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

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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;

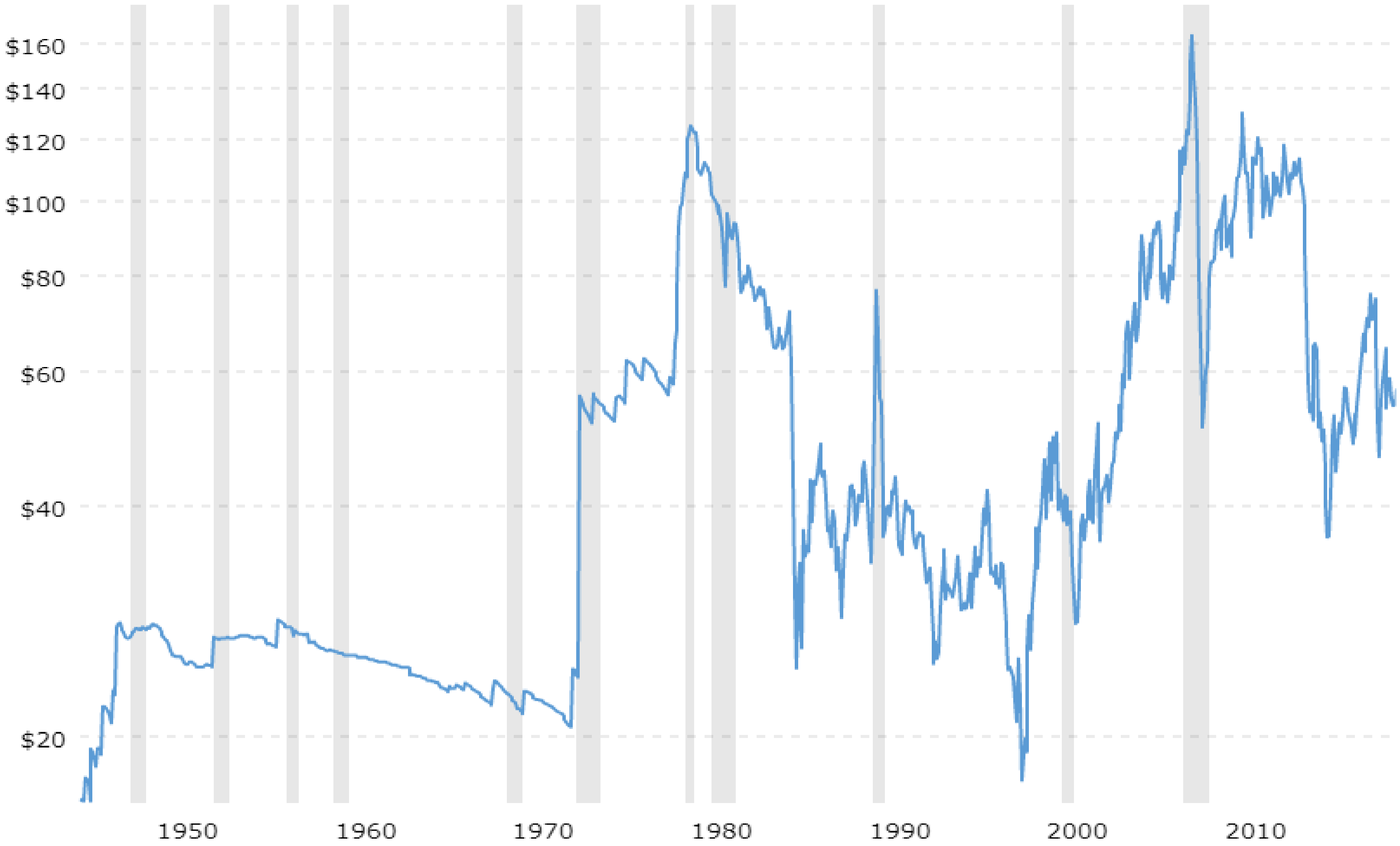
- Hence preference for commodity futures, rather than actual commodities.

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

Crude oil price since 1945



US Federal Funds Rate 1950-2019

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.