Rebuilding Economies

Trade and Economy: Operations in a New Normal

WORLD GOVERNMENT SUMMIT 2021

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COVID-19
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The COVID-19 pandemic has exacted a heavy toll on the finances of countries around the world, forcing governments to deliver unprecedented fiscal support packages for businesses. But stimulus measures have failed to resurrect flagging demand and return economic activity to pre-COVID levels—and they cannot be extended indefinitely.

With emerging market governments now facing substantial national budget deficits, the pressure is on to move beyond shoring up businesses for short-term survival to positioning them for sustainable success in the post-COVID economic landscape.

In this bid to financially future-proof themselves, governments are increasingly exploring the potential of development finance institutions (DFIs) to help rebuild ailing economies by delivering targeted stimulus packages in a systematic, fiscally responsible, and sustainable manner.

DFIs are built on a financial model that is designed both to generate returns and to advance broader development objectives. This should—in theory—make them well placed to take more risks than traditional commercial banks and to support businesses and projects that these banks would typically avoid, particularly in today’s low-yield, low-return market environment.

But one significant obstacle stands in the way: since they were first set up in response to crises such as the post-war reconstruction efforts, DFIs have been significantly weakened by a protracted period of neglect. This has left them effectively operating with one hand tied behind their backs.

Today, the only way to ensure that DFIs have the financial firepower to deliver on their mission is to revitalize, recapitalize, and reconnect them to their ecosystem. In this paper, we outline the compelling case for governments to use their national, regional, and multilateral DFIs to deliver the liquidity-injection programs needed to boost flagging industries, invest in vital infrastructure, and lead their countries out of economic penury. We also set out a seven-point roadmap to help policymakers and leaders of DFIs to gear up for the near- and medium-term future as economies take their first steps into the new, post-pandemic economic reality.
Governments around the world are facing a dual challenge: keeping a pandemic under control while also providing the fiscal life support needed to prop up their ailing economies. Several estimates suggest that the global economy is largely set to remain sluggish, with GDP not returning to Q4 2019 levels until 2022–2023.

In the US, the proportion of people out of work hit a yearly total of 8.9 percent according to the International Monetary Fund (IMF), signaling an end to a decade of job growth. Meanwhile, the UK’s economy contracted by 10 percent in 2020 and is projected to rebound by 5.3 percent in 2021. This is about 0.2 percentage points lower than in previous staff projections due to the nation’s third national lockdown, announced on January 5, 2021. Frictions in implementing the post-Brexit trade regime will also weigh on activity in the short term. Even after social distancing winds down, a period of corporate balance sheet repair is expected to depress investment while labor reallocation takes place gradually. Output would recover to pre-crisis levels in 2023 but would remain about 5 percent below the pre-2020 trend in 2025.

For India, the economic fallout of the pandemic has been substantial and broad-based. GDP contracted sharply in Q2 2020 (−24.1 percent year-on-year) due to the unprecedented lockdowns introduced to control the spread of COVID-19 (see figure 1). The contraction moderated to −7.0 percent year-on-year in Q3 2020. On January 7, the country’s National Statistical Office released its first estimate, forecasting GDP growth of −7.7 percent for FY 2020–2021.

And in the Middle East, the economy is not only being affected by COVID-19, but also by the sharp decline in oil prices in 2020. Millions of workers have also been put on government-supported job retention schemes as some sectors of the economy—such as tourism and hospitality—have ground to a near standstill.

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1 UAE’s 2020 real GDP annual growth rate estimate of −6.6% (IMF) has been reflected across all four quarters, pending actual figures
Sources: OECD, IMF, Kearney analysis
The post-pandemic economic recovery across the globe remains patchy. For instance, while unemployment is easing in some developed markets, the numbers of new job opportunities are still very low in many countries. The only major economy to grow in 2020 was China, registering growth of 2.3 percent. The IMF predicts the world’s GDP to grow by 6 percent in 2021, driven primarily by countries such as India and China, which are forecasted to expand by 12.5 percent and 8.4 percent, respectively. Recovery in large, services-reliant economies such as the UK and Italy is expected to be slow as they have been hit hard by the outbreak. And while job vacancies in Australia have returned to 2019 levels, they are lagging in countries including France, Spain, and the UK.

Meanwhile, stock markets have acted as a powerful barometer of economic impact and business sentiment. The FTSE, the Dow Jones Industrial Average, and the Nikkei all recorded huge falls as the number of COVID-19 cases rose in the first months of the crisis. Since the announcement of the first vaccine in November 2020, the major Asian and US stock markets have recovered lost ground, but the FTSE is still languishing in negative territory.
Challenges to Global Trade
In the wake of the pandemic, the global business and trade environment is going to look very different. The supply shock that started in China in February 2020 is here to stay, along with the demand shock that followed as governments around the world prioritized public health and announced varying degrees of lockdown. In the US alone, where small businesses form the backbone of the economy, employing nearly half of the private sector workforce, lockdown and work-from-home measures have had a disproportionate effect, particularly in the leisure and hospitality sectors. As the pandemic drags on, many of these temporary closures look set to become permanent. Yelp recently reported that 61 percent of the restaurants listed as closed on its platform have now shut their doors for good. Meanwhile, for businesses in the retail and nightlife categories, more than half of temporary closures became permanent.

But the permanent closure of these businesses is only part of the picture. Many businesses that remained open have registered revenues that fall far below pre-pandemic levels. The disruption caused by the pandemic has fueled a rapid acceleration of trends that were already in evidence before the crisis. This has widened the gap between the best- and worst-performing companies as businesses with more innovative models extend their lead over their competitors. Some sectors particularly vital to global GDP have been more severely affected than others. For example, the travel industry has suffered a severe blow, with airlines cutting flights and customers cancelling business trips and vacations. New variants of the virus, discovered only in recent months, have forced many countries to introduce or continue with tighter travel restrictions. Data from flight tracking service Flight Radar 24 shows that the number of flights globally took a huge hit in 2020 and is still a long way from recovery.
In addition, the protectionist government policies already on the rise before the pandemic began continue to impact global trade dynamics. The G20 standstill agreement—implemented during the Great Depression of the 1930s—enforced the commitment to stop and roll back protectionist measures, helping stem an increase in protectionism during the last financial and economic crisis (2007–2010). However, the period that followed saw a notable resurgence in protectionism. Between October 2008 and October 2019, members of the World Trade Organization (WTO) introduced a total of 1,654 measures designed to restrict trade. And between May and October 2019, the G20 countries alone took restrictive measures affecting an estimated trade volume of USD460.4 billion—the second-highest volume since this calculation was introduced in 2012.

Multiple studies conducted by central banks, economists, and think tanks suggest that bilateral and multilateral trade imbalances are strong predictors of protectionist policies by governments, and these imbalances are typically a direct result of globalization, both in its trade and financial dimensions. The US–China trade war demonstrates this trend in action and has triggered a rise in economic nationalism around the world, exposing vulnerabilities in the supply chains of companies around the world. As a result, businesses worldwide are now under greater political and competitive pressure to boost domestic production, grow employment locally, reduce—or even eliminate—their reliance on sources that are perceived as risky, and rethink inventory positions across their global supply chains. This weakness was especially visible in temporary trade restrictions and shortages of pharmaceuticals, critical medical supplies, and other products.
As such, the impact of the pandemic on international trade comes as no surprise. China experienced a sharp fall in exports during February, but quickly recovered to normal levels by July 2020 (see figure 2). However, the US experienced a dip in exports in April 2020 and is only now showing signs of a return to pre-pandemic levels. More importantly, this economic turmoil has exposed vulnerabilities in supply chains and cast doubts over globalization, compelling companies to review their global and regional networks and take action to reinforce their resilience. Will they continue to trade openly, using the capabilities that reside around the world? Or will they strive to mitigate the impact of future disruptions by focusing within their own borders?

Sources: IMF; Kearney analysis
Governments’ Fiscal and Monetary Policy Response
With some industries forced to shut down completely and consumer demand collapsing, governments in many countries have slashed interest rates to make borrowing cheaper and encourage spending to boost the economy. As well as providing a financial lifeline to their citizens, they are also partnering with central banks to support businesses through a wide range of fiscal and monetary measures. (see figure 3).

In the Middle East, UAE authorities have so far announced fiscal measures totaling around USD8.7 billion—or 2.5 percent of GDP. These initiatives include water and electricity subsidies, as well as credit guarantees and liquidity support for small- and medium-sized enterprises (SMEs). They also include a three-month deferment period for outstanding installments and interests on loans and credit cards.

The Central Bank of the UAE (CBUAE) has reduced its policy interest rate twice by a combined 125 basis points in 2020. Additionally, CBUAE has announced a USD70 billion—or 20 percent of GDP—package of measures comprising halving of banks’ reserve requirements, providing zero-interest rate collateralized loans to banks, allowing the use of banks’ excess capital buffers, a 15 to 25 percent reduction in provisioning for SME loans, and allowing banks to defer loan repayments until the end of 2021.
Saudi Arabia has announced USD21.2 billion or 3.0 percent of GDP private-sector support package. The package includes the suspension of government tax payments, fees, and other dues to provide liquidity to the private sector, and an increase in available financing through the National Development Fund. These have been augmented by the Ministry of Finance launching a loan payments deferment program for businesses. Saudi Central Bank (SAMA) announced a package to support the private sector, particularly SMEs, by providing funding to banks to allow them to defer payments on existing loans and increase lending to businesses. They also injected liquidity into the banking sector through deposit placements to increase private-sector lending until the end of March 2021.

The Indian government’s fiscal support measures include government spending, foregone or deferred revenues, and expedited spending (about 3.3 percent of GDP). These measures are designed to support businesses and shore up credit provision to several sectors (about 5.1 percent of GDP). Measures without an immediate direct bearing on the government’s deficit position aim to provide credit support to businesses (1.9 percent of GDP).

Key elements of the business-support package include financial sector measures for micro, small, and medium-sized enterprises such as a collateral-free lending program backed by a 100 percent guarantee, subordinate debt for stressed micro, small, and medium-sized enterprises (MSMEs) with a partial guarantee, and so on. The government also announced a fund-of-funds for equity infusion in MSMEs. The Reserve Bank of India relaxed some of the criteria for credit support to the exporters and importers and extended the tenor of refinancing facilities for small businesses.

Figure 3
In response to the pandemic’s economic effects, governments have provided varying amounts of financial support.

COUNTRY FISCAL MEASURES IN RESPONSE TO THE COVID-19 PANDEMIC (JANUARY 1, 2020–MARCH 17, 2021)

Sources: IMF; Kearney analysis
The UK government has launched three separate loan schemes to enable businesses to access credit. Together with the British Business Bank, the government has launched the Coronavirus Business Interruption Loan Scheme to support SMEs and the Coronavirus Large Business Interruption Loans Scheme to support bigger firms, which carry an 80 percent guarantee for loans up to GBP5 million for the former and up to GBP300 million for the latter. In addition, the government has put in place the Bounce Back loan scheme for SMEs with a 100 percent guarantee for loan amounts up to GBP50,000. Trade credit insurance for business-to-business transactions will receive up to GBP10 billion of government guarantees through the Trade Credit Reinsurance scheme, available for nine months. The government has put in place a GBP1 billion package to support firms driving innovation and development through grants and loans.

Similarly, the US has announced USD510 billion to prevent corporate bankruptcy by providing loans, guarantees, and backstopping Federal Reserve 13(3) program and USD349 billion in forgivable Small Business Administration loans and guarantees to help small businesses that retain workers.
Realigning Post-pandemic Priorities for Businesses
 Fiscal stimulus packages play a crucial role in securing the short-term survival of businesses around the world. But they must also prepare these businesses for sustainable, longer-term success by enabling them to become more resilient and better aligned with the evolving economy of the future. If stimulus packages fail to deliver this, the pandemic will have taught us nothing—and we will have missed a golden opportunity to future-proof our businesses. One thing is certain: if more established companies back away from globalization, their competitors will simply move in to exploit this gap. Instead, business leaders need to find ways to optimize their business models and establish a genuine competitive advantage over their peers.

Rethink Global Supply Chains

Businesses would have to address their heavy dependence on a medium- or high-risk single factory, supplier, or region. The US–China trade war has motivated several companies to shift to a “China plus one” strategy by spreading their suppliers or production facilities between China and a Southeast Asian country.

But this approach comes with its own risks. Businesses would have to develop a regional strategy for procuring a significant proportion of key goods within the region where the end products are expected to be consumed. For example, North America might benefit from shifting labor-intensive work from China to Mexico and Central America. To supply Western Europe with items used there, companies could increase their reliance on eastern EU countries, Turkey, and Ukraine. Indeed, Chinese firms that want to protect their global market share are already exploring Egypt, Ethiopia, Kenya, Myanmar, and Sri Lanka as potential sources of low-tech, labor-intensive production.

Reducing reliance on China will be easier to achieve for some products than for others. Clothing and household goods will be relatively easy to shift elsewhere because the inputs involved are basic materials. But it will be harder to find alternative sources for sophisticated machinery, electronics, and other goods that incorporate components such as high-density interconnect circuit boards and electronic displays. If alternative suppliers are not immediately available, businesses should determine the amount of extra stock they need to hold—and the point along the value chain where they need to hold it. Of course, safety stock—like any inventory—carries the risk of obsolescence, ties up cash, and runs counter to the highly successful models of just-in-time and lean inventories.

Accelerate Innovation

As the cost of automation declines and people see that robots can operate safely alongside humans, the pace of automation is picking up a gear. The pandemic has made automation even more attractive because social distancing in shop floors is now a must. As a result of these developments, it’s becoming more practical to return off-shored production to higher-cost countries.

New digital experiences, products, and services in response to changes in customer behaviors and needs are also driving innovation and digitization. For example, many sports and entertainment venues have moved to fully digital experiences, while a technology provider has launched an on-demand fitness offering to capitalize on the surging popularity of the category. As a result, product development is occurring faster through greater innovation and rapid iteration. For example, telecom companies, working with insurers and healthcare providers, quickly responded to the pandemic by developing telemedicine applications to support remote COVID-19 testing and diagnosis.

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Companies can build their resilience to shocks by adopting appropriate and accessible eco-friendly measures that can help save costs and protect health. One example of a potential immediate measure is remote working, which facilitates business continuity while reducing the corporate energy footprint and emissions from commuting. While this was initially implemented as a physical distancing measure, many companies are considering more permanent remote working arrangements post-pandemic. Similarly, shortening supply chains by working with local suppliers can reduce emissions from transport, stimulate local economies, and limit disruption from movement restrictions.

Companies could also improve environmental performance as a condition for stimulus support. All these shifts in focus would require governments to target their stimulus support to those businesses that make demonstrable efforts or investments in these areas. This is already beginning to happen. We contend that the way these stimulus measures are delivered is just as crucial to making them genuinely effective and to avoiding the adverse impact of suboptimal delivery. But commercial, for-profit banks have seldom proven to be reliable partners to governments on this front. This means that national and regional DFIs must now play an even greater role in rebuilding economies by becoming a crucial institutional tool for delivering stimulus packages in a systematic, fiscally responsible manner.

This is not lost on governments around the world. Initially set up in response to post-war reconstruction efforts or similar crises, DFIs have since been neglected and have struggled to keep pace with the changes around them. While this is true even in the developed world, many developing countries have it much worse, with conspicuous gaps in the mandate and capabilities of their DFIs. Clearly, DFIs must be revitalized, recapitalized, and reconnected to their ecosystem if they are to achieve their mission: helping governments to meet the needs of their citizens.
The Crucial Role of DFIs in Post-COVID Recovery
At a recent conference, António Guterres, UN Secretary-General, emphasized the need for DFIs to support the pandemic response and recovery by providing financing for infrastructure and other public goods, and by promoting financial inclusion. He made it clear that the recovery cannot simply be a return to old ways of doing business. While stimulus packages have been successful in providing immediate relief during a time of crisis, they have not been sufficient to stimulate demand and return economic activity to pre-virus levels. With national budgets facing significant deficits, governments in emerging markets are increasingly turning to DFIs—whether national, regional, or multilateral—as a source of financing to support struggling industries, invest in necessary infrastructure, and lead the way out of economic misery.

There are an estimated 400 DFIs worldwide, with combined assets of USD11 trillion. They range from global bodies such as the World Bank, and regional institutions such as the Asian Development Bank (ADB) and the Development Bank of Latin America, to national lenders such as the Qatar Development Bank and the Development Bank of the Philippines. DFIs are capitalized primarily by governments, with some of their lending co-funded by the private sector. They generally provide funding on preferential terms for projects or businesses that would struggle to secure funds from traditional commercial lenders.

Before COVID-19, estimates suggest that DFIs committed USD2 trillion per year to various initiatives, representing around 10 percent of annual global investment. While DFIs provide crucial finance for socially beneficial projects, they are particularly important to emerging markets during crises, when they can counteract the pro-cyclical nature of financial markets that constrains credit during economic downturns. For example, following the 2008 Global Financial Crisis, DFIs significantly ramped up their lending at a time when other financial institutions were reining in their allocations.
As COVID-19 continues to disrupt global supply chains and trade, DFIs—particularly those of a multilateral nature—are expected to step up their support. Indeed, institutions such as the African Development Bank (AfDB) have been crucial to the African continent’s response to the pandemic. In late March 2020, the bank raised USD3 billion from its “Fight COVID-19 Social Bond”—the largest US-dollar-denominated social bond ever listed on international markets—with the proceeds to help alleviate the financial impact of the pandemic. This was followed by USD2 million in emergency assistance to the World Health Organization, and the announcement on April 8 of a COVID-19 response facility that would provide up to USD10 billion to African governments and the private sector to combat the public health and economic impact of the virus. Also in April, the ADB launched a USD20 billion support package for member states.

Elsewhere, several other multilateral DFIs are also playing a significant role in the post-COVID-19 recovery. The New Development Bank, which covers Brazil, Russia, India, China, and South Africa (the BRICS bloc), has disbursed USD1 billion to each member country, excluding Russia, via its USD10 billion Emerging Assistance Program for 2020.

We’ve outlined seven key priorities for policy makers and leaders of DFI that can act as a road map in the near- and medium-term future (see figure 4).
Figure 4
The role of DFIs in post-COVID recovery

A
PROVIDE TARGETED FINANCING TO STIMULATE SUSTAINABLE ECONOMIC RECOVERY
a. Reinvigorate global trade
b. Lay solid foundations for the green economy

B
REVAMP DFI CAPABILITIES

C
REPURPOSE DFI LANDSCAPE

f. Strengthen national DFIs
g. Recommit to the UN’s Sustainable Development Goals

Sources: IMF, Kearney analysis
A. Provide Targeted Financing to Stimulate Sustainable Economic Recovery

1. Reinvigorate Global Trade

DFIs are also bolstering private-sector attempts to stimulate trade by focusing on trade finance. In July 2020, the heads of the WTO and six of the world’s largest multilateral development banks (including the ADB, the AfDB, Islamic Trade Finance Corporation, and the Inter-American Development Bank) pledged to address shortages in trade finance that were threatening cross-border commerce. This attempt to assist trade finance providers—including both traditional banks and non-bank financial institutions—marks the first time that multilateral development banks have joined forces to support trade finance markets, in line with WTO ambitions. The hope is that stronger support for global trade will give emerging markets the power to improve their response to the pandemic and return to growth in 2021.
B. Revamp DFI Capabilities

3. Revitalize Products and Solutions

There is no "one-size-fits-all" strategy for responding to—and recovering from—the current global health emergency and its economic fallout. A combination of pragmatic products and solutions is needed to give countries and businesses the room to make the policy choices and investments, respectively, that will lay solid foundations for a recovery that puts both people and environment at the heart of economic growth and development. During the crisis, DFIs across the spectrum need to deploy a range of instruments to provide fresh financing through specific lines of credit or programs, delivering an important boost to stimulus packages, recovery efforts, and long-term structural transformation.

A significant chunk of the hundreds of billions in emergency aid packages for companies will be provided through credit or credit guarantees. This is for two main reasons. First, many sovereigns already had high levels of government debt before the pandemic began, largely due to policies adopted in response to the Global Financial Crisis. Sovereign spreads in the euro area—and particularly in Italy—are already widening, indicating the potential for more trouble ahead for the credibility and solvency of sovereign borrowers. Sovereigns now need to preserve their fiscal resources, and gifts are more demanding than loans and guarantees.

Second, the economic effects of the pandemic are likely to play out very differently across sectors, and there is little time to fully understand this heterogeneity. In short, the heterogeneous impact of the health crisis and related lockdowns, widespread uncertainty about the course of the pandemic, the need to use sovereign resources wisely, and the pressing urgency to respond, all align in favor of using credit to support the private sector.
4. Revamp Lending Models to Ensure they Reach the Right Businesses

Many DFIs deliver their lending programs through a combination of direct and indirect channels, by using the capabilities of private financial institutions such as commercial banks, non-bank finance companies, and non-governmental organizations. Targeting credit recipients in this way means that DFIs are selecting beneficiaries through their own private channels and assessing them against their own traditional criteria. As a result, financial support programs frequently end up being granted to relatively stronger businesses, leaving behind those that need them most.

Indirect lending models might help DFIs reach more beneficiaries at lower operating costs, but they come with no guarantee that credit will reach either the businesses or the sectors that are in greatest need of support during a crisis. An intuitive solution would be to explore creative ways to enhance indirect programs through strategies that are better designed to target sectors that have no access to private financing. To ensure that DFIs can operate effectively through economic cycle, the logical way forward is for them to develop their direct lending operational capabilities by developing in-house products, distribution channels—preferably digital ones—and most importantly, robust risk assessment capabilities.

5. Manage Future Expected High Levels of Debt

Multilateral and regional DFIs are important sources of financing, especially for emerging and developing countries. By capitalizing on their credit and lending instruments—both concessional and non-concessional—and by providing non-reimbursable technical support, they empower governments and businesses to access new funding. Yet this support invariably increases public debt levels for the countries concerned.

According to the IMF’s World Economic Outlook published in April 2019, estimates show the balance of public external debt of these economies to be close to 30 percent as a proportion of GDP, while the total gross government debt (which includes both domestic and external debt) would be around 53 percent. On a regional level, the total gross government debt is 68 percent for Latin America and the Caribbean, 55 percent for emerging and developing Asia, and 49 percent for Sub-Saharan Africa.

In practice, these debt-to-GDP ratios must be within certain levels to be perceived by lenders as sustainable. The IMF estimates the maximum sustainable debt level before a default occurs is 58 percent for emerging markets and 40 percent for low-income countries. This indicates that debt in regions such as Latin America and the Caribbean and Africa was already at unsustainable levels before the COVID-19 shock. Unsustainable debt levels drive up country risk premiums and downgrade credit ratings from the large rating agencies, making access to external financing more limited and more expensive. In other words, softening the effects of the current crisis will inevitably drive up countries’ debt levels from already unsustainable levels.

Similarly, private-sector indebtedness is also problematic. In Europe, corporate and household balance sheets are stretched after the Global Financial Crisis and the European sovereign debt crisis. Furthermore, low monetary policy rates engendered widespread complacency about debt levels.
Corporate leverage now stands at an all-time high and current policies will inevitably leave parts of the corporate sector with even larger debt burdens. This level of debt will put the brakes on recovery as distressed firms tend to implement labor reductions, sell assets, reduce investments and employment, and shrink their business—making them reluctant to raise new capital.

Additionally, banks and other lenders that are stuck with underperforming loans may restrict lending. This is likely to trigger a chain reaction that filters down to their customers, suppliers, and employees—converting a temporary economic shock into long-term economic sluggishness.

To manage the looming corporate debt strains and keeping the likely precarious situation of sovereign finances in mind, we see two broad areas that DFIs would have to focus on. Credit packages such as loan guarantee programs should be designed with the mounting debt burden and the future need for debt restructuring in mind. DFIs need to ensure the programs they offer avoid conflicts of interests with other commercial financiers, as businesses’ multiple creditors make restructuring more complicated. Programs must also ensure that bailout funds are used to ensure business continuity—as intended—and not to benefit existing debtholders or shareholders. Policy should also be formulated with future crises in mind.

DFIs must also be prepared to restructure debt for those companies that receive bailouts. Considering the stress on DFIs’ balance sheets, it might be worth thinking about an independent organization of government leadership in debt restructuring.

Overall, there would be pressure on publicly funded DFIs to support poor countries through grants instead of loans, which have to be repaid, adding to their indebtedness. This demand for grants is most important for public DFIs to support a package of essential public services, including ensuring access to water, sanitation, and hygiene services.
C. Repurpose DFI
Landscape

6. Strengthen National DFIs

Governments need to step up their support for public DFIs to enable them to play a countercyclical role and ease financing and liquidity constraints. DFIs could adapt their roles to meet evolving financing needs at different stages of development. This means that DFIs are not only better equipped to carry out countercyclical lending during a crisis but are also particularly well placed to reignite growth after a crisis. Big regional and multilateral DFIs often fall short on this front as most have little or no contact with SMEs and local governments, regardless of their access to funding and trained personnel.

This also applies to institutions with regional offices, since they are often located in the country’s capital or main business city and are focused on the biggest projects. That physical distance prevents them from having a more detailed perspective of local needs and concerns, including those that are driven by cultural norms and institutions.

In this context, national DFIs should act as a financial arm of their country, deploying a full range of instruments including the moratorium and rescheduling of existing loan obligations, working capital loans, and portfolio insurance policies. For example, national DFIs can play a vital role in helping speed up the economic recovery. They have a similar mission to regional or multilateral DFIs such as the World Bank, the Inter-American Development Bank, or the BNDES of Brazil, but they operate at a much more local level. Examples include the Development Bank of Minas Gerais in Brazil, the Saudi Industrial Development Fund in Saudi Arabia, and the Emirates Development Bank in the UAE.

These national DFIs can broaden the reach and effectiveness of development networks by serving as the last-mile specialist on the ground, identifying opportunities and connecting local players to global sustainable development-oriented funds. Achieving this effectively in the wake of the pandemic will require a grassroots rethink of the way these institutions are used in the first place.

Underpinned by a financial model that focuses both on generating returns and advancing broader development objectives, these institutions are equipped to take more risks and support businesses and projects that traditional commercial banks would avoid, especially under current market conditions.

Governments can bolster the capacity of national DFI by recapitalizing them; even an increase of capital commitment of just 20 percent would have a significant impact on top of the current stimulus package. For example, each of Brazil’s 27 states and 5,570 municipalities has its own pieces of legislation that can affect a project’s design and implementation. It can be challenging and costly for a multilateral or regional bank to navigate this level of complexity without the support and knowledge of a local branch. That distance often creates a gap between what the development banks have to offer and what local economic players are demanding, leading to inefficient allocation of resources.
Coordination between multilateral and national DFIs, which can take advantage of their local expertise and operational capacity, would deliver some clear benefits. Access to local support would speed up the credit analysis process, leading to lower transaction costs, while the ability to identify a larger pool of eligible projects would enhance efficiency. An effective technical and financial partnership between multilateral and national DFIs can guarantee that development projects can be implemented and provide the right impact. In other words, national DFIs make an important contribution to the effective implementation of economic stimulus packages, especially when it comes to their last-mile strategies.
7. Recommit to the UN’s Sustainable Development Goals

It is time for DFIs to renew their commitment to accelerating the achievement of the UN’s Sustainable Development Goals (SDGs), including addressing fragility. Public DFIs need to build a new cooperation model to upscale its SDG financing programs, thus giving hope to millions for an end to extreme poverty and to provide a better, safer, and healthier future for all. They should prioritize and collaborate with the private sector—and with each other—to fill the USD2.5 trillion of financial assistance needed annually to achieve the SDGs by 2030. They must support approximately three billion people who are facing a pandemic without access to the water and soap they need to wash their hands, and the two billion who don’t have access to safely managed drinking water and are under threat from the droughts, floods, and extreme weather caused by climate change.

The COVID-19 crisis has shown the world that only joint action can ensure that we address the most urgent global challenges effectively and efficiently. For example, the World Bank is helping low- and middle-income countries stop transmission, deliver health services, ensure vulnerable households have access to medical care, prepare for future pandemics, and, most importantly, gain fair and equitable access to vaccines. The World Bank Group has rolled out its first vaccine project, providing USD34 million to help Lebanon purchase vaccines and distribute them to more than 2 million people.

Similarly, in Nigeria, International Finance Corporation has used its fast-track COVID-19 facility to help small and medium-sized enterprises in several sectors that face working-capital or trade-finance challenges through a combined USD200 million loan to First City Monument Bank, Access Bank, and Zenith Bank.
In this paper, we outline the compelling case for governments to use their national and regional DFIs as essential vehicles for delivering the liquidity-injection programs needed to combat the economic slowdown. They can also contribute much-needed discipline to the process enabling efficient and targeted delivery of government funding to relevant beneficiaries.

DFIs were created with exactly this mission in mind, but they must now realign themselves to the requirements of the situation today. Making that happen is all about maximizing their own effectiveness by strengthening their capabilities, using digital technology, developing fit-for-purpose products and services, and reconnecting with the broader financial ecosystem—all while keeping a firm focus on their financial sustainability.
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About

Kearney

As a global consulting partnership in more than 40 countries, our people make us who we are. We’re individuals who take as much joy from those we work with as the work itself. Driven to be the difference between a big idea and making it happen, we help our client break through.

Why we’re different

We represent consulting that is both personal and practical.

Working alongside you from day one, we never tell you just what you want to hear or something you already know. Instead we’re more interested in hearing you talk, asking the questions that get you thinking. With honest advice and practical guidance, we’ll help you make the shift from keeping up to breaking through.

We’re big enough to have it covered, small enough to really care.

Big change is in the details. “Transformation” is a big word for getting to know every corner of an organization to find what might just be that one, crucial way to make the difference. We know this to be true because it’s how we work. While we’re 3,600 people strong in more than 40 countries, our size means we’re small enough to stay connected. For you this means a dedicated team of doers, bringing both the scale and the focus to make change happen.

We’re for less talk, more action.

As flattering as it is to see our peers catch up to what we’ve been doing for years, we’d rather see less talk about tangible, lasting results and more of the actual getting on with it. With our heartland in operations, we’ve always known that an idea is only as good as the action it inspires. We promise to deliver, not just deliberate.