Outline

- Introduction

I- The necessity of diversifying financing sources
II- Intervention on the foreign financial market
III- Alternative sources of financing

- Conclusion

Introduction

Countries in general aspire to growth and economic development through achieving programs and projects.

- Nevertheless, the supply of public goods is constrained (essentially due to the lack of tax revenue, the fall in the main revenues on basic goods and a slower global growth.)

- As such, public debt is an opportunity to find the necessary resources for financing the needs of development.

- However, beyond conventional financing, it has become necessary to diversify financing by resorting to alternative sources, especially for developing countries.

I. The necessity of diversifying financing sources

Defining a debt **policy** and **strategy** as a plan allowing the government to determine the desired composition of its debt portfolio, reflecting its preferences relative to the cost-risk trade-off, is an important step.

- The cost-risk trade-off often renders necessary the diversification of financing instruments, to better reconcile project categories with a type of financing;

- An analysis of debt sustainability is necessary to approve any financing strategy.

Why should we diversify financing?

It allows decision-makers and debt managers to answer a certain number of questions, such as:

- Is it appropriate to indebt oneself under non-concessional conditions?
- Can the State finance itself to a greater extent on the local market, or on the foreign market?
- What is the right mix between short, medium and long-term?
- Is it appropriate or possible for a State to gain access to the international capital market?
- Are there other, more accessible and more adapted types of financing?

II. Access to the international financial market

The international financial market is an important source of financing due to its liquidity. Hence, in the past few years, developing States have resorted massively to the resources available on this market.

The international financial market has obvious benefits, but it also has requirements relating to the debt-issuing State's credibility towards investors, and **financial ratings** must be taken into account.

II-a Financial ratings

A financial rating is an appreciation by a third party (an independent and credible credit-rating agency) of the solvency risk of an entity (State, local government, company, etc.). It is essentially based on four criteria:

- **Economic soundness:** Wealth of the economy, its size, its level of diversification and its potential in the medium to the long term;
- **Institutional soundness**: Governance, « quality » of its institutions, predictability and consistency of governmental policies;
- **Tax soundness:** capacity to generate resources to face existing obligations, as well as other obligations susceptible of occurring;
- **Vulnerability to a factual risk** measures the risk of sudden rating change due to a shock that was not anticipated by the previously mentioned factors (such as catastrophes).

II-b The steps to gaining access to the international financial market

The main steps are:

- Selecting a consortium and choosing a law firm;
- Meeting of « due diligence » ;
- Road show;
- Transaction and result.

II-c The benefits of access to the international financial market

Reasons for intervening on financial markets are:

- high amounts available for massive investments;

- establishing a reference;

- diversifying investors, to reduce the risk of concentration;

- improving the maturity of public securities;

- financing important projects of which the economic and financial profitability has been established.

II-d Risks linked to the international market

- The first is the refinancing risk, or the interest rate risk (some countries' interest rate percentage is close to two digits).
- The exchange rate risk is generally covered by a swap; however, the bankruptcy of the insuring bank can lead the country to default on its payment.
- The risks of budgetary slippage can lead to the inefficiency of public investment.
- Conveyancing costs (erroneous programing of project implementation and risk of misappropriation of goods).

III –Alternative financing

Financing needs are high in developing countries, whereas their capacity to intervene on markets remains limited.

However, traditional lenders hold certain conditions to grant loans, which may be constraining.

Lastly, concessional resources are declining.

Nevertheless, other means of additional financing exist, such as **Islamic finance**, public-private partnerships (**PPP**) or specific financing such as « **green financing** » which allows for a wider pool of investors; beyond their benefits, these operations can uncover certain risks.

III- a- Islamic finance

- **Review of principles**

1- loans with interest;

2- unreliable or speculative contracts;

3- sectors considered illegal;

4- Principle of underlying assets: any transaction must be underpinned by a tangible asset. Islamic finance must be employed towards the acquisition of identifiable goods;

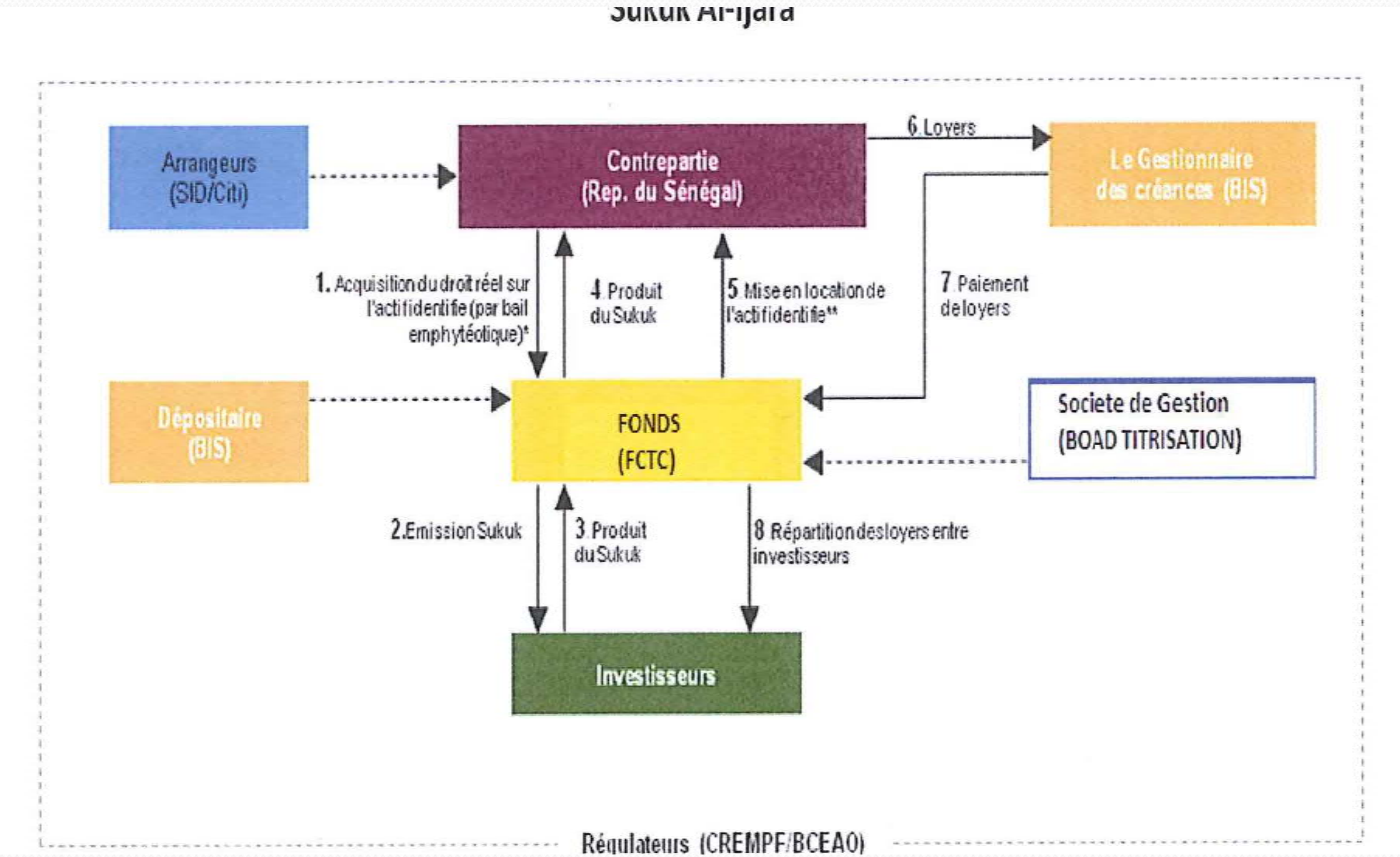
5- Profit- and loss-sharing, or equitable sharing of risks and obligations.

III- a.1 Opportunities of Islamic finance

- Islamic finance can be a real opportunity for financing infrastructure projects (such as a toll road), following the principle which underpins credits to real assets;

- Diversification of investors' portfolio.

SENEGAL'S EXPERIENCE



III- a.2 Challenges of Islamic finance

- Communication on instruments and products;
- Strengthening players' capacities;
- Managing the exchange rate risk, notably for foreign currency-denominated instruments;
- The context of the fall in petroleum prices which concerns some investors.

III- b Public-private partnerships

- PPPs are an alternative to weak public resources, because it allows for collective achievements without borrowing on the national budget and thus direct indebtedness (except, in certain cases, with the State's compensation).
- PPP financing must be produced by a bidder on the market who ensures payments are made in instalments relative to the work's progress.
- Beyond the rate of financial profitability (of interest to the concessionary), he insists on the rate of economic profitability , which includes the social aspect of the project.

III- b.1 Opportunities for Public-Private Partnerships

- PPPs are a way to mobilize resources and financing for development projects, whilst lessening the burden on the State's budget;
- Efficiency in project achievement;
- Freeing budgetary funds for other expenses;
- Enhancing risk-sharing between the State and private individuals;
- PPPs promote economies of scale as well as technological and skill transfer.

III-b-2: Example of a PPP's criteria of analysis

The diagram is

- Cross-sectional for all economic sectors. It is constant and systematic so as to identify the profitability of PPP investment projects to manage a « stock » of PPP projects.

This methodology consists in building an analysis matrix with several criteria, applied to each project on the basis of an investment file assembled in advance.

Example of the analysis criteria

Phase 1: Selection/prioritisation of the projet considering its size and socio-economic performance (SEP)

Criteria 1	Criteria 2
Project size	Socio-economic performance (qualitative and quantitative indicators)

Phase 2 – Criteria of the PPP’s relevance

Criteria 3

Potential for integrating it in a global contract

Criteria 4

Expertise of the private sector, nationally and internationally, within the sector – Presence of similar projects on the African continent

Criteria 5

Capacity of the project to generate revenue from its users

Criteria 6:

The magnitude of the gains relating to technical and financial innovations expected from the private sector

Phase 3 - Criteria of the PPP’s relevance

Criteria 7:

Knowledge of the project’s lifecycle costs, availability of the criteria and performance indicators, and stability/predictability of the requirements of exploitation and maintenance

III- b.3 Challenges and constraints of PPPs

- Identifying projects eligible for such financing;
- Strengthening good governance, institutional and legal reforms towards a world-class business climate;
- Risks of (high or hidden) costs;
- Technical and commercial risks of implementation linked to the exploitation and maintenance of services;
- Other risks linked to debt if the compensation is mobilized in the form of debt.

Conclusion

- The objectives of growth and economic development greatly increase States' investment needs.

- Thus, facing the ongoing scarcity of traditional resources from lenders, it is important to explore other sources such as the international market, Islamic finance, PPPs and other specific financing (ecological finance, foreign direct investment, etc.).

Thank you for your attention