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The Renaissance of Public Entrepreneurship: Governing Development Finance in a Transforming World

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The world is facing a historic opportunity for transformation at an unprecedented scale and pace as more and more low-income countries are taking off. This transformative agenda calls for renewed public entrepreneurship, that can initiate and accelerate large-scale and long-term development financing in the face of the fears and risks involved in entering uncharted territory.

For this entrepreneurship to thrive, we argue that it is essential to innovate and update the governance of development finance. Doing so is essential not only to help provide the incentives, financing instruments and business models needed to meet new challenges, but also to put transparency and accountability mechanisms in place to avoid the pitfalls of unconstrained financial competition and to address major issues of financial integrity.

In this note, we first set the scene to illustrate how the concept of public entrepreneurship helps better understand key policy debates in current governance of development finance. We then elaborate how newly emerging countries are often developmental states and act as a risk-taking initiator, enabler, and accelerator. Next, we move to examine the pitfalls of public entrepreneurship if abused in the absence of accountability mechanisms. We finally conclude with thoughts on how to renovate the existing governance mechanisms to harness the revival of public entrepreneurship in the right direction.

Key Policy Debates in Current Governance of Development Finance

The new development challenges are generating significant systemic debate and change, notably around the policy and market failures underlying the global problem of massive shortfalls in infrastructure investment, now a key agenda item in the G20.

First, there is an ongoing tension between pushing investment boundaries and maintaining debt sustainability. The mainstream approach seems to focus on efforts to improve the business environment in the hope that this will yield a strong private sector response to the long-term investment challenge. But a contending view is gaining ground that there is an underlying market failure problem that requires much more direct and robust public action. On this view, large investments will not happen without strong public initiative and co-ordination, which may then crowd in much subsequent private investment. Even smaller projects may need this public intervention where spillovers and long-time horizon are involved.

Second, the traditional concept of Official Development Assistance (ODA) is undergoing an identity crisis. In the context of the OECD Development Assistance Committee (DAC), a number of public development finance institutions have taken the initiative to raise low cost funding from financial markets and onlend to developing country projects. This practice involves no fresh taxpayers' money but still meets the established definition of ODA. Yet it is criticised in the DAC where there is a premium on equating official finance with "a genuine budgetary effort". But emerging providers are embracing and scaling-up the practice of leveraging market finance through state-owned entities with implicit state guarantees. Notably, China has very rapidly emerged as the leading provider of such development finance. The proposal for a BRICS bank, initiated by India, is a signal that emerging powers are ready to create a multilateral channel to solve market failures in the development process. China has also proposed a new Asian Infrastructure Bank and a Shanghai Cooperation Organisation Development Bank.

This is where the concept of public entrepreneurship provides a helpful framework for understanding the new vectors in play in development financing.

Public Entrepreneurship and the Developmental State in the Transformation Agenda

The emerging countries that have transformed the global economy over recent decades have all followed different pathways in different time periods, but with one common feature: leadership with qualities that break business-as-usual mentalities by creating long-term visions for value-creation and an implicit social contract. Such public entrepreneurship involves close interaction between a facilitating state and a dynamic enterprise sector, with three core generic features: a) alertness to opportunities, b) judgmental decision making under uncertainty, and c) bold and creative innovation.

First, public entrepreneurs are pioneers who can identify potential value-creation opportunities that are often suppressed by status-quo inertia. But public entrepreneurs bridge the gap between social and private returns. They also marshal public resources in concert with private resources for fulfilling the "imagined" vision. Thus, they can turn latent investment opportunities into realized value creation.

Second, public entrepreneurs are crucial to overcoming diffidence and inaction by creating enabling conditions for taking-off and scaling-up value creation. The large-scale transformation agenda entails an order of unprecedented complexity and magnitude with a long-term horizon. At the initial incubation/take-off stage, this is often beyond the reach of private players. Thus, public entrepreneurs can help first-movers to take risks, overcome misperceptions or even disillusionment, and bear the losses of failure in experimentation, and they can manage the political economy of reform and course correction.

Third, public entrepreneurship establishes confidence by creating and demonstrating investment viability, creates an "enabling" culture for market and capacity building, and acts as an accelerator to crowd in private finance for scaling-up.

In practice, public entrepreneurship has played an indispensable role in breaking the circle of pessimism and inaction to unleash the transformational potential for countries to advance up the development ladder. And public entrepreneurship will be essential for nations collectively to tackle global challenges such as climate change within a compressed time horizon. We see the "transformation" paradigm now becoming the new narrative for African leadership at the intellectual, institutional and political levels.

This does not mean that public entrepreneurship alone can accomplish the task. Nor does it imply centralized state planning or control that would substitute private enterprises, civil societies, and social sectors. On the contrary, it triggers and sustains the transformation agenda by coordinating efforts of multiple stakeholders and enabling bottom-up initiatives to flourish and scale up. Thus, it does not substitute for but stimulates and complements private entrepreneurship.

Public entrepreneurship shares core qualities with the developmental state. The common thread in all the developmental state stories is the capacity of public authorities to capture economic rents and channel them to meeting development objectives with long-term vision. Successful emerging countries have managed to achieve startlingly fast catch-up growth, because they create the complex political balances to allow performance driven development processes to work. Mainstream political and economic narratives have been unable to account for or predict this phenomenon.

The political feasibility of co-opting or disciplining elites in an inclusive growth paradigm is an ever present challenge, as problems of financial integrity bear witness. National and international efforts to combat illicit financial flows and create transparent and accountable public finance systems are fundamental. But as experience shows, this does not invalidate the decisive importance of the active role for the state under visionary leadership. Such leadership sets in motion dynamic learning and capacity building processes. Most developed countries have been through such a stage. And indeed the entrepreneurial state is very much alive and in demand in OECD countries, because it is a vital actor in technology origination, innovation ecosystems, social investment and local infrastructures. The G20 is now focusing on just such agendas, in no small part due to the presence of successful developmental states among them.

Public Entrepreneurship and the Governance of Development Finance: Lessons from History and Implications for Today

The revival of public entrepreneurship driven by emerging economies has put pressure on existing development finance governance systems, challenged established thinking and fostered burgeoning innovation. There are two particular areas where these pressures are manifest: export credits and debt sustainability.

First, export credits disciplines are at a crossroads. The existing export credit disciplines were laboriously put in place at the beginning of the 1990s in an effort to redress the competitive and political use of public subsidies and guarantees. Such irrational crass competition erases prudent judgments on repayment capacities of borrowers/buyers, tilts the level playing field and breeds perverse incentives. Companies focus less on improving the quality of goods and services and more on how to secure credit subsidies involving official support.

Unconstrained by the agreements among the OECD Export Credits Agreement Participants and among DAC donors, emerging economies pragmatically adapt their financing terms based on the risk/return profile of specific projects. This enables them to occupy a "niche" between the two traditional options of commercial loans and ODA.

While competition is a normal and positive process, the opaque nature of export credits has heightened fears that new players have been undercutting old players who are constrained by compliance with the established disciplines pact. The export credit rules can be useful to new players too as Brazil and others have found, and currently China is engaging with participants in a process around the financing of shipbuilding.

Yet the challenge runs deeper. Emerging economies are challenging the prevailing philosophy that any "subsidy" component will act as a "distortion" of competition, and should be eliminated. This mainstream philosophy assumes a passive and reactive role for public finance. Its role is merely to temporarily step in neutrally where markets fail to provide finance. As a result, it overlooks more proactive roles for concessional public finance beyond the current definition of ODA. Its new role could include incubating financially viable opportunities in uncharted sectors and areas. In fact, advanced economies have been compelled to reflect whether their preoccupation with combating subsidies and competition in the field of export credits has produced such complex and inflexible procedures that official support has not adapted well to addressing new development challenges and opportunities. Hence we see new initiatives to establish development finance institutions in a number of advanced countries.

Second, multilateral surveillance over debt sustainability is under stress. To avoid debt crises, the Bretton Woods Institutions have exercised multilateral surveillance over debt sustainability in order to deter excessive accumulation of foreign debts. Yet the compelling challenge today is how to strike an appropriate balance between prudent borrowing for debt sustainability and borrowing space for growth-generating productive investments.

In the most recent IMF's debt limits policy review in April 2013, it was generally agreed that the existing concessionality benchmark is losing its effectiveness as a policy lever for the purpose of multilateral debt surveillance in prevailing financial market conditions and that a new approach was needed. Decision-makers have come to realise that a rigid enforcement of capping non-concessional financing can unduly constrain the ability of borrowers to use external finance productively, because "non-concessional" finance if well managed can spur growth. While there is flexibility built into the surveillance system to allow granting exceptions to the rule, too many exceptions would question the appropriateness of the rule itself.

Conclusion

A transformative development agenda is coming into place with public entrepreneurship at the centre. Whether this renaissance of public entrepreneurship is a portent of disaster or a herald of hope ultimately depends on how governance responds to the changing landscape of development finance.

The key challenge ahead is how to govern the expanding envelope of international public finance. Effective and prudential governance can not only offer institutional space for public entrepreneurship to flourish to beat risks and conquer uncharted investment frontiers, but also put safeguards in place to avoid unconstrained public financing competition.

Yet existing governance systems have not kept pace with time. On the one hand, historical legacies have constrained traditional public finance providers from playing a more proactive transformative role; as a result, unfinanced high-return investment opportunities paradoxically co-exist with abundant capital, low interest rates and a weak global recovery. On the other hand, traditional disciplines and surveillance frameworks have been increasingly challenged by new players.

Surges in public finance carry the potential for falling into historical debt traps if not well governed. Here the role of financial integrity is now recognised as central. By financial integrity, we mean the rightful capture of economic rents and the shaping of economic incentives. This requires transparency and accountability in both domestic and international financial and fiscal systems, especially investment decision-making and implementation. It seeks to underpin the financing of successful developmental states in which sustainable development and poverty eradication are realisable goals.

Going forward, we need to recognize the mutual interests among old and new players in effective states and markets as the basis for sustainable development. This can help generate inclusive political space for durable and essential international cooperation and collective action. The governance systems will be at once more polycentric and more collaborative as the supply of development finance and its effective use expands in line with the high ambitions for post-2015 sustainable and universal development goals. The G20 and the BRICS Summits, functioning at Heads of State level, provide new political spaces for connecting up issues and efforts. Welcome to the brave new world of development finance. ■

Literature

Jiajun Xu and Richard Carey, “The Renaissance of Public Entrepreneurship: Governing Development Finance in a Transforming World”, Background Research Paper Submitted to the High Level Panel on the Post-2015 Development Agenda, May 2013, http://www.post2015hlp.org/wp-content/uploads/2013/05/Xu-Carey_The-Renaissance-of-Public-Entrepreneurship-Governing-Development-Finance-in-a-Transforming-World_FINALFINAL.pdf.