# Infrastructure Finance: Implementing Market-based Financing Options

## Issues in Finance Options

Infrastructure Finance Regional Workshop
Sponsored by USAID Indonesia


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Research Triangle Institute
(RTI Task No.: 6598-03)


March 1997


Environmental and Urban Programs Support Project
Contract No.: PCE-1008-I-00-6005-00
Project No.: 940-1008
Contract Task Order No. 02
Sponsored by the Office of Environment and Urban Programs (G/ENV/UP)
U.S. Agency for International Development
Washington, DC 20523

# INFRASTRUCTURE FINANCE: IMPLEMENTING MARKET-BASED FINANCING OPTIONS

## ISSUES PAPER


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## INTRODUCTION

### Workshop Purpose

Recognizing the need to build sustainable methods to finance the large demand for urban infrastructure, efforts are underway throughout the region to establish new mechanisms to tap private capital markets and to promote financing under market conditions. These mechanisms include creating municipal bond markets, reforming municipal development funds (MDFs), and privatizing infrastructure services . The workshop will attempt to document the state-of-the-art with regard to these efforts. Of particular interest is information on what measures governments have taken to implement new systems and the extent to which these efforts are successfully contributing to integrated systems for expanded financing urban infrastructure improvements.

### Workshop Participants

The primary audience for the workshop consists of practitioners and consultants actively working in the area infrastructure finance in developing countries in general and in Asia in particular. Participants will be drawn from the private sector, the investment community, and from government policy making and service agencies. The primary purpose of the workshop is a frank exchange of technical information regarding how to overcome obstacles in building new financing systems. Specific questions/issues that will be explored are outlined. The workshop is not intended as a forum for introducing municipal bonds to senior policy makers, discussing the benefits of bonds, MDFs, and privatization or exchanging basic information on bond markets or MDF activity. The discussion is very much intended to be technical, focusing on specific implementation strategies, rather than academic or broadly descriptive. The workshop is intended to spark a healthy debate about what is necessary to build private investor appetite through institutional and regulatory reform and building capacity of public services.

### Workshop Issues: Background

Issues in the implementation of the three financing alternatives will be explored through country case studies. The studies will serve as a springboard for discussion in plenary sessions and small work groups.

Two principal debt financing mechanisms are in use world wide: (1) municipal development funds, i.e. facilities that loan money to local governments for infrastructure improvements; and (2) municipal bonds or related kinds of securities. The first approach has been used mostly by European countries and Japan, and more recently by developing countries in Africa, Asia, and Latin America. Bond financing has been used extensively by local governments in the U.S., but is now becoming more widespread in some European countries.
A more important difference in terms of how countries apply debt mechanisms exists between industrialized and developing countries. In the former, local government debt finance has largely been successful, in the sense of providing significant amounts of funding for infrastructure development. A large part of the success appears to result from the fact that while one or the other mechanism is emphasized in a given country, both methods are typically in place, supporting each other. For example, in countries like Belgium, Denmark, France, and the U.K., municipal development funds are capitalized largely with bonds and other forms of external borrowing. In the U.S., bond banks and pooled financing schemes make the benefits of bond financing available to smaller local governments that otherwise could not access the capital markets in cost-effective fashion.

In contrast, most MDFs in developing countries have relatively little impact on local government financing needs, largely because they are undercapitalized. Such funds typically do not sell bonds, do not have independent access to capital markets, and receive virtually all of their capital from donors and/or central government budgets.

Many experts assume that, as with most industrialized countries, neither debt financing mechanism by itself can suffice to underpin a sustainable, extensive system of local government debt finance in developing countries. Many, perhaps most, local governments and local government-owned enterprises in developing countries are not capable of selling municipal bonds, even if active markets in such securities exist. Most MDFs are expected to have limited impacts until they can access capital markets, typically via bond issuance, to increase their capitalization.

Privatization is another alternative to debt financing for infrastructure investments. Privatization refers to any of a number of measures to involve the for profit sector in the construction, ownership, and management of urban services. In Asia, privatization has focused primarily on public utilities such as water and electricity. A number of regulatory, financing and management constraints typically impede privatization by failing to offer attractive conditions for private investors. However, countries, such as the Philippines where BOT actions have resulted in approximately $18 billion of private investment, have demonstrated that the appropriate regulatory change, tax incentives, and management improvements can create an attractive investment environment.

**Workshop Themes**

The key issue for many developing countries is how to develop and implement an integrated approach to infrastructure finance that improves the performance of MDFs, stimulates the development of markets in municipal bonds, and other private financing mechanisms. Developing each mechanism individually and separately has proved to be challenging; doing so in an integrated fashion, when the mechanisms are often viewed, at least in the developing country context, as natural competitors, is even more difficult, but essential to the long-term sustainability of both.

This workshop is designed to address this issue by attempting to answer the following questions, which will serve as key workshop themes:

- How should the performance of MDFs be evaluated, and how can it be improved in order to significantly increase the flow of capital to local governments for infrastructure finance?

- How can the supply of municipal bonds, and the demand for such investments, be effectively promoted in the developing economy context?

- How can improvements in sectoral policies, regulatory reform, and risk management tools be put in place to facilitate direct private sector investment?

- How can efforts to improve MDF performance, stimulate municipal bond issuance, and facilitate direct private equity investment be successfully integrated into a single national strategy for infrastructure finance? A related question is, what can donors do to stimulate progress in these areas, and avoid "crowding out" local government debt financing that attempts to access domestic capital markets via bonds or loans?

**THEME #1: IMPROVING THE PERFORMANCE OF MDFs**

**Definition**

For the purposes of the workshop discussion, "municipal development fund" is meant to be a generic term including any and all conduits for loan funds used in infrastructure projects undertaken by local governments or local government enterprises. This definition is meant to include (1) funds administered by government ministries or departments (e.g., Ministry of Local Government, or Ministry of Finance); (2) windows for municipal infrastructure loans administered by state-controlled pension, insurance, or savings funds; (3) institutions with legal and financial identities separate from central governments, including municipal development banks (privately owned, owned or controlled by local governments), municipal "windows" in such banks, associations of municipalities, development authorities owned by local governments, non-bank financial institutions providing credit services to local governments, etc.

Of particular interest are regional examples of the approximately 30 government-owned and controlled "traditional" MDFs created by the IBRD, and similar funds that have become the preferred means of donor loan disbursement to local governments in many developing countries.

**Operational Shortcomings**

Operational shortcomings typically are the most visible of MDF problems. They are often associated with government ownership and may include the following:

- Undercapitalization
- Poor financial discipline
- Poor project appraisal capabilities
- Poor marketing and outreach capabilities
- Inefficient subsidization of lending
- Interference in operations
- Vague or weak repayment mechanisms, poorly collateralized loans
- Substantial arrears, poor management of bad loans

**Lack of Strategic Clarity**

Operational problems are often manifestations of confusion about an MDF's mission or strategy. Some of the more common problems with lack of strategic clarity include the following:

> Credit Provision vs. Development: Many MDFs are caught between these two, often conflicting objectives. To efficiently provide credit, MDFs need to make loans to entities capable of paying off the debt at near commercial rates of interest (and of course new loans should not be provided to borrowers in default). The promotion of local development often means soft loans and/or grants (often for technical assistance) given as incentives to weak entities that may not be good credit risks (or that may have defaulted on previous loans). A variety of experts have concluded that in trying to pursue both objectives, MDFs rarely accomplish either in any significant sense.

Loan vs. Grant Programs: Credit and grant programs are natural enemies. Out of sheer necessity, most developing countries have substantial forms of the latter. Without rationalization of, or at least close coordination with, such grant programs, it is sometimes difficult to develop a market for loans. Grant transfers are sometimes used as collateral for loans, but this mechanism appears to work best when it provides secondary repayment support, when the primary repayment for loans comes explicitly from the revenues of the project to be constructed with the loan proceeds. More commonly, local governments or enterprises with access to grants are simply not interested in loans, or may not have feel strong incentives to honor existing loans.

Conduit for Public Funds or Private Capital: The traditional function of many MDFs in developing countries as conduits for donor loans or government funds is inconsistent with the widening effort to encourage more local government reliance on the domestic private sector. MDFs can help establish credit histories for local governments, demonstrate to the private sector the viability of lending at commercial rates to finance local revenue-generating infrastructure projects, guarantee local borrowing, and even attract private sector investment to be used as loan fund capital. But for all of this to work, local governments must have access to functioning capital markets and the MDFs themselves must be managed with a relatively high level of professional skill and independence from outside interference.

**Recommended Improvements**

Most experts recommend a gradual process of substantial reform for MDFs, including the following kinds of changes, particularly appropriate for government-owned and controlled funds:

- Focus primarily on credit provision; leave development objectives to grant programs of other government agencies/institutions;

- Target loans to larger municipalities and more prosperous regions;

- Rely heavily on project revenues and less on grant transfers as the first, formal line of collateral and repayment;

- Encourage consultation with project beneficiaries as an aspect of project planning, to insure adequate demand for services to be provided;

- Consider becoming wholesale lenders, using commercial banks to retail loans using professional banking staff;

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- More closely coordinate with rationalized grant programs;

- View their ultimate goal as one of facilitating a transition to the use of private sector capital for local infrastructure improvements; begin by using bonds for partial self-capitalization;

- Gradually move to private ownership and control;

- Gradually increase terms and conditions of loans to reflect the full cost of capital;

- Consider taking on functions of specialized infrastructure intermediaries, including selling loans to private financial institutions, packaging securities from different projects and offering shares in packages to investors; guaranteeing local government borrowing; guaranteeing local government payment for privatized services.

In addition to reforms that target the operations of MDFs themselves, it is clear that these reforms must be complemented with efforts to increase the finance and management capacity of borrowers through improving the transparency of grants and transfers, increasing local revenue mobilization capacity, clarifying service responsibilities, and building human resource capacity.

## THEME #2: BUILDING MARKETS IN MUNICIPAL BONDS

### Background

A second question that the workshop is designed to help answer is what can be done by governments to speed up development of markets in long- term, local government bonds. In other words, how can the supply of municipal bonds, and the demand for such investments, be promoted in the developing economy context?

A variety of obstacles typically exist to discourage municipal debt issuance. In many countries, markets simply lack experience with debt issuance of any kind, including corporate debt, because high inflation, lax bankruptcy laws, burdensome tax laws, and government policy promoting share ownership all encourage companies to raise capital by selling equity rather than borrowing. The lack of strong corporate bond markets, combined with the fact that in many countries central governments do not sell treasury debt (or sell only very short-term debt), also means that bench-mark yield curves are not available for pricing long-term municipal bonds.

In such weak market environments the risk of default on new issues, and the resulting risk of damage to nascent bond market activity, are extremely high. This is not only because the market is unable to efficiently select good credits, but also because issuers often have no appreciation for the mandatory nature of bond repayments, viewing debt service instead as just another bill to be paid when and if funds are available, or similar to dividends on equity shares, with payments made only when the issuer realizes a "profit."

A review of the U.S. municipal bond market, and attempts to duplicate it in a selected group of developing and transitional economies, suggest that a number of functions must be present at many levels in the market. The U.S. market is not the only model for municipal bond market development, but this market is by far the largest and most active of its kind, and it is often used as model for market development in developing countries. The functions that are successfully filled and provide great strength to the market exist at the issuer level, at the investor level, and at an intermediate level in which a variety of actors help build a sound and trustworthy relationship between issuers and investors. Exhibit 1 summarizes some of these actors and their respective functions.

Key issues that form the characteristics of a strong municipal bond market include the following:

**Regarding the demand for municipal bonds (investors)**

> Investor Familiarity & Confidence: What steps can be taken to insure that nascent municipal bond markets do not experience defaults and other sudden shocks to investor confidence that might retard rather than advance the development of market activity? How can initial issuers be selected to maximize credit quality and minimize investor risk?
>
> Ability to Trade Securities: What can be done to stimulate the development of secondary trading markets for municipal bonds?
>
> Freedom to Invest: How can government regulation of institutional investors (insurance companies, pension funds, banks, etc.) facilitate responsible investment in municipal bonds, while fulfilling the government's function of fully protecting the public interest?
>
> Investor Profitability: How can tax treatment of investment income be used to help attract investors to municipal bonds, without providing subsidies that are unfair or not cost-effective? What other ways exist for improving investor profitability on bonds without making them prohibitively expensive for issuers?

Exhibit 1

**FUNCTIONS IN A SOUND MUNICIPAL CREDIT SYSTEM**

| ACTOR | | FUNCTION |
|---|---|---|
| Investor | Institutional | ! public offering or private placement,<br>! prefers marketability (liquidity)of bonds,<br>! invests for balance of yield and credit quality |
| | Individual | ! invests for high credit quality<br>! public offering<br>! needs marketability (liquidity)of bonds |
| Supporting agencies and services | Underwriter/placement agent | ! marketing, placement, sales |
| | Credit enhancer (bond insurance, treasury trust, intercept) | ! provides assurance to investor in case of default |
| | Credit rating agency | ! objective evaluation of borrower credit worthiness |
| | Financial intermediary | ! pooling |
| | Legal advisor to borrower | ! reviews legal and contractual documents (council resolutions, insurance contract) |
| | Financial advisor to borrower/Investment banker | ! early analysis of design<br>! advises as to structure, placement, underwriting<br>! prepares bid documents |
| | Regulatory agency (ies) | ! macro-economic control<br>! reviews financial management statements according to statutory requirements<br>! approves borrowing plans |
| Borrower | Local government or other local service provider | ! sound financial position<br>! sound financial management practices,<br>! full disclosure of financial and other relevant information,<br>! sound project preparation,<br>! community-supported capital investment plan (infrastructure plan) |

Investor Security: How can tax-supported borrowing (e.g., GO bonds) provide investors with adequate security for their investments? How can revenue-backed debt be sold at interest rates that are tolerable for issuers, but attractive to investors? How can state-owned enterprises and other potential separate corporate issuers of municipal bonds be managed in ways that satisfy investor interests in securities issued by truly business-like enterprises?

Information Regarding Risks: What steps can be taken to insure that investors have access to standardized financial and legal information regarding their investments?

Assistance in Interpreting Information: How can governments support the proliferation of responsible financial intermediaries capable of helping investors understand and gain access to municipal bond markets?

**Regarding the supply of municipal bonds (issuers)**

Tolerable Borrowing Costs: How can issuance and interest rate costs become low enough to allow all interested, responsible municipal issuers to access the bond market? How, in emerging bond markets, can the costs of market development be shared across many actors rather than a single borrower?

Long-term Debt Amortization: How can bond maturities be extended enough so that issuance costs can be appropriately amortized over the lifetimes of truly long-term bond issues? How can municipal bonds be sold with 10-15 year maturities?

Effective Formal Oversight: What aspects of municipal bond market activity can and should be self-regulated in the developing country context? How can governments allow maximum procedural flexibility to prospective municipal bond issuers, without compromising their duty to protect the public interest?

## THEME #3: EXPANDING PRIVATE PARTICIPATION

### Definition

The definition of privatization, for the purposes of this discussion, is any measure taken to involve the for-profit sector in the construction, operation and ownership (equity financing)of municipal infrastructure and in the provision of municipal services. Projects can include "greenfield" operations (projects built from scratch) and privatization on ongoing assets and services ("divestment"). While this definition would include situations where government contracts with the private sector for the provision of a public service, particular emphasis in this workshop will be on those arrangements that result in the private sector providing financing for infrastructure and those in which the private sector is taking on some of the risks associated with the provision of public services, including asset ownership. The term privatization is often used interchangeably with concessions (operating agreements), PPIs (public-private initiatives), and BOO-BOTs (build-own-operate and build-own-transfer).

The majority of privatization projects that have been completed to date internationally have been in the power and telecom subsectors, but privatizations are increasing in other subsectors, including ports, water supply and wastewater, solid waste, roads and railways.

**Factors Motivating Interest in Private Participation**

Private financing and management of infrastructure is currently undergoing a growth spurt in Asia and throughout the world as governments give an expanded role to the private sector as investors, developers and operators of infrastructure projects. While there are variations among countries and sectors in the level of private sector interest that has been expressed, there is increasing acceptance of the idea that the participation of the private sector can yield significant benefits, such as:

- mobilizing capital to meet investment needs without adding to sovereign debt;
- improving the efficiency and quality of urban services;
- increasing access to advanced technologies;
- allocating risks more efficiently.

Privatization strategies vary from one region to another. Latin American countries focused initially on privatizing public monopolies, rather than public infrastructure. Eastern Europe has privatized a wide range of functions, including industrial assets, housing and agriculture. In East Asia, however, privatization efforts are generally focused on public utilities such as power, telecom and water. Strategies have included BOO/BOTs to build new capacity as well as management concessions. In the context of this workshop, privatization is being considered primarily as a financing alternative to MDFs and bonds. In this case, the private operator is assumed to have access to capital (often foreign capital) that the municipal operator would not, perhaps at a lower cost. Private operators are also assumed to operate more efficiently, thus improving the economic performance of municipal services. Like municipal bond financing, privatization requires changes in the regulatory environment governing municipal operations and finance. Many of these changes are similar to those required for debt financing, as discussed in Theme #2, above. In addition, privatization affects municipal government policy, organization and management in ways that can be quite far-reaching. These issues are not addressed in this paper.

**Constraints to Enhanced Private Participation**

The original high expectations of host country governments and project sponsors in the early-1990s for private financing and management of infrastructure in Asia have not been met. Among the factors attributed to the slow progress in enhancing private participation are the following:

- existence of a wide gap between the perceptions and expectations of government and the private sector regarding risk;
- lack of clarity about government objectives and political commitment;
- unpredictable intergovernmental approval processes;
- lack of an appropriate legal/regulatory framework;
- insufficient transparency and competition, leading to high transaction costs;
- lack of mechanisms to provide long term debt;
- insufficient management capacity and poor financial condition of public enterprises seeking to attract private investment.

The uneven pace of private infrastructure growth in East Asia is due less to a shortage of financing, per se, than to a shortage of investment opportunities of interest to the private sector. Investors require not only attractive cashflow and risk conditions, but also sector-wide policy frameworks that encourage the privatization of public enterprises. Successful transaction experience in any sector helps to build a positive dynamic of increased investor interest, more standardized procedures, and lower cost financing. But for transactions to continue on a sustainable basis, policy frameworks governing both the project and sector levels must meet the needs of governments, project sponsors, and lenders.

Government support for privatization may depend on carrying out a policy dialog among different sectors of the country to address perceived risks of private involvement in roles previously reserved for the public sector. Issues such as ensuring a local investor role, managing effects on public employees, establishing public oversight of privatized functions and continuing to develop local municipal finance capacity can be addressed while still encouraging private involvement in the delivery of public services.

**Elements of a Facilitating Framework**

The framework for facilitating large-scale private participation has several components. (These do not differ greatly from measures to ensure the success of private financing of public assets, using instruments such as municipal bonds.) The first component, not discussed in detail here, relates to policies necessary to promote a stable macro-economic environment, foreign exchange convertibility, a fair tax regime, and a credible judicial system. Beyond that, four additional policy areas require attention in most countries before extensive infrastructure privatization can take place. These include:

1. <u>Improving sectoral policies:</u> Governments should develop clear objectives, strategies, and priorities for attracting private investment in each infrastructure subsector. Objectives include:

    1) Developing clear policy to create contestable markets within the sector.

    2) Clarifying and simplifying institutional responsibilities and government approval processes.

    3) Providing enforceable guidelines and reasonable control to private operators over tariff-setting process, indexation, and adjustment mechanisms.

    4) Developing clear environmental standards and other technical frameworks within which the owner/operator must work.

2. <u>Facilitating project development</u>: High transaction costs and uncertainty associated with the critical early stages of project development can be mitigated by a range of measures by governments to make the project development and approval process more systematic and transparent. These are particularly important for foreign investors not familiar with business practices governing financial transactions in a new country.

3. <u>Managing project risks</u>: Privatization projects can proceed only if the risk levels are acceptable to both investors and lenders, as well as to the public sector. For private financing of infrastructure to accelerate, appropriate risk management tools must be understood and available

to all parties. These may include dispute resolution measures, force majeure mechanisms, tariff-setting procedures, commercial insurance and local government risk protections. Government can play a role in ensuring that these measures are available and enforceable.

4. Developing domestic capital markets: The lack of appropriate term debt financing has often been cited as a constraint to infrastructure project financing due to both cost and availability. Without local capital markets, infrastructure privatization will rely on foreign currency financing, increasing both the cost and the risk of privatization projects, and reducing investment opportunities for local investors.

While there is little governments can do to entice investors into uncompetitive projects, there is much governments can do to promote an environment more conducive to investment, including:

1) establishing stable macroeconomic conditions that help to lower the risks to investors of long-term project investments.

2) encouraging capital markets development through the creation of supervisory and regulatory structures that provide confidence to investors.

3) facilitating institutional development of auxiliary agencies and functions necessary for efficient primary and secondary financial transactions, such as credit agencies, securities registration and disclosure requirements.

4) providing regulatory support to encourage the accumulation of savings and the development of savings instruments, in order to increase the availability of local capital.

**Progress to Date**

The International Finance Corporation recently published a report entitled "Financing Private Infrastructure,"[1] that analyzes the experience they have gained in making $1.5 billion of loans for public-private initiatives (PPI) in the past two years to 64 infrastructure projects worth $13.8 billion. Their conclusions included the following:

- The pace of PPI increases with the level of political commitment to liberalization in the sector being privatized.

- Privatization as well as competition are improving both construction and operating efficiency in infrastructure.

- Economic benefits from PPI increase as larger amounts of assets come under private ownership/management and as competition increases.

[1]"Financing Private Infrastructure," The World Bank and the International Finance Corporation, Washington, DC. September 1996.

- Low income countries, or those considered to be high risk for other reasons, can still support successful PPIs, but certain types of projects are easier to finance in these circumstances: small projects, those that earn foreign exchange, projects with less market risk, and those with strong support from government or sponsors.

- Projects have demonstration effects, that is, they lead to further policy changes. These changes take place within and between countries. More than half of all PPI financing is coming from foreign sources.

## THEME #4: INTEGRATING MDF IMPROVEMENT & BOND MARKET DEVELOPMENT: THE ROLES OF CENTRAL GOVERNMENTS AND DONORS

### The Strategic Challenge

Municipal bonds and MDFs are sometimes viewed as competitors. Indeed, in most developing countries, MDFs attempt to retail their loans to precisely those local governments and local enterprises that are most likely to be capable of accessing the private capital market on their own, through bond sales or commercial loans. Because most MDF loans in the developing world typically are still subsidized, this form of funding tends to be more attractive to local government than bonds sold at market rates of interest. In the long run, however, these two kinds of financing mechanisms can and should work together, as demonstrated in most industrialized countries. Subsidized intergovernmental lending is difficult to justify except on a selective basis for local governments that have no financing alternative. This is particularly true in countries with extensive intergovernmental grant systems.

In the short run, the challenge is to apply assistance and adopt policies that allow both mechanisms to develop in an integrated fashion. In particular, this means changing the policies of MDFs to more carefully target their loans, in order to avoid crowding out other forms of financing, such as bonds. This may mean rejecting borrowers with strong signs of creditworthiness. It also means clearly distinguishing loan and grant programs, and coordinating their implementation. Finally, it may mean viewing MDFs as facilities that may eventually have to fully compete with other sources of finance for local governments, without government capital.

### The Donor Role

The task of integrating reform of MDFs and development of municipal bond markets is not exclusively the responsibility of central governments. Multilateral donors have a key role to play in these reforms because MDFs have increasingly become a principal mechanism used by these agencies for disbursing aid to local governments in developing countries. However, it is possible that, under certain conditions, donors may not do as much as they otherwise might to promote local government debt finance that involves widened access to private sector capital. Multilateral donors have identified the following three possible scenarios as pitfalls to be avoided:

- Direct Competition for Borrowers. First, are cases where donors offer subsidiary loan agreements (SLAs) directly to local governments or enterprises that could otherwise be borrowing private domestic capital, at commercial rates.

- Pressure on MDFs. A second variety of the same phenomenon can occur when MDFs are encouraged by donors to be more self-supporting and business- like in their on-lending of donor funds. These MDFs may be motivated to aggressively market loans to the strongest borrowers among local governments and local enterprises, in order to improve the performance of their own loan portfolios. However, in doing so, they may be providing subsidized loans to precisely those borrowers who could be accessing private capital at commercial rates.

- Resistance to Reform. A third variation on this theme can occur when a donor fails to support reforms to MDFs that would allow them to more carefully target loans and better facilitate increased access by local governments to private, domestic capital. Donor project staff may want funds on-lent to the strongest possible local borrower, regardless of that borrower's capacity to borrow elsewhere. Sometimes donor staff deal with perceived weakness in MDF loan appraisal skills by maintaining control over the identification of projects, thus further retarding development of business-like skills necessary for these MDFs to attract private domestic investment capital.

**The Need for New Strategies**

The point is not that large numbers of local governments or enterprises in these countries are capable of accessing domestic private capital at commercial rates. However, some clearly can. The ignition of active domestic markets in capital for local governments in some developing countries may be retarded by the lending activities of multi-nationals, which have the potential of robbing these markets of their leading players, the examples for other local governments and enterprises to follow.

The active assistance of the multi-lateral donors will be essential in changing this situation. Fortunately, these agencies have already begun to explore lending structures that encourage and support local government borrowing in domestic capital markets, rather than "crowding out" such borrowing. Instead of direct, subsidized loans to all kinds of local governments, donors have begun to think about guarantees and other credit support mechanisms for facilitating municipal bond issuance and commercial bank lending for local governments than can afford to do so. Loans to MDFs will increasingly include incentives to encourage these facilities to begin supporting local government access to domestic capital markets where possible, and to begin accessing those markets themselves, for their own capital.