

The roles and importance of development banks

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CEPAL, Seminario Fiscal, 23 de abril,
2021

Research project on National Development Banks (NDBs)

- Co-edited by S Griffith-Jones and J.A. Ocampo Issues papers + seven case studies, NDBs in Germany, China, Brazil, Colombia, Chile, Peru and Mexico
- Papers: <http://policydialogue.org/files/events/background-materials/The-Future-of-National-Development-Banks-Publication-Draft.pdf>
- information about book: <https://global.oup.com/academic/product/the-future-of-national-development-banks-9780198827948?cc=us&lang=en>
- Papers resulting from recent AFD/IDFC research and 2020 conference <https://www.afd.fr/en/actualites/agenda/visible-hand-development-banks-transition>

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The Future of National Development Banks

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The Initiative for Policy Dialogue Series

Some theoretical insights

- Need for DBs, unrecognized in "efficient" private financial markets. Renaissance of development banks, post North Atlantic fin crisis and COVID
- Stiglitz (2004), financial markets have far more market failures than government failures, key insight for government intervention. Creation of NDBs
- First justification: credit rationing + market failures
- Private finance unwilling to fund activities with uncertain returns, and with externalities, often key for structural transformation to dynamic, sustainable + inclusive development. DBs part of development or entrepreneurial State.

The case for development banks

- Limitations of private finance
- At all times, 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. Uncertainty increased COVID times
- Not funding investment key for structural transformation to inclusive and sustainable growth. Green economy: major new challenge. EIB become Green Bank, 50% of new lending since 2025 low carbon.
- During + after crises,(financial +COVID) private institutions reduce lending in pro-cyclical way

Positive case for development banks

- Key roles, multilaterally, regionally and nationally. Fund 10% of global investment, representing over US\$ 14 trillion of assets, and US \$ 2.4 trillion annual lending. NDBs in developed, emerging + low-income countries.
- Impetus given by AIIB and NDB + EIB increased role. Probable creation US Investment Bank or Green Bank <http://www.stephanygj.net/press/AnInvestmentBankToHelpTheUSProsper2020.pdf>
- Balanced approach, combine public and private institutions. New development finance paradigm?
- Provide valuable leverage for scarce public resources. Funding long term over 50% loans NDBs over 10 years

Key roles for development banks

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

Counter-cyclical lending

- Particularly during and in the aftermath of financial + COVID crises. Major role during the 2008-09 crisis for both MDBs and NDBs. NDBs increase lending by 36%, between 2007 and 2009, according to WB survey. Also key in COVID times.
- Crucial helping maintain long-term investment mitigate crises; help maintain jobs + prevent insolvencies.
- Counter-cyclical role of NDBs complement to counter-cyclical fiscal policies. Sometimes can replace Keynesian fiscal policy, better if complements it
- Key enough capital in normal times, so respond quickly in event of crisis. COVID times, especially with M/RDBs

Funding structural transformation

- Key role in fostering real innovation and entrepreneurship in national economies. Start Up Chile. Role of EIB in European Green Deal. Essential given need for major transformation, green + inclusive transformation.
- Patient, long-term committed finance, for mission-oriented investment in innovation. Increases productivity and competitiveness
- 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. Green economy leading example. Tools like shadow price of carbon, used by EIB.

Improve financial markets and instruments

- Development of local currency markets
- Capturing the upside; lending in GDP debt service instruments, for example. Venture debt in EFSI/Juncker Plan
- Other innovations, like funds of funds, venture capital
- Close collaboration required with private financial institutions
- NDBs act as bridge between governments and private sector

Support financial inclusion

- Important: funding missing middle– SMEs. High transactions costs.
- Linked to developing entrepreneurship
- Through a series of instruments, mainly second-tier credits, first-tier lending to associations of producers, and guarantees, subsidies. Technical assistance is key

Finance global public goods

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

NDBs: broadly successful

- Broadly successful at what they do; able to adapt flexibly to changing challenges
- a) New activities: entrepreneurship (Chile, Colombia), real innovation (China, Germany, Brazil), financial inclusion (Colombia, Mexico)
- b) New sectors: renewable energy, energy efficiency (Germany, China)
- c) New instruments: greater use of guarantees, (especially in COVID times, due increased uncertainty), 2nd tier lending, equity + debt funds

Greater need for MDBs, RDBs, NDBs

- Is current scale NDBs especially in Latin America, large enough for development needs of their countries and COVID recovery? Germany + China very large NDBs in proportion to GDP.
- Low levels of private + public investment, especially post Covid. Hard increase public investment, due ltd fiscal space. Leverage public resources by NDBs attractive to boost investment.
- Greater need higher investment as structural transformation more urgent, linked to need different economic model, more dynamic, greener –make growth consistent with the needs of planet—, smarter –better innovation, + more inclusive.
- NDBs needed on significant scale.

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; better if they do not change much with different governments. KfW as a good example.

Policy recommendations from Paris Summit

- Make sure capital is at sufficient scale. Problem M/RDBs
- PDBs should incorporate imperative transitions towards low carbon + equitable economic models in all their financing decisions and project cycles.
- Blend resources with private sector
- Enforce an independent and strong governance
- Give preference to instruments that maximize development impact
- Source: <https://www.afd.fr/en/ressources/10-policy-recommendations-decision-makers-public-development-banks>