

**“EMERGING TRENDS IN FINANCING SUSTAINABLE
DEVELOPMENT IN LATIN AMERICA AND THE
CARIBBEAN”**

**FIRST MEETING OF THE LATIN AMERICA AND THE CARIBBEAN
MEMBERS OF THE COMMITTEE OF EXPERTS ON FINANCING
FOR SUSTAINABLE DEVELOPMENT**

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The past decades have witnessed some 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
 - ✓ New set of *Sustainable Development Goals* (SDGs) that will build on the MDG challenges and at the same time
 - Address in a balanced way all three dimensions of sustainable development: social, economic and environmental dimensions
 - Address the impending issue of climate change and, more in general, the provision of global public goods
 - Address the issue of protecting the global commons (atmosphere, oceans, biodiversity, forests)
- 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

Sources of finance: a taxonomy from national accounts (open economy)

$$(1) \text{ GDP} = C + I + G + X - M$$

$$(2) \text{ GDP} - T = C + I + G - T + X - M$$

$$(3) (\text{GDP} - T - C) + (T - G) = I + X - M$$

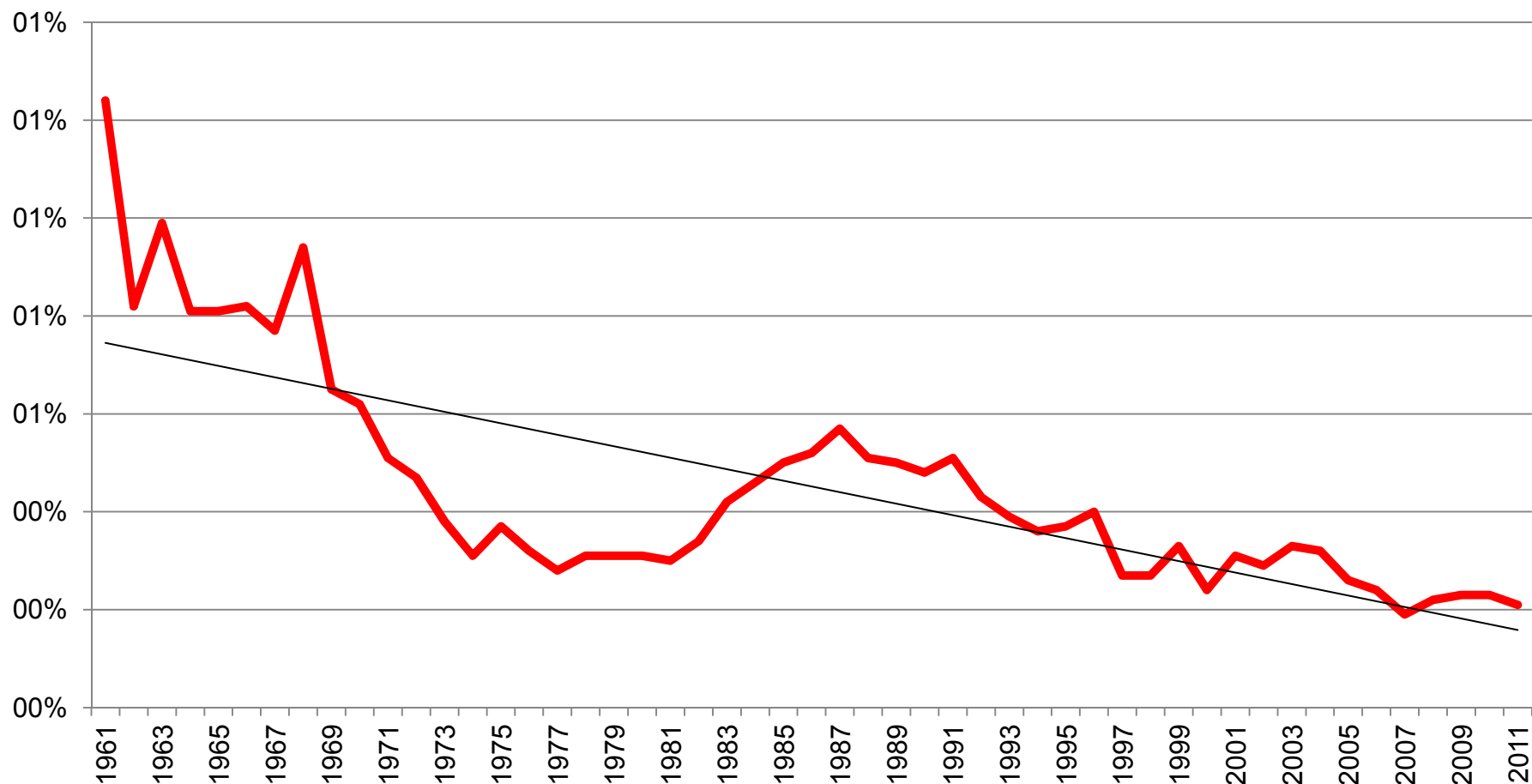
$$(4) \underbrace{(\text{GDP} - T - C)}_{\substack{\text{Domestic} \\ \text{Private Savings}}} + \underbrace{(T - G)}_{\substack{\text{Domestic} \\ \text{Public Saving}}} + \text{NY} + \text{NCT} = I + \text{CA} = I - \text{KA}$$

Using BoP identity $\text{CA} + \text{KA} - \Delta \text{RIN} = 0$
and assuming no change in reserves

| | | | | |
|----------------------|---|---|---|--------------|
| (5) Domestic savings | + Net income from abroad <i>e.g. income on debt (interest)</i> | + Net current transfers <i>e.g. Worker's remittances, ODA grants</i> | + Capital and Financial Account <i>FDI, Portfolio Investment, Loans (including ODA loans, cross border bank loans, etc.)</i> | = Investment |
|----------------------|---|---|---|--------------|

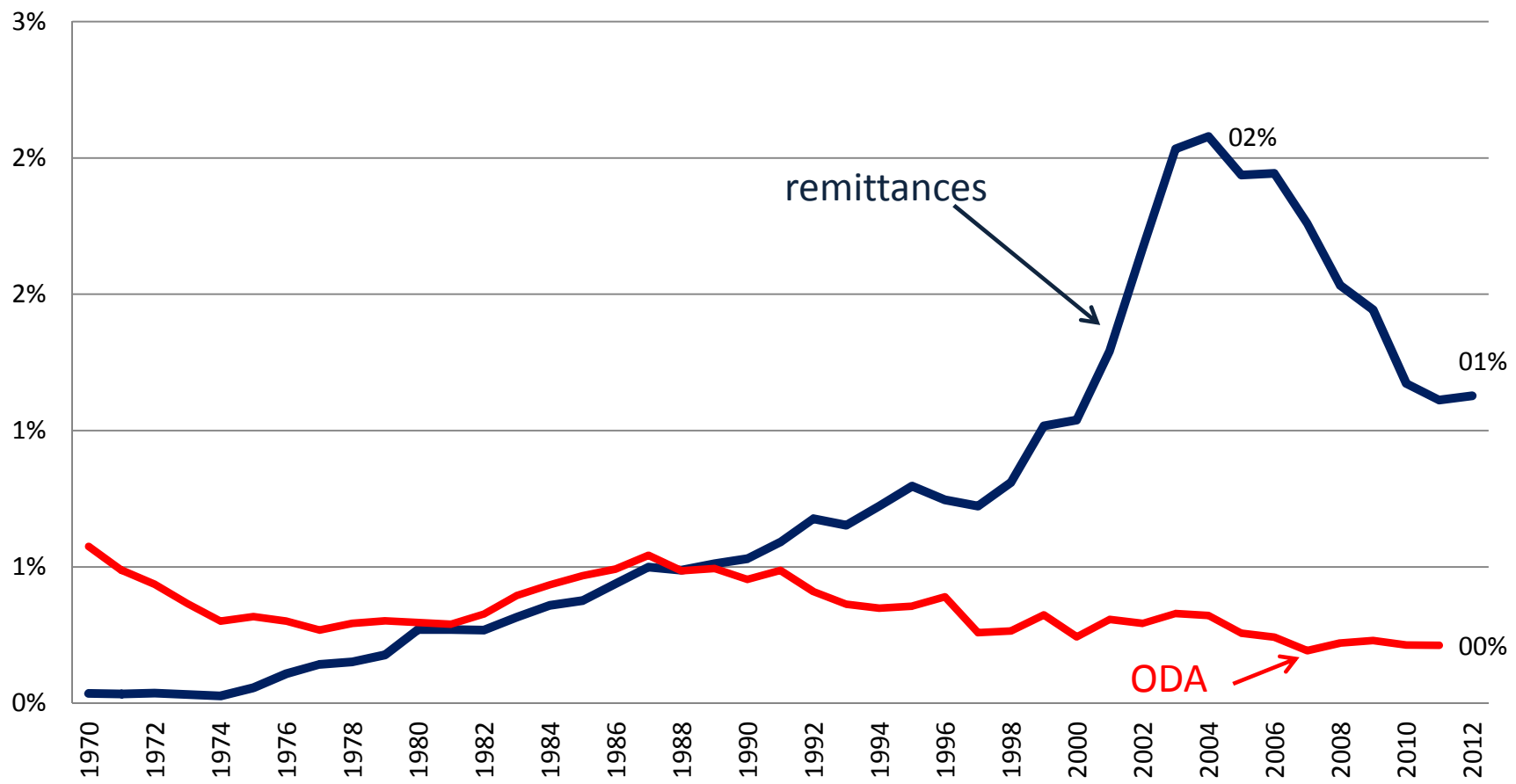
In the case of Latin America and the Caribbean, net ODA has represented decreasing shares or regional GNI across time ...

**Net ODA disbursements towards Latin America and the Caribbean
(in percent of GNI)**



Migrant remittances have become an important flow of financing towards LAC...since the beginning of the 90's they represent a larger share of GDP than ODA does...

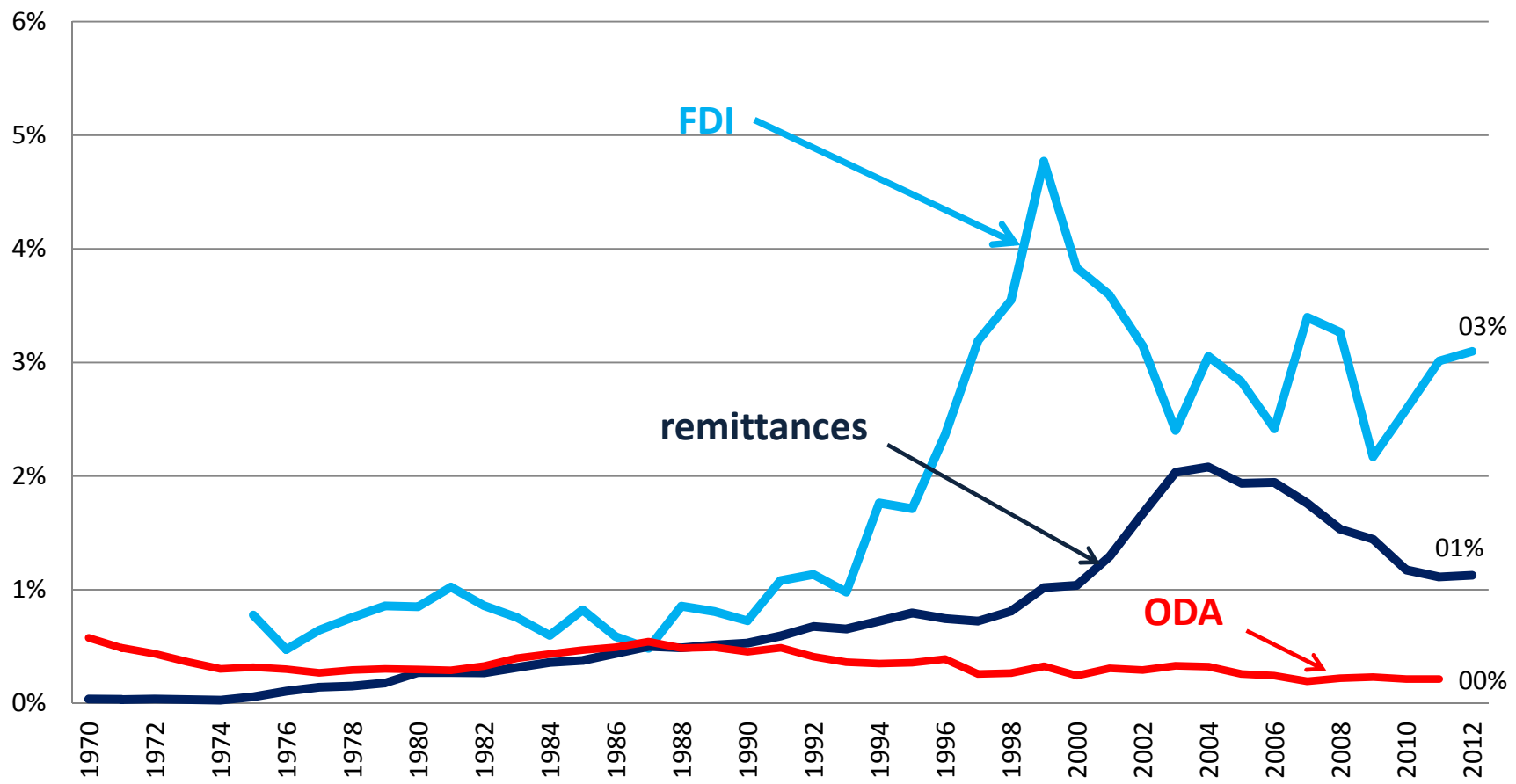
**Remittances and Net ODA towards Latin America and the Caribbean
(in percent of GDP)**



Source: on the basis of WDI, World Bank

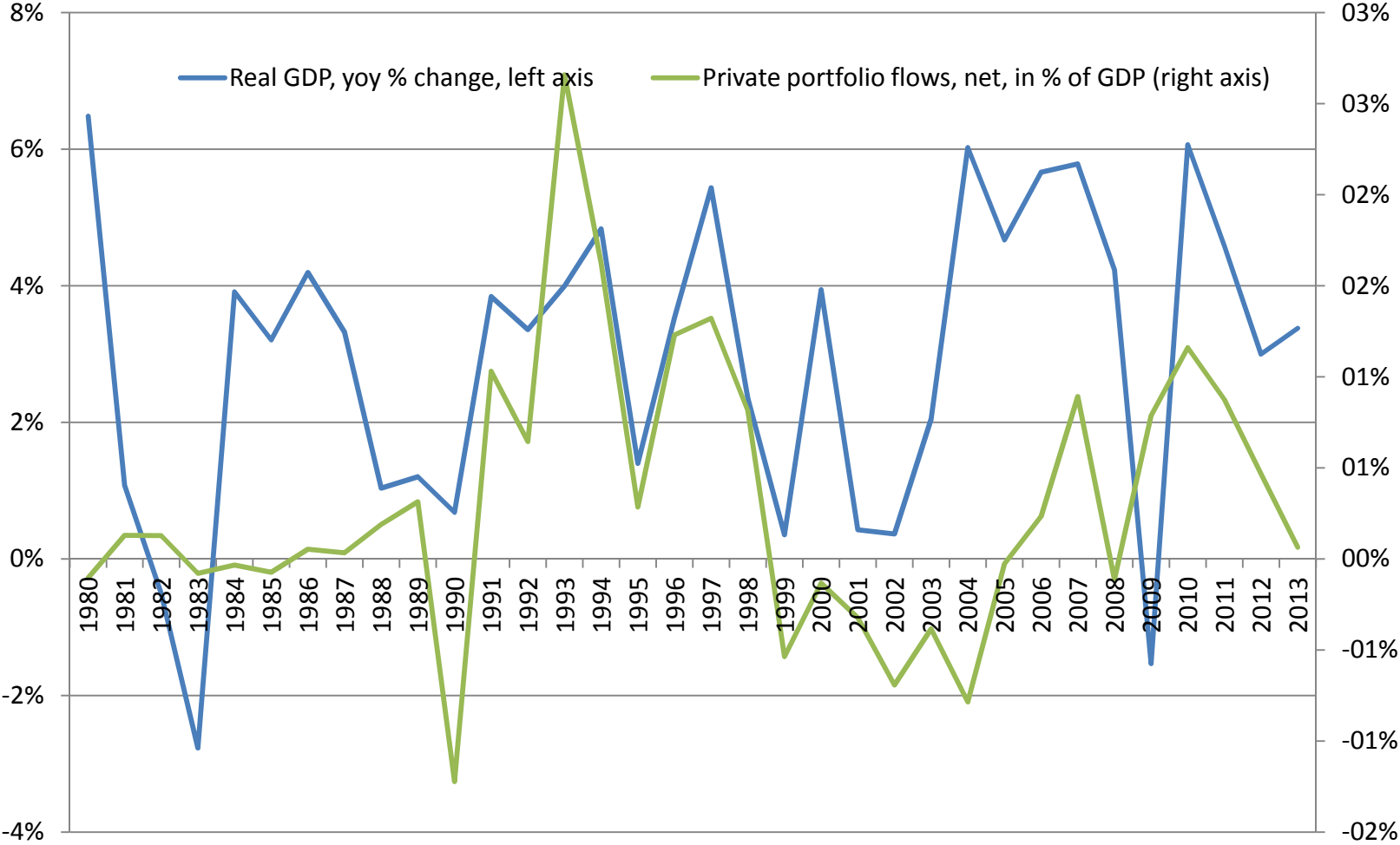
Among capital flows, Foreign Direct investment (FDI) is currently the most important and is well above ODA and remittances....

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



Source: on the basis of WDI, World Bank

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



Source: on the basis of WEO, IMF

Even though 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 the profit motive (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

New trends in financing sources have been accompanied by changes in the players channeling this finance...

- 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
 - ✓ South-South cooperation and non-DAC donor countries
 - ✓ 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

Consistently with these trends, mechanisms and instruments for development finance have also been changing...

- New initiatives that use limited public concessional resources (grants) to leverage sizeable non-concessional resources (loans)
 - ✓ Eg. Latin American Investment Facility (LAIF), 2010
 - Its primary objective is to finance key infrastructure projects in transport, energy, social and environmental sectors in LAC region
 - Uses limited funds (grants) contributed by the European Commission to leverage sizable loans from multilateral or bilateral public European Development Finance Institutions, Regional Latin American Development Banks and own contributions from partner countries in Latin America.
 - Since its inception (in 2010), grant contributions amounted to aprox. € 160 million, leveraging total new investments of about € 4.2 billion (i.e. 26 euros raised for every euro contributed by LAIF)

Consistently with these trends, mechanisms and instruments for development finance have also been changing... (cont.)

- New initiatives that use public resources to mobilize private investment towards development objectives
 - ✓ Eg. Issuing Development Impact Bonds (DIBs)
 - DIBs transform social problems into “investible” opportunities
 - Private investors provide working capital -and assume risk- for development programmes which are then carried out by specialized service providers
 - Donor funding is used to repay capital (plus a potential return) once clearly pre-defined and measured development outcomes are achieved.

Consistently with these trends, mechanisms and instruments for development finance have also been changing...(cont.)

- Other *Innovative financing mechanisms* have been increasingly discussed in view of shortfalls in ODA and comprise basically four broad categories:
 - ✓ Those that generate new public revenue streams (such as global taxes or auctioning of emission permits)
 - ✓ Debt-based instruments and front-loading (such as debt swaps and international finance facilities)
 - ✓ Public-private incentives, guarantees and insurance (such as advance market commitments (AMCs) and sovereign insurance pools)
 - ✓ Voluntary contributions using public or public-private channels (such as person-to-person giving).

The mobilization of private resources for financing sustainable development must take charge of...

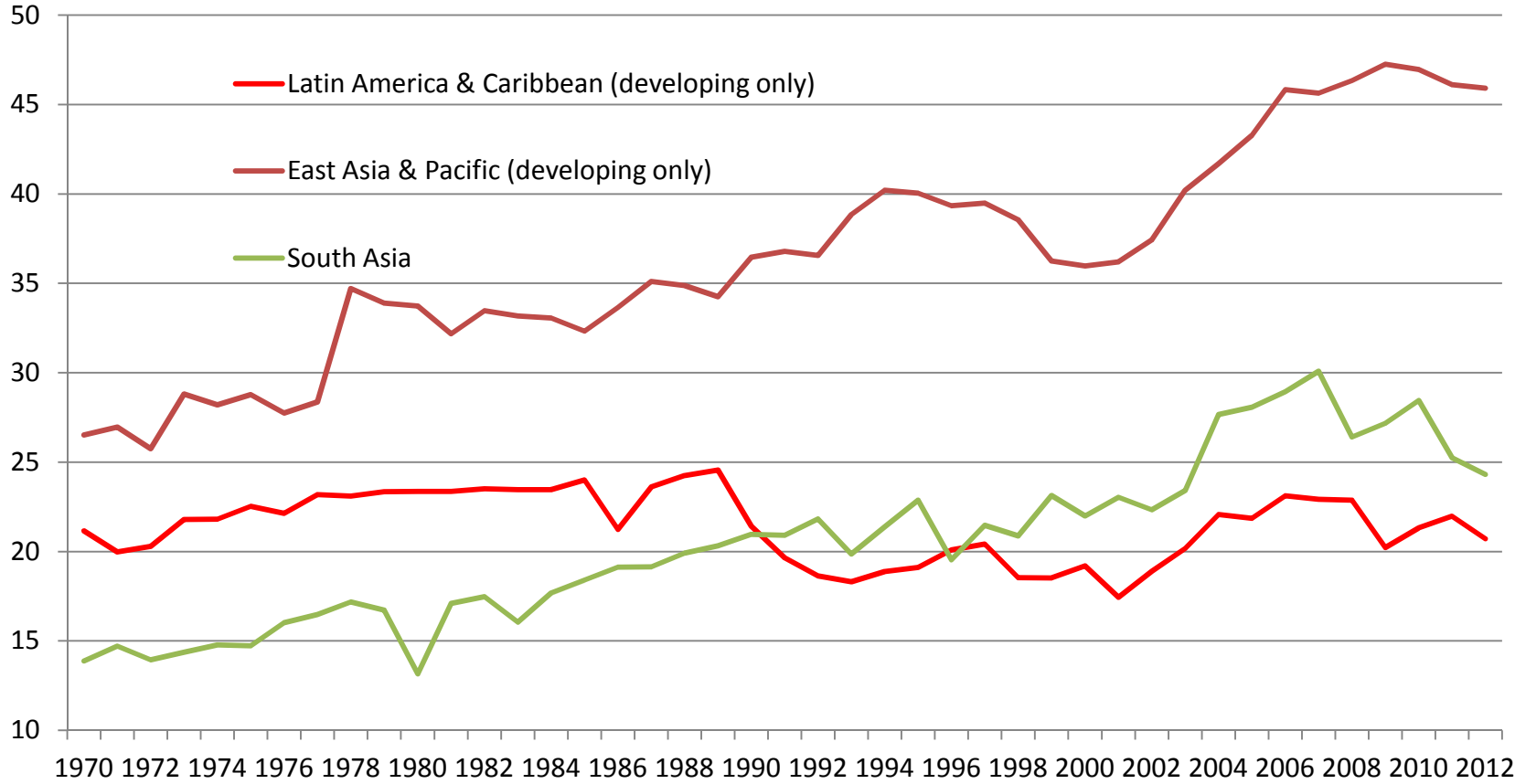
- Issues regarding volatility of private flows
- Conciliation of economic vs. social profitability and relative price issues
 - Private investments search for economic profits
 - Issues of social profitability are mainly left aside
- Incentives provided to attract private financing should be accompanied by proper regulatory frameworks and regulation
 - LAC lessons from private-public financing mix
 - Concessionary contracts and PPPs
 - Provision of social services (health, pensions, etc.)

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...

- Promoting 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.

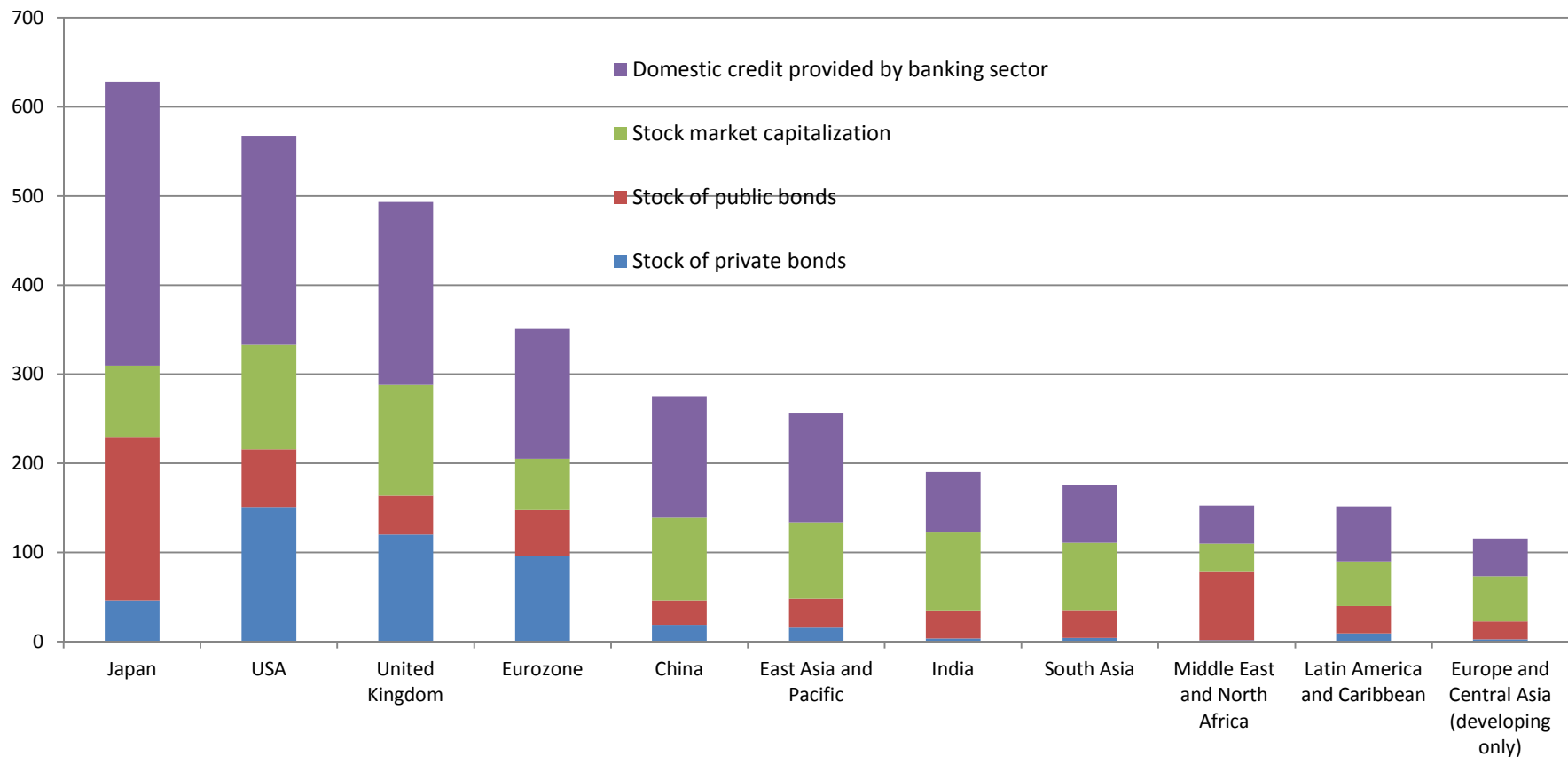
Domestic Savings (In percent of GDP)



Source: WDI, World Bank

Also the development of financial systems has proved to be a complex process in the region...

Size of different components of the financial system
(in percent of GDP)



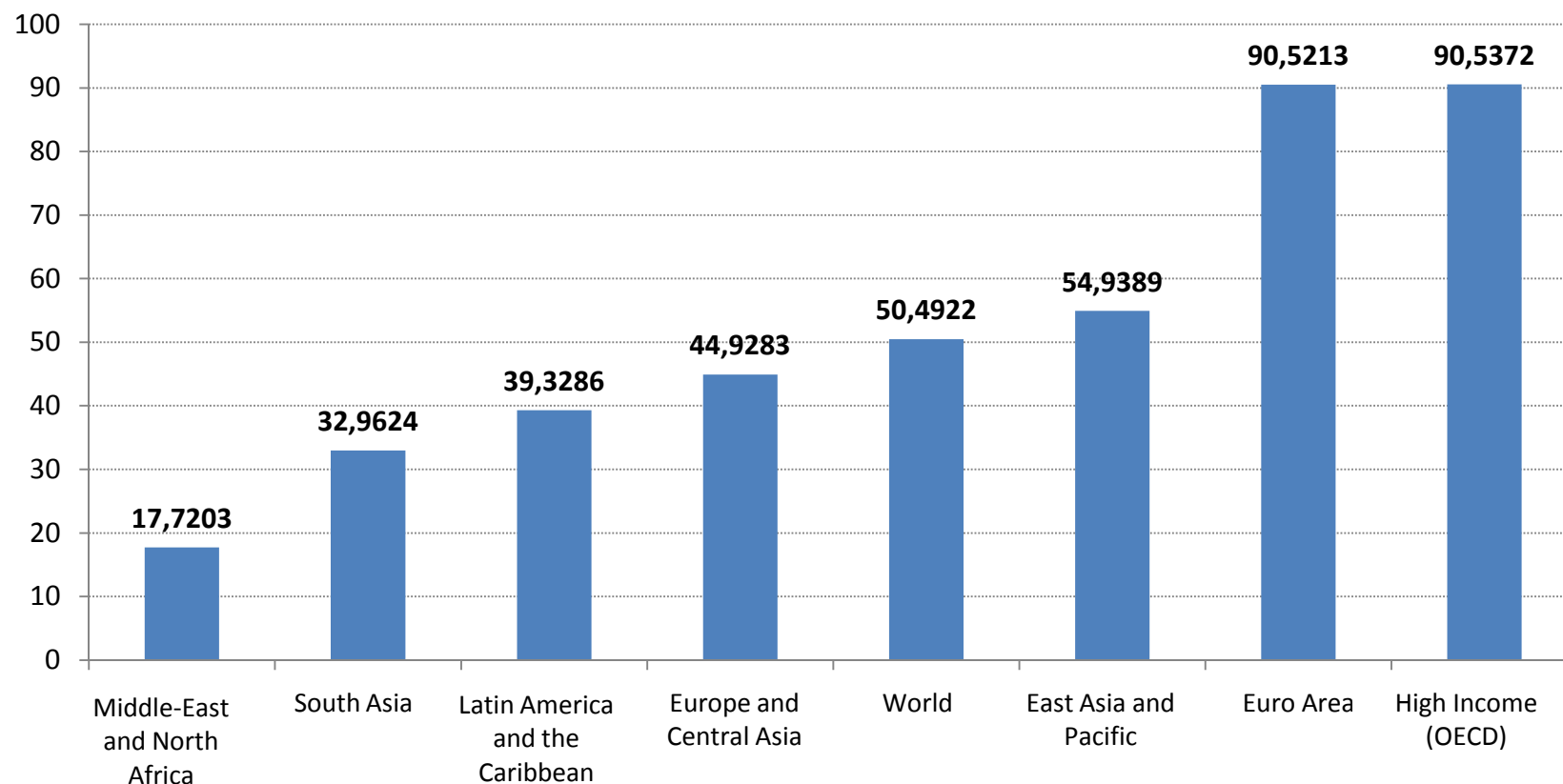
Source: On the basis of WDI and GFDD, World Bank

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

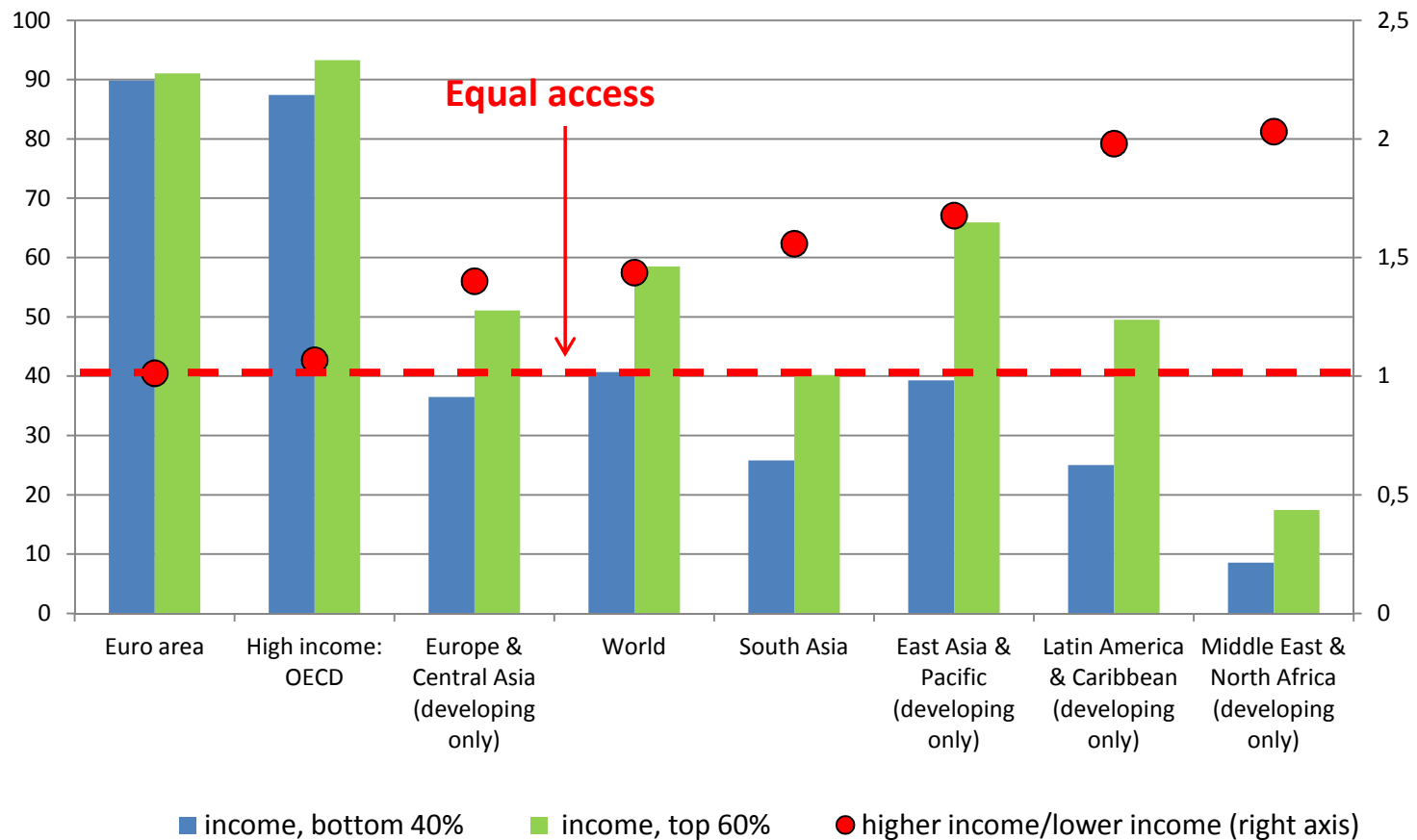
**Population (>15 years) with an account in a formal financial institution
(2011, in percent)**



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

It is normally poorer people that are left out... with obvious consequences on inequality and poverty...

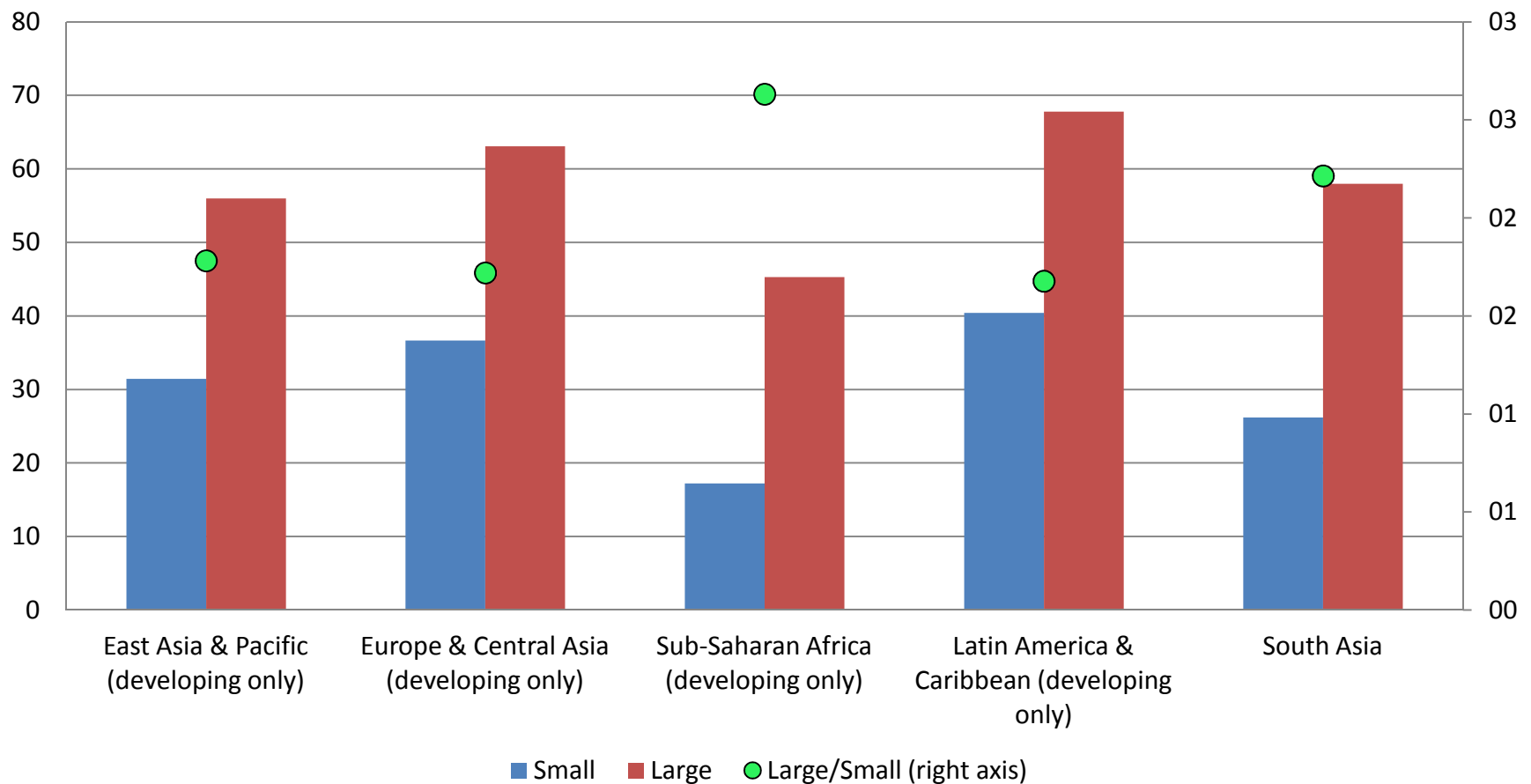
**Population (>15 years) with an account at a formal financial institution, by income level
2011**



Source: ECLAC, Financing for Development Division on the basis of World Bank Global Findex database (2013)

In the case of the productive sector, SMEs have much more difficulty in accessing financing than larger firms...

Percentage of firms with bank credit or credit line
(2011)

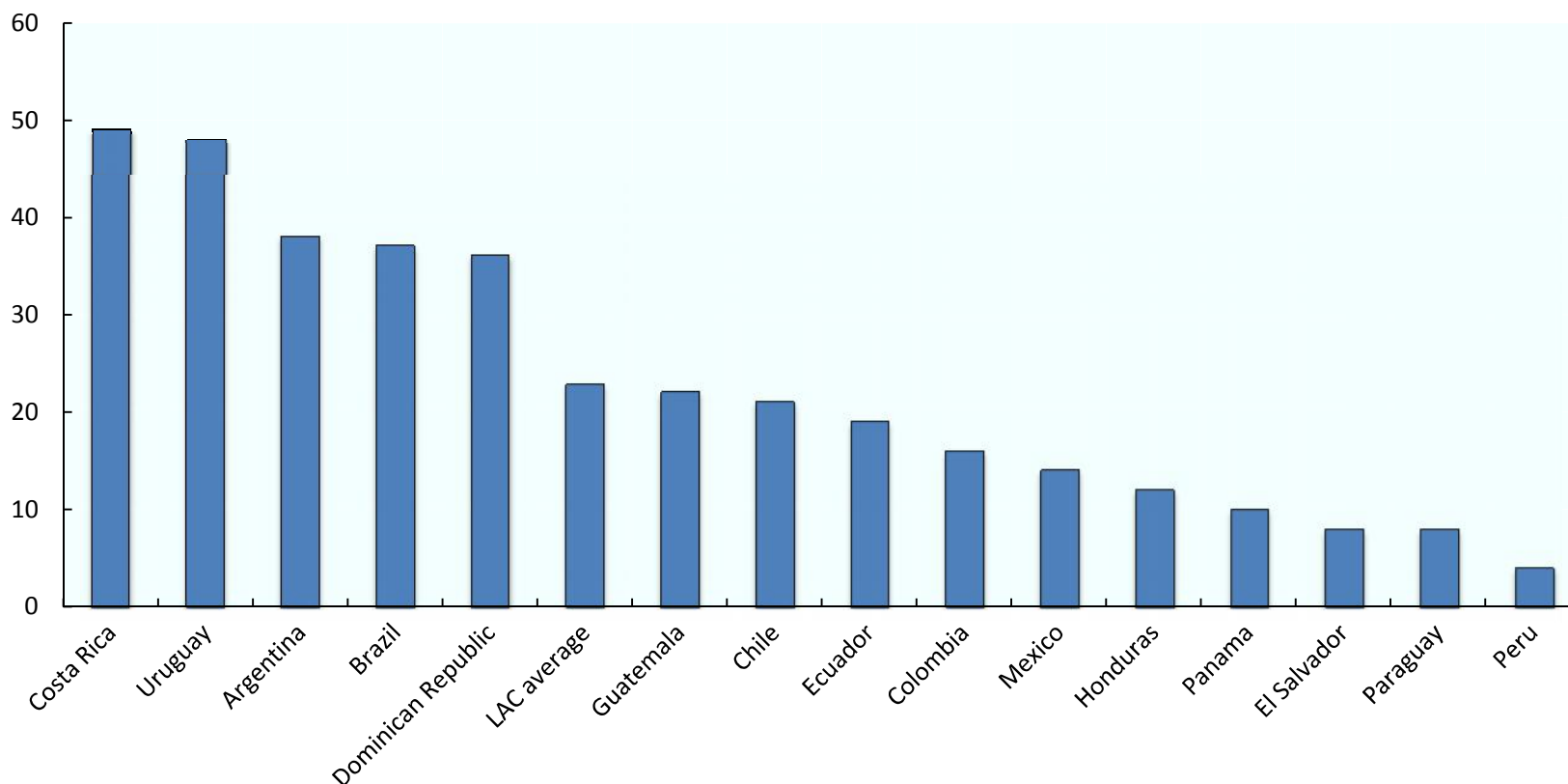


Source: ECLAC, Financing for Development Division on the basis of World Bank G-20 Basic Set of Financial Inclusion Indicators

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

Public financial institutions' participation in Latin American banking systems loan portfolio balances
In percent, 2007-09



Source: De Olloqui and Palma, 2012, based on Latin American Association of Development Financing Institutions (ALIDE) data.

Development Banks may foster financial inclusion through the implementation of innovative financial practices ...

- Innovations in the financial system's institutionalities
 - They affect the financial system as a whole
 - ✓ New ways to make financial operations (internet).
 - ✓ Establishing new types of financial intermediaries
 - ✓ Changes in the legal and supervisory structure of the financial system
- Innovations in financial instruments
 - Introduction of products and/or services to satisfy the demand for certain financial services
- Innovations in financial processes
 - Introduction of new capacities, competencies and routines to improve efficiency
 - It is often associated to technological improvements
 - ✓ Processes of *credit scoring*/visits to determine the payment capacity of a client
- Innovation in processes and products are associated with risk management.

In summary...

- The financing for sustainable development architecture faces important future challenges
 - Take charge of a widening set of development objectives and priorities
 - ✓ While at the same time being articulated in a coherent and orderly way
 - 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