The Evolution of Development Finance

1. Thinking and Practice of Financial Development / Development Finance
   a) The Dimensions
   b) Development Finance as General Capital Transfer
   c) Development Finance as Capital Transfer to Specific Target Groups
   d) Financial Development as Financial Deregulation
   e) Development Finance as Institution Building

2. Main Problems of Development Finance
   a) Common Starting Points
   b) Granting Loans which Are Paid Back
   c) The Right Role for Savings Mobilization
   d) Potentials and Problems of Institution Building

3. Are We Really Heading Towards a Consensus?
   a) Yes
   b) No
Evolution of Development Finance: The Dimensions

Four Different Phases with different views concerning

(1) what is "finance": Funding or financial sector?

(2) why and for what "finance" matters;

(3) how well markets are assumed to function;

(4) on what "finance" can, and should, have an impact;

(5) what development policy implications are warranted;

(6) how financial systems and development finance projects are to be evaluated;
First Phase: 50s - 70s: Channeling capital to D & T countries

(1) what is "finance": funding only

(2) why dev. finance matters: growth accounting

(3) how well markets function: quite well: trickle down

(4) on what "finance" can have an impact: aggregate growth

(5) dev. policy implications: transfer capital!

(6) standards of evaluation capital stock/sav. + investment rates

Assessment: Consistent, but empirically largely wrong
Second Phase: 60s, 70s., 80s: Channeling capital to specific target groups - after "the end of trickle down"

(1) what is "finance": funding only

(2) why dev. finance matters: to compensate for market failure

(3) how well markets function: very imperfectly

(4) on what "finance" can have an impact: sectoral growth and incomes

(5) dev. policy implications: transfer capital & find "channels"!

(6) standards of evaluation outreach and access for targ.gr.

Assessment: Good intentions, bad policy
Third Phase: 70s., 80s: Financial sector liberalization

(1) what is "finance": a financial system

(2) why development finance matters: benefits of "free markets"

(3) how well markets function: possibly very well

(4) on what "finance" can have an impact: availability of financial services

(5) development policy implications: deregulate and create non-subsidizing fin. institutions!

(6) standards of evaluation depth of financial markets

Assessment: Good / naive theory, good / bad policy
Fourth Phase: 80s/90s: Finance, Institutions and Incentives (NDF)

(1) what is "finance": a financial system

(2) why dev. finance matters: pervasive inf. + incentive problems

(3) how well markets function: in principle not well - but ...

(4) on what "finance" can have an impact: the functioning of fin. instit.

5) development policy implications: analyze and rationalize incentive structures / institutions

(6) standards of evaluation existence of multiple viable fin. institutions

Assessment: Good theory / very difficult policy
Main Problems of Development Finance

Common Starting Points

Three elements of the "new view"

1. Commercial approach: Do not subsidize borrowers, cover costs, and be efficient!

2. Financial sector perspective: Aim at improving the entire financial sector!

3. Institution building approach: Create sound and target-group oriented financial institutions

But how to do this in detail?

And is it compatible with the social / political role?
Target groups matter!!
Main Problems of Development Finance 1

Granting Loans Which are Paid Back

Main problem is lending to "poor" people at moderate costs and risks

Appropriate lending technology

with strong incentives to repay

highly standardized loans / high flexibility

"no nonsense" - who likes this?

Micro-business lending is possible with a margin of 20 percent - but only if the institution have two types of economies of scale!

Problem: Conflict between efficiency and social mission?
Savings and deposit mobilization are wonderful:
- essential for the entire economy
- extremely important for the target group.

Two questions:
1. How to mobilize savings efficiently?
2. But should all DFIs at any time fund their lending with mobilized savings?

Two Models of a "Credit Plus Deposit Bank"
1. Savings from the poor to fund lending to the poor
2. Savings from the rich to fund lending to the poor

How else to fund lending, if not with deposits?

What answers do CA, FSA and IBA suggest?
Main Problems of Development Finance 3
Potentials and Problems of Institution Building

What does IB entail? More than writing manuals!!!
IB is the basic design and implementation of an institutional structure and a governance system for a DFI.

Basic question: What type of institution is desirable to have?
Only banks? What kind of banks?

Basic alternatives: Upgrading / building new institutions
"Downscaling"


Problem: Who has the right / the mandate to "serious" IB?
Which donor would support IB with conflicts?
Are We Heading for a Consensus: Yes

There is a lot of common ground between the leading experts in academia and practice on the role of the three elements of a reasonable policy:

a) the Commercial Approach
   (Loan recovery is indispensible; cost coverage is highly advisable and desirable)

b) the Financial Systems Approach:
   (Development Finance Projects have to be seen and handled in the context of the respective financial systems; improvements in the financial system are "also important")

c) the Institutional Building Approach:
   Institution Building is "also very important".
Are We Somewhat Close to a Consensus? No!

Dissent between and among all groups dominates with respect to

a) the Commercial Approach:
   Relative weights of target group orientation and institutional sustainability?
   Only cost coverage or even profit maximization?
   Commercial approach as an excuse for inefficiency?

b) the Financial Sector Approach:
   Who would be willing to accept "incomplete" financial institutions?
   How can a financial system be improved?

c) the Institution Building Approach:
   Whose role should it be to shape institutions?
   Is genuine institution building "politically correct"?
   How about serious "equity for development"?