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DEBrief

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The Catalytic Role of Multilateral Development Banks in Mobilizing Private Finance

- In developing countries alone, the annual investment gap to meet the Sustainable Development Goals (SDGs) by 2030 is estimated at US$2.5 trillion.
- Multilateral Development Banks (MDBs) can play a key role in bridging this gap by mobilizing private finance flows towards SDG-related investments.
- A joint study by the IDB Group and the International Monetary Fund tested whether MDBs crowd in private finance by analyzing syndicated lending to over 100 developing countries over 25 years.
- The results show that MDB lending attracts finance from private creditors. For each US$1 MDBs invest in a loan syndication in a given country and sector over a three-year period, commercial banks lend about US$7.
- Access to credit also improves as both the average number of lending banks per loan and loan maturity increase.

SUSTAINABLE DEVELOPMENT GOALS

17 PARTNERSHIPS FOR THE GOALS

MOBILIZING PRIVATE FINANCE FOR THE SUSTAINABLE DEVELOPMENT GOALS

Despite mounting private sector interest in sustainable investing, there is a pressing need to accelerate and magnify financing towards the Sustainable Development Goals (SDGs). The UN estimates that public and private investment in SDG-related sectors in developing countries falls short by about US$2.5 trillion annually in order to reach 2030 targets.[1]

In addition to public resources and development aid, the private sector has a pivotal role to play in filling this funding gap. With an estimated US$74 trillion in global assets under management[2], there is no shortage of private capital. The challenge is attracting private investment to sectors critical for sustainable development, such as infrastructure, through projects that meet investors' risk and return expectations.

Beyond directly financing countries' economic and social development, MDBs are instrumental in mobilizing additional private resources by helping mitigate risk and paving the way for investors to enter new markets.[3] For example, the US$5.5 billion Panama Canal expansion project, about 40% of which was financed by MDBs, catalyzed nearly US$10 billion in private investment from the time it was announced in 2006 to 2011, 1.8 times the project cost.[4]

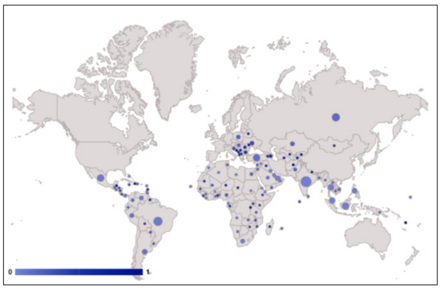
In general, MDBs can leverage additional resources either directly from co-investors contributing to the same project or indirectly by helping give investors the confidence they need to invest in a given market. MDB lending should not be a substitute for private finance, but rather a way to crowd in private financial flows to developing markets.

ESTIMATING MDB MOBILIZATION EFFECTS

To better understand the mobilization effects of MDBs, which have been largely overlooked by research on catalytic finance to date, a study carried out by economists from the IDB Group and the International Monetary Fund tested whether MDBs crowd in private sector resources to finance investment in developing countries.

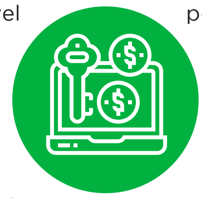
The study analyzes loan-level data on syndicated lending for a sample of over 100 developing countries between 1993 and 2017. Syndicated loans are provided by a group of lenders (e.g., banks, institutional investors, private sector windows of MDBs) that share risks by pooling capital together. The sample includes over 21,000 syndicated loans in nine sectors, with most loans going to firms in the finance, infrastructure, and manufacturing industries. The average syndicated loan in the sample is formed by 6 banks. As Figure 1[5] shows, the number of syndicated loans and the share with MDB support varies across countries.

Figure 1: Number of Syndicated Loans and Share with MDB Support by Country, 1993-2017



1. UNCTAD (2014). World Investment Report.
2. The Boston Consulting Group (BCG). Global Asset Management 2019. Will These '20s Roar?
3. For more information, see Mobilization of Private Finance by Multilateral Development Banks and Development Finance Institutions 2017.
4. IDB Invest (2018). Infrastructure Investments and Private Investment Catalyzation: The Case of the Panama Canal Expansion. See also the DEBrief.
5. The bubbles represent the number of syndicated loans by country (1993-2017): the larger the bubble, the more syndicated loans. The color represents the share of syndicated loans supported by at least one MDB in the period: darker blue indicates more syndicated loans with MDB support.

To estimate the catalytic effects of MDB lending, the study identifies new syndicated loans in a given country and sector that came in after an MDB had already provided co-financing in a syndicated loan in the same country and sector. The granularity of the loan-level data allows the authors to better isolate the effects of MDBs on subsequent bank flows, dig deeper into the impacts for the infrastructure sector in particular- given its relevance for development and pressing financing needs -, and distinguish between direct and indirect mobilization effects.



KEY FINDINGS

The results indicate that the amount of syndicated lending, the average number of lending banks per loan, and the average loan maturity all increase following the presence of a syndicated loan with MDB participation in a given country and sector.

The average effects are also economically sizable and last for at least three years. For example, having at least one syndicated loan supported by at least one MDB is associated with a cumulative increase of syndicated loans amounting to 0.125% of gross domestic product (GDP) over a three-year period. In other words, private creditors were providing more and bigger loans in developing countries, with the average size of their syndicated loans increasing by 1.2 times following MDB participation in a syndication. Overall, for each US$1 MDBs invest in a loan syndication in a given country and sector over a three-year period, commercial banks lend about US$7.

In the infrastructure sector, the mobilization effect spurred by MDB participation increases the average maturity of syndicated loans by 1 year. This finding is particularly relevant given the sector's long-term financing needs, and these results are substantial even in subsequent years.

The study includes a series of tests to verify the veracity of the findings. For example, no evidence was found of anticipation effects causing MDBs to go into markets that were already receiving more and larger syndicated loans.The findings also confirmed that the mobilization effects observed were indeed driven by MDBs and not by other players in the syndicated loan space, such as large global banks, Chinese lending, or aid flows. And, MDB mobilization effects in the syndicated loan market do not crowd out corporate bond financing.

Overall, the results show that mobilization effects vary by country. In particular, MDBs face significant challenges in attracting private resources to low-income countries.

THE WAY AHEAD

While these results confirm that MDBs are playing a key role in mobilizing private investment, much more can be done to enhance their catalytic capacity. As international commercial banks continue to rationalize their use of capital in developing countries as a result of tighter regulations, the focus is shifting towards mobilizing funding from institutional investors. These investors, however, often look for greater risk-sharing from MDBs or blended finance sources. So perhaps MDBs should consider taking on more risk than they typically do in order to get more institutional investors on board.

Ongoing efforts are underway across MDBs to design and deploy new financial tools to help unlock more private finance for development, such as bond products, specialized investment vehicles, and unfunded credit protection products. MDBs are also working on the non-financial front to better leverage their deep sector knowledge, local market insights, and impact measurement expertise to attract investors to SDG-related projects in developing countries. ■

Additional Information

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This DEBrief summarizes the findings of the study by Broccolini, C., Giulia Lotti, Alessandro Maffioli, Andrea Presbitero, and Rodolfo Stucchi (2019), Mobilization Effects of Multilateral Development Banks, which is part of IDB Invest's Development through the Private Sector Series.

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