Putting the Horse before the Cart:
Development is the End, Financing is the Means

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I. Concept and Context

If development is the objective and finances are the means, then obviously the prior question to financing is: "In what areas would proper finances make a difference to development?" And the question: what are the essential ingredients of development?

The following are three essential ingredients of development:

1. Industrialisation and knowledge-intensive production is the key to sustained growth

- No country has developed through producing low-value agriculture subject to the law of diminishing returns. Most countries in the South are trapped in this mode.
- As an economy moves to higher level of production it moves increasingly from agriculture to industry, and later from industry to towards services and the development of intellectual assets.

2. Economic liberalization without learning and global integration without innovation results in the marginalization of the poor nations

(The following is taken from UNCTAD Report on LDCS, 2007)

- Most LDCs have opened their economies and are highly integrated in the global economy but they are not climbing the economic and technological ladder
- Out of 24 value chains of LDC exports, upgrading occurred in only 9 since 1990s, and downgrading in 12 representing 52% of LDC exports
- Total share of LDCs in manufacturing value-added in 2000-03 was 11% of which 40% was accounted for by Bangladesh … and yet …
- A study of 155 firms in Bangladesh showed that there was no development of technological capacity in agro-processing, textiles, garments and pharmaceuticals.

3. Monopolization of knowledge undermines the development dimension, and is at the root of poverty amidst plenty; free access to knowledge is the recipe for eradication of poverty at both domestic as well as global levels.

- Current IP regimes lock developing countries into low technology and low value-chain growth path and widen the knowledge divide.

- Strong IP regimes have led to increased transfer of resources from LDCs & DCs to industrialized countries with no development of domestic capacity.

II. How would Financing really make a Difference to Development?

It follows from the above that financing would really make a difference to development:

- If it leads to industrialisation of the developing countries (not to their deindustrialization as at present in the case of the majority of the developing countries);
- If finances become a means of building the capacity of the developing countries to innovate and build on their own knowledge resources;
- If finances become a means of effective transfer of knowledge (scientific and technological) from the north to the south, and from south to south.
- If finances build the productive resources (human, intellectual, and material) of the developing countries, especially of the LDCs and other weaker nations.
- If finances promote "decent work" employment for rural as well as urban people. (Lop sided urban-rural development of most developing countries, including the largest ones, is the hallmark of present day "development".)

III. What, then, needs to be done to Reform Global Financial architecture in order for it to be developmental?

Here are a few essential ingredients:

1. The right to development of nations on their own terms must be the basis of financing development. National projects should be supported only if they are rooted in local efforts in which all stakeholders are involved, and which promote accumulation of national productive resources (as defined above).

2. Development finance institutions should not seek to impose the principles and practices of the Washington Consensus or any other predetermined macroeconomic policy framework on the developing countries as conditionalities. The Bretton Woods institutions as presently structured are part of the problem, not part of the solution.

3. The World Bank must be transformed so that it is genuinely developmental. It must be made accountable to the Economic and Social Council of the United Nations, where issues of development are discussed in a democratic manner, unhindered by the veto power of money. The Bank should focus on the provision of global public goods financed by donations from governments and philanthropic organizations and international taxation.

4. The role of the IMF should be limited to financing temporary payments imbalances due to external or domestic policy shocks. The lending should be related to the source of the problem, as determined by genuine dialogue between Fund staff and the borrowing country stakeholders, with provision for appeal to an independent panel set up under the

UN system. The IMF should be funded through SDRs to give it necessary independence from major donor countries.

5. Private sector financing must balance between the provision of goods and services for profit with responsibility towards the provision of national and global social goods.

6. Regional integration of countries in the South (and *not* Free Trade Agreements between the North and the South) should be the basis of development cooperation. The broader and deeper involvement of the UN regional commissions and regional banks should be the essential component in the redesigning of the international development architecture.

7. Democratization and closer surveillance, oversight and regulation of international financial institutions (including the Basel Committee on Banking Supervision currently controlled by the Group of 10), and private institutions of credit and capital flows (including hedge funds, private equity funds, and rating agencies) should be an essential feature of the new global financial architecture.

Conclusion:

The dominant conceptualization of the discourse on “enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development” (the subtitle of theme six of the Monterrey Consensus) is seriously flawed. Presently the dominant theory and practice have made development hostage to finance. The cart is before the horse.

A correct realignment of the horse and the cart would be a good start to ensuring that finances serve development and not, as it is presently, the other way round.

The current tendency of “financialisation of development” has to be reversed into “developmentalisation of finance.”
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