**UNCTAD Intergovernmental Group of Experts on Financing for Development**

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**Session 4: "The role of development banks in improving domestic public resource mobilization and international development cooperation"**

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Thank you, Mr. Chairman, for giving me the floor. I would also like to first express my thanks, on behalf of Finance Watch to UNCTAD for inviting us to participate in this Intergovernmental Group of Experts, which addresses a number of urgent and hugely important issues.

By way of short introduction: Finance Watch is a **European civil society organisation**, based in Brussels. It was founded in 2012 – at the height of the post-crisis regulatory efforts – to provide independent expert views on financial sector policy and regulation. Finance Watch members (ca. 70) represent a broad **cross-section of civil society**, including trade unions and trade associations, consumer rights groups, think-tanks, academics and other NGOs.

We have already heard comprehensive and insightful presentations from the panellists. I would like therefore to concentrate, at this point, on **two issues** that we believe deserve particular attention: the **definition of PDBs' mandate** and their **access to funding**.

## I. Constraints on development banks' role

Much of the discourse about PDBs revolves around the definition of their **mandate**, which is usually formulated in the **negative:** their primary purpose, it is said, is to remedy **'market failures'** and provide credit in instances the private sector cannot or is reluctant to address. First and foremost, however, they are not supposed to encroach on the domain of private-sector financial institutions.

I would like to contrast this with a different, **positive** narrative. Yesterday we heard Robert Kozul-Wright speak about the **"steady attrition of the public realm"**, starting in the 1980s and 90s, and how financialisation has turned profitability into the defining benchmark for all public and private endeavours. The financial crisis of 2008/09 should have ended this reliance on financial returns as the one true benchmark guiding economic policy, but the myth is still lingering.

The PDB is a financial institution *sui generis* that is dedicated to promoting the **public good**. It is legitimised, first and foremost, by a broad political consensus which defines the public good. At the national level, the public good may be enshrined in a national **development strategy** or in a variety of sectoral policies. At the global level, it is expressed in landmark documents, such as the SDG and the AAAA.

A frequent concern that is being voiced in this context is that PDBs are **"crowding out"** private-sector investment. The fact that PDBs respond, first and foremost, to a public interest objective does not imply that they are incompatible with the development of a vibrant and healthy private banking sector. In fact, PDBs and private-sector funding are, for the most part, complementary, as they should be. Where overlaps occur it is the responsibility and prerogative of the policymakers to draw clear and transparent policy lines. This why development strategies and the PDB's mandate require particular attention.

Another argument advanced by some is that PDBs' role should diminish as economies mature – that PDBs are subject to a natural **"life cycle"** and at some point **become obsolete**. But economies, developing and developed ones alike, are always subject to evolutionary cycles. Climate change, the migration from fossil to renewable energy, the deployment of high-speed digital networks and electro-mobility are all **developmental challenges** that concern developing and developed countries alike. It is up to policy makers, not PDBs, to formulate strategies that address the challenges of the day. But PDBs remain, by definition, the instrument of choice for financing these strategies.

## II. Constraints on funding

As was highlighted in the excellent background paper provided by UNCTAD, the scale of the funding challenge to achieve the SDG targets is indeed staggering[1]. The availability of **private capital**, both domestically and through inbound capital flows, will be a decisive factor in achieving the 2030 Agenda. At the same time, developed country financial markets are awash with savings[2], often tied up in low-yielding investments or chasing finite pools of assets. The barriers to mobilising these savings for development and attaining the SDGs are manifold and have already been discussed in depth by the panel and in the background paper. They include **legal, regulatory, structural and practical constraints**, such as information asymmetries, risk aversion, home bias, the fragmentation of donor funds, investment guidelines, credit ratings and prudential regulation – just to name a few.

## III. Key discussion points

### a. Prudential regulation

Let me start with the last point, as relates to the discussion about the nature and mandate of PDBs. There is an argument that the specificity of PDBs' business model and State support imply that **PDBs should not be required to comply with Basel III prudential standards**, which are designed mainly for private commercial banks. As a result, PDBs could take on higher levels of levels of leverage to achieve more with their given levels of capital.

Even if PDBs are considered as financial institutions sui generis they need to operate in ways that are consistent with the relevant, generally accepted rules, such as the Basel accords - rules that are **designed to preserve financial stability**, avert financial crises and protect investors and taxpayers. That applies even more if private investors are expected to invest in PDBs and their projects.

State support of PDBs should be considered as a way of reducing the cost of borrowing, optimising access to capital and aligning interests with the public good, but **not as a "blank cheque"**. National PDBs should be regarded as a cornerstone of financial stability in their country. They have been given an institutional framework and are responsible to the stakeholders, including taxpayers, for managing their resources responsibly.

There are, admittedly, a range issues to be considered in more detail, e.g.:

- PDBs are more likely to be constrained than commercial banks by **large exposure** rules;
- Due to the maturity profile of their assets, which are mostly long-term, PDBs are more exposed to **maturity mismatches** and refinancing risk – this is where the NSFR comes into play;
- **Leverage:** as mentioned before, State support could be seen as a reason for exempting PDBs from the leverage caps, at present 3%, imposed by Basel III[3][4];
- Finally, **systemicity**: PDBs may be systemic in some countries, in particular smaller ones with a less developed banking system; although they benefit from State support, a potential bail-out could severely affect the home State's sovereign credit rating and may event stretch its fiscal capacity to the breaking point.

These issues are, of course, very **complex** and **deserve further scrutiny**, in our view, within the remit of this expert group and beyond. Some modifications may be in order to better reflect the specifics of long-term asset exposures. At this stage, however, we would argue that the potential gains from exempting PDBs from prudential requirements are likely to be limited and could be outweighed by increasing the risks, systemic, fiscal and reputational, that these rules are designed to address.

**b. Institutional design and mandate**

There are, in our view, **other, more promising areas** that could be explored to improve access to capital for PDBs. In order to mobilise at scale, savings from developed economies, notably of the Global North, it is important to ensure that PDBs, national and international, are seen as institutionally robust, competent and transparent. They key terms routinely brought up by civil society organisations and investors alike are “confidence” and “trust”. The key element that inspire confidence and trust are the clarity of its **mandate** and the quality of its **governance**.

We have seen, in recent years, a **re-emergence of PDBs**, both at the national and international level, reversing a trend that has decimated their numbers over the previous decades. This is very welcome news, even more so as some of these institutions are, in some instances, bundling funds from large emerging economies of the global South for re-investment in developing regions of the South.

**National and international PDBs** should be considered, and deliberately designed, as being complementary. NDBs thrive on focus and **specialisation**: they can operate in full alignment with national development strategies, with simpler governance structures and processes. By joining forces, MDBs derive unique benefits from **diversity and scale** by mobilising resources, improving access to capital, pooling know-how, and introducing mutual checks and balances in governance.

**Funding sources** and the **operating model** of a PBD should be chosen in line with their defined mandate. Funding may include private-sector sources to varying degrees: while private funding is essential for leveraging public resources they do, on the other hand, increase the PBD’s exposure to financial market constraints and pressures. Regardless of their provenance, funds should be available to the PBD in a flexible manner. Compartmentalisation and conditionality may be justified on a case-by-case-basis but should be avoided in general, so long as the PBD remains diligent and consistent pursues execution its mandate.

Similar choices need to me made when targeting public-sector or private-sector borrowers or direct vs. indirect lending. Whereas we would generally support direct lending as a means of maintaining a maximum of control and engagement by the NDB, we are equally mindful that it may be more practical and effective for MDBs, in in particular, to conduct engagements through NDBs or other public-sector partners and intermediaries. These are, again, critical considerations that need to be decided on a case-by-case basis.

**c. Governance**

You have heard me mention the term “governance” several times now. That is not a coincidence. Robust governance is, in our view, a **key precondition** for a successful PDB that delivers on its public interest objectives and is capable of attracting external cooperation and funding.

With their public interest mandate, PDBs inherently serve a diverse range of constituencies, including government, business, private investors and the civil society at large. Governance of PDBs has to adequately reflect and balance the interests of these stakeholders. **Based on political legitimacy** it has to be **transparent** (in its decision making), **accountable** (in the exercise of its mandate) and **inclusive** (by being open towards all stakeholders and responsive to their interests).

To this end, PDBs, national or international, should provide for adequate representation of all stakeholders, including information and participation rights. Similarly, PDBs should provide formal fora and processes for civil society involvement to ensure that they are held accountable, in a public and transparent way, for their public interest mandate.

**d. International co-operation**

I would like to conclude pointing out the role of international cooperation among PDBs. At the **operational level**, this should be taken as granted, by virtue of the nature of their mandate and activities. I would, however, like to highlight the need, beyond that, for a global institutional framework that allows, for instance, the exchange of **"good practice"** and **peer reviews**, following the example of similar fora that exist for commercial and central banks. This could be structured, for instance, as a global body under the auspices of the UN and including the WFDFI (World Federation of Development Financing Institutions). Proven adherence to common global standards of "good practice" could go a long way towards **building the level of the "confidence" and "trust" in PDBs** that is needed to help mobilise the large and stable cross-border deployment of capital that we know are necessary to deliver on the 2030 Agenda.

With this I would like to conclude my remarks and thank you all, Mr. Chairman, panellists and delegates, for your attention.

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[1] USD 5 to 7 trn per year, according to the Intergovernmental Group of Experts on Sustainable Development Financing (2014).
[2] Growing at an annual rate of USD 22 trn, according to the Intergovernmental Group of Experts on Sustainable Development Financing (2014).
[3] vid. recent EU proposals (November 2016 Banking Package) provide for targeted exemptions for PDBs, e.g. exclusion of loans for public-sector investment from the exposure measure used for calculating the Leverage Ratio.
[4] Note that PDBs actual leverage, according to recent studies, is ca. 30 times book equity on average, i.e. broadly corresponds to the Basel III level. This could be taken as an indication that this is seen as a prudent minimum and "best practice".