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debt and development

A dangerous blend?

The EU's agenda to 'blend' public development finance with private finance

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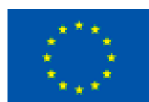
Acronyms

ACP	African, Caribbean and Pacific States
AECID	Spanish Agency for International Cooperation
AFD	Agence Française de Développement
AfDB	African Development Bank
AIF	Asian Investment Facility
BIO	Belgian Investment Company for Developing Countries
CABEI	Central American Bank for Economic Integration
CDB	Caribbean Development Bank
CEB	Council of Europe Development Bank
CIF	Caribbean Investment Facility
CIFCA	Copenhagen Initiative for Central America and Mexico
COFIDES	Compañía Española de Financiación del Desarrollo
CSO	Civil society organisation
DFI	Development finance initiative
DG DEVCO	Directorate-General for Development and Cooperation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Export credit agency
ECOFIN	Economic and Financial Affairs Council
EDF	European Development Fund
EDFI	Association of European Development Finance Institutions
EEAS	European External Action Service
EIB	European Investment Bank
EP	European Parliament
EU	European Union
FI	Financial intermediaries
FIG	Financier Institutions Group
FINNFUND	Finnish Fund for Industrial Cooperation
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden
HIPC	Heavily indebted poor countries
GDP	Gross domestic product
IADB	Inter-American Development Bank
IDA	International Development Association
IDB	Inter-American Development Bank
IF	Investment facility
IFC	International Finance Cooperation
IFCA	Investment Facility for Central Asia
IFI	International finance institution
IFP	Investment Facility for the Pacific
IMF	International Monetary Fund
IRS	Interest rate subsidy
ITF	Infrastructure Trust Fund
KfW	Kreditanstalt für Wiederaufbau
LAIF	Latin America Investment Facility
LGBF	Loan-grants blending facilities
LIC	Low-income country
LuxDev	Agence d'exécution de la coopération au développement luxembourgeoise
MIC	Middle-income country
MRI	Mutual reliance initiative
MS	Member States
MSME	Micro, small and medium-sized enterprises
NIB	Nordic Investment Bank
NIF	Neighbourhood investment facility
OCT	Overseas countries and territories
ODA	Official development assistance
ODI	Overseas Development Institute
OECD DAC	Organisation for Economic Co-operation and Development – Development Assistance Committee
OeEB	Österreichische Entwicklungsbank
PCD	Policy coherence for development
PIDG	Private Infrastructure Development Group
Proparco	Promotion et Participation pour la Coopération économique
REM	Result and measurement framework
SID	Slovenian Development Bank
SIMEST	Società italiana per le imprese all'estero
SME	Small and medium-sized enterprises
SOFID	Sociedade para o Financiamento do Desenvolvimento
TA	Technical assistance
WBIF	Western Balkan Investment Framework



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Executive summary

'Blending' is a mechanism that links a grant element, provided by official development assistance (ODA), with loans from publicly owned institutions or commercial lenders. This is not a new phenomenon. What is new is the narrative of the European Union (EU), which argues that using ODA to leverage private finance is the solution following the financial crisis. There has been an increase in development finance institutions (DFIs) and EU donors using blending mechanisms to increase support and lending to private companies and to partner with private financiers by using ever larger quantities of ODA. Eurodad is concerned about this agenda and its implications for overseas development, which are examined in detail in this report.

The EU's blending agenda is supported by a narrative that focuses on bringing the private sector to the centre of its development strategies. However, it is also a convenient excuse for donors to give less ODA, and it provides an opportunity for rich countries to support their own domestic companies. At the EU level, ODA funds have been increasingly channelled through European Commission (EC) blending facilities, and the EU hopes to use these facilities to channel a greater amount of ODA for private sector blending in the near future.

Eurodad's report finds that:

- **There is no reliable evidence to show that blending mechanisms meet development objectives.**
- **Blending mechanisms risk undermining developing country ownership, which is vital for success in any development efforts.**
- **These mechanisms are completely lacking in transparency and they are unaccountable.**
- **The added value of the grant element is questionable.**
- **Existing blending mechanisms may be wasting scarce ODA resources.**

In this report, we examine EU blending mechanisms in the context of a broader EU blending agenda. We go on to look at the eight blending facilities that are managed by the EC to support public and private investments, and look in detail at the seven facilities managed by Directorate-General for Development and Cooperation (DG DEVCO). We question the governance structure of these facilities and the lack of ownership by developing countries. The final grant decisions are taken by the EC and European member states, and there are no formal mechanisms for civil society participation in the facilities so far. The report criticises the "appalling" lack of transparency regarding decision making for project approval and implementation, with little redress for affected communities.

Part 2 attempts to delve into the current EU blending portfolio, despite the lack of information available on the ODA it is allocating to European development finance institutions through blending mechanisms. The information that is available shows that 60 per cent of grants made through these mechanisms support large-scale investments in the transport and energy sectors. While there is a need for infrastructure investments, there is also a concern that large

At the EU level, ODA money channelled through EC blending facilities has increased substantially in recent years, rising from €15 million in 2007 to €490 million in 2012.

infrastructure projects typically involve significant trade-offs, do not always directly contribute to poverty reduction in the areas where they are located, and can have significant adverse impacts on local communities.

We look at the type of grants that have been approved, mainly in the form of direct investment grants, technical assistance (TA) and interest rate subsidies. Technical assistance has been one of the most heavily criticised forms of aid, due to its failure to build long-term capacity in the recipient countries. Internal evaluations have pointed to other problems with TA in blending facilities, including a lack of strategic focus and its use to build a pipeline of deals for the lead European development finance institution, instead of responding to beneficiaries' needs.

When looking at who benefits and who profits from the current increase in blending mechanisms, our report points out that – although the majority of the funding currently goes to support public investments – the EC plans a massive expansion in the private sector as financiers and beneficiaries. Unfortunately, there is little clarity about which section of the private sector would be targeted and how this would happen. The rationale is to provide access to finance for small and medium-sized enterprises (SMEs). However, so far there is not enough information to assess whether blended finance has actually reached its intended targets.

We go on to look at financial leverage and additionality. Assessing 'financial leverage' is beset by problems of deciding who is leveraging who. Existing facilities tend to 'follow the market' by focusing on already popular areas for investment by public and private entities. Existing European-level blending facilities have largely seen both sides of the funding question – grant and loan – provided by European publicly owned institutions. This means there is no real 'leverage' of any additional resources, only a pooling of existing funding.

The concept of 'policy leverage' highlights perhaps the most worrying aspect: a strong emphasis on delivering the donors' objectives, which undermines ownership and means that non-developmental objectives will also be prioritised, such as promoting European companies or pursuing European policy interests.

Our report points out that there is little evidence available regarding how the EU-level blending facilities implement or even contribute to achieving the internationally agreed objectives of the aid effectiveness agenda, particularly the key principles of ownership, alignment, harmonisation and mutual accountability.

Eurodad recommends putting an immediate halt to any further ODA being channelled through European-level blending mechanisms, until there is:

- **A radical overhaul of the transparency and accountability of the current blending mechanisms.**
- **A full and independent review of the effectiveness of existing mechanisms focusing on their development impacts, including whether – given their governance failings – they are suitable vehicles for ODA.**

As a general principle, Eurodad believes that DFIs and aid to the private sector must demonstrate clear financial and development additionality, as well as complying with the guidelines of responsible finance, as outlined in Eurodad's Responsible Finance Charter. You can read these guidelines at www.eurodad.org.

Introduction

To support political priorities and to distract attention from diminishing aid budgets, donors are increasingly looking to private finance as a way of injecting private sector resources and expertise into development finance. According to the EC's 2011 policy paper, *Increasing the Impact of EU Development Policy: an Agenda for Change*,[1] "the EC envisages channelling a higher percentage of EU development resources to be channelled through existing or new financial instruments", known as 'blending facilities'.

According to an EC expert working group, blending facilities "combine market (or concessional) loans and other financial instruments with accompanying grant (or grant equivalent) components to gain leverage and thereby increase impact". [2]

Although the EC has been increasing the use of these instruments since 2007, it is only since 2012 that there has been a substantial shift. A new EU platform for blending in external cooperation (the EU blending platform) was set up in December 2012 to facilitate the scaling up of these blended resources.

This briefing aims to describe and analyse how blending facilities work at the EU level – particularly those facilities that are set up and managed by the EC – in order to identify the challenges and risks involved. It will also support civil society organisation (CSO) advocacy activities and campaigns towards EU institutions and multilateral and bilateral development finance institutions, which is particularly relevant in the context of the EU blending platform. The information included in this report comes from research papers, official documents and interviews with experts and officials. A summary of the methodology can be found in Appendix A.

The briefing is structured as follows. The first section presents the political context in which blending mechanisms have emerged at the EU level and describes the facilities and mechanisms set up so far, including the EU blending platform. The second section describes and analyses the current portfolio of the EU regional blending facilities, including the sectors covered, the instruments used, the beneficiaries and the standards applied. The third section addresses the crucial issues of leverage and additionality, examining definitions and implications. The fourth section identifies the problems and challenges of the current blending mechanisms, while the final section summarises the findings and puts forward a number of recommendations.

Part 1

Blending and the EU

Generally speaking, the term 'blending' refers to a mechanism that links a grant element, provided by ODA, with loans from publicly owned institutions or commercial lenders. While the grant element refers to a transfer made in cash, goods or services for which no repayment from the recipient country is required, the loan implies a repayment of principal and interest by the recipient.

Blending grants and loans is not something new in Europe or around the world. Historically, this mechanism has mostly been used to subsidise loans to the public sector in developing countries from publicly owned institutions and development banks. For many years, multilateral and bilateral DFIs have blended their own loans for infrastructure and other development initiatives with grants.

DFIs are publicly owned institutions that lend money, either at commercial rates or on concessional terms, to public or private sector borrowers in developing countries. In Europe, they include regional DFIs such as the European Investment Bank (EIB) and national DFIs, such as the German Development Bank (Kreditanstalt für Wiederaufbau – KfW) and the Agence Française de Développement (AFD).

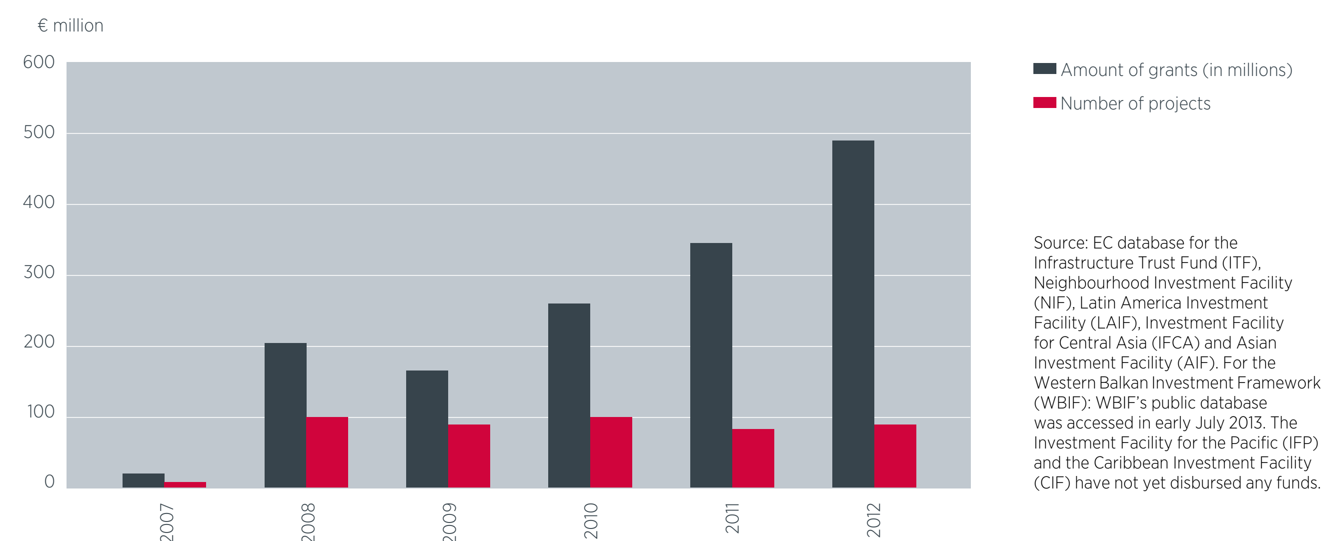
Government-backed export credit agencies (ECAs) have a long record of supporting commercial loans that have been blended with ODA grants, often in the context of tied aid programmes. At the international level, the World Bank has decades of experience blending donor funds with commercially raised loans through its low-income country lending arm, the International Development Association (IDA).

Recently many DFIs, including some in Europe, have used blending mechanisms to increase their support and lending to private companies, and to partner with private financiers in funding these activities. At the European level, this includes using ever larger quantities of ODA. Since 1996, the International Finance Corporation (IFC) – the World Bank's private sector arm – has blended small amounts of donors' concessional funds ($407 million since 1996) with the IFC's own non-concessional funding. However, in 2008 a blended finance unit was formally created to manage the concessional donor funds, which reflects an increasing support for this approach inside the IFC.[3]

At the same time, a heavy focus on private sector blending is being vigorously pursued in EU member states such as the United Kingdom, Germany and Sweden. For example, the UK is the largest contributor, after the EC, to the EU-Africa Infrastructure Trust Fund – the longest-existing European blending facility for the developing world – and an important contributor to the Global SME Finance Facility set up in April 2012 by the IFC.[4] In Germany, since the 2009 change of government, statements from the Federal Minister for Economic Cooperation and Development, Dirk Niebel, and from the German Development Bank have highlighted that there is a strong interest in promoting blending mechanisms at both a national and European level.[5] Sweden has increased ODA for private sector investments in developing countries and is promoting the use of blended finance as part of its innovative financing mechanisms, particularly to support the private sector, as well as through international development banks.

At the EU level, ODA money channelled through EC blending facilities has increased substantially in recent years, rising from €15 million in 2007 to €490 million in 2012. Between 2010 and 2012, there was a near doubling of funds (see Figure 1). This represents an increase of blended ODA in relation to EU institutions' ODA, from 0.2 per cent in 2007 to almost 4 per cent in 2012.

Figure 1 –Total ODA channelled through EC blending facilities since 2007



Source: EC database for the Infrastructure Trust Fund (ITF), Neighbourhood Investment Facility (NIF), Latin America Investment Facility (LAIF), Investment Facility for Central Asia (IFCA) and Asian Investment Facility (AIF). For the Western Balkan Investment Framework (WBIF): WBIF's public database was accessed in early July 2013. The Investment Facility for the Pacific (IFP) and the Caribbean Investment Facility (CIF) have not yet disbursed any funds.

The EU's blending agenda is supported by a narrative that focuses on bringing the private sector to the centre of its development strategies.

Despite the fact that this still represents a small percentage of overall ODA, the EC's focus on making blending mechanisms "a powerful tool to leverage private sector support" has drawn particular public attention, given that it means "a higher share of aid"[6] and a likely significant increase in private sector blending. In short, blending could be seen as part of a potential sea change for development finance, which effectively shifts ODA from the public to the private sector, while at the same time helping to replace ODA with private finance.

Political context and rationale

The EU's blending agenda is supported by a narrative that focuses on bringing the private sector to the centre of its development strategies. However, it is also a convenient excuse for donors to give less ODA, and provides an opportunity for rich countries to channel finance to their own domestic companies. During a time when European public finances are under pressure, the idea of 'financing more with less' public money is an attractive political objective. As noted above, many EU governments have also placed the private sector at the centre of their development strategies. However, in reality blending mechanisms are also meant to 'underpin EU external priorities',[7] which include enhancing the EU's aid visibility and even supporting the activity of big EU corporations operating abroad. This controversial private sector turn in development finance, of which blending is just one expression, could be seen as a reaffirmation of the Washington Consensus in Europe, which implies the predominance of market-driven approaches.[8] In some ways this may be true, as ODA would become increasingly tied to, and channelled through, private actors. However, blending also entails far larger public support and subsidies for private sector actors, and inevitably means selecting sectors and countries rather than letting the market decide.

The EC has been driving the push for greater private sector blending, and has been supported by EU governments gathered together in the European Council. *The EC's Agenda for Change* is a strategic document that is being reflected in all EU programmes, and puts forward a narrative in which "leveraging private sector activity and resources" is seen as key to delivering public goods. This approach was endorsed by the May 2012 European Council Conclusions. Since then, numerous EC policy papers and public statements from EU officials have included explicit references and commitments in this regard. For instance, according to the EC communication on improving EU support to developing countries in mobilising financing for development, released in July 2012,[9] "the EU should use its grants more strategically and effectively for leveraging public and private sector resources", through regional blending mechanisms, "which are expected to be further scaled up in future in order to leverage grant resources". These plans were also stressed in the 2013 EC Communication and EU Accountability Report on Financing for Development.[10]

Table 1 – EIB Investment Facility and own resources for ACP countries and OCTs

Instrument	Grant envelope	Capital endowment under EDF
Investment Facility for Africa Caribbean and Pacific countries	10th EDF: €400m (2008-13)	9th and 10th EDF: €3,137m (2003-13)
Investment Facility for Overseas Countries and Territories	10th EDF: €1.5m (2008-13)	9th and 10th EDF: €48.5m (2003-13)

Source: Annual report on EIB activity in Africa, Caribbean and Pacific, and the overseas territories (2012).

We can expect this concerted political push from the EC to result in a significant increase in ODA and member states (MS) contributions being devoted to private sector blending at the European level in the near future. The discussions on the EU Multiannual Financial Framework 2014–2020 have represented a key opportunity to put in practice what was established in the *Agenda for Change*. Blending was presented by the EC as a key 'new' element, on which further efforts should be focused. In addition, the EC has also encouraged DFIs, including the EIB, to enhance their participation in blending mechanisms. In its proposal on the external lending mandate of the EIB for 2014–2020, the EC states that "the EIB should endeavor further to enhance coordination and cooperation with European Financial Institutions and International Financial Institutions, notably those participating in the EU Platform for Blending in External Cooperation".[11]

However, the European Parliament (EP) and many CSOs have challenged the EC's private sector blending agenda. An EP resolution[12] adopted on 23 October 2012 called on the EC "to provide clear information on how this [blending] mechanism serves the purpose of a development policy based on ODA criteria and how the power of scrutiny of Parliament will be exercised". In its June 2013 resolution on financing for development, the EP echoed CSO concerns, calling "on the EU to properly evaluate the mechanism of blending loans and grants – particularly in terms of development and financial additionality, transparency and accountability, local ownership and debt risk – before continuing to develop blending loans and grants".[13]

Overview of EIB and EC blending facilities

The ODA that is used for EU-level blending comes from a variety of sources, but principally from the European Development Fund (EDF) and the European Commission's development budget. The EC's development budget is part of the overall EC budget and hence is subject to approval and scrutiny by the EP and all the governments of the EU, through the Council. However, the EDF is a separate voluntary fund and member states can decide themselves how much to contribute to it. As such, it is subject to its own financial rules, which are different from those that

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apply to the EU budget. This means that the EDF is controlled directly by the EC, with no parliamentary oversight, and hence it has far less accountability than the regular EC development budget. There has been mounting pressure from the EP to bring the EDF under its scrutiny by including it in the next multiannual financial framework (2014–2020) – the budget of the EU – but this decision has been delayed until 2020.[14]

At a European level, blended ODA is currently being channelled through facilities managed by either the EIB or the EC, and an internal evaluation suggests there is little coordination between the two. The EIB manages two blended funds (see table 1), and the EC manages eight (see Table 2). The mid-term evaluation review of the investment facility (IF) managed by the EIB concludes that "the Commission and the EIB generally operated on parallel tracks with few synergies despite the potential benefits of such synergies for enhancing development impact".[15] As the EC also implements programmes at national and regional level in African, Caribbean and Pacific (ACP) countries, this lack of coordination, which can create extra burdens for recipients and potentially lead to the duplication of efforts, is worrying.

EIB blended finance

The EIB manages an IF for blending that was launched in 2003 – with two separate windows. It is separate from the EIB's own resources and is a revolving fund, meaning that if returns are generated they are used for further investment. One window is for African, Caribbean and Pacific States (ACP) countries, and the other for Overseas Countries and Territories (OCT) of EU member states. The fund has a capital endowment from the EDF, which allows it to offer market-linked loans, equity funding and guarantees, and also has a grant envelope from the EDF to be used for technical assistance and interest rate subsidies, as shown in Table 1.

As the mid-term evaluation of the IF has stressed,[16] the IF has to respond to market opportunities, which all too often implies a problematic trade-off between developmental objectives and the requirement of financial viability. As the revolving fund is separate from the EIB's own budget, it is free to make riskier investments and set its pricing accordingly. However, if it loses money overall it will shrink, meaning the financial viability of projects is of paramount importance.

The political agreements guiding IF investments focus on poverty reduction, sustainable development, and the integration of these countries into the world economy. These are interpreted by the EIB as a mandate to support the private sector. Cooperation agreements guiding EIB operations in ACP countries and OCTs are the Cotonou Agreement[17] and the Overseas Association Decision, respectively. These are centred on poverty reduction and ultimately its eradication; sustainable development; and progressive integration of the ACP and OCT economies into the world economy. In this context, the IF is set up to promote private sector development and is specifically tasked with supporting the ACP financial sector and "to seek and channel funds through ACP national and regional institutions and programmes that promote development for small and medium-sized enterprises".[18]

Financial intermediaries (FIs) have been increasingly selected by the EIB as the vehicle to reach small and medium-sized enterprises (SMEs), raising concerns

Table 2 – EU regional blending facilities and grants commitments until 2013

Instrument facility and launching year	Region covered	Allocation and sources of grant funds (in €m)				
		From 10th EDF	From EU Budget*	From MS	Other	TOTAL
EU-Africa Infrastructure Trust Fund – ITF (2007)	47 African countries	308.7	329 ear-marked for SE4All	84 (as of 30 Sept. 2012)	0	721.7
Neighbourhood Investment Facility – NIF (2008)	Countries eligible for European Neighbourhood and Partnership Instrument	0	767	72 (as of 31 Dec. 2012)		839
Western Balkan Investment Framework – WBIF (2009)	Western Balkan countries	0	196 (2008-2012)		EIB: 10, EBRD: 10, CEDB: 10 19 Donors: 84.95 (as of 31 Dec. 2012)	310.95
Latin America Investment Facility – LAIF (2010)	Latin American countries	0	192	0	0	192
Investment Facility for Central Asia – IFCA (2010)	Central Asia countries	0	65	0	0	65
Asia Investment Facility – AIF (2011)	Asian countries	0	30	0	0	30
Investment Facility for the Pacific – IFP (2012)	Pacific countries	10	0	0	0	10
Caribbean Investment Facility – CIF (2012)	Caribbean countries	40	0	0	0	40
	TOTAL	**358.7**	**1,579**	**156**	**114.95**	**2,208.65**

(*) EU budget figures correspond to the period 2007-2013, unless otherwise stated.

about transparency, accountability and development impact. In 2012, 43 per cent of EIB lending went to support the ACP financial sector. FIs act as brokers between the public institution and the private company benefitting from public lending and investments. This trend has raised concerns from CSOs about the lack of transparency over where the money ends up and who actually benefits, with little information provided to the public by the intermediaries, including commercial banks, microfinance institutions and private equity funds. FIs have also been criticised for using tax havens that render their investments opaque and obstruct accountability to beneficiaries, other stakeholders and also taxpayers whose money is backing FI investments. This casts some doubts on whether the intended beneficiaries are actually reached and whether this is the right tool to provide access to finance for SMEs.[19]

EC blended finance

There are eight blending facilities managed by the EC to support public and private sector investments, which have received €2.2 billion in grants so far. As Table 2 shows, these facilities get grant funding from the EU budget, the EDF and member states, which are blended with loans from other financial institutions. These facilities cover all the regions where the EU has development cooperation and relate to specific regional and country-level strategies and partnerships,[20] with the aim of supporting EU policy in those regions and countries.

The EC-managed facilities have historically been smaller than those managed by the EIB, and the total amount of ODA used for blending at the EU level has not yet been a significant proportion of ODA. However, EC and European Council rhetoric suggests that the current negotiations over the EC budget – known as the Multiannual Financial Framework 2014–2020 – will result in a significant increase in the amount of ODA directed to private sector blending mechanisms in the future.

There are also signs that the EU hopes to use these facilities as part of its foreign policy priorities for middle-income countries (MICs), and as the main method of channelling funding to MICs. The EC has recently adopted a "differentiation"[21] approach, which basically means cutting aid from MICs to concentrate ODA in low-income countries (LICs) to "ensure the poverty focus of EU aid". For instance, in the specific case of Latin America, only seven countries would continue receiving EU country-level cooperation. However, all countries in the region would remain eligible for regional programmes such as the LAIF (Latin American Investment Facility), which points to the increasing relevance of the blending instruments for EU development cooperation in MICs.[22] While ensuring that EU aid is better targeted towards countries with a high level of poverty is laudable, it is highly questionable whether the current shift towards an ever greater involvement of the private sector in the provision of aid for MICs is a good way to meet the development challenges associated with those countries.

Governance structure of the EU facilities: EC and DFIs are key players

Although the eight blending facilities are based on a three-tier governance structure,[23] the EC chairs or co-chairs all but one of these governing bodies. This includes all of the strategic boards, meaning that these are in effect EC-managed blending facilities, as shown in Table 3. The governance structure for each facility is composed of a strategic board, an operational board and a financier institutions group. These bodies are composed of EC staff – from the Financial Instruments Unit of the EC Directorate-General for Development and Cooperation (DG DEVCO) in six of the cases – MS representatives and financial institutions (in some cases as observers), which meets to assess and take decisions on project proposals. The composition rules of the different bodies, and the grants approval processes, may differ between facilities because of the ad hoc manner in which they were set up.

Table 3 – EU blending facilities: Governance structure

	Facilities		
Body	**NIF/LAIF/IFCA/AIF/CIF/ IFP(a)**	**WBIF(b)**	**ITF(c)**
Strategic board Sets the goals of the facilities to guarantee they are in line with the wider EU policy	**Members** EC, MS, beneficiary countries and financial institutions (observers) **Co-chairs:** EC and EEAS	**Members(d):** EC, EBRD member countries, if they are donors, beneficiary countries and financial institutions **Co-chairs:** EC and one donor	**Members:** EC, MS, beneficiary countries and financial institutions (observers) **Co-chairs:** EC and AU
Operational board Decides which projects should receive grants and monitors the development of the project pipeline.	**Members:** EC, EEAS and MS, financial institutions (observers) **Chair:** EC		**Members:** EC, donors, MS which are not yet donors and the EIB (the last two as observers) **Chair:** EC (but can rotate)
Financiers group Selects projects based on guidelines and financial sustainability	**Members**: EC and financial institutions **Chair:** EC	**Members:** EC and financial institutions **Co-chairs:** EC and financial institutions	**Members**: Project financiers nominated by each donor **Chair:** No formal, typically the EIB

(a) Directorate-General for Development and Cooperation is in charge.

(b) Directorate-General for Enlargement is in charge.

(c) The EIB acts as the fund manager and is in charge of providing the secretariat.

(d) In the case of the WBIF, this body is called Steering Committee.

Source: Annual reports and public documents

The EC has the bigger say in the approval of projects through the leading and convening role of its Financial Instruments Unit. The unit is responsible for the organisation and follow up of the whole assessment and decision-making process, as well as for bringing together the different elements of the EC's opinion on the grant requests. The unit also acts as the chair of the operational board, which requires the DFIs seeking funding to present a 'project fiche', prior to discussion at the technical level, justifying the need for a grant element and the type of grant requested (see Figure 2 below). However, there is no clear information available on the method to assess the grant needs of projects proposed and there is still considerable room for a political decision.

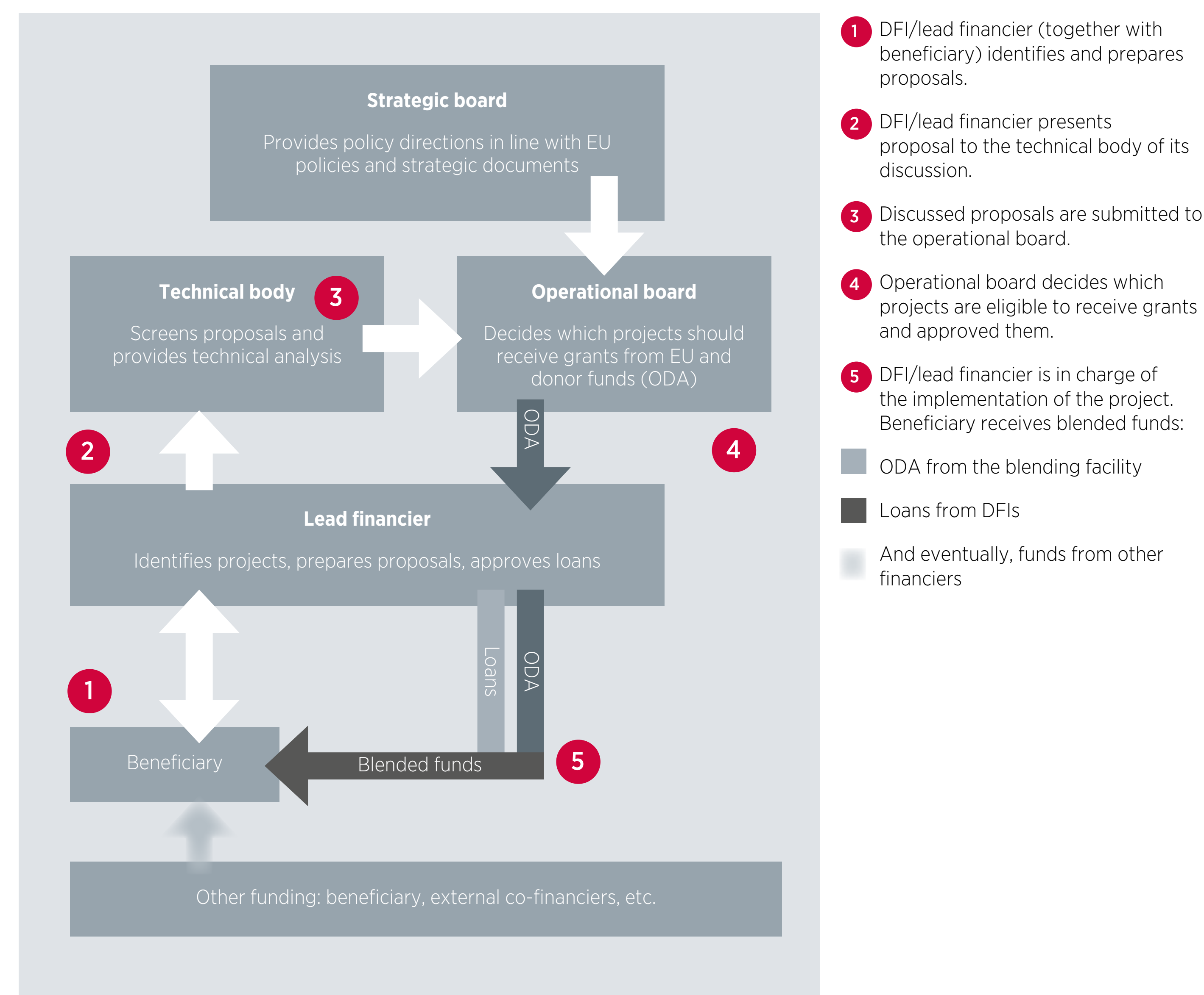
Figure 2 describes the project approval cycle of the six regional facilities managed by DG DEVCO.

Partners in the beneficiary country can be public, private or mixed, with public partners dominating the current portfolio so far. However, in 2012 the number of projects granted to private sector partners doubled from 2011 and the EC plans a massive increase in this area (additional analysis on this can be found in part 2).

In general there is a very low level of ownership over the facilities by the countries affected, a failure that will significantly reduce their effectiveness. This is despite the fact that EU member states have signed several international agreements citing ownership as a key criterion for development effectiveness.[24] Developing country governments have representation only on the strategic board, and unsurprisingly their participation has been weak.[25] This could be because they do not have the right incentives to participate actively in strategic discussions when they are excluded from the Operational Board where project decisions are made. In fact, this undermines even further the connection between the strategic directions of the EU blending facilities and the development priorities of the recipient country.

In addition, recipient country institutions or regional organisations are not allowed to lead implementation, even though they are often likely to be better placed than DFIs based in European capitals. In practice, the EC and EIB claim there is recipient governments' ownership because they negotiate and sign a loan agreement – in some cases with the ministry of finance. However, their exclusion from directing, designing and implementing projects fatally weakens this claim, even more in the case of private sector projects where partner countries are just formally notified about a proposed operation and asked to provide its consent. Finally, there is scandalously low transparency for the facilities. Information is incomplete and/or out of date – so accountability or involvement of recipient stakeholders beyond governments, such as parliaments, civil society groups and affected communities, is very low.

Figure 2 – Project approval cycle of the EU regional facilities



1. DFI/lead financier (together with beneficiary) identifies and prepares proposals.
2. DFI/lead financier presents proposal to the technical body of its discussion.
3. Discussed proposals are submitted to the operational board.
4. Operational board decides which projects are eligible to receive grants and approved them.
5. DFI/lead financier is in charge of the implementation of the project. Beneficiary receives blended funds:

- ODA from the blending facility
- Loans from DFIs
- And eventually, funds from other financiers

A dangerous blend? The EU's agenda to 'blend' public development finance with private finance

EC and European Council rhetoric suggests that the current negotiations over the EC budget will result in a significant increase in the amount of ODA directed to private sector blending mechanisms in the future.

The case of the WBIF is exceptional, since grant requests are submitted, endorsed and ranked by the beneficiary government, and in some cases by the DFIs in coordination with national authorities. This allows for active participation of the national government in the discussion of the project proposals since its inception, although participation of other stakeholders and transparency remains extremely low.

Government-owned European DFIs also play a key role in the current governance structure, due to their initial role in the project development and approval process, and the exclusion of non-European institutions from any leading role in delivery. Although non-European regional financial institutions have a consultative role, and can take part in project implementation, only a 'lead' European institution can take the lead in the financing, implementation and monitoring of the project, including coordination with other DFIs (see Table 4). There is no formal requirement for engagement at initial stages from local stakeholders.

In fact, Eurodad research shows that just four DFIs – the EIB, AFD, KfW and the EBRD – are the most important driving institutions of the EU blending facilities, representing 91 per cent of the amount of grants approved by the six EU blending facilities managed by DEVCO (see figure 3). Similarly, the ITF mid-term review found that just three DFIs – AFD, KfW and EIB – are in charge of 44 out of 48 grant operations approved or completed by 5 July 2011.[26]

The prominent role of the EIB comes as no surprise since it is, according to its own website, the "largest multilateral borrower and lender by volume". Lending in 2012 amounted to €52 billion, after a peak in 2009 of €79 billion. The vast majority of EIB activity is focused on Europe, but since 1980 the bank has increased its non-EU operation volume steadily. In 2012, lending to partner countries represented 14 per cent of total lending.[27] As well as managing the ACP IF, the EIB acts as a fund manager of the Infrastructure Trust Fund (ITF), hosts its secretariat and is responsible for treasury and accounting. Outside the EU, it operates under various mandates approved by the EP and the Council of the EU, which are based on EU external cooperation and development policies, among them the Cotonou agreement and its External Lending Mandate (currently 2006–13). It also plays a leading role in the other facilities set up by the EC. Among CSOs, concerns are rising in relation to the increasing responsibility of the EIB as creditor outside the EU. In the run-up to the approval of the new EIB External Lending Mandate for the period 2014–2020, questions focus on how to ensure that the EIB delivers on EU development objectives, in an effective, transparent and accountable fashion.[28]

In addition, as Eurodad research shows,[29] development finance institutions targeting the private sector and 15 gathered in the association of European Development Finance Institutions (EDFIs), have experienced a significant increase in their consolidated portfolios in the last four years despite the financial market crisis, from €18.5bn in 2009 to €26bn in 2012.[30] Protected by their public liability and driven by their development mandate, these institutions are in a position to make investments with potentially lower profit and higher risk, but with a higher social return. However the tendency has been to follow market trends and safe investments.[31] Although most of the EDFIs have not been involved in the EU blending facilities yet – only five of them belong to the financiers group – they have been consulted as part of the technical work of the EU blending platform and a bigger role is expected for them in the future.

Bias of the current governance structure

Given the above, it is important to make some concerns from the development perspective explicit in relation to the current governance structure:

- **Beneficiary governments are represented only at the strategic level,** and it is not clear how their priorities are translated into action at the time of selecting and approving projects. In addition, in many of the EU regional facilities the actual participation of beneficiaries in those meetings has been low.
- **The final decision of grant approvals lies with the operational board, which is in the hands of the EC and European member states,** while partner countries are not actively involved in the body where decisions are taken. As a result, some cases indicate that selected projects often do not match the needs and priorities of recipient countries.[32]
- **There are no formal mechanisms for civil society participation and consultation,** either on the strategic directions of the regional facilities or during the implementation process of the majority of the projects approved.[33] In addition, there is extraordinarily limited information available, making public participation and scrutiny, including by parliaments, virtually impossible. The EC has claimed that EU delegations are key players engaging local communities, but in fact this has not been the case yet in relation to blending projects. In particular, the mid-term review of the Neighbourhood Investment Facility (NIF) backed these concerns, asking for increased transparency of governance and publication of relevant documents, inclusion of civil society in NIF consultation mechanisms and early involvement of EU delegations in pipelines and project cycles.[34]
- **There is a conflict of interest inherent in the fact that DFIs are engaged in strategic decisions about which projects get funding and also in project implementation.** For example, in the case of the Infrastructure Trust Fund (ITF), the EIB participates as an observer in the strategic and operational bodies, and de facto chairs most of the meetings of the Financiers Group, is lead financier of 50 per cent of the grants operations approved, and is heavily involved in implementation.[35]
- **There is an appalling lack of transparency, meaning parliaments, both in recipient countries and at the EU level, affected communities and civil society groups cannot access any information about many projects, and only rudimentary facts about others.** This prevents any proper assessment and meaningful participation, which undermines the development effectiveness of such mechanisms. The message from the EC on blending is clear: trust us, do not question us.
- **Furthermore, for several of the DFIs implementing projects, there are no effective mechanisms for complaint or redress for affected communities. This is a failing that is particularly problematic given the focus on infrastructure projects, which inevitably lead to serious issues for those living nearby, including resettlement and environmental damage.** In the case of the NIF, the Tbilisi Railway Bypass Project and South Ukraine Transmission Project have raised serious concerns from national CSOs, but current governance structure and procedures do not facilitate any specific mechanism to deal with them in an inclusive and participatory way.[36]

Table 4 – EU blending facilities: participating financial institutions

Facility	Full members	Observers
NIF	AECID, AFD, CEB, EIB, EBRD, KfW, NIB, OoEB, SIMEST, SOFID	
AIF	AECID, AFD, EIB, EBRD, KfW, NIB, OoEB, SIMEST, SOFID	ADB
IFCA	AECID, AFD, EIB, EBRD, KfW, NIB, OoEB, SIMEST, SOFID	ADB, WB
IFP	AECID, AFD, EIB, KfW, NIB, OoEB, SIMEST, SOFID	ADB
LAIF	AECID, AFD, EIB, KfW, NIB, OoEB, SIMEST, SOFID	CABEI, CAF, IADB
CIF	AECID, AFD, CDB, EIB, NIB, IADB, KfW, OoEB, SIMEST, SOFID	CABEI
ITF	AECID, AfDB, AFD, BIO, EIB, FINNFUND, KfW, LuxDev, OoEB, PIDG, SIMEST, SOFID	
WBIF	EIB, EBRD, CEB, KfW, WB	

Source: Annual reports

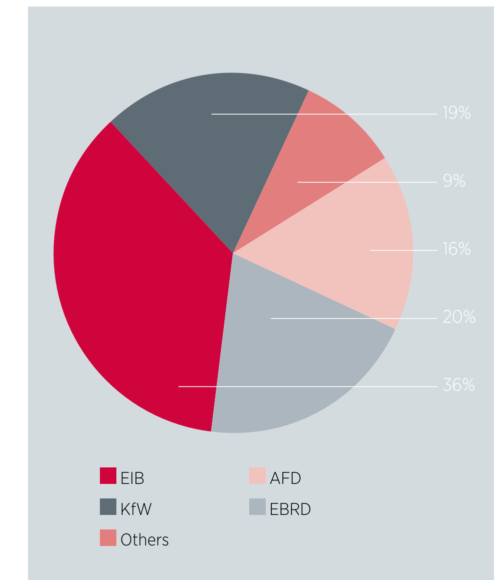
There is an appalling lack of transparency, meaning parliaments, both in recipient countries and at the EU level, affected communities and civil society groups cannot access any information about many projects.

The current governance structure of blending mechanisms is biased towards European domination, with low involvement of partner country governments, little care taken regarding the opinion of other stakeholders in partner countries, serious transparency problems, and multiple conflicts of interests. Current blending mechanisms have not been designed for development purposes.

Objectives and eligibility criteria of EU facilities

Poverty reduction and sustainable development are often part of the objectives for EU blending facilities, and are legal requirements of the Treaty of Lisbon. However, some of the institutions involved have other, potentially conflicting, objectives. The Treaty of Lisbon[37] states that development cooperation is a key element of the EU's external relations and should focus on reducing and ultimately eradicating poverty.[38] This is a clear political commitment to strive for policy coherence for development (PCD) and therefore adequate instruments are needed to pursue this. However, not all the institutions involved in the existing blending facilities have a common and agreed development mandate. For example, while the German KfW "contributes to reducing poverty and to ensuring that globalisation affords opportunities for everyone", the Italian Società Italiana per le imprese all'estero (SIMEST) is dedicated to "promot(ing) foreign investment by Italian companies and to provid(ing) technical and financial support for investment projects". This will create additional challenges to the design

Figure 3 – EU blending facilities managed by DG DEVCO by lead DFI
(% of grant approved)



Source: EC database – May 2013

When projects are selected, evaluations frequently find that poverty reduction objectives are not properly prioritised or integrated into existing blending facilities.

and implementation of projects supported by blended money, as the objective of promoting European firms has been shown to significantly reduce the development impact of funding. Despite the longstanding agreement among donors to seek to untie all aid, [39] this consensus seems to be under threat due to political shifts in donor countries, which the EU's current blending practices are also eroding.

In fact, as the following examples from internal evaluations and external case studies show, there is a matching problem between the stated objectives and the instruments and actions implemented:

- **Infrastructure Trust Fund (ITF):** Whereas the overall objective of the ITF is to "contribute to economic development growth, integration at regional level and poverty reduction", its mid-term review[40] states that the strategic intent "was not translated into specific objectives for the Fund to allow prioritisation of instruments, and set a clear results framework". In addition, the review concludes that "the objectives, whilst still relevant, are broad, do not show the causal chain from inputs to outputs, outcomes and impacts, and therefore might not reflect current and future challenges".
- **Neighbourhood Investment Facility (NIF):** Similar concerns are raised in the NIF mid-term evaluation, which finds that, although the NIF's aim is to support smart, sustainable and inclusive growth, the dimension of inclusiveness is not specifically incorporated into the design, is not assessed and is not measured and followed up.[41]
- **Latin America Investment Facility (LAIF):** In the case of the LAIF, it seems that the objectives stated do not correspond with the political and legal framework to which the facility must respond. While LAIF's main purpose is "to mobilise additional financing to support investment in Latin America", its three strategic objectives are: to a) improve interconnectivity between and within the Latin American countries; b) reach increased protection of the environment and control of climate change impacts; and c) promote equitable and sustainable socio-economic development. As research commissioned by the Copenhagen Initiative for Central America and Mexico (CIFCA) and Grupo Sur[42] mentions, "achieving the three strategic objectives of LAIF does not lead directly to achieving the main objective".

Furthermore, when projects are selected, evaluations frequently find that poverty reduction objectives are not properly prioritised or integrated into existing blending facilities. In particular, a study commissioned by the European Parliament concludes that "it remains unclear in what way poverty reduction is considered by loan-grants blending facilities (LGBFs), what the transmission channels are and to what extent positive impacts on poverty are required for operations to be eligible."[43]

- **ITF:** The ITF states that "poverty reduction will be [a] key criteria for project selection",[44] but the evaluation report states that "the ability to demonstrate relevance to all development criteria is variable, depending on the type of instrument and state of the project cycle". When reviewing the ten case study projects considered in the evaluation, it is striking to note that only two mention a direct link to poverty reduction outcomes in the application documentation,[45] while another "contributes to poverty reduction through economic development",[46] and three others refer to job creation in a broad although unclear way.[47] This casts some doubt on the criteria used and the mechanisms in place for screening the potential projects.
- **LAIF:** While documents set out a long list of criteria for project selection,[48] as the expansion of the '5 de Noviembre' hydropower plant in El Salvador and the Bii Nee Stipa II wind farm in Mexico (explored later in this report) clearly demonstrate, priorities are often given to the financial return over the social and environmental aspects of development, while the economic sustainability of the projects often remains doubtful.[49]
- **NIF:** Similarly, the NIF mid-term review concluded that "relevance to social goals, inclusive growth and poverty reduction needs to be strengthened", as well as the quality of the information included in the project proposals. The evaluation also states that "notwithstanding the importance of poverty reduction to ENP and NIF, the facility has so far not developed adequate and harmonised tools to assess, steer and monitor project portfolios according to social development and poverty reduction potential of project proposals". Therefore, the evaluation recommends improving and specifying eligibility criteria, including the introduction of priority criteria that allow the selection of the 'best' interventions.[50]

Box 1 – EU platform for blending in external cooperation

In mid-December 2012, an 'EU Platform for Blending in External Cooperation' (EUBEC) was set up. It consists of officials from EU institutions and member states, and technical inputs from the EIB and other DFIs. The EP is relegated to an observer role, and civil society participation is excluded. This platform was set up after recommendations from various expert groups[51] and a public consultation, during which Eurodad and others raised serious concerns about further expansion of blending without major reforms.[52] It aims to "provide recommendations and guidance on the use of blending in the external cooperation of the European Union", acting "as a major forum [...] to improve the quality and efficiency of blending mechanisms". However, it is not completely clear how the final recommendations will be implemented.

Chaired by the EC, the platform is composed of a policy group that is responsible for making policy recommendations. It also contains the European External Action Service (EEAS) and European member states, and the EP sits as an observer. This is informed by various technical groups, which the EC also chairs, with the EIB, bilateral and multilateral European DFIs, plus other non-European DFIs that participate in the facilities as observers. The statutes of the platform explicitly mention the possibility of additional observers and the possibility of "ad hoc consultation of other stakeholders".[53] However, CSOs are not directly involved in the work of the platform.

The ambitious workplan suggested for the platform shows how the EC hopes to use it as a vehicle to expand blending facilities, rather than subjecting them to the thorough review that Eurodad believes is necessary if they are to play any role in development cooperation. The 2013 workplan asks the platform to:

- review the existing blending mechanisms;
- enhance blending activities, notably with the development of a results-based framework and standardise efforts of the reporting environment;
- streamline agreements and promotion of cooperation and coordination;
- further develop financial instruments like guarantees or risk capital participation.

Poverty reduction and sustainable development are often part of the objectives for EU blending facilities. However, some of the institutions involved have other, potentially conflicting, objectives.

Part 2

Key features of the current portfolio

It has proved extremely difficult and time consuming to analyse the current EU blending portfolio, due to the scandalously low level of information that is publicly available, and the lacklustre efforts of the EC to track and evaluate the ODA that it is allocating to European DFIs through blending mechanisms. It is not possible to do a proper portfolio analysis of the projects supported by blended ODA, as the EC does not track or evaluate the commercial loans that ODA grants are blended with, nor estimate the extent to which the grants proved essential to attracting the loan. Based on the limited information available, however, there are some important remarks to make in terms of sectors, instruments and beneficiaries. More information on the methodology is available in Appendix A.

> It has proved extremely difficult and time consuming to analyse the current EU blending portfolio, due to the scandalously low level of information that is publicly available.

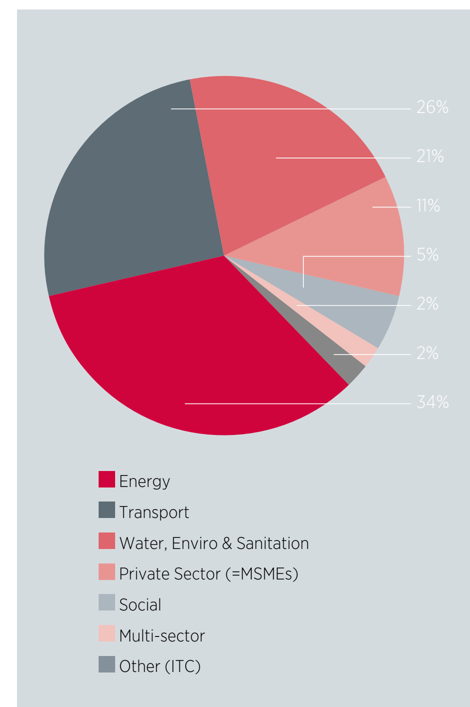
What sectors?

Blending mechanisms have focused on supporting large-scale infrastructure investments, particularly in the transport and energy sectors. As Table 5 and Figure 4 show, these two sectors cover 60 per cent of the total amount of grants approved, with social sector grants accounting for only 5 per cent, according to the latest figures available.

According to the EC, finance to support the private sector has increased substantially in the last year and it is channelled through financial intermediaries, such as banks and microfinance, to small and medium-sized enterprises (MSMEs). However, the private sector is likely to be heavily involved across all facilities as implementing agents in other projects. According to EC figures, access to finance for MSMEs accounts for 11 per cent of the seven blending facilities managed by DG DEVCO from 2007 to May 2013. As the EC pointed out in the EU Accountability Report 2012, support to the private sector – mainly SMEs –in 2012 was twice the amount of 2011 and represented 13 per cent of the total grants blended that year (these figures refer to the seven EU facilities managed by DEVCO). While access

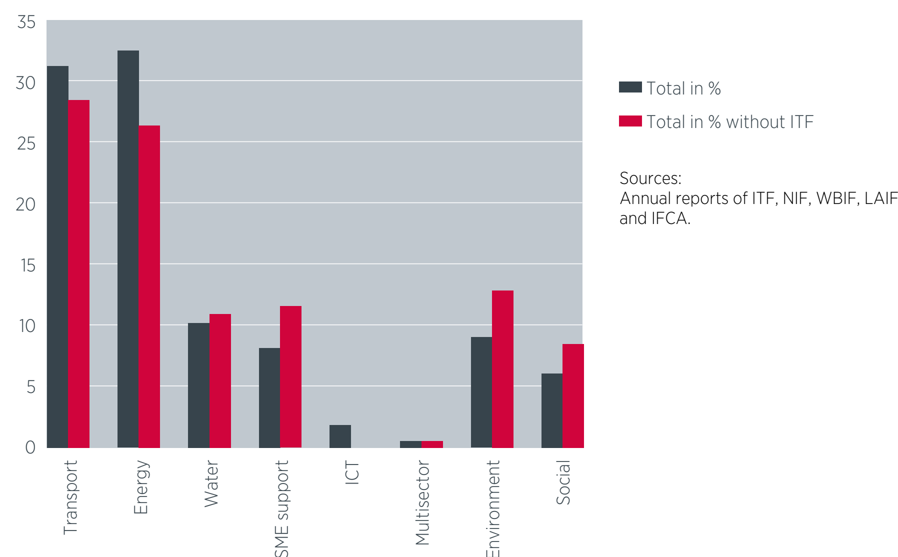
Figure 4 – EC DG DEVCO blending facilities by sectors

% of total amount of grants approved (2007-May 2013)



Source: Figures from the EC database covering ITF, NIF, LAIF, AIF and IFCA – May 2013. IFP and CIF with no approved projects so far

Figure 5 – EU blending facilities portfolio by sector with and without the infrastructure-focused facility



Total in %
Total in % without ITF

Sources:
Annual reports of ITF, NIF, WBIF, LAIF and IFCA.

> Blending mechanisms have focused on supporting large-scale infrastructure investments, particularly in the transport and energy sectors.

Table 5 – EU blending facilities – sectoral focus

Facility	ITF	NIF	LAIF	IFCA	AIF	CIF	IFP	WBIF
Private sector (=MSMEs)		X	X	X	X	Future (2)	X	X
Environmental protection/adaptation		X	X	X	X	Future (2)	X	X
Energy	Regional(3) + SE4All	X	X	X	X	X	X	X
Water/sanitation	Regional	X	X	X	X	X	X	
Social services infrastructure		X	X	X	X	X	X	X
Transport	Regional	X	X	X (1)	X	X	X	X
ICT	Regional					X	X	
Disaster prevention/ mitigation infrastructure						X	X	
Multi-sector	Regional	X	X		X	X	X	

(1) This sector needs strategic board decision.

(2) These sectors are intended to be covered through additional funding to the CIF.

(3) The ITF is the only facility restricted to the financing of regional projects or national infrastructure projects contributing to regional integration. It is also involved in the Sustainable Energy for All initiative launched by the United Nations Secretary-General.

Source: EC PowerPoint presentation, December 2012.

to finance for MSMEs is extremely necessary, given the lack of information available, it is not completely clear whether these funds are actually reaching the intended target.

The infrastructure focus of the facilities remains true even when we exclude the figures from the Infrastructure Trust Fund, as Figure 5 shows.

Although infrastructure financing is important in developing countries, and some argue that many countries may suffer from a shortage of infrastructure financing,[54] it is not clear whether large infrastructure projects need blended resources in order to take on the risk and even more importantly, whether supporting such projects is the best use of limited public resources.[55] This would apply for LICs or lower MICs, but it would be difficult to argue that this is the case for upper MICs, which have mobilised high levels of private capital in recent years, as well as increasing levels of public expenditure.[56] In this case, there might be a need for a differentiated approach in infrastructure finance for MICs and LICs, which is not possible to identify in the EU blending facilities portfolio, with the information available.

In addition, large infrastructure projects typically involve significant trade-offs, do not always directly contribute to poverty reduction in the areas where they are sited, and can have significant adverse impacts on local communities. From a development perspective, another key question to ask when analysing infrastructure financing is: who is the final beneficiary of the road, railway, port or even airport? Are there local communities behind the call for this infrastructure project? All too often communities tend to require different kinds of infrastructure projects than private sector companies operating in the country. This is clear in the case of companies operating in the extractive sector, whose infrastructure needs relate to their ability to increase their production capacity and to reach (external) markets rather than serving the specific needs of local communities, which often require access to basic services, such as health, water or energy.

What types of grants?

The grant component of blending mechanisms has been channelled through direct investment grants, technical assistance and interest rate subsidies. Although there is a wide range of possible types of grant instruments that the EU blending facilities could offer, in theory (see Table 6 and Appendix B for more details),[57] the current blending facilities predominantly use three common instruments: direct investment grants; technical assistance; and interest rate subsidies (IRS). As Figure 6 shows, these instruments account for 93 per cent of the total amount of grants approved by the seven EU blending facilities managed by DEVCO.

The precise combination of grant instruments may vary considerably among the regions, based on the regional strategies, the operational needs and the nature of the project promoter. For future operations the EU blending platform is planning to further develop guarantees – in some cases together with technical assistance provided to local financial intermediaries – and risk capital participations with the objective of achieving greater financial leverage.

In the case of the ITF, its mid-term review states that IRS accounts for over 60 per cent of total funding approved but for 27 per cent of the total number of ITF grants approved. The prominent use of IRS could be explained by the fact that some African countries need to meet minimum concessionality requirements to get additional loans. As of 5 July 2011, in eight projects out of a total of 12 IRS grant operations, this subsidy was given explicitly to meet heavily indebted poor countries (HIPC) conditionality borrowing requirements.[58]

There is no specific rule to determine the grant size and it is generally based on the type of projects, the type of instruments, the assessment of financiers and the opinion of the EC. The rationale for using investment grants is to support less profitable sectors, such as sectors requiring high upfront entry

A dangerous blend? The EU's agenda to 'blend' public development finance with private finance

Large infrastructure projects typically involve significant trade-offs, do not always directly contribute to poverty reduction in the areas where they are sited, and can have significant adverse impacts on local communities.

costs, and to contribute to behaviour change that would not otherwise be achieved, such as water and sanitation, energy efficiency, climate change and environment. Whereas the rationale for using interest rate subsidies stems from supporting sector sustainability and enhancing the concessionality of a financing package, for example, to comply with debt sustainability requirements.

Technical Assisance (TA) has been one of the most heavily criticised forms of aid. Internal evaluations have pointed to other problems with TA in blending facilities, including lack of strategic focus and its use to build a pipeline of deals for the lead European DFI, rather than responding to beneficiary needs. Research by Eurodad member ActionAid[59] has found that TA is often ineffective, which means that it has failed to build long-term capacity in the recipient countries, as well as being over-priced, often with high salaries being paid to expatriate consultants. One of the reasons for this failure is that projects have often been donor-driven, which means that TA has been heavily over-supplied in relation to demand.

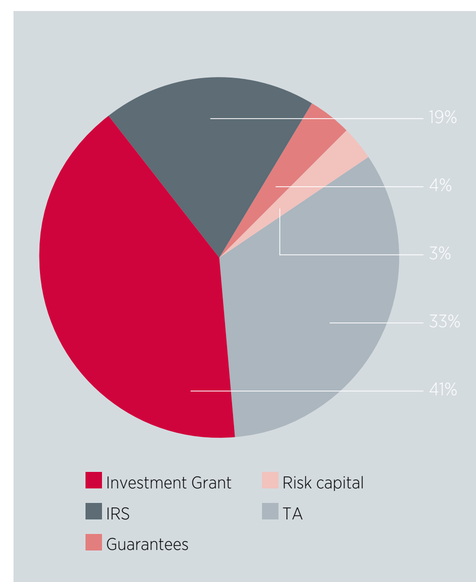
In relation to blending mechanisms, one relevant question is whether these resources replace those that recipient countries would have spent anyway. If it is genuinely additional, questions should be raised about how recipient driven it is. If the grant component of blending mechanisms are designed to finance TA, recipient country ownership is needed more than ever. This ownership will not only result from the fact that the country signs the loan, but also from an active engagement that has implications in the whole process and includes other relevant local stakeholders – besides the ministry of finance – including setting priorities for the use of grants, design and implementation of projects, among other things.

The Infrastructure Trust Fund (ITF) mid-term review concluded, "it appears that there is no particular strategy as to what technical assistance is intended to achieve through the ITF". According to the figures reviewed by the EU blending platform,[60] the rates of reported project preparatory activities leading to actual investments varies from 50–75 per cent, which means a significant proportion of TA is not directly linked to a project. In the worst case, the NIF mid-term review reported a project in which TA support was used to build a pipeline of potential deals for the EBRD, the lead institution. The justification for this was deemed as "questionable", since "their cost should be covered by beneficiary [FIs] financial institutions". According to the evaluation, "Financial Institutions [FIs] should be requested to evidence that TA will contribute to developing projects which are seen as crucial by local authorities and are in line with EU country strategy".[61]

While some critics argue that interest rate subsidy, "may present a distortion effect"[62] by crowding out commercial loans, there is also the problem of potential wastage of ODA by subsidising projects that do not need the subsidy. The market distortion effect would occur "if access to financial markets or to un-concessional lending from other EFIs is warranted for the project promoter, as they directly reduce private and public sector loans' competitiveness".[63] The development concern, in its turn, would be to ensure that subsidies are not granted to projects that actually do not need them, thus wasting scarce ODA.

Figure 6 – EC DG DEVCO blending facilities by type of grants

(% of total amount of grants approved)



Source: EC database, figures from May 2013

Table 6 – Grant instruments available in the blending facilities

ITF	NIF	WBIF	LAIF, IFCA, AIF, CIF, IFP
Technical assistance	Technical assistance	Technical assistance	Technical assistance
Direct investment grants	Direct investment grants	Direct investment grants	Direct investment grants
Interest rate subsidies	Interest rate subsidies	Incentive payments to financial intermediaries (risk capital)	Loan guarantee cost
Insurance premia	Risk capital	Interest rate subsidies	Interest rate subsidies
		Insurance premia	Risk capital

Source: Blending grants and loans for financing in the EU's Development Policy for 2014-2020

Technical assistance has been one of the most heavily criticised forms of aid.

The ITF mid-term evaluation report also includes a specific reference to this point, arguing that IRS might not be needed as the implicit risk guarantee already represents sufficient subsidy. This issue of whether there is 'true' additionality associated with the blending mechanism is covered in more detail in part 4 of this report.

Who benefits? Who profits?

Although the EC argues that EU regional blending facilities mainly support public investments – figures so far indicate that only 11 per cent of grant contributions went directly to private sector beneficiaries – the EC plans a massive expansion of private blending, which makes this move a big political issue, especially as there has been little clarity on which private sector is going to be targeted, whether from donor countries or from recipient countries, and how.

In recent years there has been an increased recognition of the role of the private sector in development. It is true that a thriving private sector plays a key role when it creates jobs, pays a fair share of taxes to the government and provides high-quality goods and services. There has also been a big push towards stimulating private flows, particularly foreign investments, although key features of these flows are not always properly considered, such as predictability, volatility and pro-cyclicality.[64]

On this basis, the EC stressed – in its last EU Accountability Report – the relevance of private finance and stated its clear intention of "looking into ways of increasing the role of blending as a catalyser of private investment for development". The EU blending platform, in turn, has also discussed how to further involve the private sector in blending mechanisms, either as a financier or as a beneficiary.

Talk of the 'private sector' can hide a focus on promoting national donor countries' firms; or an emphasis on foreign investment by multinationals; or support for the domestic private sector, normally the largest and most important element in any developing country. As the EC also recognises, the private sector is composed of a wide variety of economic entities, ranging from large international and transnational corporations to state enterprises, domestic companies, micro, small and medium-sized enterprises, and a range of social enterprises, which include formal or informal entities.[65] Each of them has different needs and business models.

When it comes to EU blending facilities involving private actors, there is a need for a comprehensive picture to allow us to go beyond general statements. However, the poor information available limits our ability to do this. This would mean at least three things:

a) assessing how EU regional facilities target the private sector;

b) analysing what happens when these regional facilities support public actors; and

c) deepening our understanding of what an increasing role of the private sector as a financier means and what leveraging actually entails.

While the poor information available does not allow us to address the first two issues in any detail – although there are some indications from previous research – the third point will be discussed in this section and in the following section.

How EU regional facilities target the private sector: SMEs through financial intermediaries (FI)?

For the most part, EU blending facilities have followed the trend set by the World Bank's International Finance Corporation and other DFIs of a dramatic rise in financial sector investments.[66] These have proved particularly difficult to track in terms of where the money goes and how and what development impacts are achieved. The rationale is to target SMEs through financial intermediaries (FIs), as the European DFIs involved do not have the infrastructure in developing countries to manage a large portfolio of smaller loans. FIs offer the possibility of reduced transaction costs while at the same time engaging with SMEs. While supporting SMEs in developing countries is key for development, as they account for about 40 per cent of jobs and 25 per cent of gross domestic product (GDP) in developing countries[67] and they often suffer from lack of access to financial resources, questions arise in terms of the effectiveness of the vehicles selected to reach them.

Eurodad research[68] has shown that these financial intermediaries can be commercial banks, hedge funds, private equity funds, credit unions or microfinance institutions, among others, and they are normally very opaque in both portfolio and investment strategies. In some cases, there have also been concerns in relation to financial intermediaries' investments through tax havens, which also undermines the potential impact for the local economy.

According to the EC database, the majority of the grant funds approved categorised as 'private sector' have been FI-related projects – mainly TA – through the NIF, and under the leadership of the EBRD. The German development bank, KfW, and the EIB also support other projects. However, besides general remarks there is no information available on the projects financed and the project's implementers, which undermines the quality of any assessment.

Although the EC argues that EU regional blending facilities mainly support public investments the EC plans a massive expansion of private blending, which makes this move a big political issue.

Support to public actors might benefit rich country firms.

Eurodad research in 2011[69] showed that approximately "$69bn of aid [is] used for procurement each year" and that the majority of this goes to rich country firms. This obviously has an impact on where and which private sector is being developed.

When blended money supports public entities in recipient countries to implement infrastructure or energy projects, some of these resources might end up benefiting rich country firms through at least three mechanisms:

a) Loans from financial institutions are fully tied to using companies from the donor countries, as in the case of Österreighische Entwicklungsbank (OeEB) and SIMEST – although their participation in the EU regional blending facilities has been low so far;

b) Public resources – grants and loans – are informally tied, which means that the contracts go *de facto* to donor country firms, as a consequences of public procurement regulation; or

c) Public resources – grants and loans – come with procurement conditionality that obliges international competitive bidding as the standard practice. This implies that the market is open for the participation of transnational companies, often to the detriment of business opportunities for local companies, particularly SMEs, which do not have the capacity to bid for larger contracts. In this framework, recipient countries are not allowed to give preference to domestic firms to contribute to local development.

Standards and aid effectiveness principles

There is little evidence available regarding how the EU-level blending facilities implement or even contribute to achieving the internationally agreed objectives of the aid effectiveness agenda, particularly the key principles of ownership, alignment, harmonisation and mutual accountability:[70]

- **On ownership and alignment:** The idea behind this concept is that aid can only be truly effective when recipient countries – meaning government, parliament and civil society – are in control of development processes, and donors are aligned behind national strategies and plans. The EC argues that the recipient country government is fully in control of blending since it signs the loan with the DFI. As described above, current governance structures and procedures of the blending facilities give the EC and DFIs the prominent role, meaning that they are likely to be in the driving seat.
- **On mutual accountability:** This concept implies a horizontal and reciprocal relationship between donors and recipient countries, as well as the existence of mutually agreed mechanisms for monitoring and evaluation. The latter has been a critical challenge for the institutions involved: a specific technical group has been set up to address this within the framework of the EU blending platform. It is worth noting that the EIB has developed a new result and measurement framework (REM). This system of reporting has been progressively implemented since 2012 and is still under development. Thus, its effectiveness has not been demonstrated yet.
- **On harmonisation:** This means that donors should improve their cooperation in order to reduce the burden on recipients to comply with different procedures and practices, and to allow donors to harmonise around recipient priorities and processes, not impose their own. In practice, efforts are being put towards mutual recognition and division of labour among the different financier institutions involved, but lack of harmonisation among donors is still an important challenge. In 2005 EIB, KfW and AFD launched a Mutual Reliance Initiative (MRI)[71] in order to agree upon collective principles to guide co-financing initiatives, among them the implementation of blending instruments. The initiative aims at a better division of labour during project preparation, implementation and the monitoring of co-financed projects and at delegating tasks to a lead institution. According to Organisation for Economic Cooperation and Development (OECD) documents, this delegation of tasks and responsibilities is based on mutual recognition of procedures, not on harmonisation of them.[72]

There is little evidence available regarding how the EU-level blending facilities implement or even contribute to achieving the internationally agreed objectives of the aid effectiveness agenda.

Box 2 – The case of Bii Nee Stipa II wind farm (Stipa Nayaa) – Mexico, Isthmus of Tehuantepec

Latin American Investment Facility (LAIF) grant approved: € 3.3 million for the public infrastructure component

Lead development finance institution for the Latin America Investment Facility (LAIF): Società italiana per le imprese all'estero (SIMEST), with a contribution of €5 million in equity participation in a special purpose vehicle created to implement the project. SIMEST also provides an interest rate subsidy for the financing granted by the Banco Bilbao Vizcaya Argentaria, Spain, to the private investor Enel Green Power (EGP), Italy.

Other DFI: Inter-American Development Bank with a corporate loan of $76 million to EGP, through its subsidiary INELEC, Mexico.

Developers: Gamesa Energía S.A., Spain and Cableados Industriales S.A. de C.V. (CISA), Mexico

This project aims to promote the wind energy industry through a public-private partnership scheme to build a wind farm in Ejido La Ventosa in the Isthmus of Tehuantepec in Mexico. This involves the second stage of the Bii Nee Stipa project, planned and developed by Gamesa Energía S.A. (Spain) and the Mexican company Cableados Industriales S.A. de C.V. (CISA).

Although the financing agreement has not yet been signed with SIMEST and the EC had not disbursed any resources (as of March 2013), the component of the project that the EC blending facility (LAIF) was supposed to support has already been built, according to Gamesa.

This situation raises a number of questions regarding both the financial and developmental incentives of the LAIF grant. Most importantly, why was the LAIF grant approved, given that the project was funded and executed without the disbursement of LAIF resources? And why was a similar project – BNS III – carried out by the same company, EGP, without a grant just months after BNS II? Will the EC offer a retroactive grant? How could this be justified? And, if so, how will LAIF resources be used once the financing agreement is signed with SIMEST?

Several elements indicate that the LAIF grant was not entirely essential to the viability of the project and only served to support the activities of large European companies. SIMEST does not have a developmental mandate but instead supports the participation of Italian businesses in foreign countries.

In 2011, Gamesa and CISA formed the Mexican company Stipa Nayaa S.A. de C.V., which owns and operates the BNS II wind farm. One year later, the company was acquired by EGP and INELEC. The energy produced by the BNS II wind farm will be sold and used mainly by two large multinational industrial groups: the Mexico Nestlé Group and FEMSA, a Coca-Cola bottler, owner of OXXO stores and other investments. These two groups themselves have a small shareholding in Stipa Nayaa.

The project generated on-going conflicts between local people, the Mexican authorities and wind farm companies. Wind farms in Tehuantepec have been resisted by indigenous and local people because they are built on their ancestral lands, without a proper consultation process. While project developers claim that the farmlands are privately owned, community leaders claim that some of these were declared to be communal by a government resolution some years ago. In addition, local communities have been exposed to environmental and social impacts, since these lands used to be places of significant agricultural and livestock production and the wind farm does not offer sustainable labour alternatives after its construction phase. The request for a contribution submitted to LAIF states that SIMEST and Inter-American Development Bank (IDB) will monitor the environmental, social, labour, health and safety aspects of the project through their internal monitoring process. However, to date there is no information publicly available about this.

This analysis reveals that the BNS II project has several elements that could be considered 'bad practice' in development cooperation terms, even though it is considered as a reference point for how LAIF can contribute to a public-private initiative in the energy sector, in the technical assessment by the LAIF structures.

Source: *"New European Union development cooperation strategies in Latin America: The Latin American Investment Facility (LAIF)"* CIFCA and Grupo Sur, June 2013:http://www.cifca.org/IMG/pdf/Report_LAIF_EN.pdf

Part 3

The issue of leveraging and additionality

As has been stated in several policy papers, blending "is seen as [a] powerful tool to leverage private sector support."[73] An expert working group set up by the Economic and Financial Affairs Council (ECOFIN) in December 2008 discussed the issue of leverage within the framework of blended finance at the EU level. They put forward two definitions:

- **Financial leverage** refers to the capacity of the instrument to "allow making available more financial resources to support investments that are deemed to be of priority European interest or to have desirable impacts and that, without them, would not happen or happen more slowly or at a prohibitive cost to the partner country".
- **Non-financial leverage** refers to how the instrument "can unblock, accelerate, improve quality or promote institutional change facilitating more, better and faster investment projects in support of EU policy goals".

Although these definitions contain controversial elements – as we shall see – we will use them to structure our analysis. Sometimes this debate is conducted using the concept of 'additionality' – but this is essentially the same as the leverage concept:[74]

- **Financial additionality** – refers to cases when a project that would otherwise not have been possible is made possible by funds or partnership of a public body such as a DFI.
- **Non-financial additionality** – refers to changes in policies or standards that occur thanks to the involvement of the public partner such as a DFI.

The European blending platform is currently expending a lot of energy trying to come up with their own definitions – see Box 3 – and we hope they will take note of the key points below.

Financial leverage/additionality – is more investment created?

Assessing 'financial leverage' is beset by problems in terms of deciding who is leveraging who. Existing facilities tend to 'follow the market' by focusing on already popular areas for investment by public and private entities. According to the expert group's report, the financial leverage is the "ratio of grants to non-grant investment in a project", which includes the implicit and controversial assumption that the investment would not have happened without the grant element. In fact, it is just as likely that the non-grant investor is leveraging the public grant, and may well have undertaken the project anyway. Assessing this issue rigorously becomes particularly important where private investors are involved, as the risk is that public ODA will end up subsidising private companies to undertake investments that they would have made anyway.

Generally speaking, DFIs are not mandated to finance operations that could or are being provided by the market, an important requirement that would also apply for EU grants.[75] A recent study commissioned by the European Parliament highlights that "having a large leverage and multiplier effect does not automatically mean that the instrument reaches a high level of additionality", as these figures "do not show whether or not the other resources that are attracted would have been used in the absence of the instrument" and whether the EU budget is substituting existing funding.[76] The ITF mid-term evaluation questions the "true" leverage effect of ITF grant operations, "considering the regular presence of other DFIs and role in the projects prior to the intervention of the ITF". Thus, they argue for reviewing the calculation of the leverage effect.

Existing European-level blending facilities have largely seen both sides of the funding – grant and loan – provided by European publicly owned institutions. This means there is no real 'leverage' of any additional resources, only a pooling of existing funding. Currently European-level blending facilities have been spectacularly unsuccessful at attracting private investment. There has been virtually zero private investment so far, meaning that what is actually happening is that the grant element is supporting investments by other public bodies, including DFIs. In practice, blending facilities have brought in additional funding from European DFIs, the EIB, other IFIs and other public funding sources, including from the partner countries themselves. Others have rightly pointed out that this should be regarded as "pooled financing", or cooperation between public bodies, not leverage.[77] If an EC grant supports an EIB financed project, has the EC leveraged the EIB funding or vice versa? In fact, both institutions would have done something with the money, so all that is happening – at best – is a redirection of public grants and loans to particular projects or sectors rather than others.

By contrast, the World Bank places the emphasis on using public money to attract private investment, defining leverage as "the ability of a public financial commitment to mobilise some larger multiple of private capital for investment in a specific project or undertaking". [78] While this still leaves open the key question of deciding whether or not the public money was truly essential for attracting the private capital, it should at least in theory exclude claims of leverage based on public grants attracting more financing from other public institutions.

> Existing European-level blending facilities have largely seen both sides of the funding – grant and loan – provided by European publicly owned institutions.

> Assessing 'financial leverage' is beset by problems in terms of deciding who is leveraging who.

Non-financial leverage – are there impacts on policies and standards?

The concept of 'policy leverage' highlights perhaps the most worrying aspect of this analysis: a strong emphasis on delivering the donors' objectives, which undermines ownership and means that non-developmental objectives will also be prioritised. This includes promoting European companies or pursuing European policy interests. The ECOFIN expert working group argued that blending "can provide 'policy leverage' on the definition of sector policies and projects. It thus allows focusing the use of resources on the regions and sectors or projects the EU find most important or most in need and which are not fundable on market conditions".

CSOs, including Eurodad,[79] have been fighting for decades against the use of ODA to promote donor interests or to induce developing countries to change their policies according to donor priorities. This 'policy influence' all too often undermines domestic democratic space and promotes a donor-driven approach in development cooperation. EU policy priorities include not just development cooperation, but also many other elements that are not necessarily compatible, such as supporting European companies operating abroad or pursuing European foreign policy or energy security priorities. As we have already seen, the low level of transparency on the standards and processes required in the current blending instruments mean it is very unclear whether blending mechanisms lead to any improvement in standards within the projects financed.

Box 3 – The blending platform's discussion of leverage

Recently, the EU blending platform has also discussed the issue of leverage, together with the need for addressing market failures and creating additionality. Although the EU platform has not issued a final report yet, interviews with key stakeholders gave us further insights in this regard. The EU platform has discussed three different indicators to compare the grant provided through each facility to the amount of funding mobilised:

Value of investment/total project cost divided by total amount of EU blending facility grant(s) relating to this investment.

Amount of total financing provided by eligible financial institutions divided by total amount of EU blending facility grant(s) relating to this investment. The first value can comprise non-concessional, concessional or grant funding.

Amount of total financing provided by private sector actors (non-grant) into the investment project divided by amount of EU blending facility grant(s).

In addition, a fourth indicator considering the total financing provided by partner countries was also reviewed at one point. On this basis, in early 2013 a technical group of the EU platform was tasked to assess the financial performance of the regional facilities by using these four indicators. However, information in relation to total financing provided by private sector actors and total financing provided by partner countries was not easily available. In addition, methodologies to calculate the different ratios may deserve further developments, as they have to reflect the difference between the nature of the grant intervention (i.e. technical assistance, interest rate subsidies and risk capital operations).

> (There is) a strong emphasis on delivering the donor's objectives, which undermine ownership and means non-developmental objectives will also be prioritised.

Part 4

Problems and challenges

This section presents a synthesis of the main problems and challenges of the current European blending facilities identified by this research, and summarises the challenges that are inherent in any private sector blending operations.

Risk of financial principles out-weighing development principles

All publicly backed development finance must ensure that poverty reduction and sustainable development are the main objectives of all investments, and the overriding criteria for project selection. It is a legal requirement not to undermine the general provisions for external action of the EU within the framework of the Lisbon Treaty. The promotion of the EU policy coherence for development (PCD) efforts would contribute to the EU standing by its development commitments. In the case of private blending – where publicly backed money supports a far greater multiple of private investment – conflicts will arise between the commercial objectives of the private actors and these development objectives. We have seen little evidence that this issue has been taken seriously enough by the existing European-level blending mechanisms. This concern has also been highlighted by several think tanks, including the Overseas Development Institute (ODI) and the report commissioned by the European Parliament, CSO reports and the two mid-term reviews.

No clear financial or development additionality

Assessing financial additionality is a difficult exercise and headline figures on the ability of blending mechanisms to leverage additional financing are not reliable. According to the evidence available, most of the resources so far come from European DFIs, so should be regarded as cooperation or pooling of funds. In addition, financial additionality cannot be assumed just because public institutions are co-financiers. As the analysis of the sectors covered and the practices of most of the financial institutions involved show,[80] it could well be that the EC and the lead financial institutions are actually replicating existing investment or following market trends instead of investing in areas with a potential positive development impact and where private investment is not currently flowing.

At the same time, when the main objective is to leverage private financing it is fair to warn against one important implication: the greater the leverage ratio, the smaller the overall contribution of the public body and the lower its influence on the design and implementation of the projects. Eurodad and partners have pushed for a cautious approach based on this self-evident fact, which was also included in the NIF mid-term review of August 2013.[81]

Transparency and accountability levels are appalling

Decision making is done behind closed doors without a clear set of criteria for project selection and with virtually no relevant information publicly available to ensure meaningful public participation and scrutiny. Some of EU regional facilities do not have any information on websites and for those that do, the information about the projects approved and the facilities portfolio is extremely basic, incomplete and out-of-date. These concerns have also been supported by several reports and the two mid-term evaluations available.

Currently national governments in partner countries are barely involved. There is no effective parliamentary scrutiny either in partner countries or from the European Parliament, and there is no active CSO involvement in Europe or in recipient countries. The lack of substantive ownership has also been noted throughout this report. There is a need for better coordination with EU delegations to ensure proper implementation of EU standards and practices.

Unclear monitoring and evaluation methods

Monitoring and evaluation help to ensure that scarce development finance is channelled to areas that have demonstrated success in meeting international and national development goals. Currently, poverty impact analyses of the facilities are left to the lead financier institutions to provide. In addition, private partners and CSOs are not required to participate in public evaluations. These assessments should include both positive and negative impacts on development and populations. They should not just be used to highlight positive outputs or results. These exercises should be independent and should include interests and views of the concerned population/citizens to ensure local ownership of the project and to prevent human rights violations and social damage.[82]

Inherent challenges with private finance blending

In addition to these four significant problems, there are recurrent challenges with any efforts to use public money to leverage private finance through blending, which should always be borne in mind:

All publicly backed development finance must ensure that poverty reduction and sustainable development are the main objectives of all investments.

Assessing financial additionality is a difficult exercise and headline figures on the ability of blending mechanism to leverage additional financing are not reliable.

- **Opportunity costs are huge and not carefully considered.** Delivering ODA through blending mechanisms to support private investment means that those resources cannot be used elsewhere. Given the current budget constraints, these opportunity costs may be particularly high in countries or sectors where the need for straightforward public investment is high such as in health, education and climate adaptation.
- **Potential risk of inflating ODA figures.** Innovative financing instruments such as blending facilities might have the potential to help meet financial targets of EU MS, without scaling up ODA commitments. In the context of EU regional blending facilities, loans provided through the facilities cannot be counted as ODA in total – only the grant component of blending operations in eligible countries does count as ODA.[83] However, this situation might change in the medium term since some donors – particularly Germany and the Netherlands – have already expressed interest in opening the ODA definition to include a variety of other financial flows.[84] While DAC members have agreed not to open the ODA definition before 2015, there is further pressure to represent 'ODA neutral flows' from development finance institutions and other investment tools that focus on concessional lending rather than grants.[85] In addition, using ODA to merge foreign trade and investment policies with aid – as seems to be the case in the Netherlands – puts ODA under threat of becoming inflated with expenses that should not be reported as ODA.
- **Potential debt risks for developing countries.** Blending mechanisms entail a debt instrument that needs to be repaid, even if they may offer softer terms to the beneficiary than purely commercial loans. In the case of public blending, introducing blended finance instead of pure grants could potentially further increase developing countries' debt exposure, which undermines their national fiscal space but also their ability to attract other sources of funding. In the case of private blending, in turn, there is a risk that the liabilities of the private actors may become public liabilities if the projects fail, either because of direct or indirect reasons. These risks have not been taken into account sufficiently when assessing the impacts of blending or leveraged finance.

Conclusions and recommendations

The EC, backed by European DFIs, is leading a major push to expand the scope of European blending of ODA with private investment, which could lead to a sea change in development finance. However, this Eurodad research has found extremely serious problems with the existing European-level blending mechanisms. There is no reliable evidence on the added value of the grant element, nor on whether development objectives are being met. They may represent wasting scarce ODA resources, they are not transparent and are unaccountable, and they risk undermining the developing country ownership that is vital for success in any development efforts. The failure of these mechanisms to provide any useful public information, and the problems highlighted in their own evaluation reports, mean that the current EC-led push to expand these facilities is based on one argument alone: 'trust us'. We see no evidence why civil society groups, parliamentarians or concerned citizens should do so.

As a general principle, we believe that DFIs and aid to the private sector must demonstrate clear financial and development additionality, as well as complying with the guidelines of responsible finance, as outlined in Eurodad's Responsible Finance Charter.

Everyone who cares about the global fight against poverty should join us in demanding this comprehensive review of the blending experiment, in order to prevent the potential wastage of large amounts of ODA and, even worse, damage to the development strategies and prospects of developing countries.

DFIs and aid to the private sector must demonstrate clear financial and development additionality, as well as complying with the guidelines of responsible finance.

Hence, we call for an immediate end to any further ODA being channelled through European-level blending mechanisms, until the following changes have been made:

A radical overhaul of the transparency and accountability of the mechanisms

- **Redesign the governance structures** of the facilities to meet internationally agreed country ownership principles, by ensuring developing country governments can take leadership roles, and properly consulting CSOs and parliaments in developing countries. These stakeholders should be involved in the assessment of social and environmental impacts of projects in their pre-approval phase as well as in the implementation and monitoring process of the projects approved. The role of the European Parliament should also be strengthened, in terms of its oversight and power of scrutiny.
- **Create genuine transparency** by switching from the current secrecy regime to a presumption of disclosure of all information. All information and documentation about projects should be automatically disclosed, with a limited regime of exceptions. This would include social, environmental and governance standards, contracts, subcontracts, and investment and partnership agreements. Legitimate concerns about commercial confidentiality should be dealt with by redacting specific text, not withholding entire documents.
- **Make additional efforts** to ensure affected people can actually access information about projects that affect their lives. This 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.
- **Set up independent complaint mechanisms** with a mandate to carry out independent investigations of financed projects. These should be available at the onset of a project to allow affected communities and other stakeholders to raise legitimate complaints and to force the implementing agency to follow up and make changes based on findings.

There must be a radical overhaul of the transparency and accountability of the mechanisms.

A full and independent review of the effectiveness of existing mechanisms focusing on their development impacts, including whether – given their governance failings – they are suitable vehicles for ODA.

This should be conducted by respected independent institutions, with a leading role for partner governments, parliamentarians and civil society representatives. We believe this review should take into account the following recommendations:

- **Poverty reduction and development outcomes** should be prioritised over financial returns. A strong focus on pro-poor development is needed. Project proposals should be submitted with ex-ante impact assessment, including economic, social and environmental considerations with a poverty reduction focus. Human rights and gender considerations should also be taken into account.
- **Monitoring and evaluation mechanisms** should be greatly strengthened. Development objectives should be mainstreamed into all investments with clear outcome indicators from the project selection phase to its completion. Strong social and environmental safeguards should be applied to projects to ensure that development impacts are not undermined, and to ensure transparency and accountability.
- **Debt sustainability assessments** should be undertaken independently of all creditors to avoid creating new public or private debt crises in developing countries. Pure economic considerations when assessing debt sustainability undermine the ability of recipient countries to fulfill development needs.
- **All projects should be aligned with country owned development strategies**, including national industrial and energy policies and strategic priorities for local private sector development, in order to respect recipient country ownership. In doing so, donor government and institutions should not attempt to influence these strategies and should report on how individual projects and investment portfolios are aligned with national strategies.
- **Companies owned and domiciled in the recipient country** should be the ones benefiting from blended finance projects. Avoid investing – directly and indirectly – in companies based or with operations in, tax havens. Request that all companies and financial institutions involved in the approved projects should disclose information regarding beneficial ownership of any legal structure directly or indirectly related to the company, including trusts, foundations and bank accounts.
- **Loans must not be tied** and use of country systems should be the default approach for development cooperation

Appendices

Appendix A: Methodology

This research is based on information gathered from annual reports publicly available for the eight blending facilities set up by the European Commission and for the EIB activity in ACP countries and on the information publicly available on the European Commission's website until July 2013. For the purpose of this research Eurodad explored in detail the seven blending facilities managed by DG DEVCO.

During the research process, Eurodad was granted access to the EC DG DEVCO's database, covering seven EU regional facilities: ITF, NIF, LAIF, IFCA, AIF, CIF and IFP, from 2007 to May 2013. Unfortunately, this database only includes the following information: a) the title of the project; b) the country/ies involved; c) the type of support; d) sector; e) the lead financial institution; f) the total facility amount approved; and g) the total cost/amount of the project. Before May 2013 no project had been approved to CIF and IFP, thus most of the figures quoted in this report only cover five of the seven facilities. When it is the case, additional references to the WBIF are based on their annual reports and website.

Eurodad has relied on those internal assessments and surveys that have been published, or that we have acquired through other means, and one detailed independent report based on case studies in Latin America. As a result of Eurodad monitoring work of the EUBEC, we conducted interviews and informal meetings with officials and experts, which makes this a participatory methodology.

Appendix B – EU blending facilities: Different types of grants

Type	Description
Technical assistance and feasibility studies	Improve the project preparation and implementation. They can be used to improve efficiency of a project and/or to facilitate a know-how transfer in certain areas; to accelerate the start of projects, implementation and management as well as the sustainability of the investment; and to help to prepare the appropriate financial package, which may be of further grant and blended loan.
Direct investment grants	Include capital cushions and equity for mezzanine loans for local financial institutions to expand their lending to SMEs. They can be used to cover specific parts of a project (i.e. social or environmental aspects or upfront to accelerate projects giving them a kick-start or at closure.)
Conditionality/ performance related grants	Linked to conditionalities, such as Output Based Aid. Ex-ante conditions are the ones that the beneficiary needs to fulfil to obtain the grant. According to the EC, their use becomes more pertinent the higher the donor support and are particularly justified in countries with weak governance.
Interest rate subsidies	Help bring down the costs of borrowing, making projects more bankable and less onerous. Can make the financing terms of development options favoured by donors more attractive than other alternatives. Important in the case of (clean) energy, under normal loan conditions "dirtier technologies" are more advantageous. Depend on the project and the potential market distortions (social project are also less bankable than others.)
Loan guarantees	Offer the lender a protection in case of default. They are risk sharing mechanisms, with grant funding serving as guarantee. Only in case of default, they lead to real disbursement, thus they can contribute to increase the development financing volumes without charging the public pursue to the same extent. This assumes particular relevance in case of portfolio loan guarantees where added diversification further reduces the cost of risk coverage, thus optimising the budgetary impact. With a guarantee (provided free of charge or at a relatively low 19 price to the lender), the interest rate charged to the borrower will be lower than without; from this perspective the effect of a loan guarantee can be similar to an interest rate subsidy.
Structured finance – first loss piece	They are similar to a guarantee, but they are used to invest in the highest risk tranche of a project to leverage funding from IFIs, EBFIs and private banks. The assumption should be that a finance institution investing its own money in the first-loss piece should aim at generating a return, while the donor support element should enable such institution to take an additional risk.
Risk capital grants	They are equity or quasi-equity investments for high risk projects. This mechanism incentives investors and financiers to participate, giving the project less risk level. They can be offered for particular risks in a project or proportionally for the whole project. It is important to determine the right level of support and avoid excessive risk coverage, biasing investment incentives. This mechanism fits well with investments in SMEs and for infrastructure.
Insurance premia	They are not used so far. They used to provide initial insurance cover offering a risk-mitigation necessary to launch projects.

Source: Updated from "Blending Grants and Loans for Financing the EU's Development Policy for 2014-2020"

Endnotes

1 European Commission. (2011). Communication: *Increasing the impact of EU Development Policy: and Agenda for Change*, European Commission, Brussels. See: http://ec.europa.eu/europeaid/what/development-policies/documents/agenda_for_change_en.pdf

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3 *The International Finance Corporation (2013) blended finance.* See http://www.brettonwoodsproject.org/art-572886

4 In this case, the UK claims that blending is part of a "value for money" strategy that aims to maximise the impact of aid money, but it also reflects the government's focus on supporting the private sector as the centrepiece of its aid policy. The UK's Department for International Development contribution to the EU-Africa Infrastructure Trust Fund was €40 million in 2011. See http://www.eu-africa-infrastructure-tf.net/attachments/Annual%20Reports/eu_africa_infrastructure_trust_fund_annual_report_2011_en.pdf

5 According to the EU Accountability Report 2013, "over the period 2010–2012, over half of blending was bilateral, and Germany accounted for 92% of the total, with the balance coming from Sweden". At the EU level, although Germany contributes far less than other donors to the EU-Africa Infrastructure Trust Fund, its contributions experienced an enormous increase since 2009.

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13 European Parliament. (2013). *Resolution of 13 June on the Millennium Development Goals – defining the post-2015 framework.* Strasbourg: European Parliament. See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0283+0+DOC+XML+V0//EN&language=EN. In addition, the EP draft report called *Corruption in the public and private sectors: the impact on human rights in third countries*, includes another reference to blending mechanisms: "the governance of those instruments [blending] need to be reviewed, with the aim of granting greater transparency in project selection criteria and accountability to society as a whole". This report was due to be voted in plenary in early October 2013. See: http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2013/2074%28INI%29

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48 In the case of the LAIF, the strategic orientation proposal mentions that LAIF contributions "will be allocated according to the quality of the proposal, the sector of intervention and its visibility, and the leverage effect that the LAIF contribution will have". In addition, it mentions a list of criteria, including: a) support to the EU strategy in the region; b) address environmental threats or climate change mitigation and adaptation; c) focusing on renewable energy; d) investments in sustainable social infrastructure; e) supporting access to finance, in particular for the micro, small and medium enterprises; and f) investments identified in national, sub-regional or regional priority plans.

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51 The final report of the 'wise persons' steering committee, set up in the framework of the mid-term review of the EIB's external lending mandate, suggested the creation of an "EU platform for Cooperation and Development". This proposal was also included in the EC *Agenda for Change* policy paper. In the process, the EC commissioned a Group of Experts, composed of MS, the EEAS, the EIB and the European Parliament (as an observer), to develop its proposals.

52 In their submission Eurodad, Counter Balance and Green Alternative Georgia put forward a cautious approach calling the Group of Experts to reflect on key concerns, specifically focused on development impacts and the opportunity costs of the mechanism, before setting up the platform and most importantly before scaling up the use of blending mechanisms.

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84 Paper commissioned by the German and the Dutch government: http://www.ecdpm.org/Web_ECDPM/Web/Content/Download.nsf/0/C3FF9A6B12CEDEF1C1257A09006081E3/$FILE/Reporting_on_Development_2012_0107452_final.pdf

85 Although the EU blending platform has not discussed this issue in detail yet, there is increasing acknowledgement of the current debate at the level of the OECD DAC.

Eurodad

The European Network on Debt and Development is a specialist network analysing and advocating on official development finance policies. It has 48 member groups in 19 countries. Its roles are to:

- 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. **www.eurodad.org**

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