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The renaissance of the development banks

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The renaissance of the development banks

Bonn, 4 February 2013. When the BRICS countries (Brazil, Russia, India, China and South Africa) meet for their next summit in Durban, South Africa, in March 2013, they will launch a BRICS bank. It is not to be a bank like any other, financing private or government projects for commercial motives, but a development bank, a bank that provides long-term capital for projects entailing risks rated too high by other banks, especially private ones.

It will be very interesting to see what kind of business model the BRICS bank will adopt and how it will differ from such other international development banks as the World Bank and the regional development banks, in which the BRICS countries are also shareholders, of course. The BRICS countries are likely to contribute equal shares of the new bank's equity and to have an equal say in its management. But how will it acquire the capital for investment projects? None of the countries has a rating on the international capital markets, which would make it possible for them to raise funds on favourable terms, as the World Bank and the regional development banks do, thanks to the high country ratings of their major shareholders from the OECD countries. Only China can raise funds as favourably, also using its enormous foreign exchange reserves. But that will not be enough to offset the financial weakness of the other BRICS countries.

As, then, the BRICS bank will have to pay more to raise funds than the World Bank, it will have to charge more for its loans. Or will the BRICS countries be prepared to subsidise it in the long term? Will it, like other international development banks, require the governments of the developing countries to give it state guarantees for its loans and so increase their indebtedness? And what standards will it expect projects to meet? The emerging economies have repeatedly argued against more stringent social and environmental standards and against the World Bank's and regional development banks' cumbersome assessment procedures, but have been unable to assert themselves against the majority shareholders from the OECD countries. Now they will be free to set their own standards and to act more flexibly and do without cumbersome conditionality when dealing with investment projects in developing countries. In the competition among the development banks, will this lead to a relaxation of the social and environmental standards that have gradually been introduced over many years?

Whatever business model it may adopt, that the BRICS bank is being set up reflects not only the desire for political independence felt by large emerging economies that no longer want to play second fiddle to the World Bank or the regional development banks, but also the fact that, since the international financial crisis, there has not been enough "patient capital" to meet the considerable demand from the developing countries and emerging economies for investment. Although there is an enormous amount of international liquidity looking for profitable and secure investment opportunities, the badly damaged banking system in the industrialised countries is risk-averse and now has a shorter planning horizon than before the crisis. Writing off huge bad investments in their balance sheets is forcing the European banks to reduce their lending and to withdraw from international transactions. The greater equity needed to satisfy the stricter banking regulations is having the same effect. Above all, the financing of infrastructure projects, which requires the long-term commitment of capital, has become more difficult after the crisis. But private businesses, too, are finding it harder to raise long-term capital.

On the other hand, the incredible decline in the debt sustainability of many industrialised countries has been followed by a steadily dwindling number of both secure and profitable investment opportunities. The risk-averse capital of institutional investors and of the sovereign wealth funds of the capital-surplus countries, not least China, prefers safe investments in the USA and Europe. A great deal of capital is flowing into the emerging economies, but much of it is short-term capital that may also be rapidly withdrawn again. Brazil and other emerging economies are resisting these inflows of capital because they drive up stock and real estate prices and the exchange rates of their currencies and so do more harm than good. These countries are increasingly financing their long-term investments with the help of their national development banks. Brazil's BNDES and South Africa's DBSA are among the world's best development banks. Like the China Development Bank, they are becoming more and more international in their operations and also financing projects in developing countries. They are likely to form the technical and financial base of the BRICS bank.

State development banks have not always enjoyed so good a reputation. The state banks of many developing countries in particular were long considered to be a failed model. Many were closed again in the 1990s. Most were long-term recipients of subsidies, were managed politically, and failed to perform their task of financing sustainable investments. Countries that followed the policy recommendations of mainstream liberal economists therefore relied on the development of the private financial sector. This strategy has been changed again, not least in Europe: the European Investment Bank has hugely increased its lending since the financial crisis and will be providing the crisis-hit countries of southern Europe with more long-term loans. France and Britain have made it known that they intend to set up a state development bank on the model of Germany's KfW, without which it is impossible to imagine the financing of long-term investments in Germany, which have included a growing number of "green" investments in recent years.

There is no doubt that vast sums are needed for investment in sustainable growth and the "green transformation" in both industrialised and developing countries. The core problem for all development banks, however, is the identification of suitable projects. The poorer or more fragile countries are, the more difficult it is to find or develop projects that will make enough to cover their costs. Long-term subsidisation often has to be included in the calculations for energy, water and transport projects if returns fall short of costs. New ways will have to be developed for closing such gaps with grants from industrialised countries or such global funds as the new *Green Climate Fund* if projects that can never be financed commercially are to be made "bankable" at least for development banks. If the BRICS bank can contribute to this, it will be a boon.

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