JULY 2023
No. 290

Authors
Stephany Griffith-Jones
Diana Barrowclough
with Vaibhav Mishra
Coordination
Régis Marodon (AFD)

"Counter-cyclical Responses: How Development Banks helped the Covid-19 Recovery, and Lessons for the Future

Research papers

ÉDITIONS AFD
AGENCE FRANÇAISE DE DÉVELOPPEMENT

Agence française de développement

Papiers de recherche

Les *Papiers de Recherche de l'AFD* ont pour but de diffuser rapidement les résultats de travaux en cours. Ils s'adressent principalement aux chercheurs, aux étudiants et au monde académique. Ils couvrent l'ensemble des sujets de travail de l'AFD : analyse économique, théorie économique, analyse des politiques publiques, sciences de l'ingénieur, sociologie, géographie et anthropologie. Une publication dans les *Papiers de Recherche de l'AFD* n'en exclut aucune autre.

Les opinions exprimées dans ce papier sont celles de son (ses) auteur(s) et ne reflètent pas nécessairement celles de l'AFD. Ce document est publié sous l'entière responsabilité de son (ses) auteur(s) ou des institutions partenaires.

Research Papers

AFD Research Papers are intended to rapidly disseminate findings of ongoing work and mainly target researchers, students and the wider academic community. They cover the full range of AFD work, including: economic analysis, economic theory, policy analysis, engineering sciences, sociology, geography and anthropology. *AFD Research Papers* and other publications are not mutually exclusive.

The opinions expressed in this paper are those of the author(s) and do not necessarily reflect the position of AFD. It is therefore published under the sole responsibility of its author(s) or its partner institutions.

Counter-cyclical Responses

How Development Banks helped the Covid-19 Recovery, and Lessons for the Future

AUTEURS

Stephany Griffith-Jones
Central Bank of Chile

Diana Barrowclough
UNCTAD

with Vaibhav Mishra
SOAS London

COORDINATION

Régis MARODON (AFD)

Abstract

The objective of this paper is to shed light on the crucial and varied counter-cyclical roles played by development banks across the globe during the COVID-19 pandemic, and lessons learned for future shocks. It presents empirical evidence, case-studies and findings from a large number of in-depth interviews conducted by the authors with senior officials of development banks at the national, regional and multilateral level. The paper presents new and original data, information and analysis of how these banks helped countries' governments, firms and households cope with the shock of 'sudden stop' to the normal functioning of the economy. It identifies key factors determining banks' different and various responses, including not only acuteness of clients' need but also the degree and nature of the development bank's capitalization, links with existing national strategies or plans, its mandate, its ability to innovate, partnerships with other banks, historical experience and degree of political support. Different modalities of responses as well as their degree can be attributed to these factors.

The paper concludes that for counter-cyclical support to be most effective, development banks needed to be able to respond at speed, at scale and with flexibility. One implication from these findings includes the need for these banks to be well capitalized during good times so as to be prepared for future crises. This made the difference between banks that could scale up massively, and those that had to leave unsupported key sectors of the economy. The paper shows various means of doing this. Another is that low-income countries with limited fiscal space to respond to crises, either financial or ones like COVID, need to be supported by the international community, including through capital, credit or guarantees. Different banks and countries found varied modalities to do this. One important additional source that hopefully can be implemented soon is the channelling of a part of the SDRs that will be re-distributed from richer to poorer countries. Another pertinent lesson concerns the need for more information about non-performing loans, resulting from the Covid crisis. This has important implications for future external shocks. In conclusion, the paper finds that the large majority of development banks made a big effort to respond to the unexpected challenge thrust upon them by the pandemic; there is a need to help support those not sufficiently well placed to respond.

Keywords

Counter-cyclical, scaling up, development banks, SDRs, Covid-19

Acknowledgements

We are grateful for the valuable support of GDN, especially Brendan Harnoys-Vannier and AFD, especially Regis Marodon, for this research. We wish to thank all the senior colleagues from development banks who were so generous with their time, information and valuable insights. The views expressed in this paper are those of the authors and do not necessarily reflect the views of the United Nations or its officials or member states. Nor do they represent the views of the Central Bank of Chile.

JEL Classification

E51, F34, G20, H12, H81, H84, I15

Original version

English

Accepted

June 2023

Résumé

L'objectif de ce papier est de mettre en lumière les rôles contracycliques cruciaux et variés joués par les banques de développement à travers le monde pendant la pandémie de COVID-19, ainsi que les leçons à en tirer pour les chocs futurs. Il présente des preuves empiriques, des études de cas et des conclusions tirées d'un grand nombre d'entretiens approfondis menés par les auteurs avec des hauts responsables de banques de développement aux niveaux national, régional et multilatéral. Le papier présente des données, des informations et des analyses nouvelles et originales sur la manière dont ces banques ont aidé les gouvernements, les entreprises et les foyers des pays à faire face au choc d'un "arrêt soudain" du fonctionnement normal de l'économie. Il identifie les facteurs clés qui déterminent les réponses différentes et variées des banques, incluant non seulement l'acuité des besoins des clients, mais aussi le degré et la nature de la capitalisation de la banque de développement, les liens avec les stratégies ou plans nationaux existants, son mandat, sa capacité à innover, les partenariats avec d'autres banques, l'expérience historique et le degré de soutien politique. Les différentes modalités de réponses ainsi que leur degré peuvent être attribués à ces facteurs.

Le papier conclut que pour que le soutien contracyclique soit le plus efficace possible, les banques de développement doivent être en mesure de réagir rapidement, à grande échelle et avec souplesse. L'une des implications de ces résultats est la nécessité pour ces banques d'être bien capitalisées en période de prospérité afin d'être prêtes à affronter les crises futures. C'est ce qui a fait la différence entre les banques qui ont pu se développer massivement et celles qui ont dû laisser des secteurs clés de l'économie sans soutien. Le papier présente différents moyens d'y parvenir. Par ailleurs, les pays à faible revenu disposant d'une marge de manœuvre budgétaire limitée pour répondre aux crises, qu'elles soient financières ou de type COVID, doivent être soutenus par la communauté internationale, notamment par le biais de capitaux, de crédits ou de garanties. Différentes banques et différents pays ont trouvé des modalités variées pour y parvenir. Une source supplémentaire importante qui, espérons-le, pourra être mise en œuvre prochainement est la canalisation d'une partie des DTS qui seront redistribués des pays les plus riches vers les pays les plus pauvres. Un autre enseignement pertinent concerne la nécessité de disposer de plus d'informations sur les prêts non productifs, résultant de la crise de Covid. Cela a des implications importantes pour les futurs chocs externes. En conclusion, le papier constate que la grande majorité des banques de développement ont fait un gros effort pour répondre au défi inattendu que leur a lancé la pandémie ; il est nécessaire de soutenir celles qui ne sont pas suffisamment bien placées pour y répondre.

Mots-clés

Contracyclique, augmentation d'échelle, banques de développement, DTS, Covid 19

Remerciements

Nous remercions le GDN, en particulier Brendan Harnoys-Vannier, et l'AFD, en particulier Régis Marodon, pour leur soutien précieux dans le cadre de cette recherche. Nous souhaitons remercier tous les collègues seniors des banques de développement qui ont été si généreux de leur temps, de leurs informations et de leurs points de vue précieux.

Les opinions exprimées dans ce document sont celles des auteurs et ne reflètent pas nécessairement celles des Nations Unies, de ses fonctionnaires ou de ses États membres. Elles ne reflètent pas non plus celles de la Banque centrale du Chili.

Introduction

The COVID crisis threw millions of people, businesses and nations into ever more precarious situations, thus complicating the path toward achieving the SDGs, and undermining development. Public development banks (PDBs) reacted positively and in many ways to the COVID crisis, in terms of scale, speed, instruments and targets. Far from being in the background, they were in fact many governments' main instrument for providing respite and guiding recovery. This recent experience is reinforcing the reappraisal of public banks already emerging since the economic crisis of 2007-2008. Post COVID, many more countries are now planning to establish new public development banks (PDBs) or to strengthen existing ones, and this paper will contribute to the debate on how best to do this.

This paper uses empirical evidence, case-study analysis and in-depth interviews with senior officials of development banks to shed light on the critical and varied role played by development banks (especially national and regional, but also multilateral), across the globe during the COVID-19 pandemic. Drawing on the AFD-INSE data base, and other sources, including PDBs themselves, the paper presents original information and analyses to show how these banks played a key role to help countries, companies and households cope with the shock of 'sudden stop' to the normal functioning of the economy caused by COVID.

The paper distinguishes the response between national banks in high, middle, and low-income countries; and also examines regional and multilateral banks; asking what was the counter-cyclical COVID response during this time of crisis. If not sufficiently counter-cyclical, what factors discouraged a sufficient response? What accounts for variation in the ability of PDBs to play a counter-cyclical role? How can these be overcome? More generally, the paper aims to show how to make PDBs more counter-cyclical in bad and good times. Factors like appropriate instruments for this purpose, as well as sufficient and timely levels of capital increases are analysed. Drawing on these findings, the paper highlights important lessons-to-learn from the COVID-19 period, for future crises and for the post COVID stage while increasing the focus on implementing the SDGs.

The timing for this review is pressing, because while some countries seem to be already coming out of the worst of the coronavirus epidemic, others especially in the developing world are still under a great deal of strain, accentuated further by the Russian invasion of Ukraine. In addition to potentially undermining the development gains achieved thus far, if nothing else the coronavirus experience has shown us that in today's highly interconnected world, when one country or even region is vulnerable, all are vulnerable. And in times of vulnerability, it is public and development banks that have the mandate and the experience to deliver what is needed – in contrast to other financial actors. Indeed, PDBs were in many historical instances borne out of crisis, and this recent crisis has shown that institutions with a long track record and well-established frameworks were best able to deliver. They will also likely be best positioned to deliver for the heavy lifting that lies ahead.

The Covid-19 pandemic and associated fall-out through the global economy was an extraordinarily dramatic shock to economies, companies, households and of course the health sector; governments around the world implemented massive support programs, albeit to different degrees depending on the depth of their pockets and the urgency of need. The paper shows that in virtually all countries, NDBs were a major tool to help moderate economic decline, using their capacity to grant counter-cyclical credit, often extremely quickly; they supported companies and jobs; municipal governments and the health service; and some directly supported house-holds. However, the mere fact of being a public bank does not mean blanket success – some banks were in a better position to play this role than others and not all could achieve the results expected. Drawing out these lessons will be extremely important. As some governments are planning new banks and revisiting existing ones, others may be struggling with high levels of debt and the threat of nonperforming loans. The time is ripe therefore for better information about how these public financial institutions can best achieve their goals.

Part I of this paper highlights important lessons for public development banks (PDBs)' ability to play a counter-cyclical role in the future – whether this should be another pandemic, external shock, or financial crisis in the context of the need to "build forward better" in a post-pandemic world. It lists some major learnings from the recent covid-19 period and digs deeper into three factors that are most critical for determining banks' ability to be counter-cyclical now and in the future. These are a) the importance of reliable and sufficient sources of capitalization, and potential new sources of capital; b) the additional support that can be given by the international community to PDBs in poorer countries and c) the potential looming problem of non-performing loans during crisis lending and its impact.

Part II stands back and nests these lessons against the landscape of Covid-19 and PDB responses, painting with a broad brush to show the sudden blockages and drawing back of private financial flows, which sets in sharp relief the scale and scope of Covid-lending, how it was countercyclical and why it was so important. Part III supports the major lessons learned by showing the different contributions from different banks and reasons for this: it draws on individual bank experiences and findings gathered from a series of semi-structured interviews with senior bank officials and contemporary literature and media. These bring original and timely views from practitioners working at the coal face of crisis lending, alongside the insights of economic theory. Part IV concludes with the strong message that, in times of crisis, counter-cyclical responses are best when they are "quick, decisive and at large scale". It suggests several ways in which this can be achieved; including the re-directing of existing resources as well as raising new ones. It also raises concerns about the potential for non performing loans – a threat which may say more about the continued challenging environment in local and global markets than the underlying viability of borrowers, but which nonetheless will be a critical issue for the PDBs and their owners.

1. Important lessons for the future

Even before Covid-19 began in early 2020, there has been an evolution of perspectives on the roles PDBs need to play, particularly in counter-cyclical lending (see eg. TDR 2019:143-168). Much of the debate and analysis about PDBs had focused in the past on their role in providing long-term finance for important but under-financed activities such as infrastructure, innovation, and transition to the green economy. These remain essential for long-established reasons. However, the Covid crisis further strengthened the view that other roles are also key, especially providing counter-cyclical responses to crises- either financial or as most recently to the COVID caused one -, at global, regional, and country level. Indeed, Ambroise Fayolle, Vice President of EIB told us, that in the wake of the global financial crisis last decade, there was initially much debate in the EIB whether it should play an important counter-cyclical role. In sharp contrast, when the COVID crisis hit, there was clear and speedy consensus at the Board of the EIB, that this institution needed to play an important counter-cyclical role. In other countries where other financial and health crisis were still in painful memory, their banks also saw the necessity of taking a quick, counter-cyclical position. As we discuss below, this time around many other PDBs also played a stronger and speedier counter-cyclical role than in past crises.

After an in-depth study of publicly available empirical evidence, literature, and semi-structured interviews with senior bank management in many public development banks around the world, three main messages stand out. These are:

a) A number of key implications arise from the importance of PDBs' counter-cyclical role

A central one is the need for PDBs to be sufficiently capitalized, to be able to respond well if a crisis or external shock hits an economy. In fact, it may be ideal if, as the CEO of an important PDB pointed out, that in "normal times", PDBs had some spare capital, so they could respond speedily enough and at sufficient scale, if a crisis hit, without having to negotiate a capital increase before; thus, the PDB, could start early and help minimize harm to jobs and companies, as well as the broader economy, including investment.

Another option is for governments to rapidly increase the capital of PDBs as soon as a serious crisis arises. This was the case for MDBs and RDBs during the global financial crisis, when after the spring 2009 London G20 summit, these banks saw an important increase in their capital; however, till now, the response of the international community has not implied an increase in the capital of most MDBs, which has limited their ability to scale up and increase lending much further than their otherwise valuable response. On the other hand, some national PDBs, such as the Uganda Development Bank and some regional ones, such as CABEI in Latin America, had their capital increased, which facilitated an important increase in lending. Furthermore, amongst MDBs, the relatively new AIIB, which had significant spare capital, as it had been planned this high capital would support a gradual rolling out of increased lending till the end of the decade, had as a response to COVID, by far the largest increase in commitments, of 120%, between 2019 and 2020, of all PDBs we studied; this in fact illustrates clearly the point made above that the availability of spare capital facilitates a rapid and large counter-cyclical response by PDBs. Furthermore, it should be noted that this rapid increase of AIIB commitments was achieved mainly by co-financing projects and programs with other MDBs, (see Box 2). Other means by which bank capitalization could be increased include a possible reappraisal of the role of Sovereign Wealth Funds, which in many countries are not allowed by law to invest at home (TDR 2019, Barrowclough 2022).

Naturally, though we highlight increases of capital as a key pre-condition, for increasing lending commitments in a counter-cyclical way, there are other complementary mechanisms that can be important to achieve counter-cyclical increases in lending, such as: 1) increasing other resources-such as access to private capital markets or funding from other PDBs- 2) possible need to adapt lending and other PDB instruments, and the sectors they lend to, as well as 3) -if necessary –to adapt or even change bank mandates. The provision of guarantees was cited by many banks as being important for their ability to scale up borrowing on international capital markets for on-lending to their clients in need; others cited the potential for bringing in new members as shareholders of the bank, both to improve their institutions` credit ratings (and thus their borrowing costs) or to increase the capitalization as new members paid in.

As we detail below, several NDBs were able to create new instruments for their COVID response to switch lending to the sectors that needed funds most (eg those in the service economy, where restrictions to movement and quarantines tended to hit hardest), and even in some cases to adapt mandates. Other PDBs were able to be counter-cyclical, without major changes in instruments or mandates; most PDBs, except very weak ones financially, changed their usual orientation and lent more to sectors which needed financial support most, as had been most badly hit by the impact of the pandemic.

b) The need for support for poorer countries

For those countries, such as many LICs, which have limited fiscal space to respond to crises, either financial or ones like COVID, it may be more difficult for their national governments to significantly capitalize their PDBs. In that case, it becomes desirable for the international community to step in, and provide additional resources, either to help capitalize these national PDBs, or provide them with additional credits or guarantees. As we discuss below, such international support could be provided by richer countries' governments or their NDBs,-like KfW, AfD or others-,and by regional PDBs, like the EIB; an alternative route could be the use of SDRs, either those already allocated to all countries in 2021, or to those originated from a potential redistribution of SDRs, as discussed, and in principle supported , by the G20, from advanced to poorer economies.

As the Covid crisis demonstrated, the world is badly prepared for confronting a global crisis with significant and synchronized spillover effects across a wide spectrum of countries. As Plant, 2023, has pointed out, sharing access to global reserves could be an important component of the response to any such crisis, especially as the only truly global financial response to the current crisis was precisely the issuance of SDRs; this is different from the global financial crisis, when for example important increases in the capital of MDBs and RDBs took place, which facilitated strong increases of their lending commitments (see for example, Griffith-Jones and Gottschalk, 2012). Furthermore, as pointed out, the G20 has expressed support for the redistribution of some of the SDRs allocated to richer countries that do not need them, to poorer countries that need them a great deal. A very good option seems for these SDRs (or at least part of the reallocation) to be channeled via MDBs, so they can increase their capital. This is currently possible only for selected institutions that benefit from prescribed holder status for SDRs (which does include the main MDBs), but it could be broadened in future to other institutions, if the international community so wished, and modified existing IMF Articles of Agreement.

How can the international community make the SDRs work to help poor and vulnerable countries respond better to the challenges still posed by COVID, both for economic recovery and greater spending on health, including vaccines? This could be done via transfers of SDRs from the rich countries to the multilateral development banks (MDBs), such as the World Bank and RDBs, such as the AfDB, institutions that are already authorized holders of SDRs; furthermore, countries could use the SDRs they have already received, as part of the US $ 650 billion global allocation in 2021, partly to capitalize their own national PDBs. There have been important calls for such a use of SDRs, (see for example UNCTAD TDR 2021:19-20), but little progress on action so far.

MDBs are the financial institutions well placed in principle for this role. They have broadly the ability, thanks to prudent financial management, to leverage their capital with private sector financing as well as other public co-financiers; and also the technical expertise to guide and manage it. They can act as intermediaries between the global financial system and countries in need, with low capacity and with difficult access to private capital markets. This includes both LICs and MICs that are urgently requiring increased long-term funding to finance investment essential for recovery as well as for health –for example for vaccine production.

If SDRs could be used to provide an addition to the MDBs capital base, this would be excellent, as it would allow them to expand their lending and guarantees, in a more counter-cyclical way without having to call on member countries to increase capital in other ways (which would also be a good, although different, strategy). Given the important strengths of the MDBs, this would help broadly to ensure the resources were well used; the leverage they have, especially by co-financing with private flows, as well as other actors, would allow the positive effect on borrowing countries to be multiplied; indeed, the AfDB estimated[1] that MDBs can leverage SDR resources 3 to 4 times. Furthermore, the MDBs' preferred creditor status may further make attractive channeling SDR resources to them. Some development banks in the low-income regions where it is already difficult to raise finance from other sources have increased resources via use of SDRs by MDBs on their radar and are hopeful for progress on the issue, as well as making proposals on how to implement them.

[1] At a French Treasury/CGD event on Exploiting the full power of SDRS, in Paris on 2 February 2022.

There are some technical challenges to reallocating SDRs to MDBs, but these stem predominantly from the requirement to retain their reserve asset characteristic (see for example, Plant op cit). But there are potentially ways of structuring any SDRs given to MDBs to both count as their capital and to maintain their reserve asset characteristic, as currently being studied by several MDBs. Similarly, it would be possible to envisage a single country's SDRs, already received thanks to the $650 billion allocation made in 2021, being used to increase the capital base of its own national PDB, or what could be technically easier, to provide additional loans to their national PDB, so it increases its lending to companies. In an era where development banks are experiencing a Renaissance, marshaling some of the country's SDRs to the benefit of much needed investment and/or working capital via their PDBs, might make a great deal of fiscal and monetary sense.

c) Future challenges

Will there be higher losses for PDBs in the counter-cyclical loans and guarantees made in COVID times, as companies struggle to recover in today's continued challenging environment both in local and global markets, now accentuated by lower growth and uncertainty due to the conflict in Ukraine? Companies can potentially be expected to have greater difficulty and willingness to pay back loans than in normal times – even for firms that before the crisis were on a solid footing. What provisions are made for NPLs of PDBs, for counter-cyclical lending and for guarantees granted? It could be assumed losses will be higher, and therefore there may be a need to have higher provisioning. If provisions are not sufficient, is there a risk that these banks find themselves in problems in the future, as losses could erode their capital and thus their future capacity to lend? In that case, should they be recapitalized? One can also even turn this question around and ask, if banks have no increased NPLs,(which from a financial perspective is clearly positive), but given the extreme needs especially in some countries, does it mean they were possibly too cautious and not sufficiently counter-cyclical in their support to firms that were temporarily in crisis, due to external events, and were otherwise viable businesses. This is a matter, which may require further study, by the PDBs themselves, as well as possibly by outside experts, and bodies like the IDFC and the regional associations of PDBs.

2. Important lessons for the future

To set these important learnings above in context, Part II briefly sketches the Covid-period financial landscape to show how the actions of PDBs contributed to relief and recovery. From the start of coronavirus, lockdown, and social distancing policies in early 2020, public development banks (PDBs) played a significant role in the outpouring of counter-cyclical support to the economy. They met the need to create credit; to guide credit where it was needed; to on-lend government resources; to offer expertise and advice, including to governments; to create co-financing and collaborative partnerships with other banks, including MDBs and RDBs, and institutions; and to reach a diverse range of clients including firms, especially SMES; local authorities and in some cases households[2]. Section I below sets their role within the broader financial landscape of the time, alongside other financial institutions, and government agencies. Every country was hit, even those that did not experience coronavirus or did not put in place lockdown policies as global trade collapsed, capital flows ricocheted (especially from developing countries to safer havens abroad) and firms and households suffered an immediate hit to revenues, working capital and liquidity. Longer-term investment projects such as infrastructure typically went on the backburner, and that finance which was still searching for yield was channeled into new and growing business opportunities in IT, or into financial assets such as real estate and equities as opposed to physical businesses. This section shows that public and development banks, often working closely with governments, played an essential role by going against that general trend.

2.1. The financial landscape under Covid-19 and the need for counter cyclical lending

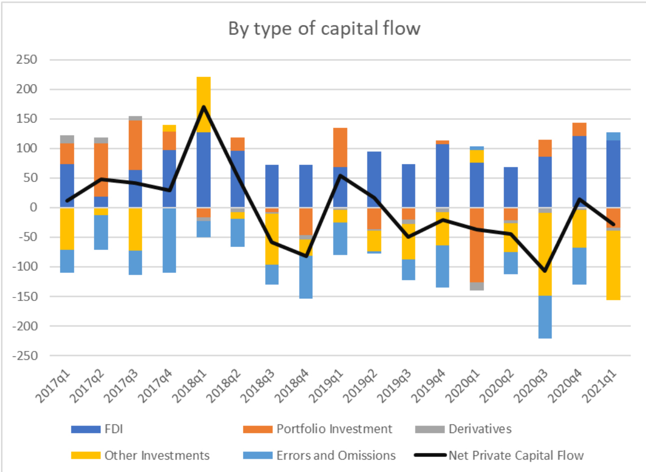
The impact of COVID on economies was massive, due to the economic shock of travel restrictions, lockdowns and quarantines, which hit both the supply (production), but later also the demand of goods and services, as incomes fell. In the context of high uncertainty, and declines of sales by firms, the private financial system did not, on its own, want to lend, leading to a pro-cyclical response, which we illustrate below, by examining trends in capital flows to emerging and developing countries. As shown in Fig 1 net capital flows were strongly negative through 2020, if fluctuating, translating into a vicious cycle of currency devaluation for many countries, further weakening debt sustainability, in a context of reduced fiscal space, which implied governments (especially in certain regions and income categories) had difficulty issuing new debt on international financial markets and limited resources with which to meet the new needs of their people.

In this context, most PDBs (at a multilateral, regional, national and sub-national level), expanded their lending significantly; their counter-cyclical response in part helped compensate the pro-cyclical response of the private financial sector (both national and international) and the shock

[2] See also MacDonald et al. 2020 and Gutierrez 2021 for reviews of this period.

of sudden-stop to anticipated revenues of companies, a dearth of working capital and tightened liquidity. Action by PDBs was complemented at national and at regional level, as clearly illustrated by the EU experience, by major support from national governments, especially in the developed countries, that had more fiscal space. Many developing country governments however had very little capacity to respond (TDR 2020); other emerging country governments did respond more, but at the cost of higher external debt levels, and increases in inflation, which is restricting their ability to continue supporting economic recovery at present.

Figure 1. Net capital flows to developing countries, by type

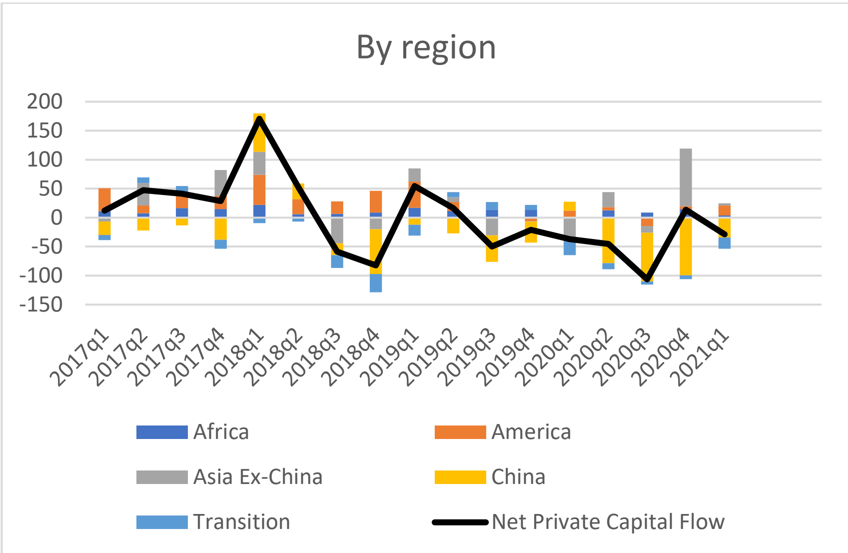


Source: UNCTAD TDR 2021

While this experience was broadly felt across the globe, on closer inspection the shock to GDP, investment and financial flows stemming from covid-19 seems to have varied greatly across countries, sometimes even within and between regions (see Figure 2). The European Union region experienced the biggest shock to GDP since WWII with a 14% drop in output from 2019 to the first quarter of 2020 and falls in the primary income to households in the order of minus 7% on average for the EU and with some individual countries experiencing even greater falls (EIB 2021: 26 and 55). Gross Fixed Capital Formation, a measure of investment, fell sharply down 14% from 2019 to 2020. In North America, GDP contracted by 3.5% with the nation also experiencing the worst recession since WWII, even as government contributed to maintaining aggregate demand with a $1.9 trillion package, some 9% of GDP (TDR 2021:31-38). Latin America was also severely hit with both a high contagion and mortality rate and a sharp economic turndown; GDP for the region fell 7% in 2020 and with low growth recovery expectations for the subsequent year to come. This has set back, or even reversed, the rather impressive social development and poverty reduction achieved in previous decades. African economies also experienced large recessions of 3.4% on average for the region, which wiped out years of development and brought tens of millions of African citizens into further poverty (World Bank 2021a and 2021b). South Africa, in particular, experienced a contraction of 7% of GDP, in 2020 alongside massive disruptions and serious setbacks to health, education and investment.

South Asia was also hard hit with a sharp contraction of 5.6% of GDP in 2020, and deficient healthcare systems and a high level of informality magnified the health and economic impacts. South East Asia contracted by almost 4% as some of the larger economies in the region struggled, especially those that were dependent on tourism and travel. East Asia was the region showing the most resilience with a growth rate of 0.3%, where economies such as China and Korea were able to minimize the disruptive impact on economic growth; although Japan experienced an annual contraction of close to 5%. The timing and prospects of recovery for all regions are still somewhat unclear as even by mid-2022 Covid was not over, and trade and business have not recovered pre-Covid levels.

Figure 2. Net capital flows by region



2.2. Counter-cyclicality – defining characteristics of scale, speed and direction

Before we start analyzing the counter-cyclical support provided by PDBs, we would like to highlight what a good counter-cyclical response means. As shown in Figures 1 and 2, the financial sector as whole tends to respond in a pro-cyclical fashion, accentuating and magnifying the trend whether positive or negative. Counter-cyclicality means essentially going against this, swimming upstream, or entering the financial market when others are retreating. Hence in our analyses it meant firstly, and perhaps most important, a significant scaling up and increase of lending and guarantees by the PDB, which is higher than increases in previous years. Secondly (and drawing also on our interviews), it implies accelerating the speed at which loan commitments are made and disbursed compared to previous periods, whilst trying to maintain the quality of evaluation. The use of digital technology, both by the PDB and by the borrowers, was very helpful in this. Thirdly, it refers to portfolio choices – counter-cyclical support meant allocating more funds to sectors and borrowers particularly badly hit by the COVID crisis, eg. services, and in some cases, exports; also to local authorities.

All of our interviews with the senior officials of PDBs revealed a high level of awareness and sensitivity to the need to provide a counter-cyclical support and what this would entail. Some, in particular the EIB, highlighted the significance of the reappraisal of the role of PBs that has evolved in recent years and subsequent much wider acceptance of the need for PDBs in general to exercise a counter-cyclical role. As mentioned above, the EIB Board had had much debate about the need for it to play a counter-cyclical role at the time of the Eurozone debt crisis, but by the time of Covid, the need for counter-cyclical support from development banks did not have to be discussed, as the idea had become widely accepted; this also seems to be the case for several other development banks, as illustrated for example by KfW and Colombian development banks . Therefore, there was in many PDBs, a significant increase of lending and financial support as private lending retreated, or grew less than in the past; in particular PDBs tended to channel funds into sectors, firms and households that were otherwise not receiving- or receiving less- revenues; without such PDB lending such firms could otherwise have collapsed due to a lack of sales and liquidity. In some cases where banks were not able to do this, they were severely undercapitalized for what was needed.

There is also a matter of speed, as pointed out above, – using existing mechanisms and instruments that are fast or creating new ones. All around the world these tended to be needed in sectors and firms that were strongly dependent on trade, whether as part of global value chains or because they were highly export oriented, but also in sectors relying on private domestic consumption, especially in services where movement and personal closeness is essential, which fell significantly, as a result of quarantines and in some cases, restrictions on domestic and international travel; these included transport and tourism firms impacted by the sudden stop in travel and movement and construction and infrastructure projects where working from home was not an option; furthermore, given the fall in aggregate demand in goods and services, companies invested much less.

Another particular sector where support from PDBs was crucial concerned the efforts for vaccine finance, this included the Covax program which may need public support because its activities and benefits are regional rather than national; also investment in the vaccine itself because of the risks and uncertainty. Furthermore, the role played by PDBs like the EIB to help finance Bion-tech, which led to the development of the Pfizer/Biontech innovative anti-Covid vaccine made a major contribution to Covid control worldwide. (Griffith-Jones and Carrera, 2021).

2.3. How development banks contribute to counter-cyclical support

Against this backdrop, the rolling out of governments' increasing support to companies and for maintaining jobs, as well as household protection schemes and the supportive role of development banks is clearly going in a counter-cyclical direction. PDBs responded rapidly and in a counter-cyclical direction– rapidly providing working capital, loans and 'breathing space' to distressed firms and households by negotiating payment moratoriums or grace periods, restructuring existing loans and extending new ones, as well as providing guarantees and other forms of support to commercial banks to increase their lending (Macdonald et al 2020; Gutierrez 2021; World Bank 2021).) See also Appendix 2, showing increases in lending during 2020, as compared to 2019, in a number of PDBs.

Most PDBs made an extra effort to be fast and flexible in meeting urgent needs, quickly learning and adopting new digital technologies and processes in their efforts, whilst accepting higher levels of uncertainty and risk, to provide a timely support service that was distinctively different from that offered by the market. They determined to provide additional and counter-cyclical support as pro-cyclical sources of finance dried up or fell in response to the uncertain and fearful times. This section presents an overview of some of the main and salient trends.

Based on our interviews and literature studies, in Europe, DBs support helped compensate for the negative health, social and economic impact of COVID itself, going in the opposite direction from the private financial sector. In most countries economic recovery happened quite quickly when economies opened up, with GDP returning to pre-covid levels, for example, by the second quarter of 2021 for at least 20 EU members and a liquidity crisis has till now been averted (EIB 2021). In several European countries, public development banks helped support the recovery, In some banks increased lending was especially marked, including KfW (+78%), EIB (+ 65%) (See Table in Annex 2). Some individual countries however remained in pain, especially in Southern Europe: for 9 EU members, GDP did not regain pre-pandemic levels by the start of 2021 (EIB 2021). The impact of PDB lending is difficult to assess precisely, but clearly a stronger PDB response contributed to smaller economic downturns and speedier recoveries Some industry sectors also continued to be hard hit across the board – notably trade, tourism, and services in general and some public finance responses directly targeted these sectors.

Of course, the role of PDBs was complemented by other public sources of finance and this is particularly the case in Europe, where the EU governing authorities initiated a series of supportive financial measures and packages[3].In a recent 300-page report by the EIB[4] on this period there is plenty of discussion of public guarantees, subsidies, loans, grants and other forms of support.

In other regions, especially where the financial sector is less deep than in the European countries, and there is often less fiscal space for Governments to increase their spending and guarantees.

---

[3] The suspension of the EU Stability and Growth Pact's deficit and debt rules at national level, enabling coordinated more expansionary national fiscal responses; secondly grants and subsidized lending facilities offered to firms and individuals at the national level, complemented by the SURE job protection facility, the European Guarantee Fund and the European Stability Mechanism's crisis response, and above all the Next Generation EU, which combines recovery from COVID, with the long-term support to make Europe greener, more digital and more resilient. A third response was the European Central Bank's large-scale purchases of euro area government bonds.

[4] https://www.eib.org/attachments/publications/economic_investment_report_2021_2022_en.pdf

the role of PDBs may be even larger, or more apparent, especially if they can leverage resources to support the productive economy and public services(especially health) when others cannot do this. They achieved it either by borrowing on the capital markets or by obtaining funds from other sources, such as multilateral and regional PDBs. While there are some broad trends emerging in each region, experiences differ at the level of individual banks, reflecting their individual contexts, structures, and resources. In Latin America, the role of bank guarantees appears to have been particularly significant, given their value for dealing with uncertainty.

More broadly, in the Latin American and Caribbean region, the response of both national development banks and regional ones was very positive, especially the former ones, as detailed below. According to CEPAL estimates, during 2020 and till February 2021, the multilateral Inter-American Development Bank (IDB) and sub-regional development banks (the Development Bank of Latin America (CAF), the Central American Bank for Economic Integration (CABEI) and the Caribbean Development Bank (CDB)), committed US$ 8 billion and US$ 12 billion, respectively, to fight the pandemic, which in total represented 0.5% and 1.9% of regional GDP and of exports of goods and services respectively. These funds were targeted to finance emergency programs, including health-related measures, as well as the provision of contingency credit lines, especially to national governments. In the case of IDB, the expansion in lending to confront the effects of COVID-19 on the region in fact surpassed those following the global financial crisis of 2008-2009. For their part, national development banks have committed the equivalent of US$ 90 billion in financial support in the same period, which amply exceeds that provided by regional and sub-regional development banks Moreover, national banks have supplied liquidity support through a variety of instruments, including guarantees, grants and refinancing schemes, focusing on lending to the private sector, especially SMEs. The emergence of national development banks as key players in the provision of finance points to the need to foster greater cooperation and coordination between regional/sub-regional and national development banks. The lending capacity of some regional development banks was increased through increased capitalization. For example, CABEI increased its authorized capital by 40% (US$ 2 billion) in April 2020.[5]

In Africa, guarantees were also important as a tool for DBs to help support their clients, and some banks further cited their dependence on sovereign guarantees for their ability to borrow on international markets. At the regional level, the African Development Bank increased lending by 36% and several national banks by a much larger magnitude.

Comparing the range of these experiences, some banks were clearly better placed to respond to the crisis conditions thrust upon them than others. Standing back and looking just at banks' lending and other empirical evidence across all the regions, we found some examples of very significant increases in lending commitments and disbursements and in other measures of counter-cyclical support, such as guarantees. Notable examples of very large increases in

[5] CEPAL (2021). Financing for development in the era of COVID-19 and beyond, March 2021. https://repositorio.cepal.org/bitstream/handle/11362/46711/1/S2100063_en.pdf

commitments are, in alphabetical order, AIIB, EIB, KfW, Nigeria Development Bank, and Uganda Development Bank (see Table 1, and Annex 2). Others did not succeed in increasing lending commitments in 2020. In a few cases, lending commitments actually went down, signaling that the bank was unable for various reasons to play its much-needed counter-cyclical role, and was in fact pro-cyclical. (One such case was BNDES). For several banks, increases in commitments did not go hand in hand with increased disbursements (Table 2); and in others, commitments fell while disbursements actually increased (e.g., AfDB). For others, commitments fell, and disbursements also fell, but by a lesser amount (e.g., DBSA, Black Sea). It is important to understand these different experiences because all banks aimed to be relevant and of support, especially in countries where their firms and households had few options to turn to. Also, they will all be expected to do the heavy lifting in any future crises, whether immediate ones such as the recent Covid one, the impact of the Russian invasion of Ukraine and its global effects or future financial or other crises; as well as long-term issues for resilience, climate change adaptation and mitigation.

Table 1. DB changes in loan commitments
Year 1 of Covid-19 (% change 2019 to 2020)

Banks with increases in Covid-year lending commitments	**Banks with decreases in commitments**
More than 20% increase Korea EXIM +23%, Korea DB +25% BOAD +36% Rwanda DB +42% EIB 65% Uganda DB +73% KfW 78% Industry bank Turkey +50% Nigeria DB +99, AIIB 120%	*More than 20% decrease* Black Sea -25% DBSA -65% AfDB -42%
Less than 20% increase BD Canada +4%, CAF +8% China DB +10% SMI +8% CDP Italy +14% Korea Industrial Bank +12%	*Less than 20% decrease* JICA -4% SIDBI -10% IsDB -15%

Table 2. DB changes in loan disbursements
Year 1 of Covid-19 (% change 2019 to 2020)

Banks with increases in Covid-year lending disbursements	**Banks with decreases in disbursements**
More than 20% increase Bank of Nigeria +79%, AfD +36%, Uganda +32%, BOAD +32%, SIDBI +22%, BOAD +32, Exim bank of Korea +23%	*More than 20% decrease* DBSA -23%
Less than 20% increase Bancoldex +11% BNDES +17.37%, CAF + 3%	*Less than 20% decrease* Black Sea -8%, BNDES –10%, Rwanda DB -17%, Islamic ICD -15%

Source: Data based on annual reports of banks, websites and other available literature. See also Table in Annex 2.

3. What accounts for differences in bank responses?

As noted above not all banks were able to be as counter-cyclical in practice as others and Part III teases out some important characteristics or features that determined what banks could offer. Nonetheless, many succeeded in significantly increasing their lending from previous 'normal' years - as well as using new modes of operation, designing new or adapting existing instruments, and in some cases changing their mandates and business model.

a) **The depth or acuteness of need.** The degree of economic shock caused by COVID and its impact on output, employment, trade, investment, and other variables varied from country to country depending in part on the structure of their economy and the degree of social support and other automatic stabilisers. As shown above the degree of GDP decline was different amongst countries (in some Asian countries it was significantly less acute during 2020, whereas Latin American and European countries had the largest declines). Countries heavily exposed to exports and especially services, both international, like tourism, and those for the domestic market, were most affected; even countries that did not have covid lockdown policies still were impacted because of their exposure to global value chains or decline in demand for their exports. However, severity of lockdowns had complex effects; on the one hand, they depressed production and demand of goods and especially services; if more effective in controlling COVID, as in China, Taiwan, Korea, New Zealand, for example, they may have facilitated quicker and more sustained recovery. Another important feature determining the acuteness of need for support by PDBs concerns the depth or strength of domestic capital markets. In Europe when capital markets dried up, they tended to recover quicker, but it was not the same and not so speedy in many emerging and developing countries, especially the lower income ones. As indicated in Figures 1 and 2, in many developing countries there was a rapid and strong reversal of capital from their shores and even if temporarily, this would be expected to contribute to tighter credit conditions.

b) **Levels of capital and other sources of funds**. This is perhaps the single most important issue and as highlighted in Part I, of immense significance for the ability of PDBs to respond in the future. In our interviews, all banks emphasized the importance of having sufficient capital and resources with which to meet their clients' needs and to fill the gap in their access to credit. While at an anecdotal level there is some question about whether commercial banks ever experienced a shortage of liquidity and of capital, or whether they were mainly unwilling to lend due to high risk and even uncertainty that companies would be able to pay back; from the public banks' perspective their ability to respond in a counter-cyclical fashion varied greatly according to the size, source, and reliability of their funds. One bank raised the importance that banks have sufficient capital in reserve so that they can act when emergency strikes, and can be swiftly counter-cyclical, at sufficient speed and scale. For this, it said, the lesson was that a prior increase above current levels was needed. Another bank, the PDB of Uganda, said its very significant increase in recovery lending benefited from an increase in its capitalization, which was doubled by the government. The CEO said she was able to commit all the new funds gained; and saw this as an indication also of the power of having wholehearted support from its government. This bank was able to boost lending from 2019 to 2020 by as much as 75%.

   Other African banks were not in the same boat. One in particular noted frustration that it could only borrow on private international markets at its relatively low governments credit rating, and hence costs were high; also, it needed a government guarantee as well – which was hard to get. For this bank, even though it did manage to increase lending commitments significantly, its actual disbursements were down by around 12%, meaning that despite its intentions it had not succeeded in being counter-cyclical. Businesses in the sectors most hard hit, such as tourism, could not be supported at all.

The case for the importance of robust capitalization is further made by the two banks that showed the greatest increase in lending among all we surveyed, namely the AIIB and KfW. While the AIIB is still a relatively new bank, having been established in 2016, its potential impact was clearly shown as it increased lending by 120%. In interview, the AIIB emphasized that its ability to scale up so significantly was because the capital was already there – in effect, they simply rolled out the lending sooner than had been otherwise anticipated. They also used a large part of these funds to co-finance loans mainly evaluated and partly funded by the Asian Development Bank and the World Bank, collaboration which facilitated AIIB ability to increase commitments so much and so quickly. Germany's KFW also has significant and reliable funding, and was provided additional funds by the Government after Covid started. Italy's CDP gave the example of the importance of source of capitalization as well – as a post office savings bank, its regulatory framework imposes limitations on how it is allowed to lend its funds and it would not normally have had so much leeway to scale up in response to Covid; however, it could respond because of its access to significant European funds. These broad experiences are also strongly supported by literature on the importance for PDBs of having a source of capitalization that is sufficient, reliable, and appropriate for its purpose (see for example, Eurodad 2017; Griffith-Jones and Ocampo, eds., 2018; TDR 2019:143-168). As noted in Part I of this paper, now debate and international action needs to focus attention on how PDBs can be better capitalized for the next crises, in addition to their other roles of supporting long-term development finance, especially for funding investment for transition to a more sustainable and just economy.

c) **An existing national government strategy**. This was especially important for some banks because it meant they had a roadmap already set out, and in some cases lines of communication directly with ministries (especially Finance) already well established. This finding from several of the banks interviewed reflects the broader argument in the economics literature of the need for a clear developmental plan when it comes to define mandates for a PDB (see for example Griffith-Jones and Ocampo, eds, op cit; Barrowclough and Marois 2022); and it is interesting that such advance planning has big benefits when it comes to crisis response also. It was helpful for banks to know national priorities when it comes to economic sectors and to be able to see their urgent and rapidly-put together loan proposals within a broader framework. The DB Uganda had already identified priority sectors that were essential for job creation and when covid struck the same sectors were relevant, but the list was extended further. This gave the banks a strategic direction and confidence that their lending decisions were also in line with government priorities. Several banks noted they felt fortunate that government plans had been clearly set out just a short period before covid struck – indicating the importance of preparation and vision. Some banks gave advise and support to their governments on a daily basis (eg CDP). This makes communications and support between Governments and DBs a two directional road.

d) **Government financial and political support** for DBs (either via increased capital or loans and subsidies) is essential – for national or as in the case especially of Europe, regional sources. It was also noted particularly by the differing experiences of the African DBs interviewed; one bank that significantly increased its lending and disbursements reported being strongly supported by its government; another that saw lending commitments increase by less and disbursements actually fall, did not cite this support. Support can come in a number of forms; one that is important concerns sovereign guarantees. Several banks that were less counter-cyclical noted the importance of these and the fact they could not always get them. "We are always looking" for this, one executive notes, as otherwise their borrowing costs are too high. Guarantees from the development bank to client banks and other borrowers were also important, especially for banks that could not do much rescheduling of loans or otherwise reduce the immediate crunch to borrowers of repayments. One element that is particularly important concerns whether government guarantees to their PDBs are registered above or below the line in the fiscal accounts as this understandably impacts significantly on the extent to which governments are willing or able to offer them.

e. **What did clients actually need?** In most cases, it was short-term loans for liquidity and working capital that were most needed, in the first stage, as companies' revenues fell. In this regard it seemed to make a big difference whether banks were oriented to SMEs, in which case they could respond quite quickly, or to infrastructure where they did not/could not, though many of the banks that had increased lending, said they were able to switch from lending long-term to infrastructure to lending short term for working capital, often mainly to SMEs. In other cases, banks noted that previous lending projects, as well as portfolios of evaluated projects which did not have enough funding previously, were valuable as they could be either expanded, renewed or financed for the first time relatively quickly; although at the same time, these still had to be relevant in the current conditions: One African PDB noted that the infrastructure projects went onto the back burner; also that tourism was no longer feasible to lend to as a sector despite the fact that firms in the sector were in dire straits. Some of the other banks that also usually lend to infrastructure, such as the AIIB, also noted that long-planned projects were delayed. Other banks with more of a tradition of lending to municipal governments, health sectors, exports, and SMES seemed to be able to increase lending and quickly.

f. **Modalities** – related to the above – the modalities used tend to be related to whether banks typically, *ie* before covid, focused on long-term investment as compared to other functions such as providing export or import cover and other forms of working capital. This is where the crunch was and the center of the liquidity crisis and banks doing this kind of lending were more likely to scale up. The type of instruments used was also linked with banks' abilities to scale up or to lend at speed. Supporting companies by buying equity in them, for example, has its attractions, but it is also heavy in terms of its capital commitment, and it takes time to organize. And the value of an equity position can be difficult to ascertain in a crisis time when markets are volatile and prices and revenue forecasts rapidly changing. Also as noted above, for some banks the modality with which they could offer counter-cyclical support was tightly regulated – some for example were not allowed to offer to reschedule existing debts or to switch modalities to provide working capital as opposed to expansion or start-up loans. However, many PDBs, for example in Latin America, had an important use of rescheduling existing debts (CEPAL 2021).

g. **Internal innovations** – many banks noted the challenges of working from home and especially having to respond speedily, having to very rapidly adopt new processes, including in particular digitalization. Some banks found themselves understaffed during the crisis (the Rwandan PDB we interviewed was coping on half the usual number) while others were able to scale up, taking on new staff members and rolling out digital loan applications, verifications, and disbursements. Uganda Development Bank is a good example on this - it re-organized itself, including by hiring new staff, modified the process review for loans (aiming to combine speed and cautious evaluation) and incorporating more digitalization.

h. **Partnerships with other banks**. DBs in the high-income countries did offer important support to fellow institutions in lower income ones and this was cited as having been extremely welcome and important to their recipients as it helped provide not only much needed capital, but also contributing to speed of response and a broadening of priorities. For example, the EU gave support to Uganda tourism sector; the EIB, AfD and KfW did also provide much support. Regional banks also supported their national members, such as the AfDB, and also the newer financial institutions such as the AIIB. In the AIIB's case, its ability to expand lending so quickly in the first months of Covid (when it raised its Crisis Recovery Facility from $5 billion to $10 billion within a month of establishing it, as requests from members were so high (Barrowclough 2020), involved in addition to the points above, adapting their operations to work closely with other MDBs and create a network of support options, especially for the most vulnerable economies. KfW gave support to many NDBs (and other actors in emerging and developing economies).

i. **Mandate**. The mandate of individual PDBs is so important that it may seem unusual to put it as the last point in this list, but in practice the preceding points are all either directly or indirectly related – or should be – to what a PDB is expected to do. For one bank interviewed, its mandate was clearly to be counter-cyclical and public-oriented – while at the same time it was required to focus more on long-term lending and to SMEs. It was nonetheless able to respond very quickly within this time, launching a Social Response within one week of the first national case registered of Covid, and issuing a bond two months later with further measures including additional loans and guarantees (see Vandone et al 2020).

   Other banks that also amended their rules by allowing "fast track" lending to health systems and small businesses under strain were also able to provide an important counter-cyclical service, even when the total amounts involved were relatively small (eg the Council of Europe Development Bank, CEB; see Reyes 2020). In another example, the bank's re-evaluation of its mandate, while keeping to the broader roadmap envisaged before Covid, enabled a massive counter-cyclical operation. The New Development Bank also had to be flexible as its existing policy framework did not support the special needs of members during the covid period, and early loans to members needed a special waiver to be allowed (Barrowclough 2020). Subsequently the Bank revised its policy on the definition of what was an emergency – which had previously been related to natural disasters and conflict. By comparison, in another bank, the mandate was not revisited even though it meant that SMES in a particularly hard-hit services sector did not get support. The reason given was the potential risk of non-performing loans, however at the same time the long-term implications for the economy, given the importance of this sector, could be far-reaching if important resources, skills and knowledge is lost.

4. Conclusions

An important conclusion of this study is that the counter-cyclical role of PDBs has increasing, as well as broad, support and consensus. This is reflected in the very large scale and extremely speedy response by PDBs to the Covid-19 crisis. For example, the EIB Board did not even debate the need for a counter-cyclical response to the Covid-19 crisis, but embraced this policy immediately and unanimously, whereas during the Eurozone crisis a decade before, the EIB Board had initially debated the need and scale of such a response. It should however be mentioned up-front that the counter-cyclical response by several MDBs (such as the AfDB) and some NDBs has been somewhat constrained by limits on their capital, or the slow speed at which such capital is being deployed. This is different from the quick and significant increase in the capital of MDBs that followed the 2008-2009 financial crisis.

Though this study emphasizes the key counter-cyclical role that PDBs do and need to play, it is important to stress that there are of course other key roles PDBs need to play, such as helping fund the massive investment required to achieve the structural transformation to low-carbon and more inclusive economies so urgently needed. In these examples, public development banks still need to lend 'against the stream' and counter to the main direction of the rest of the financial system, but this is more a feature of the inherent and permanent features of the underlying green investments (such as scale, risk, uncertainty, and public good characteristics) than cyclical trends in the economy.

With regard to counter-cyclicality, there are three dimensions we wish to emphasise. The first one is clearly scale of response, which needs to be large, to be really impactful. The second dimension is speed, as time was of the essence in Covid-19 times, as well as in other crises, to help save private companies and jobs, as well as support governments, whose revenues were declining, but who had to fund growing traditional and new roles, such as increased health spending. Indeed, the third dimension is to have the flexibility to change sectorial emphasis, reflecting the different needs generated by the crisis; this last dimension was particularly relevant for the case of the Covid-19 crisis, where certain sectors (such as services) were particularly badly hit; especially when such hits were seen as likely to be temporary, counter-cyclical support, including by PDBs, became crucial.

A good synthesis of the first two dimensions was provided by KfW, when they said that their motto for their counter-cyclical response to Covid-19 had to be "quick, decisive and fund at large scale!".

A number of key implications arise from the importance of PDBs' counter-cyclical role. A first and central implication is the need for PDBs to be sufficiently capitalized, to be able to respond well if a crisis or external shock hits an economy. In fact, it may be ideal if as the CEO of an important PDB pointed out, that in "normal times", PDBs had some spare capital, so they could respond speedily enough and at sufficient scale, if a crisis hit, without having to negotiate a capital increase before; thus, the PDB, could start early and help minimize harm to jobs and companies, as well as the broader economy, including investment.

Another option is for governments to rapidly increase the capital of PDBs, as soon as a serious crisis arises. This was the case for MDBs and RDBs during the global financial crisis, when after the spring 2009 London G20 summit, these banks saw an important increase in their capital; however, till now, the response of the international community has not implied an increase in the capital of most MDBs. This has limited their ability to scale up and increase lending in a counter-cyclical way much further than their otherwise valuable response, and/or has inhibited them from continued high levels of lending, where this was necessary.

The experience of the AIIB highlighted in a positive sense the advantage of an MDB having ample capital. Because the AIIB was a relatively new bank and had been generously capitalized so it could expand lending during the whole decade, it was able to accelerate easily its lending, which resulted in the largest counter-cyclical response (of 120% of expansion of activities between 2019 and 2020) within our sample. It should be emphasized.

It should be noted that the AIIB co-financed much of this counter-cyclical expansion by co-financing with partners such as the World Bank and Asian Development Bank, institutions that took the lead in the evaluation of programs and projects; this implied that the processes could be fast for the AIIB. One reason why this was feasible was that these banks had similar criteria for evaluating proposals as the AIIB. This illustrates the importance of close collaboration and valuable complementarities between different MDBs, in the counter-cyclical role, but of course more broadly, in other roles. **There is here an important implication for the global development finance architecture; development banks can work best, when they collaborate closely with, and complement, each other.**

This is not to say that all banks should be identical and there is much to be gained when the financial landscape has a broad diversity of banks, with different specialisms and expertise. Nonetheless, the Covid story we gleaned from the interviews shows that articulation between banks is an important element for success, and an area where further research is needed.

Though we highlight above increases of capital as a key pre-condition, for increasing lending commitments in a counter-cyclical way, there are other complementary mechanisms that can be important to achieve counter-cyclical increases in lending, such as: increasing other resources-like 1) obtaining or increasing access to private capital markets or funding from other PDBs- 2) possible need to adapt lending and other PDB instruments, and the sectors they lend to, as well as 3) if necessary to adapt or even change mandates. The ability of PDBs to incorporate digitalization into their processes, as well as encourage their borrowers to do so, was also an important and new factor that facilitated (or not), the ability to respond counter-cyclically, especially in terms of speed, but also of scale, during the Covid-19 crisis.

A second key implication of the importance of PDBs counter-cyclical function is that for those countries, such as many LICs and LMICs, which have limited fiscal space to respond to crises, either financial or ones like COVID, it may be more difficult for their national governments to significantly capitalize their PDBs. In that case, it becomes desirable for the international community to step in, and provide additional resources, either to help capitalize these national PDBs, or provide them with additional credits or guarantees. An important additional channel being discussed – and that hopefully can be implemented soon – is the channeling of a part of the SDRs that will be re-distributed from richer to poorer countries, via MDBs or RDBs. Though this proposal has to overcome some technical challenges, which seems clearly feasible, it has great potential – due to leverage – for the positive impact on the economies of some of the poorest and worst hit by Covid-19 countries. Both governments of African countries and institutions like the African Development Bank, as well as other partners in developed economies are therefore rightly supporting this important proposal.

A third implication related to the counter-cyclical role is more an issue for further research, including by the PDBs themselves. Will there be higher losses for PDBs in the counter-cyclical loans and guarantees made in COVID times, as companies struggle to recover in today's continued challenging environment both in local and global markets, now accentuated by lower growth due to the Russian invasion of Ukraine? Companies can have greater difficulty to pay back loans than in normal times. At the same time, in our interviews several banks noted that the strong business case for lending to other banks and to firms that were illiquid but otherwise viable, noting it was important not to let them sink if one wanted future clients. Hence an important but nuanced question for the future concerns what provisions were made for non-performing loans, (NPLs) of PDBs, for counter-cyclical lending and for guarantees granted? It could be assumed losses will be higher, and therefore there may be a need to have higher provisioning. If provisions are not sufficient, is there a risk that these banks find themselves in problems in the future, as losses could erode their capital and thus their future capacity to lend? If that is the case, should they be recapitalized?

Though up to now, we have emphasized general conclusions and implications of the counter-cyclical response of PDBs, it should be stressed finally, that there were important differences among countries and regions, even though Covid-19 was a global phenomenon.

Thus, for example, some countries/regions – at least initially – were less badly hit than others by Covid, largely linked to the responses they had to the pandemic, and there was a diversity of economic policy responses reflected in part by their existing institutions and resources available. As a consequence, the role that PDBs needed to play differed. Furthermore, the capacity of PDBs to respond varied, both linked to their governments' ability to offer support but also in some cases, their political willingness to give a major role to PDBs in the counter-cyclical response; furthermore, the previously existing financial and other capacities of the PDBs themselves influenced how strong their counter-cyclical response was. However, the commitment and enthusiasm of the different PDBs interviewed, showed us the great efforts made by PDBs in general to respond as much, as quickly and as well as possible to the pandemic.

Bibliography

Barrowclough D. and T. Marois (2022)
Public Banks, Public Purpose, and Early Actions in the Face of Covid-19 (2022), with T. Marois. *Review of Political Economy ROPE*, Vol 34 Issue 2. https://www.tandfonline.com/doi/full/10.1080/09538259.2021.1996704

Barrowclough D. (2020)
"South-South Public Finance: Cooperation and Resilience to face Covid-19" in McDonald, D., T. Marois and D. Barrowclough.

Carreras M. and S. Griffith-Jones (2020)
"National and Multilateral Development Banks in the Pandemic: the Role of IADB and CDC in the first phase of the pandemic in McDonald, D., Marois T. and Barrowclough D.

CEPAL (2021)
Financing for development in the era of COVID-19 and beyond, March 2021. https://repositorio.cepal.org/bitstream/handle/11362/46711/1/S2100063_en.pdf

EIB (2021)
Economic Investment Report. https://www.eib.org/attachments/publications/economic_investment_report_2021_2022_en.pdf

Eurodad (2017)
Public development banks: Towards a better model. Discussion paper. European Network on Debt and Development.

Griffith-Jones S. and R. Gottschalk (2012)
"Dealing with the only certainty: uncertainty", paper prepared for Commonwealth Finance Ministers' Annual meeting https://policydialogue.org/files/publications/papers/FMM124_Exogenous_Shocks_-_Dealing_with_the_Only_Certainty_-_Uncertainty_Stephany_Griffith_Jones_and_Ricardo_Gottschalk.pdf

Griffith-Jones S. and J.A. Ocampo (2018)
The Future of National Development Banks. OUP. Oxford and New York.

Griffith-Jones S. and M. Carreras (2021)
The role of the EIB in the Green Transformation. FEPS https://opendocs.ids.ac.uk/opendocs/handle/20.500.12413/16582

Gutierrez E. (2021)
"National Development Financial Institutions". World Bank.

McDonald D., T. Marois and D. Barrowclough (2020)
Public banks and Covid-19: tackling the pandemic with public finance. UNCTAD, *Eurodad and MSP*. https://unctad.org/webflyer/public-banks-and-covid-19-combatting-pandemic-public-finance

Plant, M. (2023)
"Is there a better way to use Global Reserves?" Center for Global Development, Washington D.C.

Reyes O. (2020)
"The Council of Europe Development Bank and Covid-19 in McDonald, D., T. Marois and D. Barrowclough.

TDR (2019)
Financing a Global Green New Deal, Trade and Development Report. UNCTAD Geneva.

TDR (2020)
From Global Pandemic to Prosperity for All: Avoiding Another Lost Decade, Trade and Development Report. UNCTAD Geneva.

TDR (2021)
From Recovery to Resilience, the Development Dimension, Trade and Development Report. UNCTAD Geneva.

Vandone *et al.* (2020)
"Covid-19 and measures to support enterprises and local authorities in Italy: the Role of CDP in McDonald, D., T. Marois and D. Barrowclough.

Agence française
de développement
5, rue Roland Barthes
75012 Paris l France
www.afd.fr

What is AFD?
Éditions Agence française de développement publishes analysis and research on sustainable development issues. Conducted with numerous partners in the Global North and South, these publications contribute to a better understanding of the challenges faced by our planet and to the implementation of concerted actions within the framework of the Sustainable Development Goals.
With a catalogue of more than 1,000 titles and an average of 80 new publications published every year, Éditions Agence française de développement promotes the dissemination of knowledge and expertise, both in AFD's own publications and through key partnerships. Discover all our publications in open access at editions.afd.fr.
Towards a world in common.

Publication Director Rémy Rioux
Editor-in-Chief Thomas Melonio

Legal deposit 3rd quarter 2023
ISSN 2492 - 2846

Graphic design MeMo, Juliegilles, D. Cazeils
Layout Denise Perrin, AFD
Printed by the AFD reprography service

To browse our publications:
https://www.afd.fr/en/ressources-accueil