THE DEVELOPMENT/PROMOTIONAL BANKS:

FROM THE FINANCIAL AND ECONOMIC CRISIS TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT

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Introduction

Global financial markets are undergoing a great transformation. Financial institutions, capital markets and institutional investors play a crucial role in providing and channeling financing for businesses' day-to-day operations and for long-term finance. The latter, as general state of agreement, is decisive to satisfy long-term physical investment needs across all sectors of the economy and specifically in key drivers of growth, competitiveness and employment.

After the financial crisis, however, the traditional sources of investment financing seem to face a difficult path to fully recover their pre-crisis role.

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Commercial Banks have been a key player in the financial system. Over time, the traditional banking model has evolved, shifting from an "originate and hold" to an "originate and distribute" approach, which, interacting with a weak regulation, created excess leverage and greater interconnectedness risk through counterparty exposure. Structural weaknesses in the banking sector have led to "bad" deleveraging processes in the form of restrained credit growth (Bassanini, Reviglio, 2014 b).

The asset quality review (AQR) and the related stress tests should speed up the restructuring of the bank balance sheets. This year could be a turning point in the process of cleaning the bank balance sheets, thanks to the planned capital increases. The banking union with its related mechanisms is a key step for managing banking crises, thus providing the economy with a stable and functional banking system which can physiologically finance it. In fact, the ambitious financial system reform programme has the dual objective of (i) making the institutions more robust and less vulnerable to any financial market shocks and (ii) breaking the risk transmission vicious circle between bank assets and sovereign securities in both directions, i.e. from bank assets to sovereign securities and vice versa from sovereign securities to the banks.

However, doubts on a robust recovery of the economy and of the banking system have not been completely overcome by policy makers and market participants, as someone still fears (at least for the Sothern Europe) a triple-dip recession which would strongly hinder banking financing and fiscal recovery. The emerging long-term financing gap is particularly acute in the infrastructure sector, but Development and Promotional Banks, as institutional investors, are in a position, at least partially, to fill in that gap. They have the credibility to act as intermediaries of financial flows for a number of reasons: long history (track record); reliability (non-volatile behavior); political institutional weight; in-depth local knowledge; benefit from preferred creditor status; strong balance sheet and financial strength due to strong and stable funding structure and financial stability; stable delivered returns consistent with risk (and market); habit to support long-term investment also because of their public mission.

Development and Promotional Banks, in fact, are different from commercial, poly functional, universal and investment banks. Their main goal is providing medium and long-term capital for productive investment, often accompanied by technical assistance. These productive investments should be identified, appraised and selected with a two-fold set of criteria: in the short term, they should help make full utilization of production factors while, in the medium and long-term, they will provide physical, financial and technical capital. Their main efforts are directed toward infrastructure and the industrial sector as well as agriculture and human resources at large (education, health). In this framework, they have a key role in implementing both private and public investment projects able to maximize not only private but also social returns.

In 2005, the UN defined these type of institutions as *"Government owned financial institutions with the objective of fostering economic or social development by financing activities with high social returns".* According to UN, since Development Banks target well identified market failures, their lending does not cause any crowding-out effects of the private sector. To ensure the previous objectives, they need adequate governance with a financially sustainable business model.

A new role of the MDBs and the NDBs and new instruments are going to be needed to mitigate risk and face credit crunch. They should work as catalyzer of institutional investors' participation to infrastructure and SMEs financing, by playing credit enhancement and leave to institutional investors the senior part of debt and by attracting co-investments in the equity side of the projects. They may also have a subsidiary role to support commercial banking, which may receive cost-covering margin for on-lending promotional loans. In doing so, they become complementary to the market and, at the same time, the privileges eventually granted to the Development/Promotional Banks (tax exemption, public guarantee) do not distort competition because they fill market failures and may have a role in balancing economic cycles. Among the new instrument which may need to be reinforced by Governments' agencies, Multilateral Development Banks (MDBs) and National Development Banks (NDBs), there are credit enhancement mechanisms, such as monoline mitigation mechanisms, which may include credit guarantees, first-loss provisions, and the provision of bridge financing via direct loans (Bassanini, Reviglio, 2013a).

Finally, the recourse to PPPs can often be an alternative way to both direct Government and corporate infrastructure initiatives. The scheme should, therefore, be promoted, particularly in a fiscally constrained environment. The D20 institutions, which have developed, across many years, high skills in PPP, can continue to provide important insight and expertise to enhance this model.

In Europe, in particular, while waiting for a return of stability in the banking system, the role of large national and multilateral development and promotional banks (EIB, KfW, CDC, CDP, ICO, BGK, PKO, and some others) has become increasingly important. New financial instruments have been designed; additional resources have been mobilized to support the economy during the crisis, most importantly by financing infrastructure and SMEs, either directly or through the banking system; and new European and domestic long-term equity funds have been launched to invest in infrastructure projects and strengthen company capitalization. Cooperation between these institutions could lead to further new initiatives and new instruments. On the debt side, for instance, the EIB Project Bond Initiative (PBI) goes in this direction; while, on the equity side, long-term infrastructure funds such as the Marguerite Greenfield LT Fund could be used as “prototypes” for broad “families” of long-term funds for investment in infrastructure, technology, R&D, SMEs, start-ups, local utilities, energy, urban development, health care, compensating for the general shortage of risk capital engendered by the crisis.

More has to be done to create a more friendly regulation for long-term investments (Bassanini, Reviglio, 2014 b).

- Firstly, currently, the main accounting rules and supervisory requirements (Basel III-CRD IV, Solvency II, the IORP, IFRS) still tend to favor the short-term and penalize the long-term investment. CRD IV has passed the vote of the European Parliament. Realistically, recalibration could be contemplated later in time (especially in terms of the ratio of liquidity and capital absorption for certain asset classes). The Omnibus II Directive contains a set of measures aimed at clarifying the treatment of insurance products with long-term guarantees in order to mitigate the effects of additional volatility. Pension funds will - hopefully - capitalize on the work done by insurance companies to obtain some significant changes. Generally, if there is a strong interest from the market and a strong support by the Governments to create a new asset class represented by infrastructure and, more generally, by the long-term investment, it will mean that some major changes are unavoidable. Regarding the possibility of a better representation of the long term investors’ business model in the IFRS, the road seems to be still rather "uphill".

  At this regard, the 2nd of May 2011 at a conference in Paris organized by the ECB and the EIB, the leaders of the founding members of the LTIC held a meeting with Mr. Mario Draghi, as Chairman of the Financial Stability Board (FSB), during which they raised the issue of the relationship between the business model of the various long term institutions and the mark-to-market philosophy which is the foundation of the International Accounting Standards (IAS). Draghi immediately grasped the point and assured them that he, in turn, would have brought the matter to the attention of the FSB. A few years later, upon the request of the G20, the FSB produced a report on long term investment in which the question that we had previously raised to Mr. Draghi was addressed for the first time. The subject is of course still open. A special LTIC Working Group is talking with the FSB. The question is whether it is appropriate to introduce an additional category for financial assets which are held with a long term horizon and do not meet the criteria for the classification at amortized cost or fair value through profit and loss. The hope is that this dialogue will provide solutions which do not penalize those institutions which have a business model based on long-term assets and liabilities (such as pension funds, insurance companies and sovereign wealth funds, SWFs) or which operate on a long-term with a public interest mission (such as national and multi-lateral development banks). After all, the concept of "value in use" is already defined in IAS 36 - Paragraph 6: "Value in use is the present value of the future cash flows expected from an asset." This definition could be extended to financial assets held by institutions with a long term perspective, thus avoiding undue short term fluctuations of the main profitability figure. The experts, however, are well aware that, although reasonable, this proposal would find technical and ideological barriers difficult to overcome.

- Secondly, tax systems, which have a direct effect on investment decisions and on savings, could be a very effective lever. Taxes can be used to correct externalities, a typical market failure. This makes a case for incentivizing infrastructure project finance. Corporate taxes in most countries tend to favor debt to risk capital, thus creating incentives for a higher leverage. In fact, interest rates are deductible, while returns on capital are not. Savings taxation can change investors' behavior, allocation of capital and investment decisions. Many states have introduced incentives to increase (long-term) savings, as needed (for example, on retirement savings). Finally, tax incentives may encourage PPP. There are strong reasons in favor of such incentives. On the one hand, in fact, they make it possible to make investment which would not otherwise be made because they need public resources; on the other hand, these investments contribute positively to growth and thus to fiscal consolidation.

  This is an incontrovertible fact, at least in all those cases in which the incentive is strictly directed to re-balance a financial plan suffering from a cancellation of subsidies, for instance. It must be limited to the higher portion of taxes collected by virtue of the investment itself, net of substitution factors.

  It should not be forgotten, finally, that we must avoid the tax incentive contributing to distort the risk assessment and leaving room to "moral hazard"

- Thirdly, in many countries, much remains to be done to have an investment friendly regulation, and to reduce risks and regulatory costs. Political and legislative stability, streamlined and fast administrative procedures, contained regulatory and bureaucratic burdens, a fast and reliable judicial system, an efficient and technically prepared public administration are known to be decisive factors in investment decisions, which today have the entire globe as their horizon. Despite some recent progress, in many European and not European countries the quality of regulation and regulatory risks remains one of the major obstacles to the LTIs. In the European administrative space, which has finally found a legal basis in the Treaty of Lisbon, it is now possible to envisage a better European regulation policy, aiming at ensuring the convergence of European and national regulations towards investment-friendly models.

- Fourthly, the package of measures adopted a few days ago by the European Central Bank was well received by the markets, which saw it as a useful contribution to renewing growth and reducing the cost of money.

  The most significant innovation consists of TLTROs (targeted long-term refinancing operations), a line of liquidity earmarked for medium-term bank financing to the real economy (aimed, according to the official statement, "at improving bank lending to the non-financial private sector, excluding loans to households for home mortgages"). This measure provides a large amount of medium-term funding (€400 bn) at low cost (i.e. at the rate on the Eurosystem's main refinancing operations prevailing at the time of take-up, plus a fixed spread of 10 basis points; currently, the interest rate would be 0.25%). The money will be supplied in two operations, in September and December, but banks that can prove that they have actually increased lending to the real economy will be able to draw down additional sums between March 2015 and June 2016. All the TLTROs will mature in September 2018.

  It is difficult to say what the effects of these measures will be. Much will depend on the concrete response from the credit system and the corporate sector (Bassanini, Reviglio 2014 a) and b)).

  The idea behind the TLTROs is, however, correct. There is a broad consensus since a long time on the need to boost investment for a renewal of growth and competitiveness.

  The ECB has made the first step. Between the Scylla of fiscal austerity and the Charybdis of credit rationing, the ECB has rightly decided to tackle at last the second of these, which is the one that falls to its responsibility. Mr. Draghi, once again, is doing everything he can to promote growth. We are now waiting for the other European institutions to move from words to deeds (Bassanini, Reviglio, 2013c)

Let us summarize in a nutshell some of the key points which characterize D20 present and future role in the global economy.

First, the D20 reaffirms its commitment to support the development and financing of infrastructure projects and to facilitate the financing of SMEs by increasing the cooperation among the National Development and Promotional and Multilateral Development Banks members, by providing policy advice, sharing knowledge and promoting capacity building.

Second, D20 is in the position to contribute to set standards and provide leadership working in close cooperation with Member States and Unions of States.

Third, the D20s bring substantial lending capacity, linkages to the financial sector and capital markets and experience and knowledge about local institutional and regulatory conditions.

Fourth, the future global demand for long term investments is going to be so huge that we can give a real contribution only if we succeed in attracting the private sector and manage to harness the power of capital markets. The objective should be to develop infrastructure investment into an "asset class" with distinct regulation, in order to allow both domestic and international institutional investors to allocate a larger share of their portfolios to it.

The global industry of institutional investors (pension funds, life insurance, SWFs) is estimated by the OECD in almost US$ 85 trillion. Today they invest less than around 3% of their Asset Under Management in infrastructure (mostly in the form un-listed equity), equivalent to about 2.3 trillion dollars globally. Potentially, long term institutional investors' asset allocation in infrastructure could grow up to about 4.5 trillion dollars, by increasing up to 5% of total Asset Under Management. The goal is reasonable and the increase of resources for infrastructure quite outstanding in size. Institutional investors are indeed facing a cultural change in developing direct investment programs in infrastructure projects and D20 institutions can help fostering this process.

Moreover, governments have to play a key role through clear and stable regulation as well as through the channeling of savings to LTI in infrastructure and real economy (Bassanini, Reviglio 2013 b).

Working closely with the G20 as a group would ensure that policies decided at G20 level can be implemented at best. The D20 goal, in cooperation with MDBs, is to move beyond traditional long-term lending and play a catalytic role for commercial financing on a larger scale and thus provide a necessary bridge between governments, projects sponsors and capital markets.

The concept and functions of development finance corporations/ development/ promotional banks

Let us take the Britannica Encyclopedia definition whereby '*development banks are national or regional financial institutions designed to provide medium and long term capital for productive investment, often accompanied by technical assistance, in poor countries.* Now, the term 'poor countries' ought to be revised as in their actual work many development banks have the specific objective to help countries in transition from planned to market economies and in a structural adjustment process. The area of the euro is undergoing a major structural adjustment process, albeit with different timing and intensity in the numerous member countries. The main determinant is that sometime in the final decades of the twentieth century, the European Union (EU) and North America lost the monopoly of technical progress they had enjoyed since the end of the eighteenth century; thus, although with different and differing degrees, its member countries need to adjust to a new and rapidly changing world wide environment(Gros, Alcidi 2013). Furthermore, for several years a primary purpose of development banks has been to provide access to international capital markets to Government and countries that either were considered too risky by international lenders or featured highly protected economies through trade restrictions and exchange controls with, as a result, exchange rates that did not reflect the economic value of the scarcity of their foreign exchange. Now, because of trade and exchange control liberalization as well as because of international economic and financial integration, neither the World Bank Group nor the major international regional development banks have this function any longer, at least as their primary aim and objective. A recent paper (Kapur, Raychaudhury, 2014) describes quite effectively how the World Bank Group has been drastically revising its aims and objectives to 'fight world poverty' – a highly challenging task but also quite different from that of promoting manufacturing and infrastructure for which development finance corporations were originally conceived.

The key point is that development banks are different from commercial, poly functional, universal and investment banks (viz. other categories of banking) in that they have the aim of *providing medium and long-term capital for productive investment, often accompanied by technical assistance.* Also, the *productive investments* should be identified, appraised and selected with a two-fold set of criteria: in the short term, they should help make full utilization of production factors (and thus increase employment) and in the medium and long term, they will provide physical, financial and technical capital (and thus, increase productivity of the production factors). In short, they should be both Keynesian and neo-classical. This, we may consider as one the key discriminating feature between development banks and other categories of investment banks.

The number of MDBs and NDBs has increased rapidly since the 1950s; they have been encouraged by the success the International Bank for Reconstruction and Development and its affiliates (normally known as the World Bank Group), created in 1944 at the Bretton Woods conference with the primary objective of helping reconstruct countries that had been devastated by World War II. The large regional development banks include the European Investment Bank established as a part of the Rome Treaty in 1957, the Inter-American Development Bank established in 1959; the Asian Development Bank which began operations in 1966; and the African Development Bank, established in 1964, the European Bank for Reconstruction and Development which opened for business in 1991. There are smaller development banks on a sub-regional basis. There is also a large number of NDBs that, in their operational policies and practices, often follow, by and large, the more established large MDBs.

Although the Russian Vnesheconombank established in 1917 can be considered a forerunner of national development finance corporations, many now important national development banks have been created in the last few decades and grown there since: eg. the Brazilian Banco Nacional de Desinvolvimento Econômico e Social, the Mexican Banco Nacional de Commercio Exterior, the Korean and the China Development Banks, the Indonesia Exibank, the Export-Import Bank of India, the Development Bank of Southern Africa, the Industrial Development Bank of Turkey. This list is by no means exhaustive but only indicative. A review of their prospects shows that, although there are differences in approaches and procedures, their emphasis is on lending and equity infrastructure financing, supporting Small and Medium Size Enterprises (SMEs) and providing relief to poverty, and eventually eradicating it, through productive activities. Several of them are State Owned Enterprises (SOEs) , but the share of private investors in their capital structure is increasing.

Normally, the MDBs and the NDBs make loans for specific national or regional projects to private or public bodies or may operate in conjunction with other financial institutions, primarily for on-lending functions. One of the main activities of the development banks has been the recognition and promotion of private investment opportunities, especially in industrial manufacturing. However, the main efforts of the majority of development banks are directed toward infrastructure and the industrial sector as well as agriculture and human resources at large (education, health). Development banks have had a special role in formulating, experimenting with and implementing both private and public investment projects with the outlook of maximizing social returns to the community not only private returns to the investors. Now, as mentioned in the previous paragraph, the challenge of fighting world poverty is becoming the primary purpose of the major international development banks. This entails major revisions in investment appraisal parameters and programs and projects selection criteria (Pennisi, Scandizzo, 2004, 2006. Cnel 2012)

MDBs and NDBs may be publicly or privately owned and operated, although governments frequently make substantial contributions to the capital of private development banks. The form (share equity or loans) and cost of financing offered by development banks depend on their cost of obtaining capital and their need to show a profit and pay dividends. A frequent critique is that their standard appraisal methodology does underestimate the environmental costs and ramifications of many categories of investments (Graves, 2012).

NDBs practices have provoked some controversy. Because development banks tend to be government-run and are not accountable to the taxpayers who fund them, there are few checks and balances preventing the banks from making bad investments or investments that do not account adequately for their external effects (eg on sustainability).. Some NDBs have been blamed for imposing policies that ultimately destabilize the economies of recipient countries. Yet another concern centers on 'moral hazard'—that is, the possibility that fiscally irresponsible policies by recipient countries will be effectively rewarded and thereby encouraged by bailout loans. While theoretically a serious concern, the existence of such moral hazard has not been yet proven.

An example of a successful wholly private development bank is the Grameen Bank founded in 1976 to serve small borrowers in Bangladesh. The bank's approach is based on microcredit —small loans amounting to as little as a few dollars. Loan repayment rates are very high, because borrowers are required to join 'lending circles'. The fellow members of a circle, which typically contains fewer than ten people, are other borrowers whose credit rating is at risk if one of their members defaults. Therefore, each member drives other members to pay on time. The Grameen approach has spurred the creation of similar banks in numerous developing countries (Yunus, 2003) and also in advanced countries with generally good outcome (Calvi,2003; Pellegrina, Scollo, 2014).

Domestic Development Banks in Europe

This general overview is useful to focus on the domestic national development banks in Europe and on the role they have in the exit from the European crisis. First research does indicate that LTIs may have a positive effect on income distribution, at least at narrowing the gaps emerged in the recent past (Bassanini, Reviglio 2014; Mattauch, Edenhofer, Klenert, Benard, 2014). A recent World Bank Policy Research Working Paper (Yifu Lin, Doemeland, 2012) does emphasizes that Long Term Investments (LTIs) are the necessary tool for an exit strategy from the crisis that has plagued the world economy since 2007. LTIs, in many European Countries, now require long term financing by development bank. In Europe, the most significant are the French Caisse des Dépôts et Consignation, the German Kreditanstalt für Wiederaufbau, the Italian Cassa Depositi e Prestiti. There are many medium and smaller development banks such as those of Austria, Bulgaria, Croatia, Greece, Poland, Spain, Turkey, the United Kingdom, and other countries.

In 2010 a study by Dalberg Global Development Advisors, an international consulting firm, examined the methods and effectiveness of the national development banks in Europe on a commission by the European Development Finance Institutions EDFI (Dalberg Global Development Advisors, 2010). The EDFI association has fifteen members - all of them are development banks. The concrete goal of the study was to describe the growing role and tasks of the national development banks in Europe and to highlight opportunities and challenges. Because many national development banks are under mandate to finance the private sector, this was given special attention. One of the highest hurdles for local businesses in these countries is the lack of access to financial services. The Dalberg study clearly shows that the private sector is the engine for growth not only in advanced market economies but in developing and transition economies as well, and that, in doing so, it makes a significant contribution to the reduction in poverty. In general, EDFI members act in accordance with three principles: a) They are present where other investors are not (yet) there; b) They act as catalysts and their presence prompts the involvement of others; c) They operate in a sustainable manner because they reduce dependence on aid payments by relying on employment and growth as sustainable sources for financing developing countries and emerging markets through taxes. In short, as mentioned in the previous section, the emphasis is not in providing access to international capital markets (the earliest purpose of several development banks) but to help channel savings towards investment with short term Keynesian effect to increase and improve utilization of production factors and, in the medium and long term, to increase and improve productivity and, thus, competitiveness.

According to the study, the fifteen specialized European institutions have succeeded in both prompting positive developmental momentum in developing and transitioning countries as well as in enjoying financial success in numerous projects. The requirement that the investments be financially successful has also kept the infusion of capital from national governments at a moderate level; up to now they have represented only a small part of the financial strength of NDBs. European countries were also able to credit the work of their national development banks to their progress in achieving the UN-Millennium Development Goals and in part to their respective Official Development Aid quotas. The study summarized by saying that the NDBs have now long established themselves as a third pillar of international development policies along with classical development work and the MDBs. In the last ten years they have emphasized environmental-friendly development.

Italy has a special tradition and role in development banking. A recent study by Amadeo Lepore (Lepore, 2012) reviews the history of the Cassa per il Mezzogiorno, the forerunner of many European national development banks, and confirms previous research by Alfredo Del Monte and Adriano Giannola (Del Monte, Giannola, 1978) that until the mid nineteen seventies the Cassa operated as one of the finest European development banks, was often praised by the World Bank Group itself and shown as a model to imitate; as indicated above, from the end of World War II to 1964, when Italy 'graduated' from been eligible for World Bank lending, all the World Bank operations for Italian reconstruction and development were made through lending to the Cassa not to the Government or some of its Ministries. The President of the World Bank, Eugene Black, had a special personal role in the start of development banking in Italy as a forerunner of similar evolution in other European countries (Farese, Savona 2014).

A number of financial development agencies operated along with the Cassa; some of the them were specific small industrial development banks to finance manufacturing in Sardinia and Sicily; others to provide support services in area such as training and project planning. Although since the mid nineteen seventies, the quality of their operations deteriorated greatly and this led to their demise, the Cassa experience is a useful building bloc to identify strength and weaknesses of national development banks for setting Europe back on a growth path.

More recent and more telling is the transformation, in the last ten years, of the Cassa Depositi e Prestiti (CDP) from a department within the Ministry of Economy and Finance to a development bank, with private minority shareholders (banks), offering a full array of services either directly or through specialized funds (De Cecco, Toniolo, 2013). CDP maintains its original objective of financing long term public investment in infrastructure but also lends and provides equity and lending to SMEs and to strategic and innovative initiatives.

This general overview provides a preliminary answer to the question raised in the first section. Development finance corporation and development banks – the difference is only nominal – may help Europe to increase its growth rate and to provide a more even distribution of growth benefits if they provide lending and equity support to well conceived and well appraised investment in infrastructure and strategic and innovative initiatives. This may very well require harmonization of appraisal parameters and selection criteria, especially when dealing with innovative programs and with projects where attempt is made to factor in equity standards in operations primarily designed to improve factor utilization and productivity.

Green, Inclusive and Sustainable Growth : the role of development banks

No doubt, MDBs and NDBs have contributed to economic growth after World War II. This has transformed and improved the quality of day-to-day life to nearly two billion of people. Even though, the EU has been in a stagnation and recession for the last two decades and now its prospects point to sluggish growth, Singapore, Taiwan, Korea and more recently, albeit to a lesser extent, Brazil, China and India offer vivid and live examples of societies that went from massive abject poverty to level of income and social development comparable to the most advanced economies. They increased living standards by moving resources into new and higher productive activities, and continually building the productivity base with investments in infrastructure, human resources and institutions (Sapelli, 2014). This path has accelerated since the last decade of the twentieth century because , as indicated in the previous section, a comparatively small group of advanced countries lost the monopoly of technical progress it had enjoyed and benefitted since around 1830 (Maddison, 2007). The world economy is now undergoing a major restructuring in terms of production, consumption, savings and investment: no one can foreseen how long such a restructuring will require and what the final outcome will be.

Even though highly unequal sharing of growth in many economies and societies (Piketty, 2014) has made of us quite skeptical about economic growth as the only avenue to betterment of human well-beings, there is no precedent for ameliorating economic and social welfare on a large scale without rapid and sustained expansion. The destiny of both advanced and developing countries – and hence of the EU itself – rely upon their ability to nurture and sustain growth.

This also implies that we must periodically rediscover that growth is a multidimensional process. More specifically, and getting at the core of this meeting, 'green' and inclusive growth does not simply happen by itself or a consequence of good rates of GDP expansion. It is the result of getting the right mix of investment and policies at the right time. Mistakes along the way are inevitable; they should be seen as a part of a learning and adaptation process (Hirschmann,1968) necessary for carrying out and sustaining a successful strategy. In a recent review of his own thirty years experience in the field, a well versed development economists (Zagha, 2014) rightly maintains that 'successful Governments have operated in a time frame that by far exceed the project cycles and the shelf life of a development bank typical economic report; these successful Governments have not been afraid to stay engaged , even when they to retreat from a specific ineffective policy or program'.

As a matter of fact , there no 'silver bullet'. A quarter of a century ago, the general belief was called 'the Washington consensus' (Williamson, 2004) and the international financial institutions ,including MDBs (as well as several NDBs), adopted as their standard therapy on the assumption that making the market work, liberalizing, deregulating and privatizing would provide the path to development. This proved to be overly simplistic and often counterproductive . While the search for best practices can hardly be challenged, one size does not fit all. For development banks, especially for those with high profile either domestic or international, the real challenge is to remain eclectic and craft custom-made solutions that nonetheless draw on a vast experience because the reality of development, especially of 'green' and inclusive development, is much complex and quite messy affair.

In any case, development needs development finance which is a special blend of finance - not just equity or lending (even concessionary lending). Development finance does not mean merely long-term finance, but long term finance coupled with the capacity to provide technical assistance to the borrower and to evaluate financial and social returns as well as to assess the opportunities and the risks inherent in development projects and programs and to formulate supporting policy measures. Only institutions with this capacity can, for example, evaluate a program of investments and associated changes in the tariff regime, fiscal transfers, and regulations. Or appraise a major infrastructure program and address its environmental dimensions. Specialized knowledge must be integrated with finance. For this very reason, the LTIC is a most needed, not only, a most appropriate tool to foster development in the EU:

It is useful to recall that it has been a long term mistake to think that development strategies are a real concerning solely or primarily the developing countries. Development is addressing long-term structural impediment many of which are present in advanced countries, namely in many EU countries, such as the quality of education, social mobility, modernization of infrastructure, restructuring of public spending and fiscal/budgetary reform. The basic issues are the same. Indeed , the forerunners of long term development institution, the World Bank Group (Kapur, Lewis, Webb,1997) started its activities in what today are some of the most advanced countries of the world: Japan, France, Italy. The dichotomy between structural issues in advanced and developing countries is in many respects, artificial; in fact the commonality of interests is increasingly significant. For these reasons, specific European lending institutions , such as the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) have borrowed many practices from the World Bank Group but can benefit from the experience of only a limited group of countries and have in certain instances found it difficult to formulate pragmatic policy perspectives to guide their operations. The LTIC has a vantage points over them because it blends different cultures and a wide rage field of experience.

Europe 2020 – eg. the EU ten-year growth and jobs strategy launched in 2010 - takes into account some of the consideration summarized above. It is about more than just overcoming the crisis from which our economies are now gradually recovering. It is also about addressing the shortcomings of our growth model and creating the conditions for a smart, sustainable and inclusive growth (Gros, Roth 2013). Five main targets have been set for the EU to achieve by the end of 2020. Within the overall objective of a ‘smarter, greener and more inclusive Europe’ in 2020, these targets cover employment; research and development; climate/energy; education; social inclusion and poverty reduction and include specific indicators (European Commission, 2013). The objectives of the strategy are also supported by seven “flagship initiatives’’ providing a framework through which the EU and national authorities mutually reinforce their efforts in areas supporting the Europe 2020 priorities such as innovation, the digital economy, employment, youth, industrial policy, poverty, and resource efficiency.

Other EU levers such as the European single market, the EU budget and the EU external agenda also contribute to the achievement of the goals of the Europe 2020 strategy. The Europe 2020 strategy is implemented and monitored in the context of the European Semester , the yearly cycle of coordination of economic and budgetary policies. The EU Commission published a Communication taking stock of the Europe 2020 strategy in March 2014, four years after its launch (European Commission, 2014) .

Macro-economic policies and green, inclusive and sustainable growth

Formulation, preparation, enactment and implementation of macro-economic policies are responsibility of Governments and Parliaments. It is also Governments and Parliaments' task to see to it that they take adequate account of green, inclusive and sustainable growth elements and that they are properly implemented. Nonetheless, development banks must play a useful role. On the one hand, to be successful many large scale investment require an adequate and consistent policy context and in certain instances may entail policy changes; eg, as mentioned in the previous section, major infrastructural investment in transport, soil protection power can often be the lever for reforms in tariffs, in budgetary allocations and in other macro-economic aspects of policy. On the other hand, macro-policies may need major modifications for investment to be useful. A frequent example are the programs to help develop SMEs. Very often they need on-lending rates that mirror the economic not only the financial cost of capital; this, in turn, raises macro policy issues in banking and finance. In other instance, they may require measures to help concentrating enterprises with a view of increasing their average size, some of these measure may get to the core of completion policies – a matter not only of national but of EU concern.

Thus, even though development banks operate primarily through lending and equity participation for specific operation, their workings do intertwine quite tightly with macro-economic as well as institutional policies.

In the last thirty years, there has been a flourishing literature on how macro-economic medium to long term development policies may take account of environmental aspects, social inclusion and the diffusion of ITC; a good, even if not fully updated review of this literature is in Fleurbaey (2009). In Italy, considerable work has been done by the Central Statistical Office and by the Economic and Social Council; a first report was published some eighteen months ago (Istat-Cnel, 2013; Istat-Cnel, 2014) and its findings were incorporated in the latest Government economic policy blueprint (Ministero dell'Economia e delle Finanze, 2014). This effort is to be considered more advanced in methodology than the, internationally better known report by the international Commission established in 2008 by the French

Government, generally known as the Stiglitz- Fitoussi Commission (Commission on the Measurament of Economic Performance and Social Progress, 2009). As a matter of fact, the Italian Istat-Cnel documents do incorporate methodological advances and the results of empirical experience obtained in the last four years and are considered by OECD as the most advanced now available. Both the French and the Italian documents propose batteries of indicators to complement those based on national economic accounting (in short GPD growth). Development banks have often anticipated some of this evolution (Nath , Nayak , Goel 2014). Also sovereign investment funds have played a useful role (Gilligan, O'Brien, Bowman, 2014).

It is useful to underline that many of the proposals on 'green' and 'inclusive' development deal also with 'smart' (viz ICT) development , as foreseen, inter alia, in a document published by the Council of Europe some ten years ago (De Filippi, Pennisi, 2003). At that time, similar issues were dealt with , in Italy, by several other institutions such as, for instance, the National School of Public Administration (Choi, De Filippi and Pennisi, 2004) and the Fondazione Rodolfo De Benedetti (Cohen, Garibaldi, Scarpetta, 2004).

The recent documents – such as those produced by the Government of France and Italy - confirm the basic tenement reached ten years ago: environmental, social inclusion and technical (ICT) considerations must not be seen as a separate set of policies, programs and measures to be added on, or to complement, macro-economic development policies but must be merged with, and folded within, the overall macro strategy. This is not always the case, as can be seen just by perusing the National Reform Programs (NRPs) prepared by the EU countries each Spring with the view of being reviewed by the European Commission and the other EU members in order to learn lesions and harmonize growth and development strategies. In this area, development banks experience can be very useful to Governments and Parliaments because in their actual workings of lending and equity operations where environmental, social inclusion and technical (ICT) considerations are tightly intertwined with those of financial profitability.

Certain specific issues

In charting future activities of European development banks, we ought to start from the assumption that EU's does not – and should not – aim to the pre-crisis path because this path was unsustainable economically, socially and environmentally. A new vision is required as emphasized in *Europe 2020* more specifically by the Stiglitz – Fitoussi report and by the Italian Istat-Cnel work summarized at para.4 of this paper (Codogno, 2011; Padoan, 2012; World Bank, 2012). As a matter of fact, the return of Europe to normality is highly unlikely; there a need to foster new sources of growth and competiveness, based on knowledge intensive activities, high productivity and environmental sustainability. There need for a new vision rooted in the medium to long run (Winters, 2014) rather than on short-term financial and economic returns.

The EU, OECD and the World Bank concur that to renew expansion and make growth sustainable, medium and long-term economic policies should address the efficient functioning of the labor markets, dealing with issues such as the skill mismatch as well as areas related to the strengthening of the single market, to the integration of the financial market and policy to the transition to a 'green economy'. At first sight, only in some of these fields, the European MDBs and NDBs might have a role because they mostly pertain more to the policy realm (a Governmental function) than to an operational function (typical of development banks). However, as seen in para. 2 above, policy and operational functions are tightly intertwined; development banks have often influenced macro-economic and development policies by providing them a good balance of micro-economic considerations.

Let us take some of these specific issues individually, one by one.

The labor skill mismatch requires mostly legislative reforms, but the European development banks can enter more directly into financing skill education and training, especially at the tertiary level (university and post-university level) as pioneered by the World Bank Group in the nineteen sixteen and now standard fare of the lending practices of all important MDBs (Heyneman, 2003); this may involve several activities - from supporting specific chairs to financing innovative higher education and research institutions, to providing study loans to deserving and needy students with talent in development fields and even providing equity financing to well designed institutions planned to make a steady return. Also, in certain specific cases, European development banks could enter the generally considered messy area of improving labor exchange and other labor market services (including those provided by the private sector). Specifically, the European MDBs and NDBs forming the LTIC have the chance of learning from each other national experience of failures and success stories and link financing to much needed and much required technical advice and assistance (Boeri, van Ours, 2009)

The strengthening of the single market implies an increase in SMEs size as well as improved Social Corporate Responsibility (SCR) which is often wanting in small firms especially within the context of a very competitive aggressive market. This point is frequently made in the EC annual reports on SMEs performance (European Commission, 2013); useful comments are made in scholarly essays based on the Italian experience, where manufacturing and services sectors are to a large extent based on SMEs (Perrini, 2006). Several European development banks - including CDP - have special windows to foster SMEs expansion and their participation in the global market. A useful area for analysis and action is to help SMEs to form consortia in order to issue ‘minibond ’as a finance tool for their growth; after some unsuccessful experience in the USA some ten years ago, now research, especially on South East Asia, shows very positive results (Wei, 2013). The strengthening of the financial market is mostly being pursued through the establishment of banking union, still under construction (Barrucci, Messori, 2014).

The transition to a greener economy is central to the Europe 2020 Strategy, as outlined in para. 4 above. It is all the more important because emerging economies and developing countries account for 60% of the global CO2 emissions and their economic growth is driving the emissions to increase. The reduction targets of the Kyoto Protocol were not achieved because Canada, Japan, Russia and the USA dismissed their participation. ‘Common global’ agreements in the energy policy- such as carbon price and energy technology standards- are needed to cut emissions. The unilateral EU approach to reduce its emission by 40% by 20139 will have a marginal effect on the global emission trend, with the risk of negative repercussions on European competiveness (Clini, 2014). In this area, the European MDBs and NDBs have a vantage point because some of them do participate in major power companies and also due to their operational work in areas such as ‘smart cities’ and recovery of industrially distressed areas(Carraro , Fay and Galeotti. 2014).

Micro-economic methodologies to include and green, inclusive and sustainable growth in investment appraisal

Financial and economic analysis at the micro level is the staple work of both MDBs and NDBs, especially if they deal with long term investment. Since the mid-nineteen eighties an important professional quarterly, *Impact Assessment and Project Appraisal*, published by Elsevier, has been providing a wealth of analytical essays and actual case studies on sustainable development. In the last years, members and subscribers of the Social Science Research Network SSRN receive daily an *Environmental Economics E-Journal* with abstracts of the main papers on the subject and the possibility to download them. Similarly, there is a very extensive literature on technological progress and inclusive growth. In Italy, specific empirical experience (including actual ‘case studies’ was published by the Associazione Italiana di Valutazione (eg Pennisi, De Filippi, Mazzanti, De Castris, Pellegrini, Centra, Scandizzo, Maiolo, 2005; Bezzi, Cioffi, De Ambrogio, Ghetti, Martelli, Oliva, Palombini, Pennisi, Rosciglione, Samek Lodovici, Silvani, Sisti, Vecchi, 2006;) as well as in monographs by the Unità di Valuazione of the Economic Develoment Ministry in a special series called *Materiali UVAL.*

In a recent paper (Pennisi, 2013), one of the authors of this paper reviewed the current status of the art in this field. LTIs have distinct and special features as compared with short and medium terms investments (Clements, 2011). These features occur especially in the infrastructure sector: the planning and construction of a major transport network, involving both highways and railways (and even including airways and waterways), is vastly different from a road maintenance program. (Briceno Garmedia, Sarkodie 2012). This is even more apparent when LTIs deal with research and innovation, human capital, energy, environment, and the like (Fukuya L., Alva L**.** 2010; Edler , Berger, Dinges , Gok . 2011).

Their main characteristics are as follows.

- A long physical implementation and gestation period before financial returns and economic and social benefits provide a positive long lasting net cash flow.
- A long temporal distance between the decision of financing a project and its "physical implementation": within such a temporal lag, the major strategic variables can change their trend especially in presence of fast social and technological changes as it is now and will hopefully stronger in the future. This requires a high capability of reading simultaneously a large number of variables.
- Serious intergenerational issues because financial and economic costs fall principally on the generation designing the investment and deciding to go ahead with it, as well as using the required resources, while financial and economic benefits typically accrue to the next generation(s); the calculation of their discounted present values present theoretical issues as well as policy, technical and operational ones.
- Uncertainties as opposed to risks in estimating financial and economic costs and benefits and their flows because of the long time-span involved. Attempts to use "averages" or to "shadow price" for future long-term costs and benefits have often proven unsatisfactory, especially from the operational and practical standpoints.
- "Lumpiness" of the LTIs; whereas for physical implementation and contracting purposes, any LTI can be, and often need to be, divided in temporal stages or phases and in specific "technical packages" for bidding and contracting purposes, their conceptual integrity is such that the various stages/phases and/or "packages" cannot have financial and economic costs and benefits distinct from those of the overall LTI. This has implications for both the use of resources and the feasibility of interrupting the investment or of changing its content and components, during its implementation., or modifying its objectives, contents and phasing (Sunstein, 2011)
- There are significant differences in outlook between private and public partners. Normally, the former are interested in not overly deferred financial returns for their stakeholders and shareholders. The latter are generally interested in promoting improved welfare and living standards of future generation(s) not solely of the present decision makers and their constituents (Magni,2011).These issues are well known to the literature (Ferrara, 2010; Glachant, Lorenzi, Quinet, Trainar, 2010, Pennisi, Scandizzo, 2004) and have often been resolved with elegant economic and mathematical modeling but also with quite practical simplified approaches and operational manuals - developed by the EU Commission as well as by the Ministries of Finance and Economics or of Economic Development in almost all major

advanced and developing countries. Advanced methodologies (eg. including 'real options techniques' to provide value for uncertainties) have been applied to investment such as airport planning in Northern Europe, substitution of analogical television with Digital video Broadcasting – Terrestrial (DvB-T) in Italy, regional planning in several European countries. In these and many other examples, full consideration has been taken for environmental aspects, ITC dimension and social inclusion. This implies that experts in finance and economics have worked very closely not only with engineers but also with environmentalists, ITC specialist and social scientists and brought to bear an interdisciplinary dimension often missing in macro policy analysis

In Italy, a recent document of the Economic and Social Council to the Government and Parliament (Cnel, 2012) has cleared some the issues and ambiguities several OECD and EU countries are still struggling with. Most specifically, the document proposes to adopt as a *numeraire* the critical level of consumption – viz. the level of consumption of the individual subject who does not receive subsidies and has no taxes to pay - and to handle intergenerational issues the *Modified Discount Method (MDM)*. These technical instrument facilitate the incorporation, in investment analysis, of environmental aspects, ITC dimensions and social inclusion considerations. With the support of Regional research institutes, the Italian Economic Development Ministry is working on the formulation of operational guidelines.

In the realm of macro economic development policies, there are not simplified synthetic indicators similar and as meaningful as those developed in social cost benefit analysis of LTIs. Thus, it is necessary to resort to a vast batteries of indicators such as those proposed by the Stiglitz- Fitoussi Commission in France in 2009 and by the Central Statistical Office and the Economic and Social Council in Italy in 2013. Nonetheless, a fuller integration of development banks work with the work of the central Economic Ministries, the Statistical Offices, Economic and Social Councils (or alike) may bring about a simplification of the now very extensive batteries of indicators and provide useful macro policy planning tools.

Summary and Issues for Discussions

This paper reviews the role of development banks in the process of improving development, with special attention to the EU. In its first part, it proposes a definition of development and singles out the differences from other types of banking (commercial, poly functional, universal investment banking) because their aims and objectives are to foster multifaceted and multidimensional development through LTIs geared not merely to output growth and good financial returns but also to environment protection and promotion, ICT diffusion, and social inclusion.

The paper maintains that there is not any significant difference between development banks operating in advanced countries for advanced countries development and development banks operating internationally and/or domestically for developing countries development. Their basic aims and objectives and operational tools are quite similar both conceptually and procedurally; however, in Regional areas, such the EU and the euro zone, development banks may benefit from harmonizing their investment appraisal parameters and selection criteria.

Development banking has built, over the years, experience in marrying output growth with environmental, technological and social inclusion considerations. These are areas where at the macroeconomic policy level many a countries are wrestling with and proposing batteries of indicators to complement national economic accounting. In these very field, development banking applies synthetic investment value indicators that captures, in an effective and eloquent manner, both output growth and aspects such as environmental, technological and social considerations. Thus, the development bank’s experience can be a useful base on which central Economic Ministries, Statistical Offices, Economic and Social Councils (or alike) may wish to build upon in refining their development work.

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ABBREVIATIONS

CDC Caisse des Dépôts et Consignations
CDP Cassa Depositi e Prestiti
CNEL Consiglio Nazionale dell'Economia e del Lavoro
DvB – T Digital video Broadcasting - Terrestrial
EBRD European Bank for Reconstruction and Development
EIB European Investment Bank
EDFI European Development Finance Institutions
EU European Union
KfW Kreditanstalt für Wiederaufbau
ICT Information and Communication Technology
ISTAT Istituto Centrale di Statistica
LTI Long – Term Investment
LTIC Long – Term Investment Club
MDBs Multilateral Development Banks
MDM Modified Discount Method
NDBs National Development Banks
NRPS National Reform Programs
OECD Organization for Economic Cooperation and Development
PBI Project Bonds Initiative
R&D Research & Development
SCR Social Corporate Responsibility
SSRN Social Science Research Monitor
SMES Small and Medium Size Enterprises
SOE State Owned Enterprises