BANKING ON DEVELOPMENT
A Public-Private Roundtable, Geneva, 28-29 February 2008

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Purpose: To bring senior executives and policymakers from developing countries, the financial services industry and official donor agencies together to discuss innovations in mobilizing private development finance in view of the upcoming UN Follow-up Conference on Financing for Development, to be held in Doha, Qatar, in late 2008.

Key points:

1. The private sector is essential to financing development, but it is important to remember that the private sector and public sectors have different objectives and respond to different demands. There is a risk of confusion of roles, objectives and methods of work. It is essential to clearly identify what the differences and commonalities are so that it is possible to move forward.

2. It was noted that private capital flows to developing countries are on the order of $600 billion, six times higher than current aid flows (and much more when ODA data are corrected for debt relief). In the forum, it was agreed that participants should not be talking about the aid industry *per se*, but more generally about the national and international financial architecture or structure. The discussion was oriented more towards banking and financial flows than about aid and donors.

3. There is a need for focus in the public sector. Ideally, the public sector should use a smaller amount of capital to leverage larger capital flows from the private sector. If private investors are willing to invest a majority of a project, it does not make sense for the public sector to make a direct loan in that case. Innovative public-private partnerships embody this priority.

4. From a broad development stance, it was acknowledged that there have been steps forward in the last two decades, in the sense that many poor developing countries have progressed to middle-income status. But there are still many pockets of poor in those countries who are not benefiting from progress. Approximately 2/3rd of the poor (subsisting on less than $2 a day) now live in middle-income countries. It was considered particularly important that innovative ideas on finance and development address the problems of these people.

5. There are a number of new actors playing an increasingly protagonistic role in development finance. It was noted that China's support for infrastructure in Africa is now greater than the World Bank, the African Development Bank and all the western bilaterals put together. Similarly, in Latin America, the Brazilian development bank, BNDES, has a loan commitment which is now larger than the World Bank and the Inter-American Development Bank put together.

6. One particularly important growth area in private finance in the developing world has been FDI. FDI is no longer only a north-south game. It is now becoming a south-south phenomenon as well. The total outward FDI from developing countries last year was $152 billion. Cross border M&As from Asia now equal those from developed countries. The outward FDI from India is almost the same size as the total FDI into China.

7. Africa remains a case apart, being still very dependent on development aid. Africa still accounts for the most acute poverty, and is highly reliant on grant-based aid. It currently receives around half of total ODA financing. Nevertheless some African countries are making progress in terms of private flows. Approximately 80 per cent of total flows to Africa are now private flows. Sovereign Wealth Funds are showing more interest in Africa, especially those funds based in the Middle East. Total Foreign Direct Investment (FDI) in Africa was $36 billion last year. This is an increase of 20% over 2006, and 200% over 2004.

8. Growth of inflows to Africa is partly due to the reduction of restrictions on foreign investment, but also related to better market prospects and the rise in commodity prices. According to the five-year average for 2001-2005, about 78 per cent of the capital flows to Africa were in the form of FDI. At the same time, it was acknowledged that increased capital flows can also imply increased risk. If an excessive concentration of FDI is in extractive industries, there is a danger that important development issues may be sidelined, or overlooked. There is also the problem of geographic concentration, with the bulk of flows being directed towards South Africa and North Africa.

9. It was argued that it is a myth that there are not large capital flows to low-income countries. The amounts may not be large at a global level, but for many of these countries, the capital flows are bigger as a percentage of GDP, and much bigger as a percentage of fixed capital formation than they are in the middle-income countries. In other contexts, such as in some Latin America countries, it was even suggested that foreign capital flows vis-à-vis domestic investment may be too large, causing risks for long-term economic stability.

10. There was much discussion in the forum over the nature of risk and risk mitigation. It was argued by some participants that risk mitigation is a misnomer; it is either risk reduction (through pooling of risks, etc) or simple private-public risk transfer. It was suggested by others that the role of the MDBs is to mitigate the heavier risks, while the private sector identifies opportunity.

11. Against this backdrop, there was some controversy over the exact role of Public-Private Partnerships. One participant claimed that it is misleading to suggest that the public sector does not have enough money to cover development and that the private sector does. If the public sector cannot borrow for these projects, why should the private sector be able to do so? The real issue is deal flow. Is there enough cash flow? Where does the cash flow come from? Either the users pay for the service, or subsidies pay for it. If users cannot pay and subsidies are not there, then the private sector cannot borrow enough.

12. An estimated $200 billion in capital commitments for development is currently not being used because of aid inefficiency at the intermediary MDB level. At the same time, it was recognized that the distortionary effect of public sector lending has been exaggerated. The World Bank's lending constitutes only 0.2% of total investment in the developing world.

13. For economies that have reached the take off stage in terms of industrialization and development, the poverty challenge is to build a strategy that provides incentives for both domestic and foreign savings in investment, infrastructure, etc., the kinds of things that result in raising the standard of living. That results in a change of outlook from traditional thinking on the poverty challenge a generation or two ago, when it was mainly a discussion of basic human needs, which are still important, but should not be viewed as the sole or even predominant challenge to dealing with poverty.

14. Developing countries need better technical expertise and advice. It was repeatedly emphasized that there is much latent potential out there. Many projects are nearly good enough to go ahead, but need just a little advice to become bankable. The issue is not solely about risk. For example, it is easy to find investors for mobile phones in DRC, but not for water development. Commercial banks are not present in Africa, not because of risk, but because the commercial volumes and the clients are not there. There is, in other words, a proverbial 'chicken or egg'. Yet there is plenty of investment in drugs and arms, with little transparency. It depends on the market's interest in what is being offered.

Challenges:

1. Development finance institutions need to think of themselves as "enablers of private capital flow, rather than lenders." It was argued by some participants MDBs should develop projects when they are riskiest, and then sell them off to the capital market. More efficient risk allocation and accurate pricing should also be a priority.

2. Development banks are often judged by how much money they dispense. However, if they are to become capacity builders rather than lenders, there is the question of how one measures capacity building. Systems and procedures need to be redirected. A need was also identified for more processing capacity at the multilateral banks.

3. There is a clear-cut need for risk management as well as mitigation and allocation. The innovative TCX project which provides currency guarantees in emerging markets for low-income countries was a good example of a collaborative project between multilateral institutions, development agencies and private banks in this sense. It is the kind of innovation which addresses market failure rather than the lack of money, helping to stabilize the market.

4. Targeting development financing is critical. 75% of approximately $25 billion per year in investment financing goes into middle-income countries. Much of this financing goes to big companies in the capital cities that could well finance themselves in the international markets. As well as mitigating risk, targeting is important.

5. Capital account liberalization in itself has not been shown to be empirically related to growth or higher levels of investment. More concerted efforts are needed to ensure increases in both domestic and foreign investment.

6. Ultimately, the ability of people to do things is what drives development—not capital flows. It is the ability of people to do new things, to learn from others what has already been invented and to transfer it to their own country, to be able to trade, and to have reasonable certainty of contract and property rights. Opening up spaces of that type is what drives development.

Suggested Solutions and actions required:

1. Three key issues for discussion at Doha are the increased emphasis on:

   a) New instruments for risk mitigation/insurance mechanisms, such as venture capital, public-private partnerships and microfinance institutions, tailed to the needs of developing countries and poor people in middle-income countries.

   b) Achieving the right balance in terms of project finance, by facilitating the right level of grant subsidy conducive to closing deals. It was argued by some participants that there is a social residual risk attached to many projects that someone other than the private sector has to take on board, in order to trigger those flows.

   c) Capacity building. A point that was raised several times during the forum was that greater capacity building efforts are to unblock the existing impediments to many development projects. This requires improving project development capacity in order to identify, document and prepare projects for consideration by funders.

2. It is important not come up with a litany of too many objectives for the Doha conference. Focus is needed on those issues where ministers can really provide an impetus. Part of that is to create a market place of good ideas, whether they come from the north or the south.

3. At a more general level, discussions revealed a need for an international financial system that is conducive to the kind of private flows discussed here. The fact that developing countries have amassed some $2.5 trillion in reserves (something which suggests that the IMF has not been able to play the role for which it was originally intended) points to the fact that there are systemic issues and dysfuntionalities in the international financial architecture that still need to be addressed. Similarly, there is still no adequate institutional mechanism for dealing systematically with issues such as sovereign debt restructuring. Put simply, it was argued that the international financial architecture needs revisiting.

4. Finally, a lot of help is required to help developing countries put in place the fundamentals for private investment—both domestic and foreign. That means going beyond reducing the cost of doing business. It essentially means strengthening the institutional underpinnings for private sector development, as well as working on the complimentary aspects of the public sector (including subsidies).