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The Challenges of Financing Development in an Era of Globalization

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"The Challenges of Financing Development in an Era of Globalization "

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I. Introduction

Eighteen months after the UN Millennium Declaration of September 2000, inclusive of the Millennium Development Goals (MDGs), the UN held an international conference on Financing for Development in Monterrey, Mexico on March 18-22, 2002. The final text of the agreements and commitments adopted at the Conference is called the Monterrey Consensus (UN, 2003). The Heads of State and Governments in Monterrey, Mexico resolved to address the challenges of financing for development around the world, particularly in developing countries. According to the Heads of State and Governments, "our goal is to eradicate poverty, achieve sustained economic growth and promote sustainable development as we advance to a fully inclusive and equitable economic system" (UN, 2003:5, para. 1). The first step in ensuring that the twenty-first century becomes the century of development for all is to mobilize and increase effective use of financial resources and achieving the national and international economic conditions needed to fulfill internationally agreed development goals, including those contained in the Millennium Declaration, namely, eliminate poverty, improve social conditions and raise living standards and protect the environment (UN, 2003:5, para 3).

Seven years after the Monterrey Consensus, the Doha Review Conference was held at which the Monterrey Consensus was reaffirmed in its entirety, in its integrity and holistic approach recognizing that mobilizing financial resources for development and effective use of all those resources are central to the global partnership for sustainable development, including in support of the achievement of MDGs (UN, 2008:2, para2). Furthermore, the Doha Declaration recognized that the international context has changed in profound ways since Monterrey. While welcoming the progress made in some areas, it was noted that inequality has widened. The increase in public and private flows since 2002 which had contributed to higher economic growth and poverty reduction witnessed during the period was welcome. However, deep concern was expressed over the new challenges presented by food insecurity, volatile energy and commodity prices, climate change and global financial crisis as well as lack of results so far in the multilateral trade negotiations and a loss of confidence in the international economic system (UN, 2008:2, para3).

These new challenges have tended to persist and it is important to regularly review their implications for financing for development with a view to articulating coping mechanisms. For this reason, a number of high level meetings have been held by the General Assembly of the UN, the last one being in March, 2010 (UN, 2010). It is therefore appropriate for policy makers, researchers and interested parties to regularly interact and debate issues identified under the various themes of the financing for Development which is the objective of this Conference. This presentation, therefore, is basically intended to contribute to this process by reviewing the challenges posed by the on-going food insecurity, volatile energy and commodity prices, climate change and global financial crisis for each of the themes of the Monterrey Consensus.

The rest of this paper is organized as follows. The development deficits and the challenges they pose for financing for development are reviewed next. This is followed, in sequence, by the challenges that food insecurity, volatile energy and commodity prices, climate change and global financial crisis pose for each of the themes of financing for development. The last part of the paper contains ssome conclusions.

II. A Review of the Development Deficits in Developing World

There is a general agreement that sustained growth is necessary for poverty reduction. Indeed, a growth rate of not less than 7% per year has always been mentioned as necessary for poverty reduction. What is not often stated is that a decent growth rate that is not accompanied by structural transformation may not have salutary and sustainable effect on poverty reduction. Experience of China suggests that the high and sustained economic growth it attained over three decades was accompanied by the structural transformation of the economy which contributed to the dramatic drop in poverty rate from 53% in 1981 to 2.35 by 2005.

A look at Table 1 below will show that while it is true that economic growth rates improved in developing countries between 2000 and 2007 compared to the preceding decade (1990-2000) it was only in East Asia and South Asia that the growth rates exceeded the 7% mark. What is more, it is only in these two regions that the share of manufacturing in GDP remained stable between 1995 and 2007 whereas in sub-Saharan Africa (SSA) and the Middle East and North Africa (MENA), the share of manufacturing in GDP remained low and falling during this period.
Table 2 illustrates the trade diversification deficit reflecting the structure of production displayed in Table 1. Clearly, merchandise export of SSA and MENA continued to be heavily dominated by primary commodities between 1995 and 2007 while, in the case of East Asia and South Asia, manufactured commodities dominated exports during the same period. On the other hand, imports of SSA, MENA and East Asia were dominated by manufactured goods between 1995 and 2007. However, notice that both imports and exports of East Asian countries were dominated by manufactured goods suggesting that East Asian countries import manufactured goods, add further value and then export.

Little wonder then that the higher economic growth experienced in SSA and MENA during the first 7 years of this century did not translate to significant poverty reduction. Meanwhile, virtually all Eas Asian countries will meet the MDGs and surpass them (See Ajakaiye, 2007). While it is easier for growth to resume, structural transformation of the economy and trade diversification will take a long time to occur. Therefore, in order to ensure that the twenty-first century becomes the century of development for allas envisioned in the Monterrey Consensus, it is necessary to mobilize and increase effective use of financial resources over a reasonably long time in support of high economic growth and above all structural transformation. In other words, high economic growth that is not accompanied by structural transformation of the economic base away from crude materials (agriculture and minerals) towards manufacturing and, subsequently, modern services are unlikely to be compatible with the aspirations of the Monterrey Consensus.

1. Growth & Structural Transformation Deficit

Indicator	SSA	MENA	East Asia	South Asia	World
GDP Growth 1990-2000	2.5	3.8	8.5	5.5	2.9
GDP Growth 2000-2007	5.1	4.5	9.0	7.3	3.2
Share of Agric 1995	18	16	19	26	4
Share of Industry 1995	29	34	44	27	30
Share of Manufacturing 1995	16	15	31	17	20
Share of Services 1995	53	50	36	46	65
Share of Agric 2007	15	11	12	18	3
Share of Industry 2007	32	40	47	29	28
Share of Manufacturing 2007	14	12	30	17	18
Share of Services 2007	53	49	41	53	69

Source: World Development Indicators, 2009 (World Bank)

2. Trade Diversification Deficit

Indicator	SSA	MENA	East Asia	South Asia	World
Share of Primary Commodities in total **exports** 1995	73	82	21	24	25
Share of Manufactures in total **Exports** 1995	27	18	79	76	75
Share of Primary Commodities in total **exports** 2007	70	84	23	32	28
Share of Manufactures in total **exports** 2007	30	16	77	68	72
Share of Primary Commodities in total **Imports**1995	27	36	22	45	25
Share of Manufactures in total **imports** 1995	73	64	78	55	75
Share of Primary Commodities in total **Imports** 2007	36	50	33	52	31
Share of Manufactures in total **imports** 2007	64	50	67	48	69

Source: World Development Indicators, 2009 (World Bank)

Another important area of development deficit is infrastructure. With respect to energy production and use, Table 3 shows that as at 2008, total energy production was lowest in South Asia followed by SSA and MENA. Notice that total energy production in East Asia was approximately three times larger than those of MENA and SSA. Clearly, this is a reflection of the fact that the economies of South Asia, SSA and MENA are dominated by primary commodities. Notably, the proportion of clean energy in total energy production is lowest in MENA followed by SSA and South Asia. The figure for East Asia is 3.2% indicating that technological capability required to mitigate climate change effects of energy production is lowest in MENA and highest in East Asia. Turning to energy use per capita, South Asia has the lowest figure followed by SSA. Notice that in per capita terms, energy use in MENA and East Asia are roughly the same. This is a reflection of the low population in MENA region compared with East Asia.

With respect to electricity production, it is clear that SSA has the lowest figure followed by MENA and South Asia. Electricity production in East Asia in 2008 was more than 8 times that of SSA, again, reflecting the rudimentary structure of economic activities in the region. Correspondingly, electricity consumption per capita was lowest in South Asia followed by SSA.

With respect to roads, communications and science and technology deficits, a look at Table 4 will reveal that SSA has the lowest percentage of paved roads in the world as at 2007 followed by South Asia. The same is true when it comes to telephone and personal computers coverage. On the other hand, the tariffs are highest in Africa for these services.

The upshot of the foregoing is that developing regions of the world face serious infrastructure deficits and a large amount of financial resources should be mobilized over a long period in order to address the infrastructure deficits in developing countries and meet the aspirations of the Monterrey Consensus. For example, Briceno-Garmendia and Foster (2008), estimated that SSA alone will require $93 billion per year to:

- Develop an additional 7,000 megawatts a year of new power generation capacity (about half through multipurpose water storage schemes).
- Enable regional power trade by laying 22,000 megawatts of cross-border transmission lines.
- Complete the intraregional fiber-optic backbone network and continental submarine cable loop.
- Interconnect capitals, ports, border crossings, and secondary cities with a good quality road network.
- Provide all-season road access to Africa’s high-value agricultural land.
- More than double Africa’s irrigated area.
- Meet the MDGs for water and sanitation.
- Raise household electrification rates by 10 percentage points.
- Provide global systems mobile voice signal and public access broadband to 100 percent of the population.

They estimated that about $62billion will relate to capital expenditure while $31billion will relate to operation and maintenance. It is conceivable that the needs of South Asia will not be too different from this figure while that of MENA may be slightly lower given the relatively better initial conditions and small populations.

In the area of human resource development, developing countries face serious deficits as well. This is especially the case with respect to tertiary education which is fundamental to the task of building human capacity required for effective mobilization of financial resources for development and efficient utilization of the resources. Table 5 shows that tertiary, secondary and primary enrolment rates are lowest in SSA followed by South Asia and MENA and East Asia. It is particularly important to note that as at 2007, tertiary enrolment rate is abysmally low in SSA compared to other regions of the world. Clearly, the human capacity to efficiently mobilize and use increased financial resources from all sources to meet the aspirations of the Monterrey Consensus is not receiving the necessary attention in developing countries.

3. Infrastructure Deficits: Energy Production and Use, 2008

Indicator	SSA	MENA	East Asia	South Asia	World
Total Energy Production (Million Metric Tons)	762	827	2373	536	11788
Clean Energy Production (% of total)	2.6	0.9	3.2	2.8	9.2
Electricity Production (billion kwh)	417	515	3394	886	18977
Per Capita Energy Use (kg)	670	1254	1258	468	1820
GDP per Unit of Energy Use ($/ kg)	3	5	3.4	4.8	5.2
Electricity consumption per capita (kwh)	531	1418	1669	459	2751

4. Infrastructure Deficits: Roads, Communications and S&T, 2007

Indicator	SSA	MENA	East Asia	South Asia	World
Paved Roads as % of Total 2000-08	11.9	81	n.a	56.9	36.9
Fixed Telephone Lines/ 100 people	2	17	23	3	20
Mobile cellular subscription/ 100 people	23	51	44	23	51
Population covered by mobile networks (% of total pop)	56	93	93	61	86
Residential fixed line tariff ($/ month	11.6	3	4.5	3.5	10.9
Mobile prepaid tariff ($/ month)	11.8	7.3	5.0	1.9	10.3
Personal Computers/ 100 people	1.8	6.9	5.6	3.3	15.9
Internet users/ 100 people	4.4	17.1	14.6	6.6	21.8
Internet Access tariff ($/ month)	100	23	21.7	31	31.4

5. Human Devt Deficits: Education, 2007

Indicator	SSA	MENA	East Asia	South Asia	World
Tertiary Enrollment Rate	5	25	21	10	25
Secondary Enrollment Rate	32	71	73	49	66
Primary Enrollment Rate	94	105	110	108	105
Youth Literacy Rate	72	89	98	79	89
Youth Literacy Rate (Male)	77	93	98	84	91
Youth Literacy Rate (Female)	67	86	98	74	87
Adult Literacy Rate	62	73	93	63	84
Adult Literacy Rate (Male)	71	82	96	74	88
Adult Literacy Rate (Female)	54	65	90	52	79

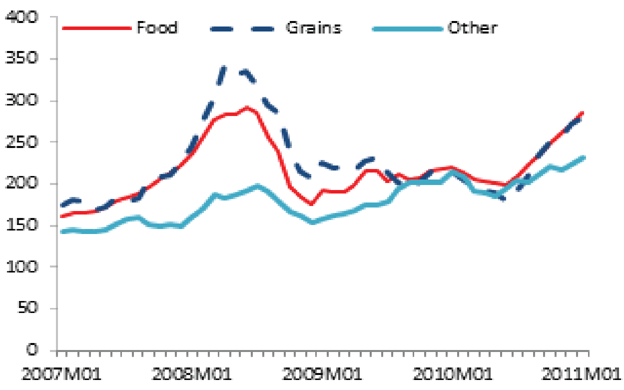
Source: World Development Indicators, 2009 (World Bank)

In summary, the development deficits briefly reviewed above call for large, sustained and predictable financing for development over a long period in order for the development deficits to be significantly addressed. Therefore, the view that is always expressed by many participants at various high level meetings on Financing for Development, namely, that innovative and other sources of financing should be seen as important complement rather than substitute for ODA should be embraced by all (UN, 2010). In that connection, initiatives aimed at stemming and reversing the illicit financial flows from developing countries estimated to be as large as $810billion per year (Karr and Curcios, 2011); encouraging multinational companies to stop tax dodging in developing countries (Christian Aid, 2010; Global Witness, 2010) and several other initiatives to increase domestic resource mobilization should really be seen as supplements rather than substitutes for ODA and other sources canvassed in the Monterrey Consensus.

III. Challenge of Food Insecurity

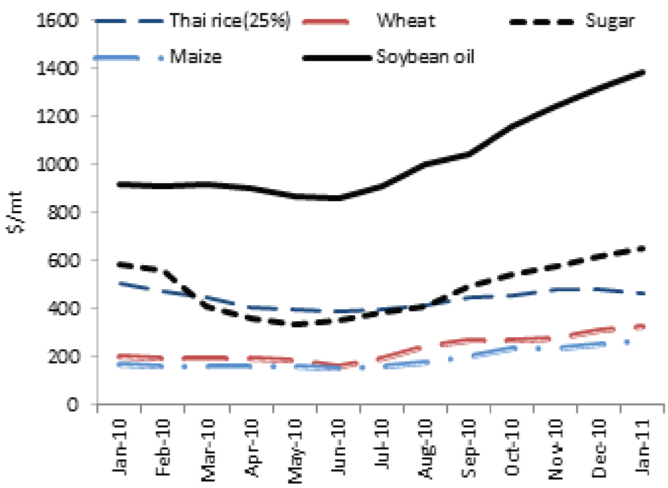
Global food prices continues to rise as can be seen in Figures 1 and 2. The World Bank's food price index increased by 15% between October 2010 and January 2011 and is only 3% below its 2008 peak. The main drivers of this sustained food price increases include emerging shifts in global patterns of food demand towards increased consumption of grain-fed beef in rapidly growing China, for example as well as weakened food supply caused by rising fuel and fertilizer costs, high subsidies on bio-fuel production in the US, adverse climatic conditions and historically low levels of food stocks (Abbot and Borot de Battisti, 2011). Clearly, these food price increases generally cause macroeconomic vulnerability especially in countries with high share of food imports and limited fiscal space to support countercyclical policies. The World Bank estimates that the food price increases since June 2010 has increased the number of people in extreme poverty by about 44 million in low and middle income countries. The indication, therefore, is that the rising food prices have serious deleterious implications for food security in developing countries.

Fig. 1. World Bank Food Price Index



Source: World Bank, 2011

Fig. 2 Global Prices of Key Food Commodities



Source: World Bank, 2011

Turning to the implications of the challenge of food insecurity for the prospects of domestic resource mobilization and utilization, it is pertinent to note that that agriculture and food production activities in low income developing countries are dominated by peasantry. As a result, they are not easily amenable to income tax. Consumption tax regimes generally exempt food items. Therefore, while developing countries that are net food producers may benefit from increased food production, this is unlikely to translate to an appreciable increase in domestic resource mobilization. For net food consuming developing countries with reasonable fiscal space, increased food insecurity will cause a reallocation of domestic resources mobilized away from activities that can address some of the development deficits reviewed earlier towards food imports. For net food consuming countries with limited fiscal space, the implication is that the number of people in extreme poverty will increase dramatically thus adversely affecting the prospects of achieving the MDGs.

The challenge of food insecurity for the prospects of mobilizing FDI and other private flows is the risk of increased concentration of FDI in resource rich countries thereby accentuating inequality and bypassing the low income resource poor countries. ODA to these countries will tend to be dedicated primarily to food imports and secondarily to initiatives that will enhance food production capacity. The implications of food insecurity for external debt depends on the composition of ODA dedicated to food imports. Generally, the higher the proportion of loans dedicated to food imports, the more deleterious food insecurity challenge will be on external debt situation. Food insecurity tends to compromise the efficacy of trade as an engine of development as it encourages protectionist trade policies.

IV. Challenges of Rising and Volatile Energy and Commodity Prices

A look at Table 6 will reveal that energy prices declined between 2000 and 2002. From 2003 onward, energy prices maintained a rising trend until 2008 when it jumped by almost 50%. Energy prices decelerated sharply between 2008 and 2009 before resuming an upward trend in 2010 although they are still lower than what they were in 2008. A similar trend can be observed in the case of non-energy commodities. They decelerated between 2000 and 2001, rose steadily between 2002 and 2007, peaked in 2008, decelerated in 2009 and resumed rising trend in 2010 but yet to attain the 2008 level. Clearly, the prices of commodities have been volatile and rising.

Table 6: World Commodity Price Indices, 2000-2010

Year	Energy	Non-energy
2000	100.00	100.00
2001	89.18	94.82
2002	87.70	100.68
2003	103.61	111.66
2004	135.85	132.84
2005	188.22	148.79
2006	220.86	190.31
2007	244.81	232.66
2008	341.97	275.17
2009	214.29	208.81
2010	271.06	266.53

Source: World Bank, 2011

While rising price trend raises costs and hence market prices, volatility creates uncertainly which can be deleterious to business planning and operations. The fundamental cause of rising commodity prices is excess demand occasioned by the large and increasing needs of the rapidly expanding economies of China, India, Brazil, Turkey and other emerging markets. Factors that prevent supply from keeping step with the rapidly growing demand for energy products include lack of excess capacity in the mineral extraction and refining industries globally and unrest in major mineral producing countries. In the case of non-energy commodities, supply side shocks occasioned by dry weather, lower than average yield, damage to crops by pests are among the key causes of the demand-supply gaps. Volatility has been blamed on speculative trading in these commodities.

The impact of rising energy and commodity prices on development prospects of countries depend on whether or not a country is a net producer or consumer of these commodities. Simply put, resource rich countries are likely to benefit from rising prices of these commodities. These countries have experienced relatively large inflow of resources as FDI and proceeds from exports of the commodities. The inflow of the resources is so large that several of the resource rich countries, especially the oil producers, have accumulated large external reserves and many of them have decided to create sovereign wealth funds as a strategy to manage the problems of low absorptive capacity, fear of unwanted exchange rate appreciation, smoothening expenditure and addressing inter-generational equity. Opinions differ as to how best to manage the huge flow of foreign exchange by these countries. See Collier (2011) and Elbadawi and Nandwa (2011) and South Centre (2008), for different perspectives on this phenomenon. From the point of view of mobilizing financing for development, it can be stated that rising prices of energy and commodities is enabling for resource rich countries. The uncertainty created by price volatility is a challenge as this may adversely affect the prospects of sustaining development activities for long enough to address the development deficits reviewed earlier.

Rising energy and other commodity prices raise costs and intensifies cost-push inflation. Volatile energy prices causes uncertainty and affects business planning and operations. In essence, rising and volatile energy and commodity prices complicate the business environment and renders it quite inclement for private investment. Therefore, rising and volatile energy and commodity prices adversely affect the operations and growth of existing corporate entities (domestic and foreign, alike) and hence the tax base. Shrinking tax base is inimical to domestic resource mobilization.

Low income countries and middle income countries without adequate fiscal space will be unable to undertake countercyclical policies implying that the consequences for such countries in terms of ability of the state to intervene, create jobs and grant concessions to existing corporate entities will be limited. Since new investors tend to go to countries and territories where existing industries are doing better (herd effects), rising and volatile energy and commodity prices will put the low income countries at a disadvantage as they will be bypassed by new investors, especially the foreign one. In essence, the challenge of rising and volatile energy and commodity prices are likely to accentuate the concentration of FDI in fewer countries, especially those that are rich in natural resources. An attribute of FDI in resource rich countries is that they are enclaves with limited spill over to the local economy. The multinational companies are also quite adept in dodging taxes (Christian Aid, 2010); facilitating illicit financial flows (Karr and Curcio, 2011); and demonstrating no aversion to lack of transparency in revenue and general economic transactions (Revenue Watch and Transparency International, 2010).

The challenge of rising energy and commodity prices also has indirect implications for the development impact of resources mobilized for development regardless of the source. This phenomenon tend to reduce the real value of ODA and other innovative sources of financing for development. This is particularly the case when such ODA resources are devoted to infrastructure projects and the additional ODA resources to meet the inevitable cost escalations are not forthcoming. External debt situation of low income countries can also be aggravated by cost escalation and delayed (or indeed abandoned) loan assisted project.
The challenge of rising prices of energy and commodities for trade as engine of development can be significant. Foremost, for resource rich countries, it tends to discourage economic and trade diversification thereby increasing vulnerability of these economies to the volatility of these prices. For low income resource poor countries, the cost push inflationary pressure tends to reduce attractiveness of these countries to foreign investors. It also tends to reduce competitiveness of domestic producers leading to de-industrialization and difficulty in expanding the industrial base of the country either through establishment of new industries or expansion of existing ones. De-industrialization will lead to retrenchment aggravating unemployment of the youth and highly educated people. The consequences for social and political tranquility are more obvious than imagined contemporarily.

V. Challenges of Climate Change

Climate change, also referred to as global warming, is described as changes in modern climate caused by human action. The recent experiences with flooding, drought, rising temperature, have dwindled doubts that sustainable economic growth accompanied by structural change should be 'clean' or 'green'. In other words, development should be 'climate proofed' to be sustainable. Climate proofed development require additional financial resources, technology and technical competence to operate, maintain and mange the facilities. In the context of Monterrey Consensus, climate proofing development will require the construction and operation of all development projects using the best available technology and process with minimum impact of the environment. It also requires financing for initiatives to adapt the existing development projects and processes to climate change. This is particularly the case with energy projects. In short, climate change adaptation and mitigation activities in developing countries should be scaled up radically in order to ensure that climate change considerations do not imply slowing down the pace of development which is inconsistent with the Monterrey Consensus.

The challenge of climate change for resource mobilization (domestic, FDI and ODA) is how to scale up the volume of resources in a sustainable, durable and predictable way because climate change adaptation and mitigation will take a long time to come to fruition in developing countries. The challenge of climate proofed development for the private sector is how to empower them with necessary financial resources and access to clean technologies while avoiding serious external debt problems. UNIDO, IFC and other agencies should, therefore, be empowered to provide private sector operators with the necessary financial and technical support in ways consistent with minimizing external debt problems for the countries.

Foreign exchange contents of climate proofed public infrastructure projects should be funded mainly from grants because of their public goods nature. For the same reason, access to technological requirements for these projects should be freely provided. More importantly, developing countries and their development partners should build capacity in the developing countries to carry out research and development activities that will enable them to mitigate climate impact of their development projects and activities. This requires a long-term sustained commitment and support by all stakeholders. In this context, development partners should consider 'buy out' of patents on climate proofing technologies and trade rules that restrict access to these technologies should be reconsidered and avoided. The same initiative should be extended to drugs and treatment protocols for diseases like HIV/AIDS, tuberculosis, malaria and other major communicable diseases.

VI. Challenges of Global Financial Crisis

Global financial crisis which originated in developed countries has had serious immediate implications for the development prospects of developing countries. The sudden stop in credit, the reduction in demand and the associated increase in unemployment prompted the developed countries to undertake countercyclical policies, protectionist trade policies and restrictive immigration policies. These poses serious challenge to the prospects of developing countries in several respects. First, development projects, especially infrastructure projects, that require resources denominated in foreign currencies suffered serious implementation setbacks. This is particularly the case for public-private partnership projects as virtually all of the private partners are foreign.

Another immediate consequence is reduced demand for and falling price of energy and non-energy commodities as shown in Table 6. It has been shown in Table 2 that these commodities dominate developing countries' exports and the implication is that foreign exchange earnings by these countries have dwindled. In response, several of them had to run down their foreign reserves. FDI and ODA also plummeted.

However, global demand for these commodities (energy and non-energy) recovered fairly quickly because of the countercyclical policies pursued by the OECD countries as well as the emerging markets, especially China, Brazil, India and Turkey. As a result, there was a rebound in the prices of these commodities to the benefit of developing countries that export them. Developing countries that import them, especially those with limited fiscal space faced considerable difficulties articulated in section V above.

Soon afterwards, the policy makers in OECD countries came under severe pressure to reduce fiscal deficits associated with the countercyclical policies. The subsequent expenditure retrenchments commenced during 2010 and the series of protests by the citizens of these countries is raising the possibility of a double dip recession in several of these countries. If this happens and the emerging markets are unable to fill the consequent slackening in demands for commodities by OECD countries, then prices may collapse again. The implications of this scenario for domestic resource mobilization, FDI, ODA and trade are as articulated in section V above.

Global financial crisis has obviated the need for addressing systemic issues of enhancing coherence and consistency of international monetary, financial and trading system in support of development. Clearly, if the economies of major OECD countries (France, Germany

Japan, UK and US) slip back into recession, the subsequent preoccupation with their domestic economic issues may reduce the tempo and commitment to international policy coordination currently being implemented as auspices of G20. A more durable arrangement such as assigning such a responsibility to the IMF or the UN has been proposed (UN, 2010, 2008; South Centre, 2008) and this should be given serious consideration by all stakeholders.

VII. Conclusion

In this paper, we have briefly reviewed the development deficits confronting developing countries as well as the implications of the challenges of food insecurity, rising and volatile energy and commodity prices, climate change and global financial crisis for the themes of financing for development, namely, domestic resource mobilization, FDI, ODA, external debt and trade. A review of the development deficits raises the challenge of mobilizing large suggests large, sustained and predictable financing for development over a long period in order for the development deficits to be significantly addressed. As a result, the view that is always expressed by many participants at various high level meetings on Financing for Development, namely, that innovative sources of financing should be seen as important complement rather than substitute for ODA, debt relief and other financial resources should be embraced by all. Initiatives such as the stemming and reversing of illicit financial flows from developing countries estimated to be as large as $810billion per year; encouraging multinational companies to stop tax dodging in developing countries (Christian Aid, 2010; Global Witness, 2010); and several other initiatives to increase domestic resource mobilization should really be seen as supplements rather than substitutes for ODA and other sources canvassed in the Monterrey Consensus.

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