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Financing for development: an institutionalist analysis.

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Abstract:

The standard market-based financial models consider the development financing as a mere question of reallocation of available funds between the supply and the demand through the market price (the interest rate). Therefore, the financing of development pertains to the market conditions in force: more markets are free from any external (mainly state-related) constraints more would be efficient and possible the financing of the development process. In the face of such a simplistic approach, I adopt an institutionalist perspective and maintain that development is not only a mere shift (an increase) of growth (usually the GDP changes) that could be supported by free market mechanisms and market-related financing procedures but a structural change that requires some specific conditions under some specific constraints and call for a "special financial attention". Institutions are supposed to play a key role in this process whose path is also related to the characteristics of each society and cannot be thought of through a unique standardized model that would fit all. To sum up, financing development is highly related to the following question: can we think about the monetary capitalist economy as humanly progressive through the reorganization of fundamental infrastructures such as financial mechanism, rules and institutions? A literature survey recalls the work on financing for development and related monetary and financial interactions (Easterly, 2006; Moyo, 2009; Sachs, 2005; Severino and Ray, 2011, to quote but a few). It presents the specific models on finance and development nexus as well as the usual ways of development financing such as Official Development Assistance, Foreign Direct Investment, loans, etc. in order to assess their relevance, limits, and benefits with regard to the needs of the development process according to institutionalists.

Key words: Development financing, monetary economy, global financial governance, institutionalism

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Financing for development: an institutionalist analysis.

A literature survey recalls the work on financing for development and related monetary and financial interactions (Easterly, 2006; Moyo, 2009; Sachs, 2005; Severino and Ray, 2011, to quote but a few). It presents the specific models on finance and development nexus as well as the usual ways of development financing such as Official Development Assistance, Foreign Direct Investment, loans, etc. in order to assess their relevance, limits, and benefits with regard to the needs of the development process. The standard market-based financial models consider the development financing as a mere question of reallocation of available funds between the supply and the demand through the market price (the interest rate). Therefore, the financing of development pertains to the market conditions in force: more markets are free from any external (mainly state-related) constraints more would be efficient and possible the financing of the development process. In the face of such a simplistic approach, I adopt an institutionalist perspective[2] and maintain that development is not only a mere shift (an increase) of growth (usually the GDP changes) that could be supported by free market mechanisms and market-related financing procedures but a structural change that requires some specific conditions under some specific constraints and call for a "special financial attention". Institutions are supposed to play a key role in this process whose path is also related to the characteristics of each society and cannot be thought of through a unique standardized model that would fit all.

I then argue that the traditional North-South development financing model which was encouraged by the institutions such as the International Monetary Fund during the last decades was not relevant for developing countries. These institutions keep on applying structural adjustment policies, even if the vocabulary to describe these policies is evolving each decade (Marques Pereira and Ould Ahmed, 2010). They roughly applied the same models and strategies, usually resting on opening up and liberalization of real and financial markets, on all developing countries and did not consider the specificities of the economies and the prerequisites for a sustainable long-term development process.

In a more specific work, Stiglitz (1989, 1994) explains that Least Developed Countries (LDCs) should not follow the path of developed countries concerning the widening and opening of their capital markets. LDCs should realize their capital market is imperfect, limited and that even a good allocation of resources and capital accumulation does not automatically lead to growth. LDCs should rely on strong institutions able to fight for their specificity. State intervention

[2] See Yong (1994) for an overview of the institutionalist debate.

through financial constraints could lead to a better resource allocation from the financial market (Stiglitz, 1994). To go further the work on the imperfect information and related market failures (and market malfunctioning) following Stiglitz (1985, 1994), Arestis and Stein (2005, p.386), in an institutionalist vein, suggest that "an approach that emphasizes and places institutions at the heart of its analysis, thereby focusing a great deal more on how economies actually work, […], is more fruitful". In this line, Arestis and Stein develop an analysis in which the financial system is separated into "five institutionally related components"[3]. The aim of their analysis is to develop a new theory for the financial systems where institutions are central and are actually designed to be developmental-friendly. Their theory differs from the imperfect information approaches mostly because the institutions would reduce imperfections which means a "greater certainty of behavior" (Arestis and Stein, 2005, p.387). With less uncertainty, institutions will be able to change the financial system and better address developmental issues.

Reducing poverty is a slow process and reaching the Sustainable Development Goals (SDG) in 2015 was too optimistic. The main consequence is that institutions had to find a complement to the existing financing for development. Since the last decades, developing countries were encouraged to focus on public and private financing for development (IMF, 2015; OCDE, 2005, 2006; United Nations, 2008, 2013). To defend this idea, the OCDE (2005) put forward the positive correlation between private investment and growth. With private investments, entrepreneurs have sufficient resources to produce (create employment and new technologies) and it is a necessary condition for growth and development. Revenues of the poor would increase and that would generate resources for government to spend on education, health care and infrastructures to increase productivity (OCDE, 2006). The main source of private investments should be the private resources of the developing country and they can be complemented with Foreign Direct Investment (OCDE, 2005). Official Development Assistance programs are also encouraged to support actions that would help to improve the productivity of private investments (OCDE, 2006). For example, ODA programs should help to mobilize investments in infrastructures and capital market development; instore pro-poor growth with a reduction of entry barriers that will refrain poor people to invest (OCDE, 2006).

The role (and the amount) of ODA is shifting as it should complement other sources of income for developing countries. Some issues might therefore be stated with regard to the will of developed countries and institutions to support developing countries' process with the use of

[3] See Arestis and Stein (2005, p.388) for the details about the five institutional components of the financial systems: norms, incentives, regulations, capacities, organisations.

public funds in order to stabilize the development path particularly in crisis times. This could also be related to another issue about a possible complementarity between private investments and public investments in the financing of a long-term development process. All in all, those issues are related to the conditions that the financial market should respect to ensure sustainable development.

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