Project Syndicate

Why the World Needs National Development Banks

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LONDON/BOGOTÁ – Support for national and multilateral development banks has grown worldwide in the decade since the global financial crisis. And the continued success of national development banks (NDBs), in particular, will be vital to achieve more sustainable economic growth in the future.
Development banks help to counteract the pro-cyclical nature of the private financial system, which lends too much in booms and rations credit during crises. The private sector also often fails to provide enough financing for small and innovative companies and infrastructure projects. Nor does it support enough of the investments in innovative activities, credit to small producers, and environmental projects that are urgently needed to make economies more dynamic, inclusive, and sustainable.

Although governments provide their paid-in capital, development banks raise funds on national and international capital markets. Moreover, these banks' loans are typically co-financed by the private sector, which is especially helpful for governments facing budget constraints during and after economic crises.

The World Bank and regional multilateral development banks (MDBs) sharply increased their lending during and after the 2007-2009 financial crisis. The European Investment Bank, the largest MDB, doubled its paid-in capital and is playing a central role in implementing the European Commission's so-called Juncker Plan, which aims to generate €500 billion ($561 billion) of additional investment across the European Union by the end of 2020. In addition, the recent establishment of two other large MDBs – the Asian Infrastructure Investment Bank and the New Development Bank established by the BRICS countries (Brazil, Russia, India, China, and South Africa) – will contribute further to a more balanced public-private mix in development finance.

The financial crisis also prompted some European, African, and Asian governments to establish new NDBs, and other countries to expand theirs. As a result, the total assets of NDBs reached approximately $5 trillion in 2015. Today, they are an important feature of most developed and middle-income countries' financial sectors, notably in China, Germany, India, and South Korea. And large NDBs can have a big impact, especially in emerging economies.

Unsurprisingly, academic researchers are finally starting to pay more attention to NDBs after a long period of neglect. They are looking to understand how these banks operate, which instruments, incentives, and governance structures work best, and how such institutions interact with the private sector and government policies.

In a recent book, we analyzed NDBs in seven countries – China, Germany, Brazil, Mexico, Chile, Colombia, and Peru– and concluded that these banks tend to be successful overall. They have been broadly efficient instruments of national development strategies in their respective countries, and they have helped to overcome major market failures in a flexible way.

Our research identifies five crucial functions of NDBs in the development process: providing counter-cyclical finance; encouraging innovation and structural transformation; enhancing financial inclusion; supporting infrastructure financing; and promoting environmental sustainability, in particular by combating climate change.

NDBs were strongly counter-cyclical in the wake of the global financial crisis. According to World Bank data, NDBs increased their lending from $1.16 trillion in 2007 to $1.58 trillion in 2009. This 36% increase was far greater than the growth in private bank credit in the same countries over that period.

NDBs have been innovative, notably in supporting new activities. China's CDB, Germany's KfW, and Brazil's BNDES have financed technological advances, for example, while others, including Chile's CORFO, have supported entrepreneurship. Such banks have also introduced guarantees and established new equity (including venture capital) and debt funds. Furthermore, they have developed new programs to increase financial inclusion, such as "correspondent" stores and post offices that provide financial services from one or more banks.

In addition, NDBs have been prominent supporters of important new sectors, such as renewables and energy efficiency. For example, KfW was initially the sole lender to private companies investing in solar energy in Germany; private banks got on board later. In China, CDB helped to design policies to encourage investment in renewable energy – particularly solar – and provided significant initial funding. As a result, Germany and especially China have been major global promoters of solar power, helping to make it increasingly competitive relative to fossil-fuel energy.

To be clear, we favor "good" development banks: well-governed institutions with highly professional staff and clear mandates that fulfill their functions well. Such banks should maximize their development impact rather than profits, while ensuring some minimal level of return.

Countries that already have NDBs should aim to expand their role, while others should consider establishing them. Doing so would help to create a financial system that better serves countries' economic and social needs.

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