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Private profit for public good?

Can investing in private companies deliver for the poor?

By Jeroen Kwakkenbos

Contents

Acronyms

ACP	African, Caribbean and Pacific countries
DFI	Development Finance Institution
EDF	European Development Fund
EDFI	European Development Finance Institutions
EIB	European Investment Bank
FDI	Foreign Direct Investment
FI	Financial intermediary
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden
GNI	Gross National Income
IADG	Internationally Agreed Development Goal
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEG	Independent Evaluation Group World Bank
IFU	Industrialisation Fund for Developing Countries
IMF	International Monetary Fund
LIC	Low Income Country
MDG	Millennium Development Goals
MNC	Multi National Company
MSME	Micro, Small and Medium Sized Enterprises
ODA	Official Development Assistance
OECD DAC	Organisation for Economic Co-operation and Development Development Assistance Committee
SME	Small and Medium Enterprises

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Executive summary

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 IFIs exceeded $40 billion. By 2015, the amount flowing to the private sector is expected to exceed $100 billion – making up almost one third of external public finance to developing countries. As global ODA stagnates, several aid agencies have suggested a dramatic scaling up of public finance devoted to supporting private sector investments.

Using ODA for private sector investment is contentious among civil society organisations. 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. They 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.

This report assesses whether external (non-domestic) public finance for private investments in the South lives up to promises to provide finance to credit-constrained companies in developing countries and to deliver positive development outcomes. More precisely, it looks into how much development finance goes to the private sector, as opposed to the public sector; which institutions deliver this type of finance and how; which types of companies are benefiting the most from public support; and how development institutions ensure they support responsible investments that contribute to equitable and sustainable development.

For this purpose, Eurodad assessed recent grant and loan trends, and the portfolios of some of the largest multilateral and bilateral development agencies providing public support to private investments in developing countries. Eurodad's sample included the World Bank International Finance Corporation (IFC), external lending of the European Investment Bank (EIB) through its African, Caribbean and Pacific countries (ACP) investment facility and Africa Infrastructure Trust Fund, and six bilateral DFIs from Denmark, Belgium, the Netherlands, Norway, Spain, and Sweden.

In 2010, on average over 50% of public finance flowing from DFIs to the private sector went to the financial sector.

Aid to the private sector: 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. However, 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. Furthermore, the use of aid for private sector investments may detract from much-needed public sector investments, which still face huge financing gaps.

The rise of development finance institutions (DFIs). During the economic and financial crisis, these institutions 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 in manners that no other financial institution can compete with. At the same time, the drying up of credit markets has allowed DFI expansion, including into new areas, such as trade finance. This undermines the role of public development finance, as which companies and sectors deserve most support from public development budgets and institutions should depend on the priorities laid out by the national development strategies of recipient countries.

Following the market. In practice, Development Finance Institutions providing support to private investments in the South have followed market-driven patterns regarding the sectors and type of companies that they finance. In particular, Eurodad found a dramatic increase in lending and investments to the financial sector:

- 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.

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 as 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.

Developing country firms bypassed. The main reason DFIs invest public funds in the private sector is to provide financing that supports positive development outcomes for companies in developing countries that would otherwise not be able to access funds. This means companies that are either too small or risky to access finance, and are based in countries where credit supply is extremely limited, or interest rates are too high making financing for local firms scarce and costly. What they do in practice may be quite different.

“ The majority of DFIs are signatories to international investment agreements such as the equator principles, the UNPRI, or other responsible financing frameworks. These guidelines, which include IFC performance standards and other such commitments, are insufficient.

Eurodad found that:

- Only 25% of all companies supported by the EIB and IFC were domiciled in low-income countries.
- Almost half goes to support companies based in OECD countries and tax havens.
- Around 40% of the companies in Eurodad’s sample are big companies listed in some of the world’s largest stock exchanges.

This casts doubt on whether IFIs are succeeding in channelling their financial support to the most credit-constrained companies in the world’s poorest countries: instead, they appear to be simply following market trends.

Measuring development impact is difficult. There is currently no harmonised approach amongst the DFIs in terms of 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 whom, how and where investments will be made, are already determined.” This implies that the additionality of projects 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, which include IFC performance standards and other such commitments, are insufficient. They tend to be ambiguous, general and often quite weak. 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. 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 newest arguments DFIs and aid agencies use to justify their investments is 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. This report shows that, as currently defined, the concept of leverage has a number of critical problems, 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, which must be repaid. This may means borrowers are more directly connected to global financial markets and thus will be more exposed to exogenous shocks and speculative capital flows.

DFIs need to target the neediest populations in developing countries and avoid "low hanging fruit."

Development finance institutions 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, the findings of this report suggest that there is a trend among development finance institutions to focus on projects where they can leverage large returns on investment and reduce their development impact to a secondary motivation.

Recommendations. It is crucial to reverse this trend and ensure that investing in the private sector is not a cheap excuse for declining aid budgets, but a truly developmental tool. DFIs need to target the neediest populations in developing countries and avoid "low hanging fruit." Eurodad has the following recommendations for DFIs:

- 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 high standards for transparency.

Introduction

The global economic and financial crisis that started in 2007 left donor governments with diminishing treasuries. In response, many countries are seeking alternative revenue streams.

Aid budgets are among those hardest hit by the crises. The Netherlands, Spain, France, Italy, and other donors have reduced their contributions to Official Development Assistance (ODA) over the last few years.[1] In many other countries ODA has stagnated. Many European Union governments and institutions are concerned that they will fail to meet commitments made in 2002 to allocate 0.7% of their Gross National Income (GNI) to ODA by 2015.[2]

EU governments and institutions are promoting alternative sources that can contribute to development finance if aid pledges are not met. From the G20 to the European institutions, official pronouncements view "private sector activity and resources [as key] for delivering public goods,"[3] and aim to "diversify and enhance sources of financing, and develop [new] financial instruments,"[4] thus reducing the burden on the public purse.

In line with this view, some development agencies believe that by using development finance to mobilise foreign direct investment (FDI) they will be able to leverage roughly five times annual ODA.[5]

Governments are looking for a cheap "win-win" situation where ODA is reduced – or at least not scaled-up – but can catalyse other sources of external development finance and mobilise further domestic resources. But while it is encouraging that donor governments acknowledge the importance of the role of diverse financial flows to developing countries, this should not be an excuse to renege on their 0.7% ODA/GNI commitments.[6]

Public support for a thriving private sector

A thriving private sector that contributes to equitable development requires public sector financial and non-financial support. Public authorities are responsible for establishing the legal infrastructure, which ensures a predictable business environment. They also invest in physical infrastructure and in health and education to ensure a skilled and healthy labour force. Often, public authorities go even further and provide long term financing at predictable rates, which is not available in private capital markets for private sector investments. They have traditionally provided finance to credit-constrained companies, thus addressing private financial market gaps and failures known as the financial additionality of public development finance institutions vis-à-vis private financial institutions. They are usually at the service of national economic development strategies and industrial policies, thus channelling support to economic sectors and companies that are considered of strategic importance for the country.

Public authorities must fulfil their responsibilities by ensuring that this money- taxpayers' money- is channelled to businesses that can deliver the best possible development outcomes, such as creating decent jobs or paying taxes. Given the profit-seeking nature of the private sector, "balancing social and financial returns can be a complex, time-consuming and sometimes contradictory affair."[7] This is why for decades public authorities have developed binding labour laws, environmental laws, and tax systems to ensure that private activities contribute, instead of undermine, the provision of 'public goods'.

In the last decade there has been a sharp increase in publicly supported cross-border support for private investments. Bilateral Development Finance Institutions (DFIs) from industrialised countries and private sector arms of Multilateral Development Banks (MDBs) have channelled most of these flows. In the past, this support has been in the form of loans, equity investments and guarantees. However, recently, these institutions have begun providing an increasingly larger share of ODA to the private sector.

External financing for the private sector

External support for private investments in developing countries must overcome several challenges in order to engage effectively in development. Firstly, foreign financial institutions 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 acknowledges, in 2010 in Africa "margins remained under pressure as supply of liquidity from Development Finance Institutions (DFIs) outstripped demand,"[8] demonstrating that the traditional hunting grounds of the DFIs are currently flooded with finance, casting doubt on the financial additionality of these types of flows.

Secondly, DFIs find it difficult to resist the temptation of supporting companies domiciled in donor rather than in developing countries (see section 2). This is particularly worrying considering that: most credit-constrained companies without access to financial markets - the supposed target of DFI funds - are not in donor countries but in developing countries; most jobs in these countries are created by domestic small and medium enterprises (SMEs); and Multinational Corporations (MNCs) are likely to be responsible for the largest amount of tax evasion.[9] 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 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.[10]

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 (MDGs), aid effectiveness principles and internationally agreed development goals (IADGs).

Providing public funds to private companies and financial institutions raises a number of fundamental questions that go beyond the remit of this report, concerning both support

Public authorities must fulfil their responsibilities by ensuring that this money - taxpayers' money - is channelled to businesses that can deliver the best possible development outcomes, such as creating decent jobs or paying taxes.

by public institutions to domestic companies and external finance for private investments in developing countries. These questions range from whether state aid should subsidise profit-seeking activities, to which financial institutions and instruments are the best equipped to conduct these activities. This report, however, has a much narrower remit, focusing on whether external (non-domestic) public finance for private investments in the South lives up to promises to provide finance to credit-constrained companies in developing countries and to deliver positive development outcomes.

For this purpose, Eurodad assessed recent grant and loan trends, and the portfolios of some of the largest multilateral and bilateral development agencies providing public support to private investments in developing countries. Eurodad's sample included the World Bank International Finance Corporation (IFC), external lending of the European Investment Bank (EIB) through its African, Caribbean and Pacific countries (ACP) investment facility and Africa Infrastructure Trust Fund, and six bilateral DFIs from Denmark, Belgium, the Netherlands, Norway, Spain, and Sweden. We assessed: how much development finance goes to the private sector, as opposed to the public sector; which institutions deliver this type of finance and how; which types of companies are benefiting the most from public support; and how development institutions ensure they support responsible investments that contribute to equitable and sustainable development.

Part 1:

State support to the private sector investing in the South: How much and in what forms?

Donor governments and multilateral institutions have provided grants and loans to private sector companies operating in developing countries for decades. However since the 1990s the scale of this support has increased dramatically. This section looks at the increased support to the private sector and finds that while investment in infrastructure that promotes the private sector has increased drastically, investment in social sectors has either stagnated or decreased. To ensure that development institutions that support private sector investments are delivering the type of development outcomes that citizens and taxpayers expect from them, at least three questions should be properly addressed:

- Are DFIs and aid agencies investing in private companies and financial institutions that do not have access to alternative finance?
- Are the limited public resources genuinely targeting the sectors and businesses most in need of publicly-backed credit, which are most important for national development plans? And
- Are investments made by DFIs and aid agencies delivering development outcomes and contributing to poverty eradication?

Part 2:

Who profits?

Eurodad reviewed the sectoral distribution of the portfolios of the World Bank IFC, the EIB and DFIs from Belgium, Denmark, Norway, Sweden and Spain and found that during the period assessed there was a dramatic increase in lending and investments to the financial sector. The financial sector is the main sectoral priority of the majority of these institutions. This suggests that DFIs invest according to their own preferences rather than targeting the priority sectors of the developing country. Research also found that for the most part the IFC and support large companies from advanced economies, which invest in poorer countries. These findings cast doubt on whether IFIs and DFIs are genuinely supporting the companies that are the most credit-constrained and that have the potential to deliver positive outcomes for long-term equitable and sustainable development.

Part 3:

Delivering development outcomes and doing development finance responsibly.

Most development agencies have difficulty demonstrating causal effects on developing countries, but none more so than the DFIs. This is partially due to the nature of investing in the private sector, where social outputs are not normally the objective of the private sector partner, and are difficult to measure. In this section Eurodad looks at responsible financing practices of the DFIs and find several major concerns. Comparing the investment policies of the DFIs to the guidelines in the charter shows that there are many holes in their approach that need to be effectively addressed. Of particular concern are:

- DFIs are not operationalising aid effectiveness principles and poverty eradication into their project selection.
- DFIs do not have a harmonised approach to their investments other than voluntary initiatives.
- Many DFIs have transparency issues due to engaging with obtuse financial intermediaries as delivery vehicles for their development finance.

Part 4:

Section four: The concept of 'leverage' – poorly defined and problematic.

One of the newest arguments DFIs and aid agencies use to justify their investments in the private sector is that this can leverage significantly more finance into their projects than development institutions could ever mobilise operating alone. This section breaks down the concept of leverage and how it is applied and finds that there is no consensus on how leverage is defined or implemented. If DFIs continue to use the concept of leverage to justify their activities, they will need to define much more clearly what they mean, and overcome a number of critical problems, including:

- Assessing financial additionality is hard, and headline figures are not reliable. Additionality – and hence leverage – cannot be assumed just because public institutions are co-investors with private funds.
- The higher the leverage ratio, the stronger the private sector influence and the lower the likely development additionality.
- Using public resources to try to leverage private sector investment means those resources cannot be used elsewhere.

The report concludes with a set of recommendations on how public support to private investments in developing countries should be radically improved in order to make sure it contributes to equitable and sustainable development.

International public support to the private sector investing in the South: How much and in what forms?

Donor governments and multilateral institutions have provided grants and loans to private sector 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 IFIs exceeded US$40 billion.[11] 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. By external public finance we mean finance where a state backed agent, such as a DFI, or state-backed multilateral either provides the funds directly, or guarantees lending. This does not include private–private flows such as Foreign Direct Investment (FDI) or remittances.

As global ODA stagnates, policy reviews in several aid agencies, including the European Commission,[12] suggest a dramatic scaling up of public finance devoted to supporting private sector investments. This would accelerate a general trend in the last decade, led by a dramatic increase in Multilateral Development Bank support to private firms investing in developing countries.

For the purpose of this report Eurodad assessed:

- The IFC portfolio for Low-Income Countries between 2006-2010.
- EIB operations in ACP countries between 2006-2010.
- Portfolios of six European Development Finance Institutions (EDFIs) which specialise in private sector lending between 2006-2010.
- Bilateral tied aid, which is bilateral grants provided under the condition that recipients use them to purchase goods and services from companies from the donor country, between 2006-2010.

Eurodad also examined:

- Six European bilateral donors: Netherlands, Norway, Spain, Sweden, Belgium, and Denmark.

The study was limited to the figures that were publicly available and to information that was comparable (for further information please see Annexe A on methodology).

We found that in 2010 around €7.27 billion of public finance was invested in private companies operating in the world's poorest countries by the two multilaterals and six bilaterals combined, and in excess of €21 billion from the EDFIs.[13] The World Bank portfolio saw steep increases in public finance to support private sector infrastructure while development finance for the social sectors either decreased or stagnated (See figure 1).

> In 2010 around €7.27 billion of public finance was invested in private companies operating in the world's poorest countries by the two multilaterals and six bilaterals combined.

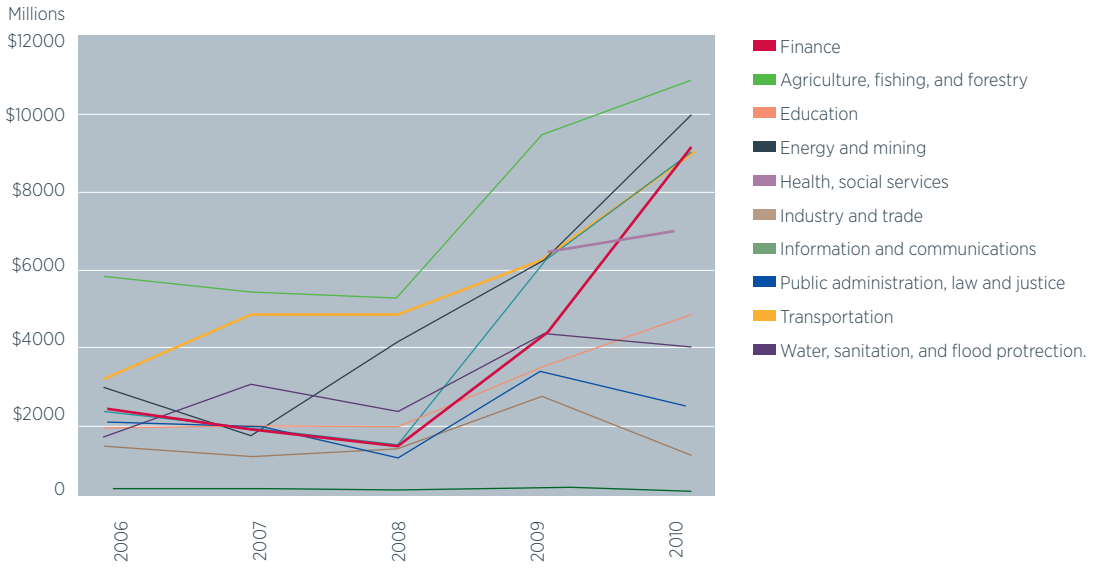
Due to the unavailability of relevant data for most of the bilateral agencies assessed, it was not possible to count the share of untied aid that is still used to purchase from donor country companies (informally tied aid), which Eurodad estimates to be on average, 60% of all bilateral aid.[14] For the same reasons, it was not possible to count the share of untied aid channelled through modalities that involved private sector participation, such as Public-Private Partnerships or Challenge Funds.

Public support is crucial to a thriving private sector

The findings of this research raise serious concerns that the balance between private and public sector investment in development finance is becoming increasingly one sided. But a thriving private sector that contributes to equitable development requires public sector financial and non-financial support:

Public development banks have historically played a crucial role

Figure 1: Total World Bank Disbursements by Sector 2006-2010



in providing long-term finance to credit-constrained companies, thus addressing private financial market gaps and failures – known as the financial additionality of public development finance institutions vis-à-vis private financial institutions. They are usually at the service of national economic development strategies and industrial policies, thus channelling support to economic sectors and companies that are considered of strategic importance for the country.

Public authorities must fulfil their responsibilities by ensuring that this money- taxpayers' money- is channelled to businesses that can deliver the best possible development outcomes, such as creating decent jobs or paying taxes. Given the profit-seeking nature of the private sector, "balancing social and financial returns can be a complex, time-consuming and sometimes contradictory affair."[15] This is why for decades public authorities have developed binding labour laws, environmental laws, and tax systems to ensure that private activities contribute, instead of undermine, the provision of 'public goods'- which are identified by the millennium development goals and other multilateral declarations as the rights of all individuals.

Public authorities are also responsible for establishing the legal infrastructure, which ensures a predictable business environment. They also invest in physical infrastructure and in health and education to ensure a skilled and healthy labour force.

More ODA is going to the private sector

Public finance to the private sector may take the form of loans, equity investments and guarantees, but can also mean ODA expenditure. Bilateral development agencies and European institutions have been channelling a share of their aid budgets to private companies for some years.

On the basis of the data disclosed to Eurodad by three of the bilateral development agencies assessed, Netherlands, Norway and Sweden, Eurodad estimates that around 2% of their direct bilateral assistance is drawn from aid budgets. The majority of support for the private sector in developing countries from these countries is channelled through the DFIs.

Though aid to the private sector is also a small share of total ODA, it has been growing rapidly in recent years. Belgium and Sweden are the most striking cases, where aid to the private sector has increased by four and seven times respectively since 2006.

Since 2006, Denmark has increased its share of untied ODA to the private sector by 30%, and Norway by 20%. These are significant increases, as this rapid growth has far outpaced the much slower increase in total ODA in these countries.

In addition to aid that goes directly to the private sector in the form of grants, aid can flow to private sector actors in less direct ways:

- **Procurement:** Public procurement is the purchasing of goods and services by governments to implement projects or provide services. Aid can be disbursed through contracts with private sector contractors that deliver goods and services paid with aid monies. Eurodad research in 2011 has shown that approximately "69 bn USD of aid [is] used for procurement each year."[16] The vast majority of these goes to rich country firms. It should be noted that a share of these contracts is 'tied aid' - formally earmarked so that partners have to award procurement contracts to companies in the donor country. Tied aid increases the cost of supplies by 15% to 40%.[17] Furthermore, in reality the majority of formally untied aid contracts from bilateral agencies also go to donor country firms (informally tied aid).[18]

- **Public-private partnerships:** Donor agencies also channel aid to the private sector through direct participation in private sector investments, such as in the case of Public Private Partnerships (PPPs) or Challenge Funds. PPPs are joint programmes undertaken with both governments and the private sector, with usually the government guaranteeing private sector investment, whereas challenge funds[20] are aid projects that are tendered out to both for-profit and non-profit private sector.

Donor governments also use ODA to subsidise the lending or other activities of development finance institutions (DFIs, see section below), this varies across DFIs. Some, such as Norfund pride themselves on raising capital almost exclusively from commercial markets. They claim that using ODA would run the risk of distorting markets and crowding out other sources of private finance by undercutting real market rates for loans and equity. Others, such as the EIB and the IFC, only use ODA to subsidise their advisory services or to back up guarantees (see table 1 for a comparison of DFIs and their private sector operations).[25]

Concerns

Using ODA for private sector investment is contentious among civil society organisations. Although some acknowledge that aid may be needed to start up some frontier business areas such as renewable energy, or in heavily credit-constrained

The dubious developmental impact of PPPs

PPPs can be quite problematic as the financial risks are often disproportionately carried by the public sector, whereas profits are enjoyed by private investors. In several countries, the private provision of water and electricity has increased the financial sustainability of some utilities at the cost of imposing unaffordable tariffs for many consumers. In Ghana and Namibia, the private provision of basic utilities and the elimination of cross-subsidies from urban to rural areas led to increased inequality between regions. In Senegal, the private provider of water successfully increased collection rates by enforcing a strict disconnection policy, but 12 per cent of connections were terminated. In Tanzania, after the privatisation of Dar es Salaam's water supply, a consortium led by the UK firm Biwater took over water provision. Although the contract with this firm was signed in 2003, it was terminated 18 months later after no improvement in services. In the city of Cochabamba in Bolivia, privatisation of the water utilities led to a 200% increase in the prices of water and triggered widespread riots in the country[21].

PPPs may attract more ODA co-funding in future, but from an aid and development effectiveness perspective there are a number of issues to address first[22]. These include, to name just a selection:

Ownership: The selection of donor-funded PPP projects seems to be in many cases an agreement between the donor and the private entity. There is a questionable level of ownership by the partner country. PPPs are often supply, not demand-driven[23].

Alignment: PPPs only take place when the private side has an interest in them too. It is often a challenge to align private profit motives with public development concerns that may lead to limited alignment of development plans and priorities.

Tied Aid: Some donor-funded PPP programs are only accessible to firms from donor countries; this is a form of aid tying. Needless to say that this practice substantially reduces their value for private sector development in partner countries, whose firms are de facto excluded from business opportunities.

Management for development results: To date it has not been clear that PPPs are always effective agents of development and poverty eradication and provide the employment promised. While some believe that the revenues created by PPPs trickle down to benefit the poor, evidence shows that the private sector has not always delivered the gains needed to eradicate poverty and create equitable and pro-poor development[24].

Incentives: PPPs can be a tool with which the public sector rewards socially responsible behaviour by private firms. But we do not find evidence that firms that violated human rights or labour standards, or evade taxes, are systematically debarred from PPPs.

Another problematic aspect of PPPs is that financial risks are often disproportionately carried by the public sector. This has led some sceptics to interpret PPPs as "publicly-guaranteed private profits". Project failure may lead to further indebtedness of developing country governments.

markets such as those in low-income countries, the concern is that the use of aid for private sector investments may detract from much-needed public sector investments, which still face huge financing gaps. In a context of limited aid resources, questions arise over whether there are better suited instruments to support the private sector – such as loans or equity – which would allow earmarking scarce aid resources for public investment in sectors such as infrastructure, health and education, which may not yield short or medium term financial returns but are key areas for creating a functioning private sector within developing countries.

Civil society groups are also concerned about the donors' push to expand the ODA definition set by the OECD Development Assistance Committee to include new forms of development finance. Donors such as the Netherlands and France have been calling for a broader group of guarantees to be considered as ODA. Currently guarantees are only counted as ODA if the project being financed fails, the project implementer defaults on its debt obligations, and the insurance or guarantee issued by a public institution – such as, for instance, an Export Credit Agency – is called by the creditor to recover outstanding debts.[26]

One problem with counting guarantees as ODA is that they are funds that may never be disbursed. In addition, there is danger that development agencies would have incentives to support riskier investments if they could count the guarantees issued for these projects as ODA, artificially inflating aid budgets, while potentially never having to actually disburse the committed funds. However, if guarantees are paid out, this could cause significant liabilities for development agencies, particularly during times of systemic crisis.[27]

Non-grant support: DFIs and private sector lending arms of the IFIs

For more than four decades donors have been channelling non-aid types of development finance to private companies and financial institutions investing in the South. This type of finance has mostly been handled by DFIs and the private sector lending arms of Multilateral Development Banks.

These institutions provide by far the majority of public finance channelled for private sector investments in the South, on average close to 80% in the sample of countries and institutions assessed by Eurodad.

> The past decade has witnessed a general trend among all MDBs which have nearly trebled their combined private sector portfolio, from €7.3 billion to €21.24 billion.

The EIB and Blending

The European Investment Bank (EIB) was initially tasked with financing European integration of new member states and with investing in under-capitalised areas of the European economy. Since its inception its mandate has expanded to include development oriented activities by investing in African, Caribbean and Pacific (ACP) countries. In 2000 the European Commission gave the EIB management over the Cotonou investment facility under the ACP-EC partnership agreement signed in Cotonou, Benin, 2000.

The Investment Facility invests only in ACP countries, and receives funds from the European Development Fund (EDF) and from borrowing from capital markets. The European Development Fund is a special facility created by European member states to target ACP countries and is controlled directly by the European Commission. There is mounting pressure from the parliament to bring it under their scrutiny by including it in the 2013 multiannual financial framework- the budget of the EU.

The facility is operated as a revolving fund, meaning that the returns generated are used for further investment. It is tasked with promoting the financial sector of developing countries and "to seek and channel funds through ACP national and regional institutions and programmes that promote development of small and medium sized enterprises."28 These grants (from the EDF) and loans (from Capital Markets) are then blended and invested into developing country projects

Blending consists of two components:

1) A loan component which is raised on capital markets with repayment required of both the principal and the interest

2) A grant component where repayment is not required.

Blending ODA with commercial loans is done to make loans concessional. The majority of the grant component goes either to technical assistance or to interest rate subsidies.

Blending raises a number of concerns:

- **Risk of diluting or undermining the development focus of aid money:** scarce ODA resources should be targeted at where they have the greatest development additionality, not to where they can make the greatest financial return.
- **Tied aid:** there is also a concern that member states will put pressure on the EIB to use its blending mechanism support EU business using arguments such as the need to compete with the other great blender, China. While the merits and drawbacks of subsidising the private sector are beyond the remit of this paper, using ODA to do this risks creating a new form of tied aid.
- **Transparency risk:** blended funds that go to financial intermediaries are often not subject to public scrutiny, despite the public component. This is due to assumptions about the commercial confidentiality of loan agreements.
- **Financial additionality** is also not clearly understood, as subsidised loans run the risk of crowding out other forms of financing.
- **The development impact** of blended finance has not yet been sufficiently demonstrated and increasing the loan component in development finance can lead to serious debt later on.

Sweden backs using aid to leverage private sector investments

Sweden is at the forefront of current trends to increase the use of aid to leverage private sector investments, and is leading the discussion in many international forums such as the OECD.

In its new strategy for engaging the private the sector, the Swedish International Development Agency (SIDA) wants to increase the manner and means by which it collaborates with private companies, particularly those in Sweden. SIDA will increase aid for private sector investments in developing countries by almost seven fold (from €5.5 million to €38 million) over a three year period[28]. Furthermore SIDA will provide private companies with the opportunity to raise additional funds from country and regional allocations as well as environmental loans and guarantees earmarked for climate finance.

Sweden has also committed to increasing the resources of the Swedish DFI, Swedfund. In 2012, it will receive an increase of €44 million in Capital, and then a further increase of €130 million over the next 3 years which represents a 62% increase from current levels. While this may seem a small amount in the context of overall ODA, it does indicate a serious shift in the destination of an increasingly important share of aid towards private sector investment. This increase comes despite two evaluations by the Swedish government, the first by the Swedish Agency for Development Evaluation (SADEV)[29] in 2008, the second by the Swedish National Audit Office in 2009[30], illustrating that Swedfund has been producing weak development outcomes. Both reports question the financial additionality of Swedfund, with the SADEV report noting that "a majority of the companies who answered the questionnaire stated that their particular project would have gone ahead without Swedfund." This criticism is a challenge for the majority of development finance involving private sector investments where clear financial additionality is difficult to demonstrate.

The past decade has witnessed a general trend among all MDBs which have nearly trebled their combined private sector portfolio, from €7.3 billion to €21.24 billion.[31] Eurodad also found that between 2006 and 2010 the DFIs assessed by Eurodad increased their portfolios by 190%. Every DFI with the exception of Norfund has at least doubled its commitments compared to pre crises levels. Belgium's Bio more than trebled from €30 million to €100 million.[32] During the period assessed by Eurodad (2006 to 2010), the combined IFC and EIB support for private investment in LICs increased from €1.6 billion to €3.4 billion.

As table 1 shows, these institutions are either government owned or the government is the majority shareholder, with only a few exceptions, usually smaller DFIs.[33]

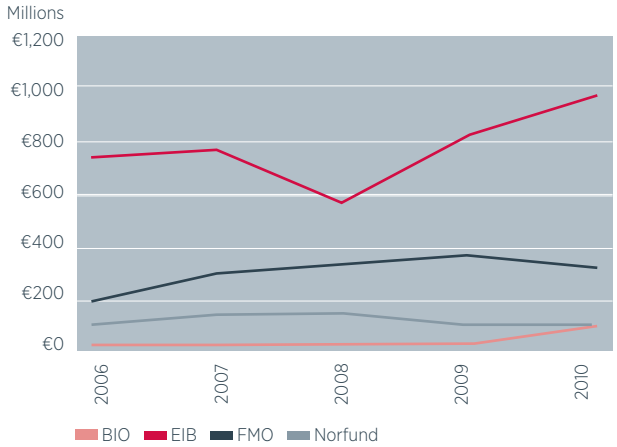
What are DFIs and how do they work?

While many DFIs were originally conceived to protect European countries' interests in their colonies or former colonies,[35] 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 IFU and Austria's OeEB 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.

In some cases the mandates have evolved over time. For example, the EIB's external lending mandate has been under continuous revision since 1963, and its most recent mandate under the Cotonou agreement has gone under two revisions.[34] While the EIB was originally meant to support industrial policies and private sector investments in European Union member states, it has also been lending outside the EU, though it is only slowly developing the expertise and safeguards necessary for these investments.

Different DFIs employ different financing instruments (see table 2 on financing instruments). The most prevalent by far are direct loans to domestic and non-domestic private sector enterprises in developing countries, but rising rapidly is the use of equity as a financing instrument. The FMO's overall portfolio of investments in LICs features over €900 million in the form of direct loans and over €400 million in equity investments, Norfund exhibits a different strategy with the majority of investments being channelled through equity (€390 million), and funds (€235 million).

Figure 2: Lending and investment increases by selected national DFIs from whom data was



DFIs are capable of raising large amounts of capital, and their government backing and development mandate would allow them to invest in high-risk investments that can reap large returns, although the tendency is to follow market trends.

Table 1. National DFIs

DFI (country)	Ownership	Portfolio 2010	Financial products	Sectoral focus	Tied / Untied
Bio (Belgium)	50% state owned, 50% owned by Belgian Corporation for International Investment (SBI-BMI).	€295 million	Equity, quasi-equity, debt, guarantees, technical assistance.	Finance	Untied
CDC (UK)	100% state owned.	€2.1 billion	Used to exclusively invest through financial intermediaries. From 2011 is increasing direct investment.	Infrastructure	Untied
Cofides (Spain)	63% state owned; 39% Spanish commercial banks: BBVA, Banco Santander and Banco de Sabadell.	€554.9 million	Equity, quasi-equity, direct loans.	Infrastructure	Untied
DEG (Germany)	100% owned by KfW.	€5.2 billion	Direct loans, mezzanine loans, equity, guarantees, syndicated loans, advisory services.	Finance	Untied
Finnfund (Finland)	89% state owned, 10.9% Finnvera, 0.1% confederation of Finnish Industries.	€90million	Direct loans, mezzanine loans, equity.	Manufacturing	Untied
FMO (Netherlands)	51% state owned, 49% Private banks, trade unions (1%), and other private actors.	€5.3 billion	Direct loans, mezzanine loans, syndicated loans, equity, guarantees.	Finance	Untied
IFU (Denmark)	100% state owned.	€75 million	Loans, equity, guarantees.	Infrastructure	Tied
Norfund (Norway)	100% state owned.	€751 million	Direct loans, equity, quasi-equity.	Energy	Untied
OeEB (Austria)	100% private, Oesterreichische Kontrollbank, though backed by Austrian Sovereign Guarantee.	€150 million	Direct loans, mezzanine loans, guarantees, advisory services.	Finance	Tied
Proparco (France)	59% state owned, 41% private.	€3.3 billion	Direct loans, mezzanine loans, equity, guarantees, syndicated loans.	Finance	Untied
SIFEM (Switzerland)	100% state owned.	€300 million	Mostly private equity.	Industry	Untied
SIMEST (Italy)	76% state owned, 24% owned by private entities.	€750 million	Primarily equity investments tied to projects with Italian companies and advisory services.	Italian industry	Tied
Sofid (Portugal)	59.99% state owned, 40% owned by Portuguese banks Banco Espirito Santo, Banco BPI, Caixa Geral de Depósitos and MillenniumBCP, which have 10% each. 0.01% owned by the Portuguese association for development and economic cooperation (ELO).	€10 million	Direct loans, mezzanine loans, guarantees, equity.	Industry	Untied
Swedfund (Sweden)	100% State owned.	€280 million	Direct loans, equity.	Industry	Untied

Table 2. Types of investment

Financial product	Main features	Debt risks for developing countries[35]
Direct loans	Money lent directly to a company or a financial institution, such as a commercial bank. These are loans that are raised on capital markets, under the institution's own accounts. They are mostly issued in major currencies but some institutions are increasingly focusing on local currencies. They are used to finance greenfield investments, as well as mergers and acquisitions.	Yes
Syndicated or 'B' loans	When a DFI or a private sector lending arm of an IFI acts as a broker between a borrower and a commercial lender or group of commercial lenders. The DFI or IFI, however, remains the sole lender of record, allowing the commercial lenders to benefit from the preferred creditor status that the public institution may have, meaning they are more likely to be repaid, for example during a foreign exchange crisis.	Allows global commercial banks to invest in the south with much lower risk.
Parallel loan	Similar to a syndicated loan except the DFI or IFI acts as a broker between borrower and other DFIs or IFIs, and groups that are ineligible under the B loan structure. This is a way for the DFIs to share risk amongst themselves.	Allows global commercial banks to invest in the south with much lower risk.
Equity	DFIs or IFIs purchase a share of the ownership of stocks from companies (that may or may not be publicly listed, but usually are not) which invest in developing countries becoming a shareholder of the company. Usually these are non-voting shares, which intentionally restrict their management role in the companies or financial institutions where they invest. Mostly bought for a limited period of time and then sold- often the DFIs promote sale through stock market flotation of the company.	No
Private Equity	Investments in private equity funds, which borrow money to buy, restructure and sell on companies in developing countries. The DFI is a limited partner in the funds, and normally takes a hands-off approach.	Significant debt problems for the companies who are often loaded up with debt from the money used to buy them in the first place. This adds to the burden of private debt, which, as demonstrated in the financial crisis, can quickly become a burden on public debt.
Quasi-equity or 'C' loans	A type of debt taken on by investors that has some elements of equity. Main examples are junior loans and mezzanine finance (see below).	
Senior and Junior loans	Senior loans are the first to be paid back in case of default, whereas junior loans are the last to be paid back.	The former have lower risk for the creditor, and the latter have higher risk for the creditor.
Mezzanine finance	Junior loans that have a very low priority for repayment in the event of default – just above the rights of ordinary shareholders. As the interest rates are high (because of the riskiness) repayment is not just through cash payments, but may involve, for example, equity.	Junior to most other loans thus considered high risk to the creditor.
Guarantees	A promise by one party to assume the debt of another in the case of default. Risk mitigation mechanism rather than an actual transfer of resources. Allows lenders to engage in riskier behaviour knowing that obligations – or part of obligations - will be met by a third party. Guarantees can encourage capital into high-risk projects that would otherwise be unable to find funding.	Yes
Grants	Some DFIs and the EIB blend grants and loans in order to subsidise interest rates or to issue concessional loans, which allows a part of them to be counted as Official Development Assistance.	Yes
Advisory services	Some DFIs offer advice to companies and to governments on diverse issues, ranging from corporate governance, environmental policies, accounting practices, and taxation. An important share of this advice focuses on how to best create an "enabling environment" to boost private sector investments.	

Public lending for private investments in developing and emerging economies can achieve high returns. During the economic and financial crisis, these institutions have seen their balance sheets increase dramatically. Sovereign guarantees and preferred creditor status protect their investments in manners that no other financial institution can compete with. At the same time, the drying up of credit markets in the immediate aftermath of the crisis allowed DFI expansion, including into new areas, such as trade finance. As a result of their healthy financial situation, on average the DFIs assessed by this report increased their commitments by roughly two fold in the second half of the 2000s. In addition, governments have been increasing the amount of funds they channel to some DFIs.

Though overall the majority of DFI lending flows to middle-income countries, DFIs have also expanded in poorer countries. The IFC's committed portfolio in low-income IDA countries has increased nearly fourfold between 2000 and 2010, from €843 million (US$ 1.1 billion) to €3.1 billion (US$ 4.1 billion). The Dutch DFI, FMO, has almost doubled its investments to LICs from €1.7 billion in 2006 to €3.2 billion in 2010,[38] and the Belgian DFI BIO has more than trebled, from €30 million to €100 million.[39]

DFIs are capable of raising large amounts of capital, and their government backing and development mandate would allow them to invest in high-risk investments that can reap large returns, although the tendency is to follow market trends and safe investments. On top of this, DFI returns are tax-free as they pay no corporate tax or dividends.[40] Most DFIs work on the basis of being a "revolving door fund," whereby profit that is made on investments is then reinvested rather than divvied up amongst the shareholders.

Different DFIs work at different levels of financing. The two largest European Development Finance Institutions (EDFIs), the German DEG and the Dutch FMO, are working with portfolios exceeding €5 billion; the

Other potential financial risks	Prevalence
When denominated in foreign currency, these loans can also contribute to balance of payment problems, particularly in the event of an external shock or a financial crisis. Local currency financing has increased among IFIs but is still problematic.	This is the most traditional financing instrument for most DFIs and IFIs, and still remains the largest share of the IFC, FMO, and EIB's portfolio.
Syndicated loans can bring finance to projects that would otherwise not be available, but run the risk of diluting the development component of the investments. Commercial banks are still only likely to invest in a project if there is a clear commercial return on the investment.	Not the focus of this research.
Similar to Syndicated loans.	Not the focus of this research.
They tend to exclude Small and Medium Enterprises in developing countries, and tend to favour the biggest companies, and usually companies registered in OECD countries.	Mixed
Depending on the strategy of the private equity fund, there may be several, including gearing the company towards repaying the debt used to purchase it through asset sales.	The IFC has a portfolio of around $3 billion, and claims to be major player in the field, having backed 10% of all funds in emerging markets.
Both place a heavier financial burden on the borrower, which commits to repaying the full amount of the loan regardless of the business performance. Same balance of payments issues as direct loans.	DFIs and IFIs, due to their mandate of engaging in high-risk investments, are more likely to issue junior loans than senior loans.
Usually quite expensive (high interest rates). Only available to relatively sophisticated companies – for example that can issue stocks, thus not normally applicable to SMEs.	DFIs engage heavily in this form of financing as they take on the majority of the risk of the investment of a project.
Can encourage further risky behaviour if not properly monitored and can lead to market distortion. All risk management products are open to the systemic risk – if a large portion of guarantees are called in at the same time, it may prove impossible to meet them.	IFIs very heavily involved – for example, MIGA is the largest global provider of political risk insurance in developing countries.
The effects of subsidising the private sector in the form of blended loans is unclear and has long term debt implications as loans that were not feasible without a grant component are made feasible.	Grants are also used by some DFIs and the EIB to provide technical assistance or advisory services.
These advisory services to governments have been controversial as they are often based on the assumption that FDI is good for development, therefore more is better. However, FDI has been proven to be a development spoiler on many occasions, particularly in the context of most FDI coming in the form of mergers and acquisitions rather than investments in greenfield projects.[37] There are also potential conflicts of interest between the DFIs or IFIs as a provider of technical advice on how governments should regulate their investment regimes, and as an investor in developing countries.	Advisory services have recently multiplied and in the case of some institutions such as the IFC account for one fifth of their entire portfolio.

two smallest, the Austrian OeEB and Portugal's Sofid, below €300 million. With these differences in budgets come differences in capacities. The smaller DFIs are quite limited in terms of staffing power and development expertise, relying on contractors and the larger DFIs for monitoring and evaluation support and development impact analysis.

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.

To ensure that development institutions that support private sector investments are delivering the type of development outcomes that citizens and taxpayers expect from them, at least three questions should be properly addressed:

- Are DFIs and aid agencies investing in private companies and financial institutions that do not have access to alternative finance?
- Are the limited public resources genuinely targeting the sectors and businesses most in need of publicly-backed credit, which are most important for national development plans?
- Are investments made by DFIs and aid agencies delivering development outcomes and contributing to poverty eradication?

The following three sections address these concerns and suggest ways on how public support for private investment could genuinely deliver for the poor.

Part 2

Who profits?

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. They 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.

Which companies and sectors deserve most support from public development budgets should depend on the priorities laid out by the national development strategies of recipient countries. However, in practice, Development Finance Institutions providing support to private investments in the South have followed some general market-driven patterns regarding the sectors and type of companies that they finance. This practice suggests that DFI and IFI portfolios respond to the centralised priorities of these institutions, casting doubt on the actual alignment of investment decisions of these institutions to the specific priorities of every recipient country. DFIs are both profit and development motivated, but ultimately they have to produce a profit to ensure their own sustainability.

Eurodad reviewed the sectoral distribution of the portfolios of the World Bank IFC, the EIB and DFIs from Belgium, Denmark, Norway, Sweden and Spain and found that during the period assessed there was a dramatic increase in lending and investments to the financial sector, which became the main sectoral priority of the majority of these institutions. We also reviewed IFC and EIB-supported companies and found that for the most part these institutions support large companies from advanced economies, which invest in poorer countries. These findings also cast doubt on whether IFIs and DFIs are genuinely supporting the companies that are the most credit-constrained and that have the potential to deliver positive outcomes for long-term equitable and sustainable development.

Leverage potential - too good to be true?

The IFC estimates that "within two decades the cost of addressing global warming in developing countries could reach $275 billion (€198 billion) per year, an investment that will not be possible without the private sector, which is expected to pay for more than 80 %."[33] Indeed the UN's High Level Advisory Group (AGF) estimates that by 2020 it should be possible to raise between USD 100 billion (€72 billion) and USD 200 billion (€144 billion) per year according to what they called a conservative leverage ratio of 1:3.[36] This estimate was obtained from papers suggesting significantly

Dramatic rise of financial sector investments

DFIs and IFIs have historically focused on infrastructure and energy. Some, such as Cofides, which confines its investments mostly to infrastructure projects, or Norfund, which prioritises energy related investments, continue to follow this pattern. However, since the global economic and financial crisis most DFIs and IFIs have massively increased investments in developing countries' financial sectors (see Figure 3).

The financial sector makes up the majority of the investments by DFIs and IFIs assessed by Eurodad for the period covered (2006-2010). On average over 50% of public finance flowing from donors to the private sector went to the financial sector. This percentage may increase even further in the coming years if the trends of the last decade persist. In 2010, combined lending and investments in the financial sector of the DFIs and IFIs assessed in this report had increased, on average, by over two fold compared to pre-crisis levels. As a result, in 2010 finance was the main sector for 3 of the largest DFIs out of 6 of assessed: the IFC, EIB, and the FMO.

In 2010, the IFC's commitments to the financial sector, including trade finance, constituted 42% of all its investments in Low-Income Countries[41], and were four times bigger than investments in any other sector. In the case of the EIB, emphasis on the finance sector is even bigger, with over 50% of investments flowing to that sector, and as much as 91% of all projects.[42] Among the bilateral DFIs, the Dutch FMO has the strongest focus on finance with 56% of its portfolio channelled to this sector compared to Norfund with only 34%, and 6% for Cofides.

Public funds invested in private financial institutions usually target commercial banks, private equity funds, and index funds. 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. In the case of the IFC, private equity only makes up 4% of their overall portfolio in low-income countries; however, in 2008 they saw a dramatic increase in use. In 2008, investments in private equity in IDA countries significantly exceeded investments in commercial banks and other forms of financial intermediaries such as microcredit enterprise. That year, 22% of the funds channelled to financial intermediaries went to loans to commercial banks, 19% to other financial services, and 59% to private equity funds.

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 Micro, Small and Medium Sized enterprises (MSMEs). 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 (MSMEs) as the financial institutions that intermediate between DFIs and MSMEs – usually commercial banks or private equity funds – do not provide in their annual reports disaggregated data on which projects and companies they supported and what development impacts were achieved. DFIs 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.

> "During the period assessed there was a dramatic increase in lending and investments to the financial sector, which became the main sectoral priority of the majority of these institutions.

Figure 3: IFC finance flowing to LICs through Financial Intermediaries by type 2006-2010

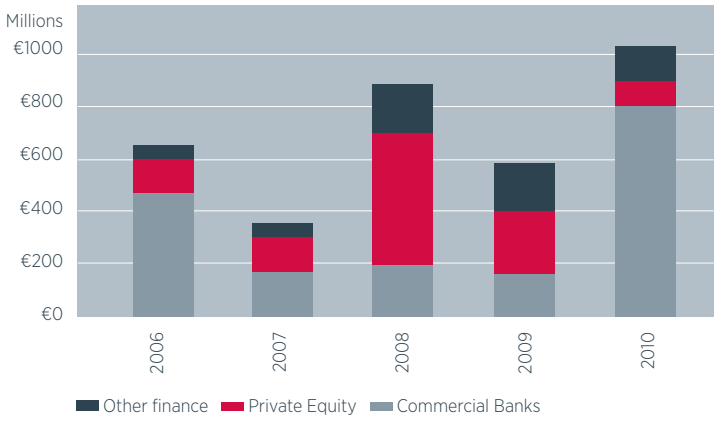
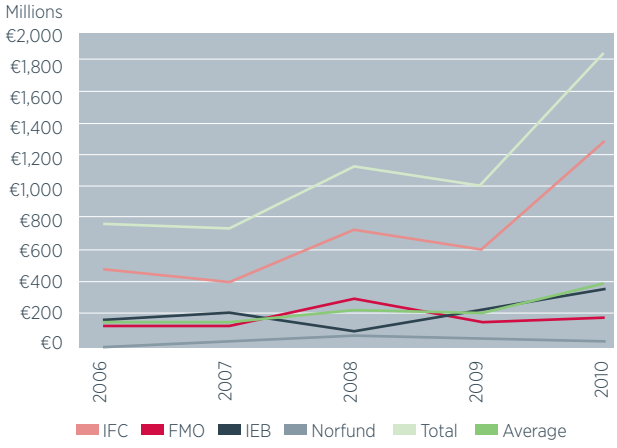


Figure 4: Amount invested by DFIs in financial intermediaries



How do development finance institutions plan to reach small companies?

Increasingly, the majority of DFI and IFI funds for private sector investment in developing countries are channelled through financial institutions which operate as intermediaries between the development agency and the final beneficiary. Over 50% of FMO and EIB investments in the second half of the 2000s were to financial intermediaries, and roughly 40% of the IFC's.

A financial intermediary is essentially a middleman between the public institution and the final private company that benefits from public lending or investments. They can be commercial banks, hedge funds, private equity funds, credit unions, or microfinance institutions, among others. The underlying rationale behind engaging with these entities is that engaging with FIs reduces transaction costs and, as the DFI or IFI has no retail outlets, this is the only manner in which they can engage directly with micro, small and medium enterprises (MSMEs). The question arises of how this actually works in practice.

Financial intermediaries are normally very opaque in both portfolio and investment strategies, particularly hedge funds and private equity funds. Therefore it is impossible for the external observer to know for what purpose the funds are being lent, and hence assess their financial and development additionality. Unfortunately development banks and private financial institutions have a spotty record when it comes to the development impact of their projects, so "trust us" does not qualify as an effective method of monitoring and evaluation.

It is not clear what real development additionality some of these intermediaries provide. This is particularly the case regarding index funds, private equity funds and country funds, as the sums they are dealing with usually surpass the amounts typically absorbed by SMEs. In some cases the DFI or IFI determines the partnership agreements of the funds, so they set the criteria for investment, but this is rare – mostly they act as a 'limited partner' with others being the 'general partner' in charge of the fund. In practice, how the fund actually invests may change significantly over time, particularly if the economic climate changes. This means that they may end up investing where the development impact is at best ambiguous and have little to do with national development strategies. This essential problem of not knowing well in advance the outcomes of DFI investment through FIs has meant that the IFC, for example, currently has two FI cases against it through its complaint mechanism, the Compliance Advisor / Ombudsman (CAO), who are also conducting a large scale review into its FI lending.

> Only 25% of all companies supported by the EIB and IFC were domiciled in developing countries. A large amount of these institutions' portfolios (49%) goes to support companies based in OECD countries and tax havens. Also, roughly 40% of the companies in Eurodad's sample are big companies listed in some of the world's largest stock exchanges.

Energy and infrastructure are no longer the main listed priority of DFIs and IFIs but still occupy a prominent second place in the sectoral priorities of these institutions. For instance, Norway's Norfund is mostly focused on energy – including renewable energy and big hydropower projects – with 45% of its portfolio. This is also the case for Cofides and IFU, which still channel most of their portfolios for LICs to the energy and infrastructure sectors. It should be noted, however, that the end recipient of finance channelled through the financial sector may still be energy and infrastructure projects. However it is not possible for this report to assess this based on the available information.

The importance of supporting local firms

The main purpose of investing public funds in the private sector is to provide financing that supports positive development outcomes for companies in developing countries that would otherwise not be able to access funds in private capital markets from private sources. This means companies that are either too small or risky to access financing from capital markets, and that are based in countries where credit supply is extremely limited, or interest rates are too high and make financing for local firms scarce and costly. What they do in practice may be quite different.

Credit constraints often represent one of the challenges facing companies in LICs, and can affect economic growth. In many developing countries, firms rely on loans from banks as they have less access to non-bank sources of financing – capital markets such as equity markets. Supporting local firms is important for strengthening the socio-economic fabric in the

world's poorest countries.

Some of the key aid effectiveness principles highlight that effective aid needs to be owned by developing countries, and country ownership must be clearly defined and demonstrated so that external development finance strengthens developing country institutions whilst at the same time delivering development outcomes. While in the private sector the role of foreign companies can be crucial when technology or entrepreneurship is not available, the principle of using country systems should also apply where possible to support domestic investment and local entrepreneurship. Research by the Washington-based Center for Global Development found that "MDB direct support to private firms could have a larger developmental impact [if it focused] on nationally owned firms, especially those that are not part of large conglomerates, and particularly on small and medium enterprises [...and] on strengthening domestic financial intermediaries.[43]"

Minimal support for companies in the world's poorest countries

Eurodad assessed all investment projects by the EIB and the IFC of the World Bank in the world's poorest countries during the second half of the 2000s and found that only 25% of all companies supported by the EIB and IFC were domiciled in developing countries. A large amount of these institutions' portfolios (49%) goes to support companies based in OECD countries and tax havens. Also, roughly 40% of the companies in Eurodad's sample are big companies listed in some of the world's largest stock exchanges. This casts doubt on whether IFIs are succeeding in channelling their financial support to the most credit-constrained companies in the world's poorest countries, or whether their investment patterns are simply following market trends. Most MSMEs in developing countries are unable to list themselves on national stock exchanges, much less the world's largest.

Out of 847 EIB and IFC projects assessed by Eurodad, on average only 25% were intended to support companies from the world's poorest countries. In the case of the EIB only 25% of the projects supported companies from ACP countries. The majority of these projects were energy projects where ownership is easy to determine. The IFC performed even worse with only 13% of the projects channelling support to companies in LICs.[44]

Both institutions channelled, on average, just over 25% of their investments to LICs, with the EIB disbursing €1.4 billion out of €4 billion to the world's poorest countries (ACP countries only), and the IFC US$ 4.9 billion out of a total of US$ 19 billion in 2010.

It is important to note that just because a project is situated in a developing country does not mean that it is operated or owned by the companies in the country in which the EIB or the IFC is investing. Many of the projects were owned by companies external to the receiving country, some based in other middle-income countries but many in other parts of the world.

Although the EIB and IFC disclose information for most of their projects, such information does not always adequately determine the final owner of an investment. Companies that receive loans or investments from the IFC are often subsidiaries or affiliates of transnational corporations, or even investment vehicles specifically created to implement a particular project. In order to clarify who actually benefits from EIB and IFC supported projects in poor countries, Eurodad traced the beneficial ownership of all EIB IF and IFC projects in LICs from 2006 to 2010, as far as information was publicly available. Tracing the beneficial ownership – the person or group of individuals who benefit from an investment even though they may not nominally own the asset - required extensive analysis of the projects and tracking down their parent companies and equity ownership.

Final Beneficiary of top 15 EIB and IFC investments

Project	Country of ownership	Org
Ambatovy Nickel Project	Canada, Madagascar	EIB
Ohorongo Cement Namibia	Germany	EIB
HeidelbergCementAfrica	Germany	IFC
Metolong Dam And Water Supply Program	Lesotho	EIB
Olkaria I & Iv Geothermal Extension	Kenya	EIB
Exim India: South Asian IDA countries Export Facility	India	IFC
Edfi European Financing Partners I	Luxembourg	EIB
GTLP Standard Bank of South Africa Limited	South-Africa	IFC
Bujagali Hydroelectric Project	Switzerland, USA	EIB
Tanzania Backbone Interconnector	Tanzania	EIB
Warid Telecom	U.A.E.	IFC
Helios Towers	UK	IFC
Vodafone Ghana	UK	IFC
Cai Mep Port	USA, Vietnam	IFC
Vietnam Bank for Industry and Trade	Vietnam	IFC

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 supply.

Public money going into tax havens

Rank based on Secrecy score multiplied by size of financial sector*	Secrecy Jurisdiction	Secrecy Score as outlined by tax justice network financial secrecy index[46].	# of projects
3	Luxembourg	68	12
32	Mauritius	74	6
70	Cook Islands	75	1
1	Switzerland	78	5
30	Barbados	79	2
49	Botswana	79	1
71	Dominica	80	2
12	Bermuda	85	4
55	Seychelles	88	1
59	St Lucia	89	1
40	Belize	90	1

*Ranking based on a 1-100 system where the lower the number the higher in rank.

> It is almost impossible for external stakeholders to actually track whether DFI and IFI lending and investments reached the intended beneficiaries (MSMEs).

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

Research conducted in 2010 by Eurodad, demonstrated that the lion's share of IFC investments, 63%, went to OECD based companies. Unfortunately not much has changed since then.[19]

Of the EIB projects where beneficial ownership could be traced in this new sample, 35% (€1.5 billion) went to companies based in the OECD. The largest beneficiaries of IFC investments in lower income countries are still companies based in middle income and OECD countries. Of the top eight investments in terms of amount committed to LICs between 2006 and 2011, five were to companies based in OECD countries and three in middle income and lower middle income countries.

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 supply. The intention of the investment facility is to create a partnership with ACP countries. As it currently stands this partnership appears very one sided.

Public money going to tax havens

It is troubling that most of the companies that receive the largest amount of funds are domiciled in the OECD. Furthermore, a number of these countries are often termed tax havens or secrecy jurisdictions. For example, Switzerland ranks number one in the the independent Financial Secrecy Index, and Luxembourg number three. As previously mentioned, 25% of EIB investments have a beneficial owner in a secrecy jurisdiction[45].

This is particularly worrying as an estimated 1 trillion dollars in illicit financial flows yearly exits developing countries[48]. Roughly two thirds of these flows are due to tax evasion and aggressive tax avoidance schemes driven by commercial agents that operate in tax havens and secrecy jurisdictions. These flows are essentially money lost by developing countries as they are untaxed and provide no social or distributive element for the developing country.

The EIB does a better job than the IFC at ensuring that financial flows remain in country and that the beneficial ownership of companies receiving those flows are resident within the developing world. Nevertheless a sizeable portion of beneficial ownership, 35% in regards to the EIB and 63% in regards to the IFC, is still based in developed economies.

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.

Part 3

Delivering development outcomes and doing development finance responsibly

Measuring development impact of DFIs is difficult

Most development agencies have difficulty demonstrating causal effects on developing countries, but none more so than the DFIs. This is partially due to the nature of investing in the private sector, where social outputs are not normally the objective of the private sector partner, and are difficult to measure. In the case of the IFC, two reports from the World Bank's Internal Evaluation Group (IEG) have demonstrated that the investments the IFC makes do not specify poverty eradication as a clear goal of the investments. "Projects are designed to contribute to growth and therefore may have poverty effects. However, it has been challenging for IFC to incorporate distributional issues in interventions[47]".

There is currently no harmonised approach amongst the DFIs in terms of measuring development impact. Norfund, the DEG and the IFU all have their own impact indicators; whereas the FMO uses a slightly altered version of the IFC's Development Outcome Tracking System (DOTS)[49]. With the different indicators come different approaches to project selection. Some DFIs, such as the DEG and FMO, engage in systematic ex-ante assessments of their investments, whereas others, such as Norfund, do not. The different approaches to development impact assessment are mostly due to capacity constraints. The larger the DFI, the more likely it is to have a robust monitoring and evaluation system.

The main problem with the monitoring and evaluation of DFI projects is that "development impact assessments tend to begin once the key decisions, on who, how and where investments will be made, are already determined[50]." This implies that the development additionality of projects 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.

Development impact assessment is one of the most important aspects of development finance. Without it we have no way of knowing whether projects are having a positive effect on poverty alleviation. Some DFIs would argue that impact assessments increase opportunity costs and detract from other investments, but they are not operating an ordinary bank where return on investment is the only necessary indicator. Effective environmental, social, and governance (ESG) assessment mechanisms are crucial to determining the financial and development additionality provided by these institutions. With them, scarce development finance can then be channelled to areas that have demonstrated success in meeting internationally and nationally agreed upon development goals.

Responsible Finance guidelines are insufficient

The majority of DFIs are signatories to international investment agreements such as the equator principles, the UNPRI, or other responsible financing frameworks. These commitments are often complemented by institutional codes of conduct, due diligence, and other internal policies to ensure that lending and investments by these institutions comply with standards of responsible finance.

These guidelines, which include IFC performance standards and other such commitments, are insufficient. They tend to be ambiguous, general and often quite weak. They often do not have enough leverage on the details of the contracts / contractual obligations between the DFI and the private entity. 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. Comparing the investment policies of the DFIs to the guidelines in the charter shows that there are many holes in their approach that need to be effectively addressed. Of particular concern are:

- DFIs are not operationalising aid effectiveness principles and poverty eradication into their project selection.
- DFIs do not have a harmonised approach to their investments other than voluntary initiatives.
- Many DFIs have transparency issues due to engaging with obtuse financial intermediaries as delivery vehicles for their development finance.

"DFIs are not operationalising aid effectiveness principles and poverty eradication into their project selection.

"Many DFIs have transparency issues due to engaging with obtuse financial intermediaries as delivery vehicles for their development finance.

The concept of 'leverage' – poorly defined and problematic

One of the newest arguments DFIs and aid agencies use to justify their investments in the private sector is that this can leverage significantly more finance into their projects than development institutions could ever mobilise operating alone. Leverage thus refers to "the ability of a public financial commitment to mobilise some larger multiple of private capital for investment in a specific project or undertaking[51]."

Although there are no agreed definitions or measures of leverage ratios, usually it is expressed as the amount of private sector euros (or dollars) invested in a project for every euro of public or publicly backed investment. For example, the IFC claims that "Every dollar of IFC investment leverages $3 from others[52]". The EIB states that the Africa Infrastructure trust fund, has a leverage ratio of 1:13.[53]

DFIs, IFIs and aid agencies have introduced further confusion by applying the term to related but different areas. For instance, the World Bank has sometimes unhelpfully labelled all public investments "that encourage much more widespread climate-friendly changes in behaviour by private firms across the whole economy"[54] as leverage. While these can be considered catalytic investments intending to change market behaviours, they can hardly be considered "leverage" as they do not directly mobilise additional private sector resources. Pooled financing of various "governments, MDBs, private sector, and other sources" – of the type used, for instance, in the Clean Technology Fund – has also sometimes been referred to as "leverage" thus not only counting additional private sector finance, but also other public sources of finance[55]. Last but not least, inducing policy reform is sometimes also described as "leverage"; and while it is indeed a type of leverage, it is clearly not the type that mobilises additional private sector resources.

In addition to explicit guarantees, private investors may assume that the DFI – or the national government - is unlikely to allow the investment to fail and may end up bailing it out – or persuade the government to do so. Or sometimes the assessment may be that, for example, an IFC-backed investment is less likely to fall foul of governmental interference, or indeed may benefit from special treatment from the government. This means moral hazard is a significant issue, as investors take greater risks because they assume they will not have to bear the full costs should investments turn sour.

> "If DFIs continue to use the concept of leverage to justify their activities, they will need to define much more clearly what they mean, and overcome a number of critical problems.

> "The higher the leverage ratio, the stronger the private sector influence and the lower the likely development additionality.

If DFIs continue to use the concept of leverage to justify their activities, they will need to define much more clearly what they mean, and overcome a number of critical problems, including:

Assessing financial additionality is hard, and headline figures are not reliable. Additionality – and hence leverage – cannot be assumed just because public institutions are co-investors with private funds. It could well be that DFIs or aid agencies are actually replicating existing investment or following market trends instead of investing in 'frontier' areas, where private investment is not currently flowing. Although most development agencies would claim they are doing the latter, there are serious concerns about whether this is the case. For instance, the sectors favoured have tended to be ones where investors – particularly foreign investors – are already investing in developing countries. For example, over half of the IFC's current portfolio is invested in the financial sector, infrastructure and extractives[57]. The IFC's own evaluations suggest it fails to achieve any financial additionality in 15% of investments. Any headline claiming that $x of public money leveraged $y of private investment should be treated with scepticism.

The higher the leverage ratio, the stronger the private sector influence and the lower the likely development additionality. In all forms of leverage where private investors put forward most of the capital, they will have considerable sway in the design and implementation of the investment. Their goal is to make money, not to promote development, and there will be trade-offs between their objectives and those of the public institution. The greater the leverage ratio, the smaller the overall contribution of the public body, and hence the lower its power and influence in design and implementation of the investment is likely to be.

There are opportunity costs when using limited public investment to leverage private investment. Using public resources to try to leverage private sector investment means those resources cannot be used elsewhere. These opportunity costs may be particularly important in certain countries or sectors where the need for straightforward public investment – for example in climate adaptation, healthcare, education, infrastructure or environmental protection – may be very high.

There are also a number of macroeconomic issues that will have to be considered carefully, particularly by the developing countries that are the destination for this lending, including:

Ensuring that they have strong national strategies in place to ensure investment is directed to areas which will increase productivity, employment and sustainable, poverty-reducing growth. Attempts to leverage private sector finance would be better directed at the national level and be directed by national strategies and institutions. Foreign direct investment can help developing economies by providing jobs, creating demand for domestic products and upgrading skills and technologies. However, there are a number of problems that can be caused by foreign private investment that need to be carefully considered and managed by developing countries.

Leverage can mean increasing debt, and often involves linking poor countries more closely to global financial markets. Leveraged finance is not aid – it is lending to companies, usually at market rates, which must be repaid. This may make greater credit available, but also means borrowers are more directly connected to global financial markets, which can be highly volatile and thus will be more exposed to exogenous shocks and speculative capital flows.

Conclusions

DFIs can play an important role in development finance by providing much needed financial resources to areas of the world that have access to none. While there is no doubt the private sector can be a key tool in eradicating poverty under the appropriate conditions, there is a trend amongst the development finance institutions to move away from these sorts of investments and look for projects where they can leverage large returns on investment, with the development impact being a secondary motivation. This shift can be attributed to the complicated role of DFIs, that lies somewhere between investment bank and development bank.

DFIs are increasingly regarded as representing a new model for development. The theory is that if DFIs can take a small amount of ODA and create large returns from it, while having a development impact, then this could be done with a large amount of ODA. However, before this is even considered, a comprehensive analysis of the development impact of DFI investments must be undertaken, as to date most have found them wanting.

DFIs are becoming larger players in the world of development finance. Public financial flows to the private sector through multilateral and bilateral DFIs are currently estimated to exceed €40 billion and by 2015 estimated to exceed €100 billion, putting it almost on a par with ODA. The growing conception that development impact and return from investment marry together, makes it likely that this amount will increase significantly in the post economic crises world.

While this model is tempting for bi-lateral and multi-lateral development institutions, it comes with some clear challenges. In order to be considered true development actors, the DFIs need to better demonstrate that they engage exclusively in pro-poor and equitable investments, where development impact is held above financial return. DFIs need to better harmonise their efforts to ensure that their investment strategies are in line with internationally agreed upon development goals and agreed upon principles of aid effectiveness. As it stands, the DFIs have a fragmented approach that at times is consistent with these principles, but often is not.

To ensure that DFIs have the greatest development impact, they need to target the neediest populations in developing countries and avoid targeting the "low hanging fruit." The cases of the IFC and the EIB demonstrate that there is not enough focus on retaining development finance in the private sector within developing countries, which can supply much needed revenues that can shore up government social programmes and public goods. The overwhelming emphasis on the financial sector of developing countries, particularly large commercial banks and private equity funds, brings into doubt their commitment to poverty eradication and achievement of the millennium development goals. That the majority of their goals are based on economic growth rather than on the development impact, further diminishes their ability to engage as true development actors. It is important for the DFIs to effectively manage their profit-seeking and development priorities, in order to ensure that the former does not come into conflict with the latter.

The increasing reliance on financial intermediaries must be complimented by increased transparency to ensure that they are engaging in programmes with clear development impacts. An assessment should also be made that determines which types of FIs are most appropriate for development work. DFIs and aid to the private sector in general must demonstrate clear financial and development additionality, as well as comply with the guidelines of responsible finance, as outlined in Eurodad's *Responsible Finance Charter*.

Recommendations for DFIs

Align to developing countries' investment priorities:

In order to respect developing country ownership, all investments should be aligned to country owned development strategies, including national industrial and agricultural policies and strategic priorities for private sector development. This would mean DFIs should:

- Develop a coherent framework that sets clear guidelines for how DFIs will align to country owned development strategies, developed by national governments in consultation with civil society groups, communities and other stakeholders. DFIs should respect country ownership, and not attempt to influence these strategies.
- Report clearly on how country investment portfolios are aligned with national strategies.

Make development outcomes the overriding criteria for project selection and evaluation:

Development impact should be the overriding priority at all levels of project selection. To ensure this, DFIs should:

- Mainstream development objectives into all investments, with clear outcome indicators and effective monitoring of projects from the project selection phase to its completion.

- Establish policies that ensure all contracts comply with high responsible investment standards: such as those outlined in Eurodad's *Responsible Finance Charter*.
- Require that the development outcomes of all projects be disclosed at project – not aggregated – level. This is crucial to improving accountability to external stakeholders and affected communities.

Target domestic companies as a preferred option whenever possible:

To ensure that investments in the private sector have the greatest development impact, they should be targeted towards domestic enterprises owned and domiciled within developing countries. This will support the development of competitive and locally owned industry, and stimulate domestic resource mobilisation. To this effect, DFIs must:

- Ensure that, by 2015, at least 50% of companies receiving financing are domiciled within the developing country where they are active.
- Set targets, for all investments, for local content requirements, and knowledge and technology transfer.
- Provide obligatory explanations when they invest in companies not based in partner countries.

Prevent tax dodging, and observe high corporate social responsibility standards:

Institutions with a development mandate must take a strong stand against tax dodging, and set high standards of corporate social responsibility. This would mean that DFIs must:

- Ensure that the investing company is domiciled in the country of investment, or in cases where the company is not domiciled in the country of the investments, the reason should be clearly stated. In instances where there is suspicion of tax dodging, the burden of proof must lie with the company.
- Request all companies and financial institutions involved in the transaction to disclose reliable annual information related to sales, employees, profits made and taxes paid in the country.
- Request all companies and financial institutions involved in the transaction disclose information regarding beneficial ownership of any legal structure directly of indirectly related to the company, including trusts, foundations and bank accounts.
- Implement effective systems to ensure adherence to international social, environmental and human rights standards. These systems must ensure that sub-projects are also covered and effective monitoring takes place, instead of relying on self-reporting.

Improve transparency of financial intermediary investments and review their use:

Financial Intermediaries present many challenges in terms of demonstrating development impact and financial transparency. We have already set out in detail recommendations for FIs in our recent climate finance report, *Cashing in on climate change?* Two critical recommendations for DFIs are to:

- Improve reporting so that money channelled through financial intermediaries can be better tracked and coordinated. Public investors should support FIs only if they can track where public funds are being invested. All project information from different investors should be harmonised and made available to the public and, in particular, to local stakeholders. There should be a presumption of the disclosure of information, with a strictly limited regime of exceptions, as detailed in the global Transparency Charter for International Financial Institutions.
- Understand the limitations of financial intermediaries and investment instruments by undertaking further research on their leverage potential and impact in developing countries. We have identified serious shortcomings in their potential to support the poorest countries, for example. The use of financial intermediaries should be looked at as just one of the many potential options. Research efforts should be directed at identifying best practices and assessing the strengths and weaknesses of different kinds of financial intermediaries.

Set high standards for transparency:

DFI-backed companies and financial intermediaries should comply with high transparency standards to ensure they are accountable to affected communities, shareholders, and the citizens those shareholders are accountable to. Improving transparency should also bring improvements to project design, implementation and evaluation. DFIs should

- Increase overall transparency as a means to improve monitoring and accountability to local stakeholders. Special efforts need to be made to ensure affected people can actually access information about projects that affect their lives, which includes, for example, translating key documents into local languages, and ensuring effective consultation processes, respecting the internationally agreed principle of free prior and informed consent. All information, including social, environmental and governance standards, contracts, subcontracts, investment and partnership agreements, should be available to the public and, in particular, affected communities.

Annex A
Methodology

Developing countries are defined as International Development Association (IDA) countries and IDA blend countries as defined by the World Bank country classifications.[57] This gives a sample of the 80 developing countries that have access to IDA, the World Bank's fund for the poorest countries.

The term "IDA-only countries" refers to countries that only have access to interest-free credits and/or grants from the International Development Association (IDA) of the World Bank, i.e. countries that do not have access to loans from the International Bank for Reconstruction and Development (IBRD) which are meant for middle-income countries.[58]

Countries included in sample and cut off date:

The report examined projects and investments between 2006 and 2010 by the DFIs analysed, including the IFC, EIB, FMO, BIO and Norfund.

The sample where possible constitutes of investments in LICs. In the case of the of the FMO and IFC it was possible to disaggregate LICS. In the case of the EIB the entire ACP investment facility portfolio was used. The entire portfolio of Norfund was used. Swedfund did not disclose the amount disbursed in their portfolio, so their investments are not reflected in the graphs.

Sources:

This research is based on a sample of projects from several DFIs portfolios. Full potfolios were provided by Norfund and Bio. Partial portfolios by FMO, Swedfund, Cofides, and IFU. Portfolio data on the EIB and the IFC was retrieved from their websites. Annual reports for the years covered were also used.

Categorisation of projects:

Categorisation was based on how the projects were identified in the portfolios. While the definitions of projects and investments were not harmonised the categories were linked as closely as possible. Some DFIs use different definitions and catagories. As a consequence, the data presented in this report cannot be used to make a perfect comparison between these institutions.

Beneficial ownership

Eurodad tracked beneficial ownership of companies by tracing the majority owner of the company implementing a given project (going up the chain of ownership until information was publicly available or until individual owners were identified).

When beneficial ownership was not disclosed by the DFIs, Eurodad conducted desk based research. When insufficient information was available, the project was considered to have a local beneficiary.

Endnotes

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2 Presidency Conclusions of the Barcelona European Council, March 15 2002: http://ec.europa.eu/research/era/docs/en/council-eu-30.pdf

3 EU agenda for change: http://ec.europa.eu/europeaid/what/development-policies/documents/agenda_for_change_en.pdf

4 G20 DWG: http://www.g20.utoronto.ca/2011/2011-dev-plan-110923-en.html

5 UNCTAD "Global investment trend monitor, Global and regional FDI trends 2010"

6 Donor governments committed to deliver 0.7% of their GNI as ODA in 1970 at the United Nations, UN General Assembly Resolution, 1970, para 43: "In recognition of the special importance of the role that can be fulfilled only by official development assistance, a major part of financial resource transfers to the developing countries should be provided in the form of official development assistance. Each economically advanced country will progressively increase its official development assistance to the developing countries and will exert its best efforts to reach a minimum net amount of 0.7 percent of its gross national product at market prices by the middle of the decade." European Union governments re-stated this commitment at the Barcelona EU Council in March 2002 which took place ahead of the UN Conference on financing for development in Monterrey, Mexico.

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20 The International Labor Organisation (ILO) defines challenge funds as the following: "A challenge fund is a financing mechanism to allocate funds. Instead of writing and funding projects written by the organization itself, the programme asks for proposals from organizations and institutions working in the targeted field, in this case cooperatives. Challenge funds are always set up to meet specific objectives – such as extending financial services to poor people. Applications are assessed against transparent criteria, and successful bidders must match a certain percentage of the grant. A Selection Committee then awards grants to those projects that best meet the aims of the objectives of the Challenge Fund." Taken from Project Design Manual, a step by step tool to support development of cooperatives and other forms of self help organisations, ILO 2011.

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22 For more information see Eurodad submission to the OECD "Public Private Partnerships: Fit for Development? " http://eurodad.org/uploadedfiles/whats_new/news/ppp_eurodad_final_in%20template1(1).pdf

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26 From IDDRI "Lessons from ODA relevant to providing improved access to adequate, predictable and sustainable financial support" François Pacquement: Guarantees make it possible to decrease the risk taken by the banks in the loans which they grant by sharing it. Foreign guarantees increase the borrowing capacity of local banks and lower the interest rates. They do not require as much funding as loans and may have a good development impact. The DAC has accepted to count guarantees as ODA only when the guarantee is called, which means that finance is in this case considered as developmental after it has failed."

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28 http://www.sida.se/Global/12691_Business_for_Development_memorandum_C4.pdf

29 Bo Sjo and Sara Ulvang Flygare, "Evaluation of Swedfund International An analysis of private sector development impacts", SADEV

30 "Swedfund International AB and its commission to society", Swedish National Audit Office

31 Guillermo Perry, Growing Business or Development Priority?, Center for Global Development

32 Numbers for Belgium : 2005-2010 from 2 to 8% of total ODA in 2009. In 2010 decrease to 5%. This decrease seems structural, as DGD entrusted us that certificates to BIO will be significantly decreased (from 100 mill € annually in 2009-2010 to 50 mill € in 2011-2013). You should note that 'development certificates' awarded to BIO by the state are fully counted as BIO, which seems to be an anomaly.

The spectacular growth of ODA for private sector support (to BIO) was in fact a bit of an anomaly. It fitted a double purpose: inflating ODA (which legally has to reach 0,7% by 2015) and not putting extra pressure on the budget. Certificates to BIO do not count for the federal budget as it is regarded as an investment and not as a cost. Therefore the National Accounts Institute has issued a binding advice this year that BIO has to reach a return of 5% on its investments to be regarded as investment. This, of course, really pushes the trade off between financial returns and development impact in favour of the first.

33 The OeEB is owned by an Austrian bank but back for Austria's sovereign guarantee

34 For more information please see second revision of the Cotonou agreement: http://ec.europa.eu/europeaid/where/acp/overview/cotonou-agreement/index_en.htm

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Eurodad

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- research complex development finance policy issues
- synthesise and exchange NGO and official information and intelligence
- facilitate meetings and processes which improve concerted advocacy action by NGOs across Europe and in the South.

Eurodad pushes for policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.
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