Development Banks, Private Banks, Shadow Banks: Points of Intersection, Tension, and Cooperation

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Discussion topics

1. Development banks and the private financial sector: Spaces for cooperation, risk of competition

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2. *Financialization*: What challenges does it pose for DFIs, and how to meet them?

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3. A key challenge: How can DFIs incentivize private-sector financial intermediaries to engage in long-term funding for innovation and investment?

Private sector trends

1. Separations within the population of private-sector depository institutions (banks):
   - Too-big-to-fail (and too-big-to-save) megabanks vs. regional banks vs. business banks vs. savings (housing finance) banks
     - Dependence of TBTF banks on fixed-income and trading profits, and on fee-based income: willing to create but not bear risk.
   - Historically-rooted, mission-specific institutions (cajas, landesbanken) vs. financial firms' homogenization
   - Hyper-leveraged, multi-market position-taking, often off-balance-sheet, vs. simple asset-liability linkages

Private sector trends

2. Rise of shadow banking:
   - Hedge funds' increased provision of commercial & industrial loans, outside of depository system and regulatory oversight
   - Private equity funds' and investment banks' hyperoptimization for short-term, zero-sum gains and fees – leading to job losses and asset-stripping elsewhere in the economy
   - Globalized financial firms shifting the geographic locus of activities to minimize tax liabilities and regulatory oversight
3. Off-balance sheet commitments:
   - The "originate and distribute" model as vehicle for redistributing risks, leveraging profits
   - The logic of standardized risk assessment vs. "character" loans

Financialization

Financialization – The secular increase of interest and financial fees in national income flows, non-financial corporations' increased dependence on financial income, households' greater debt dependence.

1. A fragilized **household** sector
   - More necessitous credit to fill in "income gaps" and meet emergency needs formerly covered by public safety-nets
   - Entrapment in indebtedness
2. **SMEs/innovating firms** unable to overcome "credit market gaps" due to standardization of risk assessment and need for collateral
3. **National governments** with exhausted fiscal capacity, due in many cases to having bailed out their too-big-to-fail banks.
4. A **globalized megabank elite** taking zero-sum gains and fees from all the rest – the 1% of the 1% of the …

Hypotheses/conjectures

1. The roles played by public banks, private banks, and shadow banks in economies are co-evolving in historically-specific circumstances.
2. When regulation cannot rein in the speculative activities, overleveraging, and excessive complexity of private and shadow banks, they will generate deadweight losses for the rest of the economy.
3. Under current rules, some (mostly globalized) banks are unwilling to provide finance, others (mostly regional/local) are unable to.
4. There is no "one size fits all" best-practice banking structure against which all national banking structures can be evaluated: we need diverse financial eco-systems.

Discussion topics

1. Development banks and the private financial sector: Spaces for cooperation, risk of competition

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2. *Financialization* – Does it close the space for SME growth and household reproduction? Does it poison the ground for a renaissance of manufacturing and for service creation?

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3. A key challenge: DFIs and long-term funding for innovation and investment
   - Willingness of private-sector financial intermediaries to engage in long-term funding
   - Creating an economically productive long-term private-sector capital market