Adviesraad inzake beleidscoherentie ten gunste van ontwikkeling
Conseil consultatif sur la cohérence des politiques en faveur du développement

Opinion of the Advisory Council on Policy Coherence for Development

"Official development assistance as a lever for mobilising the private sector in developing countries (blended finance)"

1. Introduction

01. This opinion relates to blended finance, defined by the Organisation for Economic Cooperation and Development (OECD) as "the strategic use of public or private development finance, including concessional instruments, for the mobilisation of additional commercial finance towards the Sustainable Development Goals (SDGs) in developing countries."[1] It pays particular attention to the debate currently on-going within the OECD Development Assistance Committee (DAC) on "the modernization of private sector instruments", with a view to expanding the scope for deploying ODA to invest in or grant loans or to private companies, or to underwrite their activities by giving guarantees. It makes recommendations to ensure that the additional financing made possible by blending is aligned with the strategies of the developing countries, meets the criteria of aid effectiveness and is channelled towards those countries and sectors posing the greatest challenges in terms of attaining the SDGs.

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2. Presentation of the issue

02. The additional financing deemed necessary to attain the SDGs by 2030 amounts to an average of USD 2,500 billion annually[2]. This sum is far in excess of the resources available through traditional ODA, which amounted to USD 142 billion in 2016, according to the OECD DAC.

[1] DAC, "Blended Finance for Sustainable Development: moving the agenda forward", OECD, DCD/DAC(2017)9, 24 February 2017, p. 6.
[2] United Nations Conference on Trade and Development (CNUCED/UNCTAD), World Investment Report (UNCTAD: Geneva, 2014).

It is for this reason that the donor countries consider that greater recourse to blended finance, i.e. involving the private sector through the use of ODA, as a source of development finance will be essential in the future. The leverage provided by blended finance has the potential to increase the financial resources available to plug some of the gap that currently exists between the resources available and the amounts necessary to finance SDG attainment in the developing countries.

03. Mobilising the private sector to finance sustainable development is a priority international objective enshrined in the Busan Declaration on development effectiveness (December 2011), the Addis Ababa Action Agenda on financing for development (July 2015) and the Paris Agreement on climate change (December 2015). The EU also decided to set up a European Fund for Sustainable Development to promote private investment in Africa. The 30 blended finance agencies and institutions identified by the OECD[3] consist of six development agencies and twenty-four innovative financing for development (IFD) institutions, which in turn included fourteen bilateral and ten multilateral institutions. Over the 2012-2014 period, the six leading players accounted for almost 80% of the sums mobilised through blended finance: these were the United States, the Multilateral Investment Guarantee Agency (MIGA) and the International Finance Corporate (IFC), both members of the World Bank group, the United Kingdom, the European Bank for Reconstruction and Development and the Asian Development Bank.

04. The mobilisation of the private sector in developing countries is a priority objective for Belgium, referred to as such in the General Policy Statement of the Belgian Federal Government and in the General Policy Notes of the Belgian Minister for Cooperation and Development, Mr. Alexander De Croo. The reform of the Belgian Investment Company for developing countries (BIO), to open its capital to private investors, and of the Belgian Development Agency (CTB), enabling it to delegate programme execution to third parties, including private sector operators, is specifically designed to reinforce the capacity of Belgium's development cooperation to mobilise the private sector in developing countries.

05. The OECD DAC is preparing a significant reform of the principles of ODA reporting, with a view to expanding the scope for using ODA to invest in or grant loans or to private companies, or to underwrite their activities by giving guarantees. Although the proposal by the DAC Secretariat in 2016 to "reform private sector instruments (PSIs)" was not made publicly available, the projected reform set out in particular to relax the aid reporting criteria to allow donor countries to report public support for the private sector as ODA.

06. Blended finance has the potential to increase the resources available to finance development, energise the private sector of developing countries and contribute to SDG attainment. If the SDGs are indeed to be attained, however, it is essential to ensure that the additional financing is transparent, aligned with the strategies of the developing countries, meets the criteria of aid effectiveness and is channelled towards those countries and sectors where it is most needed.

[3] OCDE, Amounts Mobilised from the Private Sector by Official Development Finance Interventions (OECD: Paris, 2016).

This is why Belgium, the European Union and the OECD should take the following recommendations into account:

3. Recommendations

07. **Improve data gathering and transparency to allow assessment of the impact of blended finance on sustainable development**:

- Extend the International Aid Transparency Initiative (IATI) identifiers, to include elements of blended finance outside the scope of traditional ODA.

- Introduce common reporting standards, on databases that are accessible, comparable, up to date and distributed, to allow for clear identification of the geographic and sector destination, the intermediaries, the beneficiaries, the method of financing, and the impact of projects funded by blended finance.

08. **Guarantee that support for the private sector adheres to the principles of aid effectiveness and human rights**:

- Require blended finance providers and private investors mobilised by ODA to adhere to the principles of aid effectiveness, such as ownership, alignment, untying, transparency and mutual accountability.

- Make private investments subject to compliance with the Guiding Principles on Business and Human Rights[4], approved on 16 June 2011 by resolution 17/4 of the UN Human Rights Council, and with internationally recognised social and environmental standards.

- Prioritise support for the private sector of developing countries by targeting the local small and medium sized enterprises that constitute the most significant sources of employment, in accordance with Decent Work standards and without recourse to tied aid.

09. **Target those countries and sectors where support for the private sector is clearly likely to attain sustainable development and poverty reduction goals:**

- Encourage blended finance operators (including IFD institutions) to focus on the least developed countries.

[4] John Ruggie, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework,* UN Human Rights Council, 2011 (Doc. UN A/HRC/17/31, Annex)

- Ensure not only *ex ante* but also *ex post* monitoring and assessment of projects financed, to ensure that blended finance policies support projects making a proven positive contribution to sustainable development in all its three dimensions (economic, social and environmental).

- Improve the quality of assessments, firstly by adopting a method for assessing the impact of investments on the SDGs and human rights, as proposed by the UN Secretary-General's Special Representative on business and human rights[5], and secondly by guarantees the inclusive and transparent nature of such assessments (involvement of all stakeholders, publication of results, possibility for local populations to call upon independent project assessment bodies, etc.).

10. **Limit PSI reporting as ODA exclusively to blended finance operations demonstrating proven value added in terms of sustainable development:**

- Exclude from ODA-eligible OECD DAC reporting all export credits and non-concessional public financing, which could be considered as a subsidy in accordance with article 1 of the World Trade Organization Agreement on Subsidies and Countervailing Measures, which in principle prohibits this type of State aid.

- Exclude from ODA-eligible OECD DAC reporting all private investments in projects where the additional contribution is exclusively financial in nature, and without proven value added in terms of sustainable development.

11. **Ensure the division of labour between ODA and blended finance to guarantee sufficient financing of sustainable development in the least developed countries and in the social sectors:**

- Continue to mobilise sufficient traditional ODA to ensure the financing of sustainable development in the poorest countries and in social sectors attracting little or no blended finance, which focuses essentially on intermediate-income countries and on economic sectors.

- Avoid recourse to blended finance for public services, to avoid any form of privatisation, particularly of education, and guarantee universal free access to quality social services.

[5] Principles for Responsible Contracts: Integrating the Management of Human Rights Risks into State-Investor Contract Negotiations: Guidance for Negotiators, Annex to the Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, Mr John Ruggie, 25 May 2011, UN doc. A/HRC/17/31/Add.3.

12. **Define a strategy appropriate to the specific characteristics of Belgian development cooperation:**

- Define a consistent institutional architecture ensuring a division of labour between potential Belgian participants in blended finance (DGD, CTB, BIO, SPF Finances, CREDENDO, FINEXPO, etc.).

- Give preference to blended finance instruments appropriate to the specific context of the least developed countries and fragile states, in order to resolve the contradiction between Belgian development cooperation's policy priorities of mobilising the private sector and focusing on the poorest countries.

4. Justifications of the recommendations

13. As estimated by J. Pereira[6], ODA spent on blended finance operations between 2005 and 2013 amounted to USD 12.5 billion, approximately 1% of total ODA spending by donor countries over the same period.

14. According to the OECD[7], private investment mobilised in developing countries through blended finance operations funded by donor countries, development finance institutions (DFIs) and multilateral development banks amounted to USD14.3 billion in 2014. This represents only some 10% of total ODA and a mere 0.7% of total international financing flows destined for the developing countries[8].

15. The volume of private investment mobilised through blended finance increased by 20% annually between 2012 and 2014. This is a significantly larger increase than in ODA, which grew by only 3.5% annually over the same period. If the current growth rate were to be maintained until 2030, the private capital mobilised in developing countries through blended finance would rise to USD42 billion in 2020 and USD252 billion in 2030 – a considerable sum, yet still far short of the additional financing deemed necessary to attain the SDGs[9].

16. Assessment of the impact of blended finance on sustainable development is inadequate, due to a lack of transparency in the data published by donor countries and DFIs. This lack of transparency makes blended finance less accountable than traditional ODA as regards its adherence to effectiveness criteria and its impact on poverty.

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[6] J. Pereira, *Understanding Donor Engagement with the Private Sector in Development*, CPDE / ITUCTUDCN / Eurodad, 2015.

[7] OECD, *Amounts Mobilised from the Private Sector by Official Development Finance Interventions* (OECD: Paris, 2016.

[8] Development Initiatives, *Blended Finance: Understanding its Potential for Agenda 2030*, November 2016, p. 7.

[9] Ibid., p. 8.

17. The private investment mobilised by blended finance is largely destined for developing countries with the lowest levels of poverty and highest levels of domestic resources: 80% of blended finance investments has been directed towards countries with poverty levels below 20%, compared to 57% in the case of ODA. Between 2012 and 2014, low-income countries received an average USD60 million in such investments, compared to USD756 million for intermediate-income countries. Over this period, only 5% of the private investment mobilised through blended finance in developing countries went to the poorest countries – a much smaller proportion than for ODA, 25% of which was directed towards these countries. The five main beneficiaries (Turkey, Chile, India, Pakistan and Serbia) together accounted for over 20% of the total – of which 7% to Turkey, the biggest single beneficiary. The biggest beneficiary of blended finance among the low-income countries was Senegal, which came in no higher than 34th position. This trend runs counter to the Belgian development cooperation objective of focusing its efforts on the least developed countries and fragile states[10].

18. The sector concentration of blended finance suggests that is capable of financing only a limited part of the SDGs. Two thirds of the private investment mobilised by blended finance in the developing countries between 2012 and 2014 was concentrated on just three sectors: energy (USD11 billion), industry, mining and construction (USD8 billion) and banking and financial services (USD7 billion). Other sectors attracted smaller amounts, including transport (USD2 billion), agriculture, forestry and fisheries (USD1.5 billion). Certain public sectors are simply not suited to blended financing and enjoyed virtually zero access to such investments, among them education (USD29 million)[11].

19. It is easily understandable that certain sectors should not be well suited to blended finance, the aim of which is to attract private investment, as it would risk leading to a form of privatisation of certain services that do not lend themselves to this model, or could only adapt to it within a strict regulatory framework. The UN Human Rights Council has recommended avoiding any form of privatisation of public services such as education or water, since experience has shown that this risks leading to high levels of socio-economic segregation[12].

20. The concentration of blended finance in intermediate-income countries and productive sectors risks diverting a proportion of ODA away from the poorest countries and from social sectors, for which ODA support is essential. The tendency of donor countries to support access to markets for their domestic companies also risks increasing the use of tied aid. Furthermore, the difficulty of determining whether a project requires an ODA contribution or could be achieved without such support carries the risk that donor countries might too readily consider a project as being in need of their support, and that a growing share of ODA might be diverted away from the SDGs – especially since a project's contribution to the development of the country concerned is often determined *ex ante* and analysis of the potential value added to be gained from an ODA contribution often focuses on the financing and not on the impact in

[10] Ibid., pp. 9-14.
[11] Ibid., p. 16.
[12] [12] Human Rights Council Resolution 32/L.33: The right to education, A/HRC/RES/32/L.33, of 26 June 2016; Human Rights Council Resolution 15/9: Human Rights and Access to Safe Drinking Water and Sanitation, A/HRC/RES/15/9, 6 October 2010.

terms of sustainable development[13].

21. The projected "reform of PSIs" begun in 2016 by the OECD DAC aims to relax the criteria enabling donor countries to include more blended finance in their ODA reporting. The risk is that too great a relaxation of the ODA reporting rules might allow donor countries to include financing offering low value added for development, by treating as ODA certain export aids or guarantees on less risky projects that are currently excluded from the definition of aid.

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[13] Oxfam, "Private-Finance Blending for Development. Risks and opportunities", Oxfam Briefing Paper, February 2017.