



# Primer on Development Finance in Latin America and the Caribbean

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## Introduction

Sustainable development and the achievement of the Sustainable Development Goals (SDGs) require securing adequate and reliable flows of external finance.<sup>1</sup> According to the OECD, the SDG financing gap<sup>2</sup> amounts to between US\$5 -7 trillion per year, and the total amount of debt is now over 320% of global GDP.<sup>i</sup> These numbers translate into a funding challenge for low- and middle-income countries that remain off-target from the SDGs. The International Monetary Fund (IMF) estimates that meeting these development objectives would entail additional annual spending of up to 15% of their GDP.<sup>ii</sup>

At a regional level, it is worth noting that 28 out of the 33 countries in Latin America and the Caribbean are classified as middle-income, based on per capita income levels.<sup>iii</sup> This classification, however, must be contextualized given the region's high levels of inequality that have increased over the last years,<sup>3</sup> proving some indicators are not necessarily a straightforward reflection of the level of economic empowerment of the entire population.

Furthermore, the economic effects of the COVID-19 pandemic, shaped by crisis-response policies and changes in consumer behaviour, resulted in a 3% shrinking of the global economy after only the first year -2020- and global poverty increasing for the first time in a generation.<sup>iv</sup> Latin America and the Caribbean faced a 7% economic contraction in 2020, with some Caribbean countries reflecting an estimated economic decline of up to 15%, due to their tourism-based economies.<sup>v</sup> The challenge is vast. Real recovery will only be possible with an effective mobilization of domestic and international resources from public and private sources.

This primer will offer parliamentarians and other interested parties a brief overview of development finance, its implications for the capital flows and debt levels of a country, and innovative ways to achieve sustainable development. It also covers the effects of governments'

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<sup>1</sup> External finance is any source of funding that is not government revenue.

<sup>2</sup> An estimation of the investment needed to meet the development objectives for education, health, roads, electricity, water and sanitation, among others, calculated by the Sustainable Development Solutions Network.

<sup>3</sup> The region showed a Gini coefficient of above 46 pts from 2012 to 2018.

efficiently mobilizing resources without negatively affecting the macro-stability of a country's economic and social development trajectory.

### *The role of parliaments in development finance*

The different roles parliaments take on to promote sustainable development fall within a broad range of functions designed to provide checks and balances on policies with the objective of stimulating macroeconomic stability while encouraging initiatives that will provide a better quality of life to its citizens now and in the future. In that sense, the following emerge as the most relevant roles:

- **Legislation.** Legislative action for sustainable economic and social development through the design, analysis, and approval of pertinent regulatory frameworks and development strategies.
- **Budgeting.** Analysis, approval, and monitoring of the national budget, which should align with the 2030 Agenda, its SDGs, and other international best practices.<sup>a</sup>
- **Debt Management.** Ratification of financial commitments with a thorough analysis of the impact on development and national debt levels. Parliaments should also play a pivotal role in the construction and implementation of strong frameworks for all generators of public debt, especially state-owned enterprises.<sup>b</sup>
- **International Negotiations.** Parliamentarians participate in international fora<sup>c</sup> where global best practices are debated and agreed upon, with the goal of more sustainable and inclusive futures for all.
- **Oversight.** Parliaments should aim to guarantee that all funds collected are invested efficiently and with a view to sustainability. In order to achieve this, open channels of communication among parliament, the executive branch, and other stakeholders should be prioritized to ensure that development strategies are being implemented in an efficient manner, tackling the needs of all, but especially, of those living in more vulnerable conditions.

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a. Inter-Parliamentary Union. 2021. "[Guidelines for parliamentarians on budgeting for the SDGs: making the most of public resources](#)"

b. Geoff. Dubrow. Westminster Foundation for Democracy (WFD). 2020. "[The role of parliament in public debt management](#)"

c. [UN Climate Change Conference](#), [Commission on the Status of Women](#), [Global Forum on Development](#), and others.

## Fiscal Implications of Development

When assessing the fiscal implications of development finance, it becomes apparent that in most low- and middle-income countries<sup>4</sup> almost all progress in social, economic, and productive infrastructure is a result of public sector spending. Given the persistent budget deficits due to structural tax collection<sup>5</sup> and other issues, debt becomes the fastest route to obtaining resources for development projects in most countries in Latin America and the Caribbean.

Public sector debt has no universally accepted definition. In the broader sense, the concept entails the combination of government debt with public non-financial and financial

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<sup>4</sup> You can learn more about this classification at the [World Bank Data Portal](#).

<sup>5</sup> According to ECLAC, the Latin American tax structure is mostly based in added value tax, being the source of tax revenue. To read more about this, visit: <https://bit.ly/3Lh3IAe>.

corporations (including the Central Bank), public guaranteed debt,<sup>6</sup> and external public debt.<sup>vi</sup> Although a certain amount of debt is good, because it allows low-income countries to collect money for development in a more time-saving manner,<sup>7</sup> it is of utmost importance that countries maintain a sustainable level of debt that does not threaten their growth or stability.

According to Dalia Hakura from the IMF, “A country’s public debt is considered sustainable if the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default.”

All borrowing, therefore, needs to be consistent with the country’s fiscal framework while also considering the returns on investments. If a country, through good governance and comprehensive regulatory frameworks, is able to transform public investment into public capital stock (e.g., public schools, public hospitals, roads, etc.), then the projected income of the new infrastructure can offset the cost of debt and help to achieve sustainable development outcomes by means of sustainable debt.

As important as managing debt ratios is for every government, these types of indicators can become barriers to accessing resources and funds at more accessible interest rates.

Many countries in Latin America and the Caribbean, including the Small Island Developing States (SIDS), have an elevated percentage of debt over GDP, as they have faced unique and consistent social, economic, and environmental vulnerabilities over the years. These challenges coupled with disasters as a result of natural hazards, have prompted governments to seek international cooperation and resources, which usually translates into high levels of external debt as the only way to cope with emergencies.

It is also important to note that with a high debt-to-GDP ratio comes greater challenges to restructuring or refinancing debt,<sup>vii</sup> as well as attracting foreign direct investment. Negative credit ratings, for a country, translate into low levels of trust from national, regional, and international financial institutions and investors.

Therefore, it is critical for the sake of the region to analyze the viability of having the international community come to terms with how debt is perceived in low- and middle-income countries. Either the benchmark falls too high and an adjustment needs to be made in terms of how multilateral development institutions and other counterparts perceive debt ratios from the region; or, debt-to-GDP ratios need to be parcelled out, noting those elements of debt that are

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<sup>6</sup> Defined as debt the public sector does not hold but has an obligation to cover.

<sup>7</sup> Other options are raising domestic revenue, improving spending efficiency, reducing corruption, and improving business environment, but all of these will take more time to implement.

the product of emergency-responses to disasters as a result of natural and biological hazards (like hurricanes or pandemics), and are not part of the development plans of countries.<sup>8</sup>

With the ultimate goal of eradicating poverty and achieving the SDGs by 2030, the international community needs to work together and focus its efforts on increasing the flow of external funds to low- and middle-income countries, either by creating innovative ways to re-invest Official Development Assistance (ODA)<sup>9</sup> received or by re-defining the concept of external debt for less developed countries.

### *Gender equality in development finance*

One of the main objectives of the international development agenda is to achieve full gender equality for all women and girls. For this to happen, significant investments and more comprehensive approaches to development finance need to flourish. Promoting the mobilization of blended and regular resources aimed at removing the legal, social, and economic barriers to women's empowerment is vital to achieving sustainable and inclusive development.

It is also essential to mainstream gender considerations across any development initiative in a country or region, for instance by designing projects and programs with a clear gender perspective. In the construction of a new highway, for instance, or a series of new public hospitals in rural areas, monitoring and evaluation indicators should reflect the impact of these projects on the livelihood of all women and girls from different backgrounds in the targeted communities.

Parliaments, in particular, can work towards ensuring a gender-equitable distribution of resources that enable equal opportunities for all. A gender-responsive analysis of the budgeting process is a mechanism that illuminates the impacts of the collection practices of funds, the prioritization in the use of those resources, and how the actual implementation of the budget aligned with the planning processes in previous years.<sup>a</sup>

Therefore, it is important for parliaments to have access to disaggregated data that reflect the differential needs and priorities of girls, boys, women, and men face in their daily lives. Having relevant and accurate disaggregated information at the time of decision-making can lead to legislative action, including budget review, that efficiently addresses intersectional gaps that deter a country from achieving inclusive and sustainable development.

Achieving the SDGs by 2030 will require a series of commitments and actions from all stakeholders, which will also require better quality and quantity of financial investments that are aligned with promoting the social and economic development of women and marginalized peoples.

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a. Mary-Ann Stephenson, OXFAM. 2018. "[A guide to gender-responsive budgeting](#)"

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<sup>8</sup> Proposal made by Dr. Hyginus 'Gene' Leon, President of the Caribbean Development Bank.

<sup>9</sup> According to the OECD, Official Development Assistance (ODA) flows are defined as those flows to countries and territories on the DAC list of ODA recipients and to multilateral development institutions which are provided by official governmental sources or international agencies with the purpose of promoting economic development and welfare of Less Developed Countries (LDCs).

## Innovative Solutions | Blended Finance

Given the challenge of achieving the SDGs in Latin America and the Caribbean, it is vitally important to explore innovative methods of bridging the estimated development gaps that some countries face. One innovative solution is the use of blended finance, which, according to the OECD, is defined as the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries.<sup>viii</sup>

### Public-Private Partnerships

One of the most well-known and trusted models for blended finance is public-private partnerships (PPPs). This model not only offers an innovative way to access funds but also responds to certain inefficiencies in public investment. Given that nearly 40% of public investment in low-income countries does not turn into public capital stock,<sup>ix</sup> the implementation of PPPs improves the productivity of public funds. PPPs allow for a higher percentage of the funds collected for investing in development initiatives to actually transform into productive infrastructure and services, not only promoting a better quality of life for all but are also a source of income for the government.

In PPPs with the purpose of contributing to sustainable development, private enterprises, government, and civil society organizations combine their resources to address a specific development issue. This combination of funders, however, can be challenged in terms of the ideal balance between shared responsibility and partner autonomy, while also ensuring the involvement of beneficiaries of the development intervention.<sup>x</sup> To promote successful alliances between public and private sectors, parliamentarians can support regulatory frameworks for monitoring these partnerships and tailoring their use to the local context of each country.

### Green, Social, and Gender Bonds

Another option, within the blended finance model, is the use of green<sup>10</sup> or social bonds. These bonds are usually issued by private investors with the philanthropic objective of addressing environmental or social issues by investing in projects or programs implemented by national or local governments. To avoid high-financial risks and be able to carry out impactful initiatives through these funds, it is important that these types of bonds (Figure 1) are issued in line with international principles, best practices, and comprehensive regulatory frameworks that uphold transparency and capital efficiency.

Green bonds, as their name suggests, focus on financing initiatives with environmental outcomes like renewable energy, energy efficiency, clean transportation, sustainable

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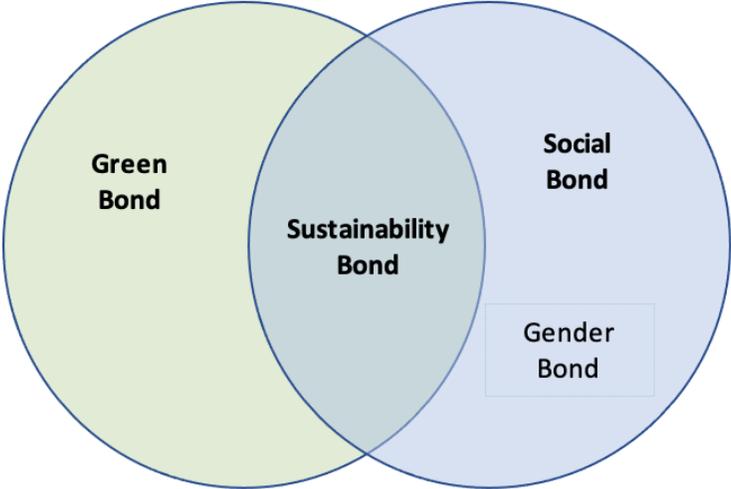
<sup>10</sup> To read more on Climate Finance, please go to: <https://bit.ly/3tAULM4>.

infrastructure, or climate change adaptation, among others. Social bonds, on the other hand, are issued to fund initiatives with the overarching goal of achieving positive social outcomes. These bonds may aim to facilitate food security, affordable housing, and access to essential services. Most recently, there have been social bonds directed at mitigating the impacts of COVID-19, with a focus on the most impacted groups.

If a social bond is primarily issued to address gender concerns or inequalities, then it can be considered a gender bond. This kind of financial instrument aims to promote projects or programs that prioritize gender equality, or women’s empowerment initiatives,<sup>xi</sup> setting them apart from social or sustainable bonds.

For these types of financial options to work in favour of any environmental or social program, the implementing country will need to have robust green- or social-policy frameworks that facilitate a solid, safe market for these investments. Parliaments can contribute to this process by reviewing the design and implementation of regulations that aid the alignment of these financial instruments with sustainable initiatives that have been prioritized in the national budget and development plans.

**Figure 1. Types of development bonds**



Source : UN Women. 2021

Although national and local governments can directly participate in the acquisition of these types of bonds, it is advisable to assess the viability of participating in these transactions through a specialized agent, like multilateral development financial institutions (Table 1). Such institutions have the human and technical resources to research and perform the acquisition of sustainability, green, and social bonds for development initiatives.

**Table 1. Multilateral development banks in the region**

<b>Multilateral Development Banks</b>	<b>For more information, visit:</b>
<b>World Bank</b>	<a href="https://www.worldbank.org/en/home">https://www.worldbank.org/en/home</a>
<b>Inter-American Development Bank</b>	<a href="https://www.iadb.org/en/about-us/overview">https://www.iadb.org/en/about-us/overview</a>
<b>Development Bank of Latin America</b>	<a href="https://www.caf.com/en/">https://www.caf.com/en/</a>
<b>Caribbean Development Bank</b>	<a href="https://www.caribank.org/">https://www.caribank.org/</a>
<b>Central American Bank for Economic Integration</b>	<a href="https://www.bcie.org/">https://www.bcie.org/</a>
<b>FONPLATA Development Bank</b>	<a href="https://www.fonplata.org/en">https://www.fonplata.org/en</a>

## Transparency and Accountability

Effective development and the achievement of the SDGs are only possible if all stakeholders involved in these processes act with transparency, accountability, and proper stewardship of resources. Gaining and maintaining public trust is fundamental to achieving real and sustained progress towards development, considering the results impact communities directly.

From a governmental standpoint, it is important to create systemic processes that allow for the sharing of complete information regarding financial commitments with public, private, and international creditors, as well as with the rest of the population. This practice creates accountability not only with the resources at hand, but also with the process of design, approval, disbursement, implementation, and evaluation of any development initiatives.

The role of parliaments in development finance can be fundamental in this regard. Although development projects or initiatives are usually designed, proposed, and implemented by the Executive branch through its ministries, the approval of the financial liabilities they entail falls under the responsibility of parliaments.

When analyzing a development finance proposal, parliamentarians should be adamant in requesting transparent and relevant information on prospective and existing projects through parliamentary budget offices, analyze the positive and negative impact of these projects, study the financial terms of the liability, the route, and objective of the mobilization of resources. They must also be aware of the macro-dynamics that might affect the implementation of such projects.

Although much of this analysis could be provided by the development finance institution through which the operations take place, it is crucial for parliamentarians to also ensure that the perspectives of civil society are being considered. Civil society organizations will usually have invaluable insight into the real impact of any development initiative on local communities.

In conclusion, development finance aims to catalyze resources to promote economic, social, and sustainable progress in countries. Parliaments should work toward becoming a filter that challenges the status quo and contributes to the promotion of the most efficient and just implementation of funds, ensuring that all stakeholders that have a role in the decision-making process, following solid guidelines and frameworks that guarantee transparency and accountability for the management of resources.

## REFERENCES

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<sup>i</sup> Sonja Gibbs. OECD. 2020. [Blog Development Matters: New Approaches to scaling private sector funding for sustainable development](#)

<sup>ii</sup> International Monetary Fund. 2019. [Staff Discussion Notes - Fiscal Policy and Development: Human, Social, and Physical Investments for the SDGs](#)

<sup>iii</sup> ECLAC. 2017. [Financing the 2030 Agenda for sustainable development in Latin America and the Caribbean: the challenges of resource mobilization](#)

<sup>iv</sup> The World Bank. 2022. [World Development Report 2022: finance for an equitable recovery](#)

<sup>v</sup> Congressional Research Service. 2022. [Latin America and the Caribbean: impact of COVID-19](#)

<sup>vi</sup> Dalia Hakura. International Monetary Fund. 2020. [What is debt sustainability?](#)

<sup>vii</sup> ECLAC. 2022. [A decade of action for a change of era](#)

<sup>viii</sup> OECD. 2018. [Making blended finance work for the sustainable development goals](#)

<sup>ix</sup> Sonja Gibbs. OECD. 2020. [Blog Development Matters: New Approaches to scaling private sector funding for sustainable development](#)

<sup>x</sup> Lea Stadler. 2012. [Designing public-private partnerships for development](#)

<sup>xi</sup> UN Women. 2021. [“Bonds to bridge the gender gap: a practitioner’s guide to using sustainable debt for gender equality”](#)