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Role of Multilateral Development Banks in the cost of Financing

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Status and Outlook for Developing countries

- IMF global outlook – low growth and high debt
- Over 60% of countries that use the joint IMF-World Bank Debt Sustainability Framework for Low-income Countries, are currently assessed as at high risk of, or already in, debt distress.
- Some countries are spending as high as four times on debt servicing as they spent a decade ago
- When considering ordinary revenue without grants, debt service payments as a percentage of revenue increased by 5% between 2023-2024.

Status and Outlook for Developing countries

- The outlook for these countries is likely to worsen in the next few years. Debt stocks are expected to rise by a further 11% across all developing countries through until 2028
- At least 20 low- and lower-middle-income countries, have had or will have large payments coming due in 2024 and 2026.
- It is estimated that there will be about $50 billion net outflows from developing countries in 2024.

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Status and Outlook for Developing countries

- The debt landscape for low income countries has become more complicated in terms of creditor composition. The ratio of MDB financing has been decreasing but still most significant.
- For the 73 DSSI eligible countries, their debt book includes:
    - MDBs at 46%;
    - bilateral at 34% with China being 19.5%; and
    - commercial creditors at 19.5% shared between bondholders and private creditors 65:35.
- IDA decreased to 5 per cent of the total public and publicly guaranteed external debt of developing countries in 2022, compared with 8 per cent in 2010.

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Why MDBs are a critical source of affordable financing

MDBs can scale up long-term concessional and non-concessional financing to developing countries at rates closer to those paid by developed countries.

MDBs provide other financial products, such as guarantees, grants and conversion mechanisms, to manage risks in order to enable investments in development-oriented projects.

MDBs also play a countercyclical role during external shocks. This can help a country achieve resilience

MDBs through leveraging can achieve greater efficiency

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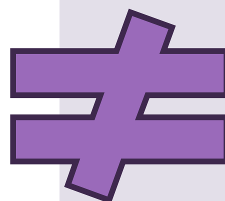
Reforms aimed at increasing the lending capacity of MDBs

Because MDBs are able to lend to developing countries at rates that are lower than private finance, increasing their lending capacity is important if it contributes to reducing the cost of financing for developing countries.



- Pushing MDBs to lend more should not come at the expense of their AAA credit rating which would increase the cost of capital; or
- Lead to compromise of their concessional and grant facilities in a bid to maximise their leveraging.
- Or stretching too thin, that undermines their impact

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Reforms aimed at increasing the lending capacity of MDBs

1. Reduce cost of financing

- The IMF announced the reduction of their general charges and surcharges by 36%.
- Some MDBs have commitment fees and surcharges on their concessional products. AfDB does not charge a commitment fee on The ADF. IDA should consider doing the same

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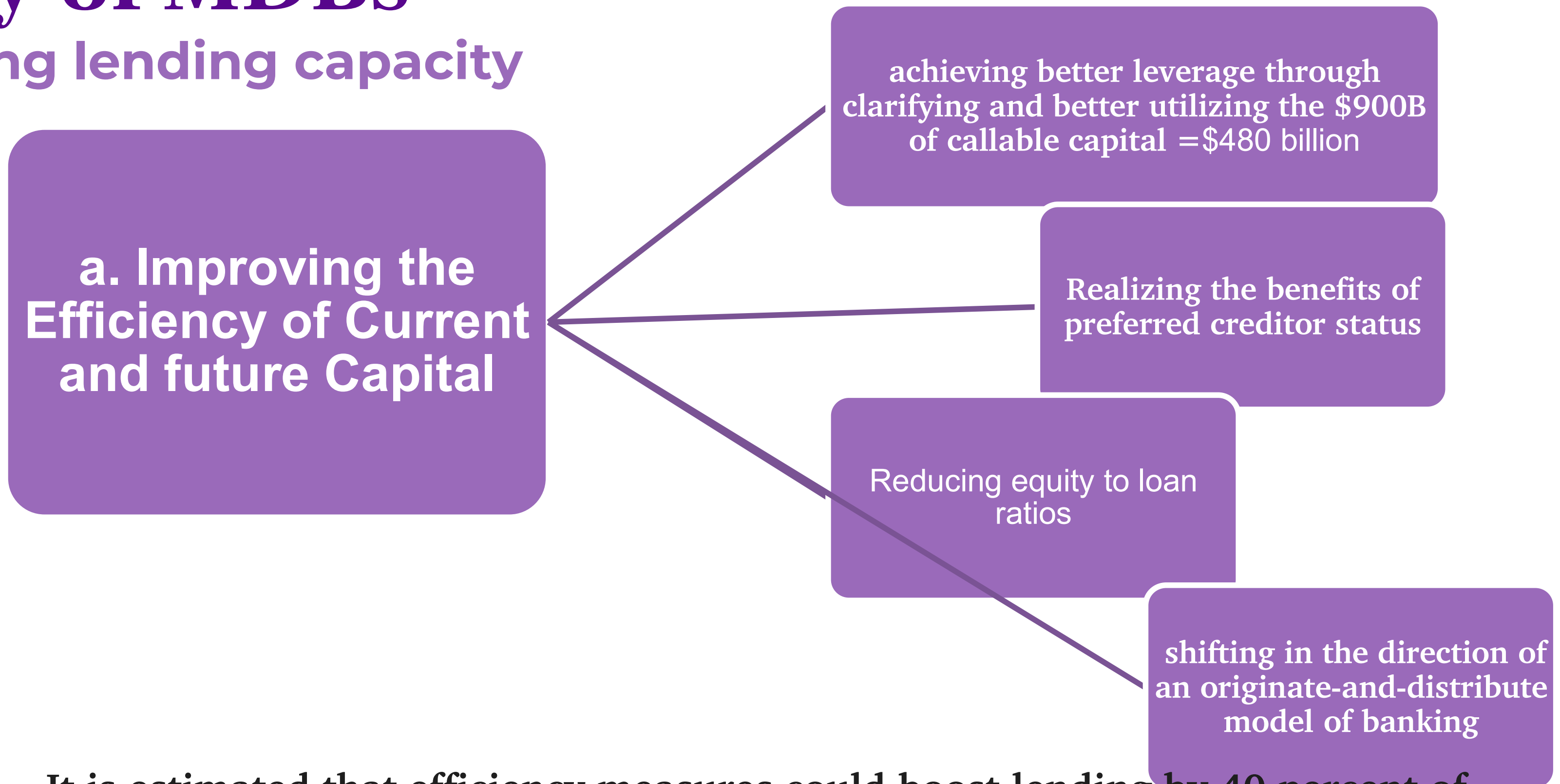
Reforms aimed at increasing the lending capacity of MDBs

2. Increasing lending capacity



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It is estimated that efficiency measures could boost lending by 40 percent of existing capacity, amounting to incremental lending headroom of $40 billion per year by 2030.

Reforms aimed at increasing the lending capacity of MDBs

Increasing lending capacity

b. Mobilizing Hybrid Capital

- Used to funnel additional financing without providing equity
- MDBs have been proposing ways of utilizing unutilized SDRs that countries are willing to re-channel through hybrid capital instruments. AfDB, IDB have proposed a hybrid capital facility which will unlock 1:4 in lending capacity and allow contributors of SDRs to still account for them as reserve assets
- The World Bank Liveable Planet Fund together with the Global solutions accelerator platform – will be used to determine the Framework for Financial Incentives.

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Reforms aimed at increasing the lending capacity of MDBs

Increasing lending capacity

c. Donor Portfolio Guarantee Funds

- These take risk off of MDB balance sheets to free up space for more lending. Could leverage 1:6
- The International Financing Facility for Education (IFFEd) - capitalized by a relatively small amount of paid-in capital from shareholders plus contingent capital commitments in the event MDB borrower arrears exceed a certain threshold. It also has portfolio-level guarantees on loans from multiple MDBs (and a grant component)
- AsDB International Financing Facility for Climate in Asia and the Pacific (IF-CAP) - use guarantees from partners for leverage 1:5 in climate financing
- EIB Guarantee fund - Participating EU Member States provided guarantees proportional to their shareholding. Fund used to provide guarantees for SME financing

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Reforms aimed at increasing the lending capacity of MDBs

Increasing lending capacity

d. General Capital Increase

- The scale of need for concessional financing requires sizeable GCI, because there's a limit to leverage. Only those loans that are linked to market interest rates can realistically and without significant losses be funded by borrowings. Grants or extremely-low interest concessional loans have to be funded by the institutions' equity
- MDB are financed through 3-year donor replenishment of concessional sovereign funding windows, and ad hoc calls for additional capital increase for non-concessional sovereign and non-sovereign windows. For example, the IBRD has had 5 GCIs - 1955, 1979, 1988, 2010 and 2018; EBRD – 2023; IDB- 2024

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Reforms aimed at increasing the lending capacity of MDBs

3. Scaling up grants and concessional financing:

- IDA, AsDF, AfDF, AIIB Special Funds, IDB concessional financing, EBRD concessional financing facility, etc.
- The need for concessional financing is only increasing:
- 60% of IDA countries are at high risk or in debt distress. Due to this position, these countries qualify for 100% grants, demonstrating the demand for concessional financing
- Measures of vulnerability faced by some of the MICs especially SIDS, also point to the need for concessional financing.
- Within IBRD, the World Bank has introduced a long maturity instrument, up to 50 years and proposes to remove the surcharge imposed on countries that have reached their single borrowing limit., for projects that contribute to a global challenge. Price and maturity incentives will only be available for projects that provide a positive cross-border externality.

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4. Reforms aimed at attracting private sector financing from ratio of 0.6 to 2

Increasing the use of guarantees

- Currently, most MDBs treat $1 of guarantee the same as $1 of loan, without risk differentiation.
- Expand the use of policy based and project sovereign guarantee instruments
- Addressing the transaction costs and
- Account for guarantees on an expected-loss basis rather than on the basis of the entire nominal amount being guaranteed

Improving private investor pricing by providing the right risk signaling

- Improve and make available macro-economic and sector investment climate diagnostics
- Improve the sharing of risk data – GEMS database
- Signaling the profitability of projects by allocating their own money in projects and loan syndicates
- Taking a subordinate loan position and extending their de facto preferred creditor status
- Using originate to distribute

Portfolio based Partnerships

- Scale up portfolio based partnerships especially with institutional investors.
- Will address the pipeline problem and the challenge of bringing risk adjusted returns into the target zone of institutional investors in different way
- Examples – AfDB Room2Run, IFC Managed portfolio co-lending program;

5. Scaling up Local Currency lending

- In the current context of overlapping debt crisis and low growth, MDBs need to consider expanding their local currency operations for domestic-oriented investments (DOIPs) ,.
- The idea is to ensure is to do so without incurring currency mismatches between their assets and liabilities, which would downgrade their credit ratings
- Using the example of the African, Caribbean and Pacific Investment Facility, led by the EU and EIB, LC lending can be undertaken without relying on external hedging. The Facility charges a premium to account for foreign exchange risk when lending in LC.
- TCX which is a non-profit entity established by a consortium of development finance institutions that provides hedges for developing countries, has demonstrated that currency risks can be effectively managed, with a positive annualized return of 1.6%

PART 01

Scaling Local Currency Lending

- Non-sovereign lending through local financial intermediaries
- Raising LC through on-shore and off-shore LC bonds
- Currency liquidity pools e.g IDB. MDBs could also create off-balance sheet LC fund pooling LC assets
- Buy LC from the Central Bank, create LC Fund (LCF) for LC denominated lending.
- Guarantees - Donor provided guarantee for LC funded projects or MDBs providing guarantees for LC funded projects
- Shareholder paying their equity capital in their LC

Credit Enhancement

- In most instances, they have proven remarkably effective in helping to reduce governments' external financing costs and mobilize private capital
- PBGs have proven useful in insulating issuers from external market turmoil and helped governments secure better terms—reducing funding costs by an average of 330 basis points compared to what governments would have achieved had they pursued unenhanced issuances.
- They have helped new issuers establish market access and grow their investor base.

PART 01

Credit Enhancement

- They have helped countries reprofile expensive commercial debt on more favorable terms.
- They have helped governments secure private sector participation in restructuring exercises – e.g. Seychelles
- And some governments are starting to use PBGs to raise funds for environmental, social, and governance (ESG) programs and projects, raising the possibility of a new generation of ESG PBGs – e.g. Belize
- PBGs have also proven more catalytic than direct lending, with $1 PBG mobilizing on average $1.8 in commercial finance

Reducing the transaction cost of financing

- MDBs can play a greater role in helping countries originate bankable projects. IDA 21, AfDB UMDF,
- MDBs need to improve their operational efficiency. World Bank has been able to cut project approval time from 19 months to 16, with the goal of reaching 12. AfDB has cut from 13 to 10 months. The speed of disbursement during COVID demonstrated that it is possible to cut this time even to 6 months.

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MDB collaboration

There is a lot of scope for MDBs to operate better as a system that will help countries. Some area include:

- Shared diagnostics
- Coordinated technical assistance for public investment management
- Focusing on country platform strengthening
- Investing in the country's regulatory and institutional reforms
- Project pipeline development
- Information exchange
- Exposure swaps and joint liquidity pools
- Dialogue with credit rating agencies
- Acknowledging each others procedures and tools

Conclusion – How can MDBs play a role in reducing the cost of financing?

- Reduce the cost of financing
- Achieve SCALE without compromising cost to produce bigger, better and faster MDBs
  - Balance sheet optimization
  - GCI
  - Hybrid Capital
  - Guarantees
- Crowd in cheaper private sector financing by addressing RISK
  - Contribute to demystifying the risk profile of developing countries through timely diagnostics and data
  - Proactively de-risking investments in developing countries
  - Portfolio partnerships
- Being a good PARTNER for developing countries that focusses on IMPACT
  - LC lending
  - Credit enhancement
  - Designing thematic hybrid capital instruments that allow more concessionality and grant components
  - MDB collaboration

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