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OPINION

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Strengthening Demand: A Framework for Financing Sustainable Development

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A crisis exists in development finance – one in which steady erosion in official development assistance (ODA), combined with declining effectiveness and legitimacy of domestic revenue-raising efforts have sharply reduced support for programmes of capacity building, poverty eradication, and environmental conservation. While non-concessional financial flows – commercial credit and direct investment – are growing, these continue to focus on large-scale industry and infrastructure projects, which are inadequate vehicles for advancing sustainable development. Small and medium-scale development finance, which holds the potential to create large numbers of sustainable livelihoods, is typically considered by commercial creditors to be too costly a resource to provide. The result is a growing deficit in support for sustainable development, even as the World Summit on Sustainable Development (WSSD) approaches. These trends reflect poorly on the global commitment to the goals of Agenda 21, and beg the question of how commitment can be renewed.

The United Nations Financing for Development (FfD) process is meant to resolve this central points of contention in global agreements – including in particular the process leading up to and beyond the UNCED – namely, the mobilisation of financial resources for sustainable development. Many Southern negotiators also perceive it as a prerequisite for further agreements on thematic or sectoral aspects of sustainable development, such as those envisaged for WSSD. In other words, the success of WSSD in pulling together the various initiatives launched at Rio and thereafter into a coherent and feasible programme of action will depend critically on success in reaching meaningful understanding of and agreements over the issue of finance.

That this is a highly complex issue hardly needs to be stressed. The complexity is borne out by its very durability as a contentious issue, the intermingling of technical and political dimensions, and the sustained and growing misgivings both about negotiating positions and alternative formulas. The FfD process was obviously intended to break this deadlock and lay the basis of a consensus solution.

Yet, the evolution of the FfD process fails to provide any basis for optimism. Essentially, the FfD documents tend to repeat conventional formulas, which have not resulted in narrowing the gap that separates the different negotiating parties. In practice, the six items on the agreed FFD agenda – domestic resource mobilisation, international resource mobilisation, foreign direct investment, debt reduction, trade and finance, and systemic issues – have been divided between the North and South, the first three viewed as Northern concerns and the latter three as Southern ones. In other words, there is a schism running through the agenda, with one group focusing on *forms* of finance, and the other on the *context* of finance.

Challenging the current FfD impasse

The Ring, an alliance of policy institutes from the North as well as the South, has floated a number of ideas with a view both

KEY CHALLENGES:

- **Secure finance for development can be strengthened by increasing the legitimacy of processes by which resources are transferred and reducing the risk of small-scale investment**
- **A demand-side perspective can help with the creation of capacity, legitimacy, and effectiveness that will attract foreign and domestic resources towards development activities**
- **Instances already exist in which the risk of commercial lending is reduced and the legitimacy of charitable aid is increased – these should be widely replicated in order to foster sustainable development efforts**

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to expanding the range of options under discussion and resolving the impasse in the negotiations. The focus of these proposals is the replacement of the current preoccupation with 'supply' issues – meaning the enhancement of the inflow of financial resources into development activities – towards 'demand' side issues – i.e. enhancing the capacity of individuals, communities, governments, and development institutions to access and effectively utilise financial resources. While the conventional approach is concerned directly with identifying new sources of funds, shoring up existing ones, and encouraging the redirection of others, the alternative seeks to accomplish all this by increasing the legitimacy of the process and reducing the risk of small scale investment.

This argument has risen from the experience at local levels in programmes and projects of sustainable livelihoods, poverty eradication, and natural resource conservation – experience that shows that, except in situations of dire emergency, support for capacity building is far more effective and relevant than the provision of concessional assistance. The poor in particular need access, not charity. In the first place, given the existing institutional structure, it is difficult to ensure that the assistance actually reaches its target. Second, capacity building is more sustainable in the long run, since it enables access to relatively stable conventional resources rather than unpredictable charitable ones. Third, this approach does not create a culture of dependence, which is inherent in approaches based on charity. Finally, the major conceptual and practical breakthroughs in this regard (e.g., micro-credit) came from institutions that sought to enhance access to market credit rather than a switch to unsustainable subsidised credit.

Financing sustainable development

This distinction has become more relevant in the charged atmosphere around discussions of sustainable development. On the one hand, there are growing concerns that the decline in official development assistance flows will seriously undermine the prospects for sustainable development. On the other hand, some point with hope and others with anxiety to the dramatic increase in foreign direct investment. In a number of the wealthiest countries, ODA has sunk to 50-year low levels, coinciding with states' shifting priorities, shrinking autonomy and increased obligations to emerging crises – changes that suggest to many that the era of aid as a force in development is nearing its end. Finally, there is a debate over whether development has to be financed mainly from domestic resources, with foreign resources playing a secondary – and, as some argue, often a deleterious – role; or whether the distinction between domestic and foreign resources has blurred in the age of rapid globalisation.

The demand-side perspective can provide a framework for assessing and even synthesising these diverse arguments. Rather than berating developing countries for not raising domestic resources, it focuses on the creation of capacity, legitimacy, and effectiveness that will attract both domestic and foreign resources toward development activities. Rather than debate endlessly the relative irresponsibility of private and public flows, it seeks to establish systems that can ensure better accountability and transparency of all such flows. Rather than bemoan the exclusion of particular areas of activities (e.g. poor communities, long-term programmes, mid-sized projects) from financial flows, it seeks actively to develop institutions that will broaden the access of hitherto excluded sectors to finance. Rather than criticising rich countries for not sustaining their ODA levels, it seeks to re-establish the legitimacy of responsible ODA amongst taxpayers in those countries. In other words, this perspective provides an alternative framework for reconciling seemingly irreconcilable positions.

The common attribute of most successful examples of mobilisation and utilisation of scarce capital for sustainable development – whether micro-credit, franchising, partnering – is that they increase the capacity of individuals and organisations to access and use finance, and strengthen the ability of institutions to serve as intermediaries. Widespread replication of this outcome – one in which both the risk of commercial lending is reduced and the legitimacy of charitable aid is increased – is needed to stabilise and foster sustainable development efforts in the current shifting landscape.

Under this approach, a renewed international commitment to Agenda 21 would involve a three-pronged agenda:

- Reversal of the trajectory of declining sources of finance.
- Creation of an institutional framework that will enable and encourage private, non-concessional finance to reach small and medium scale enterprises.
- Strengthening of the capacity of small and medium-scale borrowers to access and deploy resources effectively.

Progress toward these will be rendered more robust and sustainable if the problem is treated not merely as supply enhancement, but as that of building effective demand. ●

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