

DEVELOPMENT POLICY FORUM (DPF)



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PUSHING THE FRONTIERS OF DEVELOPMENT FINANCE BEYOND FINANCIAL FLOWS TO BANKABLE PRODUCTS

EVENT REPORT



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INTRODUCTION

Official development assistance (ODA) and charity alone can't meet the world's development needs. With the United Nations estimating its 2030 sustainable development goals (SDGs) will cost up to \$7tn a year, developing countries are being forced to look elsewhere, including to the private sector, to raise the cash they need.

The good news is that private investors are increasingly driven by social goals, and not just profits. And the global mass movement of people to cities and growth of the middle class is making such investment more pressing and profitable.

The bad news is that available capital is not making its way quickly enough or at a large enough scale to sustainable projects in less-developed countries. The UN-led 'Financing for Development' (FfD) process - which culminated in the 2015 Addis Ababa Action Agenda - calls for a more even mix of official aid, charity, private investment, trade policy and domestic resources (such as tax revenues).

The idea of 'blended finance' is starting to take hold in the development sector as a way to encourage private investment - essentially, leveraging public money to cover investors' potential losses. At Friends of Europe's event, 'Pushing the frontiers of development finance', panellists discussed how to use innovative financial products - like the European Investment Bank's (EIB) 'sustainability awareness bonds' - to bridge the investment gap in poorer countries.

This report condenses that event, which took place on 7 February, into a few key recommendations for EU development policy.

WE'VE REACHED 'PEAK ODA'

Almost 50 years on from a global commitment to spend 0.7% of national income on development aid, and governments are still struggling to meet it. Only four of the EU's 28 members - Denmark, Luxembourg, Sweden and the United Kingdom - were spending at least 0.7% of gross national income (GNI) on development in 2017.

The EU is the world's largest collective ODA provider and aims to achieve the 0.7% target by 2030. That includes a specific commitment of 0.2% of GNI for the world's least-developed countries, which numbered 47 at the UN's last count. But current levels of investment - both public and private - are nowhere near enough to cover new

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commitments such as the SDGs and the 2015 Paris climate goals. The EU itself needs around €180bn a year to achieve its 2030 climate targets. The investment gap in developing countries, the UN says, is around \$2.5tn.

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The idea is not to rule out public money - we will always need ODA - but to reduce reliance on it and use it in a smarter way. ‘Leverage’ may have been a dirty word during the financial crisis, but it’s being redefined by international financial institutions and national development banks to help make use of scarce resources.

“The government will always play a major role in financing the SDGs, and we should not forget to support the government in this role”, added **Thomas Förch**, Senior Technical Expert for Financial Sector Development and Insurance at the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ).

INVESTMENT WITH AN IMPACT

The emphasis is now on ‘financing’ rather than ‘funding’ projects. Tied to that is the increasingly popular idea that money should go to projects that have a positive economic, social or environmental impact. International institutions like the EIB and even private equity funds, such as KOIS Invest, are attempting to create new asset classes for sustainable, ‘impact’ investments.

“It’s not about the profits of the assets, but the impact on the ground and putting a monetary value on that”, stated **Béatrice Delperdange**, Head of Business Development at KOIS Invest.

‘Blended finance’ is one way of helping this along. It’s defined by the OECD as “the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries”. In 2016, the OECD’s Development Assistance Committee (DAC) agreed to develop “an inclusive, targeted, results-oriented work programme” on blended finance, and has come up with five main principles to guide policymakers on how to use of new financial instruments. These five principles are largely similar to the recommendations made by Friends of Europe’s 7 February panel of development experts. They are set out in detail below.

RECOMMENDATIONS TO BOOST 'BLENDED FINANCE'

1. Be honest about the risks and expected returns

Investing in developing economies and conflict zones has specific risks. According to the OECD, the biggest risk for investors in renewable energy projects in Africa is not construction or regulatory risk, it's the risk of non-payment by state-owned enterprises. Investors need to make money and they need help covering specific risks.

It's important to realise that not all projects are 'bankable' and that these projects will likely require ongoing ODA and philanthropic funding. An OECD survey found that 70-80% of projects linked to the sustainable development goals focus on tackling poverty (SDG1) and decent work (SDG8), while far fewer aim to tackle environmental challenges (SDG 14 on life below water and SDG15, life on land).

"There is not a business case at the moment, it seems, for all SDGs, but I think not all SDGs should be used for private funding" continued Förch.

While there are more risks in developing countries, there is also investor risk in middle-income countries. In the Caribbean, many island states have 'graduated' from ODA but are having difficulty finding investors because of the risk of natural disasters. "Private financiers don't want to invest in region where your infrastructure can be destroyed before it's finished the construction", points out Sharlene Shillingford McKimon, ambassador of the mission of Saint Vincent and Grenada to the EU.

But 'perceived risk' is often more important than 'actual risk', says **Kay Parplies**, Head of Unit for Investment and Innovative Financing at European Commission Directorate-General for International Cooperation and Development. "Actual risk is a lot lower than people think", he says, estimating few losses from a new €1.5bn Guarantee Fund created by the Commission's development Directorate General (DG DEVCO).

2. Get creative with public funds

To offset investor risk, international organisations such as the EIB, OECD, World Bank and others need to get 'creative' with the money they have. They are the ones that can roll out new financial instruments at scale.

"The smart, targeted use of public funds to leverage private investment is key" stated **Richard Amor**, Head of the EIB's Institutional and Implementation Unit.

The EIB is doing this with 'Sustainability Awareness Bonds', which are issued specifically to fund SDG-themed projects. The bank

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launched its first €500mn sustainability bond in November 2018, building on its successful ‘Climate Awareness Bonds’ for renewable energy projects. A year ago, green bonds didn’t exist - the market is now worth around \$150bn dollars, says the EIB’s Richard Amor.

The European Commission (DG DEVCO) has created a €1.5bn guarantee fund to cover investor losses above a certain level (i.e. second and third losses), targeting projects in municipal services, agriculture and the digital sector.

“The traditional grant funding that we have been doing actually doesn’t work for a lot of sectors that are central to developing economies” added Parplies.

3. Don’t neglect regional and local capital

The vast majority of investment in Africa (90%) comes from regional and local investors, according to the German development agency GIZ, while only 10% comes from overseas. However, blended finance is still focused on improving Western capital rather than on encouraging donors at home.

The money is there, says Förch, and needs to be put in perspective. The UN’s estimated investment gap of \$2.5tn equates to just 1% of global private wealth and 14% of global annual savings.

“There is a huge amount of institutional pension fund money in Africa, in Latin America, that is not being used to finance projects on site. We have to provide support to local issuers of these types of bonds” continued Amor.

Financial inclusion and education are central to getting regional capital markets flowing. As David Fouquet of Belgium’s CERIS, a post-graduate school for International Relations, put it: “Most people in Africa don’t have bank accounts, most people in Africa are in the informal economy.” Including children, women, local entrepreneurs and Islamic finance will be crucial.

“Islamic finance has, at the heart of it, the notion of doing good, so if you leverage that philosophy with our philosophies, hopefully you can get to something with a bigger impact”, added Delperdange.

4. Change the system & create a division of labour

Blended finance can help redistribute risk between the public and private sectors, but a “collaborative systems change” is also needed, says **Lubna Shaban**, Co-Director of Child and Youth Finance International (CYFI), an organisation that helps to bring the right people together to make development projects work.

The point is not only to create links but a clear division of labour - between governments, NGOs, charities, private investors, civil society and everyone else involved in the development sector. This need not cost a lot of money, Shaban insists, with CYFI acting as a kind of “honest broker” that “brings together all the different players”.

“This is an organisation that is independent, that doesn’t come with big piles of money and dictate how things should be. Somebody said to me, ‘Oh, CYFI, we’ve never heard of you’ and I said, ‘Good’. That’s our plan: we’re supposed to be playing the role of the coordinator. The actual ownership belongs to everybody” added Shaban.

Creating a division of labour means recognising not only that ODA will still be needed - and supporting governments in their efforts - but also that NGOs are also crucial, particularly for smaller projects. International organisations, such as the EU, simply do not have the resources to monitor micro-projects, according to the European Commission’s Nico Keppens.

“An on-the-ground NGO is actually delivering a socio-economic service that in a developed country might be provided by the state. Once you put a value on that - the social result of the person finding a job, the child staying in school longer - you can monetise that”, concluded Delperdange.

5. Regulate & evaluate

Regulation is still a major hurdle for investors, placing a responsibility on governments and central banks to create the right conditions for investment and to reduce barriers to lending - especially to women, local start-ups and SMEs.

“We have to get the basics right and then the private sector will follow”, concluded Amor. And evaluating the risks is just as important. The West is “at a risk of replicating a social market economy” in developing countries “that hasn’t been particularly effective at redistributing wealth”, says Brandon Locke from the ONE Campaign. “If we take that model and bring it to developing countries without evaluating some of those risks, we might not end up achieving the SDGs.”

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'BLENDED' PROJECTS IN ACTION

Encouraging SME lending in Myanmar

The German development agency GIZ worked with the Central Bank in Myanmar to help ease lending restrictions and then partnered with three local banks to promote loans for smaller companies. They managed to leverage around \$500mn in loans (from around \$3-4mn), benefiting more than 4,000 SMEs.

Using remittances to fund African start-ups

Remittances to Africa from Europe exceed official ODA and most of the money sent back home by émigrés is spent on basics. The GIZ, on behalf of the German government, set up an online platform to monitor those remittances, pledging to double any money that is invested in small businesses back home.

Advising on energy projects in Brazil, Mexico, China

An EIB-backed initiative known as FELICITY is helping to finance low-carbon investment in cities in Brazil, Mexico and China. Funded by the German environment ministry (and supported by the GIZ), it offers guidance not only on the feasibility of planned investments, but also a project's 'social and environmental soundness' (which could it meet the EIB's requirements for financing).

The focus is on major infrastructure such as public transport, waste water treatment and energy-efficient public buildings.

Boosting financial education in Côte d'Ivoire

The CYFI runs a series of financial inclusion awareness events, such as 'Global Money Weeks'. So far, 72 countries have signed up to similar initiatives, with Côte d'Ivoire winning an award for its Global Money Week, where banks partnered with schools to provide bank accounts for young people. It's a private sector-run pilot project which the government can then endorse.

Supporting rehabilitation in conflict zones

Private equity firm KOIS Invest is starting to use blended finance instruments in conflict zones. The company launched its first 'humanitarian impact bond' with the International Committee of the Red Cross in 2017, to build rehabilitation centres in Mali, Nigeria and Congo for those injured by war or disaster.



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Friends of Europe is a leading think-tank that connects people, stimulates debate and triggers change to create a more inclusive, sustainable and forward-looking Europe.