China's Development Bank Strategy and Its Implications for Brazil

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The China Development Bank (CDB) contribution to rapid growth and poverty reduction has been essential.

1. Investments in public goods sectors like infrastructure, transport, affordable housing and education lead the world as % of GDP.
2. Forging and funding innovation policy.
3. Countercyclical action is major catalyst for investment patterns in other banks and in for-profit firms.
4. Profits and loan performance are very good.

Any national financial system *without* government-run development banking is *inefficient*

1. Private-sector inefficiency is harmful:

   a. Under-investment in public goods hurts growth
   b. Pro-cyclicality worsens slumps and poverty

2. Government investment banking is essential
3. But … it has to be done well.
4. China's CDB proves that it *can* be done well.

CDB's success relies in part on an effective *Macrofinancial* design.

1. Project oversight: good vetting, CDB choice, local platform companies, national auditing, debt service discipline, limited foreign PPPs

2. Domestic reliance: effective tax system, exchange-rate actions fighting Dutch disease

3. Low-priced liquidity: appropriate deposit rate caps, capital controls, compliant central bank, well developed market for CDB bonds

The private sector and IFIs (e.g., IMF) resist government banking for inappropriate reasons

1. Flawed research: Academic studies mis-represent the significance of government banking – *average* performance misleads

2. Overlooked market failings: Excessive influence of market liberalization thinking

3. Influence of political appointees: top leader-ship vulnerable to financial sector's urgings

IMF's Terrible Prognosis for Brazil

1. Per-capita growth long-term less than 2½%
2. High inflation worsened by higher growth.
3. Pro-cyclical government and firm spending
4. Bank lending increasingly cautious
5. Credit bias to consumption, not investment
6. High consumption crowds out investment.
7. External deficit is widening.

Brazil's Government Banking Needs

1. CDB-like banking

   a. Investment shift from 20 to 35% of GDP
   b. Larger share of infrastructure lending
   c. Fewer loans to high-profit ventures
   d. More income-generating loans
      i. Direct investment-related jobs
      ii. Focus on personal productivity

2. Refute government banking critics

Recommendations for Financial System's Reform

1. Foreign short-term capital inflow controls
2. Foreign PPP significantly reduced
3. Exchange-rate intervention to cure Dutch disease and devalue more generally
4. Interest rates lowered with deposit caps
5. Bond markets friendly to BNDES paper
6. Central Bank's enhanced cooperation
7. Tax system more buoyant with growth

China and CDB's lessons for Brazil:

1. The most important are:
   a. The need to link macro policy to long term finance (development and innovation)
   b. The usefulness of a robust public financial system working to support development, innovation, and value creation, instead of working for itself and (mostly) seeking value extraction.

Questions:

1. What do you think about …

a. Overall contribution to development of effective public development banks versus the private financial system's performance?
b. Academic arguments finding government banking is bad for growth?
c. Government Banking's counter-cyclical role?
d. Financial sector reforms needed to support government banking?
e. Brazil's pro-government-banking reforms?

Discussion