies make long-term commitments to human resources development. Two illustrations of FDI-related social investment in education came to Ms. Rangel's mind. By using free transponder space on the DirectTV satellite service for distance education, 2,000 teachers in rural areas of Latin America are upgrading their skills on the back of the entertainment industry. In addition, the Cisneros Group sponsors a non-commercial education channel that reaches 37,000 Latin American schools every day.

47. Ms. Rangel also accepted that there is scope to use technical assistance through a variety of sources, in addition to the World Bank and the Inter-American Development Bank (IDB), to empower educators, communicators and others and create an enabling environment for FDI, and that the provision of resources and know-how to develop information and communication technologies is a major priority for developing countries and is best managed through public-private partnerships.

Investing in technology in developing countries (bridging the digital divide)

48. Mr. Harper recalled that bridging the digital divide has been a top priority for decision makers at the Okinawa Group of Eight Major Industrialized Countries Summit. With 1 in 2 Internet users online in the United States compared to 1 in 250 in Africa, the scope for development was clear, notwithstanding some developing country worries about information security. The way forward is not to duplicate Internet applications as used in the North, which serves only niche markets in the South. Rather, it is to make the Internet a prime economic development tool, offering relevant end-user services and compensating for the lack of certain infrastructure (e.g., in transport, health, food supply and logistics). Mr. Harper illustrated this point with reference to a range of web-based neighbourhood end-user services in developing countries, and went on to suggest some key factors for

broader Internet take-off, including dedicated broadband access, much wider dial-up access and information content with strong local added value. Partnerships are another key factor. Governments, service and content providers, financial institutions, suppliers, NGOs and the United Nations should come together to generate project finance and create value-adding products in this major growth area. He noted that new entrants to the information and communications technology market have their own funding capabilities, and local private partners are strongly motivated to form start-ups.

Dialogue

49. One participant noted that information and technology initiatives, such as the Info-kiosk project in India, have shown that telecommunication networks could potentially address a very broad range of development needs in health, agriculture and other sectors. The challenge faced by active United Nations agencies, such as the United Nations Development Programme (UNDP), is how to scale up such initiatives. How could the financing for development process help focus attention on this specific challenge? Two participants asked what telecommunications firms expect from developing countries, for instance, by way of reducing barriers to wider Internet deployment in their societies, and what they expect from the United Nations.

50. Mr. Harper replied that the key answer is to take a partnership approach. The necessary factors for success are political will, well defined, sustainable projects, project financing and a willingness to share risks. Such companies as Alcatel are in technical design and operations. They need to be connected to Governments and other actors. The United Nations role is to bring prospective partners together as an honest broker in order to exchange contacts and ideas, facilitate discussion and promote a common mindset. Such players as the World Bank could build confidence in information and technology projects by participating directly themselves.

Debt financing of projects and infrastructure in emerging economies

51. Mr. Marshella explained that his specialization is project finance, not sovereign risk assessment. Debt-financed project analysis is a relatively recent discipline, focusing on guarding against the downside through independent judgement at a time when global demand (1 to 2 trillion dollars) far outstrips supply. Private investors supply about 71 billion dollars of such debt financing. These investors became central players when, during the buoyant mid-1990s, for various reasons emerging markets looked outside for capital. He went on to characterize the experience of debt investors, primarily United States institutional investors in loans and bonds, since then.

52. Some 70 per cent of Asian project debt rated during the mid-1990s has either been downgraded or had its outlook revised downward by Moody’s. Exactly half defaulted and of those that have not, only one is still rated investment grade. Project and infrastructure investors have since moved on to more mature economies, which have sought private debt capital inflows via asset sales and the restructuring of monopoly industry (e.g., electric power). These investors evidently perceive better risk-reward ratios outside of emerging economies.

53. Several factors account for this. Most debt-financed projects in emerging markets are denominated in local currency and are thus vulnerable to currency swings and devaluations. As Asian market fundamentals have weakened, opaque embedded risks that were once hard to monitor have emerged and exchange rate risks have predominated, changing investors’ perceptions and eventually causing them to depart. Today, hedging instruments are sought to counteract risks, but there remain questions how to finance projects going forward on this basis. It is also necessary in any emerging market to understand the important role of legal infrastructure to protect creditors’ rights. Investors are not averse to a level of risk, but the key question is to identify exactly where such risks reside and what can be done to reduce uncertainty. This is not possible in the muddy situation beforehand. These basic challenges must be addressed if private capital is to flow back to emerging market projects.

Dialogue

54. Discussion centred on the following questions:

(a) How should the international community bridge the gap between the United Nations world, which speaks of such goals as halving extreme poverty by 2015, and the world of finance, which emphasizes the complexities and high risks involved in doing business in developing countries? What two or three concrete measures should governments focus on to help reduce uncertainty and close the gap?

(b) Since it is clear that the transcendent quality of private capital movements puts it beyond government capacity to manage uncertainty, is there a way to encourage those who assess profitability to take a longer-term view of risks? Should not the opportunity costs of failing to provide financing to poor countries also be assessed?

(c) As there are questions about the objectivity of country ceilings established by debt financiers, is there a need for international standards to ensure that project risks are correctly assessed, as well as a global body to oversee those standards?

(d) Would not the cancellation of unrepayable developing country debt help lower uncertainty? Would ratings agencies oppose or support such cancellation?

(e) Should not such national assets as gold or valuable commodities (oil) be weighed positively when making risk assessments?

55. One participant observed that when a ratings agency, such as Moody’s, says “no”, it simply means that a project cannot be financed on commercial terms. Projects can in fact be financed as constructs from multiple sources through a range of instruments, from grants through to full commercial loans. Moody’s could offer countries a project analysis service to expose the weaknesses that other forms of finance are needed to address. It could also rate NGOs in the microcredit business to help them qualify for mainstream capital financing.

56. Mr. Marshella observed that, for investors, ratings are just one indicator. Ratings agencies are not arbiters. They provide reality checks, not endorsements of national policy. On the assessment of opportunity costs, it has to be grasped that debt financing is a contractual obligation and that investors want certainty. Time horizons for returns are not invariably fixed and, depending on other factors, could be longer term. On offsetting currency risks by putting aside valuable commodities (oil or gold), he agreed that this might be factored into certain projects that had structural integrity provided that the commodity was denominated in the same currency as the loan. On the correctness of risk assessment, he pointed out that agencies rate risk on a relative as well as absolute basis and that country ceilings are a relevant factor. Agencies also provide the market with supplemental information that investors additionally consult. On such issues as debt cancellation, he stressed again that ratings agencies do not look to endorse particular policies or recommend special measures, which are the domain of Governments. They would, however, be glad to help countries to appraise the risks associated with project constructs along the lines previously suggested by one participant.

III. Other private capital flows

Moderator:

Ambassador Jørgen Bøjer (Denmark), Co-Chair of the Preparatory Committee

Panellists:

Cheryl Hesse, Senior Counsel, Capital International, Los Angeles

Francesco Anania, Associate Director, Structured Finance Department, Medio Credito Centrale, Rome

Yoshiyuki Fujisawa, Chairman of the Board of Directors, Industrial Bank of Japan, Tokyo

Hanns Michael Holz, Head of Global Public Affairs, Deutsche Bank, Frankfurt

Corporate governance in emerging markets: an investor’s perspective

57. Ms. Hesse referred to corporate governance as the interlocking sets of laws, regulations, corporate codes and judicial systems that govern the relationships among shareholders, directors and managers of corporations. Corporate governance codes or best practices guides have been adopted by many organizations, from stock exchanges, such as the Stock Exchange of Hong Kong, and intergovernmental organizations, such as the Organisation for Economic Cooperation and Development (OECD), to institutional

investors, such as the California Public Employees Retirement System. These codes identify three key characteristics of good corporate governance: transparency, equitable treatment and accountability.

58. Corporate governance has important implications for emerging economies, because the emphasis on good corporate governance appears to be spreading among investors as well as diverse groups around the world, such as the Asian Corporate Governance Forum, the Kenyan Private Sector Initiative for Corporate Governance, and the Republic of Korea's Participatory Economy Committee — People's Solidarity for Participatory Democracy. Germany has created a stock market that limits listings to companies that adhere to certain principles of corporate governance, and Brazil is investigating doing the same. And over 330 participants from 25 countries attended a meeting of the International Corporate Governance Network held in New York in summer 2000.

59. Several factors have contributed to the current emphasis of corporate governance, including the increase in privatization and the 1997 Asian financial crisis, which spread to other emerging markets. In many privatization instances, the liberalization of financial systems seems to have outpaced the development of sound corporate governance practices. The financial crisis that began in Asia in 1997 highlighted the risks of investing in countries with poor corporate governance. Individual companies failed, in part due to weak capital market regulation and failure to protect minority shareholders. These individual failures created uncertainty that quickly contaminated confidence in entire countries.

60. International investors have cooperated with developing nations' Governments to encourage reform. This mutual effort is an integral part of the globalization of world markets that both investors and developing countries will need to address.

61. Large investors in emerging economies, such as Capital International, are becoming more involved in highlighting the need for corporate governance reform. They recognize the need for continued and expanded dialogue on the issue of corporate governance — not only in emerging markets but also in developed markets. They also recognize that there is no single set of principles that will work for all nations: corporate governance reform must be undertaken within the context of local conditions, giving due regard to a country's corporate history and culture. While remaining committed to the process of improving corporate governance, they will also invest their clients' assets with due regard to the potential risks that corporate governance lapses bring.

Dialogue

62. Several interventions focused on the importance of corporate governance, including as a measure to reduce the cost and increase the supply of capital in developing countries. However, it is not a panacea for solving important needs of developing countries. Globalization of markets does not go hand in hand with globalization of opportunity, and the challenge is to harness equal development of both. In addition, the corporate governance field is still in evolution even in developed economies, with social responsibility increasingly taken in consideration, at times at the request of clients. For instance, the California Public Employees Pension Fund, a large United States pension fund, has recently introduced human rights conditions to its international investments. Still, economic and financial considerations remain the critical parameter for investment decisions. Debt cancellation is an example of shareholders' interests uneasily squaring off with stakeholders'.

Private capital flows to developing countries

63. Mr. Anania mentioned that Medio Credito Centrale (MCC) operates both as an investment bank specialized in project and export finance and as a development bank managing all concessional loans to developing countries on behalf of the Italian Government. Mr. Anania described different ways, illustrated by concrete examples, in which MCC's dual role can stimulate foreign investments to developing countries.

64. As an investment bank, MCC executes both project finance and corporate finance operations. The former activities generally involve large investment projects in selected sectors, such as infrastructure, energy, petrochemicals, telecommunications and environment. The contractual structure of these transactions aims to spread risk evenly among project participants (public sector, private investors, lenders, contractors, purchasers, suppliers, operators). A successful project can attract private flows in the form of equity from shareholders and private investors; bond issues from the private market; and subordinated loans

and standard commercial loans from the lenders. Mr. Anania illustrated these types of project with the examples of a steel factory in Egypt, a power plant in Pakistan and a power plant in Morocco.

65. The second type of operation — corporate finance — can attract private flows to developing countries mainly in the form of equity underwriting and loans. These transactions involve fixed investments carried out by medium-sized firms, in the form of a joint venture, mainly in the manufacturing sector (mechanical, textile, wood/paper etc.). The typical case entails Italian medium-sized companies that intend to expand the market of their products overseas and to invest in a company that has strong local roots. In such cases, the Italian company initially purchases a block of shares; subsequently, it restructures the business through technological revamping, which is generally financed with new equity and debt. MCC has provided financing to many such projects in developing countries, especially India and China.

66. MCC also manages the Italian Government's concessional loans to developing countries. These funds help to finance public and private initiatives included in the framework of multilateral long-term programmes implemented by the respective Governments. In the last 20 years, MCC has provided on behalf of the Government of Italy more than 450 soft loans for a total amount of about US$ 7 billion, mainly for public infrastructure projects. In the last few years, a new type of credit line has been used to promote private investment by small/medium-sized firms. Industrial and agribusiness projects in particular have been financed in the form of joint ventures.

67. These credits are granted to local central banks, who subsequently on-lend them through the local banking system to the mentioned joint ventures on very favourable loan terms. These facilities, recently granted to Tunisia and Egypt, among others, have been very successful and many Italian companies have invested equity to establish joint ventures.

Lending to emerging markets: a banker's perspective

68. Mr. Fujisawa promoted the Japanese model as a high saving, stable, diligent and socially equitable country. He identified two main drawbacks to applying the Japanese model to developing countries. First, countries are highly dependent on capital flows; second, capital flows are today very volatile, so that efforts at regional cooperation in this area are required.

69. Among the conditions to successfully attract foreign capital, Mr. Fujisawa underscored the importance of sound financial practices and good corporate governance. In addition, efforts to foster domestic financial markets are required to raise long-term funds. Solid risk and return analysis is also very important.

70. Moreover, the private sector needs enabling conditions, including accountability, transparency and stability, to invest in developing countries.

71. Both private and public financing are critical to achieving sustainable development in developing countries, and they complement each other. Japan is proud to be the largest single provider of official development assistance.

Dialogue

72. International Monetary Fund (IMF) conditionality was perceived by some NGO representatives as putting corporations from developed economies at an advantage against developing countries' citizens; for that reason as well as for its questionable impact, it should be lifted.

73. Capital controls imposed by developing countries remain a controversial policy instrument, even in emergency situations, in the view of participants. They represent an additional cost for investors, which needs to be factored in their risk/return analysis and would create an incentive to shift assets elsewhere.

Deutsche Bank: corporate citizenship in emerging markets

74. Mr. Holz stressed that Deutsche Bank recognizes the importance of the developing world to both its current and future success, as well as the responsibility of multinational companies to facilitate the development of local capacity and viable civil society organizations in developing countries.

75. The realities of globalization offer a unique opportunity to effect positive change, encourage sustainable communities and develop stable societies. Globalization's promise cannot be realized, however, unless globalization results in broad benefits for the majority of the world's people, especially those living outside the economic mainstream. Not only is this a

moral imperative but it is also a necessity. In the short term, it is certainly in companies' own interest to work to counter the mounting and well organized grass-roots backlash against globalization. In the long term, perhaps the most compelling argument for the involvement of companies is their own survival. To maintain the economic growth that fuels the expansion and growth of businesses, they must remove the barriers of poverty and ignorance that isolate much of the world's people from the marketplace and access to economic independence and prosperity.

76. Deutsche Bank believes its role in society must be one that helps to buffer the impact of change on the most vulnerable. To this end, Deutsche Bank established the Deutsche Bank Microcredit Development Fund (DB/MDF), which aims to provide subordinated debt to local microcredit programmes that can serve as collateral in leveraging local domestic bank borrowings.

77. Conventional relationships with domestic commercial banks are an essential step to freeing microcredit programmes from their dependency on donor aid. DB/MDF currently has loans in place supporting microcredit programmes in Chile, Mexico, South Africa, India, Pakistan and Colombia.

78. Deutsche Bank's commitment to sustainable development goes beyond contributing to poverty alleviation through microcredit, focusing also on strict environmental compliance and renewable sources of energy. Deutsche Bank is proud to be part of several networks with similar objectives, including the World Business Council for Sustainable Development, the UNEP Financial Services Initiative and the Secretary-General's Global Compact.

79. Deutsche Bank's philosophy is: "Think global, act local". It reflects the belief that while different markets require different methods and approaches, issues are often similar across countries.

Dialogue

80. The promotion of small and medium-sized enterprises in developing countries was a concrete step offered as an example by MCC, towards accelerated growth in the local economy, poverty eradication and reduced inequality.

IV. Trade, systemic and other issues

Moderator:

Asda Jayanama (Thailand), Co-Chair of the Preparatory Committee

Panellists:

Kamal El-Keshen, Deputy Director, African Export-Import Bank, Cairo

Marshall Carter, Chairman, State Street Corporation, Boston

Thomas M. T. Niles, President, United States Council for International Business, New York

Mthuli Ncube, Chief Executive Officer, Barbican Asset Management, Harare

Trade issues relevant to Africa

81. Mr. El-Keshen pointed out that exports as a share of GDP have stagnated in Africa. Poor export performance is linked to inadequate access by countries to imported inputs, which in turn is linked to inadequate financing. This completes the vicious circle: without exports and with declines in ODA without any increases in private flows, the finances will have to come from export revenues. Given the vital role of exports, therefore, a way has to be found to urgently encourage growth in the African export sector.

82. There are many debilitating characteristics of African exports: they are concentrated in a few products, dominated by tropical beverages (coffee, tea, sugar etc.), are highly commoditized and are sold to a few OECD markets, mostly those with which the exporters have had colonial histories. Exports are largely unprocessed, with low value added and limited demand growth possibilities.

83. They tend to have low technology inputs and low processing. All of these in turn lead to low export production, and therefore to low export-GDP ratios. In addition, intra-Africa trade, which has enormous possibilities, is negligible.

84. With the changes in the global environment, new problems have also arisen: many African countries have dismantled their export marketing boards but have not found adequate substitutes. With the emergence of new entrants, risks have increased and access to finance is limited now that the old marketing boards no longer exist.

85. Mr. El-Keshen enumerated several strategies for enhancing growth prospects for Africa:

(a) Create a stable macroeconomic environment, including a sound exchange rate policy;

(b) Attract foreign direct investment, which would help to (i) increase export production; (ii) alter the nature of exports, including increasing technological inputs and processing (value-added); (iii) provide lucrative market contacts; and (iv) strengthen management skills;

(c) Ensure that the current conventional wisdom of privatization and government withdrawal from financial sector issues does not mean government abdication of its responsibilities, including the creation of an appropriate regulatory environment, with clear penalties for non-performers;

(d) Attract the right kinds of finance, including venture funds.

86. Mr. El-Keshen concluded by identifying the Africa Growth and Opportunity Act and the European Union's Cotonou agreements as important for providing market access, and noting that market diversity is important if export production is to increase, and that WTO rules should be revisited to enable African countries to join with less stringent rules so that they can take advantage of the opportunities provided. Article 27, in particular (on subsidies and countervailing measures), should be expanded to cover more African countries.

Dialogue

87. The discussion that followed focused on the following main areas:

(a) Inability of African countries to attract the types of production that Asian countries have been able to capitalize on: the concern was expressed that such production was usually linked to exploitative labour practices. Mr. El-Keshen responded that Africa has not been able to provide the working environment that would enable low-cost production of goods at international standards;

(b) The Africa Growth and Opportunity Act and whether it offered concrete opportunities for growth: the question was posed whether the African Export-Import Bank can help support countries in their efforts to build strong private sectors, including help in taking advantage of such agreements, enterprise development, which is critical to export production etc. Mr. El-Keshen indicated that, unlike the development banks, African Ex-Im Bank is a commercial entity with mixed membership from central and commercial banks; it started only in 1994, focusing on short-term lending (less than one year) of about US$ 1.6 to 1.7 billion; and its primary focus is to support exports (rather than imports) in African, Caribbean and Pacific countries. He added that there are many innovations (export business zones or units, for example, with improved infrastructure and regulations) which have been used successfully in some countries to support exports. He concluded by saying that the African Ex-Im Bank had close ties with the African Development Bank (which has a special seat on the African Ex-Im Board) and that the African Development Bank is the best locus for development activities, including technical assistance and capacity-building.

Investing in emerging economies

88. Mr. Carter spoke about trends in demographics and the financial world, and how these trends might impact investing in emerging markets. He began by providing some background information on his institution, State Street Corporation, which 25 years ago was a regional bank taking deposits and making loans to corporate clients in New England; today, the Corporation is a global company that combines information technology with banking, securities processing, investment management and trade execution. It delivers these services to customers in 92 markets around the world, with over 17,000 professional staff employed in 23 countries; it holds $720 billion in customers' assets under its management and over $6.2 trillion in its custody; and touches roughly 13 per cent of the total world market for stocks, bonds and securities of all kinds every day, a market that is estimated at well over $50 trillion in assets. He covered the role of custodians in settling trades, safekeeping securities, keeping records and a host of related tasks which make the financial markets work.

89. He then discussed shifts in stock markets in the last two decades: the number of investable stock markets have doubled since 1980, from about 83 in 1980 to over 160 today, and the major global custodians routinely cover about 90 of them. This means a tremendous amount of cash and data flow,

giving custodians a sophisticated understanding on what is happening in the markets. And some of these trends have implications for investment in developing nations.

90. Some of the trends he mentioned include the shift to global capital markets finance and how developing economies can access these markets; the movement from "geopolitics" to "geo-economics"; and the advent of technology and the Internet. These are described in detail below.

The shift to global capital market-based finance

91. Global capital markets have been displacing traditional banking as the key intermediators between providers and borrowers of capital. Therefore, there is clearly enormous room for further growth of stock and bond markets in continental Europe, Asia and across the developing world.

92. The key advantage of capital markets is that, together with the derivative markets for options and futures, these markets can minimize risk (i.e., can hedge and distribute that risk widely). Countries must act soon to spur the growth of capital markets that can, in turn, finance new economy industries. But these countries also have the obligation to protect the investor.

How can emerging markets capitalize on these trends? What needs to be done?

93. Prerequisites: prior to the crisis of 1997/98, investors were attracted to emerging markets by a combination of impressive rates of economic growth and government incentives. But that has changed — institutional investors today decide whether to invest in emerging markets based on a number of factors, not just promised rates of return. Therefore, to be players in the new global economy, developing economy nations need to take action to provide confidence to investors and markets, including increased financial disclosure under internationally recognized accounting standards; globally acceptable legal frameworks; improved debt management practices; coherent bankruptcy codes and financial market supervision; more market-based, less relationship-oriented banking systems; sound macroeconomic polices; and sustainable currency exchange regimes. With such reforms, emerging markets can mobilize domestic savings and attract far more in both direct investment and portfolio flows than they have ever received in foreign aid.

94. The key to success for emerging markets is the creation of a level playing field, which is only possible when there is freedom from government interference, as well as complete transparency — meaning that the books and records, ownership, revenue streams, expenses and everything related to the financial performance and ownership of companies are open and clear for all to see.

Moving from geopolitics to geo-economics

95. The world is (hopefully) moving away from military competition and warfare towards a common quest for prosperity and growth. This movement towards geo-economics is being driven by the growth and integration of the world's capital markets; the rise in world trade — which has been outpacing the growth of domestic economies for decades; the increasing irrelevance of national borders as regulation is liberalized and tariff and non-tariff barriers disappear; and technology's ability to leverage knowledge and talent worldwide.

96. Institutional investors, such as pension funds, are leading the trend to cross-border investment; and cross-border capital flows to emerging nations already dwarf all official foreign aid by a factor of roughly six to one — $240 billion a year versus $40 billion. Part of this shift is due to declining official foreign aid — due in no small part to "donor fatigue". But the bulk of new private capital flows to developing economies is simply due to the vast new pools of capital available today.

Technology and the Internet

97. The Internet's future growth prospects are enormous in the developing world, and it can help developing countries take advantage of the major trends in global finance once the challenges of providing widespread access are met. It will force a more profound restructuring of capital markets in the next few years; it will link stock and bond markets nationally, perhaps even globally, and dramatically lower trading costs. And it will level the playing field by providing a wealth of information and analytical tools to ordinary people as well as to institutional investors.

The politics of globalization

98. Trade and investment are "win-win" transactions for national economies, but there are impacts on displaced workers and there are legitimate concerns about labour rights, the environment and cross-border investment flows. In developed nations, the global economy is often viewed with suspicion — as evidenced by the public demonstrations at recent trade meetings in the United States. In emerging markets, there is plenty of room for exploitation, and they need to develop the legal, financial, and technological infrastructure necessary to access these tremendous new pools of capital. A global economy that benefits all is within reach but is by no means inevitable.

Dialogue

99. The discussion was focused on the following main points:

(a) Debt: there have been discussions about avoiding the differential treatment of private versus official creditors (such as the Paris Club) by making all creditors of a country equally responsible for the debt workout. There is also a clear need for more comprehensive and sophisticated information of specific country characteristics. Mr. Carter responded that an early warning system that enables debt restructuring to take place well before crises hit should be available for debtor countries;

(b) Volatility: the problem of controlling volatility driven by "hot money" was raised and elicited the response that there should be restrictions on investment that is purely speculative in nature, though the challenge will be on how to do this in a workable manner; there are various available models, which have had varying levels of success;

(c) United Nations role: one participant asked whether companies are willing to come under a United Nations umbrella, to which the answer was that leadership by the United Nations regarding global financial systems is more that of leadership by persuasion than by fiat.

Global trade policy issues relevant to financing for development

100. Mr. Niles spoke about the fact that, given that development assistance is unlikely to increase, increases in exports and enhanced foreign direct investment are needed to narrow the global gap between the rich and the poor countries.

101. In the Uruguay Round of multilateral trade negotiations, the attempt was made to provide special and differential treatment to countries, but this has led to dissatisfaction on the part of developing countries regarding implementation issues. If there is a new round in 2001 after the failure in Seattle (due, Mr. Niles said, to country incompetence rather than to civil disobedience disruptions), the developed countries will have to show tremendous leadership in dismantling agricultural protection in the United States and in changing the Common Agricultural Policy in Europe. Implementing phase-out of the multi-fibre agreement is in question since developing countries are not gaining what was promised. This phase-out may, however, have the unexpected result of one country (i.e., China) dominating the textile sector in all markets. Commissioner Pascal Lamy, Mr. Niles noted, had recently proposed that the European Union should be willing to remove restrictions on all but arms imports from the least developed countries — though this was a heroic gesture, this would prove difficult to implement.

102. While underscoring the importance of labour and environmental standards, Mr. Niles stated that they should not be used in WTO as a way of maintaining protection. He indicated that the African Growth and Opportunity Act, in spite of its limitations, still represented an important first step. He recommended that countries adopt the OECD principles of corporate governance and eliminate the corruption and bribery rampant in many countries.

Dialogue

103. Following Mr. Niles' presentation, discussion was centred on the following:

(a) Labour and environmental standards: how far do the voluntary adoption of labour, environmental and human rights standards by corporations actually change their conduct — does it work for development? Mr. Niles responded that the standards are very important, but he advised going through the proposed International Labour Organization (ILO) conventions. He also noted that with increased economic development, these standards are more likely to be adhered to;

(b) Assistance to African countries to take advantage of the African Growth and Opportunity Act:

although the Act does not specifically finance assistance to countries, there are other supplementary programmes (bilateral and others) that could help;

(c) Unilateral market access agreements: it was noted that arrangements between individual countries and the developed world on market access have undermined the possibility of having such negotiations take place under WTO. Mr. Niles responded that it is often in the interest of the developed country partner to enter into these arrangements unilaterally, but that the way to resolve this is to proceed to a new multilateral trade round.

104. Additional questions and comments focused on:

(a) Protectionism in the developed world: Mr. Niles believes that it is more a political issue than a "national security" one. He also pointed out that in the United States the beneficiaries of these protections are large farmers and producers, not small ones;

(b) Market access and the Multilateral Agreement on Investment: concerning how countries can be helped to take advantage of market access, Mr. Niles responded that the Agreement is generally among OECD countries, which generally do not disagree on investments. The issue is to have workable arrangements between OECD and the rest of the world. There was some discussion about adding investment to WTO terms of reference, but it was felt that that would not be well advised. On market access, one participant commented that perhaps it would be more advantageous if developing countries could be encouraged to diversify their export base to avoid overwhelming the few sectors protected in developed countries. Although Mr. Niles agreed, he also pointed out that diversification usually comes as a result of economic growth;

(c) WTO imbalances: in response to a question on international good governance and the United Nations role in negotiating global norms, principles and standards for the private sector, Mr. Niles pointed out that the United Nations cannot play an enforcement role (since international business would reject this), and suggested that it play a more visionary role, one that promoted codes of conduct.

Financial regulatory environment in Africa

105. Mr. Ncube focused on a few points regarding the financial regulatory environment in Africa, as summarized below.

106. Stock markets have done well. For example, the Zimbabwe Stock Exchange earned 1,000 per cent in real dollar terms in seven years. Africa has small stock markets, generally illiquid, with limits on foreign currency in most countries; there are very few bond markets, with only the South African one being sizeable. The cash and money markets, therefore, are where most of the money is.

107. Banking systems are where the financial problems reside: a huge percentage of loans are non-performing, constituting on average 60 to 90 per cent on the balance sheet, where 30 per cent is usually seen as the limit. These non-performing loans have weakened the banking sector, which is normally characterized by one or two large banks that dominate more than 60 per cent of the market. This, however, can also be seen as a great opportunity for foreign bank involvement.

108. Governments are often heavily involved in the banking system, which creates room for corruption. Again, this can also be seen as an excellent opportunity for privatization. Deposit protection is important, but it is very early in the development stages in most African countries, and most banks are still in the "too big to fail" category (i.e., they will have guaranteed government bail-out because of their dominance in the market). In many countries, central banks regulate the banks that are licensed by the Ministry of Finance — this makes sanctions of banks almost impossible, particularly where there is corruption.

109. Informal credit, on which the informal sector is based, often outstrips formal credit in many African countries. Yet financial institutions have not found a way to tap into that market.

Dialogue

110. In the discussion, the questions centred on the following points:

(a) Licensing versus regulation of banks: when asked whether central banks or ministries of finance were the preferred agency, Mr. Ncube replied that this depends on individual circumstances, but highlighted the importance of having independent central banks and of putting both licensing and regulation functions under one agency, be it the central bank or the ministry of finance;

(b) Liberalization: when asked whether liberalizing the capital account would help increase stock market flows into Africa and what types of financial infrastructure could help in this regard, Mr. Ncube discussed the importance of central depository systems that are being put into place to ensure that the existing stock markets are up to standard;

(c) Currency risk: Mr. Ncube stated that the currency risk in Africa is very high, but pointed out that the successes of the Zimbabwe stock market (1,000 per cent returns in seven years in real dollar terms) still left a sizeable profit after currency risks were taken into account;

(d) Capital controls: Mr. Ncube found that capital controls made no sense since the monies are not coming into Africa anyway. It is true that currencies take an initial knock, but they do stabilize and the funds are then available to spur growth;

(e) Regional stock markets: Mr. Ncube found that currency translation between countries is unworkable, so that he favours the option of cross-listing companies between neighbouring countries (which is currently being done in a number of African countries);

(f) Donor/taxpayer fatigue: when a participant commented on the lack of confidence that taxpayers in developed countries have regarding past development assistance, Mr. Ncube was not surprised. He asserted that this is because donors are focusing on Governments whereas they should be dealing with the private sectors of African countries.