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Mustering the private sector for development and climate in the Global South – Is it realistic?

Lessons and recommendations from an on-going experiment at the World Bank Group*

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Philippe Le Houérou, Hans Peter Lankes

Philippe Le Houérou is Chairman of the board of the Agence Française de Developpement (AFD), Director of the FERDI Chair in International Architecture of Development Finance, Former Executive Vice President and Managing director, International Finance Corporation (IFC).

Hans Peter Lankes is a Visiting Professor in Practice at the London School of Economics (Grantham Research Institute), and a Senior Fellow at ODI and the LSE/Oxford International Growth Centre.

Abstract

The 2015 Addis Ababa "Billions to Trillions" initiative called for stepped-up private sector investments and financial flows in developing countries. But instead of closing, the "trillion" dollar gap between development and climate needs, and the actual flows continues to widen. Was it a fairy tale? What is certain is that the current operating model of the aid agencies and the development finance institutions, is not helping to crowd-in private flows at the necessary scale. The paper reviews the evidence and highlights what needs to change and how to do it. …/…

* The authors thank Edouard Mien (FERDI) for his Excellent research support.

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ELLE COORDONNE LE LABEX IDGM+ QUI L'ASSOCIE AU CERDI ET À L'IDDRI. CETTE PUBLICATION A BÉNÉFICIÉ D'UNE AIDE DE L'ÉTAT FRANCAIS
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…/…

Since the devil is in the details and the true test is implementation, the review is based on the preliminary lessons of the real-life experiment at IFC ("IFC3.0") launched in late 2016. The key finding is that despite some progress, more needs to be done for IFC 3.0 to deliver at scale, especially in the poorest countries. The private sector side of the WBG, i.e., IFC and MIGA, must continue to shift from a reactive to a proactive approach to creating markets and project development; and the public side, i.e., IBRD and IDA, must act in a complementary manner, embracing the private sector strategically and operationally as a key development agent. The paper concludes with detailed and concrete recommendations for what could be done rapidly. We call it WBG 3.0.

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Acronyms

AFDB: African Development Bank
AIMM: Anticipated Impact Measurement and Monitoring
AP EGO: Amundi Planet Emerging Green One fund
BNEF: BloombergNEF
CFLI: Climate Finance Leadership Initiative
COP: Conference of the Parties
CPF: Country Partnership Framework
CPSD: Country Private Sector Diagnostics
DFI: Development Finance Institutions
EBRD: European Bank for Reconstruction and Development
EDFI: European Development Finance Institutions
EMDE: Emerging Markets and Developing Economies
FAST-Infra: Finance to Accelerate the Sustainable Transition-Infrastructure
FDI: Foreign Direct Investment
GB-TAP: Green Bond Technical Assistance Program
GFANZ: Glasgow Financial Alliance for Net Zero
GIF: Global Infrastructure Facility
GISD: Global Investors for Sustainable Alliance
IBRD: International Bank for Reconstruction and Development
IDA: International Development Association
IDFC: International development Finance Club
IEG: Independent Evaluation Group (World Bank)
IFC: International Finance Corporation
IMF: International Monetary Fund
IPCC: Intergovernmental Panel on Climate Change
IRENA: International Renewable Energy Agency
J-CAP: Joint Capital Market Program
JETP: Just Energy Transition Partnerships
KPI: Key Performance Indicator
LDC: Least Developed Countries
LIC: Low-Income Countries
MDB: Multilateral Development Bank
MIC: Middle-Income Countries
MIGA: Multilateral Investment Guarantee Agency
MSME: Micro, Small and Medium Enterprises
NGFS: Network for Greening the Financial System
ODA: Official Development Assistance
OECD: Organization for Economic Co-operation and Development
PCM: Private Capital Mobilization
PFI: Project Finance International
PPA: Power Purchase Agreement
PPP: Public Private Partnerships
PSW: Private Sector Window
SDG: Sustainable Development Goals
SME: Small and medium-sized enterprise
SMI: Sustainable Markets Initiative
UNCTAD: United Nations Conference on Trade and Development
WBG: World Bank Group (IBRD, IDA, IFC, MIGA)

Introduction and background

At the 2015 Financing for Development Conference, the United Nations launched the "from billions to trillions" initiative as part of the Addis Ababa Action Agenda.[1]The objective of this initiative, briefly stated, was to bridge the gap between needs (the trillions of dollars in needed investments to accelerate development and the climate transition in Emerging Markets and Developing Economies (EMDEs)) and readily available financing (only billions of public development aid).

What was vital then has become even more so now, as pressure is mounting to build back better after the pandemic, to meet the commitments of the Paris agenda, and to address the climate challenge with increasing urgency while pursuing the Sustainable Development Goals (SDGs). The World Bank has prepared a "road map" that was reviewed at the recent Spring 2023 Meetings to find ways to respond to the climate emergency without lowering its guard on its mission to fight poverty and increase shared prosperity. In addition to more efficient management of its balance sheet and capital injections as proposed by think-tanks and international commissions, this is likely to require the mobilization of additional resources with the largest source being private capital for private sector projects.

Apart from its potential as a source of additional resources for sustainable development, the private sector can contribute to economic growth, poverty reduction, and job creation when pursued within an appropriate institutional framework (see Appendix A.1).[2] Among the major challenges facing significant parts of the world is the creation of decent jobs for a growing world population without which it will be difficult to meet the SDGs. The challenge is especially daunting in the youngest and poorest regions of the world. According to World Bank data, private employment represented 84% of total global employment in 2018, and 94% in low-income countries.[3] Most EMDEs that succeeded in promoting sustainable economic growth and poverty reduction have achieved this by developing a strong private sector.

Post Addis, we expected to see all-out efforts to scale up private capital flows to low- and middle-income countries, and for these countries to go out of their way to create the conditions for the private sector to invest. And yet, despite the rhetoric and numerous appeals, private finance and investment have not grown. This paper takes stock of what happened and why and offers paths to explore going forward based on the evidence of reforms introduced at the IFC and the World Bank in recent years.

The first part of this paper reviews the evidence of "Why" the billions haven't turned into trillions, especially for the poorest countries that need it the most and tries to determine

1 This conference was preceded by the Development Committee of the World Bank at the Spring Meetings of April 2015. See "From billions to Trillions: Transforming Development Finance" Development Committee World Bank/IMF April 2, 2015.
2 Indeed, not only does the private sector contribute directly to poverty reduction by generating incomes, it is also a source of positive externalities to the rest of the economy (through R&D or human capital accumulation) and of tax revenues that underpin public goods and social spending.
3 https://www.worldbank.org/en/data/interactive/2019/05/21/worldwide-bureaucracy-indicators-dashboard

"What" must happen to scale up private sector investment and finance in EMDEs. The short answer is a lot more, on many fronts.

The second part of the paper focuses on the "How". Based on the lessons learned from the real-life experiment of the strategic repositioning of the International Finance Corporation (called "IFC 3.0"), it reviews the potential and challenges for developing and integrating new, effective approaches and instruments at Development Finance Institutions (DFIs), starting with the World Bank Group (WBG). The short answer is that despite some progress, we have much further to go. Yet, it is doable – there is "proof of concept". The conclusion highlights the key steps needed to complete the job.

Part 1. Billions to trillions has not happened: What will it take to deliver?

The clock is ticking on the Sustainable Development Goals (SDGs), and it is almost past the hour on the climate. There is little disagreement about what is needed – a large boost in the right kind of investment and innovation and related finance, especially in Emerging Markets and Developing Economies (EMDEs). But the numbers are going the wrong way. The following sections review the evidence on investment and financial flows and contrast it with estimates of the needs. We then present a simple framework for understanding the constraints on private capital flows and discuss actions in several key areas that would be needed to unblock them.

1.1. Eight Years after Addis: Where are the trillions?

1.1.1. Urgency to scale up private finance and investment.

Considering the development needs and financing gaps, it is no surprise that the private sector has been linked emphatically to the prospects of achieving the SDGs. And there is little doubt that the original diagnostic (the need for massive amounts of private finance) was and continues to be correct – in fact, even more so today, post-Covid and with the ever more urgent need to fight climate change. Both donor and poor countries are coming out of the pandemic with more public debt and will have to contain or reduce their public spending. Fiscal pressures have been further compounded by the war in Ukraine. Public financial support—as one must unfortunately predict—is not likely to grow much. Simultaneously, the growing climate emergency and the commitments made in Paris in 2015 and at subsequent COPs, will increase the demand for climate related investments in emerging and developing economies. As a result, the gap between investment needs and publicly financed aid is likely to widen further in the coming years and decades.

The numbers were brought home starkly in 2022, with the release of the IPCC 6th Assessment Report. Reflecting the growing urgency of climate action, Bhattacharya et al. (2022) and World Bank (2023), put total investment needs for achieving development and climate goals at $3.7 trillion in 2025 and $5.9 trillion in 2030 in the EMDEs excluding China. They conclude that under a business-as-usual scenario the financing gap will represent $3.5 trillion annually by 2030, underlining the importance of finding new sources of financing (Figure 1.D; see Appendix A.2 for a review of needs estimates). According to IHLEG (2022), the incremental financing from external sources needed in these countries would ramp up to at least an estimated $1 trillion annually, much of it private.[4]

Looking at the African continent alone, needs for infrastructure investment were estimated by the African Development Bank (AFDB) in 2018 at $130-170 billion per year until 2025 with an annual financing gap of $68-108 billion (AFDB, 2018). To this must be added the estimates of the costs of the investments in health and education. Yet again there is a pressing need for private sector investment and activity in the poorest countries. For example, to absorb the new

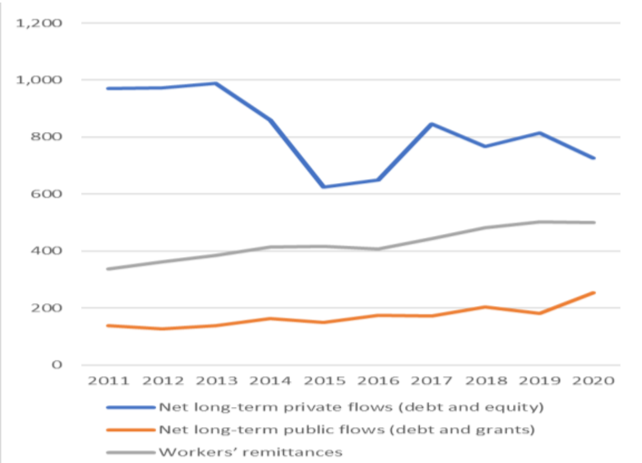
4 Appendix A.2 provides a summary of the estimates of the financing needs of EMDEs.

entrants to the labor market, Sub-Saharan Africa will have to create 16 to 20 million new jobs each year on average by 2030 (IMF, 2018). Since it is unlikely that public institutions will be anywhere near capable of absorbing this number, private activities will have to expand to avoid an explosion in unemployment and under-employment and its social and political consequences.

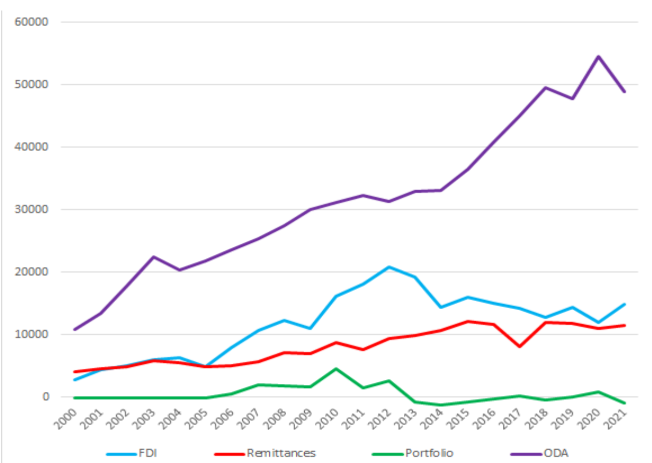
The stark conclusion is that no feasible path exists to achieving the SDGs and meeting the climate challenge without a very large increase in private finance and investment.

Figure 1: Financial Flows and Investment in Low-Income (LIC) and Middle-Income Countries (MIC) Selected Indicators

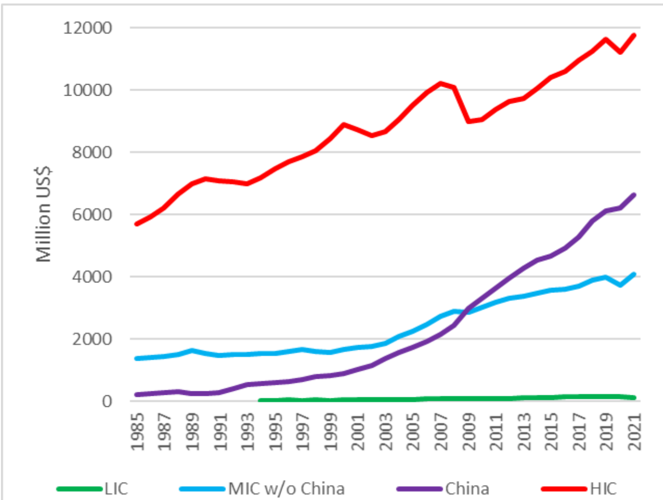
A) Net long-term financial flows to LIC and MIC

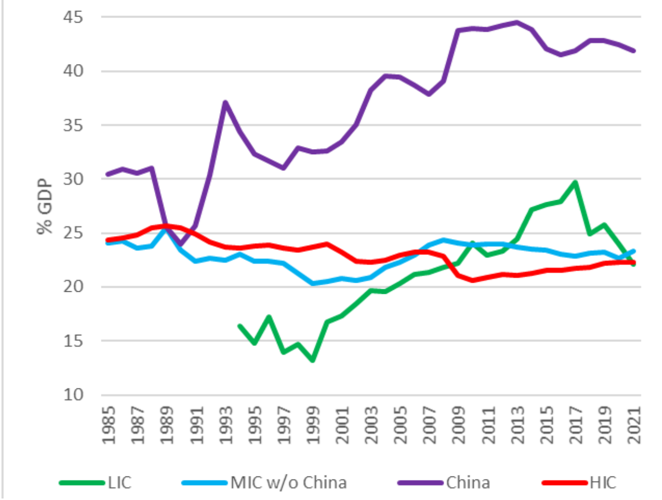


B) Financial flows to LIC by type of flow (Million 2020 US$)

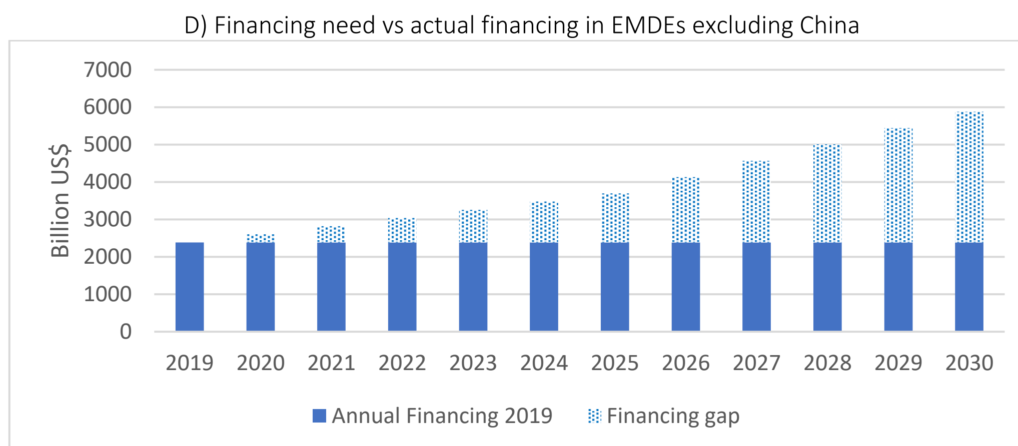


C) Gross Fixed Capital Formation in constant 2015 US$ (left) and as a share of GDP (right)





D) Financing need vs actual financing in EMDEs excluding China



Sources: World Development Indicators, Bhattacharya et al. (2022), World Bank (2023)

1.1.2. The failure to raise private finance[5]

Having crossed the half-way mark from the Addis Ababa conference to 2030, the target year for the SDGs, there is little evidence that private finance flows into EMDEs are growing. This is especially true for the poorest countries (Figure 1.A and B; Appendix A.3). By 2020, net private financial flows had recovered slightly since 2015 but remained well below their levels at the beginning of that decade, while there was a steady if modest increase in public flows (including grants). The source of finance with the strongest growth has been workers' remittances. While complete data for 2021 and 2022 are not yet available, the situation is unlikely to have improved significantly given the current challenges (the post-pandemic constraints, the Ukraine war, and inflation). [6]

The macro picture for investment—public and private, foreign and domestic—is similarly disappointing (Figure 1.C). There was strong growth in aggregate investment ratios during the first decade of the 21st century, from 20 to 24% of GDP. Since then, excluding China, gross fixed capital formation in low- and middle-income countries has seen a gradual decline, even though regional and cross-country differences are significant. The World Bank's Private Participation in Infrastructure database[7] shows an even more extreme trend: a sharp rise from $23 billion in 2004 to $158 billion in 2012, followed by a decline to $75 billion in 2021. In low-income countries, FDI has declined since 2012 while ODA has increased significantly.

On the face of it therefore, the current system has done the reverse of what the Addis initiative intended. Net long-term private flows have moved the wrong way.

5 Annex 2 provides details on the net aggregate flows to LIC and MIC (2011-2020)
6 Preliminary data from 2021 suggest a slight reduction in official debt flows and an increase in private equity flows, driven by a sharp rise in foreign direct investment (World Bank IDS website). However, there are data consistency issues that prevent incorporation in the chart.
7 ppi.worldbank.org

1.1.3. Why the failure?

There is no easy answer to the question why private finance and investment have failed to grow since Addis. There are country-level deterrents, in particular persistent weaknesses of business environments and institutions in many EMDEs, that have been shown to be significant in investment decisions (e.g., Buchanan et al., 2012; Peres et al., 2018; Sabir et al., 2019; Sadeghi et al., 2020; Teixeira et al., 2017). These factors, the broader global and local environments, are either outside of the control of most actors, or change will take considerable time to take root and to improve perceptions.

But there are other factors that weigh down on private investment and finance that have featured prominently in the discussion since Addis (Table 1). On the supply side of cross-border finance those include global financial regulation, missing financial market infrastructure and limited official support. On the demand side in-country, they include sector level (market) conditions in crucial sectors such as energy or ICT, project development capacity especially in infrastructure, as well as a weak connective tissue linking investment projects to the mobilization of domestic or foreign finance. All these factors influence the availability and the cost of capital.

And the current polycrisis is no doubt compounding the situation. The period from early 2020 to date has seen a pandemic, the disruption of supply chains, food, energy and climate shocks, growing debt distress, the recent interest rate hikes and increasing geopolitical strains.

Table 1: Challenges to scaling up private finance for development

Global level	Country level
Global macro environment [financial conditions, real sector]	Investment climate / business environment [macro stability, debt profile, institutions, infra, labor force, etc.]
Regulation [prudential, taxonomies, etc.]	Upstream market creation [sector regulation, competition policy, institutional development]
Market scaffolding [asset classes, liquidity, intermediaries]	Midstream project creation [structuring capacity, risk capital, ESG]
Public support [derisking of finance, technical assistance]	Financial sector [origination & mobilization capacity]

Efforts have been made at all these levels by MDBs/DFIs, donors, and market coalitions to address the gaps. With respect to climate finance, for example, initiatives such as the central banks' Network to Green the Financial System (NGFS), the G20 Sustainable Finance Working Group, and on the private side the Glasgow Initiative for Net Zero (GFANZ), have broadened and strengthened, and are beginning to connect and span the public, the private, and the MDBs.[8] The Just Energy Transition Partnerships (JTEPs) starting with South Africa, Egypt,

8 Other private sector-led initiatives with growing traction include, e.g., the Sustainable Markets Initiative (SMI), Global Investors for Sustainable Development Alliance (GISD), and the Climate Finance Leadership Initiative

Indonesia, and Vietnam, are a novel way of organizing efforts across public and private parties at the country level.

So far, such efforts, while going in the right direction, have had meager results—certainly in terms of aggregate financial flows. The current landscape is fragmented, has failed to produce major breakthroughs, and does not invite rapid replication or scaling.

In addition to a leap forward in the size and ambition of these efforts, a common, integrated agenda is urgently needed. Singing and acting from a common hymn sheet would increase the punch of the development finance system as a synergetic whole. The MDBs and DFIs must be at the center of these efforts, helping the public and private sectors to move together by leveraging their convening power, on-the-ground origination networks, range of financing, technical assistance and policy instruments, and long-term risk taking and mitigation capacity.

A deeper question is whether it is realistic to expect the private sector to invest trillions of dollars in EMDEs. The funds should in principle be available. From 2019 to 2021 alone, the global balance sheet expanded by $100 trillion.[9] The assets of global financial institutions reached almost half a quadrillion US dollar in 2021.[10] Only a fractional increase in annual allocations to low- and middle-income countries—which after all boast higher growth rates—would seem to be required. But the response is not as straightforward as that. It is important to acknowledge that it is not the lack of finance *per se* that is the stumbling block, but rather the combination of finance, incentives, and investable propositions. We can safely assume that, if we keep doing the same things in the same way, we should not expect a different outcome.[11] New approaches should be tried forcefully and systematically. Although it is hard to give assurances that very large volumes will materialize, much more needs to be done to make it happen.

1.2. What to do differently: act at scale and across the board.

As argued above, "billions to trillions" may have been a catchy slogan but it had substance as well, drawing attention to a real, crucial issue. Delivery may have suffered but it is too early to discard it as a fad. Instead, the approach must be to systematically tackle the various challenges described in Table 1 and unlock private investment in EMDEs – especially in the poorest countries. The focus in this section of the paper is on country-level factors, though reference is made to how action at the global level can be supportive.

(CFLI). There are also initiatives to mobilize and strengthen coordination among development banks, including the MDB Infrastructure Cooperation Platform, the MDB climate leaders' group, the International Development Finance Club (IDFC) and the Finance in Common Initiative that seeks to bring together all public development banks.

9 McKinsey "Global balance sheet" 2022: https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/global-balance-sheet-2022-enter-volatility

10 Statista: https://www.statista.com/statistics/421060/global-financial-institutions-assets/

11 Einstein's definition of insanity is to do the same thing over and over and expect a different outcome.

1.2.1. Continue to improve the business environment

Improving the quality of the investment climate and more generally the business environment in EMDEs remains foundational for raising the levels of private investment and finance, both foreign and domestic. The best efforts to attract investors will fail in a highly unstable macro environment, or when government regulation is unpredictable. Governments that are serious about achieving the SDGs will need to be committed to tackling these issues and draw on the MDBs and other external support.

This agenda is not new. The role of the business environment has been recognized and well documented for a long time, and assistance is readily available at the country level. One should note that, despite many hiccups, the quality of business environments has been improving overall. For instance, the world average score for the ease of "starting a business" (ranging from 0 – 100, a higher score reflecting greater ease) increased from 61 in 2004 to 84 in 2020 (World Bank Doing Business). Among the 191 countries reviewed, this score has declined over the data availability period in only 8 countries and either stagnated or improved in all others. Between 2011 and 2021, more than 80% of non-neutral policy measures in relation to the investment climate adopted by developing countries aimed at attracting or facilitating investment, while less than 20% were intended to restrict investment. This percentage is approximately the same for Least Developed Countries (LDCs) and developing non-LDCs, and reaches 94% for Asian LDCs (UNCTAD, 2022b). These reforms were notably intended to open new sectors and activities to FDI, increasing protections or investment support mechanisms, or introducing investment incentives.[12] The general trend is confirmed by the FDI Restrictiveness Index (OECD Data), which has declined from 0.127 to 0.064 between 1997 and 2018 in OECD countries and from 0.367 to 0.128 in non-OECD countries (though it saw a moderate increase during the pandemic).

Despite these positive trends, further improvement of the business environment remains crucial if private investment is to scale up. Apart from the need for a clear, consistent, long-term commitment from governments, the international community should ensure that a systematic toolkit is available to countries that require help.

1.2.2. Tackle inadequate markets

Often it is not (only) the broader, horizontal conditions in the economy that stand in the way of more investment, but there are sector-specific gaps. EMDEs can take a hands-on approach by creating the conditions for markets to develop and flourish.

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12 According to IFC, in Africa, half of the revisions to the investment legislation addressed FDI entry and establishment conditions, and typically opened new sectors or activities to FDI or streamlined the entry process (IFC, 2022).

Box 1: Markets

Markets describe the perimeter—for instance a sector—within which decisions to invest or transact products and services are taken in a market economy. Markets have a structure (buyers and sellers) and require institutions that define rights and guardrails, and mechanisms (typically prices) to guide decisions. Markets may fail to produce efficient, equitable or sustainable outcomes, due to externalities or in the presence of public goods, which call for targeted government intervention or public investment to support functioning markets. Gaps, distortions, or a lack of predictability in the basic components of a market—such as unreliable regulation—affect its depth or liquidity and deter investments.

Where the basic building blocks of markets are not in place, for instance in sectors closed to competition, with missing institutions, and in potentially disruptive sectors such as the digital economy, it will take actively "creating" functioning markets to turn theoretical opportunities into real investments. Action will need to be based on careful diagnostics and measures tailored to suit the source of the problem, the opportunity, and the circumstances. Sector-wide or systemic improvement might flow from:

- *Enabling Markets* – Actions that help create or stabilize the frameworks within which markets can function, including policy, regulation, standards, financial access, and other interventions;
- *Innovation and Competition* – Actions that promote competition by reducing entry and import barriers, through innovation, privatization, cost reductions and efficiencies which encourage market players to invest to improve their products and services; and
- *Demonstration and Replication* – Actions that provide demonstration effects, encouraging replication, and more generally the spillover of ideas.

Many of the impediments to the functioning of markets are found "upstream" of investment decisions—conditions that should be in place to allow investors to make decisions without having to deal with avoidable risks, and to focus on their own core capabilities.

For instance, in the energy sector, regulators and governments can strengthen investment signals through measures like improving the market for private clean energy offtake and enabling power generators to charge cost-reflective energy tariffs. A joint report from the Climate Finance Leadership Initiative (CFLI), European Development Finance Institutions (EDFI) and the Global Infrastructure Facility (GIF)[13] has tracked activity by energy sector authorities to support clean energy offtake in EMDEs. Measures assessed include whether emerging markets have made efforts to standardize power purchase agreements (PPAs), helping to lower transaction costs for offtake contracts; whether markets have PPAs of long-enough tenures to be bankable; and whether PPAs (including auction contracts) are signed or indexed to a hard currency, which can help to shield against exchange rate volatility. The results are mixed, as captured in Figure 2.

Other regulatory barriers that hamper clean energy investment, such as a lack of creditworthy off-takers or tariff misalignment, are also commonplace. For instance, price caps may be kept low to ensure electricity supply is affordable and accessible to the general population. However,

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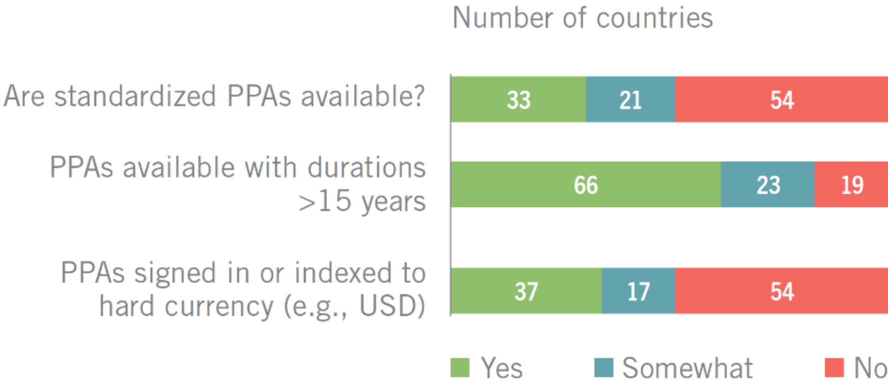
13 CFLI et al., *Unlocking Private Climate Finance in Emerging Markets*, 2021

such measures can block energy sector investment signals, which means that legacy fossil fuel capacity is not put in competition with increasingly cheap clean technologies. Just half the emerging markets tracked by BNEF[14] allow power generators to charge cost-reflective energy tariffs, and only 16% allow them to supply electricity directly at cost, compared with 52% in OECD markets.

Figure 2: Features of Power Purchase Agreements in Emerging Markets



Source: CFLI et al. (2021)

There are other potential impediments to the development of power markets, ranging from transmission bottlenecks, dispatch orders, to permitting of land, etc. Where steps are taken to address these issues, investment may follow.

The clean energy sector accounts for a particularly large share of the SDG and climate-related investment challenge in EMDEs, but the same type of approach—identifying and systematically tackling investment obstacles upstream as part of public-private strategies—can and should be applied to numerous other sectors with sizable investment potential but unfinished or imperfect markets. This might include digitalization, commercial transport or WASH infrastructure, agribusiness supply chains, or certain segments of the education and health sectors.

Capital markets

The development of capital markets is a special case. It is both 'horizontal' in the sense that better-functioning capital markets can help to source financing solutions across sectors, and 'vertical' in their ability to provide a connecting tissue with external finance. Capital markets in EMDEs are far shallower than in OECD countries almost across the board, but especially in the lower-income countries. As a result, there is little scope for intermediating local savings into investment. Themed (green or sustainability) bond issuance aimed at domestic and foreign investors has nevertheless grown rapidly in recent years, even though it remains concentrated in a few, relatively larger EMDEs that have the appropriate regulatory framework and capital

14 Ibidem

market infrastructure in place. Supply can be increased through cooperation between policymakers, technical support for capital markets authorities and issuers, and adoption of green taxonomies and frameworks aligned with leading standards.

Although deep, efficient, and well-regulated local capital markets will not spring up overnight, it is important to foster them one layer at a time (e.g., start with money markets and themed or government bonds and then increase the range of instruments). Because it is more an evolution than a single decision, the proactive development of capital markets—and more widely financial markets—should be encouraged and supported.

1.2.3. Boost the supply of bankable projects

In many cases, but especially in the poorest countries, the creating markets approach will need to go further and cover (assistance with) the preparation of projects. Although by definition hard to capture in data except for the very low aggregates of private investment and direct foreign investments in the poorest countries, the lack of "bankable projects" is very real (see Annex 4). Bottlenecks exist in project preparation and development, i.e., getting projects to investment-readiness at scale. This is despite the considerable attention that this area has received at least since the 2012 G20 and the setting up of many donor-supported project preparation facilities.

Project preparation assistance, including for example legal, procurement, or financial documentation, is typically designed and negotiated on a project-by-project basis, with a lack of transparency reflecting the private nature of most transactions. And while technical assistance facilities for project preparation abound—ODI has counted 150 for clean energy alone[15] and more are found in IFC's Global Toolbox[16]--this is a highly fragmented landscape with different mandates and requirements, making facilities often hard to access. The result can be a time-consuming process that impedes replication and scale, with financial structures that can be hard to assess for investors.

To develop the thousands of well-designed and structured projects that will be needed annually to achieve the necessary scale, it will be critical to de-fragment facilities and to build local capacity:[17]

- *Developers*: One approach is for DFIs and other investors to partner with developers or utilities that bring project development expertise into emerging and frontier markets – and indeed to help create such developers/utilities.[18] A key task is to overcome public–private cultural barriers.

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15 ODI (2018) *Clean energy project preparation facilities-mapping the global landscape*, November 2018
16 IFC/MDB's Global Toolbox to Advance Private Sector Investment, https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications/MDBs-Global-Toolbox
17 For this list, also see One Planet Labs, *Blended finance for scaling up climate and nature investments,* 2021
18 For instance, Scatec which acquired the Norfund-owned SN Power in 2020, is an integrated player with 3.5GW renewables capacity in operation in EMDEs and 12GW in the pipeline. Globeleq represents a similar approach focused on Africa and was sponsored originally by BII and Norfund. Gridworks, owned by BII, develops both grid and off-grid power in Africa.

- *Local banking system*: Another approach to scaling up is to develop portfolios of projects through intermediaries.[19] This might involve combining technical assistance for financial intermediaries with advice for borrowers and, possibly, blended finance to address early-mover risks.

- *National Development Banks* can play a local partner/intermediary role as well, especially when it comes to larger projects. As noted by the OECD, in many countries the role of NDBs is changing, with a growing focus on the mobilization of private investment and the development of bankable pipelines.[20] Enhancing their role to support blended finance will require governance, mandates and business models fit for purpose.

- *Packaged assistance*: An alternative path is to assist project developers with templates that are replicable across similar projects and countries, including for larger transactions. An example is the design of end-to-end standardized packages for utility-scale renewable energy plants, such as the IFC's Scaling Solar initiative[21]--by providing templates and advice for simple and rapid tendering, competitive financing and insurance, and risk management and credit enhancement.[22]

Apart from supporting intermediary and sector-based approaches to scaling up project development and preparation, it would be important to overcome the patchwork of existing facilities and move towards flexible, harmonized systems of support. In the infrastructure area, the Global Infrastructure Facility (GIF) was created in 2014 as a G20 initiative precisely to enable collective action and end-to-end advisory services across development partners, with a view to build bankable pipelines of infrastructure projects. It should be much larger.

1.2.4. Fix the "risk-return" equation

Many projects in EMDEs, especially in the poorest countries, do not move forward because the risk—real or perceived—is too high or the return too low.[23] If that balance is not right, the trillions will not flow. This has led to the development of de-risking approaches aimed at tilting the balance, including with blended finance. It is important to distinguish analytically between guaranteeing and blending. In simple terms guarantees buffer certain risks (political, exchange rate, non-payment, etc.). Blending combines financing on concessional and non-concessional

19 A successful example working through local banks is the European Bank for Reconstruction and Development's Sustainable Energy Financing Facilities (SEFF). SEFFs have disbursed over €2 billion via 80 banks across all economic sectors, for individual projects ranging from less than $1 million to $30–50 million. https://www.ebrd.com/downloads/sector/eecc/sei-seff.pdf

20 OECD (2020) Blended Finance in the Least Developed Countries 2020

21 See below Section 2.4 and https://www.scalingsolar.org/#toggle-id-7

22 Along similar lines, IRENA has developed an 'Open Solar Contracts' initiative.

23 There is a debate about whether African credit ratings, for instance, are painting too negative a picture of the actual risks (see e.g., M. Kotecha at https://allafrica.com/stories/202211070531.html). The UN Economic Commission for Africa identifies liquidity risk as one reason for low African ratings and has proposed a Liquidity Support Facility to address this issue.

terms, addressing situations in which fully market-based pricing would be unwarranted or unaffordable.[24] Guarantees can of course be 'blended' and provided on concessional terms.

Table 2: Addressing risks in infrastructure finance: the role of guarantees and blending

Project phase	Private sector actor	Key risks	Potential risk management tools
Phase 1: Project preparation – pre-feasibility/ feasibility	Developers/early equity investors	• Project non-investable and not proceeding. • Exchange rate risk planning	• Scaling project prep funding in existing and new vehicles • Data sharing • Planning for currency risk management through project cycle
Phase 2: Permitting and construction	Developers/ equity investors/private equity funds	• Regulatory risk • Construction risk • Exchange rate risk	• Data sharing and benchmarking • Tailored blended finance mechanisms including guarantees and insurance; cost- effective currency hedging
Phase 3: Operations – refinancing	Operating companies/ financiers (debt providers – local banks, global banks, asset managers, insurance companies, etc.)	• Sector and policy risk on viability of business model • Macro risk on ability to pay • Political risk • Exchange rate risk • Credit risk	• Blended finance mechanisms including first loss, guarantees, and political risk insurance • Cost-effective currency hedging and maximizing local currency financing to encourage local refinancing • Project aggregation • Standardized performance targets, reporting, and data sharing

Source: Adapted from Independent High-Level Expert Group on Climate Finance; November 2022

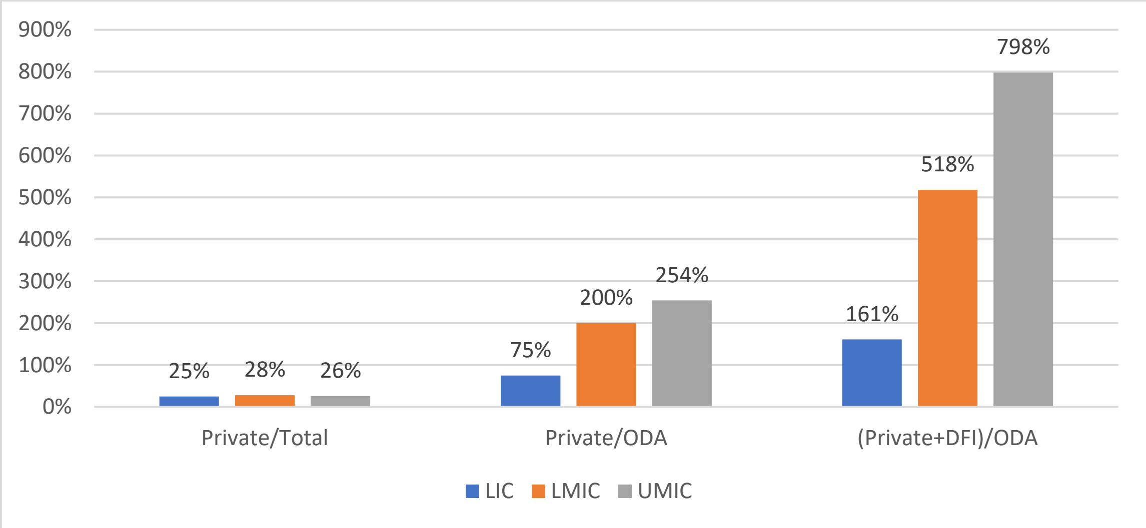
In addition to continuing to reassure private investors through solid macroeconomic management, improving the business environment and unblocking markets, blending and guarantees offer a complementary approach by reallocating investment risks. The strength of blending and of public guarantees is that they can mobilize funds by helping to match risk-adjusted returns to investor requirements. On economic principles, this can be justified if markets fail to align risk-adjusted returns with social preferences. There might be a variety of reasons for market failure, but the most relevant when it comes to EMDE investments are risks that would be absent or could be mitigated in well-functioning markets. There can also be an economic case to de-risk innovation finance if the broader economic benefits of early movers are large. Table 2 provides an overview of project stages, related risks, and the potential targeting of guarantees, blending, and other risk management tools in infrastructure projects.

Frontier strategies may achieve *high impact* but are less likely to mobilize finance at the scale needed to fill global investment gaps. Mobilization strategies aim to achieve *volume*. Indeed, as shown in Figure 3, mobilization ratios in 2020 – private finance mobilized with each dollar of concessional funding – were far higher in middle-income than in low-income countries. The gap was filled by DFIs, since the share of private finance mobilized in the total financing package was low at around one quarter in all regions. This suggests that there might be scope for higher

24 This is the joint MDB definition of blending. In the OECD definition blending combines public and commercial funds with a development purpose but does not require concessionality.

mobilization in MICs if DFIs stepped back in favor of private funding sources. Furthermore, a more granular assessment shows that concessionality is often not well targeted at the source of the risk, which implies an inefficient use of concessional funds.[25]

Figure 3: Blended finance – Private and DFI mobilization ratios by country income group (2020)



Note: Private finance mobilized as a share of total project cost; private finance mobilized divided by concessional funds invested (ODA); and the sum of private and DFI finance mobilized divided by concessional funds invested

Both guarantees and blending imply more intensive recourse to public and donor support, and there have been concerns about the use of public resources to unlock private sector investments.[26] There is, indeed, a risk that blended finance might simply be deployed to "sweeten the deal" by financing at below market rates. To avoid wasting scarce concessional resources, the use of blended finance must be subject to strict economic principles. The DFIs have agreed joint Principles that include additionality, minimum concessionality, commercial sustainability, the reinforcement of markets, and the promotion of high standards.[27] Importantly, "blended finance should be employed only in sectors and countries where commercial financing is not currently available for deployment towards development outcomes" (Bartz-Zuccala et al., 2022). The idea is to avoid an ideological debate and instead determine for which projects, contexts, at what level and in which form, blending is appropriate and when it is not.

Nevertheless, despite considerable international discussion, including endorsements by the G20 and various other fora, and growing expectations around de-risking strategies, the

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25 Ibidem

26 For instance, Charles Kenny, *Aid Transparency and Private Sector Subsidies at the IFC*, January 17, 2018. Center for Global Development. One should note, of course, that OECD countries employ public resources for such goals on a large scale with arguably less transformational impact.

27 DFI Working Group on Blended Concessional Finance for Private Sector Projects, various years; also see Mutambatsere, E. and P. Schellekens, *The why and how of blended finance,* 2020 (https://www.ifc.org/wps/wcm/connect/768bcbe9-f8e9-4d61-a179-54e5cc315424/202011-New-IFC-Discussion-Paper.pdf?MOD=AJPERES&CVID=no0db6M)

numbers so far do not live up to the hopes. We do not have reliable aggregate data on the use of guarantees. But Table 3 sets three concepts of blended finance in relation to net private financial flows to low- and middle-income countries. Whichever definition is used, the share of net flows that benefit from this form of support remains very small. The grant element involved represented US $3.2 billion or less than 2% of total ODA in 2019.[28] The DFIs report using $1.4 billion of concessional funding in 2019 for a total project volume of $10.4 billion. Climate finance comprised the largest share of blended concessional finance volumes with well over half of the total in all country income groups.

Table 3: Private finance flows to MICs and LICs, various concepts

US$ billions	2016	2017	2018	2019	2020
Net private financial flows, debt and equity	721	1,290	1,108	954	909
OECD "private finance mobilized"	35	40	48	46	51
DFI "private sector blended concessional finance"		9	6	10	11
Convergence "total blended finance"	8	13	11	11	6

Sources: World Bank DRS, OECD TOSSD, DFI Joint Report, Convergence State of Blended Finance 2022

Note: 1. OECD private finance mobilized: "strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries"[29]

2. DFI private sector blended concessional finance: "combination of concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the SDGs, and mobilize private resources"[30]

3. Convergence total blended finance: "The use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries to realize the Sustainable Development Goals."

The bottom line from this discussion is that, by tackling risks and risk perceptions that act as barriers to investment, guarantees and blended finance should be expected to play a supportive and significant role in encouraging private investors into EMDEs, especially in lower-income countries and 'frontier' situations. Boosting the deployment of de-risking tools will need to go hand in hand with a matching effort to build stronger project pipelines, through market and project creation. While the deployment of these instruments must be subject to strict governance to avoid waste and—worse—undermining markets, the case for a considerable scaling-up remains as strong as ever.

1.2.5. Strengthen financing channels for capital mobilization

At the level of (downstream) capital mobilization, the challenge is to achieve scale by shifting from tailored and *ad hoc* finance towards portfolio and market-based solutions. The focus should be on institutional investors, both international and domestic, who represent by far the largest untapped source of funds for projects in EMDEs. The constraint here is not the availability of potentially willing funds, but how to connect them to investments.

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28 OECD DAC (2020) *Official Development Assistance report 2020*

29 Note that, under this definition, development finance can be both concessional and market-based, and mobilized finance can be public or private, as long as its purpose is commercial.

30 Note that this assumes that the DFIs' own account finance is necessarily market-based and excludes, for instance, project-related technical assistance grants.

Institutional investors have conservative investment patterns, which may be yielding slowly to a quest for diversification and higher returns.[31] Institutional investors, while not a homogeneous group, tend to seek transparency of terms (standardized documentation), liquidity (achieved most easily via listed and rated securities), relatively large ticket sizes, and they prefer operating assets while avoiding early-stage and construction risk.[32] These conditions are met by few EMDE assets directly.

To tap the institutional investment market at scale, there is a need to create portfolios of investment opportunities and set up intermediaries that can aggregate, securitize, diversify, label/certify, and if necessary de-risk such assets. Market scale can be achieved in three ways, the first two of which were referenced previously:

- Through (tranched) blended fund structures, as would be the case under blended finance 'mobilization strategies';
- Through the development of markets for themed bonds which can then be aggregated for investors (such as Amundi EGO, discussed in Part 2 below); and
- Through the creation of a sustainable infrastructure asset class. A key initiative in this context is the FAST-Infra program[33], which was launched under the auspices of the OnePlanet Summit as a joint venture by HSBC, IFC, OECD, GIF, and CPI.

Each of these approaches would give investors access to EMDE assets in a more standardized and scalable format than is the case today. It is crucial that these initiatives are directed at both the international markets and domestic capital markets and reach local investors in the project countries. This is often overlooked in the current debate.

First, there is domestic capital to be tapped in most middle-income countries.[34] The development of project or corporate assets can help to give greater depth to local capital markets, which are often dominated by public debt. Second, currency risks add considerably to project risk and can be expensive to mitigate through blended finance. Tapping local capital for local currency assets provides a natural hedge. Indeed, if "billions to trillions" were to be anywhere near successful but rely predominantly on foreign capital, it would create huge external imbalances.

MDBs alone and as a group working together, can play a far more significant role in mobilizing private capital than they do at present. An approach in which MDBs would be given an explicit, ambitious mandate to mobilize private capital would see them moving from packing their

31 IRENA (2020) Mobilizing Institutional Capital for Renewable Energy
32 Ibid. Over 75% of all direct investments made by institutional investors in renewable energy projects over the 2009 to Q2 2019 period were in secondary-stage transactions, i.e. investments in already operating assets that do not require further funding.
33 'Finance to Accelerate the Sustainable Transition-Infrastructure' (FAST-Infra), https://www.climatepolicyinitiative.org/fast-infra/ FAST-Infra is developing a label for sustainable infrastructure, which it expects to be transformative for the market, and a technology-enabled platform to facilitate information and distribution of loans.
34 E.g., some three-quarters of climate assets identified by Climate Policy Initiative (CPI) have been financed domestically, mostly privately.

balance sheets in the direction of an originate-and-share business model.[35] For instance, MDBs might focus on higher-risk/earlier-stage funding while handing assets with stabilized cash flows to the private sector. They might use guarantee powers to crowd private capital into risky regulatory environments, make more use of intermediary vehicles that allow aggregation and diversification of exposures – including on a pooled basis across multiple MDBs – and expand offers to mitigate private sector currency risks.[36]

It will be important for the MDBs to develop differentiated strategies for LICs and MICs, along the lines of the distinctions between blended finance frontier and mobilization strategies. In MIC strategies, the focus should be on high-mobilization tools, on the aggregation and standardization of assets to meet institutional investor demand, and on portfolio-level or platform approaches that maximize the benefits of diversification. In LIC strategies, the mobilization expectations would be more modest. There would be a greater need for concessional tools and blended finance, and for individually tailored solutions. The key issue in LICs is not just risk but also cost, impacting risk-return considerations.

35 Gregory, N (2023)

36 Lankes, H.P. and A. Prizzon, "Multilateral development bank reform can – and must – benefit both low- and middle-income countries", ODI website

Part 2. How to do it: preliminary lessons from the IFC 3.0 experiment.

Based on the above diagnostics, in late 2016, IFC presented to its board a new strategy which tried to address the "how to". It was a shift towards doing more in the poorest countries, and as a corollary, to move from a reactive to a pro-active stance. This strategy, called "creating markets" or "IFC 3.0" rested on 7 interrelated "pillars" each of which represented new approaches for IFC: (i) Country Private Sector Diagnostics (CPSD); (ii) IFC country strategies; (iii) development of financial markets: a joint WB-IFC capital markets development initiative (JCAP) green bonds and MSMEs; (iv) the concept of the "Cascade"; (v) a push to "creating projects"; (vi) de-risking and blended finance for the poorest countries (launching IDA's Private Sector Window (PSW)); and (vii) estimating ex-ante the impact of IFC's projects (AIMM). The term "upstream" was coined at an IFC board meeting in 2016 to capture the proactive work to identify policy reforms needed in each country to create markets, as well as the push to create projects.

To be complete, the strategy also included IFC's push to increase mobilization through syndication of its loans and equities portfolios with private investors.[37] We do not discuss the mobilization strategy here, despite its importance in the current "scaling-up" debate, since it represented the continuation of a successful decades-old effort and is well-known.

These changes were endorsed wholeheartedly by the Board of Directors and were the basis of IFC's historic capital increase in 2018. However, many of the changes generated (mostly passive) resistance from staff and are taking root only very slowly as they entailed changing the deeply entrenched operating system and "culture" of both the IFC and the World Bank (WB). The jury is still out to evaluate whether the approach will be successful or not. But it is already clear that making it work better will require the World Bank to be a more pro-active partner. Part 2 of the paper is largely based on lessons and evidence from this experiment.

2.1. Country Private Sector Diagnostics and Country Strategies

It is very important to understand that in the classic private sector focused DFI model, proactivity is not required. The model is simply to wait for "sponsors" (i.e., private sector clients/investors) to come with investment projects for financing. "Originating" new transactions essentially meant canvassing, mostly existing, clients for financing their new investments, or "repeat" lines of credit. In this model, the only need was for filters for what NOT to finance (e.g., drugs, arms, nuclear, coal, etc.). The rest was all about analyzing the risks, trying to reduce them through covenants and financial structuring, and deciding whether to finance or not on that basis. This is fine and very useful, but it is not adapted to the context of poor countries where the lack of bankable projects is a major impediment.

37 The "push" for increased mobilization came through the board of the IFC in the late 2000s and became part of IFC's KPIs. From the mid-2010s IFC was increasingly successful in reaching institutional investors as syndicate partners through the Managed Portfolio Co-Lending Platforms (MCPP).

To have the most impact on development, private focused international DFIs such as IFC, should target the areas in which both policy reforms and public and private investments are most needed. This requires having a clear view of the main impediments to private sector development, both across the board and sector specific, and designing strategies to implement the necessary changes and investments. In other words, having clear and evidence-based ideas about the most promising sectors where to expand or deepen markets and to proactively develop new projects. With limited budgetary resources, where to invest efforts to be pro-active (i.e., where to work upstream)? How to redefine what could and should be privately financed? The response was to launch two new instruments, namely the Country Private Sector Diagnostics (CPSD) and the IFC country strategies.[38]

The CPSDs assess opportunities for and constraints to private sector led growth. Each CPSD includes an assessment of the state of the private sector, identification of near-term opportunities for private sector engagement, and recommendations for reforms and policy actions to mobilize private investment and drive solutions to key development challenges. It is important to note that although led by IFC, these CPSD were done jointly with WB staff. By combining both economy-wide and sector-specific analysis of constraints, the CPSD helps to create a common analytical basis to shape policy dialogue and guide transformational private investment. Between late 2017 and March 2023, CPSDs for 48 countries were published.[39]

The analysis and recommendations of the CPSDs informed the IFC Country Strategies. A key aspect of these strategies were action plans for deepening IFC's engagement in response to policy reforms, using "if/then" matrices that estimated potential private investment unlocked (THEN) based on policy reforms (IF). In addition, IFC country strategies pointed to areas where IFC should invest in upstream work to develop new projects. Crucially, IFC country strategies were designed as an internal document to feed into the WBG "country partnership frameworks" since many of the actions depended on policy reforms that the WB has the mandate and instruments to support as well as on implementation of the Cascade approach (see below).

To measure how disruptive this was, it is important to know that the World Bank Group (WBG) strategies were usually drafted by the WB with very limited input from IFC or MIGA. In other words, in WBG strategies, IFC and MIGA were most often treated as an afterthought "after the cake was baked". The WB could not be blamed since neither IFC nor MIGA saw the need to have country strategies – they viewed their mandates as mostly reactive and transactional. Since 2017, however, IFC has produced 61 country strategies as part of its reform. They have not been published since they were conceived as an input into the WBG strategies.

Unfortunately, the integration of IFC country strategies into WBG country partnership frameworks remains very "light". In part because old habits die hard, and in part because the WB country framework papers have over time become more general while IFC strategies are, by nature, very specific. For IFC strategies to be effective, and therefore to guide a pro-active

38 In addition, IFC launched sectoral "deep dives" to, among others, assess the need for joint World Bank Group action to realize development opportunities at sector level.

39 CPSDs are published only with governments' approval. IFC and other development finance institutions are working together to provide in-depth economic analyses that identify opportunities for the private sector to maximize development impact. The Country Diagnostic Platform, launched at the 2019 Spring Meetings, makes available diagnostic reports that identify these opportunities and obstacles to progress.

stance by IFC, the WBG country strategies would also need to become much sharper and closer in content to business plans. They would need to explain more precisely what reforms would unlock private investment; how those would be addressed through WB policy dialogue, including through the use of World Bank Development Policy Operations (i.e., budget support); how private solutions would be prioritized in line with the Cascade principles (section 2.2) and if not, to provide a justification for public investments in specific sectors; which advisory to deploy in support; which public and private projects would be developed over the strategy period; and how various parts of the group leverage each other's skills and instruments to maximize development and climate impact.

In short, once IFC has evolved to be more strategic and not exclusively transactional and reactive, that endeavor should be bolstered by a deliberate group-wide effort. Without it, there is the risk that IFC staff return to their reactive ways if they do not see a concrete and active follow up on their efforts by the WB, with the same results: few private projects and therefore limited private finance in poor countries. With joint efforts and coordination, significant results can be achieved. An excellent proof of concept is the Benban solar park project in Egypt (Box 2).

Box 2: The Benban Solar Park in Egypt (Source: IFC and others)

The power of policy reforms to create markets and unlock concrete private investments is clearly illustrated by the Benban solar park in Egypt. To crowd in private sector expertise and finance, the government of Egypt -supported by the IMF and the WB- reformed its electricity tariffs and the legal and regulatory framework of the electric sector in 2014-16, with a foundational law in 2015 that removed the state monopoly over the energy sector. These reforms unlocked many private sector investments to construct and operate power plants, including a huge solar park in Benban, near Aswan. It is currently the largest in Egypt and the 4th largest solar power plant in the world. On a 37 square kilometer plot provided by the government, the solar park consists of 32 contiguous and coordinated solar power plants generating about 1.65 GW of clean electricity (which corresponds to an annual production of 3.8 TWh—equivalent to 90 percent of the energy produced by the famous Aswan High Dam). The construction was completed in November 2019, 18 months after its start. It "crowded-in" about $2 billion of private investments (and hence that much in savings for the government budget). IFC spearheaded one of the financing packages that included 9 international Banks to finance 13 projects. EBRD led another consortium of lenders to finance an additional 16 projects. Proparco (the private sector arm of the Agence Française de Développement -AFD) financed another one, and the last two projects were self-financed. MIGA provided political risk guarantees to 12 projects in the solar park. Finally, to avoid having to deal with multiple sets of ESG standards applied by each bank, IFC took the responsibility to apply its standards across all projects in the park to ensure coherence and efficiency.

2.2. *Enforce the "Cascade"*

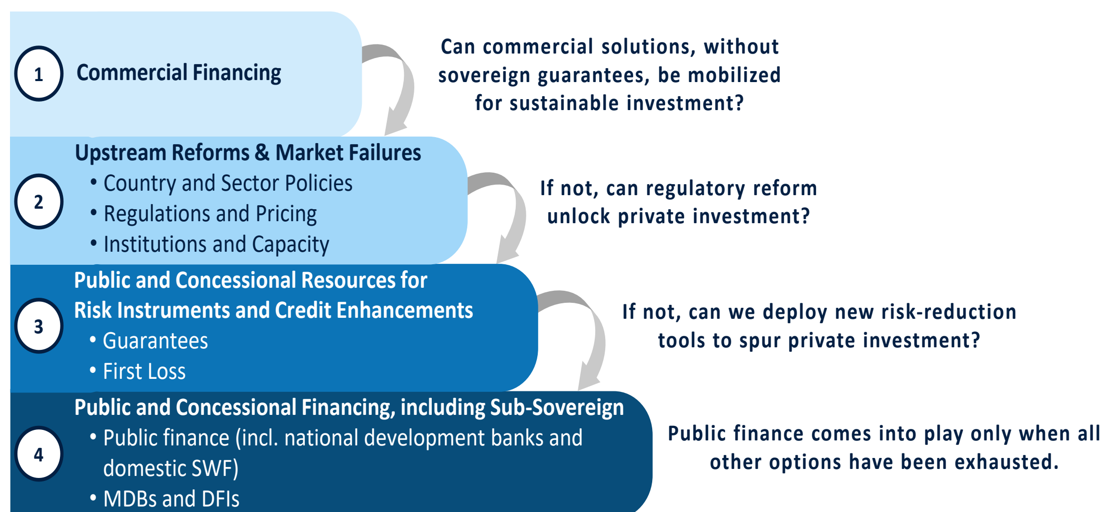
The "Cascade" is simply a way to systematically seek to mobilize private sector solutions and finance i.e., to crowd them in, instead of unquestionably agreeing to public solutions when there are good private alternatives, de facto crowding out the private sector. The Cascade was launched as part of IFC 3.0 to generalize a best practice learned in the Queen Alia Airport project in 2007, but unfortunately rarely replicated. What is interesting in this project is not the transaction itself and its success [40], but rather how it came about.

Originally the Government of Jordan approached the WB to finance the major extension and revamping of the Queen Alia airport. Instead of financing it through an IBRD loan which would have added to the government's public debt, the government and WB staff decided to approach the IFC to structure a private solution, in a good example of WBG synergy. The result is that the Government got a very modern and efficient airport, did not add to its public debt, and received a sizeable yearly income stream in the form of high concession fees. This is remarkable in the sense that the "normal" instinct and practice would have been for the WB staff and government officials to go the easy way of public finance through an IBRD loan. The project instead became the posterchild of the "Cascade approach".

The Cascade is an easy way to systematically expand the realm of private solutions and therefore "create markets and projects". The basic approach is for the public sector part of the MDBs to refrain from financing what could and should be done by the private sector and private finance, thus avoiding the creation of additional public debt. The simple idea is to limit public investment (and debt) to what cannot be done by the private sector after removal of regulatory impediments.

In graphic form, the Cascade approach can be illustrated as follows (Figure 4):

Figure 4: The Cascade as a schematic decision/action tree



Source: World Bank Group (2019)

40 For a detailed description of this project see: EMCompass IFC, April 2017; https://www.ifc.org/wps/wcm/connect/855fabf2-0f39-4cc7-a534-b4367f3eaf10/PFI-Yearbook-Article-QAII.PDF?MOD=AJPERES&CVID=lGz.tj8.

Although strongly endorsed by the IFC Board, the Cascade was resisted by many WB managers and staff who saw it as a scheme to "push them out" of commercial infrastructure and hence reduce their lending targets. It was promptly rebaptized "Maximizing Finance for Development" which enabled the concept to be diluted into a general catch-all slogan. And it diverted attention from the core of the concept which is to replace public solutions as a default with private solutions, i.e., crowding-in private solutions instead of de facto crowding them out through public lending. The Cascade has re-emerged in the recent World Bank "Evolution Road Map", and it will hopefully be fully implemented with a proper set of staff incentives that draw on the earlier experience.

The Cascade concept has the added advantage in the current context of public debt stress in many EMDEs that it limits fiscal exposure. Obviously, the use of various forms of Public-Private Partnerships (PPP) is an integral part of the Cascade. To accompany this approach, the WB should focus on helping countries reform commercial infrastructure by improving the creditworthiness of many virtually bankrupt public utilities (including through tariff reforms -- see the case of Benban in Egypt above), boosting deployment of its Partial Risk Guarantee instrument, and focusing on truly public projects where no revenue flows can be generated (e.g., rural roads).

A real issue, though -- and one underlined by WB staff – is that if the Cascade is implemented by the WB, it should also be adopted by other MDBs and bilateral aid agencies. Otherwise, those other MDBs will simply step into the relationship with governments and crowding-in the private sector will not happen. The resistance is likely to be fierce as for many MDBs, public infrastructure financing is a big part of their yearly lending commitments, and they are not likely to be keen on seeing it encroached by the private sector. Here the shareholders of these various institutions should insist on abiding by the same "rules of the game". This is a *sine qua non* for MDBs as well as bilateral aid agencies if the aim is, genuinely, to help mobilize far more private capital.

It is interesting to note that by applying the above Cascade approach to projects to fight climate change, it should typically be possible to generate and finance climate mitigation projects in the private sector, with limited public guarantees. Conversely, many if not most adaptation projects will need public financing. Furthermore, beyond infrastructure, the same Cascade principles should be applied for credit lines to MSME financing, agribusiness, housing, and even some education and health sector investments.

2.3. Develop local financial markets: J-CAP, green bond markets, and MSMEs

A very large share of the missing trillions will have to come from financial markets, and as discussed in section 1.2.5, DFIs and MDBs should direct far greater efforts to developing financial and capital markets in EMDEs. For IFC 3.0, it was also another important way to create markets and new transactions. Here again both IFC and the WB were working at different levels in different countries, hence reducing their combined impact. This led to the launch of the Joint (IFC/WB) Capital Market Development Program (J-CAP) in 2017. J-CAP aimed at combining the policy advice provided by the WB with the more hands-on advisory role of the IFC and its practical experience in launching "demonstration transactions" as anchor investors for new financial products (e.g., local currency solutions; mortgage market; public and corporate bond

market; leasing; insurance; stock exchange, etc.) – and to advise interested countries jointly. Several donors (Australia, Germany, Japan, Luxembourg, Norway, and Switzerland) backed the initiative and the program started with a limited number of countries.

Through the J-CAP, the WBG provides a "one stop shop" solution to countries as they embark on capital markets development. The distinctive feature of this initiative is precisely the combined use of advisory and transaction support to mobilize private sector financing via capital markets for key strategic sectors agreed with the authorities, be it corporate, infrastructure, housing, SMEs or climate change. The combined use of advisory and transaction work creates a virtuous cycle where one reinforces the other, maximizing impact. This approach is being deployed in six countries and one regional grouping: Bangladesh, Indonesia, Kenya, Morocco, Peru, Vietnam and the West African Economic and Monetary Union. Lessons learned from this initiative should be assessed before expanding the range of countries.

Beyond the J-Cap, IFC is proactively creating green bond markets with a mix of specific advisory services and purchase of new issuances by banks in EMDEs. In 2018, IFC launched the Green Bond Technical Assistance Program (GB-TAP) to train banks, help potential issuers identify projects, monitor results, and report according to international standards. In many countries IFC literally worked on the first green bonds issued by local banks. To scale up, in 2018, IFC and Amundi launched the Amundi Planet Emerging Green One fund (AP EGO) to stimulate demand for green bonds in emerging markets (Box 3).

Box 3: Developing the Green Bond Market – GB-TAP and Amundi Planet EGO

Green Bonds Technical Assistance Program: GB-TAP offers a range of activities and initiatives to foster the supply of emerging market green bonds, both in terms of volume and quality, by training banks in emerging markets, setting standards, and disseminating best practices across the industry. From 2018 to June 2022, the program has provided executive training to 751 participants from 176 financial institutions across more than 50 countries. This training has contributed to the issuance of 45 green, social, and sustainability bonds worth $3.2 billion. Of that amount 18 bonds worth 2.8 billion were direct issuances from alumni banks of the program. Many of these issuances were the first sustainable bonds in their countries and AP EGO invested in 6 of these bonds.

Amundi Planet Emerging Green One: AP-EGO is a joint venture between fund manager Amundi, IFC and several other DFIs. The objective was to create a platform to unlock capital from institutional investors for climate finance in developing countries. With a close at $1.42 billion, and expected to deploy $2 billion into emerging markets green bonds during its lifetime as proceeds are reinvested over 7 years, AP EGO was then the world's largest targeted green bond fund focused on emerging markets. The fund is also the first of its kind to take a holistic approach by supporting the creation of a robust green bond market through tailored capacity building activities. In addition to a cornerstone commitment of $256 million[41], IFC was responsible for helping private banks in emerging markets issue green bonds through advisory work.[42] As of August 2022, AP EGO had $1.4 billion under management, of which 77.8 percent are green bonds, well above the target of 50 percent by February 2023.

41 Other anchor investors included European Investment Bank (IEB), European Bank for Reconstruction and Development (EBRD), and France's Proparco. The Fund's ESG policy reflected IFC's 2012 Performance Standards and IFC's exclusion lists.

42 This IFC-managed technical assistance, was funded initially by a $7.5 million grant from SECO (Swiss Secretariat for Economic Affairs)

Develop Micro, Small, and Medium-size enterprises (MSMEs)

For good reasons, including its importance for job creation, MSMEs financing has for a long time been a priority for international DFIs. DFIs typically establish lines of credit and/or risk-sharing facilities with local banks and/or micro credit institutions, that know the local market far better. A lot has been done over the years and a lot of creative experiments have been documented. On the equity finance side, it is more difficult but here again international DFIs typically invest through Private Equity Funds that are better equipped to do it. Beyond finance, a key and well documented aspect of successful MSME financing is to develop a tailored technical assistance program in parallel to help these MSMEs improve their technical and financial management skills.[43]

Apart from these well documented features, it is important to draw attention to two critical but rarely mentioned issues:

- The first is the importance for governments to avoid the accumulation of arrears to MSMEs thereby pushing them into financial stress. Typically, MSMEs have very tight working capital and turning receipts into cash is critical for their survival and growth. This is a fiscal issue to which both WB and IMF should pay systematic attention when preparing budget support operations for a country.

- The second is the importance for the public side of the MDBs to finance privately managed incubators and accelerators for startups in order to help would-be entrepreneurs sharpen their ideas, navigate the often complex legal/regulatory and tax issues, and access “angel” or venture capital.

Another critical but largely taboo issue is to adjust the International DFIs’ ESG standards when it comes to supporting MSMEs. This is very sensitive among western NGOs and MDB shareholders. Yet it is critical. Most international DFI have very stringent ESG standards that are tailored to large private compagnies with strong financial and technical capacity. Many observers think that private sector focused DFIs should “take more risks”. But a harder look shows that a lot of the so called “risk aversion” is not towards credit risk but ESG risk which generates a culture of self-censorship. This is a powerful deterrent to impactful and complicated transactions as well as to MSMEs. To better reach small companies, the definition and implementation of ESG standards should be revisited. The existing standards are simply too hard to be implemented to the letter by MSMEs. The key is to accompany these micro and small enterprises to improve their environment and social standards as they grow. Such standards are very desirable as they prevent bad things from happening, but the best can be the enemy of the good. This is especially true if DFIs want to help develop a local non-oligopolistic private sector.

43 For more details on the contribution of MSMEs to economic development in Africa, see ‘Des millions pour des milliards’, Séverino FERDI, (2023)

2.4. *Creating projects*

Besides reforms identified in CPSDs and IFC country strategies, working "upstream" also means creating bankable projects. As mentioned in section 1.2.3, the lack of bankable projects has long been recognized as a major impediment to growth among multilateral and bilateral private sector focused DFIs (see Annex 4). The choice is between waiting until the project pipeline increases by itself (as a result of a sound macro framework, regulatory reforms, improved public infrastructure, education, etc.) or proactively investing time and resources to develop from scratch a pipeline of potential projects for private investors.

"Creating projects" is especially needed in the poorest countries but must overcome two key constraints:

- The first constraint is that it is very costly to develop bankable feasibility studies.[44] Given the cost, the problem was how to be selective and focus on the most transformational projects. To avoid wasting time and money, it was key to clearly identify in each country the sectors and areas in which to engage in project creation. This is why CPSDs and country strategies as described above are key to this approach.

- The second constraint is that the existing private sector focused international DFIs – including IFC – have few staff with the skills needed to develop new projects. Contrary to their colleagues in the WB on the public side, IFC staffs' skillset is not to develop new projects but rather to structure the financing of projects developed by sponsors. In the poorest countries this is not enough to scale up private investment and private finance. In plain English, IFC 3.0 needed to add entrepreneurial and project developer talents to the existing pool of financiers. It was and remains a profound transformation of the DNA of the existing private sector focused DFI staff and culture.

Such deepening of skills is feasible, as demonstrated by the "Scaling Solar" program. The program started in Zambia in 2016,[45] and was replicated in Madagascar, Senegal, Ethiopia and Uzbekistan.[46] The bottom-line is that very cheap clean electricity could be generated by attracting first rate technical sponsors through a bidding process to implement a project that was identified and prepared by IFC and the government, with de-risking provided by the WB though its Partial Risk Guarantee (PRG – see section on de-risking below). None of the private investment projects that were created and financed under the program would have materialized without IFC Scaling Solar. For relatively small markets in IDA countries, private investors would not even have considered coming on their own, spend time and resources to do a feasibility study, find and buy or lease land for their solar plant, get all the necessary government authorizations, and then take the non-payment risk by the public utility off taker. Identifying the project, preparing it, and de-risking it made the difference and enabled the investors to bid very low kwh prices.

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44 The GIF considers that a feasibility study and development cost between 5-15% of total project cost in infrastructure.
45 See: IFC (2016) "Scaling Solar delivers low-cost clean energy for Zambia
https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/scaling+solar+delivers+low+cost+clean+energy+for+zambia
46 The detailed story is captured in "Scaling Solar: the complete package" under https://www.ifc.org

Other areas can and are being developed pro-actively such as creating markets and projects for housing (including developing mortgage markets), agribusiness, etc. But the jury is still out on whether this "creating projects" drive will become the norm rather than the exception. One way to help would be to enforce a simple KPI to measure how many feasibility studies and/or bids for investors (à la Scaling Solar) are produced every year.

It is costly to create bankable projects and when a DFI generates such projects, others can free ride on it and offer cheaper finance to the selected sponsor. There are a few ways to mitigate or eliminate this potential free-rider problem. On the general cost of developing a pipeline of bankable projects, and as mentioned above, selectivity is key, and it ought to be one of the main objectives of the CPSDs and country strategies. On a project-by-project basis, the free-rider problem could be avoided by signing an agreement with the sponsor to either finance the project with the DFI that generated it and/or paying a project preparation fee if the project finance is provided by another source. A third option would be to earmark grant money – for example in the IDA Private Sector Window (PSW) or through the GIF – to finance a pipeline of bankable projects to auction to potential investors. Or a combination of the above (selectivity, success fee for the developer of project, and project preparation grants).

An alternative -and not mutually exclusive- model to systematically increase the pipeline of bankable projects and to crowd-in private finance may be for the WB to develop projects and finance the construction phase on IDA or IBRD balance sheets (for example in infrastructure and agriculture) and then sell them to the private sector. This "build and flip" model could be explored more actively. Since the "green field" construction phase is typically the riskiest phase of a project, this would help generate more private finance and free up more WB capital faster by selling the project to the private sector. Combined with de-risking when "flipped", this would be a very good way to recycle public assets quickly and to better "sweat" the capital of the WB, reduce public debt, and crowd in private solutions and finance.

2.5. De-risking and blending to crowd-in private finance

Now, let's assume that WBG country strategies are more like business plans, that pro investment reforms are being implemented and proactively translated into WB budget support operations, that the Cascade is enforced and that IFC generates new projects (e.g., through feasibility studies-cum-auctions) to finance privately. It would unlock many potential new opportunities. But in poor and many middle-income countries, with weak policy environments and institutions and small markets, it will most likely not be enough. "You can bring the horse to the river, but you cannot force it to drink". For that, the risk-return relationship must be attractive. As explained in section 1.2.4, this is where de-risking and blending come into play to unlock private investments and finance.

The many risks of private projects in poor countries are well established (see Table 2 above for infrastructure projects). So are, on paper, the instruments to mitigate them. In addition to MIGA which can shield foreign direct investments from political risk, the WB (IBRD and IDA) has a full suite of guarantees that could powerfully mobilize private sector development and

finance (see Annex 5).[47] However, since 1994, the WB has provided only 75 guarantees. Some are policy-based, and some are sector and project-based.[48] All of them are effective in mobilizing private finance for development. A recent CGD paper[49] demonstrates the great potential of policy-based guarantees for EMDEs to raise private capital in the market on improved terms. Internal and external independent assessments over the last three decades have insisted that the WB should deploy more of these instruments. Yet these guarantees are rarely used, as the WB favors direct lending.

Specifically, on the project side, the Partial Risk Guarantee (PRG) is particularly useful for infrastructure financing by partially ensuring the payment to a private company (for example an independent power producer – IPP) by public off-takers (usually a public utility in poor financial health). In fact, such backstop of the performance and payment obligations of governments (or government owned utilities and companies) is a much stronger instrument than the risk mitigation equivalent from IFC/MIGA since any default by the government to the private sector has a government/sovereign counter guarantee: the WB pays if the guarantee is called but the amounts paid become a liability of the government towards the WB. This creates an incentive for the WB and the government to work on the underlying problem of lack of creditworthiness of public utilities in many countries.

Unfortunately, the PRG are very rarely used, let alone pro-actively marketed and deployed. Over the last 10 years, only 18 such PRGs[50] in favor of the private sector were committed by the WB, less than 2 on average per year. And the trend is down: in FY21 only 1 such guarantee was provided, and it came to zero in FY22. In dollar terms, the average exposure taken by the WB on guarantees has been less than 0.7 percent of annual WB commitments made in the form of loans and grants. Yet it has been proven time and again, that deployment of guarantees is an excellent way to mobilize private finance since on average, every dollar of WB guarantee has leveraged $4 of investment project and investment finance. This lack of use can be interpreted as a lack of implementation of the Cascade, a lack of awareness or understanding of the instrument, combined with a lack of incentives for staff. In short, the WB can do a lot more with these types of risk mitigation instruments if they were deployed at scale to support both public and private sector investments.

This lack of proactive use of WB payment guarantees is in part why the IDA donors accepted to set up the IDA Private Sector Window (PSW) in IDA 18 (for the July 2017-June 2020 period) that was renewed in IDA 19 (2020-2023). For each replenishment, $2.5 billion were earmarked for the PSW. However, IDA 19 was cut to two years due to the covid response, and correspondingly, the PSW was cut to $1.7 billion (for the period July 2020-June 2022). Only $1.4 billion (55 percent) of the facility was allocated under IDA 18– partly due to stringent requirements and partly because of the time needed to roll out a new instrument requiring

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47 It is not commonly known that the WB was originally conceived as a Guarantee Institution as well as a lender (this is clearly spelled out in article 1 of the articles of agreement of IBRD.) It was only because the capital markets were not well developed in the 1950s that the WB had to step in with funding to intermediate the financial markets with provision of long-term loans towards the post WW2 reconstruction of Europe and Japan. It was only in 1994 that the WB put together its first guarantee policy.
48 For details about WBG before the PSW see "World Bank Group Guarantee Products"; April 2016
49 "MDB Policy based guarantees: Has their time come?" Clemence Landers and Rakan Aboneaaj; July 2022
50 The list of Individual WB Guarantees can be found in the external WB project portal.

coordinated activity across WBG institutions – and the remainder reverted to the IDA pot. Under IDA 19, the full (revised) allocation was used.

The IDA PSW is a key component of IFC 3.0. Through different facilities, it backstops or blends with IFC investments or MIGA guarantees to support private-sector investments in the most difficult environments. The PSW is deployed through four facilities[51]:

1. **Local Currency Facility** (LCF) to provide long-term local currency for IFC investments in IDA countries where capital markets are not developed, and market solutions are not sufficiently available (see Annex 6 for details).[52]

2. **Blended Finance Facility** to blend PSW support with pioneering IFC investments across sectors with high development impact, including small and medium enterprises (SMEs), agribusiness, health, education, affordable housing, infrastructure, climate change mitigation and adaptation, among others.

3. **Risk Mitigation Facility** to provide project-based guarantees without sovereign indemnity to crowd-in private investment in large infrastructure projects.

4. **MIGA Guarantee Facility** to expand coverage through shared first loss and risk participation via MIGA reinsurance.

As shown in Table 2 above, foreign exchange risk is a major risk and one that is present in each of the phases of an investment project. Yet it is one of the most intractable to address in poor countries. The local currency facility of the PSW unlocks investments in projects generating only local currency income. It is important to note that the poorer the country, the less investors/financiers can cover themselves for the foreign exchange risk. In rich countries and in some middle-income countries, many of these risks can be hedged though capital market solutions (e.g., deep local bond markets, future forex markets, swap and derivative markets, etc.). For lack of market solutions, in IDA countries there is typically no way to cover foreign exchange risk. The IDA LCF is in some sense the most innovative of the PSW facilities and the first of its kind.

According to preliminary estimates, every dollar of IDA PSW leveraged about 4 to 6 dollars of private finance (see "The world bank group's experience with the IDA Private Sector Window -- An early-stage assessment", IEG, July 2021). It is reassuring that, in commenting this evaluation, the World Bank Board concluded that the instrument was generally proving to be effective and governed in accordance with the principles, and "Members emphasized the key role of the instrument in mobilizing private sector engagement in countries."[53] An updated review from IEG post covid 19 is being produced and will be important to adjust the design of the facilities and to respond to critics. In addition to the leverage generated, the way to demonstrate the value of the PSW is to show that more projects are unlocked by the PSW and to demonstrate their economic, social, and climate impact.

51 See IDA website https://ida.worldbank.org/en/financing/ida-private-sector-window/what-is-ida-private-sector-window.
52 More on the local currency facility in Annex 6.
53 IEG, "The World Bank Group's Experience with the IDA Private Sector Window", July 2021

More broadly, given the huge potential for guarantees to unlock private finance, it is time for the WBG to have an in-depth review of this instrument, including new practices and innovations in the private sector and at other MDBs and DFIs. Such a review should identify the potential overlaps and complementarities between WB, MIGA, and IFC instruments, (e.g., the IFC risk mitigation facility for large infrastructure is a second best to the WB PRGs). It should also feature a frank discussion of the puzzling lack of use of the existing WB guarantees, including a hard look at the accounting of guarantees against country envelopes and provisioning. Even more importantly, a review of the governance process for the use of guarantees should ensure that their use follows rigorous economic analysis, namely creating positive externalities and/or remedying a government or market failure. Since not all guarantees are created equal, the review should assess the cost/benefit and impact for each, and whether other WB guarantees would have been better suited (see PRG above).

However, scaling up private finance for the SDGs and climate is urgent. Even before the results of a review of WBG guarantees become available, the WB should begin to enforce targets and Key Performance Indicators (KPI) on Private Capital Facilitation (PCF) and on Private Capital Mobilization (PCM) at the Group level. At the unit and staff level, together with training, incentives should be enforced to drastically increase the use of guarantees and the implementation of the Cascade.

2.6. Measure impact. Systematically.

Since what is measured gets done, it was key for IFC to develop a measurement system which could anticipate, ex-ante, the development impact of projects, just as the institution had traditionally measured ex ante a project's financial profitability (which is also an educated guess). Indeed, a loan or equity investment can be financially profitable but economically damaging in terms of welfare, for example if it reinforces a private monopoly extracting a rent on the consumer. Given IFC's ambition and mandate to be catalytic, the ex-ante measurement system had to capture both the impact (direct and indirect) of the project itself, and its impact in terms of market creation or deepening. In fact, in the absence of such a measurement system, a development institution like IFC would be running blind – set up to promote development but capable of aiming only for financial metrics.

This led to the development of the Anticipated Impact Measurement and Monitoring (AIMM) framework which was launched in 2017 and adjusted over time. AIMM inspired the impact frameworks of other development finance institutions,[54] and enabled IFC to develop the Operating Principles for Impact Management, an anti-impact-washing initiative launched in 2019 and now managed by the Global Impact Investor Network (GIIN).

AIMM allows IFC to estimate and score the expected development impact of its interventions at their initial stage, when they are still being crafted. This approach gives IFC the capacity to select projects for their development as well as financial profile, and to optimize project design. Impact is assessed against the country and sector context along both the project and market dimensions (based on two dozen sectoral 'market typologies'). Throughout project implementation, performance is updated against the ex-ante expectation. Apart from its value

54 Including, among others, the impact framework of the JP Morgan Development Finance Institution.

in project decision-making, AIMM scores are part of the IFC management scorecard and provide metrics to manage the balance between development and financial returns, both for new commitments and with respect to the portfolio during implementation (so-called strategic portfolio approach). They also serve to manage performance at different levels of the institution, down to individual staff. All in all, AIMM appears to have driven a sharp improvement in IFC's development results ratings as assessed by the WBG Independent Evaluation Group (IEG).[55]

Given its sensitivity to the size of the challenge that a project is meant to address, ex-ante AIMM scores have in practice been considerably higher for projects in low-income countries and those supported by blended finance funds. In that sense, project selection appears to be in line with strategic objectives. On the other hand, market impact (i.e., market creation) scores remain far short of IFC Board guidance and have been declining further in the last couple of years. In part, this may reflect crisis-finance following the pandemic; but it may also be a measure of IFC 3.0 implementation shortfalls, in terms of cross-WBG collaboration on creating markets.

55 Even though IEG reviews reflect on new projects only with a lag of several years, satisfactory and better ratings were given to 52 percent of investment projects for the period 2019-21, compared with the low point of 41 percent for the period 2016-18. For ratings of advisory services, which operate on shorter cycles, the improvement was even sharper, from 38 percent in 2015-17 to 62 percent in 2019-21. See IEG (2022), *Results and Performance of the World Bank Group 2022*, https://ieg.worldbankgroup.org/evaluations/results-and-performance-world-bank-group-2022

Conclusion. “The way forward: Complete the job!”

The gap between the billions available for investment in EMDEs and the trillions needed can be at least partially closed. The effort to do so should begin in earnest and urgently as all the necessary changes have been identified, there are real life experiments to learn from and adjust, and the existing instruments are good enough to shift to a higher gear. In addition to redoubled efforts by EMDEs to implement reforms to foster a competitive private sector and develop their financial markets, this means changing the traditional MDB and DFI operating system and to use their capital far more efficiently. This, in turn, entails a drastic change in the mindset and skillset of these institutions. But with less than seven years to go until 2030 and eight years after the billions to trillions initiative, if not now, when? And if not the WBG, who?

As the leading multilateral development institution, with the ability to offer public and private solutions and an unparalleled level of knowledge, the World Bank Group should take the lead on the billions to trillions challenge. IFC 3.0 has been a multiyear experiment which should be exploited to see what worked, what didn’t, and why. In the authors’ opinion, all the conceptual building blocks are there as well as new approaches and instruments. *But as was made clear at the outset, and as experience has confirmed, the strategic shift of IFC 3.0 can only work if the entire World Bank Group adjusts and works in synergy rather than in sometimes competing silos.* As can be seen in the “proof of concept” examples in Part 2, most of IFC’s innovative and transformational projects involved cooperation with the WB one way or another. Not surprisingly, the WBG Board of Executive Directors warmly welcomes such operations where each part of the group leverages the others for maximum impact.

However, despite progress made, much remains to be done to move such a strategy from exceptions to the rule. The key reforms needed to promote the shift towards a more proactive business model across the WBG aimed at crowding-in private finance, can be summarized as follows: [56]

For the World Bank (IBRD & IDA):

1/ Draw more on the IFC “IF/THEN” matrices to foster private sector development in their policy discussions with EMDEs countries and in their budget support operations.

2/ Systematically implement the Cascade and change the incentives of WB staff accordingly (developing alternatives to public-debt-creating lending volume targets). For loans financing income generating public investments, request mandatory Cascade discussions at project concept note reviews and explicitly justify in board documents why a private solution is not possible.

3/ Design “build and flip” public investment projects to maximize the use of IBRD & IDA capital by proactively crowding-in private finance after the construction period,

56 These recommendations are apart from the broader recommendations made in other fora, e.g., on efficiently utilizing WB capital and optimizing its balance sheet. See G20 (2022), *Boosting MDBs’ investing capacity: An independent review of Multilateral Development Banks’ capital adequacy frameworks.*

especially in income generating infrastructure and other sectors such as agriculture, housing etc.

4/ Promote, measure and set targets for a more proactive use of WB guarantees, especially Partial Risk guarantees for private investments.

5/ Establish annual targets and KPIs for Private Capital Facilitation (PCF).

On the IFC side:

1/ Within the "upstream pipeline", target KPIs on the number of operations designed by IFC, feasibility studies generated, and actual competitive bids (a la scaling solar) to potential investors for projects designed and/or generated by IFC.

2/ Review the impact of the IDA PSW and adjust accordingly both product design and relative amounts.

3/For MSME financing: review the definitions and implementation of ESG standards towards a more tailored and dynamic approach.

As a "group", the WBG should:

1/ Replace the current "WBG country partnership framework" with a more operational business plan including the IFC detailed country strategies and their "IF/THEN matrix". Alternatively, as an intermediary step, present IFC strategies separately to the board.

2/ Evaluate the experiment of the J-CAP with a view to expanding and scaling it up.

3/ Establish a group-wide joint KPI on Private Capital Mobilization (PCM).

4/ Review each and all the WBG (IBRD, IDA, IFC and MIGA) guarantees to ensure complementarity and a much more proactive deployment.

Together, the WBG and the IMF should:

1/ Include systematically the clearance of governments' domestic arrears to MSMEs as part of budget support operations.

2/ Work proactively with the regulators of private financial institutions to ensure that the existing regulations do not unnecessarily hinder private finance to EMDEs (Basel 3, Solvency 2, etc.).

Beyond the Bretton Woods institutions, the above agenda should go hand in hand with a redoubled partnership effort with other bilateral and multilateral DFIs and MDBs to agree on common "rules of the game", definitions and approaches (e.g., Cascade), and standards (e.g., how to use blended finance to avoid a race to the bottom) to crowd-in private investments.

In addition to their oversight role in the implementation of the above, the WBG shareholders should also play a key role to:

1/ Insist that all DFIs and MDBs in which they are shareholders abide by the same "rules of the game", approaches such as the Cascade, use of blended finance, etc.

2/ Resist pressure from CSOs, and support adjusting ESG standards for MSMEs.

All in all, it is possible to make a dent in the "billions to trillions" vision through crowding-in more private investments in EMDEs. But it is also true that "vision without implementation is illusion", and that the current development finance eco-system is not delivering private investment and finance in EMDEs at the necessary scale. It is time for the WBG to lead the way by decisively transforming its operating system. Call it WBG 3.0.

Appendix

A.1: When does private sector development reduce poverty?

It is now widely known that an efficient private sector is required to ensure job creation and poverty reduction (UNDP, 2004; Raworth et al., 2006; IFC, 2013). Indeed, not only does the private sector directly contribute to poverty reduction by providing direct income to workers, but it can also generate positive externalities (research and technology, provision of infrastructure…) and generate revenues to public institutions (through taxation) that will allow financing of public goods and public support to the poorest households. Yet, most of the empirical literature on the impact of the private sector on economic growth and/or poverty reduction consists of country-case studies (rather than cross-country comparisons). For instance, Jaax (2020) concludes that the development of private employment had a positive impact on poverty reduction at the provincial level in Vietnam between 2000 and 2009. Similarly, Suryadarma and Suryahadi (2007) find a positive impact of private spending on poverty reduction in Indonesia between 1984 and 2002. They also conclude that this poverty reduction effect is of similar size to public spending, advocating for a combination of both sectors. Belloumi (2014) finds a positive impact of private domestic investment on economic growth in Tunisia. In India, there is evidence that the liberalization reforms of 1991 induced economic growth and contributed to poverty reduction (Drèze and Sen, 2013).

The main questions that have been asked in this strand of the literature for developing countries are related to the types of private sector that one should want to promote (sector, size of firms…). A detailed IFC Report (IFC, 2013) underlines the importance of the debates between those promoting the development of micro- and small-firms and the advocates of medium firms. However, there does not seem to be any strong evidence that one category of firms contributes more to poverty reduction than the other. IFC (2013) argues that both are equally important and complementary, rather than substitutable. Based on a sample of 76 countries, Beck et al. (2003) find that SMEs contribute to economic growth, but the authors do not find evidence that growth driven by SME development contributes more to poverty reduction than overall economic growth.

Regarding the type of sectors that are the most likely to promote economic growth, it has been argued that one of the key reasons why we have observed "jobless growth" in Africa in the last decades was that much of the workforce was in the subsistence sector while growth was driven by rapid productivity gains in very specialized capital-intensive sectors (AFDB, 2018). Therefore, it is frequent to focus on the development of agribusiness or light-manufacturing industries.

A.2: Description of financial needs estimates for developing countries

Authors	Objective	Countries	Incremental needs (per year)
Bhattacharya et al. (2022) and World Bank (2023)	Achieve development and climate goals. Four sectors investigated: - Human Capital - Sustainable infrastructure - Adaptation and resilience - Restoration of natural capital through sustainable agriculture, food and land use practices, and biodiversity	EMDEs except China	Total needs: By 2025: $3.7 trillion (T) By 2030: $5.9 T Based on total financing of 2019 estimated at $2.4T we get the additional amount required: By 2025: $1.3 T By 2030: $3.5 T
Gaspar et al. (2019)	Achieve the SDGs in five areas: - Education - Health - Roads - Electricity - Water and sanitation	LICs; Emerging market economies (EMEs); Advanced economies (separately)	Additional spending needs by 2030: Total: - $0.5T for LICs - $2.1T for EMEs Only "Roads" + "Electricity" + "W&S": - $0.25T for LICs - $1T for EMEs
Schmidt-Traub (2015)	Financing the SDGs	Low and Lower-Middle Income Countries	By 2030: - LIC: $343~360B - LMIC: $900-944B Half can be financed by the private sector (the other half by a combination of ODA and domestic public spending)
Rozenberg and Fay (2019)	Investment in infrastructure required to achieve SDGs while staying on track to limit CC to 2°C	Low and Middle-Income Countries	By 2030: ranging from $640B to $2.7T 70~80% of these infrastructure needs for "transport" and "power generation" only
UNCTAD (2017) and World Bank (2019)	Achieved the SDGs Includes basic infrastructure, food security, climate change mitigation & adaptation, health, and education	All developing countries	Total needs: From $3.3T to $4.5T Based on an annual level of financing of $1.4T in 2018-2019, this leaves us with a gap of: $1.9 to 3.1 T 70% can be financed by the private sector
AFDB (2018)	Infrastructure	African countries	Total needs: BY 2025: Ranging from $130-170 B Based on current annual estimates of $62B, this leaves us with an annual gap of: $68-108 B

Source: IHLEG (2022)

A.3: Aggregate Net Financial Flows (2011-2020)

Aggregate Net Financial Flows to Low- and Middle-income Countries, 2011–20
US$ (billion)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Net financial flows, debt and equity	1,325	1,224	1,458	1,136	208	721	1,290	1,108	954	909
Percent of GNI (%)	6	5	6	4	1	3	5	4	3	3
Net debt inflows	717	588	815	540	−316	208	755	575	400	435
Long-term	405	469	448	395	172	243	433	352	372	419
Official creditors	39	34	31	48	49	62	56	81	64	129
Private creditors	366	434	417	347	122	181	377	271	308	291
Bonds	151	226	173	175	75	120	289	204	255	280
Banks and other private	215	209	244	172	48	61	88	68	53	11
Short-term	312	119	367	145	−487	−34	322	222	28	16
Net equity flows	608	636	643	597	524	513	535	534	554	473
Net foreign direct investment inflows	604	539	573	513	502	468	468	497	506	435
Net portfolio equity inflows	4	97	70	84	21	45	67	37	48	39
Net grant flows	99	91	108	115	101	111	117	121	117	125
Memorandum items:										
Net long-term private flows (debt and equity)	970	973	990	860	625	649	845	768	814	725
Net long-term public flows (debt and grants)	138	126	139	163	150	173	173	203	181	254
Workers' remittances	337	363	384	415	417	408	444	482	502	500

Sources: World Bank Debtor Reporting System, International Monetary Fund, Bank for International Settlements, and own calculations.

A.4: Lack of Bankable Projects in Developing Countries

The lack of bankable projects is often identified as one the key reasons for the lack of investment in developing economies, a crucial issue that must be dealt with to encourage private investment (AFDB, 2018; EBRD, 2022; IFC, 2022; Sharm-El-Sheikh Guidebook, 2022).

According to the Sharm-El-Sheikh Guidebook for Just financing (2022): "Private investors and development finance institutions cite a lack of bankable projects as one of the most significant challenges in LICs and MICs". This remark particularly holds for African countries (AFDB, 2018; EBRD, 2022; IFC, 2022), to the point that Lakmeeharan et al. (2020) call "Africa's infrastructure paradox" the fact that (i) funding are available for investment, (ii) there is a large need for spending in Africa, and yet (iii) most projects fail to be financed. Indeed, according to the authors, 80% of infrastructure projects in Africa are abandoned at the feasibility and business-plan stage, and another 10% fail between this step and financial close (hence only 10% of infrastructure projects succeed in reaching financial close).

Different explanations have been put forward to explain this lack of bankable opportunities:

- Lack of physical infrastructure and of human capital which tend to reduce the profitability of investments and impair the execution of large projects.
- Lack of project and financial structuring capabilities, which makes it hard to convert project opportunities into financeable propositions, and which increases transaction costs.
- High perceived project risk, even when the actual true risk is not that high.

To solve these issues and increase investment, most reports recommend the following:

- Providing technical assistance (market assessment, feasibility studies, financial modeling, corporate governance, etc.) to local private companies with high potential to reduce costs and encourage investment. An example is the "Local Champions Initiative" launched in 2018 by the IFC and implemented in Burkina Faso, Guinea, Niger, and Togo (IFC, 2022).
- Filling information gaps between investors and local entrepreneurs, as well as conducting independent screening to mitigate adverse selection (for foreign investors) and providing legal templates (for domestic entrepreneurs).
- Implementing risk mitigation measures to attract private sector financing (through additional credit enhancement, government default guarantees, credit guarantees, etc.).
- Creating platforms and encouraging pooled sources of financing to reduce the risk supported by foreign private investors. An example is the "Climate Investment Mobilization Framework", an international multi-stakeholder platform proposed at the Sharm-El-Sheikh 2022 conference and aimed at allocating finance to projects through blended finance vehicles.

A.5: Types of World Bank Group Guarantees

Institution	IBRD/IDA			MIGA		IFC	
Categories	Project-Based Guarantee: Loan Guarantee	Project-Based Guarantee: Payment Guarantee	Policy-Based Guarantee	Political Risk Insurance	Credit Enhancement	Credit Guarantee	Risk Sharing Facility
Covers	Default of public debt service payment	Default of non-loan-related government payment obligations	Default of public debt service payment	Political risks (currency inconvertibility & transfer restrictions; expropriation; war & civil disturbance; breach of contract)	Non-honoring of sovereign financial obligations by government, state-owned enterprises or public authorities	All credit risks	All credit risks
Granted to	Private or public entity	Private or foreign public entity	Commercial lenders	Foreign private or foreign public entity	Foreign private or foreign public entity	Private entity	Private entity
Type of eligible investment	Debt or payment obligation (domestic or foreign)	Debt or payment obligation (domestic or foreign)	Debt or payment obligation (domestic or foreign)	Equity, debt, and any form of investment (foreign only)	Equity, debt, and any form of investment (foreign only)	Debt (domestic or foreign)	Debt (domestic or foreign)
Context and objectives	Context of specific investment projects where governments wish to attract private financing (equity and/or debt)	Context of specific investment projects where governments wish to attract private financing (equity and/or debt)	Proceeds of the financing are applied to budgetary support in the context of development policy operations	Encourage foreign private direct investment to developing countries	Encourage foreign private direct investment to developing countries	Trade finance and corporate finance transactions, including support for SMEs	For financial institutions that wish to lend to certain sectors that IFC believes to be highly developmental

Source: World Bank Group Guarantee Products. Guidance Note (April 2016)

A.6: The IDA Private Sector Window Local Currency Facility (LCF)

The Local Currency Facility (LCF) provides long-term local currency to IFC investments in IDA countries where capital markets are not developed, and market solutions are not sufficiently available. The LCF allows IFC to provide financing in local currency for high impact projects in IDA and Fragile Conflict Affected Situations (FCS) countries where local currency solutions are underdeveloped or completely missing. This facility targets clients who operate in markets in which currency hedging options are absent or very limited.

The facility is designed to enable IFC to offer local currency loans, while fostering complementarity with existing solutions, such as domestic banks, The Currency Exchange (TCX), central banks, etc. IFC follows a "solutions hierarchy" when attempting to source local currency for IDA PSW-supported projects. It first seeks to provide the needed currency through existing market solutions, other non-market providers such as TCX, and through existing or new IFC liquidity operations in IDA PSW-eligible countries before resorting to options provided by the LCF.

This facility is backed by IDA resources set aside to backstop the LCF so that IFC can provide various operations in local currency. The facility acts as a risk transfer vehicle for IFC operations in IDA PSW-eligible countries only up to the designated allocation of IDA PSW's resources, indicated as US$400 million in IDA18. While IFC continues to hold the credit risk of the underlying loans and investments, the main operations of the LCF covers the following risks:

- Counterparty credit risk. LCF resources absorb the counterparty credit losses of IFC's hedging counterparty if its credit quality does not meet IFC's standard counterparty criteria or if they are non-traditional counterparties.
- Market and credit risk associated with managing short-term liquidity in local currency instruments. The client covers the expected negative changes in value while the IDA PSW covers unexpected changes in the value of the local investments into which the proceeds of its bond issuance were temporarily invested until disbursement.
- Transfer/convertibility risk. When using local counterparties, IFC can offer a deliverable swap but hedge the market risk with an undeliverable swap obtained offshore; the LCF resources cover the inability to convert/transfer the currency without a loss when the underlying hedged loan matures.
- Open currency/interest rate risk. If market-based solutions are not available, IFC hedges its currency and interest rate risk with the LCF, and the latter covers any losses (or receives the gains) related to changes in market rates over the term of the hedged investment.

The LCF is actively managed by IFC on a portfolio basis to facilitate diversification of risks borne by the LCF resources, which may include employing strategies to hedge open risks. Should IFC suffer actual, realized losses on local currency investments undertaken with the LCF, IFC submits a payout request to IDA for reimbursement of the amount of the loss.

The LCF operates on the principle of minimum concessionally and is consistent with the facility's capital framework, whether IDA acts as a direct counterparty with IFC or another entity that can better play the role.

Sources: IFC and IDA

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www.ferdi.fr

contact@ferdi.fr

+33 (0)4 43 97 64 60