Diversifying funding for growth in transition countries

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Participants:

Hans Peter Lankes, Managing Director, Corporate Strategy and Acting Chief Economist, European Bank for Reconstruction and Development
Çağatay Bircan, Principal Economist at the Office of the Chief Economist, European Bank for Reconstruction and Development

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Notes:

The Transition Report is published annually by the European Bank for Reconstruction and Development (EBRD). The 2015-16 edition focuses on transition countries' need to diversify their funding in order to drive sustainable growth.

Investment rates in transition countries exceeded those in other countries with similar economic, social, demographic and political characteristics prior to the financial crisis. However, since the appearance of the 'Great Recession' the trend has reversed, leading to an investment gap. Should transition economies still rely on the same financing sources or would it be advisable to shift to different ones?

Hans Peter Lankes argued for a rebalancing of finance in transition countries to foster economic growth. The challenge is not only reduced to improve the quantity of finance available, but also to explore alternative forms and sources of funding. What desirable measures should be pursued to achieve financial rebalancing and boost investment?

Among the EBRD recommendations, the following stand out:

1. Increase the role of private equity as a source of funding. **Çağatay Bircan** said "private equity is an underutilised source of finance for companies in the EBRD region." Projects that unify capital markets, such as the EU's Capital Markets Union, could incentivise private equity lending in transition countries.
2. Substitute cross-border for domestic bank funding with the aim of smoothing credit cycles (largely produced by a credit crunch).
3. Reduce foreign currency credit with the objective of mitigating risk exposure to exchange rate movements.
4. Shift towards a more diverse network of cross-border investment partnerships.

Nevertheless, the Transition Report advocates for a gradual rather than a rapid convergence to these measures.

The main conclusions of the Transition Report are

(1) The pre-crisis financing model was not sustainable and does not work.
(2) There is an existing post-crisis investment gap, which could be partially solved through the above policy recommendations.
(3) A significant rebalancing process is needed to implement a stable financial system.

Event notes by Jaume Martí Romero, Research Intern