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THE ROLE OF NATIONAL DEVELOPMENT BANKS AND COOPERATION WITH COMMERCIAL BANKS

The Czech Banking Association, Prague

October 6, 2023

Agenda

1. Introduction

2. National Development Banks in theory

3. The National Development Bank in the Czech Republic

4. Conclusion

Introductory notes

- Private commercial banks often suffer from market failures → governments created National Development Banks (NDBs)
- 3 questions to answer today:
 - 1) Should NDBs complement or compete with commercial banks?
 - 2) What is the best distribution model for NDBs (direct/indirect/hybrid)?
 - 3) What is the potential of the National Development Bank of the Czech Republic (Narodni rozvojova banka, “NRB“)?
- Prague University of Economics and Business (“UNI“) published a report on the future potential of the NRB in 2021 that included several policy recommendations

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Theoretical background 1/3

- NDBs = specialized financial institutions with the official mandate to fulfill public policy objectives
- NDBs can address **market failures** unlike commercial banks: i) long-term finance; ii) credit rationing as a result of information asymmetry, lack of collateral, and risk aversion; iii) procyclical lending.
- NDBs also deal with **suboptimal market conditions** (e.g. high interest rates)
- 5 types of NDBs: i) Multilateral development banks (EBRD, EIB), ii) National development banks (NRB in the Czech Republic), iii) Green development banks (UK, US, Switzerland), iv) Export-import banks (Czech Export Bank in the Czech Republic), v) Export credit agencies (EGAP in the Czech Republic)

Theoretical background 2/3

- **Financial additionality** (financing on terms and conditions not available in the market)
- **Non-financial additionality** (political risk cover, knowledge transfer, capacity building)
- Task for NDBs in the EU: **administration of EU funds**
- **Subsidies are usually preferred by politicians/government officials to financial instruments** (loan, guarantee, equity investment, project bond, subsidized interest rates) → typically (not only) for the Czech Republic
- Reasons: one-off subsidies, similar administrative burden of subsidies and financial instruments (e.g. generally less information on a loan compared to a subsidy should be needed)

Theoretical background 3/3

- NDBs should complement rather than compete with commercial banks → NDBs should fill the market gap through offering tailored-made products and services for a particular segment (e.g. SME*, municipalities), industry (energy), company needs (mezzanine capital for infrastructure projects) or products reflecting political goal (affordable housing)
- Distribution models of EU funds/products to clients:
 - a) **direct model** (NDB alone without commercial banks),
 - b) **indirect model** (NDB only with commercial banks: KfW),
 - c) **hybrid model** (combination of the previous models: NRB).
- *Question: Can NDBs assess clients' creditworthiness better than private commercial banks?*

*Small and Medium Enterprises

Empirical research on NDBs 1/2

Positives of NDBs

- i) NDBs lend longer than commercial banks,
- ii) NDBs finance projects with positive externalities,
- iii) NDBs address market failures in the syndicated loan market,
- iv) NDBs act countercyclically during global liquidity cycles,
- v) NDBs recently focus more on ESG* and sustainability,
- vi) NDBs can fulfill the “ESG non-compliant“ gap (financing “non-green“ assets).

*Environmental, Social, Governance

Empirical research on NDBs 2/2

Challenges for NDBs

- i) NDBs suffer from government failures owing to their poor corporate governance and political capture,
- ii) NDBs provide cheap credits to politically-connected firms that could have obtained financial support from commercial banks,
- iii) NDBs increase their lending activity in election years,
- iv) NDBs subsidizes firms that could fund their projects with alternative sources of capital,
- v) NDBs are not significant players in some countries (e.g. in the CR)

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Brief history of the NRB

- The Czech NDB is a state-owned bank founded in 1992 as the Czech-Moravian Guarantee and Development Bank (ČMZRB), in 2021 it was renamed to Narodni rozvojova banka (NRB).
- Key focus on providing support to SMEs through **bank guarantees, loans, consulting services and administration of EU funds.**
- Strong cooperation of the NRB with the Ministry of Industry and Trade and commercial banks in the Czech Republic.
- The NRB is heavily regulated because it has a full banking license and follows CRR/CRD IV, what is not so common in the EU.
- A low market share of the NRB on the Czech banking sector's assets (<1%)
- In 1992-2022 the NRB financed over 114,000 projects with directly provided or guaranteed loans in the total amount of CZK 477bn (EUR 19bn).

UNI's recommendations for NRB's future*

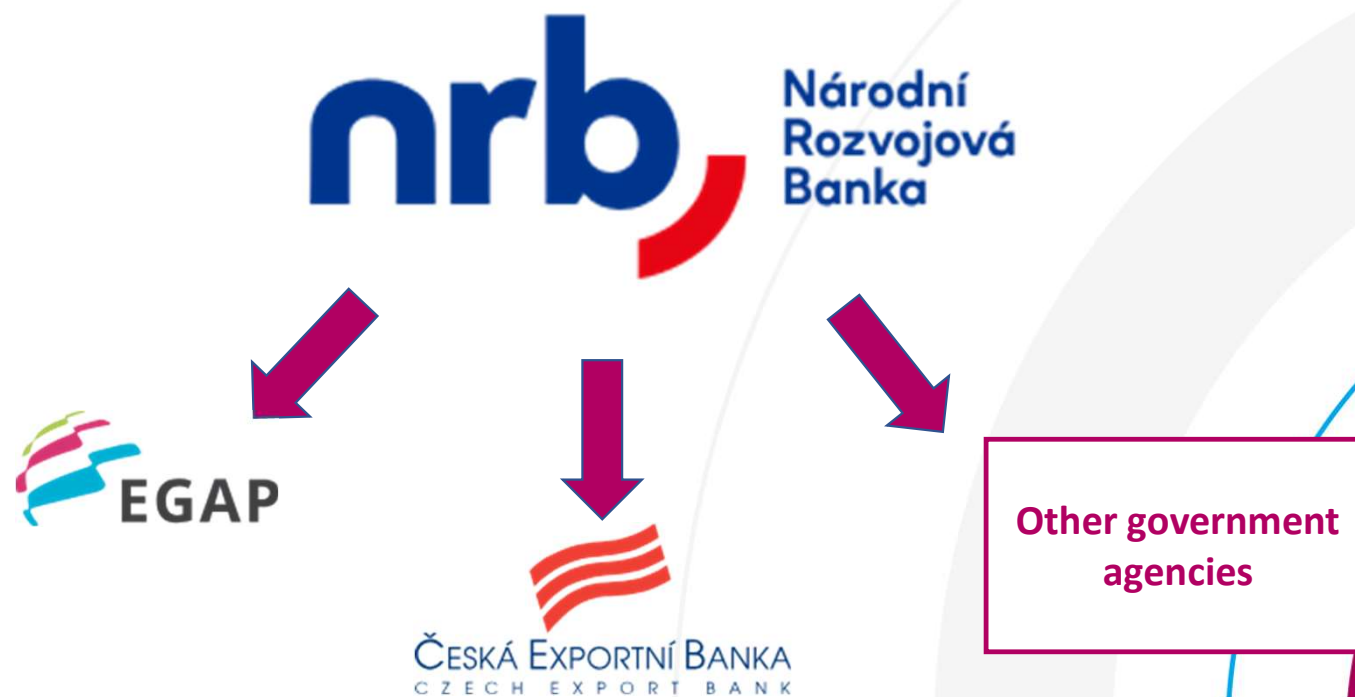
- 1) The NRB as a Czech economic policy platform for various phases of the economic cycle,
 - 2) flexible institution actively seeking out market failures and offering adequate products,
 - 3) a center of excellence in the area of financial instruments,
 - 4) a leader in the digitization of financial instruments for the public and private sectors,
 - 5) an advice platform for both the public and private sectors,
 - 6) a financial institution for public administration.
- **An increase in the NRB's registered capital (~EUR 180mn) was also recommended to boost the NRB's potential and activities.**

*Teplý, P et al. (2021). The National Development Bank. Research report. Prague University of Business and Economics

NRB's outlook

- The recent debate about the NRB's higher role among its shareholders (Ministry of Industry and Trade, Ministry of Finance, Ministry of Regional Development)
- Theoretically, NRB could act as a holding company (umbrella) for all government agencies in the Czech Republic
- Challenges: a new act on the NRB needed, bank license, corporate governance, capital and liabilities' increase needed, political appetite on subsidies rather than on financial instruments
- The first possible step: a merger of the NRB with the Czech Export Bank (state owned bank financing export credits and providing services connected with export)

NRB as a potential umbrella of government agencies in the CR



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Concluding remarks

1. NDBs should complement commercial banks
2. The hybrid distribution model combines advantages of direct and indirect models
3. The NRB has a potential to become a key player in the Czech economic policy but it is a long path ahead...

Useful sources

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Thanks for your attention.

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