International Financial Institutions and Catalyzing Private Capital Flows

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1. MDBs are separate and distinct institutions which may be desirable for regional or functional reasons. However, in the setting of today’s global economy and financial markets, it is vital that they come together as a group for certain common tasks. Most importantly if they are to coordinate to catalyze “private capital flows and domestic resources” the MDBs must establish a working consensus among themselves on the following matters.

They must set out clearly their collective financing policies, procedures, market priorities and capacities so that these are fully understood both among themselves and by private markets. This will involve setting out clearly and transparently their respective data bases, made consistent across all MDBs and communicated effectively to private market participants. This is not done effectively today.

In a world which is increasingly embracing new technologies, it is urgent that the MDBs cooperate to deploy new technologies to achieve these objectives as a matter of priority.

Example: In 2016 long term co-financing from 13 MDBs totaled $163 billion, of which $68.7 billion was for infrastructure with the balance distributed to other undefined areas. Designated participants were insurance companies, pension funds and sovereign wealth funds. Unclear in this data is whether the sum of $163 billion was the portion provided by the MDBs, or jointly provided by the MDBs and the other named sources. In any case the total amount reported is very small when set against the capacity of today’s private markets and the magnitude of needed infrastructure financing in the developing world.

2. In any such review by MDBs it should be a priority to reduce access to MDB funding to those countries that have access to funding in private markets. Exceptions could be designed for those advancing countries that mobilize private resources for difficult projects that could benefit from blended financing. Otherwise graduation of successful emerging countries from dependence on MDBs should be accelerated. Resources generated from this process should be re-directed to the poorest countries, preferably for operations that promote growth.

3. It is important that MDBs recognize the power and diversity of private markets. The reality is that the MDBs have had a relatively small influence on the evolution and growth of private markets over the past 50 years. Private market players have frequently been unhappy with their efforts to consider co-financing with MDBs. This is usually the result of frustration with the bureaucratic processes of MDBs, their different ideas concerning timing, maturity structures, and time-consuming requirements of one sort or another, as well as their sometimes off-putting attitudes towards private markets. MDBs are also thought in many instances to be uninterested or uninformed and even hostile to certain kinds of private investment interest. Today’s large and diverse financial markets, especially pockets of differentiated risk appetites or specialized investment practices are often thought by private players to be of no interest or perhaps politically undesirable to MDBs. For example, the level of private equity investment with or
through MDBs is modest, as is the interest MDBs have in emerging market privatizations among their client countries. This last area represents major opportunities lost, because privatizations around the world in the past 40 years have been a major source for many countries of finance, growth and the restructuring of economies.

The changing features of financing markets are important for MDBs to recognize. For example, in the U.S. today bank lending accounts for only about one quarter of all financing with capital markets transactions providing approximately three quarters of finance. In Europe the pattern is roughly the reverse of the U.S. Ease and flexibility of financing, capacity volume and diversity features in capital markets make it likely that the trend towards capital markets will grow. Banks in both the U.S. and Europe will likely face more regulatory constraints that will render them less competitive with capital markets.

4. An issue related to the above points is the need for MDBs to review and possibly ease their requirements and procedures for private lending and investments. This point is not intended to undermine nor diminish MDB standards, but place the continuing challenge before them of adjusting to the rise and diversity of global markets. This would be a desirable exercise conducted in consultation with private market players. If the theme of de-globalization as portrayed in some of the papers which have been distributed for this meeting were to materialize in a substantial way, MDBs might be called upon to play a very important part in keeping capital flows open to countries that may no longer enjoy the private flows that have benefitted them in recent years. Any dialogue with private markets on MDB requirements and procedures would be useful at this point.

5. An additional issue that would benefit from dialogue between MDBs and private markets, whether the investments under review are long term, medium term or equity, is the field of infrastructure finance and the clear linkages between infrastructure investment and growth. Once again it is essential for MDBs to better understand the diversity of potential investment sources, which would require far greater flexibility and market understanding than is currently lodged in the MDBs. This would also require new approaches in MDBs towards risk assessment.

6. It is my view that as a part of the need for significant change in the MDB community and more effective policies for catalyzing private investment flows to emerging and lower growth countries, steps should be taken to negotiate what in effect would be a “Charter” between the MDBs as a group and a representative group of private market participants. The objective would be to negotiate and agree a set of principles that should guide working relations between the MDB community and the diverse universe of private market participants.

This type of approach was used by the IIF a few years ago to set out a consensus on the principles that should govern country debt re-structuring requiring cooperation between a diverse universe of private creditors and governments.

7. A similar situation prevails today with multiple MDBs and a wide universe of private market financing resources. Perhaps the diversity of official institutions and their specific priorities could be well served by the negotiation of such a “Charter”. So could the diversity present today
in external public and private markets that might be more effectively incentivized to cooperate with MDB institutions.

The success of the World Bank’s “ease of doing business index” for countries all over the world might usefully be applied as a model to both MDBs themselves and to the private market financing sources they seek to engage. Competition can be an effective tool in creating cooperation.