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BLENDING LOANS AND GRANTS: THE RISING DEVELOPMENT FINANCE MODALITY

Changes in the political and economic environment in Europe and shrinking aid flows impact on donors' development policy with the tendency to see private sector as the most promising actor and to consider that *"crucial to developing countries' success is attracting and retaining substantial private domestic and foreign investment and improving infrastructure."*

In this context, the so-called **'blending mechanisms' or investment facilities**, which mix ODA grants with loans from bilateral or multilateral Development Finance Institutions (DFIs), have become the EC flagship of innovative financing for development. Among the reasons given by the EC to promote such mechanisms, we find: (1) The **economic leverage** that is being achieved: with a small public grant contribution, a very large loan based investment is realized (until now, €32 billion of additional funding for €1.2 billion of EU grants); (2) The **visibility** this mechanism gives to the EU and (3) The **dialogue** and improved coordination it enables between the DFIs, governments, donors and the private sector.

In view of facilitating that dialogue, an EU Platform for Blending in External Cooperation (EUBEC) was recently set-up to *"provide recommendations and guidance on the use of blending in the external cooperation of the European Union."* In practice this includes *"a review of the existing blending mechanisms and the development of a common results based framework to measure impact."*

Blending practices are also widespread outside the EU instruments and Development Finance Institutions (DFIs) have a choice where to seek grant support for their requests, including in the case of the European Investment Bank (EIB), from their own funds. Blending occurs with various types of DFIs, national and multilateral or regional, aimed at public and private sectors.

According to general information provided by the EC in a recent Hearing in the European Parliament, the **EU blending instruments specialise in large-scale infrastructure** investments alongside Small and Medium Enterprises (SMEs) support. Partners in the beneficiary country can be public, private or mixed but in current projects public partners form the majority (90%). Most projects are public investments in the sector of transport (26%), energy (35%), water and sanitation (20%), ICT (3%) and social sectors (5%). Only 11% of the grants have been used to support SMEs in developing countries. Investments in the area of climate change should increase in the future as well as support to the private sector and SMEs.

There are different types of grant contribution: direct investments (41%); Interest rate subsidies (19%); Technical assistance (32%); Risk capital operations (4%) and Guarantees and insurance premia (3%). In line with the *Agenda for Change* focus on supporting the role of the private sector, the latter two forms of blending should get a higher share in the future.[1]

Civil Society Concerns on blending as a development cooperation modality

According to CONCORD, i**nsufficient attention is brought to transparency and accountability issues** in the design and implementation of the existing blending facilities, which use EU development money, including EDF, and where there is **no active parliamentary or CSO involvement** in Europe or in recipient countries. National governments in partner countries are barely involved in decision making. Moreover, there is a need to keep separation between the policy and technical aspects of the grant award process and to ensure a "policy driven" screening of grant requests based on EU regional policies and strategies, as well as overarching EU development policy.

Additionality (for the development objective) cannot be assumed just because public institutions are co-financiers: It could be that the EC and the lead DFIs involved are actually replicating existing investment or following market trends instead of investing in areas with a high development potential and where private investment is not currently flowing. A recent study commissioned by DFID-UK and conducted by a European Think-Tank Group (ODI et al. 2011) highlights **the risk of financial principles outweighing development principles**. It is extremely important **to preserve the poverty focus of the grant component** of the blending mechanism and stronger and stricter standards should be used in that view.

Opportunity costs may be high, but are not carefully considered: Using ODA to financially support blended finance projects (and particularly private sector investments) 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 direct public financing is high such as in climate adaptation, health or education.

[1] All figures come from EC power point: *Increased effectiveness and impact of EU grants through blending* of 30 May 2013. Figures relate to 5 regional investment facilities (Infrastructure Trust Fund for Africa, Neighbourhood Investment Facility, Latin America Investment Facility, Investment Facility for Central Asia and Asian Investment Facility).

Potential debt risks for developing countries: By increasingly leveraging debt based finance, EU could contribute to increased indebtedness of developing countries. In the recent review of the Debt Sustainability Framework (IMF/WB 2012), the World Bank and IMF expressed concerns about the rising levels of private debt and recognised its potential impact on public debt vulnerability. The situation is further aggravated as the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative are coming to an end.

Unclear monitoring and evaluation methods: According to the evidence available, DFIs involved are responsible for the screening process of every project, to assess whether they are in line with their own eligibility criteria and, environmental, social and poverty related standards and guidelines. However, it is not clear what the mechanisms and criteria that the EC implements are to ensure that its own development policy objectives are fully respected. An additional challenge is the lack of harmonisation of criteria amongst the DFIs involved in the existing blending facilities – the EUBEC could make a contribution in this area.

Blending mechanisms in EU-ACP cooperation

In the context of EU-ACP cooperation, in addition to the EDF Investment Facility managed by the EIB, 3 main regional blending instruments exist, the Infrastructure Trust Fund for Africa (ITF) in place since 2007, the Caribbean Investment Facility (CIF – €40 million from EDF) and the Investment Facility for the Pacific (IFP - €10 million from EDF) both established in 2012. The oldest and most exemplary instrument is the EU-Africa Infrastructure trust fund in which, since 2007, €308.7 million from the EDF and €84 million from EU Member States have been injected in the form of grants for a total of €12 billion investments.

The mid-term evaluation of EU-Africa Infrastructure Trust Fund (ITF) recently finalized raises important challenges. Regarding the objectives of the ITF, the evaluation states that *"whilst still relevant, [they] are broad, do not show the causal chain from inputs to outputs, outcomes and impacts, and therefore might not reflect current and future challenges".* On the eligibility criteria It is important to note that, **out of the 10 case study projects reviewed for this evaluation, only 2 of them mention explicitly poverty reduction outcomes in the ITF application** documentation. Given this, it is fair to quote the report published by the European Parliament on blending: "*it remains unclear in what way poverty reduction is considered by LGBFs [loan-grants blending facilities], what the transmission channels are and to what extent positive impacts on poverty are required for operations to be eligible*."

Recommendations to JPA Members

- **Ensure that poverty eradication constitutes the core objective of blending mechanisms in full respect of Human rights conventions.** The standards should be the highest possible, according to the EU development policy objectives, and commitment to the promotion and protection of human rights and to policy coherence for development (PCD). It is important to note that not all the DFIs involved in the existing blending facilities have a common and agreed development mandate.

- **Learn from previous experiences** and include **civil society** organisations as they have broad experience in achieving development goals; capitalize on this knowledge when deciding on the monitoring and assessment of the poverty reduction objective in projects.

- **Adopt guarantees and transparent criteria** at the design stage of blending projects. Currently, there is little evidence available regarding how blending mechanisms implement or even translate international agreed development effectiveness principles, such as ownership, alignment, harmonization, focus on development results, and mutual accountability. Use the EUBEC to its full potential to make sure that strong criteria are established to this end.

- **Strengthen monitoring and evaluation framework with thorough analysis and CSO engagement.** Monitoring and evaluation should ensure that there is real additionality and that scarce development finance is channeled to areas that have a demonstrated positive impact on human development and on reducing poverty and inequalities. Evaluations should also include interests and views of the concerned population/citizens to ensure local ownership of the project and to prevent human rights violations and social and environmental damage.