

Financing for Development:

A view from Latin America and the Caribbean

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Overview

1. Trends in Financing for Development
2. Middle- Income Countries: A Structural Gap Approach
3. Resource Mobilization: A Balance between Private and Public, Domestic and Foreign Resources



1. Trends in Financing for Development

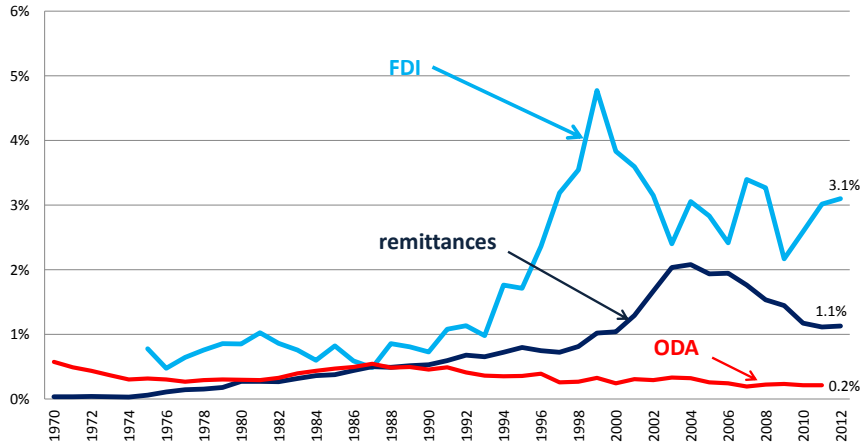


Changes and emerging trends in the financing for development framework

- A widening array of priorities within a post-2015 development agenda that demands a huge mobilization of resources
- Changing relevance of different sources of finance with an increasing importance of private flows
- In consonance with these trends, changes in the players, instruments and mechanisms through which financing is intermediated

Changing relevance of sources of finance

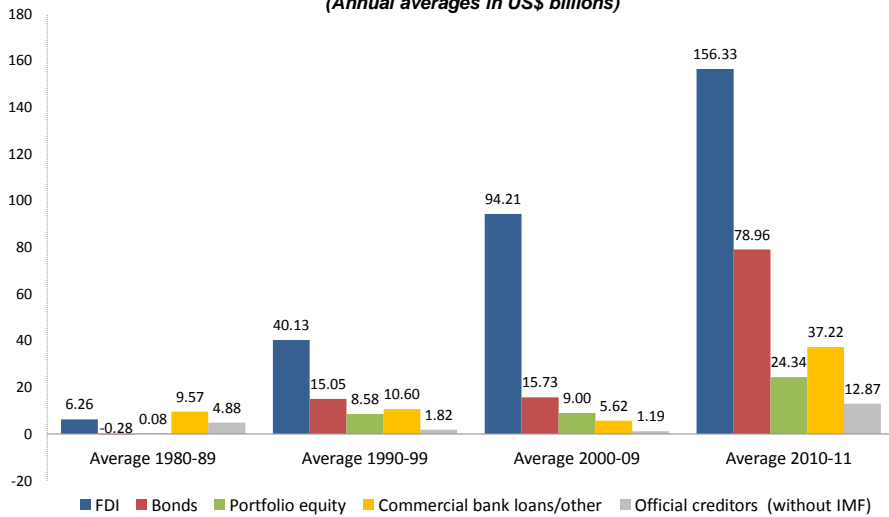
**FDI, Remittances and Net ODA towards Latin America and the Caribbean
(in percent of GDP)**



Source: on the basis of WDI, World Bank

Composition of Net Private Capital Flows in Latin America and the Caribbean

(Annual averages in US\$ billions)



Source: ECLAC, on the basis of WDI and GDF, World Bank

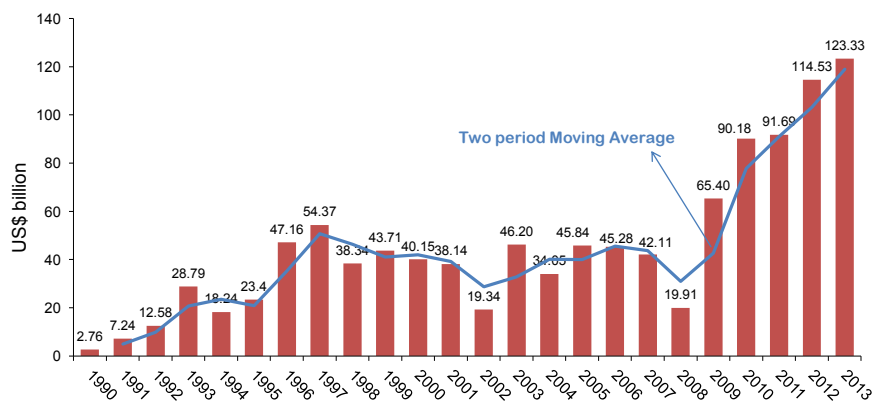
The region has made great strides in tapping international capital markets, especially bond markets

- The market for Latin American and Caribbean tradable debt has opened, deepened and broadened.
- Bond financing is the second major source of external funding in the region after FDI, and has been second since the 1990s.
- LAC access to external bond financing has become more widespread and less costly as a result.
- Debt spreads have declined and credit quality has improved.
- There has been a shift in debt composition: LAC debt issuance in international bond markets has become increasingly a corporate-denominated market.
- LAC debt is now issued on a broader range of currencies and attracts a larger and more diversified investor base.



LAC international bond issuance has thus increased considerably, especially since 2009

Annual Latin American Bond Issuance
2000 - 2013



Source: ECLAC, on the basis of data from LatinFinance, JPMorgan and Bank of America-Merrill Lynch.



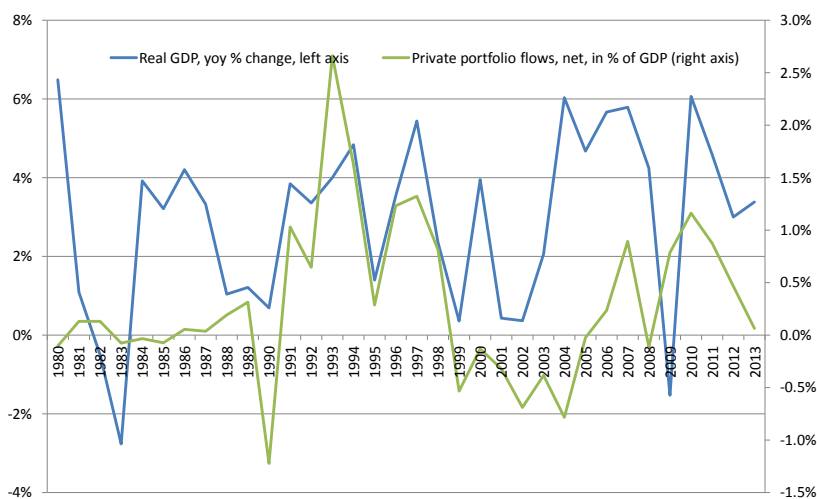
Several firsts in LAC debt markets in the past years...

- The debut of Bolivia, Paraguay and Honduras in the international bond market, as well as the debut of several corporate issuers, many of them from the high-yield sector,
 - the first issuances in Chinese offshore renmimbi and Australian dollars,
 - the first wind energy project bonds,
 - the first covered bond (a security backed by a separate group of assets).
- The increased access to private capital markets has thus provided many countries in the region with more funding options, considerably changing the landscape for development financing.

However....

- There is a high degree of heterogeneity among countries.
- Access to international bond markets is not universal, being more limited and costly for some countries than for others.

Portfolio flows have at times been a relevant source of finance but they have been volatile and during the nineties highly procyclical...



Source: on the basis of WEO, IMF

And, although a larger mobilization of private resources could be potentially beneficial, some very important issues arise from a financing for development perspective

- Public and private flows obey a different logic and respond to different incentives.
 - Private capital mostly driven by economic profitability
 - ✓ Private sector will under-invest in certain areas relevant for development if the expected return – on a risk adjusted basis – underperforms other investment opportunities
 - Public resources play a unique role, providing financing for sectors that do not attract private flows sufficiently (social profitability)
 - But there is also space and mechanisms for public policies to gear private capital towards development objectives
 - ✓ Requires an adequate regulatory environment and incentive scheme

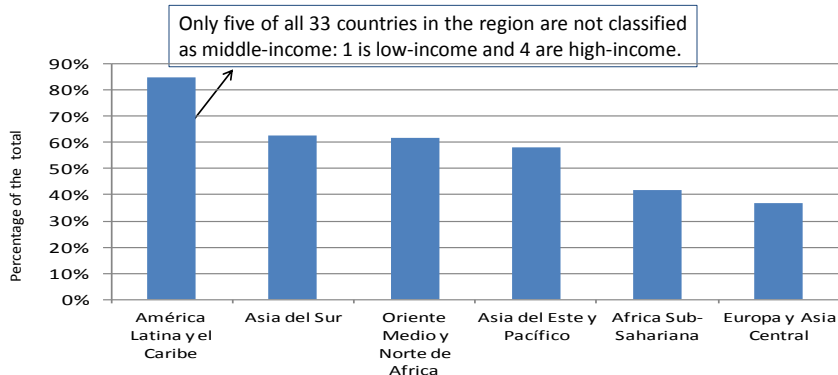


2. Middle- Income Countries: A Structural Gap Approach



Latin America and the Caribbean is a middle-income region: 85% of countries belong to this category

PERCENTAGE OF COUNTRIES FROM EACH REGION CLASSIFIED AS MIDDLE-INCOME



Source: ECLAC, on the basis of the most recent classification available from the World Bank.

Income per capita is the main criterion used to allocate the financial resources of cooperation for development. But the concept of development extends well beyond the increase in per capita income.

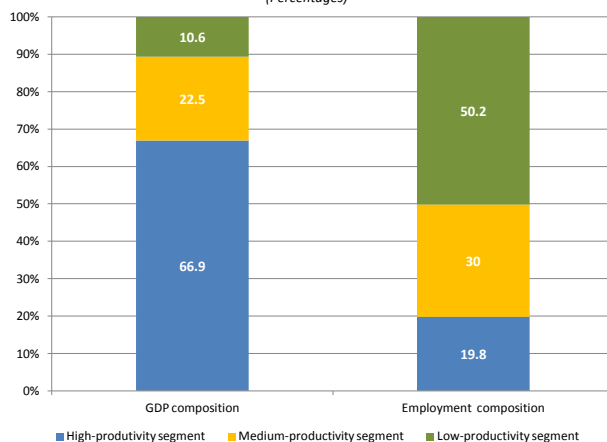
The region has made great strides (growth, poverty reduction, income distribution, increased resilience to external shocks ...) but faces serious constraints

- Informal, low-productivity jobs
- Productive and export structure based on static comparative advantages (linked to natural resources)
- Insufficient investment
- Lags in innovation, science and technology
- Scarcity of quality public goods and weak institutions

If structural changes do not take place, countries will be at risk of falling into the Middle Income Trap!

The production structure has not changed: it is heterogeneous and a source of inequalities

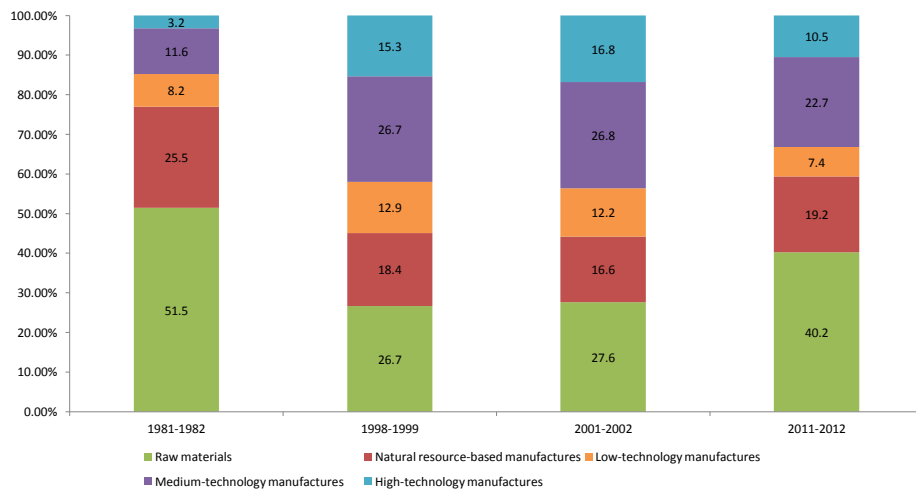
LATIN AMERICA (18 COUNTRIES) : STRUCTURAL HETEROGENEITY INDICATORS, AROUND 2009
(Percentages)



Source: ECLAC, on the basis of R. Infante, "América Latina en el 'umbral del desarrollo'. Un ejercicio de convergencia productiva", Working Paper, No. 11. Santiago, Chile, June 2011, unpublished.

Specialization in static comparative advantages

LATIN AMERICA AND THE CARIBBEAN: EXPORT STRUCTURE BY TECHNOLOGY INTENSITY
(Percentages of the total)

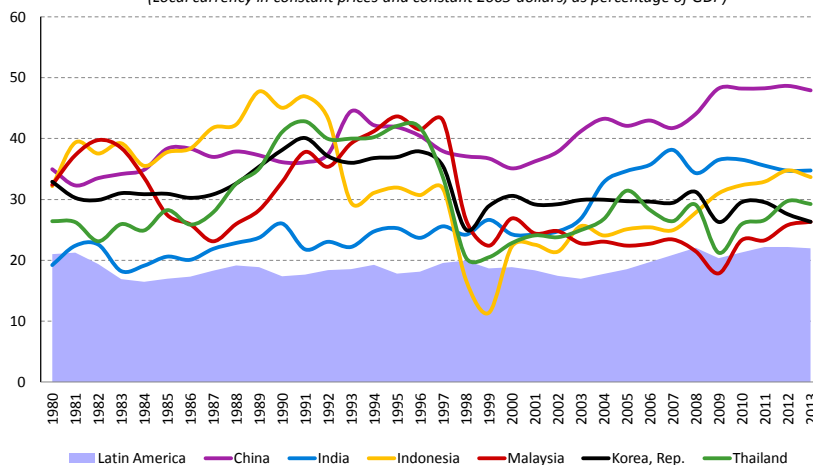


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Investment has remained at levels significantly below those of other emerging economies

LATIN AMERICA AND SELECTED EMERGING ASIAN COUNTRIES: GROSS FIXED CAPITAL FORMATION, 1990-2013

(Local currency in constant prices and constant 2005 dollars, as percentage of GDP)



Source: ECLAC, on the basis of official data, DESA/United Nations UNDATA, and World Economic Outlook database

The developing countries in Asia, unlike our region, hold an ever larger stake in global knowledge generation

WORLD PATENT APPLICATIONS
(Percentages)

	1990	2000	2012
Developed countries ^a	87.3	75.2	52.4
Rest of the world	12.7	24.8	47.8
China	1.0	3.8	27.8
Republic of Korea	2.6	7.4	8.0
Latin America and the Caribbean	1.9	3.5	2.5

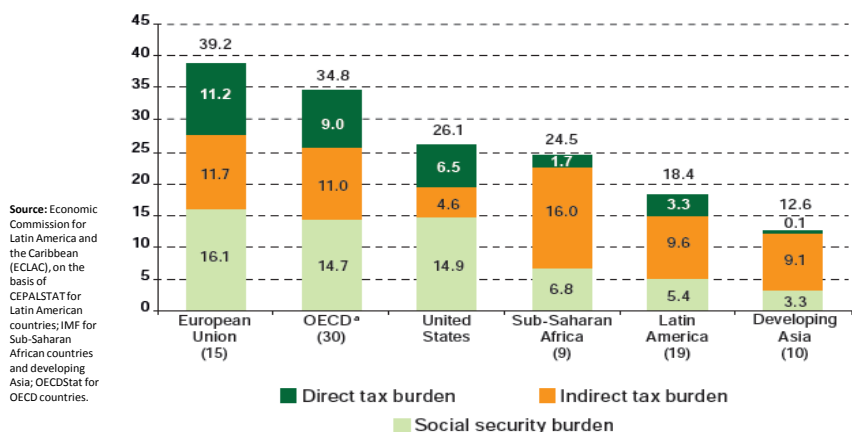
Source: World Intellectual Property Organization (WIPO).

^a Includes Europe, United States and Japan.



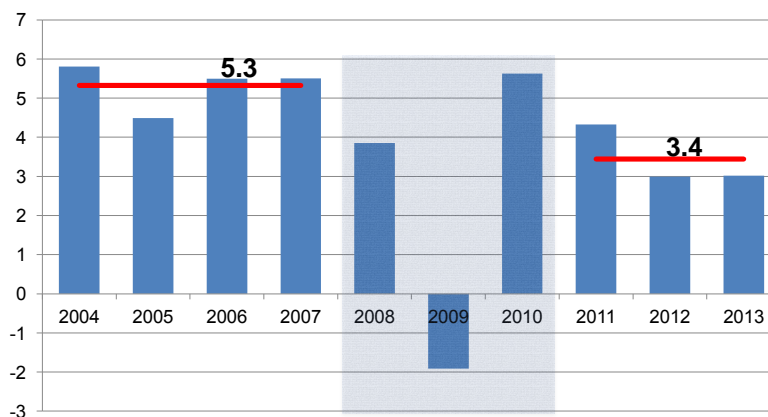
The region collects low taxes and does so inefficiently

INTERNATIONAL COMPARISON OF THE LEVEL AND STRUCTURE OF THE TAX BURDEN
(Percentages of GDP)



The New External Context Poses Challenges to Growth and to Further Poverty Reduction

(In percentages)

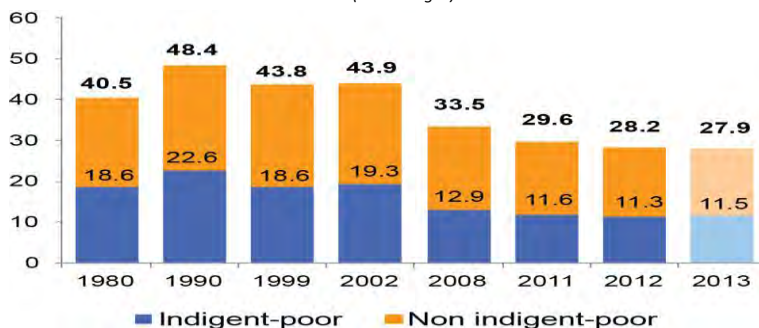


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.



Substantial reduction of poverty and inequality but poverty reduction stalls and still the most unequal region in the world

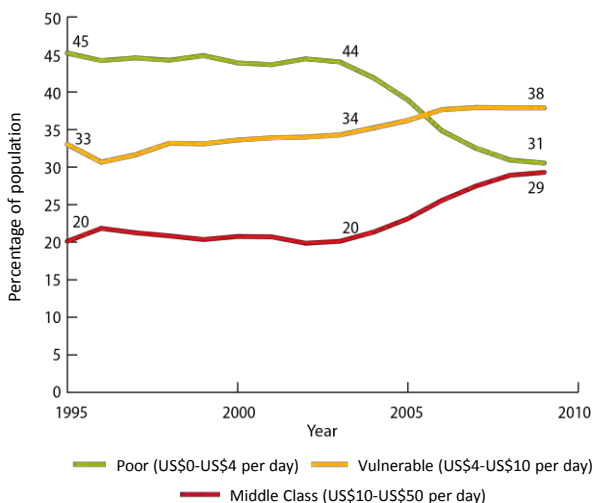
LATIN AMERICA: ^a POVERTY^b AND INDIGENCE, 1980-2013^c
(Percentages)



Source: ECLAC, on the basis of special tabulations of data from household surveys.
^a Estimate for 18 countries of the region plus Haiti.
^b Total for indigent plus non-indigent poor.
^c The 2013 figures are projections.



While poverty levels have declined over time, the percentage of the population that remains close to the poverty line (the economically vulnerable) has remained broadly unchanged...Vulnerability is not captured by GDP per capita



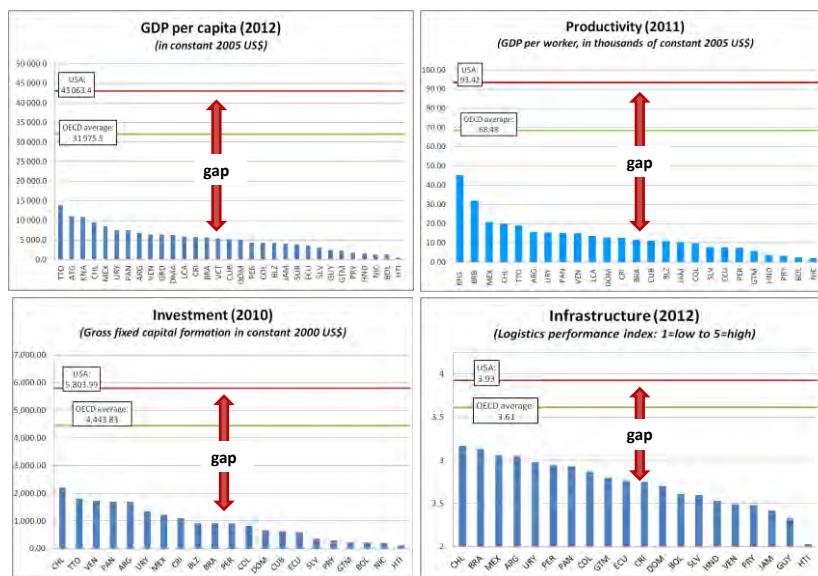
Between 1995 and 2010, the share of the vulnerable population in the LAC region has increased from 33% to 38%.

Source: World Bank, 2013

ECLAC has proposed a structural gap approach to reflect the multi-faceted nature of the development process and heterogeneity and vulnerability among countries...

- **Structural gaps** obstacles and long term structural challenges that have been major stumbling blocks for middle income countries
 - Income gap
 - Poverty and inequality gaps
 - Investment, productivity and innovation gaps
 - Infrastructure gaps
 - Education and health gaps
 - Financial and fiscal gaps
 - Gender gap
 - Environmental gaps

Structural development gaps in LAC countries are wide and heterogeneous...



Cooperation with middle-income countries should include supporting them in the challenge of achieving development through structural change, with equality at the center...

- International cooperation should adopt an alternative approach to the per capita income criteria for allocating resources. This approach implies prioritizing development gaps
 - Better identification and quantification of gaps
 - Allocation of resources on the basis of structural gaps
- Given that gaps differ among countries, as does the priority that countries assign to each gap, **a single and unique best way to channel development finance to countries therefore does not exist.**
- Overcoming different gaps may require funding from various sources and through different instruments at different times according to each country's specific reality and circumstances.

**3. Resource Mobilization:
A Balance between Private and Public,
Domestic and Foreign resources**



Mobilizing foreign resources

- Contrary to the wide-spread notion that countries with higher incomes per capita have easier access to international capital inflows, most middle income countries still face important obstacles in tapping global financial markets, and net inflows are restricted to a limited number of countries.
- Private capital flows are also typically more volatile and can be pro-cyclical, thus potentially amplifying financial and economic shocks in the recipient countries. Private capital flows are not explicitly geared towards development purposes but respond to market incentives.
- The mobilization of foreign resources must take charge of issues regarding volatility of private flows and the conciliation of economic vs. social profitability and relative prices issues.



Some players have the potential to increase their relevance in the financing for development landscape

- Private philanthropy
 - At the global level it now amounts to nearly US\$ 60 billion per year, equivalent to almost half the net ODA disbursed in one year by DAC donor countries
- Non-DAC donor countries are growing in importance
- Private and public institutional investors: Pension Funds, Insurance Companies, Mutual Funds, Sovereign Wealth Funds, etc.
 - With growing assets under management and the potential to provide long-term financing they can become important players in development finance

Mechanisms and instruments for development financing could adjust

- Identify and establish the more effective and efficient cooperation modalities in light of the gaps that are flagged as priorities. Some modalities are better suited to address certain specific gaps than others.
- New initiatives that use limited public concessional resources (grants) to leverage sizeable non-concessional resources (loans) could help. Example LAIF
- Initiatives that use public resources to mobilize private investment towards development objectives.
- Those that have attracted the most attention in recent times due to their revenue-generating potential are global taxes, and, in particular, global taxes on financial transactions.



Latin American Investment Facility (LAIF), 2010

- Prime example of a mechanism whereby the countries of the region can address the **infrastructure gap**.
- Its primary objective is to finance key infrastructure projects in transport, energy, social and environmental sectors
- Uses limited funds (grants) contributed by the European Commission to leverage sizeable loans from multilateral or bilateral public European Development Finance Institutions, Regional Latin American Development Banks and own contributions from partner countries in Latin America.
- From its inception (in 2010) to 2013, grant contributions amounted to approximately € 160 million, leveraging total new investments of about € 4.2 billion (i.e. € 26 raised for every € 1 contributed by LAIF)



Regional cooperation

- As part of the landscape of multilateral development cooperation, regional cooperation has the potential to help overcome international asymmetries.
- Regional financial institutions have specific characteristics which make them particularly valuable, as they fill existing gaps within the global financial architecture:
- Examples: Latin American Reserve Fund (FLAR, for its Spanish acronym); Development Bank of Latin America (CAF); Central American Bank for Economic Integration (CABEI); Caribbean Development Bank (CDB); Financial Fund for the Development of the River Plata Basin (FONPLATA).



Other alternatives: South-South and triangular cooperation

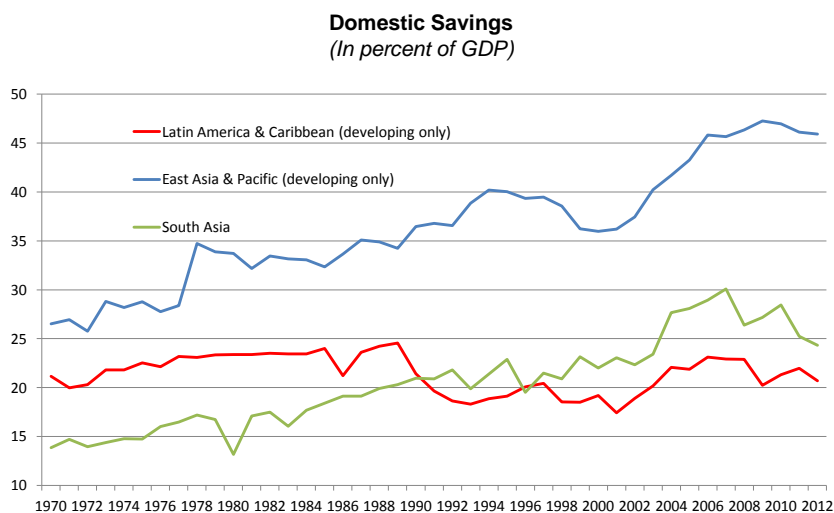
- In the case of LAC there is significant room for South-South cooperation in specific areas where some countries have wide gaps and where other countries have developed the capacities to narrow them.
- Yet for such cooperation to materialize, the volume of financing required may be beyond the means of the countries of the region. In such cases, support from traditional donors, through triangular cooperation, can be an option.



Financing sustainable development has to search for a balance between financing from abroad and larger domestic mobilization of resources to avoid an excessive dependence on foreign capital and possible current account problems...

- The internal mobilization of funds requires a set of economic and financial policies to promote the generation of savings for long-term financing and to further develop countries' financial systems
 - The ability and effectiveness with which the financial system channels financing towards productive activities depend on
 - ✓ The provision of low-cost intermediation services
 - ✓ The development of financial markets, instruments and institutions which can adapt to the productive sector's varied risk profiles, liquidity needs and financing periods

In the case of Latin America, the level of resource mobilization at a domestic level has been historically stagnant at low levels.



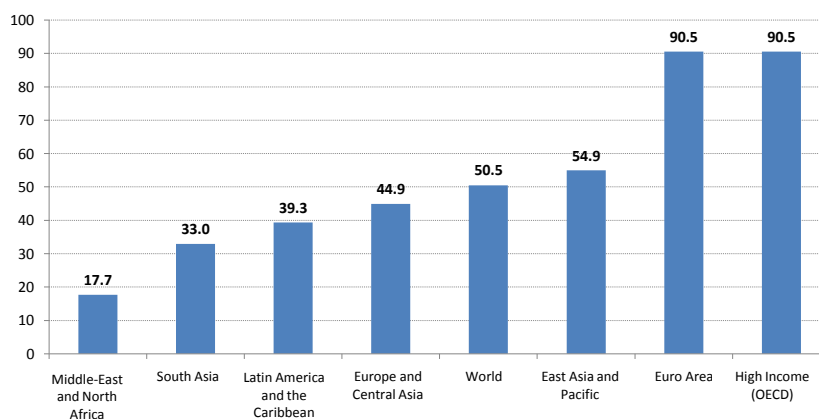
Source: WDI, World Bank

But a larger pool of domestic savings is insufficient; sustainable development requires also the implementation of public policies to promote financial inclusion...

- The capacity of financial systems to support processes of economically, socially and environmentally sustainable development relies not only on their ability to mobilize large pools of domestic savings and to channel these into productive investment but also on their capacity to be *inclusive*
 - ✓ Providing access to finance to a broad range of firms and individuals.
- This is a challenge that is still present in most developing countries

A majority of people in developing regions still do not have access to formal financial institutions

Population (>15 years) with an account in a formal financial institution (2011, in percent)



Source: ECLAC, Financing for Development Division on the basis of World Bank (2012)

Who is left out

- It is normally poorer people that are left out... with obvious consequences on inequality and poverty
- In the case of the productive sector, SMEs have much more difficulty in accessing financing than larger firms
- Public banks and development banks can play a key role in improving financial inclusion
 - Even though these banks have increased their share in the provision of credit they must make efforts to further their role as liquidity providers

In summary...

- The mindset governing the current international cooperation agenda should be revised, to incorporate the structural problems being experienced by most countries that are known as middle-income economies.
- The financial architecture for sustainable development faces important future challenges
 - Take charge of a widening set of development objectives and priorities
 - Take charge of policy issues that arise from the growing importance of private financing
 - Take charge of the necessary balance that should be maintained between foreign and domestic resource mobilization
- A key prerequisite for a sustainable financing for development strategy in LAC is the existence of a global financial architecture that is stable, inclusive in its governance mechanisms and with rules and instruments that foster the channeling of resources towards development financing. Similarly a fair and inclusive global trade system is crucial.

A Necessary Step: Increase Political Dialogue

- **Global level:**
 - Define the framework for an agenda for inclusive development
 - Expand multilateral dialogue on development financing alternatives: sources of funding and allocation criteria
- **Regional level:**
 - Deepen regional integration
 - Greater participation of the region in global governance
- **National level:**
 - Prioritization of structural gaps (identification and quantitative and qualitative measurement of the gaps)
 - Inclusive dialogue with civil society actors and the private sector