The Role of Development Banks for Financing Sustainable Development

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Some theoretical insights

- DBs need, unrecognized in "efficient" private financial markets, now latter quite discredited
- Credit rationing+market failures first justification
- Stiglitz (2004), financial markets have far more market failures than government failures, key insight for government intervention
- Private finance unwilling to fund activities with uncertain returns, and with externalities, often key for structural transformation and sustainable development. DBs, as part of development or entrepreneurial State. Works very closely with private sector.

The case for development banks

- Limitations of private finance
- In all times, eg lack of long term credit, scarce and expensive lending to smaller companies, and poorer people, newer innovative companies. Not willing to fund key development projects with high uncertainty
- Not funding investment key for structural transformation to inclusive and sustainable growth. Green a new challenge.
- During and after crises, reduce lending in pro-cyclical way

Positive case for development banks

- Key roles , multilaterally, regionally and nationally
- In emerging, low-income, and developed economies. EU and EIB; KfW
- Impetus given by AIIB and NDB (BRICS) bank, and EIB increased role
- Balanced approach, combine public and private institutions more desirable. Benefits of diversification: contribute financial stability, increase competition +specialized certain activities, eg inclusive finance
- New development finance paradigm?
- Provide valuable leverage for scarce public resources

AIIB and NDB, A dream come true?

- AIIB. Most of its capital is provided by emerging and developing governments.
- Will reflect development experience of these governments
- While the AIIB is a key part of a shift in development finance architecture towards more South–South institutions, also important it has incorporated many developed economies into its membership.
- This creates the possibility for the AIIB to learn positive lessons from their experiences, as well as avoiding the mistakes they have made.
- The AIIB a public development bank, like those created after the Second World War. Different challenge, sustainable and inclusive development. Infrastructure like WB initially

Features AIIB 1

- Regional members should have seventy-five per cent of the total subscribed capital
- Membership in the Bank shall be open to all members of IBRD. Up to now, 70 countries joined
- Authorized initial capital stock of the Bank US$ 100 billion, about one third of World Bank
- Leverage ratio of 1:1, the same as World Bank, can reach 2.5 by super majority

Features AIIB 2

- The Board of Directors shall function on a non-resident basis
- The AIIB's goal is for the environmental and social standards high, but consistent with the development needs of borrowing countries
- Strong case for a predominance of simple instruments, long-term lending, co-financed by private lending and equity. Alternative instruments, can provide more leverage, but are complicated to arrange and can hide risks

Features AIIB 3

- December 2015 President Jin, AIIB expected to lend between US$10–$15bn pa during first 5-6 years; this lending cumulative, as initially there would be no repayments,
- A stock of loans of about US$50–$75bn,in 5 years
- Own calculations: in 2025, total level accumulated loans by AIIB could reach US$120 bn; the total stock of infrastructure lending of the AIIB in 2025 could be significantly higher than WB stock of lending in infrastructure in 2014
- If co-finances with private lenders, WB and ADB, AIIB could reach well over $120 bn , up to $240 bn

Research project on national development banks(NDBs)

- Co-directed with J.A. Ocampo at Columbia University
- Supported by BNDES and CAF
- Issues papers and seven in-depth case studies, NDBs in Germany, China, Brazil, Colombia, Chile and Mexico
- http://policydialogue.org/events/meetings/the-future-of-national-development-banks-final-meeting/
- Complementary to RDBs and MDBs

Key roles for development banks

- Helping provide finance for structural transformation
- Provide counter-cyclical finance
- Deepen and improve financial markets for development friendly instruments
- Support greater inclusion
- Finance global public goods

Funding structural transformation

- Key role in fostering real innovation and entrepreneurship in national economies. Essential given need for major transformation
- Patient, long-term committed finance, for mission-oriented investment in innovation, has been fostered by national development banks
- Funding new sectors or cross cutting sectorial programs, with high uncertainty, making less likely for private finance to go in alone initially. Can have major externalities.

Counter-cyclical lending

- Particularly during and in the aftermath of financial crises. Strong empirical evidence, eg NDBs increased lending by 36%, 2007 to 2009.
- MDBs increased lending commitments by 72%, 2008 to 2009, and disbursements by 40%.
- Crucial to helping maintain long-term investment, mitigate the business cycle and help prevent financial crises from deepening
- Counter-cyclical role of NDBs should be seen as a complement to counter-cyclical fiscal and monetary policies

Deepen and improve financial markets for development friendly instruments

- Development of local currency markets
- Capturing the upside; lending in GDP debt service instruments, for example
- More broadly, eg China , NDBs helped develop deeper private capital markets
- Close collaboration required with private financial institutions
- NDBs act as bridge between governments and private sector

Support greater inclusion

- Important , not just micro-finance, but funding missing middle,- SMEs. High transactions cost.
- Key that lending is sustainable, not harm the poor or financial stability. Limits of impact.Meet different needs.
- Variety of actors as financial intermediaries: commercial banks, specialized financial institutions, and micro-financing institutions.
- Through a series of instruments, mainly second-tier credits, first-tier lending to associations of producers, and guarantees, subsidies, eg first loss
- TA key
- Corfo guarantees , increases access, but less on lowering cost

Financial inclusion 2

- Gegraphical inequality Colombia over 90000 correspondents in stores , post offices, telecom centers, credit unions. Services for 1 or more bank
- 6 months 700 million transactions
- Subsidies can be given for strategic activities or products, that can be standardized
- Linked to developing entrepreneurship

Finance global public goods

- Advantages of accumulated expertise, administrative efficiencies, and convening power
- Help Governments design policy frameworks
- Help mobilize additional funding, inc private
- Showcase the viability of certain green investments, as in renewable energy
- KfW and CDB played key roles in renewable energy

NDBs broadly successful

- Broadly successful at what they do; able to adapt flexibly to changing challenges
- a) New activities: entrepreneurship, real innovation, financial inclusion
- b) New sectors: renewable energy, energy efficiency
- c) New instruments: greater use guarantees,2nd tier lending, equity (venture capital, Start Up Chile) and debt funds, and new instruments for financial inclusion, like correspondent stores
- d) New areas,-encouraging FDI in country and national FDI abroad.

Greater need for MDBs, RDBs,NDBs

- Is current scale, NDBs especially in Latin America and Africa, large enough for the development needs of their countries?
- Low levels of both private + public investment. Leverage public resources by NDBs becomes particularly attractive to boost investment.
- Greater need higher investment as challenges structural transformation more urgent, linked to need of different economic model, more dynamic, greener –make growth consistent with the needs of planet—, smarter – better innovation, to increase productivity more rapidly—, and more inclusive
- NDBs needed on a significant scale, also as counterpart of new and existing MDBs and RDBs. Where feasible, they can raise money on private capital markets, national and international

Conditions for NDBs to operate well

- Broad context in which development banks operate is key for their success, including good macro policies and well functioning financial sector
- Country has a clear development strategy, ideally linked to a modern industrial policy
- Clear policy mandates particularly valuable if they do not change much with different governments

Areas of future research

- Key to have “good” development banks. Criteria.
- Central research issue: What is the political economy for ensuring they are well governed and well run? German KfW an example
- What are most effective instruments for NDBs to channel funds, in face of old and new development challenges?
- How can NDBs best encourage sufficient private investment whilst ensuring maximum development impact, and protecting taxpayers; angel is in the detail
- What are political economy dimensions for generating support for creating NDBs where they do not exist, and maintaining their scale or even expanding them, where required?