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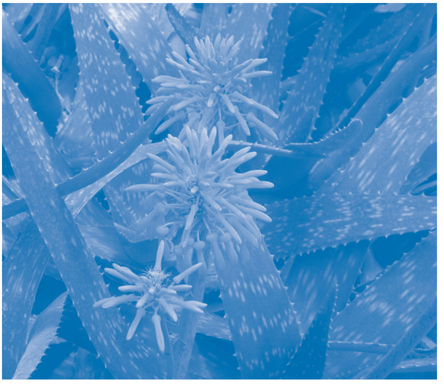
# PROMOTING EXPORT DIVERSIFICATION IN AFRICA:

## Traditional Financing Techniques and Innovative Options



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# Promoting Export Diversification in Africa: Traditional Financing Techniques and Innovative Options
## By T.C. Venkat Subramanian

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# Introduction and Forword[1] by C. C. Edordu

***Mr. Chairman***
***Honourable Ministers***
***Your Excellencies***
***Distinguished Ladies and Gentlemen.***

I am highly delighted and honoured by the opportunity to make a keynote address to this important gathering. We value the Meetings of this Group a great deal due to the enormous contributions they have made to the work of the Bank. This is why we are pleased with the growing interest the Group has attracted from within and outside Africa. In this regard, I am delighted to inform you that since November 1994 when the Group held its first meeting in Cairo, participation in its meetings has continued to grow. Today, distinguished Ladies and Gentlemen, we have amongst

[1] Keynote Address given by Mr. C.C. Edordu, President, Afreximbank on the Occasion of the Ninth Meeting of the Afreximbank Advisory Group on Trade Finance and Export Development in Africa, Lusaka, May 2003.

us top government officials, senior bankers from Africa and beyond as well as leading corporate executives from all over the world. This broad participation in the Group's meetings has ensured that the deliberations are incisive producing useful conclusions for the Bank and the Continent at large. I will therefore thank all of you for coming and hope that as usual you will make useful contributions to today's debate.

2. Distinguished Ladies and Gentlemen, permit me now to dwell on the core issues of my keynote address. As some of us gathered here are aware, a careful review of development experience around the world in the last three-four decades would suggest that exports were crucial to development success stories. In this regard, it is well known that the development experience of successful East Asian economies was powered by strong export performance. Some of those East Asian countries were known to have achieved export values in the order of 40% of Gross Domestic Product (GDP) with significant composition of those exports being manufactures. For many, such as South Korea that had export structures similar to Africa's in the early 1960s, the transformation was quite profound with manufactures and other high value exports dominating their export basket by the early 1980s. In contrast, Africa and some Latin American countries with poor development experience were characterized by poor export performances. A careful analysis will show that the link between exports and development is more than a mere coincidence. This is because a strong export base enables countries to reduce or manage their vulnerability to external shocks and brings macroeconomic stability to a country's development process. This is especially so where a country's export sector is well diversified and has enough flexibility for a rapid response to negative shocks. For example, the recent financial crisis in Asia was more effectively borne by those countries with capacity for rapid export response and adjustment, such as South Korea and Taiwan. The importance of exports in economic development process was well understood and appreciated by the Bank's Founding Fathers. In this regard, at the time of the Bank's establishment, African conditions compelled its Founding Fathers to mandate the organization to seek to:

(a) fill a static resource gap created by retreating international banks; and
(b) fill a dynamic gap required by export generative activities or in other words to conduct export development operations.

3. Faced with these two challenging broad mandates, and with limited resources, the Bank's Management had to make a strategic choice at the commencement of the Bank's operations. Accordingly, the Bank's strategic choice was to deal first with liquidity issues through filling the static resource gaps. After 10 years of existence close to nine of which had been used to deal with the static resource gap problem, and in line with the Bank's Second Strategic Plan, it is now considered appropriate to turn attention to export development activities. This requires the creation of an export sector engineered to bring growth and economic transformation. The question may be asked as to the difference between an export sector that promotes economic development and one that does not. To answer this question we only need to understand why Africa's export sector has not promoted development while that of Asia has. In this regard, it is pertinent to note that Africa's export sector was not designed for African development but to meet the needs of colonial authorities, or multinationals. This is evident in both export agriculture and export mining. The colonial masters promoted exports of raw commodities to feed their manufacturing plants at home. They did not think it necessary to process the raw exports as that would mean making huge long term investments in Africa. That was why where it was possible, they did not even promote the development of modern plantations preferring to encourage the gathering of produce from scattered farms, as with palm produce in west Africa. The notion of exports promoted by the colonial master was extractive and not regenerative. This notion influenced the nature of investments they made in Africa's export sector the consequence of which are the problems the African export sector faces today.

The above history enables us to understand why it is important to create a development-oriented export sector in Africa. In creating such an export sector, what critical issues do we need to consider?

Distinguished Ladies and Gentlemen, permit me to share my own thoughts with you regarding this important question.

4. In my considered opinion, one of the issues is that the new export sector that will be engineered will seek to remove the weaknesses that currently exist, namely

(i) Low export values currently in the order of 20-22% of GDP. This is about 50% of similar ratios for East Asian economies. These low figures are pointers to the weak export production base that Africa has - a weakness that needs to be addressed if the African export sector can promote economic growth. It is important to note here that this ratio has remained static since the early 1980s.

(ii) Slow growth in exports. For example, African trade volumes rose by 0.1% in 2002 while Asia in contrast achieved a 7.5% growth in export volumes. The weak growth in export volumes is related to weak export production base discussed in (i) above.

(iii) Concentration in export production, markets and low technology content of export production. Records show that about 80% of African economies depend on commodities for more than 50% of their export revenues; about 85% of the exports are destined to OECD countries, while the technology of production had remained rudimentary and static over the past four decades.

(iv) Poor regional integration, with share of intra-African trade in total African trade languishing at the 9% region over the years.

(v) Market instability. High concentration in commodities exposes Africa to the high volatility in market prices. Sometimes, the coefficient of variation of price of some commodities exceeds 30%.

5. In seeking to engineer the new export sector, what strategy should be adopted. My view of alternative strategies are:

(i) Market Access Strategies: In the past, negotiations with OECD states for market access had been done which had failed to bring desired results because of lack of production capacity. In this regard, many African economies failed to take advantage of the EU-ACP market access opportunities because they were unable to efficiently manufacture and export the items covered under the Agreement. Thus, it is obvious that such opportunities can only be optimized by creating export production capabilities.

(ii) Export production in enclave industries by multinationals supported by Foreign Direct Investment (FDI). This has also not created a development-oriented export sector due to the fact that the enclave nature of the export sector ensured limited linkages with the rest of the economies. Thus, skills and technology are not transferred and the export sector had little development effect on the economies concerned due to limited inter-industry linkages.

(iii) Production and exporting by poorly endowed indigenous enterprises. This approach has failed as those indigenous enterprises lacked the technology, the finance and knowledge to produce and trade exports. Exporting requires dealing with many variables at the same time, ranging from quality issues, trade policies both at home and that of the buyers, multiple currencies, etcetera. Few poorly endowed indigenous exporters have the capability to deal with these issues efficiently.

(iv) Cooperation by all parties. This is in fact an optimal strategy. In countries where exports had promoted growth, that approach was adopted. The cooperation that will work is one that brings a partnership of poorly endowed African exporters with foreign experienced exporting firms targeted at taking advantage of market access opportunities that exist for the Continent using appropriate financing to produce the needed exports.

6. What should be the role of banks in creating the new development-oriented export sector with rapid growth and diversity? The questions that arise here include:

   (i) what kind of financing does export development require? This question arises because traditional export finance has limited scope for supporting export development. Export development financing requires specialized forms of credit that meet the requirement of all parties in the export chain, ranging from term financing for export creation, working capital financing for maintaining production, packing credit for preparing exports to and export credit insurance to cover trading risks; and

   (ii) do capital markets tend to fail when they need to support export development hence the creation of EXIM banks to deal with market failure? The thinking usually is that export development requires longer term financing especially for those activities that require lumpy investments and high unit volume products. Such lumpy investments calling for tenored financing may not find financing in the African markets. What then should be the role of local banks in addressing this challenge?

7. What should be the role of macroeconomic policy? The options here include:
   (i) openness for export promotion; and
   (ii) regional integration.

   A key question, however, is whether the Asian experience is replicable considering that it took place at a time of selective openness. Would export development occur in an environment of generalized quest for exports? What are the chances of success using Openness as a strategy under an international regime of generalized openness? Will the fallacy of composition halt export development under current international environment?

8. What should be the role of Afreximbank? What is Afreximbank's intended strategy and its preliminary thinking regarding how to create a growth-oriented export sector? Although, one of the papers will outline the Bank's thoughts, however, on a preliminary basis the Bank believes in cooperation to deal with development and market access issues. The cooperation should be one that cuts across all parties that have interests in the Africa export sector, such as African Governments, African exporters, African banks, international banks and corporates with interest in producing in Africa and other multilateral institutions that provide market access opportunities for Africa.

9. The above rhetorical questions have been raised to whet our appetite and prepare us for receiving detailed presentations from a team of experts we have gathered here today. I am sure that their presentations will delve into details of the issues I have raised and provide much needed answers or provoke issues for further debate by all of us.

   The first presentation we will be listening to today is titled "Issues and Challenges in Promoting Export Diversification in Africa". That presentation will be delivered by Dr. Sylvester Ugoh, Managing Director at Skoup Nigeria Limited, a management consulting firm in Nigeria. Dr. Ugoh, who holds a Ph.D from Harvard University in the USA brings with him many years of experience gained in very senior positions in central banking, government and the private sector. He has at some point in time a distinguished career, a Minister of Science and Technology in Nigeria. He also has a deep understanding of issues of export diversification gained through years of work in that area. Skoup, which he heads, acted as consultants to the African Development Bank regarding a US$245 million loan to the Nigerian government aimed at stimulating the diversification of that country's exports away from oil. We believe that Dr. Ugoh will bring deep theoretical and practical insight to the problem his paper will be addressing.

   Mr. T.C. Venkat Subramanian will be presenting the second paper of today titled "Promoting Export Diversification in Africa: Traditional Financing Techniques and Innovative Options". Mr. Subramanian is Managing Director at the Export-Import Bank of India and brings with him many years of experience in financing manufactured exports. As some of us may be aware, India is one country that has made tremendous progress in growing its manufactured exports. That progress owes a lot to the work of Exim Bank of India, which has managed to provide much needed support for operators through the whole chain of exporting while maintaining excellent financial performance. The success of Exim India has made that bank a first port of call for developing countries trying to create financing schemes in support of export manufacturing. Given the above, we believe that Mr. Subramaniam's paper will guide us in understanding the financing issues in promoting export diversification in Africa.

The last paper we will be listening to today titled "Introducing Afreximbank's Export Development Finance Programmes" will be delivered by Mr. J-L Ekra, Executive Vice President at Afreximbank.[2] Mr. Ekra who has many years of banking experience oversees the credit operations of the Afreximbank. His presentation will introduce the Export Development Finance Programme (EDFP) the Bank introduced on July 1, 2002. That programme is aimed at providing financing and other services considered essential for ensuring export diversification in Africa.

After the presentations, a Roundtable will be constituted to discuss issues around the theme "Export Diversification as a Vehicle for Accelerated Economic Development in Africa: Myth or Reality?" The panelists will include the above paper presenters who will be joined by other experts, namely Dr. Bwalya K.E. Nga'ndu, Managing Director at Development Bank of Zambia; Mr. Habib Sfar, Director at the Central Bank of Tunisia; and Mr. Chris Goromonzi, Executive Director at Trust Bank Corporation, Zimbabwe. We hope that the Roundtable will generate debates that may clarify the issues raised in my Keynote Address and by the paper presenters.

[2] Mr. Ekra is presently the President and Chairman of the Board of Directors of the Bank. He assuned the posion of president in March 2005.

10 . As a sub-component of our gathering, we will also be holding an Investment Forum. The Bank has introduced this Forum in order to optimize the value of our meetings for the host country and the business community. We thought that it was important to bring international investors to partner with local authorities and businesses to enhance the value of our gathering for mutual gains. To plant the seeds that these parties would need to nurture and fructify as investments, we have two speakers from the Government of Zambia who will be highlighting the investment opportunities as well as incentives for investors in Zambia. We hope that those two presentations will generate discussions and one-on-one meetings between prospective investors and Zambian businesses. We are taking this component of our activity seriously and therefore have created a follow-up mechanism to ensure that promising discussions are fructified.

11. Distinguished Ladies and Gentlemen, permit me now to thank the people and Government of Zambia for the excellent logistic arrangements they made in support of this event. I will, on your behalf, particularly like to thank the President of Zambia, His Excellency, President Mwnawasa for his unalloyed support for the Bank and this event. I will also like to thank the Honourable Minister of Finance of Zambia, His Excellency, Hon. Emmanuel G. Kasonde, the Governor of Bank of Zambia, Dr. Caleb Fundaga and other very senior Zambian officials who made today's event possible. I will further wish to thank all of you for traveling from far and near to be part of today's event. Our hope is that you will find the meeting fruitful. I will now like to close by wishing all of us a successful meeting.

# Promoting Export Diversification in Africa: Traditional Financing Techniques and Innovative Options

*By:*
*T.C. Venkat Subramanian*[1]

## Introduction

### Globalisation and Export Diversification

Globalisation is seen as one of the most important factors shaping economic developments in the 21st Century. In this regard, participation in the global economy provides immense opportunities such as in the spheres of international trade and capital flows, and requires nations to seek a dynamic equilibrium at the international, regional and sub-regional levels. This has been confirmed by the success of countries that pursued outward-oriented development strategy. By contrast, the pursuit of inward-looking development strategy led to slower growth for most African countries. The pursuit of an outward-looking strategy is even more crucial for most African countries because their domestic markets

[1] This paper was presented at the Ninth Meeting of Afreximbank Advisory Group on Trade Finance and Export Development in Africa held in Lusaka, Zambia on 24 May, 2003. Mr. Subramanian is Chairman and Managing Director of Export-Import Bank of India.

are relatively small. Further, the decline in Africa's share of world exports, its continued concentration in a few primary commodities and its inability to attract inward investment have led to widespread concerns over the increasing economic marginalisation of many countries in Africa.

Globalisation is reshaping relations among countries, regions and social groups, and changing the nature of the development process itself. The nature of the globalisation process requires the adoption of new approaches as well as the development of new policies and institutions. Governments may not be able to rely solely on national initiatives although they would still be important. A mechanism aimed at promoting economic relationships should be evolved while participating with other countries in institution building to deal with issues at both the regional and global levels. But, while the benefits from globalisation can be significant, they are not necessarily guaranteed. They are dependent on the nature and forms of integration. In this regard, integration has a number of dimensions such as trade, investment, capital flows and technology. The optimal level of openness may differ for each aspect, depending on the stage of development in each particular market. In addition, the risks and costs associated with liberalisation can be considerable for small, fragile economies, as they are exposed to external shocks.

Further, participating in the global economy poses significant challenges for the economic management of fragile economies and can lead to major problems. Certain prerequisites seem necessary for countries to manage the risks and to ensure liberalisation proceeds in an orderly manner. While not down-playing the role of international trade and foreign direct investment, recent events indicate that liberalising capital flows can pose considerable risks and costs. Although few countries in Africa are facing the scale of inflows relative to the size of their economies that precipitated the Asian crisis, key lessons for Africa illustrated by the Asian crisis concern the importance of developing sound financial systems, appropriate sequencing of macroeconomic reforms, avoiding overly rigid exchange rate regimes and caution in opening up the financial sector.

## Export Diversification is Characterized by Certain Benefits and Barriers Namely:

**Benefits:**

- It minimises currency transaction risks
- It provides bigger potential market
- It promotes economies of scale
- It helps in leveraging empirical knowledge across markets

**Barriers:**

- Costs (entry costs, coordination costs, transaction costs, etc) are higher
- It reduces commitment to individual markets – resource dispersion
- Increase in information processing needs

Coming to the issue of export diversification, developing countries need to pursue export diversification as a conscious growth strategy for protection against sharp and unexpected changes in their terms of trade as well as stabilise domestic incomes and employment. The integrated orderly and stable world economy that globalisation is expected to produce is yet to emerge. What has emerged is a degree of quasi-globalisation. In particular, trade is concentrated in regional blocs instead of being fully global. The implication of this development is that African countries should place a high priority on building stronger trade and economic relations with neighbouring countries.

## Economic Development in Africa

Africa has exhibited resilience in economic activity in recent years reflected by macroeconomic stability, improvements in peace and democracy and access to debt relief under the Highly Indebted Poor Countries (HIPC) Initiative. For example, economic activity increased with real GDP growth rate rising to 3.6 per cent in 2001, from a level of 3 per cent recorded in 2000.

The increase in economic growth assumes added significance when compared with the retreat in growth in all the other major regions of the world. Although growth was sustained, during 2002, lower oil production in Nigeria and sharp decline in agricultural output in many countries (due to adverse weather conditions) resulted in a marginally lower growth of 3.4 per cent. During 2003 and 2004, the rate of GDP growth in Africa is projected to rise to 3.9 per cent and 5.2 per cent respectively (Table 1). This is expected to be aided by continued consolidation of policy reforms, global economic recovery, and higher non-fuel commodity prices among others.

Furthermore, macroeconomic policies in Africa have improved considerably in recent years reflected by the single-digit inflation rate prevailing in most countries largely due to sustained reductions in fiscal deficits since the mid-1990s. Notable exceptions are Angola and Zimbabwe, where inflation during 2002 stood at 108.9 per cent and 140 per cent, respectively and, to a lesser extent, in Ghana, Nigeria and Democratic Republic Congo. For the region as a whole, inflation stood at 9.3 per cent during 2002, down from 13 per cent in 2001 and 14.3 per cent in 2000 (Table 1).

**Table 1: Africa: GDP and Inflation Rate (Annual % change)**

| | **2000** | **2001** | **2002** | **2003** | **2004 p** |
|---|---|---|---|---|---|
| Real GDP | 3.0 | 3.6 | 3.4 | 3.9 | 5.2 |
| CPI Inflation | 14.3 | 13.0 | 9.3 | 10.1 | 7.6 |

*Note: p= projection*
*Source:* IMF, *International Financial Statistics (several issues).*

## Africa's Foreign Trade

Total exports from Africa have increased from US$96 billion in 1980 to an estimated figure of US$139 billion in 2002. Similarly, Africa's imports also rose from US$80 billion to US$133 billion during the same period. Despite the rise in trade, the share of Africa in global trade declined from a level of 5 per cent in 1980 to 2.2 per cent for exports, and from 4 per cent to 2 per cent in the case of imports.

As regards direction of exports, the industrialised countries have continued to be Africa's major trading partners, accounting for approximately 70 per cent of total exports during 2001. Among developing countries, Asian countries are the important markets (see Table 2). In the case of imports, the share of industrialised countries has declined while that of developing countries has increased, particularly for Asian countries (Table 3).

The low growth in Africa's exports can be attributed to the fact that the bulk of Africa's exports consists of raw and labour-intensive commodities, which have recorded slow growth compared to manufactured goods, which have exhibited the fastest growth in global trade.

**Table 2: Direction of Africa's Exports**

| | *% share in Total* | | | |
|---|---|---|---|---|
| ***Region/Country*** | ***1995*** | ***1999*** | ***2000*** | ***2001*** |
| **Industrial Countries** | **64.2** | **65.6** | **68.1** | **69.9** |
| **Developing Countries** | **25.9** | **29.4** | **29.4** | **28.4** |
| Africa | 10.5 | 10.2 | 9.3 | 9.2 |
| Asia | 9.1 | 10.9 | 11.7 | 10.6 |
| Europe | 2.0 | 2.2 | 2.4 | 2.4 |
| Middle East | 2.2 | 2.3 | 2.0 | 2.1 |
| Western Hemisphere | 2.1 | 3.7 | 4.0 | 4.1 |
| **Others** | **9.9** | **5.0** | **2.5** | **1.7** |

*Source:* IMF, *International Financial Statistics (several issues).*

**Table 3: Africa's Imports by Region**

| | % share in Total | | | |
|---|---|---|---|---|
| | *1995* | *1999* | *2000* | *2001* |
| **Industrial Countries** | **66.8** | **63.9** | **61.1** | **59.6** |
| **Developing Countries** | **30.7** | **33.6** | **36.5** | **39.2** |
| Africa | 8.8 | 9.7 | 10.3 | 10.6 |
| Asia | 11.8 | 13.3 | 13.4 | 14.5 |
| Europe | 2.6 | 3.4 | 3.7 | 4.1 |
| Middle East | 5.0 | 5.1 | 7.0 | 7.1 |
| Western Hemisphere | 2.4 | 2.1 | 2.1 | 2.8 |
| **Others** | **2.5** | **2.5** | **2.4** | **1.2** |

*Source:* IMF, *Direction of Trade Statistics (several issues).*

Considering that most African countries are heavily dependent on primary commodities, the effects of external shocks arising from trade in primary commodities, such as adverse terms of trade, and volatile commodity prices tend to have severe implications for Africa's export performance. As regards manufacturing, Africa's manufactured output accounts for only around 1 per cent of global industrial output (i.e. US$5,398 billion), with the bulk coming from just 12 of the 53 countries with a relatively diversified industrial base. In addition, the manufacturing sector in Africa is characterised by very low levels of capacity utilisation, averaging 30-59 per cent, as well as extreme dependence on foreign inputs, expertise and technology.

## Regional Dynamism

Africa's economic and political geography present challenging circumstances for economic development. Many African countries are too small and balkanised to provide substantial economies of scale to support profitable investment. This situation coupled with the regional rather than global nature of interaction suggest that countries place a high priority on trying to generate sub-regional and regional dynamism.

Regional integration can only work in the context of more open national economies. The first step is to work towards liberalisation of trade and payments systems between neighbouring countries in order to spur inter-country transactions. Luckily, liberalisation has already led to increasing intra-regional trade within Africa. The second step is to integrate national markets into sub-regional markets through the creation of regional infrastructure, such as roads and telecommunications networks.

In addition, while the development of financial markets presents a potential channel for integration into the global economy, most economies in Africa are too small to justify the costs involved in setting up stock markets. One of the viable ways to overcome this problem is for governments to pool resources in developing regional institutions. These could include: regional securities and exchange commissions; regional self-regulatory organisations; regional committees to promote harmonisation of legal and regulatory frameworks; development of regional bond or debt markets; regional institutions for pooling information and research; credible regional credit rating agencies; and coordinated monetary arrangements, among others.

## Regional Trading Arrangements in Africa

A number of African countries have established regional trading arrangements with a view to promoting intra-regional trade and investments. In turn, increased commercial relations are envisaged to promote economic development within member countries. These trading arrangements include the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC), the Cross Border Initiative, the Economic Community of West African States (ECOWAS) and the West African Monetary and Economic Union (UEMOA).

The success of these intra-regional trading arrangements could be discerned from the increasing level of trade within the member countries in recent years. For instance, in the case of COMESA, exports within the bloc increased from US$412 million in 1980 to US$1.5 billion in 2000, accounting for 6 per cent of total exports of the bloc. As for SADC, intra-bloc exports rose from US$483 million to US$4.4 billion during the same period. Further, intra-bloc exports of the Cross Border Initiative rose from US$209 million in 1970 to US$1.1 billion in 2000, while that for UEMOA increased from US$52 million to US$847 million during the same period.

## African --- New Initiative

The launching of the New Partnership for Africa's Development (NEPAD) in 2001 marks a milestone in the evolution of an African development programme. NEPAD, whose fundamental purpose is to re-launch Africa's development and put it on a path to lasting peace, poverty reduction, and sustainable growth development, offers a new vision for Africa in the 21$^{st}$ century. However, the success of NEPAD would depend not only on what the African countries do, individually and collectively, but also on the degree of support it garners from the international donor community. In this regard, the Government of India would like to work closely with the African countries in supporting the NEPAD Initiative with a view to ensuring that it contributes to improve economic and trade relations between Africa, as a group, and India.

The need for African countries to redouble their efforts in the fight against poverty is firmly articulated in NEPAD. Moreover, it equally states that to successfully address Africa's development challenges, it would require a fresh development paradigm based on bold and strengthened partnership with the international community. Therefore, the NEPAD programme serves to reinforce the various measures undertaken in various bilateral and multilateral initiatives with a view to forging partnership between Africa and the international donor community in order to push forward a collective effort in Africa's development process. The recent USA's Africa Growth and Opportunity Act (AGOA), the European Union's "Everything But Arms" Initiative, and the EU-ACP Cotonou Agreement, are some of the cases in point.

However, NEPAD is different from other initiatives in that it centres on ownership and management - an agenda set by the African people through their own initiatives and of their own volition. Through NEPAD, African leaders are making a commitment to promote peace and stability, democracy, sound macroeconomic management, people-centred development and to hold each other accountable in terms of economic and political governance under the plan. The major distinguishing feature of NEPAD is the emphasis on African ownership and a demonstrated commitment on the part of African leaders to take Africa's destiny in their hands. There is a new resolve to deal with conflicts and censure deviation from internationally accepted norms of governance. These efforts are reinforced by the civil society and are much more committed to regional and continental goals of economic cooperation and integration.

## India's Initiative to Boost Bilateral Commercial Relations

The Government of India launched an integrated programme - 'Focus Africa' in 2002, with a view to significantly enhance India's trade with Africa consistent with the objectives of NEPAD. The "Focus Africa" programme centres on Sub-Saharan Africa (SSA) with added emphasis on seven major trading partners in the region, namely Nigeria, South Africa, Mauritius, Kenya, Ethiopia, Tanzania, and Ghana, which together account for 69 per cent of India's total trade with the SSA region.

Further, effective April 1, 2003, the 'Focus Africa' programme will be extended to cover 24 countries in Africa. Specific products to be exported to these countries have been broadly classified into the following major product groups: cotton yarn, fabrics and other textile items; drugs and pharmaceuticals; machinery instruments; equipment; transport equipment; and information technology. At the same time, the 'Focus Africa' programme envisages enhancing India's exports to the region through integrated efforts of the

Government of India and other institutions, such as the India Trade Promotion Organisation, Export Promotion Councils, Apex Chambers of Commerce and Industry, Indian Missions and institutions such as the EximBank of India. The 'Focus Africa' programme would also supplement the Lines of Credit, which the Government of India has already extended to African countries, including Tanzania, Mozambique, Uganda, Seychelles, Zambia, Zimbabwe, Mauritius and Ghana.

Turning to the issue of globalization and how Africa can effectively take part. Africa's strategy towards globalisation should reflect the structure of their economies and their resource endowments relative to other parts of the world. While some African countries have the basic infrastructure and human capacity to embark on industrialisation, the majority are at a pre-industrial stage. In addition, Africa faces the highest transport and telecommunications costs in the world. The performance of the primary sector will be crucial since this sector dominates economic activities in most economies in Africa and provides a bulk of foreign exchange earnings. Given the long gestation period of investments in human capital, the primary sector is likely to remain crucial for many years to come.

## Primary Sector

The performance of the primary sector will be critical because this sector accounts for a lion's share of Africa's foreign exchange earnings. In this regard, the immediate task for most African countries is to rebuild their primary commodity export sectors, and formulate strategies to promote export diversification. African countries could also actively intervene in expanding and diversifying primary exports. Creating or supporting institutions for research and development as well as education and training in this sector should also be given priority. Other key transport-related obstacles that deserve attention include the lack of good roads necessary for the transportation of agricultural produce to major centres, insufficient rolling stock and lack of refrigerated trucks and cold-storage facilities for perishables.

In addition, African Governments should strive to formulate longer-term strategies to develop primary-processing capabilities, which could assist in the acquisition of new skills and technologies, productivity growth and economies of scale. If resources are managed on a sustainable basis, natural resource-based industrialisation would remain a viable development path for many African countries. There are a number of ways in which African governments could intervene to encourage exports, especially manufactured exports. Selective export promotion measures such as duty exemption and drawback schemes could be used to create free trade conditions for exporters. Other measures to be considered include the establishment of bonded warehouses and export-processing zones (EPZs), which would enable firms to import on a duty-free basis subject to the requirement that their entire output is exported.

Further, financing agriculture is considered a relatively risky venture by lenders and are therefore very reluctant to lend to the Sector. Yet in developing countries, investment finance and working capital are the main bottlenecks to smallholder farming activities because of the general absence of a viable and sustainable rural financial system. World-wide, small-scale farmers require short-term loans that are repayable immediately after harvesting and marketing of their produce. The challenges associated with rural financing have led to the reluctance of financial institutions to engage in these undertakings. These challenges include:

- Absence and/or inappropriateness of pledgable collateral;
- small-scale nature and geographically-scattered rural farmers;
- difficulty in monitoring and control of farmers' activities;
- absence of legal framework for agricultural credit; and
- poor rural infrastructure.

Generally, diversification brings economic development. It helps in improving export revenues, external finances and the balance of payments, and contributes to poverty eradication. The beneficiaries are not only producers but also agricultural labourers and employees in the export processing industry. In the case of producers, benefits result from sales of non-traditional commodities while agricultural labourers and employees engaged in export processing benefit from salaries as well as food and housing allowances.

African countries should also aim at producing agricultural exports that are competitive in the long-term. In this regard, pro-active government policies may be needed to help to minimise these costs and add value to the commodities, which are both critical to enhancing competitiveness.

## Organic Farming

During the last decade, organic agriculture has gained international recognition as a valid alternative to conventional food production. The growing awareness of the health hazards arising from the contamination of farm produce as a result of the use of chemical fertilizers and pesticides has given momentum to organic farming. Organic farming is a sustainable solution to exploitative agricultural methods, which have caused considerable damage to ecosystems. Organic farming is a holistic system of farm design and management that seeks to create a healthy ecosystem with sustained profitability. It provides weed and pest control through mutually dependent diverse forms of life, recycling of plant and animal residue, crop selection and rotation, water management, tillage and cultivation. Pest and disease management is also attained by balanced host predator. Soil fertility is maintained and enhanced by optimising soil biological activity as a means to providing a balanced nutrient supply for plant and animal life as well as conserving soil resources.

Organic farming in Africa is exhibiting increasing trends, especially in Southern African countries where more than 200,000 hectares of land is managed organically. Amongst African countries, Uganda has the largest land (122,000 hectares) under organic farm management followed by South Africa (45,000 hectares), Tunisia (18,255 hectares), Egypt (15,000 hectares) and Morocco (11,956 hectares). The growth of organic farming in Africa can be attributed to demand for organic products in industrialised countries, as well as recent attempts at maintaining and building soil fertility on land threatened by degradation and erosion. On the other hand, the domestic market for certified organic produce is developing very slowly, partly due to low-income levels and the level of organised organic movements. However, efforts to establish organic markets are going on in countries, such as South Africa, Uganda, Kenya and Tanzania. Few supermarket chains and specialised stores are selling organic produce in local markets of South Africa and Egypt. But, a larger proportion of the produce is exported. Major organic products from African countries sold in international markets are coffee, tea, cotton, bananas, honey, pineapples, dried fruits, vegetables, vanilla and sugar, among others.

As in most other developing regions, inspection and certification of organic farming in African countries are carried out by foreign organisations, which is costly to the organic farmer in Africa. Other major constraints to the development of organic farming are stringent regulations in the major importing markets, reduction in size of traditional farming area because of increasing size of rural population and lack of skilled labour to maintain farm record keeping, among others.

Nonetheless, the opportunities for organic farming cannot be ignored because of the fact that most production in Africa is traditional and complies more or less with the principles of organic agriculture as laid down in the International Federation of Organic Agriculture Movement's (IFOAM) basic standards. This is similar to the Indian standards for organic production,[2] or the European/ US/Japanese standards. Likewise, African countries should develop their own national standards, accreditation criteria for inspection and certification agencies, accreditation procedures, inspection and certification procedures for the development of organic farming in their respective countries. Unless, Africa makes a shift towards organic farming, the costs, in terms of environmental degradation and health, arising from modern agricultural practices could be huge and unaffordable.

[2] National Programme for Organic Production (NPOP) based on guidelines of IFOAM

Organic farming is therefore, a welcome alternative from three perspectives:

- Small Farmer: Less financial drain;
- Environment: subject to a more eco-sensitive mode of farming, aimed at improving soil fertility; and
- Government: by encouraging organic farming, and thereby reducing the reliance on fertilizers, can gradually trim its subsidy bill and, thus, achieve some fiscal savings.

## Captive Farming

There is a need to encourage diversification in agriculture and build up a climate for industrial investment by providing linkages between agriculture and industry so as to utilise effectively the surplus agricultural produce. There is also need to build up effective backward linkage through contract farming and captive farming. With respect to the latter, Indian companies can set up captive farms in Africa to grow pulses, which India usually imports. The output of the farms can be exported to India and the revenues arising therefrom used to service the capital investments made in the farms. The same financing pattern could be adopted for export oriented projects where export proceeds could be escrowed to recover the investment. For instance, Rajasthan, which is an Indian state, has the largest area of 52 hectares of cultivable waste land. With a view to convert desert and other areas into prosperous green belts, a policy has been formulated with rules and procedures for setting up large agro-based industrial projects on the waste lands by private entrepreneurs. Any private entrepreneur can be allotted the waste land for establishing value added agro-industrial project with captive farming, plantation and horticulture with the preference for export-oriented projects.

Turning to Africa, since the late 1960s, Africa's world trade has reflected a failure to diversify into new, dynamic products as well as a falling market share for traditional merchandise exports. Africa's trade reforms have mostly been negotiated with donors as part of sponsored adjustment programmes. African countries should now focus their economic reforms on developing strategies that promote exports anchored on competitive and stable real exchange rates, and assisting exporters to access imported inputs at reasonable prices. Further, there is a need to increase dialogue between Government and the business community with a view to developing world-class service standards. Here again, a regional approach could be vital not only to encourage intra-African trade flows, but also to provide a wider platform to encourage investments. In addition, African countries need to work together to participate in the on-going multilateral trade negotiations currently shaping the world trading system. The capacity requirements for this are too great for small, poor countries to undertake, effectively.

## Concentration of African Exports

Analysis of Africa's exports reveals a high level of concentration among major exporters, as well as in terms of composition of the commodities. The top 12 major exporters account for as much as 72 per cent of Africa s total exports, with South Africa, Algeria and Nigeria accounting for 18.6 per cent, 14.7 per cent and 13.0 per cent of total exports respectively in 2001. The remaining 41 countries accounted for only 28 per cent of the total (see Table 4).

## Commodity Composition and Concentration

African export commodities can be grouped into three broad sectors, namely agriculture, energy and metals. In the agricultural sector, the important commodities include; cocoa, coffee, cotton, palm oil, sugar and tea, among others; while in the metals sector, the important export items include copper, gold, iron ore and phosphate. In the energy sector, oil is the major export. An analysis of the major exporting countries in each commodity sub-sector reveals high levels of concentration of exports. For example, cocoa exports come predominantly from four countries. These are Côte d'Ivoire, Ghana, Nigeria and Cameroon who collectively account for as high as 97.8 per cent of Africa's cocoa and Kenya, account for 83 per cent of Africa's total coffee exports. Concerning tea, Kenya, Malawi and Uganda jointly account for around 83 per cent of Africa's total tea exports. The story is the same for other export commodities like sugar (Mauritius, Swaziland, etc), metals (Zambia, South Africa).

**Table 4: Merchandise Exports (f.o.b) from Africa**

| | 2001 (US $'mn) | % share |
|---|---|---|
| South Africa | 26,606 | 18.6 |
| Algeria | 21,125 | 14.7 |
| Nigeria | 18,700 | 13.0 |
| Morocco | 7,256 | 5.1 |
| Egypt | 7,078 | 4.9 |
| Angola | 6,703 | 4.7 |
| Cote d'Ivoire | 3,668 | 2.6 |
| Gabon | 2,897 | 2.0 |
| Botswana | 2,314 | 1.6 |
| Equatorial Guinea | 2,182 | 1.5 |
| Congo, DR | 2,180 | 1.5 |
| Cameroon | 2,129 | 1.5 |
| **TOTAL** | **102,838** | **71.7** |
| **Others** | **40,503** | **28.3** |
| **Total African Exports** | **143,341** | **100** |

*Source:* World Bank, *African Development Indicators, 2003*

## Dependence on Few Export Commodities

Besides the concentration of Africa's exports in the primary, agricultural, metals and oil sectors, the overwhelming dependence on the exports of few commodities reflect the vulnerability of the African economies to fluctuations in global commodity prices. For instance, for exporters of crude oil, fluctuations in global crude oil prices would seriously impact their export earnings. The same would apply to exporters of agro-commodities and metals.

## Financing Techniques for Promoting Export Diversification in Africa

Financing options, such as trade credit, guarantee and insurance instruments are important tools for promoting export diversification. A host of different methods and approaches need to be adopted depending on the specific requirements, economic and export possibilities of each nation. There is some resistance on the part of entrepreneurs to venture into riskier export ventures. In addition, there are occasions when banks are reluctant to finance exports due to the associated risks. Therefore, the need to develop and implement both traditional and innovative financing techniques to promote the growth and development of a diversified export base in Africa is very important.

## Successful traditional methods of financing exports usually have the following major features:

- Medium and long term export-oriented financing;
- Short-term working capital financing;
- Re-financing system of the commercial banks' export credits;
- System for insuring against political, commercial and foreign exchange risks encountered while operating in foreign markets; and,
- Provision for adequate export credit guarantee cover to commercial banks involved in the financing of export trade.

### I. Structured finance

This is essentially the technique of transferring risks in trade financing from parties less able to bear those risks to those more equipped to bear them in a manner that ensures automatic reimbursement of advances from the underlying assets. Such assets include inventory and export receivables. Structured commodity finance would be particularly relevant and helpful to commodity producing/exporting companies whose activities are perceived as highly risky by lenders. Under such circumstances, structured finance would allow many of these companies to obtain finance at reasonable terms. Sound companies in countries considered as risky by financiers can actually get credit at relatively lower rates through the deployment of structured finance techniques.

Further, structured finance can also be relevant to new companies without track records. Banks usually attach importance to a company's track record in normal asset based financing, while in a structured finance transaction, the reliability of the transaction and the ability of the company to perform its obligations is of prime importance. Comparing structured commodity finance with traditional forms of finance, especially asset based, a number of important differences come to the fore, notably:

- Country Risk: The sovereign risk factor is usually the main determinant of the interest rate paid by companies within that country. With normal financing, no company is able to raise resources from banks at rates lower than that paid by the country in which it is based. With structured finance, companies can obtain rates better than those paid by their Governments by shifting parts of the risks abroad. This is an important advantage of structured finance as interest rates and associated costs to borrowers are critical to their international competitiveness.

- Balance sheet vs. Actual Transaction: Traditional asset-based financing has a number of weaknesses, including the difficulty of knowing the real value of the balance sheet presented by a company in view of the varying degrees of accounting standards across the globe, as well as the fact that transactions of the borrowing company are not very important. In structured finance, the role of the balance sheet becomes minimal with the soundness of the transaction being decisive. In this way, even a non-performing loan can be productive if the particular export transaction is viable.

- Financing skills: Obstacles to structured finance which may not exist in the case of more traditional forms of financing is the lack of understanding and awareness of structured financing techniques and modalities. This often results in legal and policy barriers to this form of finance, including:
  - Restrictions on the use of escrow accounts;
  - transferability of export contracts; and
  - ability to pledge certain assets

## Advantages of Structured Finance

First, this form of finance moves risk away from the party which is being financed. The credit risk can be replaced by the credit risk of another commercially stronger counter-party. This implies that structured finance is relatively safe and losses on traditional commodity financing can be largely overcome by structured commodity financing.

Second, structured finance aims to convert assets into ready capital, e.g., oil fields, plantations to produce crops such as cocoa, coffee, etc., or fields to produce annual crops, such as cotton. Structuring techniques make it possible to raise funds on the basis of these assets, which can then be used to exploit these assets and convert them into ready cash.

Third, structured commodity finance requires innovative techniques in terms of the ability to structure the financing around the conditions of a company and the conditions of the country in which it operates.

## II. Forfaiting

As a trade financing technique, forfaiting has in the recent past, attracted growing interest in both the banking sector and the financial press of export-oriented countries. This is due to the fact that in many cases it has proven to be one of the most efficient instruments when it comes to export finance.

Generally, forfaiting is the term used to denote the purchase of obligations falling due at some future date arising from deliveries of goods and services - mostly export transactions - without recourse to any previous holder of the obligation. The forfaiter will deduct interest (discount) in advance for the whole period of credit and disburse the net proceeds, immediately. The exporter, thus, virtually converts his credit based sale into a cash transaction. His sole responsibilities are manufacturing and delivery of the goods for the purpose of creating a valid payment obligation of the importer.

## III. Factoring

Factoring is the discounting of receivables for goods and services on a portfolio basis, with or without recourse, to the seller. It is used to provide short-term sales financing and protection against credit losses. Factoring, which now operates as a trade finance product in about 50 countries, started first in North America in the textile industry. During the 1950s and 60s, factoring became important in the economic growth of the USA, supporting about US $62 billion worth of trade. In Europe, factoring has grown and has gained substantial acceptance in Italy, France and the UK. It was introduced in China in the 1980s and, in India in the early 1990s.

## Forfaiting vs. Factoring

The terms factoring and forfaiting have been mixed up frequently. Factoring is suitable for financing several and different smaller claims for consumer goods with credit terms between 90 and 180 days, whereas forfaiting is used to finance exports of capital goods with credit terms between a few months and several years. Factoring only covers the commercial risk, whereas forfaiting covers the political and transfer risks.

## Figure 1: Transaction Flow in Two-Factor Arrangement

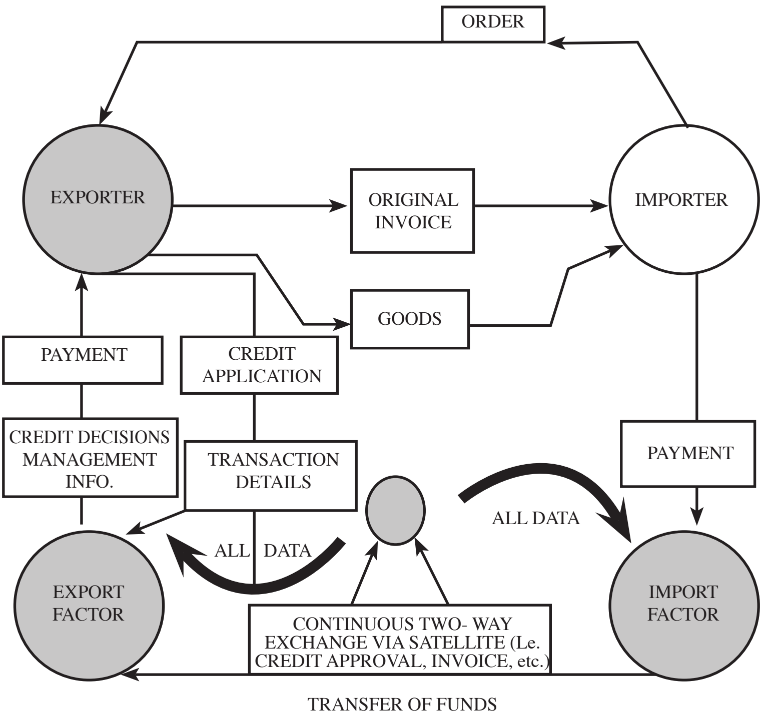
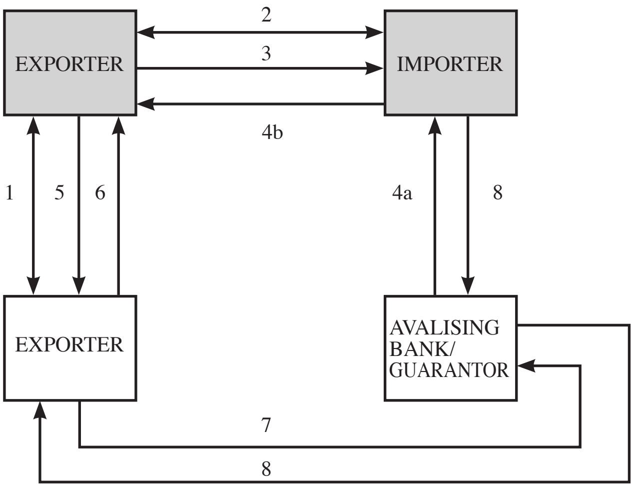



Figure 1 above shows a typical mechanism for international factoring. Factoring normally is the acceptance of an order from a buyer by a seller. The exporter discusses payment modalities with the importer, and the two can agree, in a preliminary manner to use the international factoring system for payment and collection, subject to the terms and conditions which the export factor shall offer later.

The exporter then contacts the export factor (possibly through his own local bank) to check whether the importer is indeed an acceptable counter-party for the factor. The export factor initiates a credit inquiry through his counterpart in the importer's country, and asks the import factor whether he is willing to take on the importer's credit risk. Based on the decision made by the import factor on this request, the export factor issues a "letter of undertaking" of the credit risk. He sends the original to the exporter's bank and a copy to the exporter. On this basis, the exporter and importer make their final decisions on using the factoring system, and the exporter ships the goods. The exporter then receives an advance from the export factor on delivery of the shipping documents through his bank. The goods are accompanied by an invoice which specifies that the importer has to deposit the payment into an account which may be in the exporter's name, but which is controlled by the import factor. The local bank sends the shipping documents to the import factor, and the import factor remits the documents to the importer - he may require the importer to pay prior to this. Thereafter, the import factor ensures the transfer of the sum paid (minus his commissions and costs) to the exporter through the export factor (either through a correspondent bank, or directly). Within at least one of the major factoring networks, a mutual offset arrangement has been developed.

Forfaiting is most often 'built into' the commercial contract. For example, the exporter knows that the importer is willing to pay with, say, promissory notes, which are avalised or guaranteed by a prime bank. The exporter thus contacts the forfaiting branch of an international bank or an independent forfaiting company to obtain a price quote or forfaiting terms for the specific transaction. The exporter then negotiates the terms with the importer, and is hopefully able to sign a commercial contract. Once the contract has been signed, the exporter converts the 'options to discount' into a firm offer from the forfaiter and ships the goods. Upon shipment or delivery of the goods, the importer presents his promissory or other previously agreed documents (using a pre-approved format and language which follow international norms), to his bank for an aval or a guarantee.

**Figure 2: The Flow of a Forfaiting Transaction**




***Notes:***

1. Commitment to acquire Debt Obligations.
2. Commercial Contract signed
3. Delivery of Goods to Importer
4. a) issue of Guarantee by Avalising Bank/Guarantor
   b) delivery of Avalised Notes/Bills to Exporter
5. Delivery of Avalised Notes/Bills to Forfaitor
6. Discounting of Debt Obligations by Forfaitor
7. Presentation for Payment at Maturity to Avalising Bank/Guarantor
8. Repayment at Maturity by Importer.

The guaranteeing bank remits the instruments together with its guarantee to the exporter. The exporter endorses them and sends the guaranteeing bank a copy of the invoice, bill of lading and other required documents. The endorsed avalised instruments are sent to the international bank/forfaiter, which checks the validity of the notes and signatures. If notes and signatures are in order, the forfaiter pays the exporter as per the previously agreed terms. If verification takes too much time, another solution would be an immediate payout made under the proviso that the validity of the signatures be confirmed.

Assuming that he does not sell the paper on the secondary market, the forfaiter then waits until the maturity of the instrument and present it to the guaranteeing bank which remits payment as specified. It is the responsibility of the guaranteeing bank to collect its dues from the importer.

## I. Financing of Export Receivables

In financing export receivables, finance is extended to an exporter against assigned proceeds of export contracts either already executed or yet to be executed with the proceeds from a loan. Such assignment would normally be acknowledged by the buyer with payments made directly to the lender. In cases where an export receivable facility is granted post shipment, it is regarded as re-financing which enables the exporter to continue operations without waiting for the buyer's payment.

This form of financing is similar to forfaiting and factoring with the major difference being that the future payments from the buyer are discounted and the financier takes most of all of the payment risks in forfaiting and factoring, while in export receivables financing these future payments act as guarantee for the bank's reimbursement.

## II. Securitisation of Receivables

Securitisation is the process where a bank's stress assets are sold to a Special Purpose Vehicle (SPV), which issues securities backed by these assets in the financial markets. Such securities are referred to as Asset-backed Securities. This allows the segregation of the risks of such assets into credit risk, interest rate risk and liquidity risk leading to more effective management of the risks, which allows issuers from developing countries to lengthen the maturities of their debt, improve risk management and balance sheet performance, and tap a broader class of investors. This practice is used essentially as a means of enhancing corporate liquidity.

Usually, during financial crises, developing countries find it difficult to obtain low-cost, long-term loans. However, securitisation of future flow receivables can help investment-grade public and private sector entities in developing countries to enter the international capital markets for trade and project financing. Accordingly, securitisation of future flow receivables may be the only way for many developing countries to begin accessing the international capital markets for reasonably-priced longterm financing.

## III. Counter-trade

This is one of the oldest payment methods in international trade and has been used in about one fifth of world trade transactions, and its share is increasing. Generally, it involves the exchange of goods and/or services as a condition of purchase, or as financing of purchases. Counter-trade in its various forms has evolved as an important tool for doing business in particularly difficult markets and is valuable in markets where there is a shortage of foreign exchange reserves, where the currency is not freely convertible, or where there is difficulty in obtaining export credits.

Counter-trade covers several forms of trade in which the seller is required to accept goods, services, or other instruments of trade, in partial or whole payment, for its products. It is an umbrella term for a range of reciprocal or compensatory trade mechanisms, including barter, compensation, counter purchase, buyback, offset, switch trading and tolling. The primary objective of counter-trade is to oblige a seller to generate foreign exchange for the buyer. The structure of counter-trade transactions varies according to the characteristics of the deals financed and the types of assets that form the means of repayment. At most, it is a trade practice whereby a supplier or exporter is contractually linked with the buyer, having as a condition of sale the obligation to undertake reciprocal "commercial' actions which benefit the importer and/or the importing country.

Counter trade agreements involve complications not normally found in contracts governing the sale of goods for cash between private parties, namely:

- Agreements and actions for their breach can get extremely complicated, because each party is both buyer and seller of goods and is potentially entitled to the full range of both buyer's and seller's remedies.
- Agreements are often entered into with a Government or a Governmental Agency. The exporting company therefore, needs to be aware of the possible effects of sovereign immunity.

## IV. Compensation

As a risk mitigating measure, one could use compensation as a compensatory protocol arrangement between industries linking exports and imports, combining cash and barter. It is also an arrangement between countries linking exports and imports where the foreign supplier agrees to take full or partial payment in kind for the goods sold. Compensation can be total (that is, the financial value of the goods exported is equal to that of the goods imported), or partial (the party making the first delivery receives part of the payment in cash).

In a typical transaction, a supplier from an industrialised country would sell manufactured goods to a buyer from a developing country and a monetary claim would be registered against the buyer. Such claim would be cancelled by a compensating delivery of commodities by the buyer. Both transactions would be part of the same contract. Where the manufactured goods are supplied first, the transaction would be supported by a cash deposit made by the buyer of manufactured goods in an escrow account. This cash deposit would be released to the buyer once he or she has duly delivered the commodity, perhaps under a letter of credit arrangement. In the absence of foreign exchange, the claim can also be cleared via an evidence account at a bank of the developing country. If the commodity is supplied first, as is often the case, a similar method could be used involving cash deposit by the supplier of manufactured goods. More often, the supplier may use or transfer the purchasing commitment to a third party, who may be the end-user of the products, or a trading house. In a triangular compensation, a supplier may agree to sell manufactured goods to a buyer and at the same time agree to take commodities as compensation, but not necessarily from the same party. If the supplier of the manufactured goods does not want the commodities, he or she would still take delivery of the commodities but then assign them to a trading company that would sell them for a commission to a second buyer.

## V. Commodity Imports

Government agencies have largely been responsible for commodity exports and imports in developing countries. There have been several instances of private sector exporters exchanging their export proceeds for local currency from the Central Bank. Global uncertainties had resulted in increased risk perception in lending to commodity exporters in developing countries. This has created the need to look at ways to shift risks away from the developing country lender to the importer.

The first structured solutions to the problem of import finance were developed for countries where exports and imports were coordinated by a government agency with export proceeds being used to obtain import finance at better terms. Similar schemes were operated in several other countries. For instance:

- Imports of fertilizer and other agricultural goods by the Kenya Tea Development Authority were financed using a structure in which export revenues from the resulting crop were used to repay the import credit.

- An oil import facility for Tanzania was structured on the basis of assignment of the proceeds from coffee exports. This deal had to be interrupted midway because the country's Structural Adjustment Programme forced the Government to release its control over the proceeds of coffee exports. This is one of the main reasons for the lack of popularity of such a structure.

- In Seychelles, certain European banks had provided a medium-term loan to the government taking pledge of the receivables of the country's sea food exports for the next few years.

- In another form of import finance, banks providing oil import finance to Zambia's Oil Importing Agency were responsible for receiving all payments for the local sale of this oil. Before the financing was approved, all the local sellers had to commit themselves (irrevocably) to pay for the oil that they bought from the import agency through an escrow account. The bank received these payments in local currency, and thus ran a currency risk. This was mitigated through the use of forward currency contracts. This form lost its importance in financing Zambia's oil imports because of the process of privatisation.

## VI. Microfinance

The importance of promoting local enterprises through an efficient and effective domestic credit system which complements well structured export financing arrangements cannot be overemphasised. The informal sector play a significant role in developing countries. In addition, the growing developmental impact of Small and Medium Enterprises (SMEs) and their need for financing calls for the development of microfinance institutions in developing an economy. Microfinance can help export promotion and diversification, if effective structures to finance and assist SMEs are established. In this regard, SMEs, who otherwise cannot meet the financing requirements of banks, could be assisted with micro pre-and post-shipment financing provided by Microfinance institutions.

## VII. Project Finance

The last two decades had seen project finance emerge as a tool for promoting economic investments by providing financing structured around the project's operating cash flow and assets without additional sponsor guarantees. This technique facilitates the mitigation of investment risks. By using the appropriate framework, project finance can provide a strong and transparent financing structure for projects and lead to an increase in investments and improve capacity for economic growth to the benefit of investors and the national economy. Project financing is usually tailored to meet the needs of a specific project whose risks are shared by different types of investors (equity investors, lenders, etc). There are two basic types of project financing, namely:

- Non-recourse project finance. This is an arrangement under which investors and lenders financing the project do not have any direct recourse to the sponsors as is, traditionally, the case. Though the security will include the assets being financed, lenders rely on the operating cash flow generated from those assets for repayment. Hence, the project needs to be fully structured and provide comfort to potential financiers on the basis of economic, technical and environmental viability, including capability to service its debts as well as generating financial returns commensurate with its risk profile.

- Limited-recourse project finance. This allows creditors and investors certain recourse to the sponsors. This may be in several forms of support for the project, such as pre-completion guarantee. However, creditors and investors would, primarily want the project to succeed for returns. In developing markets, use of this form of finance is on the increase.

This is instrumental in encouraging companies to participate in projects as the risks of the new project would remain separate from its existing business and even if the project were to fail, the financial integrity of the company would not be at stake. Proper restructuring will also protect the capital and debt capacity and will enable the company to expand its overall business. Because of their self-liquidating, off-balance sheet financing characteristics, counter-trade and project finance deals have the potential to complement each other when integrated into a single project financing package. Counter-trade, if integrated into project finance structures, can provide developing countries an opportunity to finance infrastructure projects with their exports, and to mitigate risk and secure repayments.

## VIII. Build-Operate-Transfer

Traditionally, the creation of infrastructure services has remained the responsibility of governments. This has been the case in both market as well as command economies. However, this view is now changing. In many countries, governments have simply run out of capital for funding all the necessary social and economic infrastructure. They are therefore looking to the private sector for investment through an innovative contracting and financing model called Build-Operate-Transfer (BOT). Here, the government authorises investors (either an individual company or a consortium) to finance and build a project, own it and operate it for a certain period, then transfer it to the government without any capital charge. Variations of the BOT model include:

- BOO (Build-Own-Operate): The company/consortium carries out the project. However, the installations remain the property of the company and consequently, are not transferred to the Government.

- BOOT (Build-Own-Operate Transfer): This approach differs from BOT by the fact that the company/consortium becomes the owner of the facility during the exploitation stage.

- BT (Build-Transfer): The company/consortium carries out the construction works, and transfers the installations to the owner, usually the Government, upon completion.

- BTO (Build-Transfer-Operate): Here the government entity becomes the owner of the works, and requires the company/consortium to exploit according to pre-determined terms.

- BLT (Build-Lease-Transfer): The company/consortium finances and builds the infrastructure facility, which it then rents to the government for a certain contractual period, at the end of which ownership is transferred.

## BOT offers two big advantages:

- The government, at little expense, transfers risks to "financial engineering" and project management (construction/ exploitation) to the contractor. At the same, it also benefits from the expertise and technologies of the contracting company by integrating the newly created physical infrastructure into the national environment; and
- The contractor gains access to a market that normally would have been difficult to penetrate. The return on investment is fixed and infrastructure projects in markets other than that of OECD countries usually offer relatively high yields when compared to the funded capital.

Some sectors that are ideal for consideration under BOT schemes include:

(i) Water supply, sewerage, sanitation and environment;
(ii) Public Housing;
(iii) Energy/power, transmission lines;
(iv) Media and telecommunications;
(v) Transportation, roads and mass transport; and
(vi) Information Technology.

## Conclusion

It is a known fact that Africa's trade has been characterised by reductions in its share of world trade and dependence on few export commodities. However, despite many challenges facing Africa, considerable progress has been achieved through prudent macro-economic management and continued structural reforms in many countries. This is as a result of the growing commitment of many African governments to fiscal discipline, monetary and exchange rate policies. Remarkably, in the face of deteriorating external accounts, money supply growth has been contained, inflation has subsided and fiscal balances have improved.

This improvement in Africa's economic fundamentals is in sharp contrast to conditions during the last decades when domestic policy stance was often compromised by accommodating deterioration in external accounts through increased deficit financing and excessive money supply growth.

Recent experiences of African countries during the last two decades show that economic reformers performed much better than the continental average in terms of trade and economic growth while also diversifying their economies and expanding non-traditional exports. Stimulus to sustained growth would emanate from the deepening of reforms. This is due to the fact that as economic reconstruction and policy reforms deepen, a more investment friendly environment would emerge.

Further, there is growing consensus that the health of local banks has a direct impact on the health of national economies. Local subsidiaries of international banks can only meet local needs. Domestic banks can provide an essential link in creating a new financing chain from the international capital markets down to the local producers. If the domestic banks are too large in number and/or too new on the market for international banks to evaluate properly, then regional banks can provide the missing link.

In recent years, the availability of commodity export credit has become rather critical due to the adoption of tight monetary policies and privatisation of commodity trading agencies in many developing countries. Such agencies were the traditional providers of trade financing to exporters and often acted as intermediaries between banks and exporters by lending funds to established businesses. However, the risk of default is the greatest constraint to the provision of credit. To this end, domestic banks can bring in their expertise to bear on commodity sector. They can act as local facilitators and/or controllers of financing transaction (e.g. ensuring the physical presence of collateral or holding title documents), co-finance, provide forward currency cover, or facilitate regional trade. Further, there is increasing potential for domestic banks to play an important and active role in financing commodity production and trade. Domestic banks have a natural advantage in facilitating commodity financing transactions. They are present locally, know local players, including the service providers and are in a position to spot problems early enough to resolve them informally or legally. In addition, domestic banks would benefit through skill enhancements and technology gains by exposing local exporters to international banks, product expansion and additional income, through correspondent banking. To harness this potential, there is a need for local banks to devote resources to both institutional and human capacity building within the banking sector.