

BANKING ON DEVELOPMENT

PRIVATE FINANCIAL ACTORS AND DONORS IN DEVELOPING COUNTRIES

by
Javier Santiso

- A large, untapped reservoir of potential partnerships between private financial institutions (banks, asset managers, private equity firms, etc.) and aid donors remains to be fully exploited.
- Banks, private equity and asset management firms are important parts of a broad set of private actors in the field.
- Private financial institutions take increasingly into account variables other than financial ones to assess their investment decisions around the world.
- The OECD Global Forum on Development could host a market place for ideas for improving and promoting donor-private financial institutions partnerships: an *Innovation Laboratory on Development Finance*.
- An *OECD Development Finance Award* hosted by the OECD Global Forum on Development should be created.

POLICY BRIEF No. 34

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by

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Introduction

The past decade has witnessed a convergence of ideas about public and private development financing. Aid donors have developed an increasing interest in the private sector while private banks have not only greatly expanded their lending in developing countries, but also created corporate sustainable lending, microfinance and social responsibility programmes.

Private banks, along with asset managers or private equity firms, play a pivotal role in economic development. They are also potential partners for public aid donors. Banks of various national origins often tend to concentrate their activity in specific regions. UK and French banks, for example, offer possibilities for working with aid donors in Africa. Spanish and US banks are more relevant for Latin America, and German, Swiss and Italian banks for Eastern Europe. US, Japanese and UK banks lead in Asia. Local banks in Brazil, India, South Africa, China, United Arab Emirates, Morocco and other developing countries also present opportunities for co-operation.

During the first OECD Global Forum on Development¹, held in early April 2007, many donors expressed increasing interest in a deeper dialogue with the private sector, e.g. corporations or foundations. The first flagship publication published by the OECD Development Centre on development financing (OECD, 2007a) echoed this interest. It insisted on the need to go beyond aid and to incorporate new actors into the development-finance system. The 2005 OECD Development Assistance Committee (DAC) annual report did the same (OECD, 2007b). The Development Centre also published several working papers in 2007 underlining the involvement of private banks in developing countries and more generally of financial actors in emerging markets (see Rodríguez and Santiso, 2007a; Rodríguez and Santiso, 2007b).

Bilateral donors have developed new financial tools and new financial institutions to strengthen and speed their support to developing countries. Leading donor agencies, recognising that public money can be a catalyst for private resources and capacities, have strived actively to mobilise them. Most European donors have founded and established specialised Development Finance Institutions (DFIs) operating on a commercial basis as an integral part of government development

1. The Forum aims to improve dialogue among OECD and non-member governments as well as a variety of private and civil-society actors. During its first thematic cycle (2006-2009), participants will identify options for a more effective development finance system. The OECD Development Centre is actively and deeply involved. One objective is to look beyond aid and foresee potential synergies between different entities — public and private, national and international, governmental and non-governmental — involved in development finance activities. See <http://www.oecd.org/dev>

policy. Switzerland, to cite just one example, established the Swiss Investment Fund for Emerging Markets (SIFEM) in 2005 as a spin-off from the Swiss State Secretariat for Economic Affairs (SECO), one of the main national institutions for development co-operation. With other donor agencies like Proparco, the French DFI, a subsidiary of the French Development Agency, and the Belgian Investment Company for Developing Countries (BIO), SIFEM now participates in many private-equity projects around the developing world. Most such projects involve local private financial operators like Tuninvest in Tunisia, Fidelity Capital Partners in Ghana (a leading venture capital and private equity subsidiary of Fidelity Investment, one of the biggest fund management companies), Ethos in South Africa, Nexxus in Mexico or BTS Investment Advisors in India.

The DFIs have developed the European Development Finance Institutions (EDFI) network, a group of 15 bilateral institutions that provide long-term capital for private enterprises in developing and reforming economies. This group shares common objectives, but its members differ in the ways they develop their operations. Some remain mostly financial entities offering capital and advice to joint-venture enterprises in developing countries, with their national firms involved in the projects. The Danish IFU, Sweden's Swedfund or Spain's COFIDES support projects mostly when Danish, Swedish or Spanish companies are involved. Other members spread their nets more widely. CDC, a UK government-owned fund with nearly \$3 billion of net assets, works actively with worldwide private equity partners like Aureos Capital, India-based Barings Private Partners and ICICI Venture, Canada's Cordiant and Citigroup Venture Capital. In 2007, CDC backed a new African initiative committing \$100 million to Citigroup's first dedicated private equity fund. The Netherlands Development Finance Company (FMO), another leading and very active DFI, launched, with Citigroup in 2006, a \$540 million risk-sharing facility for loans to small and medium-sized companies in poor countries. This was the first global partnership between an EDFI member and a leading private retail bank. EDFI members have even participated in the creation of private equity companies; one of the most dynamic is Aureos Capital, created in 2001 by two leading DFIs, the Norwegian Investment Fund for Developing Countries (Norfund) and the UK's CDC Capital Partners.

Private banks have developed a higher awareness of social, environmental and labour issues in developing countries. OECD-based bankers encountered new realities, constraints and opportunities as they expanded overseas, particularly in developing countries where they multiplied acquisitions. Through lending operations, retail business or investment banking and asset management, emerging markets and developing countries increasingly became core business areas. In parallel, and faced with greater pressures and demands from NGOs, active and activist investors and governments, the banks also developed new programmes of sustainable lending,

investment and corporate social responsibility, entering projects in which they started directly or indirectly to provide or help provide public goods like education, health, microfinance and remittance-related services to the poor. They also became involved in infrastructure projects, partnering increasingly with the public sector in most countries. In Brazil, the ABN Amro subsidiary, Banco Real, became a leading provider of microcredits and grants to the poor for educational activities. Spanish banks, heavily involved in Latin America, multiplied initiatives all around the region. Banco Santander, for example, promoted the creation of a huge educational platform, *Universia*. Both leading banks, Santander and BBVA also participated in 2000 together with government ministries and private corporations in the creation of the *Fundación Carolina*, a unique Spanish institution funded both publicly and privately to provide grants for Latin Americans to pursue studies in Spain.

All of these developments have stimulated dialogue and co-operation between private banks and aid donors, opening avenues for further collaboration. For example, the UK official aid agency, the Department for International Development (DFID), jointly with the Dutch development finance arm FMO, DEG (a subsidiary of Germany's Kreditanstalt für Wiederaufbau – KfW) and the Development Bank of Southern Africa created a public-private equity African Infrastructure Fund with Barclays and Standard Chartered banks and the investment firm Emerging Markets Partnership. The Government of Canada created a Canada Investment Fund for Africa (CIFA), a \$220 million fund dedicated to making private equity investments in businesses throughout Africa. Investors in CIFA include the Canadian International Development Agency (through the Canada Fund for Africa programme) and CDC Group plc. The fund is managed through a joint venture between two leading private equity fund managers, London-based Aureos Capital and Montreal-based Cordiant.

Bank Lending: An Overview

Bank lending, i.e. foreign claims (loans made and deposits placed in other countries), provides a good measure of the rapid internationalisation of banking. The share of foreign bank credit in total domestic credit jumped from less than 6 per cent in South America by the mid-1990s, for example, to nearly 40 per cent in 2005. Differences between regions and even within them are important. Foreign banks have much more presence in some areas or countries than in others. In Latin America, foreign bank credit as a share of total domestic credit jumped from less than 1 per cent to more than 90 per cent in Mexico between 1990 and 2005, but in Costa Rica it remained under 1 per cent in 2005. In Belize, Bolivia and Panama, the share decreased over the same period (BIS, 2007).

OECD private financial institutions have become involved in new markets in other ways as well. They have invested in or acquired major banks in developing countries and emerging European markets, which implies that direct cross-border activities may now reveal only part of the bank-lending picture. (Levy-Yeyati and Micco, 2003; Moreno and Villar, 2005; Domanski, 2005 and Arena *et al.*, 2006). The IMF (2007) highlights the rise of local lending in developing countries by foreign banks. Investment banks and asset managers have also rushed into the same developing markets, investing through their regional or global emerging-market funds. Yet international bank lending still represents a large part of the story of financial globalisation. It also reveals much about the division of labour stressed in a later section of this Policy Brief to identify, by region, key potential partners and synergies for aid donors. The sums involved are impressive. According to the Bank for International Settlements (BIS), total claims flowing from OECD private banks to emerging economies in 2005 reached \$230 billion, twice as much as total OECD official aid to developing countries.

These bank flows remain far weaker than those crossing the borders towards other OECD countries. Total cross-border claims of BIS reporting banks expanded by nearly \$3 000 billion in developed countries in 2005, ten times more than in developing countries. By the end of 2005, the stock of cross-border claims of BIS reporting banks was \$21 450 billion (BIS, 2006). Most of it was directed towards OECD developed economies, all of them democracies. Only \$2 396 billion, less than 11 per cent of the total, represented claims on emerging markets, mostly emerging democracies such as South Korea, Brazil, and Mexico. China accounts for only \$1 14.6 billion in cross-border bank claims, less than 0.53 per cent of the world stock.

Private foreign bank lending nevertheless constitutes a substantial proportion of development financing in emerging countries. Although bank flows towards emerging countries are very low in nominal terms compared with those towards OECD countries, which receive more than 89 per cent of the total, bank loans are still very important for developing economies, and they represent relatively high percentages of their GDPs. For example bank loans received by Brazil, Mexico and South Korea in 2005 equalled 20.1 per cent, 34.3 per cent, and 28 per cent of their respective GDPs. Financial depth is lower in areas like Latin America and Africa than in developed countries, however. During the 1990s, credit to the private sector represented a meagre 21 per cent of GDP in sub-Saharan Africa and 28 per cent of GDP in Latin America as against 84 per cent of GDP in developed countries (BIS, 2007).

In both sending and recipient countries, banks like BBVA, the leading Spanish bank in Latin America, have targeted specific projects and programmes dedicated to migrants and remittance recipients. The services provided go well beyond financing. Early in 2007, BBVA launched a foundation dedicated to microfinance with an initial endowment of €200 million, one of the region's major initiatives in this field. The bank became the first private international banking group to embrace microfinance wholeheartedly with direct investment via a non-profit foundation. BBVA Microfinance Foundation initiated its first operations with four local organisations (*Caja Nor Perú*, *Caja Sur*, also in Peru, and *Corporación Mundial de la Mujer* in Bogotá and Medellín); this is part of the Group's investment in a social action programme that reached €55 million in 2006. According to the Inter-American Development Bank (IADB) more than 4.5 million borrowing households in Latin America were connected in 2005 with micro-enterprises and microfinance (Navajas and Tejerino, 2006).

Private Bank Lending Flows

Foreign bank claims grew over the past decade with greater financial integration and the opening of emerging countries to capital flows. According to the Bank for International Settlements (BIS) private international loans equalled 48.3 per cent of global GDP in 2005, up 16 percentage points from 1999 and more than the sum of international trade flows, all foreign direct investment and global tourist receipts. In real terms, foreign claims in all non-BIS reporting countries rose by more than 120 per cent, while claims in developing countries more than doubled. Among emerging countries, Latin America and Eastern Europe experienced the biggest increases, exceeding 110 per cent and 165 per cent respectively. In both of these areas democratisation and the consolidation of democracy have been intensive.

Foreign claims have grown so quickly for several reasons. Financing has the advantage of facing fewer restrictions than trade, tourism, direct and portfolio investments and remittances. Distance crucially affects trade and tourism flows. The greater the distance between countries, the greater the transaction costs. Direct or portfolio investments tend to be made in homogenous countries with similar needs and preferences. Remittances tend to go to the nearest countries, or those with which the countries of origin of the funds maintain closer relations, because individuals tend to migrate to countries with these characteristics. Foreign claims are not limited by such circumstances. Loans can be granted or received quickly because relatively less information is needed to carry out transactions and the time required for closing deals is minimal. Trade and direct investment require more time for closure. Foreign claims also benefit from greater liquidity than other fund flows.

BIS data show that relatively few countries dominate international financing. The 27 countries that report to the BIS issued overseas credits totalling \$23.5 trillion in 2006, which is equivalent to approximately 95 per cent of total private international loans according to the BIS. Other countries not among those that report to the BIS, such as some oil exporting countries (Russia and Saudi Arabia, for example) are also net issuers of international loans.

The figures also show that the recipients of international loans are strongly concentrated. Developed countries are both the main issuers and the main recipients of international loans. In 2006, France, Germany, the Netherlands, Spain, the United Kingdom, the United States, Sweden, Switzerland, Australia, Austria, Belgium, Canada, Ireland, Italy and Japan accounted for 81.5 per cent of the total loans issued by the countries that report to the BIS, and in turn they received 75 per cent of the total.

A Global Division of Labour

The Latin America/Caribbean area was the main regional recipient of private bank flows to emerging countries in the mid-1980s, although they subsequently eased off. At the end of 1984, the region received 47 per cent of the flows, whereas Africa received about 21 per cent, Asia 20 per cent and the emerging European economies 12 per cent. Africa has lost the most ground since then; with a lower growth rate of loans received than that for loans to emerging markets as a whole, its share has dropped. Lending to Asia and Latin America has shown a noticeable asymmetry over time. When Latin America's share of financing has fallen, Asia's share has grown and *vice versa*. Emerging European economies have seen increased bank inflows since 1996. At the beginning of 2004, Asia displaced Latin America's lead and has received the biggest share of funding to developing and emerging economies (31.4 per cent of the total in the first quarter of 2006). In 2006, the emerging European economies became the second largest destination with 31.1 per cent of the total, followed by Latin America with 24.5 per cent and Africa with only 13 per cent.

Banks in all the countries of origin commonly finance economies that are geographically close, share the same language or are former colonies. In other words, geography, history, politics, language and cultural affinities all count alongside economic motivations as explanations for banks' foreign lending patterns in the past and present — although they do not necessarily exclude that those patterns are to some degree malleable over time, especially when market and economic factors come into play. Thus Spain lends mainly to Latin America, Portugal and Andorra. US bankers concentrate on nearby and bordering countries in Central America, the Caribbean and Canada. The United Kingdom is the main lender to Ireland, Kenya, Zimbabwe,

India and Australia, among others. It is the main lender to Africa and Asia, and the third to Latin America. In addition, it is almost the leading financier of the member countries of the Commonwealth, being the main lender to half of those nations.

French lending also reflects international ties derived to a large extent from its history. Of the 41 countries where France was the leading lender in 2004, no fewer than 28 are members of the *Francophonie* grouping defined in large part by linguistic, cultural and historical ties. France is the second biggest lender to Africa and the Middle East, where it accounts for 17.6 per cent of the region's international bank financing. Austria, Germany and Japan also are the top lenders to many countries geographically close to them. Austria leads in European emerging economies, with Germany in second place. Italian banks, through recent takeovers of German and Austrian entities, are also becoming major players there. Japan holds the top spot in several countries of South and East Asia. For a further detailed discussion of these flows, see OECD Development Centre [Working Paper #263](#).

Sustainable Banking in Developing Countries

While banks have increased their exposure to developing countries both through lending activities and through direct acquisitions, they have become increasingly keen on sustainable development issues. This concern has been at the core of the international development banks' activities for many years, but only more recently have private commercial and investment banks around the world paid more attention to these issues, particularly in their lending practices.

This in turn has led to a much greater awareness of social and environmental issues among companies seeking project finance. Broadly speaking, it has meant more concern for protecting environmental goods such as water, air and soil, and for human rights and social issues. Reputation risk has driven this increasing interest, amid mounting evidence that seeking sustainable lending makes sound commercial sense (Colonomos and Santiso, 2005). The activism of NGOs and important international actors such as the International Finance Corporation (IFC) has played a leading role in diffusing this concern. Activist investors have also included banks on their hit lists, pressuring them to move away from reputation risks (F&C Asset Management and KPMG, 2004). Newcomers in the growing socially responsible investment-fund industry also add pressure for surveillance of banks going beyond simply financial variables. Bank Sarasin, a private Swiss bank, for example, set up a sustainable division in the early 1990s and now manages €2 billion in funds dedicated to sustainable investments, targeting banks among other corporations. Dexia Asset Management, the fund-manager arm of Dexia Group, has also become increasingly active in the emerging segment of socially responsible funds.

In 2003, a group of top global bankers adopted the Equator Principles, an initiative by ten of the world's largest banks to address the social and environmental impact of the projects that they finance. Based on IFC environmental and social standards and developed with the IFC's advice, the Principles are a voluntary set of guidelines for managing environmental and social issues in project-finance lending. Since then, all the big names in project finance — 46 in total by early 2007, accounting for around 85 per cent of the world's cross-border project finance and 80 per cent of the lending market at the end of 2006 — have signed up for this series of guidelines (Eiris, 2006a). The Equator Principles have become the industry's standard for addressing environmental and social issues in project financing globally and in developing countries.

OECD banks such as Citibank, Standard Chartered, Calyon, Dexia, Credit Suisse, Intesa Sanpaolo, Dresdner, BBVA, ABN Amro or HSBC are lining up to show that their operations can measure up on sustainability goals. In 2006, the banks produced and approved a new, revised set of guidelines (Equator II) with the help of the IFC, expanding requirements for labour conditions, community health, safety and security. In parallel the *Financial Times* (FT) and the IFC launched an award for the best sustainable bank in 2006. One year later, 151 entries from 51 countries were submitted for the 2007 FT Sustainable Banking Awards, an increase of more than 50 per cent from the 98 entries submitted for the inaugural 2006 Awards, thus underlining both the programme's success and banks' increasing awareness of the issues promoted by this initiative. In 2006, among the short-listed banks were institutions like ABN Amro, HSBC, Credit Suisse and Standard Chartered as well as institutions from developing countries like Itaú, a major Brazilian bank, and Yes Bank from India. The latter, which is 20 per cent owned by Rabobank of the Netherlands, actively evaluates social and environmental risks when considering lending operations. While it is a rare exception in the Asian banking landscape, Yes Bank also points to the increasing trend toward sustainable banking in developing countries. Following the trends of their Western peers, Asian banks increasingly make public statements about operating their lending practices in a sustainable way. Japan's Mizuho Corporate Bank and South Korea's Kookmin Bank, Woori Bank and Export Import Bank exemplify Asian financial institutions joining efforts like the United Nations Environmental Program (UNEP) Financial Initiative.

In India too, some players are actively involved in socially responsible investments. Dutch ABN Amro's Indian asset management firm recently opened its Sustainable Development Fund, a three-year closed-end scheme. The fund will invest in companies that rank high on a number of attributes indicating a high level of social responsibility, such as environmental compliance and adherence to corporate governance rules. The ratings firm CRISIL will establish the rankings based on a set

of parameters and review them annually. Thereafter, ABN Amro's fund team will carry out financial analysis of the companies eligible for final investment decision. Globally, funds categorised as socially responsible investment (SRI) funds had over \$2.3 trillion in assets in 2006 in the United States, according to the Social Investment Forum (a 260 per cent increase since 1995) and nearly €1 trillion in Europe (Santiso, 2005). ABN Amro manages about \$2 billion in about 24 SRI funds. A boom in studies dedicated to this asset class (e.g. Eiris, 2006b) suggests rising interest in socially responsible investments in emerging markets.

Asset management houses with interests in socially responsible investment, either specialised institutions or firms created by banks, represent potential partners other than banks for aid donors and/or NGOs (Innovest Group, 2004; UNEP, 2006). The same applies to pension funds, particularly public funds and those managing the assets of employees working in administrations. In California, Calpers, an active \$230 billion fund manager providing retirement and health benefits for 1.5 million public employees, has deployed since 2000 a remarkable social responsibility strategy applied not only to investments in developed countries but also in developing ones. In Europe, the Dutch ABP Investments, a firm with more than €200 billion of assets under management is another public pension fund active in socially responsible areas. Other important and relevant European public pension funds are AP2 in Sweden or *Metallrente* in Germany. In France the *Fonds de Réserve des Retraites* adopted socially responsible investment strategies in 2005 for part of its €31 billion of assets under management, following Calpers' pioneering strategy. The Spanish public pension system also moved in the same direction early in 2007, although limiting its socially responsible investment screening to developed countries only.

Private banking is another promising and interesting area, with wealthy people now pressuring their private bankers not only to provide ethical investment products but also advice for investments with "social performance" (UNEP Finance Initiative, 2007). Topics at the core of the development agenda related to poverty reduction, water or climate change have also gained more attention from private bankers, investors and insurers (Allianz and WWF, 2005; Royal Bank of Scotland, 2007; Citigroup, 2007; Lehman Brothers, 2007), along with the increasing awareness of their clients and NGOs in closed monitoring (*Les Amis de la Terre*, 2007; Ethical Corporation, 2006).

Private equity and specialised investment companies operating in developing countries are also potential partners. As noted above, some European DFIs, such as the UK CDC or the Dutch FMO, have already developed partnerships while others are planning to do so. In 2007, Albright Capital Management (a fund created by the former US Secretary of State, Madeleine Albright) and PGGM have come

together to create a long-term, multi-asset-class emerging markets fund. PGGM is a Dutch pension fund that serves the healthcare and social-work sectors; it will serve as Albright Capital's strategic investor with \$329 million. This initiative follows those of other recent US officials like Nicholas Brady, the former US Treasury Secretary. In 1994, after his public career and position as Chairman of the investment bank Dillon Read & Co, he established a private equity, fixed income and mezzanine finance investment company, Darby Overseas, specialising in developing-country projects. Nearly ten years later, in October 2003, the company was acquired by Franklin Templeton Investments, one of the largest global investment management organisations. The company manages nearly \$1 billion through different investment vehicles and partnerships. One year later, former US Vice President Al Gore helped to create an investment company, Generation Investment Management, dedicated to long-term sustainable investments, with former employees of Goldman Sachs Asset Management and Sustainable Asset Management.

Former senior officials in developing countries have also played active roles in setting up private equity firms and investment companies. In Brazil, for example, Arminio Fraga, a former Central Bank Governor, created one of the most successful investment firms, *Gavea Investimentos*, following the example of Gustavo Franco, another former Central Bank Governor who created *Rio Bravo*. Some of these private equity firms (e.g. GP Investments) have already reached critical size in terms of assets under management. Moreover, Brazilian pension funds, *Previ* and *Petros* among others, have been active in socially responsible investment and support poverty reduction programmes like that led by the Lula government's *Fome Zero*. Brazilian private banks like Unibanco, Itaú or Bradesco, along with public banks or development banks like BNDES, are involved in development finance projects all around the country. In Mexico Pedro Aspe, a former Minister of Finance, created a successful investment and consulting firm, *Protego*, specialising in medium-size companies.

Probably one of the most successful institutions is *Fundación Chile*, a privately owned, non-profit institution created in 1976 by the Chilean government and the US multinational ITT (in 2005 the mining company BHP Billiton became a co-founding member and boosted the endowment of the institution). Its mission is innovation, with special emphasis on clusters like agribusiness, marine resources, forestry, fruit biotechnology, quality management and food technologies. It counts the development of the salmon industry among its successes. When it targeted that cluster, salmon exports from Chile barely existed. Now Chile is, with Norway, among the top salmon exporters in the world.

Private equity and investment firms operating in developing countries thus are common, and it is not rare for them to be created by former public officials or former senior officials of leading international organisations involved in development. They provide another set of potential partners for aid donors seeking to catalyse private investment in niche markets where the usual bankers and investment firms are not looking.

Conclusions and (Six) Policy Recommendations

The potential synergies between private banks and donors are huge and the potential partnerships almost unlimited. Several policy recommendations could be articulated in order to pursue this objective that will also help to attain the Holy Grail of Development of the Millennium Development Goals.

The first policy recommendation is to create a forum for ideas and best practices where both public and private actors involved in development finance can share their experiences in a logic and dynamic of emulation. In order to underline best practices and to stimulate projects between public aid donors and private banks, asset managers and equity firms, this Policy Brief recommends the consolidation of an international forum where demands and offers from both sides, public and private, can be shared by all these actors interested in development finance. The OECD Global Forum on Development could be the host of this market place for ideas that will be a unique Innovation Laboratory of Development Finance.

The second recommendation is to incorporate actors from developing countries and emerging economies into this logic of public and private partnership. An international division of OECD private bank lending labour does, indeed, exist that suggests where aid donors, seeking to develop financing programmes with private banks, might look for potential partners in OECD countries. UK banks and some French banks, for example, are much more active in Africa than any others, while Spanish banks remain attached to Latin America, where US banks are also heavily involved. In Asia, the leading private lenders are UK banks, followed by US banks. Austrian and German banks dominate foreign lending activities in Eastern Europe, although recent mergers and acquisitions have made Italian and Belgian banks increasingly heavy players. Other private lenders, like Dutch, Swedish or Swiss banks, have more global and balanced portfolios. At the core of our second recommendation is the fact that beyond international banks, local (public and) private banks in India, South Africa, China, Egypt, Morocco and other developing countries are also potential partners. These banks, too, have become increasingly aware of and sensitive to economic, social and environmental impacts.

A third recommendation is to consider in these potential south-north and south-south collaborations, other actors from developing countries like development banks and sovereign wealth funds from these emerging countries. In Latin America, the Brazilian BNDES is already in terms of assets and lending operations bigger than the regional development bank (IADB) or the World Bank. The *Corporación Andina de Fomento*, a leading Andean development finance institution, is also a key actor. In Asia and Africa, the China Development Bank, is already a central player. Beyond these southern development finance institutions, another interesting trend to consider in the future of development finance is related to the emergence of Sovereign Wealth Funds from leading emerging countries. By the end of 2007, they already concentrated more than \$3 200 billion. Even if part of their portfolio is allocated to OECD countries, the bulk for many of them is invested in their homelands and more and more in other emerging economies in Asia, Latin America or Africa. As suggested in a Policy Insight published in 2008 by the Development Centre, these actors could in the future transform themselves into Sovereign Development Funds, leveraging development in other developing countries, North and sub-Saharan Africa included.

A fourth recommendation is related to the need to provide a more detailed and systematic review of specific projects already developed by private bankers, private equity firms or asset managers and aid donors, which will underline the broad avenues open for international co-operation and for public-private partnerships. There are many examples of increasing interest in sustainable banking (AICC Centre for Sustainability Investing, 2004). As documented in a related Working Paper (Rodríguez and Santiso, 2007a), private banks play a pivotal role in economic development and — perhaps more surprisingly — can also offer helping hands for democratic consolidation (Rodríguez and Santiso, 2008). Cross-border private banking flows tend to increase in the years following democratic transitions. Private banks are actively involved in developing countries both through lending activities from headquarters and now increasingly on the ground. They have invested heavily in emerging economies, generating employment, best practices and many other positive outputs. Banks manage their own performance and sustainability but they can also influence socio-economic and environmental performance in client organisations and through their lending activities (Accountability – Institute of Social and Ethical Accountability, 2004).

This Policy Brief reveals one of the major challenges ahead, which goes well beyond aid co-ordination, namely the increasing proliferation of actors directly or indirectly involved in development issues in low-income and middle-income countries. Tackling this issue requires deeper dialogue between aid donors and these actors. Banks, private equity and asset-management firms are only parts of

a much broader set of private actors ranging from foundations to corporations. Mapping and co-ordinating this “non system” of development finance not only presents a challenging task but remains a very important issue for all the actors in search of a better world for poorer countries (Mavrotas and Reisen, 2007; Harms and Lutz, 2006).

Partnerships obviously can go well beyond solely the banking sector, as underlined by the recent initiative of Danone, a French multinational, and the French banking group *Crédit Agricole*, which jointly created in 2007 a novel mutual fund to invest in microfinance projects in the world’s poorest countries. Its first test will occur in Bangladesh where Danone has already created a joint venture with the Grameen Group of Nobel Prize winner Mohammad Yunus, who pioneered microfinance lending to the very poor.

It would be useful to map cross-border banking operations — trade finance, other lending and investment flows — among developing economies themselves. According to the World Bank, international development finance is experiencing a major transformation as banks, companies and governments in emerging markets become increasingly important players. In 1995, borrowers in low-income countries received a mere 3 per cent of their cross-border syndicated lending flows from emerging-market banks. Ten years later that figure had jumped to 17 per cent. In 2005, a record 27 per cent of all foreign banks in developing countries were owned by banks from emerging economies. This trend has particular importance in low-income countries, where 47 per cent of foreign banks in terms of numbers and 27 per cent in terms of assets are owned by foreign banks from other developing countries (IMF, 2007; Van Horen, 2006; Claessens and Van Horen, 2007). In sub-Saharan Africa, South Asian and other sub-Saharan African banks are the main investors. They may represent yet another potential for public-private partnerships with aid donors in development finance.

As emerging economies also become emerging donors, identifying the relevant banks working in both environments could help to open a positive dialogue in which to engage with both “emerged” donors and international banks. The Netherlands international NGO *BankTrack*, involved in tracking sustainable bank lending, has already started to address the growing role of emerging-market banks as new players in development finance. More systematic analysis could complete BIS efforts to track lending operations from major emerging countries’ banks, particularly those in countries like Brazil, South Africa, Russia, India and China.

A fifth policy recommendation concerning bank lending in developing countries would be related to the Basel II rules that oblige foreign banks to use risk-sensitive models to determine the amount of capital to be allocated for different types of

borrowers. Many studies have underlined the potential negative impacts of these new rules on development finance, private bank lending from OECD developed countries to developing countries and private bank lending within the developing countries themselves. For these countries, Basel II can raise the costs of external financing and reduce access to it, inducing more expensive and rationed credit to borrowers perceived as being of higher risk, such as those in low-income countries or small and medium-size enterprises. Basel II can also exacerbate fluctuations in the availability of external financing, an unfortunate outcome given that developing countries already suffer from volatile capital flows (Gottschalk and Griffith-Jones, 2006; Powell, 2004; Claessens *et al.*, 2003; Reisen, 2001; Liebeg *et al.*, 2007; Caruana, 2006; García-Herrero and Gavilá, 2006). In order to alleviate the impact of these new banking rules for asset allocation, in particular in the lower-income countries, public aid donors could speed up collaboration with private banks. A potential idea to pursue would be to revise the methodologies of rating systems, from private banks but also from rating agencies and export credit agencies, in order to incorporate, for example, remittance flows in the debt ratio calibrations. This will have a positive impact on the ratings and contribute to upgrades in many countries, lowering their risk premiums and spreads and contributing therefore to a lower cost of capital and better access to international finance.

A sixth and final policy recommendation is related to the visibility issue and emulation for public and private partnerships in development finance: the creation of the Development Finance Award. This would spur exploitation of the synergies and potential partnerships between private banks and aid donors, by rewarding best practices of public-private partnerships. The OECD Global Forum on Development could host such an award as a way to strengthen the dialogue between aid donors and private actors working on development issues and investing in developing countries. The objectives of the OECD Development Finance Award would be to underline already existing best practices and, through a worldwide media campaign like that developed by the IFC and the *Financial Times*, to stimulate and emulate projects between public aid donors and private banks, asset managers and equity firms. Two categories could be created: one for OECD Member institutions and a second for non-Member institutions in order to recognise the strength of emerging donors and private banks, asset managers and equity firms from developing countries.

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Websites Containing Further Information

This Policy Brief mentions numerous organisations, institutions and ventures that illustrate the degree to which public-private partnerships have already taken root or are beginning to do so. Nearly all of them have websites, which readers wishing to explore such partnerships further can consult. The following is an alphabetical listing of these sites.

ABN Amro (Sustainability Report): <http://www.abnamro.com/com/about/reports.jsp>
ABP Investments: http://www.abp.nl/abp/abp/vermogensbeheer_en/
Albright Capital Management: <http://www.albrightcapital.com/>
AP2: <http://www.ap2.se/>
Aureos Capital: <http://www.aureos.com/>
Banco Real: <http://www.bancoreal.com.br/>
BankTrack: <http://www.banktrack.org/>
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BTS Investment Advisors: <http://www.btsadvisors.com/>
Calpers: <http://www.calpers.ca.gov/>
CDC: <http://www.cdcgroup.com/>
CIFA: <http://www.cifafund.ca/>
Citigroup Venture Capital: <https://www.citigroupai.com/>
COFIDES: <http://www.cofides.es/>
Cordiant: <http://www.cordiantcap.com/>
Darby Overseas: <http://www.darbyoverseas.com/>
DEG: http://www.deginvest.de/EN_Home/index.jsp
Emerging Africa Fund: http://www.emergingafricafund.com/stake_fr.htm and
<http://www.empglobal.com/>
Equator Principles: http://www.equator-principles.com/documents/ClientBriefingforEquator-Principles_2007-02-07.pdf
Ethos: <http://www.ethos.co.za/live/index/php>
Fidelity Capital Partners: <http://fidelitycapitalpartners.com/>
Fonds de Réserve des Retraites: <http://www.fondsdereserve.fr/>

Fundación Carolina: <http://www.fundacioncarolina.es/fundacioncarolina/>

Fundación Chile: <http://www.fundacionchile.cl/>

Gavea Investimentos: <http://www.gaveainvest.com.br/>

Generation Investment Management: <http://www.generationim.com/>

GP Investments: http://www.gp.com.br/gp/index_pt.htm

Grameen Group: <http://www.grameen-info.org/>

ICICI Venture: <http://www.iciciventure.com/>

IFU: <http://www.ifu.dk/>

ITAU: <http://www.itau.com.br/>

KfW: http://www.kfw.de/EN_Home/index.jsp

Metallrente: <http://www.metallrente.de/>

Nexus: <http://www.nexuscapital.com/>

Norfund: <http://www.norfund.no/>

Petros: <https://www.petros.com.br/petrossite/>

Previ: <http://www.previ.com.br/>

Proparco: <http://www.proparco.fr/>

Protego: <http://protego.com.mx/>

Rio Bravo: <http://www.riobravo.com.br/ingles/index.asp>

SIFEM: <http://www.sifem.ch/>

Social Investment Forum: http://www.socialinvest.org/areas/research/trends/sri_trends_report_2005.pdf

Swedfund: <http://www.swedfund.se/>

Tuninvest: <http://www.tuninvest.com/>

Universia: <http://www.universia.es/>

Yes Bank: <http://www.yesbank.in/index.php>

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This Brief militates for the creation of an *Innovation Laboratory for Development Finance* to enhance interactions between public donors and private actors in development finance. It further argues for deeper involvement of actors from emerging and developing countries; multi-directional global alliances between financiers; a databank of current best practices and projects in public/private partnerships for development; and alliances between donors and private banks to alleviate the negative impact of Basel II rules. Finally, the Brief proposes the creation of a *Development Finance Award* in recognition of those institutions most prepared to exploit the synergies between private lenders and the public sector in pursuit of development objectives.

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