REGIONAL CONSULTATION
"RETHINKING THE ROLE OF NATIONAL DEVELOPMENT BANKS"

The Role of National and Regional Development Banks in Africa
Paris, 27-28 June 2006

REPORT

This consultation is part of a series of consultations launched by the United Nations (Ffd Office, UN-DESA) in December 2005, in collaboration with concerned partners: national development banks (NDBs), international financing institutions (IFIs), regional development banks, UN regional Commissions, and other public or private organisms, civil society or academic circles. These regional consultations aim to discuss how to better fulfil the role that has been, or still is, assigned to the national development banks in promoting social and economic development, in the current context of developing countries.

- **OPENING SPEECHES**

Mr **Pierre Jacquet** (AFD) reminded that most of NDBs experiences ended in failure that resulted in high costs for IFIs such as AFD. However, the “all private” ideology has also shown its limits and it is appropriate to wonder today how to articulate private and public interventions in order to address market failures. He mentioned the privileged partnership that links together the AFD, the EIB and the KfW, through which the three institutions have jointly organized this conference.

Mr **Jomo Kwame Sundaram** (UN-DESA) mentioned first of all the Monterrey Consensus. Then, he indicated that NDBs, as defined in the background document prepared by the Financing for Development Office on this subject, had a role to play in achieving MDGs, especially as being DFIs for social development and projects financing. During Lima’s consultation, the participants have identified three main roles for development banks: (1) addressing market failures; (2) directing development towards SME support; (3) improving market by acting as catalyst and investing in a contra-cyclical way. According to him, and from this perspective, NDBs can contribute to strengthen growth and put an end to long times of economic stagnation that many developing countries have often experienced.

Mr **Daniel Ottolenghi** (BEI) insisted on the need for a critical analysis of NDBs, their past and the institutional or market failures they have experienced. He went back over the relationships between EIB and NDBs in Africa. In the mid-70s, EIB supports and loans to NDBs aimed to fill two specific market imperfections: the lack of access to credit for SMEs and the lack of long term credit. Following the NDBs failures, from the 1980s, the EIB strategy evolved towards an increased support to commercial banks and regional development banks. Even if this strategy has encouraging results, the final beneficiaries keep being mainly big companies and the problem of the SMEs access to long term financial resources still remains. The experience has shown that the success of development banks financial operations rested on a certain number of conditions (appropriate financial policy, institutional capacities, good governance, managerial competencies) that have been so far under-estimated. The EIB favours an empirical and pragmatic approach, aiming to identify case by case – rather than general recommendations considered neither practical nor workable – the main issues and hindrances. A pragmatic approach that can result in choosing very different options from a country to another, and may induce the EIB to support the setting up of new NDBs in some African countries.

Mr **Bruno Wenn** (KfW) indicated that, from the 1980s failures and from its own experience, the KfW has mainly drawn three lessons related to the importance of (i) having a clear mission and especially supporting the development of financial systems and not competing with them, (ii) favouring good governance and especially guaranteeing the respect, by the State, of the public bank independence, (iii) fostering professionalism and the ability to innovate in order to deepen the market. The experience has shown that a favourable environment and an incentive system are key elements for the NDBs to play their role on a long-term basis. For a few years, the KfW has redirected its activity towards the support of microfinance institutions and the financing of SMEs. But microfinance does not resolve all the problems. Some sectors, such as SMEs, social housing and agriculture are widely under-financed. The discussions of this seminar should not only focus on NDBs as such, but rather considerate the wider issue of the development of financial sector in the mobilisation of developmental finance and the role of development banks among the other actors.

SPEAKERS' PRESENTATIONS

► Session I: Lessons and evolution of national and regional development banks in Africa.
Presentation of BRED Gestion report (Mr José Garson) "Rethinking the role of banks and sub-regional and national development finance institutions in Africa"[1] and comments by Mr de Boissieu.

Mr **Garson** concluded its presentation by formulating a series of action proposals related to:

- The support to be brought to development-oriented commercial banks,
- The support to be brought to development financial institutions (DFIs),
- The elaboration of regional and national policies for financing development.

Mr **de Boissieu** underlined, on the one hand, the excess of liquidities of banks and, on the other hand, the lack of financing for development in the economy. A situation due to (1) the behaviour of certain banks; (2) the scarcity of profitable and bankable projects; (3) the difficulty to evaluate and rate certain risks. According to the theory of bank rationing (Modigliani, 1969), financial institutions ration rather than taking risks. The lack of market would result from bad governance (political interferences), a bad management of risks (insufficient internal control), a specialization of banks (Savings & Loans crisis in the United States in the 1990s), etc. « An emerging market is a market out of which you cannot emerge in case of emergency », due to a lack of liquidity. We should contemplate financing development by other means than the creation of new institutions, and rather favour new functions, as underlined by Mr Garson. The State has a role to play; it can set up the necessary procedures and have a role of incentive : use of fiscal leverage, set up of appropriate financial products, and so on. What is important is to guarantee a loyal competition, a "level playing field" in which we would no longer have the current dichotomy by which some institutions are subjected to banking legislation and others not : we must cut the umbilical cord between DFIs and the State, and subject all financial institutions to the same banking legislation. Besides, Mr de Boissieu noticed and regretted that Basle II had been prepared only with Northern countries representatives, even though the entire world will have to abide by these new rules.

► Session II: Case studies: Which answers to address market failures? Interventions of the African Development Bank (BAfD), the Agricultural National Development Bank of Mali (BNDA), the Deposit and Consignment Office of Morocco (CDG), the Development Bank of Gabon (BGD) *(cf. ppt presentations)* and the Tuninvest Group.

Mr **Abdelkefi** briefly traced the history of Tunisian development banks. The first one to be created, the Economic Development Bank of Tunisia (BDET), has, at first, fulfilled its missions successfully. Then, the Tunisian State began to create dozens of development banks, each one with an Arab State as partner. These banks were twice public (two States were shareholders), and badly managed by civil servants. Their objective was job creation, and not profitability. Many eligibility criteria have been established, which simply had to be fulfilled in order to obtain a loan. Their difficulties have increased because they fulfilled two very different functions, the one of lender and the one of capital investor. Today, we have understood that the latter activity must be confided to specialized teams on the pattern of investment funds.

Mr **Borin** also intervened to briefly remind the different activities of the African Development Bank and to insist on the importance, on the one hand, of governance, and, on the other hand, of technical assistance to commercial banks, especially to encourage them to be part of PPPs.

► Session III: Development financial institutions in action in their competence areas: roles and instruments. Presentations of the Development Bank of South Africa (DBSA), the West-African Development Bank (BOAD), the Development Finance Company of Uganda (DFCU) *(cf. ppt presentations)* and the AFD (Financing Department).

Mr **Genevey**, after having exposed the AFD products and principles of intervention, insisted on the importance of (i) the principle of subsidiarity, which is at the "heart" of AFD actions, and (ii) the research for

[1] The BRED study and all the presentations mentioned in this report are available at the following address : http://www.afd.fr/jahia/Jahia/home/publications/conferences/pid/1296

innovation, both in terms of products (often elaborated in contact with its clients) and in terms of resources, so that they can be as much as possible adapted to the projects (for instance the raising of resources in local currency, today contemplated).

► **Session IV: Tools, governance and monitoring of results.** Interventions of the rating agency Fitchratings, the Industrial Development Corporation (IDC) *(cf. ppt presentations)* and comments of M. Lebègue, Chairman of the Institute of Sustainable Development and International Relations (IDDRI) and the French Institute of Administrators (IFA).

Mr **Lebègue** gave a rather positive review of the situation in Africa. Efforts have been made in terms of stabilization and credibility of the banking system (e.g. group for WAEMU reform). Commercial banks provide financing for big firms, foreign trade and National Treasury Departments, but do not finance housing, SMEs, agriculture or infrastructures. Two answers are conceivable: (1) through institutions, with specialized banks; (2) through tools, with the setting up of an environment that would allow the private financial system to intervene (SME financing, microcredit, risks mutualisation). None of the above solutions should be overlooked; we must know how to find the right balance, on a case-by-case basis. In order to succeed and avoid wrong risks or government intervention, it is absolutely essential to professionalize the NDBs' boards of directors. NDBs must not be conceived as serving the government, and thus their directors must be independent professionals with a strong personality, and able to resist to political pressures.

► **Session VI: What may be the role of development aid? By means of what kind of partnership?** Interventions of the South African Development Corporation (SADC), the EIB and the KfW *(cf. ppt presentations)*.

Mr **Debrat** introduced the session wondering whether the presence of Northern institutions in the capital of development banks was an anachronism or still a solution with a future. For BNDA, a North/South partnership is essential: if foreign partners get out, they are replaced by nationals, which threatens the independence of development banks. Other participants consider that donor agencies must withdraw (DFCU, Development Bank of Burundi) and that we must favour the presence of independent directors (SADC). However that may be, the vocation of bilateral or international assistance financial institutions is not to remain forever within the capital or board of directors of NDBs, and their withdrawal must be considered as a success (AFD, KfW).

DISCUSSED ISSUES

– *Reason for the disappearance of development banks*

Mr Garson's presentation suggests that the problem of development banks comes from the adoption of banking legislations based on a single pattern, the universal commercial bank. Yet, most of participants agree to say that other reasons prevail: quality of portfolio, bad management, bad governance and lack of transparency (particularly annual reports), State intervention, and so on.

– *Role of the State*

Many participants called for a withdrawal of the State from the boards of directors (BNDA, EIB) and for a professionalisation of the sector (DBSA as an example of "self-regulated institution"). The presence of shareholders and directors coming from civil society could bring an added value in terms of professionalism and governance (KfW). However, others underlined the key role of the State in some sectors, through incentive systems (Egyptian Investment Department, Mr de Boissieu) or the development of environment (especially infrastructure) so that the activities financed by development banks can be profitable (BNDA).

– *Utility and use of subventions*

Subventions are needed in order that banks or DFIs could cover some markets or sectors without threatening their financial viability (EIB). The question is to determine the nature and the level of public intervention. For instance, in the case of DFCU, there is no rebate on the financial product, but free technical assistance supply (by specialized providers).

– *Respective roles of development and commercial banks*

Commercial banks have expertise in terms of analysis, but do not have appetite for financing development, and development banks lack means (CDC). How could both systems be more complementary? For KfW, the old fashioned development banks must be definitively buried, and decisions have to be taken institution by institution (without a global plan). The SADC pointed out that banks that are doing everything are generally inefficient (including portfolios). Thus, they should specialize in order to be more efficient. For DFCU, we must encourage DFIs to diversify and offer other products. For some of the participants, development banks should have an obligation of stimulating the appearance of private sector and commercial banks in the development of financial sectors: once those in a lasting position, development banks should withdraw in order to respect a principle of subsidiarity (World Bank). For others, this principle includes the inevitable and progressive substitution of a part of development bank activities, replaced by financial markets (BNP-Paribas). A trend that would profit to every one in the long run.

Furthermore, it is important to develop financial markets. African commercial banks are often rather hostile to it (M. de Boissieu). Yet, if the competition between the bank offer and the financial market has the effect of decreasing the costs of banking intermediation, banks benefit even so from it since, being intermediaries for the financial markets, they collect in return more commissions.

– *Banking legislations*

Development banks and DFIs in the Franc Zone are subject to the same rules as commercial banks. Banking commissions often have difficulties understanding the activity of development banks; some ratios are not adapted to such an activity and impose excessive constraints on development-oriented banks (BNDA). Likewise, we can wonder to what extent the usury laws are or not a brake on financing development. The experience of microfinance shows that the possibility of keeping their rates high permits to cover difficult markets.

CONCLUSIONS

Main reflexion lines drawn

- Financing for Development (FfD) is a domain that deserves a specific attention today. The approach to be adopted should be holistic and functional rather than institutional (even if institutions matters).
- FfD's raison-d'être is to bring finance to specific clients or projects that currently do not have or have few access to credit, particularly on medium and long term. We must fill both market and State failures (infrastructures).
- FfD consists in bringing financial instruments (grants, loans, lease-credits, guarantees, etc.) but is mostly accompanied by non-financial services (advices, technical assistance, development of capacities, external technical services).
- Resources are needed to build FfD financial instruments. Liquidity exists in banking systems in Africa. When the DFIs are banks, they have access quite easily to resources through clients and governments deposits, but banking legislation makes transformation difficult. On the contrary, when DFIs are not banks, it is harder to mobilize resources, but DFIs are free to use them as they want, for lack of external regulation.
- The FfD organisation is necessarily complex: a DFI must be a knowledge organisation, able to play multiple functions (finance, advice, partnership) and to play a role of catalyst/facilitator. How to coordinate commercial and developmental domains (combining them in a single organisation, separating them, creating separate entities for each development activities)? Different models exist and seem viable (DFCU, BNDA).
- DFIs must guarantee their own durability and can be profitable!
- As generally public organisations, DFIs must have a specific mode of governance and benefit from a high level of professionalism, mainly in order to avoid risks of government intervention.

From the discussions have emerged five action proposals:

- Make an inventory of DFIs' success stories and lessons learnt;
- Organize sub-regional consultations;
- Organize the exchange of DFIs' standards and best practices;
- Liaise with other fora on corporate governance;
- Organize a working group on legislation to work on DFIs' specificities.

After the Lima consultation (June 2006), the Paris consultation will be followed by consultations in New Delhi, Cairo (fall 2006) and Johannesburg (early 2007). A final meeting will take place in Cambridge, USA.