The sustainable infrastructure challenge in Latin America and the Caribbean and the role of multilateral development banks

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This discussion paper is an edited transcript of a Keynote presentation delivered by Amar Bhattacharya (Senior Fellow, Center for Sustainable Development, Global Economy and Development Program, Brookings Institute) during the IDB and IDBInvest Annual Meeting, held in Panama in March, 2023[1].

[1] The text of this keynote was edited by Fernando Santillan, Tomás Serebrisky and Ben Solis.

Amar **Bhattacharya**

Amar Bhattacharya is a senior fellow in the Center for Sustainable Development, housed in the Global Economy and Development program at Brookings. His focus areas are the global economy, development finance, global governance, and the links between climate and development.

From April 2007 until September 2014 he was Director of the Group of 24, an intergovernmental group of developing country Finance Ministers and Central Bank Governors. In that capacity he led the work program of the Group, supported the deliberations of the Ministers, and was the principal point of interface with other organizations including the G20. He has therefore been an active participant in the global economic discussions and a key representative of the views of developing countries. Prior to taking up his position with the G24, Mr. Bhattacharya had a long-standing career in the World Bank. His last position was as Senior Advisor and Head of the International Policy and Partnership Group. In this capacity, he was the focal point for the Bank's engagement with key international groupings and institutions such as the G7/G8, G20, IMF, OECD and the Commonwealth Secretariat.

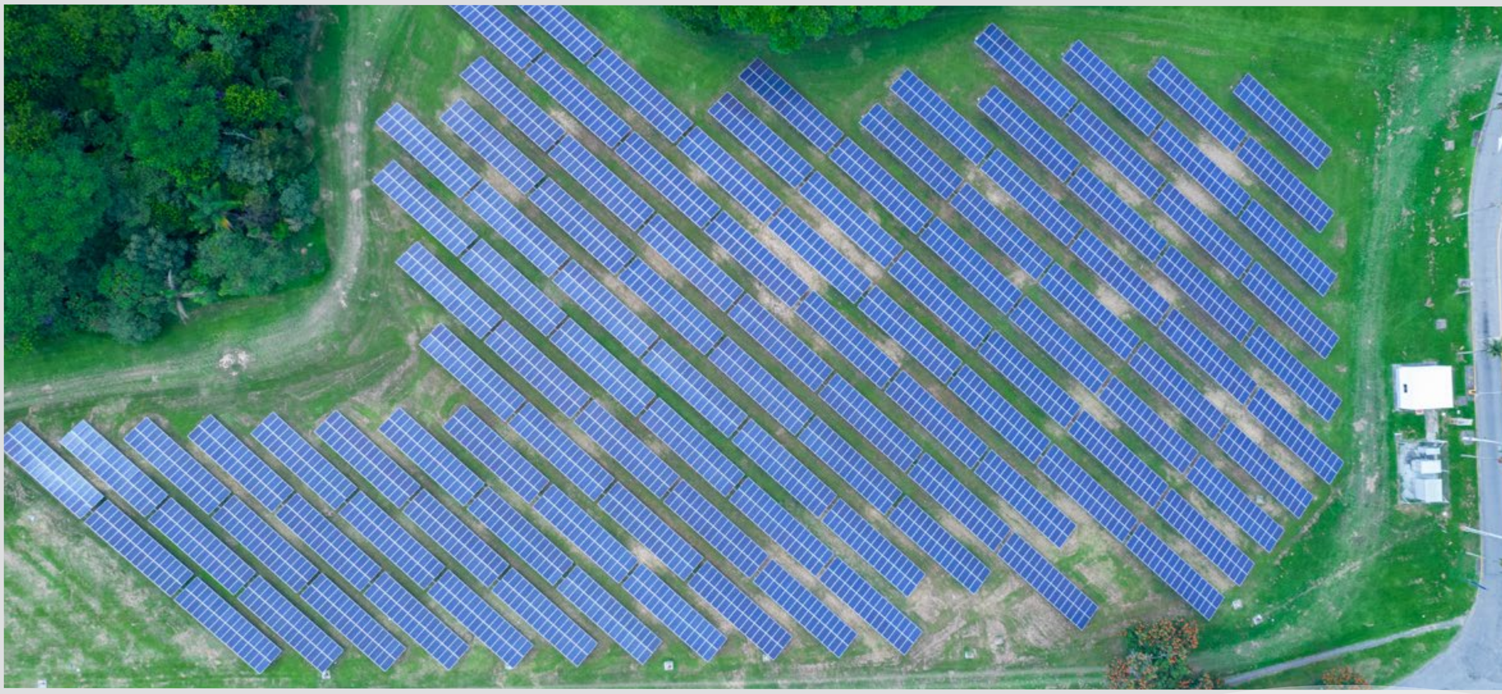
Through these different positions Mr. Bhattacharya has had a long standing engagement in research and policy discussions on the global economy and spillovers, international financial architecture, development financing and the global governance agenda including on the role and reform of the international financial institutions.

He completed his undergraduate studies at the University of Delhi and Brandeis University and his graduate education at Princeton University.

Infrastructure investment will allow countries to achieve strong, resilient, sustainable, and inclusive growth.

We are living in a truly critical moment in time for the world, for Latin America and the Caribbean, and for the planet, a time of great risk and of great opportunity. As the pandemic economic crisis and the challenge of climate change converge, a big push on investment and innovation —with sustainable infrastructure at the core— can help drive a strong recovery and restore momentum to the sustainable development goals (SDGs). Infrastructure investment will allow countries to achieve strong, resilient, sustainable, and inclusive growth. This is the only way to deliver on climate goals, but it requires a massive scaling-up of efforts on sustainable infrastructure. Although this is a big challenge, it is feasible with a much stronger partnership between the public sector, the private sector, and international institutions. Indeed, the scale of the investments needed in emerging markets and developing countries will require an integrated debt and financing strategy that tackles festering debt difficulties, but also brings together all pools of finance, both domestic and international, both public and private. In this context, we will need development finance institutions —including the Inter-American Development Bank— at the center of the efforts.

A crucial time for development and for Latin America and the Caribbean



If nothing is done, the present trajectory is one of slow growth, low investment and public spending, and rising debt service.

The world is at a critical moment in history. Even before COVID-19, emerging markets and developing countries were facing difficulties. Now, as a result of COVID-19 and the Ukraine war, emerging markets and developing countries are under a great pressure. If nothing is done, the present trajectory is one of slow growth, low investment and public spending, and rising debt service burdens in many, if not most, emerging markets. We face a significant risk of another lost decade of development.

The world is off track on virtually every SDG, and we are at risk that we will not be able to meet the development and demographic transitions that the world will be facing in the next three decades. At the same time, the urgency and opportunity of tackling climate change is clearer and more pressing than ever. And equally important is the challenge of protecting and restoring nature, especially in Latin America and the Caribbean. The positive point is that the world has made a significant change in understanding: for a long time, we thought about climate action as a cost, whereas now we know that it can actually be a way to chart a path towards better and new forms of growth.

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All of these challenges are even more difficult in Latin America and the Caribbean than in other developing regions. First, because of a legacy of low investment. The region has had the lowest rates of investment in aggregate terms of any region other than Africa; and public investment has been especially both volatile and low. The level of average public gross capital formation in countries of Latin America and the Caribbean is about 2.8 percent of GDP (**Cavallo et al., 2020**) and this figure is even lower (1.8 percent of GPD) if we weight this average considering the size of economies in the region (**Brichetti et al., 2021**). Meanwhile, countries in Asia invest on average 11.8 percent of their GDP. That is a huge difference, and it is not just a problem in terms of investment as a driver of growth, but also as a driver of long-term competitiveness and of the ability to tackle the challenges that are ahead, including climate change.

Second, the region is highly vulnerable to climate change. We see that in the form of droughts and water scarcity; in terms of rising temperatures, unevenness of precipitation, risks of rising sea walls, etc. All those issues come with a tremendous pressure for potential migration, both internal and external; and the cities themselves, which will be the recipients of most of these migrations, are not well prepared for climate change.

All of this means that Latin America and the Caribbean needs to invest in sustainable infrastructure. And it is not just a question of more infrastructure, but also of better infrastructure. Latin America and the Caribbean needs to set a path which allows it to tackle the services aspect, the quality of the services, the basis of competitiveness, the provision of social services, and, very importantly, sustainability, so that that infrastructure is compliant in a world of climate change.

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The need for an investment boost in Latin America and the Caribbean

The biggest increases are needed in climate-related investments: we are under-investing in clean energy, adaptation and resilience, and nature protection.

To recover from the present crisis fostering a strong, resilient, sustainable, and inclusive growth and to restore momentum to the SDGs, the world (and Latin America and the Caribbean) needs a big surge of investment and innovation. Investment must step up by several points of GDP if we are to deliver on the SDGs and if we are to deliver what needs to be done to face climate change. We estimate that, between now and 2030, emerging markets and developing countries will need to double the amount of investment in SDGs, from something like 2.4 trillion to about 5.6 trillion dollars, most of it in sustainable infrastructure. The biggest increases are needed in climate-related investments: we are under-investing in clean energy, adaptation and resilience, and nature protection. When we look at the climate and sustainability part of the agenda, the increase needed in this decade is fourfold: it is indeed a very big step up in increase in investment.

The Inter-American Development Bank has assessed the magnitudes of the investment and financing gap in Latin America and the Caribbean in the key infrastructure sectors (electricity, transportation, water and sanitation, digital infrastructure)[2]. The conclusion of that estimation is that Latin America and the Caribbean needs to be investing around 3.1 percent of GDP to deliver on the SDGs, but between 2008 and 2019 it was only investing about 1.8 percent of GDP annually. The spending has to double just from the perspective of the SDGs, and the increase is much greater if you add climate because the region needs to accelerate the energy transition: it needs to invest in loss and damage adaptation and resilience; it needs to invest in the restoration of natural capital, and in Latin America and the Caribbean that means investing a lot more on sustainable agriculture. Adding all that up and taking into account the large requirements for protection of biodiversity and forests, the scale of the financing the region is looking at is probably one or two percentage points higher. In a few words, the investment challenge for Latin America and the Caribbean is massive.

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Nevertheless, this context has a silver lining: the great opportunity presented by innovation. We often think about innovation in the sense of renewable energies, and there are indeed opportunities there, but the innovation associated with green transformation is much deeper. In the next five years, more than half of crucial green technologies will reach their tipping points: in renewable energy and storage, in efficiency technologies, in the grid, in electric vehicles, sustainable transport, green hydrogen, etc. We are at a moment of massive technological change, and though this process of structural and systemic change will be multi-decade, the next decade will be crucial, and it is crucial particularly in avoidance of climate instability.

[2] The publication can be downloaded in the following link: **"The Infrastructure Gap in Latin America and the Caribbean: Investment Needed Through 2030 to Meet the Sustainable Development Goals"**.

Acceleration of action is needed and needed now, and luckily enough now we have innovation possibilities that we would not have dreamed of a few years ago. For example, artificial intelligence and digital transformation are creating real opportunities for this acceleration.

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This new technology-driven sustainable growth story represents the greatest investment opportunity since the Industrial Revolution, and a great opportunity for development. Faster growth of emerging markets and developing countries relative to rich countries and the location of renewable energy sources largely in the South mean that we can potentially be changing the world's industrial geography. At the same time, of course, there is a response to that: the United States' Inflation Reduction Act seeks to improve its competitiveness, and Europe has responded in a similar way. Countries are competing for competitive comparative advantages with sustainable and new infrastructure at the core.

In any case, the private sector will provide much of the investment that is needed, but it will only happen with strong leadership coming from public authorities, and strong support coming from international institutions. Consequently, Latin America and the Caribbean must get on that bandwagon and, at the moment, it is behind the curve.

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The challenge of financing and the role of multilateral development banks

Translating investment opportunities into reality will be challenging. Most countries will find it hard because of the inherent complexities of infrastructure: its long-term nature, its interconnectedness, its externalities, both positive and negative, and its social ramifications. In particular, there are three elements of infrastructure that bring difficulties: **i)** the decision-making processes, with a contrast between the political cycle and the infrastructure cycle; **ii)** issues of governance, because in each case the investment has to be undertaken by the private sector but the result is a public good; and **iii)** incentives to both operate efficiently and maintain infrastructure assets in a way that produce long-term value.

What can be done to address these issues?[3] I would mention three key ingredients: robust upstream policy and institutional frameworks; the ability to prepare projects efficiently; and the quality and sustainability of individual projects. As we so often say in infrastructure, we need to choose the right projects and we need to do the projects right. This means capacity for strategy and investment planning at the central government level (and also at a local government level); a sound investment climate for private investment; appropriate fiscal rules that do not pull back on investment at times of difficulty (which has been a repeating challenge in Latin America and the Caribbean); and a focus on sustainability and climate change. In this line, the technical capabilities of multilateral development banks can be of great assistance to governments.

Lastly, the scale of the investment needed requires a commensurate scale of financing. The bulk of the financing has to come from the private sector, but the cost of capital is very high, and in Latin America and the Caribbean that is true for most countries. The reasons are probably known: because of macroeconomic instability, there are high risk premiums; second, policy-induced risk is a factor; in some cases, particularly for green technologies, there is technology risk; and then there are diffuse investments, with credit risks and the need for aggregation.

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At the moment, internationally, there are about 400 trillion dollars of private investment, but close to zero of that is going to developing countries. This is, obviously, the second way in which multilateral development banks, such as the Inter-American Development Bank, can play a crucial role. They can work with the governments in a strategic and systemic way, not only strengthening the strategic capacities of the governments as I mentioned above, but also supporting them in mobilizing the financing that will be necessary; including, of course, their own financing which is generally the best value to be had.

[3] An IDB publication on this topic can be downloaded in the following link: **"Reforms to Foster Sustainable and Inclusive Infrastructure in Latin America and the Caribbean"**.

For different reasons, at the moment the international community is putting a lot of thought into the role of multilateral banks. But the moment is also one in which multilateral development banks can have a key role: with their technical capabilities and capacity to mobilize finance, they can be key actors in multiplying the investment the region and the world need to get back on track towards the SDGs and to promote a strong, resilient, sustainable, and inclusive growth. I am certain the Inter-American Development Bank can play a fundamental part in this story by truly becoming a bank for the 21st century.

Recommended Readings

- Sustainable Financing of Economic and Social Infrastructure in Latin America and the Caribbean: Trends, Key Agents, and Instruments.
- La evolución de los precios de los servicios de infraestructura en América Latina y el Caribe entre 2012 y 2022
- Access to water and COVID-19: a regression discontinuity analysis for the peri-urban areas of Metropolitan Lima, Peru
- ¿Impacta la calidad regulatoria de los servicios de infraestructura en el crecimiento económico y la distribución del ingreso?: el caso de América Latina y el Caribe
- Transport for Inclusive Development: Defining a Path for Latin America and the Caribbean
- COVID-19 y servicios de infraestructura: ¿Cómo afectó la pandemia a los servicios de energía, transporte, agua y saneamiento en América Latina y el Caribe?
- Infraestructura y empleo: el rol de los sectores de transporte, energía, agua y saneamiento en la recuperación económica post COVID-19
- Reforma tarifaria e inclusión social: el caso de los subsidios en los servicios de agua y saneamiento en Lima y Callao
- La brecha de acceso a la infraestructura aeroportuaria en América Latina y el Caribe
- The Role of Active Transport Modes in Enhancing the Mobility of Low-Income People in Latin America and the Caribbean
- Operating Subsidies in Urban Public Transit in Latin America: A Quick View
- El potencial de la inversión en infraestructura para impulsar el empleo en América Latina y el Caribe
- From Structures to Services: The Path to Better Infrastructure in Latin America and the Caribbean

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