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# TRADE AND DEVELOPMENT REPORT 2019

## FINANCING A GLOBAL GREEN NEW DEAL

## OVERVIEW

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## OVERVIEW

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## *Note*







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# OVERVIEW

*Seventy-five years ago, in the cool mountains of New Hampshire, the international community came together to forge a new world order with one central aim: to constrain financial markets and empower states in their place. The immediate goals of the Bretton Woods institutions were to deliver full employment, keep trade flowing, regulate speculative capital and prevent imported deflation. The system would promote policy coordination in support of global economic stability and discourage beggar-thy-neighbour policies that could upset that stability, while leaving policy space for sovereign states to pursue their national priorities.*

*Forty years ago, market forces struck back. From the early 1970s, a series of hard economic hits unsettled the post-war policy consensus and triggered political strife. As the decade came to a close, a newly elected British prime minister promised to bring harmony and hope by freeing markets and releasing entrepreneurial energies; and to emphasize that doing so would require a clean break with the Bretton Woods era she instructed her Cabinet colleagues to brush up on Friedrich Hayek's The Constitution of Liberty.*

*Mrs. Thatcher was joined six months later by a kindred spirit in Washington who – less attuned to the ruminations of the Austrian school of economists – succinctly captured the shifting ideological mood by proclaiming that "government is not the solution to the problem, government is the problem".*

*A coterie of academics and think tanks, on both sides of the Atlantic, were ready at hand with market-friendly policies for every economic problem, both real and imagined. Theirs was a simple message: that everything had a price and, if markets were free to determine that price, prosperity and social harmony would follow.*

*The debt crisis of the early 1980s provided an opportunity to spread the message to the developing world, joined shortly thereafter by* *the collapsing centrally planned economies of Eastern Europe. The attrition of the public realm went global.*

*But while economic ideas were the spark plug of the neo-liberal project, the newly liberated financial sector was its engine. Setting capital free from the constraints of government regulation and oversight opened up rent-seeking opportunities for an energized banking sector, while a new set of trade rules (covering financial services, investment and intellectual property rights) extended greater protection to footloose capital.*

*Alan Greenspan, a one-time disciple of neo-liberal scribbler Ayn Rand, had no doubt that the expansion of cross-border finance along with a new generation of innovative financial products would turbocharge the global economy by improving the worldwide allocation of scarce capital, unbundling and dispersing risk and boosting hedging opportunities. This was, he claimed, Adam Smith's invisible hand working at the international level; "unregulated global markets do clear" he opined and, "with rare exceptions, appear to move effortlessly from one state of equilibrium to another".*

*Things did not turn out quite as smoothly as Greenspan anticipated. Booms and busts punctuated the economic landscape, culminating, in 2008, in the deepest economic crisis since the 1930s, and revealing the darker side of a world driven by private credit creation, underregulated banks and financial chicanery.*

*With markets in freefall, government, it turned out, really was the solution to the problem. And both separately and collectively (through the G20) they threw resources at the problem on an unprecedented scale; financial institutions were saved, markets stabilized and economies righted. In high policy circles, the era of financial greed was pronounced over and a new set of priorities was promised to tackle the inequities and insecurities of rampant hyperglobalization.*

*The international community has responded with a set of ambitious and transformative goals, and an exacting delivery date of 2030. But in a dramatic reversal of fortune, the overlords of mass financial destruction are now being asked to avert the threat of mass environmental destruction.*

*Money still talks but governments apparently have lost their voice. Rather, tapping the hearts, minds and wallets of the moneyed elite – whether through a sense of corporate social responsibility* *or impact investment or financial innovation – is deemed the only way to deliver the big investment projects that are required for a more inclusive and sustainable future. Everything, it seems, has had to change, for things to stay as they were.*

*This is not only wishful economic thinking; it is, if history is any guide, a recipe for making the world less inclusive and less sustainable. The way to deliver the public goods we need to achieve the Sustainable Development Goals (SDGs) by 2030 is to create a healthy, democratic and inclusive public realm at the global as well as the national level.*

*Much as it was for the architects of Bretton Woods, restoring "faith in the wisdom and the power of Government" needs to be the first order of business of the international community. But this can't be framed simply as a return to the Bretton Woods era. The original project had too many flaws of its own; it was run as a rich man's club that widened technological gaps, failed to address unequal trade relations, tolerated wasteful military spending and was indifferent to environmental pressures.*

*If we want to reverse the polarization of income within and across countries, create a stable financial system that serves the productive economy, mitigate the threats and seize the opportunities associated with new technologies, and undertake massive investments in clean energy, transportation and food systems, we need a Global Green New Deal.*

## Good times, bad times

Prospects for the global economy are currently shrouded in a fog of international trade tensions and geopolitical disputes. But, the bigger story a decade after the G20 stepped in to contain panic in markets and salvage a battered financial system, is that growth has failed to find a firm footing.

The United States is in its longest recovery on record but it is also one of the weakest, and the impact on incomes has been subdued. The pick-up since the 2017 tax cut is fading, with little sign of the promised investment boom. Elsewhere in the developed world, the pick-up has been even more short-lived. The eurozone is slipping back towards stagnation, with the German economy showing clear signs of fatigue; and while Brexit is an unwanted distraction for the entire European economy, the United Kingdom looks set for a particularly traumatizing 2019.

There is a good deal of speculation that recessionary winds will blow the advanced economies, and with them the global economy, off course in 2020. Monetary normalization has already been put on hold by leading central banks but there are growing concerns that even another round of quantitative easing will fail to provide the needed boost to overall demand.

Whether or not pushing down on the monetary accelerator would again help emerging economies is also an open question. The slowdown this year, 2019, is apparent across all developing regions, with Latin America particularly hard hit. Talk of "decoupling" and "convergence" which briefly united the chattering and investor classes after the global financial crisis (GFC), as developing (including so-called emerging) economies bounced back quickly, has gone quiet. The BRICS economies, which as a group saw average annual growth over 10 per cent immediately after the GFC, grew at 6.3 per cent last year.

With debt levels higher than ever across the developing world, totalling around $67 trillion, keeping interest rates on hold would ease servicing pressures. But financial markets are fickle and under the wrong circumstances can turn feral; against a backdrop of rising uncertainty and investor anxiety, a flight from emerging markets to the relative safety of the United States could still trigger a self-reinforcing deflationary spiral.

Not surprisingly, policymakers everywhere are scanning the horizon for possible shocks. Heightened trade tensions are one likely source of increased friction. Trade has stalled with the weakening of global demand; growth in the first quarter of 2019 relative to the corresponding quarter of 2018 is estimated at just 0.4 per cent. Unilateral tariff increases by the United States, which began in early 2018 on specific products and have subsequently been extended on a broader range of imports from China, have not helped. Retaliation has followed in a number of countries. While the impact to date has been contained, a resumption of tit-for-tat tariff increases could prove very costly if combined with a further slowdown in investment.

There are other dangerous currents beneath these already troubled economic waters. There is a growing awareness that the dispute between the United States and China is less about tariffs and more about the technological ambitions of a middle-income developing country. Accessing foreign technology helped today's advanced economies climb the development ladder and efforts to kick that ladder away by further reducing their policy space will face resistance from developing countries. This could add to the already diminished levels of trust in the multilateral system, with further damage to global economic prospects.

Currency movements are adding to the sense of economic anxiety. These have become much more volatile in the era of hyperglobalization with the financialization of currency markets. The Morgan Stanley Emerging Market Currency Index rose significantly at the beginning of 2019 but fell sharply between mid-April and late May, only to climb again thereafter. Three factors are behind this volatility: sharp fluctuations in crisis-hit countries such as Argentina and Turkey; the volatility of capital flows to emerging markets resulting from policy uncertainty in the developed countries and weaker growth prospects in emerging markets; and more generalized pressure from the United States Administration to keep the dollar "competitive". In an international financial system still heavily dependent on a predictable role for the dollar, turning that role – long recognized as an "exorbitant privilege" – into a source of economic ordnance could bring more destabilizing consequences. An immediate worry for many developing countries is that any sharp loss of confidence in their own currency coming after a rapid increase in external debt could expose them to much deeper deflationary pressures, as has already occurred in Argentina and Turkey.

Commodity markets have been on a rollercoaster ride since the financial crisis; these are now in a softer phase, with prices well below post-crisis highs. While depressed demand underlies the absence of price buoyancy in many commodity markets in recent months, medium-term volatility has been influenced by the wide fluctuations in oil prices, by the financialization of commodity markets and by the concentration of market power in a small number of international trading companies.

The UNCTAD commodity price index fell from 134 in October 2018 to 112 in December that year, and since then has risen to reach a level in the neighbourhood of 120. Fuel prices drove the fall in the index in the last quarter of 2018, with the index of fuel prices falling from 149 in October to 115 in December. The subsequent recovery has been partially on account of higher oil prices affected by sanctions on Iran and partially because of mild buoyancy in the prices of minerals, ores and metals.

A spluttering North, a general slowdown in the South and rising levels of debt everywhere are hanging ominously over the global economy; these, combined with increased market volatility, a fractured multilateral system and mounting uncertainty, are framing the immediate policy challenge. The macroeconomic policy stance adopted to date has been lopsided and insufficiently coordinated to give a sustained boost to aggregate demand, with adjustments left to the vagaries of the market through a mixture of cost-cutting and liberalization measures. Ephemeral growth spurts and financial volatility have been the predictable results. But there are deeper challenges ahead that are truly daunting for people and the planet.

## Sign o' the times

Financial insecurity, economic polarization and environmental degradation have become hallmarks of the hyperglobalization era. These are, moreover, closely interconnected and mutually reinforcing, in ways that can give rise to vicious cycles of economic, social and environmental breakdown.

This threat coincides with a worrying erosion of political trust, as income gaps have widened across all countries and the policy agenda perceived as catering to the interests of the winners from hyperglobalization, with scant attention paid to those who have seen limited gains or have fallen further behind. Even after the GFC, the rules of the game that had generated high levels of inequality, insecurity and indebtedness prior to that crisis have remained largely intact, adding further layers of resentment, often aimed against outsiders, and widening political divisions. This breakdown in trust has occurred at the very moment the collective actions needed to build a better future for all depend on a greater sense of shared responsibility and solidarity.

The SDGs, agreed at the United Nations in 2015, were designed as a guide to that future. But with their delivery – planned for 2030 – already behind schedule, frustration is growing across different policy communities and at all levels of development. The perceived problem is a shortage of finance to achieve the scaling-up of investments on which the 2030 Agenda ultimately depends. With government finances burdened by increased debt levels and a fractured politics impeding long-term planning, pushing the financial envelope from billions to trillions of dollars each year will, it is claimed, have to rely on tapping the resources of high-wealth individuals and private financial institutions.

At first glance the signs are encouraging. Global corporations are sitting on an estimated $2 trillion cash pile, while high net worth individuals have access to more than $60 trillion in assets. The OECD estimates that institutional investors in member countries hold global assets of US$92.6 trillion and while figures for institutional investors in developing countries are harder to come by, estimates for the assets held by Brazilian pension funds exceed $220 billion and some $350 billion for combined African pension funds. Redirecting a relatively small portion of these resources to meet the SDGs should, the argument goes, be able to solve the financing challenge facing the 2030 Agenda.

A string of measures, marshalled under the call to “blend” and “maximize” finance, have been proposed that would channel public money into “de-risking” big investment projects while employing securitization and hedging techniques to bring in the private investors. If only things were that simple; the evidence suggests that blended finance fails to mitigate risk and instead boomerangs back to the public purse and the tax payer.

In fact, vast amounts of public resources have already been used to save banks (and other financial institutions) that proved too big to fail after employing these same techniques to indulge a frenzy of speculative activity in the run-up to the financial crisis. Moreover, underpinning the vast trove of private assets is a tangled web of financial funds and debt instruments. Channelling a portion of these assets into long-term productive investment, whether in the public or private sectors, is not a matter of appealing to the better nature of those managing such funds nor establishing a more welcoming environment in which they can do business.

In reality, too many governments, at all levels, have for decades been extending incentives and protections to international finance in the hope of boosting capital formation. Instead, they have been sucked in to an unstable financial world geared to short-term trading in existing assets, prone to boom and bust cycles, with baleful distributional outcomes and large debt overhangs that act as a persistent drag on the real economy. Re-engineering financial stocks and flows to support productive investments (whether private or public) will not happen without a fundamental change in the rules of the game.

The current global economic environment – where austerity is the macroeconomic default option, liberalization the favoured policy tool for affecting structural change and debt the main engine of growth – is heading in the wrong direction when it comes to delivering on the ambition of the 2030 Agenda. Accordingly, this year’s *Report* seeks to make an alternative case for delivering the 2030 Agenda through a Global Green New Deal with a leading role for the public sector.

## A climate for change: The case for a global green expansion

Beyond the immediate risks that could stall the global economy are a series of macrostructural challenges that predate the GFC and have gone largely unattended since then. Four stand out because of their high degree of interdependence: the falling income share of labour; the erosion of public spending; the weakening of productive investment; and the unsustainable increases in carbon dioxide in the atmosphere.

International economic-policy gatherings, where fidelity to the virtues of open borders, capital mobility and market competition is often a condition of participation, have largely neglected these challenges. But if trends continue along current lines, the global economy in 2030 will have gone through another decade of substandard and unstable growth, income gaps within and across countries will have widened further and the natural environment will be stretched to breaking point.

As labour shares across the world continue to fall, household spending will weaken, further reducing the incentive to invest in productive activities. At a minimum, this will mean lacklustre job creation and stagnant wages in developed countries as well as slow expansion (or outright contraction) of domestic markets in developing countries. Both outcomes will worsen if governments keep promoting cuts to labour costs as their adjustment strategy of choice. Aggregate demand will be weakened further, as governments continue to reduce social protection and abstain from infrastructure investment, which will also make supply constraints tighter. Unchecked private credit creation and predatory financial practices will continue to fuel destabilizing financial transactions, while failing to stimulate private productive investment. In the meantime, absent sufficient investment and international agreement on technology transfer, carbon emissions will push the climate closer towards a point of no return.

Against these trends, it is critical for governments across the world to reclaim policy space and act to boost aggregate demand. To do so, they must tackle high levels of income inequality head on, adopting more progressive fiscal arrangements, and directly targeting social outcomes through employment creation, decent work programmes and expanded social insurance. But they must also spearhead a coordinated investment push, especially towards decarbonization of the economy, both by investing directly (through public sector entities) and by boosting private investment in more productive and sustainable economic activities.

The threat of global warming requires immediate action to reduce greenhouse gas emissions and stabilize the Earth's climate. Recent studies by the Intergovernmental Panel on Climate Change (IPCC) and the United States Global Change Research Program, among others, have made it clear that if we fail to change course, we are only a few decades away from disastrous climate-driven losses.

A successful response to the climate crisis will have multiple benefits, including environmental "co-benefits" such as cleaner air and oceans and forest reclamation. Less obvious, but also important, is the economic impact of climate policy. Climate protection requires a massive new wave of investment, reinventing energy and other carbon-emitting sectors. New low-carbon technologies must be created, installed and maintained on a global scale.

That wave of green investment would be a major source of income and employment growth, contributing to global macroeconomic recovery. Many, though not all, of the jobs created by green investment are inherently local to the area where investment occurs and involve training in new skills. Recent discussions call this strategy (in combination with high wages and standards, social services, and employment opportunities for all) the "Green New Deal" recalling the 1930s New Deal, which tackled unemployment and low wages, the predatory nature of finance, infrastructure gaps and regional inequalities, in the context of recovering from the Great Depression.

There are certainly numerous opportunities for investment in energy efficiency and renewable energy supply, many of them already cost-effective at today's prices and in new patterns of high-density, transit-centred urbanism. This implies new configurations of housing, work and public services, connected by more extensive mass transit. A full-scale transition to electric vehicles will also require a more extensive infrastructure of charging stations, and continued progress in reducing vehicle costs. New technologies, not yet commercialized, will be needed to complete the decarbonization of the global economy, along with new agricultural practices, tailored to minimize emissions. A just transition will also require big investments in communities that have become dependent on resource-intensive livelihoods.

Developing countries may face lower conversion costs as they are still building their energy systems. As a result, the available resource savings from clean energy may be greater in developing countries. Clean energy is of great potential value to developing countries for another reason. Delivering energy to remote communities via an urban-centred national grid, as is usually done in developed countries, entails the substantial expense of long-distance transmission lines. Developing countries may be able to move directly to more efficient microgrid systems without the sunk cost of running wires far into remote areas. Still, they will need technology transfers and significant financial support from the international community to make the transition.

Such an investment push requires governments to use all policy instruments at their disposal, including fiscal policies, industrial policies, credit provision, financial regulation and welfare policies, as well as international trade and investment policies. International coordination is critical to counteract the disruptive influence of capital mobility, contain current-account imbalances and support the transition to a low-carbon economy, especially in developing countries.

Strategies for sustainable development and economic growth can take a variety of paths but they must all correct current patterns of aggregate demand. Leveraging the multiplicative effects of government spending and higher labour incomes is a straightforward approach.

First, raising the shares of labour income towards the levels of a not-so-distant past can by itself lead to significantly faster growth (0.5 per cent annually on average) thereby also increasing capital incomes. This effect will be strongest if all or most countries act in a coordinated manner.

Second, a fiscal reflation financed by progressive tax increases and credit creation would boost growth even more, owing to fiscal multipliers in the range of 1.3 to 1.8 (or even higher if fiscal expansion takes place in many countries in a coordinated way). In particular, with many economies currently experiencing weak or insufficient demand, fiscal stimulus is likely to elicit a strong response of private investment.

Third, public investment in clean transport and energy systems is necessary to establish low-carbon growth paths and transform food production for the growing global population, as well as to address problems of pollution and environmental degradation more generally. This requires the design of appropriate industrial policies, using subsidies, tax incentives, loans and guarantees, as well as investments in R&D and a new generation of intellectual property and licensing laws.

Based on the existing estimates, an internationally coordinated policy package of redistribution, fiscal expansion and state-led investment can realistically yield growth rates of GDP in developed economies of at least 1 per cent above what could be expected without it. In developing economies other than China, growth rates will increase by about 1.5–2 per cent annually. China will have a more moderate acceleration as its growth axis bends towards the household, with lower growth rates than the earlier East Asian tiger economies experienced when they had the current per capita income of China.

By 2030, employment would increase above projections from current trends by approximately 20 million to 25 million jobs in developed countries and by more than 100 million jobs in developing countries

(20 million to 30 million of which would be in China). These are conservative estimates that probably underestimate the employment gains, because existing econometric estimates based on decades of job-shedding strategies cannot incorporate the potential of a globally coordinated strategy centred on state-led investment and social spending, the expansion of service employment and a new energy matrix.

Data on growth and employment as well as on environmental factors, suggest that bold efforts are necessary to achieve global growth and development that are sustainable economically, socially and environmentally. Estimates of multipliers for the world's 20 largest economies and the remaining regional blocs indicate that this is a matter of pragmatic policy choice, not of immutable financial constraints. A Global Green New Deal would require additional financial resources – for less than a decade – generated through a mixture of domestic resource mobilization and international cooperation agreements. Estimates also indicate that the growth impact of social spending is high in all countries, while progressive taxation has little or no cost in terms of growth, pointing to a future of higher labour incomes, lower inequality, stronger growth and a healthier environment that is available for policymakers to choose.

International coordination is key both to mobilizing the required resources and to expanding policy space to manage the changes involved. Today's economic and geopolitical tensions do not bode well in this respect. But it bears remembering that Franklin Delano Roosevelt called the founding of the International Labour Organization at the end of the First World War "a wild dream"; and wild dreamers are exactly what may be needed to deliver on the bold promises of the 2030 Agenda.

## All dried up and drowning in debt

Finance is a matter of faith; and at the heart of that faith is credit – whose etymological origins lie in the Latin verb "to believe". History has demonstrated the effectiveness of credit in fostering economic development by financing investment supported by present and future income flows, rather than by pre-existing saving, leading to higher productivity and, in turn, increasing revenues from which the debt could be repaid. But there is a darker side to debt that carries a more cautionary tale and this poses a persistent challenge to policymakers.

Once banks got involved in the process of credit creation, its economic possibilities began to expand. Using deposits (and other short-term loans) to create longer-term loans has been a standard practice of banks for centuries. But even when existing assets, such as land or houses, can be mobilized as collateral to back borrowing to finance investment, maturity transformation is inherently risky. That has typically meant commercial banks restricting their credit activities to smaller-scale and more short-term lending. Large-scale and longer-term lending, particularly to governments and corporations, was traditionally left to more specialized institutions.

This entire system is founded on trust: that borrowers will honour their commitment to make good on future payments; that banks will honour their liabilities; and that the state will provide secure assets for banks to hold, monitor bank behaviour and discipline them if there is a breach of trust, and provide liquidity through the lender-of-last-resort facility in the event of unforeseen difficulties.

Managing debt thus involves a focus on banks as creators of credit, but also on a set of robust institutional practices that can help build trust between lenders and borrowers and can employ regulatory firewalls and disciplines that keep the system in check. In their absence, credit creation can drag the economy through damaging episodes of boom and bust and can embolden irresponsible or predatory behaviour of one kind or another. Critically, policies to generate sustainable and equitable growth by managing debt require a state with the fiscal capacity to issue and service its own debt, which can borrow directly from the central bank at varying maturities and can manage, to some degree, the inflow and outflow of capital. This further requires that the state's tax base expands with the productive opportunities being financed by credit and direct government expenditure. But the more open the economy and the more limited the domestic wealth base, the greater the constraint on government finances. Financial deregulation has a long history of undermining the trust on which a healthy system of credit depends and it has done so on every occasion by allowing an unchecked process of private credit creation. This time is no different. Since the 1980s, when deregulated finance grabbed the reins of hyperglobalization, global debt has risen more than 13-fold from $16 trillion in 1980 to a staggering $213 trillion in 2017, dominated by private debt, which rose from $12 trillion to $145 trillion.

Rather than promoting productive and inclusive growth, private credit creation has been heavily concentrated in speculative activities, channelled through shadow-banking practices and leading to deeper income inequalities. While this rise of shadow banking is lionized in some quarters as an indication of the value of financial innovation, in practice these products have proved to be a source of instability. But, particularly when the purpose of credit is to purchase financial assets that in turn are used as collateral for further borrowing to purchase more financial assets, the greater concern is about financial instability, fuelled by speculative excess and the pursuit of assets of diminishing quality, followed by the inevitable defaults by borrowers and falling asset prices.

While these trends have raised alarm bells across international organizations, including UNCTAD, many proponents of the 2030 Agenda have nevertheless turned to private finance to fund the public goods and investment needed to deliver the SDGs. Simply put, without deep-seated reforms to the financial system, this will not do the job; the real question is how to make debt work better for development and its possible role in a Global Green New Deal.

Credit creation works when it is accompanied by long-run relationships between the lender and the borrower, giving the former inside knowledge of what the latter is doing with the money and encouraging a degree of patience with the management of their debts but also allowing them to exert strategic pressure through their repayment. This is particularly the case when credit creation is used to support the kind of robust domestic profit–investment nexus that has been part of a successful structural transformation over time. By providing advance means of payment, thus purchasing power, the provision of credit backed by claims on future incomes frees current capital accumulation from the shackles of past saving and becomes a central vehicle to unlock future growth potential. But for credit to play this developmental role requires governance and regulatory structures of domestic and international credit creation that put the long-term requirements of structural transformation at the centre of their operations. This, in turn, necessitates that policymakers have the space to build appropriate public institutions to direct domestic credit creation towards productive investment, as well as sustained efforts by the international community to recover public control of the management of international credit and to redirect public finance towards development-friendly goals.

The current international agenda for the financing of development, instead, subordinates developmental policy to timely debt servicing and the minimization of future repayment risk. This agenda seeks to enhance the ability of developing countries to attract private wealth through "financial innovation" that safeguards investor (and creditor) risk by diversifying and insuring such risk. While measures to improve the quality of developing country debt data and debt transparency are generally welcome and long overdue, the focus of the development finance agenda on complex – and mostly non-transparent – new financial instruments and on securitized finance, does not bode well for its ability to deliver reliable financing at the required scale to where it is most needed.

This is a greater concern as the 2030 Agenda entails unprecedented investment requirements, particularly in developing countries. UNCTAD estimates, for a sample of 31 developing countries, that meeting the basic SDG-related investment requirements to address poverty, nutrition, health and education goals, would result in an increase of public debt-to-GDP ratios from around 47 per cent at present to no less than 185 per cent, on average, if current expenditure and financing patterns prevail. Alternatively, to achieve these SDGs without an increase in existing debt-to-GDP ratios by 2030, developing countries would have to grow at an average annual rate of 11.9 per cent per year. Clearly, neither scenario is remotely realistic.

The *Report* estimates that improved domestic resource mobilization could raise between one fifth and one half of this SDG financing gap while stabilizing debt-to-GDP ratios at current levels (depending on country-specific circumstances). "Leveraged" international private finance is not anywhere near on track to provide the trillions needed to close the remaining gap. Substantially scaling up public international development finance, including through development assistance and debt relief, should therefore be an urgent priority, if a massive new developing country debt crisis is to be avoided and the 2030 Agenda achieved on time.

Such steep demands on the mobilization of international public finance will require the international monetary and financial system to open up more policy space for developing countries to develop and manage their own banking and financial sectors in the interest of structural transformation. At the international level, progress can be made by leveraging old instruments to facilitate increased liquidity provision and international funding for climate change mitigation and combating the wider environmental crisis, in developing countries. Region-specific "debt-for-nature" swaps are already gaining traction, and a step further could be to extend these regional initiatives to the creation of Special Environmental Drawing Rights at the international level. While there seems little political appetite at present to use or expand these facilities for short-term crisis management, there is a growing consensus on the need to manage international credit creation in the interest of combating an unfolding environmental crisis that affects us all.

Furthermore, and in the absence of a political consensus to rein in global financial rentierism in the interest of development, developing countries can and should leverage the power of credit creation (and debt financing) at the regional (including South–South) levels. This, too, is not a new proposal, as Southern regional payment systems and clearing unions have a fairly long history of facilitating public credit creation and liquidity provision for late development. Regional payment systems that use some form of internal clearing mechanism can make a difference in a number of ways: they can simply lower the costs of intraregional trade by allowing for settlement of corresponding financial transactions in domestic currency. More ambitiously, such arrangements can prop up national self-insurance against exogenous financial shocks through pooled reserve-swaps and by providing temporary liquidity relief within clearance periods and extending credit lines beyond these, for final settlement in domestic currency rather than the United States dollar. Finally, full-blown regional clearing unions can leverage the power of home-grown credit creation to systematically coordinate regional adjustments between deficit and surplus regional economies, thereby shielding entire developing regions from the nefarious influence of short-term rentierist international capital flows. How and when regional credit creation can provide an effective buffer for developing countries against their exposure to private credit creation in speculative international financial markets largely depends on current regional trading patterns and the political will to shape these in future.

Last, though not least, debt restructuring and relief need a revived hearing in light of the demands of the 2030 Agenda. Remarkably, given that the current state of highly complex and fragmented debtor–creditor relations has already generated rising debt and financial distress across developing countries, discussions of their management have been confined to debt reprofiling and renegotiation. Practicable ways forward are now needed to facilitate equitable and efficient sovereign debt restructurings that could, in future, also pave the way to an international regulatory framework to govern sovereign debt restructurings.

## Complete control

Private foreign capital is, as suggested earlier, increasingly being cast as the Good Samaritan in the resource gap story around the 2030 Agenda. But increased financial integration has already exposed developing countries to global financial cycles and volatile capital flows. This has tended to widen macroeconomic imbalances, create financial vulnerabilities, and impair monetary autonomy in ways that work against productive investment, particularly in the public sector.

Under the current international monetary and financial arrangements, developing countries have sought some degree of protection by accumulating external assets, usually in the form of short-term dollar-denominated bonds, as self-insurance to prevent a sudden capital-flow reversal and/or to contain its adverse effects. In some cases, countries have used current-account surpluses to build up reserves but in many other cases, they have borrowed on international capital markets to do so. However, the return differentials between safe external assets held to insure against risky external liabilities create a resource transfer from developing to developed countries which, for the period 2000–2018 and the 16 developing countries examined in the *Report*, amounted to roughly $440 billion a year, or 2.2 per cent of these countries' GDP.

An alternative form of protection against volatile capital flows is the use of capital controls. Having in place legislation providing for comprehensive capital controls allows policymakers to act quickly and avoid lengthy debates and procedures, especially during surges of capital inflows when the build-up of macroeconomic and financial vulnerabilities is greatest and when the political forces against regulation tend to be strongest. Such capital controls can be effective tools for altering the composition of flows to ensure a close match between gross external assets and liabilities, as well as for countercyclical management.

The International Monetary Fund (IMF) is moving, somewhat cautiously, in this direction. It now acknowledges that capital controls form a legitimate part of the policy toolkit, stating that, in addition to their potential benefits, capital flows carry risks, and that full liberalization is not always an appropriate goal. It recognizes that capital-account liberalization should be sequenced, gradual and not the same for all countries at all times. However, despite the lack of a strong correlation between capital-account liberalization and economic growth, especially in developing countries, the IMF still treats capital-account liberalization as a policy goal.

Given the multiple financial vulnerabilities linked to hyperglobalization, developing countries need multiple instruments to integrate effectively into the global economy, without preconditions for their use. These instruments should combine macroeconomic policies that secure economic growth and sustainable macroeconomic and external conditions with prudential policies, comprehensive and lasting capital controls, and other regulatory measures that insulate domestic conditions from externally generated destabilizing pressures. Such insulating measures, including capital controls, will need to be country specific, determined by the nature and degree of a country's financial openness and by the institutional set-up of its financial system.

To enhance the effectiveness of these domestic policies, two supportive measures seem to be indispensable at the international level. First, policymakers' ability to use capital controls requires keeping capital-account management out of the purview of regional and bilateral trade and investment agreements, or at least establishing safeguards in such agreements that allow countries the right to regulate capital flows without conflicting with their contractual commitments.

Second, capital controls would be much more effective if capital flows were controlled at both ends. This could be achieved through multilateral endorsement of specific cooperative mechanisms, which would particularly help recipient countries with limited capability to enact capital controls, either for lack of institutional capacity or because of legal constraints, such as from trade and investment agreements. Source-country governments may wish to regulate outflows, in order to enhance the effectiveness of monetary policy by steering credit towards productive investment in their own economies and preventing the leakage of monetary stimulus into financial investment abroad. Coordinating capital controls might achieve greater stability in capital flows with relatively lower levels of restrictions at both ends, instead of stricter controls at one end. The recognition that such changes may be essential for achieving the SDGs may provide additional motivation for their enactment.

Another way in which foreign investors can help boost the resources available for meeting the SDGs is by paying their taxes. Illicit financial flows on the part of multinational enterprises (MNEs) are estimated to deprive developing countries of $50 billion to $200 billion a year in fiscal revenues. These flows are facilitated by international corporate tax norms that consider affiliates of MNEs as independent entities and treat taxable transactions between the different entities of MNEs as unrelated. Instead of such an inefficient tax system, it is time to think of a system of unitary taxation that recognizes that the profits of MNEs are generated collectively at the group level, combined with a global minimum effective corporate income tax rate on all MNE profits. This could be set at around 20–25 per cent, which is the average of current nominal rates across the world. To distribute these taxes on corporate profits across countries, the option most promising for developing countries is that of "formulary apportionment", whereby the total taxes of the MNE group are allocated across countries according to an agreed formula, ideally one that prioritizes employment and productive physical assets over total sales.

Another drain on fiscal resources has emerged with the digital economy. The losses are already high for developing countries, because they are less likely to host digital businesses but tend to be net importers of digital goods and services. Addressing these leakages requires reviewing several features of existing international corporate tax norms, such as the nexus rules (which determine which jurisdiction has taxing rights); the profit allocation rules (which determine how cross-border transaction between the different entities of an MNE are treated) and the measurement of value creation when intangible assets are significant in economic transactions and when users become a significant source of value. Determining fair taxing rights in a digital economy requires using the concept of significant economic presence, which would create a taxable nexus for a company operating in a digital environment if it generates revenue from sales or transactions that exceed certain levels.

This would also facilitate the unitary taxation of MNEs, since it would enable the inclusion of values created from using a company's intangible assets and from user-generated content.

While waiting for international consensus on this matter, several developed and developing countries have explored temporary unilateral domestic tax measures for the digital economy. One example is the excise tax, equalization tax or levy that several countries (many of which are European Union members) have considered or started to apply. A simple estimation of potential additional tax revenues from such unilateral measures ranges between $11 billion and $28 billion for developing countries alone. Similarly, while consensus at the World Trade Organization has not been reached, terminating the moratorium on custom duties on electronic transmissions could provide additional fiscal revenue of more than $10 billion globally, 95 per cent of which would go to developing countries.

All in all, implementing these various proposals could increase resource availability in developing countries by roughly $510 billion to $680 billion a year, an amount similar in size to their total foreign direct investment inflows.

## Banking on the public

Banking stopped being boring during the financialized transition to a globalized world, and it also stopped serving the needs of the productive economy. The transformation of banking into a high glamour, high paid, globalized industry came with financial deregulation and a surge of cross-border capital flows. As a result of deregulation, retail banking activities blended with investment activities to create financial behemoths operating with an "originate-and-distribute" business model whereby loans were securitized and a range of financial services boosted the rents they could earn. The resulting shift to packaging, repackaging and trading existing assets created a system in which the bulk of transactions involved other financial institutions, predatory practices became acceptable and contagion effects were aggravated.

The fragility of this system was exposed during the GFC as an estimated $50 trillion was wiped off asset values. But the social cost that followed the bailout of banks that had become “too big to fail” was, if anything, even more corrosive. At the same time, the damage to the environment and the cost of mitigating this is becoming more and more visible and is also serving to weld together a broad coalition seeking a new way forward and more responsible practices from the world of banking, alongside other spheres.

The 2030 Agenda requires the biggest investment push in history and banks will be called upon to do their bit. Banks can offer the benefits of scale and reach because of their ability to create credit and their modus operandi of forming partnerships with other financiers and investors. But despite the use of taxpayers’ money to bail out the banking system and the recognition that current practices work against them serving the productive economy, serious banking reform has not taken place since the crisis. This is raising new questions about how to make banks work for people and the planet, with growing attention to the potential role of public banking, because it is distinctively different – or should be – from private banking.

The important distinction is that public banks’ goals include social and developmental objectives, and this is the case as much for public banks operating along commercial lines as it is for development banks. They can fulfil these objectives best when operating within an articulated system with other banks and in close alignment with government policy objectives and instruments; however, even where this articulation is lacking, recent history shows public banks are expected nonetheless to be able to leap into action. They are the first line of defence in times of crisis when credit becomes scarce, providing countercyclical and additional finance to mitigate the economic effects of a shock.

For the Global Green New Deal, the task is more of a marathon than a sprint. Here public banks have another advantage, because they have a more diversified portfolio and broader geographic reach to underserved areas and segments of the economy and (especially development banks) take a longer-term approach. By contrast, private (and especially foreign) banks are known for avoiding such lending as they pick profitable cherries elsewhere.

The paradox is that, just as governments are calling out for much more long-term investment, they are at the same time exhibiting little willingness to give their public banks the tools for the task. Banks need to be able to scale up, to lend in the desired directions, and to be evaluated by performance metrics that fit their developmental mandate. However, these three things do not often come together.

The lead shareholders in the large multilateral financial institutions are underwhelming in their support for capitalizing these banks, and continue to divert significant revenues when profits are made rather than reinjecting them into the equity base. Instead, scaling up is being promoted through securitization and balance-sheet optimization, which potentially bring a whole new set of problems. Southern governments have been much more willing to take the lead in expanding the role of public banks, in part out of a sense of frustration with the inadequate response from the North. They have established new public banks, and expanded existing ones, scaling up so quickly that even though they only started to become actively engaged since the early 2000s onwards, they have surpassed the older multilateral banks. The stock of outstanding loans made by the China Development Bank was $1,635 billion in 2017, much larger than the total loans by the World Bank (for 2017, the net outstanding loan of IBRD and IDA are $177 billion and $138 billion respectively).

Southern-led multilateral initiatives have been just as significant – the BRICS countries' New Development Bank and the Asian Infrastructure Investment Bank have been in operation for just a few short years but are already making their presence felt. These Southern-led banks are well capitalized with reliable funding sources, which permits them to have a longer-term horizon and thereby finance long-maturity projects such as infrastructure, which more commercially oriented banks may not be so ready to support. They have also shown speedier response, taking on average six months to approve loans from initial application as compared to one or even two years for the big multilaterals. While some banks in the North have similarly upped the ante, a lot more is needed in order to meet the vision of the Global Green New Deal.

Some encouraging noises are being heard from the different levels of the banking ecosystem, including central banks, which may have more space than is sometimes envisaged to resume their traditional role of creating and guiding credit to the areas of the economy where it is needed most. Indeed, central banks played this role in several of the successful examples where countries managed to transform themselves from agricultural to industrial economies. It is only in recent years, under the rubric of "independence", that the traditional interlinkage between banks and government development goals has been cut.

The extent to which governments provide support to "their" development banks is an important factor in their success. Many governments require their banks to maintain high credit ratings – typically AAA, even if this is higher than the rating of the sovereign itself. This gives banks two masters: they must please credit-rating agencies and also meet their developmental goals, which by definition include riskier projects. If governments were perceived by credit-rating agencies as being more willing to "stand by" their banks, a more favourable rating would ease their costs of borrowing and free up hundreds of billions of dollars for development lending. Ironically, governments themselves are facing falling credit ratings thanks to the entirely predictable failure of the austerity policies that were designed, in part, to please credit-rating agencies' expectations. This mess reveals once again that the notion of "independence" between governments and the banks they own is an illusion – and not a desirable one. UNCTAD has in the past called for a review of the power of credit-rating agencies and today's challenges reinforce this. It is perhaps time to design a new metric for evaluating large public investment projects that more accurately assesses their social and economic dimensions, rather than being based on narrow financial measures and ideological biases.

What is also important is the wider regulatory environment in which public banks operate. Global rules need also to be refigured in light of the new needs. The need to review trade and investment agreements that bind the ability of policymakers to use capital management policies was suggested above. The Basel norms and rules, a standard internationally designed regulatory framework adopted by virtually all countries around the world, similarly need to be more flexible. At present they treat all types of banks the same, and hence penalize institutions with long-term or riskier exposures – which is the usual terrain chosen for public and particularly development banks. Moreover, although Basel rules are adopted by national jurisdictions, they also affect multilateral and regional development banks, at least indirectly.

The banks that suffer most are the smaller regional banks that end up holding too much capital for the total of loans they provide. At the same time there is the paradox that, even as regional developmental needs are so severe, the banks that serve such regions are often dismally small. There is, therefore, an urgent need to find ways to capitalize such banks so that they can support national country needs and also regional projects. One possible route is to align better with Sovereign Wealth Funds, which are currently holding at least $7 trillion of assets by recent estimates, but typically not directed towards developmental lending. Others include increasing the pool of resources by bringing in new countries as shareholders; or seeking a more integrated approach between such financial institutions and regional capital markets, whose potential has, to date, been underexplored.

All this requires rejection of the notion that markets always know best. There is a growing acknowledgement of the idea that governments should underwrite risks, staunch leaks and fill gaps left by private banking but public banking in the past has proved to be catalytic and game-changing; the current situation offers opportunities to play this role again.

## Pull up the people, cool down the planet

In 1930, John Maynard Keynes speculated on "the economic possibilities for our grandchildren" a hundred years hence. Keynes was pessimistic about immediate economic prospects but on the long-term possibilities he was much more hopeful. Indeed, thanks to a combination of compound interest, technological progress and the bounties of the natural world, Keynes believed that this would be a privileged generation free from the day-to-day chores of economic life, preoccupied instead with how to fill their long hours of leisure time with more fulfilling pursuits.

As chance has it, 2030 is concentrating the minds of those very grandchildren who now occupy positions of political influence and policymaking. Technological progress, as Keynes anticipated, has over the passing decades given a massive boost to the productivity of the economy and the efficiency of day-to-day life. However, the problem of technological unemployment is not proving to be the "temporary phase of maladjustment" he had expected. Moreover, the dominant social customs and economic practices around moneymaking are still very much with us, along with the destabilizing financial forces and widening wealth and income gaps that Keynes predicted would follow.

He would no doubt be reconsidering the consequences of his own cavalier attitude to the natural world, as the grandchildren of his era come to terms with the mounting threat of environmental collapse; and would also be reminding them that the massive social investments still needed for a more inclusive and sustainable world would require taking a much firmer hand over the rent-seeking proclivities of the financial sector along with the large public investment programmes to, as he wrote in an open letter to President Roosevelt, "get across the crevasses before it is dark". In a similar vein, this *Report* has set out some of the elements needed for financing a Global Green New Deal and to deliver the 2030 Agenda.

But to this should be added a bold industrial vision and a new social contract that embraces the needs of the many and not just the interests of the few. While Keynes was less than enthusiastic about Roosevelt's National Industrial Recovery Act, which set out such a vision, a green industrial recovery programme would seem to be one way forward, for developed as much as developing countries. And just as, 75 years ago at Bretton Woods, bold thinking animated the discussions around establishing a multilateral system that would extend the new deal to the international economy, this is once again needed to combine the desire of prosperity for all with a determined commitment to heal the planet.