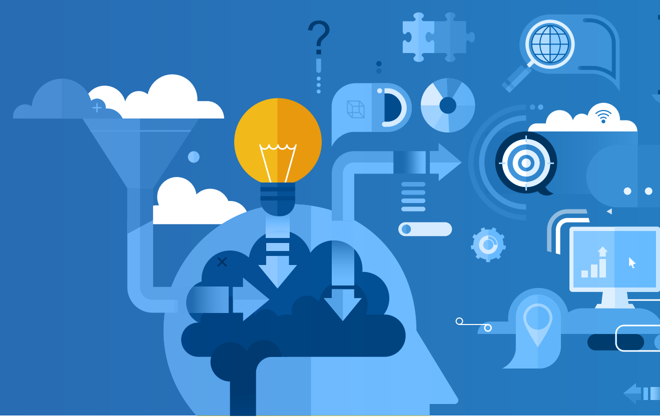
RESEARCH INSIGHTS



IDB

What Can Multilateral Development Banks Do to Reduce Infrastructure Gaps in Emerging Economies?

- **Through their loans, Multilateral Development Banks (MDBs) are key resource mobilizers.**
- **MDB lending to a sector in a country significantly increases inflows from other sources up to two years later.**
- **The resources mobilized are more than four times the size of MDB financing. They come from both the public and the private sector, and the mobilization that takes place is cross-border as well as national.**

CONTEXT

Investment needs in developing countries are large. Before the COVID-19 pandemic, estimates suggested that US$1 to $1.5 trillion dollars per year would be needed between 2015 and 2030 to close the financing gap that has kept those countries from addressing their deficiencies in infrastructure. Due to the costs of dealing with COVID-19 and its medium to long-term consequences, those financing needs are now even larger. Closing this gap is crucial for development. Public sector resources, including direct lending from MDBs, are not enough. Private funds are required, and MDBs can play an important role in attracting them.

Key concept

RESOURCE MOBILIZATION

The ability to use an institution's own resources to crowd-in additional resources towards the same purpose.

PROJECT

This paper uses a unique dataset covering more than 6,500 transactions involving infrastructure projects in emerging economies from 2005 to 2020 in order to identify how MDB financing in a particular sector in a given country (e.g., transportation in Mexico), mobilizes additional resource to the same country-sector in the years following the MDB transaction. The study additionally explores differences among countries of different characteristics and whether global events alter the dynamics of resource mobilization.

RESULTS

There is a strong and significant correlation between MDB financing and financing from other parties at the time of MDB transactions and up to two years thereafter. In fact, a comparison of resources mobilized by third parties and the amount of MDB funding finds that the MDB infrastructure multiplier is close to 4.4. Resources are mobilized from both the public and the private sector, mostly the latter.

This finding is critical in light of the difficulties faced by the public sector in financing large infrastructure projects in times when fiscal consolidation is needed and demand for public sector resources is high. When MDB resources are used to mobilize private sector resources, governments can use their available fiscal space to meet social demands while ensuring that infrastructure projects are financed.

This mobilization comes mostly from cross-border sources, but some mobilization of national resources occurs as well. Since domestic savings are usually low in developing and emerging economies, the finding that foreign savings are mobilized is relevant for developing countries. Given the risk mitigation role of MDB lending, the recipient country becomes attractive to foreign savings.

The results also indicate that MDB financing of both sovereign guaranteed and non-sovereign guaranteed operations mobilizes third-party resources. Moreover, official lending from multilateral and bilateral institutions is complementary and mutually reinforcing. Even though bilateral lending seems to have stronger mobilization effects, multilateral institutions tend to enter a market first, subsequently mobilizing bilateral resources.

Country-specific characteristics are important in determining the size of mobilization effects. They are smaller in countries with more capital controls, and larger in low income and lower-middle-income countries. Given that low and lower-middle income countries have lower levels of private and public savings—and weaker infrastructure—mobilization in these countries is critical to finance the investments needed to close development gaps.

POLICY IMPLICATIONS

Funding needs to close infrastructure gaps are large, and governments in Latin America and the Caribbean and other emerging regions face large fiscal constraints that limit the amount of public sector resources directed to infrastructure. The limited size of MDB balance sheets, moreover, means that direct financing cannot meet all those needs. Private sector resources therefore need to be mobilized, and MDBs can play a critical role in this process.

Both countries and MDBs can take action to realize MDBs' potential as mobilizers. MDBs can improve their tools and possibly increase their capital to foster more mobilization. Countries, for their part, need to focus on maintaining a strong institutional environment that fosters and protects private investment and encourages cross-border flows of private resources towards that investment.

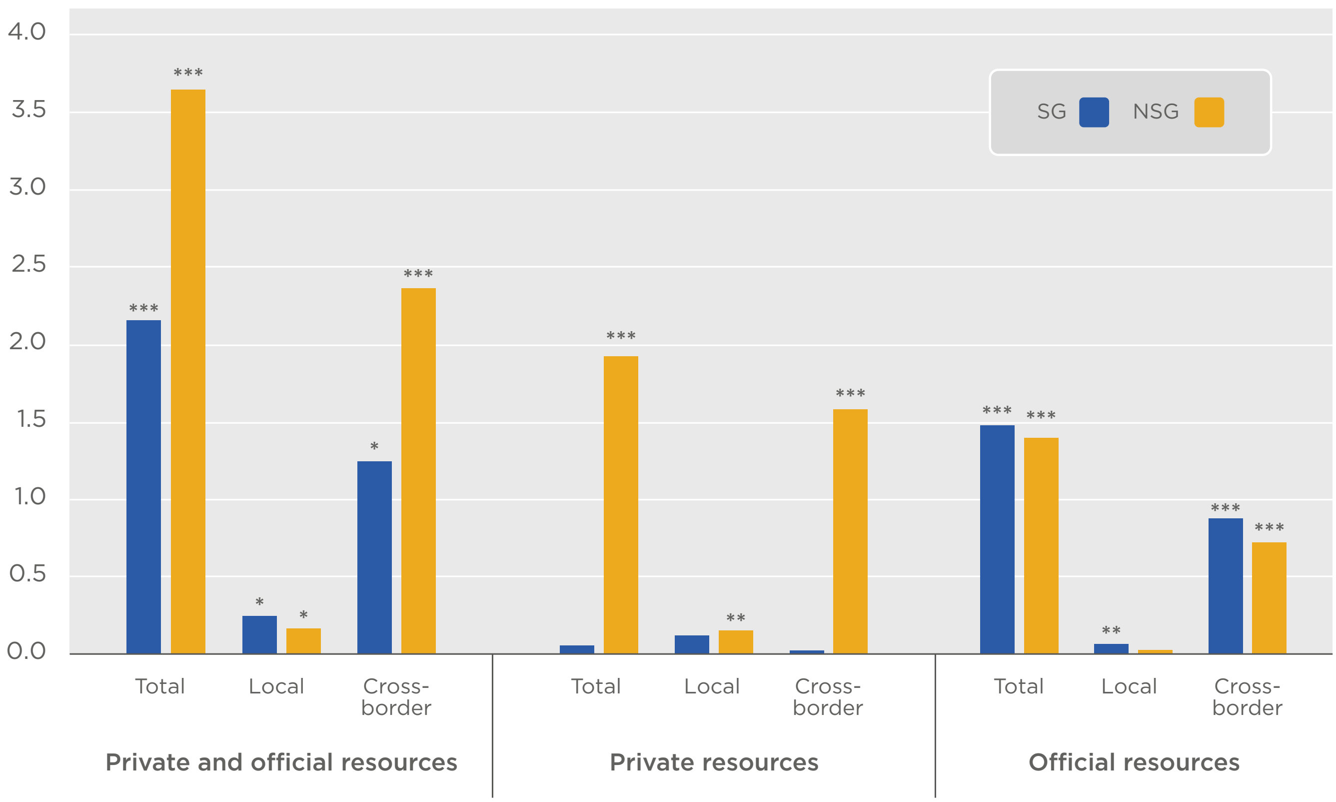
From a policy perspective, two views need to converge. On one hand, domestic policies should aim to take advantage of the mobilization opportunities offered by MDBs. This may involve complex trade-offs, such as substituting conventional loans that provide immediate liquidity for lending instruments such as guarantees that are key for mobilization. On the other hand, global policies should recognize the mobilization potential of MDBs and encourage them to expand their balance sheets. This could be achieved through balance sheet optimization policies, which most MDBs around the world have already significantly advanced, or through additional capitalization, which has been less explored in recent years.

Key concept

MULTILATERAL DEVELOPMENT BANKS (MDBs)

Institutions owned by various governments to provide financing, mostly to middle and low-income countries, for development-related projects with the objectives of promoting sustainable and equitable growth and reducing poverty.

Figure 1. Mobilization Multipliers in Infrastructure



Source: Avellán *et al.* (2022).
Notes: *** significant at 1%, ** significant at 5%, * significant at 10%.

IDB RESEARCH ON THE ROLE OF MDBs

This project was a collaboration of the Research Department and the Department of Strategic Planning and Development Effectiveness of the IDB.

FULL STUDY

Avellán. L., A. Galindo, G. Lotti, and J. Rodriguez. 2022. "Bridging the Gap: Mobilization of Multilateral Development Banks in Infrastructure."

DEPARTMENT OF RESEARCH AND CHIEF ECONOMIST

The Department of Research and Chief Economist generates new ideas to enrich the knowledge base that supports the policy agenda of the Inter-American Development Bank (IDB) and its member countries for achieving sustainable and equitable development in the region. To maximize the impact of its research, the Research Department carries out activities that serve as inputs to other IDB departments, governments, the academic community and public opinion in the region.

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Authors: Leopoldo Avellán, Arturo Galindo, Giulia Lotti, and Juan Pablo Rodríguez

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