10 policy recommendations for decision makers on Public Development Banks

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THE VISIBLE HAND:
Development
Banks
in Transition

Major planetary concerns, including climate change, loss of nature and inequalities among human beings, call for very large scale concerted action at all levels. The challenge is to favor major structural transformation of all economies to achieving higher productivity, while becoming low carbon and more inclusive. Public Development Banks (PDBs), whether at a local, national, continental or international scale, are key instruments to help governments finance the rapid recovery from the COVID crisis and achieve long-run transformation of existing economic models to ones that serve people and planet far better.

By providing direct public financing and mobilizing private finance, PDBs should transform themselves with tools and indicators that allow them to proactively select and support long-term productive investments, emphasizing low-carbon operations, as well as those that support poorer regions and people. They should set up a “sustainable development analysis grid” to select operations, based on criteria that help maximize development impact; financial returns are important, but secondary for PDBs. They must also ensure that none of their financing encourages activities that run counter to the achievement of sustainable development goals (SDGs), including climate and nature.

An international research program was set up, sponsored by International Development Finance Club (IDFC), Agence française de développement (AFD) and Ford Foundation. It includes 20 prominent researchers from all over the world, including from Institute of New Structural Economics (INSE) of China, Columbia and Boston Universities from United States, FERDI and IDDRI from France, ODI from England, UNDESA and UNCTAD from the UN system, as well as development banks such as BNDES and BDMG.

The researchers produced 16 research papers, including in each of them key recommendations for decision makers to increase and improve the role as well as the efficiency of PDBs in promoting sustainable and inclusive structural transformation.

This research concluded that PDBs, under certain conditions, such as being sufficiently capitalized and having good governance, are crucial to play a leading role in helping fund investment, essential for a just transition to sustainable development. The most striking recommendations read as follow:

1 Make National Development Banks the forefront for transitions

Multilateral banks, donors and climate funds should use National Development Banks (NDBs), especially small ones in low-income countries, to channel funds.

The report of the G20 Eminent Person Group on Global Finance Governance calls precisely for this via the setting of "country platforms". Both non-concessional and concessional funds are relevant, provided that they are dedicated to transitional projects and programs, as part of national trajectories to low-carbon economies.

While on-lending helps credit-constrained NPDBs to gain access to international resources, international lenders should foster exportenhancing investment projects in line with latent comparative advantages of host countries to mitigate risk of potential balance of payment crises. Alternatively, it would be crucial to develop financial instruments denominated in local currency, to avoid currency mismatches.

2 Make sure capital is at scale

Existing PDBs should have sufficient scale to perform their functions.

In particular, all regional, and subregional Multilateral Development Banks (MDBs), which had their capital significantly increased in the wake of the 2007/09 financial crisis need urgent and significant capitalization in this far worse COVID crisis. National Development Banks also need further capitalization. Some of the funds mobilized to alleviate the Covid-19 crisis could be devoted to that end.

The three Chinese policy banks' total assets account for 26% of China's GDP, while in Africa, assets of development banks range from 2 to 4% of GDP. PDBs need to be provided sufficient capital, as well as other financial support to make them able to provide crucial counter-cyclical finance in difficult times, like COVID, and to support the structural transformation to low carbon and inclusive development.

In countries which do not have PDBs, it would seem key to create one.

3 Measure to manage

PDBs should incorporate the imperative of transitions towards low-carbon, resilient and equitable socio-economic models in all their financing decisions and project cycles.

It implies that each development bank should equip itself with the necessary analytical tools to allow monitoring and accountability for the impacts of its financing.

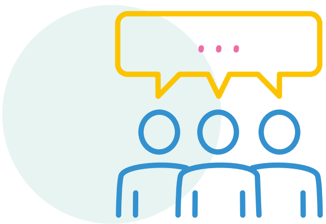
There is a need to accept complexity and conflictual interests between SDGs as one of the new facts of our Anthropocene era.

4 Shape the future

PDBs need to move from being just "project-takers" to "project makers".

Once goals are defined, e.g. for climate and SDG action, it is essential for them to take a proactive role in acting as the first-mover to overcome uncertainties and risks, define programs and projects, including creating special funds for project preparation. Development banks could even become "development hubs" to originate and develop more sustainable projects, that they could turn to private sector investment once matured.

5 Blend with private sector



PDBs should help mobilize private sector finance for what private sectors alone would otherwise not fund, so as to bring together all actors towards sustainable development objectives.

This should be done in ways that maximizes the sustainable development impact of these flows, which is the main goal of PDBs.

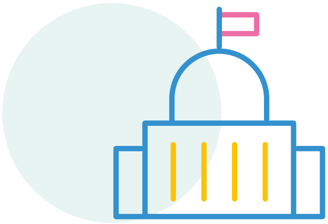
6 Apply regulations appropriate to PDBs

The existing framework of financial regulation does not consider PDBs' role in mitigating financial stability concerns.

Regulators should consider differentiating prudential rules to account for PDBs' contributions to future financial stability. It is in the long-term interest of financial regulators to encourage investments that enhance climate change resilience and sustainable development.

PDBs often cannot use market-based responses to tighter regulation, by issuing common equity. Alternatives should be promoted that, based on transparent governance and international cooperation, widen their access to capital markets without creating systemic stability hazards.

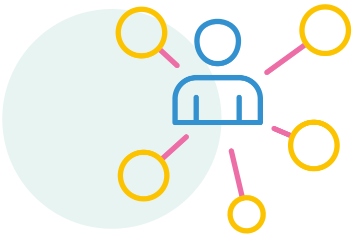
7 Enforce an independent and strong governance



Good governance matters for NDBs to fulfill their mission to promote development and achieve development impact. But it is not destiny that NDBs are afflicted with poor governance in poorly-governed countries.

Data shows that with support of farsighted leadership even poorly-governed countries can have well governed NDBs. Furthermore, some NDBs evolved and undertook reforms to restructure their internal organization, and significantly improved their governance despite relatively constant low institutional indices at country level.

8 Do not stay isolated, integrate the community of PDBs



PDBs should be encouraged to build a global and united coalition committed to the transition for sustainable development and the operationalization of the Paris agreement on climate change.

Going beyond isolated initiatives is essential to tackle problems at a global scale. Cooperation between multilateral and national banks is crucial, and networking better within themselves will secure a better access to the international system of grants and global funds, especially the green climate fund. This will help in financing more projects with positive environmental externalities.

The world needs a horizon of solutions and of actors capable of embodying new forms of collective action, in support of multilateralism, to instill optimism and positive dynamics around sustainability.

9 Give preference to instruments that maximize development impact

It is important that risks taken are focused on the real economy, such as investing in impactful innovative projects, rather than financial engineering risks, derived from instruments themselves.

Whilst loans are the main and simplest instrument used by PDBs in case of market failures, guarantees may however perform a useful role when there is high uncertainty, like in COVID times.

For innovative technology and high risk projects with potentially high development and profit potential, it seems desirable to use more intensively equity investments, so PDBs can capture the upside.

10 Call on development banks to help concrete design of, and finance SDGs policy objectives

Projects matter, but they are not all. The setting of proper multi-sectoral policies is key, given the inter connections existing between all SDGs.

A water project is never simply producing water, as its impacts affect directly nature, gender equality, poverty, job creation, energy, cities, almost all SDGs.

National development trajectories should be aligned with international agreements. For those who are fit for the task, PDBs should actively support governments willing to embark that journey, including with policy loans instruments not assigned to particular projects.

As a general standpoint, PDBs should align their mandates with SDGs

Policies and counter-cyclical financing to support recovery should be explicitly aligned with SDGs, with a particular priority in supporting the mitigation and adaptation to climate change. The role of PDBs should be enhanced in (i) supporting countries and regions that lag behind; (ii) promoting innovation and structural transformation; (iii) enhancing social development; (iv) increasing financial inclusion; (v) financing infrastructure investment; and (vi) supporting provision of global public goods.

These recommendations are based on the 16 research papers issued in the framework of the research program "Realizing the Potential of PDBs for Achieving SustainableDevelopment Goals", initiated by INSE and financed by AFD, Ford Foundation and IDFC.