What role for private finance?

If countries were struggling to finance the necessary transformations to achieve the SDGs, COVID-19 has only made the situation worse. How can the international community encourage safer borrowing mechanisms, with a greater role for private credit, to bridge the shortfall?

By **Sonja Gibbs**, Managing Director and Head of Sustainable Finance, Global Policy Initiatives, Institute of International Finance

With less than 10 years left to achieve the Sustainable Development Goals (SDGs) by the 2030 target, the international development community remains hard at work to realise full implementation by the deadline. Failure to progress on the SDGs would leave countries more vulnerable to financial crises while reducing their capacity to mitigate or adapt to the impact and risks of climate change, extreme poverty and rising inequality. The COVID-19 pandemic has underscored the fragility of our economies and societies to unexpected shocks.

While forecasters will need time to determine the full economic impact of the COVID-19 outbreak, it is clear that the pandemic could impair progress towards the SDGs. With their less diversified economies, many emerging markets (EMs) and, especially, low-income countries (LICs) will find it even more challenging to mobilise limited domestic resources towards the SDGs.

Against the backdrop of large job losses and lacklustre corporate earnings, a deterioration in household and corporate balance sheets could endanger the speed and the strength of the recovery while limiting external funding opportunities for many countries. This surge in sectoral indebtedness could prompt companies and households to deleverage – sell assets to reduce debt – as the recovery matures. This could place growth well below potential, further hindering progress towards the SDGs.

Many LICs, especially in sub-Saharan Africa and Oceania, remain far off target. This unfortunate reality mainly reflects the difficulty in sourcing the investment needed to build resilient infrastructure for sustainable industrialisation. Success over the next decade will require addressing an SDG financing gap of $5–7 trillion per year, with EMs and LICs making up over $2.5 trillion of the total. SDG investment needs in EMs and LICs are particularly notable in power infrastructure ($790 billion), climate change mitigation ($700 billion) and transport infrastructure ($650 billion).

The International Monetary Fund (IMF) estimates that EMs need additional annual spending of 4 per cent of GDP to reach the SDGs by 2030. The scope of the challenge for LICs is even more daunting, with average incremental spending needs of some 15 per cent of GDP per year. With the public sector still the main funding source of social and economic infrastructure in LICs, the challenge of meeting high SDG financing needs will add to concerns about rising indebtedness. With persistent budget deficits in many LICs, government debt has risen rapidly over the past decade, increasing from some 30 per cent of GDP in 2011 to nearly 47 per cent in 2019. As COVID-19 continues to unfold, LIC government debt is expected to surge by over seven percentage points to nearly 55 per cent of GDP this year – the largest annual increase since 2000. This has left many of these fragile countries struggling with higher financing costs and debt sustainability. According to the IMF, as of June 2020, eight LICs were already in debt distress – in other words, experiencing difficulties in servicing their debt. Another 27 countries are at the high risk of falling into debt distress due to increasing external debt burdens.

Sustainable approach

Within this landscape lies tremendous opportunities for the private sector across the spectrum of investment vehicles – including foreign direct investment (FDI), listed and unlisted equity and private equity, in addition to the wide variety of debt instruments. Given the massive build-up of EM debt over the past two decades, a shift towards more non-debt financing could be a more sustainable approach to closing the SDG funding gap.

One aspect of the problem is inefficiencies in public investment: nearly 40 per cent of public investment in LICs does not turn into tangible 'public capital stock'. Further, at present, reliance on debt-generating capital flows (FDI debt, portfolio debt, bank loans and trade credit) is much higher for LICs compared to their EM peers. One potential remedy is improving domestic tax regimes and incentivising funding alternatives and partnerships that promote non-debt-creating capital flows such as equity finance. This in turn would reduce pressure on fiscal budgets. However, establishing an effective framework for monitoring public–private partnerships and associated contingent liabilities will be vital to managing key fiscal risks and encouraging private-sector SDG financing.

Another problem for many LICs is lack of transparency about the full extent and nature of their debt obligations – in some cases associated with 'hidden debt' or poorly understood contingent liabilities, as well as weak governance. The resulting uncertainty can increase the risk of debt distress, constrain market access or result in higher borrowing costs.


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Diversification in the external creditor base would also help. At present, official bilateral and multilateral creditors are the major external funding source for most LICs, comprising 80 per cent of public external debt. Establishing SDG-dedicated LIC debt funds and SDG-aligned bond issuance that is partially guaranteed by multilateral development banks could help mobilise private creditors. Furthermore, development of domestic bond markets could help channel domestic funding towards SDGs while adding welcome diversification in the investor base.

Official development assistance (ODA) – government aid to developing countries – could also play a greater role in promoting FDI in LICs, while fostering social and economic infrastructure development in fragile and less-developed countries. The strategic use of ODA financing and enhanced risk mitigation could help scale up private non-debt finance – for example, through blended finance (mixed commercial and philanthropic funding), de-risking (the non-profit and state sector taking on or underwriting risk to maintain interest from the profit sector) and public–private partnerships. It could also mobilise much-needed international private capital for SDG-related long-term infrastructure projects.

However, despite their vital role in financing the SDGs, ODA inflows as a percentage of GDP have been on a downward trend since 2003. While contributions from the 30 members of the Organisation for Economic Co-operation and Development's Development Assistance Committee account for 60 per cent of total ODA flows into LICs, they remain well below donor countries' 2015 pledges and a long way short of states' 1970 commitment to raise ODA funding to 0.7 per cent of gross national income. International financial institutions can play a more active role in scaling up ODA financing to deliver the SDG agenda – for example, through poverty-reduction strategy processes.

International collaboration

Priorities on SDG financing will obviously vary across countries, but the success of the SDG agenda entails global collaboration across a broad range of stakeholders, including international and regional development partners, national governments and, increasingly, the private sector. To make the 2020s a true 'decade of delivery' for the SDGs, ensuring a more targeted, efficient global allocation of private capital is a vital step. ●