Finance, Foreign Aid, and External Debt: A Comment

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The view expressed are those of the author and do not necessarily reflect the views of UNCTAD
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This presentation is comment on a note prepared by UNCTAD as background on the same subject for the LDC Experts Meeting on February 18-19.
UNCTAD paper makes three main arguments

- Investment - savings is a major constraint on growth – and so lowering lending interest rates through price controls is needed to channel capital to productive activities.

- Development assistance is necessary – indeed urgent – to finance development, and at higher volumes than at present.

- Debt remains a major constraint to growth – and so the paper implicitly argues that a debt moratorium would be best for LDCs.
Development assistance is critical...

- Financing requirements are increasing because of the crisis
- ODA to LDCs has increased over the last decade...

ODA flows to LDCs, 1980-2008 (in Billions of dollars)

Source: Masataka Fujita - Trends and Issues in FDI inflows to LDCs, UNCTAD 2010.
Development assistance is critical...
- Financing requirements are increasing because of the crisis
- ODA has increased over the last decade...
- But in coming years, these levels are at risk

Source: David Roodman, Center for Global Development
Development assistance is critical...

- Financing requirements are increasing because of the crisis
- ODA has increased over the last decade...
- But in coming years, these levels are at risk
- ...and multilateral aid is for political reasons more vulnerable..and yet a greater share of multilateral assistance goes to low-income countries.
- Are targeted special mechanisms really the right demand on donors?
  - Special purpose funds require multiple requirements to access; multiple procedures lead to multiple headaches
  - Ear-marking makes it difficult for country to allocate ODA to its priorities rather than donor priorities
  - It takes time to set up new funds
- Consider also: Advocating greater concessional financing through IDA, AfDB, and AsDB – if with change in governance, lower conditionality, composition
...and quality is important. The fall in financing for infrastructure has to be reversed

Percent of ODA to low-income countries for infrastructure

Source: World Bank “IDA-15 Role of Infrastructure” Background note, World Bank staff
Debt: Is a moratorium the best response?

Is “one size fits all” the best policy advice?

Average GDP growth rate 1998–2008

-10.0  -5.0    0.0    5.0    10.0    15.0    20.0    25.0

Percent of total Africa population

Growth 4.0% or higher

Growth less than 4%

Oil countries

Equatorial Guinea
Angola
Chad
Sudan
Nigeria
Cameroon
Congo, Rep.
Gabon

Liberia
Mozambique
Sierra Leone
Rwanda
Uganda
Sao Tome and Principe
Ethiopia
Tanzania
Cape Verde
Mali
Burkina Faso
Botswana
Ghana
Gambia, The
Mauritius
Mauritania
Namibia
Senegal
Niger
Benin
Zambia
Madagascar

Kenya
Malawi
South Africa
Guinea
Lesotho
Swaziland
Seychelles
Burundi
Comoros
Central African Republic
Togo
Cote d'Ivoire
Eritrea
Guinea-Bissau
Zimbabwe

Zimbabwe
Guinea
Guinea-Bissau
Cote d'Ivoire
Eritrea
Comoros
Central African Republic
Togo
Cote d'Ivoire
Eritrea
Guinea-Bissau
Zimbabwe
Debt relief has reduced debt burden by over 80% percent for beneficiary countries...

35 Countries: post Decision-Point HIPC 1/

Sources: HIPC country documents, World Bank and IMF staff estimates
1/ Simple averages, excludes: Afghanistan, CAR, and Haiti for which data for 2000 were not available
Questions that might be asked before recommending an across-the-board moratorium...

- Which mechanisms are the fastest to deliver financial assistance and create fiscal space in the recipient countries?
- Which mechanisms avoid creating adverse incentives for both debtors and creditors?
- Which mechanisms are less expensive to operate?
- What countries would benefit from any mechanism?
  - How to select countries and the amount of debt relief provided to each.
  - Haiti versus an oil-exporting LDC?
- How will the write-down be financed? Out of future ODA...
Investment-savings: Issues for the next draft

- Is LDC growth constraint only lack of capital formation?
- Investment needs to be coupled with productivity to grow fast

Share of Capital and Productivity in Growth
(Country Growth Rates by Decile)

Growth rate p.c.

Investment-savings: Issues for the next draft

• Is LDC growth constraint only lack of capital formation?
  • Investment needs to be coupled with productivity to grow fast
  • Increasing LDC savings is needed for growth and to reduce aid dependency

Gross capital formation and gross domestic savings as a % of GDP

Source: World Bank, World Development Indicators 2008 and 2007
Investment-savings: Issues for the next draft

- Is LDC growth constraint lack of capital formation?
  - Investment needs to be coupled with productivity to grow fast
  - Increasing LDC savings is needed for growth and to reduce aid dependency

- Low investment and high real interest rates are symptoms not causes.

Increasing investment requires improving:

Business climate
**Investment-savings: Issues for the next draft**

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**Increasing investment requires improving:**

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<tr>
<th>Region</th>
<th>Time to export (days)</th>
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<tr>
<td>Sub-Saharan Africa</td>
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<tr>
<td>South Asia</td>
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</table>
Investment-savings: Issues for the next draft

- Is LDC growth constraint lack of capital formation?
  - Investment needs to be coupled with productivity to grow fast
  - Increasing LDC savings is needed for growth and to reduce aid dependency

- Low investment and high real interest rates are symptoms not causes.

Increasing investment requires improving:

- Business climate
- Competitiveness
- Infrastructure
- Political stability

Note: Road density is in kilometers per kilometer squared; telephone density is in lines per thousand population; generation capacity is in megawatts per million population; electricity, water and sanitation coverage are in percentage of population.
Investment-savings: Issues for the next draft

- Is LDC growth constraint lack of capital formation?
  - Investment needs to be coupled with productivity to grow fast
  - Increasing LDC savings is needed for growth and to reduce aid dependency

- Paper mixes up symptoms with causes – exogenous v. endogenous

- Analysis of *why lending rates are high* should precede policy prescription that price controls are the answer for all LDCs
  - Is the problem lack of competition – and if so perhaps opening the market or adopting regionalize financial systems is more appropriate?
  - Is the problem macro instability – with high and variable inflation?
  - Is the problem inadequate investor confidence in the banks?

- If policy is to keep interest rates low...
  - How can interest rates create incentives to save?
  - How can capital flight be contained?
  - How can governance of public banks avoid private capture?
  - Can “wage and incomes” policies offset inflationary pressures from excessively expansionary monetary policy?
Conclusion… LDCs face some strategic choices in their advocacy for LDC IV

- Maintaining political effort to mobilize ODA in 2010-2012 is urgent, but should they advocate new specialized funds versus increases in concessional finance in existing channels?

- Focusing on debt reductions is important – should LDCs build on MDRI efforts or advocate across the board policies?

- Before advocating particular policies – such as interest rate controls – it is important to get the analytics right, particularly separating policy and other causes from symptoms, and analyzing options through the lens of differing country realities is important.
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