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Work of the Chair in International Architecture of Development Finance

An IFC/World Bank Group experiment in mustering the private sector for development

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Private financial flows to Emerging Markets and Developing Economies (EMDEs) today are lower than in 2015, when both the UN's Addis Ababa Agenda for Action and the Paris Agreement were adopted - committing the world to financing the SDGs and reducing carbon emissions. Were the expectations simply unrealistic? How can we hope to measure up to the challenge of our generation?

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... /... In the run-up to this week's Paris Summit for a New Global Financing Pact, we wrote (here) about the obstacles to achieving these goals and detailed a real-life experiment launched in 2016 at the IFC/World Bank Group that aimed at achieving the necessary change at scale ("IFC3.0 – Creating Markets")—by moving the institutions from a reactive to a pro-active stance combining their sovereign and private instruments to grow private investment. The strategy had the strong backing of shareholders (indeed, it was the basis for IFC's historic capital increase in 2018); the main challenge was the internal culture at both IFC and the World Bank.

There were six core elements:

• **First, integrated World Bank Group private sector diagnostics and strategies.** It is important to understand where the opportunities and the obstacles are and what needs to happen, and then to forge agreement across the World Bank Group to deploy the most impactful public and private sector instruments. 48 country private sector diagnostics and 61 country strategies had been prepared by March 2023. At the core were a series of "If-Then" scenarios that connected investment potential to government and World Bank Group action. The crucial task is ensuring that these diagnostics and strategies are designed in collaboration across the World Bank Group. There has been modest progress but ideally, the WBG Country Partnership Frameworks (CPFs) would be replaced by more operational, detailed business plans that include the detailed IFC country strategies.

• **Second, enforcing the "Cascade".** This is basically a principle of subsidiarity—the World Bank Group should give preference to private sector solutions where feasible and appropriate, for instance SME credit lines or power generation, and preserve its public lending firepower for situations which require a public approach. A prime example was the Queen Alia airport in Amman, Jordan, which moved from an IBRD-supported public sector concept to a successful, IFC-led private model. In in-between type situations, private approaches might require public support, for instance policy dialogue, guarantees or blended finance to de-risk investments. To systematically implement the Cascade, World Bank staff incentives should be changed (developing alternatives to public-debt-creating lending volume targets); for loans financing income generating public investments, there should be mandatory justification in board documents why a private solution is not possible.

• **Third, developing local capital markets.** A large share of the global investment challenge will have to be financed domestically. IFC and the World Bank launched a joint capital markets development program (J-CAP), so far running in a dozen countries, that combines advice for policy-makers and regulators with transaction support – such as anchoring transactions in mortgage markets, bond issues or stock exchanges. An example was the creation of a mortgage refinancing market in the CFA Franc Zone. Beyond the J-Cap, IFC is proactively creating green bond markets with a mix of specific advisory services and the purchase of new issuances by banks in EMDEs. To scale up, in 2018, IFC and asset manager Amundi, launched the Amundi Planet Emerging Green One fund (AP EGO) to stimulate demand for green bonds in emerging markets.

• **Fourth, "creating projects".** The lack of bankable projects and of local capacity (or foreign interest) to develop them has long been recognized as a key impediment. Our scaled-up finance will chase the same small number of projects unless we have a massive, hands-on approach to project development. IFC 3.0 needed to add entrepreneurial and project developer talents to the existing pool of financiers—staff working 'upstream' of investments to create opportunities and prepare feasibility studies. For instance, IFC teams are working to accelerate the

transition to electric buses in emerging market cities such as Cali, Colombia, Lviv, Ukraine, and Ho Chi Minh City, Vietnam. In a little over two years, 250 new staff have added some $30 billion in potential investment pipeline. This was and remains a profound transformation of the IFC DNA. And it is a cost that other DFIs can free-ride on: there is a need for a DFI system-wide solution.

• **Fifth, de-risking investments where appropriate.** Risk, both perceived and real, is a key barrier to greater foreign finance and investment. With its partial risk guarantees (PRG) and MIGA, the World Bank Group has powerful instruments to mitigate investor risk, especially in infrastructure. As mentioned above, these are a core part of the Cascade: private and guarantee solutions should be the default, sovereign loans should require justification. But unfortunately, guarantees continue to be extremely rare and the trend is down. This, despite internal and external independent assessments over the last three decades emphasizing the value of these instruments and calling for a big step up. There is a need for proactive management, for a change in incentives and for new skills. Separately—partly to fill the guarantee-void—the IDA Private Sector Window (PSW) was set up in 2017 to de-risk IFC and MIGA investments in the poorest countries through concessional blending, for instance, by mitigating local currency risk. The PSW's mobilization performance could be improved, but it remains a crucial instrument.

• **And sixth, measuring impact systematically.** To strengthen its focus on development but also to help connect strategy to projects, it was key for IFC to create a measurement system that could (1) anticipate, ex-ante, the development impact of its operations, and (2) capture not only project impact but also the broader influence investments would have on the market or country. IFC launched the Anticipated Impact Measurement and Monitoring (AIMM) framework in 2017. AIMM inspired the impact frameworks of several other development finance institutions and enabled IFC to develop the Operating Principles for Impact Management, an anti-impact-washing initiative launched in 2019 and now managed by the Global Impact Investor Network (GIIN).

Complete the job

As the leading multilateral development institution, with the ability to offer public and private solutions and an unparalleled level of knowledge, the World Bank Group should take the lead on scaling development finance from billions to trillions. IFC 3.0 has been a multiyear experiment which should be exploited to see what worked, what didn't, and why. In our opinion, there is progress but also a need to double down on implementation. The private sector side of the WBG, i.e., IFC and MIGA, must continue to shift from a reactive to a proactive approach to 'creating markets' and project development; and the public side, i.e., IBRD and IDA, must act in a complementary manner, embracing the private sector as a key development agent.

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