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Whither Democratization and Sustainability?

A Critique of Key G20 Proposals to Further Expand the Role of Private Investment in Development

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

This article provides a brief critique of the final report of the G20 Eminent Persons Group (EPG) on Global Financial Governance, which is being submitted to the meeting of the G20 Finance Ministers and Central Bank Governors to be held in Bali, Indonesia during the annual meetings of the IMF and World Bank (October 12-14). The report will also be submitted to the G20 Summit, to be held in Buenos Aires, Argentina (November 30-December 1).

The report, "Making the Global Financial System Work for All," (hereafter "G20 EPG Report"),[1] lists 22 proposals across three broad areas for increasing the firepower of the current development finance system.

Among the key proposals is one which would create a coordinated system of development finance institutions (DFIs), including multilateral development banks (MDBs) and bilateral donor agencies. This system would work through the establishment of new country and regional platforms, guided by a new set of core standards for project preparation, procurement, transparency, etc.

Creating such a system would establish divisions of labor among these actors as well as greater economies of scale through collective lending operations. In this division of labor, it appears as though the United Nations could be subordinated to more powerful actors and confined to roles in fragile and conflict affected states. Another concern is that the combined firepower of these actors could diminish country ownership and repress civil society.

As discussed below, it is concerning that the G20 EPG Report provides as a positive example of a country platform the Indonesian Slum Upgrading Project financed by the Asian Infrastructure Investment Bank (AIIB), the World Bank Group and the Government of Indonesia.

Most striking is the G20 EPG Report's call for each MDB to undertake fundamental governance reforms in order to streamline decision-making within the system. Specifically, it proposes that the MDBs abolish the traditional role for their executive boards in voting on individual loan operations and devolve such operational responsibilities to Management. [This resembles the governance model of the China-led Asian Infrastructure Investment Bank (AIIB)]. This could diminish the accountability of the MDBs.

Other key proposals call for expanding the system wherein public resources (e.g., taxes, pensions, user fees, aid) would be used to leverage far greater sums of new private investment in not only in individual development projects, but also for portfolios of projects. In the latter instance, financiers securitize the future revenue streams from portfolios or "pipelines" of projects by bundling them into financial instruments for trading in the global capital markets. A goal of securitization is to provide an attractive revenue stream for institutional investors, such as pension funds, life insurance and sovereign wealth funds, which control over $100 trillion.[2]

Securitization is not possible without "de-risking" development projects, but this can involve transferring unsustainable risks from the private to the public sector. For instance, efforts to "de-risk" investments can undermine sustainable development by accelerating (or failing to curb) global warming; saddling governments and citizens with too much debt; raising the costs of basic services; and exacerbating levels of inequality (if gains are privatized and losses nationalized).

Another concern relates to accountability. As the revenue flows from project portfolios are securitized, it is unclear whether or how norms – such as the MDB's environmental and social safeguards

[1] Nancy Alexander, the co-author of this article is named in the "List of Contributions" at the conclusion of the EPG Report as having engaged in a meeting of representatives of civil society organizations with the G20 EPG; however, she only observed the meeting.

[2] Jesse Griffiths and María José Romero, Three compelling reasons why the G20's plan for an infrastructure asset class is fundamentally flawed, EURODAD, July 2018.

– would apply. How would governments and their citizens be assured that new holders of the debt and equity will be responsible for enforcing environmental and social safeguards associated with the underlying projects?

With a system of development finance institutions working with added financial firepower from private capital markets, the Western-led development finance system could reinvent itself as both a collaborator with and a competitor to the growing alternative China-led system. Infrastructure competition between the systems is seeking to help secure or expand access to natural resources and markets.

These, and other concerns about democratic accountability and the role of civil society, are detailed below.

A CRITIQUE OF KEY PROPOSALS BY THE G20 EMINENT PERSONS GROUP (EPG) ON GLOBAL FINANCIAL GOVERNANCE

On April 21, 2017, the German G20 established the terms of reference and membership of an Eminent Persons Group (EPG) on Global Financial Governance to formulate proposals for major reform of the system for development assistance and the system of interconnected financial markets.

Over the last 17 months, the EPG has vetted its proposals with G20 and non-G20 countries and a wide array of institutions. Therefore, it is anticipated that the G20 EPG Report will be favorably received by the meeting of the G20 Finance Ministers and Central Bank Governors in Bali and by G20 Leaders at the Argentine G20 Summit in Buenos Aires.

The G20 EPG Report sets out 22 ambitious reform proposals divided into three main sections:

(1) "**Achieving Greater Development Impact**" by, among other things, reforming the governance and functions of the international financial institutions (IFIs) to enhance their collaboration in ways that include catalyzing new private capital flows and domestic resources to meet development challenges;

(2) "**Securing the Benefits of Interconnected Financial Markets**" to promote economic stability and sustainable growth;

(3) "**The G20 and the IFIs: Making the System Work as a System**".

(1) Regarding the first set of proposals for "Achieving Greater Development Impact".....

The G20 EPG Report proposes a new system of coordination and collaboration among the disparate collection of development finance institutions (DFIs), including multilateral development banks (MDBs) and bilateral donor agencies, in order to achieve greater economies of scale through collective financing of development. This would require that all development partners adopt core standards to guide and coordinate their efforts to mobilize greater levels of private sector investment; reduce inefficiencies; and establish divisions of labor among participating donors/creditors within the platforms.

Country platforms are also intended to be part of regional platforms that harmonize DFI participation via a Global Toolbox to Advance Private Sector Investment. It is a guide to (a) Project preparation and advisory facilities; (b) Risk mitigation vehicles and guarantees; (c) Co-investment platforms; (d) Project financial instruments; and (e) Blended finance project instruments in Asia, Africa, Latin America/Caribbean, and Europe. Citizens have been excluded from consultation on this toolbox.

The G20 EPG Report gives examples, such as the Indonesian National Slum Upgrading project, of such country platforms. The Indonesian project financed by the Asian Infrastructure Investment Bank and World Bank has been plagued by problems, including failures to carry out meaningful public consultation, land-grabbing, threats and intimidation.

This top down platform models will be unsustainable and engender public resistance. There are also valid concerns related to the manner in which country platforms could promote a strong bias against public works and in favor of public-private partnerships (PPPs). Other risks include those of over-leveraging private investment; and building up public liabilities and debts; limited access to social and economic infrastructure services due to unaffordable user fees; and the possibility that the combined firepower of donors and lenders could override "country ownership," or the ability of a developing country to pursue its own national economic development agenda.

• Core Standards

The G20 EPG Report states that the country platforms could facilitate "the adoption of common core standards to ensure sustained development impact and lower the cost of working with a range of partners" (p. 35). The core standards could include those relating to: (a) debt sustainability; (b) environment, social and governance (ESG) standards; (c) coherent pricing policies; (d) local capacity building; (e) procurement; and (f) transparency and anti-corruption.

MDBs have consulted with a range of partners to set existing standards, but there are questions about whether the new core standards would override existing ones and what processes would be used to establish the standards.

It is vital that states ensure that their national laws and regulations are equivalent to the MDBs' environmental and social safeguards. Yet, in his remarks to stakeholders, the Chairman of the G20 EPG has emphasized that, on the issue of safeguards, flexibility in implementation is key, noting that, "Not all countries are Denmark." The suggestion is that environmental and social safeguards and accountability mechanisms could be flexibly side-stepped or de prioritized when setting of the new common core standards among donors and funders.

The risk in adopting such flexibility in the new standards is that the lessons and experience of civil society organizations – including the affected communities intended to benefit from development operations – would continue to go largely unheeded. Indeed, there are no established G20 mechanisms to regularly and systematically consult with civil society.

• Standardization of Transactions

The G20 EPG Report proposes reorienting the MDB business model in ways that standardize transactional approaches.

The G20, the OECD and the World Bank have published a list of dozens of policy strategies and project-related processes which are being standardized.[3] Examples include: G20 Principles for the Infrastructure Project Preparation Phase; the G20/OECD High Level Principles of Long Term Investment Financing by Institutional Investors are vetted with business, but not civil society; and contractual provisions for public-private partnerships (PPPs).

With regard to the High Level Principles of Long-term Investment Financing by Institutional Investors, this critique of the latter Principles shows how latitude is given to institutional investors to make the Sustainable Development Goals (SDGs) or environmental and social safeguards a secondary and optional concern.

With regard to contractual provisions for PPPs, the G20 and the MDBs have resisted input by legal experts and civil society groups to the way in which contractual provisions for PPPs are being standardized. Such input seeks to ensure that the new standards protect the rights of sovereign states to own equity in infrastructure assets, to regulate in the public interest, and to limit the risk to which public sector finances are exposed.[4]

Regulating in the public interest – and setting standards accordingly – would mean that states retain the flexibility to enact and enforce laws which meet domestic commitments to environmental and social protection as well as international commitments, such as those to the SDGs and climate goals.

To conclude, there are several concerns with the substance of norms and values that guide the standardization of policies and project-related guidance, as well as the exclusivity of consultations that drive decisions. There are also concerns that the standardization of risk/return profiles of infrastructure investment, which is recommended by the October 2018 Communique of the Business 20, could lack even-handed treatment of states and investors.

• System-wide Risk Insurance and Securitization

The G20 EPG Report proposes a "shift in the basic business model of the MDBs from direct lending towards risk mitigation aimed at mobilizing private capital," including by developing system-wide political risk insurance and expand use of private reinsurance markets."

Another fundamental reform would greatly expand securitization processes, as described above, in ways that create liquid assets (revenue flows) out of currently illiquid assets. The new proposal to "systematize" such efforts across all MDBs would create larger and more diverse pools of assets to securitize, which would create new opportunities for investors in capital markets. Doing so lowers the risks of default among the underlying assets. According to the G20 EPG Report, Annex 2:

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[3] G20/OECD/WB Stocktake of Tools and Instruments Related to Infrastructure as an Asset Class – Progress Report, March 2018.

[4] See Motoko Aizawa, Key Messages on the World Bank Group's 2017 Guidance on PPP Contracts, Heinrich Boell Foundation, September 2017; Foley Hoag, Summary Comments on the World Bank Group's 2017 Guidance on PPP Contractual Provisions, September 2017; Martin Dietrich Brauch, Contracts for Sustainable Development, International Institute for Sustainable Development and Heinrich Boell Foundation Washington, D.C., December 2017.

"To achieve the scale of an asset class and meet vast development needs, risk exposures have to be standardized and pooled from across the MDB system, into securitization or fund structures that enable easier investor access. Non-sovereign loans, infrastructure-related and others, would be a good group of assets with which to start. In the MDB system alone there are US$200-300 billion of such loans, which offers a critical mass for institutional investors. Including an aggregation of commercial bank loans would lead to much larger asset class."

Traditionally private investors have not been interested in development projects in the majority of developing countries, mostly because the financial returns are not viewed as worth the high risks involved. Especially since 2014, the G20 has tried to solve the problem of how countries can attract private investors, particularly long-term institutional investors (pension and insurance and mutual funds and sovereign wealth funds) which hold over $100 trillion in savings.

For instance, the G20 directed Development Finance Institutions (DFIs) to expand a financing model that aims to use billions of dollars of public finance (e.g., taxes, fees, pensions, aid) to leverage trillions in new private investment in emerging and developing economies. In 2015, six Multilateral Development Banks (MDBs) launched an initiative called, "Billions to Trillions: Transforming Development Finance," but so far it has not attracted meaningful levels of new private financing. To provide a blueprint for the MDBs to attract private investment, Leaders at the 2017 German G20 Summit adopted Principles of MDBs' strategy for crowding-in Private Sector Finance for growth and sustainable development.

Despite their best efforts, donors and creditors have not been successful at luring in these private investors. The report, *Contribution of Institutional Investors to Private Investment in Infrastructure*, finds that the current level of institutional investor activity in new infrastructure deals in abysmally low and represents only 0.7% of total private participation in infrastructure investment in emerging market and developing economies.[5] Efforts to accelerate and replicate public-private partnerships (PPPs) have had limited success as well.

To address this problem and attract greater levels of private investment, the G20 EPG Report proposes reforms to the financial architecture that would offer less risks and greater rewards for private investors – not only in infrastructure, but for all sectors requiring development finance.

However, the proposals for system-wide political risk insurance and expanded securitization exacerbate the fundamental problem of obscuring the true risks associated with the underlying assets. Consequently, they undermine the ability of regulators and investors alike to weigh actual risks, not unlike the role securities played in the building up of risk prior to the 2008 global financial crisis.

As noted above, another major concern related to the securitization of development finance is the lack of clarity about whether or how the MDB's environmental and social safeguards for investment projects would be implemented. Once the MDB loans are bundled and repackaged as securities to be bought and sold and traded as a new asset class on global capital markets, will the new holders of debt and equity be responsible for enforcing environmental and social safeguards associated with the underlying projects?

[5] Abha Joshi-Ghani, "Behold the White Knights! New research on institutional investor participation in financing EMDE infrastructure", Infrastructure and PPP Blog, World Bank Group, March 15, 2018.

• Concerns about the G20's Approach to the Global Commons

Already, the current G20-led system of global financial governance fails to adequately support "country ownership" by prudently and effectively deploying capital to help achieve investment priorities of governments and their citizens. Such priorities include measures to achieve sustainable development and climate goals, which were adopted by the world community in 2015. It is imperative that these goals be realized because, among other things, inequality (especially within countries) continues to increase, and there are rising and competitive pressures in the infrastructure sectors, which are responsible for nearly 60% of global greenhouse gases.

However, the G20 EPG Report does not mention Agenda 2030 which includes the Sustainable Development Goals (SDGs) or the Paris Agreement on Climate Change. In the 100 pages of text, "climate change" is mentioned four times, particularly with regard to adaptation to the phenomenon.

The G20 EPG Report proposes strengthening "joint capacity to tackle the challenges of the global commons" (Proposal 6). As an example the Report states that:

> ***"Total infrastructure capital round the world will double in the next 15 years. How that investment takes place will have a profound influence on the global commons."***

In particular, the nature of this future investment would "make or break" the efforts to achieve the SDGs and climate goals. However, without mentioning these goals, the G20 EPG Report posits weak and, in some respects, misguided proposals to address challenges of the global commons (e.g., climate change, global pandemics; loss of biodiversity; threats to oceans; forced displacement of people).

One proposal would "create global platforms with the UN guardian agency and the World Bank coordinating and leveraging on the key players in each of the commons". It would "integrate activities in support of the global commons into the IFIs' core programs and coordinate them within country platforms" – an approach which would rely on "market-based approaches that would crowd in the private sector into action on the global commons". This approach – especially in the context of poorly regulated economies dominated by foreign capital – is demonstrably inadequate and sometimes counter-productive. On a governance level, it threatens to further subordinate the non-G20 countries of the World Bank and IMF and the United Nations to the G20.

2) Regarding the second set of proposals for "Securing the Benefits of Interconnected Financial Markets" to promote economic stability and sustainable growth.....

This second set of proposals seeks to strengthen domestic financial markets, move toward greater openness to capital flows, and manage the risks to financial stability. On these issues, the G20 EPG Report's proposals would further centralize power and responsibility in rich countries for addressing financial risk by, for instance:

(a) *integrating the surveillance efforts of the IMF, the Financial Stability Board (FSB) and the Bank of International Settlements (BIS),* including through creating a "coherent *global risk map"* which would be managed by expanding the existing "early warning system" as well as through "stitching together the various layers of the Global Financial Safety Net to achieve scale and predictability".

Importantly, the member countries of the FSB are almost the same as the member countries of the G20; moreover the central bank membership of the BIS is also dominated by powerful countries. For instance, the BIS has 35 European member banks and 2 African member banks.

(b) *establishing a standing IMF liquidity facility to give countries timely access to temporary support during global liquidity shocks.*

It is possible that the EPG proposals for "*Securing the Benefits of Interconnected Financial Markets: Reforms for Global Financial Resilience*" could actually undermine resilience. In a forthcoming article by Daniela Gabor,[6] some risks of deepening financialization in ways envisioned by the G20 EPG Report include:

(a) limiting the capacity of domestic authorities to provide macroeconomic stability, since domestic financial conditions would be increasingly tied into the vagaries of global financial cycles and the interest rate decisions of large countries, particularly the US;

(b) encouraging states to divert fiscal resources into creating the financial infrastructure to attract foreign institutional investors, by for instance supporting guarantees and subsidies for private investors as well as the system-wide risk insurance system envisaged by the G20 EPG Report;

(c) reintroducing privatization of public services through the back door by normalizing the idea that public goods – education, health, infrastructure – can be provided by private entities and financed by institutional investors via capital markets. Development financing is thus redirected towards securing the profits of private companies and private finance;

(d) reducing the credit available to local companies, and therefore the demand for sustainable jobs. Such outcomes would undermine the ostensible goals of the G20 EGP Report such as supporting job creation and social stability.

3) Regarding the third set of proposals for "The G20 and the IFIs: Making the System Work as a System"…..

According to the Report, making the DFIs work as a system would require "two significant step-changes – to ensure coherence and synergies in a more diverse and decentralized world, and to achieve a critically needed shift in business models to catalyze private investments and enable greater development impact" (p. 66).

The proposals are divided into three parts: (a) The role of the G20 in developing forward-looking thinking and on global financial governance and crisis responses; (b) Governance of the IFIs as a system, so that they collectively deliver much more than the sum of their individual contributions; and (c) Governance within IFIs, in particular streamlining responsibilities for Executive Boards and Management to ensure effectiveness and outcome-driven oversight.

[6] "Understanding the financialisation of international development through 11 FAQs," University of the West of England (UWE, Bristol), October 2018.

To reform the governance of IFIs as a system, one proposal would establish a G20-led Group, with representation from key non-G20 constituencies and the IFIs, to "steer the reorientation of development finance over the next three years before handing the coordinating role to the IFI Heads. This should include building complementarity among all development partners, and a clear system of metrics to track impact and value for money."

With regard to governance within the MDBs, the EPG Report calls for streamlining the role of the Executive Board to focus more on strategic directions and devolve operational and transactional functions to Management. This striking proposal, which would abolish the traditional role for their executive boards in voting on individual project loans, would significantly insulate the Board from external constituencies and accountability for decisions on project operations. This governance structure resembles that of the China-led Asian Infrastructure Investment Bank.

CONCLUSION

As they stand, the proposals of the G20 EPG Report promote what Harvard's Dani Rodrik has called "hyperglobalization" —the attempt to eliminate most or all transaction costs that hinder trade and capital flows. In "Who Needs the Nation-State?" – Rodrik states that the imbalance between global markets and the domestic rules that govern them can be corrected either by expanding governance beyond the nation-state or restricting the reach of markets. The recommendations of the G20 EPG takes the former route. Importantly, Rodrik emphasizes that, whether globalization sets off a "race to the bottom" or not, we can break the deadlock between the proponents and opponents of globalization by accepting a simple principle: "Countries can uphold national standards in labor markets, finance, taxation, and other areas and can do so by raising barriers at the border, if necessary, when international trade and finance demonstrably threaten domestic practices that enjoy democratic support" (Roepke Lecture in Economic Geography, Clark University, 2012).

Summary of Key Concerns

- *The excessive focus on mobilizing public resources to leverage private investment, especially in social and economic infrastructure*

The fundamental problem with this focus is that private investors have inadequate incentives to serve the public good. The G20 and its partners are proposing core standards and standardized transactions to scale up private investment that lack meaningful social and environmental components, including a commitment to low- or no-carbon development pathways.

Moreover, there is a risk that spending on "big ticket" megaprojects does not tighten the noose of debt and austerity and eclipse other priorities.

To foster democracy and accountability, transparency, participation and accountability are needed. The MDBs have been scaling up this model of leveraging private investment since 2015, yet most of the preliminary results for several pilot countries and sectors have not been disclosed. Nor has domestic civil society been consulted.

- *Concerns relating to financialization, including securitization*

In the aftermath of the global financial crisis when there were questions about how trade and investment levels could be revived, the G20 and MDBs designed the financialization model to inject massive levels of private investment into the global economy. One expectation was that massive investment in megaprojects would compensate for declining levels of world trade. Moreover, there were hopes that financialization of infrastructure as an asset class would deliver returns to fill the gaps in retirement and insurance plans. For instance, retirement savings gap in just a few countries was $70 trillion in 2015 and may grow by 5% annually to $400 trillion by 2050, according to estimates by the World Economic Forum.

Unfortunately, the G20-led model attempts to plug the retirement gap with the same risky financial engineering strategies that contributed to the global financial crisis and retirement gaps. The G20-led financialization model also has the benefit of enabling the West to draw upon the savings of long-term institutional investors – some $100 trillion – to compete more effectively with the Chinese model in the arena of development finance.

In response to financialization efforts, it is important to assess the systematic risks underpinning the presence of global asset managers in the local bond markets of emerging and low-income countries, on the one hand, and the role of central banks and other national regulators, on the other. To enhance democracy and sustainability, it is necessary to identify ways that these countries can build significant protections and find entry points to influence the financialization efforts both "upstream" and "downstream."

- *The role of China and other emerging market countries*

It is notable that the Chinese model relies on state-owned enterprises (SOEs) and the enormous China Development Bank and China Export-Import Bank as well as its MDBs. At the same time, there is collaboration among all G20 members, including China, in financializing infrastructure (and potentially other sectors) as an asset class.

Two dynamics are playing out in the U.S. and the West, more generally: One is to bash the Chinese infrastructure efforts, as the U.S. Administration does. Another is to lower the transparency and environmental and social standards of Western-led development banks in order to compete more effectively with China.

However, what is needed is careful study and comparison of the Chinese "model" featuring its massive state-owned enterprises versus the G20-led model featuring the expansion of private investment, including long-term institutional investors, such as pension funds. This should lead to proposals for strong, system-wide core standards that protect citizens and the natural environment. Instead, the G20 EPG Report proposes core standards that emphasize protection for investors.

- *Democratization, including the role of civil society*

Dominance by the G20 in formulating and implementing proposals to reform global financial governance further centralizes power in the G20 member countries which already dominate the governance of the IFIs.

To fairly and effectively reform the global financial system, the discussion of G20 EPG proposals must be democratized; there must be more seats at the table. The governments of some 173 countries which are not members of the G20 should engage their citizens in assessing the proposals. Of those proposals that are approved, non-G20 countries should join G20 countries in leading the process of their implementation.

To date, most published input to the EPG has been limited to a few U.K. and U.S. think tanks.[7] Much broader segments of civil society should have far greater input to measures that would establish core standards, country platforms, and mechanisms for securitization. Such input should focus on ways to ensure upstream environmental and human rights due diligence and downstream application of safeguards.

Moreover, the space for civil society, which is shrinking at the global, regional, and national level, must be expanded. Civil society organizations (CSOs) as well as their elected representatives must be viewed as legitimate interlocutors. Instead, dissent is being criminalized in many countries. In "State of Civil Society – 2018", CIVICUS focuses on a range of issues from failing neoliberalism and a growing role of the private sector in governance to the undermining of democracy, the media, and civic space in many countries around the world.

These conditions exist in the context of a rise of autocracies and oligopolies; deregulation; poor rules relating to transparency (for business and security reasons); and opaque financial engineering such that the regulators and owners of financial assets do not know their value. If left untamed, the power of the private sector can eclipse democracy and hopes for a better world.

Instead, its power should be harnessed to ensure a livable, thriving planet and societies. This requires that efforts to advance private investment in social and economic infrastructure, agriculture, and other sectors must bear the burden of proof to show definitively that such investments serve the public good and long-term sustainability. This is especially the case in the context of the so-called "infrastructure arms race" which could overtake the more urgent race to meet the sustainable development and climate goals.

[7] See a joint paper by CGD, Brookings and ODI prepared for the EPG: https://www.brookings.edu/research/the-new-global-agenda-and-the-future-of-the-multilateral-development-bank-system/ and blogs by Brookings and CGD on the work of the EPG: a) https://www.brookings.edu/blog/future-development/2018/02/20/time-to-reform-the-multilateral-development-bank-system/; b) https://www.cgdev.org/blog/new-agenda-mdbs-five-practical-reforms; c) https://www.cgdev.org/blog/g20-eminent-persons-group-update-im-disappointed-still-hopeful; d) https://www.cgdev.org/blog/8-ideas-reforming-mdbs-eminent-persons-group. See also Chris Humphries, Channeling Private Investment to Infrastructure: What Can Development Banks Realistically Do? Overseas Development Institute Working paper 534, April 2018.

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