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Impact of Development Finance Institutions on Economic Growth: Implications for Reconstruction and Development Fund of Uzbekistan

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Abstract: The International financial system has been increasingly supporting the economic growth in all economic groups of countries by offering a range of opportunities to push development paces. Establishment of financial development institutions is growth driving engine of both developed and developing countries through development-oriented projects and funding tools. However, developing economies are facing particular challenges in prioritizing the basic financing areas through the development of financial tools. This article analyses the impact of global development finance institutions on world economic growth and proposes policy and research-oriented recommendations for Reconstruction and Development Fund of Uzbekistan.

Keywords: Development finance, DFI, Reconstruction fund of Uzbekistan, Development fund of Uzbekistan

1. Introduction

Development finance institutions (DFIs) play a fundamental role in emerging markets and developing economies (King & Wood Mallesons, 2013). DFIs provide a broad range of financial services in developing countries, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds and financing for public infrastructure projects (Dickinson, 2009). The global economy needs development support from different sources of financing in diverse geographic areas to bridge the expanding gap in development status of countries. Initially, the Bretton Woods institutions paved the pathway of development finance by investing in and supporting the developing societies to keep pace with developed counterparts. In a short time frame, successful lending and cofinancing projects revealed the impact of development financing tools on infrastructure and living conditions of the population. The positive impact of development finance was a good stimulus to spread and emerge as an alternative development finance body such as Chian Mai Initiative and Asian Monetary Fund on the bilateral and private basis. Moreover, this trend became a proven path of supporting economic growth and societal wellbeing, countries, who were striving for development, established national development finance institutions and launched projects and funding schemes to ensure sustainable growth.

Nowadays largest contribution to development finance is being made by national DFIs in the form of specialized development banks, public development funds or cluster of private funds. International DFIs are classified as multilateral and bilateral ones depending on the origin and core aims of an establishment. AFD/Proparco (France), KfW/DEG (Germany), CDP/SIMEST (Italy), FMO (Netherlands), NorFund (Norway), SIFEM (Switzerland), COFIDES (Spain), CDC Group (United Kingdom) and OPIC (United States of America) are the largest bilateral development supporter for developing economies. Multilateral DFIs operate in the form of development banks, namely the Bretton Woods institutions, ADB, AfDB, EBRD IDB and invest under government guarantee (Table 1).

The number of Islamic banks around the world is 396 in 53 countries managing a total fund of US$442 billion. In addition, non-main stream banks around the world which offers Islamic banking windows are 320 banks managing a fund of US$200 billion (Nasser and Muhammed, 2013). Companies enjoy with high growth rate and profits command high price earnings ratio and higher share price whereas companies slowing down or with fewer growth prospects are punished by lower price-earnings ratios and stock prices (Singhania and Anchalia, 2013).

However, to maintain and monitor the robust of Islamic banks performance is more difficult. There are some challenges which influenced the performance of Islamic banking operations such as lack of human resources capital, limited alternatives to Islamic investments and etc. Thus, improvement and innovation should be undertaking in order to overcome the challenge faced by Islamic banking institutions. Messis and Zapranis (2014) stated that the role of financial markets and institutions in the economy is very important since they constitute the channel of passing funds from savers to investors. A small volatility in the prices of financial assets is acceptable due to the process of allocating funds among competing uses.

Table 1: Development funding(lending, technical assistance, and grants for development purposes) by multilateral and bilateral DFIs in 2016, million USD

DFI name	***Concessional flows***	***Non-Concessional flows***
African Development Bank (AfDB)	2 282	2 376
Arab Fund for Economic and Social Development (AFESD)	618	
Asian Development Bank (ADB)	2 700	9 785
Arab Bank for Economic Development in Africa (BADEA)	126	
Caribbean Development Bank	57	85
Climate Investment Funds (CIFs)	247	
Council of Europe Development Bank (CEB)	54	252
European Bank for Reconstruction and Development (EBRD)		5 026
Global Environment Facility (GEF)	813	
Global Green Growth Institute (GGGI)	9	
Inter-American Development Bank (IaDB)	2 126	8 938
International Fund for Agricultural Development (IFAD)	546	110
International Finance Corporation		9 659
IMF (Concessional Trust Funds)	1 472	
Islamic Development Bank (ISDB)	195	1 833
Nordic Development Fund	39	
OPEC Fund for International Development (OFID)	395	633
UN Development Programme (UNDP)	420	
UN Economic Commission for Europe(UNECE)	14	
UN Environment Programme (UNEP)	125	
UN Population Fund (UNFPA)	313	
UNICEF	1 402	
World Bank (IDA and IBRD)	13 375	19 234
TOTAL	**27 328**	**57 931**

Source: OECD, 2017

Emerging and developing economies regularly need financial support in maintaining economic development. Moreover, in particular conditions multilateral and bilateral DFIs do not allocate the needed funding source deriving from their own analysis of the funded project, although this funding tool may have a significant social importance. In order to cope with difficulties in ensuring financial provision to socially important but economically less effective projects, governments establish their own DFIs. Some governments use the assets of national DFIs as a guaranteeing tool for foreign investments and cofinancing operation with international multilateral and bilateral DFIs.

As a rapidly growing economy, Uzbekistan has close cooperation with DFIs in promoting the effectiveness, modernization, and diversification of the national economy. In line with cofinancing with multilateral and bilateral DFIs, Uzbekistan established national DFI – Reconstruction and Development Fund of Uzbekistan in 2006 in order to implement modernization and technical equipping of leading and priority sectors, to ensure dynamic, sustainable and balanced socio-economic growth, to run effective and structural investment policy.

2. Literature Review

Although development finance is becoming a hotly debated topic, literature is very limited to track the chain of studies. Publication of discussions and analytical reports gain a purely political character and oriented to policymaker's materials. There is a bunch of literature which have restrictions on scale, scope, geography, and depth of studies. Hence research community development finance conducted studies from diverse angles and concepts. Park (1973) investigated the linkages between IMF's attempts to reform monetary system and their impact on development finance architecture focusing on SDR regime and development lending procedures. Santiso (2001) examined the roles international DFIs in establishing good governance by increasing the effectiveness of development funding in case of the World Bank. He found that there is a growing need for improving good governance to shift the effectiveness of development financing by all multilateral DFIs. Addison, Mavrotas, and McGillivray (2005) clarified the difference between development finance and development finance, which is often confused and both provided by DFIs. Shafik (2011) approached the role of DFI's in future and analyzed the relevance and future focus arear of DFIs. Results of his in-depth studies showed that DFI's role keeps strengthening and it will become an effective tool for problem-solving. Yuan and Gallagher (2015) examined the role and importance of DFIs from another corner based on the global needs and concluded that DFIs must pay attention to building the green economy.

3. Methodology

Modelling of impact analysis is an issue of the wide research community if it is related to the economic development issues. Considering the volatile global economic profile and unevenly distributed development levels among regions and countries poses the issues of uncertainty, mismatching, and errors in obtained results. Therefore, it is decided to build a cumulative data modeling in OLS method. Global development finance indicators can be developed into several indicators characterizing the type, coverage, and geography of funding. It is decided to run OLS test based on functional relationship among following indicators:

$$f(ECD)=(TDF, MAF, FDI) \qquad (1)$$

Where, ECD – economic development – key impact indicator and dependent variable in OLS test. TDF – total development funding – cumulative amount of investments for development purposes, MAF – multilateral agency funding – development financing tools by multilateral and bilateral DFIs, FDI – foreign direct investment – a comparative indicator to assess the impact. Deriving from the functional relationship, we specify our econometric model in OLS method:

$$ECD_t = \beta_0 + \beta_1 TDF_t + \beta_2 MAF_t + \beta_3 FDI_t + \varepsilon_t \qquad (2)$$

4. Analysis and Results

The data used in this analysis is focused on long period dynamic behavior for the share price of BIMB. The data selected for this research is collected from the year of 2010 until 2016. Before moving to the OLS test, descriptive statistics is run to see the oval scenario of the relationship between economic growth and development finance in comparison to foreign direct investment. We selected the annual data from 2005-2017 as an observed period of study. Descriptive statistics show that selected indicators ranged normally in the selected period (Table 2). Despite high probability, kurtosis, standard deviation, and Jarque-Bera coefficients are an acceptable level.

Table 2: Descriptive statistics

	ECD	TDF	MAF	FDI
Mean	93518374	135214.2	37440.86	1554254.
Median	92063791	132662.8	38676.43	1563409.
Maximum	1.20E+08	170518.0	57931.00	2019505.
Minimum	67745612	107280.4	22638.22	990808.0
Std. Dev.	16766304	21046.98	9377.795	282197.5
Skewness	0.112561	0.122797	0.404927	-0.370625
Kurtosis	1.853026	1.925161	3.228852	2.816572
Jarque-Bera	0.683114	0.607797	0.354118	0.291548
Probability	0.710663	0.737936	0.837730	0.864353
Sum	1.12E+09	1622571.	449290.4	18651048
Sum Sq. Dev.	3.09E+15	4.87E+09	9.67E+08	8.76E+11
Observations	12	12	12	12

Using EVIEWS 9.5 analysis tool we run OLS test. OLS test results showed that all independent variables (TDF, MAF, FDI) positively influence on the dependent variable (ECD) (Table 3). In other words, development finance tools positively relate to economic development in the selected period.

Table 3: OLS test results

	Coefficient	Std. Error	t-Statistic	Prob.
C	-17267890	12685435	-1.361238	0.2105
TDF	640.1249	166.8664	3.836153	0.0050
MAF	186.8539	385.6218	0.484552	0.0410
FDI	11.08976	4.844274	2.289251	0.0513

R-squared	0.955585	Mean dependent var	93518374
Adjusted R-squared	0.938929	S.D. dependent var	16766304
S.E. of regression	4143381.	Akaike info criterion	33.57312
Sum squared resid	1.37E+14	Schwarz criterion	33.73476
Log likelihood	-197.4387	Hannan-Quinn criter.	33.51328
F-statistic	57.37272	Durbin-Watson stat	2.542848
Prob(F-statistic)	0.000009		

In this test, we aimed to get the overall scenario of the linkages between economic development and development finance. Then, we set another objective: running comparative analysis of foreign direct investment and development finance assignations. Comparative analysis revealed that development finance tools positively support the economic development in 640/11 ratio or 58 times better. Among three factors, total development funding supported economic growth most, multilateral development finance volume was in the second position in forwarding economic growth. The foreign direct investment was also an engine for economic development in the world in the selected period.

5. Conclusion

Undoubtedly, development finance is becoming a key asset and a driving force of boosting economic development over the world. However, its impact is rarely measured due to the abovementioned cases. Despite regular growth in the world economy in 2-3 percent on average, it cannot sufficiently support socio-economic advances in developing and emerging economies. Development finance is a good tool for bridging this gap and imperfection. Following the common trend of development finance and considering the OLS test results, we propose following generalized and tailored recommendations to further improve the efficiency of Reconstruction and Development Fund of Uzbekistan in economic development:

1. In line with attracting foreign investments, internal sources play the central role in boosting gross national income (GNI). Further expansion of investment capacity of the Reconstruction and Development Fund of Uzbekistan facilitates the extra value added in economic development.
2. As a national DFI, the Reconstruction and Development Fund of Uzbekistan is to expand the coverage and financing/co-financing infrastructure related projects to support living condition enhancement and business climate advance.

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