Global Economic Governance Seminar

Session 2: Official Development Assistance and the Aid Architecture

Analistas Financieros Internacionales (Afi)
Independent consultants

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We are independent consultants in finance

- Since 1987, consulting in **economics**, **banking** and **finance**
- Based in Madrid (**Spain**)
- Strong international focus on **Latin America** and **North Africa** (30+ countries)
- Main international clients are **multilateral financial institutions** and their **local beneficiaries**

- Other clients include:
  - **Spanish financial institutions** (deposit institutions, insurance companies, asset managers, etc.)
  - **Private international clients** (financial and corporate sectors)
  - **Public administrations**

Financial Cooperation for Private Sector Development

- Section 1. Development Finance Institutions and Financial Cooperation in perspective
- Section 2. Development Finance Institutions
- Section 3. Challenges today
- Section 4. The future ahead: concluding remarks

Financial Cooperation for Private Sector Development

This paper is aimed at:

- ✓ Analyzing **DFIs' main features**, such as their owners, institutional arrangements, goals and objectives, instruments, operations financed, sectorial and geographic specialization, among others.

- ✓ Understanding the **impact of DFI activity** on private sector development and their relationship with other areas of ODA.

- ✓ Highlighting some of the **main concerns** that arise from the civil society, such as the need for:
  - transparency
  - measurement of development impact
  - sensitive development issues
  - tax havens
  - DFI potential under today's international development cooperation architecture.

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- Section 1. Development Finance Institutions and Financial Cooperation in perspective

To thrive, **private sector** requires a favorable environment that facilitates growth, with an easy and guaranteed access to information, technical support, funding and markets (both global and local).

These desirable features are often non-existent or face several fundamental **weaknesses** in developing and emerging countries:

- legal and institutional framework unfavorable to the development of private business and investment attraction.
- precarious, limited or unavailable infrastructures (communications, transportation, energy, water and sanitation).
- inaccessible basic social services – education, health.
- local financial systems that hamper universal access to stable and reliable services.
- a substantial degree of micro and macroeconomic uncertainty that tends to exacerbate the risk (actual or perceived).

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- Section 1. Development Finance Institutions and Financial Cooperation in perspective

Improvement of such conditions require **technical assistance / cooperation** to facilitate adoption of structural reforms that improve the business climate for private sector development.

General **budget support** and sector budget support (in education and health sectors, primarily) are also available to those beneficiary countries showing enough institutional preparedness.

Other barriers, however, are not quite eligible for traditional support, and require **non-reimbursable** support:

- fall within the scope of the economic and financial relations;
- are of such magnitude that it is inconceivable to satisfy them by non-reimbursable means;
- are met through public-private partnerships
- implicitly carry the prerequisite to create or strengthen a financial culture of repayment between public and private agents and the general public,
- are the result (not just the cause) of malfunctioning or failed markets, including the financial markets, also driven by a chronic deficiency in the generation of domestic savings.

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- Section 2. Development Finance Institutions

Table 1. DFIs tied to national interest

DFI	Donor country	Tied to national interest
FMO	Netherlands	Partial
DEG	Germany	NO
CDC	United Kingdom	NO
PROPARCO	France	NO
Norfund	Norway	NO
SIMEST	Italy	YES
COFIDES	Spain	YES
IFU/IFV	Denmark	YES
FINNFUND	Finland	Mostly
BIO	Belgium	NO
Sifem	Switzerland	NO
SWEDFUND	Sweden	Partial
OeEB	Austria	NO
SBI/BMI	Belgium	YES
Sofid	Portugal	YES
OPIC	USA	YES
IFC	World	NO
Other regional DFI	Regional	NO

- DFIs are alternative financial institutions that provide finance (higher-risk loans, equity positions and risk guarantee instruments) to private sector investments in developing and emerging countries.
- DFIs are either owned or backed by donor states.
- Multiple bottom-lines: (i) development impact, (ii) economic and financial sustainability and (iii) crowding-in private investment.
- "Pure" DFIs are not (explicitly) tied to national interest (mission statements)

Source: own elaboration based on public information

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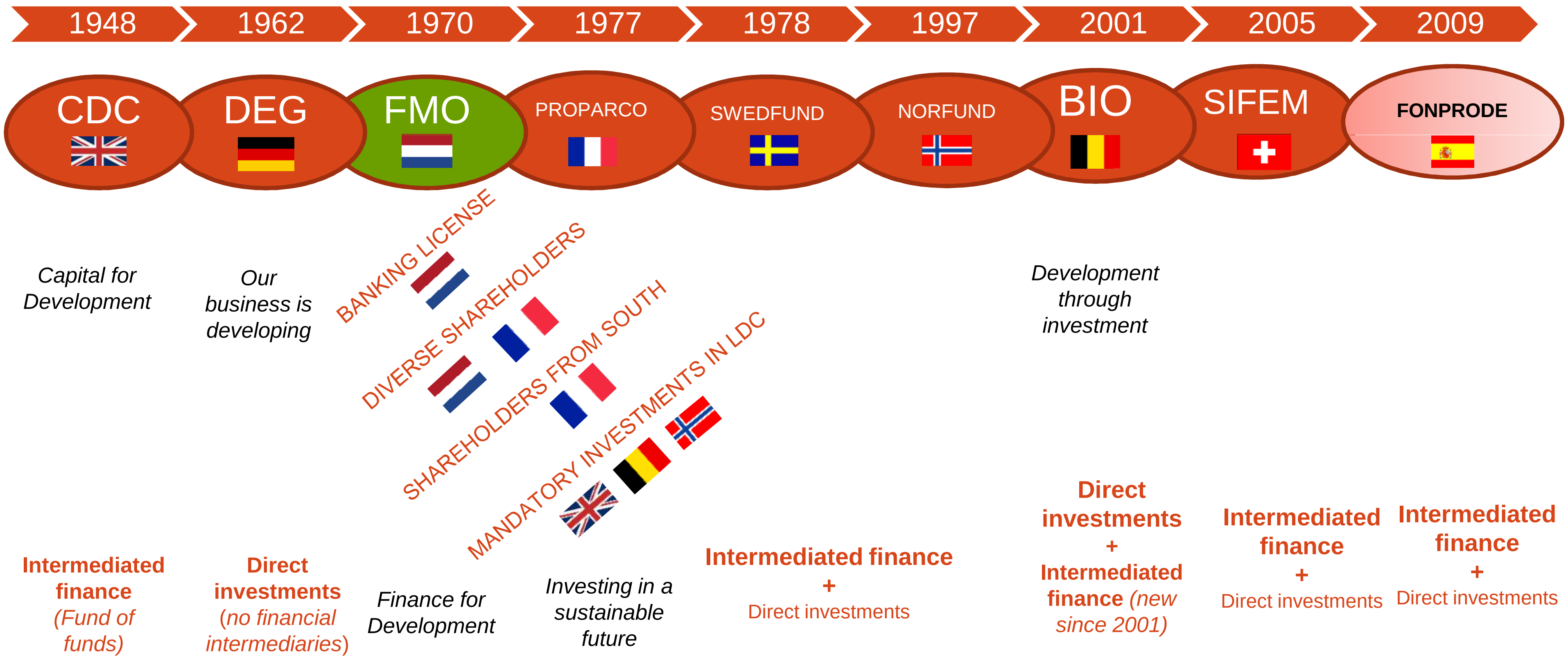
- Section 2. Development Finance Institutions



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- Section 2. Development Finance Institutions

Table 2. Reimbursable Financial Cooperation instruments: some basic features

Capital & Quasi-capital	Direct participation in financial institutions' equity, or through equity funds
	Always minority stake (5% -35%)
	Representation in the Board of Directors
	Investments term 5-15 years
	Previously defined exit strategies: selling shares to local partners
Loans	Senior, mezzanine and junior debt
	Syndicated financing
	Currency: EUR, USD and local
	Market interest rate
	Term: 3-15 years (IFC infrastructure projects max. 20 years)
	Grace period
Guarantees	Structuring guarantees to mobilize resources from the private sector
	Asset securitization and structured finance vehicles
	Bond issuance in local markets

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- Section 2. Development Finance Institutions

Figure 1. Use of financial instruments

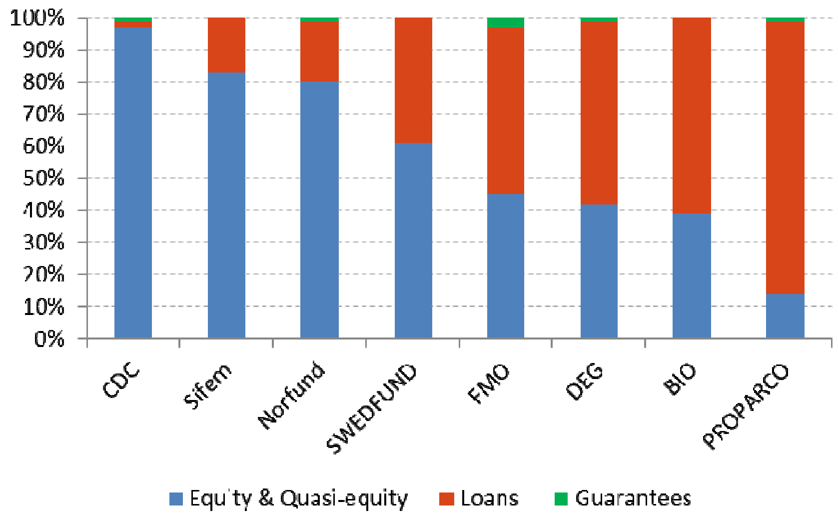
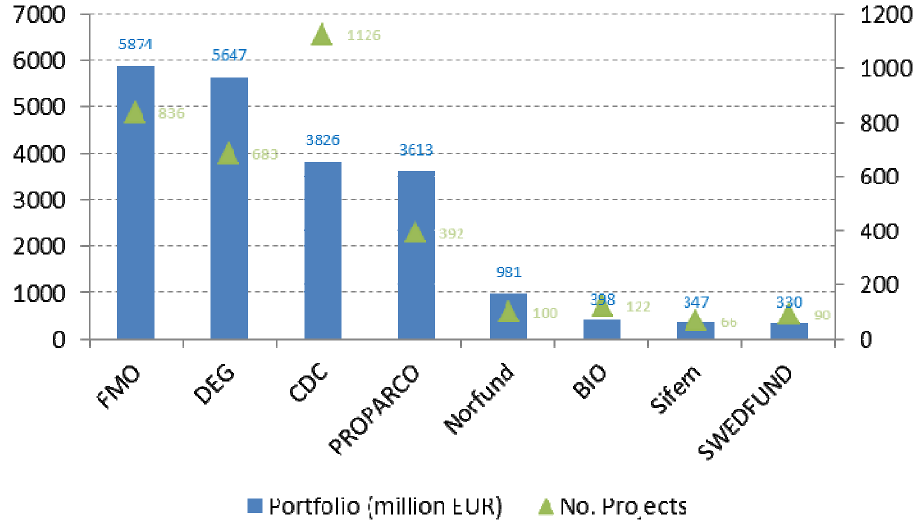


Figure 2. European DFI portfolio



EDFI associates' portfolio: EUR 23,615 million (2011)
IFC alone total portfolio: USD 29,934 million (2011).

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- Section 2. Development Finance Institutions

Figure 3. Geographic distribution

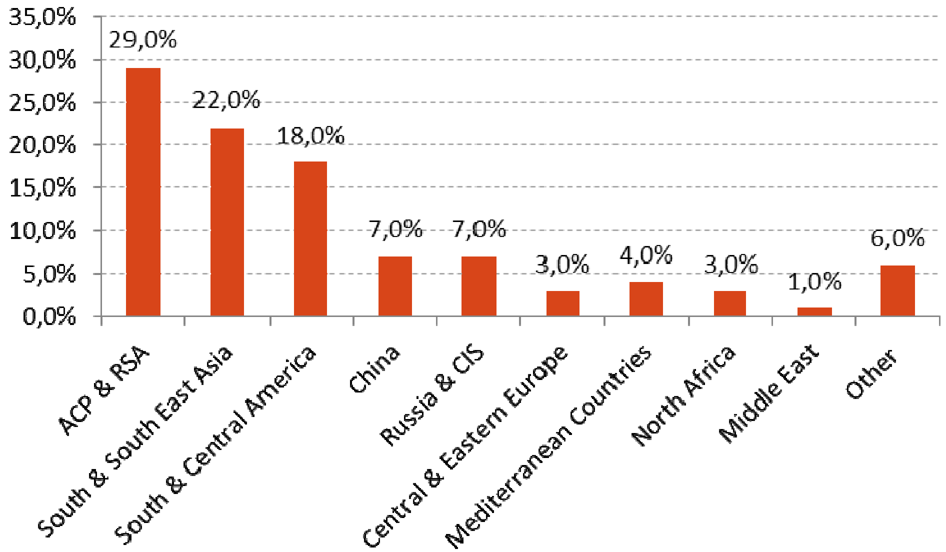
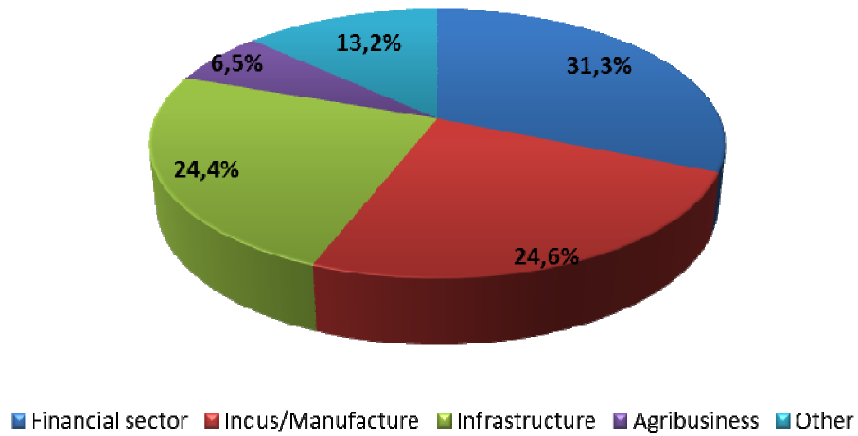


Figure 4. Destination sectors



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- Section 3. Challenges today

DFIs are:

(i) growingly important operating channels for donors' attention to private sector development;

(ii) financial institutions at donors' beck and call;

(iii) specialized in structuring financial operations aimed at financing investment projects in the financial, infrastructure, energy and industry sectors; and

(iv) for critics, these instruments are far from the ideal institutional, functional and operational arrangement for a development agent.

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- Section 3. Challenges today

Transparency vs. Confidentiality / NDA

- Taxpayers should get more and better information on what is being financed through DFIs, exactly at the same level of detail as non-reimbursable aid.
- Working through financial institutions should not impose a veil on the important details (goals, expected results, activities, resources, time frame) that matter to citizens.

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- Section 3. Challenges today

Responsible finance and good governance

- Donors have the ultimate responsibility to monitor and control what is done and how it is done with the development aid resources they offer in administration to third parties.

- Active participation in governing bodies and establishment of clear development objectives and responsible finance guidelines are reasonable means to solve the inherent ***principal-agent problem***.

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- Section 3. Challenges today

Development impact and OECD/DAC recognition

- OECD and donors should update how reimbursable aid – beyond the concessional finance concept – is considered as contribution to ODA.
- Incorporation of development impact results ought to be considered.
- Going beyond monitoring and accountability: measuring development impact

Not crowding out local investment

- Donors should push DFIs to always prioritize development objectives over profitability, avoiding comfortable market skimming strategies or “low-hanging fruit” investments.
- Additionality to avoid potential conflict between development impact and financial return.

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- Section 3. Challenges today

Tax havens

- Donors should appropriately justify the use of tax haven jurisdictions to their nationals. It is by no means reasonable to hide from taxpayers the reasons driving official behaviors to act contrary to what is a compulsory conduct for nationals.

Land grabbing

- Since there seems to be an issue on the potential and apparent link between specific DFI investments and acute land grabbing episodes, donors and DFIs should consider, on the one hand, compliance with a standard Code of Conduct on the issue and, on the other, allowing for more accessible information for taxpayers.

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- Section 4. Concluding remarks: the future ahead

  - In 2011, the outstanding portfolio of the IFC + “pure” European DFIs > USD 50,000 million. By 2015 is expected to exceed USD 100 million.

  - Some donors have decided to seriously cut traditional ODA and compensate with an increase in reimbursable financial aid.

  - It is good news! However, pay attention to issues such as: **transparency**, clear **priority of development impact** objectives over investment profitability, **avoidance of the crowding out** of private and local investment initiatives, care and distance with sensitive issues (**tax havens & land grabbing**), **responsible finance** (highest corporate social, environmental and governance responsibility standards) + focus and **specialization**.

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Thank you!

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