Financing for Development: Some Key Issues

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Successful Development Requires Finance

- But it requires more than that
- It requires that the finance be of the form and nature that promotes macro-economic stability
- And enables the country to pursue social and developmental goals
  - Including the growth of employment, the reduction in poverty and inequality, and the improvement of the environment
  - Important to use metrics that assess these broader goals (as argued by the international Commission on the Measurement of Economic Performance and Social Progress)
- The world has the resources with which to do this
  - Allocating more of these resources to inclusive development would be good for the global economy
- The question is, can we develop the institutional arrangements through which this can best be accomplished

Finance and the Real Economy

- Finance cannot be separated from the real economy
- Developing and emerging markets need *more* finance
- The form in which they receive finance matters
  - Exposure to risks
  - Loss of voice
  - Distributional consequences
- An example: reliance on foreign sources brings risks
  - Exchange rate risks
  - Political risks
    - Foreigners "dictate" economic policy *and more*
    - And often, economic policies are misguided—at least from a developmental perspective (failure of Washington Consensus Policies)
    - Often difficult to get coherence among different funders
- Why it is imperative for countries to promote domestic savings
  - Part of success of East Asian countries

Unbounded Needs and Opportunities

- To maintain growth necessary to provide jobs for new entrants in the labor force, developing countries will require large investments, including in infrastructure

Africa needs **over US$100 billion of infrastructure** investment per year (World Bank). How to finance the infrastructure gap?

- Developing countries have shown ability to maintain high growth trajectories, large absorptive capacities
  - Partly based on better macro-economic frameworks, better governance, more open markets
  - Partly based on successful *development state* strategies

Large pools of savings

- New institutional players
- Global reserves now amount to US$11.6 trillion
- Large pension funds
- Large Sovereign Wealth Funds

Failures and Risks of Private Financial Markets

- Failed to translated pools of savings into productive investment
  - Bernanke declared that there was a savings glut
  - But there was not excessive savings
  - Private financial markets simply couldn't bring savings to where it was needed, in ways that managed risks effectively
- Most evident in misallocation of resources in the run up to the Great Recession
- Little evidence concerning the superiority of private sector in managing risk and allocating capital
  - Though there is evidence that they are better at exploitation, predatory behavior, etc.

Private Debt Flows

- Highly volatile and pro-cyclical—with severe macro-economic consequences
- No adequate way of resolving debt problems when debt becomes too large to be managed
  - Political economy problems: incentives under current arrangements for private sector to encourage excessive indebtedness
  - Subsequently, private creditors are often saved through IMF bailouts—at great cost to the country
- Especially short term debt brings with it the loss of effective sovereignty

FDI little better

- Also highly volatile and procyclical
- Going to limited number of countries, limited sectors
- Investment agreements making matters worse—countries opening themselves up to constraints on regulations to protect health of citizens and health of economy
- PPP mixed record—too often partnership entails government taking risk, private sector taking profits
  - Hard to design incentive-compatible contracts
  - Long history of failures
  - Including problems with private sector reneging on contract
- For Emerging Markets, implicit cost of capital often greater than if the government undertook the project directly
- For Developing Countries, financial constraints often partly a result political pressure from abroad (e.g. from IMF, as a result of flawed accounting practices.)

- In Africa, FDI mainly limited to natural resources, buying already existing assets, telecom
  - Limited role in real development, transformation of economy,
  - In bringing in new technology
  - Or gaining access to new markets
  - Disappointment especially great because flows have been limited even in countries with good governance and macro-stability

Reforms necessary to make private markets work better

- Revise all investment agreements
- Create a framework for sovereign debt restructuring
  - Supporting UN initiative
    - Including using innovative approaches, like GDP linked bonds, aligning interests of creditors and debtor
  - Private contracting approach won’t suffice
- Standardized *fair* natural resource contracts and bidding systems
- Curbing tax and corruption havens

Countries Need to Create "Enabling Environment"

- But our understanding of this has changed over last fifteen years
  - Macro-stability requires monetary policies that do *not* just focus on inflation
    - Need to focus also on access to funds
    - Matter of equity and development
  - But can also increase effectiveness of monetary policy
  - Regulations on cross border flows
  - Macro-prudential regulations
  - Strong banking and financial sector regulations
  - For developing countries especially, exchange rates need to be managed in ways to ensure competitiveness and stability
  - Important role for government in promoting development

Other sources of *finance for development*

- Most important: helping countries grow through opening up advanced country markets *and not hurting poor countries*
- That was what *Development Round* was supposed to be about
- But some of the advanced countries reneged on their promises
  - Agriculture subsidies continue—hurting poor countries
  - Escalating tariffs still designed to retard development
- Making knowledge *less* accessible hurts poor countries
  - What separates developed from developing countries is not only a gap in resources but a gap in knowledge
    - Knowledge and capital (funds) are complements
  - Especially access to life saving medicines
  - World Commission on the Human Dimensions of Globalization called for rebalancing TRIPS
    - Things have gotten worse
- New Trade /investment agreements may lead to more instability, reduce policy space, impair development

Aid

- Poor countries still need aid
- Commitments of advanced countries still not met
- Aid for Trade especially important in opening new sources of revenue
- Imperative that developed countries meet obligations for climate funds
  - And not just from private investment
  - Developing countries will be hurt most by climate change
  - Will face large costs in adaption, mitigation
  - Unreasonable to ask them to sacrifice development

Creating New Institutions; Redirecting Old

- Importance of development banks
  - Need to be strengthened, increased capitalization
- New development banks—AIIB, NDB
- New governance, new mandates, new instruments
- Reflecting 21st century economic and political realities
  - Governance of old institutions hard to change
  - Today's financial markets different from those 80 years ago
  - New challenges—including challenges of global warming

New Domestic Sources of Finance

- Appropriating more of the resource rents, through better auctions, better contracts
  - Better systems of risk sharing
- Better systems of taxes and tax collection
  - Preventing tax avoidance
  - Need more global cooperation
- Environmental Taxes

Innovative Global Sources of Finance

- Expanding airline tax
- Global green fund—sharing of revenues for the imposition of a global price on carbon
- Global minimum corporate income tax—sharing of revenues with developing countries
- Global reserve system—sharing of new reserve emissions

Innovative Private/Public Initiatives

- Global Infrastructure Investment Platform
- Bringing new sources of demand together with new sources of finance
- Key challenges:
  - Selecting and managing investment projects
  - Structuring financial products to allocate risks efficiently
  - Governance—voice both for those who contribute funds and for those who receive funds

Governance and Coherence

- How decisions are made makes a difference
- Important that the voice of developing countries and emerging markets are heard more clearly
- Long overdue reforms in governance of IFI's
- Movement from G-20 to Global Economic Coordinating Council
  - As recommended by 2010 UN Commission of Experts
  - More representative, more legitimacy
- Need to create "Think Tank" parallel to OECD, and working with OECD to address issues of *global reform*
- Need to make more use of UN institutions (like Tax Committee) for designing global agreements
  - Again, more representative, more legitimacy