EXECUTIVE SUMMARY

Accelerating private capital flows to emerging market and developing economies (EMDEs) is the only way to finance the 2030 Sustainable Development Goals (SDGs) and international climate commitments. This paper discusses how, by investing and exiting through *public* markets, official sector actors can attract large-scale institutional co-investors, accelerate capital velocity, generate demonstration effects, and have systemic impact by triggering domestic capital market development. Public market mobilisation has the potential to catalyse far greater capital flows than is typically possible through traditional private market development finance.

A step-change in private investment for sustainable development in EMDEs is needed. Post-COVID-19, the SDG financing gap increased to over US $4trn while private finance flows to developing countries are declining. Portfolio flows to many EMDEs have been declining since the financial crisis in 2008, and private capital mobilised to these markets through co-investment by official institutions has broadly flatlined since 2018.[1]

In response, the international community has called for reforms to increase multilateral development banks' (MDBs) investment capacity and their mobilisation of private finance. The G20's landmark review of MDB Capital Adequacy Frameworks, the G7's Partnership for Global Infrastructure and Investment, and the 2023 Summit for a New Global Financing Pact all call for optimisation of MDB balance sheets and catalytic investment to mobilise private capital into EMDEs, including by transferring MDB risk and assets to private investors. In doing so, official development finance actors can lay the foundations to transition more fully from a buy-and-hold business model toward an originate-to-distribute or originate-to-share business model.

Reigniting public market flows must form part of this reform agenda due in part to their unique scale and liquidity:

- Stock exchanges and public debt capital markets jointly intermediate 100 times the combined balance sheets of the MDBs, offering deep pools of capital to be co-invested with development finance actors.[2]
- With average equity holding periods less than half those in private markets, public market investments and exits could greatly accelerate capital velocity and facilitate gradual exits, protecting MDB value and impact.
- Public market structured products can facilitate exits or risk transfer from what otherwise may appear to be subscale or illiquid MDB assets, including through securitisation of bilateral loans and equity and debt sales to listed investment companies or public platform companies.

Public markets are also a natural platform for development finance actors to generate much sought-after 'demonstration effects'. Throughout each day, large volumes of highly standardised data and disclosures across asset classes and regions are made freely available by stock exchanges and public debt markets. This information is pored over by industries of analysts and asset managers to inform investment decisions. Therefore, development finance transactions in listed markets can create perpetual public information streams relating to risks and returns in EMDEs, helping to correct investor misperceptions and information asymmetries.
In doing so, such 'demonstration transactions' can trigger follow-on commercial investments in EMDEs that need not tie up *any* official sector capital. Such transparency contrasts with the decade-long debate over the disclosure of MDBs' private risk data through the Global Emerging Markets Risk Database.

1 https://www.oecd.org/dac/2023-private-finance-odfi.pdf

2 https://thegiin.org/research/publication/impact-investing-market-size-2022/; https://www.rockefellerfoundation.org/report/reimagining-the-role-of-multilateral-development-banks/; https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review

Most importantly, public market mobilisation has the potential to trigger a positive cycle of domestic market development in EMDEs. Deepening capital markets is essential for macroeconomic stability and enables EMDEs' self-financing of sustainable economic development. Official sector actors can accelerate the flow of assets in domestic EMDE capital markets by exiting their holdings or transferring risk. They can also enhance liquidity and valuations in these markets through co-investment and generate market information through demonstration. Deeper pipeline, accelerated velocity, and enhanced transparency can attract international investors, further improving liquidity and valuations. When complemented with technical support to connect domestic, regional, and international capital markets more effectively, official sector actors could generate truly systemic and enduring impact through public market transactions.

Effective domestic and international policy and regulation are required to manage the risks associated with public markets while capitalising on the opportunity to close the SDG and sustainable infrastructure financing gap. Several of these risks are driven by the same factors underpinning the unique advantages of public markets, including their scale and liquidity. While inward investment creates a positive macroeconomic cycle, market liquidity means that investors can also create a negative macroeconomic cycle should they choose to exit en masse, especially if this is triggered by external factors. Risks of sudden stops and reversals are particularly acute in those EMDEs that lack sufficient market regulation, macroeconomic policy buffers, and domestic market depth, underscoring the importance of prudent policy and regulation and efforts to deepen domestic markets.

The envisaged approach to private capital mobilisation in public markets through distribution, demonstration, and domestic market development has strategic implications for the role of official sector investors. As recommended by the G20 review of MDB Capital Adequacy Frameworks, official development banks and institutions are considering a shift in their business model from 'originate-to-hold' to 'originate-to-distribute' or 'originate-to-share'.[3,4] In addition, we encourage consideration of a complementary approach, namely 'originate-to-demonstrate' by sourcing, selecting, and supporting pioneering public market transactions that increase the flow of both capital and *information* for market participants. These may be among the most catalytic investments available to official sector actors, offering scale, capital velocity, and potential to trigger follower transactions and a positive cycle of domestic market development.

3 https://cdn.odi.org/media/documents/ODI_Working_paper_An_exploration_of_bilateral_development_finance_institutions_x0AEs0S.pdf

4 https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/news/news/CAF-Review-Report.pdf