Chapter 1
Public Development Finance and the Private Sector

Investing in the "business" of development-Donor approaches to engaging the private sector

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Introduction

The private sector has become the new donor darling. Over the past few years, members of the OECD-Development Assistance Committee (DAC) – the forum through which rich countries coordinate their aid efforts – have renewed their focus on economic growth and the private sector as driving forces behind development. At the international level, donors put their weight behind statements in support of the private sector at the United Nations Millennium Summit in 2010[1] and more recently at the 2011 Fourth High Level Forum on Aid Effectiveness (HLF4) held in Busan, Korea.[2] This shift has come in the context of fiscal austerity programs that are decreasing or freezing the resources allocated to aid budgets. With it, donors are emphasizing "cost effectiveness" and "value-for-money," seeking to leverage shrinking aid budgets through innovative financing mechanisms, private sector-inspired solutions and direct partnerships with private sector actors.

Despite these trends, donor policies for promoting economic growth and private sector strategies have received very little comparative assessment. This chapter seeks to address this gap with an initial mapping and exploratory assessment of bilateral donor strategies on the private sector and economic growth. It is based on an examination of publicly available OECD-DAC donor[3] policies reviewed between January and June of 2012, including websites, strategy papers, policy documents, and donor commitments at HLF4 and in other multilateral fora.

The research sought to identify emerging themes in donor policies around growth and the private sector by comparing and contrasting different elements of their approach. These elements include the structure of strategies in terms of their market vision and assumptions, rationale for poverty reduction, pillars, areas of focus, and budget size. The research also looked at how donors see the role of the state, private sector actors and other development actors in their strategies. Finally, it examined the extent to which donor strategies take into consideration development and financial additionality, international aid and development commitments as well as crosscutting issues such as sustainability, gender, human rights and corporate social responsibility. This chapter presents some of the findings of that research and its policy implications, and identifies future areas of research.

Donor strategies on the private sector: an overview

While donors may unanimously agree that growth is integral to development, and that the private sector has a key role to play in this, their approaches vary greatly in terms of what they target and how they approach implementation. Nevertheless, the private sector is commonly projected as a "*development actor*" and as a key enabler of development.

Policy frameworks for working with and through the private sector

Where donors have an explicit private sector strategy, they tend to take one of three approaches. Donors such as Denmark, Finland and Germany have specific strategies that define modalities for engagement or partnership with the private sector. Japan's private sector development work represents a second approach, one which targets the establishment of and support for the private sector in developing countries, by focusing on, for example, supporting local business. A third approach combines these two. Sweden and the United Kingdom (UK) have specific policy documents that outline how they will work with the private sector to deliver development cooperation across different thematic areas and how they will support private sector development in developing countries.

Some donors do not have a private sector strategy. Instead, they weave their private sector programming and engagement into their economic growth or trade and development strategies. Australia, Canada and New Zealand are examples – their thematic focus on sustainable economic growth interweaves private sector elements. Other donors include engagement with the private sector as part of their broader development strategy, often coupled by a webpage on the private sector (rather than an actual strategy per se). Austria and France take this approach. Finally, these approaches are not mutually exclusive: Belgium, for example, includes elements of private sector engagement in thematic priorities, on a dedicated webpage, and makes reference to the role of the private sector in their overall development strategy.

Supporting the private sector - how much and where?

It is very difficult to quantify how much support donors are actually providing for the private sector and economic growth strategies. There is a lack of public reporting on specific initiatives or on the larger strategies. Out of the donors examined, a handful publicly indicated how much funding they are devoting to the private sector and/or economic growth strategies. In 2011, Norway devoted roughly 14.5% of its aid budget to economic development and trade.[4] In 2010/11, CIDA disbursed Cdn$824 million or 22.9% of its aid budget on its growth strategy, again encompassing a whole range of sectors and sub-sectors.[5] Spain provides a complete breakdown of its economic growth spending based on the DAC Creditor Reporting System (CRS) sector coding, reporting just over €97.4 million for 2010.[6]

One of the key challenges for measuring donors' spending on the private sector and/or economic growth is that these figures depend on how donors define these areas of work. For example, Norway, Canada and Spain use different CRS codes in their reporting. While perhaps relevant to "economic development," Norway's inclusion of all activities coded multi-sector, budget support, and action relating to debt can similarly be questioned in terms of their focus on economic growth and the private sector.

Some figures exist on direct partnerships with the private sector although it is impossible to paint a comprehensive picture. Germany reports on all its partnerships with the private sector. For example, its PPP Facility, a special fund for development partnerships with the private sector, spent €190 million in the ten years between 1999 and 2009 for PPPs, leveraging[7] an additional €301 million in private sector resources.[8]

In short, it is difficult to make any accurate, meaningful and comparable assessment of the scale and scope of donor financial support either in the area of growth or the private sector.

Unpacking the strategies

3.1 Divergent logic and assumptions: where the private sector, growth and development meet

One of the striking features of our comparative analysis is the lack of coherence among the donors assessed, in particular on something on which they all clearly agree – that the private sector is key to development. Important areas of convergence and divergence become apparent as the various approaches among donors to growth and private sector are unpacked.

All donors see the private sector as the key driver or engine of growth and development. The private sector serves as the nexus between growth and development by nurturing new investments, contributing to self-regulating markets and producing market efficiencies, creating new and better jobs (leading to rising incomes for individuals), and generating new sources of domestic tax revenue (from which governments can dedicate more resources to social programs and reduce poverty). However, beyond this, donors' strategies for connecting the dots between growth, the private sector, development and poverty reduction fall within a very broad spectrum.

Some donors tend to see the end goal as partnering with the private sector. This will help harness declining aid resources and leverage alternative sources of development financing, as well as identify innovative private sector-managed solutions to development challenges, including the provision of goods and services to poorer populations (bottom of the pyramid approaches for example).[9]

Others see the end goal as growth, in which the private sector are a key conduit. In this case, the link between growth and poverty in developing countries is a direct one: a vibrant private sector contributes to growth, which in turn automatically contributes to poverty reduction.[10] Generally, however, most donors go a bit further. These donors see the private sector as a means to increase incomes (through job creation) and public revenues (through taxation) to deliver on social services. This is evident in both the overall rationale for some donor strategies[11] and/or in the pillars and activities in their strategies.[12] However, the extent to which donors explicitly target the quality of jobs created and enable governments to effectively collect taxes and deliver on social services varies considerably.

Similarly, there is also a difference among donors in terms of the extent to which they consider the distributional impacts of growth – that is, how the revenue from a thriving private sector will be shared with, and/or explicitly target, those living in poverty. Some donors recognize that patterns of growth matter. Germany, Finland and Japan highlight environmental considerations, *inter alia*, in their focus on patterns of growth while the European Union, Switzerland and USAID are concerned with who benefits from growth.

France and Belgium are outliers in comparison to their OECD-DAC counterparts and take a solidarity approach to growth. For France, the solidarity approach recognizes that "globalization means rethinking new pathways to growth" that are cognizant of mutual global interdependence and shared common destiny and seek to find pragmatic solutions to problems that transcend borders like inequality and global public goods.[13] For France this is defined by paying attention to "the quality of growth, its ability to create employment, its impact on welfare and the environment and its contribution to strengthening States", and to "[m]echanisms that reduce inequalities and protect the most vulnerable […] (pro-poor policies, risk reduction, redistributive fiscal policies)."[14] Belgium's social solidarity economy approach promotes autonomous, democratic and participatory management of social and economic associations and prioritizes people and work over capital when redistributing revenue.

While most donors recognize that patterns of growth matter, few seem to identify the corresponding challenge of strengthening government capacity to actively redistribute the benefits to those who are most marginalized by many economic activities that contribute to growth. Donors tend to focus on making markets equitable within countries, and growth shared among countries, rather than trying to directly reduce often growing inequalities in society. The former emphasizes making markets work for the poor, whereas the latter suggests a more proactive role for the state in addressing inequality. There are some exceptions. Denmark prioritizes income distribution and human rights in dialogues with governments receiving budget support, while France identifies the tripartite relationship between growth, poverty reduction and inequality – including a suite of policy tools for addressing these complexities.

Regardless of the different donor rationales to the growth, private sector and development nexus, the entry points for programming and partnership are often similar. For example, Germany, Sweden, Switzerland, the UK and the US all have as their entry point making markets more competitive, or making markets work better for the poor (both as producers and consumers), despite placing very different emphasis on critical issues, such as employment and decent work, ecological and social impacts, and human rights.

Tensions in roles of the state and the private sector in delivering development

In general, donor policies and strategies take an apolitical approach to growth, the private sector and development, which reflects a technocratic understanding of the state and which largely ignores ongoing debates with regard to the proactive role the state must play in development.

For some, contributing to a "stronger state" focuses only on the state's role in promoting an enabling environment for business through the right policy and regulatory mix. Other donors take a more nuanced perspective adding to this a role for the state in delivering social services. While most donors recognize the role of the state in ensuring access to social services, they differ in terms of the extent to which they see the private sector playing a role in this regard. Sweden, for example, states that it will not support a policy or program whereby people become reliant on the private sector for a right (for example, basic education) that the state has an obligation to fulfill.[15] On the other hand, while acknowledging that the state has a role to play in delivering social services, the UK explicitly supports improving the private provision of social services.

On the whole, donors rarely promote a more pro-active role for the state in development. This includes donor policies that fail to allow the policy space for countries to develop socio-economic approaches specific to their national context and that take into account the views of citizens. There is seldom space to consider heterodox models for development that have been successful in emerging economies. There is little if any sensitivity to balancing the 'right' policies (which tend to be whatever ideas are the hegemonic ones for the day) and the political space and necessary capacities for developing countries, including civil society, to determine their own policy mix.

A mix of intervention levels and modalities for engagement

Donors support the private sector at the macro, meso and micro levels. Macro level donor policies focus on creating a *business enabling environment*

– building the economic legal and regulatory foundations to ensure that the right conditions exist for the private sector to thrive (property rights, financial regulations, governance and sound public financial management). Meso level interventions are those that *"make markets work"* in ways that address market failures and imperfections, enhance competitiveness, and better integrate all actors into markets. These interventions include aid for trade, building value chains, provision of finance and transfer of technological innovations. Finally, micro level interventions – *investing in businesses and people* – entails building support services to enhance longer-term private sector development and growth. Examples include investments in businesses (technical and financial support to the private sector) and people (infrastructure development; health, education, vocational skills training, in particular for women, focused on generating a thriving workforce; and environmental sustainability).

Table 1 categorizes modalities of private sector engagement found at the macro, meso and micro levels. It only includes interventions that specifically focus on private sector actors, although other forms of intervention with the state or other development actors exist under each category (for example, interventions at the government level regarding regulatory reform would fall under "business enabling environment").

Donors' policies run the gamut of these interventions, with most doing at least one, and many doing all three.

Table 1 Examples of donor modalities for engaging the private sector at various intervention levels

Macro: Business Enabling Environment	• engagement with private sector as dialogue partner on national development planning (ex. Germany, Sweden, UK)
Meso: Making Markets Work	• competition or challenge funds to develop products and services that benefit the poor (ex. Australia, Austria, Germany, UK, Canada) • advance market commitments (ex. Canada, France, Italy, UK) • matching initiatives that couple firms in donor countries with businesses in developing countries (and sometime CSOs), often with a significant focus on development impact (ex. Denmark, Norway, The Netherlands, and Finland) • support for micro, small and medium size enterprises, including farmers, with a view to integrating them into global value chains (ex. Austria, Canada, Italy, New Zealand) • financing for firms in donor countries to invest in developing countries (ex. Denmark, Germany, Finland)
Micro: Investing in Businesses and People	• technical assistance to private sector enterprises in developing countries (New Zealand, Denmark, UK) • support for feasibility studies for pro-poor product or service development (ex. Austria, Germany)
Other	• support for national and international corporate social responsibility standards like the Global Compact or the Extractive Industries Transparency Initiative (ex. Denmark, Germany, Sweden, Canada) • support for multilaterals that work with or on the private sector (ex. Austria, UK) • Research on best practices for engaging the private sector (ex. UK) • Private contractors (ex. Australia, Sweden) • Public-Private Partnerships, including with CSOs (ex. Australia, Denmark, Germany, Sweden, UK and Canada)

Implementation considerations

It is essential to examine the extent to which donors are committed to financial and development additionality, support firms in developing countries versus their own companies, and make explicit reference to international norms, standards and principles, including aid effectiveness, in their policies and strategies.

Financial additionality refers to the extent to which aid funds target sectors and businesses that otherwise would not have funds available. Development additionality refers to the extent to which aid resources to and for the private sector work towards eradicating poverty and achieving other development goals, such as the Millennium Development Goals. Analysis of donor policies suggests that they do not ensure additionality across all areas of their work and engagement with the private sector. However, most have at least one initiative in their portfolio that includes financial and/or development additionality as criteria for partnership. A clear articulation of intended development and poverty reduction outcomes for example, is required for matching schemes that pair domestic companies with businesses in developing countries and innovation funds aimed at generating solutions to development challenges (see Table 1).

Donors are not always clear about which private sector (domestic or foreign) is best placed to contribute to growth and poverty reduction, and what this choice implies for other development actors. For example, challenge funds are open to most private sector actors, while matching initiatives benefit foreign and domestic firms. In general, donors see a role for their own domestic and international private sector actors in their strategies. Some donors include the promotion of their own commercial interests as an explicit part of their strategies.[18] Donors such as Austria, Finland and Norway see their own businesses as having the potential to make positive development impacts through linkages in developing countries. While many donors are supporting their own private sector, nearly all also include provisions for promoting the private sector in developing countries in their work, often using capacity building and financial services for small and medium sized enterprises as their entry points. Cognizant of the thin line that donors are starting to tread, in the OECD-DAC's most recent Peer Review, the OECD-DAC noted that Canada needs to ensure that development objectives and partner country ownership are paramount in the activities and programmes Canada supports with respect to private sector development.[19]

In terms of standards, only half of the OECD donors analyzed make reference to international norms and standards in their economic growth and/or private sector strategies. Table 2 below highlights the most commonly referenced norms and standards.

The extent to which donors' strategies and policies take into consideration key aid effectiveness principles set out in a series of High Level Forums in Paris (2005), Accra (2008) and Busan (2011) – ownership, alignment, harmonization, mutual accountability and results – varies. The majority of donors have a separate policy on aid effectiveness, and only a couple – Spain and New Zealand – make specific reference to Paris or Accra in their policies on the private sector. Many however, make implicit references to aid effectiveness principles, for example, by committing themselves to partnership, working with other donors and demand-driven assistance.

Table 2: Explicit mention of key international standards and principles as part of strategies

Donors[20]	UN Global Compact[21]	OECD Guidelines on Multinational Enterprises	International Labour Organization	UN Human Rights Conventions Declarations and/or Guiding Principles on Business and Human Rights
Australia				x[22]
Austria	x	x	x	x
Belgium				
Canada				
Denmark	x		x	x
EU		x[23]	x	
Finland	x	x	x	x
France			x	x
Germany	x	x		x
Ireland				
Italy				
Japan				
Korea				
Luxembourg				
The Netherlands	x	x	x	
New Zealand				
Norway	x	x	x	
Portugal				x[24]
Spain			x	
Sweden	x			x
Switzerland	x	x	x	
UK	x	x		

Conclusion

This scoping study has sought to unpack the logic, assumptions and implications of donor strategies and policies on the private sector and economic growth for development and for poverty eradication .

Currently it is very difficult to assess the scale of donor interventions with the private sector. In large part this is because 1) many forms of private sector engagement exist and 2) donors categorize and track their private sector interventions and partnerships differently. While most donors recognize that the benefits from growth need to be shared, this study shows that, at least at a policy level, most donors are not engaging fully on the critical structural questions relating to the roles of the state and the private sector in ensuring pro-poor development outcomes that tackle inequality. In addition, the study indicates that donors could be doing more to ensure financial and developmental additionality in their work and support for the private sector. Most donors promote their own private sector, with mixed provisions for supporting private sector actors in developing countries. Finally, only half of OECD donors make reference to important international standards on corporate social responsibility, aid effectiveness and human rights to guide the implementation of their policies and strategies with the private sector.

A number of implications arise from this provisional analysis:

1. Donors emphasize different priorities, entry points and roles for state and non-state actors, creating potential for inconsistent policy advice and technical assistance across donors, as well as fragmentation in their private sector programming;

2. Donors have not made across-the-board commitments to financial and developmental additionality which creates a risk of diverting aid funding from development to the promotion of commercial interests;

3. To the extent that donors are looking to the private sector both as a financial substitute for their waning aid budgets and as a political substitute for investing in effective institutions in developing countries, without a balance to this approach, donors run the risk of continuing to bring short term solutions to long term development challenges; and,

Relative to other development programming, many donors have not sufficiently incorporated their commitments to human rights, aid effectiveness principles and other international standards into their private sector strategies.

While this chapter provides a broad overview of some of the emerging themes and characteristics of the various bilateral donor policies and strategies, more research is needed on three key areas:

1. The scope of bilateral donor engagement with the private sector, an accurate measurement of the scale and historical trends of such private sector support (in particular relative to the rest of their aid budgets), and an assessment of the range of national-level actors beyond traditional bilateral donors (for example, development finance institutes and investment banks) that are engaging more substantively in development;

2. An assessment of how these donor policies are being implemented in practice, in particular from a financial and development additionality perspective; and,

3. The impact of these interventions on the ground.

Endnotes

1 Donor Committee for Enterprise Development (DCED) Member Agencies, Bilateral Donors' Statement in Support of Private Sector Partnerships for Development, 22 September 2010, New York, on-line: http://www.enterprise-development.org/page/partnerships

2 Fourth High Level Forum on Aid Effectiveness, Expanding and Enhancing Public and Private Co-operation for Broad-based, Inclusive and Sustainable Growth, December 1, 2011, Busan, December 1, 2011, on-line: http://www.oecd.org/dataoecd/25/36/49211825.pdf

3 These include: Australia, Austria, Belgium, Canada, Denmark, the European Union, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, The Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and the United States.

4 Norad, Norwegian Aid Statistics, 2012, online: http://www.norad.no/en/tools-and-publications/norwegian-aid-statistics. This figure includes the following sub-sectors: transport and

storage; communications; banking and financial services; business and other services; agriculture; fishing; industry; mineral resources / mining; construction; trade policy and regulations; tourism; other multi-sector; general budget support; developmental food aid / food security assistance; and action relating to debt.

5 Figures from Government of Canada, Report to Parliament on The Government of Canada's Official Development Assistance – 2010-11, 2011, p.5. CIDA's sustainable economic growth strategy includes the DAC CRS codes related to public economic management, trade policy and regulation, economic infrastructure, environment and natural resources, business development and industry, financial sector development, skills development and elements of urban and rural development.

6 Ministerio de Asuntos Exteriores y de cooperación (AECID), Sector crecimiento económico para la reucción de la pobreza, 2011, pp. 4-6, on-line : http://www.aecid.es/galerias/que-hacemos/descargas/AF_FICHAS_CRECIMIENTO_ECO.pdf.

7 In a study of six bilateral donors, the World Bank's International Finance Corporation, the European Investment Bank and six bilateral donors (not including Germany), Eurodad found that there is a growing trend among donors to identify projects through which they are able to leverage the most resources while giving only secondary consideration to the development impacts. Kwakkenbos, Jeroen, Private Profit for Public Good? Can investing aid in private companies deliver for the poor?, European Network on Debt and Development (EURODAD), Brussels, May 2012, on-line: http://eurodad.org/wp-content/uploads/2012/05/Private-Profit-for-Public-Good.pdf

8 BMZ (Federal Ministry for Economic Cooperation and Development [Germany]), Development partnerships with the private sector. Annual Report 2009. 2010, Bonn, p. 7, on-line: http://www.bmz.de/en/publications/type_of_publication/information_flyer/information_brochures/Materialie201_Information_Broschure_02_2010.pdf. It should be noted that in the context of Germany's annual ODA of $12 billion in 2011 alone, both these figures represent a very modest figure, in particular given it is over the past 10 years.

9 This approach is particularly present in the private sector engagement policies of donors such as the Netherlands, Finland, Germany, Japan, Sweden, and the UK.

10 Examples include Austria, Germany, Netherlands, UK, and Sweden.

11 Australia, Austria, Canada, European Commission, France, Japan, Spain, Switzerland, US.

12 This includes Canada, Denmark, Switzerland, UK.

13 MAEE, Ministère des Affaires Etrangères et Européenne, 2011. Development Cooperation: A French Vision – Strategy 2011. Directorate General of Global Affairs, Development and Partnerships. P. 10.

14 MAEE, p. 14

15 Swedish International Development Agency, Business for Development: Programme for Sida's cooperation with the business sector 2010-2012, 2011, Sweden, on-line: http://www.sida.se/Global/12691_Business_for_Development_memorandum_C4.pdf .

16 Meant to harness private sector expertise and innovation to develop solutions to development challenges. Examples include Australia's Enterprise Challenge Fund (http://www.enterprisechallengefund.org/) and the UK's Construction Ideas Fund (http://www.dfid.gov.uk/Work-with-us/Funding-opportunities/Business/Construction-Ideas-Fund/) .

17 Donors seek to match their domestic business with business in developing countries. Extent to which these include explicit development additionality criteria varies. Danida Business Partnerships are one example (http://um.dk/en/danida-en/activities/business/partnerships/).

18 Austria, Finland, Germany, Norway, UK and the Netherlands.

19 Organization for Economic Co-operation and Development (OECD), Canada - Development Assistance Committee (DAC) PEER REVIEW, 2012, Paris, p. 11, on-line: http://www.oecd.org/development/peerreviewsofdacmembers/canadapeerreview2012.pdf.

20 Greece has been excluded as the next iteration of their five year plan is currently underway and there is insufficient information available online to assess their private sector policies and programming.

21 The Global Compact is a UN initiative that encourages business to align their operations and strategies around a set of ten principles related to human rights, labour, environment and anti-corruption with a view to helping to ensure that the activities of companies contribute to the well being of economies and societies and to the realization of the Millennium Development Goals.

22 Refers to "rights" in general sense.

23 Refers to OECD Guidelines broadly.

24 Refers to "rights" in general sense.

Private profit for public good? Can investing in private companies deliver for the poor?

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Summary[1]

Donor governments and multilateral institutions have provided grants and loans to private companies operating in developing countries for decades. However, since the 1990s the scale of this support has increased dramatically.

In 2010 external investments to the private sector by international financial institutions (IFIs) exceeded US$40 billion. By 2015, the amount flowing to the private sector is expected to exceed US$100 billion – making up almost one third of external public finance to developing countries. As global Official Development Assistance (ODA) stagnates, several aid agencies have suggested a dramatic scaling up of public finance devoted to supporting private sector investments.

Development finance institutions (DFIs) can play a crucial role in the fight against poverty by providing much needed financial resources to areas of the world that have access to none. However, based on analysis of recent grant and loan trends, and the portfolios of some of the largest multilateral and bilateral development agencies providing this development support,[2] there is ample evidence showing that DFIs are focusing on projects where they can leverage large returns on investment and reduce their development impact to a secondary motivation.

Introduction

Box 1 How do DFIs aim to reach small companies? The key players

Increasingly, the majority of DFI and IFI funds for private sector investment in developing countries are channelled through financial institutions that operate as intermediaries, or as 'middlemen', between the development agency and the final beneficiary. Hence the process is often referred to as 'intermediated finance'.

Among others, these financial intermediaries (FIs) can be:

- commercial banks
- hedge funds
- private equity funds
- credit unions
- microfinance institutions.

The rationale for engaging with FIs in this way is that by doing so FIs reduce transaction costs and, as the DFI or IFI has no retail outlets, this is the only way in which they can engage directly with micro, small and medium enterprises.

1 This chapter is a summary of a longer Eurodad report, "Private profit for public good? Can investing in private companies deliver for the poor?", by Jeroen Kwakkenbos, May 2012, accessible at http://eurodad.org/wp-content/uploads/2012/05/Private_profit_report_eng-VF5.pdf.

2 The World Bank's International Finance Corporation, the external lending of the European Investment Bank and six bilateral DFIs from Belgium, Denmark, the Netherlands, Norway, Spain and Sweden.

Public development finance can play crucial roles in providing funds to credit constrained companies, unleashing the potential of a thriving private sector that in turn creates decent jobs, pays a fair share of taxation to the government, and provides goods and services to citizens. However, it is fundamental that public finance is channelled to the companies and sectors that have least access to private capital markets, hence ensuring that scarce public resources are genuinely additional to private finance. These resources must also be channelled to firms and sectors that can deliver the best outcomes for the poor, thus ensuring that public development monies are used for intended purposes.

ODA flows to the private sector have been growing rapidly in recent years, though they remain a small proportion of the total. Belgium and Sweden are examples of striking cases, where aid channelled to the private sector has increased by four and seven times respectively since 2006. Previous Eurodad research has revealed that the majority of aid flows through the private sector in the form of procurement contracts for goods and services, and that the vast majority of this goes to rich country firms. The use of aid for private sector investments may also detract from much-needed public sector investments, which still face huge financing gaps.

During the economic and financial crisis, DFIs have seen their balance sheets increase dramatically. Between 2006 and 2010 the DFIs assessed by Eurodad increased their portfolios by 190%. Sovereign guarantees and preferred creditor status protect their investments whereby no other financial institution can compete. At the same time, the drying up of credit markets has allowed DFI expansion, including into new areas, such as trade finance.

DFIs providing support to private investments in the South have followed market-driven patterns regarding the sectors and type of companies that they finance. In the period 2006-2010 there has been a dramatic increase in lending and investments to the financial sector. Commercial banks are by far the largest recipients of IFI and DFI funds amongst financial intermediaries, although private equity funds are quickly becoming a favoured vehicle.

One of the main arguments provided by IFIs and DFIs to justify this massive shift to the finance sector is their willingness to scale up funding for small businesses. However, besides general statements of intent, it is almost impossible for external stakeholders to actually track whether DFI and IFI lending and investments reached the intended beneficiaries. Commercial banks, private equity funds and other financial intermediaries do not provide disaggregated data on which projects and companies they support and what development impacts are achieved. The DFIs themselves claim that providing this type of information is not possible due to commercial sensitivity and the fact that money is fungible and public and private funds are mixed once invested in private financial institutions.

More of this kind of development business in the pipeline…

As global ODA stagnates, policy reviews in several aid agencies, including the European Commission, suggest a dramatic scaling up of public finance devoted to supporting private sector investments.

While many DFIs were originally conceived to protect European countries' interests in their colonies or former colonies, their more recent mandates focus on engaging in high risk investments in areas that have limited access to capital markets. Some, such as Denmark's

Box 2 Key figures – who's winning the private sector development game?

- In 2010 IFIs' external investments to the private sector exceeded US$40 billion. By 2015, the amount flowing to the private sector is expected to exceed US$100 billion – i.e., an amount that is almost one-third of external public finance to developing countries.
- In 2010, on average over 50% of public finance flowing from DFIs to the private sector went to the financial sector.
- In 2010 lending and investments in the financial sector by DFIs and IFIs had increased, on average, more than two fold compared to pre-crisis levels.
- Only 25% of all companies supported by the European Investment Bank and the World Bank's International Finance Corporation were domiciled in low-income countries. Almost half goes to support companies based in OECD countries and tax havens.
- Around 40% of the beneficiary companies identified in the sample group of companies are large organisations listed in some of the world's biggest stock exchanges.

IFU, are tied directly to national commercial interests. Others, such as the World Bank IFC and the German DEG, are not. The DFIs tied to national interest require any project in the south to be sponsored by a company based within their country.

Though overall the majority of DFI lending flows to middle-income countries, DFIs have also expanded into poorer countries. The IFC's committed portfolio in low-income IDA countries has increased nearly fourfold between 2000 and 2010, from €843 million to €3.1 billion. The Dutch DFI, FMO, has almost doubled its investments to low-income countries from €1.7 billion in 2006 to €3.2 billion in 2010, and the Belgian DFI BIO has more than trebled, from €30 million to €100 million.

Considering their success in accessing difficult financial markets and their focus on generating a return on investments, governments might be tempted to regard DFIs as a new model for development finance. This would provide a convenient justification for government failures to deliver on ODA pledges.

Moreover, development debates are increasingly portraying the private sector as a more efficient vehicle for delivering tangible development results, without increasing the burden on public treasuries. However, the private sector is not a monolithic entity, and different firms and sectors can have very different development results. There remains a substantial need for direct public investment, including in basic services.

Why this approach to development is failing

Measuring development impact is difficult.

There is currently no harmonised approach amongst the DFIs for measuring development impact. One of the greatest difficulties in evaluating DFI projects and investments is that development impact assessments tend to begin once the key decisions on with whom, how and where investments will be made, are already determined. This suggests that the additionality of projects for development is assessed as a secondary aspect of project selection. If the methodology for monitoring and evaluating development impact is not included at the project selection stage, it is unclear how the project will have an effect on development priorities.

Responsible finance guidelines insufficient.

The majority of DFIs are signatories to international investment agreements such as the Equator Principles, the UNPRI, or other responsible financing frameworks. These guidelines, that include IFC performance standards and other such commitments, are insufficient[3]. They tend to be ambiguous, general and often quite weak. Particular concerns arise over whether DFIs are operationalising aid effectiveness principles and poverty eradication into their project selection.

'Leverage' – poorly defined and problematic.

One of the latest arguments DFIs and aid agencies use to justify their investments is that they can *leverage* significantly more finance into their projects than development institutions could ever mobilise operating alone. DFIs, IFIs and aid agencies have introduced confusion into the issue by applying the term in a lax and confusing fashion.

The concept of leverage, as currently defined, has though a number of critical shortcomings, including:

- Additionality cannot be assumed just because public institutions are co-investors with private funds.
- The greater the leverage ratio, the smaller the overall contribution of the public body, and the lower its influence in design and implementation of the investment.
- Using public resources to try to leverage private sector investment means those resources cannot be used elsewhere.
- Leveraged finance increases debt – it is lending to companies, usually at market rates, that must be repaid. This may mean borrowers are more directly connected to global financial markets and thus will be more exposed to exogenous shocks and speculative capital flows.

Limited local knowledge of the developing world.

Foreign financial institutions, the recipients of growing volumes of development finance from DFIs, often have limited local knowledge in comparison to locally based organisations, challenging their ability to reach the most credit-constrained companies in recipient countries. As the Dutch DFI FMO has acknowledged, in 2010 in Africa "margins remained under pressure as supply of liquidity from Development Finance Institutions (DFIs) outstripped demand".

Keeping development funds close to home.

DFIs find it difficult to resist the temptation of supporting companies domiciled in donor countries rather than in developing countries. This is of particular concern given that: most credit-constrained companies without access to financial markets – the supposed target of DFI funds – are not in donor countries but in developing

3 For the equator principles please ref er to: http://www.equator-principles.com/index.php/about-ep/the-eps
For the IFC performance standards please refer to: http://www1.ifc.org/wps/wcm/connect/115482804a0255db96fbffd1a5d13d27/PS_English_2012_Full-Document.pdf?MOD=AJPERES

countries; most jobs in these countries are created by domestic small and medium enterprises; and multinational corporations are likely to be responsible for the largest amount of tax evasion.

Most EIB and IFC support still goes to companies in rich countries ... and in tax havens

Research conducted in 2010 by Eurodad revealed that the lion's share of the World Bank's International Finance Corporation's (IFC) investments, 63%, went to OECD-based companies. Of the European Investment Bank's (EIB) projects where beneficial ownership could be traced in this new sample, 35% (€1.5 billion) went to companies based in the OECD. The fact that a large portion of investments made by the EIB and the IFC end up supporting firms headquartered in developed countries raises serious questions about the financial and development additionality that these investments provide.

A number of these OECD countries are well established to be tax havens or secrecy jurisdictions – 25% of EIB investments have a beneficial owner based in a secrecy jurisdiction. This is particularly worrying as an estimated USD 1 trillion dollars in illicit financial flows yearly exits developing countries. These flows are essentially money lost by developing countries as they are untaxed and provide no social or distributive element for the developing country.

This brings into question the ability of the EIB and IFC to engage as development institutions and their contributions to poverty eradication and real development impact. In order to demonstrate that they have clear development impacts, they must ensure that the majority of their investments have clear development and financial additionality.

Recommendations for DFIs

Box 3 Alarm bells ringing, within the DFIs themselves

Given all these weaknesses – and failings – of intermediated finance, it is perhaps not surprising that a May 2011 report of the World Bank Independent Evaluation Group (IEG), *Assessing IFC's Poverty Focus and Results,* found that less than half of the IFC projects reviewed were designed to deliver development outcomes, and just one third of the projects addressed market failures, such as enhancing access to markets or employment of the poor.

The IEG report rang serious alarm bells on whether donor governments are breaching their contract with taxpayers, as DFIs and development agencies are mandated to deliver poverty eradication and sustainable development as defined by the Millennium Development Goals, aid effectiveness principles and internationally agreed development goals.

The growing conception that development impact and return from investment are two-sides of a highly beneficial coin, which DFIs can readily deliver, makes it likely that the upward trend in public financial flows to the private sector via these agencies is likely to increase significantly in the coming years.

This model, though, comes with some very clear challenges, and in order for such investing in the private sector to become a truly developmental tool, Eurodad has the following recommendations for DFIs.[4]

[4] To encourage these institutions to raise their game, Eurodad has put together a "Responsible Finance Charter", which provides a comprehensive guide to engaging in responsible finance. It can be found at http://eurodad.org/4562/

- Align to developing countries' investment priorities.
- Make development outcomes the overriding criteria for project selection and evaluation, including by developing clear outcome indicators, and complying with high responsible investment standards.
- Target domestic companies as a preferred option whenever possible, including by ensuring that by 2015 at least 50% of companies receiving financing are domiciled within the developing country where they are active.
- Prevent tax dodging, and observe high corporate social responsibility standards, including by requesting country by country reporting.
- Improve transparency of financial intermediary investments and review their use.
- Set higher standards for transparency.

Aid for the Latin America Investment Facility: Clarity on private sector and focus towards SMEs needed

Toni Sandell, APRODEV
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Introduction: the focus on private sector

The private sector and its role in development has become in recent years a central political discussion in the European Union (EU). This is due to a change in the political environment in Europe as well as the prospect of shrinking aid flows. There is also an increasing recognition from donors that the private sector indeed plays a fundamental role in economic growth, innovation and job creation, providing tax income to poor governments as well as offering services and goods for the citizens.

The increasing role of financing to the private sector is shown also in numbers: by 2015, the amount flowing to the private sector from the International Financial Institutions (IFIs) is expected to increase from US$40 billion in 2010 to US$100 billion.[1]

Besides the IFIs, bilateral donors and the EU are more and more interested in collaborating with the private sector. The European Commission (EC) and some EU member states, such as Sweden and Netherlands, already direct significant amounts of Official Development Assistance (ODA) funds to the private sector by way of different "aid for trade" and other initiatives.

The private sector is also heavily involved in ODA through procurement processes: according to Eurodad calculations, more than 50 percent of ODA is spent on procuring goods and services from private firms for development projects, amounting to a rough estimate of US$69 billion annually. Eurodad also points out that approximately two-thirds of untied aid is still awarded to firms from OECD countries, and 60% of in-country aid resources in developing countries also go to firms from the donor country.[2]

Nevertheless, the EU still strives to find new ways to bring the private sector to the centre of its development strategies. The EC, in its 2011 policy document, "Increasing the impact of EU development policy: Agenda for Change",[3] identifies a three-fold strategy for supporting the private sector: (1) Support to a Small and Medium Enterprise (SME) business environment by supporting capacity building and legal frameworks, access to business and financial

1 *Private profit for private good?* Eurodad 2012.

2 *How to spend it. Smart procurement for more effective aid.* Eurodad 2011.

3 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "Increasing the impact of EU Development Policy: an Agenda for Change". Brussels, 13.10.2011 COM(2011)637 final

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services as well as promoting agricultural, industrial and innovation policies; (2) Support to regional integration, especially through Free Trade Agreements; and (3) Offer incentives for the private sector to fund and implement development projects, especially infrastructure initiatives. According to the EC, "crucial to developing countries' success is attracting and retaining substantial private domestic and foreign investment and improving infrastructure."[4]

It is in this context that so called "blending mechanisms" or investment facilities, which mix aid with loans from the International Financial Institutions (especially for large infrastructure projects) have become the EC flagship of innovative financing for the private sector.[5]

At the same time the European Commission recognises that these facilities are still in the making and that the EC is "learning by doing". This provides an opportunity to have a thorough debate on benefits and limitations of these blended investment and aid modalities.

Blended Investment Facilities: The logic of the Latin American Investment Facility (LAIF)

The new investment facilities mix non-refundable grants from the EC with loans from multilateral or bilateral European Development Finance Institutions (DFIs) and Regional Latin American Banks. A first facility was created for the neighbouring countries of the European Union in 2007 and the EC is planning to cover all the regions in the world with such facilities.[6]

As such, mixing grants with loans within a same project is nothing new. The European Investment Bank (EIB) and the German Development Bank (KfW) for example for years have already had access to their own grant resources, which they have used together with loans for infrastructure and other development initiatives. During the last decade the EC has worked hand-in-hand with the EIB and regional banks in Latin America, by offering parallel co-financing for infrastructure projects.[7] An innovation of so-called Loan and Grant Blending Facilities (LGBFs) is the inclusion of grants as an integral part of one joint investment.

In interviews carried out in Brussels during May 2012, EC officials expressed enthusiasm for Loan and Grant Blending Facilities (LGBFs) for the following reasons: (1) The economic leverage that is being achieved: with a small European taxpayers grant contribution, a very large loan-based investment is realized (up to 30 to 40 times the value of the grant); (2) The visibility this mechanism gives to Europe (difficult to reach with other, non-EU initiated mechanisms

4 Communication from the Commission, Ibid. Page 8.

5 On Blending Mechanisms, see for example: European Think-Tanks Group (2011). EU Blending Mechanisms: Implications for Future Governance Options.

6 Since 2007, eight Loan and Grant Blending Facilities (LGBFs) have been launched: the Infrastructure Trust Fund (ITF) in Africa (2007), the Neighborhood Investment Facility (NIF) for countries under the EU Neighborhood Policy (2008), the Western Balkans Investment Framework (WBIF, 2009), the Latin America Investment Facility (LAIF, 2010), the Investment Facility for Central Asia (IFCA, 2010), the Asia Investment Facility (2011), the Caribbean Investment Facility and the Investment Facility for the Pacific (2012).

7 The EU has been co-funding with EIB and regional Financial Institutions projects such as the "Transportation corridor Santa Cruz Puerto Suarez", providing a first non-refundable investment of €38.17 million, and a complementary sum of €18.89 million. Among these projects, it is also worth noting the gas pipeline Bolivia-Brazil, the largest joint investment in Latin America, crossing the ecosystems of the Gran Chaco, Pantanal and the Atlantic rainforest in the southwest of Brazil. See Hernández, Gustavo. The Chronicle of a Death Foretold. The bioceanic transportation corridor Santa Cruz - Puerto Suarez in Bolivia and its socio-environmental impacts. CLAES, 2008.

such as Trust Funds of the World Bank); and (3) The dialogue and improved coordination that this mechanism enables between the financial institutions, governments and the private sector.

The Latin American Investment Facility (LAIF) is financed with funds from the Development Cooperation Instrument (DCI) of the EU, which has an explicit poverty reduction focus. The LAIF aims to contribute to achieve the objectives of the DCI Regulation and the Regional Strategy for Latin America (by addressing the newly identified challenges such as climate change and its impact on the environment). The EC also justifies the LAIF with the view that pool investments support *inter-connectivity* in the region and advances regional integration.[8]

In practice, the LAIF focuses on energy, environment and transport investments. These priority sectors for developing infrastructure coincide with the sectors in which the EU has high geopolitical and economic interests. The EC also plans to support social infrastructure and SMEs with this mechanism. The expected results of the LAIF consequently relate to better transport and energy infrastructure, increased protection of the environment, improved social services and infrastructure, and strengthen growth for SMEs. The primary beneficiaries for the EC will be Latin American countries and their private sector, in particular the SMEs.[9]

The EU justifies the focus on infrastructure arguing that the Latin American countries have large problems in finding investment capital for improving infrastructure, which is key for technological development and improving competitiveness in the global markets. This in turn might lead to faster growth and reduction of poverty. On their side, Latin American governments also highlight the private sector orientation, access to European investors, and the importance of European investors´ role in support of EU foreign direct investments in the region.

Aid architecture in flux: what will be (un)done

The funding for LAIF for the period 2009-2013 is relatively modest (€125 million) but the EC has announced "a higher share of aid to be delivered trough such innovative financial tools".[10] As aid flows are reducing, utilising donor funds for blending mechanisms means reduction of aid for other purposes. In December 2011 the EC proposed country cuts and new priorities for aid to Latin America as part of its proposal for the Development Cooperation Instrument (DCI) for 2014-2020. Accordingly the DCI will end bilateral development cooperation in upper middle-income countries, as well as countries whose GDP exceeds 1% of the world's GDP (India and Indonesia). Out of 19 countries proposed to cut, 11 are in Latin America.[11]

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8 http://eeas.europa.eu/la/docs/com09_495_en.pdf.

9 http://ec.europa.eu/europeaid/where/latin-america/regional-cooperation/laif/documents/laif-action-fiche-2009.pdf

10 http://trade.ec.europa.eu/doclib/docs/2012/january/tradoc_148992.EN.pdf

11 The DCI proposal reflects the priorities set out by the EC on 13 October 2011 in its strategic document: *Increasing the impact of EU development policy: An agenda for Change*. This policy document proposes cutting aid from middle-income countries as well as focusing aid on two broad priorities - governance and inclusive and sustainable growth - and no more than three sectors at country level. The EC urges also the member states to implement this agenda.

EU country-level cooperation would continue only with Bolivia, Cuba, El Salvador, Guatemala, Honduras, Nicaragua and Paraguay. But all countries of Latin America would remain eligible for regional programmes, such as the LAIF, the two thematic programmes of the DCI (public goods and civil society organisations/local authorities), and the EU horizontal instruments (Instrument for Stability, Instrument for Democracy and Human Rights and the New Partnership Instrument). Thematically, the DCI proposes more private sector cooperation and new modalities, by mixing loans and grants.

This means that the LAIF will probably be the single most important cooperation modality for those Latin American countries that will not receive country-level aid from the EU. Considering that Latin America is still the most unequal continent in the world, and that every third person (around 180 million people) still lives in poverty, this leads to the following intriguing question: is this modality the most suitable one to tackle the *problem of inequality* in the region?[12]

Supporting the private sector through the LAIF: which private sector is benefiting?

As of June 2011, eight projects had been approved to receive funding from the LAIF. Of these projects, five are regional or country projects in Central America, and three cover all of Latin America. Three projects are related to renewable energy production, two to enable access to international climate financing, and three are building transportation infrastructure.

The EC argues that blended aid through the LAIF can both support public or private investments. In this context, it is important to clarify that ´the private sector´ comprises a wide array of formal and informal economic entities, from large international and transnational corporations, to state enterprises, domestic companies, micro, small, and medium-sized enterprises (MSMEs), and a range of social enterprises. Thus, an important question is which private sector is being supported with blending mechanisms in the region.

Indeed, Latin American MSMEs are key for development. For example, CEPAL has pointed the productivity gap that exists between big companies and SMEs (which are the main source of jobs both in the context of Europe and Latin America). Especially in Latin America, SMEs have very restricted access to the capital that they require to grow and expand, with nearly half of SMEs in developing countries rating access to finance as a major obstacle.[13]

However, in the context of projects approved by the LAIF, only one project supports directly SMEs. This relatively small regional project in Central America facilitates financing to SMEs for investment projects in the areas of energy consumption reduction, energy efficiency and renewable technology for energy generation.[14]

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12 On different aspects of inequality in Latin America, see for example: "The Scandal of Inequality in Latin America and the Caribbean". ChristianAid (2012). Accessed at: http://www.christianaid.org.uk/images/scandal-of-inequality-in-latin-america-and-the-caribbean.pdf.

13 http://www.eib.org/attachments/dalberg_sme-briefing-paper.pdf[1]

14 The list of projects can be found at: http://ec.europa.eu/europeaid/where/latin-america/regional-cooperation/laif/projects_en.htm

This project will be carried out through financial intermediaries to whom technical assistance and funding will be provided in order to support SMEs.

Instead of SMEs, it seems to be the private *corporate* sector that is heavily supported by LAIF projects through the procurement processes for mega-scale investments in infrastructure. As the priorities for the LAIF projects focus on introducing technological innovation from Europe under the "green economy" framework,[15] especially in the energy and green technology sectors, it would not be surprising that most of the contracts are to be awarded to European companies.[16]

Besides financial benefits that may flow to the European corporations, the LAIF also gives political leverage for the EU to influence strategic decisions of partner governments. As boldly put by the Center for European Policy Studies in a study commissioned by the EC: "For the EU, the Loan and Grant Blending Facilities allow it to some extent to gear the lending activities towards specific areas of interest for the EU and the partners […] The LGBFs have increased joint European action for development and elevated European visibility in the regions concerned. Furthermore, the facilities have become centres for strategic dialogue with beneficiaries on large-scale development projects as well as collaboration and coordination platforms for the financiers".[17]

As stated above, involvement of European private companies in the implementation of ODA is nothing new as this has been the reality for traditional development projects. However, this political leverage with large-scale projects and possible benefits for the European companies is highly sensitive, considering that these capital-intensive investments are loan-based and thus increase the potential sovereign indebtedness of the partner country in the future.

Thus it becomes all more important to have clear and transparent criteria regarding the priorities, inception and implementation of LAIF projects, in order to reduce any possible doubt that there exist possible conflicts of interest between poverty reduction, European corporate self-interest and sustainability issues in mega-investment decisions.

Furthermore, while blending mechanisms may give more political leverage for the EU in influencing the strategic decisions of governments in infrastructure, this may be reduced in other areas such as good governance, democracy and human rights, to which the EC plans to give increasing importance from 2014 onwards as well.

Nicaragua offers a good case in point. European bilateral donors and the EC blocked their budget support to the current Sandinista government due to governance issues and especially due to fraudulent municipal elections during November 2008.[18] The EC has in principle earmarked these funds, totaling to around US$47 million, to be used for LAIF projects in Nicaragua. Governance

15 *Rio+20: the discursive change of the EU from a (non-existing) "sustainable development" towards "green economy"* http://www.alop.org.mx/sites/default/files/Discursive%20Change%20EU%20GreenEconomyfinal.pdf. See also *Sustainability. Pandora's Box in the hands of corporations* http://www.alop.org.mx/sites/default/files/Ecoverde%20Boletin%20Alop%20final%20english.pdf[16]
http://ec.europa.eu/europeaid/where/latin-america/regional-cooperation/laif/documents/laif-action-fiche-2009.pdf

16 On the importance of the European companies in the energy sector in Latin America, see for example http://www.cepal.org/publicaciones/xml/0/46570/2012-181-LIE-capitulo_IV.pdf[1]

17 CEPS. *Innovative Approaches to EU Blending. Mechanisms for Development Finance*. Jorge Núñez Ferrer and Arno Behrens. May 2011.

18 See Sandell, T. (2010). *Nicaragua: A testing ground for Aid Effectiveness Principles.* ROA 2010.

conditionalities on the one hand, and economic development needs of the people on the other hand, are always a delicate balance for the donors. In this case, the Nicaraguan government has surely welcomed this shift in EC strategies as LAIF projects do not require engagement of the government in discussions on governance issues. As well, major infrastructure projects financed by the LAIF and other loans give high visibility to the Nicaraguan government.

"Bottom-up approach": the role of Latin American development banks

The EC and the Council of the EU consider that LAIF supports a bottom-up approach in development policy planning. It is, they argue, the regional banks in Latin America that take the initiative in proposing the LAIF projects together with their European partners. When interviewed on the issue of ownership, a functionary of the EC specifically explained: "Opinions are requested from the Delegations of the EU, civil society and governments. There is enormous transparency. But as in the case of a surgery, not everyone can have a say". The EC further stresses that the projects need to be in line with the national development plan.

From the civil society point of view, these arguments hardly guarantee a bottom-up approach. Latin American governments have no direct role in the LAIF governance structure, and there are no mechanisms for civil society´s participation and consultation. The final decision lies in the Board, which is in the hands of the EC and European Member States.[19] The financial institutions in Europe and Latin America have a consultative and an executive role, but only European banks can take the lead in the implementation and monitoring of the projects.[20] In summary, the role of beneficiaries in setting strategic priorities is not clear and there is also little formal information available as to how specific choices are made as to which projects to support.

Furthermore, due to the absence of sound and transparent socio-environmental safeguards for their own operations, the Latin American financial institutions [the Inter-American Development Bank (IDB), the Central American Bank for Integration (BCIE) and the Andean Development Corporation (CAF)] can hardly be considered as the most adequate guardians of the local ownership, transparency and sustainable development. Despite some advances in mainstreaming environmental and social sustainability, their comparative advantage as "green" banks in Latin America remains at best unclear. Recent initiatives on climate and sustainable energy have been at the margins of their core business, while poorly planned infrastructure and extractive sector investments have exacerbated land use contributions to greenhouse gas emissions.[21]

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19 According to the EC official this is also due to the financial regulations of the EU, which would make it complicated to give financial support through financial institutions based outside Europe.

20 The LAIF Board is presided by the European Commission, and meets once or twice yearly. It defines the overall strategy and takes operational decisions. The Board is composed of representatives of the European Commission, EU Member States and other donors. Observers of each partner country and of each eligible finance institution are able to attend these meetings http://ec.europa.eu/europeaid/where/latin-america/regional-cooperation/laif/documents/laif-action-fiche-2009.pdf

21 A new IDB Environmental policy came into effect in 2006 and a Blue Ribbon Panel (BRP) on the Environment was reconvened in 2007 to advise IDB Management on sustainability issues in the Bank reorganization. The BRP laid out three broad recommendations to Bank Management to make sustainability a viable outcome of the realignment: 1) to move from "do no harm" approach to "doing good"; 2) correct the sustainability functions within the Bank's organization; and 3) provide adequate human and financial resources to sustainability functions http://www.iadb.org/en/topics/sustainability/blue-ribbon-panel,1538.html

Monitoring and evaluation

As a whole, the blending finance facilities do not yet have unified standards on monitoring and evaluation. The lead financial institution currently carries out monitoring of individual projects based on their own criteria. However, following the fundamental principles of the EU, the EU may indeed insist on including poverty reduction more clearly in the strategies of the European and Latin American development banks as well as improving their transparency and sustainable development monitoring mechanisms. If implemented widely, this dialogue can be considered as one of the major strengths of the Latin American Investment Facility.

Establishing a critical number of select and minimum monitoring and evaluation requirements could facilitate comparability and a coherent basis for information on the performance of operations. At the beginning of each year, the LAIF secretariat prepares an annual activity report on the implementation of the Facility, which provides information on the financed operations and assesses their contribution towards the LAIF objectives. This report, however, is only presented and discussed in the LAIF Strategy Board meetings.

To strengthen accountability, the progress and development impact of projects should be systematically reported to justify the use of aid resources by the Facility, not only to the donors and the European institutions involved, but also to the whole society in Europe and Latin America.

Conclusions:

Strengthening SMEs is central to development in Latin America, but so far local SMEs have received little support through the LAIF. The focus on the energy sectors indicates that it will be European companies that are mostly involved in these large-scale investments.

The LAIF also brings political leverage as the EU may be in a better position to exert influence on business transparency and the investment environment of the partner countries by offering grants to accompany government loans. On the other hand, given political will to do so, the EC could also use this political leverage to influence the financial institutions' poverty reduction strategies.

The LAIF raises issues concerning the balance between supporting local companies or foreign investments as well as the question of debt sustainability. These issues affect the political economy and strategic directions for development in the partner countries themselves. If the EU strives for the most effective poverty reduction strategies in Latin America, then instead of simply attracting investments, the focus should be on productivity and generating employment that decreases inequality. Achievements in these areas are still early to evaluate. The LAIF so far lacks transparency and clear monitoring and evaluation mechanisms in order to make such assessments.

These issues of the benefits arising from the economic and political leverage provided to the EU by LAIF can be addressed only through more substantive and coherent discussions on the overall purpose of blended financing mechanisms. There must be greater transparency in project selection criteria and accountability to society. As long as the definition of the private sector continues to be unclear and the political desire to support European companies hidden, there will be no clarity on best strategies to involve the private sector in poverty reduction initiatives.