Chapter 18

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SOUTH-SOUTH PUBLIC FINANCE: A RAPID REVIEW OF COOPERATION AND RESILIENCE TO FACE COVID-19

This chapter provides a "rapid review" of four major South-South public banks and public funds to give a flavour of how regional financial cooperation in the South is offering resilience in the face of Covid-19. It draws on the experiences of the Islamic Development Bank (IsDB), the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (NDB) and the Latin American Reserve Fund (FLAR) to show how South-South public banks and public funds responded quickly to the Covid-19 crisis. These Southern-owned and Southern-led public financial institutions have not received the same attention as those from the world's largest economies nor global public lenders like the World Bank and International Monetary Fund (IMF), but they are nonetheless making an important contribution to supporting countries in the South. Very quickly after the start of the pandemic, they upped their support to members, increasing the scale of finance available, broadening the scope of lending, adapting loan terms and conditions, and augmenting loan efficiency by facilitating country-to-country sharing of expertise, group procurement policies and partnerships with other firms, banks and governments. They have changed the definition of what constitutes an emergency and reappraised the role of social and human capital with respect to infrastructure. Their response to Covid-19 suggests that even more can be achieved in the future, if they continue to strengthen the strategic partnerships at the heart of South-South cooperation and use their solidarity to support moves towards a more inclusive global financial architecture.

INTRODUCTION

South-South public banks and funds responded quickly to the Covid-19 crisis, scaling up the finances available and adapting their approach to help their members fight the economic and health impacts of Covid-19. The term South-South has come to denote forms of cooperation between developing countries such as regional or multilateral financial institutions where the majority ownership lies with governments in the South, the motivation is often one of 'solidarity' and the orientation of services is firmly with countries in the South. These Southern-led public financial institutions have not received the same attention as those from the world's largest economies nor the global public lenders, like the World Bank and IMF. They are, nonetheless, making an important contribution to supporting the South. Very quickly after the start of the pandemic, these institutions upped their support to members – increasing the scale of finance available, broadening the scope of lending considerably, adapting loan terms and conditions, and augmenting loan efficiency by facilitating country-to-country sharing of expertise, group procurement policies and partnerships with other firms, banks and governments. They have changed the definition of what constitutes an emergency and reappraised the role of social and human capital with respect to infrastructure.

This chapter gives a brief "rapid review" of four major public banks and funds to give a flavour of how regional cooperation in the South is offering resilience in the face of Covid-19. This includes the Islamic Development Bank (IsDB), the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) as Southern-led public banks that are profoundly changing the nature of the development finance landscape. It also includes the Latin American Reserve Fund (FLAR) as a foreign exchange reserve fund that helps its member countries withstand exchange rate fluctuations and balance of payments distress. It is not a bank, but it has many bank-like qualities. All these institutions have been part of the broader and most significant trend in the financial sector this century, whereby South-South banks, funds, credit swaps and bond issuances are bringing trillions of dollars and technical expertise to complement what is available through the Bretton Woods institutions, adding a new voice for the South that is more commensurate with its economic weight (Barrowclough et al. 2020). Their response to Covid-19 suggests that even more can be achieved in the future, if they continue to strengthen the strategic partnerships at the heart of South-South cooperation and use their solidarity to support moves towards a more inclusive global financial architecture (UNCTAD 2020a).

SOUTHERN NEEDS AND THE IMPACT OF COVID-19

Developing countries have been the hardest hit by Covid-19 (UNCTAD 2020a, 2020b). They are especially vulnerable to the economic shock waves caused by the rapid fall in commodity prices, the collapse in trade, tourism revenues and remittances, and they typically lack the macroeconomic 'automatic stabilizers' of unemployment support and other social services found in richer countries. They also have under-resourced public health systems and limited provision of public water and sanitation, and less ability to pay the rapidly rising prices of Covid-related medical supplies and equipment. This is not to say they are doing nothing, but compared to the advanced economies, their governments have less fiscal space with which to boost expenditure and their central banks have fewer options to boost liquidity without severely risking their currencies. Public development banks in the South are playing a role, but with much less fire-power and while struggling to meet a multiplicity of needs with lower levels of capitalization and less ability to raise funds on international capital markets on long-term and favourable terms.

Developing countries can of course turn to the legacy Bretton Woods institutions and these did quickly scale up their resources to meet the new Covid-19 needs. The IMF has pledged more than US$1 trillion and the World Bank more than US$27 billion (World Bank 2020a, 2020b). The major multilateral regional banks, such as the African Development Bank and the Asian Development Bank, have also announced special Covid support (while these banks may be Southern-oriented they are not described as South-South because they have a significant number of Northern countries as members and co-owners).

Many developing countries have turned to these global funders of last resort. Yet these Bretton Woods institutions have not scaled up nearly as much as has been needed. According to the Overseas Development Institute (ODI), lending by the World Bank, the AfDB and the ADB increased by only 29% in response to Covid, which is a much smaller magnitude than their response during the global financial crisis. Moreover, this increase is planned for only one year, and most lending has gone to middle-income developing countries with only 5% directed to the lowest-income countries with the greatest needs. Finally, these loans come with the same conditionalities and structural adjustments that are typical of World Bank or IMF lending, and of which many developing countries are already wary. There is a demand for Southern-led alternatives.

RESPONSES OF SOUTHERN-LED PUBLIC BANKS AND FUNDS TO COVID-19

The many individual initiatives launched by South-South public banks and funds are beyond the scope of this "rapid review". The following pages aim rather to highlight some of the experiences of four public banks – the Islamic Development Bank, the New Development Bank, the Asian Infrastructure Investment bank (AIIB) and the Latin American Reserve Fund. In doing so, it seeks to draw out elements that are particularly relevant for public banking in the Covid-19 context and beyond.

The Islamic Development Bank

The Islamic Development Bank (IsDB) is a global Southern-led public bank and all of its 57 member countries are potentially eligible for its Covid-19 support package geared towards health and livelihood resilience. Announced in April, the package is worth US$2.3 billion – just over a quarter of the bank's average lending per annum. Arrangements were made quickly, and by May the IsDB had already made plans with 27 members, accounting for more than half of the total package, to cover loans, provide loan guarantees, support import finance, provide pre-export finances and to support health systems, food production and social safety nets.

The rapid response was financed mostly by a re-allocation of committed reimbursements, in particular the Reverse Linkages programme, which was suspended for 2020 and its funds re-tooled for IsDB's Covid-19 (IsDB 2020). Another US$1.5 billion was raised by the bank's issuance of what it calls "the first ever Covid Sukuk" (an Islamic finance form of bond) and the rest arranged in partnership with other multilateral development banks. Notably, Sukuk bonds must have a tight integration between the funds raised and the real economic activities that underlie it, which in this case is healthcare, sanitation and making finance available for Islamic small- and medium-sized enterprises. This response thus constitutes a somewhat different profile from the bank's usual lending, which is heavily oriented towards energy projects and with a smaller proportion going to finance, transport and agriculture. Since its inception, health services have accounted for just 3% of total IsDB approvals, so 2020 represents a big change.

The IsDB's Covid-19 package, called the Strategic Preparedness Response Programme, is divided into three pillars. The *Response* pillar focuses on fast disbursement of finances to pay for healthcare and facilities, and for food. An example is the loan of US$36.6 million to Yemen. Of this, US$20 million went to financing the setting up of 32 specialized Covid-19 treatment centres and to increasing laboratory testing capacity in two medical universities (including providing them with the medical equipment needed for treating severe cases of Covid-19 and providing personal protection equipment for health workers). As is typical with South-South lending (Barrowclough et al. 2020), technical support is a feature and in this case the IsDB created a partnership for the first time with the World Health Organization to help coordinate and support activities. This cooperation is significant given the extra difficulties inherent in Yemen, which was suffering problems of conflict, hunger, disease, displacement and economic collapse even before the pandemic. The IsDB Respond pillar is further supported through the Reverse Linkages division of the bank, which facilitates country-to-country cooperation between members to share expertise. For example, ministries of health and medical experts from Turkey, Indonesia and Malaysia have shared knowledge with other IsDB members alongside the flows of finance.

The second pillar, *Restore*, focuses more on medium-term investments to strengthen the health sector and economy more broadly, and in this case, IsDB interventions are directed to small- and medium-sized enterprises, and to trade in an effort to restore strategic value chains that were interrupted or blocked by the pandemic fallout. Finally, the third pillar, *Restart*, has a long-term focus on catalyzing investment in infrastructure and enhancing value chains, notably aimed at attracting private sector partners.

In disbursing the loans, some IsDB funds fell under specific pillars while others involved all three pillars and multiple partners. Such is the case, for example, with the US$30 million fund established for Senegal formed in collaboration with a reverse linkage programme that included technical cooperation and exchange of knowledge, technology and other non-financial resources with the private sector, and cooperative agreements with the United Nations Children's Fund (UNICEF) and other United Nations (UN) agencies to help with service delivery. Partnerships with governments are also on the table for IsDB Covid loans. The IsDB aims to provide Islamic financing instruments that can be coordinated and integrated with governments' fiscal policies to form social safety nets and other pro-poor policies.

The New Development Bank

The New Development Bank (NDB) – formerly known as the BRICS bank of Brazil, Russia, India, China and South Africa – had to be flexible when Covid-19 struck as their existing policy framework did not support the special needs the crisis provoked among its members. When established in 2014, its mandate was to mobilize "resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries, complementing the existing efforts of multilateral and regional financial institutions for global growth and development." With an initial subscribed capital of US$50 billion, the NDB became operational in 2016 and swiftly started to build a robust and diversified infrastructure portfolio, making headlines because of its big and fast lending to projects in member countries. However, Covid-19 related urgent needs did not fit its usual profile, requiring a change in approach.

In February 2020, the NDB announced its readiness to support its members against Covid-19 and gave its first Covid-19 loan to China in March 2020 for CNY7 billion. This was financed in part by a special Coronavirus Bond issue, denominated in the local currency and was used to finance healthcare and local authority budgets for three regions of China. Because this loan did not fit the normal lending policy purpose, a special case waiver was needed. By April, a second special case waiver was needed to lend US$1 billion to India. By this time, it was obvious that the Covid-19 pandemic and the impact of lockdown measures were going global. On June 10, the NDB announced a new Fast Track Covid Emergency Assistance Response Facility with up to US$10 billion of financing available, divided into US$5 billion earmarked for health and social assistance and US$5 billion for economic recovery. A few weeks later it also announced a new emergency response protocol (see NDB 2020) so that subsequent loans to South Africa and Brazil did not need a waiver.

The changes in policy are interesting because they denote a new way of looking at "emergencies." In the past, emergency referred narrowly to natural disasters or, in some specific cases, to post-conflict settings – both of which typically still required infrastructure-related project finance for physical reconstruction and restoring assets and reviving production. In the Covid-19 fallout, borrowers were needing assistance with relief and social assistance as well – needs that are usually part of government welfare or social support and for which the NDB was not primarily designed. As the Covid-19 disaster spread, the NDB had to change and adapt.

The Asian Infrastructure Investment Bank

In the first days of March, the Asian Infrastructure Investment Bank (AIIB) announced a US$5 billion Covid-19 Crisis Recovery Facility to help public and private sector clients manage through the pandemic. Like the NDB, the AIIB also widened the scope of its lending beyond the long-term infrastructure purpose for which it had been originally established in 2016. Within a month, requests from members for funding were so high that the AIIB doubled its Covid-19 facility to US$10 billion.

The AIIB was clear about the need for rapid action that went beyond its initial infrastructure profile because of the lessons learned during the Asian and global financial crises. In these crises, investment in public gross fixed capital plummeted to just 2% of Gross Domestic Product (GDP) from highs of 6%, and the AIIB feared this would happen again due to Covid-19, setting back development momentum and gains thus far.

The AIIB saw a strong need to protect key infrastructure development at a time when private sector risk aversion would be high and as public capacity for investment was increasingly constrained. Covid-19 would undoubtedly put added fiscal pressures on government budgets. Based on its clients' feedback, the AIIB felt it was imperative to broaden the scope of its response and noted three key areas where its members needed help immediately: to alleviate healthcare pressures, through providing health infrastructure and pandemic preparedness; to provide liquidity, through on-lending facilities and credit lines to address working capital and liquidity shortages; and to ensure governments received immediate fiscal and budgetary support so they could focus on addressing the human and financial impacts of Covid-19 (AIIB 2020).

In order to meet these "urgent and extraordinary" needs, which are very different from the normal work of the AIIB, it was necessary for the institution to adapt and to work closely with other international financial institutions to create a network of support options, especially for the most vulnerable economies. It approved a range of measures to make it easier to "seamlessly" partner with other development banks (AIIB 2020). It also identified some priorities for future lending in the longer term, which in addition to the more conventional infrastructure and telecommunications services, included the need for proper health infrastructure such as clean water and sanitation, which were seen as key parts of health security and epidemic preparedness.

Without proper investments in public health infrastructure, developing countries will remain vulnerable to further outbreaks.

This was considered especially essential in the Asian context of megatrends towards urbanization and an ageing population. As is known, Covid-19 affects the elderly more than young people, and in Asia the number of senior citizens over 65 years old is projected to double within the next 20 years. According to the AIIB, “It is clear that health infrastructure needs to be expanded and the Covid-19 crisis further underscores this” (AIIB 2020). To this end, the AIIB has approved, among other projects, financing for many water and sustainable cities projects across Asia, and AIIB-funded water, sanitation and drainage infrastructure is already on track in Pakistan, Bangladesh, India and Egypt.

The Latin American Reserve Fund (FLAR)

Finally, the Latin American Reserve Fund (FLAR) is also notable for its rapid response to the Covid-19 crisis. In April 2020, FLAR met with other regional financial institutions and the IMF to discuss responses to help its members in distress. Many countries in Latin America are dependent on commodity exports, for which prices had fallen sharply. Their economies were highly exposed to fluctuations in the US dollar. On top of this, many members have large populations and high levels of poverty, as well as under-financed health systems. By May, FLAR had borrowed significantly on international capital markets to augment its capacity to support members in need by 60%, taking its lending potential up to US$6.8 billion without having to increase the subscribed capital of its members, as they had done in 2012. Compared to the FLAR’s two previous experiments with bond issuances, which totalled just US$400 million, this is comparatively massive. It is also an important signal of solidarity, if only for the fact that, until now, the Fund historically carried zero debt (FLAR 2020).

The FLAR also significantly changed its terms on offer, reflecting the gravity of the pandemic and its impact. Before Covid-19, the rules were that Balance of Payments loans to members were limited to a maximum of three years with one additional year’s grace, and for a maximum amount of 2.5 times the paid-up capital of each member (rising to 2.6 times in the special cases of member countries Bolivia and Ecuador). Since Covid-19 struck, FLAR has adjusted these parameters and the maximum loan per member rose to five years plus three years' grace – an extremely large change. This was made in recognition of the fact that the hit to productive capacity and to exchange rates throughout the region are not likely to recover quickly (FLAR 2020). Hence, the FLAR needed to enhance its support to member governments.

CONCLUSION

This chapter has very briefly touched on some of the ways in which Southern-led banks and funds are working together to face the Covid-19 pandemic. The public financial institutions have contributed to the creation of a broader and more diverse range of Covid-19 relief options for Southern governments. In each case, the public banks and funds scaled up lending. Moreover, each institution provided the needed financing rapidly and on flexible and favourable terms. These public institutions notably lent directly to governments to provide essential breathing space in a time of crisis. In the process, the IsDB, NDB, AIIB and the FLAR showed the ability to adapt quickly and dynamically to changing needs and circumstances. Significantly, the scope of their lending shifted to include social support and non-physical infrastructure in ways that went beyond their conventional mandates.

These Southern public banks and funds demonstrate the capacity to play a meaningful role in facing the Covid-19 emergency. This is a signal they could have play a central role in building forward better for a green and just transition to sustainable development. They will each face constraints and challenges in doing so. Still more finance is needed, and there is the continued paradox of a glut of surplus finance in some parts of the world and a shortage in others. Another challenge is that, once the Covid-19 crisis has passed, it will be important that their performance evaluators, their government owners and the public in general properly value the social and developmental lending these institutions have undertaken in response to the pandemic. Profitability or returns on assets in conventional terms will have little utility in building forward better. At the same time, as ever, these public institutions should not be idealized. Public banks can only be as good as their members and society makes them be. Substantive accountability and transparency will be important in the post-Covid reckoning that is sure to come.

Finally, while South-South initiatives can do a lot to provide some relief and support for recovery, they cannot do it alone and cannot be expected to substitute for what else is needed – which continues to be a better financial system globally, and with true multilateral support. The experiences briefly described in this review hint at what could be done in terms of international coordination and cooperation for the future crises that are inevitable, and to help ensure a better recovery for the next time.

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