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Solidarity and the South: Supporting the new landscape of long-term development finance

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Abstract

This paper is structured in five sections. Part 1 introduces the many recent innovations in Southern-led development finance and their potential benefits, tempered with a reminder of lessons learned about the support these new institutions will need in the future. Part 2 charts the new landscape of development finance, identifying Southern-led and global mechanisms and resources that now potentially offer trillions of dollars' worth of support through foreign reserves, national development banks and sovereign wealth funds, southern regional banks and funds, plus the global multilateral World Bank and regional banks. It shows that the centre of gravity of development finance has moved firmly southwards. Part 3 assesses the extent to which the changes in bank ownership, mandates and governance means Southern-led banks are 'doing things differently', with respect to conditionality, scale and speed of loans. Amid these potentially positive developments, Part 4 warns that some things are not that different after all – including long-standing regional imbalances, the continued power of Credit Rating Agencies, and concerns about concessional lending. Part 5 concludes by suggesting how the development community can better support the new and expanded southern banks and funds, to build on their strengths and address their limitations.

Key words: south-south, development banks, sovereign wealth funds, AIIB, SDGs, regional integration

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1. Introduction

The many innovations in Southern-led development finance appear as one of the most significant trends of the new century. Trillions of dollars' worth of southern-owned currency reserves, Sovereign Wealth Funds, Development Banks credit swaps and bond issuances have transformed the development finance landscape. Existing banks and investment funds boosted their scale, scope, and mandates and entirely new ones came from nothing to become operational within a surprisingly short time. Moreover, Southern solidarity seems more than just a mantra; it is a mandate with real meaning for its members and practical implications that could promise qualitative differences in terms of governance and lending decisions, compared to those offered elsewhere. This paper sketches briefly the most significant ways in which the landscape has changed, before addressing the important question of how to ensure these new or enhanced institutions can meet the immense investment expectations.

If they live up to their promise, they could massively increase the capital available for the long-term investment needs expressed in the Sustainable Development Goals (see Table A.1). They could bring qualitative differences too – if they prove to be more willing to invest in productive activities, more 'green' and responsive to local needs, more streamlined in administrative requirements and less conditional. For such advantages, developing countries appear willing to pay the higher cost of capital compared to loans from the World Bank or other northern-led sources.

However, there are no inherent guarantees they can or will do this. Firstly, these new Southern-led sources of finance may look so large compared to traditional lenders in part because the latter were always under-financed compared to the magnitude of the task. It is possible that even the best-capitalised of the new Southern institutions will find themselves constrained by the same challenges besetting traditional Northern-based ones. Moreover, the euphoria generated by the new opportunities should not erase lessons learned about why some development banks stumbled in the past. Finally, the new landscape is still far from complete – despite the addition of new players and the expansion of existing ones, it is somewhat ad hoc and many gaps remain, especially in the poorest countries and regions. In short, support from national and international policymakers remains essential if the new south-south sources of finance are to grasp the opportunities created by a scaling up of investment finance, and to fulfil their development potential.

2. Charting a new Southern-led landscape

The many southern initiatives to boost long-term finance for development have changed the map of development finance significantly. It is true the map remains somewhat incomplete and ad hoc – reflecting the fact the initiatives emerged in a piecemeal basis and are not a coordinated southern effort to break with the old order. Nonetheless, the new institutions are doing things in a different way. Also, each new institution is slightly different in what it offers and how it operates. Together, they have the potential to help fill important institutional and financing gaps in a system that otherwise failed to reform despite the crisis of 2007-2008 and its fallout (Grabel 2015) and potentially can provide real benefits to a financial architecture that has long been under stress.

In terms of individual initiatives, there are too many to mention by name here. This section classifies them broadly into two categories: national and multinational activities. These categories are chosen because of their implications for governance and decision-making, rather than the scale or ambition of operations. Multilateral institutions have attracted most of the media and political interest; however, national ones are also extremely important, and together, their collaboration through linked-up networks whereby regional systems engage actively with national banks and national financial systems may prove to be one of the most transformative opportunities created by this new landscape. Table 1 summarizes some of the funds currently and potentially available for development. Some figures such as those from new southern banks and funds are still modest in face of the long-term financing needs of developing countries, but, as argued further below, the potential for significant expansion exists, provided southern governments further enhance their support to these institutions in the coming years. On the other hand, it needs also to be remembered that some finances are "borrowed" and cannot necessarily be relied upon – such as the foreign reserves based on short-term capital inflows that owe more to global capital markets than physical trade. These can abruptly reverse as global financial conditions change.

Table 1. A significant change in scale and scope - the new southern-led landscape

	Mechanisms and institutions	*$ value potentially available*
Southern National	Foreign reserves[1]	$6.7 trillion
	National development Banks[2]	$400 billion
	Sovereign Wealth Funds[3]	$6.3 trillion
Southern Multilateral	Development Banks and Investment Funds[4]	$302 billion
Global Multilateral (WBG)	World Bank Group, MIGA[5]	$300 billion
	AfDB, ADB, IADB[5]	$197 billion

Source: Development Banks' annual reports, World Bank Development Indicators and SWF Rankings, the latter accessed on 12 Feb 2018 on https://www.swfinstitute.org/sovereign-wealth-fund-rankings/.

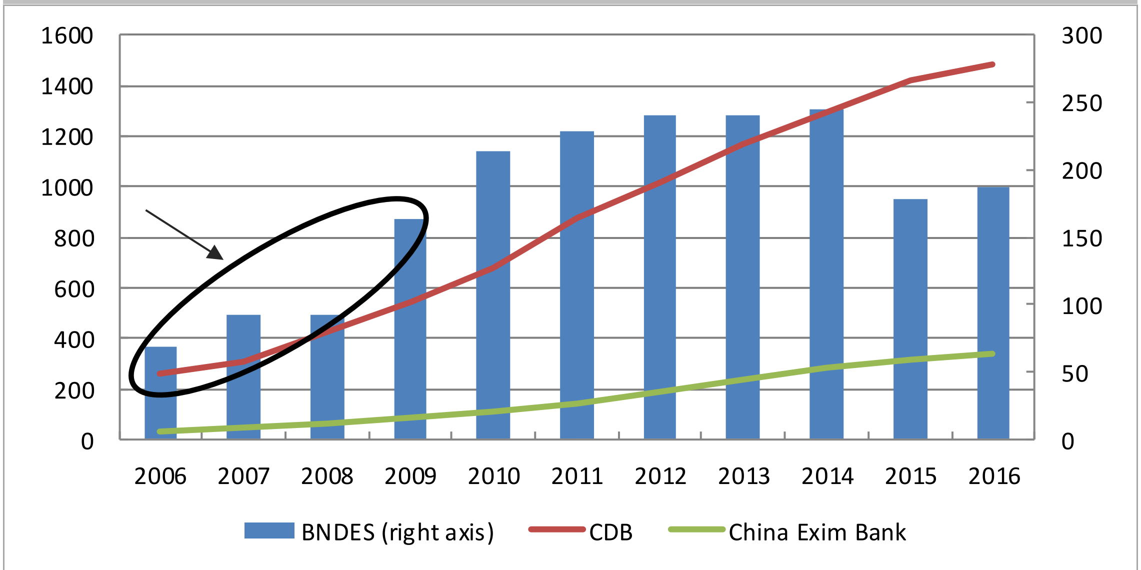
Note: [1]Foreign reserves (minus gold) of 111 developing countries in 2016. [2]Corresponds to total foreign loan portfolios of CDB, China Exim and BNDES in 2016. [3] Total includes all SWFs listed on SWF Rankings minus those funds from Australia, Canada, Ireland, New Zealand and United States. [4]Potential lending capacity of AIIB, NDB and CAF, based on banks' total equities and a loan-equity gearing ratio of 5, plus China's backed investment funds, as reported in Gottschalk and Poon (2018). [5] Banks' total loan stocks in 2016.

2.1 National initiatives are looking outwards

One of the major themes of the last decade has been the way that national public lenders and investors have enhanced their role to go beyond their territorial boundaries and become providers of development finance at the regional and even global south level. For example, there are now more than 250 *national development banks* in the developing world alone (UNCTAD 2015) and some of these are now immense, dwarfing long-standing multilateral institutions such as the World Bank and becoming major lenders for their regions and beyond.

Brazil and China have been among the most pro-active developing countries to use their national banks to support southern investments, and their banks are now significant international players, providing external financing as part of their standard operations. (Admitedly, this may be motivated more for the purpose of supporting national companies than to support south-south solidarity per se, but the trend remains). The China Development Bank (CBD), Export and Import Bank of China (China EXIM) and Brazil's BNDES have increased their assets and loan portfolios very rapidly in the 10 years between 2006 and 2016 (Figure 1).

Figure 1. **National development banks: Stock of loans over the years 2006-2016** ***(in U$ billion)***

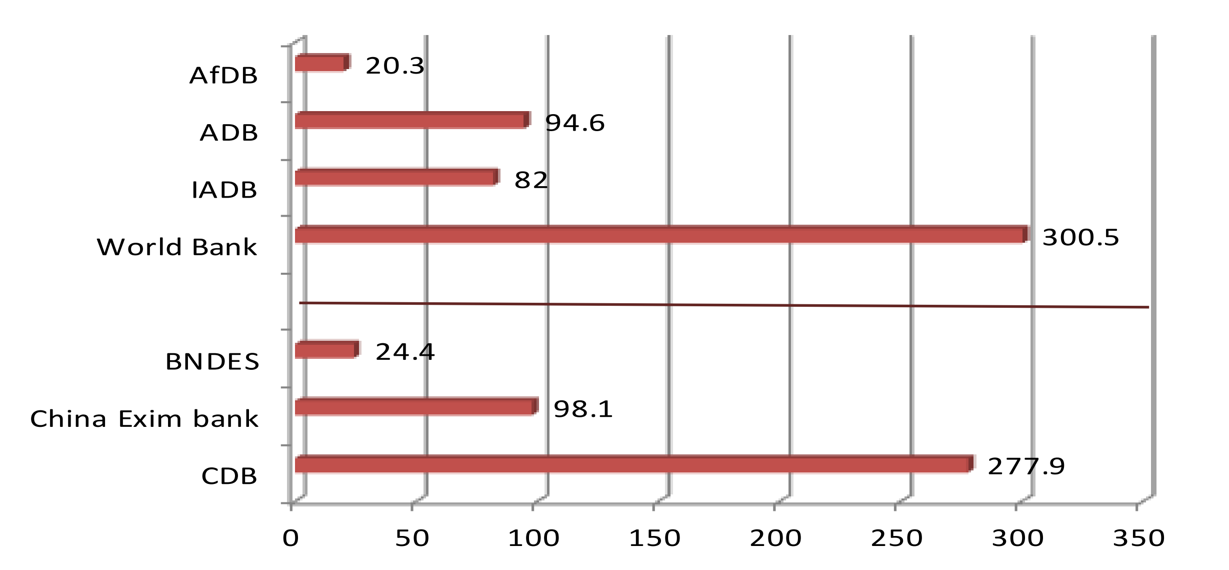


Source: Authors' calculations, based on data from Banks' annual reports and IMF database.

The stock of international loans held by China's banks (some $375 billion) is already larger than the global total of loans by the World Bank ($300 billion), and the total portfolio of China's banks would obviously be larger still if one included their domestic loans. The BNDES's stock of loans at $187 billion, of which 13% is in foreign currency, is not too far behind, if compared to those of the larger regional development banks (Figure 2). What is particularly impressive is that the larger multilateral development banks have been around for over 50 years or more, as compared to these national banks that only started to become actively engaged in outward operations from the early 2000's onwards. The impacts from the perspective of recipient countries are potentially very considerable. As described by Bertelsmann-Scott and Prinsloo (2018), Chinese financing of investment in African infrastructure alone accounted for almost $21billion in 2015 and dwarfed the total investments to the region made by at least nine other countries combined (France, United Kingdom, Japan, Germany, India, Brazil, United States, Canada and South Korea). Together, these nine countries invested just over one third of that total amount.

Another major national provider of investment finance emerging in many developing countries is that of *Sovereign Wealth Funds*. SWFs are a public investor, often seed-funded from government revenues earned by exports of commodities such as oil and gas, and they are now so plentiful and well-financed they could potentially (if not currently in practice) change the game for long-term developmental investment (see TDR 2015 and Barrowclough 2015).

Figure 2. International loans by Southern-led national banks already dwarf the total loans of multilateral development banks
(Year 2016, $US billion)

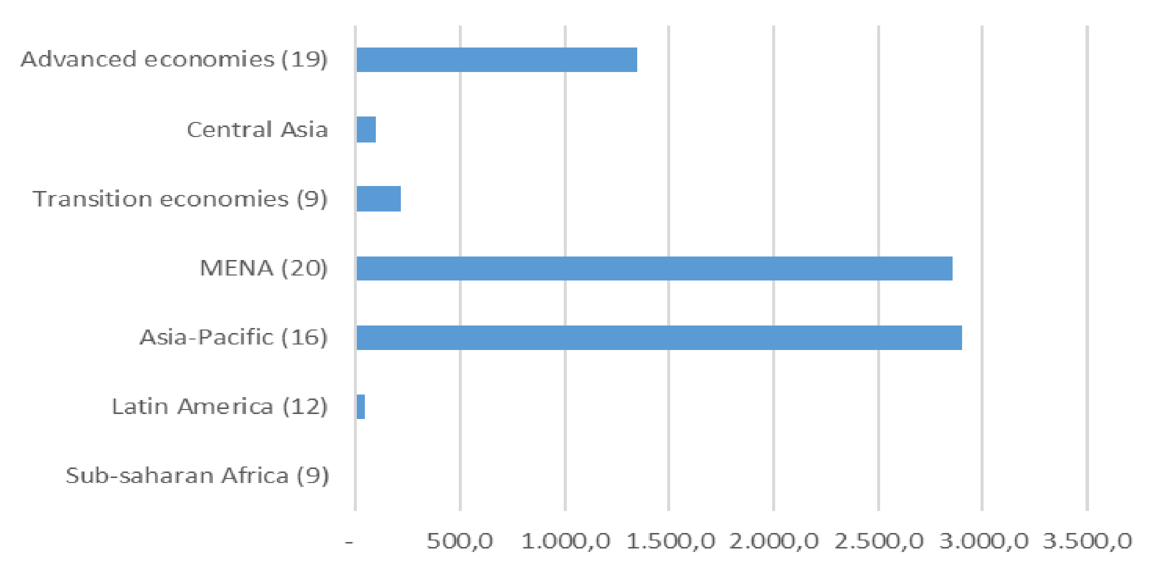


Source: Authors' elaboration, based on banks' annual and financial reports.
Note: WB: Sum of net outstanding loans of the IBRD and of the IDA, 2016 financial year; IADB: Outstanding loans of ordinary capital, fund for special operations and other funds; ADB: Outstanding loans of ordinary capital resources and ADF, as of 1 January 2017; AfDB: Net loans of AfDB only; China Exim bank: International cooperation loans only; CDB: International loans only; BNDES: values are merely indicative, based on loans in foreign currency.

Several features of SWFs stand out particularly in this context of southern-led development finance. It is not just their size – although the fact the total global value of assets held in SWFs is estimated at around $7 trillion is definitely part of it. This is an order of magnitude far greater than what is available through the world's largest multilateral institutions, whose lending firepower is still measured in billions of dollars. Another reason they are attracting attention is that of that $7 trillion, developing countries own or control as much as $6 trillion.

This reflects a flurry of activity in the years since the early 2000's, related to the emergence of extremely large current account surpluses in many commodity-based developing countries and some East Asian non-commodity exporters. Between the years 2000 and 2015, as many as 52 new SWFs opened worldwide, compared to just 15 funds for the twenty years before that, and of those new funds, more than 40 are owned by the south (Barrowclough 2015, 2018). Developing countries also account for the world's largest ones – of the 42-plus SWFs with more than $10 billion assets, 32 belong to developing and transition economies. Also, size is not the only thing that matters – funds do not need to be massive to be useful, and much smaller funds can play an important role in areas where other sources of finance are less forthcoming. The latest estimate of assets held by nine SWFs in Sub-Saharan Africa at $7.78 billion is too small to show up in Figure 3 relative to the other regions, but it can make a significant difference in the country if well invested (ibid).

Figure 3. SWF assets under management by region
($ billion, reported as of April 2018)



Source: Authors, derived from SWF Institute database. Figures in parentheses indicate number of funds per region. Assets values are estimates made by the SWF Institute, based for the most part on official sources.

However, this dramatic change in the landscape of southern-led financial institutions does not automatically translate into an effective change in the availability of finance for development. This depends on the mandate and the political will. Some Funds, such as stabilization funds, have a macroeconomic stabilization mandate and hence can support counter-cyclical lending and investment but should not be counted on for the long term. Also, many developing countries' SWFs are actually pension and life funds, and insurance companies, whose long-term mandate is to provide a cash-stream to cover pension liabilities or as a savings vehicle. They could be directed to more long-term developmental (infrastructure) activities, but for this to happen, however, certain obstacles would have to be overcome. Many funds have clear rules that forbid them to invest abroad (or in infrastructure projects – see, for Africa, AfDB (2018:77), and Barrowclough 2018). Finally, not all yet have the appropriate transparency, accounting and accountability mechanisms in place. Lack of transparency is a continued concern and criticism that hinders their use.

2.2 Southern-led multinational or multilateral initiatives

The burst of national, South-South activity described above has been overshadowed by the second major theme that captures most media and development interest, namely that of multi-national or multilateral, activities. The lack of reform in the global financial system prompted some developing countries to take much bolder steps by creating south-south development banks that can by joining forces across a number of countries, greatly increase their footprint. These initiatives reflect in particular the disillusionment with the government structures, patterns of lending and especially the conditionalities associated with lending by the Bretton Woods institutions and some of the leading regional banks.[1] The Bank of the South (based in South

[1] The history of conditionality embedded in IMF-World Bank loan programs is long, in the case of the WB starting back in the late 1970s as part of its structural adjustment programs. By the mid-2000s, conditions attached to loans were both broad and deep covering areas such as public financial management reform, budget process, social reforms and private sector conditions. Many related to

America), the BRICS New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB) are new southern institutions that are fully controlled and in some cases fully owned by the developing countries themselves. AIIB has already raised some $100 billion capital stock; the NDB has $50 billion in subscribed capital, and the Bank of the South has an initial promised capital of $20billion.

Existing Southern regional banks and funders have also scaled up their resources and in some cases re-engineered themselves to serve better the pressing needs of their regions. The 17 members of Latin America's CAF opened up the membership to take on new members from the hard-hit Caribbean states and in 2015 agreed a capital increase of $4.5 billion. Their counter-cyclical role increased from 2015 under the rubric of 'contingent operations' and further capital was accessed through different markets around the world. Similarly, the Development Bank of Southern Africa, (DBSA) initially established in 1983 as a South African government financed development bank with the mandate to provide finance for infrastructure development, expanded in 2013 its mandate to enter the entire African continent. Within two years it was devoting just under a quarter of its $929 million portfolio to infrastructure investment in countries outside South Africa, including Kenya, DRC, Mauritius and Zambia among others (Bertelsmann-Scott and Prinsloo, 2018). In other parts of the developing world such sums may not seem large but in Africa, investment is comparatively so low that this contribution is extremely significant for its recipients. The total volume of infrastructure investment financed by DBSA is now roughly three times larger than that of the regional development bank for West Africa and dwarfs other regional banks.

2.3 Creating a new centre of gravity

Taken together, these national, sub-regional and supra-national initiatives, whether new or enhanced versions of what already existed, mean that the landscape of the global financial architecture now looks very different compared to just a decade ago. This could have some negative consequences as well as positive ones, given it is in part a response to deficiencies in the global financial architecture and more time is needed to see what this implies for development in practice. Nonetheless, the trend is clear – the centre of gravity is gradually moving southwards.

As described above, the scale of finance potentially available to developing countries, controlled and governed by developing countries, has at least doubled. Figure 4 below also shows that annual disbursements are significantly higher, when southern banks (including national ones) are added to the picture. Moreover, this finance is held by institutions whose reach is focused more at the regional level than the global; and whose footprint of ownership is centered more around the South rather than the North. As shown in figure 5, there is a movement to the lower right-hand quadrant. Some of the new Southern-led institutions have many northern members as well – such as the AIIB, which is therefore sited somewhat 'north-east' of institutions that have only a few northern members, such as the Latin American bank CAF (with Spain and Portugal as members).