11th UNCTAD Debt Management Conference

13–15 November 2017

Palais des Nations , Geneva

Debt for Development: Still an option in the «age of anxiety»?

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

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Will SDG financing efforts contribute to a new debt crisis?

UNCTAD, 13. November 2017

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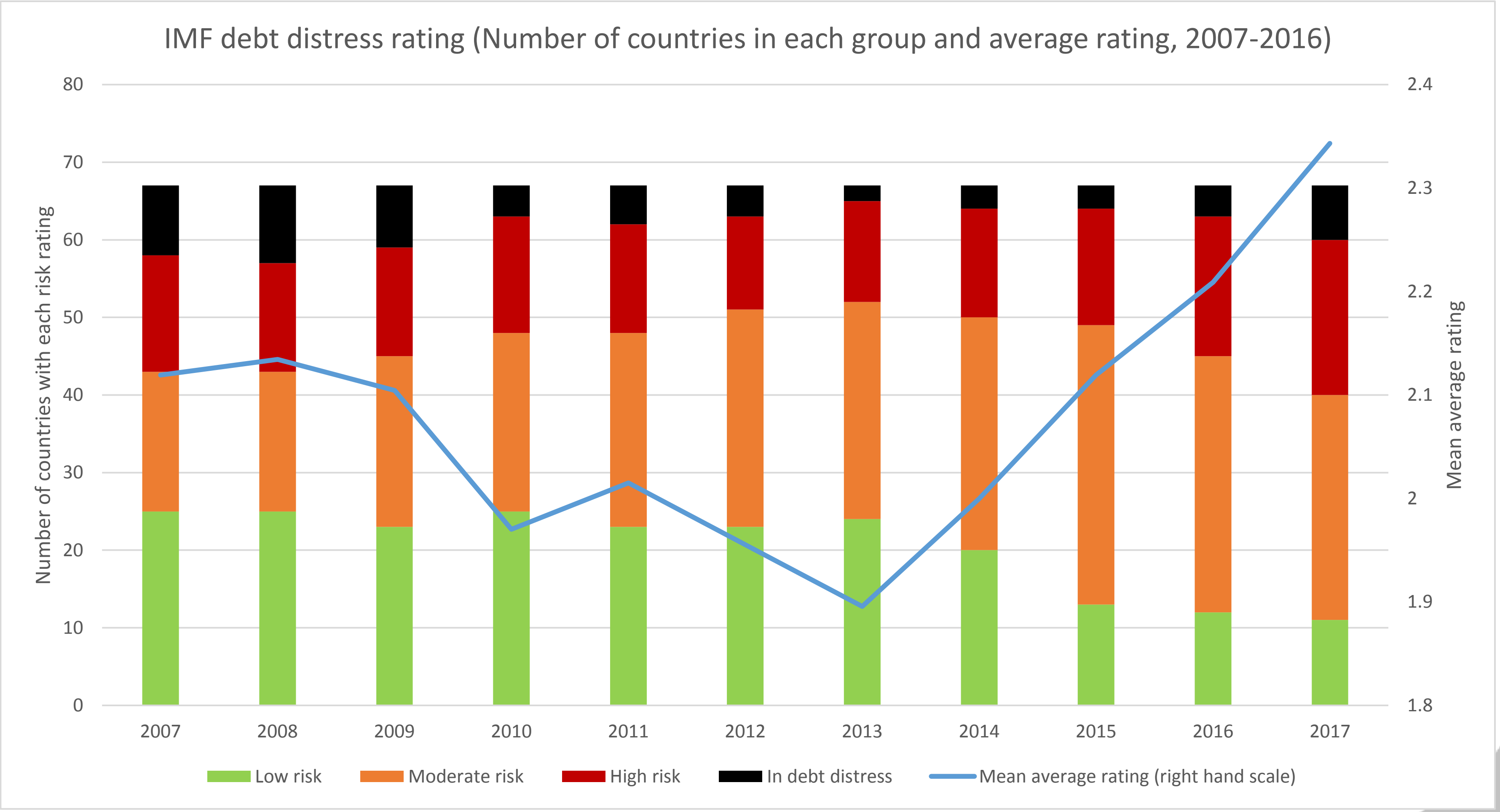
ÖFSE
Österreichische Forschungsstiftung für Internationale Entwicklung

Content

- Rising debt levels in developing countries
- Increased importance of the private sector in development cooperation
- SDG-financing „gaps“ – hopes are projected to Private Finance – „from billions to trillions“
- Are debt risks sufficiently taken into account?

Debt on the rise again



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Greater Role of Private Sector in Development Cooperation

- **FFD Process since 2002 (Monterrey, Doha, Addis Ababa - AAAA)**
  - Importance of the private sector, e.g. promotion of private sector financial innovations & PPPs.
  - Private Sector as a target and actor in the process itself
- **HLF for Aid Effectiveness since 2003 => Busan partnership agreement (2011)**
  - Central role of PS in development; encourages closer private-public engagement
- **EU-Agenda for Change (2012)**
  - Calls for making the private sector a main partner in development
  - Aims for greater use of blending to mobilise private capital
- **2030 Agenda for Sustainable Development**
  - Private sector as main partner in developing & implementing SDGs
- **G20 – Compact with Africa**
- Private Investment in Infrastructure

The SDG-financing gap

- Need for infrastructure – huge estimated financing gaps
- **Global Infrastructure Outlook 2017**
  - Global need for infrastructure investment: $94 trillion by 2040, a further $3.5 trillion required to meet SDGs for electricity and water.
  - Africa's infrastructure investment gap doubles from 2016 to 2040, from $1.7 trillion to $3.3 trillion owing to additional investment needed to meet the SDGs
- Public sector cannot bear this alone
- Move from billions (ODA) to trillions with private sector finance

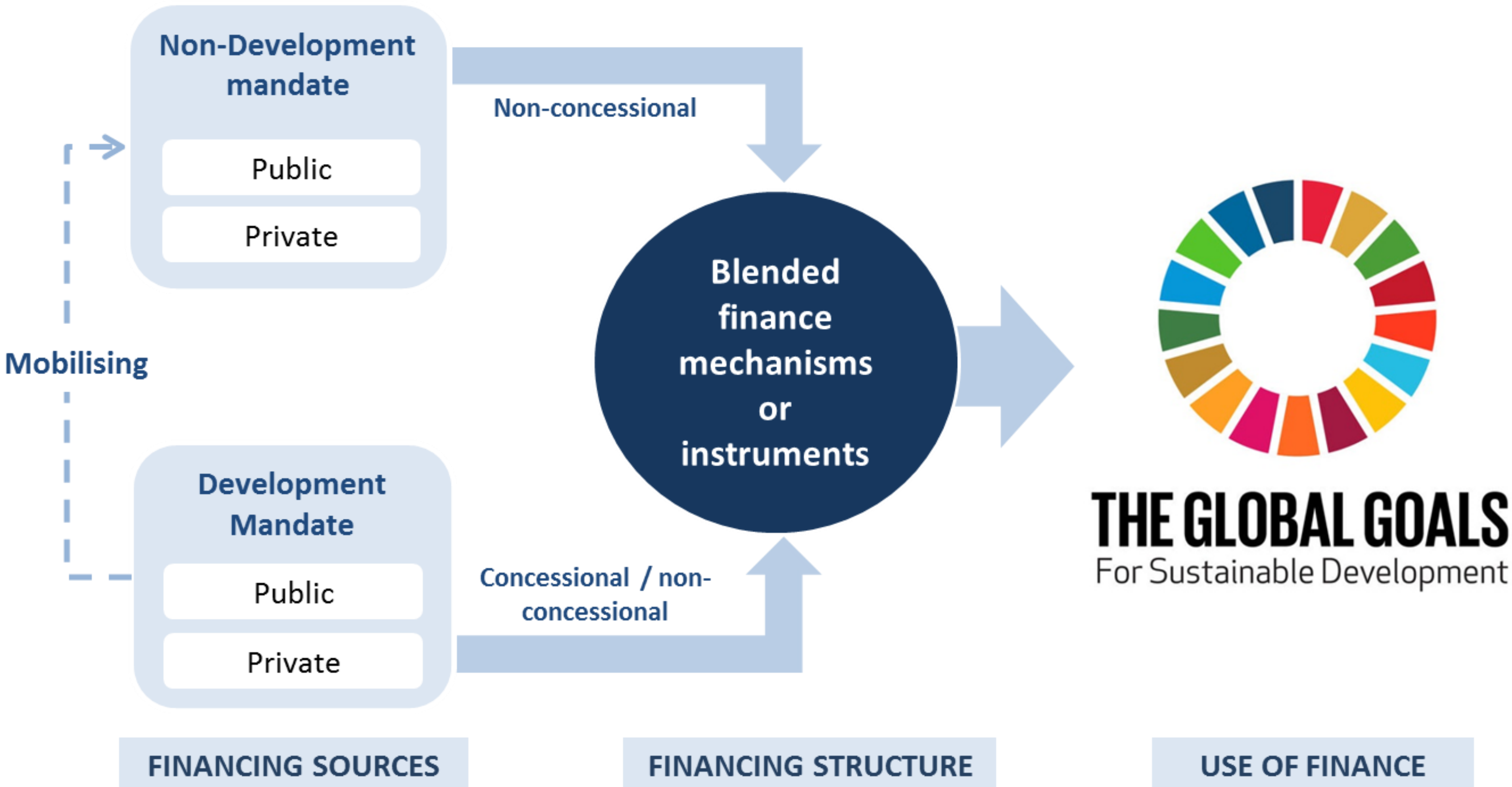
Mobilizing private capital: „Blending“

Definition of Blending

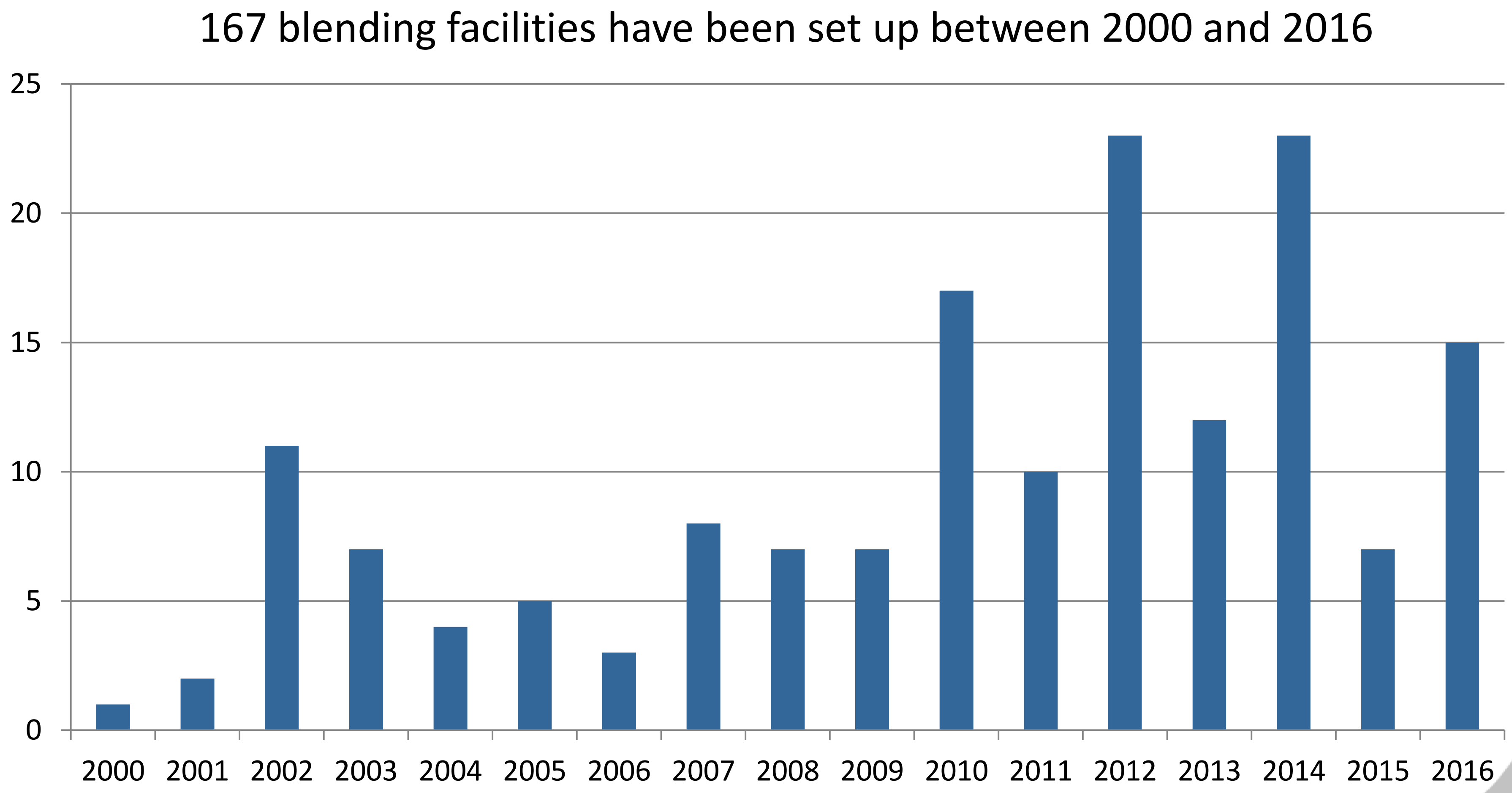
“Strategic use of development finance for the mobilisation of additional finance towards the SDGs in developing countries’. Additional finance refers primarily to commercial finance not currently addressing development objectives” (OECD 2017)

- “Blended finance is emerging as one solution with significant potential to help meet the investment gap by using public support to mobilise commercial finance” (OECD 2017)

Design of blending mechanisms

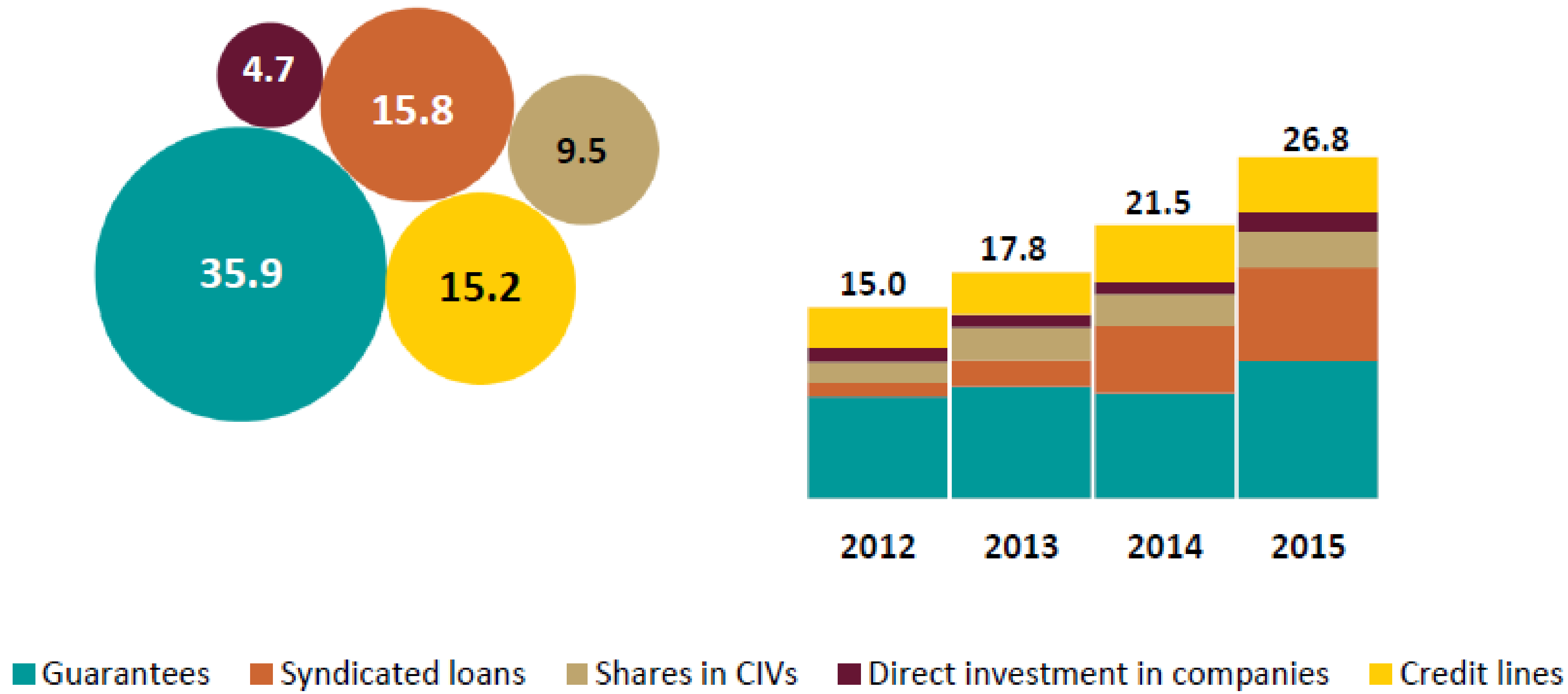


Proliferation of blending facilities



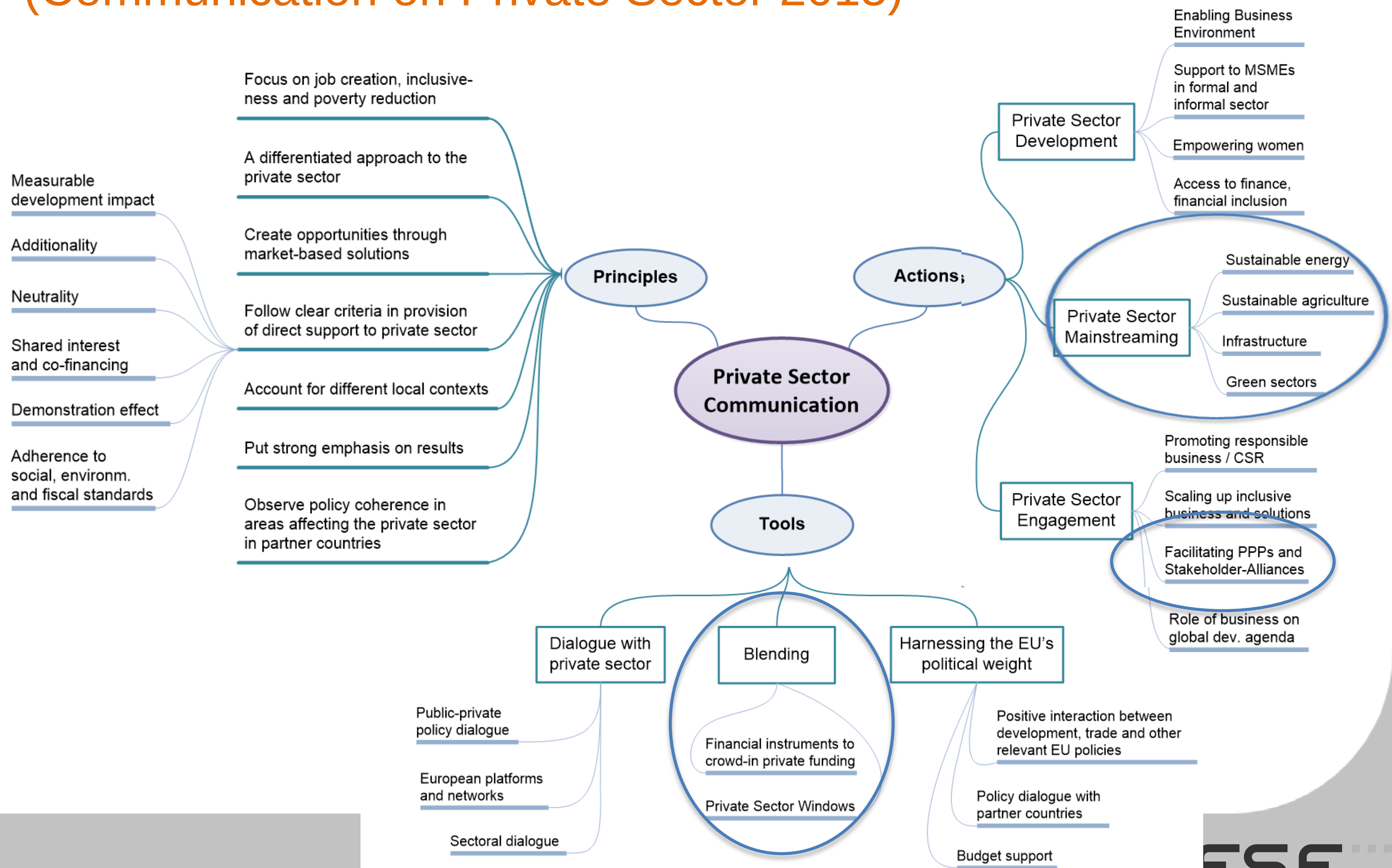
Leverage/mobilisation of different instruments

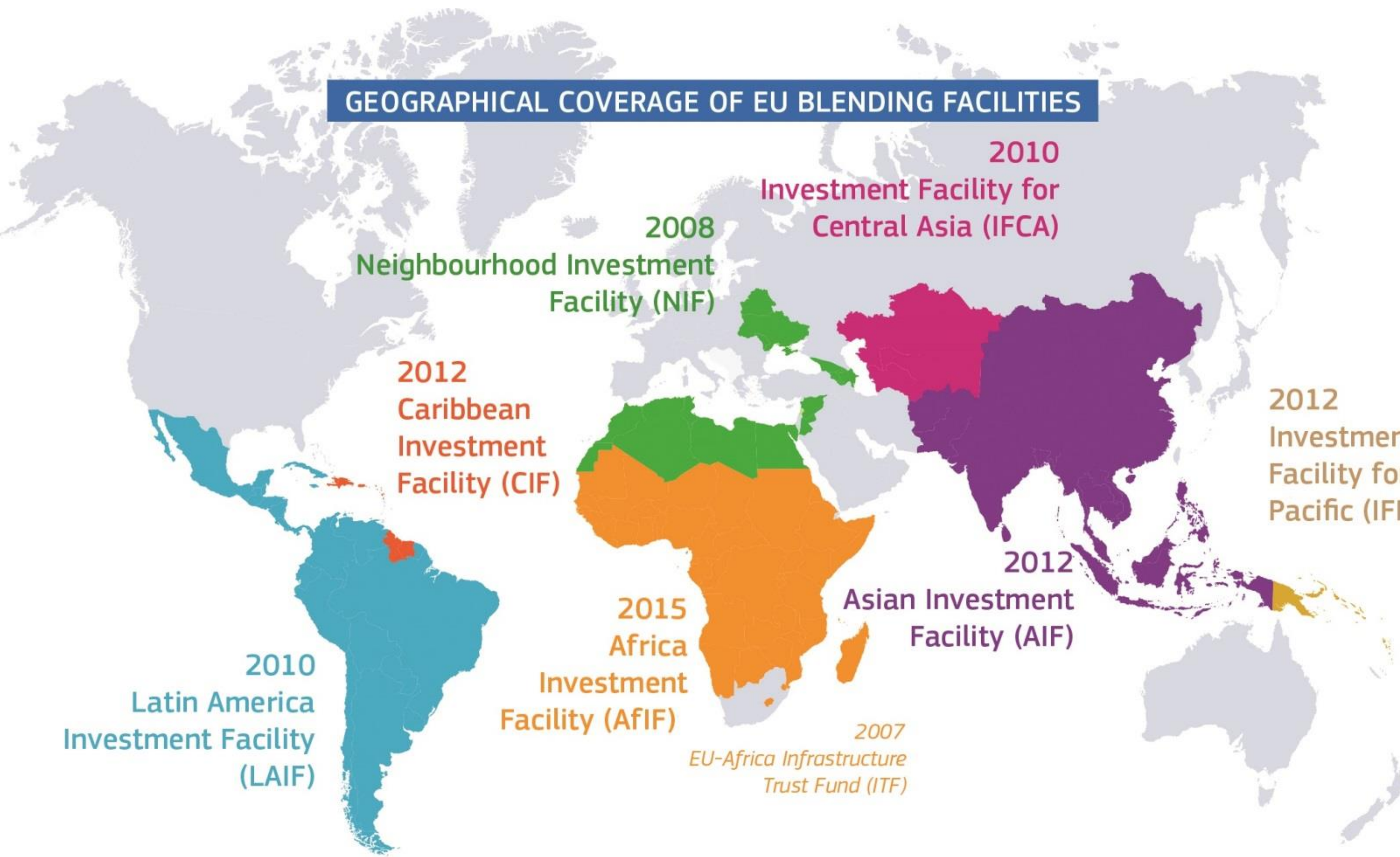
2012-2015: US$ 81 billion mobilised from private sector by ODF interventions



Benn et al. 2017

EU as an important actor in blendig
(Communication on Private Sector 2015)





GEOGRAPHICAL COVERAGE OF EU BLENDING FACILITIES
2010
Investment Facility for
Central Asia (IFCA)
2008
Neighbourhood Investment
Facility (NIF)
2012
Caribbean
Investment
Facility (CIF)
2012
Investment
Facility for the
Pacific (IFP)
2012
Asian Investment
Facility (AIF)
2015
Africa
Investment
Facility (AfIF)
2010
Latin America
Investment Facility
(LAIF)
2007
EU-Africa Infrastructure
Trust Fund (ITF)

Leverage effect

Framework	Facility name	Year of establishment	EU contribution	Leverage effect 2010-2015	
Development cooperation instrument (DCI) blending framework	Latin America Investment Facility (LAIF)	2010	€232 million for 28 projects (2010-2015)	1:29	
	Asia Investment Facility (AIF)	2010	€89 million for 18 projects (2010-2015)	1:30	
	Investment Facility for Central Asia (IFCA)	2010	€119 million for 22 projects (2010-2015)	1:7	
European Development Fund (EDF) blending framework	Africa Investment Facility (AfIF) (replacing former EU-Africa Infrastructure Trust Fund (EU -AITF) in place since 2007	2015)	€654.9 million for 77 projects (2007-2015)	1:14	Part of EFSD
	Caribbean Investment Facility (CIF)	2012	€68.6 million for 9 projects (2012-2015)	1:8	
	Investment Facility for the Pacific (IFP)	2012	Two EIB-led operations €10 million (2012-2014)	No data	
European neighbourhood blending framework	Neighbourhood Investment Facility (NIF)	2008	€1.072 billion 95 projects (2008-2014)	No data	Part of EFSD

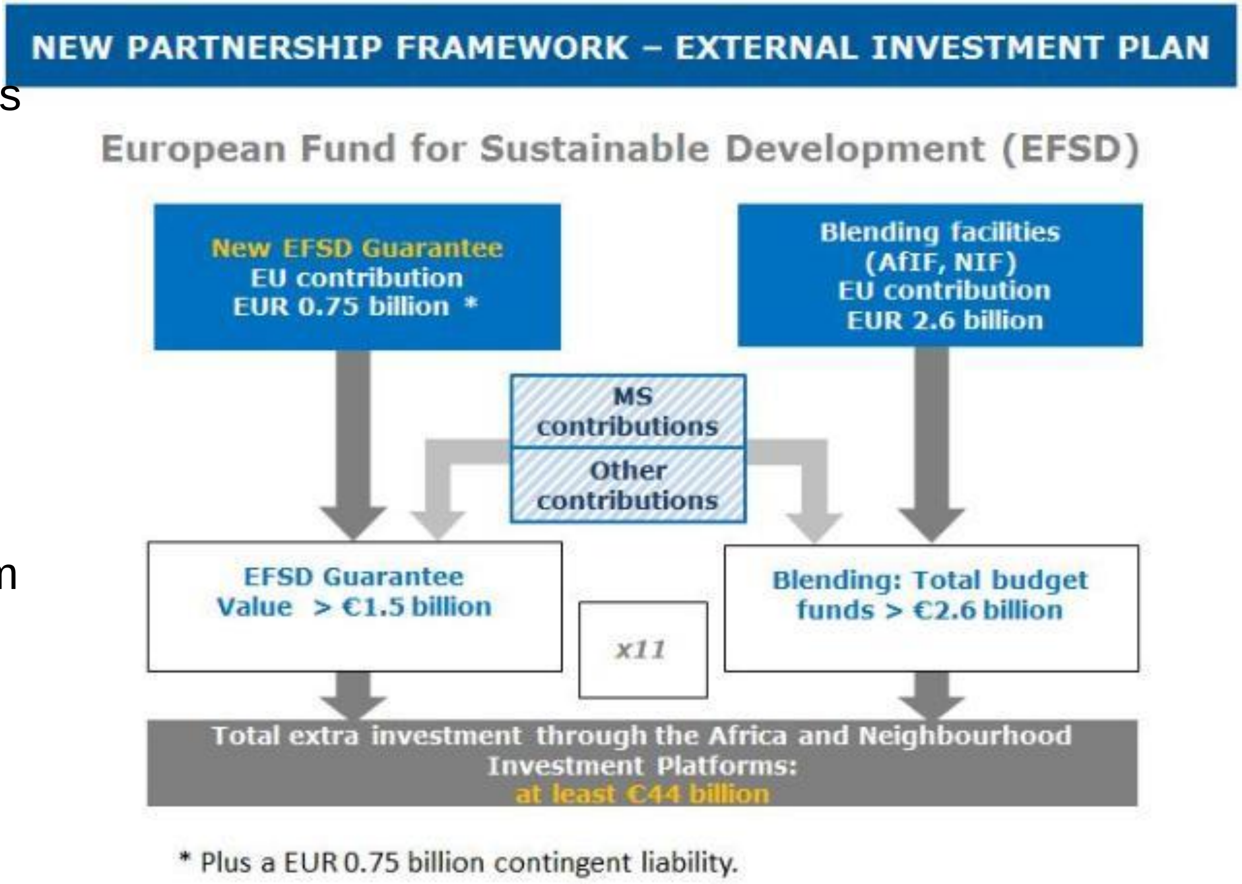
Source: European Commission.

External Investment Plan (EIP)

ESFD will combine existing blending facilities with a guarantee instrument

Objectives:

- ➢provide a one-stop-shop for proposals from public DFIs & private investors
- ➢leverage additional finance, in particular from the private sector, as EFSD guarantee will reduce risk and absorb potential losses



EC-Contribution €4.1 bio; expected leverage > €44 bio by 2020

To enhance "firepower and efficiency" Member States & other partners should contribute

Will blending close the „gap“?

- “Thinking of blended finance simply as a way of turning ‘billions to trillions’ obscures the fact that it turns grants into a type of finance (close to market terms) that cannot be so widely used in pursuit of sustainable development, because only a subset of development needs will be delivered by investments that generate returns.“

  Paddy Carter, ODI (2015)

- Evaluations pose questions of additionality, accountability, ownership

Potential debt risks for developing countries

- Blending mechanisms entail debt instruments
- Could further increase DCs debt exposure => undermine fiscal space & ability to attract other sources of funding.
- Private blending: risk that liabilities of the private actors may become public liabilities if the projects fail

- **Have these risks been taken into account sufficiently?**

Discourse (ctd): The SDG-financing gap

- Need for infrastructure – huge financing gaps
- Public sector cannot bear this alone
- Move from billions (ODA) to trillions with private sector finance

Other reasons:

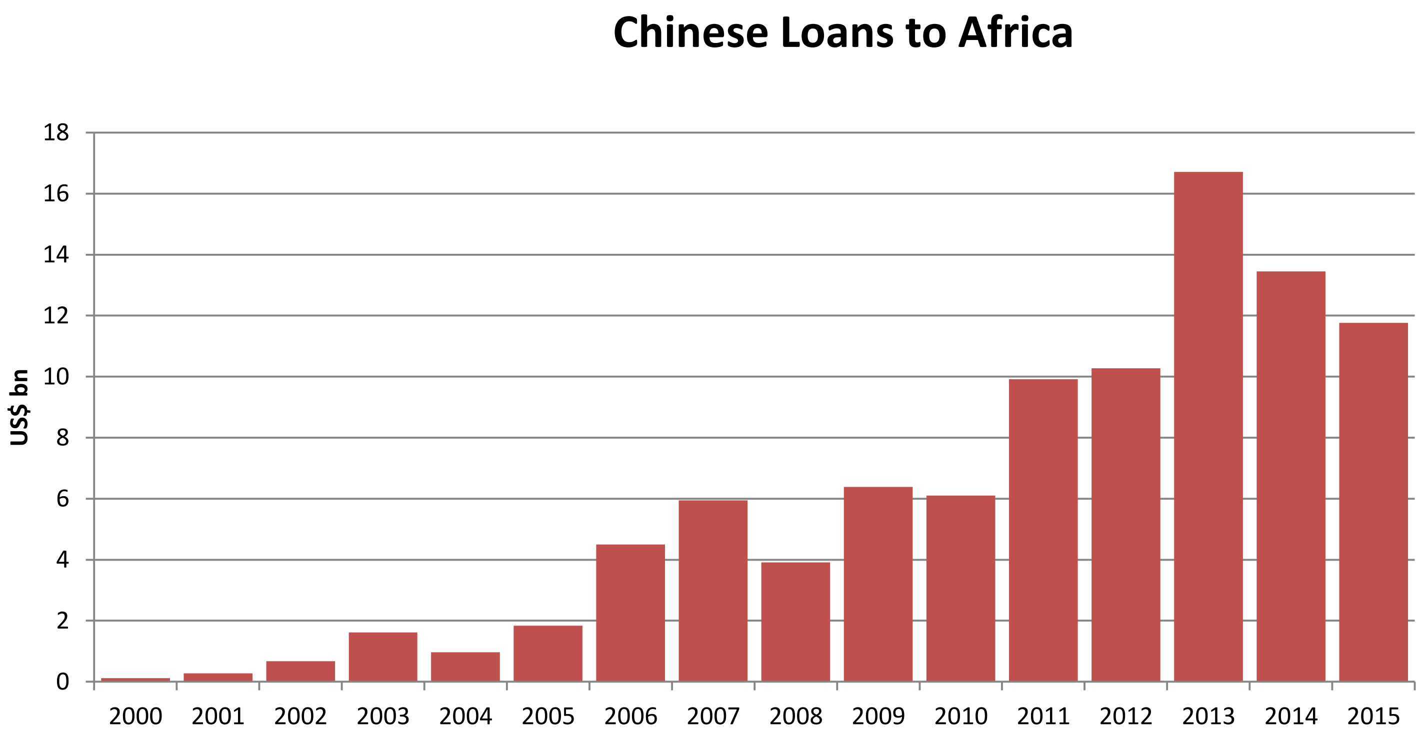
- Loans from China – rising competition?
- Private investors looking for returns (eg. institutional investors in OECD countries hold 90 trillions in assets in 2014, expected to grow to 120 trillion in 2019) (OECD 2015)

Competition from China

- Chinese support their (public) investment using an array of instruments including concessional loans, grants, and export credits. “There is anecdotal evidence suggesting that a Chinese companies’ access to state guaranteed loan and capital swung the deal in mining bids.” (European Think Tanks Group 2011)

- Between 2000 and 2015 China provided USD 94 bn of loans to African countries with a strong focus on infrastructure. In 2015, President Xi pledged another USD 60 bn in development funding for Africa, mainly in form of loans and export credits (Atkins at al. 2017, Dollar 2016 Middlehurst 2015).

Chinese Loans to Africa



Version 1.3. May 2017

CHINA AFRICA RESEARCH INITIATIVE

JOHNS HOPKINS SCHOOL of ADVANCED INTERNATIONAL STUDIES

Source: Atkinson et al 2017

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Public Private Partnerships

- Institutionalised form of blended finance
- Collaborations between public and private entities in which risk, returns and financing are negotiated between partners. Latter typically provide public services for financial returns
- Risk should be borne by those who are best place to manage it (IMF 2005, Jomo 2016)

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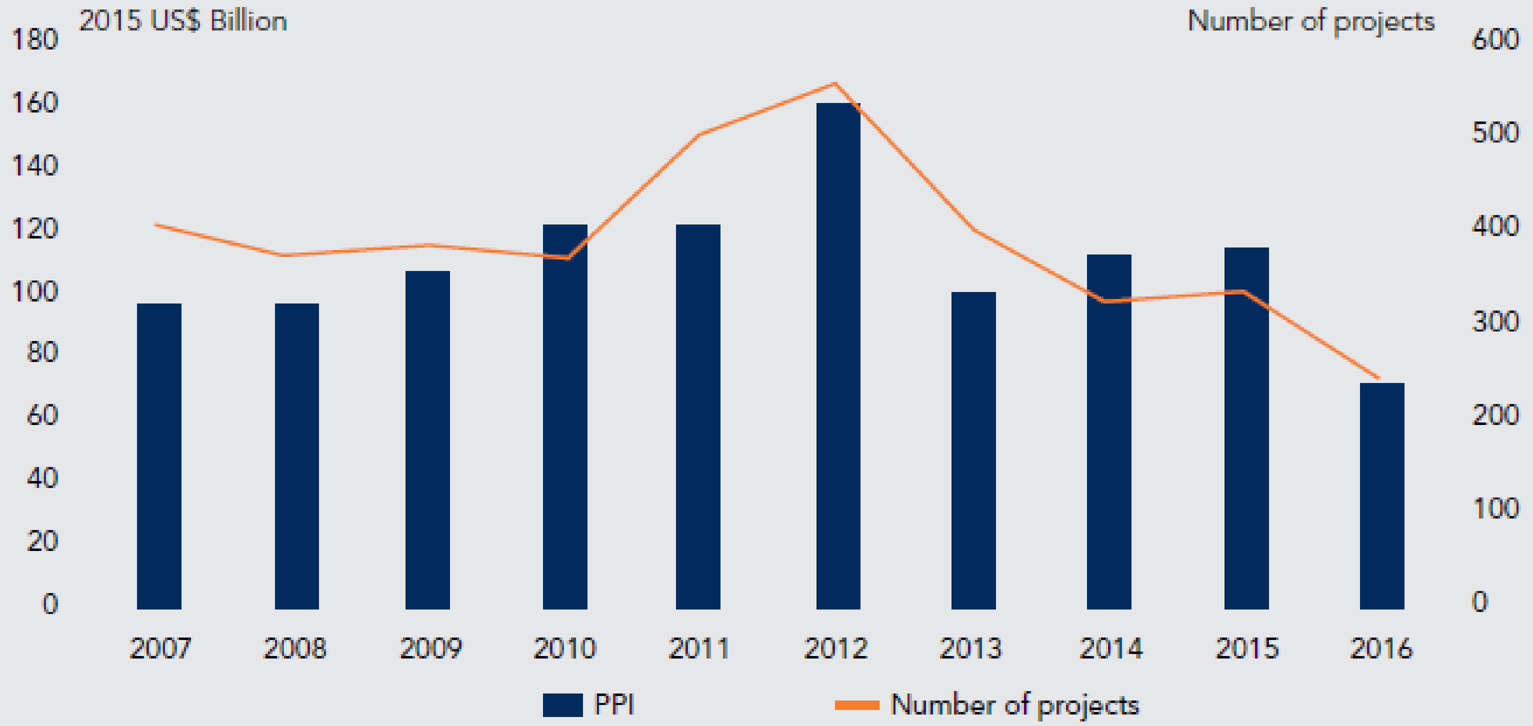
Investment commitments in infrastructure projects in EMDEs with private participation

FIGURE 1
Investment commitments in infrastructure projects with private participation in EMDEs and number of infrastructure projects with private participation in EMDEs, 2007–2016



Source: PPI Database, World Bank, as of June 2017

Note: All investment is adjusted by US CPI.

World Bank 2017

Controversy about PPPs

- Effective interest rate of private finance deals often higher double than of all government
- PPPs are often very complex to tender and negotiate => higher transactions costs.,
- Cost of construction is higher under a PPP
- Assess risk transfer ist difficult

- Potential motive for the public sector: get projects “off the book” => appearance of lower debt levels (Jomo 2016)

„Contingent liabilities“

- Payments required from governments if a particular event occurs (e.g. fall in exchange rate in demand), occurrence, value and timing of the payments are outside the control of the government.
- currently treated “off budget” => often non-transparent to the public or even national parliaments

- Explicit contingent liabilities: Mostly public guarantees.
- Implicit contingent liabilities: eg. bailing a private sector company => debts shifted to the public sector

Joint CSO submission on World Bank Group's framework for disclosure in PPPs (2016)

- Include PPPs in national accounts, i.e. they get registered as a government debt, and therefore are part of debt sustainability analysis, rather than being off balance sheet;
- Explicitly recognise the risk of hidden contingent liabilities should the project fail, through adequate risk assessment.
- Select best financing mechanisms, including examining public borrowing option, on the basis of an analysis of the true costs and benefits of PPPs over the lifetime of the project, taking into account the full fiscal implications over the longterm and the risk comparison of each option.

Revision of Debt Sustainability Framework
IFI Annual Meeting Oct 2017

- some of hidden costs from Public-Private Partnerships (PPPs) will be included in DSAs
- reduce importance of WB assessments of economic policies in lending decisions
- acknowledges the importance of debts owed by the private sector in causing debt crises. Reform of IMF's and World Bank assessments still being discussed
- DA will not be carried out by an independent body.
- DA will continue to be based on possibility of default, rather than a broader definition of debt crisis (debt preventing meeting of basic needs or progress towards SDGs)

Current blending & PPP initiatives

- Lack of data & evidence
- **Lack of effort to create evidence?** (Carter 2015)
- Lack of common frameworks, alignment and harmonisation

- OECD: effort to track volume of private finance mobilised by ODF Interventions

- **Risks of creating new debt risks have to be taken into account**

Conclusions 1

- More transparency & accountability of blending & PPPs
- Multiple debt risk of PPPs – costs, contingent liabilities, legal/litigation risks (=> Bilateral Investment Treaties)
- Look closer at motives behind blending enthusiasm & bring discussions together (PSD, SDG financing, debt, BITs…global economic and financial governance..)
- Private capital has been less forthcoming than expected – how much subsidies & risk taking are needed to attract private capital to LICs?

Conclusions 2

- Infrastructure projects that are most needed will not bring high returns – financing via loans will increase debt & fiscal constraints
- Infrastructure does not generate income in foreign exchange – should not be financed with foreign currency (=> morning session)
- Private sector needed to implement SDGs => wise industrial policies
- Why aren‘t there enough public resources? Tax avoidance, evasion, capital flight – serious efforts more than urgent
- Learn from past experiences!! (70s/80s)

Thank you for your attention!

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