Whether and how public financing and investment for development be scaled-up? What challenges does this pose for public leadership in this area, at domestic and international levels? UNCTAD  March 22, 2022

Professor Stephany Griffith-Jones
Sgj2108@columbia.edu

The key issues for this session are clearly outlined in the Introduction to this session. Already prior to the Covid-19 pandemic, financing gaps to achieve the 2030 Agenda were substantial, and even optimistic scenarios, by the IMF and UNCTAD amongst others, see these widening further over the next few years unless decisive action is taken to reverse this trend. Further challenges are being posed by the Russian invasion to Ukraine, especially to countries trading with Russia and Ukraine, and to oil, as well as cereal importing developing countries.

Current approaches to financing for development prioritize the use of public funds to de-risk private investment through innovative financing instruments. Has the time come to re-think this priority and the balance of private and public roles in development financing this entails? What can be done to boost “patient” private investment that is more reliably aligned with the sustainable development goals? And is there a case for scaling-up public financing and investment for development directly to ensure the delivery of required development finance on time? What challenges does this pose?

I would agree strongly with this initial statement, in that I believe that public financing and investment for development needs to be scaled up significantly to ensure both development and transition to green economy financing is sufficient. I also agree that it is important for public funds to help catalyze and crowd-in “patient” private finance, valuable for helping meet the SDGs, but to do so in ways that are not focused on de-risking private investment , but on maximizing development impact of such private flows (see for example Griffith-Jones et al, 2022, just published in ROPE journal).

I believe a key role can be played in this task by public development banks, (PDBs) at all levels, multilateral, regional, national and sub-national. PDBs are already important actors in the world economy, holding around US $ 11 trillion dollars of assets, according to recent AfD estimates. They were estimated to lend around US $ 2.4 trillion annually, which represents approximately 10% of world investment. However, it seems clearly desirable that their scale is increased, given the crucial role they have played in the response to the COVID crisis thus fulfilling their counter-cyclical role , as well as the key role they need to play in helping fund the urgent major structural transformation
needed towards more dynamic, greener, and more inclusive economies worldwide.
PDBs have many advantages and key roles (See for example Griffith-Jones and Ocampo, eds, The Future of Development Banks. 2018, OUP). It seems interesting to highlight here that, in tight fiscal times, they can provide leverage to relatively scarce public resources, as the impact of any public increase of their capital can be magnified by additional private (capital market) or other (e.g., international, such as contribution from climate funds or multilateral development banks) sources of financing. Therefore the impact of government resources on investment and thus on development is magnified via being channeled via PDBs.

During COVID, PDBs have played many key roles, for example in their support for the health sectors. One nice example is how the EIB (European Investment Bank) funded with a loan part of the initial research of Biontech, which led to the development of the Pfizer Biontech vaccine against COVID, with huge benefits for the EU, but also worldwide!

I want to focus here more generally on the very valuable counter-cyclical role PDBs have played during COVID, drawing on research am just finishing with Diana Barrowclough from UNCTAD. However, before doing so, I would like to stress again that of course PDBs need to play other key roles, including that of helping fund the large investment needed to support the green and inclusive transition in all economies, as well as supporting innovation, as well as other activities to increase productivity and economic growth.

As regards the counter-cyclical role played by PDBs during COVID, I would like to mention that public development banks (PDBs) reacted positively and in many ways to the COVID crisis, in terms of scale, speed, instruments and targets. They were in fact many governments’ main instrument for providing respite and guiding recovery; in other cases, they complemented governments’ major fiscal responses. This recent experience is reinforcing the reappraisal of public banks already emerging since the economic crisis of 2007-2008. In recent years, many countries are establishing new public banks or strengthening and expanding existing ones.

Win our study with Diana Barrowclough, we found major lessons from the PDB experience under COVID, that are most critical for determining banks’ ability to be counter-cyclical now and in the future. These include a) the importance of reliable and sufficient sources of capitalization, and potential new sources of capital; b) the support that can be given by the international community to PDBs in poorer countries, for example by resources provided by richer countries’ governments or their national or regional PDBs, as well as potentially by the use of SDRs for this purpose.
Thus, two main messages stand out. These are:

a) A number of key implications arise from the importance of PDBs’ counter-cyclical role. A 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, BPI, 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 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 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; 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). This shows the value of cooperation amongst PDBs, in the context of the development finance architecture.

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 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 to the bank, both to improve their institutions’ credit ratings (and thus their borrowing costs) or to increase the capitalization as new members paid in.

Several NDBs were able to create new instruments for their COVID response, switch to lend 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 to lend more to sectors, which needed financial support most as had been most badly hit by the impact of the pandemic.

b) 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, forthcoming, 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, Gottschalk and Griffith-Jones, 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.

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, institutions that are 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 have, thanks to prudent financial management, the ability to leverage their capital with private sector financing, and expertise to intermediate between the global financial system and LICs and MICs, which are urgently requiring increased long-term funding to finance investment essential for recovery as well as for health –for example for vaccine production-, as well as in some countries, shorter term loans for working capital to maintain production and employment.

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. Given the strengths of the MDBs, this would help ensure the resources were well used; the leverage they have, especially by co-financing with private flows, would allow the positive effect on borrowing countries to be multiplied. Some development banks in the low-income regions where it is already difficult to raise finance from other sources already had this on their radar and are hopeful for progress on the issue.

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.

More broadly, and to conclude PDBs, at II levels and in most countries, have shown themselves as valuable public actors, working closely with the private sector, to help fund both the countercyclical response to COVID and other crises, as well help fund the essential transition to greener, more inclusive and dynamic economies. There is an urgent need to further improve their performance and governance, but also significantly increase their scale!

Many thanks