



Navigating Local Currency Capital Mobilization (LCCM) for Public-Private Partnerships (PPPs)

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OVERVIEW

The Global Infrastructure Hub estimates the gap between projected infrastructure spending and the amount needed to meet the world's infrastructure needs to balloon to about \$15 trillion by 2040. The annual infrastructure financing gap for achieving SDGs by 2030 in developing countries alone is estimated to be around \$3.8 to \$4.3 trillion per year. Public-Private Partnerships (PPPs) offer a proven mechanism for ensuring public interests are met while mobilising private sector resources thereby facilitating bridging the infrastructure development gap, particularly in emerging economies.

Given increasing fiscal constraints and reduced development aid, PPPs can serve as critical instruments for facilitating sustainable infrastructure delivery within limited fiscal budgets. For emerging and developing markets, to be able to effectively and affordably deliver on infrastructure through PPPs, there is a growing need for local currency financing.

Traditional reliance on foreign currency financing has exposed countries to significant exchange rate volatility and worsened debt levels for countries already facing limited debt service capacity. According to the World Bank's International Debt Report developing countries spent a record \$1.4 trillion to service their foreign debt as their interest costs climbed to a 20-year high in 2023, with interest payments surging to a record \$406 billion.

Local currency financing is therefore a pivotal tool for balancing the required in-country infrastructure spend and existing foreign currency obligations. It has the potential to mitigate financial sustainability vulnerabilities and reduce the financial strain on developing economies whilst advancing sustainable infrastructure and development goals.

Understanding Local Currency Financing in PPPs

Local currency financing in PPPs involves raising capital in the domestic currency of the project's host country. This requires utilizing financial instruments, markets and regulatory frameworks within that country as opposed to relying on foreign currencies. This critically manages currency risk by aligning project revenue streams with arising debt obligations. In contrast foreign currency funding is typically denominated in hard currency (e.g. USD, EUR, GBP, YEN) and is sourced from international banks, multilateral agencies, donors or global bond markets. Despite the availability of local currency financing mechanisms, an estimated 80-90% of DFI and MDB disbursements continues to be denominated in foreign currencies. The landscape of external financing is evolving. Notably, bilateral debt has become a significant component of EMDEs' external liabilities, and in some cases, it now surpasses multilateral debt. Furthermore, China has emerged as a major, with instances of being the largest single bilateral lender to numerous EMDEs, altering the traditional dynamics of development finance and introducing new considerations regarding debt sustainability and geopolitical influence. The increasing exposure of numerous countries to Yuan trade imbalances and the significance of this trend is further highlighted by the growing influence of currencies like the Yuan and recent developments such as the digital currency agreement between Nigeria and China, signaling a potential move towards de-dollarization in international finance.

Benefits for PPP Projects

Risk mitigation is paramount in PPPs and local currency financing offers significant advantages for PPPs by mitigating foreign exchange volatility, thereby shielding projects from costly currency mismatches that can impact bankability, disrupt cash flows and ultimately weaken profitability. By reducing reliance on foreign-denominated debt, it enhances economic resilience, strengthening domestic financial markets while alleviating sovereign debt burdens that often arise from exchange rate shocks. This approach also bolsters investor confidence by ensuring alignment between revenue streams, such as tariffs or user fees, and local currency obligations, improving long-term project sustainability. A compelling benefit for emerging markets and developing economies, is that local currency financing fosters inclusive economic growth by deepening domestic capital markets, encouraging local investment, and promoting broader financial inclusion, ultimately creating a more stable and self-reliant financing ecosystem for infrastructure development.



Challenges in Implementing Local Currency Financing

While local currency financing offers compelling benefits for PPPs, its implementation faces several structural and operational hurdles. Market limitations present a primary obstacle, including the restricted availability of long-term financing due to underdeveloped domestic capital markets and institutional investor constraints. Additionally, shallow market depth and liquidity further complicate efforts to secure adequate funding, as illiquid secondary markets deter investor participation. Regulatory challenges such as inconsistent legal frameworks, cumbersome approval processes, and a lack of standardized project financing protocols at the local financial institution level negatively impact the required level of growth and innovation required to strengthen local markets. Risk management remains another critical challenge, as projects must navigate credit risk, volatile interest rates, and inflation uncertainty—all of which can erode financial viability without robust hedging mechanisms. Compounding these issues is the need for a well-defined project financing regimen among local financial institutions, which often lack the expertise or incentives to structure long-term, currency-matched funding solutions.

Addressing these barriers requires coordinated policy reforms, market-building initiatives, and enhanced risk mitigation tools to unlock the full potential of local currency financing for sustainable infrastructure development.

Global Legislative Frameworks & Regulatory Reforms

The growing recognition of local currency financing's role in sustainable infrastructure development has prompted jurisdictions worldwide to adapt their legal and regulatory frameworks to better support such mechanisms. Emerging trends include the introduction of policies that incentivize domestic institutional investment, the development of local capital markets through bond issuance programs, and the establishment of risk-sharing facilities to mitigate currency and credit risks. In Colombia, regulatory reforms have paved the way for local pension funds to invest directly in PPPs. Law 1508 of 2012, along with subsequent financial regulations, enabled domestic investors to finance major infrastructure programs like the country's 4G road network. These changes have been supported by Colombia's Financial Development Agency (FDN), which played a key role in crowding in local currency capital through blended finance and credit enhancement mechanisms. South Africa has actively reformed its regulatory framework by revising Regulation 28 of the Pension Funds Act, in turn increasing the permissible allocation to infrastructure to 45%. This regulatory shift empowers pension funds to contribute to the country's infrastructure needs while supporting projects with long-term local currency flows to drive development.

International financial institutions, such as the EBRD and World Bank Group, have contributed to this shift by providing guidelines and technical assistance aimed at strengthening local currency financing ecosystems. Regional development banks like African Development Bank (AfDB), Inter-American Development Bank (IDB), Asian Development Bank (ADB) actively promote local currency bond market development in their respective regions. These efforts often focus on enhancing regulatory clarity, improving market liquidity, and fostering public-private collaboration. Across various markets, reforms are increasingly prioritizing the alignment of revenue structures with local currency obligations, while also addressing systemic barriers such as restrictive foreign exchange controls and underdeveloped financial infrastructure. This global movement reflects a broader commitment to reducing reliance on foreign currency debt and building more resilient hyper localized financing models for long-term PPP success.

Delving Deeper: Innovative Solutions and Strategies

Advancing local currency financing for PPPs requires both innovative financial tools and forward-looking policy and technological solutions that strengthen domestic markets. Local markets require innovative support mechanisms that address key challenges like currency volatility and long-term funding mismatches, creating a more stable investment environment. Complementing these tools are targeted policy initiatives, including regulatory sandboxes for testing new financing models and incentives for institutional investors to participate in local markets.

A transition toward local currency financing also demands a re-evaluation of macroeconomic dependencies. De-dollarization while reducing exchange rate vulnerabilities introduces potentially complex trade-offs such as reduced access to foreign capital pools, short term liquidity constraints and the need for robust and clear monetary policies.

As the PPP community navigates this market shift, WAPPP is developing a technical paper that aims to provide a framework for understanding, evaluating, and implementing local currency financing strategies to promote more sustainable and resilient infrastructure development in emerging and developing economies through PPPs.