Public development banks: towards a better model

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A blueprint for successful public development banks at national, regional and global level.

What are Public Development Banks (PDBs)?

PDBs are state-owned financial institutions with the overarching objective, or mandate, to deliver on public policy objectives to support the economic development of a country or region. This policy mandate distinguishes these banks from commercial banks and other kinds of state-owned financial institutions, such as state-owned commercial banks or insurance companies. Although PDBs are concerned with financial returns, as financial institutions, profit is not the overall goal of their activities.

There are four main roles that PDBs can play to improve the impact of the financial sector on development:

- To direct finance – or provide it on better-than-market terms – to sectors or regions that are important for a national development plan.
- To build the financial sector, either by filling gaps in the supply of credit (lending to households or businesses that cannot access credit from commercial banks), or by helping to create demand (helping businesses or other customers to develop bankable projects).
- To promote economic stability, by playing a counter-cyclical role, to ensure a supply of credit when a financial or economic crisis causes the commercial financial sector to seize up.
- To improve standards, by insisting on, for example, social or human rights safeguards in the projects or institutions they finance.

The key question addressed by this briefing is: how can PDBs be improved to realise their potential to support development, while avoiding the risks or problems that can be caused by badly run PDBs? It is clear that the 'right type of finance' needs to flow through 'good institutions' if PDBs are to play an important role in financing development - but what does this mean in practical terms?

This briefing aims to provide a framework for institutional and governance reform that challenges the practices of existing and emerging institutions, and the governments backing them, to get better at supporting nationally driven-sustainable development policies, becoming more accountable and learning from past mistakes. All the requirements of this reform framework should be understood as a whole, not as a set of ideas that could be pursued in isolation.

The rise of PDBs

PDBs are enjoying a resurgence. At a time when private capital is in short supply, their role in providing financing for development is increasingly important. The World Bank estimated in 2012 that state-financed institutions accounted for "25% of total assets in banking systems around the world." We need PDBs because the commercial financial sector is unlikely, of its own accord, to provide the finance needed to support rapid economic development.

Since the 2000s, there has been a resurgence in PDBs:

- Some national PDBs have expanded to financing development projects in other countries.
- Many big national PDBs – particularly from BRICS countries (Brazil, Russia, India, China and South Africa) – finance exporters from their own countries, as well as infrastructure and energy projects in neighbouring countries.
- After the 2008 global financial crisis, national PDBs have provided vital counter-cyclical financing, which contributed to increase their relevance in support of national policy objectives.
- Several countries have established new PDBs, including the SME Development Bank of Thailand (2002); the Banco de Desarrollo Productivo (BDP) in Bolivia (2007); and Bpifrance in France (2012).

However, in some cases expansion has brought criticism, especially for failing on sustainable development outcomes, decreasing inequalities, being accountable and democratic, and protecting human rights and the environment.

At the regional and global level, the debate on the role of development banks has been recently energised by emerging markets, particularly the BRICS countries. In 2012, the BRICS group discussed setting up a New Development Bank, which materialised in the Fortaleza Summit in July 2014. In parallel, China led the process of setting up the Asian Infrastructure Investment Bank (AIIB), which was formally established in June 2015. Both institutions started its operations in 2016.

The relevance of PDBs has been recognised in the United Nations (UN) Financing for Development process since its inception in 2002. The Third UN International Conference on Financing for Development in Addis Ababa in July 2015 saw governments "call on national and regional development banks to expand their contributions" and "urge relevant international public and private actors to support such banks in developing countries" (Paragraph 33).

Key features of a model PDB

The rationale for these features can be found in the full report at www.eurodad.org/public-development-banks.

A. Clear development mandate and role

PDBs need clear mandates and roles that focus the whole institution on delivering development-focused outcomes. This is essential if PDBs are to serve the sustainable development agenda, supporting the delivery of the SDGs – which focus on poverty eradication, the fight against climate change and environmental degradation, and combatting inequality, including economic and gender inequalities.

We have identified five components which are essential if PDBs are to serve the sustainable development agenda and support the delivery of the SDGs:

- Strong development mandate to deliver sustainable development outcomes, avoiding vague or dual mandates.
- Targeting finance where it is needed most to regions, sectors or clients that are most in need, or that have the highest development pay-out.
- Responsible social and environmental standards, taking responsibility for the human rights and environmental outcomes of all its activities, including financial transparency and responsible taxation policies.
- Stable, long-term perspective, with a focus on sustainable, predictable and counter-cyclical funding.
- Support for national strategies, where activities align with democratically determined national plans.

B. Operational strategy

PDBs must take care when deciding how they raise money, as it can significantly impact their development mandate. Public funding can help insulate them from commercial interests, but they also need to ensure that investments are geared to delivering development benefits, not financial reward. A "best practice" operational strategy should include:

1. The right mix of public and private funding

- Mainly 'public' financing, complemented by private sources – principally borrowing on bond markets.
- Use of public financing to insulate PDBs from market pressures which tend to prioritise profit over development.
- Avoid over-reliance on private capital with the potential for undue influence.

2. Choose investment carefully

- PDBs should invest to ensure their development mandate takes precedence over generating financial returns.
- For multilateral PDBs, demonstrating financial 'additionality' (more development 'bangs per buck' than a national PDB would get for the same investment) is particularly important.
- If multilateral PDBs are to be genuine longer-term partners for a country's development, they should seek to empower national PDBs, not undermine or compete with them.
- Multilateral PDBs should avoid using commercial financial intermediaries, such as large commercial banks or private equity funds, as they pose significant challenges to transparency and accountability.

3. Internal systems to focus, assess and monitor

- PDBs should have robust, clear internal systems to assess the impacts of their policies and investments.
- Assessment should include overall development impacts (such as contribution to the common good, innovation, environmental, social, gender and health) and not just narrow economic indicators such as growth, jobs or investment.
- Effective due diligence procedures, accompanied by supervision and monitoring mechanisms, are important.

C. Financial sustainability

PDBs should be financially sustainable in the long run so they can deliver consistently on their development mandate. However, the tension between development outcomes and financial returns means PDBs must ensure sustainable development outcomes are always the priority, and are never sacrificed for financial returns. To help avoid this, PDBs should:

1. Prioritise development outcomes

- Development must always take precedence over financial returns, although of course a PDB must earn sufficient returns to guarantee long-term sustainability.
- Prioritising financial returns risks hindering development outcomes - for example, if a PDB were to avoid investing in areas with high development impact because profit levels are deemed too low, or risks too high.
- Staff should be trained and incentivised to approve projects according to the public good, as opposed to purely commercial decisions.

2. Reinvest any profit

- PDBs range from non-profit to for-profit, but any profit should be reinvested to support development outcomes.
- Distributing profits back to shareholders should be ruled out on good governance grounds, because it could prioritise revenue over development.
- Focusing on overall financial sustainability – rather than profitability – should allow PDBs to fund innovation (such as investment in green technologies) that commercial lenders may see as risky.

3. Take care with public grants

- Great care must be taken if PDBs are subsidised by public funds beyond initial capital injections - high levels of national accountability are crucial.
- Government guarantees and subsidies can boost PDBs by improving access to cheaper, longer-term, counter-cyclical financing. But they can also potentially lead to poor lending which undermines the PDBs' mandate and mission.
- There must be strong democratic oversight and governance processes to make sure PDBs use public subsidies appropriately.

4. Incentivise staff to deliver for the public good

- PDBs should draw on their development focus to recruit and motivate staff, without copying the bloated salary and bonus culture of parts of the commercial financial sector.
- PDBs must recruit and retain highly qualified staff, especially senior management, without losing sight of the need to operate for the public good.
- Put in place transparent fixed pay ratios between the highest and lowest paid PDB employees and institute staff participation in decision-making and governance processes.

D. Good governance

Good governance is a major factor in how PDBs operate and their overall ability to deliver on their mandate. They need representative and democratic governance structures and open, inclusive and accountable decision-making processes. We have identified five prerequisites for good governance.

1. Equal borrower representation in multilateral PDBs

- Borrower countries should have at least half of the vote and board seats.
- Developing countries should have a greater say through the 'double majority voting' system.
- PDBs should include other actors – not just governments – in decision-making.

2. Strong transparency policies

- PDBs should facilitate the right of access to information by including transparency clauses in contracts.
- Automatic disclosure of comprehensive information on the activities PDBs finance either directly or through intermediaries.
- Limited exceptions – PDBs should clearly demonstrate that there is an overriding public interest to withhold information.
- Citizens should have the right to request information and PDBs should maintain a public register of documents.
- Decision-making meetings and processes should be open and accessible to the public, and institutions should publish details of different country positions on the board.

3. Active participation of civil society and bank employees

- Civil society groups, including trade unions and bank employee unions, should be included in PDBs' decision-making – possibly through Civil Society Councils.
- Employees should also take part in governance, for example by having worker representation on the board.
- Employees should be free to submit any concerns to management in an open way without expecting any form of retaliation.

4. Insulation from political pressure

- PDBs must be insulated from undue government pressures that might be contrary to the bank's mandated purpose.
- The risk of using PDBs as political pawns - particularly at the national level - should be reduced as much as possible.
- PDBs should be scrutinised by democratically elected bodies, including having members of national and/or regional parliaments on the board and approval of accounts by national and/or regional parliaments.
- Recruitment of staff and presidents of PDBs should be clear, transparent and fair.

5. Strong accountability policies

- Independent evaluations and lessons learned, with sufficient resources to finance independent evaluations.
- Active and meaningful participation of everyone affected, including CSOs, communities and national/ regional parliaments.
- User-friendly, independent and effective complaints mechanisms which are not seen as obstacles but as crucial to achieving development outcomes.
- Enforcement mechanisms including internal and external sanctions, and an end to privileges, exemptions and immunities which enable management and boards to avoid justice.

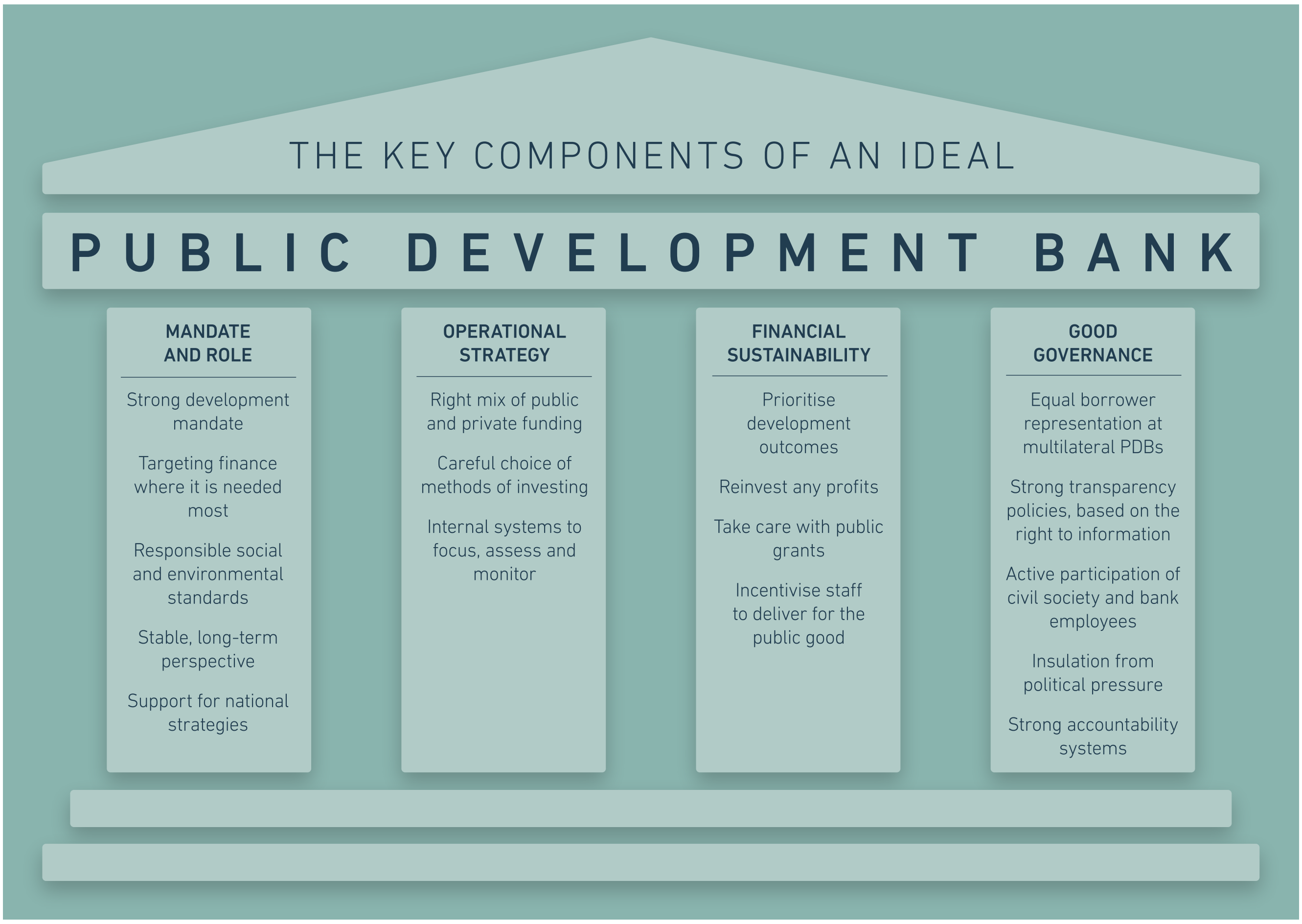
Conclusion

PDBs are in a unique and powerful position to deliver on public policy objectives. They can – and should – play a very significant role in development. As this briefing and its accompanying full report show, PDBs can direct finance to important sectors or regions, build national financial sectors, promote economic stability, and improve standards – for example, through environmental, social or human rights safeguards.

However, PDBs face considerable challenges in performing their role, and some of them have been rightly questioned about the negative impacts of their operations. A significant reason for the inconsistent performance of PDBs is the nature of the institutions themselves, which vary considerably, with diverse mandates, roles and operational strategies.

This summary is based on the full report 'Public development banks: towards a better model' by Maria Jose Romero, which can be found at:

www.eurodad.org/public-development-banks



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