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Debt and Securitization of Development Finance: Useful Innovation or Recipe for more Toxic Debt

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.
THE EFFICIENCY OF DEBT COLLATERAL IN DEVELOPING COUNTRIES

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Summary

1. Introduction: What is efficient collateral?

2. Efficiency of Export Commodity collateral.

3. Perceptions of Commodity export risk

4. Conclusion: Domestic liabilities need to be backed by domestic assets.
Introduction: What is efficient collateral?

Efficient debt collateral *keeps its value* (or increases it)…;

And has *low carrying cost*;

This makes financial assets efficient collateral; real estate and commodities less so.
Efficiency of (raw material) commodity collateral

• Reduced by ‘carrying cost’ of raw materials;

• Hence preference for commodity futures, rather than actual commodities.
Commodity-Exporting Countries

• Collateralise their foreign borrowing on commodity exports that bring in foreign exchange necessary for debt service.

• This exposes them to the commodity-price super-cycle
Business cycles and the commodity price ‘super-cycle’

• Super-cycle is longer because it depends on *aggregate* or *average* growth of global industrial demand (distorted by Chinese economic growth and less stable growth in other countries);

• During commodity boom, commodities benefit from looser monetary policy in countries in recession (esp. US) vs. apparently booming commodities.
Differences in economic growth:

• China’s long industrialisation boosts demand for raw materials and commodity prices; (long gestation of FDI that boosts supply)

• US growth less stable, hence shorter fluctuations in $ interest rates in which developing countries borrow.
Since crisis of 2008

• Recession in Europe & N. America in 2008 loosened monetary policy;
• Loose monetary policy + global aggregate demand drove FDI into commodities;
• Commodity prices turned in 2014 new commodity supplies come on stream, and aggregate demand growth slows.
Conclusion:

• Exports of raw materials are poor collateral for developing country debt, due to
• Interaction between Commodity-price super-cycle, global monetary cycle, and FDI gestation gives excessive encouragement to external debt (‘Feast’) followed by debt crisis (‘Famine’).
Need for new models of development finance

Emphasizing *domestic financing to grow domestic markets*. Vs. *External financing for unstable external markets; transmitting external instability into domestic economy.*