A Renaissance for Development Banks

By Gavin O'Toole (excerpts) on 08/01/2018 on the Global Government Forum Website

Since the credit crunch, many private banks have retreated from lending to key economic sectors. So governments are stepping in – creating development banks to support start-ups and the industries crucial to sustainable growth.

"Market imperfections are the main reason for the existence of a development bank like KfW," says Dr Jörg Zeuner, chief economist of the giant German financial group.

"It is very hard to argue the case that markets in all areas of our economy are so perfect that you cannot find misallocations of resources or projects not happening that should be happening, and which it is quite obvious will have a positive economic return."

This candid recognition of market failure helps to illustrate why national development banks have experienced a renaissance in Europe since the 2007-08 financial crisis. Set up, part-funded and guided by governments, development banks are designed to boost sectors poorly served by their commercial counterparts and to pursue wider public goals, such as promoting investment in sustainability technologies.

A recent global symposium on development banks explored their continuing relevance. One estimate puts the number of these at over 500, of which about a fifth were created in the last 17 years.

Europe is a hive of activity, with both the oldest and newest development banks in the world. The Network of European Financial Institutions for Small and Medium-Sized Enterprises (NEFI), for example, now has 19 members.

Development banks exist to promote growth by providing credit in economic sectors poorly served by commercial banks, particularly small and medium-sized enterprises (SMEs). Created in 1948, KfW has played a major role in Germany's development. About 70% of its promotional lending – totalling €81bn in 2016 – is domestic.

By addressing gaps in the market, national development banks obey a broader strategic vision of economic development that emphasises public interest over profits. An example of market imperfections that demand solutions in the public interest are economic activities that have environmental "externalities", which KfW addresses by funding green projects.

In its early years it focused on reconstruction – but today it has the largest funding volume for environmental and climate protection projects of any development bank: 44% of the group's commitments.

The role of development financial institutions in the new millennium

José de Luna-Martínez: Lead Financial Sector Specialist, World Bank Group

Are national development financial institutions (DFIs) still relevant? What are the critical factors that make these institutions succeed? What are concrete examples of sound, well-administered and innovative DFIs? Why do they still remain in business in countries with large and sophisticated financial systems? How can we assess their economic and social impact? Have our views on DFIs evolved in the past decades?

All these interesting questions were discussed during the Global Symposium on Development Financial Institutions, an event jointly organised by Bank Negara Malaysia and the World Bank Group in September 2017 in Kuala Lumpur, Malaysia. With the theme "Balancing Sustainability and Social Mandate: Development Financial Institutions in a New World" the Global Symposium brought together 500 participants from Malaysia and around the world to discuss the challenges and opportunities faced by DFIs.

Historically, DFIs have been created by governments around the world to promote economic growth and support social development. They typically provide credit and a wide range of capacity-building programs. In doing so, they seek to promote strategic sectors of the economy, such as agriculture, international trade, housing, tourism, infrastructure, and green industries, among other sectors.

We need to think of innovative instruments to attract and channel new resources to finance our developmental aspirations, as outlined in the 2030 Sustainable Development Goals now more than ever. Reliable and well-administered development financial institutions will continue to be an important vehicle to accelerate economic and social development.

They can play a catalytical role by generating new knowledge, convening stakeholders, and providing technical assistance to build capacity in the private and public sectors.

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Investment could be made in emerging technologies, innovative ideas, new businesses, and development of existing businesses through a Technology Development Bank, funded by the Reserve Bank. This would retain New Zealand ownership of the businesses, provide employment and upskilling of the workforce, and keep the profits in New Zealand to benefit the New Zealand economy.

Refer "Funding Our Future" for the viability of using Reserve Bank Funding.