Side event

Development Finance in LDCs: Tackling Risks and Vulnerabilities

HOW TO DEAL WITH VULNERABILITIES THROUGH DEVELOPMENT FINANCE

Introductory remarks

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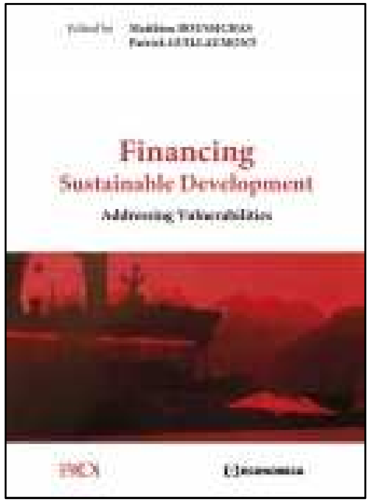
Event relying on the recent book:

FINANCING SUSTAINABLE DEVELOPMENT

ADDRESSING VULNERABILITIES

Edited by Matthieu Boussichas and Patrick Guillaumont,
Economica, Paris 2015



Origin of the book and relevance for LDCs

- Published in 2015 the book « *Financing Sustainable Development. Addressing Vulnerabilities »/ « Financer le développement durable. Réduire les vulnérabilités »,* initially prepared for the Addis UN Conference on financing development
- Takes place in Ferdi long standing research on LDCs (see list) with the book *Caught in a trap. Identifying the LDCs,* 2009*,* to be followed by its companion, *Out of the trap. Supporting the LDCs,* presented here yesterday in a pre-launch meeting
- Actually the content of the book *Financing Sustainable Development* is particularly relevant for the LDCs, as poor and vulnerable countries

Vulnerability at the heart of the LDC category

- LDCs designed as poor (low income) countries suffering from structural handicaps to growth (now to sustainable development), identified by a low level of human capital (HAI) and a high structural economic vulnerability (EVI)
- Now one third of LDCs (17/48) are no longer low income, but most of them, as well as the recently graduated and graduating ones, are still highly vulnerable
- Thus the FSD book mainly, but not exclusively, concerns the LDCs

Message and approach in a nutshell

- What is at stake: financing a sustainable development, in the 3 dimensions of sustainability, economic, social and environmental (mainly climatic)
- Vulnerability is threatening the sustainability of development and has itself 3 corresponding dimensions: economic, social and environmental identified)
- So, financing a sustainable development involves to address the various sources of vulnerability by appropriate methods of finance, in a comprehensive framework
- Issues approach rather than a toolkit approach: rather than listing instruments, the book starts from issues to be addressed, asking to a number of well known experts (45), from the North and the South, to expose their view, each one on a specific issue related to financing sustainability (in 25 complementary chapters)

Three kinds of issue, and related examples

- ***Financing economic sustainability***, including issues such as *debt management* when shocks occur, increase in *tax effort*, financing *regional integration*, role of *guarantees*,…
- ***Financing social and political sustainability***, including issues such as how donors can *help FS*, how to support *risk management by the poor*, how *financial deepening* can reduce vulnerability of the poor, how *aid for trade* can also do it, …how *impact investment* can become a major tool to change development pattern
- ***Financing environmental sustainability***, including issues such as optimal *mining taxation*, various kinds of *innovative finance*, possibility to mobilize SDRs, reinforcement of *REDD+,* …and the issue of *additionality* with ODA

A global approach, with pending other issues

- Many answers (and questions too) in a global framework, "*holistic approach*" needed (Gyan Acharya)
- With the view that there is not a general or common answer, but a *need of a strategy* to address vulnerabilities, the set of answers depending on the structures and policy choices of the countries
- All financial issues related to vulnerability are not examined in depth in the *FSD* book, as they are in other Ferdi works, in particular the *volume* of concessional public finance and its a*llocation* between countries
- Volume of development finance for LDCs, an important issue, with
  - a decreasing trend of ODA to LDCs since 2010 (ratio to GNI 0.09%)
  - and a decrease in the share of ODA to LDCs (less than 30%, far from a possible goal of 50%)
- Important to see what the new TOSSD concept will involve for LDCs

Taking into account vulnerability in the allocation of public concessional resources between countries is a part of the strategy

- Important matter of discussion mainly for multilateral assistance
- Ferdi proposal: LDCs identification criteria, because they refer to poverty and structural handicaps to development, in particular vulnerability (EVI), are logical criteria for aid allocation
- Reflected in the UNGA resolution 67/221 on « smooth transition » of graduating LDCs (and in EC new EDF and DCI)
- Dampens possible decrease in ODA received by an LDC after its graduation
- Channels ODA towards the LDCs, not only as a whole, but also towards the least developed ones, and the other most vulnerable
- What is valid for ODA allocation is even more so for the allocation of concessional resources for adaptation…

- **…**taking into account the vulnerability to climate change in the allocation of concessional resources for adaptation is fully legitimate
- Will help to make poverty reduction finance and climate finance consistent
- Here the vulnerability considered should be a physical, exogeneous, vulnerability to climate change, measured by an appropriate index, other than EVI
- Would supplement the (limited) principle of 50% of the Green Fund for LDCs and vulnerable countries
- LDCs, on average highly vulnerable to climate change, and would benefit from this allocation, without substitution to ODA
- Whatever the fungibility in the use of resources

Thank you

Annex:

Content of some chapters

(I) Debt sustainability when shocks occur involves new flexible rules of debt service (ch 9)

- Flexibility in debt management according to the economic environment has a strong potential to make debt sustainable, and economic growth as well.
- Already implemented by AFD through ‘counter-cyclical loans’, where the debt service can be postponed in case of export shortfalls
- At the macro level Ugo Panizza suggests to index the debt repayment on GDP, so that the degree of concessionality (which could be 100% if needed, i.e. a pure grant) depends on the economic situation of the country
- A grant would thus be decided *ex post* according to *ex ante* arrangements on debt cancellation rules.

(II) Scaling up private investment in LDCs involves an increasing access to guarantees schemes (ch 14)

- Another way to cover risks, with a high potential for innovation and extension is guarantees that can be made by public entities for investments in countries where the risks are high but where the investment needs are no less
- Guarantees remain an underutilized instrument (5% of ODA mobilized through guarantees in 2014, probably even less for LDCs)
- Their use should be increased when market conditions in developing countries enable them to mobilize additional resources (regulatory framework, reliable payments systems,…)…
- By giving a proper incentive to donors through partial accounting in ODA (on the basis of differentiated discount rates? possibly limited to LDCs?)
- Guarantees for LDCs should be a complement to usual ODA, not substitute

(III) Sustainable agricultural development involves appropriate schemes of credit and insurance for the poor (ch 16)

- Agricultural development in LDCs, where the share of agricultural value in GDP remains high, is strongly constrained by the climatic instabilities (as well as market instabilities) faced by poor farmers
- Innovative finance, through insurance, credit or savings, are available, the feasability of which has recently be tested and evidenced , as well as the conditions of success (examined by A. de Janvry & E.Sadoulet, from results of Ferdi workshops they organized)
- Effectiveness and sustainability of the domestic instruments may be reinforced by international subsidizing or reinsurance

(IV) Financial deepening is essential for reducing poverty (ch 17)

- More generally, private secure savings is a powerful means for allowing poor people to face risks and also invest in productive activities, even more than private credit to which access is limited, (« conduct effect » revisited),
- Access to credit will come afterwards
- Private savings of the poor may be increased by the development of banking infrastructure
- Now made easier by electronic transactions and mobile banking

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(V) impact investment is needed
to make small entrepreneurship sustainable (ch 20)

- Impact investment (or « investissement de mission ») combines a minimum financial return with significant social effects and externalities
- It allows small entrepreneurs to develop their activities in the formal sector and to do so durably (by reinforcing local capacities, access to credit, housing, health services, and extending formal employment,…)
- Needs to mobilize backward sources of private finance motivated not only by financial return
- Opening the way of a new development model

Many other messages on how finance can make development sustainable, for instance…

- How to boost domestic savings (ch10)
- How financing regional integration can reduce economic vulnerability (13)
- How can donors help diversifying the economies of fragile states (ch 15)
- How aid for trade can be used as a finance for the poor (ch 18)
- How pooling the risks can generate a global compact for sustainable health financing (ch 19)
- What are the principles of a sustainable mining taxation (ch 24)
- How new international resources (SDRs) can be mobilized for financing energy transition in developing countries (ch22)
- Etc…