INTRODUCTION

THE KEY ROLES OF DEVELOPMENT BANKS[1]

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I will focus my article on the key roles of the development banks in financing. At the international level, there has been a renaissance of public banks and development banks after the North Atlantic financial crisis and post the covid pandemic. They are even more important now, in view of the difficulties that exist at the international level due to the invasion of Ukraine and the risks of inflation and recession globally.

I would like to mention some theoretical insights and contextualize something professor Stiglitz said about financial markets: they have more market failures than government failures. And that is the reason why intervention is necessary, because financial markets are flawed, for example in creating a low-carbon economy, as private financial markets are full of imperfections. That is why public intervention is important, not because governments and public institutions are perfect, but because they are less imperfect than private financial markets are.

Market failures in creating a low-carbon economy is one of the challenges for Brazil and Latin America. Indeed, private financing alone is not willing to finance activities with uncertain returns and other externalities. And sufficient finance is key to a structural transformation to a greener and more inclusive economy. Therefore, there is a strong need for development banks due to the severe limitations of private sector finance to act on its own. Long-term private loans are scarce and expensive, alongside the uncertainties due to the pandemic and the need for a climate transition, which makes it especially difficult for smaller and newer companies to access credit.

The shortage of enough funding to finance the massive investment for the structural transformation towards a green economy is a big challenge. Some financing sources are required to make this transition so that there is a more credit for green economy. The European Investment Bank (the large development bank of the European Union) is becoming a green bank, since 50% of its loans

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will be destined for green economy by 2025. In the United States, the Congress and president Biden have just approved the creation of a federal green bank, with an initial public capital of USD 27 billion. This is an important role of development banks for structural transformation.

During the recent crises, many private financial institutions have reduced lending as a pro-cyclical measure, given increased uncertainty. However, public development banks, multilateral, regional, national and sub-regional have significantly increased their lending, playing a crucial counter-cyclical role, and thus helping recovery and maintaining levels of investment.

Development banks have a crucial role both at the multilateral, regional, and national level. It is important to know that they finance 10% of global investment representing more than $20 trillion in assets and around $2.4 trillion of annual lending. Development banks are important in both emerging economies and low-income countries, as well as in developed economies. For example, in Europe also development banks are important.

A balanced approach must combine both public and private institutions. It is important to point out that the support of development banks implies a reflection of a balanced approach that includes the participation of both the public and private sectors. There must be a paradigm shift instead of deciding whether it is the role of the state or the market in finance which dominates, because this is not what matters. It is better to talk about complementarity of both sectors and consider the strength of each of the sectors, and how best they can work together.

An important advantage of development banks is that they are able to leverage public resources to maximize impact on development. In situations of fiscal retrenchment and low growth, where there are high debt levels and high inflation rates, public resources become particularly scarce. Thus, development banks can help leverage public resources and therefore can have a greater impact on the recovery of the economy and long term development. The other advantage of development banks is that they tend to provide very long-term loans, in other words, it is patient capital. World Bank surveys show more than half of the loans of development banks are over 10 years.

How important is the role of development banks? Development banks key roles include to enable countercyclical financing and to provide resources for structural transformation. Furthermore, they should help create greater inclusion, finance public goods, and meet new challenge of supporting the post-covid recovery and making sure it is aligned with green goals.

Counter-cyclical measures are very crucial in the current post-crisis pandemic circumstances. They played an important role during the 2008-2009 crisis. Lending by national development banks worldwide increased by 36% between 2007 and 2009 according to a World Bank survey. Another example has been the large expansion of development banks lending during covid. During the covid period the largest expansion of loan commitments amongst multilateral banks was that of the Asia Infrastructure Investment Bank (AIIB), which grew by 120% in a year. Brazil is one of the exceptions to the counter-cyclical response. Even though previously had been an example in the region because it had a large development bank. But Brazil played a small counter-cyclical measure compared to other countries, in covid times, allocating only between 0.75% to 0.89% of the gross domestic product (GDP) in 2019 and 2020. It is important to mention that the scale of the BNDES has been proportionally diminished when looking at loans in relation to GDP. The BNDES' performance in lending commitments relative to GDP is receding. There is a contrast with the international trend, in which development banks have increased their activities.

And why are counter-cyclical measures important? Because they are crucial in the post-crisis periods to have long-term investment as a way to mitigate the effects of the crisis and the effects of the pandemic. They also need to support the solvency of the companies and preventing many of them from going bankrupt, and unemployment increasing. For development banks to be able to provide this kind of assistance, it is very important that they have enough capital to be able to respond quickly in difficult periods of crisis. As we have seen in recent years, multilateral banks have had insufficient capital to help.

The second point is that these long-term loans can help structural transformation, which is a key to having a more inclusive and a greener economy. Also crucial is their support for innovation and entrepreneurship in national economies. It is very important because it serves as a bridge between the public and private sector and development banks can contribute in significant ways to financing new sectors and cross-sector projects, to aid countries in order to become more dynamic in their economy.

Additionally, banks can be crucial to support the green economy. And finally, I would like to highlight the important role these financial institutions have. They have advantages because of their accumulated expertise, administrative efficiency, and the power to make loans that, as I mentioned, are crucial for this transformation. They also help governments design their green transformation public policies and structures, as in the case of China and Germany – two cases that it is worth to point out.

Development banks are also important to help mobilize additional funding, mainly in the private sector. They can prove the viability of some sustainable investments. Germany's KFW is the second largest commercial bank and like the Chinese Development Bank it played an important role in the renewal of the energy matrix both nationally and globally, towards renewables.

One of the interesting conclusions of this analysis is that we need both multilateral and national development banks. Some countries like Germany and China have very large development banks in proportion to their GDP and this helps a lot with transformation and recovery. In the current scenario there are low levels of investment in both the public and private sectors, which makes this recovery more complicated. Here development banks can be particularly valuable, due to the leverage they provide.

What are the conditions for development banks to be more effective? As well as a functioning financial sector, I think it is important that the country has a clear development strategy that focuses on the green and fair transformation. We also need to have clearer policy targets for the development banks. It would be better if these banks did not change so much their mandates with different governments, and a good example of this is the KFW, because they change as a result of the needs of the economy and not in response to the demands of different governments.

I would like to finish with some conclusions and policy recommendations from the first meeting of the public development banks that was held in Paris and attended by over 400 banks. The first recommendation said that it is important to ensure that the capital of development banks is at a sufficient scale. The second point is that public development banks should incorporate transition to low carbon and inclusive economies into all their financial decisions and all their project cycles. It is important that they blend resources with the private sector and there are several ways that these public banks can interact with the private sector. I think there are some methods that are better than others. The first is that public development banks can finance themselves on the capital market. They can also co-finance with private banks and private investors.

Finally, they can use more complex instruments with high leverage but there is a risk of creating problems of future contingent liabilities for the development banks, furthermore, this may imply they lose policy steer. This may be less desirable.

The main message is that development banks have to be effective, and they have to maximize their development impact. It is important that they have good financial results, but the main aim, fir which they need to be evaluated is for their impact on innovation, and structural transformation to a more dynamic, greener and more inclusive economy. I think a lot has already been achieved by these development banks, including in Brazil. They are pioneers but there is a lot to be done yet.