Financing a big investment push strategy for inclusive, sustainable and resilient recovery and development

G24 Briefing
September 7, 2022

Center for Sustainable Development at BROOKINGS

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

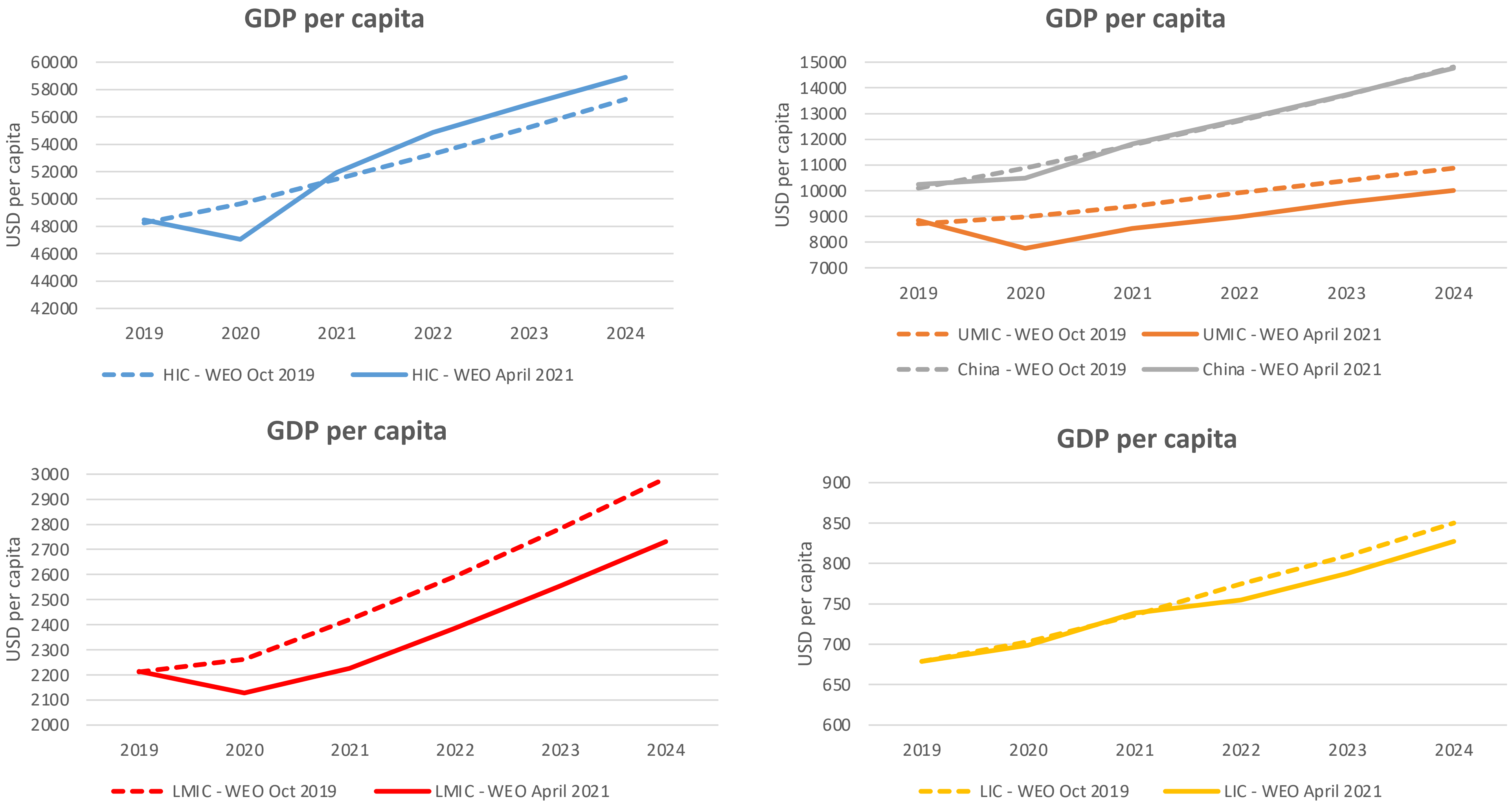
Grantham Research Institute on Climate Change and the Environment

Photo by Tyler Casey on Unplash

EMDEs at a crossroads

1. Underlying challenges (slowdown in growth, investment and productivity; informality of labor markets and technological change; inequality, weak safety nets and pressures on social cohesion; growing threats of climate change, environmental degradation and biodiversity loss).
2. The Covid pandemic has been the most severe and broad-based shock faced by EMDEs.
3. As a result of large differences in policy support and access to vaccines, we have experienced a divergent and protracted recovery. Has been compounded by the fallout of the Ukraine war.
4. Next three decades will be critical for development and climate requiring a major, rapid, and sustained expansion of investment

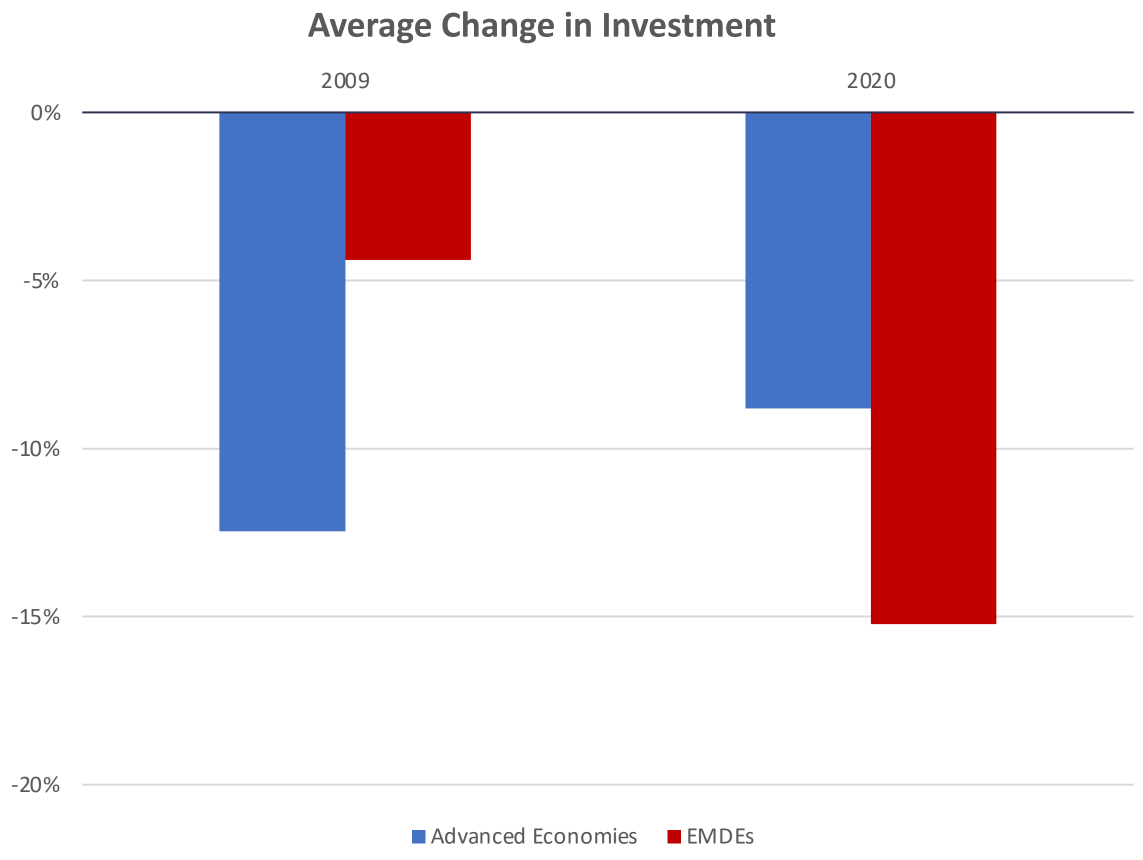
Figure 1: A divergent and protracted recovery

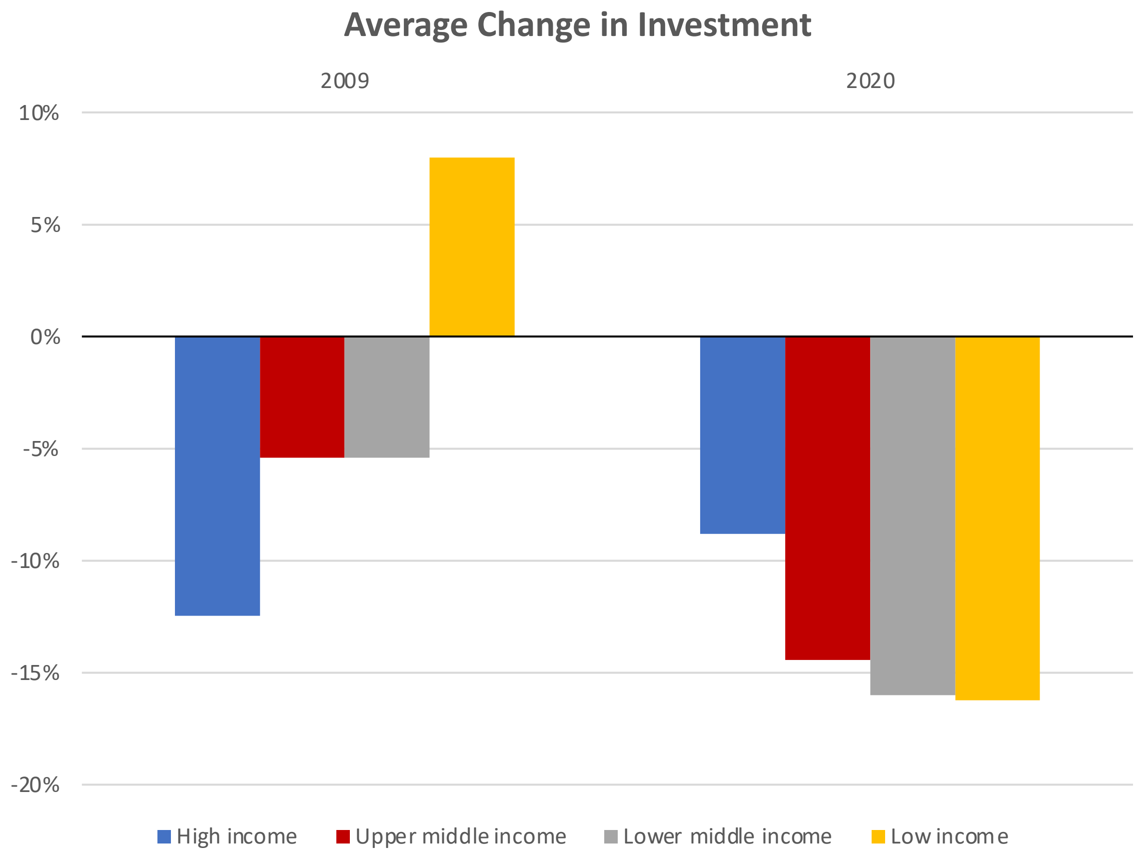


Towards a robust and sustainable recovery

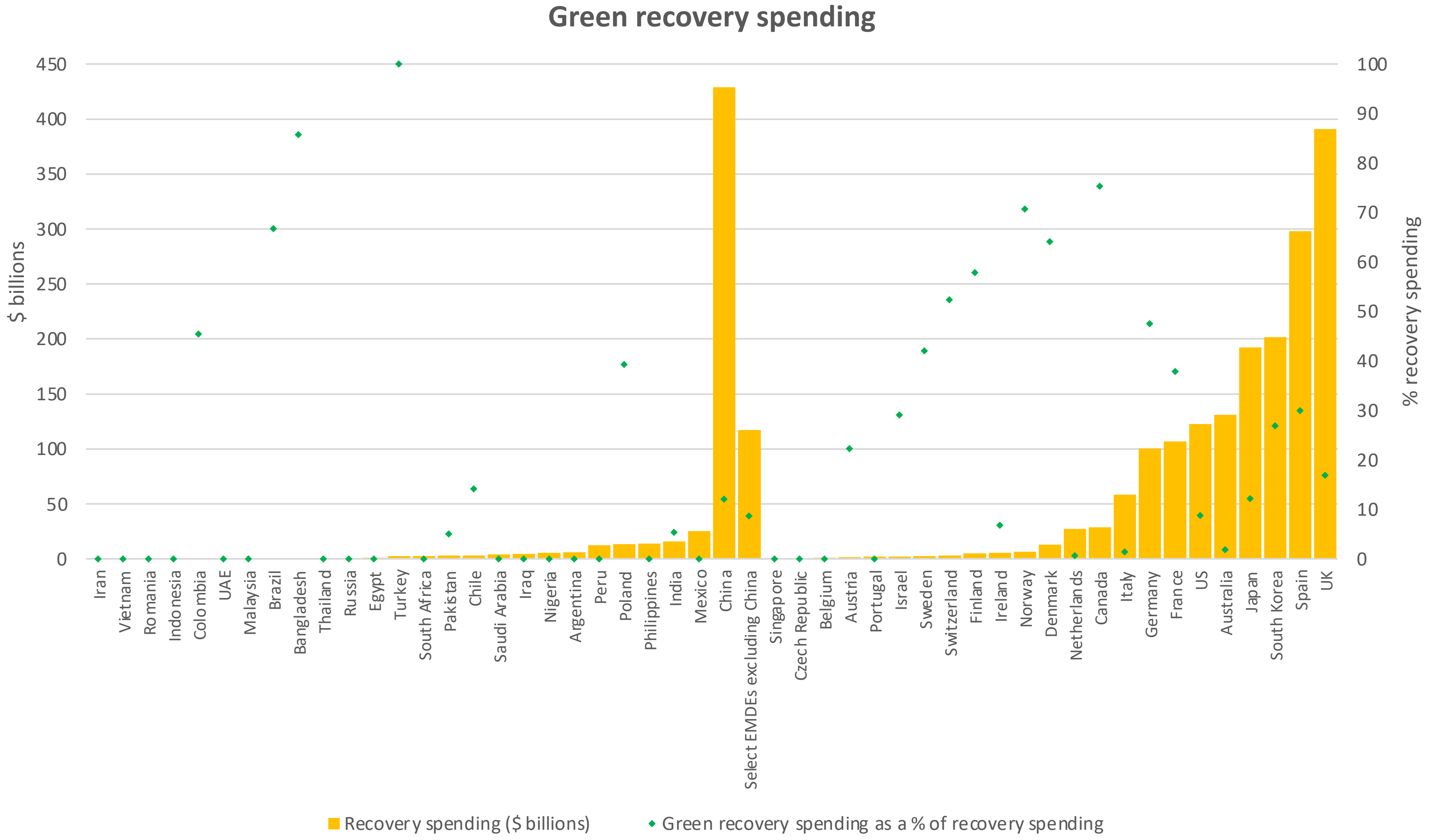
- EMDEs and especially LICs need to boost public spending to deal with the human and social costs of the pandemic. IMF staff estimate that LICs/PRGT countries need a boost in public spending of around 2 percent of GDP to reach pre-pandemic income levels. A smaller, but still significant, boost of 1% of GDP is needed in other EMDEs. If the recovery is delayed, additional costs will be incurred to protect people and jobs.
- While the decline in GDP growth in advanced economies in 2020 was greater than in EMDEs, the collapse in investment has been much greater in EMDEs and much steeper than what it had been in the aftermath of the global financial crisis of 2009.
- The strategy for recovery of investment in EMDEs must accomplish three objectives:
  - Restore investment to their pre-pandemic *levels.*
  - Raise investment *growth rates* to the levels of the 2000-2010 period; this would mean increasing investment by 2-3 percent of GDP from pre-pandemic levels.
  - Ensure that the *scale and quality of the investment recovery* puts economies on a path to meet the development and climate transitions over the coming three decades.

Changes in Investment Rates 2009 vs 2020





Recovery spending



	Total spending ($ billion)	-of which recovery spending ($ billion)	--of which green recovery spending ($ billion)
Select advanced economies	13108.64	1700.13	396.2
China	2234.27	428.95	52.06
Select EMDEs excluding China	1362.93	117.14	10.58

Source: The Global Recovery Observatory (26.06.21)

Estimated spending needs for Covid recovery

($ billion)

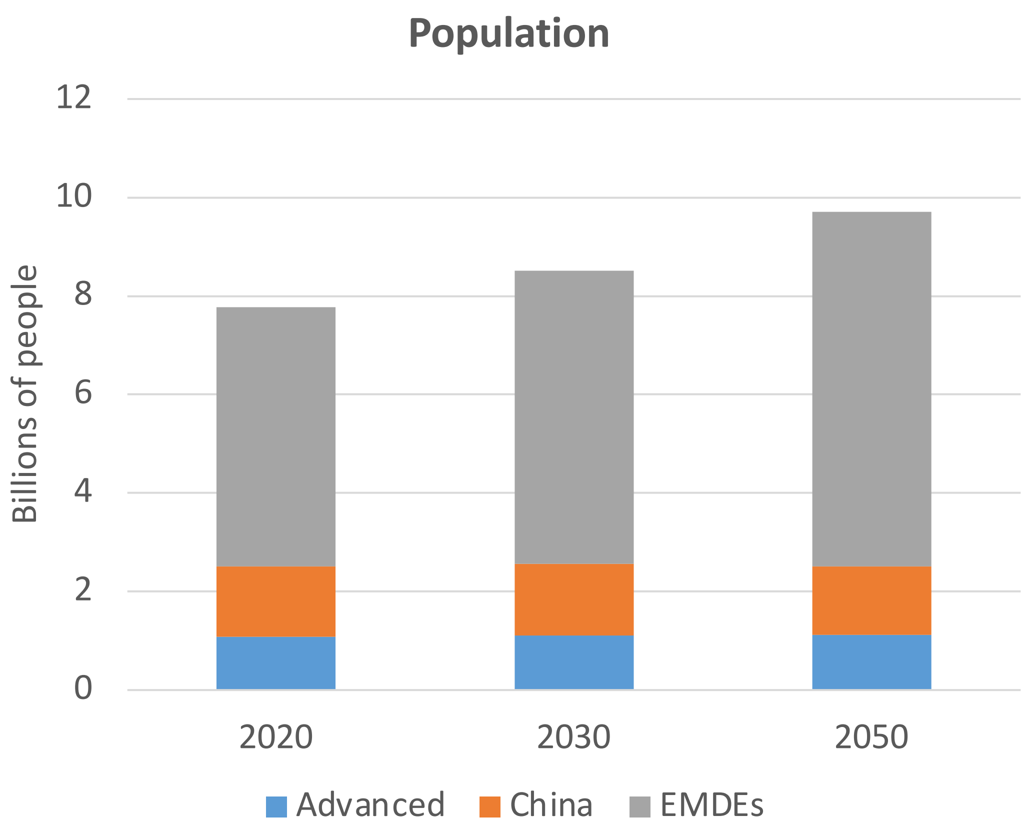
	Health and income support	Restore investment to pre-pandemic levels
UMICs	400 -700	300 - 350
LMICs	200 - 400	200 - 250
LICs	150 - 250	15 - 20
EMDEs	750 - 1350	515 - 620

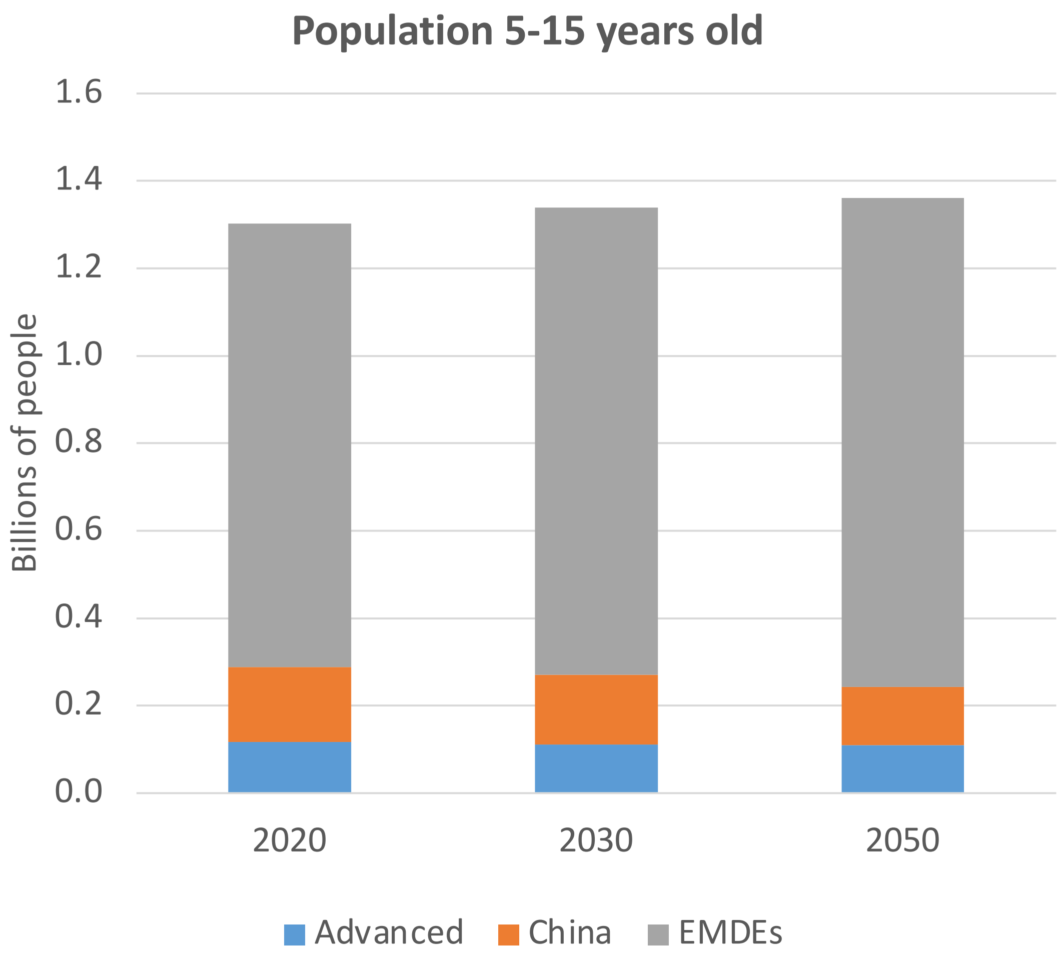
Priorities for development and climate transitions

- Interlinked objectives of People, Planet and Prosperity in the context of major demographic and environmental transitions
    1. Human capital – boost health and education spending, address demographic transition
    2. Sustainable infrastructure - manage key transitions to deliver on development and climate—energy, transport, cities, water, digital and industry
    3. Agriculture, food, land use (AFOLU) – sustainable agriculture and forestry investments, scale up food production, conserve and restore nature and biodiversity
    4. Adaptation & resilience – help countries cope with changing climate, especially poor and vulnerable countries

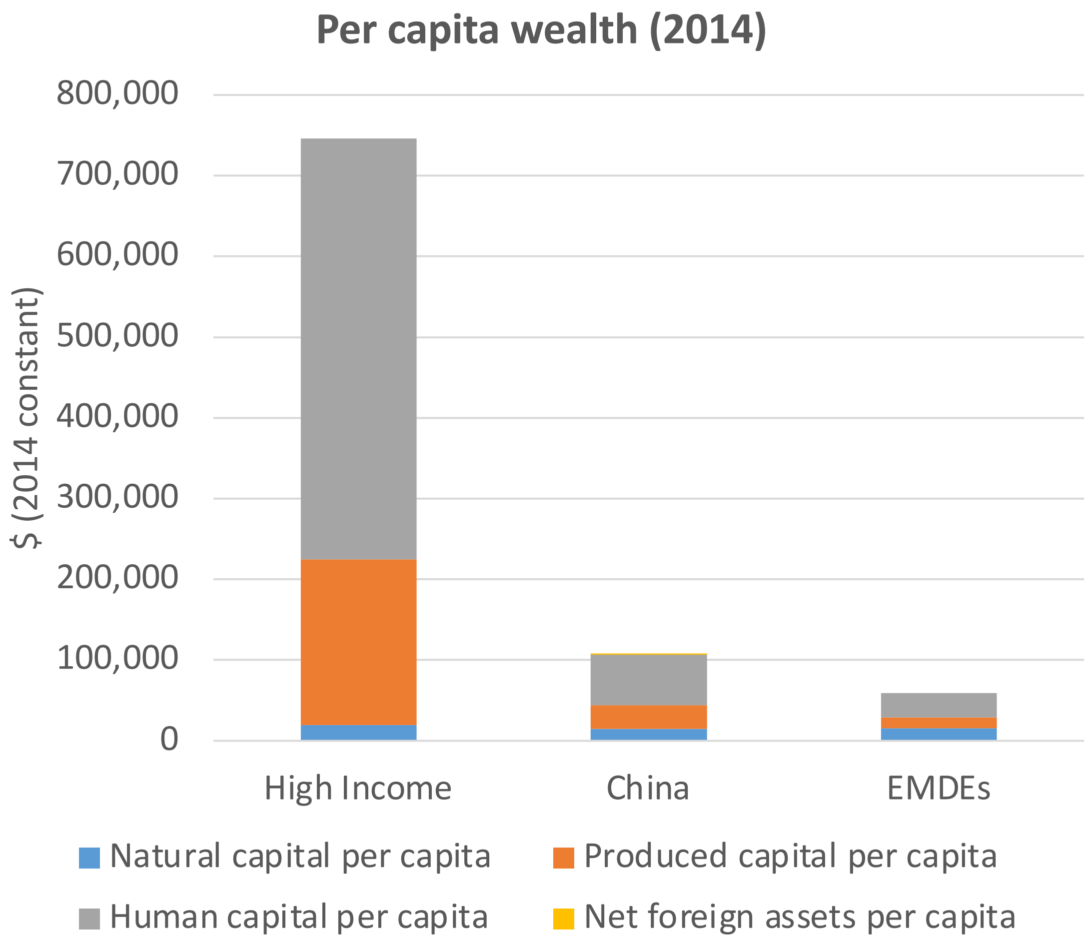
- **These categories are overlapping and complementary**

Demographic Transition





Wealth

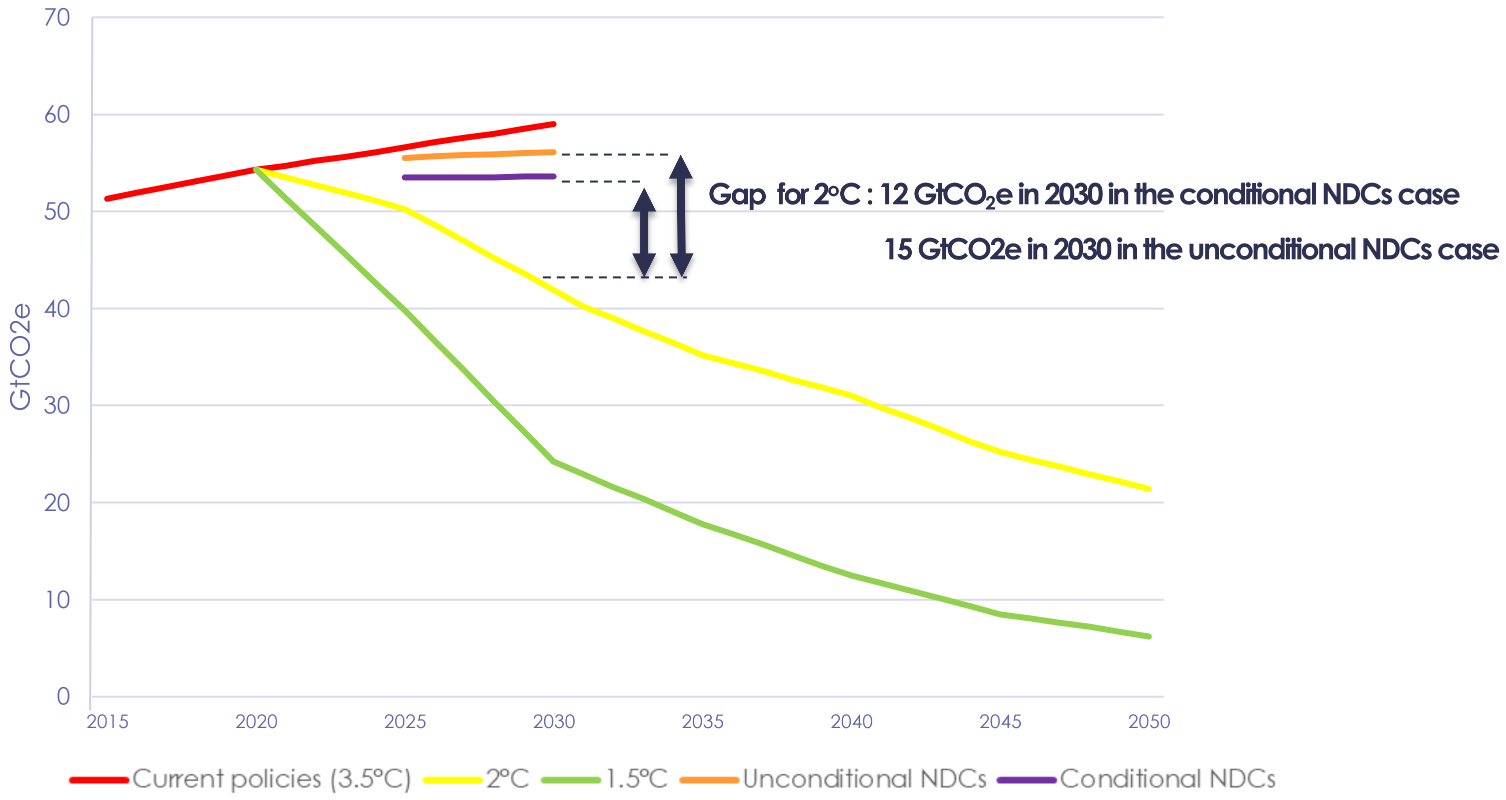


Source: World Bank (2018). The Changing Wealth of Nations 2018

Income group	Estimated public spending per capita on the SDGs in 2015
Low income	$115
Lower middle income	$267
Upper middle income	$2,200
High income	$12,753
Global	$2,914

Source: Kharas and McArthur (2019). Building the SDG Economy.

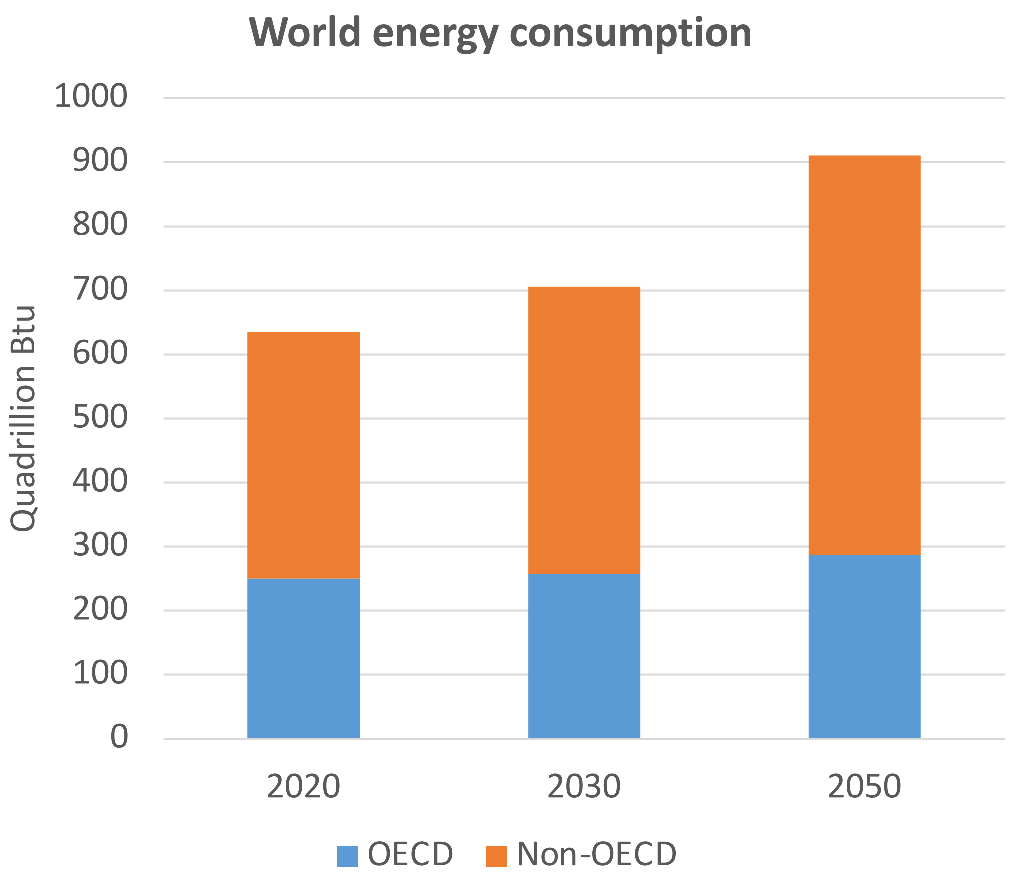
Emissions pathways

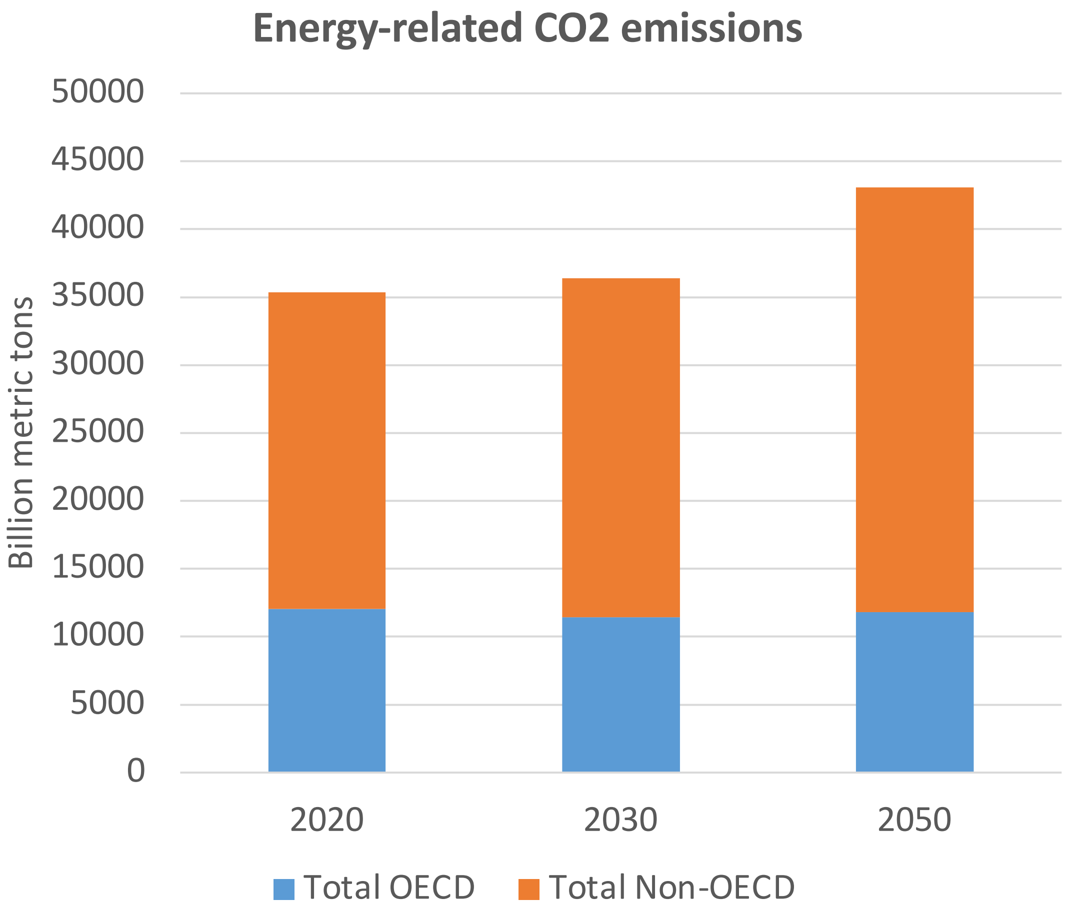


NB: The 1.5°C scenario used by the UNEP report relies on the widespread use of negative emissions technologies (NETs) later in the century.

Source: Trajectories based on UNEP (2020)

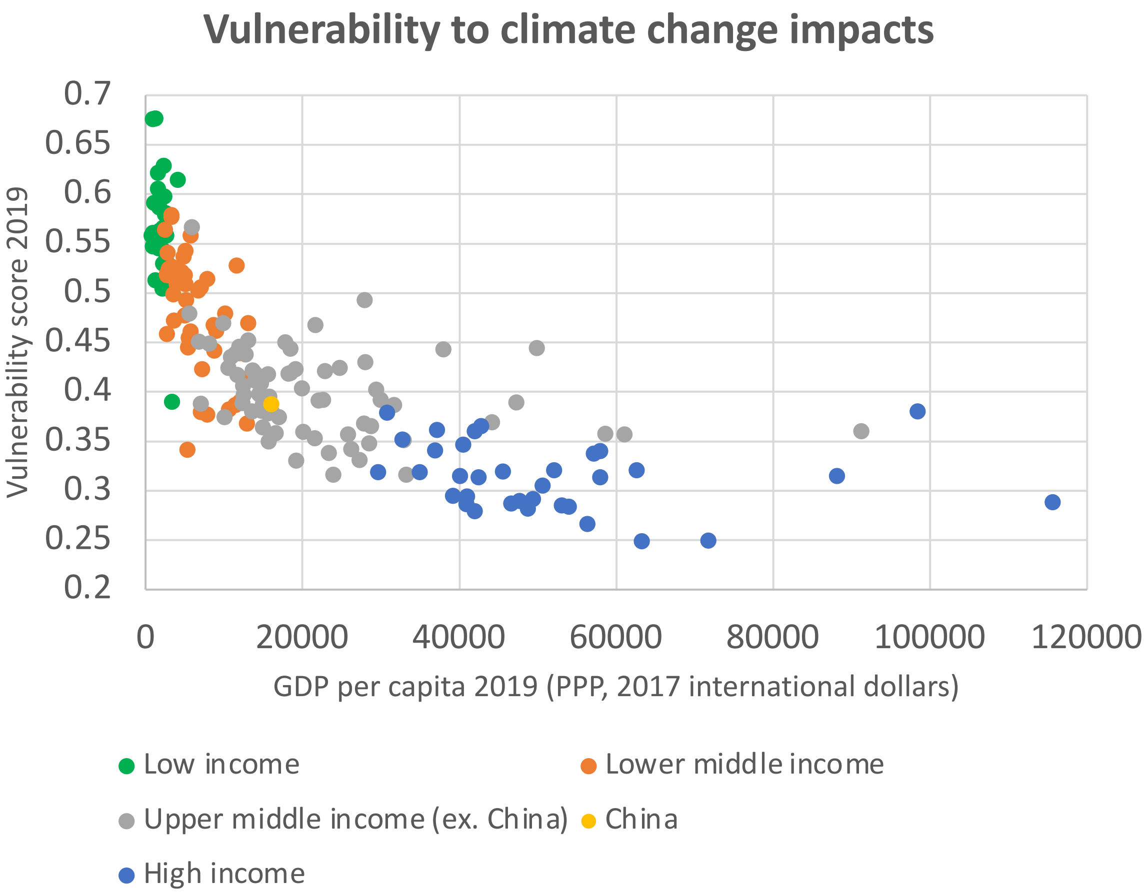
Energy consumption and emissions will be driven by EMDEs

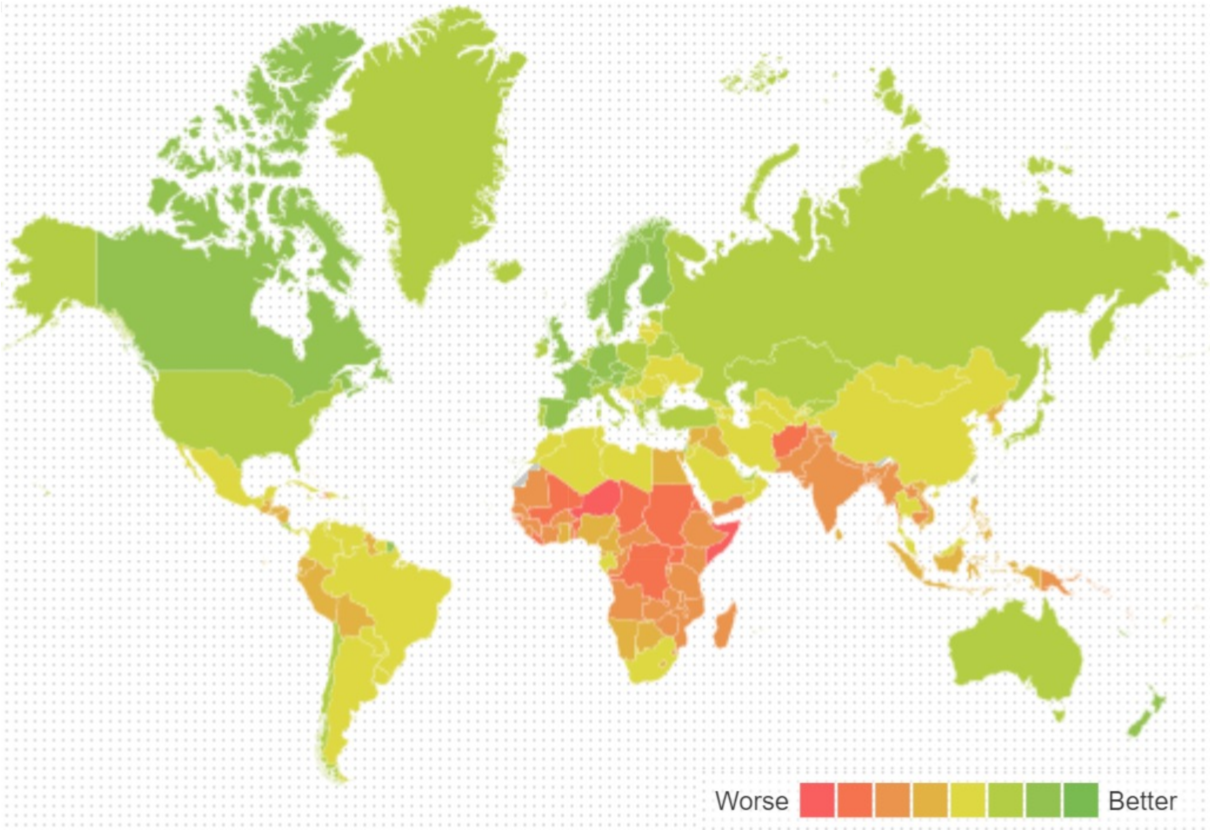




Source: U.S. Energy Information Administration (2019) International Energy Outlook 2019 with projections to 2050. https://www.eia.gov/ieo

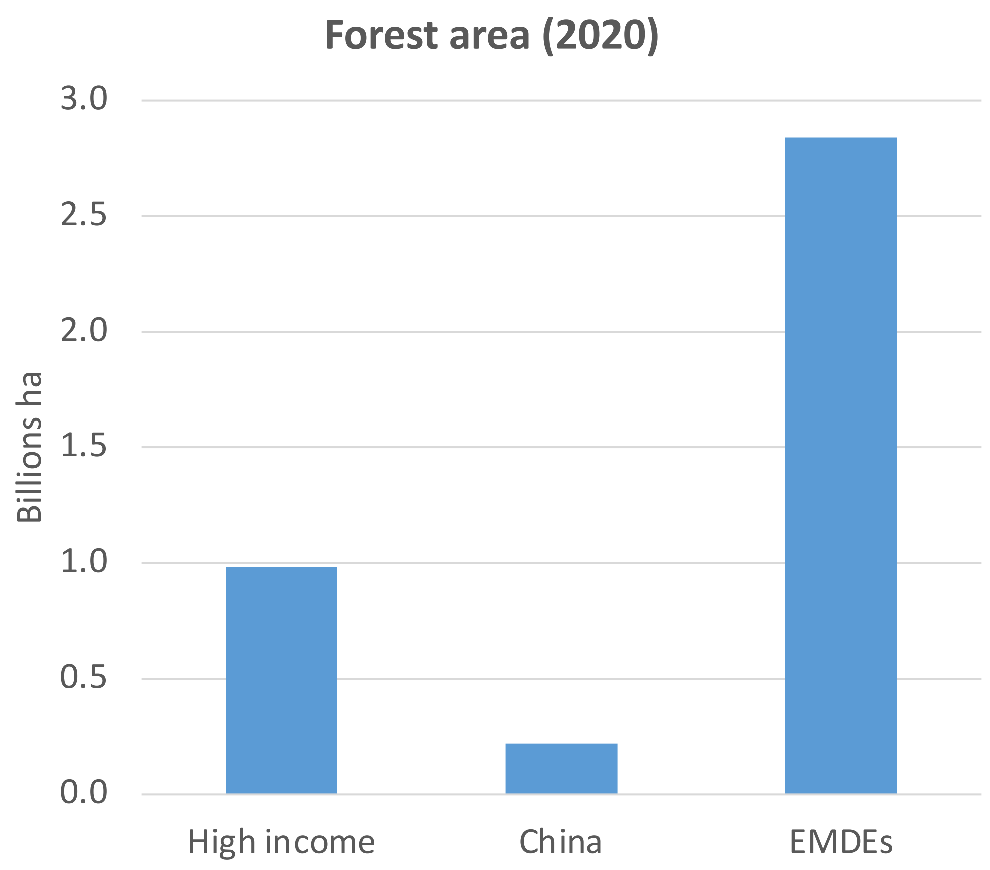
Climate change impacts

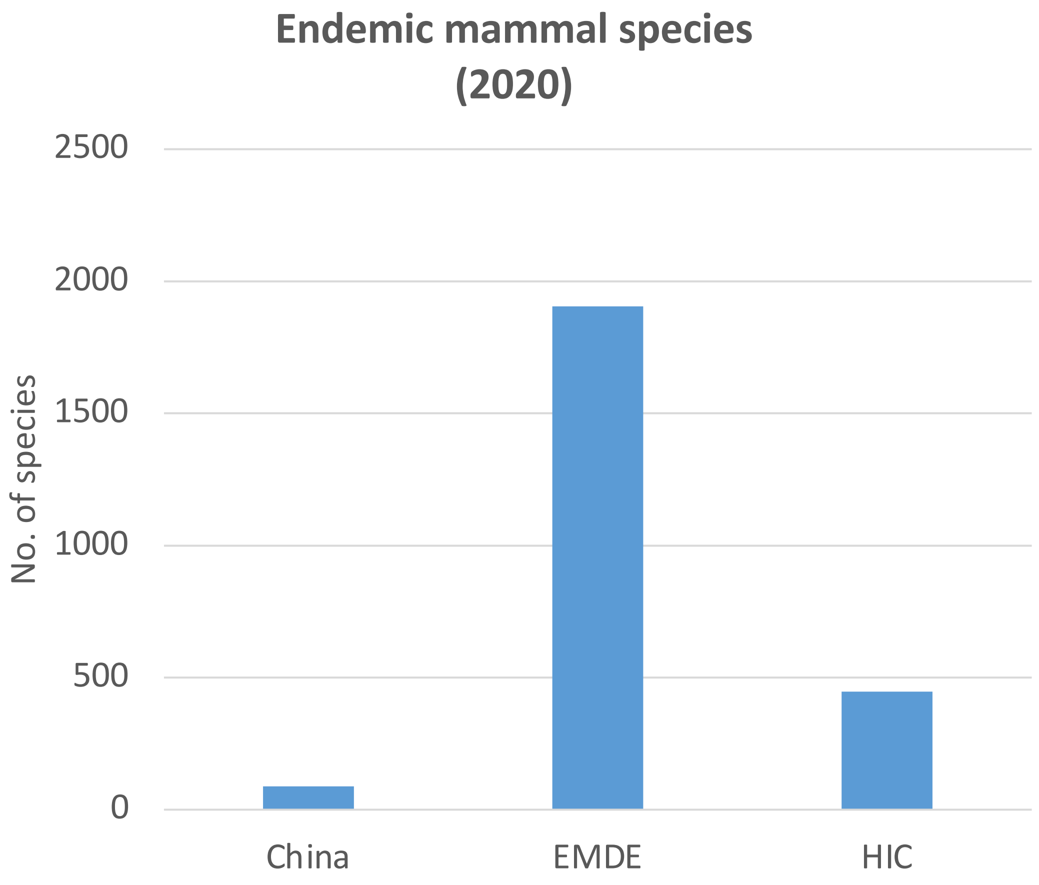




Source: Notre Dame Global Adaptation Initiative & IMF WEO database (2021).

Nature and biodiversity



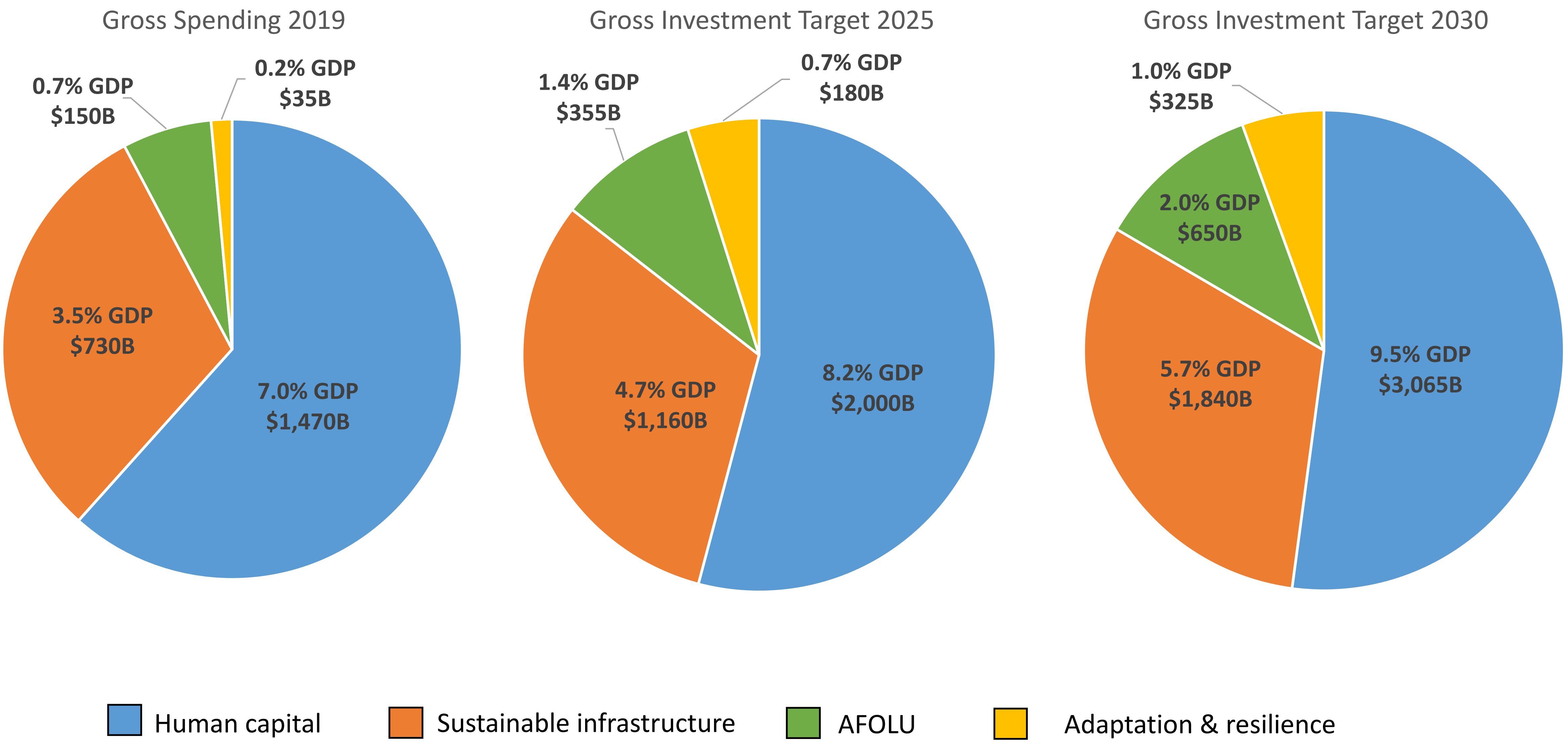


Investment and development spending targets (developing countries ex-China)

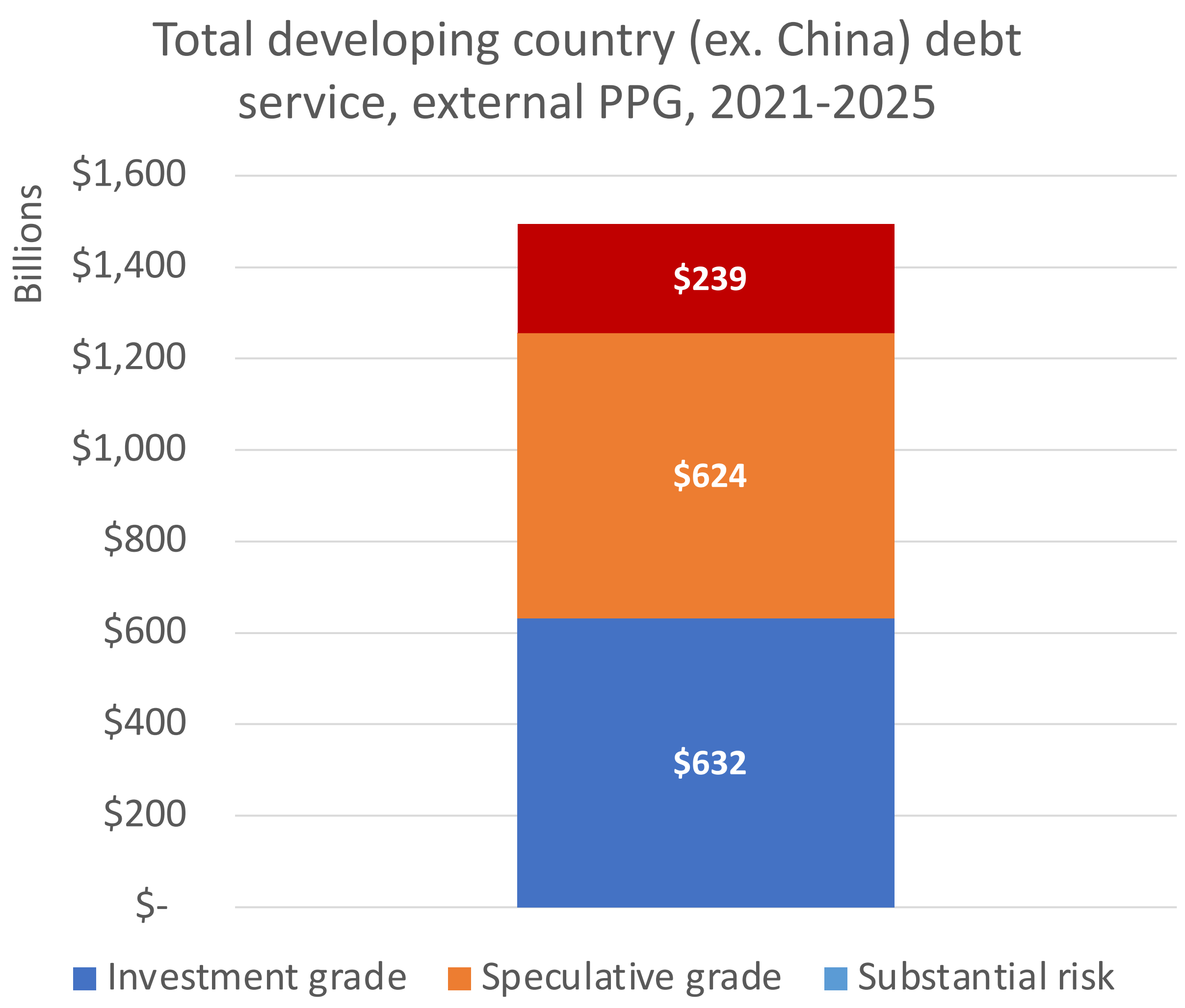
	Gross spending 2019		Spending target 2025		Spending target 2030	
	$bn	% GDP	$bn	% GDP	$bn	% GDP
Human capital	1470	7.0%	2000	8.2%	3065	9.5%
Sustainable infrastructure	730	3.5%	1160	4.7%	1840	5.7%
AFOLU (agriculture, food, land use, nature)	150	0.7%	355	1.4%	650	2.0%
Adaptation & resilience	35	0.2%	180	0.7%	325	1.0%
Total	2385	11.3%	3695	15.1%	5880	18.2%

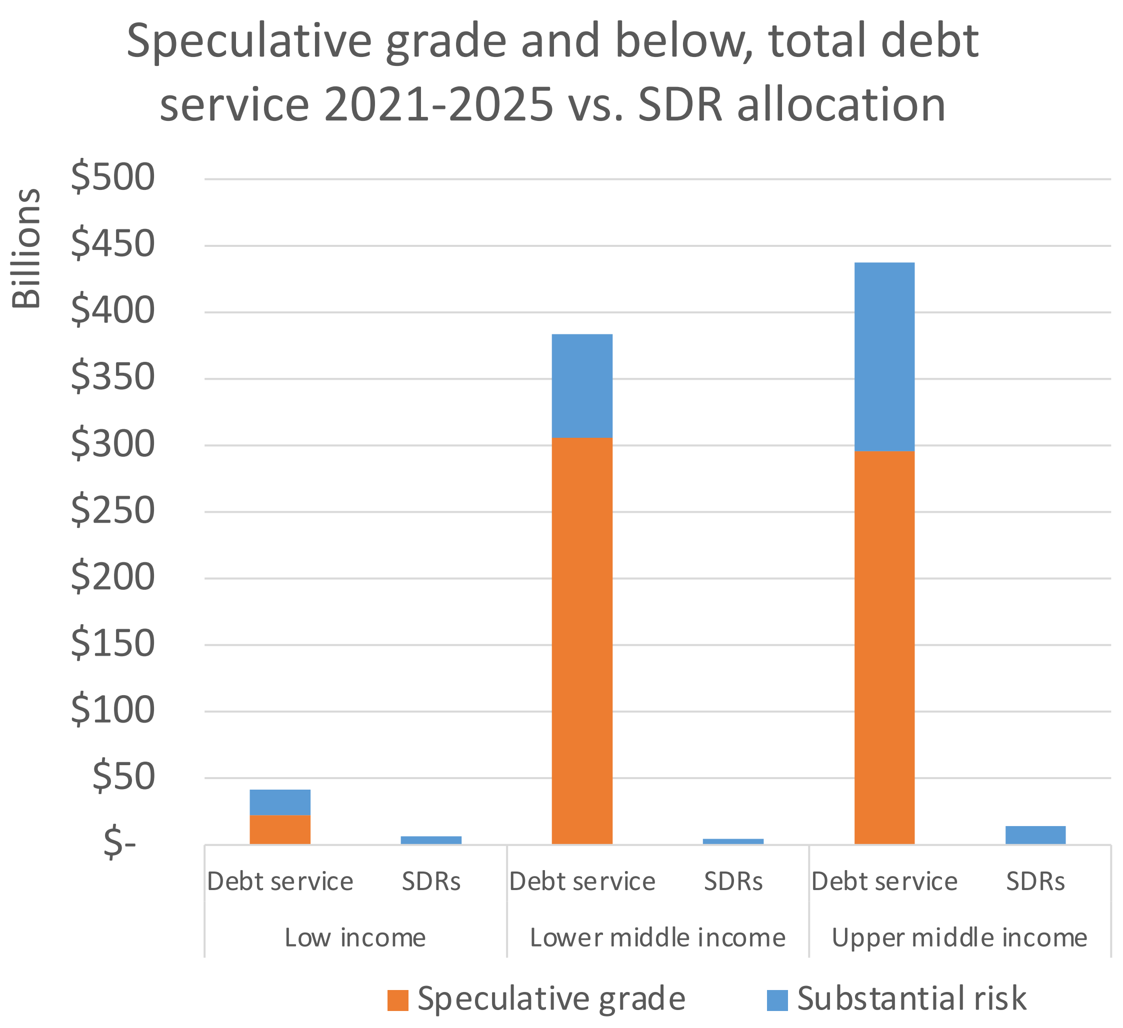
Gross Investment Targets 2019-2030

Total EMDE ex. China

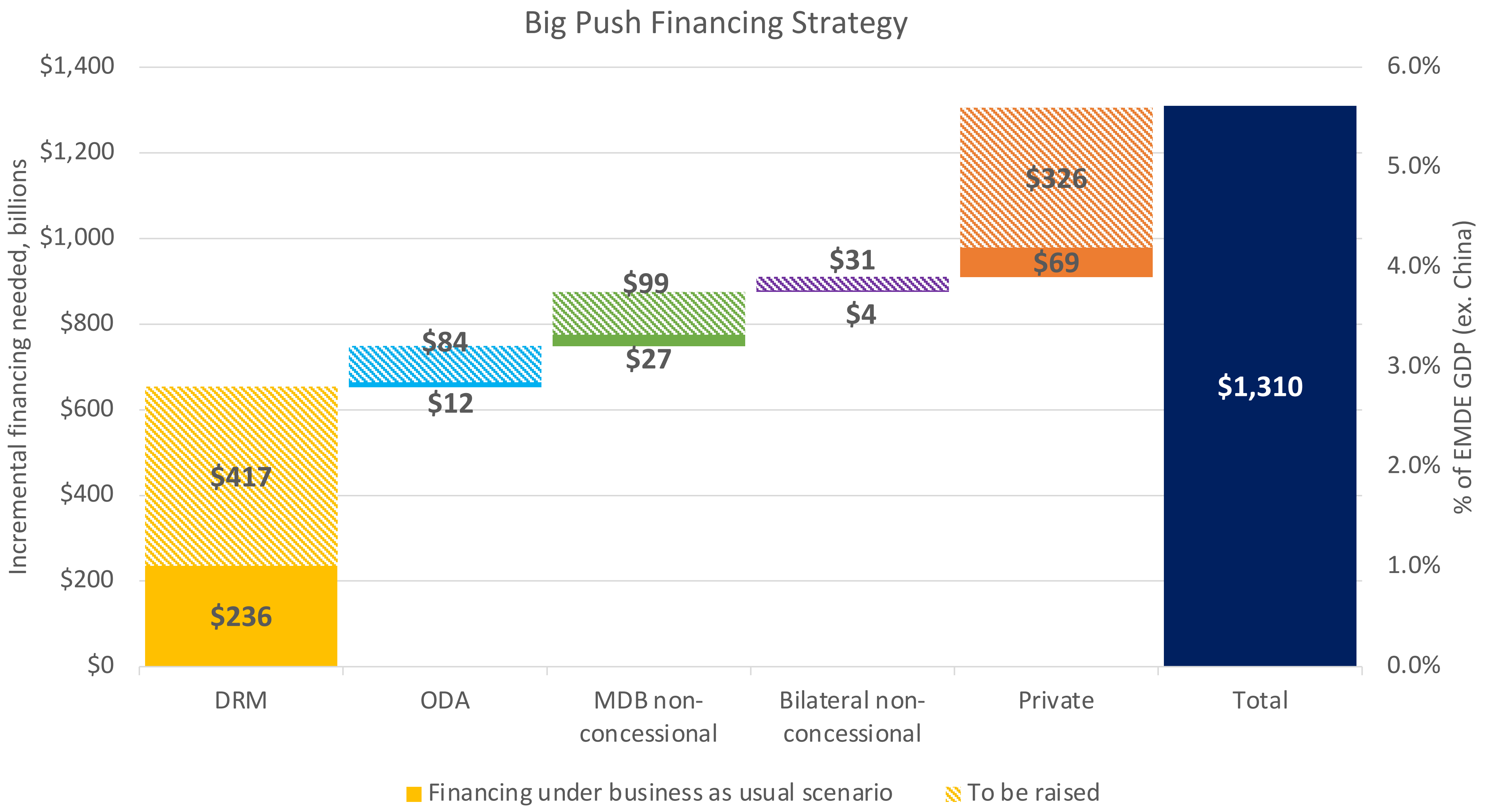


Rising debt obligations





Filling the Long-term Financing Gap of a Big-Push Investment Strategy



Big Push Financing Strategy Package

	2019 gross financing ($bn)	2025 gross financing target	2025 incremental financing	Relative size
DRM	5311	5964	653	+ 2.7% of EMDE (ex. China) GDP
ODA	192	288	96	50% increase, equivalent to 0.15% donor GDP
MDB non-concessional	63	189	126	Triple 2019 lending
Bilateral non-concessional	35	70	35	Double 2019 lending
Private	377	772	395	Approx. double 2019 lending

MDB reform agenda

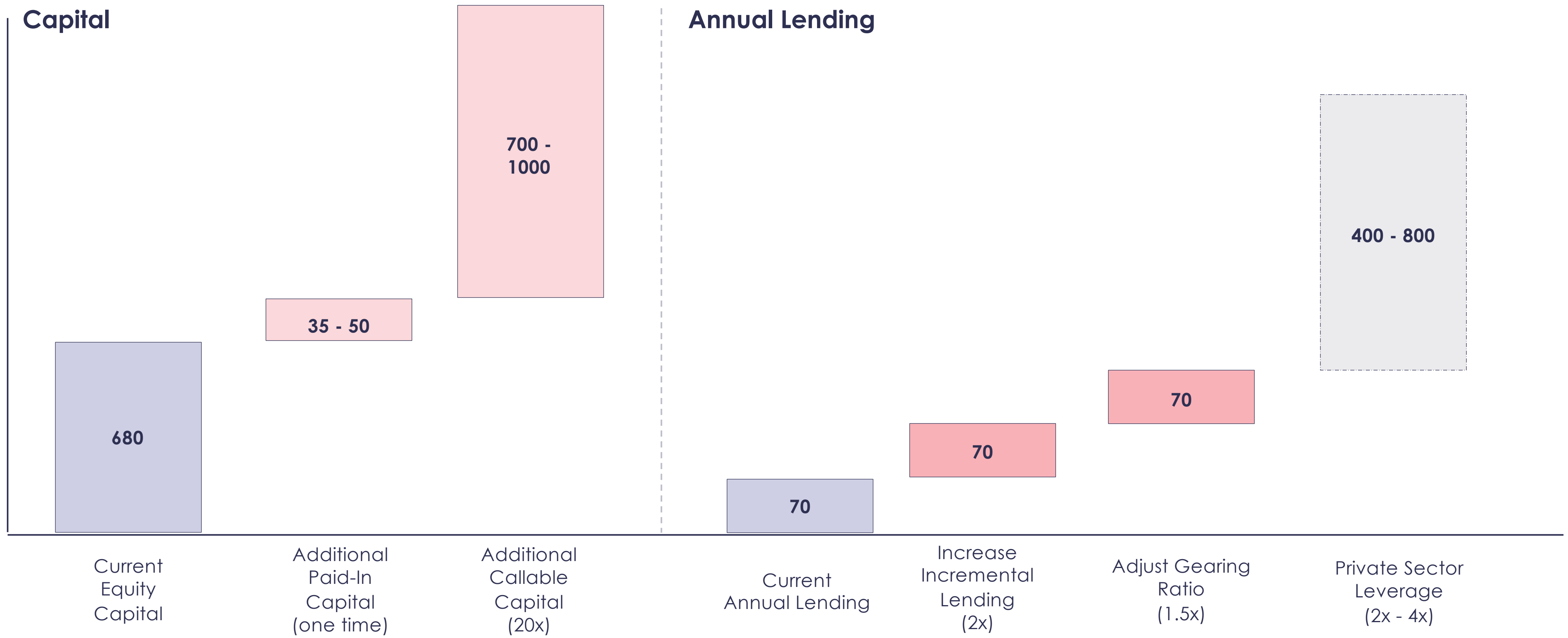
+$126B: Triple 2019 lending levels

- MDBs central to both Covid recovery and sustained growth and transformation. Covid response has required exceptional support with impact on sustainable lending limits.
- Alignment of future support with SDGs and Paris agenda. MDBs are critical to scaling up investments in all areas, and in both low and middle-income countries, for which they will need to take a system approach through country/sector platforms in unlocking investments, project preparation and de-risking at scale.
- Review of capital adequacy methodologies and further steps on balance sheet optimization. More efficient use of lending capacity including through asset sales. Proposals from G20 Independent Review of Capital Adequacy Frameworks.
- Improved private sector multipliers through enhanced partnership with the private sector anchored by GIF and reform of instruments (for matching de-risking needs) and incentives.
- Work better as a system at country, regional and global levels.
- Ambitious replenishments of IDA, AfDF, CIF and GIF and proactive capital increases commensurate with development and climate ambition.

Using the MDB system to mobilize development finance on scale: a suggestive approach

- Currently MDBs have a **capital base of around $680 billion with lending of $70 billion per annum**
- **$38 billion of paid-in capital (one-time) would double the capital base** because of leverage from callable capital (20X). More than half could come from emerging markets.
- **Scope for adjusting gearing ratio through better utilization of capital** (lending to capital) which have been historically overly conservative (1.5X)
- This would **allow annual lending from MDBs to treble from $70 billion to $210 billion**
- With this level of annual lending, MDBs could **mobilize $400-$800 billion in private financing per annum** (4X).
- This would allow MDBs to mobilise **$1 trillion in development finance per annum** providing sufficient scale to bring about systemic change.

Development banks can play a key role to moving from "billions" to "trillions" to finance a big push investment strategy



The MDBs have a crucial role to play in helping reduce government-induced risk through the use of their instruments (global equity, long-term loans, and guarantees), thereby reducing the cost of capital. They also bring trust and convening power in supporting projects and platforms.

Need better utilization of capital, more capital, and higher private sector multipliers to deliver necessary scale of finance.