



Mark Edwards/Still Pictures

Forming *a Bond*

DAVID DE FERRANTI outlines a new proposal for mobilising finance to combat climate change and reduce poverty in developing countries

No single solution, no silver bullet, exists for such global problems as widespread poverty and looming climate change. Experience shows that progress requires efforts on many fronts. Now increased attention is being given to innovative approaches to mobilising and using finance – including a new idea, Global Development Bonds.

If it is to combat climate change, the world needs to transition away from its reliance on fossil fuels towards new systems which use energy much more efficiently and where clean forms of power generation predominate. This will need trillions of dollars of capital investment – but that in turn can be a catalyst for economic development and job creation. One approach – advocated, for example, by the Energy Future

Coalition, a US public policy initiative affiliated with the United Nations Foundation – is increasingly to develop and use biomass fuels for transport: these could reduce security risks, improve trade balances, and spur rural development – even as they cut greenhouse gas emissions.

Of course – with close to half the world’s people still living on under \$2 a day and over a billion on less than \$1 – the world also faces formidable challenges on poverty. Developing microenterprises can do much to help the world’s poor – those characterised by C.K. Prahalad as the “bottom of the pyramid” – create jobs, earn income, and set themselves on the path out of poverty.

One step higher on the pyramid, small and medium enterprises (SMEs) are also vital to development, but can face huge problems in getting the capital they need. Loans are hard for them to get – and may not help if they are short-term ones when firms need longer-term, “patient” capital in the shape of equity or longer-maturity loans. Venture capital is barely available in most developing countries.

Huge resources

Tackling poverty, of course, involves more than addressing enterprises’ financial constraints. Further progress is still needed in ensuring and sustaining good macroeconomic management – including fiscal, monetary, trade, and exchange rate policies. Countries still have much to do to ensure that the broader environment for developing enterprises and creating employment is conducive to growth and innovation: this involves addressing issues in education, infrastructure, the rule of law, security, regulatory burdens, and many other fields.

Victory on these policy fronts will not happen overnight – though there are signs of progress in many countries. So, while the hard work of development and policy reform is undertaken, it is also essential to explore ways of attracting more capital – and especially more of the private sector’s huge resources – to potentially worthwhile investments in developing countries.

Importantly, the techniques being explored – including asset securitisation and credit enhancement – are not abstract notions, but concrete instruments already proven on a large scale in the United States and elsewhere. The objective is to try to extend them to more countries and more types of investments so as to help meet development and environmental goals. One such approach, proposed by the Energy Future Coalition, goes under the label of Global Development Bonds (GDBs).

Local entrepreneurs in India see an opportunity to improve a water supply system, thus helping both farmers and urban water users. Other groups elsewhere see similar possibilities in roads, electricity, housing, and so on. But these projects cannot get funding because local banks lack available capital or cannot take on the risks.

Social pressures

Suppose, however, that a private global financial institution in, say, New York and London was willing and able to provide much of the needed funding to local institutions. These could, in turn, lend to the project sponsors, creating an initiative that sparks sustainable development and economic growth. ►

The global institution can intervene because it has raised funds by issuing GDBs. The bonds – supporting a highly diversified portfolio of private-sector project debt – are partially guaranteed by entities trusted by investors, and by the ratings agencies to which they look. Such backstopping reduces the risks and makes the bonds more attractive. The GDBs also package the risks involved in ways that allow more conservative institutional investors, like pension funds, to take the least risky share of the investment – while others take the riskier share and thus get higher compensation.

The backstopping enhancements for GDBs would need to be significant enough to make a difference. The types of risk to be protected against might include currency fluctuations, possible national political changes, policy reversals, regulatory shifts, and/or social pressures. (The business risks would be managed in conventional ways.)

Creative financial engineering in the private sector can handle some of these credit enhancements, but some public backing may also be needed. In the US, for example, this might most readily be achieved by enabling the Overseas Private Investment Corporation (OPIC) to strengthen its support. Other, larger steps could include a joint private/public entity to help re-guarantee GDBs, and/or expanded support through special purpose vehicles or government sponsored entities.

Sustainable development

The developers of the idea observe that even a modest start could significantly increase financial flows to developing countries. More than \$19 trillion are invested in US securities markets each year – 270 times as much as the roughly \$70 billion provided in official aid to developing countries

annually. If just a few tenths of a per cent of this were to shift to investments in developing countries, it could match or exceed aid. Furthermore, risk mitigation that enabled large institutional investors to join in would have a potentially huge impact. US pension funds alone totalled \$7.8 trillion in 2004, US life insurance company assets are \$4.2 trillion – and there is a considerable appetite from investment managers for prudent opportunities to support sustainable development.

Much more investigation is still needed to determine the conditions under which GDBs could prove feasible and how exactly they should be designed. Those thinking seriously about them include people with considerable financial market experience and others versed in development and political issues. Term sheets and organisational structures laying out how the concept would work have been prepared, and policy implications are being explored.

These explorations may seem ambitious. But, as a private-sector-led initiative GDBs are politically attractive, and will require only a fraction – if any – of the upfront budget allocations of conventional aid. Earlier major financial innovations, including the development of US municipal bond markets, once appeared visionary. When the emergence of new financial products and markets is blocked by such barriers as information gaps, a push is sometimes needed to break them down and “prime the pump.” GDBs could do this for greater flows of private funds to developing countries, and thus help the world meet crucial goals for tackling poverty and addressing environmental challenges ■

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UNEP Sasakawa Prize



The UNEP Sasakawa Prize has been redesigned after two decades of recognising and rewarding important environmental initiatives in both developing and industrialised countries. The new phase in its life follows an assessment by UNEP and The Nippon Foundation, the Prize sponsors.

The focus of the Prize will shift from being a reward for past achievements towards being an ‘incentive’ for environmental ideas and initiatives that are innovative, replicable, and – most important – sustainable in the long-term. Nominations for the \$200,000 Prize will be solicited each year on the basis of the theme chosen for the annual United Nations World Environment Day celebrations, which in 2006 is ‘deserts and desertification’.

The Selection Committee – consisting of two environmental experts and a previous Sasakawa Prize laureate, re-appointed each year, plus a representative each from UNEP and The Nippon Foundation – will select a shortlist of five candidates who will be announced on World Environment Day, 5 June, for consideration by the UNEP Sasakawa Prize Jury.

The Jury, consisting of two standing members – the Executive Director of UNEP and Chairman of The Nippon Foundation – and three internationally known personalities respected for their environmental credentials, will select a single winner, who will be announced to the world at the UNEP Sasakawa Prize ceremony, which will be held each year at the Planetarium, at the Museum of Natural History in New York ■