

Eighth KfW International Financial Sector Symposium

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Session 6: Lessons from the Crisis –The Future of Development Finance and Outlook on an Unfinished Agenda

Summary prepared by Michael Klein and Birgit Holderied-Kress based on the opening statements of the panellists and the subsequent discussion.

Session 6 was composed of the following experts:

Panellists:

Haroon Sharif Department for International Development (DFID), Senior Regional Advisor Private and Financial Sector Development

Jyrki Koskelo International Finance Corporation (IFC), Vice President Capital Markets

Moderation:

Doris Köhn Senior Vice President Europe, Middle East and North Africa, KfW Entwicklungsbank

After recapturing the key themes and issues that emerged from the preceding sessions presentations and discussions¹, the participants in this final session specifically focused on identifying further issues that could be decisive for development finance institutions (DFI) and the challenges for private sector development in the context where the public sector played a major role in stemming the adverse impact of the market collapse. Specifically it was asked for the prospects on how the “new normal” will look like. This question was quickly adopted as the recurrent topic throughout the discussion.

Take Away 1. The impact of the crisis did not go along the traditional line between advanced countries and developing countries in development. This brings along also a paradigm shift in learning patterns: the traditional model of transferring experience from advanced countries to developing countries is in question – DFI now have to learn from experiences globally.

DFI's will have to revise their role and adapt to the new situation. Given the budget deficits in many advanced countries, DFIs will have less of a role. Emerging markets in particular will serve as learning models and of partnering actors in the future. There is a strong need to analyse the evidence of what has and what has not worked through the crisis. It will also be critical for DFI's to translate the lessons learnt into practice, but patience is required – quick fixes are not to be counted on. DFIs will also need to build upon creative initiatives that have emerged in the crisis reaction phase. One example is the Vienna Initiative that was established by Central Banks in emerging markets in Eastern Europe that were hit hardest by the crisis. Other examples are crisis simulation or special liquidity funds.

Take Away 2: The current heavy involvement by the public sector in the crisis may inadvertently shift the balance away from private sector approaches in the short run. In order to include the private sector, new partnerships will have to emerge.

The new partnerships will not only become apparent among the DFIs' clientele. As DFIs receive public money its mandate and human resources are traditionally linked to the public sector mindset. There needs to be an institutional shift in DFIs to get the private sector more involved. For example the Asian Development Bank (ADB) set the target for 2015 that 50 % of its lending should go to the private sector. Another question would be whether capital for DFIs should be geared more towards private sector development as in the case of the ongoing capital increase

¹ See summaries of the five preceding sessions.

for the ADB. Do DFIs possess sufficient and adequately qualified personnel to take on the challenges?

Take Away 3: Private sector investment requires an enabling environment i.e. pricing to step in after crisis.

The call for private sector participation in new markets is clearly understood, but the key fundamental that has to be considered is that private sector only goes to where the risk-adjusted return is regarded as adequate. Especially in those areas where private sector participation is needed (for example renewable energy), linked to positive external effects, pricing plays a crucial role.

Take Away 4: One of the most important issues for the upcoming five years will be the handling of distressed assets - and at the same time to beware of new asset-bubbles.

Until now, the issue of distressed assets is still remarkably underestimated. In the face of reduced capital availability from the banks the question is what to do with distressed assets - the upcoming decisions associated with distressed assets will be of importance for the whole economy: who are the borrowers that should be saved and who not; how to cope with the resulting financial exposure? Globally, a strengthening of insolvency schemes is urgent.

At the same time, both policy-makers and financiers need to watch out for excessive growth, system-wide, country-wide and for individual institutions. One of those developments to be watched is the growth of asset prices in China.

Take Away 5: New roles for DFIs are difficult to predict at the moment and can only be derived from a thorough understanding of how the New World will look like in a few years.

Until now, we do not know if there will be enough capital in the market to target development priorities. Where will the money come from – given the diminishing role of consumption in the US and huge budget deficits. Will the growth in emerging markets be enough to compensate for these changes? Will emerging markets be able to mobilize their capital markets? How will Carry-Trade interact? Or will the “OECD-capital”, once resumed, be enough for the investments needs? And there is also the regional aspect to be considered. How will DFIs position themselves in the eventual increase of South-South- or South-North- finance flows respectively? Furthermore, how will the financial architecture look like - there are still some regulatory biases to be overcome. The market of securitization, for example, as an important tool for capital flows, is still sustained.