Debt and Securitization of Development Finance: Useful Innovation or Recipe for more Toxic Debt

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.
Debt and securitization of development finance

Prof. Daniela Gabor (UWE Bristol)
AfDB Room2Run (2018): synthetic securitization
Securitization for Sustainability

Does it help achieve the Sustainable Development Goals?

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Shrinking space for green developmental state
The turn to securitisation

• Maximising Finance for Development (WB, IMF, G20)
• Key premise: de-risking to produce SDG assets for institutional investors to *turn sustainability into profitable business that attracts institutional investors with long-term horizons & deep pools of capital*
The trillions of institutional investors
The turn to securitisation

- Maximising Finance for Development (WB, IMF, G20)
- Key premise: de-risking to produce SDG assets for institutional investors to *turn sustainability into profitable business that attracts institutional investors with long-term horizons & deep pools of capital*

- The turn to derisking – the de-risking state
‘....we have to start by asking routinely whether private capital, rather than government funding or donor aid, can finance a project. If the conditions are not right for private investment, we need to work with our partners to de-risk projects, sectors, and entire countries’.

Jim Yong Kim, World Bank Group President (2017)
Wall Street Consensus: de-risk SDG assets

• create the derisking state, with MDBs support, into de-risking new SDG asset classes created via PPPs (footsteps of KfW - Volberding 2018)

• structural transformation of local financial systems: from bank based to market-based finance to create investible SDG assets
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The Cascade Approach – World Bank’s MFD
Box 1: Maximizing Finance for Development – Cascade Objective and Algorithm

Maximize financing for development by leveraging the private sector and optimizing the use of scarce public resources. WBG support will continue to promote good governance and ensure environmental and social sustainability.

When a project is presented, ask: “Is there a sustainable private sector solution that limits public debt and contingent liabilities?”

- If the answer is “Yes” – promote such private solutions.
- If the answer is “No” – ask whether it is because of:
  - Policy or regulatory gaps or weaknesses? If so, provide WBG support for policy and regulatory reforms.
  - Risks? If so, assess the risks and see whether WBG instruments can address them.
If you conclude that the project requires public funding, pursue that option.
Sustainable private solution?

Regulatory gaps

Build local securities, repo and derivative markets

(MDB) Securitization of infrastructure loans

PPP Port Enfidha Tunisia

SDG bonds

SDG bonds

Demand risk

Political risk

Climate risk

Liquidity risk (SDG assets)

De-risking (subsidies & guarantees)

Public funding

MFD/Cascade Approach

Channel the trillions of global institutional investors into local SDG assets
Demand risk in PPPs: Nigeria’s Azura power plant

According to Mr Hafez Ghanem, the World Bank Vice President for Africa, the bank can, together with the private sector, leverage government resources to bridge infrastructure gaps in Nigeria.

"We have supported and seen success in transport, energy and power sectors using Public-Private Partnerships (PPPs) models. The Azura power project is an example of how we have attracted private sector investment in the power sector.

"We are happy to work with the Government of Nigeria on power sector reforms, which will create a better environment to attract more private sector financing," Ghanem said.

"Illicit and insolvent"

The payment problems in the Nigerian power sector were thrust into the spotlight in March when four generating companies filed a lawsuit against the government and Azura.

To ensure the generating companies were paid in full throughout 2017 and 2018, the government created a 701 billion naira ($2.3 billion) loan fund at the central bank to guarantee payments. When the fund was established in 2017, Azura wasn’t part of the calculations.

But when Azura started producing electricity, the fund was also used to pay the new plant to ensure the terms of loan deals guaranteed by the World Bank were not breached. As a result, the other companies were told they would only receive 80 percent of the sums owed, according to the lawsuit filed in March.

The four energy companies want the fund to reimburse them in full, rather than allocating part of the money to the new plant. Azura declined to comment on payments for power generated.

"If the central bank wasn’t paying, the system would collapse," an official at a multilateral lender said on condition of anonymity. "Qua iboe IPP would enter a system that is illiquid and insolvent. The liquidity is being provided by the central bank."
Climate risks: Wall Street Climate Consensus

1. Wall Street decides what is green and brown (private taxonomies - Environmental, Social and Governance/ESG)
2. Wall Street links ESG with SDG (Maximising Finance for Development/Infrastructure as an Asset Class).
3. Private taxonomies: greenwashing
4. State – subsidising ‘green’
5. Private greenwashing, socialised costs: the derisking state

Distribution of risks - the physical risks of extreme climate events that would morph into demand risks and transition risks that would morph into political risks
Institutions embrace ESG investing

Growth of ESG assets controlled by nearly 500 institutional investors surveyed, in trillions.

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<th>Year</th>
<th>ESG Assets</th>
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<td>2005</td>
<td>$1.49</td>
</tr>
<tr>
<td>2007</td>
<td>$1.88</td>
</tr>
<tr>
<td>2010</td>
<td>$2.03</td>
</tr>
<tr>
<td>2012</td>
<td>$2.48</td>
</tr>
<tr>
<td>2014</td>
<td>$4.04</td>
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<tr>
<td>2016</td>
<td>$4.73</td>
</tr>
<tr>
<td>2018</td>
<td>$5.61</td>
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Source: US SIF Foundation

Institutional investment in ESG assets by investor type as of 2018.

- **Labor**: 1%
- **Foundations**: 1%
- **Education**: 6%
- **Other**: 1%
- **Insurance companies**: 37%
- **Public funds**: 54%

E: climate change, carbon emissions, pollution, resource efficiency, biodiversity;
S: human rights, labor standards, health & safety, diversity policies, community relations, development of human capital (health & education);
G: corporate governance, corruption, rule of law, institutional strength, transparency.
Subjective and conflicting ESG data/ratings - greenwashing
Sustainable private solution?

Regulatory gaps

Credit enhancement for PPPs
Tariffs above cost recovery
Forex convertibility

De-risking (subsidies & guarantees)

Risk distribution in PPP contracts
Currency hedging facilities (Sri Lanka)
Re-orient National Investment Banks (Egypt)
Securitization of bank energy loans (Vietnam)
Public pension funds to capital markets

SDG assets

Public funding

And a lot more in WB InfraSAPs (Egypt, Sri Lanka, Vietnam)
Change financial market structures
Maximising Finance for Development

Infrastructure as an asset class

World Bank/MDBs

Securitisation markets

Sustainable bond markets

Reengineer financial systems

Local Currency Bond Markets Initiative

Global institutional investors

Billions to Trillions Agenda

Structural reform of GS financial systems
Market-based finance is more fragile

- more vulnerable to global financial cycle and US dollar financing conditions (Rey 2015)
- wholesale adoption of US financial architecture: shadow banks and markets, systemic vulnerabilities to portfolio investors (Lehman Brothers)
- technocratic capacity to manage systemic vulnerabilities
Wall Street Consensus threatens DEC public debt profiles

• Derisking state: subsidised private greenwashing

• Alternative: green finance for just transitions to low carbon economies
Alternative: green finance for just transition