Building Opportunities for Growth in a Challenging World

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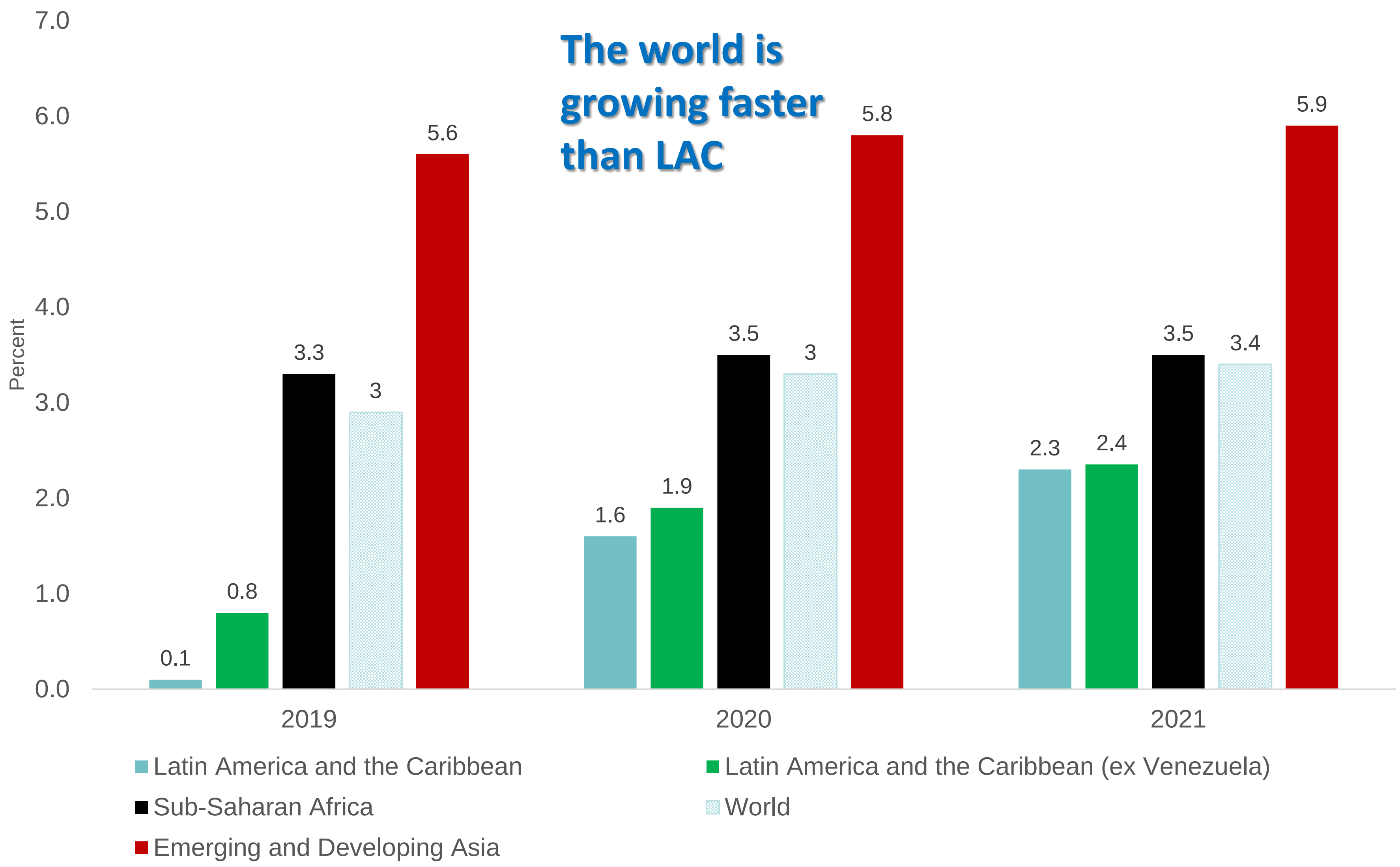
Latin America and the Caribbean: continuing to lose share in world GDP

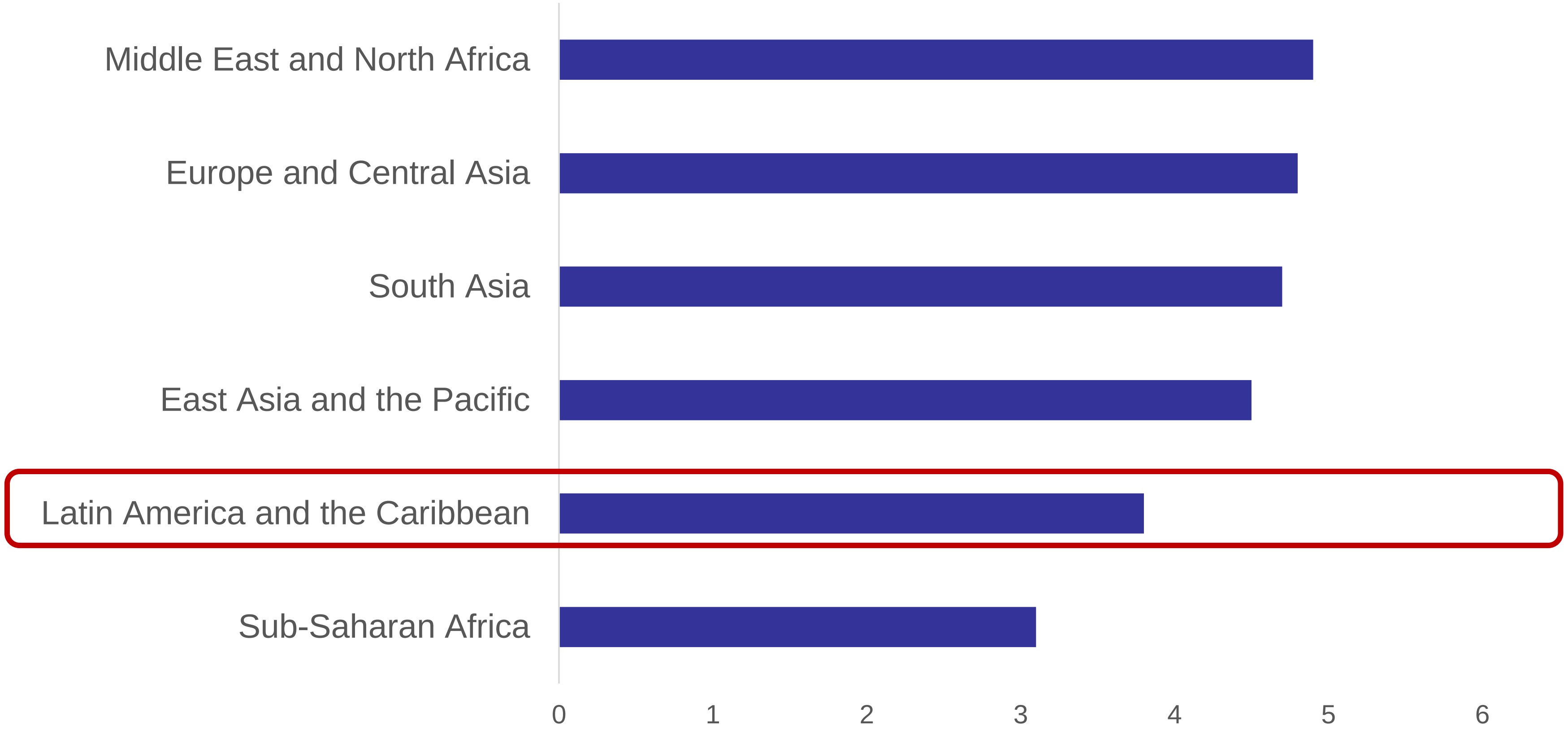


Source: IDB staff calculations based on IMF World Economic Outlook, October 2019

Plan of the presentation

- **Infrastructure as an engine of growth**
- The financing of infrastructure
- Conclusions

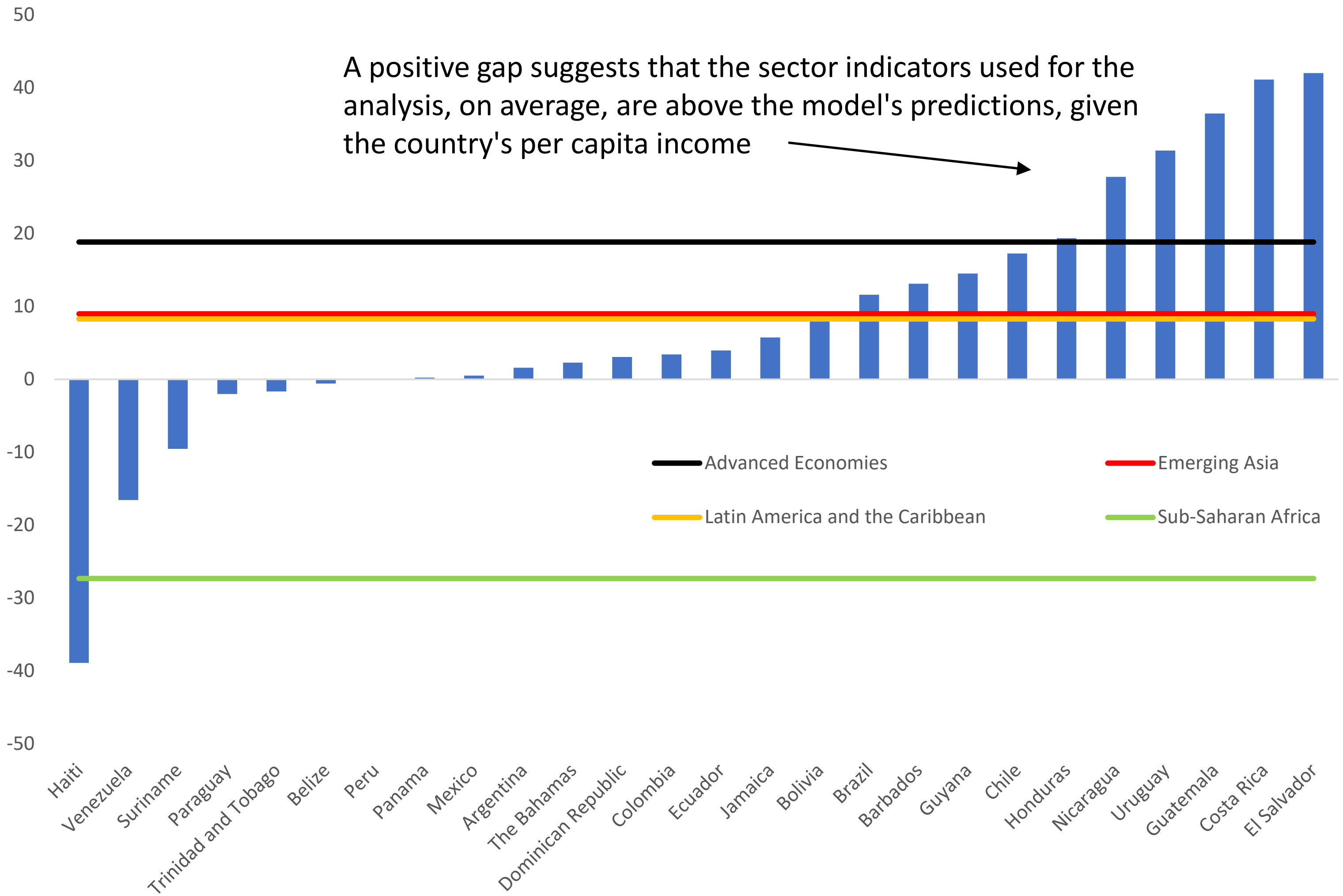
Infrastructure gaps are significant in Latin America and the Caribbean



Latin America and the Caribbean scores poorly in the World Economic Forum's surveys on infrastructure quality

Source: IDB staff estimates based on World Economic Forum's Global Competitiveness Report dataset. See also Castellani et al. (2018).

Heterogenous gaps within the region: i.e., Energy

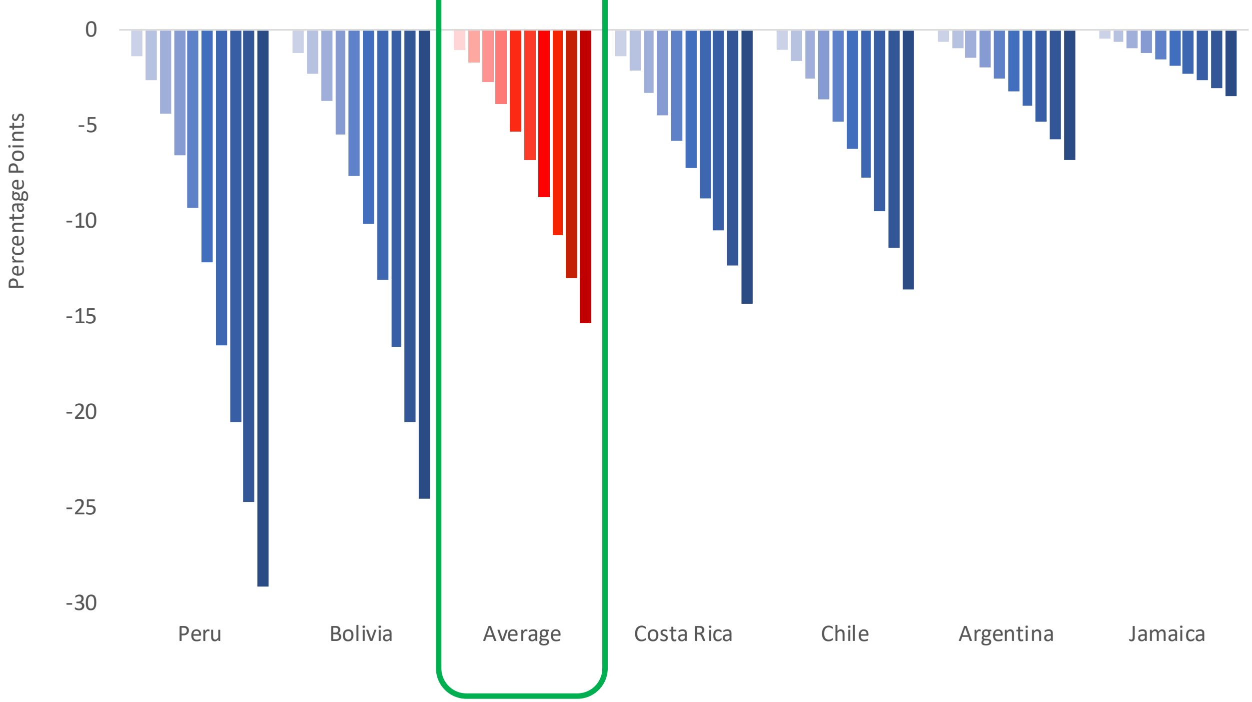


In the case of the energy sector, Latin America and the Caribbean are located near emerging Asia and, in fact, slightly above the expected values

Source: IDB staff calculations

Not investing more in infrastructure has large costs in terms of forgone GDP growth…

Estimated impact of disinvestment in infrastructure sectors on GDP (from t to t+10)



Source: IDB staff calculations

- **Not investing more in infrastructure can cost 1pp of forgone growth in the first year**
- **The cost rises to 15pp ($900 bn) in forgone growth if the gap persists for 10 years**

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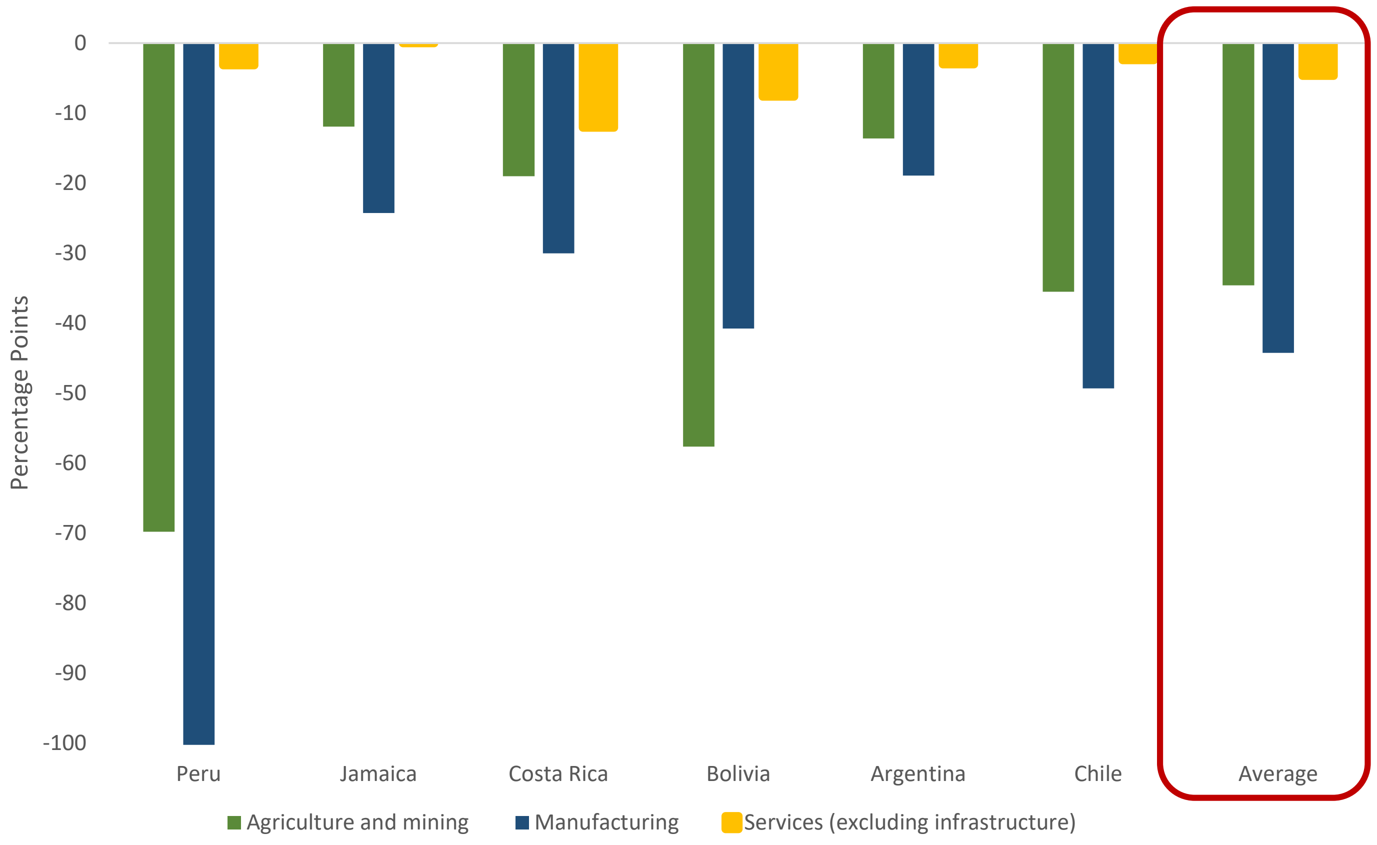
…and affects the high productivity manufacturing sector more…

Estimated impact of disinvestment in infrastructure sectors on sector-level GDP (cumulative 10 year effect)



Source: IDB staff calculations

Notes: Units in the figure are the cumulative differences in percentage points of sector-level GDP growth between the benchmark and the counterfactual scenarios in year t+10

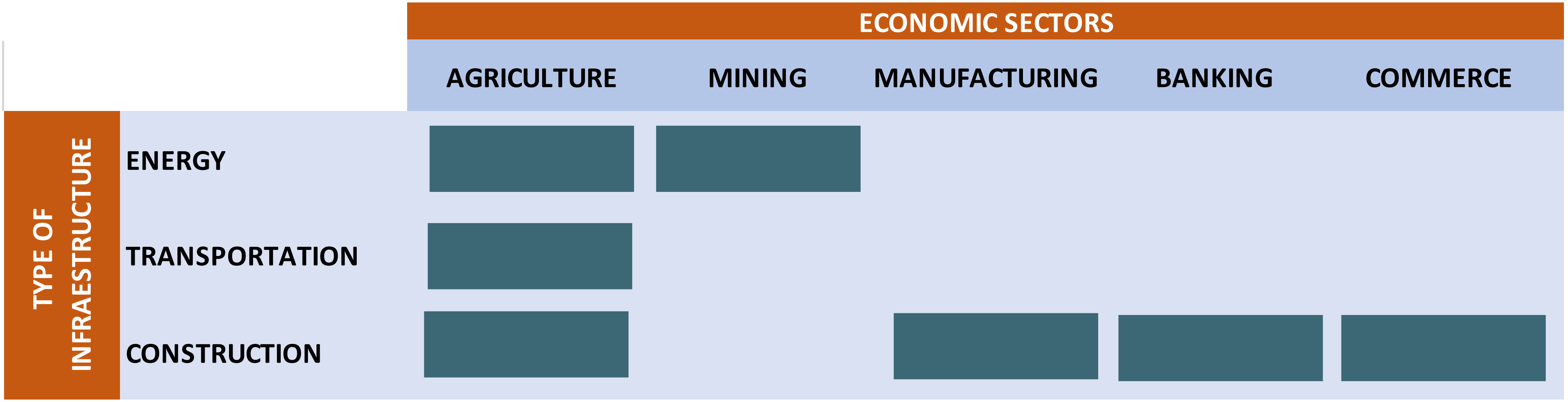
…and it is regressive

Estimated impact of disinvestment in infrastructure sectors on real incomes (cumulative 10 year effect)

Source: IDB staff calculations

What type of infrastructure is the most appropriate?

Long-run Impact of Labor Productivity Increases in Infrastructure Sectors
on Labor Productivity of Economic Sectors



Source: IDB staff calculations based on Ahumada and Navajas (2019).

If LAC countries increased labor productivity growth in these infrastructure sectors to those of OECD countries, then the economy-wide productivity growth could increase by 75 percent with respect to the historical average. This implies that the region's income per capita could double in half the time

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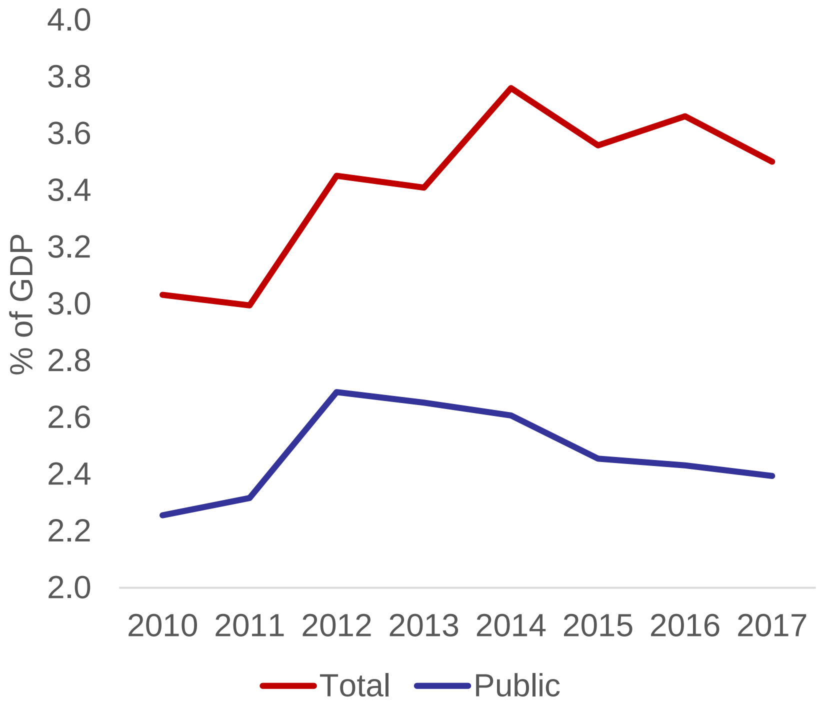
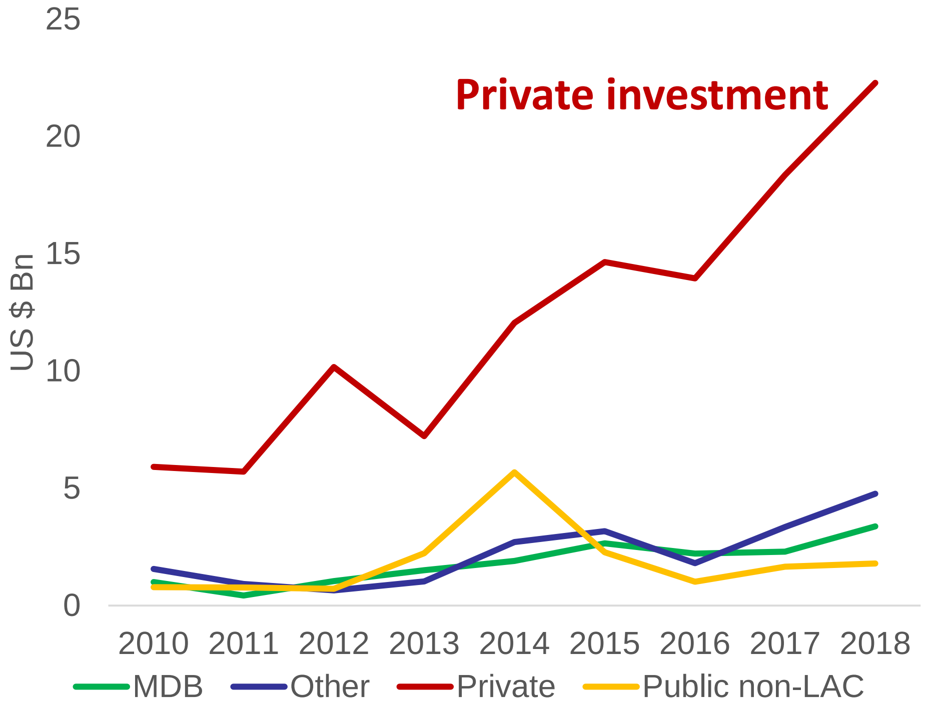
The region has low investment in infrastructure but "private" Investment is growing

Average infrastructure investment is low



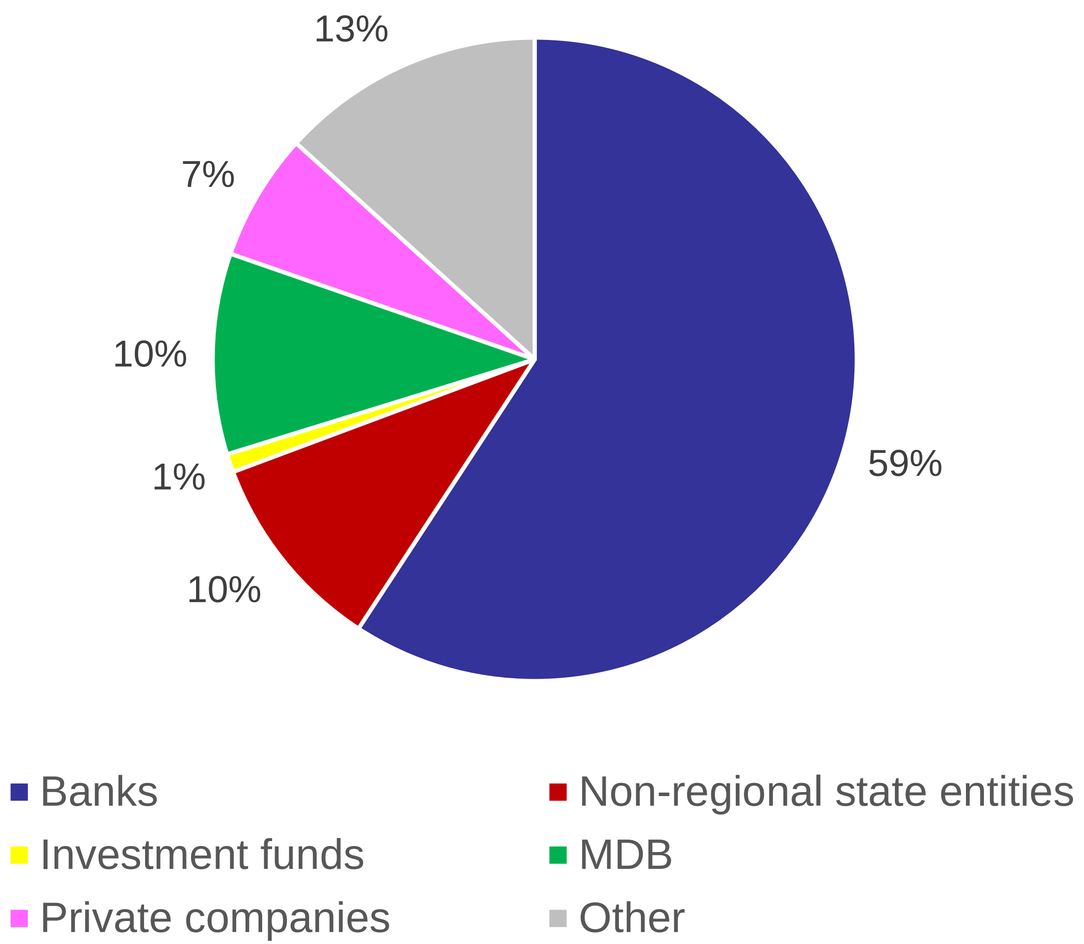
Private investment includes banks, companies and funds.



Source: IDB staff calculations based on data from IJ Global.

Note: In the left graph, Public is sourced from InfraLatam dataset and focuses on budgeted public investment. The total includes private investment, investment from state entities from within and beyond the region and non sovereign MDB lending.

Most non-public financing comes from commercial banks



Two thirds of this investment is in eight countries: Argentina, Brazil, Mexico, Chile, Argentina, Peru, Colombia, Uruguay and Panama

Source: IDB staff calculations based on data from IJ Global.

Closing infrastructure gaps between countries

- A bottleneck is the identification and development of projects
- Given the fiscal restrictions, a second bottleneck may be the availability of financing
- To attract private financing
  - Projects must be viable (adequate funding)
  - An adequate institutional framework is needed
  - Risks must be understood and managed correctly
- The importance of commercial banks is notable, possibly because of their project-finance skills, including the ability to monitor
- But commercial banks say that long-term loans are increasingly difficult due to regulatory pressure (incl. Basel III capital and liquidity ratios). It would be important to attract more financing from institutional investors

Typology of Risks in Infrastructure Projects

Exogenous

i.e. rain pattern affecting a hydro project

Diversify risks across investors

Insure with market instruments if available; government and/or MDB enhancements may help create such markets or instruments if missing

i.e. exchange rate devaluation

Idiosyncratic

Systemic

i.e. delays due to bad contractors

Control through governance contractual structures; design of any guarantees should take into account potential moral hazard

Most challenging; MDB enhancements may be most approriate, especially if the source is government support

i.e. contract renegotiations

Endogenous

A possible solution

- A country-level fund with an associated facility to:
    - Provide knowledge (project identification and development)
    - Issue infrastructure bonds to provide more financing
    - To manage the risk of individual projects through special purpose vehicles (SPVs)
- This type of instrument can favor a greater participation of institutional investors

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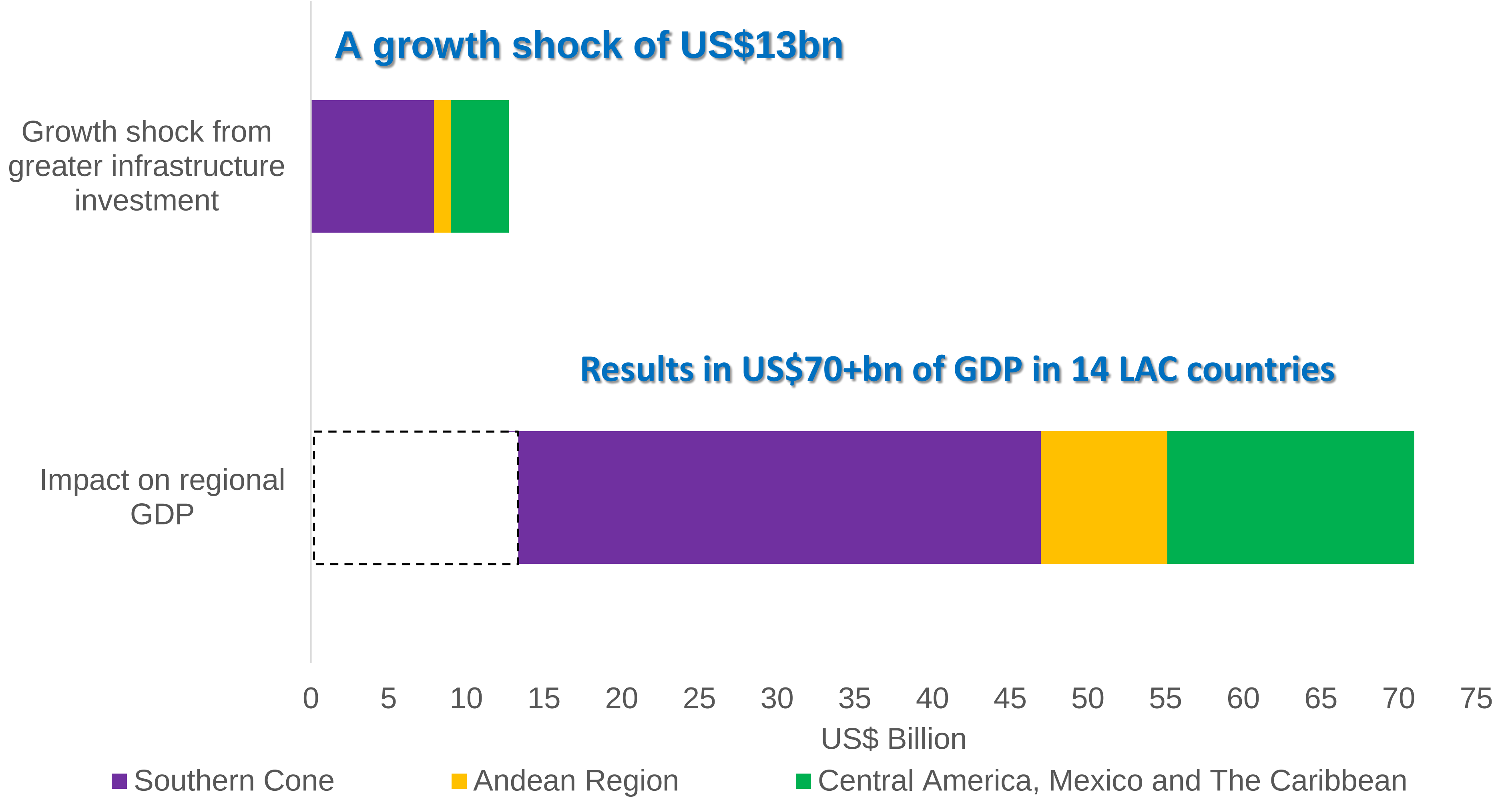
Conclusions

- Given current projections, Latin America and the Caribbean will experience relatively modest growth in the coming years
- Even those modest growth rates are subject to external risks
- Internal policy challenges include continuing fiscal adjustments while protecting public investment.
- Better and greater investment in infrastructure could significantly increase productivity and growth in the region
- Private investment is growing but there is a need to attract more investors to close the identified infrastructure gaps

A relatively small boost in infrastructure spending in each of five large economies could have significant regional growth impacts



Source: IDB staff calculations employing a statistical G-VAR model incorporating a 0.3% of GDP growth shock in five large LAC economies.

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