Chapter 2

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RECLAIMING PUBLIC DEVELOPMENT BANKS TO FINANCE A SUSTAINABLE AND EQUITABLE RECOVERY POST COVID-19

Public development banks (PDBs) are in a unique and powerful position to play a key role in the post Covid-19 recovery. Following efforts to frame policy responses to the Covid-19 pandemic under a ‘building back better’ approach, this paper aims to contribute to a debate that focuses on reclaiming public banking for the public good. It presents the challenges that most PDBs face, including the fact that their operations have been skewed toward private interests over and above the public interest.

This chapter also details the key features that PDBs, at different levels, need to possess to maximize development results for the most vulnerable members of society. This includes delivering on the climate crisis and contributing to the fight against inequalities, especially gender inequalities. As a whole, this chapter makes a strong case in support of pro-public and accountable institutions working at different levels in a complementary way.
INTRODUCTION

The Covid-19 pandemic has the potential to seriously undermine developing countries’ progress toward achieving the Sustainable Development Goals (SDGs) (United Nations 2020). The health, economic and social crises triggered by the Covid-19 pandemic have magnified pre-existing structural problems and vulnerabilities, exposing – and even intensifying – inequality at all levels and across all spheres (Furceri et al. 2020). All this comes on top of the ecological crisis that the world was already facing before the pandemic struck.

Developing countries are in urgent need of more and ‘better’ development finance. According to the World Bank, the additional financing needs for developing countries arising from the crisis will be exceptionally high and are likely to persist over the medium term (World Bank Group 2020). In March 2020, the United Nations Conference on Trade and Development (UNCTAD) called for a US$2.5 trillion package for developing countries (UNCTAD 2020a), which followed a 2019 call for financing a Global Green New Deal (UNCTAD 2019).

With efforts to frame policy responses to the Covid-19 pandemic under a ‘building back better’ approach in mind, it is key to learn lessons from the problematic aspects of the prevailing development model, and to call for a rethink of the institutions that have played a dominant role in channelling development finance up to this point. It is imperative to reclaim public banking for the public good. The pandemic has shown the important role that the state plays when directing and guiding public policies and finance in the public interest. The ‘right’ type of finance needs to flow through the ‘right’ type of institutions. The private commercial financial sector alone is unlikely to provide the finance needed to help developing countries emerge from the current crisis, in a way that matches the challenge of inequalities and of financing
environmentally sustainable development.

In 2017, Eurodad and partners published the discussion paper *Public development banks: towards a better model* (Eurodad 2017). This proposes a framework to assess existing institutions, and the governments backing them, to get better at supporting development, becoming more accountable and learning from past mistakes. This current chapter builds on arguments put forward in the 2017 discussion paper and aims to further contribute to the debate on the types of institutions needed to finance a sustainable and equitable recovery in the context of Covid-19.

This chapter focuses on the mandate, policies, business model and governance that public development banks need to have in order to serve the public good in an accountable and transparent way. To start with, we describe what public development banks are and explain the challenges that they face, including the challenges posed by the Covid-19 pandemic. Then we argue why we need public development banks and make a strong case in favour of pro-public and accountable institutions working at different levels in a complementary way.

We also detail the key features that public development banks need to have to maximize development results for the most vulnerable people in society, including delivering on the climate crisis and contributing to the fight against inequalities, especially gender inequalities. If governments are serious about financing an equitable recovery after Covid-19, public development banks should be reclaimed to serve the public good.

### WHAT ARE PUBLIC DEVELOPMENT BANKS?

Public development banks (PDBs) are state-owned financial institutions that aim to deliver on public policy objectives to support economic development in a country or region. Although PDBs are concerned with financial returns, profit is not the
overall goal of their activities. This makes them different from private commercial banks and some other kinds of state-owned financial institutions, such as state-owned commercial banks or insurance companies.

PDBs are run at different levels, which can be grouped into three categories:

- **National**: including sub-national institutions such as local or municipal PDBs, and provincial or state-level PDBs.
- **Regional**: including both continent-wide PDBs, and those focusing on a sub-region.
- **Global**: including institutions with a world-wide scope of operations.

Regional and global PDBs, owned by a group of countries, are known as multilateral development banks (MDBs). Examples include the African Development Bank or the World Bank Group (WBG), among others. Meanwhile, governments’ PDBs operating in developing countries are commonly known as development finance institutions (DFIs).\(^1\) These institutions are typically organized in different associations – for instance, the Association of Bilateral European Development Finance Institutions (EDFI), or the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP). Examples include the German’s DEG – a subsidiary of the German development bank KfW – or France’s PROPARCO – a subsidiary of the AFD. DFIs are dedicated to supporting private sector companies, public enterprises and services as well as municipal, state and national governments.

Over the last decade, PDBs have seen a resurgence, particularly given the important role they have played in providing countercyclical financing when private capital is in short supply. Although much of the emphasis has been placed on the role of the existing MDBs, national development banks (NDBs) are relevant players in

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\(^1\) Other authors, such as Macfarlane (2018), prefer the term ‘state investment bank’ (SIBs) to differentiate from ‘development finance institutions’. SIBs are active both in the developing and developed countries.
providing finance to sectors and regions that private financial institutions do not serve sufficiently. They were major players in the financial sector of many economies as they developed (for example, in Germany, India, Turkey and Brazil), and they continue to play an important role today, particularly in emerging countries.

A 2012 survey by the World Bank estimated that state-financed institutions accounted for “25% of total assets in banking systems around the world” (Luna-Martínez and Vicente 2012). More recent research by Marois (2019) indicates that, by 2017-18, national public banks plus multilateral banks numbered more than 700 institutions and controlled over US$40 trillion in assets. The figures have continued to grow, with new NDBs recently created in both developed and developing countries (World Bank Group 2018). The Development Bank of Nigeria started its operations in 2017 and the FinDev in Canada in 2018. In Ghana, conversations are currently ongoing to set up the Development Bank Ghana with the support of global and European institutions (Business Ghana 2020). In India, similar discussions are focused on setting up an NDB to finance both social and economic infrastructure projects (Indian Express 2020).

At the regional level, new multilateral institutions have also been recently established. In 2016, two new Southern-led institutions started their operations: the BRICS’ [Brazil, Russia, India, China and South Africa] New Development Bank and China-led Asian Infrastructure Investment Bank (AIIB). Although these institutions might replicate other multilateral banks, particularly in terms of portfolio, and environmental and social standards, their creation can be understood as a coordinated political response to the discontent of emerging countries with the lack of representation and the slow pace of governance reform, as well as frustration with the policy conditions and advice received from the World Bank (Horta 2019; Bond 2016; Barone and Spratt 2015; Schablitzki 2014).

In 2019, the European Union started discussions to rethink its
financial architecture for development. A High-Level Group of Wise Persons on the European financial architecture for development was created and developed options to create a new EU Development Bank (Wieser et al. 2019). This discussion is likely to continue in the coming years, now energized with the need for additional financing to support the recovery from the Covid-19 pandemic.

In recent years some global and the regional multilateral development banks have substantially increased their capital to expand their business operations, for instance, the Inter-American Development Bank (in 2012), the World Bank Group (in 2018) and the African Development Bank (in 2019), while others are currently in the process of discussing doing so (for example, a capital increase for the Islamic Development Bank is being considered) (Islamic Development Bank 2019). At the European level, the European Investment Bank (EIB) as the ‘EU Bank’ has also increased its role. The Juncker Plan – which aimed to promote growth and create jobs – was centred around the EIB, which in practice meant putting together a guarantee fund for the EIB.

**CHALLENGES FACING MOST PDBS**

PDBs are very diverse and not all PDBs succeed. They are institutions with different sizes, development objectives, business models, funding arrangements, financial performance and governance practices. While some have contributed positively to development outcomes, we have also seen that PDBs – the most scrutinised being the multilateral development banks – can have considerable negative development impacts. Moreover, the potential role of most PDBs is being skewed towards providing for private interests over and above the public interest.

The development model promoted by major MDBs has been at odds with delivering on their development mandate (Brunswijck 2019; ITUC 2020). In some cases, we have seen that PDBs’ policies
and operations result in major negative development impacts, including human rights and environmental impacts (see Eurodad 2010 and 2012, among others). There is limited evidence to support the financial and development additionality of DFIs’ interventions. For instance, research by Dreher et al (2019) points out that World Bank Group (WBG)’s International Finance Corporation lending tends to favour companies from major WBG shareholders. Compelling figures released by the Center for Global Development also indicate how marginal DFI operations are in terms of volumes and development impact (Kenny 2019). Concerns have also been raised in relation to the lack of transparency and poor accountability of DFIs’ operations (SOMO et al. 2015).

Before Covid-19, most discussions on development finance were focused on using public money and institutions to leverage private finance. The dominant policy paradigm has argued that public interventions are better used if directed to de-risk private finance and to create markets (World Bank Group et al. 2015). The WBG’s ‘Maximising Finance for Development’ approach is perhaps the best-known illustration of this drive (World Bank, N.D.). The objective has been to mobilize the trillions of dollars managed by private institutional investors to help finance the UN 2030 SDGs. ‘De-risking’ private finance is central to this approach and implies changing the investment climate and using financing instruments like guarantees, equities or public-private partnerships (PPPs) to underwrite private returns. As part of this, we have also seen an increased financialization of development lending, which implies the creation of financial products out of bundled loans, ostensibly to diversify risk, which can then be traded.

This private finance-led approach to close a so-called ‘financing gap’ has shown its limitations. Despite the rhetoric in support of an increased role of DFIs as development actors, recent figures have been a reality check to the highly anticipated leveraging potential of DFIs. In April 2019, research by Attridge and Engen (2019), from the Overseas Development Institute (ODI) revealed
that “each US$1 of MDB and DFI invested mobilises on average US$0.75 of private finance for developing countries, but this falls to US$0.37 for low income countries.” Existing evidence also refers to the geographical concentration – in favour of middle-income countries – of publicly-backed private finance, while DFIs face serious challenges to broaden their activities in the least-developed countries (Kenny et al. 2020a).

WHAT HAPPENS IN THE CONTEXT OF THE COVID-19 PANDEMIC?

The Covid-19 pandemic has resulted in highly volatile private capital (UNCTAD 2020b) and the disruption of global supply chains, with food and essential medical supplies suffering the most. The solution has focused on finding large-scale counter-cyclical funding to help maintain economic activity, and especially jobs. Equal if not more efforts in some cases have been focused on channeling money into the health sector, local authorities and national governments to help purchase the supplies needed and to support the health crisis. All this has increased the demand for support from DFIs and MDBs for public authorities and private sector companies in an unprecedented way. In some cases, this has led to the capitalization of DFIs (i.e. capital injection from governments, which in the case of donor governments can be reported as official development assistance).

DFIs and MDBs have been at the centre of the financial response to the crisis. From early March 2020 onwards, most DFIs and MDBs announced emergency packages to support the health, economic and social crises. Bilateral DFIs are strengthening their collaboration so they can share risk across their balance sheets and are sharing due-diligence processes and pipelines. A DFI Alliance, made up of 16 Organisation for Economic Co-operation and Development (OECD) DFIs, has agreed to work together to ensure a central role for DFIs post-Covid-19 (EDFI 2020a). They have also
joined the Response, Recovery and Resilience Investment Coalition (‘R3 Coalition’), which aims to link DFIs with impact investors and philanthropic networks (GIIN 2020). In the case of the WBG, the pandemic has pushed the World Bank to respond in a speedy way as developing countries’ demand for support saw a dramatic increase. Most resources were channelled through the WBG’s private sector arm – the International Finance Corporation (World Bank 2020).

However, some of the challenges presented above have not gone away with the crisis, and might even have been intensified (Coalition for Human Rights in Development 2020). On the one hand, DFIs’ business models seem unsuited to responding to crises, as they are not ready to take much risk in their operations. If they rely on private sources of capital – for instance, selling bonds in the private capital market – they are likely to be strongly influenced by those financing sources, as they need to make sure they maintain good scores from credit ratings agencies. This has an impact, for example, on their risk appetite and potentially on the sectors they might invest in. On the other hand, the speed of the response has led, in most cases, to a focus on existing clients – leaving little space to shift portfolios to where they are most needed or to sectors that are most strategic in a context of a sustainable and equitable recovery. It has also tended to bypass practices that ensure high standards in terms of accountability, and social and environmental impact (Oxfam International 2020; Bank Information Center 2020). Moreover, in the case of the WBG there has been a persistent prioritization of private over public interests, and there seems to be no prospect of any immediate re-orientation away from the ‘Maximizing Finance for Development’ approach. On the contrary, the current WBG stance, compounded by the limited fiscal space that developing countries will face in the post-Covid-19 context, might indicate that the WBG’s approach to development finance, with private finance at its core, will even be strengthened.
THE NEED TO RECLAIM PUBLIC DEVELOPMENT BANKS

The Covid-19 pandemic has led to calls to re-focus the state as an agent with the capacity to enact public policies and to direct finance toward the public interest. In June 2020, the World Bank estimated that the additional financing needs for developing countries arising from the crisis will be exceptionally high and is likely to persist over the medium term (WBG 2020). Pandemic-related external financing gaps for low-income countries could be in the range of US$25 billion to US$100 billion per year – assuming that incremental financing needs arising from the crisis are in the range of 2.5 to 10 per cent of Gross Domestic Product per year and that only half of these can be met internally. For middle-income countries, the equivalent range is US$150 billion to US$600 billion annually.

However, in the post Covid-19 context, it is imperative that the ‘right’ type of finance flows through the ‘right’ type of institutions (Chadwick 2020). The private commercial financial sector alone is unlikely to provide the finance needed to support the sustainable and equitable recovery that is so urgently needed. Before the pandemic, it was clear that private investors failed to provide stable and sufficient levels of long-term financing for sustainable infrastructure, making evident the need to provide and ensure climate finance (Griffith-Jones et al. 2020).

Tackling the crisis and paving the way for a sustainable and equitable recovery requires a strong public sector commitment at all levels. We are calling on all PDBs to step up their game and play a greater role in the development process to maximize development results for local people, including strengthening public health systems, delivering on the climate crisis and contributing to the fight against poverty and inequality.

While some have called for a greater role for Northern-led DFIs, with specific demands to rethink their business models as a result of getting increased capital, others have argued that national PDBs are
better placed to support essential public services and the local private sector (Griffith-Jones and te Velde 2020; EDFI 2020b; Chadwick 2020; Kenny et al. 2020b). We argue that, given the specific level of activity of different institutions, it is important to achieve greater coordination and better integration, in order to build complementarities and avoid unnecessary competition. A strong case can be made – under the principle of subsidiarity\(^2\) – for seeing national PDBs as the primary tools for implementing development plans. This includes support for health systems, sustainable infrastructure and the local private sector, among other key tasks. Regional and global PDBs can contribute by supporting these national institutions, where they exist, or helping to build them, if not. Importantly, this requires strengthening of the policies, procedures and governance system of NDBs and a substantive change in the way that most regional and global multilateral PDBs currently channel their finance (Kenny et al. 2020b).

By working through national public institutions – rather than private sector companies directly – national stakeholders, including national and local governments, as well as local public and private sector actors and workers’ cooperatives, are more likely to be empowered to drive their development path, and to hold PDBs to account (for more analysis on this discussion see Kring et al. 2019, Gallagher and Studart 2016, and Marois 2019).

In order to understand the potential of PDBs, it is worth detailing their five main functions:

- **To direct finance** – or provide it on better-than-market terms – to sectors or regions that are important for a national development plan, in line with human rights and an equitable transition.
- **To build the financial sector**, either by filling gaps in the supply of credit (lending to households or businesses that

\(^2\) For instance, at the European Union, the principle of subsidiarity is defined in Article 5 of the Treaty on European Union. It is the principle whereby the EU does not act (except in the areas that fall within its exclusive competence), unless it is more effective than action taken at national, regional or local level.
cannot access credit from commercial banks) or by helping to create demand (helping businesses or other customers to develop bankable projects). Particular attention has to be paid to equity considerations and to prevent further financialization of our economies.

- **To promote economic stability**, by playing a countercyclical role, to ensure a supply of credit when a financial or economic crisis causes the commercial financial sector to freeze.
- **To improve standards**, by insisting on, for example, human rights safeguards in the projects or institutions they finance.
- **To encourage innovation**, structural transformation and promote environmental sustainability.

If the institutions are to perform all of these functions to the highest standard, a holistic approach is essential to upgrade current policies and practices at all levels.

**A REFORM AGENDA FOR PUBLIC DEVELOPMENT BANKS**

The need for a greater role of PDBs calls for a discussion on the key characteristics of these institutions to deliver for the public good. How can PDBs be improved so they can realize their full potential to support sustainable and equitable development? What are the governance arrangements and mechanisms that would prevent the risks of over-reliance on private finance?

We suggest key features of PDBs should be developed around four main pillars. We present the rationale behind the pillars below, while the key features are summarized in Table 2.1.

**A. Mandate and role**

Mandate and role are derived from the explicit policy objective of the institution, linked to development outcomes, and in line with international commitments, which include the Sustainable Development Goals (SDGs), the Paris Agreement, international human rights law
and gender equality commitments. The mandate and role drive PDBs’ activities and clearly focus their investment decisions, such as clients and sectors to target. They also allow stakeholders, including civil society groups, to hold banks and management to account, particularly for the human rights and environmental outcomes of all their activities.

B. Operational strategy
The business model of a PDB drives the processes that enable the institution to fulfil its core mandate of financing development projects. It refers to how PDBs raise money, including identifying the right mix of public and private funding, and their investment methods, as both have an impact on the ability of the institution to deliver positive development outcomes. It also refers to the internal systems developed to focus, assess and monitor the outcomes of the operations.

C. Financial sustainability
The long-term financial sustainability of PDBs is key to delivering their development mandate in the longer term. This does not mean, however, maximizing commercial profitability. It means ensuring sufficient cost recovery and surplus to remain institutionally viable, while focusing on delivering development outcomes. The long-term financial sustainability of a PDB should not undermine its ability to invest in higher risk areas, or projects where development returns are high but profitability may be low.

D. Good governance
The governance of PDBs refers to who makes decisions, and how decision-makers are held accountable. It includes provisions to ensure insulation from undue political influence and corporate pressure, and to ensure democratic accountability. Accountability has to be understood in its broadest sense, which means downwards accountability (towards citizens and affected communities) and upwards accountability (towards national parliaments, governments and courts of auditors).
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<th>Core features &amp; key components</th>
<th>Explanation/Detail</th>
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<tr>
<td><strong>A: MANDATE AND ROLE</strong></td>
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<tr>
<td>i. Strong development mandate</td>
<td>The mandate of PDBs is to deliver sustainable development outcomes, in line with the agreed SDGs, avoiding vague or dual mandates. For instance, this means a focus on reducing poverty and inequalities, and encouraging domestic resource mobilization.</td>
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<td>ii. Targeting finance where it is needed most</td>
<td>PDBs target regions, sectors or clients that are most in need, or that have the highest development pay out, and not only a high level of return for the PDB. Special attention is given to initiatives and actions that do not to reinforce gender inequalities.</td>
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<td>iii. Responsible social and environmental standards</td>
<td>PDBs take responsibility for the social and environmental outcomes of all their activities, including human rights, labour rights, climate and gender impacts. The PDB aligns its policies and operations with the Paris Agreement and actively contributes to the fight against climate change, for instance, by pursing a truly carbon-free strategy. The PDB ensures that companies they work with, as clients or partners, do not avoid or evade taxes.</td>
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<td>iv. Responsible gender equality standards</td>
<td>The PDBs’ responsibility to gender equality and women's rights is embedded in a policy addressing gender and development. As a result, PDBs: promote gender equality and women's rights, where possible make its programmes and projects more gender-inclusive avoid gender bias and minimize gender-related vulnerabilities and risks</td>
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<td>v. Stable, long-term perspective</td>
<td>The focus of PDBs is on long-term, sustainable, predictable and counter-cyclical funding to help bolster financial stability and support the sustainable transformation process of national economies.</td>
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<td>vi. Support for national strategies</td>
<td>PDBs align their activities to democratically determined national plans, to ensure that they help improve the financial sector, steering these toward a more sustainable, just and long-term path.</td>
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### B: OPERATIONAL STRATEGY

| i. Right mix of public and private funding | PDBs receive some public funding, so they are not purely commercial institutions. |
| ii. Careful choice of methods of investing | PDBs invest in ways that ensure their development mandate takes precedence over generating financial returns. |
| iii. Internal systems to focus, assess and monitor operations | PDBs have the internal capacity to assess and systematically show the impacts of their policies and investment decisions (ex-ante and ex-post comprehensive impact assessments analysis are conducted regularly), and have effective human rights, environmental, gender-sensitive and fiscal due diligence procedures, accompanied by supervision and monitoring mechanisms. |

### C: FINANCIAL SUSTAINABILITY

| i. Prioritize development outcomes | PDBs ensure development outcomes take precedence over profitability. |
| ii. Reinvest any profits | PDBs reinvest any profits to support the development focus of their institution. |
| iii. Take care with public grants | Strong public accountability must be in place if PDB operations are subsidized by official development assistance beyond initial capital injections. |
| iv. Incentivize staff to deliver for the public good | PDBs draw on their development focus to recruit and motivate staff, explicitly avoiding the bloated salary and bonus culture of parts of the commercial financial sector. |
### D: GOOD GOVERNANCE

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<th>i. Equal borrower representation at multilateral PDBs</th>
<th>Multilateral PDBs have a governance structure that gives, as a minimum first step, equal voting power to borrowing countries.</th>
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<td>ii. Strong transparency policies, based on the right to information</td>
<td>PDBs have a strong and carefully implemented transparency policy based on: the right of access to information across stakeholders, including civil society organizations; automatic disclosure of information with limited exceptions; the right to request information across stakeholders, including civil society organizations; and public access to decision-making, across stakeholders including civil society organizations.</td>
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<td>iii. Active participation of civil society and bank employees</td>
<td>PDBs have open channels for the meaningful participation of civil society groups, including trade unions, feminist and women’s rights organizations, and bank employee unions, in their decision-making processes and in project design, implementation and monitoring.</td>
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<td>iv. Insulation from political and corporate pressure</td>
<td>PDBs have specific governance arrangements in place that protect them from undue political influence and corporate pressure that might be contrary to the bank’s mandated purpose. This will ensure that the public mission of the banks is not be diverted by both political and corporate considerations.</td>
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<td>v. Strong accountability systems</td>
<td>PDBs have well-implemented accountability systems, including independent evaluations; parliamentary scrutiny; meaningful participation of external stakeholders, including a broad range of civil society organizations; and effective and user-friendly independent complaints mechanisms. PDBs can be challenged in front of courts, as immunity of banks undermines their accountability.</td>
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CONCLUSION

The Covid-19 pandemic has confronted us with critical challenges. Public development banks are in a unique and powerful position to play a key role in the post Covid-19 recovery. They can – and should – play a very significant role in the development process as a whole to maximize development results for local people, including strengthening public health systems, delivering on the climate crisis and contributing to the fight against poverty and inequalities.

As this chapter shows, PDBs can direct finance to important sectors or regions, build and steer the financial sector into a more sustainable and equitable path, promote economic stability, improve standards – for example, through environmental, social or human rights safeguards – encourage structural transformation and promote environmental sustainability.

However, PDBs face considerable challenges when it comes to performing their roles, and some of them have been rightly questioned about the negative impacts of the development model promoted and their operations. Most of their challenges have not gone away with the Covid-19 pandemic, and some might even be intensified. Importantly, the potential role of most PDBs has been skewed toward private interests over and above the public interest. This has to change.

This chapter makes a strong case in support of pro-public and accountable institutions working at different levels in a complementary way. National development banks can be the primary tools to implement development plans, while regional and global PDBs can support these national institutions where they exist, or help to build them if they do not exist. This is not free of challenges either, but it would ensure a development path that is more rooted in national needs.

This chapter also presents key features that public development banks need to possess to maximize development results for the
most vulnerable members of society, including delivering on the climate crisis and contributing to the fight against inequalities, especially gender inequalities.

In the months and years to come, civil society organizations have the opportunity to actively contribute to the debate on the types of institutions needed to finance a sustainable and equitable recovery post Covid-19. The Finance in Common Summit taking place on 12 November 2020 will be just one opportunity to further advance this debate. The Summit is being organized by the World Federation of Development Finance Institutions and aims to bring together the whole development bank community along with other key stakeholders, such as governments and representatives from the private sector, civil society, think tanks and academia. We call on civil society and academics to reclaim public development banks and engage in a public debate on this matter.

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