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