Blended finance is emerging as one of the means to mobilise more effectively commercial capital to achieve the Sustainable Development Goals and the Paris Agreement – stimulating impactful investment, quality job creation and inclusive economic growth. To accomplish these objectives, blended finance operations must respond to local needs and realities.

While all blended finance projects stem from local development considerations and land at the local level, they commonly stem from a client-driven and deal-oriented approach, which might be generated from an external or more standardised approach. As a result, many blended finance operations do not take local context and dynamics enough into consideration.

Drawing on the experiences of some development finance institutions (DFIs) and multilateral development banks (MDBs), this paper considers several dimensions of the local context and illustrates them by highlighting some of the principles, approaches and practices that could serve as useful guidance to anchor blended finance to local realities. This requires direct responses to well-identified local demands based on broad consultations, strong local ownership, development of local (private and public) institutions and markets, and explicit positive spillovers at the local level – related to sector and economy-wide transformations, such as an improved investment climate.

DFIs and MDBs need to enhance their understanding of local political economy dynamics, including power relations, market and institutional structures, to assess better vested interests, drivers of change and domestic constraints. The coordination between donor agencies and DFIs and MDBs is paramount to anchor their actions to local context and actors. While diversity of approaches should prevail, comprehensive frameworks and integrated approaches can help address the many dimensions of local engagement in blended finance.
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The author would like to thank ACET and the OECD, participants to the OECD-ECDPM-ACET session on Guidance on the OECD DAC Blended Finance Principles: A closer look at the Local Context during the OECD Private Sector for Sustainable Development (PF4D) Week on 16 January 2019 in Paris, all the persons interviewed for this study and those who kindly provided comments on an earlier version of this paper.

The views expressed in this paper are those of the author only and should not be attributed to any other person or institution. Comments and suggestions are most welcomed: San Bilal sb@ecdpm.org.

Acronyms

AFD  Agence Françaises de Développement
AfDB  African Development Bank
AIIB  Asia Infrastructure Investment Bank
AsDB  Asian Development Bank
BOAD  West African Development Bank
EADB  East African Development Bank
EBRD  European Bank for Reconstruction and Development
EDFI  European Development Finance Institutions
ECDPM  European Centre for Development Policy Management
EFSD  European Fund for Sustainable Development
EIB  European Investment Bank
EIP  External Investment Plan
EU  European Union
DAC  Development Assistance Committee
DBSA  Development Bank of Southern Africa
DFI  Development finance institution
CDB  Caribbean Development Bank
CwA  Compact with Africa
FMO  Netherlands Development Finance Company
ICD  Islamic Corporation for the Development of the Private Sector
IDB  Inter-America Development Bank
IDBG  Inter-American Development Bank Group
IFA  International Financial Architecture
IFC  International Finance Corporation
IMF  International Monetary Fund
JICA  Japan International Cooperation Agency
KfW  Kreditanstalt für Wiederaufbau
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<th>Abbreviation</th>
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<tr>
<td>MBD</td>
<td>Multilateral development bank</td>
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<tr>
<td>MCC</td>
<td>Millennium Challenge Cooperation</td>
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<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
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<tr>
<td>MSME</td>
<td>Micro, small and medium-sized enterprise</td>
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<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<tr>
<td>NGO</td>
<td>Non-governmental organisation</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>ReM</td>
<td>Results Measurement</td>
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<tr>
<td>Proparco</td>
<td>Promotion et Participation pour la Coopération Économique</td>
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<tr>
<td>SDG</td>
<td>Sustainable development goal</td>
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<td>TDB</td>
<td>Trade and Development Bank</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WBIF</td>
<td>Western Balkans Investment Framework</td>
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Executive Summary

Blended finance is emerging as one of the means to more effectively mobilise commercial capital towards achieving the sustainable development goals (SDGs) and the goals of the Paris Agreement, stimulating impactful investment, quality jobs creation, and inclusive economic growth. To be effective, blended finance operations must respond to local needs and realities. Yet, anchoring blended finance for development to local context entails many dimensions.

All development finance institutions (DFIs) and multilateral development banks (MDBs) attempt to do so in one way or another. Several principles offer useful guidance to adopt better practice, including the specific one among the Principles for Blended Finance established by the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) which relates to the need to tailor blended finance to local context: “Development finance should be deployed to ensure that Blended Finance supports local development needs, priorities and capacities, in a way that is consistent with, and where possible contributes to, local financial market development.” The central concept of additionality, which refers to the notion that DFIs/MDBs interventions should make contributions beyond what is available in the market, without crowding out the private sector, also require a proper understanding of local needs and conditions.

While all blended finance projects stem from local development considerations and land at local level, they might be generated from an external or standardised approach, with insufficient considerations for local context and dynamics. They may also be purely client driven, with no consultation with a wider range of local stakeholders, and little explicit consideration to broader systemic influenced they may have at the local level. On the contrary, some blended finance projects may have a strong local ownership, responding directly to local demands, resulting from broader consultations, and entailing explicit positive spillovers at the local level.

The local context principle is there to stress the need to anchor all blended finance activities in local realities, building on local development priorities and ownership, fostering local institutions and markets development, and in synergy with sector and economy-wide transformations, notably in terms of investment climate. This requires also a proper understanding of local political economy dynamics, including power relations, market and institutional structures, so as to understand (vested) interests, drivers of change and domestic constraints.

But the translation into practice is far from easy. A major challenge is that DFIs/MDBs are principally transaction-driven institutions, which de facto limits their ability to comprehend the local context in a more systematic and holistic manner.

One of the options is to adopt a more explicit framework to anchor DFIs/MDBs activities in the local context. This is the approach adopted by the European Bank for Reconstruction and Development (EBRD) to ‘transition qualities’, based on a comprehensive methodology and framework, supported by a clear set of criteria. The advantage of this approach is to combine under a single framework the transactional role and transformational role of DFIs/MDBs. The challenge is to combine these two roles in practice so as to ensure effective synergy and complementarity.

Another approach is to combine the contributions of various institutions and instruments in a comprehensive manner, the action of DFIs being complemented by a development cooperation actor. This is the case for instance for the International Finance Corporation (IFC) with the World Bank, the Agence Françaises de Développement (AFD) with its subsidiary the Promotion et Participation pour la Coopération Économique (Proparco) and to some still too limited extent the European Investment Bank (EIB) with the
European Union (EU). The newly established External Investment Plan (EIP) of the EU, which seeks to harness in a more coherent framework DFIs/MDBs interventions, including with guarantees and technical assistance, as well as linkages to the investment climate, provides ample opportunities to better anchor blended finance to local realities and dynamics, taking advantage of the strong presence of EU Delegations in developing countries.

To anchor blended finance in local context, DFIs/MDBs must not only adopt explicit strategies to do so, they must also set in place the incentives and mechanisms to draw on local dynamics and initiatives, and move beyond project-based activities to broader transformational changes. They should rely on explicit political economy assessments, in particular of financial markets, to better guide their interventions and ensure effective development impact (on end beneficiaries and on economy and market wide transformations), and prevent rent-capture by vested interested. While diversity of approaches should prevail, comprehensive frameworks and integrated approaches can usefully be fostered to tackle the multi-dimension of local engagement in blended finance.
1. Introduction

In the development finance community, blended finance is emerging as one of the means to more effectively mobilise commercial capital towards achieving the sustainable development goals (SDGs) and the goals of the Paris Agreement, stimulating impactful investment, quality jobs creation, and inclusive economic growth. With a view to promote better practices aligned to the SDGs, the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) has identified through multi-stakeholder consultation key blended finance principles for unlocking commercial finance for the SDGs. One of the five OECD/DAC Principles for Blended Finance relates to the need to anchor blended finance for development to local context:

Principle 3: Tailor Blended Finance to Local Context
Development finance should be deployed to ensure that Blended Finance supports local development needs, priorities and capacities, in a way that is consistent with, and where possible contributes to, local financial market development.

a) Support local development priorities.

b) Ensure consistency of Blended Finance with the aim of local financial market development.

c) Use Blended Finance alongside efforts to promote a sound enabling environment.

While all blended finance projects stem from local development considerations and land at local level, they might be generated from an external or standardised approach, with insufficient considerations for local context and dynamics. They may also be purely client driven, with no consultation with a wider range of local stakeholders, and little explicit consideration to broader systemic influence they may have at the local level. On the contrary, some blended finance projects may have a strong local ownership, responding directly to local demands, resulting from broader consultations, and entailing explicit positive spillovers at the local level.

The local context principle is there to stress the need to anchor all blended finance activities in local realities, building on local development priorities and ownership, fostering local institutions and markets development, and in synergy with sector and economy-wide transformations, notably in terms of investment climate. This requires also a proper understanding of local political economy dynamics, including power relations, market and institutional structures, so as to understand (vested) interests, drivers of change and domestic constraints.

The local context principle should not be seen in isolation, as it builds on a coherent principle-and-value based approach to blended finance. In particular, the local dimension of blended finance is strongly connected to and also present in the other OECD/DAC blended finance principles, namely:

- Principle 1 “Anchor blended finance use to a development rationale”, which can only be properly articulated if it rests on local considerations and ownership of development objectives, outcomes and impact;
- Principle 2 “Design blended finance to increase the mobilisation of commercial finance”, which includes local initiatives to mobilise commercial finance, as well as efforts to mobilise local commercial finance; and
- Principle 4 “Focus on effective partnering for blended finance”, which should include partnership with local actors.

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• Principle 5 “Monitor blended finance for transparency and results”, which should explicitly integrate the local dimension and include the perspective of local actors.

The local dimension is also integrated in the Shared value system on blended finance under the Tri Hita Karana Roadmap for Blended Finance, fostered under the aegis of the OECD, which encompasses the development rationale, anchoring blended finance into the SDGs and structuring blended finance to build inclusive markets. In particular, it states:

“Blended finance should help to accelerate inclusive sustainable market development, including the local financial market. Local engagement and ownership should be pursued. At the same time, blended finance should be accompanied by efforts to promote a sound enabling environment and investment climate. In addition, availability of information relevant for market making should be coordinated among policy makers, development finance providers, commercial investors and investees to leverage experience and track record. Ultimately, in each market, clarifying, sharing and addressing the root causes for requiring blended financing should be prioritised.” (emphasis added)

These principles and shared values reinforce the G20 International Financial Architecture (IFA) Working Group’s Principles of MDBs’ strategy for crowding-in Private Sector Finance for growth and sustainable development adopted in 2017, which notably emphasise the primacy of country ownership and the necessity to create investment-friendly environment. The local dimension has been further stressed by the G20 Eminent Persons Group on Global Financial Governance in March 2018, who proposed that “the IFIs [International Financial Institutions] should collaborate through country platforms – in capacity-building, strengthening the investment environment, developing the supply of bankable projects, and sharing knowledge and data. These platforms should be owned by the countries’ governments, with appropriate support and coordination from the IFIs.” (emphasis added).

At the same time, blended finance is also a key issue for the G20 Compact with Africa (CwA), which focuses on enhancing private sector investment in the 12 Compact countries (Benin, Burkina Faso, Côte d’Ivoire, Egypt, Ethiopia, Ghana, Guinea, Morocco, Rwanda, Senegal, Tunisia and Togo). Strengthening the contribution of Development Finance Institutions (DFIs) and Multilateral Development Banks (MDBs) is also one of the priorities under the G20 CwA to ensure its effective delivery based on local ownership.

Turning local dimension principles into action is part of the daily business of DFIs/MDBs, and yet remains one of the challenges for blended finance actors. This paper considers various dimensions of the local context principle, and illustrates them by highlighting some of the approaches and practices of a selected number of DFIs and MDBs, notably the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), the Agence Françaises de Développement (AFD) and its subsidiary the Promotion et Participation pour la Coopération Économique (Proparco). Attention is also given to the European Union (EU) framework and its innovative External Investment Plan (EIP). The discussion is structured as follows. Section 2 addresses the local dimension inherently present in all DFIs engagement, notably as embodied in the additionality principle. Following sections focus each on a specific aspect of local

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context: Section 3 on the local investment climate and business environment, Section 4 on market development and demonstration effects, Section 5 on stakeholder consultation, Section 6 on support to local institutions and Section 7 on local presence. Section 8 concludes the discussion with considerations on more integrated approaches.

2. Local dimension: an underlying consideration for all DFIs

The mandates and strategies of DFIs are geared towards transformative development objectives, based on private investment for development. By nature, DFIs are mainly transaction-driven financial institutions, which seek to achieve developmental impact in developing countries. As a result, their activities have always local dimension in developing countries, directly or indirectly.

Directly at the project level, the “know-your-customer” principle is key for any financial transaction. In practice, DFIs have to be able to identify their potential clients and ensure their quality over other potential similar customers. This requires also to have some understanding of the environment under which the transaction will take place and its potential development rationale, all aspects which necessitate some assessment of the local context.

DFIs/MDBs also seek to provide the most appropriate instruments to serve the local market, for instance in terms of improving access to finance, financial inclusion, sustainability criteria, infrastructure development, local currency lending, etc. Again, this requires understanding of the local environment and actors, and potential needs.

The local dimension can thus be traced to the raison d'être and rationale for DFIs intervention. In this respect, the notion of additionality is worth paying specific attention to, as a fundamental principle underpinning DFIs blended finance interventions.

The concept of additionality refers to the notion that DFIs/MDBs interventions “to support private sector operations should make a contribution beyond what is available in the market and should not crowd out the private sector”. The principle of “[a]dditionality is central to the engagement of MDBs with the private sector”, as highlighted by the group of Multilateral Development Banks. To be applied properly, the additionality principle must be based on a careful assessment of the local context. Indeed, MDBs stress that “additionality varies by country, sector, market and client context, all of which are dynamic and evolve over time. MDBs use the project design and due diligence processes to make sure that their interventions are additional, relative to the condition of the market in question” (emphasis added). The notions of additionality and local context are clearly closely connected.

Further, it is interesting to distinguish between financial and non-financial additionality, though the two concepts are closely linked in practice. Financial additionality relates to key financial inputs a project can contribute to, addressing market gaps (as for instance in the case of local currency lending) or providing innovative financing structures. To be effective, these require a proper assessment and understanding of

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6 For instance, the Association of European Development Finance Institutions (EDFI) defines DFIs as “government-backed institutions that invest in private sector projects in low and middle income countries to promote job creation and sustainable economic growth, and to contribute to the Sustainable Development Goals, alongside aid agencies and development banks.” https://www.edfi.eu/

7 MDBs (2018), Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operations, September, p.3.

8 Ibid, p.6.

local market conditions, structures and actors. Non-financial additionality criteria, such as higher (sustainability) standard setting and knowledge innovation, are also important dimensions of DFIs initiatives, which also depend on local context. Perhaps even more noteworthy are the non-financial additionality that have spillovers to policy and regulatory environment. For instance, the MDBs’ Harmonized Framework for Additionality in Private Sector Operations identifies as one of the dimensions of non-financial additionality projects "designed to trigger a change in the policy, sector, institutional or regulatory framework, or enhance practices at the sector or country level."\(^\text{10}\)

While additionality is a useful guiding principle to engage locally, it can be a challenging one to operate in practice, and even more so to assess and monitor.\(^\text{11}\) The experience of the EBRD is in that respect very interesting, as it recently thoroughly reviewed its concept and application of additionality.\(^\text{12}\)

The EBRD attaches great importance to the changes that its involvement can trigger, at the project level, but also beyond, sector and country wide, including in terms of regulatory and institutional setting. Additionality (in particular non-financial) is therefore strongly connected to (though different from) its ‘transition qualities’, the transformational ambitions of EBRD approach (discussed in Section 3). The review identified that while additionality was at the core of the EBRD engagement (in line with MDBs additionality principles), in practice the EBRD focus on a “project-level approach to additionality is not well-suited to capture additionality at a framework level”.\(^\text{13}\) Besides the strong transactional approach on projects, the main challenge relates to monitoring and reporting issues, with no clear linkages to market benchmarks, no clear “guidance on acceptable sources, and on ways to understand [non-financial additionality assessment] value, no aggregate monitoring and reporting on additionality”\(^\text{14}\).

The merits of the EBRD review are not only to highlight in a transparent manner the challenges EBRD has been confronted to in operationalising the additionality principle, but also to illustrate the more widely shared challenges faced by DFIs/MDBs.\(^\text{15}\) To the extent that the additionality principle is at the core of the local dimension of blended finance, it is also symptomatic of the importance, as well as the limits, of explicitly taking into account local dimensions in transactional project-based approaches of DFIs, and in particular to properly monitor and report it.

3. Investment climate

Although DFIs are transaction-driven, the nature of their interventions is affected by the overall local context, and in particular the investment climate in which they operate. The underlying theory of change for most DFIs/MDBs also includes broader development impact related to the local context, including the investment climate and business environment.

The World Bank Group has formalised this in its Cascade approach, whereby priority should be given to mobilising commercial financing and solutions, and when not effective, then regulatory and market reforms

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\(^\text{10}\) Ibid, p.8: see non-financial additionality category “Policy, Sector, Institutional, or Regulatory Change”.


\(^\text{12}\) EBRD (2018), Additionality in the EBRD: Review of Concept and Application, EBRD Evaluation Department.

\(^\text{13}\) Ibid, p.v.

\(^\text{14}\) Ibid.

\(^\text{15}\) The difficulty to assess and report on additionality was a key theme at the ECDPM-CGD Roundtable on Pushing the envelope with the EFSD(+): Fostering additionality in EU external investment with DFIs and MDBs in Brussels, 25 March 2019.
should be pursued with government, before having recourse to concessional resources, and only in last resort using public finance, as illustrated in Figure 1. Besides the emphasis given to commercial finance and market-based mechanisms, the Cascade approach illustrates well the strong connection between the investment climate and regulatory reform agenda with blended finance initiatives.

Figure 1: World Bank’s Cascade approach


The World Bank Group strength is also its opportunity to combine the World Bank support with International Finance Corporation (IFC) operations and Multilateral Investment Guarantee Agency (MIGA) guarantees, offering a more comprehensive package, linking blended finance to investment climate and market reforms. Arguing for comprehensive approaches to blended finance in conjunction with other efforts, a recent IFC study stressed the need “to view the use as part of a transformative process that involves actions at many levels to maximize long-term development finance. Operatively, this approach implies a close link between blended concessional finance, advisory services, upstream efforts, sector plans, and regulatory reforms in maximising development finance.”

Other donors are able to mix their broader development support instruments with their private sector arm operations. This is the case for instance for AFD, with its subsidiary Proparco (the French DFI), which seeks to maximise such synergy between its financing operations and change dynamics, as articulated in its new strategy:

“Support for the design of development paths and related public policies, equivalent to support for financing projects; selection of “best path” approaches that allow more rapid completion of projects. This passage toward a more dynamic, policy-oriented and long-term conception of support assumes that AFD Group will give less emphasis to the objects it finances, and more to the actors and processes that link projects to development paths and policies. It also assumes that the Group will expand its range of nonfinancial services, with knowledge transfers and capacity building integral and complementary to funding.”

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The EIB approach also explicitly includes considerations on the investment climate and regulatory environment under which its operations take place, including development priorities set by local authorities, as framed in the EIB’s Results Measurement (ReM) framework (see Annex 1). The EIB also operates in the framework of the EU, in terms of EU strategic priorities in foreign policy engagement, but also development support instruments. The potential for strong synergies between EIB operations and other EU development initiatives is there, though in practice it often remains limited, notably in terms of investment climate and business environment reforms, where the complementarity between EU policy dialogue on investment climate and EIB engagement is not sufficiently explored. The fact that the EIB engagement must be in line with EU policies and national priorities as defined by the government offers some interesting opportunities for synergy. For instance, in Kenya, the EIB engaged in the energy sector, in line with the EU priority sector, responding to the Big 4 Agenda of Kenya, which comprise manufacturing, for which energy is an important enabler. Dialogue with the government includes both the EU and the EIB, although through different entry points. But the approach remains ad hoc, and the EIB is not systematically involved in EU policy dialogues and initiatives on investment climate.

One channel through which synergies between DFIs/MDBs and the investment climate can be fostered is through budget support. Budget support is the mechanism through which development aid is given directly to recipient countries, through their budget, as a means to strengthen domestic ownership and strengthening their budgetary processes, notably in terms of transparency. In doing so, donors like the EU pay great attention to the macro-economic conditions and investment climate in the country, as well as their institutional setting and public finance management. Such assessment of the investment climate can prove very useful for blended finance operations as well. The MDBs that engage in budget support are also well placed to link investment climate considerations to their concessional finance operations. Cooperation with the International Monetary Fund (IMF) is very useful in that respect. MDBs have also internal capacity to conduct macroeconomic analyses, investment climate assessments and more sectoral or thematic analyses. These contribute to their understanding of the local environment under which they operate, and can help guide their strategic engagement and activities. AFD, the EIB and the EBRD all engage in such knowledge development and assessment. They also participate to cooperation endeavours with other MDBs and DFIs to share experiences, knowledge and good practice principles, notably on the local context.

In practice, however, the operational nature of DFIs/MDBs engagement makes it more difficult to identify and directly influence more comprehensive changes such as investment climate.

The EBRD provides an interesting example in that respect, both because of its dedicated strategy and mechanisms to address systemic changes in the local environment, as well as its efforts to assess its effective results in that respect, in a transparent manner.

The EBRD has an explicit mechanism to account for the systemic transition impact, which is an important dimension explicitly accounted for in the rationale for EBRD interventions and project selection. It is underlined by an explicit set of transition indicators, which in principle facilitates the assessment for project selection. The two pillars of the EBRD transition concept relevant for the business environment/investment climate

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19 See for instance G20 MDBs (2018), Coordination Between the International Monetary Fund and Multilateral Development Banks on Policy-Based Lending- Update on the Implementation of the G20 Principles, prepared by the staffs of the IMF, WB, IADB, in coordination with the staffs of the AfDB and ADB, August.

climate are to be “competitive” and “well-governed”, completed by four other transition qualities (to be “inclusive”, “green”, “resilient” and “integrated”) needed for a sustainable market economy. The EBRD also keeps track of the progress in transition and structural reforms achieved, through annual transition scores based on 139 indicators.\(^{21}\) The EBRD interventions should thus be guided by these transition objectives, which help framing their priorities for each country, as outlines in Figure 2.

Figure 2: Standardised indicators for ERBD’s country strategies

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Annex 2 illustrates how this is done in the case of Tunisia, where both transaction-based and more systemic initiatives are combined to achieve economy-wide transformations, including in terms of investment climate. Tunisia is perhaps a good example of donors/MDBs coordination around investment climate, industrialisation and development policy financing reforms, which has been conducted under the coordination of the Tunisian government, together notably with the IMF, World Bank/IFC, the EU, the EBRD, the EIB, AFD, KfW and the African Development Bank (AfDB). Consultations were also carried out with a broader range of local stakeholders, in particular key local civil society organisations.\(^{22}\) This effort towards donors and MDBs coordination, through a high-level mission held in July 2018,\(^{23}\) led to the joint identification of key axes of reforms, grouped under a common matrix with indicators derived from the G20 Compact with Africa for Tunisia, the IMF Structural Benchmarks for Tunisia and various budget support operations. While this coordination process is still in its infancy, remains too selective and suffers from insufficient level of appropriation, it is an encouraging start, which could be further enhanced and emulated in other countries.\(^{24}\)

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\(^{22}\) See for instance this document of the World Bank.


\(^{24}\) In Tunisia, a follow up coordination effort is still envisaged for 2019. The EU, in setting up its budget support operations, is also seeking synergy with other partners, such as the World Bank/IFC, EBRD and AfDB, as well as the Japan International Cooperation Agency (JICA) and the US Agency for International Development (USAID) / Millennium
The combination of the project engagement and wider transformative objectives is well articulated in the EBRD approach, and more systematically accounted for than in the more loosely defined framework and reporting mechanism of the EIB for instance. Most DFIs, being transaction focused, do not have means and methodology similar to the EBRD to operationalise their transformative mandate in a more systemic manner at the local level, and therefore do not monitor, measure and report on their additionality and impact at the wider systemic level.

Yet, even the EBRD appealing model is running into practical challenges, carefully identified in a recent EBRD own evaluation. While the EBRD engages both in transaction-driven changes and in wider transformational changes, “these two roles require fundamentally different approaches to strategy design and deployment of resources. The transaction-driven role requires client commitment: it is demand-driven, opportunistic and technically focussed. By contrast, the change agent role requires wider skills and engagement, including: a broader knowledge of the key issues; preparatory analysis and diagnostic work; engagement with a (committed) government at higher tiers and often inter-agency co-operation; and mobilising networks to effect institutional and behaviour change. These two roles also flow from different relationships with partners – the former often reflects competitive interests while the latter benefits from synergies.” It further finds that “[a]dministrative processes are geared towards transaction-driven engagement and often fail to support longer-term, transformational initiatives. […] Activities beyond those that are transaction-driven are often short of funding and human resources, and rely exclusively on donor funds.” As a result, investment climate “support activities have often developed ad hoc and opportunistically, without clear and measurable goals or intended results[…]. The lack of higher-level goals means that there are no metrics and baselines against which progress could be measured in a meaningful and reliable way.”

The EBRD’s experience illustrates the challenge that most DFIs/MDBs experience: as an interested investor, they seek direct development impact through their client-based, transaction-driven engagement. It is therefore with this prime objective that they can consider the local context. As noted by EBRD evaluation, though, “individual investments may also deliver wider value regionally, sectorally or industry-wide.” But such wider impact is often not explicitly monitored and assessed, at least not ex post. Most often, it can be found in the ex ante justification and articulation of projects only. Connections with the wider transformational changes, at the macro-economic and investment climate level are thus often aspirational, and when carried out, it is often disconnected from individual projects.

Here, it is useful to also distinguish between the types of blended finance operations. Sovereign operations involve the government, and thus are more prone to dialogue with the government on regulatory issues (related to infrastructure development for instance) than non-sovereign operations, where DFIs’ clients are directly the private sector and where the government is not necessarily present.

In considering wider transformation, DFIs/MDBs do tend to think also in terms of portfolio of projects, though their local dimension may not be explicitly articulated beyond an ex ante rationale.

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25 EBRD (2018), The EBRD’s Investment Climate Support Activities, EBRD Evaluation Department, October 2018.
27 Ibid, p.2.
Many DFIs/MDBs, as in the case of the EIB, do not have their own explicit country strategies, and thus operate on more ad hoc basis, which also limits the opportunities for influence on wider investment climate objectives.

Overall, although the rationale for blended finance is well anchored into transformational considerations of the investment climate, there is a lack of systematic evidence on how DFIs/MDBs can most effectively link the two. An anchor with a donor’s organisation - like the World Bank for IFC, AFD for Proparco, or the European Commission and EU Delegations for the EIB - seems to be a strong asset for DFIs to potentially link their activities to changes in the investment climate. Direct engagement with the national government and local authorities, as well as technical assistance, are key elements for linking DFIs blended finance to investment climate dimensions. The EBRD has established an attractive integrated framework to link its operations to transformational objectives of the investment climate and beyond, through clearly defined transition qualities and criteria. While this is clearly one of the core comparative advantages of the EBRD model, it still encounters key challenges for its effective implementation.

4. Market development and demonstration effects

Perhaps a more pragmatic and directly achievable objective for DFIs/MDBs is their contribution to strengthening local financial markets and achieving demonstration effects, both of which are anchored in local dimensions. A core aim of blended finance is to compensate for and address market gaps and weaknesses. In this respect, blended finance is often perceived as critical to building or strengthening private sector markets.

Indeed, according to the IFC, “[t]o assess whether blended finance is needed and how it can be effectively structured, it is essential to understand the restrictions and market failures and the sectoral and country context, and to articulate how blended finance is supporting the creation of markets or is helping them move toward commercial sustainability.” IFC distinguishes three phases to market creation:

1. “In the first phase of creating markets, the focus is on the initial triggers of market change. These typically include pioneering investments, building market platforms, and adoption of new technologies and business models”;
2. “As markets grow, the second phase of creating markets is characterized by expansion and clustering of complementary investments and government action […]. Blended finance can also play an important role in reinforcing markets, particularly in supporting the introduction of innovative technologies and business processes.”
3. “In a third phase, as markets mature, business models are ideally scaled up and extended, new standards and market norms are established, new financing is mobilised as additional private players join, and efficiency and dynamism are further promoted.”

The above narrative - not specific to IFC but underlying the interventions of many DFIs/MDBs - also suggests a range of interventions, mostly centred on individual transactions, that can have a wider effect on market development. These have been translated into a well-articulated principle of the DFI Enhanced Principles on blended finance, endorsed by the major DFIs (see Box 1).

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32 Ibid, pp.2-3.
Box 1: DFI Enhanced Principles on blended finance: Reinforcing markets

Principle 4. Reinforcing markets. DFI assistance to the private sector should be structured to effectively and efficiently address market failures, and minimise the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.

Guidelines
- Identify and, where feasible, implement measures to overcome the obstacles identified that are barriers to commercial sustainability.
- Monitor, where feasible, the obstacle identified as giving rise to the need for blended concessional finance.
- Introduce, where feasible, market monitoring and coordination among DFIs to leverage experience, coordinate policy, and demonstrably take steps over time to reduce the root causes for requiring blended financing.
- Structure blended concessional finance to align incentives to accelerate sustainable market development.

Many of the DFIs blended finance operations with private sector contribute, directly or indirectly, to foster market development. These ranges from engagement with financial intermediaries to improve access to finance for micro, small and medium-sized enterprises (MSMEs) or women entrepreneurs for instance, to providing local currency operations, improving market liquidity, reducing risks and fostering product diversification, among others. Donors support to institutions like TCX, which works with DFIs to mitigate local currency risks, is innovative framework that plays an important role in local market development.

Innovation and demonstration effects, pioneering new initiatives, are also roles that DFIs can play to create markets and steer actors in new endeavours (in terms of standards, products or sectors). For instance, FinDev Canada, the new Canadian DFI, calls for the need to “think in terms of ‘making markets’ and fundamentally shaping incentives to move the needle in areas like gender equality and women’s economic empowerment”, an objective that can be applied to other areas as well. Blended finance can have a critical demonstration effect for actors in the markets, as it can contribute “to initiate first-of-its-kind investment that can showcase commercial viability in the longer run, and thereby attract subsequent private investment on commercial terms”.

There are numerous examples of DFIs activities that have contributed to shaping local markets. A recent evaluation of the EIB for instance indicated that “[t]he EIB tailored its objectives to the needs of local financial markets and selected intermediaries accordingly. Intermediated lending operations contributed to strengthening financial sectors by supporting competition, primarily through the financing of local second tier

Development Bank (AfDB), the Asian Development Bank (AsDB), the Asia Infrastructure Investment Bank (AIIB), the European Bank for Reconstruction and Development (EBRD), European Development Finance Institutions (EDFI), the European Investment Bank (EIB), the Inter-American Development Bank Group (IDBG), the Islamic Corporation for the Development of the Private Sector (ICD), and the International Finance Corporation (IFC).

34 One of the major comparative advantages of the EIB has been its ability to lend in local currency. Other DFIs are also increasingly doing so. The EBRD for instance has become a significant provider of local currency financing, which amounts to some 36% to 40% of EBRD operations. See also EBRD (2019), Local currency financing: Treasury. Other initiatives, such as Proparco new guarantee scheme UNLOCK allows financial institutions to jointly cover risks associated to long-term financing in local currency: see https://www.proparco.fr/en/unfunded-local-currency-keystone-financing-solution


banks." This illustrates well the effects of DFIs interventions, meant to engage with some financial actors (in this case financial intermediaries), selected in a careful manner to address a market weakness or failure, with the ambition to generate positive spillovers in terms of competition. Assessments refer however mainly to the financial additionality principle (and only partly the non-financial additionality), with a strong focus on transaction-based, client-driven operations, and less with potential synergy and complementarity with broader market development endeavours. The EIB support benefits mainly the intermediaries and by extension the end beneficiaries, with little attention given, even in the evaluation and reporting, to potential more systemic implications on strengthening markets.

It is important to note that in engaging in market support and development, DFIs/MDBs should pay careful attention to the sources of market failures, including market structures, and the underlying power relations and interests at play. With rampant crony capitalism in many developing countries, DFIs/MDBs interventions should build on careful political economy assessment of financial markets, to ensure the intended benefits of their interventions are not captured by vested interested.

5. Coordination and stakeholder consultations

Consultation with government is a common feature of donor engagement in developing countries. MDBs are often associated to it, and in the case of sovereign operations, are directly engaging with the government. DFIs working closely with their donor agency, as in the case of Proparco with AFD, or IFC as part of the World Bank Group, can be associated to and directly benefit from their stakeholder consultations. Donor coordination mechanisms have similar potentials, both in terms of synergies among initiatives and both direct and indirect consultation with government. Yet, too often donor mechanisms and consultations omit to more systematically include all relevant DFIs. Efforts should be made to capitalise on the emulate the experiences of donor coordination with financial institutions and government, as for instance with the Western Balkans Investment Framework (WBIF), a joint blending facility where the European Commission brings together financial institutions (such as the EIB, EBRD, KfW and the World Bank) with bilateral donors and Western Balkans countries’ governments. The newly established EU’s External Investment Plan, which seeks to harness DFIs interventions to the investment climate, offers a renewed opportunity for the EU Delegations to play a more active role in coordinating their local interventions with DFIs and MDBs, as well as local actors (see also Section 8 below).

To be effective, consultation and coordination mechanisms should respond to the priorities of and be owned by developing countries government. Too often, however, national governments fail to effectively do so; their interactions with its financial partners, various donors and DFIs/MDBs are often not coordinated internally, being spread over different ministries and directorates.

To promote sustainability criteria and address issues such as inclusiveness, land management and tenure, and environmental and social impact, in particular in infrastructure development, DFIs also tend to engage in broader stakeholder consultations, notably with civil society organisations and affected communities (see also Annex 2 for an illustration). Another means of consultation is through platforms and associated partners,

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39 For a discussion and examples, see for instance Diwan et al. eds. (2019), Crony Capitalism in the Middle East: Business and Politics from Liberalization to the Arab Spring, Oxford University Press. In the case of Tunisian financial sector, see also Anis Marrakchi Talk (2019), “L’économie de rente en Tunisie : comment en sortir”, https://www.youtube.com/watch?v=dbsvC63E8Bc

40 Western Balkans Investment Framework

41 EU External Investment Plan
as in the case for instance of the FinTech platform recently launched by FMO and its partners, FinForward to the MENA region.\textsuperscript{42}

The EIB engages on stakeholder consultation (government, local authorities, civil society and local communities) in particular in the context of sovereign financing (often related to infrastructure development). This consultation is more difficult when engaging in non-sovereign blended finance with private actors, as government is generally not involved and EIB engagement is more client-based. EIB has been criticised, by NGOs notably, for not sufficiently engaging with local population, notably in North Africa, and for relying on its consultation with authoritarian regimes.\textsuperscript{43} While the EIB is meant to align its strategies and operations to EU interests and priorities, it has been criticised for not sufficiently considering national interests where it operates, as in the case of the Arab Spring in Tunisia.\textsuperscript{44} Similar criticisms have been raised for other DFIs/MDBs as well.

The challenge for most DFIs rests therefore in more systematically consulting a wide range of local stakeholders in their various operations. This challenge is particularly acute in transaction-based, client-driven blended finance projects for the private sector. This is because the linkages to economy and market wide transformations are often not explicit and more difficult to assess, making a stakeholder consultation less directly relevant in the absence of clearer systemic effects or project-based impacts. As a result, beyond a narrow range of private sector actors, non-sovereign blended finance operations entail limited effective local consultations. This in turn might reduce local ownership and broader local dynamics towards more transformational economy, sector or market wide outcomes that a project could contribute to trigger.

6. Support to local institutions

Another important local dimension of blended finance is the opportunity to work with and build the capacity of local institutions. Most of the attention of DFIs/MDBs is turned to private sector institutions, notably financial intermediaries, in the context of market development, as discussed in Section 4. By combining concessional lending or risk mitigation instruments with technical assistance, DFIs/MDBs often contribute to the development of the institutional capacity and standards of those financial institutions they are working with, as well as helping them foster innovation. DFIs/MDBs engagement also helps to improve credibility and reputation of these local financial institutions in the local and international financial markets. While DFIs/MDBs typically evaluate the impact of their operations with financial intermediaries on the end client, they tend to pay less attention to assessing the systemic impact they may have on local financial institutions and market, though these may have longer term and ultimately larger benefits.\textsuperscript{45}

Some DFIs/MDBs also engage with local public financial institutions, such as regional and national development banks. Their project-based partnership is often accompanied by some technical assistance and institutional cooperation. Yet, there is also some reluctance by many DFIs/MDBs to do so. This does not only stem from the fact they may be competitors in a small market, but mainly because of limited information and

\textsuperscript{42} FMO (2018), \textit{FMO Presents Fintech Platform FinForward to MENA Region}, 12 July 2018.


\textsuperscript{45} A notable exception is the IFC, which tries to capture some of these effects in its impact assessment. See for instance IFC (2013) IFC Demonstration Effects Study, January; and IFC (2018), How IFC Measures the Development Impact of its Interventions.
the perceived risk associated with working together with a very weak local public financial institution, with too low standards and prone to domestic political capture. African regional banks, such as the AfDB and the Development Bank of Southern Africa (DBSA), do not have such reluctance, and tend to see their engagement with local financial institutions, private and public, as part of their mandate. Working with local public financial institutions also brings additional capital and most of all, local know-how and connection. In doing so, local ownership and long-term sustainability can also be achieved at the project level and in terms of wider systemic transformations.

Some DFIs/MDBs however have an explicit strategy to engage with local financial institutions, including public ones. This is the case for instance of KfW, which sees national development banks as a natural partner, for their local expertise and network. KfW also actively supports the development of new local public financial institutions (as in Kenya, Nigeria and Tunisia\textsuperscript{46}, for instance).

AFD has also an explicit strategy to support the development, strengthening and work of local public financial institutions, in addition to its engagement with private ones. It is doing so notably by engaging with national Caisse des Dépôts (as in Morocco and Senegal) and helping foster the establishment of such an institution, like in Burkina Faso, which is carried out in a joint effort between AFD and the French Caisse des Dépôts. While the institutional framework of a Caisse des Dépôts may be the result of both a historical perspective and strategic choice of France\textsuperscript{47}, it does reflect the will to support financial institutions building and strengthening, towards more systemic impact of the AFD Group beyond individual projects. AFD also works with local private financial institutions to foster non-sovereign lending at lower rates for local authorities and public sector companies.\textsuperscript{48}

Similarly, the EIB works with regional development banks, such as the AfDB of course, but also the West African Development Bank (BOAD), the East African Development Bank (EADB), the Trade and Development Bank (TDB), and the Caribbean Development Bank (CDB), among others. The EIB is increasingly developing new joint innovative initiatives with these banks (notably AfDB and TDB), which are valued by their partners. But the EIB has generally not engaged in capacity building for the weaker regional development banks (not having the financial and human resources to do so), and has mainly refrained from engaging with national development banks and other local public finance institutions.

Yet, the demonstration effect and long-term transformational effects of DFIs/MDBs also rest on their ability to engage with not only private, but also public local financial institutions, as a way to leverage domestic resources mobilisation and stimulate local institutional development and innovation.

7. Local presence

Local presence, notably through field offices, is recognised as a great strength to understand local contexts and establish direct connections with local stakeholders (clients, local authorities, civil society). It is also helpful to identify emerging needs, local challenges but also new opportunities, and initiate new transactions,

\textsuperscript{46} Realités Online, \textit{Banque Des Régions : les annonces se succèdent, et après ?}, 6 September 2018.
\textsuperscript{47} A report by the French Senate has questioned the relevance of the AFD approach which seeks to transpose a French model to different contexts in sub-Saharan African. See Sénat (2018), Rapport d’information fait \textit{au nom de la commission des affaires étrangères, de la défense et des forces armées (1) relatif à l’avis rendu sur la proposition de contrat d’objectifs et de moyens entre l’État et l’Agence française de développement pour la période 2017-2019}, Par M. Jean-Pierre VIAL et Mme Marie-Françoise PEROL-DUMONT, No.104, p.34.
based on the principle of know-your-costumer and underlying trust needed in business relationship and relations with governments.

EBRD field offices are in this respect a clear added value to its activities. AFD 62 agencies across the world (not counting offices in French overseas territories) and its subsidiary Proparco, also allow to better anchor their activities in local context. While the EIB remains centred on its headquarter in Luxembourg, it is also slowly enhancing its presence in developing countries, with few regional offices (Georgia, India, Cote d’Ivoire, Kenya, South Africa), and increasing presence in EU Delegations in partner countries. This is also meant to help foster more direct cooperation and synergy at the local level between the European External Action Service and the EIB. Yet, the EIB main handicap in Africa, compared to institutions such as the World Bank Group, EBRD and AFD, is its too limited presence in the field.

Most DFIs do not have field offices. They rely mainly on field missions, platforms, networks, direct contacts and contacts through their country’s embassies in developing countries. Teamming up with another DFI/MDBs on programmes or projects is also a way to enhance not only financial capacity, but also skills and local knowledge, in particular if the other DFI/MDB has a stronger local presence. In practice, however, the full potential for such cooperation is rarely achieved. As noted by the EBRD, “With transaction-driven engagement dominant, relationships with other IFIs and international organisations are often competitive while wider policy engagement requires collaboration and ‘coopetition’ (collaborative competition). [Investment climate] support is a natural and largely unexploited area for synergy – particularly in diagnostics and policy dialogue.”

8. Towards integrated approaches

As discussed in this paper, anchoring blended finance for development to local context entails many dimensions. All DFIs/MDBs attempt to do so in one way or another. Several principles offer a useful guidance. But the translation into practice is far from easy. A major challenge is that DFIs are principally transaction-driven institutions, which de facto limits their ability to comprehend the local context in a more systematic and holistic manner.

One of the options is to adopt a more explicit framework to anchor DFIs activities in the local context. This is what the EBRD approach to ‘transition qualities’ is aiming at, based on a comprehensive methodology and framework, supported by a clear set of criteria (see Figure 2 above and Annex 2). The advantage of this approach is to combine under a single framework the transactional role and transformational role of the DFI. The challenge is to combine these two roles in practice so as to ensure effective synergy and complementarity.

Another approach is to combine the contributions of various institutions and instruments in a comprehensive manner, the action of the DFI being complemented by a development cooperation actor.

This is the case for instance for IFC with the World Bank, the EIB with the EU and Proparco with AFD, as mentioned in Section 3. In this regard, an interesting initiative is the newly established External Investment Plan (EIP) of the EU. It is an open system of EU blended finance and guarantee, which DFIs (with a

49 The EBRD considers that “The Bank’s field presence is a clear strength – the application of context-specific local knowledge and skills put the Bank ahead of some of its international counterparts”, EBRD (2018), The EBRD’s Investment Climate Support Activities, EBRD Evaluation Department, October, p.2.
51 EBRD (2018), The EBRD’s Investment Climate Support Activities, EBRD Evaluation Department, October, p.2.
preference for European ones) can apply under the European Fund for Sustainable Development (EFSD). This blended finance mechanism stands as the first pillar of the EIP. A second pillar consists of the provision of technical assistance. This technical assistance can be useful for the preparation and support of projects financed under the first pillar. It can also support activities under the third pillar of the EIP, focused on investment climate. The European Commission provides the technical assistance, and engages together with EU diplomatic corps in policy dialogues with the government and local stakeholders on investment climate. The DFIs can input to and be associated with this endeavour, within the limits of their capacity and mandate. The purpose of the EIP is explicitly to build on the synergy between these three pillars, with all three be anchored in local context and respond to local priorities and dynamics. It is also meant to build on budget support mechanisms of the EU, notably in terms of assessing and addressing local investment climate (see Section 3 as well).

AFD with its new initiative Choose Africa is providing a somewhat similar framework to the EIP, though at a smaller scale. Synergy between Proparco and AFD is one of the pillars of the AFD Group. Proparco can offer commercially-driven financing solutions, as in the case of the Choose Africa initiative to support African start-ups and MSMEs, complemented by AFD support. This includes technical assistance to local financial intermediaries, MSMEs (notably on sustainability dimensions) and innovative solutions and networks (including incubators). A third pillar encompasses support to investment climate and regulatory reforms, to foster a more transparent, competitive and innovative business environment. This combined financing, technical assistance and investment climate pillars echoes the External Investment Plan set up at the European level, where a similar logic is at play.

To anchor blended finance in local context, DFIs/MDBs must not only adopt explicit strategies to do so, but also set in place the incentives and mechanisms to draw on local dynamics and initiatives, and move beyond project-based activities to broader transformational changes. They should rely on explicit political economy assessments, in particular of financial markets, to better guide their interventions and ensure effective development impact (on end beneficiaries and on economy and market wide transformations), and prevent rent-capture by vested interested. While diversity of approaches should prevail, comprehensive frameworks and integrated approaches can usefully be fostered to tackle the multi-dimension of local engagement in blended finance.


53 The effective implementation of the EIP is only starting in 2019, so there is no result to be assessed yet. While the approach is most promising, it is also a challenging one, as discussed in Bilal, S. and S. Große-Puppendahl (2018), The European External Investment Plan: Challenges and next steps for a game changer, ECDPM Briefing Note No.102.
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Annex 1: EIB intervention logic

The three pillars of the EIB’s Results Measurement (ReM) framework

1. **Pillar 1 – Contribution to EIB, EU and national priorities**
   - 1A. Consistency with EIB mandate objectives
     - Development of social and economic infrastructure
     - Local private sector development
     - Climate change mitigation and adaptation
     - Regional integration
   - 1B. Contribution to EU and country development priorities

2. **Pillar 2 – Quality and soundness of the project**
   - Soundness of project or intermediary and operating environment
   - Environmental and social sustainability
   - Financial and economic sustainability (ERR)
   - Outputs & Baseline values
     - Expected values at completion
     - Results achieved at completion and completion +3 years

3. **Pillar 3: EIB Technical and Financial Contribution**
   - **EIB Inputs – market alternative**
     - Financial contribution
       - Long-term financing
       - Local currency funding
     - Subsidy
   - Financial facilitation
     - Innovative financing
     - Raising standards
     - Attracting other financiers
   - Advice
     - Financial advice and structuring
     - Technical contribution and advice

*Source: EIB (2017), The Results Measurement (ReM) framework methodology.*
Annex 2: EBRD Country strategy: the case of Tunisia

By adopting country strategies, the EBRD seeks to identify strategic priorities and some kind of theory of change for its interventions, both through transactional and systemic engagement. It does so following consultation with the government, local stakeholders and relevant DFIs and international development partners present in the country. Over the recent years, the EBRD “has made multiple efforts to strengthen its [investment climate] IC support. This includes new institutional architecture to strengthen policy dialogue, various IC initiatives, a dedicated governance team, and a redefined transition concept which emphasises ‘well-governed’ and ‘competitive’ as key transition qualities. Fourteen current country strategies explicitly prioritise improved investment climate/business environment and a level playing field for investors.”

In the case of Tunisia, the EBRD also participated to the international partners coordination meetings with local stakeholders, and defined, drawing on insights and experience from its field office in Tunis, its Tunisia Country Strategy Priorities, based on a careful assessment of the local context.

4. Defining Tunisia Country Strategy Priorities

<table>
<thead>
<tr>
<th>What needs to change? (Section 2)</th>
<th>Can it be changed? (Section 3)</th>
<th>What can the Bank do? (Section 4)</th>
<th>Strategic Priorities (2018-2023)</th>
<th>What We Want to See in 2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concentration of resources in low productivity sectors in the private sector, with limited integration into global value chains.</td>
<td>Government economic reform momentum but implementation capacity needs to be strengthened.</td>
<td>We facilitate products to support SMEs and corporates (local currency financing, value chain programs, advisory networks).</td>
<td>Move to higher value-added activities, through greater integration of Tunisian companies into global value chains, and improved operating standards.</td>
<td>Improved economic governance and greater competition.</td>
</tr>
<tr>
<td>Challenging business climate stemming from excessive regulatory constraints and weak enforcement of competition.</td>
<td>Development of a formal SME and IFC cluster and further GVC integration.</td>
<td>Established track record in supporting internationalisation of Tunisian firms and catalysing FDs.</td>
<td>Increased private sector participation in some state dominated sectors and SOE commercialisation.</td>
<td></td>
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<tr>
<td>Sectoral barriers to entry and SOE dominance in key sectors limit domestic competition.</td>
<td>Momentum on PPP is building up, with focus on transport, logistics, energy and municipal infrastructure.</td>
<td>Good experience in facilitating public-private dialogue on investment climate issues.</td>
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<tr>
<td>Capital controls constrain outward FDs and internationalisation of Tunisian firms.</td>
<td>Recent Government’s SOE strategy to improve corporate governance.</td>
<td>Strong track record in supporting privatizations and SOE commercialisation.</td>
<td></td>
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<tr>
<td>Skills mismatch among young graduates coupled with lack of quality employment.</td>
<td>Some recent steps to alleviate some constraints related to capital controls.</td>
<td>Effective instruments to support underserved segments (ASS, WEP, SEMED Youth Employment Programme).</td>
<td>Enhanced access to entrepreneurship and skills for young people.</td>
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</tr>
<tr>
<td>Rigid labour market regulations, leading to informality and low-skilled jobs.</td>
<td>Social inclusivity highlighted in 2020 Development Plan.</td>
<td>We facilitated impact of living private social investment and TF grants to promote skills-enhancing programmes.</td>
<td>Reduced regional disparities in terms of access to employment, skills, services and finance.</td>
<td></td>
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<tr>
<td>Strong regional disparities, with interior regions poorly integrated and lagging behind in economic growth.</td>
<td>Informed awareness to support private sector job creation, limit the public sector wage bill and carry out labour market reform with trade unions.</td>
<td>Can leverage off in SDIs, and enhance investment and delivery portfolio outside Tunisia.</td>
<td>Increased gender equality in access to economic opportunities.</td>
<td></td>
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<tr>
<td>Low female labour market participation in global comparison (albeit among highest in MENA).</td>
<td>Ongoing decentralisation process, including strengthening local governance.</td>
<td>Tunisia perceived as regional role model for women’s emancipation.</td>
<td></td>
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<tr>
<td>Shadow financial system, with limited access to finance, esp. for SMEs and women entrepreneurs.</td>
<td>Social Inclusion highlighted in 2020 Development Plan.</td>
<td>Effective instruments to support underserved segments (ASS, WEP, SEMED Youth Employment Programme).</td>
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<tr>
<td>Strong dominance of the banking sector, with high NPL concentration, weak governance.</td>
<td>Ongoing (albeit slow) government reforms to address banking sector vulnerabilities (Sols governance, interest rate cap, NPLs, insolvency)</td>
<td>We facilitated impact of living private social investment and TF grants to promote skills-enhancing programmes.</td>
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<tr>
<td>Some provisions in regulation distort banks’ incentives to lend.</td>
<td>Legacy of banking sector distortions – incl. state-directed lending and loan directives to support target sectors.</td>
<td>Can leverage off in SDIs, and enhance investment and delivery portfolio outside Tunisia.</td>
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<td>SMEs’ dominance in the energy sector incl. in nascent renewables sector and distorting energy subsidies.</td>
<td>Government commitment to deliver on NDCs under COP21.</td>
<td>Wide range of dedicated products to encourage funding to underserved segments.</td>
<td>Broader access to finance, in particular to under-served segments.</td>
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<tr>
<td>Inefficient use of energy, / resource and a lack of a share of renewables.</td>
<td>Significant renewables potential, particularly solar and wind.</td>
<td>Expertise in improving SOE governance and designing NPL resolution solutions.</td>
<td>Improved governance of the financial sector.</td>
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<td>High level of water stress and vulnerability to climate change (e.g. agriculture).</td>
<td>Recent momentum around private sector participation in renewables, with two rounds of tender launched.</td>
<td>Strong track record in capital markets development.</td>
<td>Decrease capital markets as a viable alternative to banking sector for long-term finance.</td>
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</tbody>
</table>

The EBRD also engaged on a mapping of other international partners engagement in Tunisia, so as to avoid duplication and foster complementarity and synergy.

54 EBRD (2018), The EBRD’s Investment Climate Support Activities, EBRD Evaluation Department, October 2018, p.1.
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