

Marginal, Not Transformational: Development Finance Institutions and the Sustainable Development Goals

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Abstract

Development finance institutions have positioned themselves as key agencies to help the world meet the Sustainable Development Goals. It is doubtful that they can deliver. This paper outlines the challenges facing DFIs in achieving (anywhere near) such an expansion in their impact, particularly in infrastructure and particularly in the poorest countries. It notes that private investment in SDG priority areas is low in the poorest countries, and the record of private investment in rolling out services is mixed. These issues are linked in part to significant supply side constraints based on country characteristics. DFIs do better than the market as a whole at investing in challenging infrastructure—but not by much. And while the scale of their ‘leverage’ in terms of attracting dollars that would otherwise not have been invested is hard to determine, in the poorest markets in infrastructure it is certainly low. Finally, DFIs and donors more broadly have long tried to improve deal flow with limited success, suggesting there are few deals on the margin of occurring which only require small extra incentives to materialize.

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Goals**

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Introduction

Development finance institutions (DFIs) are development banks or subsidiaries usually owned by governments that are set up to support private sector projects in developing countries. There are (at least) seventeen bilateral and seven multilateral DFIs.¹ In the lead-up to the agreement of the Sustainable Development Goals, DFIs committed to play a significant role in delivering on investments that would be required if the Goals were to be met—including investments to support universal access to sanitation and water, electricity, transport and housing, secondary schooling and health services.

The primary investment needs for the SDGs are in infrastructure, health and education. Schmidt-Traub (2015) estimates infrastructure costs are above 65 percent and education and health investments are at 20 percent of the \$1.3 trillion annual incremental investment costs required if low and lower middle income countries are to meet the SDGs, for example.² (Any such exercise comes with numerous caveats as Schmidt-Traub notes, not least that investment alone is insufficient and that this misses numerous additional investments that would be required including in social protection systems and climate change mitigation.)

The Blended Finance Taskforce for the Global Goals, primarily made up of representatives from private and multilateral banks alongside DFIs, suggested that development finance including aid could be used to crowd in private capital to help meet these SDG investment requirements.³ An additional \$1.1–\$1.5 trillion in private sector investment in developing country infrastructure could be mobilized a year if \$100 billion in aid and multilateral development bank-backed blended finance was leveraged at a 9:1 ratio, notes the Taskforce.

As part of an expansion in their activities, the UK's CDC, the World Bank's IFC and the European Union's European Fund for Sustainable Development amongst other institutions are ramping up both the total size of their portfolios and the use of subsidized finance for the private sector in an effort to achieve greater impact, especially in the world's poorest countries. Other development finance institutions are growing their unsubsidized portfolios including the US DFC (formerly OPIC).

This paper outlines the challenges facing DFIs in achieving (anywhere near) the proposed expansion in their impact, particularly in infrastructure, health and education and particularly in the poorest countries. It notes that private investment in SDG priority areas is low in the poorest countries, and the record of that investment in rolling out services is mixed. These issues are linked in part to significant supply side constraints based on country characteristics. DFIs do better than the market as a whole at investing in infrastructure in challenging environments—but not much. And while the scale of their 'leverage' in terms of attracting dollars that would otherwise not have been invested is hard to determine, in the poorest markets in infrastructure it is certainly low. Finally, DFIs and aid agencies have long

¹ (OECD, 2019)

² (Schmidt-Traub, 2015)

³ (Business & Sustainable Development Commission, 2019)

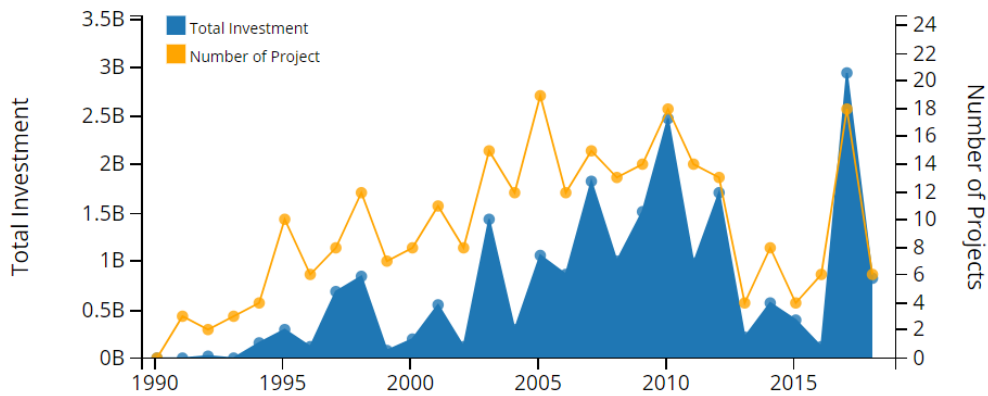
tried to improve private deal flow in the poorest countries with limited success, suggesting there are few deals on the margin of occurring which only require small extra incentives to be realized. That has implications for the efficacy of subsidies in ramping up investment.

Private (Overseas) Investment in SDG Priority Areas is Low in the Poorest Countries

Over the 27 years 1990-2016, private investment in developing country infrastructure has totaled \$1.6 trillion—or about two years of estimated infrastructure investment needs.⁴ That said, the long-term trend in private investment has been upward. In 2014, the OECD estimates that the private sector accounted for 10 percent of water and sanitation investment, 35 percent of transport and 45 percent of energy investment in developing countries as a whole.⁵

Most investment flows to middle income countries. Low income countries accounted for \$3 billion out of \$93 billion in infrastructure projects with private participation in 2017 (much of that \$3 billion will in fact have come from the public sector, as we shall see). Again, PPI data suggests that sub-Saharan Africa saw \$2.7 billion in investments with private participation in 2017. Compare these amounts to an estimated need for \$93 billion in annual infrastructure investment for sub-Saharan Africa.⁶

Figure 1. Low income PPI investment⁷



The private sector is a significant but still a minority provider of health and education services in developing countries. Private education accounts for 18 percent of total primary enrollment in developing countries and 28 percent of total secondary enrollment according

⁴ (Saha, Hong, Modi, & Zemlytska, 2017)

⁵ (Miyamoto & Chi, 2016)

⁶ (Gutman, Sy, & Chattopadhyay, 2015)

⁷ Created using World Bank PPI Visualization Dashboard (PPI, 2019)

to the World Bank. A considerable proportion of health care services in developing countries are delivered by private providers from traditional healers through pharmacists through mission clinics and hospitals to private for-profit hospital providers. Analysis of DHS data from 26 sub-Saharan African countries suggests almost half of the parents of a child who had diarrhea or a respiratory infection do not seek care while 28 percent brought the child to a public facility; and 22 percent took them to a private provider.⁸

At the same time, these services are primarily delivered through small (frequently non-profit) local providers rather than larger multinational firms that dominate much of private infrastructure provision. This limits the potential to leverage global capital markets to ramp up investment in health and education.

These Issues are Linked in Part to Significant Constraints in the Supply of Financially Sustainable Projects...

With regard to infrastructure, there are trillions of dollars of private funds with the potential to be invested worldwide, and ever-more of this finance is being specifically targeted at investment deals in developing countries. A review of institutional investor backed private investment in developing country infrastructure found ‘dry powder’ for infrastructure investments amongst institutional investors has tripled between 2004 and 2017, for example. But that same study found that between 2011–2017 (H1) there were a total of 41 deals worth \$1.9 billion—or only about \$300 million a year—that involved institutional investors.⁹ The challenge is on the supply side.

Take this list of why sub-Saharan Africa attracts little in the way of private investment inflows from a 1997 *Finance and Development* article:¹⁰

- Civil strife
- Macroeconomic instability
- Slow economic growth and small domestic markets
- Inward orientation and burdensome regulations
- Slow progress on privatization
- Poor infrastructure
- High wage and production costs

A more recent list by a former Minister of Public Works of Liberia included “the questionable quality of domestic institutions, over-politicization of project selection, misaligned incentives of governments, and low levels of quality and predictability of the regulatory environment.”¹¹

⁸ (Marek, O’Farrell, Yamamoto, & Zable, 2005)

⁹ (Saha et al., 2017)

¹⁰ (Bhattacharya, Montiel, & Sharma, 1997)

¹¹ (Moore, 2018)

Poverty alone makes private sector delivery of the services called for by the SDGs simply unsustainable. Take the SDG commitment to electricity access. Kenya has made considerable progress towards the goal, with the percentage of the population with access climbing from 23 percent to 56 percent between 2006 and 2016 according to World Bank data. But this has been accomplished not least by connection fees dropping to \$150 compared to actual costs of between \$1,400–\$1,900. And the newly connected customers use a very small amount of electricity—average demand per residential customer fell by 70 percent 2009/10–2016/17.¹² In short, these connections are not financially viable, and will necessarily involve considerable subsidies to sustain.

Consumers living on a few dollars a day are not wealthy enough to support the full range of infrastructure, health and education services outlined in the SDGs, and so private investment will not deliver those services absent considerable government financial and institutional engagement. In turn this dramatically reduces the potential to leverage trillions of private investment from billions of global public finance to deliver them.

And This Can Have Limited Development Impact

The complexity of deals, the fragility of institutions and the poverty of consumers helps to explain the patchy record of success in using the private sector to roll out infrastructure. Gassner et al. (2009) studied the impact of private participation in electricity and water provision in developing countries. While there are strong outcomes in terms of greater efficiency and quality of provision (also associated with job losses) the results in terms of rollout of services are fragile for electricity and small compared to unmet need for water and sanitation (a ten percent increase in connections).¹³

It is worth noting that these problems are similar in sectors including education and health. While service delivery indicators suggest that private providers in Sub Saharan Africa tend to perform better on indicators such as diagnostic accuracy and drug availability in clinics as well as teacher knowledge and attendance in schools, for example, the differences are marginal: a 61 percent rather than 56 percent performance in diagnosing common ailments in private versus public health facilities in Uganda, or a 42 percent score compared to a 32

¹² (Taneja, 2018)

¹³ Challenges with private provision are a worldwide problem: the European Court of Auditors' (2018) report on the use of EU finance to support Public Private Partnerships was subtitled "Widespread shortcomings and limited benefits." In a study of 12 EU co-financed PPPs, the auditors suggested while PPPs allowed public authorities to procure large-scale infrastructures through a single procedure "they increased the risk of insufficient competition" putting authorities in a weak negotiating position, they took more time (a procurement duration of 5-6.5 years) suffered considerable delays (seven out of the nine completed projects studied), saw considerable cost overruns and far lower than predicted usage, and saw remuneration rates to private providers that "did not always reflect the risks borne." The auditors concluded that "implementing successful PPP projects requires considerable administrative capability that can be ensured only through suitable institutional and legal frameworks and long-lasting experience in the implementation of PPP projects." If that is a considerable problem in the EU, it is likely to be even worse in small, poor countries.

percent average teacher score on a test of material those teachers were meant to be teaching in Nigeria.¹⁴

An analysis of outsourcing in Liberia’s schools suggested that the government assigned outsourced schools 37 percent more teachers than non-outsourced schools, including first pick of better-trained, new graduates, that some of the outsourced schools dismissed teachers (which regular schools could not) and that they spent between twice and more than twelve times the budget of non-outsourced schools. Despite that, impacts on learning were limited, with outsourced schools still seeing less than one in five grade 3 students able to fill in the blank on the question “4 x _ = 28,” for example, compared to around two in five students in Yemen and more than half in every other tested country. Scores on reading looked even worse in international comparison, suggesting that even the combination of private provision and considerably more money than currently available to governments is not enough to come close to guaranteeing the SDG target of literacy in Liberia.¹⁵ Note also the service providers provided limited investment in human capital (teacher training) or physical capital (school plant) as part of outsourcing contracts.

DFIs Do Better than the Market as a Whole at Investing in Low- and Lower-Middle-Income Countries—but They Are Bit Players in SDG Sectors Nonetheless

The challenges of private provision make even marginal increases in private investment flows that achieve development results very complex to achieve in sectors including infrastructure, education and health. But DFIs are trying hard to expand these results, especially in the poorest countries. In 2010 the IFC committed that 50 percent of projects would be in IDA countries, for example.¹⁶

The last few years suggest the IFC has struggled to meet its earlier promises. Between 2005–2008, 30 percent of IFC’s investments were in IDA countries.¹⁷ That climbed to 32 percent over 2009–2012 but declined to just 25 percent in 2013–2016. In 2016 only 2.6 percent of IFC’s total investments were in LICs.¹⁸ That said, the percentage of IFC country-level investments in low- and lower-middle-income countries is greater than the percentage of developing country GDP produced by those countries. And CDC country-level investments are 100 percent in those poorer countries (Table 1).

¹⁴ (Service Delivery Indicators, 2019)

¹⁵ (Romero, Sandefur, & Sandholtz, 2017)

¹⁶ (IFC ROAD MAP FY11-13, 2010)

¹⁷ (Kenny, Kalow, & Ramachandran, 2018)

¹⁸ (Kenny & Ramachandran, 2018)

Table 1. The Focus of Investments

	% Share in LIC/LMICs
IFC country investments 2012-2016	44
OPIC country investments 2012-2016	46
CDC country investments 2012-2016	100
Developing country GDP (current market, 2016)	25
ODA (2016)	57

Source: World Development indicators and <https://www.cgdev.org/sites/default/files/comparing-five-bilateral-development-finance-institutions-and-ifc.pdf>

It is worth comparing DFI investments to the size of the economies they are assisting. In 2016, IFC investments in low income countries were equivalent to 0.06 percent of their current market GDP, whereas IFC investments in lower-middle and upper-middle-income countries were worth 0.04 percent of GDP and 0.02 percent of GDP, respectively. IFC has performed better in previous years on this measure in low-income countries, but in 2007, the best year between 2001 and 2016, IFC financing in low income countries as a proportion of low income country aggregate GDP was still only one percent. It has not risen above 0.4 percent since then.¹⁹

Regarding infrastructure, the sector accounted for nearly half of MDB and DFI commitments to mobilize private finance in low income countries and around a third in lower-middle income countries 2013–17.²⁰ Nonetheless, the OECD estimates that ‘development partners’ account for around 6 percent of total developing country (non-communications) infrastructure investment of \$710 billion in 2014 (this includes not just DFIs but bilateral and multilateral donors and banks).²¹ Of official support, the OECD estimates that DFIs and IFIs ‘mobilized’ \$2.6 billion for private infrastructure investment in 2014 through guarantees and provided an additional \$3.3 billion in loans and equity (IFC accounted for \$2.1bn of that total \$6.1 billion). That suggests DFI and IFI guarantees, loans and equity in infrastructure were worth about ten percent of official development finance for infrastructure in developing countries and about 0.6 percent of developing countries’ total infrastructure investment. The more significant route for official finance of infrastructure

¹⁹ (Kenny, Kalow, & Ramachandran, 2018)

²⁰ (Attridge & Engen, 2019)

²¹ (Miyamoto & Chi, 2016)

with private participation at that point was through the public sector arms of international financial institutions rather than development finance institutions.²²

Recent figures are only somewhat more impressive. The PPI database suggests that DFIs provided direct debt support of \$7.9 billion in 2018, or about 9 percent of total PPI investment and a little over one percent of total infrastructure investment.²³

The role of DFIs is even more limited in other priority sectors for SDG investments. Between 2013–16 (inclusive) health and education combined accounted for about 4 percent of IFC investment (compared to about 17 percent for infrastructure excluding telecoms).²⁴ For a set of five bilateral DFIs, the combined share was about five percent (compared to 28 percent for transport and utilities).²⁵ This reflects the fact that most private provision in health and education in developing countries is provided by small-scale local providers ill-suited to standard DFI operations.²⁶ Assume total DFI investments of around \$87 billion in 2017,²⁷ and that the health and education share is the same across all DFIs, that would suggest an investment of about \$3.5 billion for health and education projects a year.²⁸ Compare that to annual spending on health and education in developing countries of about \$3 trillion a year.²⁹

The Scale of DFI ‘Leverage’ is Hard to Determine, but it Isn’t Big

DFIs aim to crowd in private finance alongside their own resources. The true extent of this ‘leverage’ or ‘mobilization’ is hard to measure, because we do not know what would have happened without DFI investment. Ratios based on the proportion of funding from DFIs compared to other investors assume in effect that investments would not have happened without DFI support—often unreasonably. In the 1996–2007 period, an IEG desk review suggested that in only 27 percent of cases was IFC involvement essential for the project to

²² Tyson (2018) suggests that from 2008 to 2014 IFI-supported private finance for infrastructure averaged \$37 billion annually, and that declined to \$13 billion between 2015 and 2017.

²³ (World Bank, 2018) share of total investment estimated based on the OECD figure of \$710 billion in developing country infrastructure investment in 2014.

²⁴ Attridge and Engen (2019) suggest aggregate MDB and DFI commitments to mobilize private finance as a whole are below five percent in every income group.

²⁵ Calculated from (Kenny, Kalow, Leo, & Ramachandran, 2018).

²⁶ Even in infrastructure, the limited financing role of DFIs in overall private financing of infrastructure in developing countries is reflected in outcomes. Taking into account mobilization of one sort or another as well as support through the World Bank’s public sector lending, the World Bank Group’s evaluation arm estimates that “the grid-based connections supported by the Bank Group are estimated to be about 4.4 percent of all connections added during FY2000–2014 by all country clients, and 4.8 percent of all connections added by low-access country clients for the same period.” (Independent Evaluation Group, 2015).

²⁷ (Runde & Milner, 2019)

²⁸ Samantha Attridge (in comments on this paper) suggests this is if anything an over-estimate based on the analysis in Attridge and Engen (2019) which suggests many DFIs do not invest in social sectors at all.

²⁹ Current GDP is about \$29 trillion and health and government education spending combined are 10.2 percent of GDP –WDI.

go ahead (in an additional 53 percent of cases the Corporation was at least ‘catalytic’).³⁰ Mobilization ratios simply based on the percentage of financing that comes from the blended finance vehicle do not really tell us if the blended finance increased overall investment in at all.³¹

With that significant caveat, we do have indicators of what percentage of investment in projects is provided by DFIs and donors. Across sectors, the MDB private sector windows may have a direct and indirect mobilization ratio of 1:1.5 according to the Blended Finance Task Force (one dollar of multilateral support ‘leveraged’ \$1.50 of private investment). Attridge and Engen (2019) suggest DFIs and MDBs combined see a leverage ratio of 1:0.37 in low-income countries, 1:1.06 in lower-middle-income countries and 1:0.65 in upper middle income countries. (Compare that to leverage ratios of 1:9 hoped for by the Blended Finance Task Force). Looking across all sectors, Attridge and Engen estimate \$16 billion of private finance was invested alongside \$21.4 billion of MDB and DFI resources in projects on average over 2013–15 in low- and middle-income countries.³² Attridge and Engen also estimate an MDB plus DFI leverage ratio of 1:0.8 in infrastructure specifically between 2013–2015 (compared to about 1:0.9 in social sectors).

In 2018, by investment volume, more than a quarter of PPI finance in developing countries involved multilateral or bilateral development finance institution participation, up from less than 15 percent in 2013.³³ These statistics might suggest a slightly better ‘leverage ratio’ of about 1:1.8 (i.e., 25 percent of PPI investment volumes were supported by DFIs which themselves provided nine percent of total investment volumes). Note however, it is an overestimate because this includes funds ‘leveraged’ from the public sector—governments, aid agencies and multilateral institutions.

Regardless, leverage is certainly low in the poorest markets where many ‘private participation’ deals are already dominated by government and aid. Attridge and Engen (2019) report that ratios for infrastructure and social sectors drop precipitously in low income countries to below 1:0.3. In 2016, looking at the nine (out of 14) IDA-country deals with detailed financing information available in the World Bank’s PPI database, private banks provided 8 percent of the total \$1 billion in investment, 31 percent was equity largely provided by sponsors, leaving 61 percent provided by multilateral and bilateral institutions and public financing institutions in the countries home to the investment.³⁴ In the past, the IFC estimates that only 39 percent of PPI investment in IDA countries was actually financed

³⁰ (Independent Evaluation Group, 2008). Carter (2015): “Whilst it is inevitable that donors are going to report ‘leverage ratios’, as little weight as possible should be placed upon these data. Certainly no incentives within organisations should be based on achieving high leverage ratios. The easy way to hit a high leverage target is to attach a small sum of public money to a large already viable investment project.”

³¹ See (Kapoor, 2019).

³² Attridge and Engen (2019)

³³ (Independent Evaluation Group, 2008)

³⁴ WBG (2017) 2016 PPI Annual Update

by private sector sources.³⁵ That again suggests leverage ratios considerably below one from all public sources combined.³⁶

It is also worth noting how much DFIs have been unable to deliver on increasing overall private sector investment in infrastructure in developing countries—since the billions to trillions proposal was launched, actual investment in infrastructure with private participation has stagnated in developing countries and the 2018 volume in IDA countries (at \$3.1 billion) is half that of 2014 (although deals are still rare enough that volumes fluctuate a lot over years). The situation may have been worse without DFIs, and this is not for lack of trying, but may reflect the limited impact of additional DFI finance compared to the multiple supply side challenges of infrastructure projects in more challenging markets as well as global changes including the new Basle regulations.

DFIs and Donors Have Tried to Improve Deal Flow with Little Success

A recent Independent Evaluation Group review of IFC market making notes that the IFC’s typical approach to engage with clients for the downstream stage—from identification to implementation. “This engagement modality does not markedly increase the number of bankable projects—a binding constraint to investments in developing countries,” they argue.³⁷ But to be fair to the IFC, other DFIs and donors more broadly, they have tried to move upstream to tackle some of the upfront costs and broader issues involved in bringing a project to market in a lower-income country. Take some recent initiatives:

- The AfDB Africa50 Infrastructure Fund to mobilize resources and support project development;
- The World Bank Private Infrastructure Development Group facilities including InfraCo Africa and The Emerging Africa Infrastructure Fund, again designed to develop commercially viable projects and provide finance;
- The US Power Africa initiative to advance catalytic transactions, support policy reform and mobilize financing; and

³⁵ Further details on the proposed IFC-MIGA Private Sector Window in IDA18. Carter (2015) notes that the use of subsidies makes even more of a mockery of mobilization. “Using a small public grant to ‘catalyse’ private finance can be just another way of creating a concessional loan, and the appearance of mobilising finance is an illusion”

³⁶ The data also suggests that private finance ‘mobilized’ by aid is considerably less focused on the poorest countries than aid flows as a whole are. Attridge and Engen (2019) suggest about one quarter of ODA is directed to low income countries compared to less than one twentieth of mobilized private finance.

³⁷ (Independent Evaluation Group, 2017)

- The World Bank Global Infrastructure Fund to identify, prepare, and finance large infrastructure projects.³⁸

This was also the broad intent of earlier project preparation facilities, PPIAF, GPOBA, DevCo, joint IFC-World Bank departments, joint World Bank-IFC operations, TA from both the IFC and World Bank, and numerous World Bank structural adjustment and policy-based lending conditions and triggers.

Sadly, the IEG review cited above also notes “[p]rogrammatic and country-based, client-focused initiatives aiming to move IFC farther upstream from its traditional engagement at the financial structuring stage... have had mixed results and have not been mainstreamed...”³⁹ For example, out of the 38 engagements undertaken by the InfraVentures program, designed to help get projects to the feasibility stage, only two reached the financing stage. Regarding infrastructure project preparation facilities as a whole “performance to date has been weak, with relatively few projects reaching financial closing.” In health, “the Health in Africa program undertook market studies and country assessments aimed at supporting health-related SMEs. ... Most potential investments, however, were not realized or were closed without disbursement...”

Technical assistance to support regulatory reform have also seen limited impact. The Independent Evaluation Group Report suggests that “empirical evidence shows no automatic link between business climate reforms, and the supply of investments. This accounts to a significant extent for the lack of bankable projects in sectors of key importance for development, especially in infrastructure.”⁴⁰ Regulatory fixes are important but are only one part of the story as to why there are few bankable projects, as we have seen.

Outside of the largest SDG investment sectors, upstream efforts in solar lighting and MSME lending were more successful according to the IEG, suggesting other opportunities for DFI expansion may be more plausible than infrastructure, education and health.

That there Aren't that Many Deals on the Cusp of Happening has Implications for Subsidies

Limited growth in PPI volumes and less in DFI engagement in SDG priority-investment sectors outside of infrastructure suggest there may not be a large number of deals ‘just over the horizon’ that need only a small additional subsidy or assistance to deliver.

If a DFI is receiving (close to) market rate returns, their financial value added is any implicit political risk guarantee of being associated with a multilateral institution or government alongside willingness to offer ‘patient capital’ products not available in the market (including

³⁸ (Gutman et al., 2015)

³⁹ (Independent Evaluation Group, 2017)

⁴⁰ (Independent Evaluation Group, 2017)

loans with longer payback periods or in local currency). But the value of both the implicit guarantee (or explicit guarantee products like MIGA) and of patient capital will tend to be highest in countries where other barriers to profitable investments are also high—poverty, instability, a weaker macro climate in general.⁴¹

In fact, as Kapoor (2019) notes, DFIs are already ‘soft blending’ in their standard operations by accepting returns in the single digits rather than the double digits that might be expected by private equity funds in developing countries. Explicit subsidy (which Kapoor labels ‘hard blending’) simply reduces the hurdle rate of return a little lower.⁴² And slightly better financing terms or somewhat greater political risk coverage will only have a considerable impact on the number of deals if there are a lot of projects that are close to the (risk adjusted) margin of profitability required by private investors that only need this little push to get them over the line.⁴³ The recent history of DFIs in infrastructure in poorer countries suggests there are few such deals.

Both explicit subsidies and technical assistance can surely help—greater subsidization will allow DFIs to make deals further away from delivering (risk adjusted) market-rate returns—but they will help at the margin not by the exponent, and ‘crowd in’ deals that are less plausible as demonstration or market-making investments precisely because their returns are so low. The mid-term review of the IDA PSW window which provides subsidized finance for IFC deals in IDA countries noted “deal origination in PSW-eligible markets does not come easy”—this even with IDA subsidy—and the \$1 billion Risk Mitigation Facility, designed to guarantee private investment in infrastructure, had spent nothing by mid-term.

It is unsurprising, then, that adding a subsidy element to deals in low income countries does not appear to significantly improve ‘leverage.’ Looking at blending concessional with private financing, in 2014–16 \$1.5 billion of concessional finance plus \$5.2 billion of non-concessional official finance was invested alongside \$8.5 billion of private investment in developing countries—a 1:1.3 ratio when sweetened with concessional finance. To add to concerns, private investors in blended finance deals are often impact investors, suggesting that money is not being crowded in by blending that would otherwise not have been used to back development finance.⁴⁴

⁴¹ As Nancy Lee (2017) has noted about surveys of infrastructure actors, less than 20 percent see MDB risk-mitigation tools as successful “Market participants report problems both with the products (too complex) and MDB processes (too slow and nontransparent).”

⁴² (Kapoor, 2019)

⁴³ Paddy Carter, in comments on this paper, notes that thinking of the subsidy as accepting a slightly lower than market return may be mischaracterizing the actual decision process, which involves tolerance of failure rather than expected average return. A low overall portfolio hurdle allows a DFI to take on more risky projects.

⁴⁴ (Business & Sustainable Development Commission, 2017). Kapoor (2019) estimates that in the best of cases, involving new approaches and more staffing at DFIs, a co-mobilization ratio of 1:2 might be achieved.

The Role of DFIs Will Remain Marginal

It is surely not the DFI's fault that the SDGs set such ambitious targets, but it is their fault they suggested they could play such a big role to meet them. Billions to trillions was based on faulty premise that DFIs and multilateral development banks could be a major force behind aggregate private investment decisions when they are only one factor amongst many in terms of investment flows.

The more honest approach for the leadership of international financial institutions including DFIs at the Addis Financing Conference where billions to trillions was launched would have been to say to rich countries “if you really want any hope of meeting these goals you are going to have to dramatically ramp up aid and other official flows, especially to the poorest countries, by orders of magnitude.” This is what institutions supposedly working on the side of the world's poorest people *should* be saying rather than massively over-promising based on current policies and aid volumes.

DFIs can continue to play an important if marginal role in financing SDG investment priority sectors. They can expand that role through market-making—taking the lead in developing new project proposals, and (potentially) investing in platforms on the model of Globeleq (an independent power provider owned by CDC and Norfund) and Gridworks (a transmission and distribution company owned by CDC). A marginal role in global development can still involve considerably improving the lives of tens of millions of people. But the scope for aid finance and government to government loans to deliver results remains considerably larger in infrastructure, health and education given that these sectors appear set to remain predominantly publicly owned and operated.

Again, DFIs should continue supporting investments that create jobs, incomes and exports in other sectors through activities such as lending to local banks to on-lend to SMEs, but accept that even where increased volumes are easier to achieve, macroeconomic impact will remain small.⁴⁵ Using formality as a loose (and over-generous) proxy for ‘good jobs,’ there is a strong relationship between levels of GDP per capita and the proportion of jobs that are formal.⁴⁶ As with quality infrastructure provision, it is not clear that a significant impact on job quality is sustainable without considerable economic growth.⁴⁷ Once again, DFIs can

⁴⁵ Eight of the 12 IDA PSW projects reviewed at mid-term were in financial markets, and SME lending accounted for more than a third of total PSW commitments, and the IFC's analysis suggest a \$50 billion “finance gap” for micro and small enterprises in low-income countries, for example (World Bank, 2017). At the same time, the World Bank Group's Independent Evaluation Group has suggested weaknesses in efforts to quantify development results, and critics including Fernandez-Arias et al (2019) are deeply skeptical: “Subsidized lending to SMEs may be futile or counterproductive on productivity grounds unless such lending targets young firms that bring innovation and have high-productivity potential.”

⁴⁶ (Ghani & Khanbur, 2013)

⁴⁷ Might DFIs be ‘transformational’ in supporting investments that produce intermediate goods which, in turn, have an effect on productivity across sectors, raising growth and allowing for greater spending on SDG investments? Potentially, but infrastructure provision itself is precisely this kind of investment—one that can increase the returns to other investments—and, as this paper has demonstrated, DFIs have struggled to deliver a

play an important marginal role in progress towards SDG targets but it is implausible to imagine much more than that from aggregate investments that account for a fraction of a percentage of developing country GDP each year.

What are the broader policy implications for donors that follow from this analysis? In declining order of political plausibility: (i) expand official financial support for DFIs to allow them to increase their marginal impact, and allow them to invest significantly in technical assistance to both firms and countries to increase deal flow; (ii) reform rules around the ODA classification of public finance for private investment to remove perverse incentives to channel aid resources to DFIs in a manner that will reduce targeting and impact of aid on progress toward the SDGs in the poorest countries;⁴⁸ (iii) limit ODA support for private sector subsidies through DFIs to the rare cases where there is a strong public policy case that bespoke (noncompetitive) subsidy provision by outsiders is the most efficient public policy tool to deliver progress on the SDGs in the poorest countries; (iv) provide additional ODA and (where sustainable) official finance to governments to support public investments in health, education and infrastructure; and (v) work to implement the transformational global economic policy agenda that would be required to meet the SDGs, not least involving order of magnitude increases in the flow of goods, services, finance, technology and—most importantly—people.

dramatically improved product in that regard. Perhaps the picture is different in the other major sector of DFI investment—banking and finance—which can also have this kind of intermediate impact. But previous footnotes have suggested some grounds for skepticism in that regard as well.

⁴⁸ Current rules allow DFI finance to be classified as ODA as soon as it is delivered to the DFI, potentially many years before the resources are used to subsidize projects (if they are ever used in that regard). And it is provided to organizations that (already) struggle to provide finance to poor countries, to priority SDGs investment sectors in those countries, and in particular to poor people within those countries.

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