EDITED BY DIANA BARROWCLOUGH,
KEVIN P. GALLAGHER AND
RICHARD KOZUL-WRIGHT

ROUTLEDGE

SOUTHERN-LED DEVELOPMENT FINANCE

Solutions from the Global South

RETHINKING DEVELOPMENT

SOUTHERN-LED DEVELOPMENT FINANCE

Southern-Led Development Finance examines some of the innovative new south-south financial arrangements and institutions that have emerged in recent years, as countries from the Global South seek to transform their economies and to shield themselves from global economic turbulence.

Even before the Covid-19 crisis, it was clear to many that the global economy needed a reset and a massive increase in public investment. In the last decade southern-owned development banks, infrastructure funds, foreign exchange reserve funds and Sovereign Wealth Funds have doubled the amount of long-term finance available to developing countries. Now, as the world considers what a post-Covid-19 future will look like, it is clear that Southern-led institutions will do much of the heavy lifting.

This book brings together insights from theory and practice, incorporating the voices of bankers, policymakers and practitioners alongside international academics. It covers the most significant new initiatives stemming from Asia, tried and tested examples in Latin America and in Africa, and the contribution of advanced economies. Whilst the book highlights the potential for Southern-led initiatives to change the global financial landscape profoundly, it also shows their varied impacts and concludes that more is needed for development than just the technical availability of funds.

As governments and businesses become frustrated by the traditional North-dominated mechanisms and international financial system, this book argues that southern-led development finance will play an important role in the search for more inclusive, equitable and sustainable patterns of investment, trade and growth in the post-Covid landscape. It will be of interest to practitioners, policy makers, researchers and students working on development and finance everywhere.

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Solutions from the Global South

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Kevin P. Gallagher and
Richard Kozul-Wright

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ACRONYMS

ADB	Asian Development Bank
ADF	Asian Development Fund
AfDB	African Development Bank
Afri-ID	Africa Infrastructure Desk
AIIB	Asian Infrastructure Investment Bank
ALADI	Latin American Integration Association
ALALC	Latin American Free Trade Association
ALBA-TCP	Bolivarian Alliance for the People of Our America
AoA	Articles of agreement
ASEAN	Association of Southeast Asian Nations
AU	African Union
BNDES	Brazil National Development Bank
BoG	Board of Governors
BOT	Build-operate-transfer
BRICS	Brazil, Russian Federation, India, China and South Africa
CABEI	Central American Bank for Economic Integration
CADF	China–Africa Development Fund
CAF	Andean Development Corporation (Corporacion Andina de Fomento)
CAF	Development Bank of Latin America
CAN	Andean Community
CARICOM	Caribbean Community
CDB	China Development Bank
CELAC	Community of Latin American and Caribbean States
CLAIFUND	China–Latin American Industrial Cooperation Investment Fund
CLO	Collateralized loan obligation

CMC	Consejo Mercado Común
COSIPLAN	South American Infrastructure and Planning Council (Consejo Suramericano de Infraestructura y Planeamiento)
CPF	Promotion and Finance Commission
CRA	Contingent Reserve Arrangement
CRA	Credit Rating Agencies
CRPM	MERCOSUR's Commission of Permanent Representatives
CSO	Civil Society Organisations
DBSA	Development Bank of Southern Africa
DFI	Development Finance Institute
DRM	Domestic Resource Mobilisation
EBRD	European Bank of Reconstruction and Development
ECLAC	United Nations Economic Commission for Latin America and the Caribbean
EIB	European Investment Bank
ESF	Environmental and Social Framework
EU	European Union
EXIM	Export–Import Bank
FDI	Foreign direct investment
FOCEM	Structural Convergence Fund of MERCOSUR (Fondo Para la Convergencia estructural del Mercosur)
FONPLATA	Financial Fund for the Development of the River Plate Basin
FTAA	Free Trade Area of the Americas
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GIF	Global Infrastructure Facility
GTI	Inter-institutional Technical Group
HIPC	Highly Indebted Poor Country
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICA	Infrastructure Consortium for Africa
IDA	International Development Association
IDB	Inter-American Development Bank
IDC	Industrial Development Corporation of South Africa Limited
IIRSA	Initiative for Integration of the Regional Infrastructure in South America (Iniciativa para a Integração da Infraestrutura Regional Sul-Americana)
LAC	Latin America and Caribbean
LOC	Lines of Credit
LPI	Logistics Performance Index
MCCA	Central American Common Market
MDB	Multilateral Development Bank
MER	Central American Regional Electric Market
MERCOSUR	Southern Common Market

MIC	Middle Income Country
MIDP	Mesoamerican Integration and Development Project
NAFTA	North American Free Trade Agreement
NBF	NEPAD Business Foundation
NDB	National Development Bank
NDB	New Development Bank
NDFI	National Development Finance Institute
NEPAD	New Partnership for Africa's Development
NEPAD–IPPF	NEPAD Infrastructure Project Preparation Facility
NGO	Non-Governmental Organisation
OAS	Organization of American States
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
PAHO	Pan-American Health Organization
PFM	Public Financial Management
PIDA	Programme for Infrastructure Development in Africa
PIDA-PAP	PIDA Priority Action Plan
ppp	Private-public partnerships
PPP	Plan Puebla Panamá
RICAM	International Network of Mesoamerican Highways
RTA	Regional Trade Agreements
SAFE	State Administration of Foreign Exchange (China)
SDGs	Sustainable Development Goals
SICA	Central American Integration System
SIECA	Central American Economic Integration Subsystem
SIEPAC	Central American Electrical Interconnection System
SOE	State Owned Enterprise
SRF	Silk Road Fund
SSA	Sub-Saharan Africa
TIM	International Goods Traffic
UA	Unit of Account
UCS	Use of Country Systems
UNASUR	Union of South American Nations (Unión de Naciones Suramericanas)
UNECA	United Nations Economic Commission for Africa
UTF	FOCEM's Technical Unit
WB	World Bank

INTRODUCTORY ISSUES AND ROADMAP TO SOUTHERN-LED DEVELOPMENT FINANCE

Diana Barrowclough, Kevin P. Gallagher and Richard Kozul-Wright

Developing and developed nations alike face enormous financing challenges over the coming decades as they seek to foster structural transformation in a manner that is stable, inclusive, and green. Even before the Covid-19 crisis and lock-down policies in early 2020, it was clear to many that the global economy needed a re-set and massive increase in public investment, as it faced tipping points with respect to financial instability, economic inequality, and social unrest, and a climate breakdown. As countries around the world struggled to contain the spread of coronavirus, the social and economic pains caused by lock-down revealed long-standing cracks and dependencies that were not only unsustainable, but were also a source of fragility to all. Many commentators see the crisis as a chance to rebuild the economy in a better way, including authors in this volume. Few voices, if any, suggest this should be a private sector role – rather, around the globe, it is public banks, development banks, and regional financial institutions to whom they have turned. These institutions are the focus of this book, and in particular those from the South, as these have been by far the outstanding source of long-term, patient, and catalytic finance, and in the magnitudes required. To finance global infrastructure gaps alone in such a manner, there is a gap of 2.1% of global GDP on an annual basis from now until 2030 (Bhattacharya et al. 2019). For decades, developing nations have asked the advanced economy for financial assistance to achieve these broader goals. Such finance was sometimes promised and seldom delivered. When such financing did come, it often accentuated rather than alleviated these problems and came with tight strings attached.

Over the past decade, the global south has moved to catalyze its own savings to meet its own needs on its own terms. This volume stems from the extraordinary trends in South-South financial cooperation of the last decade and highlights what is needed to take it to the next level. It takes a fresh approach to address some new emerging challenges on both the supply and demand side of

South-South development finance, and identifies some lessons learned in the last decade to help move from "potential" to concrete outcomes for inclusive and sustainable development of the kind needed in today's post-Covid world.

As described in this volume, South-South development financing initiatives have achieved much progress in recent years: the creation of new development finance institutions (AIIB, NDB), the consolidation and expansion of existing ones (multilateral development banks such as IsDB, national development banks such as BNDES, CDB), and new investment programs (Belt and Road Initiative, NEPAD-IPPF). In a very short time, Southern-led banks have become the largest sources of development finance in some developing regions, dwarfing the traditional multilateral lenders. Southern-led and Southern-oriented banks now amount to more than $1 trillion, even without including the more than $7 trillions of dollars in Southern-owned Sovereign Wealth Funds and Foreign Reserves that could potentially be re-oriented towards development. At the same time, in a parallel and related move, the South has been setting up and strengthening mechanisms to meet official liquidity needs (FLAR, BRICS CRA, Chiang-Mai), as complement to the long-term finance instruments. In addition, South-South FDI has grown dramatically since the early 2000s.

The authors gathered here include practitioners from the world of banking and finance, policymakers, and academic experts, each bringing a different perspective that links theory, case-study examples and evidences from interviews, and a pragmatic observance of political economy. Three chapters focus attention on the Asian region, where some of the most recent and largest changes have emerged; three on Latin America, which has a longer history of experimenting with different models and which has also been a major recipient of some of the Asian funds; one chapter on Africa, where the needs are greatest but financial capacities remain the least; and two chapters taking a more global overview. The chapters paint a picture of a massive change in the financial landscape, with a great deal of new potential emerging whilst at the same time noting there are still important gaps and limitations that remain.

All the authors note the scale of new financial resources that are now potentially available, and the particular role that development banks can play as opposed to commercial lenders or investors which are much more constrained in terms of what they can finance. Several focus on the potential for increased investment in green and climate-change oriented activities (Gallagher, Gottschalk and Poon, Kamal and Ray among others); a chapter on Chinese banking describes an innovative "consortia" approach that goes beyond the simple provision of finance to include commercial partnerships that can directly impact production and exports (Gallagher). At the same time, countries need to be ready to take advantage of the moment: almost all the authors note the need for governments to have in place a co-ordinated and coherent plan that can furnish the appropriate demand to rise to the opportunities created by the new supply. It is much more than just having some "shovel ready projects" on hand for the development banks (although this already is a challenge in some areas), and rather countries and indeed regions need regional plans for smart infrastructure and logistics that can spur innovation

and inter-regional trade. Chapters by Studart, Gallagher, Carciofi, and Bertlesmann highlight the need to create institutions that can interface between lenders and borrowers to ensure the opportunities are grasped in a useful and transformative way.

Even with all the new institutions and enlargened existing ones described in this volume the fact remains that scaling up is difficult, involving mismatches of timing, maturities and mandates and the needs are immense. Traditional sources do not seem able to ramp up finance as they might be expected to help meet the global challenges of the Sustainable Development Goals, and more recently, the consensus emerging for development to be Green. Countries still face massive constraints in terms of what they can finance and how. Development Banks remain under-funded for the essential heavy lifting; gaps remain in areas such as concessional finance (critical for LICs), financing for dealing with shocks, especially natural disasters which are becoming even more frequent and destructive. Long-standing essential needs such as water remain unfinanced, just as new and important areas are emerging such as the digital economy. Moreover, the phenomenal growth of South-South finance has not been even – some parts of the world remain extremely under-funded, particularly in Africa. And while the volume does not devote particular attention to the long-standing multilateral institutions, it is important to note they too are not sufficiently financed nor governed appropriately for the tasks expected of them. Unhelpful and intrusive conditionalities remain in place despite the concerns of many developing countries and the "voice" of developing countries remains well below their economic weight. Potentially only countries at their last resort and with no other funder will choose to use them.

1. Rationale – why we need regional integration and development banks

In recent years, this argument has not needed to be made as much as in the past because the potential catalytical role of banks with a long-term and more socially oriented mandate – especially public banks – has become widely appreciated once again. There is also an appreciation of the role of banks in terms of creating credit, as well as guiding it to the desired purposed (see Eurodad 2017; Macfarlane and Mazzucato 2018; UNCTAD 2019 among many others). As described in the chapter by *Studart and Ramos*, this reflects the rejection (once again) of the mistaken idea that banks can be nothing more than an intermediary between savers and investors. Even if some still believe that loans must be predicated by savings first – an idea that misunderstands the essential credit-creating role of banks – in developing countries this would be highly unlikely to happen because savers are for various reasons especially unwilling to lock their capital into long-term projects. A second reason this canard has been abandoned is that in developing countries, banks are too weak and fragile to bear the burden of the liquidity and maturity mismatches – which is already difficult in the most advanced and deep financial markets. Alternatively, perhaps the re-found fashion

for development banking rather reflects the acceptance of the evidence – in both the north but particularly the South – of the positive contribution made by public banking in development now and in the past.

The volume opens with the experience of Latin America as a region, in part because it has strongly promoted regional integration in recent decades and also because it experienced all the ups and downs of the fashion (or some would say ideology) with respect to development banking. In the first half of their chapter, Studart and Ramos set up the case for why development banking is needed in the first place, before heading into the details of the Latin American development banking experience. The authors show that during a period of history while new development banks were being created around the world, in Latin America banking was rather in decline. Ideological pressure meant that many national development banks privatized or overhauled, to the extent that the number of banking institutions virtually halved between the years 1988–2013. Those that remained had a narrower mandate. They did appear to improve efficiency, and the new expectations following the crisis of 2007–2008 that banks should play a counter-cyclical role meant that some banks were re-capitalized or profits re-invested, meaning they could increase lending with their own resources. However, the question remains whether this expansion is sufficiently useful to address the enormous infrastructure financing gaps in the region.

The authors compare the models operating in Chile, Mexico, and Brazil, before turning their attention to the new possibilities that opened up with the emergence of big new multilateral banks from the South, in particular the AIIB and NDB. Although these big new contributors can help significantly by scaling up the financial resources available, other obstacles remain just as important, in particular, the need to create a pipeline of projects, for which particular technical and technological capacities are needed at both public and private sectors. This is lacking in most parts of the developing world. This lack could to an extent be resolved through the creation of special "origination platforms" dedicated to identifying potential projects and mitigating uncertainties associated with their early stages.

It is particularly difficult in Latin America because the systematic reduction of national development banks has created a vacuum in terms of many of the much-needed capacities. The new South-South institutions such as the AIIB and NDB could play an important role in this regard, over and above the provision simply of finance. At the same time, however, the authors warn, this can only happen if the new multilateral banks do not fall into the old prejudices and modus operandi of the historical multilateral banks. These solutions are not technical, but rather depend on the appropriate mindsets and the always needed political will.

2. The "special offer" of banks from the south

Political will and support for development banks from the south has certainly changed the landscape for long-term development finance in recent decades –

but does this mean that the Southern banks can live up to the high hopes placed in them? Expectations are that the new range of Southern-led financial institutions will make a dramatic difference in scaling up the availability of financial resources, especially if existing multilateral development institutions can take a leaf out of their book and make the most of their potential. Taking a broad brush approach, Barrowclough and Gottschalk show that the mechanisms and resources that are owned or controlled by the South now potentially offer trillions of dollars' worth of support through national holdings of foreign reserves, national development banks and sovereign wealth funds, and also southern regional banks and funds – in addition to what has always been available to the south through the global multilateral World Bank and Regional banks.

The center of gravity for development finance has thus shifted firmly southwards. In addition to significantly increasing the total sums of lendable finance available, the Southern banks are also lending much more quickly, arranging loans in a matter of weeks rather than months and even years. The conditionalities that are typically attached with World Bank loans are also notably absent (although this is not necessarily a good thing if it undermines environmental or labor standards). At the regional level, the sense of solidarity that is fueling the movement can have very real tangible benefits, as measured in the ability of multilateral banks to obtain credit on international financial markets at lower levels of interest or better terms than individual countries could obtain alone. The new banks also seem to be more open to partnering with the private sector, as well as being more open to support productive activities and green investments. The Southern-led banks are lending heavily to infrastructure and in particular to renewable and "green" infrastructure.

However, the authors also caution about excessive optimism and note that some long-standing concerns and themes remain unchanged. Not all regions have been served equally and some of the smaller and poorer countries and regions remain extremely under financed for what is needed, in particular in Africa. Countries that are less likely to set up strong national banks are in turn less likely to benefit from the opportunities created by the new regional ones. Moreover, despite their efforts to scale up resources for long-term investment, Southern development banks continue often to adopt a conservative approach to lending, following quite closely to the patterns established by the old multilateral lending institutions. The three major Credit Rating Agencies have still maintained a strong grip over the international credit markets on which many banks and borrowers still depend, and their criteria for rating the banks and funds are not very transparent. As long as the banks and funds find themselves caught in the balancing act – real or perceived – between financing activities that will make a strong impact on development without making a competitive financial return, then they may not make as much difference as is hoped for.

This kind of tension is also evident in the question of concessional lending, according to the authors. The historical multilateral banks have always been important in terms of providing this through their soft windows, with about 30%

of their total lending until recently being in the form of concessional lending. However, this may change in the coming years and this is important because none of the new Southern-led banks have clear institutional set-ups to provide concessional lending, even if some levels of subsidies are provided by those banks that have treasury or central bank support. Hence, there remains much to be done to support these new institutions, to ensure they can fulfill their potential to be real game-changers.

It may come as a surprise to learn that the largest source of development finance in Latin America is from China's two global development finance institutions – the China Development Bank and the Export-Import Bank of China, as shown in the chapter here by Kevin Gallagher. Gallagher's analysis shows that, contrary to the suggestions of some, Chinese development finance is complementing rather than directly competing with other forms of development and private finance. The majority of the development finance from China flows to infrastructure and energy, sectors long neglected by Western-backed financial institutions and the private sector. Moreover, Chinese finance tends to flow to countries that are neglected by those actors as well, largely concentrating in Brazil, Venezuela, Ecuador, and Argentina.

Gallagher also notes that both Latin American hosts and Chinese investors need to work more diligently to jointly maximize the benefits of this newfound development finance and minimize the risks. Investments in large infrastructure projects are endemic to social and environmental problems, debt sustainability, and corruption. To its credit, Gallagher shows that unlike some Western counterparts China does not put policy conditions on its lending to host country governments but rather relies on host "country systems". However, there is a difference between policy conditionalities – lending on condition of privatization, governance standards, etc. – and project-level due diligence. Many projects that China is financing are raising concerns about debt sustainability and social and environmental conflict. Many of these risks can be anticipated and mitigated with the proper due diligence policies – at the host country and the DFI level. Gallagher suggests that a South-South dialogue takes place to ensure that such policies are in place in a manner that respects mutual sovereignties and that also allows all parties to maximize benefit and minimize risk.

3. Going in a different direction

The Chinese model stands in contrast therefore with the story told in the chapter by C. P. Chandrasekhar which rather shows an example where a country did *not* take the leading role of South-South development finance that could otherwise have been anticipated, given its economic size, historical context, and the intellectual contribution it has made elsewhere. In India's immediate post-independency years, there was a strong commitment to developmental banking and the Indian financial system comprised a diverse variety of banks and financial institutions.

Numerous banks specialized in particular sectors or long-term activities and dedicated their technical competence and financial resources to agriculture, housing, shipping credit, power, tourism, renewable energy, and small industries. Many were financed directly from government budget or surpluses held by the Reserve Bank of India, and hence benefitted from having a relatively low cost of capital, which in turn facilitated lending for long-term purposes at relatively low-interest rates. In the early 1990s however, it was argued these banks should also obtain resources from the capital market. Moreover, it began to be questioned whether there was any need for specialized institutions that concentrated on the long-term perspective.

As Chandrasekhar describes, after some years of this, the distinction between developmental and commercial banks was blurring. This led to the argument that development banks should no longer be allowed the privilege of concessional capital and should be on the same footing as the commercial banks. (As opposed to an argument they should focus on being more developmental, as is discussed at the end of this Introduction). Next came the Indian Government's decision to phase out the main all India development financial institutions. The emphasis changed too – with the remaining state-owned banks being expected to focus more on profitability, shareholder value and corporate governance, whilst at the same time juggling an awkward mix of developmental goals alongside the goals of neoliberalism.

The upshot of these changes has been a fundamental and negative change in India's financial structure, argues the author. It became reliant on the use of periodically rolled over short-term funds to finance longer-term debt and grew increasingly fragile. Foreign investment has been volatile, and the gap in finance available eventually filled by a sharp increase of foreign capital inflows following Quantitative Easing in the north, leading to increasing liquidity in the domestic economy and an explosion of credit. Lending increased dramatically not only to houses and consumer loans for automobiles etc., as one might expect, but also into industry and even infrastructure sectors such as steel, roads, and ports. However, Chandrasekhar warns, this is not a positive picture. First, foreign capital flows can and have dried up very quickly in other parts of the world. Second, commercial banks typically prefer to lend to short-term purposes and this high-risk strategy of lending long-term may rather reflect their belief that losses will be covered by the Government. (While government had stepped back from public investment, it had at the same time stepped forwards to encourage Public-Private Partnerships or private investments – to the extent there appeared to be an implicit sovereign guarantee to these loans). At the same time, the lack of development of a local bond market meant the corporate sector had little choice but to turn to the one remaining source of finance, the banks, for longer-term funding. Both these factors are supported by suggestions that the high number of defaults and non-performing loans would, in normal circumstances, have provoked concerns about insolvency and perhaps triggered a run on the banks.

4. Africa and new options

In Africa, countries are looking for ways to prepare themselves better for the potential embodied in Southern lenders such as the New Development Bank and others. The chapter by Bertlesmann and Prinsloo describes the changing landscape of infrastructure finance in Africa, showing how new donors from developing countries such as China have increasingly played a critical role as an alternative to the higher interest rates and conditionalities offered by the traditional lenders such as the World Bank. The continent has mapped out its need and designed a plan, clearly articulated in the Programme for Infrastructure Development in Africa. This was endorsed officially by the heads of state of the African Union, in partnership with the New Partnership for Africa's Development (NEPAD), the African Development Bank (AfDB), and the United Nations Economic Commission for Africa (ECA). Its overall goal is to promote socio-economic development and poverty reduction throughout Africa, through improved access to regional and domestic infrastructure networks. The most critical of these include projects in transport, energy, information and communication and of course water and the sums that are needed are large – estimated as being at least $7.5 billion annually.

Hence the African continent has a plan for development, but this is not the same thing as being able to finance and implement it. The authors note that the vast sums needed are resulting in a renewed focus on involving the private sector – however following a model that has changed little over decades and relying on continued partnership with traditional multilateral development banks that have not kept pace with the changing needs and demands of today's global environment. Unchanged from the conditions prevailing during the latter part of the last century, many multilateral development banks today continue to insist on strict loan conditions, and with layers of bureaucracy, these banks find themselves with access to large amounts of funding but deceasing calls for borrowing. Governments are instead looking elsewhere, including Official Development Assistance, the private sector and increasingly new donors and banks such as the BRICS institutions.

At the time of writing, the authors note the NDB had made only a very small contribution to Africa's infrastructure deficit. The bank's early lending was spread across all the member nations, and in its first tranche of lending, the loan to South Africa's electricity transmission was significantly smaller than to other countries. They suggest ways this could be increased in the future. One is to co-finance and partner with other African banks, and they seek ways to increase this in the future. They note that the NDB could work more closely with the major African banks without introducing negative elements of competition. For example, Southern Africa's largest development bank, the DBSA, has developed a niche within the renewable energy sector and this could be expanded more widely in the region were finances forthcoming. The NDB's use of issuing bonds through domestic markets, rather than on international bands markets, could

be complementary to the work of the DBSA and not competitive – because the NDB is roughly 60 times larger than DBSA it was unlikely they would be competing for funding similar projects even if raising funds on the same financial markets. Moreover, the DBSA could provide local knowledge, networks and presence to complement what was offered by the NDB. Similarly, with regard to South Africa's Industrial Development Corporation (IDC), there appears to be a divergence in the types of activities undertaken and projects likely to receive funding, so they could be complementary rather than competitive. The IDC focuses on financing manufacturing activities. Similar examples could be found in other countries. The authors further argue that expanding the banks' membership on the African continent should also allow for most investment into African infrastructure, and to allow the NDB to align more closely with the plans outlined for the continent by the African Union.

5. Scaling up – new challenges, experimental responses

The chapter by R. Gottschalk and D. Poon argues that most long-standing multilateral finance institutions are unnecessarily limiting their lending impact, by having a conservative loan approach and relying on too narrow a capital base. On the question of gearing ratios of loans to equity, the authors find that several African banks are lending at ratios of less than 2; compared to ratios of around 5 for the European Investment Bank and in sharp contrast to the Chinese Development Bank, at 11. The authors summarize various ways that banks could increase their lending capacities, even without increasing their capital. These included being allowed to relax capital requirements, to take advantage of the "headroom" that exists without putting at risk the high ratings they have been granted; or merging concessional with non-concessional windows in development banks' balance sheets, to increase their equity capital and therefore boosting leverage capacity; and in particular making callable capital more transparent so that credit rating agencies can consider them as part of equity for calculating the gearing ratios.

The main contribution of the chapter shows how the Articles of Agreement of the Asian Infrastructure Investment Bank has opened the door for increased lending in the future. Alongside the ordinary operations that are financed from "ordinary resources", which consist of "authorized capital stock of the Bank, including both paid-in and callable shares", the Articles also allow for special operations financed by "special funds resources". Importantly, these two types of operations may separately finance elements of the same project or program. It remains to be seen how the AIIB will use this special feature of its AoA, but it does appear to be a way that the bank can increase its scale of project loans whilst at the same time respecting the statutory limit to its gearing ratio. The design is seen by the authors as a de jure gearing ratio that is aimed at ensuring the banks access to international capital markets, without endangering its receipt of the highest credit ratings, whilst also creating a conduit that allows for financing to

be scaled up beyond those statutory limits. Certainly the evidence that China's Development Bank is willing to follow a much higher gearing ratio suggests that the AIIB could also be willing to experiment with much higher ratios, over time.

This finding is important because, as the authors argue, current MDBs have found that their ability to raise resources on international capital markets is constrained by their narrow capital base and their conservative lending approaches, which are designed to maintain high credit ratings. As shareholders show little appetite to increase capital, despite some encouraging rhetoric, the banks risk losing their relevance at precisely the time they are needed most. The new Southern-led MDBs therefore may be taking a leadership role in terms of offering examples of new forms of governance and design to promote scaling up as well as through the sheer firepower of their operations.

Any study of the role of the AIIB cannot ignore of course the particular role of China, as its main shareholder and with veto power that makes it seen as a new phase of China's international engagement. However, as noted by various authors in this volume, China's experiment with development banking did not start with either the AIIB nor the New Development Bank nor the Belt and Road Initiative. It has been providing significant financial assistance since the early 2000s, through its national development banks CDB and China Exim and other funds and programmes. All of these experiences hint at its willingness to experiment with different forms of institution building and different forms of South-South and multilateralization finance.

6. Benefits of being borrower-led

Perhaps one of the most important points for scaling up and taking on a more diversified portfolio of loans is that the Southern banks are essentially borrower-led and members have a shared vision. Solidarity is more than just a mantra; it has tangible benefits including local expertise and understanding that can catalyze lending in instances that might otherwise not attract finance, as well as high repayment rates of loans once taken. Being borrower-led also means that banks are well positioned to react to governments' increased demand for long-term investment during periods of weak economic growth, and to bridge the gap between periods of high political will and periods of full government coffers. This counter-cyclical role is well described in the chapter by Kamal and Ray, which shows that how two Southern-led development banks – the Development Bank of Latin America (CAD) and the Islamic Development Bank (IsDB) – compare positively compared to northern-led banks the Inter-American Development Bank (IADB) and the World Bank. Being borrower-led means the banks can respond to borrower demand, even though their relatively lower levels of callable capital and low-credit ratings of member nations act to limit their ability to raise capital on international capital markets.

To address some of these limitations, Kamal and Ray examined banks' infrastructure loans and in particular clean investment loans, using methodology

developed by the UNFCCC Clean Development Mechanism to compare their relative performance. The authors find the Southern banks have been more creative, maintaining multiple lending and investment windows in the same institution, which allows smoother collaboration and blending instruments to support hard to finance or complex projects. The Southern banks were also found to participate in multilateral funds, even as small minority partners, thereby enabling them to learn from their larger counterparts about new types of loans and projects. Being borrower-led further endowed them with access to in-depth knowledge of potential risks of large projects, including environmental and social risks that could support lending; and relying on local staff and experts gives greater flexibility that could also support lending. At the same time however, the authors note that some important risk reducing mechanisms are lacking, including procurement oversight and dispute resolution mechanisms.

7. Evolving processes

As noted in the Latin American examples, the evolution of development banking occurs not in a vacuum but strongly nested within broader political contexts. The political economy processes underlying the emergence of some of largest new Southern-led institutions is explored in the chapter by Mah Hui Lim. A former banker, his practical insights may be especially prescient given the potential some see in today's confluence of economic pressures and instabilities, for a repeat of the economic and financial crises of the last decade.

Lim describes the hopes that were initially placed in the Bretton Woods institutions when created in 1945, and the breakdown and disappointments that followed the financial deregulation and liberalization in the 1980s and 1990s. Starting with the Latin American debt crisis in the 1980s, followed by the Mexico in the mid-1990s, and then Asia and Russia in the late 1990s. The Asian crisis in particular was not the boom and bust of a normal business cycle, he argues, but rather the result of speculative and erratic financial flows, the dramatic reversal of which led to a drastic fall in currencies that ballooned foreign currency debt and bankrupted corporations and banks alike. The medicine given by the IMF to Indonesia, Thailand, and South Korea was once again the "one-size-fits-all" prescription that had been used in Latin America, despite the fact the causes of crisis were different in the Asian case. As Lim argues, among the many hard lessons the Asians learned from this experience were the need for self-reliance, to lessen dependence on the international financial institutions, and to strengthen regional cooperation and resources to deal with crisis. This provided the impetus for Asian nations to search for an alternative regional financial architecture. Before the crisis, there had been no structure or forum to deal with regional financial issues, except for a forum of central bankers that had been established in 1991 and really only became active in the years after the crisis.

Lim has written elsewhere about the "defensive" crisis-prevention mechanisms instituted in Asia, such as the Chiang Mai Initiative, whose purpose is

to cooperate and pool resources together to overcome regional economic and financial crisis. These are briefly described but the chapter rather focuses on the "developmental" mechanisms, whose purpose is to establish policies and institutions that promote greater economic integration and higher growth in the region. Both, he notes, are important and complementary. Thus the chapter provides a former professional banker's view of the important mechanisms that emerged, including the ASEAN+3 Finance Ministers Meeting, at which the creation of an Asian Bond Markets Initiative was discussed alongside other financial and fiscal issues; and the role of the Executive's Meeting of East Asian and Pacific Central Banks EMEAP, which is an active promotor of Asian bond markets. The importance of exchange rate mechanisms and capital flows co-ordination is also described, because unregulated flows of "hot money" can not only cause harmful appreciation of currencies, they contribute to boom and bust modes and short-term debt that provokes instability and fragility that undermines the developmental objectives of increasing trade and investment in the region.

The main vehicle chosen by the Asian policy leaders to achieve this more developmental objective is through the development and integration of the region's financial system, and in particular through the development of a regional bond market. It was argued that this could be a useful way not only to recycle the region's massive foreign reserves, but also to provide the long-term loans needed for infrastructure investment and capital development, and which were under-provided by the existing banking system which focused only on short-term loans. Lim describes how the Asian bond market grew extremely rapidly but he warns that this is in fact a potential source of great instability to the region. It is not true to argue that having bonds in local currencies is a protection against currency reversals, because local bonds can be purchased by foreign as well as domestic investors. The second part of the chapter focuses on the role of regional development banks, and Lim argues that in their zeal to correct Asian economies' over-reliance on the banking system, there was inadequate attention paid to the risks associate with direct financing through the capital markets vis-à-vis the benefits of using indirect financing through intermediary banks. The lessons that long-term credit banks played in the economic development of Japan, South Korea, and Germany have not been sufficiently well understood. The successful emergence of the Asian Infrastructure Investment Bank in 2015, despite strong resistance from the United States is contrasted with Asia's inability to set up an Asian Monetary Fund in 1997, when the United States also objected. It signals the declining influence of the United States in the international financial system. However, the AIIB is focusing only on large scale infrastructure, and more development banks are needed especially to support industry – potentially a regional bank for micro, small, and medium enterprises could be established. Moreover, a question still remains about the business model these banks should follow – what is the acceptable level of profit, and should profits be maximized at the expense of the public good? Lim concludes by arguing that regional and

national development banks should adopt the concept of socially acceptable rate of return rather than maximizing shareholders' returns. They should undertake projects that are financially sound, ecologically sustainable, promoting long-run growth and welfare maximizing. They should also be run by professionals, without political interference, being in the best practices of corporate governance of both the public and private sectors combined.

8. What else is needed – more than just money

The need for many capacities and capabilities over and above that of finance is a message further reiterated by other authors in this volume. Chapters by Barrowclough and Gottschalk, Gallagher and Studart, all argue that support is needed is the demand side of the equation, which is just as important in the development finance equation as the supply side that is being addressed by the new sources of funding becoming available. For some this could be embodied in the use of national country systems, "consortia" partnerships between banks, business and governments, or the creation of special origination platforms; other equally important measures to support the demand side are covered in the chapter by Carciofi and Gayi. Their study on three distinct experiences of physical integration and connectivity in Latin America shows that investing in regional infrastructure is not just a technical question that can be dealt with by infrastructure specialists. It depends crucially also on co-ordination and planning at the level of sectoral policies, project selection, regulatory convergence as well as investment plans and financing mechanisms. This is a challenge that involves not only financial and institutional resources but also considerable reserves of political capital as well.

The three Latin American examples described by Carciofi and Gayi were different in their ambitions and members, but some common themes also stand out that are interesting for the future. The Initiative for the Integration of Regional Infrastructure in South America (IIRSA), which aimed to integrate transport, energy, and communications in South America, began with a rather informal mechanism of inter-governmental dialogue and cooperation. In time this was then supported by the creation of the regional inter-governmental body UNASUR, which helped to solve some of the inherent obstacles when integrating national policies with regional agreements. (It did not however succeed, in the authors' view, to solving other obstacles that would have helped with the goal of physical inter-connectivity such as addressing the lack of intra-regional trade and intra-industrial exchange or cross-border investment that was also needed). The MERCOSUR Structural Convergence Fund (FOCEM) focused more on the Southern Cone of Latin America, and aimed to reduce disparities between larger and smaller countries and to promote structural convergence. Finally, the Mesoamerican Integration and Development Project (MIDP) aimed at the central region, again focused on regional investments in transport, energy, and telecommunications.

Summing up this wealth of experiences, the authors conclude that while finance is obviously essential – and lack of finance remained a handicap in some cases, especially when finances came only from national budgets and were not leveraged more highly – it is not the only thing that matters. Crucially all three institutions required other, non-financial kinds of support. This included the co-ordination and cooperation of a vast number of sectoral agencies from all the member countries. Regional development banks played a useful function in terms of technical expertise and policy dialogue, as well as finance. The private sector was also involved, through specific avenues that were tailored to the specific needs and rules of the individual member countries. Hence the authors conclude, all dimensions involved in processes of regional physical investment need to flow together; basic political understandings, intra-regional trade and a favorable climate for cross border investments, institutional rules that provide clear signals, and clear cut decisions that help ensure investments and projects support the overarching goal (which in this case was regional connectivity.)

The chapter by *Biancarelli* reinforces this message. Even with the strong support for regional integration processes that marked the early 21st century – which included the creation of the Union of South American Nations (UNASUR) and the rejection of the United-States Free Trade Area of the Americas, as well as the creation of several regional currency mechanisms and payment systems, and a reserve pool the FLAR in addition to support for Southern-led development banking, and moreover novel goals for the region such as reducing asymmetries between members – tangible outcomes in terms of catalyzing intraregional production and intraregional trade proved to be very hard to establish. Integration of production and industrial complimentarity remained weak; intra-regional trade remained weak.

It seemed that the financial "bonanza" years following the economic crisis of 2007 were even more difficult than the "commodity boom" years, in terms of encouraging inter-regional investment, FDI, wealth sharing, and trade. With trade in particular, the rise of export-oriented southern manufacturers such as China made the environment for Latin American intraregional industrialization even more difficult. Biancarelli's conclusion is that bolstering South America's efforts towards development, and productive and financial integration requires more than finance and even more than overarching supporting institutions, there is also a need for the design and implementation of appropriate policies, intervention measures, and coordinated strategies (among countries and public/private agents) to achieve these goals. In the current circumstances, the most promising (or unique) approach he argues is to focus on the development of regional infrastructure, including transport, communications, and energy, which would be an important means of achieving physical integration, reducing logistical costs and obstacles, and enabling a greater degree of intraregional trade and investment. It would also foster complementarity of production and help make regional exports more competitive in global markets.

9. The historical multilateral lenders – what role remains? Firepower, leadership and governance issues

The pages in this volume paint a picture of strengthening government support for regional multilateral public and developmental banking that is very different from what is occurring in the West, where governments have been reluctant to increase the capital base of the long-standing global Multilateral Development Banks. This contrast is stark, not least because the needs for a more concerted effort have been increasingly apparent not only since the global financial crisis, but also in light of the new ambitions inherent in the SDGs and even the newly emerging concept of a Green New Deal. In this last decade, it is the emerging market and developing countries that took the lead in expanding the finance available for these, to the extent that development banks from the south now dwarf the size of the Western-backed multi-lateral development banks. This volume has not focused attention on the World Bank because so much has been written about this already, and our goal is to direct attention to the new and to the South. However, it is notable that rather than welcoming these Southern-led institutions into an evolving system of development finance institutions across the world, the West has been quick to criticize them, including for potentially failing to meet environmental safeguards and other best practices in the West. This may have important implications for development, which are not considered directly by the chapters in the volume and therefore briefly highlighted below.

One issue concerns financial firepower. Hinting at a step-change, last year the shareholders of the World Bank Group followed the lead of the Southern governments and backed a $13 billion capital increase. According to the World Bank, the capital injection will double its capacity – lifting its potential lending to nearly $80 billion in 2019 compared to $59 billion last year. As shown in this volume, scaling up is very difficult to achieve and so this increase in development finance should be supported – however what is also required is that the World Bank leads by example in terms of best practices and governance because the finance alone will not be enough. First, while the Bank's increase seems big, it will not by itself redress the strange disconnect that continues to yawn between what developing countries need and want, and what the Western-backed institutions offer. An extra $21 billion lending is small when compared to the trillions of dollars estimated for sustainable infrastructure (an annual 3.3 trillion USD by some estimates) and the continued lack of credit available for small and medium sized businesses (another 2.5 trillion needed).

Moreover, as shown in the chapters here, it is small compared to what the banks in this volume offer. And yet, as the only truly global bank (the ISDB, described in chapters by at least two authors here is global compared to the other regional banks but it is present only in Islamic countries), one could argue that it should be THE global multilateral development bank, and with a 70+ years history as well. It has 189 members some of whom are very rich. And yet, in the

wake of the financial crisis, and while the rest of the world has made major injections to fuel their development banks, the Western DFIs stood relatively still.

The point is not that the Southern-banks should compete with or even replace the World Bank; they should be complements in a broad-reaching and diverse network where different kinds of banks can specialize and thrive, making different offers that reflect their particular advantages be it in terms of expertise, knowledge, and reach. All are needed, and all have their role to play in shouldering the challenge of long-term investment where social or environmental returns may come fast but financial sustainability comes slow.

The second issue therefore is governance. Going back to the Zedillo Commission report on World Bank governance in 2009, Southern-led banks have long been concerned that the World Bank has been plagued by an unequal shareholder decision-making structure that pits industrialized countries versus developing ones, and that the bank has placed onerous conditionalities and safeguards on projects that slow down project completion and do not necessarily improve development outcomes.

This was a powerful incentive for many of the Southern institutions to emerge in the first place; as described in these pages and some have directly addressed these issues. The BRICS' New Development Bank has an equal shareholder voting structure where the founding shareholders have an equal vote regardless of the amount of quota shares a member has contributed. The AIIB has put in place a set of streamlined environmental safeguards that claim to be greener than the World Bank's and to take far less time and be far less onerous. Time will tell if these innovations have staying power, but they signal that Southern-led banks have a different vision for DFIs.

It is time for the World Bank to determine what its proper niche is in this evolving system of DFIs, to embrace the other institutions, and to decide where it wants to excel. If the World Bank wants to lead by example it will need to reform its inherently unequal shareholder voting system, the way it leverages private sector financing, and its social and environmental safeguards. The case-studies and examples of other models of developmental banking explored in this volume lead us to ask the question – Can the World Bank put in place a more equal decision-making system like the NDB and other DFIs such as the Development Bank of Latin America (CAF) that have more equal structures in place? Can new capital reduce the pressure on banks to continue to 'sweat' their balance sheet in risky ways to increase leverage – including taking loans off-balance sheet, and the collateralization, securitization, dicing and splicing that caused so many problems in the US mortgage markets just a few years ago? Similarly, the Bank's renewed calls to sweeten the pill for private sector investors by leaning ever more heavily on the State without offering much in return have a "same old" flavor that rightly causes concern. Private investment has already fallen sharply across the board despite record profits, so relying on it for the low-profit or non-profitable activities for which DFIs are designed should not be very appealing.

The third issue regards leadership. For example, can the World Bank's new environmental safeguards and policies improve environmental and social conditions in a manner that better acknowledges host country capacities and needs? Germany's decades' old KfW and Latin America's CAF have instruments whereby if a borrower cannot meet particular standards, they provide financial and technical support to build capacity to meet them. The World Bank's new policy has traces of this approach; can it improve outcomes? If the World Bank's new capital increase can help the bank lead by example in terms of governance and outcomes, it can again be seen as an effective DFI. If it does not use this opportunity to reform, developing countries will continue to look to and create alternative institutions, and cannot be blamed for doing so.

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