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"Supranational banks have one big advantage over traditional ones." IIB First Deputy Chairperson Mr. JOZEF KOLLÁR speaks to HOSPODÁRSKÉ NOVINY

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Translated from Slovak.

MB: The world will need money after the pandemic. There is actually a lot of money and many sources of financing available, but some traditional commercial institutions may be replaced by alternative sources of financing like supranational institutions. That is why today we will be talking with the First Deputy Chairperson of International Investment Bank, Mr. Jozef Kollár, about financing options from other sources.

MB: Mr. Kollár, you are an experienced banker, and for many years, you were engaged in the Slovak banking sector in various important positions. Today you are here representing an international financial institution. International Investment Bank has a history dating back to the communist era, but its role has changed over the past few years. What has changed and how? We know from the media that the bank was relocated from Moscow to Budapest. Could you tell us something about why that happened?

JK: The truth is that International Investment Bank (IIB) is one of the oldest international development banks in the world, being established in 1970 based on an inter-governmental agreement. It is run by nine countries and the founding documents are archived at the UN Secretariat in New York.

Hence we have the status of an international development bank, a so-called multilateral development bank. This is the same status or business model as the European Investment Bank, IBRD, and others. The important thing is, as you have already said, that the Bank was established in the former socialist block. Then, after the enormous political changes in Europe and in the socialist block, the Bank was something of a sleeping beauty, doing basically nothing, until 2012. In 2012 there was a moment of transformation when a fundamental reform of the Bank was initiated, and today, less than nine years later, we can say that IIB is a modern international development institution with a three-level system of administration, of corporate governance. The Board of Governors is at the very top with representatives at the level of Ministers of finance of member states or Central Banks' Governors. Then there is the Board of Directors at the level of the directors, also representatives of each member state. And then at the bottom there is the Management Board, which I am a member of, and which runs the daily business of this institution.

The fundamental reforms brought the Bank to where it stands today, when we have an "A" level credit rating with stable outlook from all three leading international rating agencies—Moody's, Standard & Poor's, and Fitch. It is also true that in the last year we were the only international development bank whose rating was upgraded, while in the first half of this year all three international rating agencies reaffirmed our rating. And that was the key moment when the Bank became a modern institution with the same copy-and-paste business model as other institutions of this type around the world. In addition, the reform was carried out with technical support from the Washington – based World Bank.

And the last new development is that the Headquarters of the institution were relocated from Moscow to Budapest two years ago. The Russian Federation's share of the paid-in capital has been markedly decreasing since 2012. Originally, it stood at around 60%, today it is approximately 42%. On the other hand, we see the opposite trend—an increasing share of five European Union countries, or NATO member states, if you wish. Together, these five countries today hold 52% of the paid-in capital in the Bank. There is a Europeanization process going on inside this institution linked to this trend, meaning that basically no decision can be taken in the Bank today without the consent of the five European countries. In other words, these European countries have a blocking majority and can veto any decision. This is why today we say that it is no longer the Bank known in history books as the bank of the socialist block, it is rather a modern international development institution controlled by European countries, and at the same time the share of European countries in the Bank's loan portfolio exceedes 60%. The share of European countries in funding, i.e. the acquisition of long-term resources on the liabilities side of the balance sheet, has reached almost 70%. These are key parameters that clearly demonstrate, together with the ratings, Europe's share in the paid-in capital and loan portfolio and resources, that the reforms process is at its end, and now we have one modern development institution, a supranational one, the potential of which it would be a pity not to use during the economic recovery of countries, especially after the pandemic.

MB: What are the advantages, from your point of view, that you have over commercial banks? Or in general over supranational institutions known to have played a role in the historical context of changes but whose business activities in the last few years have focused on 'cherry picking', with international institutions often supporting the credit boom by buying bonds and mortgage securities? What particular services can you offer that traditional banks cannot?

JK: Today we are seeing the so-called rediscovered role of the international development banks in the overall system of global financial institutions mainly because we are witnessing, not only now during the pandemic or post-pandemic period because it has been the same for the past twenty years,on the one hand, concerning public investment, investments executed mainly by governments, that governments sooner or later reach limits and cannot keep increasing their indebtedness or increasing the public debt compared to the performance of their economies, to GDP. And we are already reaching this limit. We see that the public debt to GDP ratio in the Eurozone has already exceeded 100%. If I'm not mistaken, it is already 102% today. On the other hand, we have a system of private/commercial banks established for the purpose of maximizing their profit, which is legitimate in an open market economy. Yet their shareholders expect the maximization of their dividends. At the same time, the private sector—represented by private commercial banks—is also approaching its limits, which I would concisely define as an increasingly strong regulatory environment, with regulation becoming stricter year by year, I mean the regulatory framework for commercial banks. And here we come to the rediscovered role of the international, supranational development institutions to cover the gap on the market between public investment and the commercial sector.

As regards the question concerning the differences, or the services that can be offered by international development banks compared to public investors or the traditional commercial bank as investor, I see two big areas of difference. The first concerns the international development banks as so-called non-profit driven institutions. These were never established for the purpose of maximizing profit or maximizing dividends for their shareholders. That is why the Slovak Republic has not yet received a single euro in the form of dividends from the European Investment Bank, from the European Bank for Reconstruction and Development, or from the World Bank. These institutions operate on entirely different business models. The fact that we are a non-profit driven institution means that these development banks have a much higher risk appetite than traditional commercial banks.

This means that they can also invest into projects with much longer maturity periods. For example, today we have some loans with maturities of fifteen or twenty years. You won't find it easy to get financing for twenty years on the market today. At the same time, we are able to decrease the interest margin because our role is to cover OPEX and CAPEX, operating expenses and capital expenditures but not to maximize profit.

And last but not least, the Visegrad region and also the neighbouring countries, are gradually being abandoned or have already been abandoned by the traditional dinosaurs like the European Investment Bank, IBRD and others because they have already fulfilled their historical mission which was, twenty years ago, to boost or support economic convergence, to prepare the future European Union Member States for the level of economic development of the European Union. Since this goal has already been achieved, these institutions are gradually leaving this region.

We are a bank that can openly be called a boutique character bank, meaning that even with a relatively low volume of assets—our balance book has around EUR 1.7 billion today—we are able to quickly and flexibly react to the needs of the market. And thus our loan portfolio, especially after moving from Moscow to Budapest, after a paid-in capital majority was acquired by the five European countries, during these two years our loan book grew by 30%. Here we see the development effect by which the development banks, including our institution, contribute to the long-term sustainable growth of their own member countries.

Yet something even more important is the integration effect, where we invest into projects run in two or more of our member countries. And that is also a very vital moment, since traditional commercial banks rarely go beyond their borders. Thus, banks with their seat in Slovakia primarily focus on Slovak corporate debtors or projects based in Slovakia, and a Slovak bank only rarely finances a project in Budapest and vice versa, or a project in Prague. And because we are an over-arching institution of nine countries, over 30% of our loan portfolio measured by volume is comprised of such projects. Over 30% of our loans fall under this category of integration projects implemented on the territory of two or three member states. There are two typical examples, Schaeffler and Medicover. In Slovakia, Schaeffler has created several thousand jobs, therefore highlighting the huge development potential of International Investment Bank via contributing to job creation through investment.

MB: I understand the capital market financing through the issue of bonds. So, are you a bank that tries to take advantage of the interest rate mode or are you trying to issue bonds in Czech crowns because you have a certain interest deal in the Czech Republic? Because I expect that the main long-term source of money for your Bank is loans more than let's say business on the bonds market. You mentioned that the development of capital markets is one of the aims.

JK: The primary aim is to finance projects. To support competitiveness in economies and their mutual connectivity, as I mentioned before, integration projects implemented over multiple countries, etc.

MB: Does that mean you will now be active in the Czech Republic, in connection with the issue this year?

JK: 80% of our loans are denominated in euros and approximately 20% or maybe 30%, this changes every month due to the provision of new individual loans, and the balance—the 20% to 30% of other loans—are denominated in local currencies. This means we are also able to provide loans in Romanian lei, Hungarian forints,Czech crowns or in Russian roubles. Yet, we have to add that we are very sensitive to what is called an open currency position so we do not take on any exchange rate or foreign currency risks. We are so sensitive to this that our open currency position cannot exceed 1% of equity, the paid-in capital. We are a bank that on the one hand does not have any official financial supervisory authority, meaning an official authority that would oversee this institution. And it is the case for all supranational development banks. Maybe your viewers have not heard about banks such as the Nordic Investment Bank. Five northern countries joined together with some others to establish a bank to cover the gap in the market. There is also the Black Sea Trade and Development Bank, a bank established by the countries around the Black Sea. We have the Asian Development Bank, the Asian Investment Infrastructure Bank, AIIB.

MB: The current governor of the Japanese Central Bank was the former head of the Asian Development Bank.

JK: We have the New Development Bank, sometimes called the "bank of the BRICS countries", i.e. Brazil, Russia, India, China, South African Republic etc. In our case it is not an exception as it is the same for the whole group of international development banks, with the principle that they don't have an overarching supervisory authority to oversee them. But watch out! Our supervisor, the highest supervisory authority, are the rating agencies that can quickly assess the quality of our compliance, our internal regulation to prevent money laundering and our risk management systems. Our risk management system is absolutely fully compliant with all the regulations of the OECD, Basel II, and prudential business principles for banks. In certain cases, we are already implementing the Basel III rules, not only Basel II. Just as you have IFRS 9, these are the international rules of reporting etc. So, we walk hand in hand with all other banks concerning prudential business, which is good because at the end of the day this will impact the investment ratings, will manifest through lower borrowing prices, and then you can provide cheaper loans, which help the borrowers.

MB: What financing possibilities can you see for IIB in Slovakia? Which particular projects can you imagine being discussed in the near future? We know that we have on the table a recovery plan you already mentioned as being one of the reasons why international financial institutions such as your Bank see space for their activities. Could you tell us about the key projects concerning Slovakia in particular?

JK: Concerning our activities in Slovakia as of today, our current exposure in Slovakia is EUR 126 million. That figure is from 30 June, since we are talking about mid-year results. These EUR 126 million—if we compare this figure with Slovakia's share in the paid-in capital, which is EUR 24 million, and if we add to the EUR 126 million pipeline projects that will be approved within one year and the money for which has been approved—we are comparing approximately EUR 200 million to EUR 24 million. This means we are working with a leverage of 1:5. Even more clearly, every euro invested into the paid-in capital of the Bank brings 5.5 times more to the respective country, i.e. EUR 5 to 6, as financing for the projects we already mentioned. And we are not only talking about loans. Let's not forget about other areas such as trade finance, bills of credit, guarantees, over-the-counter securities and other instruments, some of them already among sub-balance sheet items. So altogether we are able to reach the EUR 200 million limit within a short time.

MB: And do you think this trend will continue?

JK: These are connected vessels. Every euro a country invests into our Bank brings five euros into the economy. Slovakia's share in the Bank's capital is about 6.5% today. So, for your viewers, the key number for reference here is 6.5%. Yet Slovakia's share of the Bank's loan portfolio is over 11%. You can already see it is double. So, for us it is an accelerator that is profitable, and it is also profitable because for example we are buying Slovak state bonds which again, accumulated since 2012 when the fundamental reform of the institution was initiated, have reached the sum of EUR 150 million. Then we have established the Technical Assistance Fund together with the Slovak Ministry of Finance and this also has a very important role, for example in financing market research and other assistance and consulting services in developing economies like Mongolia. Here, through the Technical Assistance Fund, we have financed the establishment of brand-new legislation to prevent money laundering in Mongolia. And I could provide more examples.

MB: Yet Mongolia is very far away.

JK: It is, but we are forgetting one thing. The whole of Asia—let's not speak only about Mongolia, let's talk about the whole Asian continent—the process there has already begun and will accelerate. Centres of economic power will be transferred more and more to these territories, whether you like it or not.

MB: The money to be provided through the recovery plan to European Union Member States will be partly in the form of grants, but there will also be loans, and these will contribute to the already high indebtedness of European Union countries. What do you think about that? What is the position of Slovakia concerning the macroeconomic balance? All the countries have been severely impacted by the pandemic, yet some harder than others. According to some reports, Slovakia is among the countries with the unfortunate reputation of a long-term debtor with one of the worst outlooks in the European Union. You are somebody involved in development programs and various pandemic-related programs aiming at supporting the economy. How can we get out of this situation?

JK: The New Generation or Recovery Plan is a vital instrument proposed by the European Commission, there are no doubts about that. On the one hand I welcome the fact that Slovakia was one of the first European Union Member States to approve its recovery plan. At a technical level it has been very well and efficiently prepared. Yet implementation will prove crucial.

I'm very happy to see that the Slovak Minister of finance has even added his signature to the common statement of the hawks, the countries of the north like Denmark, Sweden, Finland, etc. This means we are on the same side as the countries raising a warning finger and urging caution. It is not possible to relax the budgeting rules because that is the way to hell. On the other side of the spectrum there are the dove countries of the European south, like Portugal, Spain, Italy and Greece, which say… and I have had the worst nightmares over recent days as I've been reading their proposals for drafting the European budget, because they are proposing two basic things for the reform of the budgeting rules of the European Union. First, they are proposing that green investments should not be counted as public debt. And the second part, the second key reform suggestion, is to exempt the COVID-related debt—all measures related to the pandemic—from the public debt. Under the methodology of Eurostat etc, I don't want to go into great detail here.

Yet now I'm asking, and I think that everyone will understand, all households, corporations, and also the governments should understand and also those countries of the European south should understand, those countries that are proposing this nonsense, they should all understand that any debt generated anywhere throughout the world has a debtor but also a creditor. So not only the party borrowing the money, but also the party lending the money. And we cannot pretend that when European Union Member States generate unacceptable debts with regard to their economic performance, we cannot pretend that there is no creditor linked with the green debt. There is always one. You can delete this debt statistically, you can exempt it from the public debt, but you cannot delete the creditor—this party will be there waiting for their money. If not, we get into a situation that bankers and economists hate to hear of: bankruptcy, default. And the same holds for any debt which was and still is generated in order to solve the pandemic situation. We cannot pretend that an artificial intervention into the European Union budgeting rules reform will exempt this debt from the public debt. It is just a delusion with possibly fatal consequences.

MB: I wanted to ask one more general economic question. Governments, not only in Europe but around the world, had a significant impact on the course of the pandemic, mainly by providing a series of support programs. The result is high inflation causing central banks to increase interest rates, but these central banks were also part of the support and stimulation programs. There are quantitative release programs through which they inject liquidity into the market. They do everything they can to provide money to commercial banks so that the economy has enough fresh blood, as we say, enough money. And they should have modified their inflation targets prior to the rise in inflation so that they could temporarily tolerate it. What will be the consequences of this situation in the long term? You say that your Bank can provide money for twenty years into the future. What will happen to the world if we have higher long-term inflation but interest rates close to zero?

JK: This is not the first time such a situation has occurred. We first encountered a similar effect when the global financial crisis started in 2008-2009. At that time, the central banks injected into the economy firstly a great amount of money and secondly very cheap money. They flooded the world with money. With the help of these measures, they managed to overcome the emergency and lead the world out of that financial crisis. Now this situation is repeating itself but with one difference: at that time the initiator of the crisis was the financial sector, but now the initiator is the pandemic, infection, COVID, a health-related topic that caused a suppression of the economy. To some extent we can conclude that these measures will help the world overcome the crisis with less damage, with a lower number of unavoidable deaths etc. That is true. Yet one question that arises is when will judgment day come? The day of final judgment? As I said, one day the creditors will ask for their money back.

MB: I will ask you one last thing: Cryptocurrencies are currently a hit, and were exceptionally popular this year, at the beginning of this year. Do you think that the growth of these coins, such as Bitcoin, Ethereum etc. by 100% is a result of this mistrust that people and investors have for traditional currencies?

JK: Certainly, this is one of the reasons why some investors are leaving traditional currencies and I can even say are “fleeing” to cryptocurrencies. This might be one of the reasons. They do not trust the traditional currencies and the money-issuing monopoly of the central banks. This could be one of the reasons. I’m not a big fan of cryptocurrencies. I consider them something created in the digital world, something similar to virtual reality. I’m not a big fan of cryptocurrencies but there is freedom of choice. Everyone, not only big institutions but also normal people, can decide for themselves the form in which they want to hold their savings.

MB: What future do you forecast for the Slovak economy in the short-term and in the long-term if the characteristics of the macroeconomic balance remain unchanged?

JK: Here it will be good for all of us if we have some humility and modesty. I don’t have a crystal ball that can predict the future of the Slovak economy. I can only make two remarks.

First, the Slovak economy has not been an island for a long time, and probably will never be one again. We cannot pretend that we are a bridge between the east and the west, that we have a cheap and qualified work force, no. We are no longer an island and that means our destiny, whether we like it or not, also our economic destiny, is and will be even more closely linked to the world around us. We are an open economy. The performance of the Slovak economy depends on whether German and French car factories demand what we make or not. For the first time we are not an island and it does not depend entirely on us.

And the second remark is also very important. With all due humility and modesty, we should all accept the proposition that we should treat all finance prudently. Meaning we should be wary and very prudent, starting with family budgets through to corporate finance, where we act as employees and managers or shareholders, it does not matter, all the way to public finance, the public administration budget. Let’s behave very prudently at all these levels and consider every item of expenditure, every euro, four times over and think carefully about whether it is effective, whether it is socially desirable, whether it is in layman’s language value for money, for example. We talk about this or that instrument or unit a lot. More attention should be paid to the principle of value for money, and there should be more space to evaluate the expenditure side of public finance. This is why I welcome discussions on introducing an expenditure ceiling as soon as possible—it was already too late ten years ago. I remember that when I was the chair of budget in the European Parliament in 2010-2012, now almost ten years ago, we were already discussing the inevitability of introducing an expenditure ceiling. Yet one has still not been introduced. So here I wanted to demonstrate that we do not know the future, we do not have a crystal ball, but we know and can influence a responsible and prudent attitude towards finance, whether this is family finance, corporate finance or public finance. We have to act with great responsibility at all these levels.

MB: We will conclude today with this call for prudency in business, family, corporate and public finance. This has been an interview with Mr Jozef Kollár, First Deputy Chairperson of International Investment Bank. Thank you very much for taking part in this discussion.

JK: Thank you for the invitation.

MB: Have a great day.