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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.

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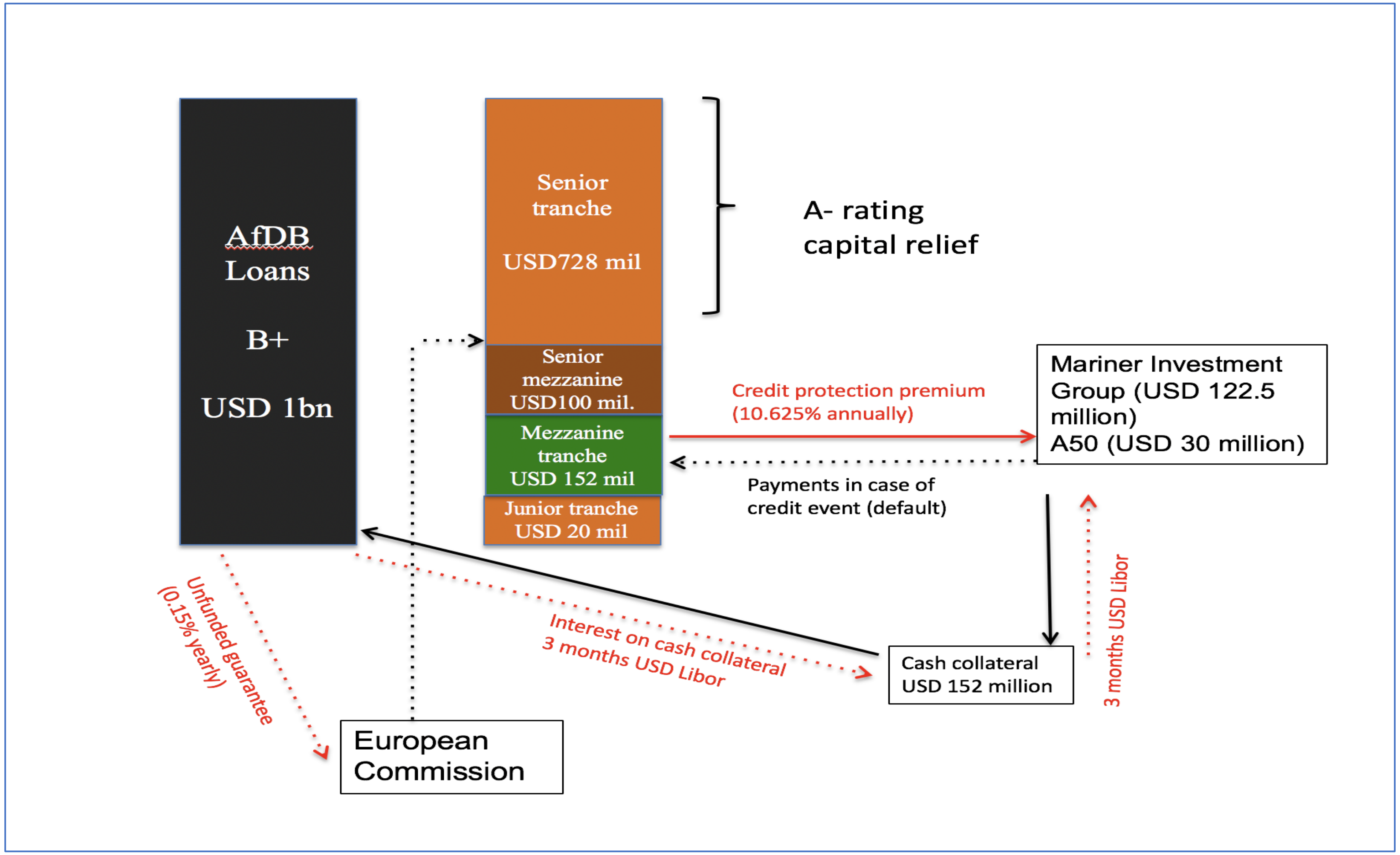
Debt and securitization of development finance

Prof. Daniela Gabor (UWE Bristol)

AfDB Room2Run (2018): synthetic securitization



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Securitization for Sustainability

Does it help achieve the Sustainable Development Goals?

By Daniela Gabor

<table>
<tr><th></th><th>MDB Securitization</th><th>MDB support for (shadow) bank securitization</th><th>Country-level securitization</th></tr>
<tr><td>Pathways to securitization</td><td>Balance sheet (funding) vs synthetic securitization (capital relief) options

AfDB Room2Run Synthetic Securitization</td><td>MDBs to help structure risk-return profile demanded by private investors directly by purchasing bank loans / guaranteeing tranches or indirectly by promoting financial market structures supportive of securitization markets

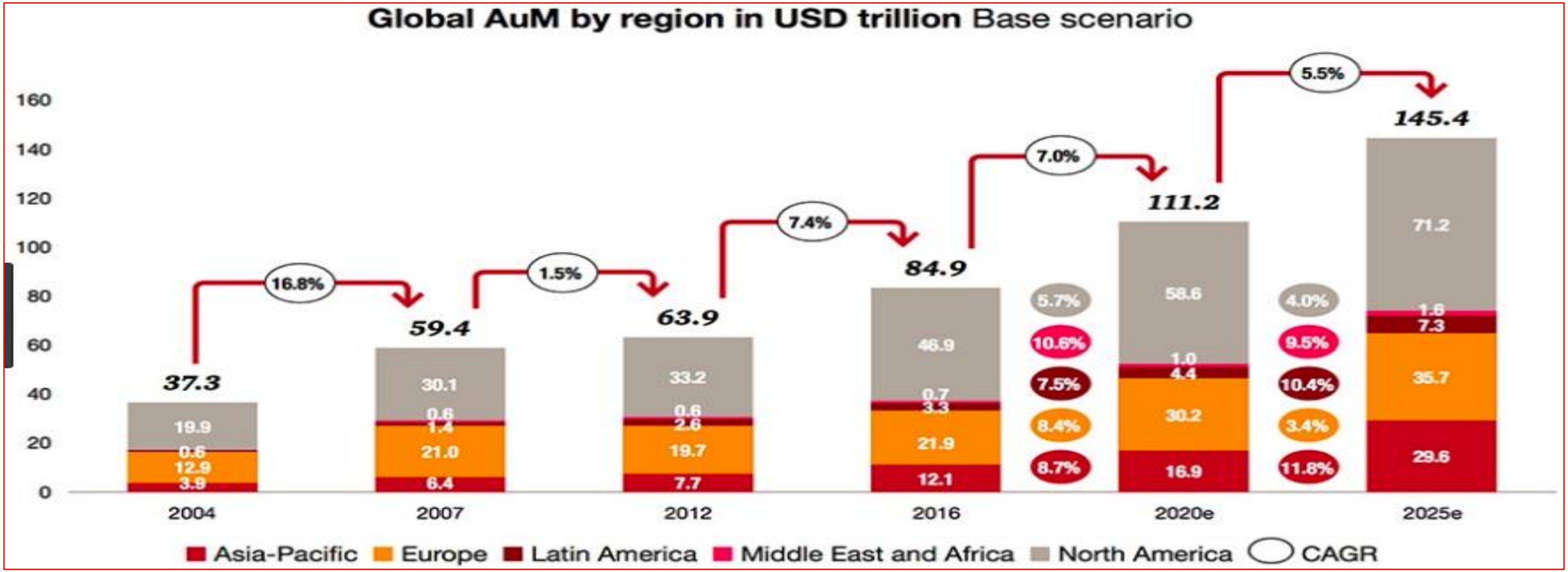
AIIB Infrastructure Private Capital Mobilization Platform</td><td>Re-orient financial systems towards market-based finance, with liquid (SDG-backed) securities financed via wholesale money and derivative markets

G20 Infrastructure as an Asset Class</td></tr>
<tr><td rowspan="2">Sustainability and accountability</td><td rowspan="2">Weak(er) incentives for continuously enforcing ES(G) performance, on tranches and loans in the securitization pool</td><td>Trade-offs between achieving scale (market depth) and enforcing strict ESG/ sustainable taxonomies</td><td>Trade-offs between achieving scale (market depth) and enforcing strict ESG criteria/ sustainable taxonomies</td></tr>
<tr><td colspan="2">Sustainability washing: lack of ESG universality leads to ESG ratings shopping, misalignments between SDGs and ESG, ongoing ESG compliance for tranches.</td></tr>
<tr><td>Financial Stability</td><td>Limited systemic impact from synthetic securitization</td><td>Systemic fragilities characteristic to shadow banking and market-based finance</td><td>Systemic fragilities characteristic to shadow banking and market-based finance</td></tr>
<tr><td rowspan="2">Developmental Impact</td><td>Privatization/PPP (social) infrastructure to generate cash flows for institutional investors</td><td>Privatization/PPP (social) infrastructure to generate cash flows for institutional investors</td><td>Privatization of social and other infrastructure to generate cash flows, fiscal resources to de-risk "bankable" projects</td></tr>
<tr><td colspan="3">Shrinking space for green developmental state</td></tr>
</table>

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



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- 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*

Washington Consensus	Wall Street Consensus: Maximising Finance for SDG-led Development
Fiscal discipline, central bank independence	Fiscal discipline, central bank independence
Public spending: switch from subsidies to investment in primary education, primary health, public infrastructure	Public spending: de-risk PPP ‘infrastructure as an asset class’ for global institutional investors (**G20 Infrastructure as an asset class**)
Tax reform: lower marginal rate, broader base	Sustainability reform: ESG ratings
Macro-finance policy: replace developmental banking with market-based interest rates	Sustainable bond finance: engineer market-based finance, prioritize **securitization** & other blended-finance
Exchange rate: either market-determined or ‘competitive’ according to equilibrium theories, capital account liberalization	Local currency bond markets to manage vulnerabilities of global financial cycle (**G20 Local Currency Bond Markets Initiative**)
Trade liberalization	Financial globalization
FDI promotion	Mega-infrastructure led-development (PPP)
Privatization	Domestic resource mobilization Privatization/PPP public services for infrastructure as an asset class
Property rights	Digital financial inclusion

The Cascade Approach – World Bank’s MFD

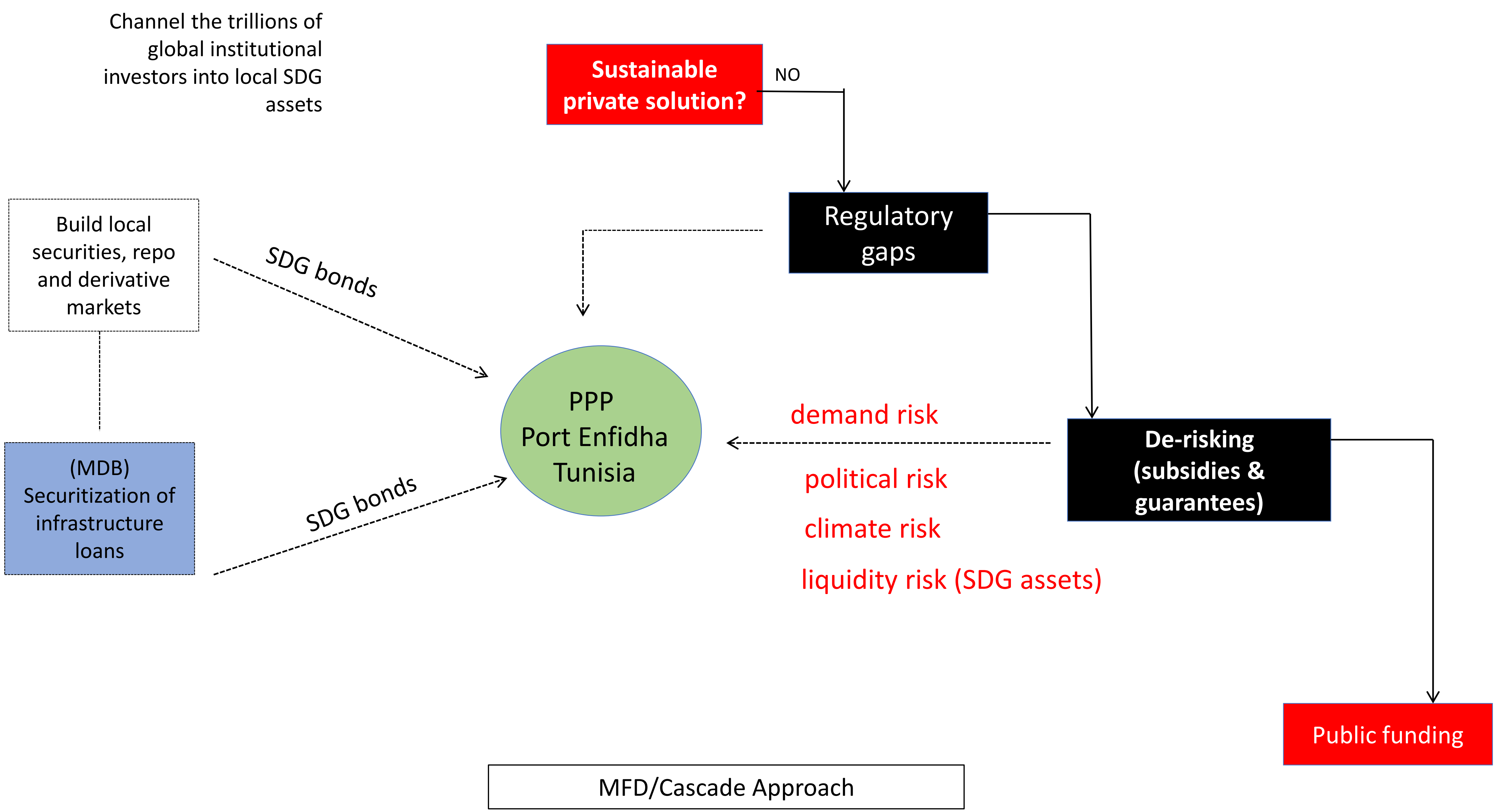
Box 1: Maximizing Finance for Development – Cascade Objective and Algorithm

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.


Channel the trillions of global institutional investors into local SDG assets
Sustainable private solution?
NO
Regulatory gaps
Build local securities, repo and derivative markets
SDG bonds
PPP
Port Enfidha
Tunisia
demand risk
political risk
climate risk
liquidity risk (SDG assets)
De-risking (subsidies & guarantees)
(MDB) Securitization of infrastructure loans
SDG bonds
Public funding
MFD/Cascade Approach

Demand risk in PPPs: Nigeria's Azura power plant

Home Markets Financial Literacy Business New

According to Mr Hafez Ghanem, the World Bank Vice President for Africa, the bank can, togethe 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 crea a better environment to attract more private sector financing," Ghanem said.

'Illiquid 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.

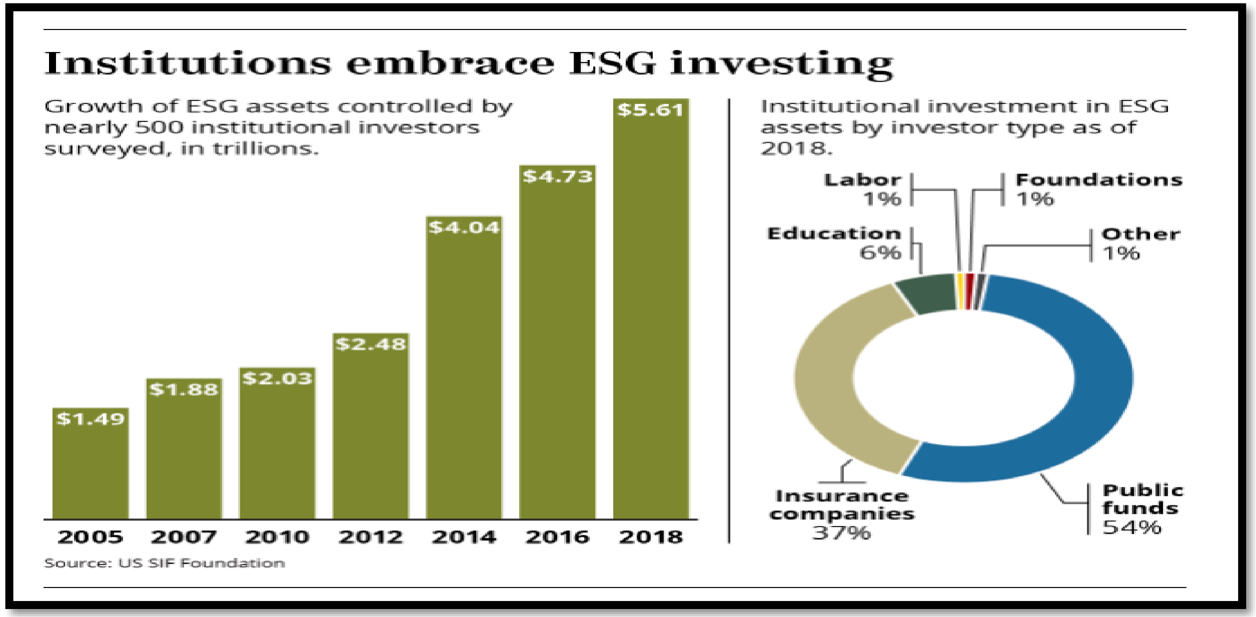
The four energy companies want the fund to reimburse them in full, rather than allocating part of the money to the new plant. Azura declined to comment on payments for power generated.

"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

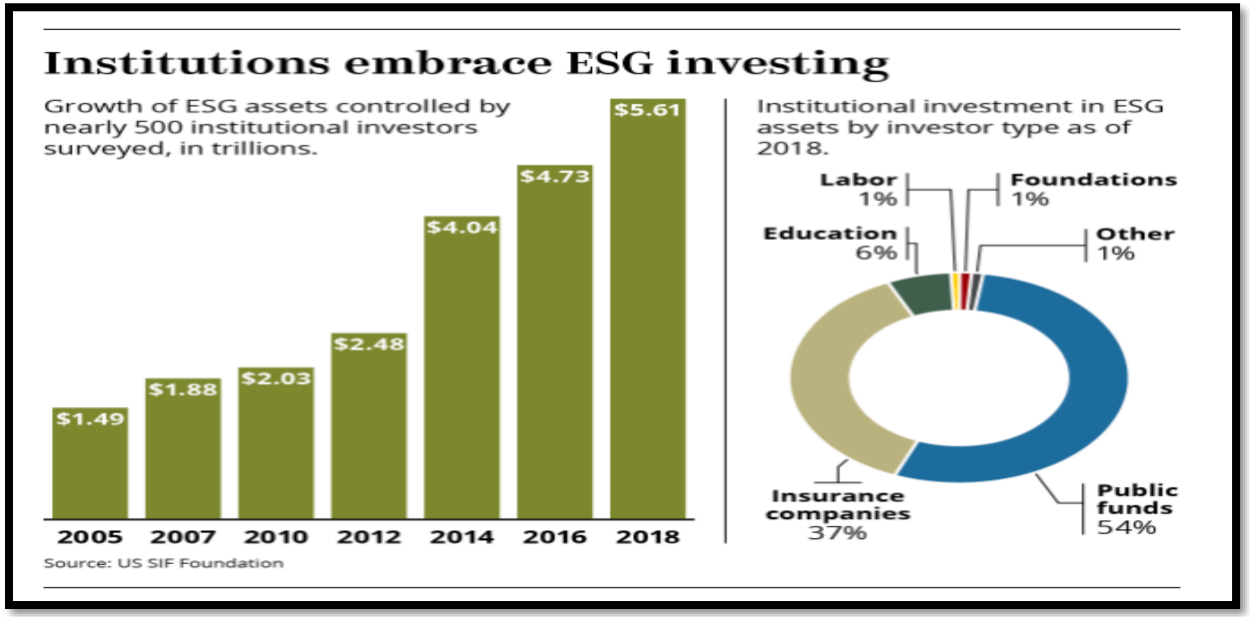
Distribution of risks - the *physical risks* of extreme climate events that would morph into *demand risks* and *transition risks* that would morph into *political risks*



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.



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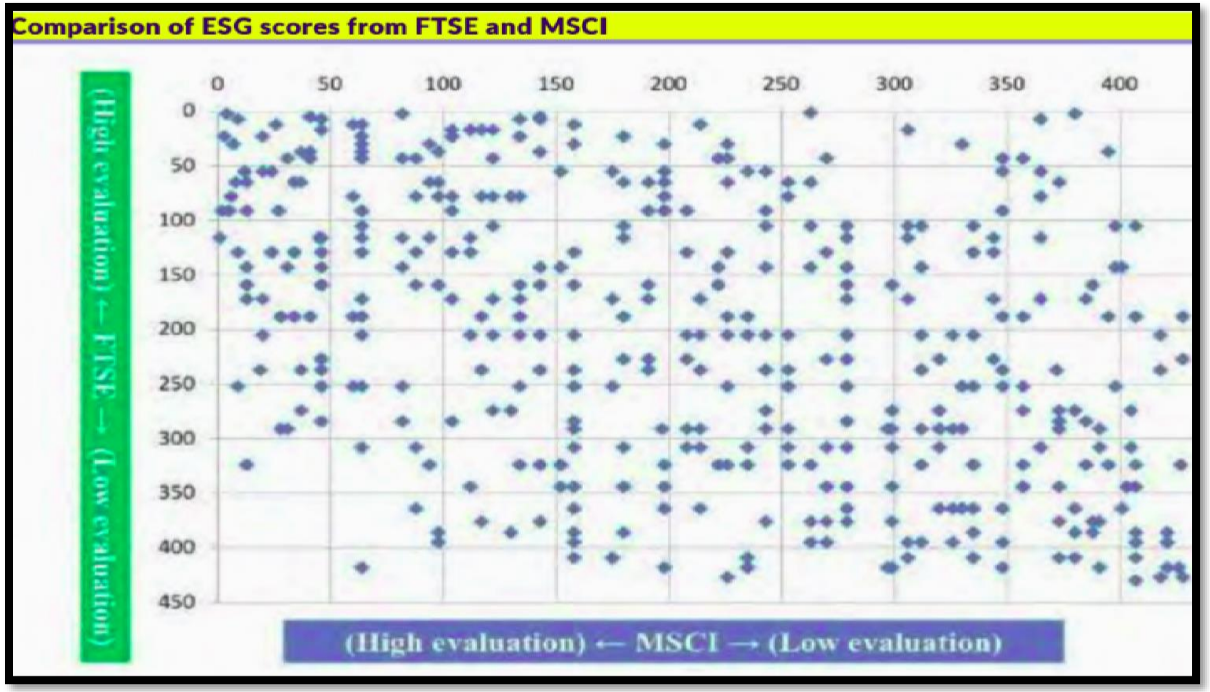
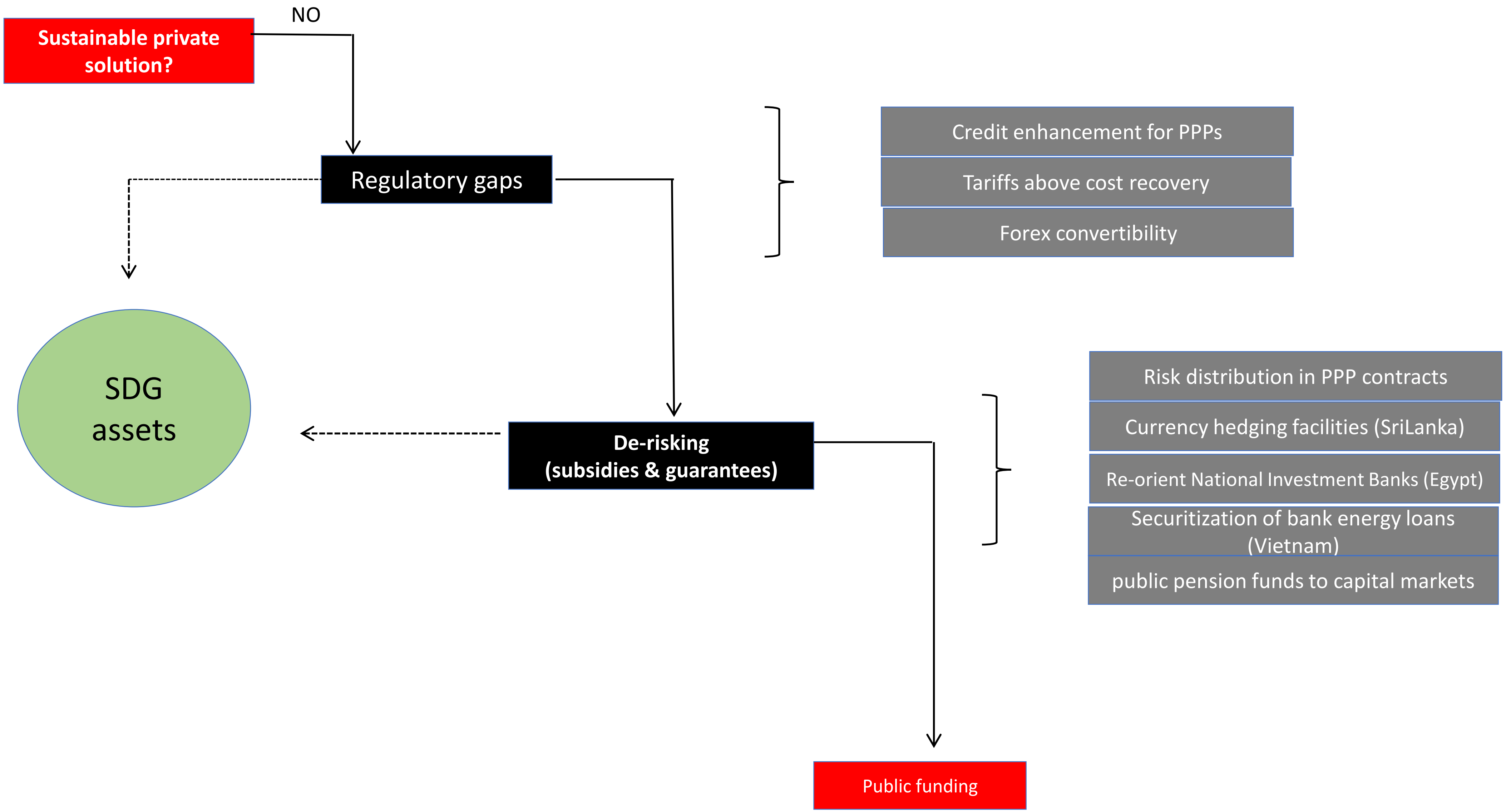
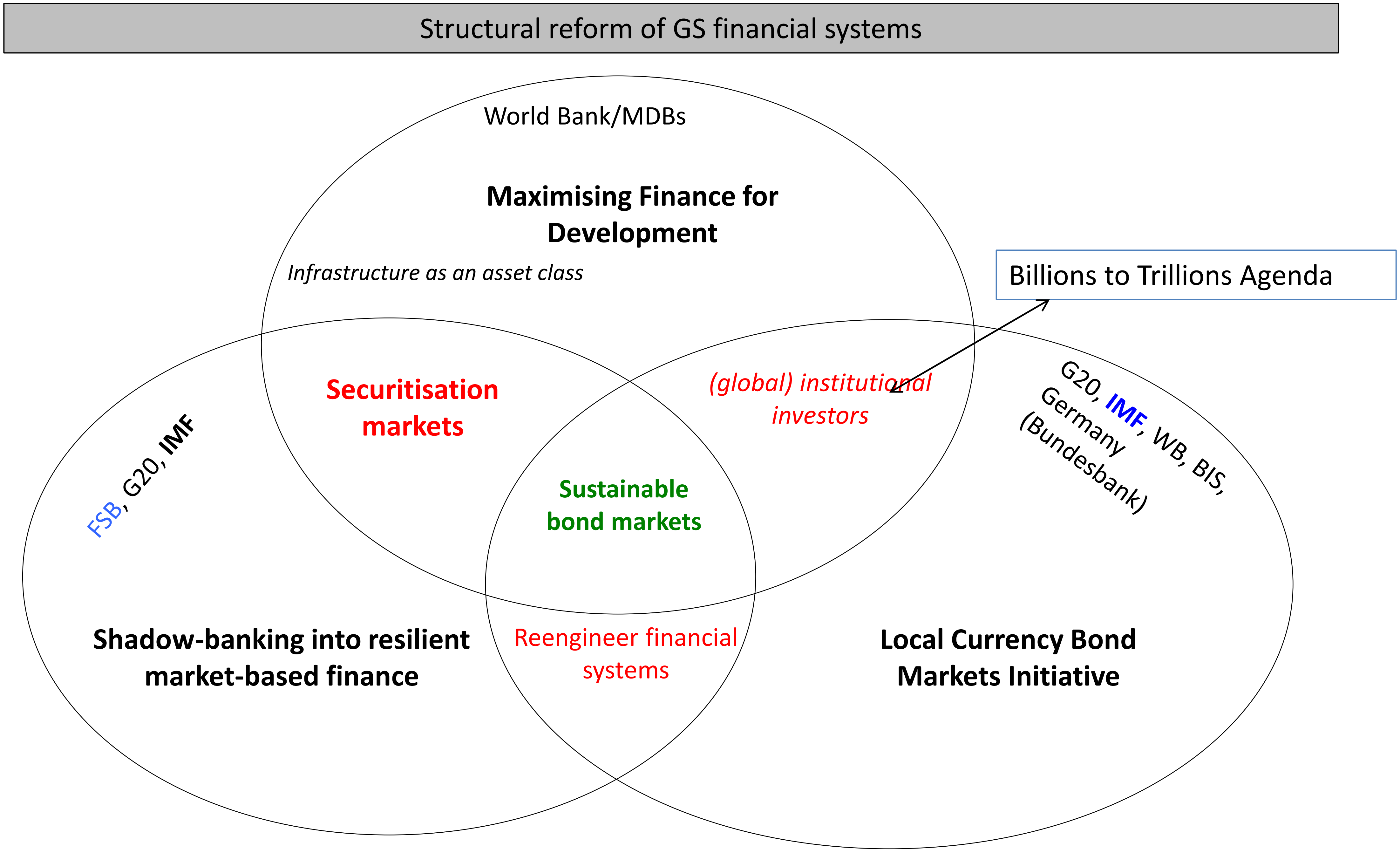


Subjective and conflicting ESG data/ratings - greenwashing

And a lot more in WB InfraSAPs (Egypt, Sri Lanka, Vietnam)



Change financial market structures


Structural reform of GS financial systems
World Bank/MDBs
Maximising Finance for Development
Infrastructure as an asset class
Billions to Trillions Agenda
Securitisation markets
(global) institutional investors
FSB, G20, IMF
G20, IMF, WB, BIS, Germany (Bundesbank)
Sustainable bond markets
Shadow-banking into resilient market-based finance
Reengineer financial systems
Local Currency Bond Markets Initiative

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