United Nations
Economic Commission for Africa

Assessing the effectiveness of National Development Banks in Africa

November 2022

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Executive Summary

National Development Banks (NDBs) are financial institutions that are fully or partially owned or controlled by a national government and have been given an explicit legal mandate to reach socio-economic goals in a region, sector, or market segment. NDBs are important entities, mostly incorporated by a state legislative instrument for channeling long-term finance in less developed financial markets and economic sectors perceived as risky. These institutions have great potential to support the developmental goals of their countries because they have some unique advantages that integrate well within the public sector and are well connected to the domestic private sector.

The role of NDBs in providing credit at subsidized interest rates has changed significantly, hence there is the need to improve our understanding of the changing roles of these banks. The promotion of successful NDBs requires a paradigm shift in the approach. This entails a completely new focus in approach that considers the following: (1) ensuring financial viability of the NDBs and their lending programs, and (2) creating an environment that fosters financial intermediation in traditionally marginalized sectors, as well as providing non-financial support to various sectors of the economy.

NDBs have been part of the financial system in African countries for a long time. With the oldest NDB in Africa being the Agriculture Bank of Namibia, which was created in 1907. These institutions are known to have played a crucial role in the rapid industrialization process ever since the 1950s. Many theoretical perspectives have been used to rationalize the creation of NDBs. The perspectives draw heavily on the existence of financial market failures due to asymmetric information, moral hazard, missing or insufficient collateral, high transactions costs, and term structure mismatch between funds available in the system and the needs of investors and consumers. It is also arguable that the case for NDBs is anchored on the needs to compliment Multilateral Development Banks (MDBs) in speeding up development in poorer countries. In some countries, NDBs have become critical market-makers.

Globally, there was an estimated 408[1] NDBs as of 2019, down from 550 recorded in 2009, this decline is heterogenous across regions but is mostly attributed to the liberalization policies of the structural adjustment period. In Africa, the larger share of NDBs is in Eastern Africa followed by Western Africa and the least number of NDBs are in Central Africa. The majority of the NDBs were created post-2000, following the rise in the adoption of the developmental state[2] as most countries tried to replicate the Asian Tigers. The 2008 financial crisis also exacerbated the growth of NDBs among African countries.

It was clear that Africa needs to rapidly invest in its development priorities and the art of national building through effective service delivery. There has always been an economic and a moral case for international provision of large-scale concessional funding to Africa. Today the continent is projected to be the most affected by climate change, while having an estimated annual sustainable development goal financing gap of $200 billion (UN Financing for Sustainable Development Report (2020). The NDBs in Africa have to deal with both old and evolving mandates. A scan of the literature highlights a number of issues including industrialization, delivery of 'global' and continental commitments such as the SDGs and Agenda 2063, dealing with unemployment and job creation, leadings efforts on redistribution, equity and inclusion, and combatting the negative effects of climate change.

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[1] https://afdshiny.shinyapps.io/developmentbanksdatabase/, Fitch Ratings, AFD

[2] A developmental state strives to balance economic growth with social development. It focuses on reducing poverty and expanding economic opportunities through the use of state resources and influence.

The anecdotal evidence suggests that the lending strategies of NDBs get influenced by, and tend to shift in response to, emerging national challenges. This is logical as such challenges, opportunities and priorities will require new tools and approaches. NDBs therefore should employ the appropriate instruments as their objectives to go beyond pursuing returns to investment and seek to integrate many social development and emergent priorities as determined by the national development strategy. In recent times, NDBs have been called upon to address key national development challenges including unemployment, equity, redistribution and inclusion, diseases, and pandemics (HIV/AIDS, Malaria & COVID-19), and climate change.

It is important to discuss experiences of selected NDBs and draw lessons for the future, particularly in what works or the operational challenges of such banks. This paper uses two cases from Africa and one case from Brazil. It explores how Brazil operationalized its developmentalist project using the Brazilian National Development Bank (BNDES) with elements of both change and continuity through Brazil's developmentalist past. The large loans went to many of Brazil's historic large firms and industrial sectors – as reported widely – but the data also show significant numbers of smaller loans to firms in all sectors, as well as renewed support for internationalization and innovation. In contrast, the Land Bank in South Africa has been dogged with many operational difficulties. While the Agricultural Credit Morocco did relatively well as compared to the South African experience.

A number of lessons can be drawn from the three NDB case studies, and these can be used to provide recommendations to National Development Banks in Africa. Governments must consider issues such as governance, risk management, funding priorities, sustainability, the quality of pipelines and emerging opportunities such as the AfCFTA as key factors to bear in mind when managing or setting up an NDB. There is also a need to identify, measure, monitor, control the risks and to determine that NDBs holding adequate capital against those risks, which is an essential component of the overall corporate governance framework and a key driver of performance. The regulatory and business environment is also critical for the success of NDBs. Moreover, the state regulatory and supervisory regimes could usefully be supplemented by market-based measures such as credit ratings.

In summary, NDBs hold important keys to most of Africa's economic and social development agendas, namely sustainable economic growth, inclusive growth, employment, productivity, industrialization among many more solutions. Upon the delivery of their mandate of supporting economic development through medium-term and long-term lending, NDBs can contribute to financial development in various ways. Given efficient balance sheet management and synergies with other financial institutions, National Development Banks can contribute to domestic bond markets and financial sector development by leveraging their comparative advantage in long-term lending. They can also enhance financial inclusion, notably by directly and indirectly channeling resources to credit rationed sectors, especially small and medium enterprises and youth and women-owned enterprises. NDBs also have a critical role in complementing the activities of MDBs. In this regard, in-depth bank and country case studies would shed light on the full potential of National Development Banks to contribute to economic growth, industrialization, financial inclusion, and financial sector development in Africa.

1.1 Introduction

National Development Banks (NDBs) are financial institutions that are fully, partially owned or controlled by a national government and have been given an explicit legal mandate to reach socio-economic goals in a region, sector, or market segment (World Bank, 2018). NDBs have the capacity to contribute greatly to national development goals, notably by financing industry, supporting employment creation, and mitigating financing constraints faced by small and medium enterprises and other traditionally credit rationed sectors (Ndikumana et al., 2020). NDBs can also play a vital role in offsetting the procyclical nature of the financial system, promoting "innovation and structural transformation", improving financial inclusion, increasing financing infrastructure investment, and supporting public goods provision, encouraging environmental sustainability.

Amongst developing economies, private sector financing often does not provide sufficient long-term finance for investment, of which can be attributed to the limited maturity transformation required for long-term finance. Private financial institutions deem these to be risky and thereby, favor short-term returns over long-term development financing. This has been further exacerbated in light of the COVID-19 pandemic, which has led many governments in Europe, Asia, and Africa to ultimately establish new NDBs, while other countries have had to expand the scope of their NDBs (Griffith-Jones and Ocampo, 2018). This follows from the renewed interest in the importance of NDBs, as key players in economic transformation, in the last decade, especially following the 2007/8 financial crisis, the emergence of climate change, environmental degradation (including loss of natural capital), and growing unemployment and social inequality.

NDBs, together with Multilateral Development Banks, can play an active role in mobilizing long-term resources from the public and private sectors to support new investments – the success of NDBs will be crucial in achieving further sustainable economic growth amongst developing economies.

The aim of this report is to assess the effectiveness of NDBs in Africa as a tool to crowd in additional private finance and support long term economic development. These institutions are of significance due to the strain that global shocks and climate change have had on slowing down the progress towards the Sustainable Development Goals, while simultaneously widening the financing gap necessary to achieve them.

The promotion of successful NDBs requires a paradigm shift in the approach. This entails a completely new focus that considers the following: (1) ensuring financial viability of the NDBs and their lending programs, and (2) creating an environment that fosters financial intermediation in traditionally marginalized sectors, as well as providing non-financial support to various sectors of the economy.

In this study a triangulation approach is used, of which refers to the use of multiple methods or data sources in operational research to develop a comprehensive understanding of phenomena (Patton, 1999). Triangulation also has been viewed as a research strategy to test validity through the convergence of information from different sources. Denzin (1978) and Patton (1999) identified four types of triangulations: (a) method triangulation, (b) investigator triangulation, (c) theory triangulation, and (d) data source triangulation.

In this Report, our approach was anchored on (a), (c) and (d) viz.: literature review, examination of secondary documents such as annual reports, board documents, Articles of Association (AoAs) and comparative case studies. This will be followed by an evaluation of NDBs activities and an assessment of the impact that COVID-19 has had on the operations of NDBs. Subsequently the research will present case studies in which a comparative analysis will be made between the mandate of the NDBs, and the national development strategies as means to establishing institutional effectiveness (sectors, instruments and regions). To conclude, this report will cover various recommendations to enhance the effectiveness of NDBs.

1.2 Literature Review

Many theoretical perspectives have been used to rationalize the creation of NDBs which draw heavily on the existence of financial market failures due to asymmetric information, moral hazard, missing or insufficient collateral, high transactions costs, and term structure mismatch between funds available in the system and the needs of investors and consumers (Stiglitz 1993; Stiglitz and Weis 1981). Market failures affect both the demand side and the supply side of credit markets, mostly due mismatches in the market (Eslava and Freixas 2018; Smallridge and de Olloqui 2011). Maturity mismatch of funds is usually cited as the perennial challenge. On the supply side, credit markets are dominated by a shortage of long-term investment capital. On the demand side, the financial markets face moral hazard because of the behavior of borrowers and the lack of private operationalizable collateral (Holmstrom and Tirole 1997). Private collateral is critical for the functioning of credit markets as it acts as a signaling device and allows for the screening of potential borrowers. It also enhances credit risk mitigation. The lack of collateral therefore leads to under-provision of credit as a result of credit rationing.

Our review of the theoretical literature on NDBs can be classified into five interlinked categories: the development view, the social view, the macroeconomic view, the political view and the life-cycle view. Under the 'development view' (see Gerschenkron 1962), NDBs are needed to fund sectors and industries that are not likely to be funded by private commercial banks. Two reasons are exposed for this: a preference not to invest in these sectors due to their perceived risk and a lack of capacity due to the lack of long-term capital that is required by industries. NDBs have therefore a transformative role in supporting the growth process (Mazzucato 2013).

In the 'social view', NDBs finance investments that have positive externalities, without attractive financial returns, and thus not in the interest of commercial banks, especially, for investments that are directed at the provision of social services such as education, health, low-income housing and others (Atkinson and Stiglitz 1980; Stiglitz 1993). In this regard, NDBs are policy instruments for poverty reduction and social development.

Under the 'macroeconomic view', NDBs provide counter-cyclical lending (Bonomo, Brito, and Martins 2014; Smallridge and de Olloqui 2011). Financial markets are subject to booms and busts and can destabilize the real economy. The countercyclical role of NDBs also derive from their social welfare mandate whereby, they are expected to increase lending during bad times or economic downturns, irrespective of the profitability of the funded activities.

However, the 'political view' portrays NDBs as reducing efficiency and may even be outright counterproductive. The viewpoint that when governance is weak, NDBs usually suffer from mission creep, mismanagement and inefficiency that lead to misallocation of financial resources. From this perspective, NDBs are often used as tools of state intervention that can undermine financial development, thereby retarding economic growth (La Porta, Lopez-De-Silanes, and Shleifer 2002; World Bank 2012).

Finally, with the 'life cycle' view, NDBs "emerge in countries with some solid institutions but incomplete and inefficient financial markets; growing up alongside industrialization and the development of financial markets; and wither and die as countries fully develop" (Torres and Zeidan 2016, 98–99). Thus, NDBs are expected to develop in three critical stages. The first is the establishment stage where NDBs put together the infrastructure to facilitate project identification and to provide direct credit to execute the projects. The second stage is developmental, in that NDBs roll out the direct credit provision program. In the third and final stage, or the 'engine of growth' phase, NDBs evolve gradually from direct credit to indirect mechanisms of allocating financial resources to support industry. In this 'final' stage, the volume of direct lending by NDBs is minimal, focusing on indirect mechanisms, eventually becoming eclipsed thanks to increased capacity and efficiency of a mature market-based financial system. However, NDBs have remained an integral part of modern financial markets regardless of the degree of financial sophistication and economic development.

1.2.1 The rationale, roles and evolution of NDBs in Africa

The discipline of development banking has its roots in the early growth theories. Several theorists like Arthur Lewis, Roy Harrod, and Evsey Domar, among others highlighted the idea that the growth of income is directly and positively related to savings – for example as in the Harrod-Domar model. This means that the more an economy can save and invest, the greater should be the growth of its domestic product. Capital investment was thus taken as the means to achieve accelerated economic growth. However, in cases when private savings and investment is low, governments have been seen directing funds to the market through vehicles like NDBs, hence the creation of development banks was taken as a solution to the problem of alleviating the shortage of development financing. Similarly, the above rationale ultimately led to the creation of the World Bank, under the Marshall Plan.

During the 50's to the 70's, most countries created NDBs to be used as the catalyst for industrialization. During the same period, they were adopting a developmental state strategy, in which the State took a key role in propelling an economic growth take-off. Successful implementation of such strategies has been predominant among the Asian Tigers, as they implemented economic policies such as the *flying geese* model, (Kojima, 2000). During these years, NDBs were seen to generate a multiplier effect aimed at driving sustainable economic growth. However, it should be acknowledged that the role of NDBs has also evolved over time. Some of the main sources behind their evolution include economic liberalization, privatization of public enterprises, and the progressive globalization of world trade finance. Such policies took a centre stage during the 80's and the 90's (Griffith and Ocampo, 2018). This period was associated with few NDBs, as most were privatized, forming commercial banks, while other countries had closed some of their NDBs. Following the Global Financial Crisis, the resurgence of developmental state, the global COVID-19 crisis and the Sustainable Development Goals targets have led to NDBs again taking a centre stage.

According to the UN Financing for Sustainable Development Report (2020), achieving the SDGs will require additional investments of USD 5 trillion-USD 7 trillion annually and globally for key sectors, ranging from energy, infrastructure, agriculture, health, and education, of which USD 1 trillion is required for Africa alone. As a result, this calls for the assistance of NDBs in facilitating the achievement of the SDGs in Africa, and by extension, developing countries. As a result, most countries are implementing policies aimed at improving the effectiveness and efficiency of NDBs. The big question is what does this mean for NDBs in Africa? In answering the question, this study seeks to identify the nature and state of NDBs in Africa and provide ways to improve their roles and mandates and use the NDBs as a tool to crowd in additional private finance and support economic development. Lessons will be drawn from mixed NDB stories of success and failure within the continent and beyond.

1.2.2 The state of play and existing NDBs - an analysis of the evolving African landscape

NDBs have been a part of the financial system in African countries for a long time. One of the oldest NDBs in Africa is the Agriculture Bank of Namibia, established in 1907. These institutions are known to have played a crucial role in the rapid industrialization process since the 1950s. More generally, NDBs became a part of the institutional-building and development-planning tools of the post-independent African States, starting from the 1960s. The majority of the NDBs were created post-2000, following the rise in the adoption of developmental state, as most countries tried to replicate the development model of the Asian Tigers.

Globally, there was an estimated 408[3] NDBs as of 2019, down from 550 recorded in 2009 (Bruce, 2009), this decline is heterogenous across regions, but is mostly attributed to liberalization policies. Figure 1 below shows that 33 percent of NDBs are located in Asia and the Pacific, while Africa has the smallest share of 21 percent. Europe and Asia have recorded little increase in the number of NDBs, while Africa and America have recorded decreases in the share of NDBs over the period of 2009-2019. The huge state-driven development projects and the successes of the earlier NDBs, are the main cause for a large share of NDBs in Asia-Pacific and the increase of NDBs in Europe. Industrial Finance Corporation of India, Development Bank of Japan, and China Development Bank are among some of the more successful NDBs in the Asia-Pacific.

Figure: 1 Percentage share of NDB in the world, 2009-2019