

THIRD WORLD *Economics*

TRENDS & ANALYSIS

Published by the Third World Network KDN: PP 6946/07/2013(032707) ISSN: 0128-4134 Issue No 666 1 – 15 June 2018

US-EU trade truce could spell trouble for South

Fears of an all-out trade war receded on one front following a deal struck between the US and the EU in late July. This informal pact could however lead the two industrial powers to train their joint sights on the developing countries, including by targeting preferences accorded to the latter in the WTO system.

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THIRD WORLD ECONOMICS is published fortnightly by the Third World Network, a grouping of organisations and individuals involved in Third World and development issues.

Publisher: S.M. Mohamed Idris; **Editor:** Chakravarthi Raghavan; **Editorial Assistants:** Lean Ka-Min, T. Rajamoorthy; **Contributing Editors:** Roberto Bissio, Charles Abugre; **Staff:** Linda Ooi (Administration), Susila Vangar (Design), Evelyn Hong & Lim Jee Yuan (Advisors).

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New twist – good and bad – in trade war

The United States and Europe struck a deal to avoid escalating their trade conflict, but will these two giants now redirect their guns on the developing countries instead, asks *Martin Khor*?

There was a new twist to the global trade war on 25 July. The United States, which had threatened to impose a 25% additional tariff on European cars, made a deal with the European Union.

US President Donald Trump suspended the automobile tariff plan and may exempt the EU from the earlier US tariffs on aluminium and steel. In exchange, the EU countries will buy more soybean and energy products from the US. And the two giants will work to eliminate tariffs and subsidies on all industrial products traded between them.

Trump and European Commission President Jean-Claude Juncker also agreed to work to reform the WTO and to tackle China's market abuse, according to a Reuters report.

"If it holds, the US-EU pact could allow both to focus on China, whose economic rise threatens both," added the report. Trump's economic advisor Larry Kudlow said that "US and EU will be allied in the fight against China, which has broken the world trading system, in effect."

Developing countries in the crosshairs?

Thus, the US-EU deal appears to be both good and bad news. Good because there is a cooling off on one component of the global trade war. Bad because the traditional Western allies may gang up to attack not only China but also the rest of the developing countries.

The US and the EU may now jointly pressurize China on various issues. A bigger aim is to hinder China from its Made in China 2025 plan to upgrade its domestic industry in 10 high-tech areas including robotics, autonomous and electric cars, artificial intelligence, biotech and aviation. The Western giants don't want Chinese firms to emerge as world-class champions that rival their companies.

The US, the EU and Japan last December signed an understanding to

jointly act against China on trade issues, including steel overcapacity, technology transfer, and the role of subsidies, state financing and state-owned enterprises.

Over the years, the EU has turned to some developing countries as potential allies when it has a conflict with the US but eventually it strikes a deal with the US and then the two Western powers unite and take aim at the developing countries.

This famously happened in 2001-03 when the EU fought the US in the WTO over agriculture subsidies. They then reached an understanding to protect their own subsidies while pressurizing developing countries to open up their agricultural markets.

Today, developed countries continue to spend many hundreds of billions of dollars in subsidies, as well as maintain high tariffs, to keep their farms in business. The US and the EU also flood the world market with their artificially cheapened farm goods, while insisting that developing and poor countries open their markets through lower tariffs for both agricultural and industrial products. This hypocritical practice is at the heart of the imbalances and inequities of the world trading system.

Now, as part of their deal, the US and the EU seem to want to continue this practice of double standards. They agreed to work to cut industrial tariffs and subsidies to zero, but to leave alone their agriculture tariffs and subsidies.

Moreover, they agreed to work on reforming the WTO, without spelling out what this means. At the WTO, the US and the EU have recently moved to change the way the system has differentiated between developed and developing countries.

Recognizing the weaknesses of developing countries, the WTO long ago adopted the principle of special and differential treatment (SDT) for developing countries. Under this principle, in talks to cut tariffs, developed countries have to cut by a higher percentage than de-

veloping countries, and the least developed countries (LDCs) need not reduce tariffs at all. In various WTO rules, developing countries and especially LDCs are mandated to take on less obligations.

However, the developed countries are now challenging the SDT principle. "Developing and least-developed countries are facing the worst crisis yet at the WTO due to the sustained assault by the US along with the EU and Japan," according to Ravi Kanth writing in the Geneva-based *South-North Development Monitor (SUNS)* on 4 July.

"Using Trump's aggressive trade demands as a pretext, some major developed countries such as the EU and Japan have been attempting to deny the SDT flexibilities to developing countries," added *SUNS*, quoting a trade envoy from a major developing country.

"The entire system of the WTO is under threat following the Trump administration's trade initiatives based on reciprocal market access as well as the attempt to foist plurilateral outcomes without multilateral consensus, and intensified moves to undermine the SDT flexibilities by industrialized countries, particularly the EU."

Meanwhile, the US actions in unilaterally raising tariffs on aluminium and steel, and on \$250 billion of Chinese products, have violated the WTO's main principles, threatening the credibility and viability of the organization itself.

But Trump is not worried or sorry at

all. At the beginning of July, he said: "The WTO has treated the United States very badly and I hope they change their ways. They have been treating us very badly for many years, many years, and that's why we were at a big disadvantage with the WTO."

According to the *SUNS* article: "In short, the developing and least-developed countries face the prospect of their hard-won SDT flexibilities being taken away once and for all so as to ensure that the US stayed at the WTO."

When the US and the EU were locked in a big conflict over auto tariffs, the main enemy of the EU, China and other countries would have been the US. Now the EU and the US have agreed to "reform the WTO" as part of their bilateral deal. It is likely that such an initiative would attempt to reduce the rights of the developing countries, and even to entirely remove the principle of special and differential treatment or even the very status of "developing countries" in the WTO.

The trade war could thus wreak huge collateral damage. All the more reason for the developing countries' political leaders to pay close attention to what is happening in the trade negotiating and policymaking arena. □

Martin Khor is adviser to the Third World Network. This article was first published in The Star (Malaysia) (30 July 2018).

data from 2000 to 2011 revealed that at least nine of the world's largest producers of soy and beef, two industries considered to be main drivers of deforestation, use offshore subsidiaries to finance their operations in the Amazon forest, which Galaz called "a sleeping giant" in the climate change system. Scientists agree that deforestation is one of the main causes of global warming as the carbon dioxide that is typically absorbed by trees gets released in the atmosphere when they are cut or burnt.

The Stockholm University researchers found that, over the decade, about 70% of foreign capital – or about \$18.4 billion – reached the operating companies in Brazil after being routed through subsidiaries in low or zero tax rate jurisdictions, such as the Cayman Islands. (Central bank data is not available for the years after 2011.)

Such routing is legal and often used to decrease companies' tax burden, the report says. The lack of transparency associated with operations in tax havens, however, makes it difficult for watchdogs and researchers to monitor how offshore financing may affect operations "on the ground."

Although the years examined partly overlap with the highest rate of deforestation in the Amazon, the authors say it's currently "impossible" to establish a direct link between capital flowing from tax havens, land use and environmental damage. "Direct proof of causality remains elusive," according to the report.

In response to the researchers, international grain companies including Louis Dreyfus Company, Cargill, Bunge and Amaggi Group have said their organizational structures and trading policies comply with the law and that they are committed to the highest environmental standards.

Taking advantage

In the past, investigations by the International Consortium of Investigative Journalists (ICIJ) and its partners have shown how natural resource and agribusiness companies often take advantage of the secrecy provided by the offshore industry for various purposes, including tax avoidance.

Last year, ICIJ partners Premières Lignes in France and Poder360 in Brazil reported that the Brazilian Amaggi and

New study raises red flags on tax haven role in environmental destruction

Capital channelled through tax havens may be funding unsustainable exploitation of natural resources in developing countries.

by Scilla Alecci

Tax havens – and the financial secrecy they provide – may bolster industries tied to Amazon deforestation and the unsustainable management of natural resources, a new study has found.

"We need to start seeing the environmental costs of tax havens" and "how financial actors and financial flows are shaping the planet in very profound ways," said Victor Galaz, a researcher at Stockholm University's Resilience Centre and the leading author of the report

that looked at the use of tax havens by agribusiness and fishing companies.

The study, which started after the unveiling of the Panama Papers investigation into offshore tax havens in April 2016 and has been published in the journal *Nature Ecology & Evolution*, examined jurisdictions where agri-business conglomerates operating in the Amazon and fishing vessels involved in illegal activities are registered.

An analysis of Brazilian central bank

the Swiss-French Louis Dreyfus in 2009 set up a joint venture to operate in Bahia and other areas of Brazil. According to the investigation, the beneficial owner of the joint venture's Cayman Islands subsidiary was Brazil's current agriculture minister, Blairo Maggi, who denied any wrongdoing.

The findings were part of the Paradise Papers, a global investigation based on 13.4 million leaked files which detailed how wealthy individuals and corporations use shell companies in tax havens to avoid or evade taxes.

In Namibia, ICIJ found that Pacific Andes, a major fishing company, set up a Mauritian subsidiary to manage its operations in the country and take advantage of a treaty between the two jurisdictions that shielded it from taxes. Pacific Andes told ICIJ the majority of the fees stayed in Namibia as capital.

Another report by ICIJ published in November 2017 found that a Singapore-based pulp and paper producer used a web of shell companies to avoid paying withholding tax on loans and to expand its Indonesian operations, while alleg-

edly contributing to the destruction of the country's fragile rainforest. A company spokeswoman said it "meets all tax obligations in the jurisdictions where it operates."

At the time, experts interviewed by ICIJ questioned forestry and agribusiness companies' practice of funding their business through offshore subsidiaries to exploit natural resources in developing countries.

"While profits are really earned from tangible land-based operations, a large portion of profits are routinely declared in jurisdictions with low corporate tax rates," said Tom Picken, the forests and finance campaign director for Rainforest Action Network, a non-governmental organization.

As a result, Picken said, supplying countries may end up with a lower tax revenue and fewer funds to implement critical national development programmes for health, education and infrastructure.

The Organization for Economic Cooperation and Development (OECD) estimates that about \$200 billion is lost ev-

ery year by developing countries due to tax avoidance.

The Stockholm University report also explores the role of tax havens in enabling and disguising illegal fishing. Through analyzing multiple datasets, researchers found 70% of vessels identified by Interpol as responsible for carrying out illegal or unregulated fishing are currently, or have been, flagged in a financial secrecy jurisdiction, mainly in Panama and Belize.

The study is part of an ongoing research project that explores the relationship between financial markets and sustainability and will eventually include other environment-impacting sectors.

To promote sustainability, you need accountability, which comes with transparency, Galaz said. Only then "you have the power to change things," he said. "Any progress we can do would have environmental benefits." □

Scilla Alecci is an investigative reporter and video journalist for the International Consortium of Investigative Journalists (ICIJ). The above is reproduced from ICIJ's "The Global Muckraker" blog (<https://www.icij.org/blog/>).

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Third World Network

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Crisis alla Turca

Its financial fragilities meant the Turkish economy was a crisis waiting to happen, writes *Yilmaz Akyüz*, and worse may yet be to come.

The meltdown of the Turkish currency over a matter of a few days in August has elicited various reactions and interpretations both at home and abroad, and created widespread concern that it could mark the beginning of a series of crises in emerging economies exposed to a reassessment of risks by international investors and lenders as well as a rapid normalization of monetary policy in the United States.

Some commentators have attributed the crisis to the sanctions imposed by a Trump administration discontented with the foreign policies pursued by Turkey on many fronts. The government of President Recep Tayyip Erdogan has been too happy to put the blame on “the economic warfare launched by the United States”, rather than years of misguided policies that rendered the economy highly susceptible to political and economic shocks. It has even enjoyed support from some Western governments weary of Trump’s errant foreign policy. Others drew parallels with previous crises in emerging economies, notably the East Asian crisis, placing particular emphasis on the role of external debt in dollars, notably excessive short-term borrowing.

Vulnerable

In reality, the Trump sanctions only acted as a trigger as the economy was sitting on a time bomb. The currency was already under pressure before the sanctions came into force because of growing awareness of the fragility of the economy. The lira had lost a quarter of its value against the dollar between January and July 2018.

On the other hand, there are some crucial differences between the underlying vulnerabilities culminating in the Turkish and East Asian crises, particularly with respect to the size of current account deficits, the foreign presence in domestic securities, credit and deposit markets, the extent of dollarization and the scope for capital flight by residents. In all these respects, Turkey has been much more vulnerable to currency turmoil than were the East Asian economies

in the 1990s.

In a book published by OUP last year, I identified Turkey as the most fragile emerging economy highly vulnerable to external financial crisis after examining, as of end 2013, various sources of potential pressure on its currency and drain on its international reserves in the event of a sharp turnaround in market sentiments and a sudden stop of capital inflows. It was clear that in such an event, Turkey could not at the same time finance its current account deficit, remain current on its external debt payments in dollars and allow a rapid exit of non-resident portfolio investors from domestic financial markets even in the absence of capital flight by residents. It was also remarked that capital flight by residents often constituted greater pressure on the currency and international reserves. This was a serious potential threat in Turkey as residents could freely buy and sell dollars, hold forex deposits in local banks and transfer their assets abroad.

The economy has become even more fragile since then. The current account deficit has remained unchecked as the government sought consumption/construction-led, debt-driven economic expansion which has added very little to productive capacity and export potential. Persistent deficits have been financed by massive sale of national assets and external borrowing, leading to a rapid deterioration of the net international investment position, from around -42% of GDP in 2013 to over -54% by 2018.

External debt as a proportion of GDP rose from 41% in 2013 to 63% on the eve of the crisis. A large proportion of this debt, over 25% of GDP, had a remaining maturity of up to one year. The sum total of short-term debt and current account deficits was more than twice as much as international reserves. Furthermore, the presence of non-resident portfolio investors in domestic markets became more visible and capital flight by residents remained an even more serious source of pressure on the currency and reserves for political as well as economic reasons.

Sovereign external debt now ac-

counts for some 20% of the total while the rest is equally divided between banks and non-financial corporations. The latter have been allowed to borrow in dollars both at home and abroad irrespective of their potential to earn foreign currency to service it. Such debt poses greater threat to stability than sovereign debt since, at times of currency turmoil, private debtors attempt to close their open positions by purchasing foreign currency in order to avoid further losses and this in turn accelerates the decline of the currency.

Intense pressure

Turkey has thus practised an extreme form of *laissez faire* in financial affairs and, in effect, become a highly dollarized, dual-currency economy. Not only liabilities and assets are increasingly denominated in the dollar, but an important part of property prices, incomes and rents, as well as government contracts in public-private partnership projects are also fixed in dollars.

In such an economy, a significant loss of confidence can exert intense pressure on the currency irrespective of volume and terms of external debt. With the Trump sanctions, the lira started a freefall primarily because of flight of residents, both asset holders and dollar debtors, from the currency, sudden stop of capital inflows and the exit of non-residents from local markets. Besides, the decline was accentuated by speculators shorting liras in swap operations in anticipation of a significant drop in the currency. The short-term dollar debt to international creditors has not yet come into play. Still, the outcome has been steep falls in the lira and stocks and a hike in yields on local-currency sovereign debt. The cost of insuring Turkish debt (credit default swaps – CDS) has shot up, reaching 500 basis points compared with 240bp for Brazil and 315bp for Greece.

In view of stern opposition by the president, the central bank avoided a hike in lending rates, but closed its low-cost repo funding, forcing banks to borrow at its more expensive overnight rate – something aptly described as a “stealth” tactic to hike borrowing costs. Further, it has limited currency swap transactions to curb speculation against the lira.

Turkey, as most other major emerging economies, is highly averse to re-

course to the International Monetary Fund (IMF) for international liquidity because of the IMF's appalling record in interventions in past crises in emerging economies. As anticipated in an earlier IPS article, Turkey thus sought help from its close allies, securing a pledge of \$15 billion from Qatar.

These measures, together with nine days' respite offered by the Muslim Eid Al-Adha holiday, brought some calm to currency and financial markets. But all is not over yet. The underlying structural fragilities remain unabated and cannot be remedied overnight because they involve severe balance sheet distortions and imbalances.

Debt danger

Even if the lira remains relatively stable from now on, the sharp decline it has so far undergone – by some 40% since the beginning of the year – could impinge heavily on unhedged debtors, resulting in serious debt-servicing difficulties and even defaults. As Bloomberg reports, the CDS curve is inverted – as it was in Greece in the worst days of its debt crisis – not only for sovereign debt but also for the debt of some of the biggest commercial banks; that is, it costs more to insure one-year default than to buy five-year protection. This suggests that markets are expecting imminent debt-servicing difficulties.

As loans and bonds mature in coming months, the country may find it very difficult to persuade creditors to roll over debt or to replace maturing bonds with new ones even at significantly higher rates. An important part of syndicated bank loans is due for renewal in September. The dispute with the US involving the state-owned Halkbank over Iranian sanctions can make the renewal process complicated (I thank Hakan Ozyildiz for this point). Thus, with short-term debt coming into play, the crisis could cease to be a currency crisis but a full-blown debt and banking crisis, leading to a deep and protracted economic contraction.

The crisis could also generate severe contagion to the rest of the world. Defaults by Turkish debtors could squeeze some European creditors, mainly a number of banks in Spain, Italy and France which have relatively high exposure directly or through subsidiaries in Turkey.

This would also have a serious impact on global risk appetite. A sharp reassessment of risks, together with monetary tightening in the US and Trump follies in trade, could wreak havoc in several emerging economies which have gone out of bounds in the years of easy money since 2008.

When so many policy mistakes are committed and so much debt is accumulated and assets are lost, there is no easy way out. But, it is always possible to ease the pain. It is not clear if the Turkish government will be able to move from popu-

list rhetoric to effective economic measures to address the root causes of the crisis. On the other hand, should the crisis spread globally, the international community is unlikely to be able to manage it in an orderly and equitable way, rather than muddling through it as in the past, because it is no more prepared to respond to such crises than it had been in previous episodes. (IPS) □

Yilmaz Akyüz is former Director at the United Nations Conference on Trade and Development (UNCTAD) and former Chief Economist with the South Centre in Geneva.

Global economy vulnerable a decade after

The 2008-09 global financial crisis exposed serious deficiencies in the international financial system, but 10 years on, these remain unresolved even as new sources of fragility confront the world economy.

by Anis Chowdhury and Jomo Kwame Sundaram

Ten years ago, deteriorating confidence in the value of US sub-prime mortgages threatened a liquidity crisis. The US Federal Reserve injected considerable capital into the market, but could not prevent the 2008-09 global financial crisis (GFC).

The 2008 meltdown exposed the extent of finance-led international economic integration, with countries more vulnerable to financial contagion and related policy "spillovers" exacerbating real economic volatility.

It also revealed some vulnerabilities of the post-Second World War US-centred international financial "architecture" – the Bretton Woods system – modified after its breakdown in the early 1970s.

Robert Triffin, the leading international monetary economist of his generation, had long expressed concerns about the use of a national currency as the major reserve currency.

International liquidity provision using the US dollar required the US to run balance-of-payments deficits, ensuring US monetary policy spillovers to the world economy while eroding confidence in the greenback.

The Bretton Woods system was under increasing strain from the late 1960s, as US President Johnson funded the increasingly unpopular Vietnam War by

issuing debt, rather than through higher taxes. The system finally broke down when the Nixon administration unilaterally cancelled the US commitment to dollar (gold) convertibility in August 1971. What emerged was a "non-system" for Triffin.

Since then, the US dollar, issued by fiat, has relied on the greenback's own credibility and legitimacy to continue as de facto world currency.

In 1985, Triffin identified three systemic problems of the international financial "non-system".

First, "its fantastic inflationary proclivities, leading to world reserve increases eight times as large over a brief span of fifteen years" since the breakdown of the Bretton Woods system.

Second, "skewed investment pattern of world reserves, making the poorer and less capitalized countries of the Third World the main reserve lenders, and the richer and more capitalized industrial countries the main reserve borrowers of the system".

Third, "crisis-prone propensities reflected in the amplitude" and frequency of financial crises such as the 1980s' debt

(continued on page 10)

IMF loan conditions: Structural adjustment and micromanagement

The structural adjustment conditions tied to loans from the IMF have often unduly extended into the sovereign policymaking domain of borrower states and proved counterproductive.

by Jürgen Kaiser

The provision of loans almost always comes with conditions. Only among friends, if at all, is money lent with no strings attached. The conditioning of loans is therefore neither unusual nor objectionable.

A special situation arises, however, when sovereign states experience balance-of-payments problems. In such a setting, they need fresh loans from other governments or international financial institutions (IFIs). By definition, these are crisis scenarios. The solvency of the borrower is uncertain, so it needs to be safeguarded. Consequently, governments asking for credit must typically agree to comprehensive structural adjustment measures meant to restore their economic viability. All too often, however, such measures have failed.

Loans to restore solvency are not development finance. They do not relate to a specific project, but to macroeconomic exigencies. Loan conditions therefore do not apply to an individual project either, but to economic policymaking in general. Recipient governments must strive to improve economic performance and consolidate public budgets. According to the division of labour of IFIs and bilateral lenders, the International Monetary Fund (IMF) decides what these efforts should look like.

In the worst cases, countries are excessively indebted. If so, their fiscal capacity to act cannot be restored through new loans and adjustment measures alone. Debt relief becomes a necessity. As a precondition for debt relief, however, lenders typically demand even more structural adjustment.

In principle, a sufficient criterion for conditioning would be a government's ability to service its debt again in the future. After all, once contractual obligations are met, every lending agency should respect the national sovereignty

of the borrowing country. Indeed, the IMF does offer loans of this kind through its "Flexible Credit Line". However, only a very small circle of potentially unproblematic borrowing countries are eligible.

In practice, adjustment programmes are geared to many things apart from future debt-servicing capability. The starting point is often to examine why a borrower has become insolvent. This question obviously makes sense. The problem is that it often becomes a gateway to demanding the restructuring of the entire economy in accordance with radical market orthodoxy. Therefore, the conventional structural adjustment programmes emphasized liberalization, deregulation and privatization.

The leading role of the IMF has proven problematic in many ways. Particularly in the 1980s and 1990s, when many structural adjustment programmes were drafted, the Fund and its macroeconomically trained experts took over the micromanagement of many sectors which they did not properly understand. For instance, IMF economists saw expenditure on primary education merely as costs rather than as an investment in youth that gives opportunities to disadvantaged communities. Moreover, the fact that inequality harms economic growth was systematically overlooked. Criticism of such failings has been expressed even by the IMF's own Independent Evaluation Office (IEO).

Nowadays, the IMF commits to no longer defining such granular adjustment programmes. In practice, however, it does not always seem to have stayed entirely true to its word. The dispute it is engaging in with critics over whether IMF policies worsened the Ebola crisis in Sierra Leone, Liberia and Guinea is awkward, to put it mildly. Yes, the IMF did force those countries to dismantle

public health systems.

Generally speaking, however, it is evident that the IMF has accepted the charge that many programmes were inherently flawed. It has also acknowledged that it frequently demanded too many adjustment measures and that those measures were often overly complex. At the start of this decade, the Fund therefore pledged to reduce the number of policy-related conditions per programme. By and large that has happened. According to the latest IEO report, the number of conditions dropped from an average of 9.3 between 2003 and 2007 to just 6.2 between 2010 and 2017.

Main points of criticism

One of the core problems with conventional structural adjustment programmes is the disproportionate cutting of social spending. When public budgets are slashed, the primary victims are disadvantaged communities who typically are not well organized. Such communities include shopkeepers, people working in the informal sector, unskilled labourers, small farmers and the landless.

Only very few of them receive transfers along the lines of the Western welfare state model. Given that their social protection benefits are tiny, budget cuts must affect masses of them in order to substantially contribute to consolidation. The same people, however, suffer indirectly when state expenditure on infrastructure is reduced. The communities concerned rarely have constitutional means to fight policies that harm them. Therefore, their reactions tend to oscillate between apathy and violent resistance.

An almost classic criticism of structural adjustment is pointing out the dramatic cuts in the education and health sectors. In many cases, governments ended up spending less money on these essential services than on servicing international debts. The global debt relief movement turned this fact into an effective narrative. It helped to bring about the debt relief initiative for Heavily Indebted Poor Countries (HIPC), which was launched in 1996 and enhanced at the G8 summit of leading industrial nations in Cologne in 1999.

As a matter of fact, many countries were stuck in a debt trap at the end of

the 1990s. This situation had been exacerbated by structural adjustment programmes. Changes to economic policy had not spurred economic growth, but all too often hampered growth. At the same time, ongoing debt servicing remained unbearably expensive. It was not until the second debt relief initiative, the Multilateral Debt Relief Initiative (MDRI), that the poorest countries were able to escape this trap. The MDRI started in 2005.

More recently, we have seen a debt trap scenario in Greece. After 10 years of crisis, conditionalities, bailouts and insuf-

ficient debt relief, EU lending countries have demanded that Greece generate budget surpluses until the year 2060 so it can service its debt. Such policy ideas systematically overestimate what structural adjustment can achieve. At the same time, they underestimate how much public spending on infrastructure and social policies contributes to growth. To some extent, these ideas remind one of ancient debt slavery. It is commendable that the IMF no longer supports such policies with regard to Greece.

More or less inequality?

The G8 summit in Cologne in 1999 launched the enhanced HIPC initiative and decided to modify adjustment programmes. While the conventional adjustment goals were not changed, they were supplemented with the demand that the countries concerned had to draft a Poverty Reduction Strategy Paper (PRSP).

This approach led to real success stories in many places. One example is Bolivia, where the people were involved in designing policies. In cases like this, power relations within society changed. However, a recent study (Sembene, 2015) found that the PRSP approach hardly made a difference in sub-Saharan Africa. Neither absolute poverty (assessed by the income of the poorest fifth of the population) nor inequality was reduced there.

The conventional structural adjustment approach of the 1980s assumed that a certain degree of inequality would boost economic performance and thus drive growth. While giving partial evidence of individual incentives, the aforementioned study shows that great inequality actually inhibits growth. In macroeconomic and socio-political terms, excessive inequality is definitely harmful.

In the meantime, the IMF has modified its discourse. While it still insists on cutting too broadly conceived social spending, it now wants the savings to be used for two purposes: Fiscal consolidation is first, but the second is better-targeted social programmes in support of the most vulnerable people.

Better-focused social policies actually make sense. The truth is that social spending all too often primarily benefits middle classes and the elite. One example is fuel subsidies, which especially benefit those who use a lot of energy – such as the owners of large cars. However, official statistics are unreliable in many countries, so the IMF can hardly demonstrate the efficacy of more targeted social services.

The IMF has certainly learnt some lessons from its mistakes. However, there are alternatives to its policies (see box). Both civil society organizations and multilateral institutions like the International Labour Organization (ILO) and the UN Economic Commission for Africa have suggested other approaches. While ap-

Alternatives to IMF-style structural adjustment

The structural adjustment programmes of recent decades were often unsuccessful or even counter-productive. Therefore alternatives have been discussed for many years.

Important criteria for such options include:

- Distribution effects must be explicitly taken into account during the design of adjustment programmes. In case of doubt, these concerns should guide decision-making.

- The link between structural adjustment and debt relief needs to be re-defined. Whatever is achieved in terms of adjustment must be sufficiently rewarded through debt cancellation. And in line with this principle, people must see that their country's efforts pay off in terms of a reduced debt burden.

- The legitimacy deficit of the IMF should be addressed. The Fund is the decisive actor in the definition of adjustment policies but its lack of democratic legitimacy is reflected in its policies. It drafts programmes that over-indebted countries cannot reject.

Several steps would boost the legitimacy of the IMF:

- The Fund could gear decisions more stringently towards reducing inequality. Doing so would improve the lot of the poorest people relative to both local elites and international lenders.

- Developing and newly industrializing countries should be given more of a voice inside the IMF. In its present governance structure, it is being domi-

nated by the G7 major industrialized countries.

- The IMF should step back from its current triple role as lender, monopolist of mandatory evaluations and primary author of reform programmes. The quality of reform programmes would benefit from such a step. They would no longer exclusively be drafted by an institution that is focused on ensuring the servicing of its own loans and that also has a monopoly on interpreting countries' need for debt relief.

Pioneers of proposing alternative adjustment strategies are the UN Economic Commission for Africa, Oxfam and the ILO. The UN Economic Commission presented its African Alternative Framework to Structural Adjustment Programmes for Socio-economic Recovery and Transformation (AAF-SAP) as early as 1990. Oxfam developed the concept of "structural transformation", putting forward suggestions from a civil society perspective. The ILO formulated the notion of "adjustment with a human face". Various proposals for pro-poor growth are also relevant.

– Jürgen Kaiser/D+C

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preciating that deficiencies in a country's governance and its social and economic policies can cause problems and lead to excessive debt, the alternative approaches emphasize that these problems could be solved by other than market-orthodox measures. □

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Why universal basic income costs far less than you think

Providing a basic income for all is not as expensive as conventional cost estimates make it out to be, explains *Elizaveta Fouksman*.

Want to get rid of poverty, lessen inequality and provide financial stability in a world of precarious work? Well, why not simply give everyone enough money to ensure basic sustenance?

This is the deceptively simple solution proposed by advocates of universal basic income (UBI). Just transfer enough money to everyone, every month, to guarantee a basic livelihood. The policy is universal and unconditional (you get it no matter who you are or what you do).

This means no bulky bureaucracy to administer the programme, or onerous reporting requirements on the poor. Nor do you have to wait to file paperwork to benefit: whether you lose your job, decide to strike out on a new career path or take time away from work to care for a family member, the money is already there.

But the UBI movement has a major problem: both critics and even many supporters don't understand how much the programme would really cost. To calculate the cost, most people just multiply the size of the monthly income (say, \$1,000) by the population (it's universal after all) and – voilà! – a number that seems impossibly expensive.

But this is not how much UBI costs. The real cost – the amount of money that actually needs to be taken from someone

and redistributed to someone else – is just a small fraction of these estimates.

The key to understanding the real cost of UBI is understanding the difference between the gross (or upfront) and net (or real) cost. Here's a simple example: imagine a room with 15 people who want to set up a UBI for the room of \$2 per person. The upfront cost of the policy would be \$30. The 10 richest people in the room are asked to contribute \$3 each towards funding it. After they each put in \$3, raising the total \$30 needed, every person in the room gets their \$2 universal basic income. But because the 10 richest people in the room contributed \$3 and then got \$2 back as the UBI, their real, net contribution is in fact \$1 each. So the real cost of the UBI is \$10.

Estimates that just multiply the size of the UBI by the population of a country do the equivalent of claiming that the cost of UBI in the room above is a whopping \$30. But the real cost in this scenario – the money redistributed from the wealthy – is only \$10.

The billionaire's dilemma

It's important to understand who will be gaining money through a UBI and who will be contributing to it. The common mistake is to double-count the net

contributors. Yes, they get a UBI, but in contributing to the UBI pot they first return their UBI, and then throw in some money on top of that. So it's incorrect to count them when calculating the true UBI cost.

This is a fundamental point that often gets missed: those that are taxed to pay for the UBI will get some of that cost back – by getting their UBI. You can also think about it in reverse: while the UBI goes to everyone, the rich in effect give it back in the first chunk of taxes they pay, so you don't need to count their UBI in cost estimates.

This also resolves UBI's "billionaire's dilemma" – why give someone like Bill Gates a basic income? The answer is that Gates would simply return that UBI through his taxes – and help pay for others. But if Gates becomes suddenly destitute, the UBI will still be showing up for him to use every month. And since his tax bill will drop, he'll become a net beneficiary rather than contributor.

Any UBI estimate that just multiplies the size of the UBI by the population is a red flag that the cost has been over-inflated. A true cost estimate will always discuss who the net beneficiaries will be, who the net contributors will be, and the rate at which we gradually switch people over from being beneficiaries to being contributors as they get richer (this is sometimes called the claw-back rate, the withdrawal rate or the marginal tax rate – which is not an overall tax, but simply the rate at which people start to return their UBI to the communal pot as they earn more).

Cost estimates that consider the difference between upfront and real cost are a fraction of inflated gross cost estimates. For instance, economist and philosopher Karl Widerquist has shown that to fund a UBI of \$12,000 per adult and \$6,000 per child every year (while keeping all other spending the same), the US would have to raise an additional \$539 billion a year – less than 3% of its GDP. This is a small fraction of the figures that get thrown around of over \$3 trillion (the gross cost of this policy). Widerquist's simplified scheme has people slowly start contributing back their UBI in taxes to the common pot as they earn, with net beneficiaries being anyone individually earning less than \$24,000 a year.

This point still holds if you're raising money for UBI from other sources than income or wealth taxes. If you use a

corporate or data tax, or a natural resource or carbon tax to finance a UBI, you are still redistributing money that would otherwise ultimately be profits that go to Google shareholders or BP executives. And you're taking less away from them than you would think – because they too get a UBI. So the money they end up losing through the new tax is offset by the UBI they receive. The same holds if you're paying for a UBI by reshuffling your budget.

Some people get confused and question whether UBI is really universal if only a portion of the population actually ends up with extra income, while another portion pays for it. But any policy that is universal yet redistributory works this

way. Public transit, roads and schools are all universal benefits, but some people pay a lot for their funding through their taxes, while others enjoy them for free or at a lower cost.

In light of the huge benefits available from a UBI, it's a waste of time to argue over wildly inflated cost estimates. The numbers are out there – we can pay for a basic income. □

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nated by the G7 leading industrial economies. After all, every financial crisis is followed by appeals for reforms, with complacency setting in with hints of recovery.

Less coping capability

Most developed-country governments are now more heavily indebted than in 2008, when they bailed out large financial institutions but failed to sustainably revive the world economy. Major monetary authorities do not have much policy space left after long pursuing unconventional expansionary policies.

Meanwhile, developing countries have been subject to increasing international integration, e.g., through global value chains, foreign financial institutional investments and increased short-term capital flows induced by the unconventional monetary policies of the US Federal Reserve, European Central Bank and Bank of Japan, while debt-sustainability concerns for some are growing again.

These vulnerabilities have been compounded by growing trade protectionism and dwindling precautionary reserve holdings of many developing economies as global trade has slowed. Even before President Trump's election, developed countries had effectively killed the Doha Development Round, not least by opting for bilateral and plurilateral instead of multilateral free trade deals.

Trump's more explicit rejection of multilateralism in his efforts to eliminate major US bilateral trade deficits is now expected to further set back prospects for world economic recovery. Despite pious declarations to the contrary, most national policymakers typically turn from rhetoric about international cooperation to focus on domestic issues.

It has not been different this last time. A decade after the worst economic downturn since the 1930s' Great Depression, the world economy remains vulnerable. (IPS) □

Anis Chowdhury, Adjunct Professor at Western Sydney University (Australia), held senior United Nations positions in New York and Bangkok. Jomo Kwame Sundaram, a former economics professor, was United Nations Assistant Secretary-General for Economic Development, and received the Wassily Leontief Prize for Advancing the Frontiers of Economic Thought in 2007.

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Reform appeals

crisis causing developing countries' "lost decades".

Other critics have identified further flaws.

First is the "recessionary bias", due to the asymmetric burden of adjustment to payments imbalances. While deficit countries are under great pressure to adjust, especially when financing dries out during crises, surplus countries do not face corresponding pressures to correct their own imbalances.

Second is the cost of the perceived need of emerging and developing countries to "self-insure" against the strong boom-bust cycles of global finance by building up large foreign exchange reserves and fiscal resources, especially after the 1997-98 Asian financial crisis.

Such precautionary measures enabled emerging market economies to undertake strong counter-cyclical measures during the GFC. But they have huge opportunity costs as such reserves are generally held as presumably safe, liquid, low-yielding assets, such as US Treasury bonds.

Hence, Triffin complained that "the richest, most developed, and most heavily capitalized country in the world should not import, but export, capital, in order to increase productive investment in poorer, less developed, and less capitalized countries ... [The] international monetary system is at the root of this absurdity."

There were renewed calls for reform of global economic governance in the wake of the GFC, especially by the 2009 UN Conference on the World Financial and Economic Crisis and Its Impact on Development.

Governance reform of the International Monetary Fund (IMF) and the World Bank should ensure fairer, more equitable representation of developing countries. This should improve the accountability and credibility of the Bretton Woods institutions, enabling them to better address current financial and economic challenges in the world.

The UN also called for a "multilateral legal framework for sovereign debt restructuring". Without a fair, legally binding, multilateral sovereign debt workout mechanism, developing countries remain vulnerable to private creditors, including vulture funds.

There were also renewed hopes for trade multilateralism and early successful completion of the Doha Development Round of the World Trade Organisation (WTO), giving developing countries better access to external markets, seen as vital for balanced global recovery and development. The promise to keep international trade open echoed G20 leaders' unfulfilled commitment to eschew protectionism.

However, only a few of the modest promised reforms have been implemented, with limited changes in international financial governance, still domi-

The pitfalls of private infrastructure financing

The G20 major economies grouping aims to mobilize private financing for infrastructure projects by turning infrastructure into a tradable asset class. *Jesse Griffiths* and *María José Romero* doubt whether this plan will ensure that essential infrastructure gets built in the developing countries which need it most.

There is little doubt that investment in sustainable infrastructure must be significantly ramped up if we are to achieve the Sustainable Development Goals (SDGs). Growing economies need “economic infrastructure”, such as railways, roads and ports, sanitation, communication networks and energy grids, as well as “social infrastructure” including schools and hospitals. Sustainable infrastructure can support the SDGs, promote environmental stability and encourage inclusive growth.

However, badly designed and poorly implemented infrastructure projects can damage the environment, displace populations, lead to human rights abuses and lock countries into a high-carbon future. They can also create excessive fiscal burdens on the public purse, which in turn can lead to cuts in government spending. Many countries have suffered a history of “white elephant” infrastructure projects stemming from corruption, lack of transparency and poor monitoring – all of which undermine democratic accountability.

“Private finance first”

In recent years, the World Bank Group (WBG) and others have argued that levels of infrastructure investment are too low, and that this cannot be fixed by traditional financing methods. Instead, “reinvigorating the supply of infrastructure within the developing world requires supplementing traditional sources of official finance with new resources of equity and debt finance.”

Towards this end, the WBG has been promoting a “private finance first” approach. This “cascade” approach, as it is known, encourages private financiers by “de-risking” infrastructure investment. This means changing the policy and regulatory environment to create more favourable conditions for private investors while providing subsidies, guarantees and various other risk-mitigation instruments through public institutions. While the cascade approach is currently focused on infrastructure, the WBG expects to expand it to other sectors, such as finance, education, health and agribusiness.

Taking its cue from the WBG, the G20 group of major economies has been promoting similar ideas. Infrastructure was put on its agenda under the 2010 Korean presidency of the group, and was a major theme under the Australian G20 presidency in 2014, when the G20 established the Global Infrastructure Hub. “Infrastructure for development” is a priority under Argentina’s current presidency. In March 2018, G20 finance ministers agreed in their communiqué that mobilizing additional private capital was needed to meet global infrastructure needs. “To achieve this,” they said, “we agree to promote the necessary conditions to help develop [economic] infrastructure as an asset class.”

An asset class is a group of tradable securities or investments – for example, equities or bonds. Transforming infrastructure into a tradable asset class would mean repackaging

money invested in an infrastructure project into a number of standardized financial instruments which are easy to buy and sell, and which provide an attractive revenue stream. The argument – set out in the G20’s “Roadmap to Infrastructure as an Asset Class” and endorsed by G20 finance ministers – is that “private savings in the hands of institutional investors [such as pension or insurance funds] are currently at an all-time high [of] \$80 trillion in assets under management”, and that “harnessing” this large pool of cash can help fill the infrastructure investment gap.

Infrastructure assets such as shares in infrastructure companies, government infrastructure bonds and specialist infrastructure investment funds are by no means new. However, the concept of grouping financial infrastructure assets together to form a distinct class is relatively recent. The promotion of a tradable infrastructure asset class can be seen as part of a drive by multilateral institutions such as the WBG to attract private investors to specific projects, as well as to infrastructure development in general.

Both the G20 Roadmap and the WBG cascade approach are attempts to present private capital – particularly from institutional investors – as the solution to the perceived infrastructure financing gap. The Roadmap aims to “address common barriers to the emergence of infrastructure as an asset class, including the heterogeneous nature of infrastructure assets, the lack of a critical mass of bankable projects and insufficient data to track asset performance.” It proposes two solutions to promote greater standardization:

- (i) “Improved project development” includes developing standardized contracts and financial models, improving project preparation and providing better data.
- (ii) “Improved investment environment” promotes financial engineering and regulation change to reduce risks for institutional investors.

The G20 has set up seven workstreams to ease the way forward for an infrastructure asset class:

- (i) Contractual standardization;
- (ii) Financial standardization;
- (iii) Project preparation;
- (iv) Bridging the data gap;
- (v) Financial engineering, risk allocation and mitigation;
- (vi) Regulatory frameworks and capital markets; and
- (vii) Quality infrastructure.

Although none of the workstreams is truly new, the combination of them all, and the G20 and WBG coordinated push, are new features. This agenda – if successful in all workstreams simultaneously – would represent a major global shift in how infrastructure is financed. Unfortunately, as argued below, there are three compelling reasons why the plan is fundamentally flawed.

This article aims to advance the ongoing debate on infrastructure financing by focusing on the G20 Roadmap's specific proposals, in the context of the broader discussion on developing an infrastructure asset class.

Reason 1: The G20 plan ignores the main issue: how to increase and improve the quality of public investment

Historically, infrastructure projects in developing countries have been almost exclusively financed through public investment. A previous World Bank background paper for the G20 found that, in developing countries, "private capital has contributed between 15 and 20 per cent of total investments in infrastructure" – meaning that public investment has been 80–85% of the total. Private investment is even lower in some countries and regions with fast economic growth – for example, one study found that "in China, almost all infrastructure financing is undertaken by the public sector, with private financing as a proportion of GDP close to zero." In Asia as a whole, the Asian Development Bank found that "The public sector currently finances around 92% of the region's infrastructure investment."

There are very good reasons why it is difficult to persuade private investors to invest in infrastructure. The International Monetary Fund (IMF) itself acknowledges that public financing is normally the preferred option, arguing that:

- Infrastructure investments are often large, capital-intensive "natural monopolies";
- They tend to have significant up-front costs, with the returns only apparent over many years or even decades; and
- The positive social outcomes are often more important than the returns generated for a private operator.

Opportunities for purely commercial infrastructure projects are limited and most require significant public investment by default. Rural roads and sewage, for example, would not provide attractive returns for a private investor, especially in developing countries – meaning there is no commercially viable model for delivering them. As the Inter-Agency Task Force (IATF) 2018 report on Financing for Development says: "For example, investments in ecosystems will largely be publicly financed due to the public good nature of the sector [and] the use of private finance is more challenging in areas where equity considerations and large financing gaps reduce profit prospects, such as water." For instance, water and sanitation infrastructure investment in Asia in 2011 was entirely publicly financed, and transport more than 90%. Energy had a higher proportion of private financing but was still mainly funded publicly. The only sector with a majority of private finance investment was telecommunications, and even then only in upper-middle-income Asian countries.

Public-private partnerships (PPPs) – heavily promoted by the World Bank and others – may actually saddle the public sector with significant costs. The Organization for Economic Cooperation and Development (OECD) defines PPPs as "arrangements whereby the private sector provides infrastructure assets and services that traditionally have been provided by government ... [which] ... should involve the transfer of risk." There are two PPP funding models:

- User-funded PPPs, where a private partner charges the public a fee for using the facility, sometimes subsidized by government or local authorities.
- Government-funded PPPs, where a private sector com-

pany builds and runs infrastructure and receives regular payments from the public partner based on the level of service provided.

Both models can – and often do – ultimately weigh heavily on the public purse: government-funded PPPs rely heavily on public expenditure, while even user-funded PPPs may entail costs for the government through subsidies. PPPs can lead to high public costs for infrastructure in three main ways:

- Higher direct costs from higher interest rates (the cost of capital), a high expected rate of return for the private operator, and higher construction costs.
- Higher indirect costs from limited competition and costs of negotiating complex contracts, including high fees from consultancy firms, and renegotiating of contracts – the IMF estimates that more than half of all PPPs are renegotiated.
- Hidden costs, either because of accounting methods that keep PPPs off the government's books, or because of high levels of contingent liabilities.

For these reasons and many others, Eurodad (the European Network on Debt and Development) has repeatedly called on the World Bank and others to stop promoting PPPs until they are radically reformed. PPPs should be included in national accounts, i.e., they should be registered as government debt rather than being off balance sheet; and budgeted transparently, so as to fairly compare them with alternative options. The cost-benefit analysis that supports the decision to go for a PPP, and the contracts, guarantees and contingent liabilities must be fully disclosed. Unfortunately, experience shows that mobilizing private capital for PPPs often results in high public costs, and unless this lesson is learnt, a similar outcome for the new infrastructure asset class seems inevitable.

Encouraging private investment in challenging infrastructure sectors often entails significant public costs in the shape of subsidies or risk guarantees. Major public investment is often necessary in order to attract private investment in infrastructure sectors with limited commercial returns, either to offset the risks of long-term, uncertain projects or to ensure that the benefits reach the whole population, not just those who can afford them. In Latin America, for example, the World Bank has noted that "while PPPs account for about 40 per cent of Latin America's infrastructure investments, they depend heavily on government support: about a third of their financing comes from public sources, and about half of all deals receive some type of government guarantee. In other words, constrained public finance also means constrained private finance for infrastructure."

Public subsidies are inevitable to meet the SDGs' pledge to "leave no one behind". The SDGs include many commitments which require physical infrastructure such as clean water and sanitation (SDG6), affordable and clean energy (SDG7), and health centres and hospitals in urban and rural areas (SDG3). It is clear that universal access in many developing countries will only come about with significant public investment – for example, the World Bank's State of Electricity Access Report notes that "in Africa, unsubsidized connection costs often exceed the country's monthly income per person, and households have to pay these plus fees for inspection and application, security deposits, internal wiring, and equipment costs."

There is no evidence that "traditional" funding sources cannot fill the "infrastructure investment gap". Analysis of the

“investment gap” in global infrastructure financing comes mainly from a series of papers by the McKinsey Global Institute, the latest of which estimates that “the world needs to invest about 3.8 per cent of GDP, or an average of \$3.3 trillion a year, in economic infrastructure just to support expected rates of growth [and] emerging economies account for some 60 per cent of that need. But if the current trajectory ... continues, the world will fall short by roughly 11 per cent, or \$350 billion a year.” In global terms, therefore, these figures do not suggest that a major change is needed, but rather a relatively modest increase from 3.8% to 4.2% of global GDP. However, the report goes on to quote the UN Conference on Trade and Development (UNCTAD), which estimates – also partly on the basis of McKinsey data – an additional \$1.1 trillion per year of infrastructure investment is needed to meet the SDGs. Although not insignificant, that would raise the requirement to only around 5% of global GDP.

Several countries already spend significantly more than McKinsey’s estimate. For example, China – where infrastructure is largely publicly financed – invested an average of around 8.8% of GDP between 2008 and 2013. McKinsey’s own data suggests Chinese spending is significantly more than necessary to fill their domestic infrastructure gap between 2016 and 2030. China’s challenge is the quality, not the quantity, of its infrastructure investment, which undermines the argument that traditional sources of investment are inadequate for the scale of the task. As McKinsey itself notes, public finance and direct corporate investments make up about three-quarters of private finance, and “the vast majority of infrastructure will likely continue to be financed by the public and corporate sectors.” Despite this evidence to the contrary, the G20 Roadmap assumes that the infrastructure gap cannot be filled by traditional forms of investment, and argues that “Given the magnitude of the infrastructure gap, the G20 must adopt a new collaborative approach to crowd in private capital in order to harness the large pool of private savings looking for long-term investment.”

It is clear that the scale of the infrastructure financing gap is being used by financial institutions, and the governments backing them, to justify political choices. Research suggests the World Bank’s policy response has often been to promote an expanded role for private capital in financing development projects, rather than increasing and strengthening the public financing of development. This trend may be driven by wealthy institutional investors seeking stable and profitable returns.

Developing countries would have significantly more money that they could spend on infrastructure if rich nations met their official development assistance (ODA) commitments – in 2017, just five countries met the ODA target of 0.7% of gross national income. Public infrastructure investment would be even further increased if steps were taken to tackle illicit financial flows and tax havens effectively. Developing countries are losing very large amounts of development finance due to multinational corporations taking advantage of the current global tax system. UNCTAD estimated in 2015 that one type of corporate tax avoidance alone is costing developing countries around \$100 billion per year, meaning that the total loss can be assumed to be significantly higher. This is why the establishment of a UN global tax body to combat international tax dodging remains a top priority of developing countries and civil society campaigners.

Faced with these rather powerful arguments, some World Bank researchers concluded in a recent paper on infrastructure funding and financing: “by making public finance more efficient, some reforms symmetrically reduce the need for private finance, showing that strong public sectors with an ability to raise taxes and spend efficiently are clearly an effective solution to infrastructure finance.”

Priority should be given to improving the quality of infrastructure, rather than channelling more money into infrastructure in countries with poor track records. McKinsey estimates that “Up to 38 per cent of global infrastructure investment is not spent effectively”. Furthermore, the G20’s assumption that improved project design will somehow solve infrastructure problems in many countries is bordering on the naïve and fails to take into account the deep-seated political, economic or capacity problems which often arise. Attempting to radically redesign the fundraising model is not likely to address these problems, and indeed may exacerbate them by increasing complexity whilst reducing transparency and accountability.

Finally, it is worth stressing that infrastructure as an asset class does not help address the fundamental problem of the funding source – as opposed to the financing mechanism – of infrastructure. As we shall see, mechanisms that attract private financing can enable projects to get built, but they do not necessarily solve the problem of who funds the operating costs and repayments to lenders and investors, and liabilities should things go wrong or take longer than planned. These are costs which can often end up falling on the public purse. Although these problems occur in both public and private sector investments, touting an infrastructure asset class as a solution to the financing gap ignores them.

If the G20 is truly committed to delivering more and better infrastructure services, it must put delivering and improving public financing of infrastructure centrestage. It must take actions at international level to support higher levels of public investment in developing countries, including stemming public revenue losses by clamping down on tax dodging; dealing with unsustainable debts through a debt resolution mechanism; meeting ODA commitments; and getting behind new sources of public financing such as the UN’s proposal for annual reserve assets for developing countries.

Reason 2: It is likely to prove very costly for the public purse and for citizens

The direct and indirect costs of developing an infrastructure asset class are enormous. These costs will fall on the public sector – and therefore on the citizens who pay for it through taxes and who benefit from it through services. As the G20 Roadmap notes, “The viability of infrastructure as an asset class requires that these risks are addressed, mitigated and *allocated to relevant stakeholders*” (emphasis added). There are several reasons why allocating some risks to the public sector and citizens could result in significant financial and other problems.

“De-risking” for the private sector in order to generate more attractive returns for private investors could mean transferring some of the risks to the public sector. One way to de-risk is through a public sector guarantee that a project will be completed even if the private sector fails. PPPs commonly include public sector guarantees which, if triggered, increase the already high cost of private financing.

According to the G20 Roadmap, de-risking is “an adequate diversification of financial instruments [which] provides a variety of tools which, alone or combined, have the potential to de-risk infrastructure assets.” “De-risking” is highly misleading in this context. It is of course possible to de-risk investments by improving their quality, but the G20’s risk list covers just about every aspect of a project, many of which are difficult to reduce, including “construction, completion, currency, revenue stability, environmental, and demand fluctuation. Other risks arise as a result of a project’s jurisdiction, including risks stemming from the macroeconomic, political and regulatory environment.”

Many of these risks are unavoidable – in fact, the G20 Roadmap itself admits they can only be mitigated and allocated to “relevant stakeholders.” In other words, in order to make an investment attractive to institutional investors, others have to accept these risks. Some investors may take a gamble by taking on the more risky slices of a project, but all too often, it falls to the public sector or public institutions such as multilateral development banks (MDBs) to guarantee them. Of course, guarantees are not always called in, but when projects do run into trouble, it is the public sector which has to pick up the pieces – especially since high public expectation and political considerations make it difficult for public authorities to abandon infrastructure projects once underway.

Finally, it is worth noting that highlighting foreign exchange risks as being of “particular importance” suggests the G20’s aim is to mobilize international or foreign private capital investment in infrastructure.

Reducing risk for private investors by subsidizing – or “blending” – their investment with public funds is another potential problem. The Roadmap says that “mechanisms such as blended finance can also provide a base to effectively crowd-in private funding and enhance risk mitigation.” Blending combines concessional public finance or development aid with non-concessional private finance. However, several problems arise from this effective subsidizing of commercial companies engaged in development-related work.

Firstly, there’s the opportunity cost – without an overall increase in aid or other concessional public finance, blending means less concessional public finance for public services or other essential help for people living in poverty. As a recent Eurodad paper argued, the commercial imperative that must accompany blended aid makes it unlikely to help achieve the SDG pledge of leaving no one behind.

Secondly, the theory that blending encourages the private sector to be more development-friendly is unproven in practice – it is very hard to measure whether the same outcomes would not have happened anyway. A 2016 evaluation of European Union blending between 2007 and 2014 found that in almost half of the cases examined, blending added no clear value.

Thirdly, it is likely that local development needs will come second to the interests of the private sector in donor countries. The OECD has yet to agree on mitigating the risk that blending will lead to an increase in tied aid (the use of aid to subsidize firms in the donor country), a practice that is widely recognized as bad for development effectiveness.

Guaranteeing revenue from infrastructure asset class bonds could create extra public sector debt. In theory, bonds would be repaid using income from a project, but because in-

frastructure projects often take a long time to complete, repayments would need to start well before income begins to flow. In addition, many projects such as rural roads, water or sanitation will yield little or no commercial income, leaving the state to pick up the bill for repayments.

The G20 proposals are likely to shift the risks and costs onto the public sector and infrastructure users. Standard contracts may be good for the private sector but could threaten infrastructure quality by reducing essential public oversight and weakening environmental and social standards. “Greater standardization of contracts and documentation in the bidding and procurement stages of an infrastructure project life cycle” may sound sensible or even innocuous. But standard contracts governing multi-year infrastructure investments will necessitate assigning the many risks and costs of changes that will arise during the lifetime of the project, and cautious institutional investors will look to the public sector to take on these risks.

Again, PPPs should serve as a warning. The World Bank’s attempts to standardize PPP contracts – which are supposed to balance risks, rights and responsibilities carefully between the public and private sectors – have, according to a recent legal analysis, resulted in “proposals which are often skewed to favour private interests to the prejudice of the public entities that are ostensibly the beneficiaries of the projects and services being contracted for.” Furthermore, legal analysis of the 2017 edition of the Guidance on PPP Contractual Provisions concludes that “the Guidance does not take an equitable approach to balancing public and private interests ... the Guidance neglects the long-term and legitimate interest of developing countries. As a result, the World Bank Group’s client countries and their citizens are potentially ill-served by the Guidance.”

The current focus on standardization included in the G20 Roadmap panders to the longstanding demands of private investors. The 2016 McKinsey Global Institute report stresses that “capital markets for infrastructure assets remain relatively complex, non-standardized, and illiquid,” and argues that limited standardization increases transaction costs. By the same token, following the February 2018 G20 Infrastructure Financing Seminar, the CEO of the Global Infrastructure Hub made clear that standardization means “the creation of plug-and-play contracts, documentation and risk allocation for public-private infrastructure transactions.” Significantly, he added: “If we want to scale up private infrastructure investment, we have to move to standardized products,” which in his view “reduces barriers to entry and cuts costs.”

Ultimately, the goal of creating an asset class is to create safe, high-return products for institutional investors, while the tasks of planning, implementing, assessing and mitigating social and environmental costs and dealing with unforeseen problems will fall to others. To ensure that the tradable assets produced are seen as safe by investors will require strong guarantees that risks will be underwritten by the public sector and that revenue streams (returns on assets) will be guaranteed even if the project meets major difficulties.

Furthermore, private infrastructure investment frequently lacks transparency and accountability. Firstly, infrastructure as an asset class requires standardized investment products which bundle multiple infrastructure assets with unknown risks, often involve offshore structures and vehicles, and bias

risk and return in favour of investors. Financial products are engineered to disconnect investment performance and return, thus guaranteeing investors a healthy return regardless of the performance of the investment asset.

Secondly, democratic accountability is undermined because many layers separate the asset manager from the citizens who pay road tolls or water tariffs. According to one analysis, “much of the \$3 trillion plus that is invested by private investors in infrastructure is one step or more removed from direct holdings in actual bricks and mortar.”

Thirdly, most asset managers and investment funds lack the ability or desire to ensure that the products they trade support sustainable development and climate goals. Institutional investors – who have a duty to protect their clients’ interests – often view government rules to protect the public interest as obstructive.

Lack of transparency and public scrutiny of deals regulated by commercial and competition laws can tend to foster corruption. PPP projects are especially vulnerable. In Australia, for example, an Independent Commission Against Corruption found that ministers at the state level unlawfully interfered with a decision on a water PPP with the aim of siphoning off A\$60 million of state money to one of the ministers, his family and associates. In Brazil the construction giant Odebrecht paid bribes to government officials in countries throughout Latin America. *The Economist* revealed in early 2017 that the main method for the company to win contracts was to make low bids and “then corruptly secure big increases in costs through addenda – in some cases when the ink on the contract was barely dry”. According to the report, 22 contract addenda caused the cost of a PPP road linking Brazil and Peru to rise from \$800 million to \$2.3 billion.

Creating an asset class for infrastructure could trigger macroeconomic risks including increased likelihood of financial crises, and a shift of investment from other sectors. Focusing the financing of infrastructure on creating asset classes for international capital markets makes it vulnerable to damaging financial crises and increases the likelihood of such crises. As the 2018 IATF report said: “Developing this asset class has to be done with care, as it is creating liquid instruments on illiquid assets. This could attract investors with short-term investment horizons, with the potential of creating short-term bubbles that could impede rather than help long-term sustainable development. Indeed, many of the financial market crises over the past 25 years involved some form of mis-pricing of liquidity.”

The G20 should learn from the experience of trying to use PPPs to attract private finance to infrastructure. An operational note released by the World Bank in 2014 lists many different examples where the performance of PPP projects reflects macroeconomic crises. In the late 1990s, several Asian countries suffered from the regional financial crisis which transformed PPP contingent liabilities into immediate obligations. According to the World Bank’s note, “all PPP road projects in countries affected by macroeconomic crisis (Greece, Portugal, and Spain recently, and previously Malaysia and Mexico) simultaneously suffered demand challenges (and faced bankruptcy risk) creating a systemic risk”. An economic crisis can reduce demand for a PPP service (the so-called demand challenge), which in turn causes a knock-on effect in the public sector. An additional unintended consequence of creating an attractive,

risk-free infrastructure asset class could be that institutional investors shift large amounts of capital from other sectors, but thus far the G20 has not assessed the trade-off of such a shift.

It is not hard to work out what may really lie behind the G20’s push for an asset class for infrastructure. One of the G20’s priorities is economic and employment growth through trade and investment, especially in the context of the financial crisis and bank bailouts. The G20 also faces pressure from institutional investors who have seen low returns from traditional assets for many years, and who are keen for governments to create higher-yielding alternatives whilst relieving them of the risk burden. According to the World Economic Forum (WEF), institutional investors holding trillions of dollars under management and seeking a diversified portfolio of infrastructure assets with attractive returns have exerted pressure to launch several infrastructure funds. As the WEF argues, institutional investors believe “infrastructure project risk-return profiles present an attractive alternative investment – especially with real fixed income returns being near zero in the wake of the global financial crisis.”

The G20 should pause its radical plans for reinventing infrastructure financing and consider whether private financiers are really interested in delivering infrastructure which “leaves no one behind”. Poorly thought-out policies will not only hinder the 2030 Agenda for Sustainable Development but could actually undermine the SDGs. As the Heinrich Böll Foundation’s Nancy Alexander rightly warns, attracting private investors through financing vehicles “can create vast inequalities as they could privatize gain and socialize loss on a massive scale.”

Reason 3: An infrastructure asset class would be a dangerous leap in the dark

The push to develop an asset class for infrastructure is a huge leap in the dark as private investors have not been increasing their investments in developing countries’ infrastructure. Despite the G20’s energetic championing of private investment in infrastructure for nearly a decade, “private participation in infrastructure has fallen each year since the Addis Agenda [on financing for development] was adopted in 2015”, according to the IATF report. The Center for Global Development (CGD), using the World Bank’s own figures, suggests that infrastructure investment with private participation fell from \$211 billion in 2012 to \$76 billion in 2016.

In fact, institutional investors are currently tiny players in infrastructure financing. Infrastructure investment by pension funds in the seven largest markets is currently close to zero. According to the IATF, “investment in infrastructure still represents less than 3 per cent of pension fund assets, with the majority in advanced economies,” while a 2018 World Bank report reveals “the contribution of institutional investors is minuscule, at only 0.67 per cent of the total global PPI [private participation in infrastructure] investment (comprising 0.4 per cent of the total debt and 1.3 per cent of the total equity).” When it comes to insurance companies, a recent World Bank blog reported that “insurance companies still allocate less than 2.5 percent of assets under management to infrastructure investment.”

A 2018 report from the Overseas Development Institute (ODI) explains that “most traditional institutional investors

have a strong bias towards fixed-income securities (55-60 per cent of investments), frequently government bonds and other highly rated, low-yield, long-term bonds, with most of the remaining assets allocated to publicly traded equities." Security of investment is paramount: "the great majority (87 per cent) is invested in high-income countries, while only 11 per cent is directed toward upper-middle income countries and very little to other markets."

There are very good reasons why institutional investors don't put money into infrastructure. According to the World Bank, the "challenges to institutional investor flows to infrastructure" include:

- (i) Lack of a "sizeable" project pipeline;
- (ii) Limited resources for setting up specialized infrastructure teams;
- (iii) High risk/low returns;
- (iv) Challenges due to the inherent nature of infrastructure projects: projects do not yield returns during the construction phase etc;
- (v) Differing mandates and lower risk appetite of institutional investors;
- (vi) Unpleasant past experiences;
- (vii) Information asymmetry.

Against this, the IATF points out that institutional investors favour liquid assets which are easy to buy and sell, and are subject to fewer government regulations.

The G20's plans are unlikely to work because of the fundamental contradiction between private investors' need to maximize profits and the generally low returns of infrastructure investment. Reliable data on the actual performance of investments is hard to come by, and returns vary widely according to country, sector, timing and the way a deal is structured. Nonetheless, analysis suggests that targets are fairly ambitious. According to the Preqin infrastructure database of private equity, infrastructure funds typically target an average net return of 15.8% (12% for developed markets and 19.3% for emerging markets) – although the returns in Africa are expected to be far higher at 30%. The reality, however, is that developing countries find it difficult to develop a pipeline of projects to provide investors with attractive risk-adjusted returns over the project life cycle without creating a heavy burden on the public purse. Getting an attractive credit rating on a bond guaranteed by an infrastructure project, for example, could itself increase the cost of the project.

The G20's agenda is unsuitable for low-income countries where capital markets tend to be small and banks provide the majority of non-firm private financing. The Roadmap notes that "steps to ensure that domestic capital markets are deep and liquid will also support the development of infrastructure as an asset class." Though the World Bank has promoted the development of capital markets, it recognizes that the poorer the country, the smaller the capital market. Institutional investors such as pension and insurance funds also tend to be far smaller in developing countries, and low-income countries have very low levels of assets as a share of GDP.

The G20's solutions are therefore unsuitable for fragile and low-income nations which face the biggest infrastructure financing gap, because these are precisely the countries where international private capital is least likely to invest. The most profitable projects – especially telecommunications – will always attract private investment, but desperately needed wa-

ter and sanitation infrastructure struggles to attract any private money at all. A 2015 World Bank working paper points out that "only 24 out of the world's poorest 56 countries had a single infrastructure project with private investment in the five years between 2011 and 2015, and one country (Laos) accounted for one third of the total."

The G20's drive to mobilize private investment encourages major regional infrastructure plans and mega-projects that can be socially and environmentally damaging. Given their size and complexity, mega-projects tend to be financed by foreign private investors, to the exclusion of domestic players, and there are concerns that corridors of mega-infrastructure projects exacerbate regional inequalities. Evidence suggests that many infrastructure projects currently being financed favour specific regions and geographic areas by "agglomerating" cheap labour and capital.

Conclusion

If the G20 is serious about increasing and improving investment in infrastructure, then it needs to stop putting private finance first and start focusing on how to improve and deliver publicly financed infrastructure. Creating an asset class is not the way to ensure that essential infrastructure gets built in those developing countries which need it most. The G20 must resist the siren calls of private investors who are concerned more about profit than "leaving no one behind".

This article has presented a compelling case for the G20 to rethink its infrastructure financing proposals, and offers three key critiques of the G20's approach. Firstly, the approach ignores the main issue of how to increase and improve the quality of public investment. Secondly, it is likely to prove very costly for the public purse, and thus will have a negative impact on citizens. Finally, an infrastructure asset class would be a leap in the dark – an unnecessary, extremely difficult and potentially dangerous development which will not deliver for the world's poorest and most vulnerable.

Public financing is less costly and more accountable, but it is also being starved of funds because of a lack of action at international level. Clamping down on losses of public resources through tax dodging, dealing with unsustainable debts through a debt workout mechanism, increasing levels of international concessional resources including through meeting ODA commitments and creating new sources of public financing would all be a better contribution to bridging the global infrastructure gap and thus achieving the SDGs.

Transparency and accountability must be radically improved to avoid the damage caused by badly designed or implemented infrastructure. Climate change must be taken seriously – which means meeting longstanding commitments to properly finance adaptation and mitigation in developing countries and discouraging investment in carbon-based infrastructure projects. Recognizing that the "infrastructure financing gap" is in fact a public financing gap, and that no amount of wishful thinking will allow private financing to replace public financing for critical kinds of infrastructure, would be the logical place to start. □

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