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Mobilization of financial resources for inclusive and sustainable development

Note by the UNCTAD secretariat

Summary

In 2015, the international community agreed to one of the most ambitious development agendas in history – the 2030 Agenda for Sustainable Development, with 17 Sustainable Development Goals and 169 targets. That same year, agreement was reached in Paris to pursue efforts to keep the rise in global temperatures to 1.5 degrees Celsius above pre-industrial levels. Achieving both requires scaling up investment on an unprecedented level, in new areas of energy delivery, productive activity and in infrastructure provision. This can only be accomplished through adequate, reliable financing for long-term productive investment.

Given current global challenges and the urgent need to finance the Sustainable Development Goals, this note discusses core policy options and requirements for the effective, long-term mobilization of development finance. It focuses on scaling public investment and crowding in private investment. It evaluates regional institutions and mechanisms to facilitate resource mobilization for development, including regional monetary integration; the role of networks of national, regional, and multinational development banks; and the facilitation of access among small and medium-sized enterprises to reliable sources of affordable finance.

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I. Introduction

1. In 2015, the international community agreed to one of the most ambitious development agendas in history – the 2030 Agenda for Sustainable Development, with 17 Sustainable Development Goals and 169 targets. The 2030 Agenda is of unrivalled ambition. It aims to balance the three dimensions of sustainable development – economic viability, social inclusion and environmental sustainability. In particular, it provides a shared vision and shapes collective action in support of a development path that incorporates these dimensions.

2. With roughly a decade left to achieve the 2030 Agenda, efforts to meet the Sustainable Development Goals are behind schedule. What is required to put it back on track is a coordinated investment push – on an unprecedented scale – across the world. Given current conditions, as well as the structure of the global economy, a major challenge involves the scaling the financing of productive investments.

3. This note highlights policy options and requirements for the effective, long-term mobilization of development finance. Policymakers may wish to consider these options during the fourth session of the Multi-year Expert Meeting on Enhancing the Enabling Economic Environment at All Levels in Support of Inclusive and Sustainable Development, and the Promotion of Economic Integration and Cooperation.

4. Closing the Sustainable Development Goal financing gap will require, at a minimum, an additional $2 trillion to $3 trillion a year in developing countries alone.[1] The *Trade and Development Report 2019: Financing a Global Green New Deal*[2] shows – for a sample of 30 developing countries across all income categories – that with weak multilateral support, developing countries would see their debt-to-gross domestic product (GDP) ratios rise to 185 per cent on average by 2030; or they would require average annual GDP growth rates of 12 per cent to meet the investment needs of only the first four Sustainable Development Goals (eliminate poverty, achieve better nutrition, promote good health, ensure quality education). Requirements vary across income categories and regions. On average, low-income developing countries need additional annual resources equivalent to 21.6 per cent of GDP. This figure falls to 9.6 per cent and 3.3 per cent of GDP for lower-middle-income countries and upper-middle-income countries, respectively.

5. Mobilizing domestic resources for productive investment is a long-standing challenge for many developing countries, and hopes of funding the Sustainable Development Goals from the proceeds of economic growth alone seems wishful thinking, given that the global economy has been unable to establish a robust, stable growth path since the 2008 financial crisis. Weak demand, rising debt and volatile capital flows have left many economies oscillating between incipient recoveries and financial instability. Austerity measures and a widespread corporate “rentierism” have pushed inequality higher, dragging down growth and damaging the social and political fabric. Financialization has dominated the global economy; yet the promise that it would generate a dynamic investment climate has not materialized.

6. In response to these challenges, market-oriented solutions, such as blended finance or public–private partnerships have been promoted, particularly since the 2008 financial crisis, by various think tanks and international agencies. To date, however, these have failed to push economies in a more financially, socially and environmentally sustainable direction. Indeed, as emphasized in previous UNCTAD publications, efforts to finance the Sustainable Development Goals by blending public and private sources have routinely failed to boost productive investment. Moreover, they were instrumental in the boom-bust cycle that fuelled the 2008 financial crisis.

7. For the 2030 Agenda to move from rhetoric to results, a new multilateralism is needed on a different financial footing. Such a process should start with a serious

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[1] UNCTAD, 2014, *World Investment Report 2014, Investing in the Sustainable Development Goals: An Action Plan* (United Nations publication, Sales No. E.14.II.D.1, New York and Geneva).

[2] UNCTAD, 2019, *Trade and Development Report 2019: Financing a Global Green New Deal* (United Nations publication, Sales No. E.19.II.D.15, Geneva).

discussion of public financing options. This would be part of a wider effort to repair the social contract through which inclusive, sustainable outcomes can emerge and from which private finance can be engaged on more socially productive terms.

8. Given current global challenges and the urgent need to finance the Sustainable Development Goals, this note argues that achieving sustainable development is only possible through a coordinated expansionary macroeconomic strategy that revives global growth, strengthens industrialization in the South and reduces carbon emissions, inequalities and instability. It discusses scaling public investment and crowding in private investment. It evaluates regional institutions and mechanisms to facilitate resource mobilization for development. Issues explored include regional monetary integration; the role of networks of national, regional, and multinational development banks; and the facilitation of access among smaller business to reliable and affordable sources of finance.

II. How to scale up public investment and crowd in private investment: Mixed financing options for large-scale infrastructure projects

9. Making finance work for development has been a challenge for many international agencies, researchers and other stakeholders in the development business. The recent report of the Group of 20 Eminent Persons Group on Global Financial Governance claims that a serious reform of the global financial architecture is overdue. [3]

10. The last four editions of the UNCTAD *Trade and Development Report* call for a paradigm shift for effective long-term mobilization of development finance. According to UNCTAD, what is needed is a new global financial order that would boost infrastructure investment in the context of structural transformation. The new order would also provide countries with an alternate perspective on how to plan, execute and coordinate those investments to build their industrial capacities. These reports also argue that the need for fundamental reform is driven by several challenges.

11. The following section briefly reviews these challenges. It states that the decarbonization challenge required to achieve sustainable development is only possible through a macroeconomic strategy that supports expansionary fiscal policy to revive global growth; strengthens industrialization in the South; and reduces carbon emissions, inequalities and instability everywhere. It draws heavily on the *Trade and Development Report 2019*.

A. Structural challenges for long-term productive investment

12. Four global trends are hindering achievement of the Sustainable Development Goals: the fall of labour’s share of global income, the erosion of public spending, the weakening of productive investment and the unsustainable increase of atmospheric carbon dioxide.[4]

13. The increasing stock of atmospheric carbon dioxide, which is responsible for global warming, harbours the threat of serious socioeconomic damage across the planet and to life itself. The rise of temperatures must be stopped and reversed soon if it is not to become self-sustaining. [5] This is only possible through decarbonization. Investing in renewable energy needs to be pursued on a global scale and to be supported by a green industrial

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[3] Global Financial Governance, 2018, Making the Global Financial System Work for All: Report of the G20 [Group of 20] Eminent Persons Group on Global Financial Governance.

[4] UNCTAD, 2019.

[5] Intergovernmental Panel on Climate Change, 2019, *Global Warming of 1.5°C*: *An Intergovernmental Panel on Climate Change Special Report on the Impacts of Global Warming of 1.5°C above Pre-industrial Levels and Related Global Greenhouse Gas Emission Pathways, in the Context of Strengthening the Global Response to the Threat of Climate Change, Sustainable Development and Efforts to Eradicate Poverty*, Geneva.

policy using a mix of general and targeted subsidies, equity investments, tax incentives, loans and guarantees. It should also be supported by investments in research, development and technology adaptation and a new generation of intellectual property and licensing rules.[6] Technological solutions abound[7] but their adoption on a large scale is at odds with other global trends.

14. Although operating on a different time horizon, one of the most alarming global trends is the falling share of labour income. Since the 1980s, the share of national income accruing to labour has decreased in almost every country. This shift has generally been larger in developed countries; in some countries, 10 per cent or more of GDP has transferred from workers to capital, including in Australia, Italy and Japan. The trend has been visible in developing countries as well, highlighting a global race to the bottom in labour costs.

15. The proximate cause of the latter is wage repression, which has prevented wages from keeping pace with the cost of living and increases in productivity. Other, more fundamental factors have included the erosion of social security, growing market concentration, decreasing unionization rates and the spread of outsourcing through global value chains,[8] all of which have eroded labour's bargaining power. As a result, a growing share of household spending has been financed with borrowing. Overall, household consumption and business investment have slowed, undermining aggregate demand, with negative consequences on productivity growth.

16. Next, consider the third component of aggregate demand: government spending, which averages 20 per cent of GDP in developed and developing countries alike. (The other two components of demand – contributions of private consumption and investment – amount to 55–60 per cent and 18–25 per cent of GDP on average, respectively.) By fuelling demand for goods and services, including those produced or provided by government employees, government spending contributes to aggregate demand as much as, or more than, private investment.

17. Fiscal policy determines the level of government spending. In most countries, fiscal policy has been flat or contracting for several decades. Exceptions occurred during the shallow recession in the United States in the early 2000s and during the global financial crisis. Following the Great Recession, several countries adopted fiscal stimulus packages, only to tighten sharply in 2010.[9]

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[6] KP Gallegher and R Kozul-Wright, 2019, *A New Multilateralism for Shared Prosperity: Geneva Principles for a Global Green New Deal*, Global Development Policy Centre, Boston University.

[7] W Steffen, J Rockström, K Richardson, TM Lenton, C Folke , D Liverman, CP Summerhayes, AD Barnosky, SE Cornell, M Crucifix, JF Donges, I Fetzer, SJ Lade, M Scheffer, R Winkelmann and HJ Schellnhuber, 2018, Trajectories of the Earth system in the Anthropocene, *Proceedings of the National Academy of Sciences of the United States of America*, 115(33):8252–8259.

[8] A Izurieta, P Kohler and J Pizarro, 2018, Financialization, trade and investment agreements: Through the looking glass or through the realities of income distribution and government policy? Working Paper No. 18-02, Global Development and Environment Institute at Tufts University; UNCTAD, 2017, *Trade and Development Report 2017: Beyond Austerity – Towards a Global New Deal* (United Nations publication, Sales No. E.17.II.D.5, New York and Geneva); UNCTAD, 2018, *Trade and Development Report 2018: Power, Platforms and the Free Trade Delusion* (United Nations publication, Sales No. E.18.II.D.7, New York and Geneva).

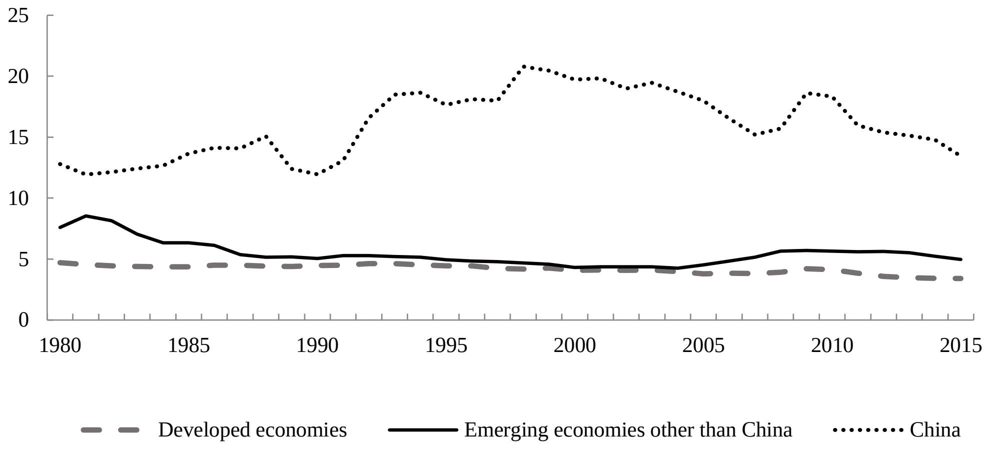
[9] P Devries, J Guajardo , D Leigh and A Pescatori, 2011, A new action-based dataset of fiscal consolidation, Working Paper No. 11/128, International Monetary Fund.

18. The subsequent fiscal contraction, in the form of spending cuts and increases in value added taxes, aimed to reduce government debt relative to GDP. In most countries, the cuts affected social protection systems[10] and public investment.[11] This further exacerbated inequalities,[12] heightened insecurity and diminished prospects for future growth.[13]

19. Declining public investment in developing countries in the 1980s and 1990s can be linked to the adoption of fiscal adjustment policies. These, in turn, were a response to the rash of debt crises, triggered in large part by monetary policy decisions taken in advanced economies and ensuing structural adjustment programmes. The upshot: today, the world is underinvesting and consequently, is creating a cumulative infrastructure gap, though the exact order of magnitude is unclear.

20. In developed countries, public investment, a proxy for infrastructure investment, was at a historic low in 2015, at 3.4 per cent of GDP, compared with 4.7 per cent in 1980 and about 6 per cent in the 1960s. In emerging economies other than China, it fell from above 8 per cent of GDP in the early 1980s to about 5 per cent in 2000, recovering to 5.7 per cent in 2008 and declining thereafter (figure 1). The outlier was China, which enjoyed impressive rates of public investment to GDP of 15–20 per cent and associated high rates of output growth for several decades.

Figure 1
Trends in public investment, 1980–2015
(Percentage of gross domestic product)



Source: UNCTAD secretariat calculations, based on International Monetary Fund capital stock data set.
Note: Public investment refers to general government investment (gross fixed capital formation).

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[10] International Labour Organization, 2017, *World Social Protection Report 2017/19: Universal Social Protection to Achieve the Sustainable Development Goals*, International Labour Office, Geneva.

[11] A Bhattacharya, KP Gallagher, M Muñoz Cabré, M Jeong and X Ma, 2019, *Aligning G20 [Group of 20] Infrastructure Investment with Climate Goals and the 2030 Agenda*, Foundations 20 Platform, Brookings Institution, Washington, D.C. and Boston University, Boston, Massachusetts; Global Infrastructure Hub and Oxford Economics, 2017, *Global Infrastructure Outlook: Infrastructure Investment Needs 50 Countries, 7 Sectors to 2040*; Organization for Economic Cooperation and Development (OECD), 2017, *Investing in Climate, Investing in Growth*, OECD Publishing, Paris.

[12] Office of the United Nations High Commissioner for Human Rights, 2013, *Report on Austerity Measures and Economic and Social Rights*, Geneva; C Perugini, J Žarković Rakić and M Vladisavljević, 2019, Austerity and gender inequalities in Europe in times of crisis, *Cambridge Journal of Economics*, 43(3):733–767; V Popov and JK Sundaram, 2015, Income inequalities in perspective, *Development*, 58(2–3):196–205.

[13] JD Ostry, P Loungani and D Furceri, 2016, Neoliberalism: Oversold*? Finance and Development*, 53(2):38–41.

21. These declining trends in aggregate demand brought increased reliance on credit for total spending, including private investment, consumption and government spending. Such reliance is not necessarily negative, if credit is used productively. However, since at least the 1980s, credit expansion in many countries has surged without a corresponding accumulation of fixed capital. This sometimes occurs for long periods, before contracting in a credit crunch. In periods of expansion, credit has been used to finance speculative activities by financial and non-financial corporations,[14] as well as by households to maintain living standards in the face of stagnant real wage growth.

22. This decoupling of credit and investment is a concern for most developed and developing countries. It affects productive investment in two major ways. First, due to funding financial operations with credit, non-financial corporations turned away from productive investment because of its long maturity, low liquidity and often lower yields. Simultaneously, credit-fuelled accumulation of large financial liabilities produced financial crises and recessions that inhibited productive investment. Overall, productive investment has not increased, despite repeated bouts of credit expansion, increases of corporate profit shares and corporate tax cuts, in developed and emerging economies alike.

B. Scaling up public investment and crowding in private investment: Mixed financing options for large-scale infrastructure projects

23. Infrastructure investment, with its lower yields and longer maturities, has been particularly affected by weaker investment trends.[15] This has had negative impacts on industrialization in developing countries and on productivity growth everywhere due to its central role in transforming economies.[16]

24. Infrastructure encompasses a broad category of goods and services that involve investments in the social and physical stock of capital. Definitions of the term by development economists have often not been precise.[17] For example, Hirschman, employing the umbrella term "social overhead capital", defined infrastructure as those "basic services without which primary, secondary and tertiary productive activities cannot function"[18] and which are provided or heavily regulated by public agencies.

25. According to Hirschman, this heavy involvement of public agencies in an unbalanced growth stage allows for a more effective selection of productive resources targeted at sectors with the potential to build backward and forward linkages, thereby revealing gaps and generating price disruptions that stimulate private investment. This would further promote institutional capabilities needed to keep the growth process going and to send the right signals to policymakers for productivity-enhancing infrastructure investments.

26. Recently, there has been a revival of interest in infrastructure investment. This is in part due to a growing belief that such spending can have positive short- and long-term impacts on growth, and thus, a role in tackling secular stagnation.[19] It also reflects recognition of the importance played by large infrastructure projects in the remarkable growth and poverty-reduction story that has unfolded in China and an awareness of the urgent need to decarbonize economies through green investments.

[14] M Schularick and AM Taylor, 2012, Credit booms gone bust: Monetary policy, leverage cycles and financial crises, 1870–2008, *American Economic Review*, 102(2):1029–1061; UNCTAD, 2015, *Trade and Development Report 2015: Making the International Financial Architecture Work for Development* (United Nations publication, Sales No. E.15.II .D.4, New York and Geneva).

[15] Bhattacharya et al., 2019.

[16] UNCTAD, 2018.

[17] GK Ingram and M Fay, 2008, Physical infrastructure, in: AK Dutt and J Ros, eds, *International Handbook of Development Economics*, Vol. 1, Edward Elgar, Cheltenham, p. 301.

[18] AO Hirschman, 1958, *The Strategy of Economic Development*, Yale University Press, New Haven, Connecticut; AO Hirschman, 1961, *Latin American Issues: Essays and Comments*, Twentieth Century Fund, New York, p. 83.

[19] LH Summers, 2016, The age of secular stagnation: What it is and what to do about it, *Foreign Affairs*, March/April.

27. Multilateral financial institutions, including institutions from the South, such as the Asian Infrastructure Investment Bank and the New Development Bank, are scaling support for infrastructure investment in developing countries. There are also several international initiatives, such as the Belt and Road Initiative (China) and Marshall Plan with Africa (Germany), that put infrastructure investments at their centre.

28. International institutional investors seem increasingly keen on infrastructure as an asset class, because of the prospect of steady returns. This reflects the broad understanding that infrastructure projects, particularly the capital intensive ones, such as highways, airports, harbours, utility distribution systems, railways, water and sewer systems and telecommunication systems, have exhibited scale and network effects that spill over to the private sector and engage both the public and private sectors in a variety of complicated financial, economic and political interactions.[20]

29. Arguably, the most complicated among these interactions is of a financial nature. As noted previously, the scale of the financing challenge is daunting, from billions to trillions, even with more resources becoming available. The dominant narrative to scale up the financing efforts is one that focuses on closing the financing gap to meet the 2030 Agenda.[21]

30. With respect to infrastructure, the conventional financing gap narrative rests on several assumptions. First, the estimated infrastructure investment gaps imply a financing gap of a similar order of magnitude. Second, public sectors in most countries are financially constrained, face governance problems and run the risk of running into debt-sustainability issues if they undertake infrastructure investments on the scale needed to reach the Sustainable Development Goals. Third, given this public resource constraint, private capital, which is typically invested in short-term financial assets, should be unlocked for infrastructure projects. Fourth, for this to occur, a pipeline of bankable projects needs to be developed.

31. Bankable projects are defined as those “that provide investors with appropriate risk-adjusted returns”.[22] Projects that fit that profile are thought to be scarce, while the risk-adjusted returns of existing projects are too low to attract private investors.

32. Numerous factors are said to restrict the delivery of bankable projects. These include low preparation capacity, high transaction costs, lack of liquid financial instruments, weak regulatory frameworks and legal opposition, along with various types of risks during the life cycle of a project, including macroeconomic, political, technical and environmental risks; cost over-runs; and demand and revenue risks.[23]

33. This narrative has serious limitations. The first concerns the expected scale and role of private sector engagement in infrastructure development. Throughout history, domestic public financing for infrastructure development has been dominant. Experience suggests that such public sector dominance will continue even if private finance grows in the years ahead.

[20] UNCTAD, 2018.

[21] Ibid.

[22] J Woetzel, N Garemo, J Mischke, P Kamra and R Palter, 2016, Bridging Global Infrastructure Gaps, McKinsey Global Institute, McKinsey and Company, June, p. 17.

[23] A Bhattacharya, M Romani and N Stern, 2012, Infrastructure for development: Meeting the challenge, Centre for Climate Change Economics and Policy, Policy Paper, Grantham Research Institute on Climate Change and the Environment in collaboration with the Intergovernmental Group of 24 on International Monetary Affairs and Development; T Serebrisky, A Suárez-Alemán, D Margot and MC Ramirez, 2015, *Financing Infrastructure in Latin America and the Caribbean: How, How Much and by Whom?* Inter-American Development Bank, Washington, D.C.; World Bank, 2011, *Multilateral Development Banks Infrastructure Action Plan: Group of 20 Documents (Vol. 2): Supporting Infrastructure in Developing Countries*, Submission to the Group of 20 by the Multilateral Development Banks Working Group on Infrastructure, Washington, D.C.

34. In places where private finance does exist, it comes together with public funding. In Africa, domestic public finance accounts for 66 per cent of total infrastructure finance.[24] In Latin America, when private financing of infrastructure occurs, public finance still accounts for a third of total project funding.[25]

35. In Asia, private investment is prevalent in the telecommunications sector. It also has a significant presence in the energy sector. But its participation is small in transport and virtually non-existent in water and sanitation.[26] Private sector involvement in infrastructure investment may increase with a greater supply of bankable projects.

36. However, this current fashion for reducing infrastructure planning to a portfolio choice, with a focus on the bankability of individual projects and risk-adjusted returns in line with the calculations of the private investor approach, is particularly problematic for developing countries because it delinks development from financial feasibility.

37. Instead, the place to start should be with a national development strategy that should determine infrastructure planning – what scale to target, which sectors and technologies to prioritize, for example – and indicate the resources required to achieve the desired goals. This, in turn, necessitates a reversal of the sequencing implied by the financing gap approach, which starts with the identification of gaps between actual and needed investment for infrastructure, followed by assumptions of capacity of government expenditure and estimates of private financing required, ending with project design strategies to attract private capital to fill the gap.

38. The rapid recovery of overall infrastructure investment will depend on Governments' capacities to carry out their leadership roles in planning and implementing new infrastructure projects. To do so, Governments should reclaim their policy and fiscal space and boost aggregate demand. They should assume a leading role in a coordinated investment push by investing directly (through public sector entities) and establishing the conditions for productive investment by the private sector. Governments should address inclusiveness and sustainability challenges by redistributing income in ways that bolster growth and by directly targeting social outcomes through employment measures, decent work programmes and expanded social insurance.

39. A range of policy instruments are required. These include fiscal policies, industrial policies, credit policies, financial regulation and welfare policies, and international trade and investment policies. Their effectiveness demands appropriate international coordination 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.

40. The transition to a low-carbon economy is already under way in a number of advanced economies, albeit at too slow a pace, but it also opens up an opportunity to introduce the Global Green New Deal described in the *Trade and Development Report 2019*. This would recast the Depression era's signature policy on a global scale, with the potential to generate income and employment growth, stabilize the climate, clean the air and create numerous other environmental benefits. Income distribution would improve, too, as many of the jobs created by green investment are inherently local to the area where investment occurs.[27] This process can drive developed countries closer to full employment and help achieve better conditions of work in developing countries.

41. Reaching sustainable development requires financial regulators, including central banks and financial market authorities, to curb destabilizing financial trades and return

[24] World Bank, 2011.

[25] M Fay, LA Andres, C Fox, U Narloch, S Straub and M Slawson, 2017, *Rethinking Infrastructure in Latin America and the Caribbean: Spending Better to Achieve More*, World Bank, Washington, D.C.

[26] Asian Development Bank, 2017, *Meeting Asia's Infrastructure Needs*, Manila.

[27] International Labour Organization, 2018, *World Employment and Social Outlook 2018*: *Greening with Jobs*, International Labour Office, Geneva; International Monetary Fund, 1998, *World Economic Outlook: Financial Turbulence and the World Economy*, Washington, D.C.

finance to its socially useful function of funding productive investment.[28] The implementation challenge to this productivist approach to finance is the need for complementary policies on many fronts, including international capital controls,[29] exchange-rate management, subjecting bank mergers to financial stability tests and establishing international protocols to resolve sovereign debt crises so as to avoid predatory financial behaviour. The next two sections will elaborate on those issues.

III. Institutions and mechanisms to facilitate resource mobilization

42. In addition to the essential roles described above, financial institutions and mechanisms have a direct role to play in creating and allocating credit. While the Sustainable Development Goals and their re-framed vision as the Global Green New Deal represent an extraordinarily broad-based consensus of what is needed, the first question is always, "how can this be financed?" On one level, this should not be such an obstacle because the world currently has a surplus of capital with low and even negative interest rates. There is also compelling evidence that many reforms will pay for themselves, through increased fiscal revenues, reduced illicit financial flows and decommissioned subsidies of various kinds, among others. However, as described above, the financial system has in recent years morphed into a system that favours speculation rather than productive activities. It has proved reluctant to invest, especially in the kinds of activities needed to achieve the Sustainable Development Goals.

43. Notwithstanding the particularities of currently existing institutions, two main financing needs must be met:

(a) Ensuring adequate and reliable sources of patient, long-term finance, which continues to be scarce, despite a deluge of short-term finance. This means not only scaling up significantly but in a robust and sustainable way, respecting the developmental mandate for finance;

(b) Making sure that finance has breadth, both geographical – especially to underserved areas in Africa – and sectoral – in particular to underserved activities such as water – extending to underserved communities as well (for example, small enterprises and cooperatives).

A. What public banking can offer

44. Public banking has the ability to meet these requirements, as reflected in the renaissance of interest in this long-standing but somewhat neglected area. Banks can mobilize resources by virtue of their capacity to create credit, although this depends on maintaining credibility and viability. However, there is no need to wait until sufficient savings have been accumulated before investments can be made. Banks can offer further benefits of scale and reach because of their modus operandi of forming partnerships with other investors and financiers. And public banks are distinctly different from private banks because they can include social and developmental objectives, as well as financial ones – or they should. As the financial needs of the Sustainable Development Goals and the Global Green New Deal are more in the nature of a marathon than a sprint, only public banking has the capacity to create the diversified portfolios, spread over a broad geographical range, that can reach the underserved areas and segments of the economy. In principle, they also have

[28] S Storm, 2018, Financialization and economic development: A debate on the social efficiency of modern finance, *Development and Change*, 49(2):302–329.

[29] C Baba and A Kokenyne, 2011, Effectiveness of capital controls in selected emerging markets in the 2000s, Working Paper No. 11/281; International Monetary Fund, 2010, *World Economic Outlook:October 2010 – Recovery, Risk and Rebalancing*, Washington, D.C.; JD Ostry, AR Ghosh, K Habermeier, M Chamon, MS Qureshi and DBS Reinhardt, 2010, Capital inflows: The role of controls, International Monetary Fund Staff Position Note 10/04, International Monetary Fund.

the capacity to take the long-term view, another sharp distinction, as compared with private banks.

45. Taken together, public banks and bank-like institutions are already pulling above their weight when it comes to financing the Sustainable Development Goals. Estimates of their number and size vary[30] but most agree that public banking accounts for about one fourth of the total banking universe and a higher proportion in developing countries. Yet they support a much higher proportion of Sustainable Development Goal-type investments than that. Of the $454 billion estimated to be invested in climate finance in 2016, the public sector contributed almost half.[31] Private finance is important, but how it can be better harnessed alongside these public efforts in ways that balance risk and reward?

46. In this regard, different kinds of banks have different roles to play. Ideally, countries host a diverse variety so that in addition to broad-based financial services, specialist institutions can offer particular technical expertise and managerial capacities in addition to finance. National systems vary greatly in this area, reflecting regulatory frameworks and historical contexts. Germany and the Republic of Korea are examples of countries that avoided the concentration seen elsewhere and maintained a wide range of different kinds of banks, including many public and development ones. In other countries, including the United States, public banking is going through something of a renaissance, with new ones being established, and old ones better supported.

47. In some countries, central banks, as the command centre and head of a country's banking system, are looking for ways to offer the new leadership required for the twenty-first century. After the 2007–2008 financial crisis, central banks showed that they could step into a crisis situation. Now, for perhaps the first time in decades, debate about their role is being raised again. Some are concerned about the "tragedy of the horizon"[32] or the potential for a rapid system-wide adjustment that threatens financial stability ("climate Minsky moment", table 1),[33] and about 40 central banks have created a global network that is raising awareness and designing climate change stress tests.[34] However, they could do more. For example, some are already using tools such as variable reserve requirements or quotas for environmentally friendly loans and targeted lines for refinancing to commercial banks at subsidized rates for priority sectors and others are purchasing green assets as part of quantitative easing.[35]

48. Are central banks allowed to do this? Even though most have taken a narrower mandate in recent years, considerable policy space remains, even for those singularly focused on price stability. Others can find space through their mandate to ensure financial stability. Some have multiple mandates that include employment and development goals; some never narrowed their mandate and have always sought to support government development policy in addition to price or financial stability.[36]

49. Alongside central banks, public development banks are the engine room providing the heavy lifting required for a big investment push. Many are already doing a great deal, especially in developing countries, where new Southern-led and Southern-oriented banks

[30] J de Luna-Martínez and CL Vicente, 2012, Global survey of development banks, Policy Research Working Paper No. 5969, World Bank; T Marois and AR Güngen, 2019, A US [United States] green investment bank for all: Democratized finance for a just transition, The Next System Project; UNCTAD, 2019.

[31] Marois and Güngen, 2019.

[32] M Carney M, 2015, Breaking the tragedy of the horizon: Climate change and financial stability, presented at Lloyd's of London, London, 29 September.

[33] M Scott, J van Huizen and C Jung, 2017, The Bank of England's response to climate change, *Quarterly Bulletin*, Bank of England, Q2:98–109.

[34] Network for Greening the Financial System, 2019, A call for action: Climate change as a source of financial risk, First comprehensive report, Banque de France and Network for Greening the Financial System Secretariat.

[35] A Tooze, 2019, Why central banks need to step up on global warming, *Foreign Policy*, 20 July; UNCTAD, 2019, p. 154.

[36] Bank for International Settlements, 2009, *Issues in the Governance of Central Banks*, Basel; UNCTAD, 2019, p. 152.

have been established at a phenomenal rate and long-standing ones, significantly expanded. Southern development banks now lend as much as the Bretton Woods institutions in some cases, and under much more flexible conditions.[37]

Table 1
Threat of a climate Minsky moment

Physical risks	*Economy*	*Transmission mechanism*	*Financial system*
Extreme weather, drought, flood, heat Gradual changes in climate Conflicts and security threats Human and animal displacement	Weaker economy, lower demand, productivity shock, reduced economic growth, inequality and poverty Disruption of business Scrapping of capital Reconstruction and replacement Rise in commodity prices Failure of old forms of agriculture Need for new crops and farming systems Some areas uninhabitable Displaced populations, more migration	Fall in asset values (homes, properties) Less household wealth Lower profits Increased litigation Rise in insurance costs Food shortages Increasing prices in other areas that have benefited from rising temperatures	Financial losses, contagion, tightening of credit, feedback to economy Finance market losses (fall in price of equities, bonds and commodities) Credit market losses (home and business loans) Loss underwriting, insurance market failures Losses to households and firms if not insured Liabilities and operational risk Increased potential risk of sovereign default

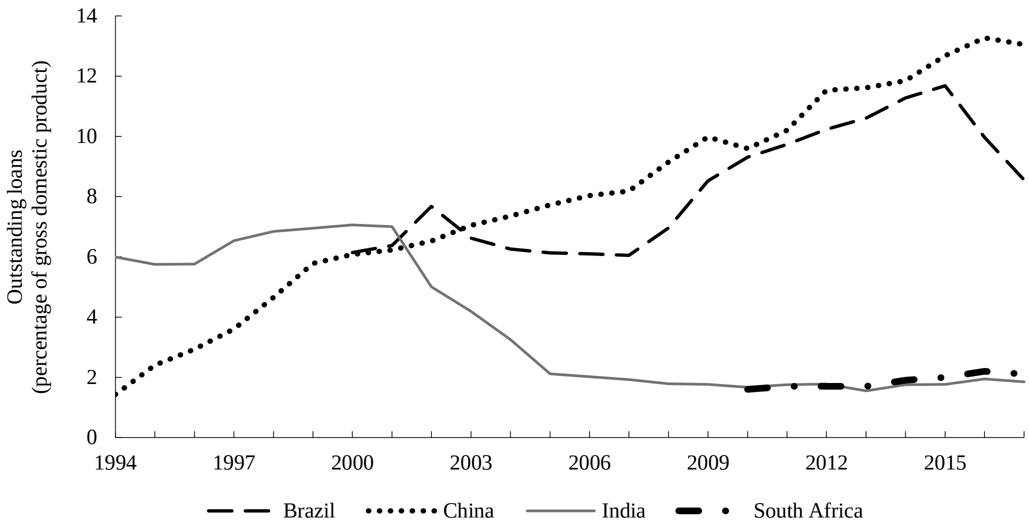
Source: Based on UNCTAD, 2019, *Trade and Development Report 2019: Financing a Global Green New Deal*, p. 144.

50. At the same time however, development banks are uneven in their coverage for developing countries (especially the least developed countries and small island developing States), and many gaps remain. They are also often constrained by limited capitalization, low gearing ratios and the continued requirement on the part of their government shareholders to achieve super-high credit ratings (often AAA credit ratings). There is a disconnect in some instances between the high ambitions Governments appear to have of their development banks, while neither granting them sufficient capitalization for the task, nor sending the positive signals of support that could help their abilities to raise capital on the markets.[38]

37 D Barrowclough and R Gottschalk, 2018, Solidarity and the South: Supporting the new landscape of long-term development finance, UNCTAD Research Paper No. 24, United Nations.

38 Standard and Poor’s Global Ratings, 2017, Key considerations for supranationals’ lending capacity and their current capital endowment, 18 May.

Figure 2
Role of development banks, selected emerging countries, 1994–2017



Source: UNCTAD, 2019, *Trade and Development Report 2019: Financing a Global Green New Deal*, p. 157.

51. Finally, for all banks to better play their role, a well-articulated system is needed that links central banks, development banks and governments' development plans with industrial policy, social support systems and the broader social justice framework that ensures a more equitable path on which none are left behind. The Global Green New Deal should not be allowed to create a new category of social and economic losers, as did the last industrial revolution.

B. Balancing multiple mandates

52. Central to the issue is that public banking embodies multiple and sometimes competing objectives, as compared with public investment. The State is intersecting directly with the private sector, the market and society in a mix of roles that includes co-investors and customers, as well as citizens. With public investment, Governments may invest directly through their function as buyer of last resort or financier of public goods – whence resources can be mobilized through political will without the rationale of a future stream of revenue and even profit. By contrast, when public banks are involved, this creates a different mix. There is some expectation of financial return, even if small and in the longer term. Compared with private banking, public banks can focus on projects where social or developmental benefits exceed purely commercial returns or with long or uncertain lead times; on sectors or locations where private finance will not go; and on borrowers who may be small, new or lack collateral or a credit history. Nonetheless, there is still an expectation that costs will be recovered, even if not to their full extent, and some banks are expected to profit. At the same time, they are expected to lend under more favourable conditions than commercial banks.

53. This mixture of expectations and pressures can create a difficult balancing act, requiring profits on some projects to enable losses on others, so that on average banks can remain viable. To be effective, banks need to have sufficiently large initial capitalization from government and reliable and stable sources over time. Virtually all public banks use this capitalization to borrow more funds on international capital markets, so they can on-lend them to other borrowers, and the extent to which they are reliant on these international markets determines crucially the extent to which they can afford to make more social and developmentally oriented choices when they lend.

C. Risks of securitization

54. It is therefore a concern that one of the main means promoted for banks to scale up is through securitization approaches, as a way to bring private investors into financing development. Securitization involves pooling various kinds of contractual debt or other non-debt assets that generate returns and selling their associated cash flows to third-party investors. This is not in itself new. In the past, development banks have directly sold loans from their balance sheets to private investors. However, securitization can take different forms, and banks may adopt some of its more complex forms, which can create financial and reputational risk. This in turn creates significant risks for the public sector, which will be left to bail out the banks if they fail.

55. Recalling the role securitization played in the junk mortgages that led to the financial crisis just one decade ago, it is a concern the debate is not about weighing the various risks involved in different forms of securitization but rather how more complex forms of securitization can attract private investors to developing countries. The idea is to establish infrastructure as an asset class for investors seeking high risk-adjusted returns but even the proponents of securitization see an inherent ceiling to this because most banks extend to governments loans priced at subsidized rates. To smooth the path, the Group of 20, with support from OECD and banks, plans to introduce greater standardization in infrastructure loans, including requirements for project development and the wider investment environment.[39] These add new layers of complexity and high transactions costs for developing countries and draw on already limited administrative capacity that could probably be deployed more effectively in the real economy. If the point of such procedures and instruments is to scale up capital for public banking, this can be done in other less risky ways.

IV. Financial inclusion

56. Current mechanisms and institutions that can mobilize resources are unevenly distributed. Even with the rise of Southern-led finance, poorer countries and regions remain unserved. The situation of regional banks in Africa is particularly difficult and indicative of the challenge. Four of the main regional banks in Africa, which have existed for more than three decades, are currently in sound financial positions, with investment grades in credit ratings and strong shareholders. Nonetheless, the amounts lent remain low especially in light of the needs. Despite recent expansion, the total portfolios of loans and assets of these banks are but a fraction of just one Latin American bank alone.[40] Similarly, while $6 trillion is estimated to be held by sovereign wealth funds of developing countries, a small amount is either held by African countries or invested in them.

57. The uneven allocation of public banks and public funds has important implications for social inclusiveness, as well as for long-term investment. In addition to investment in physical transformation such as infrastructure, inclusive and sustainable development also means ensuring that the process of transformation is just, so that the move to new forms is more inclusive than was the transformation caused by the previous industrial revolution. Just as the crises in the financial markets have typically produced costs that fall disproportionately onto those who are least able to withstand or change them, so too can the shock of a sudden move away from historical fossil-fuel processes to a newer, greener system.

58. As former assets become stranded or unused (for instance, electricity stations using dirty coal; farms that relied on climatic conditions which no longer exist), there will be knock-on effects far beyond those immediately involved (table 2). For example, insurance companies may fail under the weight of natural-disaster claims, and loans that were contingent on other factors may suddenly appear unviable. Public banks may be needed to

[39] Group of 20, OECD and World Bank, 2018, Stocktake of tools and instruments related to infrastructure as an asset class: Progress report.

[40] UNCTAD, 2019, p. 161.

ease the shock, guiding credit to new economic sectors that can absorb displaced workers for example, or that can harness the creative elements of re-investment in new activities that are the other side of destruction. These requirements are already on the radar screen of policy experts in many parts of the world. In South Africa, for example, it has been estimated that hundreds of coal mines may close in the next 20 years, drastically affecting not only local communities but also democratic processes.[41]

Table 2
Banking for a just transition

Drivers of transition risks	*Economy*	*Transmission mechanism*	*Financial system*
Government climate policies Consumers' push for green economy New technological developments to promote deep structural transformation	Some winners and some losers Former assets are stranded or unusable (vehicles, coal-powered electricity systems) New opportunities are created from creative destruction – reinvest and replace New forms of energy are invented; old forms are more expensive Infrastructure needed to clean renewable sources is upgraded New forms of farming to cut emissions are adopted	Fall in value of old assets and rise in value of new ones Loss of jobs in old economy and rise of new jobs in green economy Migration and movement Loss of old export markets and opening of new ones Replanting of forests, cleaning up of polluted landscapes	Financial market losses in some sectors (equities, bonds, commodities). Debt write-offs Failure of firms Failure of insurance markets Boom in new sector, gains in financial market Credit market losses (as old firms go bust, banks suffer loan defaults; new firms emerge, new loans are profitable)
Articulated policy responses	Central banks revise models and approaches, create and guide credit towards new green activities, away from conventional fossil-fuel-dependent ones. National banks support firms and investments in new green infrastructure, agriculture and other business activities, and innovative research and development. Regional banks support cross-cutting and cross-regional lending for greener activities. Other government ministries in a cycle of positive articulation provide incomes support and social support to groups of society that have lost jobs and livelihoods, support education in new, greener technologies, and research and development; pension funds and sovereign wealth funds to remove funding from fossil-fuel activities in the interest of supporting renewable energies.		

Source: Based on UNCTAD, 2019, *Trade and Development Report 2019: Financing a Global Green New Deal*, p. 145.

[41] M Swelling, 2019, presented at a meeting on transformative industrialization, the African Continental Free Trade Agreement and global governance, co-hosted by UNCTAD and the Nelson Mandela School of Governance, Cape Town, South Africa, 27 and 28 September.

A. Microfinance brings macro problems

59. The provision of finance for underserved communities and activities is not new but the needs are now greater. At one time, it was thought that microcredit could be a solution – lending either at the level of households or to microenterprises and thereby helping the poor to establish their own income-generating activities. From small beginnings in the mid-1980s, microfinance became one of the most popular poverty-reduction policies, being highly praised as a way to both lift people out of poverty and generate sufficient returns as to be self-financing. However, these laudable beginnings swiftly became co-opted as the microfinance industry became mainstreamed by the financial services industry and increasingly associated with excessively high interest rates, high profits for the lender and a kind of debt bondage for the borrowers.[42] The scale of loans was so small that few if any borrowers ever got beyond being small traders, burdened by rising debts; and its focus on individual entrepreneurs meant that borrowers were rarely if ever incorporated into any significant step-change in terms of productive capacities or even incipient manufacturing, let alone a path towards industrialization. Rather than being helped, the global poor became trapped at the bottom of the new world of globalized financialization.

B. Gender

60. At the start, microfinance was often aimed directly at women, reflecting that they were the least served of all when it comes to finance, as in other areas, but also taking advantage of the fact that women appeared to be good risks with sound repayment records – for many reasons, not all positive. An important "g" that is implicit although silent, thus far, in the concept of the Global Green New Deal must be the "g" in gender, although this aspect is more difficult to address through the world of banking and finance because it must also be supported by social and cultural mores that have an impact on economic distribution and the world of work, as well as legal and financial ones. Green indicators and targets can be relatively straightforward to incorporate into banking principles and performance indicators, to the extent that carbon emissions can be measured, for example. It is much more difficult to incorporate meaningful measures for gender. To date efforts have been superficial and not supported by underlying social or institutional change. This remains a long-standing and significant gap in banking models and processes, to which the debate has yet to contribute.

61. Returning to the topic of inclusion in general, some solutions may lie in more traditional, also locally arranged, financial institutions such as credit unions, mutual societies and finance cooperatives – with examples including the local financial institutions that played an important part in the economic transformation of northern Italy after the Second World War or the Mondragón cooperative experiment in northern Spain and the diverse range of long-standing local and regional state banks in Germany. Community development banks in Brazil and urban and rural credit cooperatives in China are other examples, among many. Such collectives and community banks are to be found in most parts of the world, and now the debate has moved on to what can be done to link them in networks that would allow them to increase scale and reach.

V. Issues for discussion

62. Experts may wish to consider the following topics for discussion:

(a) What can be done to better promote long-term productive investment?

(b) How can central banks use their capacities to create and guide credit more effectively for development? Can they ever be truly independent of government and why should they be?

[42] M Bateman, S Blankenburg and R Kozul-Wright, eds., 2019, *The Rise and Fall of Global Microcredit: Debt, Development and Disillusion*, Routledge, London; UNCTAD, 2018.

(c) How can development banks be ensured a reliable and sufficient source of capitalization? What is the impact of different forms of capitalization on their operations?

(d) Are credit-rating agencies an obstacle to long-term investment? What other mechanisms can play their role?

(e) How can banks scale up while retaining their public and developmental orientation?

(f) How can private finance be harnessed in more developmental and less costly ways for the State, with a better balance between rewards and responsibilities?

(g) How can development banks help support industrial policy and vice-versa, to ensure adequate demand for the kinds of investments that will promote sustainable transformation when long-term finance is available?

(h) How can existing mechanisms be more effective in reducing the threat of systemic financial instability, in light of past crises? What are the most critical gaps remaining?

(i) How can the financial resources, expertise and experience of the South be better shared and disseminated throughout the South?