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Position Paper

Caritas Europa
EU Blended Finance for Development

Introduction

Despite the amount of Official Development Assistance (ODA) invested by OECD countries, the $2.5 trillion gap (UNCTAD 2014) between the amount of public finance dedicated to development and the amount necessary for the achievement of the Sustainable Development Goals (SDGs) has not shown any signs of narrowing. In the hope of making up the shortfall, and due to consistent failure to meet ODA commitments, the international development community has, over the last ten years, increasingly turned to private investment. Rooted in SDG 17 and the Addis Ababa Action Agenda, the EU, in its new Consensus on Development (2017), has mainstreamed private sector cooperation into the EU's development cooperation policy and created a European Fund for Sustainable Development (EFSD) as part of the External Investment Plan (EIP) aimed at using ODA to leverage additional private finance, termed 'blending'.

The amount of EU ODA channelled through the European Commission's seven blending facilities[1] has risen over the last decade (European Commission n.a.) and this trend is set to continue with the new Commission (European Commission 2019:5). The European Commission has given many reasons for promoting these facilities, including the economic leverage being achieved, the visibility that these facilities give the EU, and the dialogue and improved coordination they enable between the Development Finance Institutions (DFIs), governments, donors and the private sector.

While agreeing that economic growth is necessary for development and while supporting the role that the private sector has to play in Agenda 2030, Caritas is concerned by the overemphasis on financial returns and the lack of evidence in blended finance projects of significant contributions to the achievement of ODA's primary objective: the eradication of poverty. Caritas does not see poverty as merely a lack of income, but in accordance with the UN as "a denial of choices and opportunities, a violation of human dignity" (United Nations 1998). The private sector should serve the common good by responding to the needs and dignity of the worker, as well as to the needs of society (COMECE and Caritas Europa 2017). Consequently, Caritas is troubled by the big push for blended finance,

[1] See European Commission "Innovative Financial Instruments (blending)."

which "risks skewing ODA away from its core agenda of helping eradicate poverty in the poorest countries" (Attridge and Engen 2019:12).

This position paper sets out Caritas Europa's position on the use of blended finance for development in the EU context and contributes to discussions on the EFSD+ and its implementation in the Multiannual Financial Framework 2021-2027.

"*Put simply, it is a matter of redefining our notion of progress. A technological and economic development that does not leave in its wake a better world and an integrally higher quality of life cannot be considered progress.*"

Pope Francis, *Laudato Si 194*

Caritas' Concerns

There are several issues concerning the use of ODA to leverage private investment which should be taken into account before increasing any further the scale and scope of blended finance. Blended finance must not jeopardise the potential of EU development projects to reduce poverty, fight inequalities, and promote integral human development[2].

1: Lack of emphasis on excluded and marginalised groups

Several evaluations, including one from Eurodad, highlight that projects funded by blended finance have not placed enough emphasis on benefitting excluded and marginalised groups (Weeks 2017). On the contrary, in many cases where blending projects have aimed to improve access to financing, they have targeted existing bank customers and those already employed in the formal job market rather than focusing on small entrepreneurs from less privileged groups and those with unstable and informal jobs (European Commission 2016a:74). This is particularly problematic for African countries. According to the African Development Bank, nine out of ten rural and urban workers in Africa have informal jobs, and most of these employees are women and youth (ILO 2009:iii). Furthermore, a recently published paper by Development Initiatives (2019) has found that the current narrative on blending is "not grounded in robust consideration of the impact that such investments will have on poverty and on the people most at risk of being left behind" (Development Initiatives 2019:3). The aim of blended finance projects should not be to develop an enabling environment for businesses and to expand the private sector but rather to advance on Agenda 2030, leaving no-one behind.

[2] *Integral human development* places the human person at the centre of the development process. It may be defined as an all-embracing approach that takes into consideration the well-being of the person and of all people in seven different dimensions:

1. The *social* dimension
2. The *work and economic activity* dimension
3. The *ecological* dimension
4. The *political* dimension
5. The *economic* dimension
6. The *cultural* dimension; and
7. The *spiritual* dimension.

Kadysheva; Taran; Wickramasekara; Fondello; Gnes; and Pfohman 2019. Pp 1.

2: Insufficient additionality - development additionality

A further concern with blended finance is the risk that its projects will prioritise economic growth and financial return over development impacts[3] (Attridge and Engen 2019:22-23). This is pertinent given the opportunity cost of using public money to mobilise private finances. In the absence of increasing levels of development aid, every euro of public money that gets spent on leveraging private finance is one less euro being spent on essential public services that more directly help alleviate poverty. Primarily, only grant money through budget support and other aid modalities goes towards supporting education, healthcare and social protection. As seen from the 2016 evaluation of blending, the majority of projects aimed at improving infrastructure and access to energy in countries in transition to medium income states but did not address as fully as they could have the specific development challenges of LDCs (European Commission 2016a:65). The Official Development Institute's new report on blended finance suggests that it is "generally harder to mobilise commercial finance for projects that prioritise strong developmental benefits" (Attridge and Engen 2019:29).

Financial Additionality

In addition to development additionality, there must also be financial additionality. According to the Overseas Development Institute (2019), each $1 of MDB (Multilateral Development Bank) and DFI invested mobilises on average $0.75 of private finance for developing countries, but this falls to $0.37 for low-income countries (Attridge and Engen 2019:59). Moreover, according to the European Court of Auditors, in half of the blending projects, there was "no convincing analysis to show that a grant was necessary for the financial institutions to contract the loan" (European Court of Auditors 2014:25). This suggests that not only do blended finance projects have low leverage ratios but that in many cases ODA was not necessary for the project to go forward.

3: Lack of consideration for development effectiveness principles

Blended finance also risks placing less importance on the development effectiveness principles; most notably, the principles of country ownership, transparency and accountability. According to conclusion 2 of the 2016 blending evaluation, "blending projects were not as closely aligned with national policies and priorities as they could have been" (European Commission 2016a:iii). Transparency and accountability are also a challenge in many blending projects and some of the actors involved in these projects lack independent complaint mechanisms (Pereira 2017:44). These mechanisms should always be established otherwise it is difficult for local communities and other stakeholders to hold donors to account.

4. Lack of human rights, environmental and social safeguards in proposed EFSD+

There is a lack of human rights, environmental and social criteria in the proposed EFSD+ compared to the current EFSD. In the absence of a legally binding European regulation on business and human rights, as well as specific legislation guaranteeing European companies' full compliance with human

[3] For further examples see: Tovar; Hernandez; and Sandell 2013. Case Studies, pp 28-33.

rights due diligence, those safeguards are crucial to ensure that the selection process of all projects adheres to the highest human rights, environmental and social standards. This also applies to commitments on women's human rights and equality between men and women outlined in the EU Gender Action Plan II and EU Treaty obligations. For women to benefit equally from blended finance projects, specific policies must be put in place to support them (CONCORD and Eurodad 2018). These safeguards would help ensure responsible business conduct (CONCORD and Eurodad 2018).

5: Use of ODA to prevent migration to Europe

Despite the global focus of the EFSD and the intended EFSD+, Caritas is particularly concerned with the instrument's implementation in Africa. The current EU rhetoric found in the EFSD 2017, the EU Consensus on Development 2017, the proposal for a Neighbourhood, Development, and International Cooperation Instrument 2018 (NDICI - MFF), and in the priorities of the new Commissioner for International Partnerships (European Commission 2019), is that development aid can and should be used to reduce migration to Europe. Much of this ODA support for reducing migration to Europe is foreseen as the creation of jobs and economic growth through blended finance. The EFSD (from 2021 onwards the EFSD+), the blending modality arm of the EIP, was designed in part to address the 'specific socioeconomic root causes of migration and fostering sustainable reintegration of migrants returning to their countries of origin and strengthening transit and host communities' (European Parliament and the Council 2017:249/6). Both the Consensus on Development and the proposed NDICI make reference to the EFSD+ as an instrument to address the root causes of irregular migration through increased economic growth and employment opportunities (European Parliament, Council, and European Commission 2017: 210/8-210/11; European Commission 2018:46). These policies and instruments place great expectations on the ability of development aid to leverage private investment in order to boost economic growth in Africa, thus tackling the root causes of irregular migration, with the intended result of curbing arrivals to European shores. Whilst creating jobs in Africa is vital to achieve Agenda 2063[4], this objective should never be subordinated to the objective of preventing migration to Europe. The purpose of ODA in relation to migration should be the "facilitation of orderly, safe, regular and responsible migration and mobility" (OECD DAC 2018:Purpose Code 15190).

6: Insufficient ODA going to Least Developed Countries (LDCs)

A further issue of blending ODA with private finance is that instead of investing in LDCs and fragile countries, the parts of the world furthest behind and most in need of development assistance, most blended finance projects target lower-middle- and middle-income countries. This is due to a higher number of investable opportunities and a better investment climate amongst others (Attridge and Engen 2019:52). The Commission's evaluation of blending in 2016 found that over "80% of blending during the period served lower medium or medium income countries" (European Commission 2016b:1). Only 26% of blending focused on low income countries and only nine projects in fragile states were carried out (European Commission 2016b:3). Given that nearly 70% of countries in Africa

[4] Agenda 2063 is the continent's strategic framework that aims to deliver on its goal for inclusive and sustainable development.

are classified as Low-Income Countries (LICs) (OECD DAC n.a), it is necessary to better assess whether the EFSD+ is the best instrument to address development challenges in Africa.

7: Increase in tied aid

There is a risk that the real winner from blended finance projects will be the private sector in donor countries at the expense of local communities (Meeks 2018a). Tied aid, ODA given with the condition that it must be used to buy goods or services from companies in the donor country, "puts the interests of a handful of firms in rich countries ahead of the priorities of people living in poverty" (Meeks 2018b). According to the OECD's own analysis, high levels of aid already flow back to companies based in the donor country (OECD DAC 2017:8). Concerns have grown about the potential conflicts between commercial and development objectives and further cases of both tied and informally tied aid. It will be necessary, as the DAC admits in its 2017 report on the untying recommendation, to clarify how an increased role for the private sector in development relates to commitments on untying aid (OECD DAC 2017:3).

8. Poor monitoring and evaluation of the socioeconomic and development impacts of blended finance initiatives

According to the Commission's own evaluation of blending, the degree to which socioeconomic and development impacts have so far been monitored is a weak point of EU blending projects (European Commission 2016b:6). Many donor governments have not yet adopted guidelines on how blended finance should be monitored and evaluated. The development impact of blending is often assessed based purely on financial indicators without looking at the positive impact on the local community (OECD 2018:149). Blended finance actors need to consistently and thoroughly monitor and evaluate the socioeconomic and development impacts of their projects in order to determine the contributions made to local development.

Conclusions and Recommendations

Conclusions

Considering the Commission's blending evaluation, reports from the Court of Auditors, other international organisations, and NGOs, there is so far little evidence of blended finance's much anticipated contribution to reducing poverty and reaching the furthest behind. It is very clear for Caritas Europa that blended finance, which uses ODA in the following ways, is a poor use of public money and will not serve those most in need:

- attracting large investors without rigid criteria relating to the development effectiveness principles, development additionality, human rights, environmental and social safeguards, as well as the inclusion of marginalised groups and LDCs;
- mobilising private capital to foster economic growth in order to prevent migration to Europe; and
- tying aid, subsidising companies in donor countries.

In order to truly contribute to poverty eradication, any use of ODA must not only pursue economic development but also contribute to a person's integral human development and ability to participate in society.

Caritas Europa therefore recommends that ODA, as a scarce resource, should first and foremost be spent on the provision of social services, country-led policy reforms, and the strengthening of institutional frameworks through budget support and other grant modalities, which are more transparent and suited to delivering development impacts for LDCs and marginalised groups. We are concerned by the strong appeal to the private sector in a context where there is no clarity over the different objectives of private sector actors compared to those of public and civil society organisations. Nevertheless, given the strong trend in support of blended finance, Caritas Europa would like to see the following recommendations to the European Commission taken into account when mixing public and private finance to at least ensure that blended finance projects do no harm.

Recommendations to the Commission

Recommendation 1: Ensure the inclusion of marginalised and minority groups
Blended finance projects should always take into consideration and address the local realities in the country and be structured to include marginalised groups, particularly women and youth, not only as receivers but also as co-designers, partners and implementers of projects. Three sets of questions developed by Development Initiatives (2019:4) set out some key considerations to help achieve more inclusive, better poverty-focused decision-making on ODA allocation and fall under these broad headings: who will benefit from the investment?; what is the intended impact on access, inclusiveness and affordability?; and over what timeframe will such impact be achieved?

Recommendation 2: Ensure that all blended finance projects financed under the EFSD+ adhere to the development effectiveness principles (particularly country ownership, transparency and accountability)
In order to ensure real ownership of the projects at national, regional, and local levels, the EU should: align with national development priorities and action plans; engage in dialogue with civil society in both the donor and partner countries in the formation and implementation of its projects; and ensure local communities are involved in decision-making with their right to free, prior and informed consent guaranteed. Donors' commercial interests should not drive project selection decisions (COMECE and Caritas Europa 2017). Independent complaint mechanisms should be established for every project carried out and should be easily accessible to local communities to ensure transparency and accountability. Furthermore, it is vital that all public resources that are blended with private finance should undergo the same level of scrutiny as resources committed to CSOs or other government bodies.

Recommendation 3: Ensure that all blended finance projects financed under the EFSD+ have sufficient development and financial additionality

Development additionality: There needs to be clear demonstration that blended finance enables faster or better development impacts than the public or private sector would be able to achieve alone.

Financial additionality: If increased ODA resources are going to be used to mobilise additional private finance, then the leverage ratios must be increased, and projects must only be undertaken when it is clear that they would not be feasible via private investment alone.

Recommendation 4: Ensure that the future EFSD+ contains human rights, environmental and social safeguards

The future EFSD+ should contain at least the minimum safeguards found in the current EFSD relating to the climate, environment, human rights, and equality between men and women. It should also contain reference to an effective and accessible redress or grievance mechanism so that victims of human rights violations and other stakeholders entitled to redress have access to justice and can hold the donors and other implicated actors to account. Caritas Europa supports the European Parliament in its amendments for much stronger environmental and social safeguards in the EFSD+ including a ban on providing social services such as health. There is also a need for a much stronger emphasis on information disclosure and public access to data.

Recommendation 5: Ensure that ODA is only spent in accordance with development objectives and not for preventing migration to Europe

The right to migrate is a human right and development aid, where it links to migration, should only be used in order to ensure that right. All development aid should contribute to the eradication of poverty, to fighting inequalities, and to promoting integral human development.

Recommendation 6: Draw up guidelines on how to reduce the risk of increased tied aid

The EU must clarify how blending and an increased role for the private sector in development relates to commitments on untying aid[5]. Since the complexity of blended finance makes it easy for donors to get away with tying their aid, the EU should consider, in consultation with civil society, drawing up guidelines to prevent as far as possible increased instances of aid tying.

Recommendation 7: Carry out more research into the financial and development additionality of investing ODA in blended finance

Since every euro invested in blended finance is one less euro available for budget support and other aid modalities that traditionally target the LDCs and have a more concentrated focus on development additionality, we need to better understand and think carefully about the added value of investing ODA in blended finance, namely the financial and especially development additionality, given its specific objectives.

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[5] See OECD DAC 2018 "REVISED DAC RECOMMENDATION ON UNTYING ODA"

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Recommendation 8: Improve the monitoring and evaluation of the socioeconomic and development impacts of EFSD+ blended finance initiatives

Once a project has gone through a rigorous selection and approval procedure and is being implemented on the ground, it should be monitored particularly according to its development additionality as well as financial additionality, based on compliance with development effectiveness principles and with the sustainable development objectives of the Regulation (CONCORD and Eurodad 2018). These projects should also be evaluated in the same manner through stringent ex ante assessments in order to identify their strengths and weaknesses to inform all future blended finance projects. All information on the monitoring and evaluation of these projects should be made public. Furthermore, an obligatory periodic report on the evaluation of private investment projects financed under the EIP should be submitted to the democratic scrutiny of the European Parliament.

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