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FINANCING A GLOBAL GREEN NEW DEAL



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A. Introduction

The global financial crisis left deep and lasting scars on the societies it touched. Those scars have only been deepened by a decade of austerity, sluggish productivity growth, stagnant real wages, rising levels of household and corporate debt, and increasing inequality. Disparities of wealth and income have grown, and local communities are fragmenting under the dynamic and destructive forces of hyperglobalization. Thousands of lives are being lost to “deaths of despair” each year (*The Economist*, 2019), and trust in political institutions has evaporated. Growth has slowed in most developing countries, albeit with considerable variation across regions. The struggle to create good jobs has intensified, with rapid urbanization, premature deindustrialization and rural stagnation widening the gap between the “haves” and the “have nots”.

All over the world, anxiety over the prospect of economic breakdown is compounded by the impending threat of environmental collapse. The IPCC (2018) has raised the stakes by giving the world just 10 years to avert climate meltdown; but this is just part of a growing recognition of a wider and deeper ecological crisis. Thousands of species are going extinct every year, soils are being degraded, oceans acidified and entire regions desertified.

The international community has agreed upon a series of goals in an attempt to ensure an inclusive and sustainable future for people and the planet. But with little more than a decade left to meet the 2030 Agenda for Sustainable Goals, these efforts have fallen drastically short of their proponents’ ambitions. Today, there is widespread agreement that there is just one option left: a coordinated investment programme

on an unprecedented scale across the entire global commons. The numbers are daunting. Cost estimates have gone from “billions to trillions” according to the World Bank (2015), to an additional \$3 trillion a year for developing countries alone, according to UNCTAD estimates.

Mobilizing investment on this scale will be challenging for many national policymakers. This is certainly true in most developing countries where there have been long-standing resource constraints on development ambitions; but in recent years, sluggish investment, particularly in the public sector, has also been a concern for policymakers in advanced economies, with many acknowledging serious deficits in their infrastructure provision (McKinsey Global Institute, 2017). Moreover, the macroeconomic and financial pressures that are likely to accompany any big investment push require policy coordination that goes well beyond countries simply putting their own house in order to include revitalized international support and cooperation.

A decade ago at the G20 gathering in London, the world’s major economies came together to stem the global financial panic triggered by the collapse of the sub-prime mortgage market in the United States and to establish a more stable growth path going forward. Their talk of a fresh start – “a new international order” for President Sarkozy, “a new Bretton Woods” for Prime Minister Brown – was an acknowledgement that the existing multilateral system had failed to provide both the resources and the coordination needed to underpin stable markets and a healthy investment climate.

A decade on, that effort has stalled, leaving those tasked with meeting the Sustainable Development

Goals (SDGs) wondering whether the multilateral system is fit for purpose. These concerns are compounded by the dizzying rise in debt levels to a scale similar to those seen before the financial crisis (see chapter IV). If the routine warnings from financial analysts and at international gatherings are to be believed, the global addiction to debt is no longer sustainable.

Rising indebtedness presents a challenge to those attempting to deliver on the 2030 Agenda. A consensus is emerging that with public finances under stress, the required resources must be provided by the private sector. Whether by appealing to their “better angels” through narratives of social responsibility or to their economic self-interest through the use of impact investment, champions of the SDGs are now focused on finding ways to entice high-net-worth individuals and corporations to provide the financial resources necessary to meet these goals.

At the same time, the scale of the economic, social and environmental challenges requires us to go beyond simply redeploying existing resources to mobilize new ones as well. This means taking up the call to reform the multilateral system and to find new ways to finance public goods at both national and global levels. The preferred solution is, once again, to appeal to the private sector to provide these resources – often by creating innovative financial products that can reduce the risks associated with big investment projects. The bias towards private financing has continued to go unchallenged, even as such schemes

have consistently failed to deliver desired outcomes for the productive economy, whether in the private or the public sector.

This *TDR* will examine some of the proposals behind the private financing agenda. It will suggest that the bias towards private financing is based on limited empirical support and pays insufficient attention to the dangers of a world dominated by private credit creation and unregulated capital flows. Such an approach therefore runs the very serious danger of, as Angel Gurría, head of the OECD has put it, wanting “to change things on the surface so that in practice nothing changes at all” (cited in Giridharadas, 2018: 9). Doing so will not only fail to generate the resources required for the investment push needed to deliver the 2030 Agenda but, in all likelihood, will further exacerbate the inequalities and imbalances that the Agenda is designed to eradicate.

Instead, the *Report* suggests that meeting the financing demands of the 2030 Agenda requires rebuilding multilateralism around the idea of a Global Green New Deal, and by implication forging a collective financial future very different from that of the recent past. The first step towards building such a future is to seriously consider a range of public financing options, as part of a wider process of repairing the social contract on which inclusive and sustainable outcomes should be based, and out of which can emerge a more socially productive approach to private financing.

B. Revving up the private financing engine

The question of how to make the global financial system work for all has been taken up by the G20 Eminent Persons Report on Global Financial Governance (EPR-GFG), released in October 2018. The report makes the bold claim that, in light of the overlapping and pressing challenges identified in the 2030 Agenda, serious reform of the global financial architecture is overdue. It recognizes, moreover, that the anachronistic structure of the international system – premised on the dominance of the United States and Western-led multilateralism – could compromise efforts to respond to these challenges.

As the report emphasizes, promoting “mutually reinforcing policies between countries and minimize

negative spill overs” in this context presents many challenges. Policymakers must be careful to ensure that national and international policies “aimed at growth and financial stability” reinforce one another, rather than deepening divides, conflict and economic stagnation. This requires “a framework [...] to mitigate such spill overs and their effects as much as possible” not least to avoid reducing national “policy space” (EPG-GFG, 2018: 12).

In light of these challenges, the argument of the report is that we should reject calls to return to the “old multilateralism”, and instead create a “cooperative international order” in line with today’s multipolar world. Such a new multilateralism should be tasked with establishing a resilient and healthy investment

climate to unlock the private capital needed to finance the big challenges of the twenty-first century (EPG-GFG, 2018: 4).

To do so, the report proposes a three-pronged strategy which, it is argued, offers a new model for development finance. First, strengthen national capacities by deepening domestic capital markets, improving tax administration, promoting “development standards” around debt sustainability, adopting coherent pricing policies and, more generally, creating a low-risk national investment climate through transparent economic governance and robust “country platforms”. Second, “de-risk” private investment and maximize the contribution of development partners by joining up regional and global “platforms” to boost investment, primarily by creating new large-scale asset classes, such as “infrastructure assets” that can be “securitized” by bundling high- and low-risk loans into new and “safer” financial products. Third, strengthen global financial resilience by improving global risk surveillance, improving management of policies with large spillovers and building a stronger global financial safety net, including a global liquidity facility. The report outlines 22 proposals to advance this strategy.¹

Paradoxically, the proposals are simultaneously quite radical and oddly familiar. The familiarity stems, in part, from the fact that much of the model (especially the emphasis on private financial flows) is an extension of the path that the international financial institutions (IFIs) have been following for some time and which the G20 has been actively promoting since 2014.² The radical element of the analysis is the emphasis placed in the report on “de-risking” private investment, a term that applies not only to securitized infrastructure assets but to creating a safe, low-risk investment climate for private investors more generally.

The focus on de-risking will, it is suggested, give IFIs greater scope to adopt a variety of mitigation instruments that make it more attractive for private finance to invest in public goods and the global commons – for example, public guarantees, insurance programmes and co-investments. But while this suggests a new approach for the IFIs, it draws on the same arguments about the role of financial markets in boosting competition and innovation that came to prominence in the 1990s, which supported a new generation of instruments of risk-management. These instruments supposedly allowed investors to manage complex risks in ways that enhanced trade and portfolio flows and promoted real capital formation, boosting living standards worldwide (Shiller, 2012).³

The G20 report argues that the sense of urgency that now exists around the delivery of the SDGs could provide the impetus needed to scale up these innovations as part of a wider programme to create open, liquid capital markets that are attractive to global investors in the developing world. This wider transformation includes (but is not limited to) making infrastructure an asset class; creating liquid assets (i.e. revenue flows) out of currently illiquid assets; promoting “shadow banking” to create investment opportunities in economic and social infrastructure; pursuing the privatization of public services (by normalizing the idea that public goods such as education, water and health care can be better provided by private investors); replacing disaster relief with private financing instruments; and extending the “microcredit” option to the poorest households.⁴

Pursuing this approach to refashion the multilateral financial system begs an obvious question: why, having crashed spectacularly in 2007–2008, should this model offer the preferred way to deliver on the ambition of the 2030 Agenda? Addressing this question requires a detour through recent history.

C. Financialization matters

1. From servant to master

When more than 700 international policymakers gathered at Bretton Woods 75 years ago, they had one clear task: making finance into the servant of capitalism, rather than its master. The delegates aimed to construct a more regulated capitalism geared

to delivering full employment, boosting incomes and supporting democratic principles. Most of the participants had witnessed first-hand the economic destruction of the previous decades – caused by mercurial flows of hot money and exaggerated by procyclical monetary policies and fiscal austerity. There was a broad consensus that curbing such flows

of hot money through financial oversight and regulation at both the national and international levels was a prerequisite for economic stability, a healthy investment climate, open markets and effective national policy making.⁵

While the aim of the conference was clear, the negotiations were far from simple, and tensions between the rising United States and the declining United Kingdom were high.⁶ Still, the multilateral system that emerged from the negotiations permitted nations to regulate international markets and to pursue strategies for more equitable prosperity and development. Such a system had emerged because the leaders who negotiated it – those elected in the wake of the Second World War – believed in managed capitalism and full employment. Having experienced both the Great Depression and the defeat of fascism, they sought to build a value-driven and rules-based global economy with appropriate checks and balances – an economy that would, in the words of the first post-war Chancellor of the United Kingdom, favour “the active producer as against the passive rentier”.

The system was far from perfect: the technological divide between North and South persisted and unequal trade relations inhibited diversification in many developing countries; wasteful military spending under a tense East–West divide fuelled proxy wars and crippled economic prospects in many poorer regions; racial and gender discrimination endured; and carbon-heavy growth was pursued heedless of the environmental cost. However, its core principles provided a rough template for a more balanced form of prosperity in a globally interdependent world (UNCTAD, 2014; Gallagher and Kozul-Wright, 2019).

That system broke down in the early 1970s, as the economy of the United States struggled to manage its twin deficits and as global banks and corporations found ways to circumvent the checks and balances that had underpinned the social contract at home and the monetary compact abroad. The system of fixed exchange rates was first to buckle. With a slowing global economy, recurrent economic shocks and growing constraints on domestic policymaking, political allegiances and ideologies shifted rapidly. During this time of transition, the ideology of neo-liberalism rose to prominence. The neo-liberals argued that the state’s role was to support the operation of free enterprise and to leave free markets to adjust to any shocks until equilibrium was reached. Monetary

policy was tightened, fiscal austerity adopted and labour markets deregulated (Glyn, 2006).

Over the subsequent decades, politicians, policy-makers and the public were cajoled and persuaded into believing that what was good for footloose finance and international corporations was good for everyone else.⁷ Inevitably, given its economic weight and the dominant position of the dollar in international markets, the United States was the bellwether. Depression-era regulations separating commercial and investment banking were eliminated, as were regulations on new financial products such as credit-default swaps; investment banks were allowed to dramatically increase their leverage; regulatory oversight of financial markets was weakened; controlling inflation became the singular focus of government policy and insistence on the free flow of international capital became the dominant ideological mantra. Similar policies were implemented across the developed world, albeit to varying degrees and on different timescales (Kay, 2015).⁸

Supportive changes were under way at the international level. The Basel Accords allowed banks to measure their own risk exposures, and regulators barely attempted to update regulation in line with the tremendous pace of financial innovation. Above all, the role of the dollar as the financial lodestone in a world of floating exchange rates was preserved by ensuring that the financial markets and institutions of the United States became the magnets for attracting and recycling footloose capital. Paul Volcker, Chair of the Federal Reserve between 1979 and 1987, was candid about orchestrating a “controlled disintegration in the world economy” that would preserve the exorbitant privilege of the dollar’s reserve currency status and pave the way for a much greater role for financial, and in particular Wall Street, institutions, in shaping economic prospects at home and abroad (Mazower, 2012: 316–317).⁹ Doing so involved an unprecedented hike in interest rates in the United States, and by the time those had returned to more normal levels, the Bretton Woods system was well and truly buried.¹⁰

2. The shadowy world of financial innovation

Proponents of this new world order claimed that deregulating finance was the best way to unlock the benefits of globalization by improving “the

worldwide allocation of scarce capital and, in the process, [engendering] a huge increase in risk dispersion and hedging opportunities” (Greenspan, 1997). By the end of the 1980s, through a combination of pressure and persuasion, emerging economies had started to open their capital accounts and tentatively welcome foreign investment, which began to flow from North to South in search of higher yields.¹¹ The collapse of the Soviet Union converted yet more states to the gospel of financial deregulation. The era of financialization was in full swing.

As we have argued in previous *Trade and Development Reports*, the rise of self-regulation in financial markets has led to increased inequality, an unprecedented growth in indebtedness (both public and private) and growing insecurity and instability. Financialization has led to a dramatic shortening of economic horizons, the concentration of market power and the re-emergence of rent-seeking behaviour – the bugbear of the architects of Bretton Woods – often in a highly extractive and predatory guise (Nesvetailova and Palan, forthcoming).

Banks have been central players in the financialization of the world economy, growing dramatically in both size and complexity in the process. As a result of deregulation, banks merged their retail and investment banking arms to create financial conglomerates that could operate with an “originate-and-distribute” model that would allow them to make and securitize loans, while providing a host of other financial services (Ahmed, 2018). The resulting shift among banks towards packaging, repackaging and trading existing assets has increased volatility and aggravated contagion effects.

In fact, financial deregulation has created an entirely new financial sub-system, aptly referred to as shadow banking, which is estimated to account for around a third of the global financial system (Nesvetailova, 2018: xiii).¹² Shadow banking originally emerged with the creation of the Eurodollar market in the 1960s (Guttmann, 2018), and today it is dominated by over-the-counter markets, which coordinate interactions between vast networks of financial dealers and intermediary institutions with undisclosed balance sheets. New financial products yield high profits for inventors and their clients precisely because they exploit regulatory loopholes. The emergence of structured finance allowed banks and their shadow arms to package and repackage assets of varying qualities in a process known as securitization. These

products were repeatedly sold, rated, collateralized and insured through an ever-lengthening chain of clients. In the end, “the chain that linked [these products] with a ‘real’ person was so convoluted it was almost impossible for anybody to fit that into a single cognitive map – be they anthropologist, economist or credit whizz” (Tett, 2009: 299). Opaqueness and regulatory evasion resulted in heightened uncertainty and fragility.

Long-standing institutional and market firewalls have been broken down in the name of competition, efficiency and innovation. But the main aim of the financial innovation that took place from the 1970s onward has been to put credit creation ever further out of reach of regulators. Banks began to use their powers over lending to engage in arcane speculative activities. As financial innovation proceeded apace and the scope for state oversight and management reduced, speculative financial markets flourished at the expense of credit directed to the productive sector.

Regulators’ loss of control has been particularly acute in developing economies that have opened their financial markets to non-resident investors, foreign banks and other financial institutions. Evidence suggests that non-residents account for a much higher share of both equity markets and sovereign debt markets in emerging than in developed economies, with attendant vulnerabilities linked to shifts in global risk appetites, liquidity conditions and policy positions (Akyüz, 2017).

Together these trends have weakened traditional bank–client relationships, the incentive for due diligence in risk-assessment and the regulatory oversight of state agencies. In their place has emerged a web of complex market-based financial transactions, often of short duration, many cross-border and most of a highly opaque nature. The result has been the development of a deeply fragile system, highly vulnerable to shocks and bouts of contagion. Financial crises were a perennial feature of the mis-named “great moderation” era, but in the end it took the collapse of a relatively small part of the United States housing market to trigger a chain reaction that brought the entire financial system to the brink of collapse (Admati and Hellwig, 2013; Tooze, 2018).

The financial crisis and its aftermath should have refuted the argument that competitive market forces, liberalized financial flows and financial innovation

provide the best mechanism for financing production, capital investment and economic transformation. The crisis showed once and for all that, left to their own devices, financial markets are far from perfectly efficient. Financial deregulation cannot be used to generate credit to finance productive activity without undermining the integrity of the financial system

itself. Securitization had “secured” droves of a windfall profits for the few but had failed to de-risk financial innovation for the many. Yet, this same formula – evident in the enthusiasm for “securitization”, “new asset classes” and “financial innovation” – is at the heart of proposals to cede delivery of the SDGs to financial markets.

D. Money, banks and resource mobilization: The hidden role of the state

As financialization has been presented to the public as a natural and inevitable process, we have ceased to ask ourselves what role money and credit should be playing in a productive economy. Money is a multifaceted entity, functioning as a means of exchange, a unit of account and a store of value. Most orthodox accounts of the monetary system rely on the “myth of barter”, which emphasizes the first two uses above the other. According to this account, primordial systems of barter evolve into payments systems, before developing into the modern banking system. The function of these banking systems is to intermediate between savers and borrowers by allocating “loanable funds”.¹³

But the myth of barter really is nothing more than a myth. As economic anthropologists have long insisted, money, credit and debt have been closely interrelated for centuries. Modern money evolved out of systems used to settle national and international debts;¹⁴ money and credit are therefore central to the functioning of any commercial economy, providing a stable basis for contracts, and thus production and investment.

Today, banks do not simply intermediate between savers and borrowers – they have the capacity to create new money by issuing currency in the form of credit. Banks’ capacity to create money is a privilege awarded to them by the state, whose creditworthiness underpins the value of the currency. Because deposits come into being when this debt is taken on by banks, the money supply is substantially the result of banks’ lending decisions. While the conventional narrative was one of banks waiting for deposits which would then be allocated in loans (financial intermediation), it is now widely accepted that loans come first (McLeay et al., 2014; Pettifor, 2016). In other words, the money supply is endogenous (depending on banks’ lending

decisions) rather than exogenous (fixed by the central bank).

Central banks do not simply manage price stability through setting (or targeting) interest rates. They manage liquidity and thus financial stability – where the latter does not automatically follow from the former. They foster structural financial development and they support the state’s financing needs in times of crisis (Goodhart, 2010). Central banks have a range of tools at their disposal both to safeguard the stability of financial relations at home, and, through interaction with other central banks and financial regulators, globally. These tools include bank taxation, the use of sanctions and of resolution mechanisms to discipline private sector behaviour incompatible with national or global financial stability, the management of government (and publicly guaranteed) debt, and the setting of central bank interest rates. As guardians of financial stability, central banks play a critical role in determining whether financial systems serve the interests of society, or the other way around. Recently, however, central banks have abjured their role in promoting financial stability and have instead focused mostly on inflation targeting.

Traditional banking models operated according to an “originate-and-hold” principle, which saw banks use their comparative advantage in underwriting to make loans and hold them to maturity. This raised a problem of maturity mismatch, resulting from the fact that banks borrow from depositors over short time-horizons while lending money over much longer terms. The success of the system is founded on trust that banks can nevertheless honour their liabilities – but when this trust evaporates, bank runs ensue. Leaving markets to solve this problem would only make matters worse. The public trusts the state to support the banks by providing secure assets (balances with the central bank, government bonds, etc.) for

banks to hold; regulating, supervising and monitoring banks to ensure prudent portfolio behaviour; and providing liquidity through the lender-of-last-resort facility in the event of unforeseen difficulties (to be resolved when the risk of panic withdrawals is over). As commercial banks have been deregulated, the supply of credit – and therefore the money supply – has increased dramatically.

Financial deregulation meant that banks shifted their focus from an originate-to-hold to an originate-to-distribute model as banks started to turn their assets into financial securities that could be traded on financial markets and, in turn, used as collateral for further loans. Banks would often create shadow banking entities at arm's length from themselves in order to keep the securities they were creating “off balance sheet” and insulate them from regulatory oversight. While these processes were praised in some quarters as evidence of the power of financial innovation, in practice these products have proved to be a source of heightened instability (Carney, 2015). In particular, when credit is created in order to purchase financial assets, and these assets are, in turn, used as collateral for further borrowing to purchase more financial assets, financial instability can result as investors pursue assets of diminishing quality, ultimately leading to a wave of defaults and a “debt deflation” spiral. When such a crisis occurs, the dependence of money and credit on the role of the state is starkly revealed as the state is forced to

bail out financial institutions to mitigate damage to the real economy.

Proper management of the financial system requires recognizing the procyclical credit-creating role of banks, and imposing countercyclical breaks to mitigate these tendencies. In the absence of such safeguards, what *The Economist* (2012) called “the rotten heart of finance” can readily surface through irresponsible or predatory behaviour of one kind or another. Adequate financial regulation is the preserve of financially sound states – that is, those states with the fiscal capacity to issue and service their own debts (Greenspan, 1997; McLeay et al., 2014). Financially sound states must ensure that their tax base expands alongside the productive opportunities being financed by credit and direct government expenditure. More financially open economies, and those with less accumulated domestic wealth, face greater constraints on government finances. Occasionally, such states face the danger of a vicious circle whereby weak government finances reduce confidence in domestic sovereign debt and thus the domestic financial system, increasing liquidity preference, encouraging capital outflows and discouraging inflows, further inhibiting efforts to manage credit. In some circumstances, this can lead to the perverse incidence of developing economies (including the least developed) becoming net international lenders (see chapters I and V).

E. Bamboozled

Some time ago, the economist Jagdish Bhagwati (1998) complained that “the fog of implausible assertions that surrounds the case for free capital mobility [...] have been used to bamboozle us into celebrating the new world of trillions of dollars moving daily in a borderless world”. These trillions of dollars are now of interest to those policymakers hoping to deliver the SDGs.¹⁵ But these policymakers have also tended to ignore the dependence of contemporary financial markets on access to cheap credit, the fragile nature of the assets that underpin the credit system, the perverse incentives and excessive risk-taking of many financial actors, and the resulting fragility of the entire financial system. Mistaking the accumulation of debts for the accumulation of capital is not a sound basis for delivering the SDGs.

Such ignorance of the destabilizing potential of financial integration is evident in policymakers' attitude towards capital account management in the developing world. Economists have spent decades arguing that “opening up” one's financial markets to the rest of the world is a critical element of sustainable development. But the evidence for such claims remains extremely thin.

Financial liberalization has not consistently led to more credit for productive investment (Alper and Hommes, 2013). Rather, in periods of financial euphoria, increased access to credit has fuelled the growth of speculative activities, rather than productive investment. Even when bank credit has expanded to non-financial businesses, it has been used to

finance activities (such as mergers and acquisitions and stock buybacks) that have not established new productive capacity (Durand, 2017: 4; *TDR 2015*). While some of these activities do stimulate economic growth in periods of rising asset prices – through “wealth effects” that induce higher spending on goods and services – they also slow down longer-term growth of output and productivity (Cecchetti and Kharroubi, 2012, 2015; Borio et al., 2016; Jordà et al., 2017; Comin and Nanda, 2019).

The emergence of the privatized credit system has allowed the financial sector to transact more and more with itself, creating a complex network of closely interconnected debtor–creditor relations that cannot easily be re-engineered for productive investments (private as well as public) without a fundamental reorganization of the financial system. At the same time, these flows have produced a highly unstable environment that is subject to short-term speculative trading, boom and bust cycles and highly unequal patterns of income distribution. When prices inevitably fall, financial booms leave behind large debt overhangs that delay the recovery of the real economy, sometimes for decades.

There is, moreover, abundant empirical evidence that public financing of domestic public goods, particularly infrastructure, is cheaper, more sustainable and more conducive to financial stability. This is unsurprising, as the kind of long-term investment required to finance big infrastructure projects is not attractive to private investors given the high risks and relatively low economic returns. There are few opportunities for purely commercial infrastructure projects, and those that do exist tend to require complementary public investment (*TDR 2018*; Griffiths and Romero, 2018).

There is also unambiguous evidence that public incentives aimed at encouraging private investment in infrastructure over the last several years (e.g. through subsidies and risk guarantees) and efforts to marry public and private resources (through public–private partnerships [PPPs] and blended finance) have failed to unlock available pools of private capital (*TDR 2015*; Eurodad, 2018; European Union, 2018). A survey by the World Economic Forum of 40 major infrastructure actors shows a distinct lack of enthusiasm for risk-sharing tools – fewer than 20 per cent perceive the risk mitigation tools deployed by multilateral development banks (MDBs) as successful for both public and private partners in infrastructure projects (Lee, 2017: 13). Thus, in today’s highly

financialized world, there seems little likelihood that the expansion of such instruments will bear additional fruit, especially in what are seen as the riskiest environments (such as in least developed countries or for climate-related challenges). Even in the best-case scenario, such tools are simply likely to increase funding for “mega projects” rather than the smaller, more inclusive and environmentally sustainable ones.

Public–private infrastructure financing tends to be more expensive than public financing alone. Subsidies and risk guarantees for private investors can therefore waste the scarce resources of MDBs and/or host governments. In many cases, the public sector and host government have perversely assumed the risks that should be borne by private investors, creating a problem of moral hazard (Griffiths and Romero, 2018). Governments have often found themselves with binding financial obligations even when failed PPP projects have had to be taken back into public ownership (*TDR 2015*).

The World Bank has acknowledged that, despite its efforts, PPPs have attracted very little private investment. Even where they have been more successful, the risks were generally borne by the Bank and host country governments (IEG of the World Bank, 2014). PPPs in infrastructure have, moreover, undermined transparency and public accountability as they frequently appear as “off book” transactions. Infrastructure is a public good that must be broadly accessible, but accessible and inclusive infrastructure may conflict with the objectives of private investors who seek to recover upfront investment costs through user and other fees. Blended finance introduces additional opportunity costs. It is increasingly being used as aid, which typically favours private partners from donor countries, while being driven by profit rather than public interest (*The Economist*, 2016).

Private participation in infrastructure is not only costly, it is also highly concentrated geographically and sectorally. It clusters in commercially attractive sectors and countries that are more likely to offer what are termed “bankable” opportunities (which are rarely low income countries, LICs) (Tyson, 2018: 11; *TDR 2018*). Middle income countries (MICs) have received an estimated 98 per cent of all private infrastructure financing between 2008 and 2017, and of this 63 per cent went to upper MICs (Tyson, 2018: 11). LICs, which have the greatest need for infrastructure development, have received less than

2 per cent of total private investment financing for infrastructure in the last decade (ibid.: 12). From 2011 to 2015 International Development Association (IDA) countries received less than 4 per cent of the value of infrastructure projects in developing countries with private investment (Lee, 2017: 7).

Private financing for infrastructure has also been heavily concentrated in certain sectors. Energy and the information and communications sectors received 37 per cent and 30 per cent of total funding flows, respectively, between 2008 and 2017 (Tyson, 2018: 11). Water and sanitation received only 7 per cent of total private financing in the decade to 2017 (ibid.: 12). Much the same can be said of roads in developing countries, where private investors have been far less active than in other areas. There have been three times more PPPs in the power sector than

in the transportation sector. In fact, private investment in roads has declined to a 10-year low and is highly concentrated in MICs. In LICs fewer than 1 per cent of all road projects involve private participation (Pulido, 2018).

The optimism around private capital that marks, for example, the EPG-GFG, 2018 report seems, in part, to reflect the conditions of the post-crisis world when the “search for yield” drove investors into developing countries. In the unique environment of 2008–2014, private funding to infrastructure averaged \$150 billion a year (Tyson, 2018: 12). Since monetary policy in wealthy economies (and especially in the United States) has “normalized”,¹⁶ investors have turned away from developing country markets (including infrastructure, which halved to an average of just \$75 billion annually) (ibid.).¹⁷

F. Making finance work for all: A developmental perspective

As the global crisis made clear, financial deregulation and integration can introduce severe fragility to the financial system. These trends can also inhibit transparency and frustrate attempts to assess risk in the financial system. The crises that inevitably result from financial market liberalization provide frequent and abrupt reminders of how quickly the value of these assets can evaporate.¹⁸ The bailouts that tend to follow the crises have perverse distributional outcomes as they socialize private risk. Such an analysis should cast serious doubts on the leading desirability of private financing as the mechanism for delivery of the SDGs.

Still, there is no disputing that the multilateral trade, investment and monetary regime is in need of urgent reform if the 2030 Agenda is to move from rhetoric to results. Reform was promised a decade ago at the G20 meeting in London. Instead, as Martin Wolf (2018) has recognized, “most efforts to date have been driven by a desire to go back to a better past; lower taxes and labour market de-regulation dominate policy discussion, growth has remained dependent on rising indebtedness and asset prices, monopoly and ‘zero-sum’ activities are pervasive. Few doubt that another large crisis is somewhere on the horizon”.

Moreover, the response to the crisis has further increased income disparities. Fiscal austerity has had

a disproportionate impact on welfare programmes, while loose monetary policy designed to mitigate the effects of high levels of debt has boosted asset prices and thus the wealth of the already rich (*TDR 2017*; Stiglitz, 2019). Even as unemployment has dropped, real wages have remained stagnant in flexible labour markets. Banks that were too big to fail are bigger still (if somewhat better-capitalized), while financial services have become the preserve of a small number of giant firms in asset management, credit rating, accounting, business consultancy, etc. Under these circumstances, it is difficult to see how extending the market option will now bring about more inclusive and sustainable outcomes.

Rolling back financialization is often casually dismissed as “old thinking” or “backward looking” – at odds with the technological opportunities of the twenty-first century. However, the hyper-globalized world is not an inevitable product of technological progress or disembodied market forces, but of ideological persuasion, institutional reform and policy choice. These same pressures that were once used to promote financialization must now be used to roll it back, in order to forge a global new deal that can halt environmental breakdown and economic polarization, and establish a new social contract with sustainable development at its core.

The New Deal, launched in the United States in the 1930s and replicated in distinct ways elsewhere in the industrialized world, rolled back the laissez-faire model of the interwar years and, in doing so, built a new social contract that fostered decades of equal and sustainable growth. This contract was centred on four broad components: relief from mass unemployment; sustained economic recovery; regulation of finance; and redistribution of income. These elements were consistent with more specific policy priorities tailored to particular economic and political circumstances. But all in all, the New Deal policies of the post-war period facilitated the emergence of a virtuous circle of job creation, expansion of productive investment, faster productivity growth and rising wages.

The internationalization of the New Deal through the Bretton Woods regime was only partially directed at development and environmental challenges and certainly not with the urgency or on the scale required today. The Global Green New Deal must learn from the mistakes, as well as the successes, of its forerunner (Gallagher and Kozul-Wright, 2019).

Under the Global Green New Deal, states will have greater space to implement proactive public policies to boost investment and raise living standards. Such policy space is also a prerequisite for encouraging those states to cede, where appropriate, sovereignty to international bodies to establish international regulations and forge collective action in support of the global commons. Building this Global Green New Deal to meet the ambition of the SDGs will certainly require much greater participation of developing countries in international decision-making than that seen at Bretton Woods.

As before, the Global Green New Deal will be driven by an expansion in the space for public action, in “a pragmatic and non-ideological attempt to restore the balance between government, markets and civil society based on a new social contract between voters and elected officials, between workers and companies, and between rich and poor” (Stiglitz, 2019). Financial sector reform will be critical to such a project. As James Tobin (1984) predicted more than 30 years ago, the disconnect between the private rewards of many financial activities and their social productivity has not only drained the financial sector of its useful purpose but has given rise to unproductive and in some cases predatory purposes that produce recurrent and damaging crises.

The underlying intent of reviving the public option in finance is not to extinguish private finance, but rather to find pragmatic ways to make it once again serve the public interest (*TDR 2017*; Foroohar, 2019). De-financialization will no doubt take different forms in different countries, but the fundamental goal is “a smaller, simpler financial services system that is better adapted to the needs of the non-financial economy” (Kay, 2015: 306). Regulating private financial flows will be essential to steering private finance towards social goals and curtailing predatory and restrictive business practices will be key to reining in rentierism and crowding in private investment to productive activities including in the green economy. But just as importantly, it will require promoting alternative mechanisms of delivering finance in support of a more inclusive and sustainable growth path.

A healthy global economy is a prerequisite for such a reform agenda – and this cannot be taken for granted. Chapter III reviews the state of the world economy, stressing that the combination of weaker government expenditure, compression of wage shares, and financialization have suppressed private investment, employment creation and economic development. By way of an alternative, the chapter proposes a globally coordinated reflation strategy with a focus on development and environment recovery, in which the public sector plays a pivotal role. A significant, well-planned and stable pattern of public expenditure can exert a lasting and positive effect on private investment (crowding-in), support employment creation, decent work conditions and wages, and trigger technological advances for a “green” productive transformation. What is more, an effective public sector can help lift supply constraints, especially in developing economies, and ensure that credit creation and financial conditions serve the real economy, rather than the other way around. Policy coordination is essential to resolve trade-offs between growth targets, financial stability and environment protection, and to prevent national policy actions that could trigger a regulatory race to the bottom.

Given that credit will be essential to supporting such a massive investment push, sovereign debt sustainability will be key to achieving a more balanced economy. As chapter IV makes clear, current challenges to external debt sustainability will have to be resolved quickly and smoothly through increased official development assistance and the restructuring of debts, if the international community is serious about meeting the SDGs on time. As the

chapter shows, there is no “private” option in this time frame. If anything, a focus on “de-risking” will only deepen current external debt vulnerabilities. In the longer run, developing countries must continue to build up capacity to record and monitor national debt, and should pool their growing expertise in dealing with a fragmented and increasingly privatized international monetary and financial system by strengthening regional public systems to facilitate cross-border payments and liquidity provision. They can also build up expertise to address sovereign debt restructuring processes collectively, rather than on a case-by-case basis.

Given their procyclical nature, the inherent volatility of financial markets and the predatory behaviour of financial institutions, private capital flows can just as readily extract resources from as add resources to the productive economy. Developing countries are more vulnerable than developed countries to such outcomes, but the threat is a ubiquitous one. Mitigating this danger and establishing a regime of longer-term and more stable flows is discussed in chapter V. To mitigate such risks, many developing countries have accumulated large foreign-exchange reserves. This strategy has high opportunity costs, causing a resource transfer from developing to developed countries and widening rather than bridging the finance gap. Governments have, moreover, lost sizeable fiscal revenue from so-called “tax-motivated illicit financial flows” as a result of multinational

enterprises reducing the payment of corporate income tax (CIT) through a shift of their profits to affiliates in tax havens or by exploiting tax loopholes in domestic legislation or international tax treaties. Such leakages have been further augmented by digitalized economic transactions that make the current CIT norms less and less apt to determine where taxable value is created and how to measure and allocate it between countries. A radical overhaul of these norms could significantly improve countries’ capacity for domestic resource mobilization.

An ambitious programme of financial reform is required to shift the focus away from financial speculation and towards the financing of productive investment. Within a more stable financial framework, the state can manage credit in a variety of ways. Direct credit controls became unfashionable in the era of “efficient markets”. Yet incentives (e.g. placing government deposits) and disincentives (e.g. portfolio restrictions) can be effective in steering credit to the most productive investment opportunities. Governments can achieve this even more directly by setting up their own development banks, which would have a greater capacity than retail banks for “patient lending”. At the same time, governments can actively promote a variety of alternatives to traditional banking to tap new development opportunities, simultaneously promoting more equitable development. These options are discussed in chapter VI. ■

Notes

- 1 Similar proposals for financing the SDGs have been advanced by the international financial institutions, (see World Bank, 2015); by the OECD, 2018; and by myriad think tanks, (see Lee, 2017).
- 2 While there has been discontinuity in the positions adopted by the IFIs since the financial crisis, measures to unleash financial markets – through transparency, securitization, capital account liberalization, public–private partnerships etc. – became part of the Washington Consensus over the previous two decades or longer. On the evolving mix of continuity and discontinuity in the approach to development finance of the IFIs, see Gabor, 2010, Helleiner, 2014, and Gabel, 2017.
- 3 On the various ideological roots of neo-liberalism, see Turner, 2008, and Slobodian, 2018; on its extension to finance, see Shaxson, 2018, and Storm, 2018.
- 4 In 2017 the World Bank sold its first pandemic bonds, raising \$320 million from private investors in a deal that was seen to help developing countries facing serious outbreaks of infectious diseases. Former Bank president Kim said they were a way of “leveraging our capital market expertise” ... “to serve the world’s poorest people”. On this and the wider trend of replacing disaster aid with private finance, see Ralph, 2018, Keucheyan, 2018, and Allen, 2019. On the limitations and dangers of microcredit, see the various papers in Bateman et al., 2018.
- 5 In his inaugural address in 1933, President Franklin Roosevelt had insisted that the “practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men”. A decade later, at Bretton Woods, Henry Morgenthau, Roosevelt’s Treasury Secretary, made it clear that driving “the usurious money lenders from the temple of international finance” was the job of the conference. In a similar, albeit more morbid spirit, Keynes had earlier called for

the design of monetary policy that would lead to the “euthanasia of the rentier” and he left little doubt at Bretton Woods that his proposals were intended to finish the job at the international level.

- 6 For a vivid account of the Bretton Woods negotiations, see Conway, 2014.
- 7 The former chief economist of the International Monetary Fund (IMF) Simon Johnson, 2009, has described this capture of government as a “quiet coup”.
- 8 As noted by Glyn (2006: 65) “Amongst OECD countries, 5 out of 19 were classified by the IMF as having open capital markets in 1976, including the USA and Germany. The UK and Japan followed suit by 1980. By 1988 only one OECD country was classified as having controls in one of the five strongest categories, compared to half the countries in 1973. In the late 1980s and early 1990s the rest of the OECD liberalized with Norway the last of the social democratic strongholds to succumb in 1995”.
- 9 As Volcker later put it, under the new international regime, “The external financing constraints were something that ordinary countries had to worry about, not the unquestioned leader of the free world, whose currency everybody wanted”; cited in Varoufakis, 2013: 102.
- 10 The damage to highly indebted developing countries and satellite countries of the Soviet Union from these interest rate hikes also carried profound geopolitical consequences, derailing the agenda for a new international economic order and laying the ground for the rise of the Washington Consensus and opening up more economic space for mobile international capital; see UNCTAD, 2014.
- 11 In the mid-1970s, Latin American governments in the Southern Cone adopted policies in line with the neo-liberal agenda but this ended badly; see Alejandro-Diaz, 1985, and TDR 1991.
- 12 Although the term was coined only in 2007, the practices it describes go back much further. According to Bernanke, 2013, “Shadow banking, as usually defined, comprises a diverse set of institutions and markets that, collectively, carry out traditional banking functions – but do so outside, or in ways

only loosely linked to, the traditional system of regulated depository institutions. Examples of important components of the shadow banking system include securitization vehicles, asset-backed commercial paper [ABCP] conduits, money market funds, markets for repurchase agreements, investment banks, and mortgage companies”.

- 13 Most conventional economic modelling splits the world into monetary and real components. This is usually defended as a useful methodological gambit for getting at the “fundamentals”. While never a particularly persuasive line of reasoning, in today’s highly financialized world it is a decidedly unreal approach which not only left economists bewildered when the crisis hit but has crippled their ability to contribute to effective policies for recovery (see Galbraith, 2014). However, as Stiglitz, 2017, and others recognize, integrating these components together has proved a difficult task.
- 14 In this vein, Ferguson aptly defines money as “the crystallized relationship between creditor and debtor” (2008: 30).
- 15 The OECD, for example, estimates that institutional investors in member countries hold global assets of \$92.6 trillion (Lee, 2017: 8) and that “investment of only 1% of those funds in developing country infrastructure would go a long way” (ibid.). In a similar vein, the corporate sector is estimated to be sitting, worldwide, on very large piles of cash – over \$2 trillion according to S&P Global – that could also be tapped to help fill the financing gap (Global Finance, 2018).
- 16 In March 2019 the European Central Bank moved away from normalization when it announced a return to expansionary policy.
- 17 In fact, infrastructure with private participation has been on a falling trend since 2012 when private participation in infrastructure was valued at \$210.6 billion; in 2013 it was \$155 billion; in 2014 \$165.8 billion; in 2015 \$117.8 billion; and in 2016 it fell to \$76 billion (Lee, 2017: 8).
- 18 An estimated \$50 trillion in the market value of assets evaporated during the 2008–2009 financial meltdown.

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