NEGOTIATIONS ON THE FINANCIAL MARKET ACCESSIBILITY BY LDCs IN THE WTO DOHA DEVELOPMENT AGENDA: PROBLEMS AND PROSPECTS

By

Godwill Wanga
Email: wangagg@yahoo.com
DAIMA ASSOCIATES-TANZANIA

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1.0 INTRODUCTION

1. The ongoing Doha Development Agenda (DDA) negotiations are designed to strengthen dialogue to promote integration with the regional and global economies. A closer involvement of civil society, the private sector and the economic and social actors in the LDCs has emerged as an important new dimension to be promoted in the DDA negotiations. The CSOs are crucial to assist LDCs in **the areas of implementation of WTO obligations and WTO negotiations** based on five interdependent pillars: a comprehensive political dimension, participatory approaches, a strengthened focus on poverty reduction, a new framework for economic and trade cooperation and a reform of financial cooperation.

2. The Declaration[1] of the latest Doha Agreement stated that there exists recalcitrance of the WTO Secretariat and the few rich nations who have greatest pull on the WTO agenda to address the developing country and civil society demands, to push the Doha Ministerial towards an outcome that may either spell disaster for the majority of its members or another Seattle. Under existing WTO agreements, the poorest countries' share of world trade has declined and many poor countries' development and health policies have come under attack as violations of WTO rules. Thus, they called for outright rejection of an invalid text.

3. In order to ensure maximum benefit is derived from this cooperation, LDCs need to have determined, prior to the serious WTO negotiations, the forms the financial cooperation should take to most effectively promote, protect and guarantee the flow of domestic and foreign direct investments to LDCs and how such cooperation could be incorporated in DDA negotiations.

4. This paper makes a contribution towards enhancing the negotiating strength of the LDCs in the area of investment, trade and poverty alleviation and provokes discussion on the LDC's common position and the LDC Ministerial Declaration as an input to the WTO's ongoing Doha Development Agenda negotiations. The LDCs Ministerial declaration should bear in mind that the international financial products both risk capital and technical assistance in terms of aid and/or grants are very central in the social and economic development agenda.

[1] Alliance for Democracy, U.S. Contact Ruth Caplan (Washington DC): 202-244-0561 Arab NGO Network for Development, Lebanon Contact Ziad Abdel Samad (Beirut): +961-1-319-366 ECOROPA, France Contact Agnes Bertrand (Sauve): 33-4-66-77-0704 Focus on the Global South, Thailand Contact Aileen Kwa (Geneva): 41-22-791-8050 Friends of the Earth - International Contact: Alexandra Wandel (Brussels) +32-2-542-0185 or Ronnie Hall (London) +44-1243-602-756 Global Exchange, U.S. Contact: Juliette Beck (San Francisco): 415-255-7296 x 254 IBON Foundation, Philippines Contact Tony Tujan (Manila): +632-714-1580 Institute for Agriculture and Trade Policy, U.S. Contact Shefali Sharma (Geneva) +41-22-789-0724 and Sophia Murphy (Minneapolis) +612-870-3454 Institute for the Re-localization of the Economy, France Contact Agnes Bertrand (Sauve): 33-4-66-77-0704 Public Citizen, U.S. Contact Margrete Strand (Washington DC): +202-454-5106 Via Campesina, International Contact Nico Verhagen (Brussels): +32-2-343-8444 : Declaration of the Latest Doha Agreement 31 October 2001.

2.0 THE FINANCIAL PRODUCTS FOR THE LEAST DEVELOPED COUNTRIES

2.1 Overview

5. The financial sector is important to the business cycle (e.g., prevents decline and a recession) because it channels the flow of savings back into the circular flow either as consumer loans, business loans, or government loans. Likewise, the financial sector increased flows into the spending stream (loans) that exceeds savings, an upturn or boom might result and inflation might rise. Typically, the financial sector provides financial and technical support for investments from a number of Developed countries (DCs) to Least Developed Countries (LDCs. Investment has been one of the key components of development and has become an important objective of regional economic integration for the LDC.

2.2 Financial Products, Characteristics and Role in Investment Support

6. The financial sector raises on the markets substantial volumes of funds which it directs on the most favourable terms towards financing capital projects. This fosters entrepreneurship and growth, which will lead to long-term sustainable economic development and the alleviation of poverty. The financial products are under discussion below.

7. **Risk-Based Investment Facilities***:* These are risk-taking financial instrument designed to support the development of the private sector. They take project-related risks and expect a commensurate return. They support the growth of local enterprises, and finances foreign direct investment and commercially viable public enterprises. Also, special efforts are made to improve the **acces**s of small and medium-sized enterprises (SMEs) to financial sector's risk sharing instruments and to "term finance" including loans, equity, quasi equity and guarantees. The support for SMEs, most dominant in LDCs, is channelled through the local financial sector. The instruments are also supposed to finance private sector facilitating infrastructure projects in the public sector.

8. The various forms of financing instruments allow flexibility in setting terms and conditions, which are adapted to the nature of a project. The financial sector offers long-term, senior debt on very favourable financing conditions for larger operations and for those with lower risk. They base their lending conditions for the finances on their credit rating, which enables it to pass on related advantage.

9. **Technical Assistance Investment Facilities***:* The financial sector also offers funds to contribute to poverty reduction through wealth creation by supporting the development of investments in the LDCs. The supports are mainly reflected in the identification and

promotion of bankable/ profitable projects, which are eligible for assistance mainly to improve their productivity and profitability.

10. The financial resources are obtained from the funds and voluntary contributions by DC. The bulk of the finance is in the form of grants, which are given under specific Conventions and/ or Agreements. The financial sector provides grants and services to the company before, during and after investment. For instance, they might not fund investments but can, in certain cases, give assistance while the company is looking for appropriate funding.

11. The eligibility conditions tied to such financial resources include the involvement of enterprises in creation, extension, diversification and restructuring; financial and technical viability; creation of direct, induced, rural or urban employment opportunities; adding value to local primary materials and developing and/or using local skills and substantial turnover.

12. In addition, direct assistance is provided to help the company function in the long-term. This assistance covers defining the project, conducting pre-feasibility, feasibility and market studies, searching for technology, sources and partners, carrying out the financial engineering, establishing the legal base for setting up the project, doing quality and environmental studies. The assistance is also offered in start-up and technical sourcing, training of personnel, technical, financial and management diagnostic studies and audits, management and marketing, restructuring, integrating the company with professional networks and associations at national and regional level, and establishing quality standards, labelling procedures and measures to protect the environment.

13. Also, the assistance takes the form of funds for technical and sectoral meetings, seminars, trade fairs, industrial missions, professional gatherings, and promotion activities at national and regional level.

14. **Technical Assistance for Investment Supporting Organisations:** There are financial institutions, which provide assistance to intermediary organisations on a case-by-case basis. For instance, they provide assistance in the management of intermediary organisations, putting such organisations in contact with companies in the same sector of activity in countries with a view to setting up partnership agreements and providing training and technical assistance to member companies for their own programmes.

15. In addition, there are financial institutions, which undertake capacity building (CB) in three areas including public-private dialogue (PPD), business development services (BDS) and company matching initiatives (CMI). CB objective assists LDCs to formulate, develop and promote policy changes which will improve the environment for both domestic and foreign investment. BDS assists LDCs to improve their professional skills and extend the range of investment promotion related services. The objective of company match-making initiatives (CMI) is to develop the capacity of LDCs to organise and promote partner-matching events with the Developed Countries (DC) and other developing countries.

3.0 THE LDC'S PROBLEMS OF ACCESSIBILITY TO FINANCIAL PRODUCTS ISSUES

16. There are financial institutions which offers products but with some difficulties. For instance, the LDCs have suffered from poor access to the products due to the following reasons.

17. **Sectoral Biasness**: The financial institutions issue some funds are confined to specific sectors (lending out was not open to any sector which had bankable projects). In addition, there are conditions which seem to limit accessibility to financial technical assistance. For instance, the beneficiary in the LDC is required to contribute either in cash or in kind at least a certain percentage of the total eligible expenditures. It has been very difficult for some companies in the LDCs to meet the obligation due to capital requirements of the investment project. Also, the multilateral financial institutions lend most of their products to governments and public investments, sometimes on the expense of the private sector in LDCs.

18. **Conditionalities**: The financial institutions issue products which are tied to cumbersome conditionalities. For instance, issued funds could finance only up to 50% of any project and the rest would have to come from equity or loans from elsewhere. In addition, the conditions are not always appropriate for the type of private sector that is dominant in the region. The conditions attached such as the minimum size of loan that can be sanctioned is often beyond the absorptive capacity of most enterprises in LDCs.

19. Also, the requirements for an organization/institution to qualify for technical assistance grants are unrealistic given the characteristics of the target organisation/institutions. Most of the SMEs perceived the financial institutions as bureaucratic and not user friendly. A major gap in the financial markets in some LDCs is found in long term development finance. Since partnership arrangements and joint ventures between DCs and LDCs partners have not been successful to a large extent due to unequal partners.

20. **Scarcity of Good or Feasible Projects:** A shortage of bankable projects has been one of the main factors responsible for SMEs not to benefit fully from the financial assistance provided by financial institutions. Financial institutions face difficulties in lending funds due to the scarcity of good or feasible projects. Experience shows that the demand for good projects is greater than the supply.

21. **Exchange Rate Risks**: The denomination of loans in foreign currencies scares potential borrowers by exposing them to high exchange risk. For instance, lend out in US$ or Euros to

LDC's borrowers who would pay back in the domestic currency had the effect of exposing these financing facilities to high exchange risk.

22. **High Interest Rates:** The commercial rates of interest being charged on loans to SMEs are often not in line with rates of returns, which are generally low given the investment cost profile. The cost of capital has been one of the factors that has made it difficult for SMEs to take full advantage of the products offered.

23. **Centralised Financial Technical Assistance:** There are financial institutions offering their products earmarked for technical assistance directly at their headquarters mainly in DCs. However, there are financial institutions which are taking steps to decentralise and build capacity by gradually giving selected institutions in LDCs. For instance, they are setting up the (regional) field offices and decentralized management units in LDCs. Also, in financing investments or providing technical assistance, none of the institutions in question covers full costs of the project.

24. **Poor Information System:** The access to information about the existence of the financial products has been as a major problem. Most of the intended beneficiaries in the LDCs have not obtained any useful information on the existing products but on an informal basis. There are no formalised and systematic channels through which information on the financial institutions and their products can be obtained. Concern has been expressed that awareness and information dissemination is weak. Awareness of the existing instruments and how they can be accessed has remained very low. As a consequence, many have bumped into this information in a variety of ways.

25. **Poor Coordination System:** It is true that there are a variety of financial products offered and the amount of funds put at the disposal of LDCs private investors by the financial institutions. However, it could go a long way to build a vibrant private sector in LDCs due to the lack of a coordinated approach among the suppliers of funds.

4.0 CONCLUSIONS AND PROSPECTS

4.1 Conclusions

26. It is true that LDCs have problems including poor macro-economic fundamentals, unstable political environment, unfavourable regulatory environment, and bad governance. In addition, the private sector in general is still nascent and weak. The bulk of the sector is predominantly in the hands of small operators whose investment knowledge is limited and their financial position is weak.

27. In spite of so many institutions armed with a variety of risk capital and technical assistance instruments, the flow of private investments into the LDCs is still very small.

28. In order to ensure maximum benefit, LDCs need to have determined, prior to the serious WTO DDA negotiations on improved accessibility of the financial products to effectively promote, protect and guarantee the flow of domestic and foreign direct investments to them.

4.2 Prospects

29. Negotiators should be concerned with all the raised issues including the following:

- The financial institutions, should devise a scheme for lowering the cost of its products including risk capital and technical assistance to competitive levels. Such a scheme may entail using subsidies without favouring particular enterprises or industry or introducing distortions in the financial market, establishing guarantee schemes to provide cover for both investors and lenders to SMEs.

- The financial institutions should relax conditions including those governing forced partnership and joint venture arrangements.

- the funds made available to support projects should not be restricted to selected preferred sectors. They should be allowed to be flexibly allocated to any sector which is commercially viable.

- **T**he financing institutions should lend out to borrowers who would pay back in the domestic currency had the effect of exposing these financing facilities to high exchange risk.

- **T**he minimum amount that can be lent should low enough to accommodate small requirements of SMEs. It should more appropriately reflect the nature and capacity of the private sector in the region.

- It is recommended that greater attention be paid to promoting the capacity to generate good and bankable projects.   Negotiations should be made for evolving education and training for entrepreneurship development.

- The **f**inancial institutions should help to strengthen the Development financial institutions network which has been established by LDCs to fill the financial intermediation gap.

- The comprehensive packages should consist of technical assistance for diagnosis of the situation on the ground, preparation of a feasibility studies and business plans, financing of various types (venture capital, investment and working capital) and related financing facilities.

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