

The Role of Multilateral Development Banks in mobilising private capital

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Speeches

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Dear Ladies and Gentlemen,

Both the Asian Infrastructure Investment Bank (AIIB) and the European Stability Mechanism (ESM), the institution I am managing, are young institutions. The AIIB began operations in 2016, and the ESM in 2012. We have something else in common: Both institutions have come a long way.

In just a few years, the AIIB has established itself firmly in the global financial architecture. From 21 countries which signed the AIIB founding document in 2014, you have grown to 70 members and 27 prospective members from around the world.

And the ESM, after contributing over the past seven years to successful crisis resolution in Europe, has just received a new and strengthened mandate from our member states. This reflects their confidence in what we do, and that we can and should do more going forward.

Our missions, while not the same, have a common foundation and a common goal: we were created in response to an urgent need.

The AIIB to help bridge the significant infrastructure gap that exists around the globe. Having adequate infrastructure is one of the necessary conditions for sustainable economic growth and social development. It was identified by the G20 as a top priority to be addressed in the global economic and financial system.

And the ESM was created to restore financial stability in the euro area. We close the large financing gap that had opened up in several euro area member states in the context of the global financial crisis and the euro crisis.

Underneath these urgent tasks lies a larger purpose: we both are key actors in an international system that relies on cooperation, dialogue, and mutual support to advance sustainable growth and financial stability. The AIIB by helping countries in Asia and around the globe to meet their infrastructure needs. And the ESM by ensuring the financial stability of the euro area.

The theme of this year's Annual Meeting is "*Cooperation and Connectivity*". It is one that resonates strongly with me and our mission at the ESM. And the topic of our seminar here today "*Extending Country Risk Appetites*" fits squarely with what the ESM has done, and will do with a broader mandate.

Since 2012, we have been the lender of last resort to sovereigns in the euro area by offering financing to countries in financial difficulty. ESM support is conditioned on the implementation of policy measures to reduce macroeconomic imbalances and restore competitiveness, as a key foundation of sustainable growth.

Together with its predecessor EFSF, the ESM provided assistance to five countries: Ireland, Portugal, Cyprus, Spain and Greece. During 2011 to 2018, we disbursed a total of €295 billion to these countries. All five countries have adjusted and implemented deep reforms, have regained market access, and most importantly,

have returned to growth.

The ESM loans were important. But I believe equally important was their 'catalytic' effect in supporting and fostering policy reforms, increasing market confidence, and providing an environment where other creditors and investors – public and private – were willing to come in again.

This is where I see perhaps the most important parallel with what the AIIB is doing: financing growth-enhancing investment projects. More broadly, fostering an environment where investment can take place safely and with adequate returns for both investors and the recipient country.

As a multilateral development bank (MDB), you help close the gap between global savings and capital on the one hand, and countries' investment needs on the other.

The ESM provides financing to sovereigns in support of an adjustment and reform programme. The AIIB does it by providing financing in support of projects that meet high standards of project quality in an institutional and policy environment that gives comfort to investors.

Today, the AIIB stands for excellence in pursuing these goals. The Bank has worked hard and with great success to develop superior lending standards. Its advice and policy support has helped many countries improve their investment climate and attract investors. Let me take the opportunity to congratulate President Jin Liqun for his excellent leadership of the AIIB, and the whole institution for their great work.

Bridging the investment gap

Let me now explore a bit further the challenges we all face in bridging a country's investment and financing gap. By 'we all' I mean all stakeholders involved, official lenders, recipient countries, investors and other creditors.

For some time now we have seen two striking developments in the global economy:

- Firstly, savings have gone up, especially in Asia but in many other, mainly advanced countries as well.

- And secondly, the infrastructure gap has been widening, especially in developing and emerging market economies.

The United Nations estimated that at current levels of investment in the ten priority sectors for sustainable development, developing countries alone face an annual investment gap of \$2.5 trillion.

Barriers to investment

The question is, how do we connect investors with large amounts of capital to the pipeline of available investment opportunities? Clearly, this is an amount that cannot be met by public sources alone. That is why private capital is a potential game changer for developing countries. However, there are barriers to private investment.

Speaking from a market perspective, I know that private investors are driven by risk-reward considerations. These considerations are shaped by the policy environment and investment opportunities in recipient countries. The ESM funding team works together with around 1500 loyal investors. Last year we had almost 150 investor meetings in 35 countries.

What we hear when we meet investors is clear: private investors lack 'bankable projects'. Bankable in the sense that they expect their financing to be repaid with adequate return. It is the job of MDBs to help countries unlock, leverage and catalyse private sector finance for investment.

This is where the AIIB plays a crucial role. The Bank can provide policy guidance, technical assistance and financing support, which typically includes some co-financing of a project as well as advice on how best to structure the entire financing package. This is the quint-essential 'catalytic' role: to sufficiently change the risk-reward balance to attract private capital to infrastructure opportunities in recipient countries.

Crowding-in of private capital

Let me emphasise three areas where I see MDB involvement as particularly important to attract private investors:

First, profit margins of investments in development projects are often too low compared with the cost of acquiring country knowledge, building relationships, and employing necessary services. As such costs approach or exceed the expected return, private financing becomes less attractive, if not impossible. Here, potential investors can reduce costs as well as risks by partnering with an MDB which can enhance both project quality and the project environment.

Second, looking at credit enhancement and de-risking of investment opportunities: when MDBs are engaged as participant investors in projects, they can bring innovative financing tools but also increase ownership between MDBs, governments and the private sector. This can enhance private capital flows.

Finally, I want to stress the importance of factors that are not directly related to investment profitability, but to the benefits for the recipient country, and thus indirectly to longer-term debt service and repayment prospects.

Here MDBs also have an important role: making sure that the investment benefits the country and its citizens. The agenda here is large, from transparent procurement and project governance (i.e., reducing project costs as well as the risk of corruption) to environmental standards, social considerations (such as employment of local labour), budgeting for adequate maintenance after project completion, and ensuring debt sustainability. These are critical public goods that will enhance both the project's value for the recipient country and, more generally, the environment for growth-supporting investment in the country.

The ESM and MDBs - Complementarity and collaboration

Let me return to where our missions align: the ESM together with other crisis resolution mechanisms and MDBs work to help countries achieve sustainable growth with financial stability. We both are looking to further international cooperation and global integration. In countries that request financial assistance from the ESM, the contribution from MDBs both in terms of financing and policy support are often key ingredients in a successful programme.

As the G20 Tharman report highlighted last year, coordination at international level is key. In that spirit, good collaboration should also define our relationship with the AIIB going forward.

I am happy to tell you that we will sign a Memorandum of Understanding with the AIIB later today. This document will provide a general framework to strengthen the collaboration between the two institutions and a basis for future cooperation.

Thank you.

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