Discussion Paper

ecdpm

No. 207

December 2016

Blending 2.0

Towards new (European External) Investment Plans

by San Bilal and Sebastian Große-Puppendahl

www.ecdpm.org/dp207

Blending 2.0

Towards new (European External) Investment Plans

San Bilal and Sebastian Große-Puppendahl

December 2016

Key messages

Blending ODA with other sources of finance is one of the forms taken to stimulate and leverage private investments and finance for sustainable development. It is by no means a magic bullet, and should be used with great caution, so as to prevent unwarranted subsidy to private sector and market distortion, and waste of scarce ODA.

So far, blending efforts and approaches have been rather fragmented and different among key stakeholders. Despite similar rationales for blended finance, the principles, modalities and practices (not to mention definition) do vary among European financing institutions, and MDBs/DFIs.

To enhance the coherence and effectiveness of its external investment support for sustainable development, in line with the SDGs, the EU is establishing the External Investment Plan (EIP): a 'one-stop-shop', to promote sustainable private investments with a view to also tackling some of the root causes of migration in Africa and the EU Neighbourhood.

To live up to its ambitions, a number of challenges need to be overcome, related to the EIP's focus, design and politics, and synergy with other initiatives. It will notably require: to better monitor sustainability outcomes; to maximise effective additionality and leveraging; and stimulate development reform dynamics.

Table of Contents

List of Figures

List of Tables

Acknowledgements

ECDPM gratefully acknowledges the financial contribution of the UK Department for International Development (DFID), which made this study possible.

The authors would like to thank their colleague Karim Karaki and the persons consulted in the framework of this study. This paper has benefited from many informal exchanges with a range of stakeholders, for which we are grateful. ECDPM will keep working actively on financing for development, blended finance and the European External Investment Plan in the coming months and years.

The views expressed in this study are those of the authors only and should not be attributed to any other person or institution.

Acronyms

AAAA	Addis Ababa Action Agenda
AFD	Agence française de développement
AfDB	African Development Bank
AfIF	Africa Investment Facility
AgriFI	Agriculture Financing Initiative
AIF	Asia Investment Facility
CIF	Caribbean Investment Facility
DCI	Development Cooperation Instrument
DFI	Development finance institutions
DG DEVCO	Directorate-General for International Cooperation and Development
DG ECFIN	Directorate-General for Economic and Financial Affairs
DG GROW	Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs
DG NEAR	Directorate-General for Neighbourhood and Enlargement Negotiations
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECDPM	European Centre for Development Policy Management
EDF	European Development Fund
EDFI	European Development Finance Institutions
EEAS	European External Action Service
EFSD	European Fund for Sustainable Development
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
EIP	European Investment Plan
ElectriFI	Electrification Financing Initiative
EU	European Union
EU-AITF	EU-Africa Infrastructure Trust Fund
EUBEC	EU Platform for Blending in External Cooperation
HRVP	High Representative of the Union for Foreign Affairs and Security Policy/Vice-President of the European Commission
IF	Investment Facility
IFC	International Finance Corporation

IFCA	Investment Facility for Central Asia
IFE	Impact Financing Envelope
IFI	International financial institution
IFP	Investment Facility for the Pacific
ITF	Infrastructure Trust Fund
LAIF	Latin America Investment Facility
LDCs	Least-developed countries
MDBs	Multilateral development banks
NIF	Neighbourhood Investment Facility
ODA	Official Development Assistance
RDBs	Regional development banks
SDGs	Sustainable Development Goals
SDIP	Sustainable Development Investment Partnership
SMEs	Small- and medium-sized enterprises
TA	Technical assistance
TG	Technical group
WBIF	Western Balkans Investment Framework

Executive Summary

The UN 2030 Agenda for Sustainable Development places new emphasis on the need to mobilise financial resources to achieve the 17 universal sustainable development goals (SDGs). The ambition is to ‘move from billions to trillions’, mobilising much higher resources in the pursuit of sustainable development (MDBs, 2015). Contrary to the Millennium Development Goals (MDGs), aid is no longer at the centre of a transformative development agenda. Blending Official Development Assistance (ODA) with other sources of finance is one of the forms taken to stimulate and leverage private investments and finance for sustainable development. It is by no means a magic bullet, and should be used with great caution, so as to prevent unwarranted subsidy to private sources of finance and waste of scarce ODA.

The rationale behind blended finance is that “subsidising private investment in developing countries is a legitimate use of aid when the benefits to society exceed private returns” (Carter, 2015). This is based on the concept of additionality, where the blending of public finance leads to an additional result than would happen otherwise. In sum, blended finance rests on three interconnected pillars (WEF and OECD, 2015b): (i) leveraging additional investment from (private) capital; (ii) generating additional developmental/ sustainable impact, beyond what private investment alone would yield otherwise; and (iii) be economically viable and sustainable, i.e. generating sufficiently attractive financial returns for (some or all) investors.

There are many reasons why investment projects might not attract sufficient funding at normal market rates**.** Blending financing is therefore meant to address some of the following shortcomings (ECA, 2014): blended finance projects may (i) be insufficiently profitable despite potentially high economic, environmental and/or social benefits; (ii) have excessive risk profiles for private investors; or (iii) be located in heavily indebted countries, which means they have to comply with International Monetary Fund (IMF) requirements for loans, stipulating a certain minimum level of concessionality.

Many stakeholders however question the added value of the grant element provided, based on a number of concerns and risks, that can be summarised as follows (Bilal and Krätke, 2013): i) financial incentives outweighing development principles; ii) concentrating financing towards certain sectors and countries; iii) crowding-out private financing and distorting markets; iv) providing insufficient attention to transparency and accountability; v) unclear or ill-defined monitoring and evaluation methods; vi) debt for developing countries of increasing lending; and vii) inefficient way of incentivising private investment and addressing risk.

The onus is on the development community, and primarily donors and development finance institutions (DFIs), to raise their game, build on their accumulated experience and identify better practices to address these challenges so as to ensure an effective deployment of blended finance. Multilateral development banks (MDBs) have joined forces to move in that direction, hopefully together with other DFIs and donors.

The European Union (EU) ambition is also to build on its own experience to move its blending approach to the next level – blending 2.0.

The EU has especially pushed the blending agenda since 2007 through the creation of regional blending facilities, such as the then EU-Africa Infrastructure Trust Fund (EU-AITF), and its successor since 2015 the Africa Investment Facility (AfIF) to support sustainable growth in Africa. While blending has already been an important means of triggering private investments for the EU and beyond, efforts and approaches have been rather fragmented and different among key stakeholders - EC, EIB, EBRD, AFD, KfW and other EDFI. While the underlying rationale behind blending has been common to all, the principles, modalities and practices (not to mention definition) do vary among European financing institutions, and more generally among MDBs/DFIs.

In order to address such fragmentation, at least at the European level, and provide an integrated framework going beyond pure investment promotion with potentially significant non-financial benefits, the European Commission (EC) and the European External Action Service (EEAS) have jointly proposed the European External Investment Plan (EIP). It was heralded as a new chapter of EU development policy (Mogherini and Mimica, 2016). The EIP's overall aim is to promote sustainable private investments with a view to tackling some of the root causes of migration in Africa and the EU Neighbourhood. Its main ambition is to provide a coherent integrated framework and approach to the EU's external investment support; a 'one-stop-shop', which contributes to the global architecture for long-term sustainable development.

The EIP is expected to do so by leveraging funds from and enabling full cooperation among the EU, its Member States, its partner countries, international financial institutions (IFIs), other donors and the private sector. The EIP represents a good opportunity for the EC to make external investment promotion more coherent and effective, to contribute to sustainable development through providing financial and non-financial support. However, to become fully operational a number of challenges need to be overcome so that the EIP will be recognised as a success and a useful contribution in the context of private sector engagement for development.

The EIP will face a number of challenges, related to its objectives and implementation. These include, among others the issues of: a) its underlying assumptions on the migration-development nexus, b) its capacity to bring effective additionality, and c) its design and (internal) politics. One of the major opportunities of the first pillar of the EIP - i.e. the European Fund for Sustainable Development (EFSD) - will be the guarantee mechanism and its risk-mitigation and risk-sharing instruments, which combined with the other two pillars of the EIP – i.e. technical assistance and structured political dialogue - will yield good opportunities to more systematically and coherently contribute to some risk sharing and mitigation of private investments in developing and fragile countries, only up to the level necessary and commercially acceptable. The success will only be measured by the results it is able to achieve, which requires the EIP to avoid business as usual by doing three things: (i) better monitoring of sustainability outcomes; (ii) maximisation of effective additionality and leveraging; and (iii) identification of development reform dynamics (Bilal, 2016).

If the EIP is able to address the aforementioned challenges for blended finance in the fields of the migration-development nexus, enhanced additionality, and its design and inherent politics, it can be a promising tool to create financial and non-financial benefits by triggering private investments in Africa and the Neighbourhood. If not, it will be a missed chance for the EU to not only promote the role of the private sector in international cooperation but also to more effectively incentivise sustainable private investment in Africa, while contributing to improve the investment climate and business environment.

Besides contributing to greater coherence and effectiveness of the EU financing for development, the EIP should also seek to build on and complement international efforts, including among international financial intuitions, to adopt common guiding principles and shared transparency and reporting criteria on blended finance. In addition, it should also contribute to build synergy with other multi-stakeholders public-private platforms, such as the Sustainable Development Investment Partnership (SDIP).

It is because of its high ambitions that the EIP has been heralded "a new chapter in EU development cooperation" (Mogherini and Mimica, 2016), or more simply, blending 2.0. Living up to the expectation will be the exciting challenge.

1. Introduction

The UN 2030 Agenda for Sustainable Development places new emphasis on the need to mobilise financial resources to achieve the 17 universal sustainable development goals (SDGs) identified (ODI et al., 2015). The ambition is to 'move from billions to trillions', mobilising much higher resources in the pursuit of sustainable development (MDBs, 2015). The needs are particularly high in terms of level of funding for hard infrastructure (transportation, energy, water and communication), which is estimated to require some additional investments of US$2.5 trillion a year (The Economist, 2016; OECD, 2014). But financial resources are needed across the board, including for tackling issues such as social, environmental and economic transformation, as embodied in the commitments made in the 2015 Addis Ababa Action Agenda (AAAA) (ODI et al., 2015).

Most of the resources required should come from more effective resource mobilisation, primarily at the domestic level, but also at the international level. Contrary to the Millennium Development Goals (MDGs), aid is no longer at the centre of a transformative development agenda. Greater emphasis is now placed on the capacity to mobilise and leverage other sources of funding, and in particular private finance and investment. Official development assistance (ODA) should therefore be more focused, in particular on the poorest countries, and used in more efficient and strategic ways.

One such a way is to more actively support and accompany private sector investment when necessary, through development cooperation and other public instruments, to achieve sustainable development objectives. In doing so, particular attention must be given to the creation of decent and sustainable jobs, as "jobs are the major channel through which economic growth uplifts the poor" with more than nine out of ten jobs being created in the private sector in low and middle income countries (LICs and MICs) (EDFI, 2016).

Blending ODA with other sources of finance is one of the forms taken to stimulate and leverage private investments and finance. It is by no means a magic wand, and should be used with great caution, so as to prevent unwarranted subsidy to private sources of finance. But it is part of the financial toolbox that policy makers can use. And as such, it has the potential to help donors contribute to finance the 2030 Agenda (Development Initiatives, 2016a).

Blended finance has been used for a long time by development and international finance institutions (DFIs and IFIs), such as the European Investment Bank (EIB), the German KfW Development Bank, the Agence française de développement (AFD) and International Finance Corporation (IFC) of the World Bank Group, as well as by the European Commission (EC) (Bilal and Krätke, 2013). The European Union (EU) has especially pushed the blending agenda since 2007 through the creation of regional blending facilities such as the then EU-Africa Infrastructure Trust Fund (EU-AITF), the Investment Facilities for the Neighbourhood (NIF) created in 2008, Latin America (LAIF) and Central Asia (IFCA) created in 2010, and the Caribbean (CIF), Asia (AIF) and the Pacific (IFP) all created in 2012. The EU-AITF has been replaced by the Africa Investment Facility (AfIF) from mid-2015 onwards to support sustainable growth in Africa.

The European Commission President recently announced a new European 'External Investment Plan' (EIP) (Junker, 2016; EC, 2016a).[1] It was heralded as a new chapter of EU development policy (Mogherini and Mimica, 2016). Its overall aim is to promote sustainable private investments with a view to tackling some of the root causes of migration in Africa and the EU Neighbourhood, and more broadly to contribute to sustainable development (EC, 2016a). The objective is to increase coherence and improve the approach towards blending and EU's external investment support, and providing a 'single coherent integrated

[1] See also https://ec.europa.eu/europeaid/news-and-events/state-union-2016-european-external-investment-plan_en

framework' as a 'one-stop-shop' for all blending initiatives in these two regions. The main innovation for the EU is the reliance on guarantee mechanisms, as a way to better leverage private finance. The ambition is thus to take blended finance to the next level, *blending 2.0*, including to move beyond purely EU actors by including all IFIs. In practice, however, a number of questions and challenges need to be addressed relating to its design and actual implementation (Bilal, 2016).

In the same vein, Germany, under its Presidency of the G20 which started on 1 December 2016, intends to launch, in partnership with Africa, a 'Compact with Africa', to "help make private investment in Africa more attractive by making it more secure, and reducing the barriers to investment [.… with] [t]he objective to boost growth and jobs, promote inclusion and give people economic perspectives at home so that they do not have to leave their home country to seek subsistence elsewhere" (Schäuble, 2016). The aim is to promote a more conducive business and investment environment in Africa (coherent with the ambitions of the third pillar of the EIP), in particular for infrastructure investment. KfW, the German development bank, has been very active in blending finance, and should play a key role in the new German sponsored initiative.

As blended finance is taking a more prominent role in development finance, it is useful to review the context of and rationale for blending (Section 2), take stock of blending activities at the EU level (Section 3), outline the key features of the European EIP as *blending 2.0* (Section 4) and finally identify key opportunities and challenges in taking the agenda forward (Section 5).

2. Blending what and why?

> *"Blended financing platforms could have a great potential, particularly where there is a benefit to the public sector. Where they are considered however, it is important to ensure that these arrangements are subject to safeguards to verify that they contribute to sustainable development. They must not replace or compromise state responsibilities for delivering on social needs. Such policies need to ensure fair returns to the public, while incorporating social, environmental, labour, human rights and gender equality consideration"* (UN Secretary General, The Road to Dignity by 2030, 2014).

2.1. Context, objectives and rationale

The shift away by the international development community from the reliance on development assistance as the main instrument to promote development has been precipitated by several factors. These include the fast growing emerging economies which overtook developed nations as a share of global GDP, de facto calling into question the aid-dependency syndrome in favour of more win-win approaches à la China (Bilal, 2012; Pries and Berla, 2012). Fast growing developing economies were no longer perceived as only basket-cases, which required a solely benevolent approach to help. Instead, they have been increasingly perceived as lands of opportunities, for new investment and prosperity. The financial crisis in 2008, and resulting budget deficits, followed by wide ranging austerity measures and economic slowdown, has decreased the capacity and willingness of some donors to rely too heavily on grants in their development assistance. Downward pressures on aid budgets combined with increasing channelling of funds to address the perceived migration "crisis", have further contributed to lead many donors to rethink their approach to development cooperation. It is in this general context that the 2030 Agenda and accompanying AAAA must be seen.

This has led many donors, and the EU in particular, to reassess their approach to promoting more investments and finance that effectively contribute to sustainable development (EC, 2016b; OECD, 2014). Supporting private sector, enhancing the business environment and partly de-risking investment are increasingly perceived as effective use of development assistance to leverage private investment and finance. In this respect, aid can also be an attractive means to catalyse finance and investment through IFIs and DFIs. At the European level, the EU has increasingly relied on the EIB, which is the EU bank, and the other European Development Finance Institutions (EDFI); and at international level it has engaged with regional development banks such as the African Development Bank (AfDB) and international ones such as the IFC.

The main thrust of blending is to use ODA to leverage additional capital for development objectives. By blending public and private finance, the objective is to 'crowd in' private finance and investment, thereby increasing the overall amount of funding available for sustainable investments for development purposes (Table 1). Against this backdrop, the role of DFIs and other development banks becomes increasingly important to provide development finance beyond aid, mainly grants and other concessional finance: "expanded flows are more likely to be found in blended finance, lending or guarantees *than* aid" (Kenny, 2015).

Table 1: The current landscape of development finance to fight poverty

Complementary development finance strategies			
source?	**Aid**	**Public sector loans**	**Private sector investment**
what?	*Grants and technical cooperation for humanitarian and development assistance*	*Concessional and non-concessional loans to states & state institutions*	*Equity, loans, guarantees to commercially sustainable private sector projects*
who?	**Donor agencies**	**Development banks**	**DFIs**
Blending *→ grants and subsidies provided alongside public sector loans and private sector investment*			

Source: EDFI, 2016

The rationale for blended finance is to encourage more private sector investments on the basis of existing public funding, such as ODA, or also other capital from philanthropic sources.

The rationale behind these is that "subsidising private investment in developing countries is a legitimate use of aid when the benefits to society exceed private returns" (Carter, 2015). This is based on the concept of additionality,[2] where the blending of public finance leads to an additional result than would not happen otherwise.

The dimension commonly referred to is the *financial additionality*, which is the additional investment – desirable from a developmental point of view - that is taking place because of the public finance component. If the investment would have happened anyway, at similar level, then there is no additionality, but rather simple subsidisation of the investment (public finance substitute for private finance). Another important reason would be that an investment project would not have gone ahead without the public finance component.

2 For a detailed discussion on the concept of additionality, see also IFC (2008).

A less common dimension of additionality - but important as well - is the *operational and institutional additionality*, that is the improved quality of the investment due to public finance - for instance related to innovation, or technical, social, environmental, governance standards and practices (Friends of the Earth, 2013; Griffiths, 2012).

A broader dimension is the *systemic additionality*, or *catalytic effect*, which refers to the positive signal to the market, or demonstration effect, that blended finance can generate, illustrating the viability and positive impact of some projects, which conservative investors may have overseen. A typical example is the high perceived risk of investment in some developing countries, which is not necessarily well founded (or poorly assessed) by risk-averse investors. By providing some risk mitigating and sharing mechanisms, blended finance might help overcome some biased perceptions and comfort some otherwise reluctant investors. Blended finance projects might also contribute to institutional and policy reforms (e.g. Benn et al., 2016).

In practice however the issue of additionality is not only fuzzy, and thus somewhat contentious, but it is also often very difficult to assess, as discussed in Section 2.3 (Griffith, 2012; Heinrich, 2014).

The notion of additionality is closely linked to the one of leverage, and hence often used to mean the same thing. Leverage is mainly about how much private capital is attracted by public finance. However, as noted by CIF (2014, p.5) "[w]hile the discussion of leverage focuses mainly on how much private finance is mobilized, some agencies talk of leveraging both public and private finance; some count only financing mobilized by public concessional (or below market rate) funds; and others include both concessional and non-concessional funds". The difference of approaches among development institutions, as discussed below, might be a source of confusion.

In sum, blended finance rests on three interconnected pillars (WEF and OECD, 2015b):

i) leveraging additional investment from (private) capital,
ii) generating additional developmental/sustainable impact, beyond what private investment alone would yield otherwise, and
iii) be economically viable and sustainable, i.e. generating sufficiently attractive financial returns for (some or all) investors.

There are many reasons why investment projects might not attract sufficient funding at normal market rates**.** Commonly mentioned ones include the following (ECA, 2014):

- projects may be insufficiently profitable despite potentially high economic, environmental and/or social benefits;
- projects may have excessive risk profiles for private investors; or
- projects may be located in heavily indebted countries, which means they have to comply with International Monetary Fund (IMF) requirements for loans, stipulating a certain minimum level of concessionality.[3]

Blending financing is meant to address some of these shortcomings.

It is important to stress however that blending public and private finance is no magic solution to all development problems, and should therefore be used with great caution, in a very disciplined manner, as part of a more comprehensive approach (IFC, 2016). Blending should not substitute for (i.e. 'crowd out') private finance and unduly distort markets with unfair subsidies. It is thus more appropriate in case of highly

[3] The IMF requires that heavily indebted countries only contract loans with terms that are substantially more favourable than loans at market conditions. Such loans are referred to as concessional loans with a minimum concessionality level of 35%.

inefficient or weak market structures, as in many poorer developing countries, which have no or only nascent capital markets. Blending cannot only be successful in financially viable projects. “Blended finance can sometimes be helpful to tip the balance in marginally profitable, risky projects towards attracting commercial investment, but it can’t alter the fundamental economics of the project” (Gregory, 2016). Blending is also no substitute for market and regulatory reforms, or (hard and soft) infrastructure developments. It can accompany and support such transformations, but cannot replace them. Last, but not least, blended finance must have, like other development assistance mechanisms, a clear and demonstrated development objective and impact.

2.2. Several definitions and approaches

One of the challenges of discussing blending is the multitude of definitions used. Blending activities combine “funding from development institutions, philanthropic entities, and profit-seeking investors and put that capital to work in a way that is aligned with the UN’s Sustainable Development Goals (SDGs)” (Larrea, 2016). Other definitions consider blending “to cover a range of investment activities where ODA is invested in private sector projects on concessional terms” (Commons Consultants, 2015a), recognising, however, that “blended finance is not a well defined term at the international level, nor does it refer to one specific financing arrangement” (Development Initiatives, 2016b). The World Economic Forum (WEF) together with the OECD (2016) define blended finance as “the strategic use of development finance and philanthropic funds to mobilise private capital flows to emerging and frontier markets, resulting in positive results for both investors and communities”.

The Commons Consultants’ (2015b) analysis of more than 100 blending funds shows that aid agencies apply a few **common ‘innovative financing’ mechanisms** to encourage their participation in blending funds:

1) **investments** through fund participation with equity or debt alongside private investors;
2) **subsidies** that cover expenses related to fund establishment and project support; and
3) **risk-sharing** and incentive mechanisms, such as first-loss-cover, other lower preferences in the distributions waterfall, or capped returns with excess profits distributed to other investors.

But financial institutions consider and classify blending according to their own terms and definitions. In general, blending entails some of the following instruments (ETTG, 2011):

- direct investment grants;
- interest rate subsidies;
- loan guarantees;
- technical assistance (TA), and
- risk mitigation, guarantee and equity instruments.

The emphasis on tools and forms of blending varies according to the institution concerned, as illustrated in Table 2. IFC for instance does not consider that the technical assistance it provides constitutes a form of blending. The EU does. KfW tends to focus its blending on mixing loans (from KfW) and grants (from German government), but does not consider concessional loans as a form of blending, contrary to the approach of multilateral development banks. Besides, as discussed above, different institutions adopt different definitions and measures to assess the leverage ratio of their blended finance (CIF, 2014; Griffiths, 2012).

These differences of approach have some influence on the reporting and comparability of blending impact and practices by different financial institutions. A group of multilateral development banks is currently trying to address this issue, working towards the establishment of common principles on blended finance, expected to be adopted in 2017.[4] The objective is for the development financiers to agree on common definitions, principles, and reporting criteria, including on the level of concessionality and possible benchmarking, so as to increase transparency and accountability, and promote better practices (MDBs, 2016). If adopted jointly with other DFIs, this would mark a significant improvement in the blending community.

Table 2: Differing institutional approaches towards blending

	EIB[5]	EC[6]	IFC[7]	KfW[8]
Definition	**combining EIB loans with EU grants**: → helps to ensure the efficiency & best use of resources available → improves project quality & long-term impact → optimises the EIB's service to beneficiaries → promotes donor cooperation between European aid actors	**combining EU grants with loans or equity from public & private financiers**: → an instrument for achieving EU external policy objectives, complementary to other aid modalities and pursuing the relevant regional, national and overarching policy priorities	**combining donor funds invested at concessional or below market rates with own funds**: → to support investments in sectors where blending concessional funds may catalyse investments that wouldn't otherwise happen	**matching German government funds (mainly grants) with KfW loans** raised on the capital market → together with EC in their investment facilities
Form of grant contribution	→ interest rate subsidies → technical assistance (TA)	→ investment grant & interest rate subsidies → TA → risk capital:(quasi-) equity → guarantees	→ funds (loans, guarantees, or equity) from donor partners → TA grants ***not*** considered blending	→ investment grants → interest rate subsidies → guarantees or first-loss tranches

Source: Authors' elaboration

2.3. Blending in practice

Blended finance is not new. There is therefore a lot of experience already accumulated. However, because of the diversity of approaches to blending, the multiplicity of tools and instruments, and the lack of common definitions and reporting criteria, comparison (e.g. between types of projects, or financiers) is often difficult, and insights remain limited.

In financial terms, most of the blending activities are concentrated on public investment projects in the infrastructure sector, comprising mainly subsidised loans to the public sector in developing countries, as illustrated in Figure 1. Yet, increasing attention and efforts are dedicated to leverage private finance and investment, including beyond the infrastructure sector (Bilal and Krätke, 2013).[9] Blended finance accrues mainly to (lower and upper) middle income countries, and far less to the poorest countries, which have

---

4 This group of MDBs comprises the African Development Bank (AfDB), the Asian Development Bank, the Asian Infrastructure Investment Bank, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank Group, the International Finance Corporation (IFC), the Islamic Development Bank, the New Development Bank, the World Bank, together with the International Monetary Fund.

5 EIB, 2016a.

6 https://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending_en

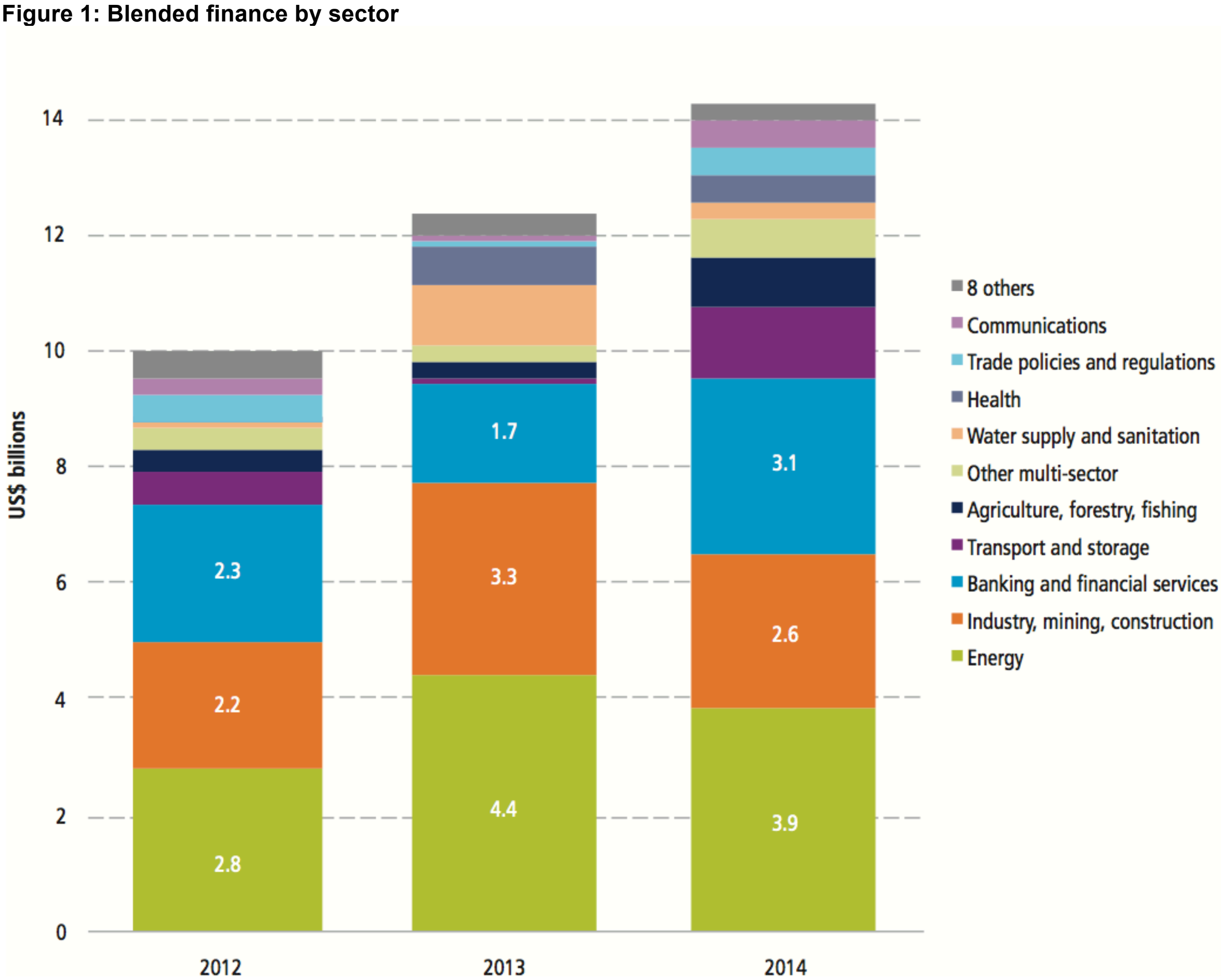
7 IFC. 2012. Blended Finance at IFC - Blending donor funds for impact. October 2012.

8 https://www.devex.com/news/kfw-official-stands-up-for-blending-79561

9 The 2015 EU decision to transform the EU-Africa Infrastructure Trust Fund (EU-AITF), created by the EC and the EU Member States in 2007 "to develop regional infrastructure by blending grants with long-term financing from finance institutions (EIB, 2016), into the Africa Investment Facility, open to blending for private sector activities, including at national level, is an illustration of this trend.

traditionally been less attractive for private finance (also in term of the size of their economy).[10] Interestingly though, sub-Saharan Africa is estimated to receive about a quarter of the private investment mobilised through blending, the largest share of any region in the world (Benn et al, 2016; Development Initiatives, 2016a).

Figure 1: Blended finance by sector



Note: Based on OECD survey (Benn et al., 2016).
Source: Development Initiatives (2016a, Fig.16)

Having surveyed 74 funds and facilities, the WEF and OECD (2016) provide some additional interesting data on blended finance:

- 22.3% of total capital investments ($25.4 bn) went to sub-Saharan Africa ($5.7 bn) representing 36 funds/facilities
- 29.2% targeted health care, followed by financial services (21.4% but excluding micro-finance) and infrastructure (17.7%)
- “Average expected returns of 4.9% for debt and 11.4% for equity are consistent with market rates for such instruments in developed economies”
- “regional funds tended to focus on infrastructure (35.0% of capital sampled), while global funds focused more on healthcare and financial services (41.3% and 26.4%, respectively)”.

[10] This is one of the reasons why the European External Investment Plan wants to focus on fragile, poorer countries, in an effort to promote private investment, through blended finance, in these countries.

In terms of assessment, there is no systematic evaluation of blending mechanisms by various institutions. Financial institutions tend to report their own activities, and conduct some form of evaluations, sometimes independent (e.g. IFC, 2008), and mainly at project level (such as the Results Measurement –ReM- framework of the EIB; EIB, 2016b). But formal comprehensive evaluations across projects are not common practice, and there is no common methodology, making comparison and aggregation difficult. As a result, evidence on impact of blending remains patchy, and thus often weak. The bulk of the independent scrutiny on blending comes from NGOs. Few are from research institutions and consultants.

The purpose here is not to review all the available information, but instead to only highlight some of the recent key findings.

In its review of assessment studies, Pereira (2015) outlines a number of factors found to affect the impact of blending. Not surprisingly, the design of the project matters a great deal, a point stressed by development financiers as well. The country where the operation is taking place is another important factor, with a higher ‘crowding in’ effect of blending in poorer countries with weak or non-existent financial markets. This is good news for development stakeholders. The effectiveness of blending in mobilising private resources and development impact seems also greater the earlier the financing institution is involved in the project design. Blended finance targeted at SMEs also seems to generate higher financial additionality. There is also tentative evidence suggesting some catalytic effects in terms of policy and regulatory reforms. More surprising is the fact that although economic, social and environmental standards are part of blended projects, there is only weak evidence that they are actually implemented.

In their survey commissioned by the ReDesigning Development Finance Initiative (RDFI), WEF and OECD (2016) analysed 74 funds and facilities. They conclude “that blended finance has contributed significantly to catalysing capital for emerging market investment, resulting in positive development outcomes”. According to the survey, the non-financial benefits of blended finance have been considered “particularly interesting, including the ability to address market failures, extend the reach of finance, reduce risk exposure, increase the viability of innovative structures and access specialized knowledge from partners”. However, a number of challenges have been raised that should be addressed to better understand the impacts and effectiveness of blended finance relating to “standardized interpretation of concepts and related classifications, consistent approaches to evaluating impact and leverage ratios, recognition of new approaches within the measurement of Official Development Assistance, and greater visibility of financial returns for investment vehicles”.

Focusing on European development finance and aid institutions, Commons Consultants (2015b) concluded that while blended finance contributed to development finance objectives, its additionality, in particular above DFIs (non-blended) investment, was “uncertain”. Donors may provide excessive incentives and risk coverage to private sector, including through first-loss cover, using too complex blending funds structures, difficult to supervise, and with excessive fund management costs (including too high remuneration of fund managers). The timing of the public finance commitments, often not in sync with private investment decisions, has reduced the incentive and catalytic effects of the donors’ involvement.

The disparity of results and insights partly reflect the heterogeneity of approaches to blended finance and diversity of projects and countries. It is also compounded by the lack of shared or common methodology and criteria to assess blending.

A common concern rests on the issues of additionality and the measurement of development impact (Savoy et al., 2016). Civil society organisations in particular have voiced scepticism about the lack of proper monitoring and accountability of donors in their blending approach. Eurodad (2013) for instance finds that “there is little evidence available regarding how the EU-level blending facilities implement or even contribute to achieving the internationally agreed objectives of the aid effectiveness agenda, particularly the key principles of ownership, alignment, harmonisation and mutual accountability”. They further criticise a lack of transparency and proper accountability mechanisms. Such concerns were reflected in the 2015 *Declaration from the Addis Ababa Civil Society Forum on Financing for Development*, endorsed by more than 600 civil society organisations and networks:

> “We caution that the optimism towards private finance to deliver a broad sustainable development agenda [...] is misplaced. Civil society along with a number of Member States have consistently raised serious concern on the unconditional support for Public Private Partnerships and blended financing instruments. […] Private sector companies are also increasingly benefiting from development cooperation funds without adequate impact analysis. Indeed, a whole new category of development finance instruments has emerged such as blended and leveraged finance, including a robust promotion of Public-Private Partnerships (PPPs). However, there is a lack of proof that PPPs are actually delivering positive economic, social and environmental outcomes. We encourage holding inclusive, open and transparent discussion on principles and criteria for publicly-backed private finance at the United Nations.”[11]

In essence, many stakeholders question the added value of the grant element provided, based on a number of concerns and risks that can be summarised as follows (Bilal and Krätke, 2013):

- financial incentives outweighing development principles;
- concentrating financing towards certain sectors and countries;
- crowding-out private financing and distorting markets;
- providing insufficient attention to transparency and accountability;
- unclear or ill-defined monitoring and evaluation methods;
- debt for developing countries of increasing lending; and
- inefficient way of incentivising private investment and addressing risk.

The onus is on the development community, and primarily donors and development finance institutions, to raise their game, build on their accumulated experience and identify better practices to address these challenges so as to ensure an effective deployment of blended finance. MDBs have joined forces to move in that direction, hopefully together with other DFIs and donors. The EU ambition is also to build on its own experience (Section 3) to move its blending approach to the next level (Section 4).

3. EU blending so far

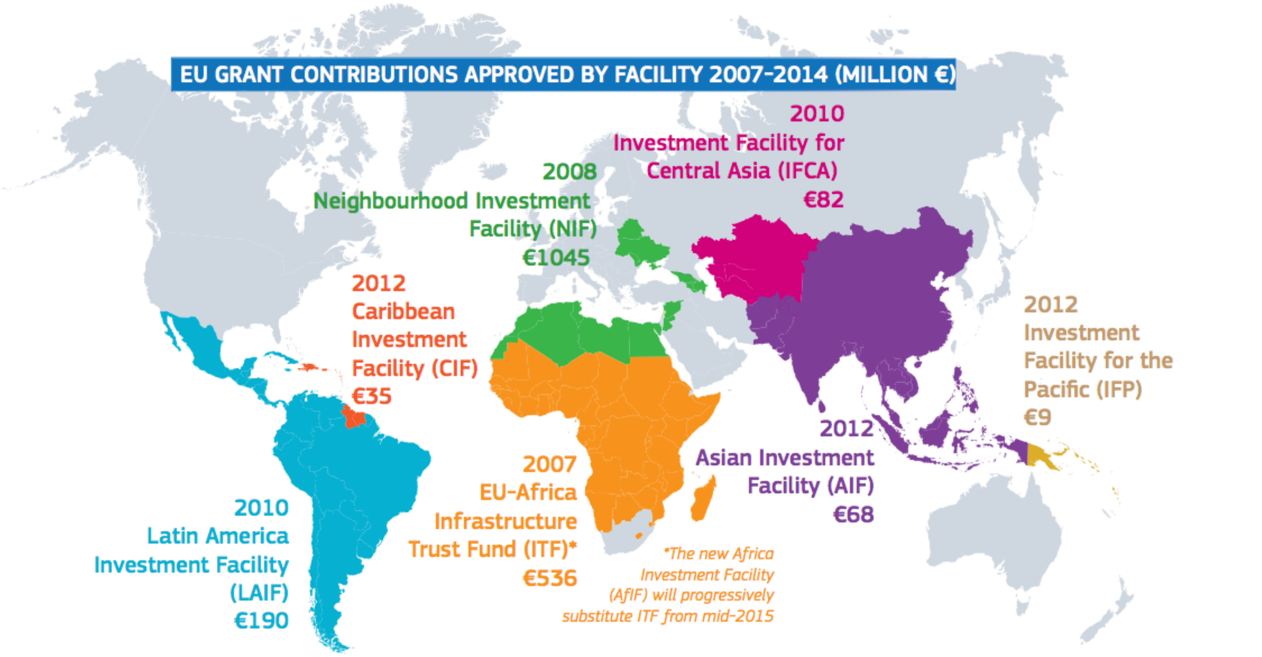
The EU has accumulated quite a lot of experience, at the EU and national levels, on blended finance (Hultquist, 2015). But over the last few years, it has started to develop a more strategic approach, towards private sector engagement and finance, and to blending mechanisms. The 2011 *EU Agenda for Change* stated that “*in selected sectors and countries, a higher percentage of EU development resources should be deployed through existing or new financial instruments, such as blending grants and loans and other risk-sharing mechanisms, in order to leverage further resources and thus increase impact*”, which therefore recognises blending as an important means both to leverage additional resources and to increase the impact of EU aid.

[11] https://csoforffd.files.wordpress.com/2015/07/addis-ababa-cso-ffd-forum-declaration-12-july-2015.pdf

3.1. EC blending facilities

For the EC, blending serves as an instrument to support EU external policy objectives based on combining grants with loans or other private finance. Accordingly, the EU grant element is used to attract additional financing that enables investments through mitigating risk.[12] The EC's Directorate-General for International Cooperation and Development (DG DEVCO) has set up a number of blending facilities (Figure 2). These are regional facilities, like the Africa Investment Facility (AfIF), but also thematic windows (Box 1), as in the case of Electrification Financing Initiative (ElectriFI) and Agriculture Financing Initiative (AgriFI) (Ridolfi, 2015). By doing so, the EU aims to increase its development assistance effectiveness, for enhanced support to policy reforms, while tapping into significant additional financing for development priorities, thereby boosting socio-economic sustainable development.

Figure 2: EU blending facilities and operations 2007-2014



Source: EC, 2015

Between 2007 and 2014, EU grants of approximately €2 billion leveraged around €20 billion of loans from European DFIs and regional development banks (RDBs), which together financed over 240 blending projects (EC, 2015). In total, EU grants combined with public and private financing unlocked investments of approximately €43 billion in EU partner countries, of which 64% of EU grants supported energy and transport infrastructure initiatives, followed by 24% going to social infrastructure (access to clean water, waste treatment, housing, health, urban development, as well as the environment), and 11% supporting private sector projects, particularly SMEs, to enhance both production capacities and job creation (EC, 2015).

According to Ehlert (2016), grant approvals between 2012 and 2014 by the EC reached about €400 million annually, mainly in the form of investment grants (47%), technical assistance (TA) (31%) and interest rate subsidies (11%). In 2015, the EDFI group commissioned a study, which found that "European donors have allocated more than €10 billion in ODA since 2002 to more than 100 different 'blending funds' focused on private sector projects" (EDFI, 2016). The annual level of investments by European DFIs reached €6 billion

[12] EC's website on its innovative financial instruments, including blending facilities.

in 2015, being roughly equivalent to 10% of all bilateral ODA from European aid agencies and the EU institutions, at approximately €60 billion, up from an equivalent of 4% in 2005 (Commons Consultants, 2015b).

Box 1: Thematic EU blending initiatives: The cases of ElectriFI and AgriFI

The Electrification Financing (ElectriFI) Initiative - a €75 million blending facility funded by the EC and managed and implemented by FMO jointly with the new EDFI Management Company - was launched at the end of 2015 to accelerate "the access to electricity and modern energy services through intervention at the development stage of a project".[13] It aims to "provide access to affordable, reliable, sustainable, and modern energy in developing countries" (ElectriFI, 2016) with an expected investment per client between €2 million to €6 million.[14] One of the main tasks is to make projects bankable for senior debt providers by providing "catalytic risk capital and advisory services, primarily at the early project stage or in highly additional situations where extra financing is required to reach financial close" (EDFI, 2016). Approximately 15% of the initial funding is earmarked for providing technical assistance to promoters for up to 10 years.

AgriFi - Agriculture Financing Initiative's has been set up "to unlock, accelerate and leverage investments with a value chain approach focusing on smallholder's inclusiveness and/or Micro, Small and Medium Enterprises (MSME) agri-business".[15] This is to overcome the investors' perception of rural markets being risky and to attract private finance for viable agricultural investments, as Ridolfi (2016) outlines. The initiative was launched in 2016 and the EC will provide €200 million, while most AgriFI investments will come through the EU blending framework, thus, having a (preferably European) Development Bank or Financing Institution as the lead financier, with a possibly similar structure like ElectriFI. The aim is to foster the development of sustainable value chains and food systems in order to achieve food security and improve nutrition. AgriFI will be based on three pillars: 1) investment, 2) business development and advisory services to farmers and agri-entrepreneurs; and 3) a robust monitoring framework based on value chain analysis for better accountability and decision making (Ridolfi, 2015).

3.2. The role of DFIs and the EIB in EU blending

The financial institutions in Europe most active in blended finance are the EIB and the EBRD at the EU level, and the Agence Française de Développement (AFD) and KfW at the national level, which can blend finance with their national aid and with EU aid. Table 3 illustrates this for EU blending only: considering the individual EDFIs that provided loans to the EU regional investment facilities between 2007-2013, the EIB seems to take a particularly prominent role, as they provided more than 45% of all loans, followed by EBRD 19%, AFD 18%, KfW 15% and other DFIs 2%.[16]

While a majority of those loans went into the Neighbourhood Investment Facility (55%), 13% of them were provided to the Infrastructure Trust Fund (ITF), the predecessor of the AfIF until July 2015.

Up to now, "more than €2.7 billion of EU grants have leveraged almost €23 billion of loans with a total investment volume in partner countries of more than €50 billion" with the AfIF already having an indicative

[13] More information at http://www.electrifi.org/ and here: ECDPM Interview with Frederik van den Bosch, Managing Director of the EDFI Management Company.

[14] FMO and EDFI-members launch ElectriFI at COP21 in Paris. FMO news on 4 December 2015.

[15] Agriculture Financing Initiative – AgriFI Concept Note, 1 July 2015.

[16] Other eligible financial institutions are Agencia Española de Cooperación Internacional para el Desarrollo (AECID), African Development Bank (AfDB), Belgian Investment Company for Developing Countries (BIO), Caribbean Development Bank (CDB), Council of Europe Development Bank (CEB), Compañía Española de Financiación al Desarrollo (COFIDES), Finnish Fund for Industrial Cooperation Ltd. (FINNFUND), Inter-American Development Bank (IADB, observer in LAIF), Luxembourg Development Agency (Lux-Dev), Nordic Investment Bank (NIB), Private Infrastructure Development Group (PIDG), Österreichische Entwicklungsbank AG (OeEB), Società Italiana per le Imprese all'Estero (SIMEST), Sociedade para o Financiamento do Desenvolvimento (SOFID). (ECA, 2014)

pipeline of 148 projects and a total envisaged grant amount of around €2 billion for projects that have a total investment cost of more than €25 billion (EC, 2016b).[17]

Table 3: Financial institution loans by regional investment facility 2007-2013 (in millions €)

	EIB	EBRD	AFD	KfW	Other financial institutions	Total
ITF	1 237	-	881	246	-	2 364
WBIF	1 760	600	200	160	-	2 720
NIF	4 498	2 588	1 100	1 429	11	9 626
LAIF	209	-	823	772	397	2 201
IFCA	170	142	-	4	1	317
AIF	110	-	203	45	-	358
CIF	-	-	37	-	-	37
Total	7 984	3 330	3 244	2 656	409	17 623

Source: ECA, 2014

The EIB, as 'the EU Bank', has a special place in the EU financing architecture, including on EU blending. It is the "world's largest multilateral borrower and lender" with 10% of its operations outside the EU. Together with lending and advising activities, blending is one of the three core pillars of the EIB's strategy. It does so by blending its loans, other loans or sources of finances with grants mainly from the EU budget, as well as the European Development Fund (EDF) for African, Caribbean and Pacific (ACP) countries. So, besides its participation in the different regional blending investment facilities of the EU, as indicated in Table 3, the EIB is able to conduct much more blended finance.

First, it is important to recall that blended finance is not restricted to activities in developing countries. The EIB's extensive experience and activities inside Europe are in that respect important. Within the EU, the EIB can conduct blended finance activities through the now famous European Fund for Strategic Investments (EFSI), its own Structured Finance Facility, the Europe 2020 Project Bonds Initiative, the Joint European Resources for Micro to Medium Enterprises (JEREMIE), InnovFin – EU Finance for Innovators, the Natural Capital Financing Facility, various Trust Funds and guarantee instruments.[18]

Outside the EU, the EIB is also active on a number of fronts, with several initiatives that rely on blended finance. These include notably the newly announced EIB's Crisis Response and Resilience Initiative, the Neighbourhood Finance Facility, or the Risk Capital Facility for the Southern Neighbourhood. It is worth highlighting, however, the ACP Investment Facility (IF)[19] for its innovative approach in the EU framework. Conceived as a revolving fund, with an EDF endowment, it allows the EIB to actively support private sector in the ACP through various forms of blended finance. Additionally, the IF's Impact Financing Envelope (IFE), with an initial €500 million ring-fenced investment window - increased to €800 million in September 2016 and made revolving as well, bears higher risks for achieving greater development impact by providing social impact equity funds, loans to financial intermediaries, risk sharing facilitating instruments and direct financing (EIB, 2016a). Bilal and Große-Puppendahl (2016) looked at aspects of the ACP-EU Cotonou

[17] The EU contracted ADE to undertake a strategic evaluation of its new blending instrument between 12 January 2015 and 12 July 2016 (ADE reference A456-005).
[18] See http://www.eib.org/products/blending/index.htm
[19] The EIB's ACP IF, however, should not be confused with the Commission's AfIF, to which the EIB however contributes funding. Instruments available under the ACP IF - (senior, intermediate, junior, subordinated) loans, (quasi-) equity funding, guarantees - can be blended with EU grant components in the form of TA or interest rate subsidies.

Partnership agreement that have been critical for EIB operations in ACP countries, as well as presenting different options beyond 2020 for the EIB to continue its activities.

3.3. Assessing EU blended finance

The EU's blending activities have been closely scrutinised. The 2014 European Court of Auditors special report examined 'The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies' and found that the regional investment facilities have been "generally effective" and "well set up" but their potential benefits "were not fully realised due to Commission management shortcomings" (ECA, 2014). While the examined projects were considered relevant for the regions and countries concerned, "the approval process undertaken by the Commission was not thorough, and the decisions to award the grants, at a particular level, were frequently not convincingly evidenced", as there was a lack of guidance in the decision-making process in terms of which criteria the Commission should use.

Further, there were also concerns about unnecessarily high advance disbursements as well as the EC's monitoring, as it "did not ensure that the added value of grants was achieved in all cases". Additionally, in approximately 50% of the examined projects, "there was no convincing analysis to show that a grant was necessary for the financial institutions to contract the loans" and a majority of the loans came from the aforementioned four European financial institutions (Figure 2), which identified the qualifying investments. These shortcomings echo those identified by Commons Consultants (2015) on blending funds at national level (see Section 2.3).

The Court of Auditors' special report concludes by providing several recommendations, which call for "a documented assessment of the added value resulting from the grants in terms of achieving EU development (...) objectives" based on adequate full process guidelines, taking a more proactive role in identifying and selecting projects, evidence-based additionality, and enhanced monitoring through "a results-measurement framework that includes indicators for following up the impact of EU grants".

Civil society organisations welcomed the findings of the Court of Auditors, cautioned the EU against expanding its blending activities before addressing the shortcomings identified, and called for a more balanced approach to private sector engagement in general, focused on smallholders and SMEs, financed through greater domestic resources mobilisation (Action Aid, Eurodad and Oxfam, 2014). This illustrates serious scepticism on blended finance as a means to successfully finance development.

The European Council also welcomed the Court of Auditors' special report on the regional blending facilities, but for different reasons.[20] It reiterated its support to the principles underlying its approach to blended finance, and recognised some of the shortcomings identified by the Court confirming "the need for blended finance to fully take into account debt sustainability and accountability and to avoid market disturbances and budgetary risks". The Council underlined the importance of ownership and alignment with national and/or regional development strategies, which should be taken into account in all blending operations. It further welcomed the EC's report on the activities of the EU Platform for Blending in External Cooperation (EUBEC), which found that "existing EU blending facilities show positive signs regarding performance in support of EU external policies" (EC, 2014) (see discussion in Section 3.3). As a follow-up to the Court of Auditors' report, the Council calls for continued enhancement of the blending facilities' management and "demonstrating the added value of the grant element, including in financial terms, and avoiding market distortions in blending operations".

[20] Increasing the impact of EU Development Policy - Council Conclusions 9369/12, May 2012.

EUBEC - the EU Platform for Blending in External Cooperation

In order to exchange on issues around increasing the effectiveness of blending and other issues related to the use of this instrument, the EC set up the EU Platform for Blending in External Cooperation EUBEC in 2012.[21] In seven technical groups (TGs) they discuss with experts from the Commission (DG ECFIN and DG DEVCO), EU Member States, European Parliament, European External Action Service (EEAS) and participating finance institutions. The EUBEC process really indicates the dedicated interest and commitment of the EU to learn from shared experiences and insights, and reflect and improve its approach and practices on blended finance. It is worth noting that this has been a very official process though, surprisingly with no participation of private sector representatives, let alone civil society. The "EUBEC reviewed the existing blending mechanisms as well as the ex-ante technical and financial analysis of projects, defined indicators for measuring results, developed the financial instruments further as well as exploited options of cooperation with the private sector and climate change financing" (EC, 2015; Maertens, 2015). Overall, the EUBEC assessed the experience on blended finance so far as positive, noting that blending significantly contributed to mobilising public resources, and that "blending facilities enhanced coordination, exchange of information and cooperation between European aid actors" (EC, 2014). EUBEC also identified issues for improvement on EU blended finance approaches (EC, 2014), including in terms of (EC, 2014):

- using more risk capital, guarantees and interest rate subsidies;
- involving more EU Delegations in pipeline development;
- enhancing coordination;
- promoting wider participation among EU aid actors and financing institutions;
- encouraging the involvement of non-European financing institutions (such as regional banks as lead financing institutions);
- involving more systematically and thoroughly partner countries and regions in project design and preparation;
- improving monitoring and reporting systems.

EUBEC has also guided the European Commission in addressing the recommendations of the Court of Auditors, notably by (EC, 2016c):

- "the development of a harmonised and improved project application form and its guidance notes;
- the development of a results measurement framework including standard indicators;
- the adoption of a Guidelines document on blending operations;
- a more proactive and closer role of the EU Delegations in identifying and selecting the blending projects;
- a revised new Governance of the blending facilities;
- a streamlined and shortened approval process;
- an extended training programme for EC officials dealing with blending in Brussels and in Delegations; and
- the publication of a short description of each blended project in a dedicated website for visibility purposes."

In parallel, the EC is conducting an independent evaluation of its blending activities.

---

21 For official information on EUBEC, see the dedicated webpage of the Register of Commission Expert Groups. Hultquist (2015) also provides a useful overview. The technical groups (TG) have various objectives, and are labelled: TG1 Review of Existing Blending Mechanisms, TG2 and 3 Enhancement of Effectiveness, Transparency and Accountability of Blending Activities, TG4 Further Development of Financial Instruments, TG5 Results Measurement Framework, Improvement of Processes, TG6 Private Sector Engagement and TG7 Climate Action.

4. Blending 2.0 - The European External Investment Plan

While blending has already been an important means of triggering private investments for the EU and beyond, efforts and approaches have been rather fragmented and different among key stakeholders - EC, EIB, EBRD, AFD, KfW and other EDFI. While the underlying rationale behind blending has been common to all, the principles, modalities and practices (not to mention definition) do vary among European financing institutions, and more generally among MDBs/DFIs. In order to address such fragmentation, at least at the European level, and provide an integrated framework going beyond pure investment promotion with potentially significant non-financial benefits, the European Commission and the EEAS have jointly proposed the European External Investment Plan (EIP).

The EIP aims to promote sustainable private investment, to contribute to the implementation of the 2030 Agenda, and the AAAA on Financing for Development by promoting an enhanced framework for EU engagement with the private sector. By doing so, it expects to tackle some of the root causes of migration in Africa and the EU Neighbourhood. The aim is to build on the experience gained with the '*Juncker Plan*', the Investment Plan for Europe and its European Fund for Strategic Investments (EFSI) that "mobilised close to €116 billion across 26 Member States in less than a year", benefiting more than 200,000 SMEs.[22]

Perhaps the main ambition however is to provide a coherent integrated framework and approach to the EU's external investment support; a 'one-stop-shop', that contributes to the global architecture for long term development in Africa and the Neighbourhood.[23] The EIP is expected to do so by leveraging funds from and enabling full cooperation among the EU, its Member States, its partner countries, international financial institutions (IFIs), other donors and the private sector.

With a fund of €3.35 billion under the EU budget and EDF resources[24], the EIP will provide 'innovative' guarantees and similar instruments to trigger private investment to support social and economic infrastructure, and SMEs. This shall enable it to mobilise up to €44 billion of investments, and possibly €88 billion, if EU Member States and other partners match the EU's contribution. It is organised along three pillars:

1. **European Fund for Sustainable Development (EFSD), including an EFSD guarantee**, with €3.1 billion in total until 2020[25] for two regional investment platforms, one for Africa and one for the EU Neighbourhood, to address obstacles to private investments through risk mitigation and risk-sharing instruments (e.g. first-loss guarantees, risk capital, SME loan guarantees or other guarantees);
2. **Technical assistance (TA)** to develop a higher number of better and more sustainable projects and attract investors; and
3. **Structured political dialogue** targeting both the business environment and investment climate along a range of dedicated thematic/national/regional EU development cooperation programmes.

One of the main innovations, at EU level, of the EIP is the establishment of new guarantee mechanisms as core elements of the EFSD. These will enable the EIP to provide partial guarantees, risk sharing and

[22] State of the Union 2016. *European EIP: Questions and Answers*. MEMO-16-3006.
[23] EEAS Factsheet: State of the Union 2016 External Investment Plan.
[24] This is the sum of EU contributions of €0.75 billion under the new EFSD Guarantee and of €2.6 billion under the AfIF and NIF. EIP Questions and Answers, September 2016.
[25] "This will consist of €2 billion from the European Development Fund (EDF), of which €1.6 billion will come from the AfIF and an additional €0.4 billion from EDF envelopes. Moreover, €0.94 billion from the NIF and €0.16 billion from the Development Cooperation Instrument (DCI) will be mobilised." (MEMO-16-2118)

mitigation mechanisms, to intermediary finance institutions, which can in turn facilitate access to capital for final beneficiaries through providing loans, guarantees, equity or similar products.

4.1. Key opportunities and challenges ahead

The EIP represents a good opportunity for the EC to make external investment promotion more coherent and effective, to contribute to sustainable development through providing financial and non-financial support. However, to become fully operational a number of challenges need to be overcome so that the EIP will be recognised as a success and a useful contribution in the context of private sector engagement for development.

Based on the blended finance principle to use scarce public aid to leverage private resources, the EIP has the potential to increase development effectiveness in line with the 2011 Busan Partnership Agreement for Effective Development Co-operation. Lonsdale (2016) argues that the "principles of effective development cooperation can and should apply to all forms of development cooperation, including blended finance" recognising however various key barriers to do so. Those relate to a lack of agreement on the role of blending in sustainable development and what effectiveness means. Despite the recognition of effectiveness principles as being important, there is less clarity among stakeholders on how to operationalise them, partly due to institutional constraints. Carter (2016) argues along similar lines for "applying the effective development cooperation principles to the private sector as a development actor and that an appropriate indicator for blended finance should be developed".

The EIP also offer an excellent opportunity to bring more coherence in the EU blended finance. It can do so in several ways. First, in its management structure, the EIB brings key EU institutional actors, i.e. EEAS and key DGs concerned, as well as EU member states, under the oversight of the European Parliament. Second, the EIP aims at instilling both greater completion, but also enhanced cooperation among the institutional financiers, including beyond Europe. Finally, by bringing the three pillars of blended finance, technical assistance and political dialogue under a single EIP umbrella, the EU will be able to provide stronger strategic and political leadership in its action, as well as reinforce the effectiveness of its interventions by combining these three dimensions in a synergetic and complementary manner.

However, this potential for increased coherence is most likely to be difficult to achieve in practice, at least in the short term. Different actors will be leading different parts of the EIP, with possibly different interests and priorities. Overcoming the EU traditional fragmented approach and turf wars will not be a simple task. Political priorities may interfere with financial realities and interests, in particular when commercial and private financial returns are at stake. And competition among financing institutions may not be as beneficial as the Commission anticipates. Access by non-EU financing institutions to the EFSD is most desirable. But this also leads to question and reassess the roles and added values of each European DFI, and most of all, the EIB, as *THE* EU Bank. The role and place of the EIB in the EIP has not yet been properly conceived, including in terms of i) its experience in managing guarantee mechanisms, ii) its role and experience in managing and operationalising EFSI and, iii) its role and complementarity with the ACP Investment Facility.

Several authors have recently pointed to potential additional challenges related to the EIP and its objectives (Alonso, 2016; Tempest, 2016; Fox, 2016; Bilal, 2016), which can be divided into three categories: a) migration-development nexus, b) additionality, and c) its design and politics.

Migration-development nexus

While Alonso (2016) points to the EIP's language ("speaking of root causes is meaningless without looking at why some migration is irregular"), she and others before (e.g. de Haas, 2010) have questioned the correlation between more development leading to less migration, at least for poorer countries. While not undermining the potential value of the EIP, it does challenge the logic of the EIP as a tool to rapidly reduce migration from fragile countries targeted by the EIP. In fact, an initial reduction of poverty (to which the EIP aims to contribute) may well lead to more migration, at least in a first stage.

Additionality

Bilal (2016) argues that like the Juncker Plan, the EIP "recognises the central place of private sector investment in job creation, economic growth and wider transformation endeavours, and seeks to leverage private finance". At the same time, Alonso as well as Tempest (2016) argue that directing ODA towards supporting firms is controversial due to "dubious development results" and private companies not targeting those most in need due to low prospects of investment returns. Alonso (2014) also refers to the 2014 European Court of Auditors report on the use of blending, as "there was no convincing analysis that tax payers' money was necessary in order for the company to invest in a developing country". This then relates to wider issues of engaging the private sector for development that are not unique to blending (Große-Puppendahl et al., 2016c). The EIP will have to be able to demonstrate effective additionality, from a financial point of view, but also from an operational and institutional one, as well as a clear catalytic effect, which effective coherence between the EIP's three pillars should entail.

Design and politics

Fox (2016) recognises that, similar to the EFSI, "there's not much hard cash behind the initiative" but that unlike other finance vehicles, the EIP's "EFSD is overtly political" being managed by the EC rather than the EIB. Fox considers the incentives, which are being provided to European and African public and private actors, as innovative, but he remains sceptical about linking the investment fund to migration, finding EU 'compacts' "a risky political move". He contends that the EIP is yet "another incentive for African leaders to give higher priority to border management [hence] if nothing else, a carrot among the sticks". An interesting suggestion is that "the Commission proposes that national contributions to the fund be classified as 'off balance sheet' to avoid being classified as public spending, and allow governments to earmark their contributions to a specific region or sector". This could be particularly justified in the case of funds for guarantees, which are unlikely to be depleted.

4.2. Way forward

One of the major opportunities will be the EFSD guarantee providing risk-mitigation and risk-sharing instruments, which combined with the other two pillars will yield good opportunities to more systematically and coherently contribute to some risk sharing and mitigation of private investments in developing and fragile countries, only up to the level necessary and commercially acceptable. The success will only be measured by the results it is able to achieve, which requires the EIP to avoid business as usual by doing three things (Bilal, 2016):

1. Better monitoring of sustainability outcomes;
2. Maximisation of effective additionality and leveraging; and
3. Identification of development reform dynamics.

According to Federica Mogherini, the High Representative of the Union for Foreign Affairs and Security Policy (HRVP), the plan will work by '*creating the conditions for Europeans to expand their business and move into new countries*' and it '*will support our partners' economies and societies, as well as our strategic* *foreign policy goals, from security to global development*'.[26] By connecting economic diplomacy and internationalisation of European firms to foreign and development policy goals, HRVP Mogherini stresses that the EIP is far more than just a migration response but rather an opportunity to more systematically engage with and support the private sector both for development and commercial purposes (Große-Puppendahl et al., 2016a, b, c).

If the EIP is able to address the aforementioned challenges for blended finance in the fields of the migration-development nexus, enhanced additionality, and its design and inherent politics, it can be a promising tool to create financial and non-financial benefits by triggering private investments in Africa and the Neighbourhood. If not, it will be a missed chance for the EU to not only promote the role of the private sector in international cooperation but also to more effectively incentivise sustainable private investment in Africa, while contributing to improve the investment climate and business environment.

Besides contributing to greater coherence and effectiveness of the EU financing for development, the EIP should also seek to build on and complement international efforts, including among international financial institutions, to adopt common guiding principles and shared transparency and reporting criteria on blended finance. In addition, it should also contribute to build synergy with other multi-stakeholders public-private platforms (Blended Finance Innovators. 2016), such as the Sustainable Development Investment Partnership (SDIP).

It is because of its high ambitions that the EIP has been heralded "a new chapter in EU development cooperation" (Mogherini and Mimica, 2016), or more simply, blending 2.0. Living up to the expectation will be the exciting challenge.

[26] Press release IP-16-3002. 14 September 2016.

References

Action Aid International, Eurodad and Oxfam International. 2014. *Policy brief on the role of the private sector in Europe's development cooperation.* Communiqué 8th December 2014.

Alonso, N. 2016. *Juncker's new investment plan shows he still has not understood the problem*. Article published on EurActiv on 14 September 2016.

Benn, J., C. Sangaré, T. Hos, G.M. Semeraro. 2016. *Amounts Mobilised from the Private Sector by Official Development Finance Intervention: Guarantees, syndicated loans and shares in collective investment vehicles.* OECD Development Co-operation Working Paper 26. February. Paris: OECD.

Bilal, S. 2016. *The European External Investment Plan: more than old wine in a new bottle*. Op ed published on EurActiv on 16 September 2016.

Bilal, S. 2012. *What is the rise of South-South relations about? Development, not aid.* MO* Papers no.70. September.

Bilal, S. and S. Große-Puppendahl. 2016. *The EIB's innovative role in ACP countries under the Cotonou Agreement: Options beyond 2020.* (Discussion Paper 196). Maastricht: ECDPM.

Bilal, S and F. Krätke. 2013. *Blending loans and grants for development: An effective mix for the EU?* ECDPM Briefing Note 55. Maastricht: ECDPM.

Blended Finance Innovators. 2016. *Improving Impact: Increasing Blended Finance to achieve the Sustainable Development Goals*. Discussion draft for release on October 1.

Carter, P. 2016. *Where next for Development Effectiveness? Investing in private enterprises*. Conference Note 3. October 2016. London: ODI.

Carter, P. 2015. *Why subsidise the private sector? - What donors are trying to achieve, and what success looks like*. November 2015, London: ODI.

CIF. 2014. *Assessing "Leverage" in the Climate Investment Funds*. Climate Investment Funds.

Commons Consultants. 2015a. *Study of ODA for Blended Finance in Private Sector Projects*. Final report 3 February 2015.

Commons Consultants. 2015b. *The Pitfalls of Innovative Private Sector Financing - Emerging lessons from benchmarking of investment funds supported by aid agencies*. Summary Report, 25 August 2015, Copenhagen: Common Consultants.

Development Initiatives. 2016a. *Blended finance: Understanding its potential for Agenda 2030*. Report. November.

Development Initiatives. 2016b. *The role of blended finance in the 2030 Agenda: Setting out an analytical approach*. Discussion Paper, July 2016.

EC. 2016a. *Strengthening European Investments for jobs and growth: Towards a second phase of the EFSI and a new European EIP*. Communication (2016) 581 final. Brussels, 14/9/2016. European Commission.

EC. 2016b. *Financing Global Sustainable Development: Illustrations of EU contributions to the 2030 Agenda.* EU brochure. European Commission.

EC. 2016c. *Report on the activities of the EU Platform for Blending in External Cooperation (EUBEC) from August 2014 until end of 2015*. COM(2016) 600 final, Brussels, 19.9.2016. European Commission.

EC. 2015. *EU Blending - European Union aid to catalyse investments*. EU leaflet. European Commission.

EC. 2014. *Report on the activities of the EU Platform for Blending in External Cooperation since its establishment until end July 2014*. COM(2014) 733 final, Brussels, 15 December 2014. European Commission.

ECA. 2014. *The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies*. Special Report No. 16. Luxembourg: European Court of Auditors.

EDFI. 2016. *Investing to Create Jobs, Boost Growth and Fight Poverty -European Development Finance for Private Sector Projects in Low and Middle Income Countries*. Flagship Report July 2016, Brussels: EDFIs.

Ehlert, Y. 2016. *EU Blending and MSME Promotion.* Presentation at MSME in Development Cooperation 3 February 2016, Brdo pri Kranju.

EIB. 2016a. *Annual Report 2015 on EIB activity in Africa, the Caribbean and Pacific, and the overseas territories.* May 2016, Luxembourg: EIB.

EIB. 2016b. *The Results Measurement (ReM) framework methodology.* March 2016, Luxembourg: EIB.

ElectriFI. 2016. Invitation to Submit Applications for Project Support Round 1 Phase 1. Document released on 15 April 2016.

Eurodad, 11.11.11 and Oxfam International. 2015. Letter For the attention of: Permanent Representation of Latvia to the EU.

Eurodad. 2013. *A dangerous blend? The EU's agenda to 'blend' public development finance with private finance*. October 2013.

ETTG. 2011. *EU Blending Facilities: Implications for Future Governance Options. European Think-Tanks Group* (ODI, DIE, ECDPM, FRIDE).

Fox, B. 2016. *The EU's new offer to Africa*. Article published on EU Observer, 27 September 2016.

Friends of the Earth. 2013. *Additionality and Leveraging Private Finance*. Issue Brief.

Gregory, N. 2016. *Untangling misconceptions about blended finance*. February.

Griffith, J. 2012. *'Leveraging' private sector finance: How does it work and what are the risks?* Bretton Woods Project, April.

Große-Puppendahl, S., B. Byiers and S. Bilal. 2016a. *Beyond aid in private sector engagement: A mapping of the opportunities and challenges of development and commercially-oriented public support to private sector engagement*. ECDPM Discussion Paper 187. Maastricht: ECDPM.

Große-Puppendahl, S., B. Byiers and S. Bilal. 2016b. *Blurred lines: Cases of EU development and commercial instruments for matchmaking.* ECDPM Discussion Paper 188. Maastricht: ECDPM.

Große-Puppendahl, S., B. Byiers and S. Bilal. 2016c. *Matching businesses, public support and sustainability ambitions.* ECDPM Briefing Note 90. Maastricht: ECDPM.

Haas, H. de. 2010. *Migration transitions: A theoretical and empirical inquiry into the developmental drivers of international migration*. DEMIG project paper 1. Working Paper 24. International Migration Institute, University of Oxford.

Heinrich, M. 2014. *Demonstrating Additionality in Private Sector Development Initiatives - A Practical Exploration of Good Practice for Challenge Funds and other Cost-Sharing Mechanisms.* April 2014: DCED.

Hultquist, I. 2015. *Mapping of EU blending.* UTV Working Paper 2015:1. December 2015, Stockholm: SIDA.

IFC. 2016. *Blending public and private finance: What lessons can be learned from IFC's experience?* EM Compass Note 3. April. Washington D.C.: IFC.

IFC. 2008. *Independent Evaluation of IFC's Development Results 2008: IFC's Additionality in Supporting Private Sector Development.* Independent Evaluation Group (IEG).

Junker, J.C. 2016. *State of the Union 2016.* 14 September. https://ec.europa.eu/priorities/state-union-2016_en

Larrea, J. 2016. *Sizing Up 'Blended Finance': A Guide to a New Financing Approach to Fuel Sustainable Development.* Guide published on 27 July 2016.

Lonsdale, C. 2016. *Aligning blended finance with the Busan principles of development effectiveness.* Discussion Paper October 2016, Bristol: Development Initiatives.

Maertens, C. 2015. *EU Blending in Africa.* Presentation at JAES Reference Group on Infrastructure 24 March 2015.

MDBs. 2016. Statement by Multilateral Development Banks: Delivering on the 2030 Agenda. Press release 9 October. http://www.worldbank.org/en/news/press-release/2016/10/09/delivering-on-the-2030-agenda-statement

MDBs. 2015. "From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance", prepared jointly by the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank Group.

Mogherini, F. and N. Mimica. 2016. The European External Investment Plan: An innovative new chapter. *GREAT Insights* Volume 5, Issue 5. October/November 2016. Maastricht: ECDPM.

ODI, DIE, ECDPM, University of Athens and Southern Voice Network. 2015. *European Report on Development 2015. Combining finance and policies to implement a transformative post-2015 development agenda.* Brussels: May 2015. Overseas Development Institute (ODI), German Development Institute/Deutsches Institut für Entwicklungspolitik (DIE), European Centre for Development Policy Management (ECDPM), University of Athens (Department of Economics, Division of International Economics and Development), Southern Voice Network.

OECD. 2016. *Development Co-operation Report 2016: The Sustainable Development Goals as Business Opportunities*. Paris: OECD.

OECD. 2014. Using financial instruments to mobilise private investment for development, Chapter 11 in *Development Co-operation Report 2014: Mobilising Resources for Sustainable Development.* Paris: OECD.

Pereira, J. 2015. *Leveraging Aid: A Literature Review on the additionality of using ODA.* UK Aid Network (UKAN).

Pries, G. and V. Berla. 2012. Private equity in emerging markets: Exits from aid, steps toward independence. *ImpactAssets Issue Brief #6.* ImpactAssets & Sarona Asset Management.

Ridolfi, R. 2016. *Financing smallholder farmers: from risks to opportunities*. Article from 11 March 2016 on the Technical Centre for Agricultural and Rural Cooperation (CTA) website.

Ridolfi, R. 2015. 2015. Engaging with business for agricultural growth: Opportunities and risks. *GREAT Insights* Volume 4, Issue 5. August/September 2015. Maastricht: ECDPM.

Samans, R. 2016. Blending public and private funds for sustainable development, Chapter 3 in *OECD Development Co-operation Report 2016: The Sustainable Development Goals as Business Opportunities.* Paris: OECD Publishing.

Savoy, D.F., P. Carter and A. Lemma. 2016. *Development finance institutions come of age: Policy engagement, impact, and new directions.* A report of the CSIS Project on Prosperity and Development and the Overseas Development Instittue (ODI), Washington D.C.: Center for Strategic & International Studies (CSIS).

Schäuble, W. 2016. Speech by Dr. Wolfgang Schäuble, German Federal Minister of Finance, at the B20 Conference on 1 December 2016 in Berlin. www.bundesfinanzministerium.de/Content/DE/Reden/2016/2016-12-01-b20.html

Tempest, M. 2016. *Oxfam questions 'blending' financing in SDG delivery*. Article published on EurActiv on 14 September 2016.

The Economist. 2016. *Trending: blending - The fad for mixing public, charitable and private money*. Article published on 23 April 2016.

UNSG. 2014. *The Road to Dignity by 2030: Ending Poverty, Transforming All Lives and Protecting the Planet. Synthesis Report of the Secretary-General On the Post-2015 Agenda*, December 2014, New York: United Nations.

WEF and OECD. 2016. *Insights from Blended Finance Investment Vehicles & Facilities*. ReDesigning Development Finance Initiative. January 2016.

WEF and OECD. 2015a. *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders - An overview of the strategic use of development finance and philanthropic funds to mobilize private capital for development.* ReDesigning Development Finance Initiative. September 2015.

WEF and OECD. 2015b. *Blended Finance in the Private Sector Context.* ReDesigning Development Finance Initiative.

About ECDPM

ECDPM was established in 1986 as an independent foundation to improve European cooperation with the group of African, Caribbean and Pacific countries (ACP). Its main goal today is to broker effective partnerships between the European Union and the developing world, especially Africa. ECDPM promotes inclusive forms of development and cooperates with public and private sector organisations to better manage international relations. It also supports the reform of policies and institutions in both Europe and the developing world. One of ECDPM's key strengths is its extensive network of relations in developing countries, including emerging economies. Among its partners are multilateral institutions, international centres of excellence and a broad range of state and non-state organisations.

Thematic priorities

ECDPM organises its work around four themes:

- Reconciling values and interests in the external action of the EU and other international players
- Promoting economic governance and trade for inclusive and sustainable growth
- Supporting societal dynamics of change related to democracy and governance in developing countries, particularly Africa
- Addressing food security as a global public good through information and support to regional integration, markets and agriculture

Approach

ECDPM is a "think and do tank". It links policies and practice using a mix of roles and methods. ECDPM organises and facilitates policy dialogues, provides tailor-made analysis and advice, participates in South-North networks and does policy-oriented research with partners from the South.

ECDPM also assists with the implementation of policies and has a strong track record in evaluating policy impact. ECDPM's activities are largely designed to support institutions in the developing world to define their own agendas. ECDPM brings a frank and independent perspective to its activities, entering partnerships with an open mind and a clear focus on results.

For more information please visit www.ecdpm.org

ECDPM Discussion Papers

ECDPM Discussion Papers present initial findings of work-in-progress at the Centre to facilitate meaningful and substantive exchange on key policy questions. The aim is to stimulate broader reflection and informed debate on EU external action, with a focus on relations with countries in the South.

This publication benefits from the generous support of ECDPM's core, institutional and programme funders: The Netherlands, Belgium, Finland, Ireland, Luxemburg, Portugal, Sweden, Switzerland and Austria.

ISSN 1571-7577

ecdpm

HEAD OFFICE
SIÈGE
Onze Lieve Vrouweplein 21
6211 HE Maastricht
The Netherlands *Pays Bas*
Tel +31 (0)43 350 29 00
Fax +31 (0)43 350 29 02

BRUSSELS OFFIC E
BUREAU DE BRUXELLES
Rue Archimède 5
1000 Brussels *Bruxelles*
Belgium *Belgique*
Tel +32 (0)2 237 43 10
Fax +32 (0)2 237 43 19

info@ecdpm.org
www.ecdpm.org
KvK 41077447