Financing for Development: Beyond Business as Usual

by

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Development Finance and Financial Stability in Open Capital Markets

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SOME BALANCE OF PAYMENTS ACCOUNTING

- CAPITAL ACCOUNT = CURRENT ACCOUNT
- DEVELOPMENT FINANCE IS AN INCREASE IN FOREIGN DEBT
  - Borrowing from non-Residents to buy imports, finance investment or fund domestic expenditure
- Development based on Foreign capital will eventually generate a growing current account deficit and an unsustainable level of debt
  - Debt in foreign currency: currency mismatch
  - Debt service requires
  - net exports,
  - additional borrowing
  - or debt relief/debt default
  - Depreciation to create exports: usually price inelastic
  - Depreciation increases the real value of the debt
  - So adjustment is through compression of imports by reducing income growth
  - Which means abandoning the development strategy
Some Financial Accounting: Assets=Liabilities

■ DEVELOPMENT FINANCE: ASSET FOR THE CENTRAL BANK
  - Increase in Foreign Exchange Reserves
  - Supports Domestic Exchange Rate

■ BALANCED BY CREATION OF A PAYMENT LIABILITY
  - Increase in Reserves of Domestic Banks (High Powered Money)
  - Credit to Deposit of Aid Recipient
  - Increases the ability of banking system to lend for other purposes

■ INCREASES DOMESTIC ABSORPTION
  - Increase domestic demand, or cause further increase in exports
  - Domestic inflation or further deterioration in current account

■ IF ADJUSTMENT POLICY SETS TARGET MONEY SUPPLY AID CONFLICTS WITH MACROSTABILITY CONDITIONS AND MAY PRECLUDE AID EXPENDITURE
Conditions on Debt Relief Limit Aid Flows

- Stephen Lewis, former UN Special Envoy for HIV / AIDS in Africa highlights the budget cutbacks demanded by the IMF as a precondition for Zambia benefiting from a partial debt-relief programme.

- In a statement issued after the July 2004 G8 summit Lewis noted that in Zambia the debt relief deal was conditioned on its compliance with strict fiscal and monetary policy targets, and IMF “imposed macroeconomic policy means that the Ministry of Health can hire no more staff, and fully twenty per cent of the municipal districts have no doctors and no nurses’.

- Lewis explained, ‘The Government urgently wants to confront the pandemic, but it cannot do so with its financial policy and planning in a straitjacket … The Board of the IMF must come to realize that rigid macroeconomic conditionality is putting Zambia at risk … I have argued before in cases involving the IMF, and I argue again that it has failed to grasp the demonic force of the human and economic carnage caused by HIV and AIDS’ (Lewis 2004).
In Uganda a finance ministry official noted that “ceilings for overall health spending in the economy (and its impact on the rate of growth of the money supply, i.e. inflation) had been set by the medium-term expenditure framework.

Their concern was that even if the funds were off-budget, if some were spent as wages in the domestic economy’s money supply this could still be inflationary. The decision had already been made in the minds of the IMF and finance ministry that it was better to prioritize maintaining the very low inflation rate over other needs, such as funding for HIV/AIDS.

Such fatal calculations led Professor Francis Omaswa, to note that ‘The IMF, World Bank and Ugandan Finance Ministry have decided that protecting against inflation is more important than [protecting] people’s lives,’ he said, referring to the many thousands of Ugandans who die each year unnecessarily because of lack of treatment for preventable diseases and curable illnesses (Nyamugasira and Rowden 2002).
DOMESTIC FINANCIAL BALANCES

- FROM NATIONAL ACCOUNTS: INCOME = EXPENDITURE
- INCOME (Y) = CONSUMPTION (C) + INVESTMENT (I) + NET GOVERNMENT (G-T) + NET FOREIGN EXPENDITURE (X-M)
- \( Y = C + I + (G-T) + (X-M) \)  \( \)  \( (Y-C) = I + (G-T) + (X-M) \)  \( \)  \( <(Y-C) = S> \)
- \( S + T + M = I + G + X. \)
- \( (S-I) + (T-G) + (M-X) = 0. \) If \( S>I \) then \( G>T \) or \( X>M \)
- \( (M-X) = (I-S) + (G-T). \) If \( M>X \) then \( G>T \) or \( I>S \)
- EXTERNAL BALANCE = PRIVATE SECTOR BALANCE + GOVERNMENT BALANCE
- EXTERNAL DEFICIT = PRIVATE DEFICIT &/OR GOVERNMENT DEFICIT
- HIGHER M FROM FOREIGN BORROWING (DEVELOPMENT FINANCE)
- MEANS HIGHER I-S (PRIVATE BORROWING) AND/OR HIGHER G-T (GOVERNMENT BORROWING)
INTERNATIONAL FINANCIAL BALANCES

- SUM OF GLOBAL EXTERNAL BALANCES IS ZERO
- FOREIGN LENDER CURRENT ACCOUNT SURPLUS ($M-X<0$)
  
  $$(M-X<0) = (I-S<0) + (G-T<0)$$

- FOREIGN LENDING SUBSTITUTES DOMESTIC BORROWING
- AID RECIPIENT CURRENT ACCOUNT DEFICIT ($M-X>0$)
  
  $$(M-X>0) = (I-S>0) + (G-T>0)$$

- GOOD MACRO POLICIES: $(G-T<0)$ $(I-S=0)$
Good Macro Policy and Debt Stability is Sector Ia Of Sector IV BUT this means a Private Sector Deficit External Financial Stability comes at the price of Domestic Financial Stability
Internal Contradictions in Good Macro Policy

- Anis Chowdhury and Jomo KS highlight the implications of the World Bank’s Doing Business Report. In the most recent report Malaysia slipped five places … 23, down from 18 in the previous two reports for 2015 and 2016. …

- Malaysia slipped because, it had ‘made starting a business more difficult by requiring more companies register as a GST payer,’ and made tax payments more complex ‘by replacing sales tax with GST’.

- Previously, Malaysia was recognized in DBR 2016 for reducing the property tax rate from 12% to 10% of the annual rental value for commercial properties in 2014, even though this contributed negatively to overall government revenue or public finance.

- Thus, ‘be damned if you do, and be damned if you don’t’. Countries are asked to raise domestic revenue, but stand to slip in their rankings if they act to raise tax revenues. Taxation may reduce the incentive to invest, but low tax revenue would also hurt the business environment if it reduces government revenue needed to finance public infrastructure, education, healthcare and business services.”

– Inter Press Service News Agency “Stop worrying about Doing Business ranking” Anis Chowdhury and Jomo Kwame Sundaram
THANK YOU

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