

Development finance institutions and the coronavirus crisis

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Key messages

- Development finance institutions (DFIs) are mandated by their shareholders to provide finance to the private sector (usually at commercial terms, but subsidised implicitly), crowd in private sector finance and have a development impact.
- While DFIs aim to be additional to the market, they have not been sufficiently counter-cyclical in past crises. That has to change, as poor country firms and their workers face major hardship now. Today’s crisis is larger than those in the past.
- We suggest shareholders provide regulatory and financial space for DFIs to fast-track new investments, allow for some repayment postponements and announce a Bounce Back Better facility, to save companies and workers from bankruptcy and to protect previous transformation efforts so that the bounce-back is faster and better.

Spelling out the opportunity

Developing countries are facing considerable financing shortfalls as the global economy is going into a steep recession. Immediate challenges exist with regard to financing firms and workers in the poorest countries, [including in Africa](#). If these firms collapse, and others stop investing, some of the major engines of a country’s transformation path may not survive, and will start shedding jobs. Traditional trade finance solutions that emerged during the 2008 global financial crisis will not solve these problems, as there is little trade now.

Development finance institutions ([DFIs, such as IFC, CDC, FMO and DEG](#)) provide finance (loans, equity, guarantees) and technical assistance to the private sector in low- and middle-income countries. The majority shareholders are governments. The mandates of DFIs usually combine provision of finance on commercial terms, additional to the market, earning a financial return and contributing to development.

DFIs should be more counter-cyclical in the current crisis. This may involve them abandoning conservative lending practices, if shareholders allow potential future losses on a portion of DFI portfolios. This is urgently needed, as businesses across the developing world are, or are at risk of, going under. A subsidised Bounce Back Better facility will have major returns in protecting workers and investments. It may facilitate future higher payments by businesses, if it leads to quicker growth.

Development finance prospects

It is too early to discuss with precision what financial flows are expected to decline by how much this year. The table below considers broad expectations. Most

private flows are expected to fall considerably, but the evolution of public flows depends largely on ambition. For example, national development banks were strongly counter-cyclical in the wake of the global financial crisis. [They increased their lending from \\$1.16 trillion in 2007 to \\$1.58 trillion in 2009](#). This 36% increase was far greater than the growth in private bank credit. This note focuses on how public funds could protect transformative firms and their workers from bankruptcy and promote new investments.

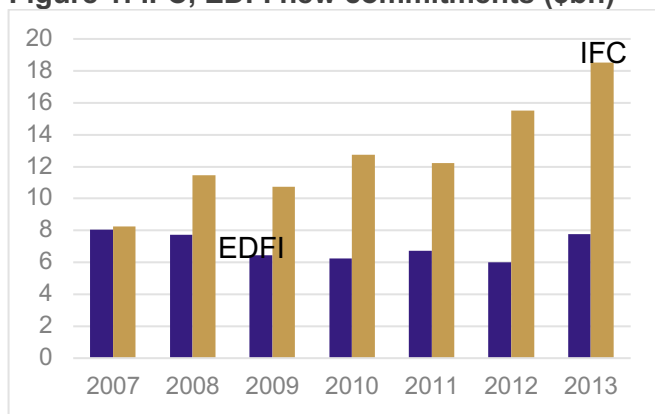
| | Expected impacts | Experience during 2008–2010 crisis |
|------------------------------------|--|--|
| Foreign direct investment (FDI) | Global drop of 30–40% in 2020 | FDI to world and Africa fell by a fifth in 2009 |
| Portfolio flows | Withdrawals faster than in previous crisis, withdrawing \$42 billion by early March 2020 | Rapid flight to safety, portfolio flows to Africa dropped significantly in 2009 |
| Cross-border bank lending | After very strong performance until recently, we expect a sharp downturn | Immediate drop in 2009 (10% in Africa); no growth globally in years afterwards |
| Remittances | Expected to fall | Fell by 6% in 2009 |
| DFIs | Depends on ambition | Not sufficiently counter-cyclical |
| Multilateral development banks/IMF | Depends on ambition | World Bank and regional development banks sharply increased lending |
| Official development assistance | Depends on ambition | Flat 2008–2009, increase 2010–2011 |

Role of DFIs in previous downturns

[Previous research](#) gave detailed examples of how European DFIs (EDFIs) and IFC responded to the global financial crisis. However, while DFIs were able to keep investment higher than the counterfactual (in

some countries by more than 2% of GDP), overall, in terms of value of new investments, DFIs were not sufficiently counter-cyclical during the global financial crisis. Figure 1 shows that new commitments by EDFIs was lower in 2009–2012 than in 2007–2008. IFC new commitments in 2009 were lower than in 2008 but higher afterwards. DFIs increased the value of portfolios more than private banks but could have raised it much further.

Figure 1: IFC, EDFI new commitments (\$bn)



Source: EDFI, new commitments. Converted into \$; IFC own account commitments, FYs according to IFC.

How are DFIs responding to the coronavirus crisis?

IFC has increased [the amount of financing](#) for companies to help fight the outbreak by \$8 billion, with \$2 billion each for (i) the Real Sector Crisis Response Facility, to support firms in infrastructure, manufacturing, agriculture and services vulnerable to the pandemic; (ii) the Global Trade Finance Programme, to cover payment risks of financial institutions; (iii) the Working Capital Solutions programme, to provide funding to banks to extend credit to help businesses shore up their working capital; and (iv) the Global Trade Liquidity Programme. IFC [is working](#) on new investments in 300 companies and extending trade finance and working capital lines.

CDC says it remains [open for business](#) and issues [guidance for investee companies](#), [FMO](#), [Proparco](#) and [DEG](#) are concerned with [staff](#). [DEG](#) says, 'In our role as an international development finance institution our aim is to actively contribute to overcoming this difficult global situation.' However, none of these EDFIs has publicly announced sufficiently large new initiatives to raise investment.

DFIs face three major constraints for being counter-cyclical in a crisis. They are mandated to support private firms at commercial terms and supposed to get their funds back. There will be far fewer profitable opportunities during a global recession. In addition, many investee companies struggle to repay loans and dividends, which most DFIs normally recycle. Finally, DFIs have different ways of accessing more resources.

Some access the capital markets and will face additional difficulties, but others have had recent helpful capital increases from governments.

What needs to be done?

The insufficient response of DFIs in previous downturns should be a wake-up call. Given the economic damages developing countries and poor people face, governments urgently need to work with DFIs to consider these three options.

Fast-track response. DFIs need to fast-track increased finance for supporting investments even if they are risky. This means temporarily lifting stringent criteria on financial returns. This would protect perfectly good firms from the current recession. It could increase non-performing loans (NPLs) somewhat in the future, but it still makes development sense if it protects otherwise good companies. And a stimulus today may in fact reduce future NPLs.

Moratorium on repayments. DFIs should allow investee companies a holiday in interest and loan repayments for 2020 (similar to mortgage payment holidays, or the Compensatory Credit Loan already used by AfD for some loans to African countries), or link payments to future profits. Postponed payments this year may temporarily reduce the value of the portfolio, but at least today's additional space may keep investors afloat, with a development, and indeed potentially a financial, pay-off for later.

Bounce Back Better facility. A new facility would provide interest-free loans to transformative firms that support many workers and livelihoods (e.g. [garment](#) or flower farm workers). It should also allow credit to retool manufacturing facilities for the public good (e.g. protective gear such as quality face masks or hand sanitiser). It could be channelled directly to firms or indirectly to local banks or other financial institutions. DFIs have the capability to channel finance to firms but need earmarked capital for this.

Next steps

Dfi shareholders can take three steps: (i) redirect [2%](#) (or [\\$100 billion asked for by African finance ministers](#)) of the \$5 trillion stimulus packages G20 countries have already announced to help firms beyond G20 countries. This could allow for a moratorium on interest payments and debt repayments and the set-up of a Bounce Back Better facility; (ii) loosen up credit criteria to allow DFIs to take on more risk, with some potential but not certainty of more financial losses later; however, growth and development pay-offs may actually lead to lower losses, as is the case, for example, for GDP linked bonds, or indeed equity instruments in general; (iii) increase their contribution, as part of their broader new funding initiatives.