Remarks by Judith Karl, UNCDF Executive Secretary

on the occasion of the side-event:

"Development Finance in LDCs: Tackling Risks and Vulnerabilities"

Saturday 28 May 2016, Adriatic-I, Hotel Titanic Belek, Antalya, 1:15 – 2:45 pm

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UN Capital Development Fund
Two UN Plaza, 26th Floor, New York, NY 10017 | Tel: +1 212 906 6565 | Fax: +1 212 906 6479
www.uncdf.org | www.facebook.com/UNCDF | www.twitter.com/UNCDF

Question: "UNCDF is an investment agency for LDCs. It develops finance models to get financing flowing to where development needs are greatest. How do we ensure that the development finance is sustainable and addresses the various types of vulnerabilities faced by poor countries?"

Thank you for your question and for organizing this event on a very pertinent topic for the LDCs. I also appreciate that FERDI's excellent book – Financing Sustainable Development: Addressing Vulnerabilities – provides a wealth of insight into this topic and was prepared in the run up to the Financing for Development Conference in Ethiopia, where many of the issues highlighted were debated and new agreements captured in the Addis Ababa Action Agenda.

As that Action Agenda makes clear, ensuring that different sources of development work together effectively and can tackle risks and vulnerabilities is so important for meeting the SDGs and LDC graduation targets.

In 2016, projections for global growth of 2.4 per cent, and while growth in the LDCs is projected to be much higher - at under 5 per cent – this is far below the 7 per cent target set by the Istanbul Programme of Action.

LDCs also face unfavourable external conditions. Volatility and shocks – related to conflict, climate change, environmental degradation, and commodity price swings– could unwind development gains and affect graduation ambitions in some LDCs. Many countries in Africa have experienced a decline in agricultural output and increase in food prices due to El Niño. In the aftermath of the strong El Niño in 1997-98, poverty rates increased by 15 per cent in some affected countries. Moreover, there is as yet too little economic diversification in most LDCs, with investment flows often concentrated in few countries and sectors. As argued by Prof. Guillaumont, vulnerability to economic volatility is one of the main elements of the poverty trap in LDCs.

Still, we know that development finance can be used effectively to build productive and resilient households and local economies, so that underserved communities can become more dynamic contributors to growth as well as more resilient actors in face of shocks and crises.

I want to discuss five points in this regard.

First, we need to invest in transforming poor households into stronger economic actors, which is something that is extensively covered in FERDI's book.

Financial inclusion is recognized, both in the SDGs, and the IPoA, as a key enabler for poor households, women and small enterprise to actively engage in their local economies, and for activating excessive liquidity and dormant resource flows – notably savings - through the economy.

Financial inclusion provides poor people with the services and products they need to build ladders out of poverty, to improve their lives, and, importantly, though products like micro-insurance and savings, to manage better risks they face without having to sell down assets.

Financial inclusion can also improve remittance flows and reduce transaction costs to poor families; provide financial planning, services and safety nets for the unbanked poor; and they can strengthen the reliability and stability of national financial systems.

It can also promote pro-poor growth and reduce inequalities. This can work, for example, by making it easier for poor people without credit history to access the funding they need to pay school fees, expand their businesses, or buy a home. Or it can work by ensuring that people living in remote areas can make and receive payments using low cost digital technologies such as mobile phones.

Second, we need to tackle risks associated with how growth is distributed within countries. Disparities in incomes and living standards are the result of the unevenness of economic development across space and distance, including within countries. Location matters more for living standards in poor countries than it does in rich ones.

When growth is heavily concentrated in certain sectors such as urban real estate or commodities, and there are limited linkages to other sectors of the economy and other parts of the territory, including rural and peri-urban areas, there are increased risks to economies and societies.

Connected to this, subnational authorities are increasingly on the frontlines of the major development issues of the day – adapting to climate change, copying with growing urbanization and migration, building quality basic services, and creating decent jobs for young men and women. There are serious economic and social risks if local authorities are not empowered to address these challenges, or lack the finances to do so.

What this points to is the need for public resources, both domestic and ODA, to be channeled towards sub national institutions and capacities to build stronger local economies, empower communities, and accelerate inclusive and sustainable growth at the local level in support of the IPoA and the SDGs. This includes expanding the reach of financial services and investing in local infrastructure and services that promote, inter alia, food security; women's economic empowerment; local climate-resilience and clean energy; and local economic development.

That's why UNCDF supports central and local authorities in designing performance-based fiscal transfer systems that encourage local accountability and build local capacities for building essential infrastructure and services.

Third, we need to support LDCs in mobilizing resources, especially from domestic sources.

ODA tends to be volatile, heavily concentrated and dependent on the priorities of development partners.

FDI flows can also be volatile. Single projects may account for nearly all FDI inflows in a country, with sudden outflows causing serious problems and ripple effects throughout the economy.

Domestic resources, on the other hand, are sustainable; they retain value locally; and they help build economies that are resilient.

Apart from building capacities to collect and administer taxes, ODA can also help mobilize domestic resources in other ways.

As mentioned in Chapter 10 of FERDI's book, expanding financial inclusion is one way to achieve this, mobilizing domestic savings out of the mattresses and putting them into productive circulation.

Structured project finance is another. In this case, ODA can de-risk local economies and draw the investment of domestic resources – from pension funds or bank liquidity - into local economies and services. This leads to increased local revenue, through taxes and fees, as well as second round effects, for local governments, which can be reinvested in local economies.

Remittances are another critical and often untapped source of investment. Remittance flows to developing countries are expected to reach $459 billion in 2016. Diaspora savings of migrants originating from developing countries were estimated at $497 billion in 2013. There is huge potential to tap into these savings, such as through Diaspora Bonds, to build productive capacities in LDCs.

Fourth, we need to get more private sector resources working together with public resources in support of the SDGs. There has been a lot of attention since Addis on blended finance models and the potential of public-private partnerships and how they can lower investment-specific risks and incentivize additional private sector finance.

At the same time, some of these instruments are complex and require enabling environments or market conditions and that can be absent in LDCs. So we need to also focus on working with LDCs to build the institutions and systems which can identify and effectively manage public-private partnerships.

Finally, we need to think of international public finance holistically. While development finance, humanitarian finance, and climate finance might all be located in different line ministries or departments, they need to meld together to support sustainable development in LDCs. I have just attended the World Humanitarian Summit in Istanbul where the need to balance humanitarian needs with longer-term development assistance has been discussed at length. Figures on displacement are shocking - the average duration of displacement is now 17 years which makes it almost a semi-permanent condition. In addition, climate change is increasingly linked to sudden-onset weather-related disasters. So climate finance must be pro-poor; development investments needs to be climate-proofed, and both need to build longer-term resilience at the national and subnational levels.

Tackling risks and vulnerabilities is an essential pre-requisite for LDC graduation. There is huge potential for development finance to do more in this regard.

I look forward to an interesting conversation on how to make that happen.

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