

Going Beyond Aid and Concessional Loan

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Overview of Presentation

- **Why Go Beyond Aid and Concessional Loan**
- **New Structural Economics**
- **New Sources for Financing Development Opportunities for Structural Transformation from South-South Development Cooperation**
- **Concluding Remarks**

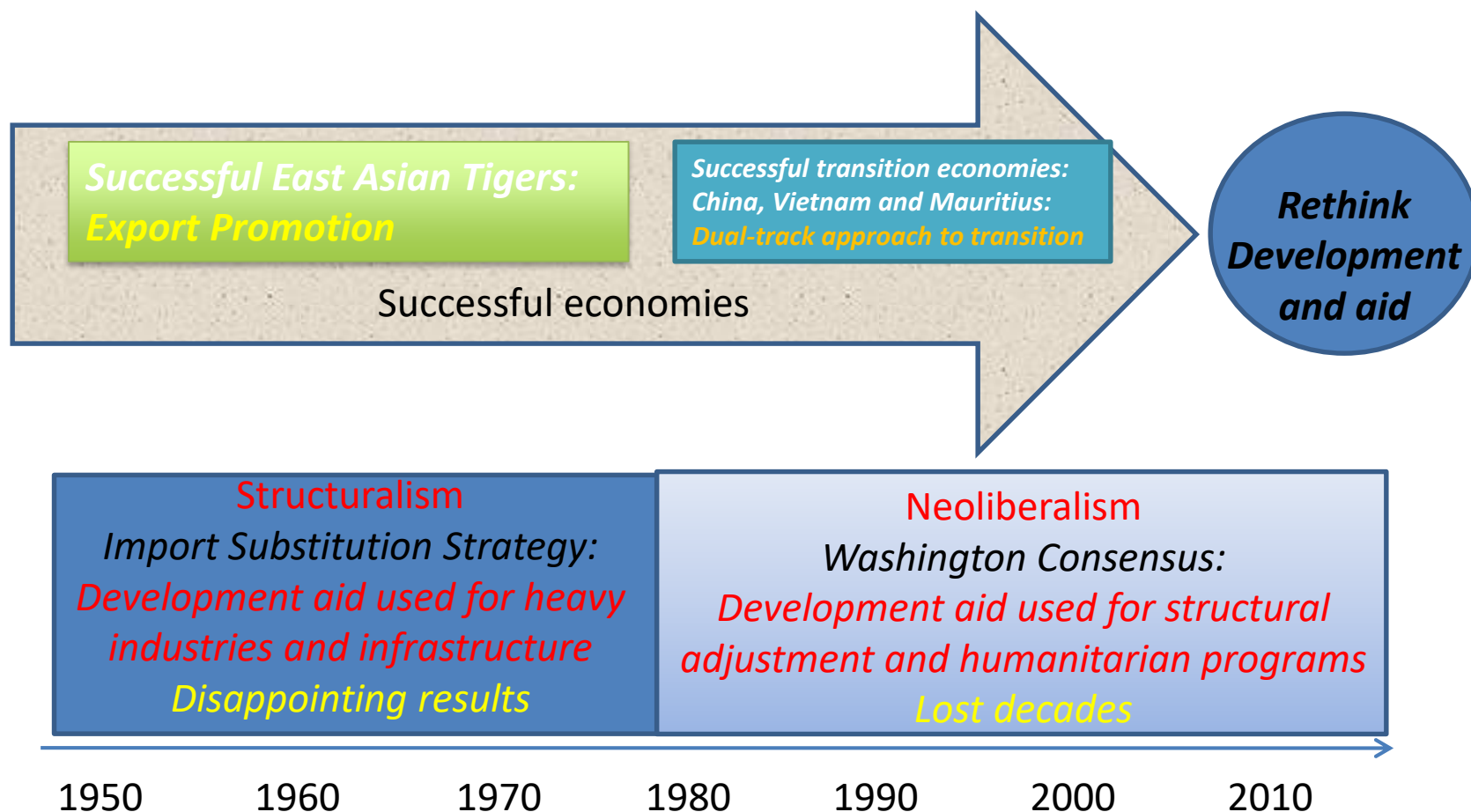
Why Go Beyond Aid and Concessional Loan

- No poverty is the goal No. 1 of SDGs.
- The way to eradicate poverty is to create jobs (SDG8) for the able people and to increase their labor productivity through technological innovation, industrial upgrading/diversification and infrastructure improvement (SDG9).
- Developing countries have the latecomer advantage in technological innovation and industrial upgrading and potentially can grow faster than advanced countries, and become prosperous and achieve convergence.
- However, many developing countries have been trapped in low income and poverty in spite of various efforts by their own and multilateral development institutions.

- Investment is essential for technological innovation, industrial upgrading and diversification and infrastructure improvement
- After WWII, many multilateral and bilateral development institutions were set up to provide development aid and concessional loan to developing countries.
- Theoretically, the development aid and concessional loans increase the capital availability for investment and should contribute to development and poverty reduction in developing countries. However, most developing countries are trapped in poverty
- Is there a way to make development assistance more conducive to development success?

- As Keynes said, “It is ideas, not vested interests, which are dangerous for good and evil.
- The efforts of national and international development communities are guided by development thinking.
- The failure of development efforts, including development assistance from multilateral and bilateral development agencies, are due to inadequate development ideas embedded in the mainstream developing thinking

Development theory is in need of rethinking



THE NEW STRUCTURAL ECONOMICS

New Structural Economics

- An application of neoclassical economic approach to study the determinants of **economic structure and its evolution** in development, which is the nature of modern economic growth
- **Why do I call this approach New Structural Economics?**
 - By convention, it should be called structural economics
 - Add “new” to distinguish it from structuralism

Structure, Structural Change, and Income Traps

- **The main hypothesis.** Industrial structure in an economy is endogenous to its endowment structure, which is given at any specific time and changeable over time
- **Endowments** at any specific time determine the economy's total budgets and relative factor prices at that time, which in turn determine that specific time's:
 - Comparative advantages of the economy, i.e., industries that have the lowest factor costs of production in the world
 - Optimal industrial structure (endogenous) is endogenous to endowment structure
- **Dynamics.** Income growth depends on:
 - Upgrading industrial structure, which in turn depends on
 - Upgrading of endowments, that is, accumulation of capital
 - Improvements in “hard” and “soft” infrastructure to reduce transaction costs to make comparative advantage become competitive advantage
- The low-income trap and the middle-income trap are both the result of a country's inability to have a dynamic structural change, which makes a developing country to grow slower than the high-income countries

Comparative Advantage following strategy and development success

- *Following comparative advantage (determined by the endowment structure) to develop industries is the best way to achieve dynamic growth and convergence:*
 - *The economy with an adequate infrastructure will be most competitive, produce the largest surplus, have the highest possible returns to capital and thus savings, ensure the fastest upgrading of endowment structure, and achieve the rapidest industrial upgrading and income growth*
 - *In this process, a developing country can have the latecomer advantages, grow dynamically, generate jobs, become prosperous and reduce poverty.*

The Market, the State and Development Assistance

- Firms maximize profits...choice of technology and industries based on relative factor prices...

Need for a competitive market system

- Industrial upgrading and diversification needs to:
 - Address externalities
 - Solve coordination problems in hard and soft infrastructure improvement

Need for a facilitating state

- Development assistance will be conducive to development success if it increases a facilitating state's resources and capability to support structural transformation

The Failure of Structuralism

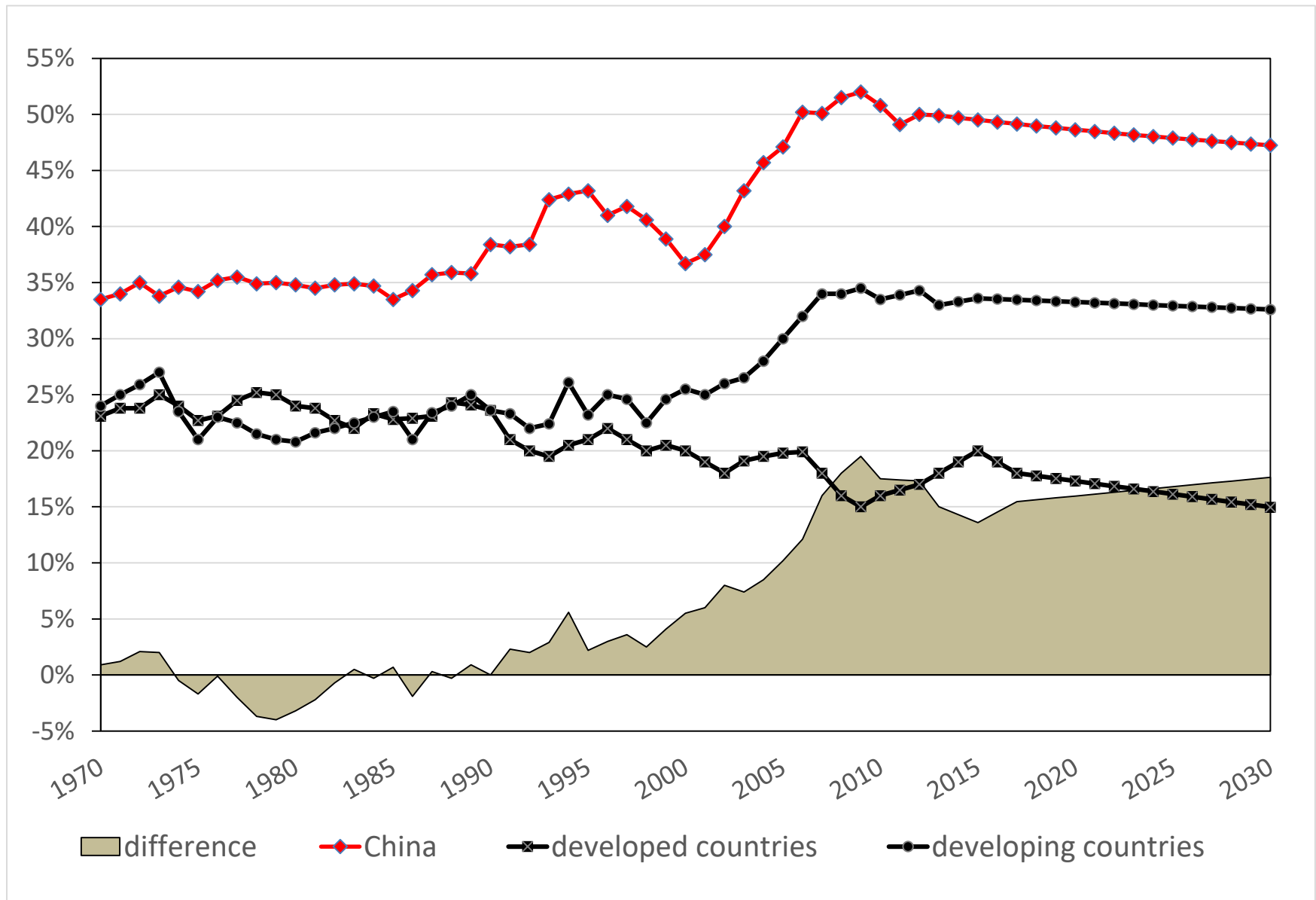
- Structuralism advised governments to develop modern industries, prevailing in high-income countries, that were **too far advanced** compared to their countries' level of development and went **against their comparative advantages**.
- **Development aid and concessional loans were used to support this strategy**
- Structuralism fails to recognize industrial structure is endogenous to endowment structure. The **firms were non-viable in open competitive markets** and required government's subsidies and protection for their initial investment and continuous operations.
- This led to misallocation of resources, **rent-seeking, corruption, and political capture**.
- The dynamic growing East Asian Economies adopted an comparative advantage following, export-oriented development strategy

The Failure of Washington Consensus

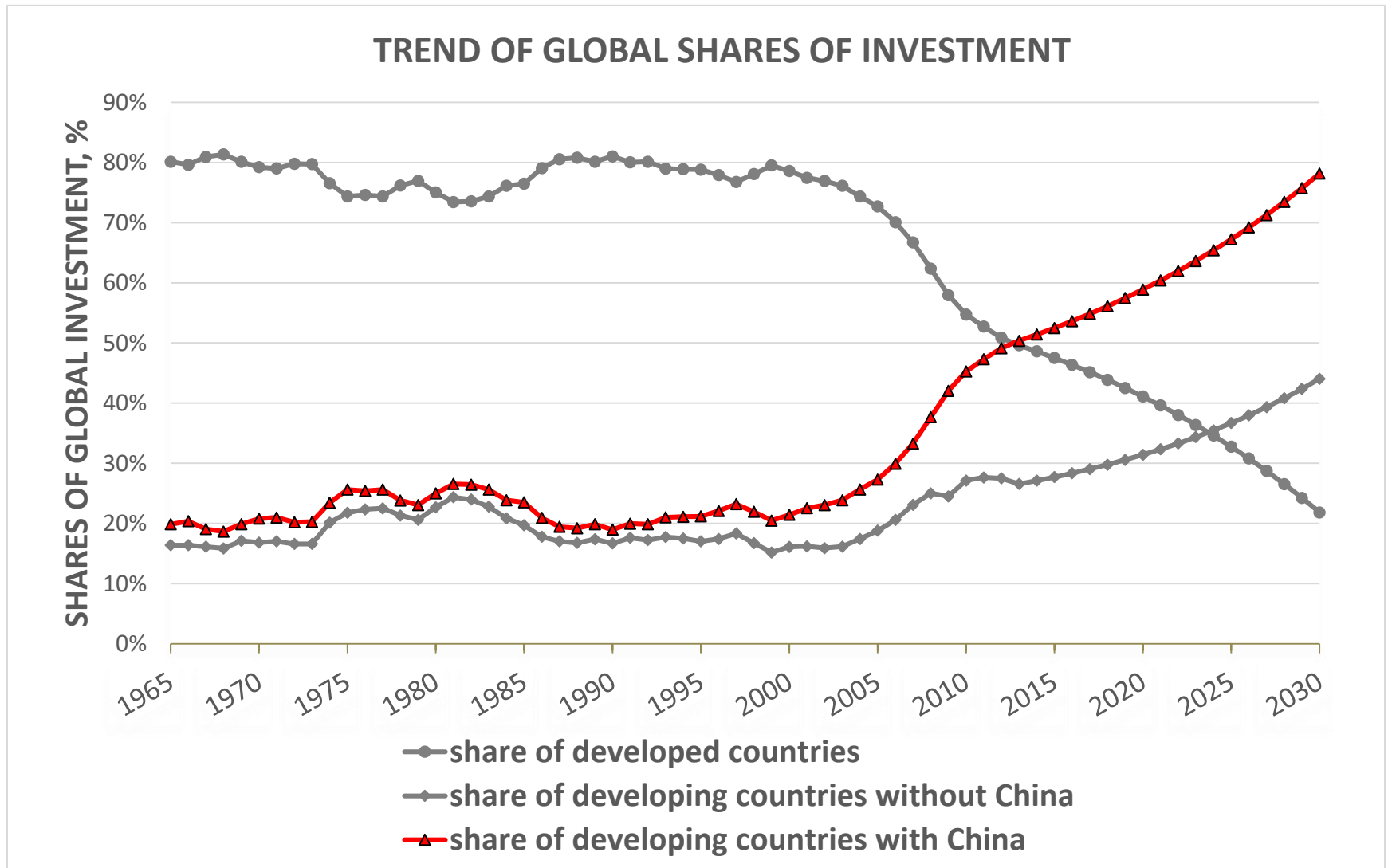
- All transitional economies started with many distortions and nonviable firms in their old priority sectors due to their **comparative advantage-defying development strategy**.
- **Development aid and concessional loans were used to support structural adjustment**
- The Washington Consensus **failed to recognize that the distortions were endogenous** when advocating for the protection of nonviable firms in the priority sectors and advised the government to eliminate all distortions immediately, which caused **the collapse of old priority sectors**.
- The Washington Consensus also **opposed that government play a proactive role in facilitating firm entry** into sectors consistent with the country's comparative advantages.
- **With failure of structural adjustment policy, development aids were used to support good governance, education, health and etc., but not for structural transformation**
- The dynamically growing transitional economies adopted **a dual-track approach**:
 - The government continued to provide transitional support to nonviable firms in the old priority sectors and removed distortions only when firms in those sectors became viable or the sectors become very small.
 - The government facilitated private firms' entry to sectors that were consistent with the country's comparative advantages, which were repressed before the transition.

New Sources for Financing Development in Africa

Projection of savings rates 2015-2030



Projection of Global Investment 2015-2030

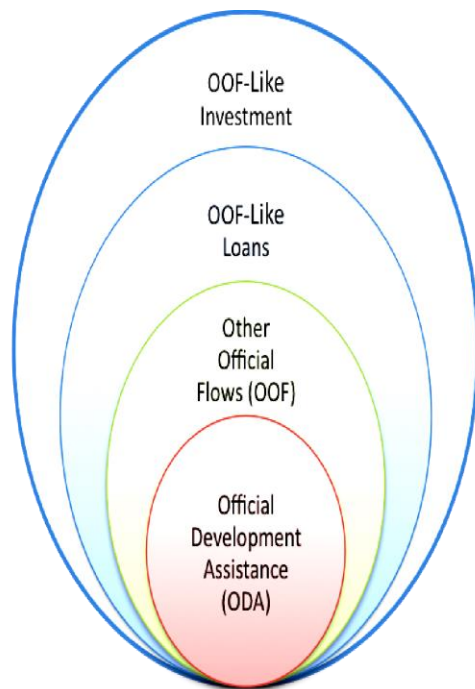


New commitments by China

- China launched the Belt and Road Initiative in 2013 with infrastructure connectivity as its core.
- China initiates the AIIB in 2013 and is a founding country for NDB
- Xi Jinping announced in UN 2015 to set up
 - a sustainable development fund of \$2 billion, and more
 - a \$2 billion fund for South-South Cooperation.
- China also sets up a industrial capacity cooperation fund with a \$2 billion dollars
- In the FOCAC V meeting in South Africa in 2015, Xi committed to support Africa transformation by \$60 billion dollars in three years, consisting, grants, no interest loans, concessional and non-concessional loans. Xi further committed another \$60 billion for Africa this year at FOCAC VI for the coming three years.

There is a need for redefine development assistance

Definitions of Development Assistance



- The role of emerging donors will continue to rise, providing funding, promoting learning by doing, transferring tacit knowledge through south-south development cooperation
- ODA (official development aid) will decline in relative importance in the next decades;
- But other official flows (OOF) and other official flows-like loan (OOF-like loans) will grow.
- There is a need to expand the definitions of development assistance to include ODA, OOF, OOF-like loans (blended, like AIIB, CDB, EXIM bank), and OOF-like investments (Equity investment, SWF, and Silk Road Fund)
 - $DF1 = ODA$
 - $DF2 = DF1 + OOF$
 - $DF3 = DF2 + OOF\text{-like loan}$
 - $DF4 = DF3 + OOF\text{-like investment}$

Comparison of North-South and South-South Development Cooperation

- Conventional North-south development aid and concessional loans are not effective for structural transformation:
 - Based on development experiences and theories in the north
 - Narrow definition of Official Development Aid and concessional loans
 - Untying aid with trade and structural transform
- South-south development cooperation are more effective for structural transformation:
 - Based on the development experiences from the South
 - **Combining Aid, Trade and public and private investment**
 - Utilizing comparative advantages of all countries

Concluding Remarks

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Going Beyond Aid

Development Cooperation
for Structural Transformation

- Development assistance will be helpful for development if they are used for expanding the government's resources for facilitating structural transformation
- Both because of conventional development aid/concessional borrowing's poor development results and likely decline of development assistance from the north countries, there is a need to go beyond conventional development aid and concessional loans to include OOF, OOF-like loans and OOF-like investments from emerging market economies in the definition of development assistance.
- Increase of development assistance, based on the expanded definition, from the south will assist developing countries in the south to better capture the window of opportunity for structural transformation, poverty reduction and achieving SDGs