EU Blending Facilities:
Implications for Future Governance Options

European Think-Tanks Group
January 2011

Design: www.stevendickie.com/design

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Acknowledgements:

This study has been funded by the UK Department for International Development (DFID), as part of the Overseas Development Institute's European Development Cooperation Strengthening Programme (EDCSP).

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The German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE), Bonn, Germany;
The European Centre for Development Policy Management (ECDPM), Maastricht, Netherlands;
Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE), Madrid, Spain;
The Overseas Development Institute (ODI), London, UK.

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Oladiran Wasiu Bello (FRIDE)
Simon Maxwell (ODI)
Jeske van Seters (ECDPM)
Peter Wolff (DIE)

This study has also benefited from the inputs of key stakeholders, including the European Commission (EC), the European Investment Bank (EIB), KfW Bankengruppe, Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ), the Agence Française de Développement (AFD) and the UK Department for International Development (DFID).

The views presented in this paper are those of the authors and do not necessarily represent the views of ODI or any other of the organisations involved.

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Acronyms

CEB	Council of Europe Development Bank
DFI	Development Finance Institution
EBRD	European bank for Reconstruction and Development
EFI	European Finance Institution
EIB	European Investment Bank
ENP	European Neighbourhood Partnership
FEMIP TF	Facility for Euro-Mediterranean Investment and Partnership Trust Fund
FIG	Financial Institutions Group
IFCA	Investment Facility for Central Asia
ITF	EU-Africa Infrastructure Trust Fund
JGF	Joint Grant Facility (WBIF)
LAC	Latin American & Caribbean
LAIF	Latin America Investment Facility
MS	Member State
MSBFI	Member State Bilateral Financing Institution
MSDA	Member State Development Agency
NIB	Neighbourhood Investment Bank
NIF	Neighbourhood Investment Facility
PFG	Project Financiers Group
SME	Small and Medium Enterprise
TA	Technical Assistance
UfM	Union for the Mediterranean
WBIF	Western Balkans Investment Framework

Executive Summary

This paper discusses the complementary use of grants and loans (blending) in the European Union's (EU) external assistance. The wise persons' report (the so-called "Camdessus" report) established in the framework of the mid-term review of the EIB's external mandate suggested the creation of an "EU platform for cooperation and development". The Proposal for a Decision on the EIB external mandate (COM(2010) 174), which is under discussion, suggests that the Commission should study the development of this platform. The report's executive summary (p. 4) states: "The Commission and the EIB, in close collaboration with the Member States, should establish an "EU platform for external cooperation and development", i.e. a mechanism for blending grants and loans. This report considers the pros and cons of possible future governance options for such a co-ordinating platform.

Whilst blending has emerged rapidly and is now common practice in development finance, there is currently a limited evidence base on the effects of blending. Whilst a sizeable literature exists about the theoretical use of loans and grants, there is little on how it works in practice, which methodology or procedure works best and whether a certain governance model is more effective in reaching its objectives. With respect to the EU's existing blending facilities in particular, we face challenges because the majority have only been operational for less than three years.

Blending mechanisms, when adding grants to loans, aim to achieve a number of objectives, including the need to increase the volume of development finance in a context of constrained resources. A literature review suggests that compared to pure loans, blending mechanisms allow for:

- Making transfers to heavily indebted countries without exacerbating debt overhang problems; (although in practice most of the EU blending facility grants go to projects in the form of technical assistance and hence the grant element tends to be low in the facilities we examined, with a few exceptions);
- Addressing positive externalities to bring the financial rate of return closer to the economic rate of return for projects with a high socio-economic and/or positive environmental impact;
- Improving the quality of funded projects (in practice the grant component also allows projects to be funded which otherwise recipients are unable to finance, in addition to improving the quality of projects compared to a no grant situation);
- Strengthening ownership by funding measures which build on recipient countries' policies; and to which the partner provides their own resources;
- Enhancing EU visibility, and supporting the division of labour by strengthening coordination between EU donors and lenders.

We have reviewed five existing EU blending facilities:

- The Neighbourhood Investment Facility (NIF);
- The Western Balkans Investment Framework (WBIF);
- The EU–Africa Infrastructure Trust Fund (ITF);
- The Latin America Investment Facility (LAIF);
- The Investment Facility for Central Asia (IFCA).

Each blending facility is one of the instruments set up by the European Commission to support the EU policy, regional strategy and partnership in the targeted region and countries.

Each facility covers a specific region. The potential range of instruments includes: technical assistance (TA); feasibility studies; investment co-financing; equity participation; risk-capital; interest rate subsidies; on-lending; guarantees; insurance subsidies; and incentive payments. TA/feasibility studies and interest rate subsidies provide for the largest number of projects.

The facilities specialise in large-scale infrastructure investments alongside SME support. They all cover similar, broadly defined, sectors i.e. transport, energy, social, environment and finance for SMEs. Partners in the beneficiary country can be public, private or mixed with public partners dominating the current projects aside from SME support. Most projects are public sector projects. The ITF is restricted to the financing of regional infrastructure and, recently, national infrastructure contributing to regional integration. Moreover, the ITF does not provide financing for SMEs.

The publically available data on the NIF (neighbourhood countries) and ITF (African countries) show substantial variation in the value of the grant as a share of the total project value (see table 5 and Annex 2). The average share of grants in the total value of the project is 2.3% and it is very slightly higher in the NIF than in the ITF. This is contrary to what one would expect if projects were allocated according to government capability to deal with debt (ITF countries tend to be poorer than NIF countries). We should emphasise however that projects can also have different levels of concessionality before grants from the blending facilities get blended in. This reflects the DFIs assessment of factors such as the level of risk and revenue potential associated with a project. In addition, project financiers, like AFD or EIB, also have access to own grant resources which they can use to vary the level of concessionality. The grant share is 5.2% of the overall DFI finance value in the NIF, and 13.7% in the ITF.

For the NIF, and the ITF, only IFIs and members of the Financial Institutions Group (FIG)/Project Financiers Group (PFG) can submit project proposals; while the eligibility of other multilateral finance institutions can be examined on a case by case basis. Some of the other facilities have options to accept proposals from beneficiary countries or other funders. All the facilities have similar structures:

- A strategic body providing policy direction;
- A decision-making body deciding which projects should receive grants; and
- A group of financiers screening proposals and providing technical analysis before forwarding select proposals to the decision-making body.

There is a difference in the membership of the groups. For the NIF, LAIF and IFCA, the European Commission chairs all three bodies. In the WBIF, the European Commission co-chairs the three bodies alongside the Member States. While the European Commission currently, but not necessarily, chairs the decision-making body in the ITF, the strategic body includes both beneficiaries and African organisations without restricting them to an observer role only. The European Commission is not present in the group of financiers of the ITF but co-chairs the secretariat. The decision-making body of the ITF can be chaired by a donor other than the European Commission. However, this possibility has rarely been used since its launch. The Member States are not present in the Project Financiers

Group of the WBIF, which is co-chaired by the European Commission on a permanent basis and by the partner IFIs (EIB, EBRD and CEB) on a rotating basis every 6 months.

It is not straightforward to evaluate blended projects. This is because of methodological reasons (lack of counterfactual) and lack of specific data on: 1) the economic and social effects of the blended project; and 2) the exact contribution of the grant component. We do, however, have a large number of project descriptions of grant components of blending mechanisms (Annexes 3, 4 and 7) suggesting they are used to finance essential studies, improve the quality of the project and achieve the required level of concessionality, providing evidence for the importance of blending. There is little quantitative evidence to back this up, though we have provided some pointers.

We were unable to pinpoint any large differences in operational outcomes as a result of a different internal governance arrangement (e.g. ITF vs. NIF). There is however a discussion possible on the principles which may help to inform the best possible governance option, for example:

- The need for a fair arbiter (e.g. in the NIF, various project financiers may come together in complex projects) in order to avoid potential conflicts of interest between eligible Finance Institutions;
- The need to ensure a "policy driven" screening of grant requests based on EU regional policies and strategies and overarching EU development policy as enshrined in the European Consensus on Development.
- The need to keep a separation between the policy and technical aspects of the grant award process (to donors vs. DFIs in the ITF);
- The need for transparent and formal checks and balances on the proposals of project financiers at early stages beyond the checkboxes in the templates;
- The European Commission needs to be ultimately responsible for the spending of all EC aid (for auditing purposes).

On the one hand, the principles or the evidence do not favour one approach over another (e.g. should DG DEVCO in the European Commission or the EIB chair the project financiers group). On the other hand, interviews suggested that there was a clear perception that the chair of the group mattered for which projects were being considered for blending. There are two ways to resolve this. Either the chair uses a transparent and objectively measured way to decide which projects will be considered for blending (e.g. the minutes of the meeting could be made public), or a third party would be brought in to chair the project financiers group. A third party might be DG ECFIN which has oversight of the EIB in general.

We introduce five possible governance options of a future platform. The first option is 'business as usual' - the current situation where there is some informal collaboration and common procedures. Project applications currently use facility specific templates, but they do not determine the grant share of blending. The second option is 'governance light' – where the platform applies a standardised template for grant applications; offers benchmarks for assessing and comparing grant values across facilities and brings out differences in blending according to these criteria; Offers learning possibilities; and promotes harmonisation more systematically than is currently the case (e.g. in environmental projects). The third option 'governance medium', formalises learning and harmonisation, and applies a standardised template for grant applications according to which grants

are assessed. It provides a globally coordinated strategy, taking over this role from the individual facilities, and enforces guidelines on the facilities which determine project areas eligible for grant funding. The fourth option, 'governance heavy' moves decision-making on individual projects into the platform. This allows the platform to have an overview of all projects submitted across the facilities and assess their comparative strengths and weaknesses. The platform can be responsible for allocating resources to specific projects on the basis of project, region and theme specific yardsticks. The fifth option is 'governance super heavy'. This represents a scenario where all the facilities have been amalgamated together into a single facility under the platform, covering all themes and regions. This single entity comprises a single strategy, a single grant application template and a single fund.

We examine these options on the basis of the following criteria:

- Flexibility: can the level and nature of blending be discussed on a case by case basis (high) or are the same guidelines applied to each project and enforced (low)?
- Eligibility: does clarity exist on the nature of projects eligible for blending?
- Sustainability: is the project likely to be financially viable (high) or is it likely to be unsustainable and hence market distorting (low)?
- Transparency: is the project assessed according to a set of fixed criteria?
- Harmonisation: do the blending facilities operate independently (by regional area and by theme) with different criteria (low) or do they operate as one with common criteria?
- Visibility: is a bundled approach more visible than a fragmented approach leading to greater policy influence?
- Donor policy influence in areas beyond loans: to what extent does the allocation of grants reflect donor and recipient priorities? Projects presented by the Finance Institutions ("demand driven", i.e. identified and negotiated with the beneficiary country) shall not be contradictory to or inconsistent with the EU country strategy or regional strategy (e.g. EU Delegations are systematically consulted in the decision-making process). However, they can complement the EU country strategy by supporting investments not specifically covered by this strategy.

Table 1 illustrates there are pros and cons associated with the five governance options.

Table 1: Assessing governance options

	Business as usual	Governance light	Governance medium	Governance heavy	Governance super heavy
Flexibility	High	High	Medium	Low	Low
Clear Eligibility	Low	Low	High	High	Low
Sustainability	High	High	Medium	Low	Low
Transparency	Low	Medium	Medium	High	Low

Harmonisation	Medium	Medium	High	High	High
Visibility	Medium	Medium	High	High	High
Donor policy influence	Low	Low	Medium	High	High

If we attach a value to the assessment in the table (e.g. High=3, Medium=2, Low=1), the options 'governance medium' and 'governance heavy' score highest, if all principles are treated equally. Moreover, given that our study suggests there is a lack of transparency about blending decisions (at least to outside observers) and if we therefore think that it is important to strengthen transparency (e.g. to clear up misgivings on the importance of the chair of the groups), the 'governance heavy' option is the most preferred option. This option might help to promote more upstream discussions between the project financiers and the grant providers. In all cases however, transparency could be improved by publishing the interaction between the DFIs and the platform.

Along with transparency, harmonisation of practices and visibility were viewed as principles that had few negative effects. The 'medium' and 'heavy' governance models are suggested as being the most likely to optimise both harmonisation and visibility potential.

The remaining concepts are highly intertwined and maximising one generally involves trading off the potential to maximise another. Flexibility for DFIs and the sustainability of projects are thought to go hand-in-hand. Donor policy influence and clear (strict) eligibility criteria also were viewed as moving together. Together these two pairs of principles frame the debate on the potential and pitfalls of grants leading loans.

1 Introduction

This paper discusses the complementary use of grants and loans in the European Union's (EU) external assistance. It aims to contribute to ongoing discussions on loan and grant blending mechanisms with a view to ensuring greater efficiency and effectiveness of EU development financing. The paper offers an independent contribution to the EU's internal discussions on its future blending mechanisms, by providing a theoretical framework, drawing lessons from practical experiences and existing mechanisms and reviewing and proposing possible governance models of blending operations.

There is currently a limited evidence base on the effects of blending. Whilst a sizeable literature exists about the theoretical use of loans and grants, there is little on how it works in practice. With respect to the EU's existing blending facilities in particular, we face challenges because the majority have only been operational for less than three years. In addition, the aim of the paper is not to evaluate existing facilities (for which we also have to examine the effects on ultimate beneficiaries of the different governance structures and on which we lack sufficient data) but to facilitate a discussion about the future set-up of blending. The EIB mid-term report (EIB, 2010) and associated 'Camdessus' report suggested that an EU platform for co-operation and development, which would govern blending facilities, should be considered. Thus we focus on this particular aspect and consider what could be possible governance options and what might be the possible pros and cons.

The paper is structured in six parts. After the introduction, Section 2 provides background to blending. Section 3 analyses the economic gains of using different blending instruments, as opposed to pure grants or pure loans. Section 4 compares the EU's existing blending facilities and their differing governance arrangements, drawing lessons concerning the role of each blending instrument in different sectors and regions. Section 5 discusses the pros and cons of various platform options. Section 6 summarises.

2 Blending, background and issues

This section provides the definitions behind blending and the relation between Official Development Assistance (ODA) and blending. We also provide the background against which blending takes place – for example, EU blending seems a direct response to the increased need for development financing and emergence of other countries which implicitly blend resources for investment in poor countries. We also show that DFIs can access various EU facilities which can add grants to their loans.

2.1 What is blending

Grants are transfers made in cash, goods or services for which no repayment from the recipient is required.

Loans are transfers for which repayment of principal and interests by the recipient is required. A loan is characterised by its face value (or nominal value) which equals the amount of money the borrower receives; interest rate which represents the cost of borrowing money; maturity which is the redemption period after which the loan repayment is due; and grace period which allows repayment to be received for a certain period of time after the actual due date. Some loans can include a grant element and are called concessionary (or soft) loans. The grant element reflects the financial terms of a commitment (interest rate, maturity and grace period) and measures the concessionality of a loan.

Blending as carried out by the EU facilities, mixes loans and grants. It entails a combination of market (or concessional) loans with grant (or grant equivalent) components which may be in various forms:

- Direct investment grants;
- Interest rate subsidies;
- Loan guarantees;
- Technical assistance,
- Risk mitigation, guarantee and equity instruments, etc.

Blending can take place in two main set-ups:

(i) Parallel co-financing, where funding partners contribute separately to fund a given project or programme;
(ii) Joint co-financing, where funding partners' contributions are pooled together to fund a given project or programme.

It is the mechanism of achieving a blended package and the resulting 'associated financing' structure which includes funds from third parties (public, private and from the beneficiary) that distinguishes a loan blended with a grant, as provided by the facilities, from a concessional loan, as might be provided by DFIs outside the facilities.

2.2 Blending and ODA

It is important to define the interface between blending and ODA. The DAC defines ODA funds as:

- Those provided by official agencies;
- For developmental purposes;
- With a concessional element of 25% or more compared to a 10% reference interest rate (35% for tied aid).

As interest rates have fallen since the 1970s the 25% concessionality level has become easy to achieve. However, loans must still be concessional, i.e. at less than the market rate. The entire loan value is counted as ODA for qualifying funds. As such, blended packages with a grant element of 5% (e.g. when a large loan project needs to have a feasibility study) are therefore still likely to be ODA as the loan is likely to meet the 25% concessionality criteria in its own right.

It is not clear whether the recording of funds provided via third parties to form parts of a blending package should count as ODA. Currently, loan funds provided as a single concessional loan can be recorded as ODA but not when those funds are supplied to a third party (e.g. the EU/EIB) and then re-combined as part of a blended package. Due to the value to donors of recording funds as ODA, this arrangement appears to be a disincentive to the use of blending facilities that might be avoided. At the same time, the contrary will allow for donors to move towards their ODA targets by counting loan funds that were previously not recorded as ODA. This may lower ambitions in terms of grant levels. Yet, interviewed stakeholders suggested that loans by Finance Institutions are provided directly to the beneficiary country in the context of EU blending mechanisms.

2.3 Blending, the EU private sector and China

Blending at EU level does not occur in a vacuum but is constantly affected by global challenges. For example, a current trend in many European countries is to move towards more private sector development. The private sector is crucial for long-term development, so more finance for the private sector could help development. In this context, there is pressure to use grants proactively to leverage in EU business, although this does not imply tying of aid which is not consistent with EU procurement rules. The private sector, for their part, sometimes shy away from grants on the basis that grants distort the market and render the project unsustainable. Hence, in EU blending facilities, cost effectiveness and financial viability of projects is an important factor in grant allocation.

Blending frequently occurs in other countries, particularly in China. This may give China an unfair advantage over the EU. China provides a lot of cheap loans. The Chinese support their (public) investment using an array of instruments including concessional loans, grants, and export credits – with much of the financial flows staying in China. There is anecdotal evidence suggesting that a Chinese companies' access to state guaranteed loan and capital swung the deal in mining bids. In 2006, Sinopec offered Angola's Sonangol a bonus of USD 1.1 billion to secure rights to two oil blocks, whilst a consortium of European companies including Italy's ENI tried unsuccessfully to match this, falling short of USD 900 million.

2.4 Blending practice outside the EU facilities

Blending practices are widespread outside the EU facilities (section 4) and we need to recognise that the various DFIs have a choice where to seek grant support for their requests, including from their own funds. They occur in various types of development finance institutions, bilateral and

multilateral, aimed at public and private sectors. For example, Agence Française de Développement (AFD) and KfW Bankengruppe (KfW) have long provided loans. AFD has a blending strategy and has constructed a template for application of loan/grant blending. The EIB also has access to its own grant resources[1] as well as those available in the EU facilities.

AFD's strategy (2010) suggests that its 2008 commitments for blended loan/grant products stood at EUR 1.8 billion, excluding technical project assistance. Instruments include:

- Interest rate subsidies and leverage on-loans;
- Project preparation and study funds;
- Technical assistance;
- Project grants – For the Nam Theun II dam in Laos, AFD and PROPARCO financed the BOT with a EUR 60 million unsubsidised loan, while AFD allocated a EUR 5 million grant to the Laotian State to finance its equity investment in the operation;
- Support to equity investment;
- The loan guarantee fund.

A three-year programme is broken down into two "Programmes":

- Programme 110 includes interest rate subsidies for sovereign and non-sovereign subsidised loans;
- Programme 209 mainly includes envelopes for project grants and project preparation and study funds.

Detailed programming is conducted over a three-year period, project by project, with hypotheses on amounts and levels of subsidy or grant. Although various unforeseen events constantly modify the state of programming, three-year forecasting optimises the allocation of resources for blending grants and loans. Programming is determined by a matrix approach that compares geographical, sectoral and thematic priorities. A sequence of regular iterations enables an optimal balance between the envelopes available for blending grants and loans. The preparation of each project is used to guide the proportion of the loan/grant blend according to the microeconomic and financial principles described above.

DFIs aimed at private sector finance also use TA. Te Velde and Warner (2007) summarise this showing that use of TA by DFIs is fragmented into different pots by different institutions. A guiding principle behind blending in the EU context, is to join forces (development expertise) and resources (development finance) between the European Commission (EC), the Member States and the development financiers following the spirit of division of labour and complementarity in order to fulfil partner countries development needs in the most efficient manner.

Te Velde and Warner (2007) also describe a performance-based grants initiative (PBGI) for the grant co-financing of individual private-sector project under the Global Partnership for Output-Based Aid (GPOBA). The IFC had USD 365 million set aside for this purpose, as at end of 2006. Global Partnership on Output-Based Aid[2] (GPOBA) is a multi-donor trust facility to fund and demonstrate

[1] The situation varies greatly across regions. The Cotonou Agreement, for example, allows subsidised EIB operations in ACP countries but not other regions. As a rule, the EIB would do 'either or' but not combine ITF and Cotonou subsidies.
[2] Compiled from various documents sourced from GPOBA http://www.gpoba.org/gpoba/index.asp

output-based aid (OBA) approaches – the use of explicit performance-based user fee subsidies in the delivery of basic services (water, sanitation, electricity, telecommunications, transportation, health and education). Output based aid subsidies are fundamentally different from input/interest rate subsidies.

To illustrate the initiative, a subsidy was granted to support the Government of Laos PDR in the provision of safe drinking water to 21,500 households in 21 district towns using local/regional private operators. The purpose of the output-based subsidy is to reduce the required investment costs that will need to be recovered directly from poor users through connection fees or through the tariff, thereby giving greater access to water services to the poor.[3]

There is also the possibility of blending alongside blending by existing EU blending facilities, including in their own institutions such as the EIB. For example, in accordance with the terms of the Cotonou Partnership Agreement, Investment Facility (IF) operations and own resources (OR) loans can benefit from an interest rate subsidy[4] in order to increase their concessionality under certain specific conditions.

Under the IF, interest rate subsidies are common in the case of sovereign and public sector loans to HIPC countries because they need to meet conditionality requirements. There can be interest rate subsidies of up to 3% (Art. 2(7) b) for infrastructure and other projects with social/environmental benefits. The European Commission's guarantee to the EIB generated about EUR 28 billion of lending with a financial leverage of 20 (EIB 2009). The 20:1 ratio relates to the amount of EIB's guaranteed loans and the provisioning by the EU budget of the Guarantee Fund supporting the EU guarantee.

[3] GPOBA project profiles http://www.gpoba.org/activities/details.asp?id=55

[4] Limited to maximum EUR 400 million over a five-year period 2008-2013, of which a maximum of 10% can be allocated to technical assistance.

3 Loans and grants: a brief overview of the technical literature

3.1 Introduction

A key issue in development assistance is how to use scarce financial resources in the most efficient way. Efficient use of funds can depend on various factors such as sector, institutional and policy environment, but also the type of instrument. Historical trends reveal loans as the dominant aid instrument up to the 1980s. The subsequent debt crisis in developing countries called into question their use to finance development. As a result, there was a general shift from loans to grants, and a debate on the relative merits of loans and grants in development finance followed.

Table 2 summarises the advantages and potential disadvantages of using grants or loans (which may be concessional) from a macroeconomic, strategic/institutional/political, financial and operational project perspective.

Table 2: Grants versus loans

	GRANTS		**LOANS**	
	PROS	*CONS*	*PROS*	*CONS*
Economic criteria	• No inherent debt sustainability risk.	• Can lead to a decline in domestic revenues in low capacity recipient countries. • Can lead to market distortions.	• Generally associated with higher fiscal revenues, lower public consumption, and higher investment rates in recipient countries.	• Debt sustainability risk. • Could lead to market distortions (e.g. bias on the choice of projects and technologies) even though smaller than those created by grants.
Strategic/Institutional/ Political criteria	• Ability to fund projects with significant positive externalities which however are not financially viable.	• Moral hazard issues.	• Can contribute to improve debt management capabilities in recipient countries. • Can increase partner ownership and support demand driven co-operation	
Financial criteria	• Are more predictable in the short-term and for small volumes of aid. • More transparent (e.g. accounting of outright grants is more straightforward than for concessional loans where the calculation of the grant element can be subject to different interpretations and	• Subject to tying practices.	• Flexibility to specific project needs. • Can provide larger volume of funding and over long-term periods.	• Disbursements are subject to initial conditions that may prove difficult to achieve thus delaying disbursements and impacting predictability. • Higher degree of complexity.

	mislead recipients on benefits received),although in practice grant allocation can also be unclear.			
Operational Criteria		• Weak donor's monitoring and control once grant has been disbursed.		

Source: Adapted from Baudienville et al. (2009).

As a result of the recent global financial and economic crises, development financing resources have become even more constrained when some private sector resources have dried up and government budgets are under pressure. Furthermore, the economic crisis, climate change and other global challenges have dramatically increased the financing needs within the developing world. Therefore, there is a need to find new alternatives to increase the volume of development financing made available without worsening debt sustainability.

Towards the end of 2008, the EU recognised the importance of blending mechanisms: *[…] blending becomes one of the answers for the future in meeting global development challenges. […] They show great promise, as tools to increase the leverage and visibility of EU external assistance and promote cooperation among bilateral and multilateral finance institutions*" (Piebalgs 2010); "*[…] blending of grants and loans is an effective way to maximise political and financial leverage and support EU policy objectives outside the EU*" (EIB 2010).

Below we analyse the advantages of blending mechanisms as opposed to pure grants and pure loans, and we shed light on the economic gains obtained so far by using blending mechanisms. More details are available in Annexes 1, 3 and 4.

3.2 Economic gains of blending instruments

This section reviews the strengths of using blending mechanisms rather than pure grants or pure loans to deliver aid and achieve development goals. The analysis takes the perspective of both recipient countries and EU donors/lenders. The merits of blending are assessed against a set of criteria identified on the basis of existing documentation (see, among the others, EIB 2009, and European Commission 2009) and which can be classified into four broad categories:

- Economic criteria;
- Strategic, institutional and political criteria
- Financial criteria;
- Operational criteria.

Economic criteria support the analysis of the impact of blending mechanisms on recipient countries' macroeconomic aggregates and on the allocation of resources across countries and projects. Strategic and political criteria are used to review the influence of blending loans and grants over a number of political aspects in recipient and donor countries. Financial criteria guide the assessment of blending efficiency in terms of costs, financial leverage and adaptability to specific funding needs.

Operational criteria help improve understanding of the impact of blending on the efficiency and effectiveness of fund management from a recipient country and donor perspective. Table 3 assesses the benefits (and potential shortages) of blending as opposed to pure grants or pure loans (non-concessional), against the criteria. More details are available in Annex 1.

Table 3: Assessing Blending vs. Pure Loans and Pure Grants

	BLENDING vs. PURE LOANS		**BLENDING vs. PURE GRANTS**	
	PROS	*CONS*	*PROS*	*CONS*
Economic criteria	• Contribute to solve the issue of debt sustainability in heavily indebted countries.	• Market distortions.	• Can mitigate the fiscal side effects of pure grants.	• Reduced debt sustainability • Risk of financial principles outweighing development policy principles
Strategic/Political criteria	• Can finance projects with significant positive externalities but not financial sustainable, as well as solve the issue of negative externalities associated to a given project. • Policy leverage especially in middle-income countries and emerging markets. • Can enhance EU visibilities.	• Loss of visibility of individual donors, because blending occurs at EU level.	• Policy leverage, especially in low-income countries at the country sector and project levels. • Can enhance EU visibility.	• Loss of visibility of individual donors, because blending occurs at EU level.
Financial criteria	• Financial leverage through risk mitigation. • Can offer more flexibility with regards to disbursement conditions, initial costs or project speed.	• Potential transparency issues. Risk of imprudence in recipient countries. • Cannot eliminate risks but just transfer them to the EU.	• Financial leverage, especially in low-income countries. • Can offer more flexibility in adapting the volumes of funds to specific projects needs than pure grants.	• Potential transparency issues.
Operational Criteria	• Can allow speeding up projects. Can enhance project quality. • Can enhance coordination between donors and lenders. • Can allow for knowledge transfer and demonstration effect.	• Loss of control of individual donor. • Potential slowdown of decision-making.	• Can provide greater incentives than pure grants for donors to monitor funded project. • Give donors access to project management expertise of lenders. • Can enhance coordination between donors and lenders. Demonstration effect. • Can allow risk sharing	• Loss of control of individual donor. • Potential slowdown of decision-making.

			and mitigation	

Source: Author's elaboration on different sources.

The use of grants in blending mechanisms provides financial leverage through a mobilising effect and broader risk-sharing. For example, in 2009, the EUR 99.7 million of grants provided through the Neighbourhood Investment Facility (NIF) attracted a contribution from the European Finance Institutions of about EUR 2.5 billion (NIF Annual Report 2010). Also, in Eastern Africa, the blending of loans with TA grants made possible the construction and operation of the 10,000 kilometre East Africa Submarine Cable that would not have happened without blending (EIB 2009)[5].

Moreover, compared to pure loans, blending mechanisms can promote investment with positive externalities and help mitigate negative externalities associated with a specific project. Blending mechanisms may be used to finance projects with high social and/or environmental impact (positive externality) but which are not financially sustainable. The grant element compensates for the insufficient financial return (at least in the short-term) until the project becomes sustainable. Blending mechanisms also consent to use the grant element to bear any additional cost needed to solve the issue of negative externalities associated with a given project. For example, the construction of a dam could have a negative impact on the surrounding environment and communities. Blending mechanisms, through the grant component, may provide an incentive for the recipient to sustain the costs needed to make the project more environmentally friendly and to reduce the adverse impacts on society. For example, in Egypt blending loans with EUR 10 million TA grant allowed the construction of a wind farm of up to 200MW to produce environmentally sound power thus reducing CO2 emissions (EIB 2009). In Barbados, a EUR 1.965 million IRS and a EUR 63,000 grant ensured an economically viable project to construct a wind farm of 9.4MW more environmentally friendly (EIB 2009).

Finally, compared to pure loans, blending mechanisms allow for the acceleration of a project. Grants may accelerate a solution to the challenges of the project's financial sustainability and the need for TA involved in a smoother project preparation or adequate capacity building. There is evidence that grants provided through the former Instrument for Structural Policies for Pre-Accession countries (ISPA) led to the speeding up of the schedule of compliance to the '*acquis communautaire'* by accession countries.

3.3 Concluding remarks

Blending mechanisms are a response to the need to increase the volume of development financing in a context of constrained resources.

[5] For more examples, we refer the interested reader to the selected case studies in Annex 1 of EIB (2009).

Compared to pure loans blending mechanisms allow:

- Making transfers to heavily indebted countries without exacerbating debt overhang problems; (although in practice most of the grants go to projects in the form of technical assistance and hence the grant element tends to be low in the facilities we examined, with a few exceptions);
- Addressing positive externalities to bring the financial rate of return closer to the economic rate of return for projects with a high socio-economic and/or positive environmental impact;
- Improving the quality of funded projects (in practice the grant component also allows projects to be funded which otherwise recipients are unable to finance, in addition to improving the quality of projects compared to a no grant situation);
- Strengthening ownership as compared to pure loans by funding measures which also build on recipient countries' policies; and to which the partner provides their own resources;
- Enhancing EU visibility, and supporting the division of labour by strengthening coordination between EU donors and lenders.

Nevertheless, the literature also suggests that in order to guarantee an efficient allocation and implementation of blending mechanisms, it is important:

- To reduce the complexity of blending mechanisms as much as possible, by for example, clearly assigning responsibilities (accountability), in order to avoid compromised transparency issues;
- To carefully assess the impact that mixing a loan element with a grant element could have on a recipient country in order to avoid crowding-out other potential sources of funding;
- To cautiously define the percentage of the grant element in order to deter recipient countries from borrowing beyond prudence levels;
- To reach an agreement among aid actors on requirements and steps needed to provide funds in order to avoid slowing-down decision-making processes;
- To provide the right incentives to individual donor countries to participate into blending schemes by guaranteeing them enough visibility;
- To ensure development policy objectives and principles drive the allocation of public funds.

4 A review of existing blending facilities

This section reviews five existing EU blending facilities:

- The Neighbourhood Investment Facility (NIF);
- The Western Balkans Investment Framework (WBIF);
- The EU–Africa Infrastructure Trust Fund (ITF);
- The Latin America Investment Facility (LAIF);
- The Investment Facility for Central Asia (IFCA).

The Facility for Euro-Mediterranean Investment and Partnership Trust Fund (FEMIP TF), which is managed by the EIB, is also included for comparison whilst recognising that it has significantly different features in terms of governance, scope and instruments to the other facilities.

The primary aim is to highlight key areas of current practice in terms of funding, operation and governance that can help to inform a future governance platform. The remainder of this section examines further details. This comparison of the facilities draws on publically available documentation and a series of interviews with key stakeholders.

4.1 Coverage

All the facilities have been operating in their current form since 2007 at the earliest, except for the FEMIP TF (operational since 2005). LAIF and IFCA only started operating in 2010. As a result of this and the long gestation periods for infrastructure investments, data and evidence on outcomes/impacts is sparse. There have not been any significant evaluations of the facilities but some implicit evaluation is expected in the next evaluation of EU external instruments. At the project level, the evaluations are done by the implementing IFI rather than the facility. Private partners are not required to participate in public evaluations.

Each facility covers a specific region and although the NIF and FEMIP TF overlap geographically, measures are in place to ensure their complementarity. For example, there appear to be informal arrangements not to 'step on each other's toes' (e.g. the NIF does not supply Risk Capital in the Southern Mediterranean where the FEMIP TF does).

The facilities have similar sector lists with various combinations of: transport, energy, environment, social and telecoms (all for relevant infrastructure) depending on the region. In addition, several (notably not the ITF) also have a SME based private sector target.

Table 4: Value and sources of grant funding (million Euros)

	Total	EU Budget	MS incl. EC	EU MFIs
NIF	754 (2007-13)	700	54	
WBIF	145	110	5	10 each from EIB, EBRD, CEB
FEMIP TF	34		34	
ITF	399.7 (2010)	308.7 (EDF)	80 (2010, excl. the EC)	11 from MS
IFCA	20 (2010)	20		
LAIF	146 (2010-13)	146		

Source: Annual reports of facilities, publically available documentation and consultations.

4.2 Internal structure of funding, pooling and earmarking

Most of the facilities have similar internal structures partly as a result of ongoing harmonisation efforts (e.g. of meeting calendars) and the deliberate creation of new facilities such as the LAIF and the IFCA in the mould of the NIF. One significant variation is the number of different 'pots' grant funds are held in. Where there is more than one 'pot' the most common arrangement is a separation of the EU Budget funds from direct and additional Member State and EU Budget funds channelled through the European Commission contributions to a separate trust fund (the WBIF has five parallel 'pots').

Blended grant funds may co-exist with several other financing streams within a single financing package in addition to funds from the bilateral and multilateral DFIs, beneficiary funds and those of private partners. Only the ITF maintains a single pool for all grant funding. Earmarking of funds (except between regions in the NIF) is not allowed.

4.3 Eligible/Participating Financial Institutions

As a general rule, all European development finance institutions are eligible to participate in blending facilities. Non-EU development banks, notably regional development banks and the World Bank, can co-finance projects already supported by the European DFIs and blending facilities. However, development finance institutions like PROPARCO and FMO, which focus solely on the private sector, can only participate alongside a European DFI. Beneficiary governments provide substantial co-financing but the position on non-EU private financing is unclear.

4.4 Financial instruments used

The potential range of blending instruments is varied and includes:

- Technical Assistance;
- Feasibility studies;
- Investment co-financing;
- Equity participation;

- Risk-capital;
- Interest rate subsidies;
- On-lending;
- Guarantees;
- Insurance subsidies, and
- Incentive payments.

TA and feasibility studies provide for the largest number of projects. For the remainder of projects, the NIF has one risk capital project; the WBIF occasionally uses credit lines, bond purchase and guarantees; the FEMIP TF has two private equity operations and one seminar series; and, eight ITF projects are interest rate subsidies (see Annex 2).

4.5 Current project, sectors and partner types

The facilities mostly specialise in large-scale infrastructure investments and excepting the ITF, alongside SME support. They all cover similar, broadly defined, sectors i.e. transport, energy, social, environment and finance for SMEs. Partners in the beneficiary country can be public, private or mixed with public partners being the majority of the current projects aside from in projects focussed on SME support.

4.6 The grant share of blended finance

Annex 2 contains a detailed list of approved projects and lists the financial value of the projects, the value of the contributions by the European project financiers and the value of the facility grant. Table 5 provides the average grant as a share of the total project value and also as a share of the value of all DFI loans for both the NIF and the ITF. It is important to recognise that these aggregate ratios are based on small samples and conceal significant variation in the project specific factors which drive the different grant and loan allocations. Any strong inference drawn from these ratios must therefore take into account the different project and country contexts of the individual projects and facilities, if it is to be used as more than a rough indication.

For the NIF and the ITF, we compare the average grant share of the total project value and also of the total DFI funds value. Most stakeholders considered the latter to be a better comparator. The NIF and ITF internal documents tend to focus on grant to loan leverage ratios.[6] Average grant share can differ for many reasons, but ceteris paribus, we would expect the ITF to have a higher grant share compared to the NIF based on the income of the beneficiary countries covered.

Contrary to expectations based on recipient country incomes, the calculations suggest that across all projects including TA projects, the grant share for the ITF and the NIF are similar when using the total project finance value (2.30% in the NIF vs. 2.28% in the ITF), although it is higher in the ITF than in the

[6] Both of these concepts (grant share and grant to loan leverage ratio) differ from the traditional concept of 'grant element'. The grant element concept identifies the concessionality of the loan element of a project as a result of the financial terms of the loan, for example, interest rate, maturity (interval to final repayment) and grace period (interval to first repayment of capital). A typical calculation of the grant element can be found on the IMF website: http://www.imf.org/external/np/pdr/conc/calculator/default.aspx. In contrast, grant shares and grant to loan leverage ratios identify the balance (in terms of funding) between grants and loans in blended projects. They do not take into account the concessionality of the loan.

NIF when considering the share as % of total DFI value. The main reason why the average share of the ITF is not higher than in the NIF is because there are a number of large projects which have a small grant share (e.g. hydro power in Ethiopia/Mozambique), and because these projects do not have any DFI value data, they do not appear in the second set of calculations. It is worth highlighting that the grant share in ITF TA projects is very low whilst the grant share in other ITF projects is higher than in the NIF and this effect can be seen in the rows 'other projects' which give data excluding TA projects. We should further emphasise that loans provided by the DFIs already have different levels of concessionality before the addition of further grants by the blending facilities.

Table 5: Average grant share in EU blending facilities

As % of total project finance value	NIF	ITF
Weighted by value of project – i.e. the 'average' project		
All projects	2.30%	2.28%
Technical assistance projects	1.2%	0.5%
Other projects	3.4%	9.0%
Unweighted data – i.e. the 'typical' project		
All projects	10.3%	4.8%
Technical assistance projects	8.6%	2.3%
Other projects	11.7%	9.8%

As % of total DFI finance value	NIF	ITF
Weighted by value of project – i.e. the 'average' project		
All projects	5.2%	13.7%
Technical assistance projects	1.9%	5.0%
Other projects	8.9%	16.4%
Unweighted data – i.e. the 'typical' project		
All projects	15.3%	18.3%
Technical assistance projects	3.9%	15.5%
Other projects	21.9%	20.0%

Source: ITF and NIF secretariats. NIF: 35 projects over 2008-2010, ITF: 29 projects over 2008-2010. See Annex 2.

Stakeholders also suggested that a large amount of interest rate subsidies provided by the ITF[7] (EUR 75.5 million, i.e. 45% of total ITF grants approved to date) has been specifically designed to allow European Finance Institutions to meet the minimum concessionality requirements required by the IMF. On the contrary, only a small proportion of investment grants provided by the NIF (EUR 39 million, i.e. 15% of total NIF grants approved to date) are directly linked to debt concessionality

[7] For example, IRS for the Beira Corridor project; the Benin; Togo Power Rehabilitation project; the Felou Hydropower project, and the Rehabilitation of Great East Road, Zambia

requirements. They concern two countries of the Eastern Neighbourhood, Armenia and Moldova, which are bound by these constraints. The main part of investment grants provided under the NIF aim to address affordability issues.

4.7 Who submits project proposals?

The limited information obtained identifies some variation among the facilities in the formal role played by beneficiaries. For the NIF, and the ITF, only IFIs and members of the Financial Institutions Group (FIG)/Project Financiers Group (PFG) can submit project proposals. For example, this means that, in order to benefit from the NIF, a project has to be submitted by a European Public Finance Institution (EPFI) and recognised by the NIF Board as "eligible". Currently this comprises the EIB, the EBRD, the CEB, the Nordic Investment Bank, AFD, KfW, the Oesterreichische Entwicklungsbank AG, the Società Italiana per le Imprese all'Estero, or the Sociedade para o Financiamento do Desenvolvimento. The LAIF and IFCA also accept proposals from regional Finance Institutions in which EU Member States share part of the capital. However, for the FEMIP TF, beneficiaries may also submit proposals, similarly for the WBIF, but only when they do so with a partner IFI or via the National IPA Co-ordinator. The share of project proposals actually submitted as a result of these differences by beneficiaries or other non DFI actors is uncertain.

Informally, project beneficiaries (the countries where the project is being implemented) play a substantial role in combination with the DFI to identify and design projects. This is typical of the DFIs practice, very necessary given the large scale public works most of the projects comprise and reflects that beneficiary governments are often also co-financing the project. Beneficiary countries are typically also involved at the strategy group of the facilities and may be observers at other groups.

4.8 Who approves project proposals?

All the facilities have similar structures:

- A strategic body providing policy direction;
- A decision-making body deciding which projects should receive grants; and
- A group of financiers screening proposals and providing technical analysis before forwarding select proposals to the decision-making body.

There are differences in the membership of the groups. For the NIF, the LAIF and the IFCA, the European Commission chairs all three bodies. In the WBIF, the European Commission co-chairs the three bodies alongside the Member States. While the European Commission currently, but not necessarily, chairs the decision-making body in the ITF, the strategic body includes both beneficiaries and African organisations without restricting them to an observer role only. The European Commission is also not present at the working group of the ITF. Strategy in the FEMIP TF is provided by a Ministerial meeting (comprised of Euro-Mediterranean Finance Ministers) assisted by the FEMIP TF Committee (representatives of the EU Member States, the Mediterranean partner countries and the European Commission). Decisions on project proposals are taken by all donors to the FEMIP TF. Decisions are reportedly taken on the basis of consensus and where this is not achievable, in the NIF, the LAIF and the IFCA, standard EU voting rules apply except where the grant source is the Member

States trust fund. Little information is publically available about the working procedure in practice, hard criteria for awarding grant support or identifying failed project proposals.

Impact of NIF and ITF governance structures on project outcomes

The NIF and the ITF represent the two distinctive governance structures of EU blending facilities. In the NIF, the technical body (FIG) is chaired by the European Commission whereas in the ITF, the technical body (PFG) is generally chaired by the EIB although it has been chaired by KfW and AFD in the past. We asked stakeholders to consider the differences in terms of operational criteria. The following issues were suggested:

Principles

- The need for a fair arbiter (e.g. in the NIF, various project financiers may come together in complex projects) in order to avoid potential conflicts of interest between eligible Finance Institutions;
- The need to ensure a "policy driven" screening of grant requests based on EU regional policies and strategies and overarching EU development policy as enshrined in the European Consensus on Development.
- The need to keep a separation between the policy and technical aspects of the grant award process (to donors vs. DFIs in the ITF);
- The need for transparent and formal checks and balances on the proposals of project financiers at early stages beyond the checkboxes in the templates;
- The European Commission needs to be ultimately responsible for the spending of all EC aid (for auditing purposes).

In the ITF, the EIB generally chairs the technical body[8] and it has been suggested that it could be a challenge, therefore, for it to be both a fair arbiter as well as a source of funds and submitter of projects.

In the NIF, (and the LAIF and the IFCA) the European Commission chairs the technical group and it might be a challenge therefore to avoid political influence on a technical decision.

Practical differences

Consultations with stakeholders clarified that the ITF maintains one single pool of grant funds whereas the NIF maintains two pools, separating EU contributions from those of the Member States. This was seen as a possible outcome of the different governance structures.

Despite these differences and principles, there was no evidence to suggest that either situation was a significant issue. Both facilities were reported to be 'working well' despite possible improvements.

Consultations further suggested that the operational context might lead to different optimal governance models. Complex environments with several institutions (NIF) need an honest broker. The need for the European Commission to chair is of less practical use when dealing with specific activities (ITF) restricted to specific types of regional infrastructure projects or national infrastructure

[8] KfW, AFD and OeDB have also shared the chair.

projects contributing to regional integration, or in the context of the multi-annual framework of the EDF's financial commitments, which makes budgetary trade-offs less critical, contrary to blending facilities financed by the EU budget on an annual basis. These requirements have to be weighed against the need for highly technical expertise regarding the technical decisions taken at the project financier's groups.

The consultations were not able to outline any specific operational differences in outcomes as a result of different internal governance arrangements, however, the EIB report that these have emerged and have motivated the EIB withdrawal from the LAIF.

We do, however, question the lack of formal checks and balances in the process at an early stage – consultations suggested that the project template would be discussed before filling it out without the need for extensive discussions on the project proposal. It is also important to create space for high level discussions between the DFIs and the grant providers about projects and project areas.

In conclusion, whilst the principles or the evidence do not favour one approach over another (e.g. should DG DEVCO in the European Commission or the EIB chair the project financiers group), interviews suggested that there was a clear perception that the chair of the group mattered for which projects were being considered for blending. There are two ways to resolve this. Either the chair uses a transparent and objectively measured way for deciding which project will be considered for blending (e.g. the minutes of the meeting could be made public), or a third party would be brought in to chair the project financiers group. One third party might be DG ECFIN which has oversight of the EIB in general.

4.9 Project eligibility criteria

Beyond the targeted sectors, all the facilities have broad stated objectives for example:

> *"Promoting equitable socio economic development and job creation through the support for small and medium size enterprise and the social sector."*

and:

> *"To provide greater coherence and better coordination among the donors."*

These objectives represent aims and/or statements of potential value added to be achieved. Amongst these is often (but not always) mention of supporting the European Neighbourhood Policy (ENP), the Joint EU-Africa Partnership Strategy for the ITF or in the case of the LAIF, set by joint EU-LAC Declarations, for IFCA the EU Strategy for Central Asia and FEMIP TF policy priorities and UfM initiatives identified as priorities in the Joint Declaration of the Paris Summit of July 2008 respectively. FEMIP TF reportedly has 80% goal alignment with UfM priorities. Most also include supporting EU linked businesses as a priority which arguably contradicts Member States' commitments on untied aid. The role of beneficiaries in setting strategic priorities is also not clear beyond their involvement in the production of Country Strategy Papers and participation in some of the strategic boards. Beyond these broad statements there is little formal information available as to how specific choices are made as to which projects to support[9].

[9] The study has seen further information for the ITF including requirements for projects to be regional in nature, to fulfill some development objectives e.g. supporting MDG attainment and that social/environmental issues have been considered.

Table 6: Project approval and eligibility

	NIF/LAIF/IFCA	ITF	WBIF
EC present at technical body	Yes (Chair)	No (no formal Chair, rotating basis, typically EIB chair)	Yes, Chair alongside MS
Strategy provision	EC, MS	EC, MS	EC, MS
Project eligibility/priority	EU ENP/EU-LAC/ EU-CAS	Africa Partnership/ Joint EU-Africa Strategy – cross-border and regional infrastructure	Beneficiaries

Source: Annual reports and public documentation

4.10 Do the facilities use a set of criteria of when to use grants or loans?

This lack of formal and specific guidelines or criteria also applies to the grant share decision. The closest publically available document is the final report of the 'Working Group on the Additionality of Grants in the Framework of Blending Mechanisms' published in 2009 (European Commission, 2009), which includes a set of key parameters to guide the grant share decision and a template. Several facilities also have similar templates but again, their role, the extent (and stage in the process) where they are discussed and decisions are made as to the suitability of, for example, grant shares and instruments is not clear. As such it is hard to identify whether they are an effective decision-making tool. They also lack transparency as the data they contain is also not made public. For an example see Annex 7.

Knowledge about 'appropriate' grant shares gained from experience with former project proposals and also experience of loan packages outside the blending facilities lies within the financiers groups and the individual development banks. The grant share decision also depends, to a large extent, on the type of project. For TA, and for subsidies driven by considerations of debt sustainability, the amount of the subsidy is well-defined (for example, by the international agreements on debt sustainability or knowledge of similar TA studies carried out). However, regarding the remaining project-specific grant share decisions, there is considerable room for judgement in blending decisions.

Within the facilities, the size and form of the grant component is currently suggested by the DFIs who design the project and moderated by the acceptance or refusal of applications put to the decision-making body of the facility. The role of eligibility criteria from the strategic body in influencing this choice is unclear (see Annex 5 for an example set of criteria). However, this may be because the imposition of strict guidelines is impractical and can potentially produce counter-intuitive effects. For example, a thematic edict to support renewables which anticipated more grant support being needed in low income countries may have to contend with the majority of likely applications being

However, it is not clear how much such an eligibility list is enforced and whether it is specific enough to determine allocation of grant funds between competing projects. Stakeholders suggested that the eligibility criteria have been recently reviewed and adopted by the Executive Committee through a unanimous decision. Decisions of the Executive Committee consider the criteria with evidence in the projects that are/were not approved or needed to be submitted.

from middle income countries and therefore middle income countries receiving a higher share of grants a result.

4.11 Efficiency and effectiveness of blending

The theoretical literature outlined in section 2 is able to provide a rationale for various situations where grants and loans have specific advantages and disadvantages as aid instruments. In the current blending facilities (excluding TA/feasibility studies and IRS for the sole purpose of meeting IMF criteria on debt sustainability, which will be discussed later), the key area for analysis is whether blending (adding small grants to large loans) is effective and efficient compared to loan finance only.

The economic and financial criteria are fairly clear, blending i.e. grant components do not lead to increased indebtedness for beneficiaries and can be used to leverage additional loan resources. On this basis for example, the appropriate size of the grant component would depend on the level of indebtedness of the beneficiary and its ability to repay and the facilities could be compared in their effectiveness and efficiency by how closely their projects track a theoretical standard (e.g. compliance with the debt sustainability framework). Similarly, the effectiveness and efficiency of blending on the leverage component could be assessed across the different facilities by comparing the ratio of non-grant funds leveraged. However, aside from the fact that these two objectives almost certainly run counter to each-other, neither of these approaches is feasible as neither takes into account the many country and project specificities that also govern the share of grants that should be awarded in each package.

For example, theory suggests that an effective and efficient blending instrument should involve lower grant shares in countries with higher incomes (other things being equal). However, based on the current projects, the grant share appears not to be lower in the NIF than in the ITF contravening this principle (and even slightly higher). In reality, an assessment of the average grant share of the facilities somewhat disguises the individual partner countries' needs addressed with an individual project. Furthermore, it gives a limited overview of the total concessionary level as the loans by the DFIs are also concessionary. Unfortunately, ceteris paribus does not hold for the individual countries' credit ratings, the specific needs of the sector for up-front costs, whether the project is income earning, the size of the project, whether the beneficiary is private or public and many other factors including the operational grant share required by the specific blending instrument which differs between for example IRS, TA/feasibility studies, risk capital, on-lending etc.

Given the difficulty in deciding the appropriateness of the grant element, an alternative is to allow the grant share to continue to be determined by the project financiers on a case by case basis with their more detailed knowledge of the project and to rely on their motivations/incentives to ensure 'bankability' – that the grant awarded is the difference between the economic and financial rates of return for a project and the experience of the operational body to ensure that no more is given as grants than is needed. Clearly, the Member States and European Commission rely on this expertise heavily in the operation of the facilities.

Alternative means of assessing the effectiveness and efficiency of blending across the different facilities can be sought and this is suggested by many of the participants. Given the importance in

this assessment of the operational and strategic practices governing project implementation of the facilities these practices (such as harmonisation of audit procedures) can be assessed and the resulting principles fit much more closely with what the facilities appear to regard as their 'value added' – this also involves considering the effectiveness and efficiency benefits of the 'package' of blending rather than just the advantages and disadvantages of the separate components.

Flexibility, increased speed of disbursement, leveraging of knowledge and knowledge transfer to the beneficiary, project quality, donor coordination, complementarity, reduction of inter-EU-actor transaction costs, increased visibility and the political leverage achieved can all be compared across the facilities. For example, one statistic from the NIF indicates that 85% of NIF projects involve at least three donors (including the European Commission) and this implementation of donor coordination, division of labour and work on practical harmonisation of procedures seems likely to be increasing the efficiency and the effectiveness of the facilities cooperation as well as its visibility, making the facility more effective and efficient from both the donor and beneficiary standpoint.

Efficiency and effectiveness could also be assessed across the facilities by investigating their adherence to the Aid Effectiveness principles of Paris/Accra: ownership, alignment, harmonisation, management for results and mutual accountability, in addition to untying aid, all relate to efficiency and effectiveness.

On this basis it might be worth considering whether TA/feasibility studies should be separated away from other types of blending as they are clearly different both in terms of applicable economic rationale and practice. The potential distortions of using TA/feasibility studies to solve specific knowledge shortfalls (downstream TA) in the implementing entity suggests that there may be benefits to facilities considering the use of TA/feasibility studies separately from the main grant subsidy decision. This is a reasonably common practice outside of the blending facilities and therefore has an independent rationale. Combined with the specific rationale for IRS support to meet IMF criteria, most of the discussion over grant sizes, instruments and value added of grants should be specifically directed to the subset of blending projects that lies outside these two exceptions.

The final report of the 'Working Group on the Additionality of Grants' provides a further analysis of the issues above (European Commission, 2009). The participants of the Working Group agreed that "there is no "one - size- fits - all" approach to blending"; that "LGB design needs to be tailored to the specific project objective that is being targeted" and that "uncertainty and measurement problems in project outcomes and impacts hamper the elaboration of precise and quantifiable ex-ante decision criteria".

Impact of blended finance: stakeholder views

Stakeholders were asked to comment on how blended projects financed through EU investment facilities may have made a difference in two respects:

- Whether or not the grant component has added value to the overall project;
- What the impact was of the grant component (e.g. jobs saved, carbon dioxide emissions saved, higher quality of the project; feasibility etc.).

The expectation was that stakeholders would answer whether or when blended finance delivers better outcomes compared to a loan alone. However, this it is not straightforward. The fact that there has been no evaluation to date of either the grant component or the blended project from the point of view of the EU facilities does not make the task easier. One stakeholder suggested that it is "too early to answer the question of effectiveness. Even for the ITF, which is the oldest blending facility, implementation of projects on the ground has only just begun. For many others, implementation has not yet begun. Furthermore, the evaluation of the results and impacts of the projects is the responsibility of the Lead Financier's institution.

Consultation with stakeholders suggested consideration of three views:

1) *Stated preferences on blending (differentiating TA from IRS)*. Some suggested TA is useful because the project financier has stated this is needed for the project to go ahead; grants possibly by means of IRS would be needed to achieve a certain level of concessionality. Whilst this is a clear idea, it is potentially difficult conceptually because there is no counterfactual against which this can be assessed (e.g. what would have happened if TA was not used? Or would the project have gone ahead if no IRS was available, or would the type of project have changed?).

2) *Outcomes of projects overall:* Others suggested that it is not helpful to think about the added value of grants, but rather to look at the effects of the projects overall. It was suggested that blending is useful because the projects that involve blending have had certain positive outcomes. This might be appealing in a general sense, however, this would not reveal any specific evidence on the role of blending (i.e. adding a grant) versus non-blended projects. For this reason we do not report overall project achievements as evidence for the specific effects of the grant component.

3) *Detailed impact assessment*: Ideally, information is obtained on the specific role and effects of grants in a blended project. But this information is scarce or not available. To date, there has not yet been any evaluation of blended finance.

Appendices 3 and 4 describe blended projects in the NIF and ITF. They mention the project, the type of blending support (TA, IRS), the contribution in relation to the project size and the expected added value. The added value for NIF projects was based on a yes/no answer to the following questions:
Does the project:

- Support higher risk activities for which access to finance is limited, such as: energy savings, energy efficiency, increasing renewable forms of energy production, and broadening access to energy services?
- Improve social services and social infrastructures?
- Help to reduce regional disparities in income per capita, to improve local development capacities and to increase access to services?
- Promote substantial social returns or global public goods returns and investments for countries with limited borrowing capacities? (The use of subsidies simply to increase the volume of lending to the Neighbourhood will be avoided.)
- Improve access to finance for micro, small and medium enterprises?

- Support the development of local capital markets?
- Support the development of a local labour market and improved opportunities for employment?
- Support environmental projects with cross-border effects?
- Leverage, as much as possible, important sectoral reforms in beneficiary countries in accordance with the ENP Action Plans?
- Seek to ensure donor harmonisation and complementarity of investments at national and regional level in the beneficiary countries?
- Promote sustainable socio-economic development, with a particular focus on pro-poor growth?

There is project specific advice in the project assessment sheets that are sent to the board's operational meeting. However, these tend to be general. The following statements are broad examples made in the project appraisal documents:

Added Value for Beneficiary

- The contribution from the NIF for a power generator and overhead lines consists of EUR 0.8 million technical assistance as part of a total project size of EUR 301 million. The expected value is that sustainable development and management of the energy production and distribution infrastructure should positively affect the social infrastructure, environment and market economy.
- Extension of the reach and quality of the transmission infrastructure in the beneficiary countries, thus creating a better environment for private sector investment and growth and, in turn, contributing to poverty alleviation. As HIPC countries, they are restricted in terms of the financing costs they can bear for their respective public sector investments; the ITF grant is therefore of great importance.
- It is a highly important project pertaining directly to the main priorities of intervention of the NIF. This operation will help the Beneficiary meeting its target of renewable energy resources. This will also enable the Beneficiary to cope with its increasing electricity demand.

Leverage and impact

- The amount of funding requested from the NIF consists of EUR 2 million for TA, for a total budget of EUR 33 million, which represents a favourable leverage ratio.
- The amount of funding requested from the NIF consists of EUR 10 million additional grant, for a total budget of EUR 340 million. At the request of the national government, the EC has also foreseen a grant intervention of EUR 20 million under the 2009-2010 programming. In total, the leverage ratio is favourable as the grant element represents +/- 8% of the total budget.
- The contribution from the ITF consists of EUR 12.25 million, for a total budget of EUR 73.2 million / leverage 6:1.

There are a number of conclusions from such ex ante project reviews:

- There seems to be no objective assessment of the size of the grant – it often uses terms such as “favourable” to describe the grant size without referring to a guiding framework;
- There is no data on jobs saved, carbon dioxide emissions saved, etc by project. Not ex-ante and not during execution;
- Some projects have not yet disbursed and are delayed;
- However, in HIPC countries it is clear that IRS is needed to achieve a minimum level of concessionality by the facilities’ financing packages.

Further information is available from the monitoring work by the ITF secretariat. The documents are not open to the public, so we discuss only some general issues. Some ITF grants are applied as interest rate subsidies. Grants channelled through loans to a HIPC country government for on-lending to the promoters requires that the project includes a minimum concessionality element of 35%. In one case, the ITF interest rate subsidy is up to EUR 9.3 million to the loan of EUR 33 million (although no disbursement had been made yet) would enable the three countries that are borrowers for the project to meet HIPC2 requirements, while contributing to strong regional development through the production of sustainable and clean power generation. The three borrowers would on-lend the loan amount. The grant obtained from the ITF would allow for: (i) a subsidised interest rate of 4.5% instead of a fully commercial rate (which is welcome at a time where the financial situation remains difficult); and (ii) the interest rate differential between 4.5% and 1.9% (which corresponds to the rate paid by the three states) to be used for rural electrification. In a further case the ITF Grant was used to subsidise the three loans. Each loan was for EUR 35 million and received a EUR 5 million subsidy. At loan signature, the three finance contracts stipulated that ITF grant shall be applied as a classical interest rate subsidy.

ITF grants have been used to finance studies and improve the quality of the project. ITF grants have been used to finance Feasibility Studies, Environmental and Social Impact Assessment (ESIA), a Resettlement Action Plan an Environmental and Social Management Plan, a line route study, audits, studies focusing on the institutional and financial framework; consultancy services to enhance the capacity to manage the expansion project through review of documentation, monitoring performance of the contractors and consultants and advising the Authority management on smooth project implementation to deliver the project; hiring of the core management team; and the management team’s costs during the construction phase of the project.

The consultations also revealed further information on the NIF. The main expected value added of the grant contributions approved to date (EUR 260.3 million) can be broken down as follows.

- Meeting concessionality constraints (e.g. investment grants in Armenia & Moldova): 15%
- Generating positive externalities and addressing affordability issues (investment grants in road and energy transportation networks and in social and environmental sectors[10]): 39%
- Development of the financial and private sector in the beneficiary country (risk capital operations & technical assistance to the financial sector): 24%
- Project acceleration and project quality (other technical assistance and studies): 22%

In practice, the overlaps between aims and externalities are hard to measure.

[10] Renewable energy, energy efficiency, water and sanitation, urban transport…

In conclusion, it is not straightforward to evaluate blended projects. This is because of methodological reasons (lack of counterfactual) and lack of specific data on: 1) the economic and social effects of the blended project; and 2) the exact contribution of the grant component. We do however have project descriptions of grants suggesting they are used to finance essential studies, improve the quality of the project and make up for the required level of concessionality. There is little quantitative evidence to back this up, though we have provided some pointers.

4.12 Fit with EU country strategies

The objectives of most facilities refer to EU priorities. Each blending facility is one of the instruments set up by the European Commission to support the EU policy, regional strategy and partnership in the targeted region and countries:

- The Neighbourhood Policy, the Eastern Partnership and the Euro-Mediterranean Partnership ("Union for the Mediterranean") for the NIF;
- The EU Pre-Accession Strategy for the Western Balkans for the WBIF;
- The EU Strategy for Africa and the EU-Africa Partnership on Infrastructure for the ITF;
- The EU regional strategy for Latin America and the EU-Latin America partnership ("Global Players in Partnership" for the LAIF;
- The EU regional strategy for Central Asia ("Strategy for a New Partnership with Central Asia") for the IFCA.

Potentially, projects awarded grants would reflect this if EU country strategies were reflected in the project eligibility criteria (the proposed template in Annex 6 asks a question on links to strategic questions, and NIF and ITF project proposals are assessed according to these). The ITF guidelines mention PRSPs but not as a strict criteria. However, there is little hard evidence for this due to the lack of transparency of the decision-making process and the multiple stages (projects rejected/withdrawn and then resubmitted with changes) and multiple criteria that have to be taken into account.

The European Commission might already be well placed on the strategic and operational boards of all the facilities to be able to channel priorities from EU country strategies. However the role of European Commission between representing the interests of the Member States that contribute to the EU budget and acting as an independent donor seeking to advance projects consistent with EU country strategy papers is unknown.

Most of those involved in the blending facilities suggested that projects need to be assessed on a case-by-case basis and the leading position of the supply side / project pipeline in this process questions the room for manoeuvre that is available to pursue very specific objectives from country strategy papers. It also seems worth recognising that country strategy papers themselves cover a wide range of priorities. This means that whilst it is possible to promote eligible projects, there is little scope for grants to steer loan financiers into certain very specific areas.

For the facilities and the IFIs involved, supporting EU country strategies are only one objective amongst many others. For example, the facilities role in leveraging additional funding for development has significant value in its own right.

Most facilities have ensured that resources from the European Commission and bilateral agencies have been pooled leading to increased scale and visibility. The pooling of resources brings up the question on the different methods for using either national or community resources (AFD, 2010). The current work on harmonising procedures should be helpful for the ultimate recipients (they deal with one set of procedures rather than many).

Finally, it is easy to imagine situations where priorities from EU country strategies conflict with other criteria both internal to the strategy and external. Employment objectives and environmental objectives can be in conflict and this reflects a situation where country strategies are less of an instruction manual and more of a shopping list.

4.13 Summary

- Grant shares are small - blending by the facilities consists of small grants packaged with large loans. The average share of grants in the total value of the project is 2.3% and it is actually slightly higher in the NIF than in the ITF (contrary to expectations based on country income levels). We should emphasise however that projects can have different levels of concessionality before the addition of further grants from the blending facilities. In addition, project financiers, like AFD or EIB also have access to own grant resources which they can use to change the level of concessionality.
- The grant share is 5.2% of the overall DFI finance value in the NIF, and 13.7% in ITF.
- There are some differences in the practices of the facilities but at this stage it is unclear whether these have a significant impact on their functioning at an operational level.
- It is unclear how grant funds are allocated due not only to the technical nature of the decision but also to the lack of transparency of how the formal procedure and governing criteria are applied - generally or on a case by case basis.
- There are several applicable concepts of efficiency and effectiveness in addition to those provided by the loan vs. grant literature. The merits of the current blending facilities are best when considered from a rich, multidimensional perspective. Paris principles especially on the supply side are an essential driver of blending in addition to mobilizing/leveraging resources.
- Technical assistance and feasibility studies are significantly different from other forms of grant element, for example, interest rate subsidies.
- It is not straightforward to evaluate blended projects because of methodological challenges and lack of specific data. However project descriptions of grants suggest they are used to finance essential studies, improve the quality of the project and make up for the required level of concessionality.
- The policy steer provided by EU country strategies is unclear in terms of its impacts on the project financing process beyond ticking boxes in a template (although the facilities have been set up to implement EU strategies for the regions).

5 The future of blending: pros and cons of governance options

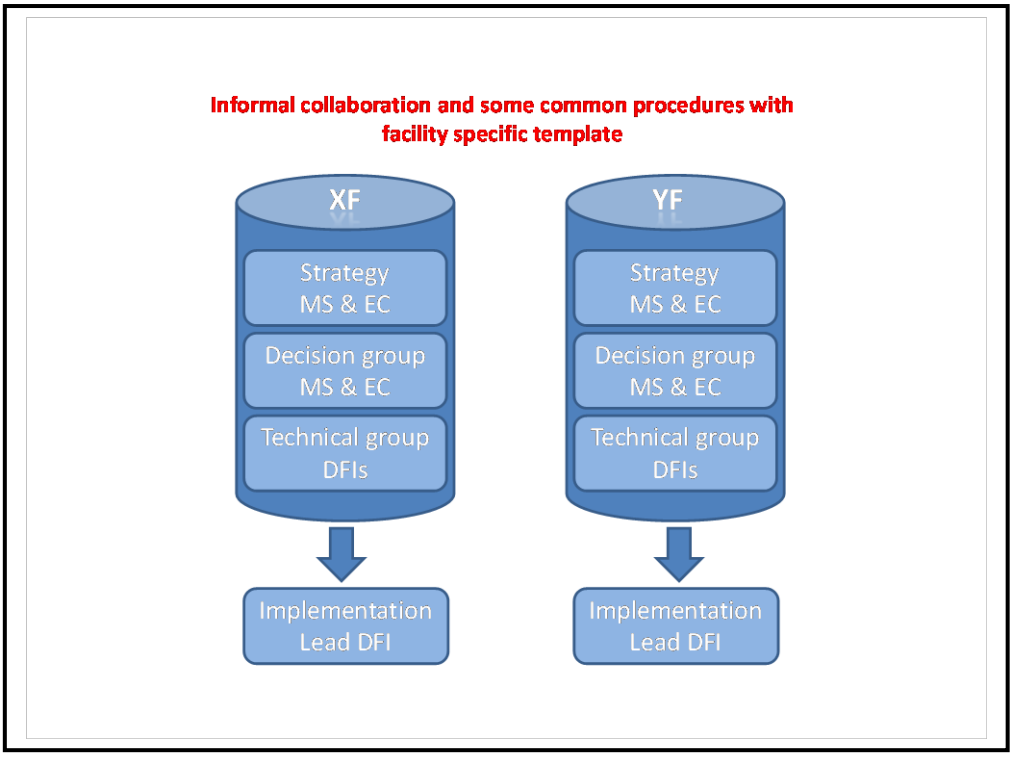
In the future, EU blending facilities may operate under a blending 'platform'. What are possible governance options for a platform and what are the pros and cons of each?

5.1 Possible governance options

We introduce five possible governance options:

The first option is 'business as usual' - the current situation. Figure 1 shows the typical internal structures of the facilities (Facility 'X' and Facility 'Y') and highlights the informal nature of collaboration and the existence of some common procedures. Project applications currently use facility specific templates (for an example see Annex 6), but they do not determine the grant share of blending.

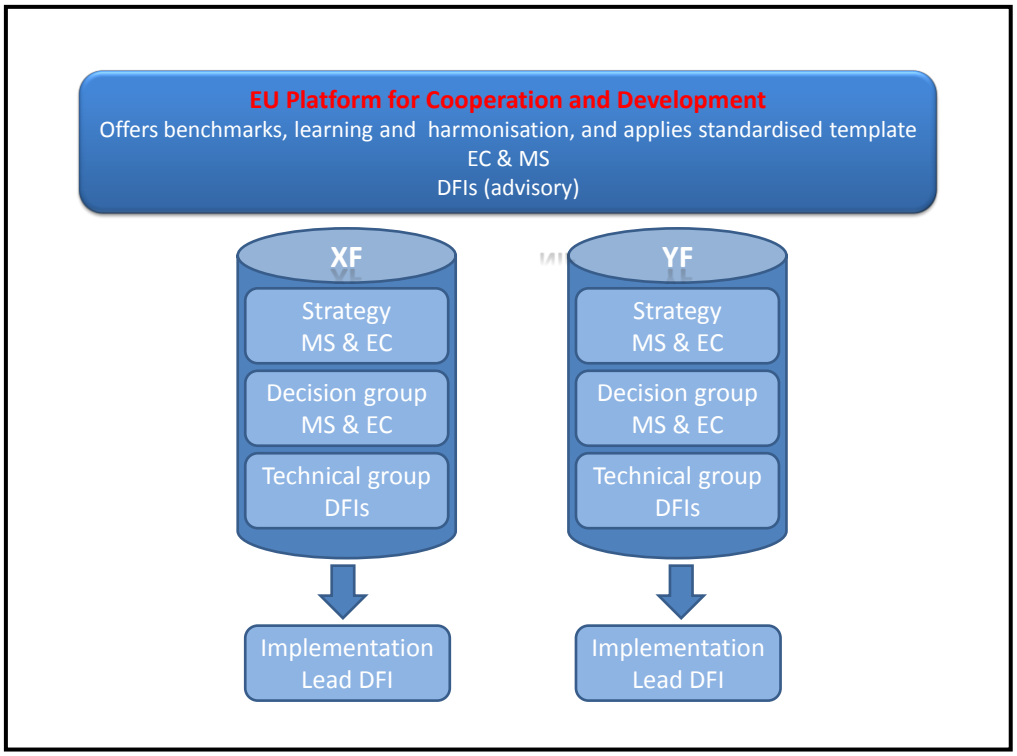
Figure 1: Option 1 – 'Business as usual …'



The second option, figure 2, is 'governance light' – where the EU platform for co-operation and development:

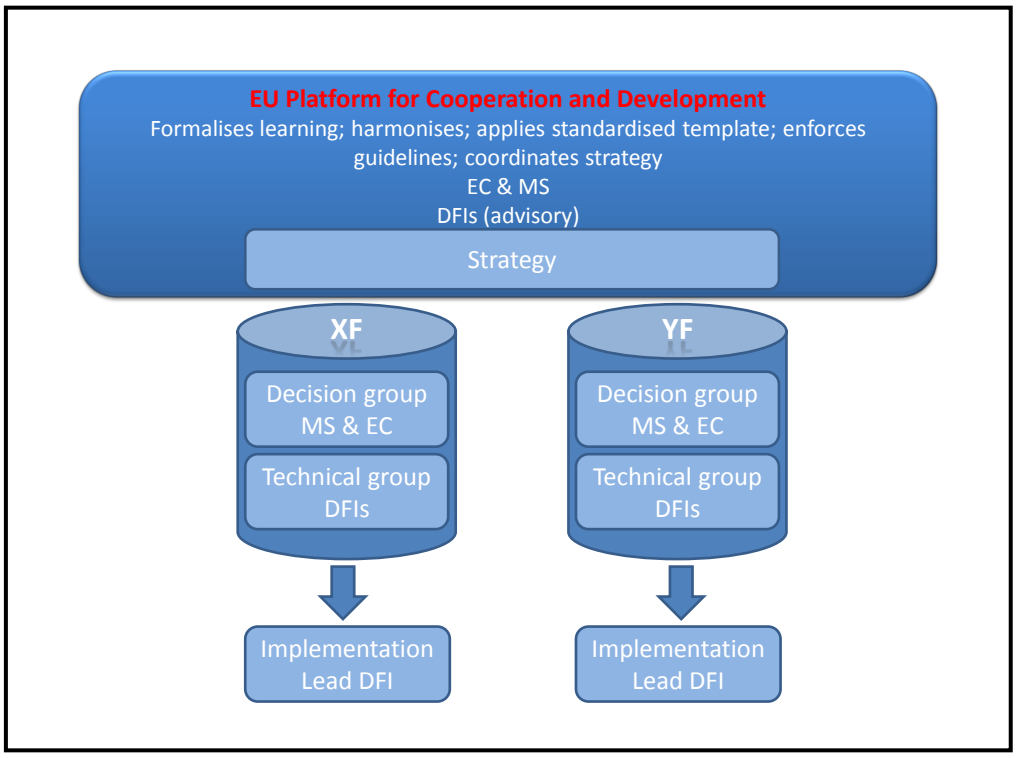
- Applies a standardised template for grant applications;
- Offers benchmarks for assessing and comparing grant values across facilities and brings out differences in blending according to these criteria;
- Offers learning possibilities;
- Promotes harmonisation more systematically than is currently the case (e.g. in environmental projects).

Figure 2: Option 2 – 'Governance Light'



The third option, figure 3, is 'governance medium', where the EU platform formalises learning and harmonisation, and applies a standardised template for grant applications. In addition, it now provides a globally coordinated strategy, taking over this role from the individual facilities, and enforces guidelines on the facilities which determine project areas eligible for grant funding. The individual facilities are still responsible for selecting which particular projects from their pipeline should receive funding and contribute towards the targets identified within the platform's strategy guidelines.

Figure 3: Option 3 – 'Governance Medium'



The fourth option, figure 4, is 'governance heavy'. This builds on option 3 by moving decision-making on individual projects into the platform. This allows the platform to have an overview of all projects submitted across the facilities and assess their comparative strengths and weaknesses. The platform is now responsible for allocating resources to specific projects on the basis of project, region and theme specific yardsticks. However, the technical work to prepare project applications is still done by the facilities. But the technical work assessing the project applications is moved towards the platform.

The fifth option, figure 5, is 'governance super heavy". This represents a scenario where all the facilities have been amalgamated into a single facility under the platform, covering all themes and regions. This single entity comprises a single strategy, a single grant application template and a single fund.

Figure 4: Option 4 – 'Governance Heavy'

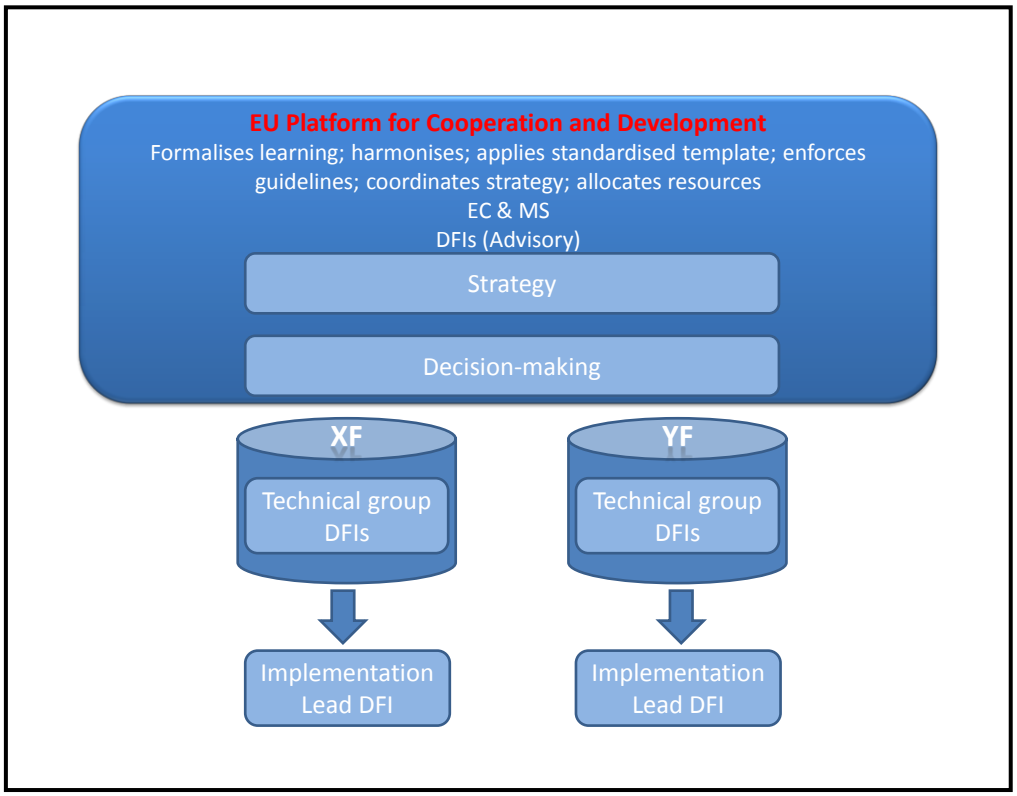
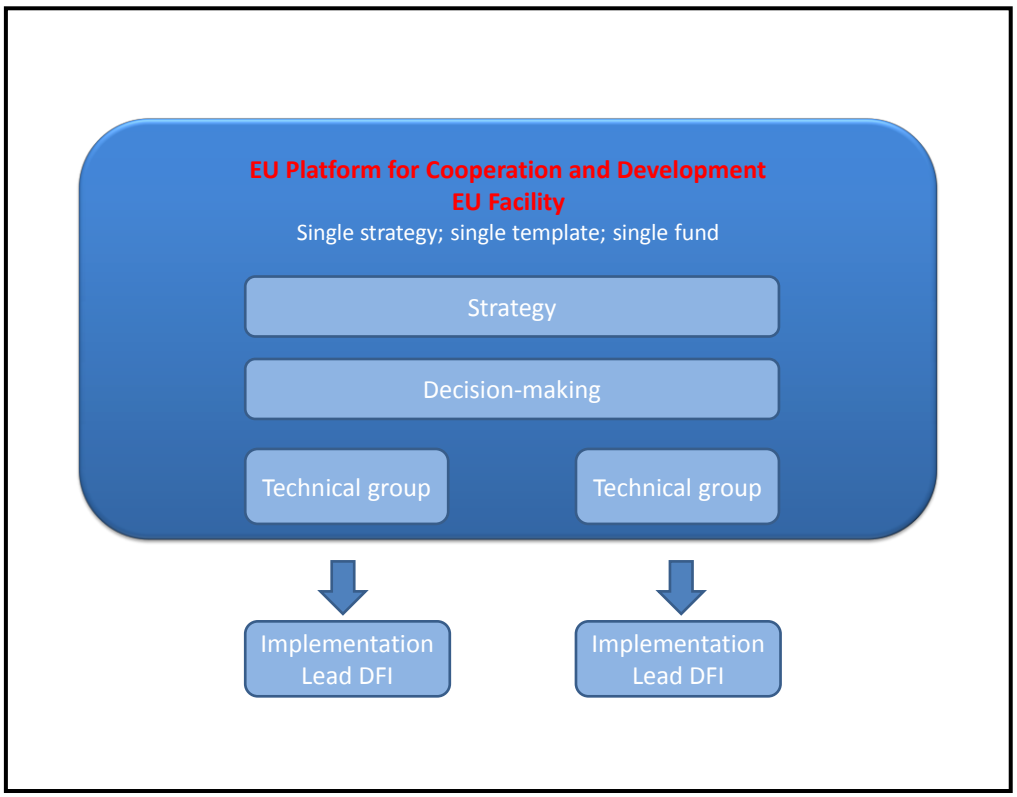


Figure 5: Option 5 – 'Governance Super Heavy'



5.2 Assessment criteria[11]

- Flexibility: can the level and nature of blending be discussed on a case by case basis (high) or are the same guidelines applied to each project and enforced (low)? The application of strict benchmarks restricts the grant share and the type of instrument that can be used and therefore flexibility is low. Conversely, where there are no restrictions imposed, flexibility is high.

- Sustainability: is the project likely to be economically viable (high) or is it likely to be market distorting (low)? When project financiers (i.e. the DFIs who need to be commercially / financially viable) lead the application of projects, it is more likely that projects are financially viable. When grant providers lead the allocation of projects, this is less clear and it is possible that financial sustainability could be compromised.

- Donor policy influence: to what extent can donors use to allocation of grants to support donor priorities including those from recipient countries and country strategy papers? There is a key difference between loan-led projects (where the project financier chooses a project) or grant-led projects (where the grant providers determine where projects are executed through affecting grant submissions). When grant providers identify projects, the likelihood of coherence with other policies is higher.

- Eligibility: does clarity exist on the nature of projects eligible for blending? Clear and detailed eligibility criteria imply consistent allocation of resources across facilities, themes and regions.

- Transparency: is the project assessed according to a set of fixed criteria? If the performance of a project against these criteria can be openly assessed[12] (e.g. the size of the grant given the project setting), this leads to high transparency.

- Harmonisation: do the blending facilities operate independently (by regional area and by theme) with different criteria (low) or do they operate as one with common criteria? Do they use common procedures for due diligence and the provision of finance which will reduce transaction costs etc? Whilst the current facilities have begun to adopt common approaches, further harmonisation seems possible and may be aided by roles performed in common.

- Visibility: is a bundled approach more visible compared to a fragmented approach? The current facilities remain fragmented by region. A platform allows for greater visibility. At the project level, visibility via the lead DFI is unchanged.

[11] Several other criteria, for example, the role of beneficiary countries, are also important factors when assessing the blending facilities. However, these are not significantly affected by the different governance structures, so are not included as direct criteria here.

[12] Annex 6 includes a guidance template used by the facilities. Many of the facilities use templates however, the extent of discussion that takes place over the contents and therefore how these templates actually guide decisions (e.g. on size of grant) is unclear. They are also not open access tools.

5.3 Scoring the five options on the basis of the assessment criteria

Table 7 presents, in very broad terms, possible values for these criteria as associated with the 5 options. Here we discuss the scores bringing out the differences between the various options.

- Flexibility: currently the level and nature of blending is discussed on a case by case basis (so that flexibility is high) but in the 'governance heavy' option the same guidelines are applied to assess each project and such guidelines are enforced (so that flexibility is low). The application of strict benchmarks restricts the grant share and the type of instrument that can be used reducing flexibility and potentially sustainability.

- Sustainability: When project financiers (i.e. the DFIs who need to be commercially / financially viable) lead the application of projects, it is more likely that projects are financially viable (this is the case in 'governance light' issues). When grant providers lead the allocation of projects, for example, according to some benchmarks and priorities (as in the 'governance heavy' option) financial sustainability could be compromised. The project financiers sometimes better understand the situation on the ground.

- Donor policy influence: the 'governance medium' and 'governance heavy' options allow for more donor influence because they could more easily steer donor support to specific geographical areas and themes. In the 'light' option the platform is a 'mirror' and can only reflect on facility strategies, When grant providers identify projects (together with recipient countries), the likelihood of coherence with other policies is higher. In the current situation, the projects depend in great part on the project proposals by the financiers (without the possibility of actively filling financing gaps in the strategy). The relationship between the 'platform' strategy and the policy steer from, for example, the EU Africa Partnership in the case of the ITF would need to be carefully considered.

- Eligibility: Clear and detailed eligibility criteria implying consistent allocation of resources across all facilities, themes and regions are features of 'governance medium' to 'governance heavy' platforms. Eligibility is based on a globally co-ordinated strategy. The option 'governance super heavy' would score low given that all decisions are taken by one body without any clear external checks and balances.

- Transparency: in the 'business as usual' platform option, there is little transparency on whether and how the projects are being assessed according to a set of fixed criteria and how their scores compare across projects. But even in the 'governance light' option, we suggest there is a database of information on how projects score against some benchmark (higher transparency). The option 'governance super heavy' would score low given that all decisions are taken by one body without any clear external checks and balances.

- Harmonisation: the current facilities have begun to adopt common approaches (but this is still at a low level). In the 'governance super heavy' option all procedures are harmonised.

- Visibility: blending is already visible in the current situation, but in the 'governance heavy' option it is easier to become more visible (e.g. easier to access significant resources as long

as it falls under the global strategy). It may be harder for beneficiaries to engage with a larger platform with a single strategy and which is geographically more diverse.

Table 7: Assessing governance options

	Business as usual	Governance light	Governance medium	Governance heavy	Governance super heavy
Flexibility	High	High	Medium	Low	Low
Clear Eligibility	Low	Low	High	High	Low
Sustainability	High	High	Medium	Low	Low
Transparency	Low	Medium	Medium	High	Low
Harmonisation	Medium	Medium	High	High	High
Visibility	Medium	Medium	High	High	High
Donor policy influence	Low	Low	Medium	High	High

5.4 Discussion

The designers of the future EU platform face a stark choice. Should the blending facilities remain a flexible vehicle for blending grants with a loan which is likely to leverage commercially viable projects but with few objective yardsticks to judge the appropriateness of the grant component? Or should there be a more centrally governed facility where the grant providers guide the financiers providing a more visible and coherent response from EU development policy but with fewer certainties about the number of commercially viable projects it could support?

Part of the discussion relates to the overall purpose of the blending facilities, the challenges they are trying to solve and the constraining factors, for example:

- Leveraging in the EU private sector;
- Competing with China which is supporting Chinese companies using loans and grants;
- Using grants more pro-actively (grants capturing loans);
- Creating a visible, transparent, blending platform fully accountable to taxpayers.

The first two points would favour a more flexible approach. The last two would favour a more tightly governed approach.

If we attached a value to the assessment in table 7 (e.g. High=3, Medium=2, Low=1), the options 'governance medium' and 'governance heavy' score highest if we treat all the principles equally. For example, given that our study suggests a lack of transparency about blending decisions (at least to outside observers), and if we therefore think that it is important to strengthen transparency (e.g. to clear up misgivings on the importance of the chair of the groups), the 'governance heavy' option is the most preferred option as it scores highest on transparency. In all cases however, transparency could be improved by publishing the interaction between the DFIs and the platform.

Along with transparency, harmonisation of practices and visibility were viewed as principles that had few negative effects. The 'medium' and 'heavy' governance models are suggested as being the most likely to optimise both harmonisation and visibility potential.

The remaining concepts are highly intertwined and maximising one generally involves trading off the potential to maximise another. Flexibility for DFIs and the sustainability of projects are thought to go hand-in-hand. Donor policy influence and clear (strict) eligibility criteria also were viewed as moving together. Together these two pairs of principles frame the debate on the potential and pitfalls of grants leading loans.

Stakeholders suggested that there was an important discussion to be had as to how finely donors could direct the sector and subsector that they wanted to support to ensure that blended projects supported donor strategies. If donors are too specific then there might be very low flexibility for DFIs to select projects which in turn may lead to the selection of less sustainable projects or an operating environment constrained by the lack of available projects. A key question to ask is: at what level does this occur? Opinions ranged widely on this issue as to where the balance lay – importantly there was little disagreement with the values of the principles themselves, for example, that grants should lead loans and the DFIs needed flexibility to select projects. If grants increasingly lead loans and flexibility is reduced at the level of the blending facilities then it will be important not to lose the knowledge available from DFIs in the policy planning process suggesting that DFIs should be increasingly involved in designing programmes before the grant allocation stages.

6 Conclusion

This paper has discussed the complementary use of grants and loans (blending) in the European Union's (EU) external assistance. The wise persons' report (the so-called "Camdessus" report), established in the framework of the mid-term review of the EIB's external mandate, suggested the creation of an "EU platform for cooperation and development". The Proposal for a Decision on the EIB external mandate (COM(2010) 174), which is under discussion, suggests that the European Commission should study the development of this platform. This proposal was taken up by the Member States in the Council's General Orientations on the revised EIB external lending mandate. The Member States envisaged the creation of an expert working group to study the creation of such a platform. Thus we consider the pros and cons of possible future governance options for such a platform.

Whilst blending has emerged rapidly and is now common practice in development finance, there is currently a limited evidence base on the effects of blending. Whilst a sizeable literature exists about the theoretical use of loans and grants, there is little on how it works in practice, which methodology or procedure work best and whether a certain governance model is more effective in reaching its objectives. With respect to the EU's existing blending facilities in particular, we face challenges because the majority have only been operational for less than three years.

Blending mechanisms, when adding grants to loans, aim to achieve a number of objectives, including the need to increase the volume of development finance in a context of constrained resources (although we have flagged up some possible disincentives to using the blending facilities as certain loans may not be counted as ODA). A literature review suggests that compared to pure loans blending mechanisms allow for:

- Making transfers to heavily indebted countries without exacerbating debt overhang problems; (although in practice most of the grants go to projects in the form of technical assistance and hence the grant element tends to be low in the facilities we examined, with a few exceptions);
- Addressing positive externalities to bring the financial rate of return closer to the economic rate of return for projects with a high socio-economic and/or positive environmental impact;
- Improving the quality of funded projects (in practice the grant component also allows projects to be funded which otherwise recipients are unable to finance, in addition to improving the quality of projects compared to a no grant situation);
- Strengthening ownership by funding measures which build on recipient countries' policies; and to which the partner provides their own resources;
- Enhancing EU visibility, and supporting the division of labour by strengthening coordination between EU donors and lenders.

We have reviewed five existing EU blending facilities:

- The Neighbourhood Investment Facility (NIF);
- The Western Balkans Investment Framework (WBIF);
- The EU–Africa Infrastructure Trust Fund (ITF);
- The Latin America Investment Facility (LAIF);
- The Investment Facility for Central Asia (IFCA).

Each blending facility is one of the instruments set up by the European Commission to support the EU policy, regional strategy and partnership in the targeted region and countries.

Each facility covers a specific region. The potential range of blending instruments includes: technical assistance (TA); feasibility studies; investment co-financing; equity participation; risk-capital; interest rate subsidies; on-lending; guarantees; insurance subsidies; and incentive payments. TA, feasibility studies and interest rate subsidies provide for the largest number of projects.

The facilities specialise in large-scale infrastructure investments alongside SME support. They all cover similar, broadly defined, sectors i.e. transport, energy, social, environment and finance for SMEs. Partners in the beneficiary country can be public, private or mixed with public partners forming the majority in the current projects aside from those focussed on SME support. Most projects are public sector projects. The ITF is restricted to the financing of regional infrastructure and, recently, national infrastructure contributing to regional integration. Moreover, the ITF does not provide financing for SMEs.

The publically available data on the NIF (neighbourhood countries) and ITF (African countries) show substantial variation in the value of the grant as a share of the total project value (see table 5 and annex 2). The average share of grants in the total value of the project is 2.3% and it is very slightly higher in the NIF than in the ITF. This is contrary to what one would expect if projects were allocated according to government capability to deal with debt (ITF countries tend to be poorer than NIF countries). We should further emphasise that projects often have different levels of concessionality in the DFI loans before further grants get blended in by the facilities. In addition, project financiers, like AFD or EIB, also have access to own grant resources which they can use to vary the level of concessionality. The grant share is 5.2% of the overall DFI finance value in the NIF, and 13.7% in the ITF.

For the NIF, and the ITF, only IFIs and members of the Financial Institutions Group (FIG)/Project Financiers Group (PFG) can submit project proposals; while the eligibility of other multilateral finance institutions can be examined on a case by case basis. Some of the facilities have options to accept proposals from beneficiary countries or other funders. All the facilities have similar structures:

- A strategic body providing policy direction;
- A decision-making body deciding which projects should receive grants; and
- A group of financiers screening proposals and providing technical analysis before forwarding select proposals to the decision-making body.

It is not straightforward to evaluate blended projects. This is because of methodological reasons (lack of counterfactual) and lack of specific data on: 1) the economic and social effects of the blended project; and 2) the exact contribution of the grant component. We do, however, have project descriptions of grants suggesting they are used to finance essential studies, improve the quality of the project and achieve the required level of concessionality, providing evidence for the importance of blending. There is little quantitative evidence to back this up, though we have provided some pointers.

We introduce five possible governance options of a future platform. The first option is 'business as usual' - the current situation where there is some informal collaboration and common procedures. Project applications currently use facility specific templates, but they do not determine the grant share of blending. The second option is 'governance light' – where the platform applies a standardised template for grant applications; offers benchmarks for assessing and comparing grant values across facilities and brings out differences in blending according to these criteria; offers learning possibilities; and promotes harmonisation more systematically than is currently the case (e.g. in environmental projects). The third option 'governance medium', formalises learning and harmonisation, and applies a standardised template for grant applications according to which grants are assessed. It provides a globally coordinated strategy, taking over this role from the individual facilities, and enforces guidelines on the facilities which determine project areas eligible for grant funding. The fourth option, 'governance heavy' moves decision-making on individual projects into the platform. This allows the platform to have an overview of all projects submitted across the facilities and assess their comparative strengths and weaknesses. The platform can be responsible for allocating resources to specific projects on the basis of project, region and theme specific yardsticks. The fifth option is 'governance super heavy'. This represents a scenario where all the facilities have been amalgamated together into a single facility under the platform, covering all themes and regions. This single entity comprises a single strategy, a single grant application template and a single fund.

We examine these options on the basis of the following criteria:

- Flexibility: can the level and nature of blending be discussed on a case by case basis (high) or are the same guidelines applied to each project and enforced (low)?
- Eligibility: does clarity exist on the nature of projects eligible for blending?
- Sustainability: is the project likely to be financially viable (high) or is it likely to be unsustainable and hence market distorting (low)?
- Transparency: is the project assessed according to a set of fixed criteria?
- Harmonisation: do the blending facilities operate independently (by regional area and by theme) with different criteria (low) or do they operate as one with common criteria?
- Visibility: is a bundled approach more visible that a fragmented approach leading to greater policy influence
- Donor influence: to what extent does the allocation of grants reflect donor considerations, recipient countries and country strategy papers?

We find that there are pros and cons of the various governance options. In particular we suggested that options 'governance medium' and 'governance heavy' score highest if all principles are treated equally. Moreover, given that our study suggests there is a lack of transparency about blending decisions (at least to outside observers) and if we therefore think that it is important to strengthen transparency (e.g. to clear up misgivings on the importance of the chair of the groups), the 'governance heavy' option is the most preferred option. This option might help to promote more upstream discussions between the project financiers and the grant providers. In all cases however, transparency could be improved by publishing the interaction between the DFIs and the platform.

Along with transparency, harmonisation of practices and visibility were viewed as principles that had few negative effects. The 'medium' and 'heavy' governance models are suggested as being the most likely to optimise both harmonisation and visibility potential.

The remaining concepts are highly intertwined and maximising one generally involves trading off the potential to maximise another. Flexibility for DFIs and the sustainability of projects are thought to go hand-in-hand. Donor policy influence and clear (strict) eligibility criteria also were viewed as moving together. Together these two pairs of principles frame the debate on the potential and pitfalls of grants leading loans.

We hope that this examination promotes further discussion of the platform options.

List of people consulted:

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Annexes

Annex 1: Pros and cons of blending: a brief overview of the technical literature

Below we analyse the relative advantages and potential shortages of blending mechanisms compared to pure grants and pure loans.

Blending versus pure grants

The Pros

Economic criteria

Fiscal discipline: empirical evidence suggests (indirectly) that blending grants with loans as opposed to pure grants, may allow for higher growth rates in countries that are well governed. It can also mitigate the side effects on government consumption spending, government investment spending and domestic tax revenues traditionally associated with pure grants. Indeed, while the use of grants is found to curtail tax revenues, Gupta et al. (2003) argue that loans encourage revenue raising. In particular, they argue that a doubling of the current level of a loan may increase tax revenues by 0.4% of GDP. On the other hand, Djankov et al. (2004) find that Official Development Assistance (ODA) has a positive effect on government investment if the ratio of grants to ODA is small enough, thereby suggesting that if ODA is given in the form of loans, investment may increase.

Financial criteria

- *Financial leverage*: blending mechanisms by combining limited grant funds with more readily available loan resources enable the financing of more and bigger projects than would be possible with grants alone. The combination of a grant element with a loan element brings significant added-value to countries without access to capital markets (i.e. low-income countries).
- *Flexibility*: blending mechanisms offer more flexibility in adapting the volumes of funds to specific project needs.

Operational criteria

- *Financial discipline*: blending grants and loans provide greater incentives than pure grants for lenders to monitor funded projects since a repayment is due (because of the use of loans). Moreover, blending mechanisms give donors access to project management expertise of lenders thus reducing their monitoring and administrative costs.
- *Coordination between donors and lenders*: blending mechanisms lead to enhanced coordination between donors and lenders with clear advantages for both donor and recipient countries. From a donor perspective, increased coordination could allow for less duplication or dispersion of efforts thus leading to better efficiency and effectiveness of development assistance. From a recipient country perspective, increased coordination between donors and lenders implies dealing with a smaller number of officials, less administrative steps and streamlined procedures.
- *Demonstration effect*: successful blending mechanisms can become a blueprint for other actors to fund projects.
- *Synergies between different actors*.

Strategic/political criteria

- *Policy leverage*: compared to pure grants, blending mechanisms through the financing of larger projects, allow donors to exert greater influence on recipient countries' policies at the country, sector and project level which are deemed to be of a priority for the EU (e.g. debt sustainability, environmental protection, financial stability, governance, etc.).

- *EU visibility*: blending mechanisms can enhance the visibility of European development assistance in partner countries by improving the investment capacities and coordination at the strategic and operational level of European actors (multilateral and bilateral donors, financial institutions).

The Cons

Financial criteria

- *Potential transparency issues*: given the complexity of blending mechanisms and the vast array of country-specific and project-specific circumstances to which they should be adapted, transparency issues may arise thus creating the space for potential misallocation or waste of funds.

Operational criteria

- *Loss of control of individual donors*: given that blending mechanisms pool together several donor countries' initiatives under one single umbrella, single donors may lose control over the use of funds in the case of disagreement on political and/or economic grounds.
- *Potential slow-down of decision-making*: given that blending mechanisms bring together and coordinate the funds from various partners with different rules and administrative procedures, there is always the risk of increasing bureaucracy, rising costs and time delays.

Strategic/Political criteria

- *Loss of visibility of individual donors*: given that blending mechanisms pool together several donor countries' initiatives under one single umbrella, there is a risk of overshadowing single funding partners' efforts thus discouraging them from future participation in blending schemes.

Blending versus pure loans

The Pros

Economic criteria

- *Debt sustainability*: Mixing a loan element with a grant element may partly solve the issue of excessive, unsustainable borrowing in heavily indebted countries.

Financial criteria

- *Financial leverage through risk mitigation and risk sharing*: blending mechanisms, by means of the grant element (e.g. in the form of guarantees, interest rate subsidies or technical assistance (TA) grants), may attract private investment towards high-risk countries, sectors or projects , that would, in the case of pure loans, be characterized as financially unsustainable and therefore not funded at all. For example, blending mechanisms might be useful for funding innovation projects that have potential but, due to the uncertain country environment and future revenues, are perceived as too risky to be funded through pure commercial loans.
- *Mobilizing effects by attracting other donors.*
- *Flexibility*: blending mechanisms offer more flexibility than pure loans in the definition of financing terms related, for example, to disbursement conditions or the project speed.

Operational criteria

- *Project acceleration*: compared to pure loans, blending mechanisms allow for the acceleration of a project. Grants may help to solve in a faster way the issue of the project's

financial sustainability as well as to provide the technical assistance (TA) needed for a smoother project preparation and adequate capacity building.

- *Project quality*: with respect to pure loans, projects funded through blending mechanisms can benefit from TA attached to the grant component that allows for the improvement of the preparation, implementation and management of projects, thus enhancing their overall quality.
- *Coordination between donors and lenders*: blending mechanisms lead to enhanced coordination between donors and lenders with clear advantages for both donor and recipient countries. From a donor perspective, increased coordination could lead to less duplication or dispersion of efforts and thus better efficiency and effectiveness of development assistance. From a recipient country perspective, increased coordination between donors and lenders implies dealing with a smaller number of officials, less administrative steps and streamlined procedures.
- *Knowledge transfer and demonstration effect*: as opposed to pure loans, blending mechanisms can benefit from TA usually provided in the form of grants, which may enhance the efficiency and effectiveness of a specific project by providing knowledge dissemination. Moreover, successful blending mechanisms can become a blueprint for other actors to fund projects.
- *Synergies between different actors*.

Strategic/Political criteria

- *Control of externalities*: compared to pure loans, blending mechanisms can promote investment with positive externalities and help mitigate negative externalities associated with a specific project. Blending mechanisms may be used to finance projects with high social and/or environmental impact (positive externality) but which are not financially sustainable. The grant element compensates for the insufficient financial return (at least in the short term) until the project becomes sustainable. Blending mechanisms also consent to use the grant element to bear any additional cost needed to solve the issue of negative externalities associated with a given project. For example, the construction of a dam could have a negative impact on the surrounding environment and communities. Blending mechanisms, through the grant component, may provide an incentive for the recipient to sustain the costs needed to make the project more environmentally friendly and to reduce the adverse impacts on society.
- *Policy leverage*: compared to pure loans, blending mechanisms allow lenders to exert greater influence on recipient countries' policies at the country, sector and project level. In middle-income countries and emerging markets with access to capital markets such policy leverage is possible through the introduction of the grant element.
- *EU visibility*: blending mechanisms can enhance the visibility of European development assistance in partner countries by improving the investment capacities and coordination at the strategic and operational level of European actors (multilateral and bilateral donors, financial institutions).

The Cons

Economic criteria

- *Crowding-out effects*: given their own nature blending mechanisms offer improved terms with respect to pure commercial loans, so that they could crowd-out other potential funds within a country, especially if the latter has sufficiently developed financial markets. However, as reported by the EIB (2009) "In the current international financial climate, the likelihood of IFI funds crowding out commercial lending has little force for the target countries covered by the various partnership agreements of the EU. The forces that favour crowding in seem more persuasive […]".

- *Market distortion*: with respect to pure loans, blending mechanisms may risk giving unfair advantages to local governments or particular projects thus distorting the allocation of development assistance across countries and/or projects. Therefore, lenders should demand guarantees from international financial institutions that blending does not produce market distortion effects.

Financial criteria

- *Potential transparency issues*: given the complexity of blending mechanisms and the vast array of country-specific and project-specific circumstances to which they should be adapted, transparency issues may arise, thus leaving creating the space for potential misallocation or waste of funds.
- *Risk of imprudence*: the presence of a grant element in blending mechanisms may entice certain recipients to borrow beyond prudent levels in order to pursue projects that enhance reputation or satisfy certain lobby groups rather than the public interest.
- *Insufficient risk provision*: the use of grant components in blending mechanisms in the form of, guarantees does not allow for the elimination of risks. It merely transfers the risks from the recipients to the EU.

Operational criteria

- *Loss of control of individual donors*: given that blending mechanisms pool together several donor countries' initiatives under one single umbrella could mean that individual donors may lose control over the use of funds in the case of disagreement on political and/or economic grounds.
- *Potential slow-down of decision-making*: given that blending mechanisms bring together and coordinate the funds from various partners with different rules and administrative procedures, there is the risk of increased bureaucracy, rising costs and time delays.

Strategic/Political criteria

- *Loss of visibility of individual donors*: given that blending mechanisms pool together several donor countries' initiatives under one single umbrella, could mean that there is a risk of overshadowing single funding partners' efforts thus discouraging them from future participation in blending schemes.

Annex 2: NIF and ITF grant operations and calculation of grant share

Facility	Project name	Beneficiary	Sector	Type	Facility grant	DFI value	Project value	Grant share of total project value	Grant share of DFI value
ITF	EASSy	Sudan, Djibouti, Somalia, Kenya, Tanzania, Madagascar, Mozambique, Mayotte, Comoros, RSA	ICT	TA	2,600,000	33,000,000	201,000,000	1%	8%
ITF	Felou	Mali, Mauritania, Sénégal	Energy	IRS	9,335,000	33,000,000	211,500,000	4%	28%
ITF	Ethiopia-Kenya Interconnector	Ethiopia, Kenya	Energy	TA	550,000		660,000,000	0%	
ITF	WAPP - CLSG power interconnection project	Ivory Coast, Liberia, Guinea, Sierra Leone	Energy	TA	3,000,000		260,000,000	1%	
ITF	Caprivi Interconnector	Zambia, Namibia, RSA	Energy	IRS	15,000,000	105,000,000	302,000,000	5%	14%
ITF	Ruzizi	Rwanda, DRC, Burundi	Energy	TA	4,200,000		300,000,000	1%	
ITF	Beira Corridor	Mozambique, Zimbabwe, Zambia, Malawi	Transport	IRS	29,000,000	65,000,000	189,000,000	15%	45%
ITF	OMVS Gouina Hydropower (GHPP)	Mali, Mauritania, Senegal, Guinea	Energy	TA	1,000,000		250,000,000	0%	
ITF	WAPP - Coastal Backbone transmission lines	Ivory Coast, Ghana, Togo, Benin, Nigeria	Energy	TA	1,750,000		60,000,000	3%	
ITF	Update of the WAPP Masterplan	15 ECOWAS Member States	Energy	TA	1,450,000				
ITF	Port de Pointe Noire	Congo	Transport	IRS/TA	8,600,000	58,000,000	127,000,000	7%	15%
ITF	ECOWAS Electricity Regulation	15 ECOWAS Member States	Energy	TA	1,700,000	2,929,326	8,348,073	20%	58%
ITF	Benin - Togo Power Rehabilitation	Benin, Togo	Energy	IRS	12,250,000	49,000,000	73,200,000	17%	25%
ITF	Mozambique Backbone (CESUL)	Mozambique and SAPP countries	Energy	TA	700,000		1,000,000,000	0%	
ITF	Jomo Kenyatta International Airport Extension	Kenya and West African Region	Transport	TA	5,000,000	128,400,000	215,000,000	2%	4%
ITF	Expansion of Port of Walvis Bay	Namibia and Southern African Region	Transport	TA	450,000		200,000,000	0%	
ITF	Sambangalou Hydro Power Plant	Gmbia, Guinea, Guinea-Bissao, Senegal	Energy	TA	350,000		350,000,000	0%	
ITF	Gibe 3 Hydro Power Plant	Ethiopia, Kenya	Energy	TA	1,300,000		1,450,000,000	0%	

ITF	Transmission Line Kibuye-Goma-Birembo	Rwanda, DRC	Energy	TA	800,000	19,000,000	69,000,000	1%	4%
ITF	Mount Coffee Hydropower	Liberia, Sierra Leone, Guinea and Ivory Coast	Energy	TA	1,500,000		116,000,000	1%	
ITF	Rehabilitation of the Great East Road	Zambia linking to Malawi and Mozambique	Transport	IRS/TA	26,000,000	237,860,000	250,000,000	10%	11%
ITF	Kampala Water – Lake Victoria WATSAN	Uganda and States around Lake Victoria	Water	IRS/TA	22,000,000	170,000,000	212,000,000	10%	13%
ITF	Lower Orange River Hydro Electricity Power Scheme	Namibia, RSA	Energy	TA	1,600,000		250,000,000	1%	
ITF	Engaging Banks in Financing Energy Transition Projects in East Africa	Kenya, Uganda, Tanzania	Energy	TA	2,000,000	60,000,000	60,000,000	3%	3%
ITF	AXIS - The African Internet Exchange System	African Continent	ICT	TA	5,100,000				
ITF	Satellite eMedicine for Africa	African Continent	ICT	TA	4,000,000				
ITF	Capacity building for environmental impact assessment and clean development mechanism initiatives	UEMOA countries	Energy	TA	900,000				
ITF	Access to Douala	Cameron, Chad, CAR	Transport	IRS	5,700,000	60,000,000	60,000,000	10%	10%
NIF	200 MW Wind Farm in Gulf of El Zayt	Egypt	Energy	Grant	10,000,000	241,500,000	340,000,000	3%	4%
NIF	IWSP (Improved Water and Wastewater Services Programme)	Egypt	Water	Grant	5,000,000	178,900,000	295,100,000	2%	3%
NIF	Programme National de Routes Rurales	Morocco	Transport	TA/Grant	9,800,000	120,000,000	397,000,000	2%	8%
NIF	Feasibility Study for Solar Thermal Power Plant in Tunisia	Tunisia	Energy	TA	1,000,000		110,000,000	1%	
NIF	Kesrwan Wastewater	Lebanon	Water	TA	4,000,000	111,000,000	214,000,000	2%	4%
NIF	Education	Morocco	Social	TA/Grant	15,000,000	250,000,000	1,900,000,000	1%	6%
NIF	Tramway de Rabat (5+3)	Morocco	Transport	TA/Grant	8,000,000	60,000,000	346,000,000	2%	13%
NIF	STEP (3+5)	Tunisia	Water	Grant	8,000,000	74,230,000	127,000,000	6%	11%
NIF	Egyptian Power Transmission	Egypt	Energy	TA/Grant	20,000,000	360,000,000	762,000,000	3%	6%
NIF	Master plan (combined RE) + FS for CSP in Egypt	Egypt	Energy	TA	3,000,000		500,000,000	1%	
NIF	PNA	Morocco	Water	TA/Grant	10,000,000	78,000,000	176,000,000	6%	13%
NIF	Réseau Ferré Rapide de Tunis (14+14)	Tunisia	Transport	TA/Grant	28,000,000	297,000,000	550,000,000	5%	9%

NIF	Jordan Electricity Transmission	Jordan	Energy	TA	2,200,000		150,000,000	1%	
NIF	Black Sea Energy Transmission System	Georgia	Energy	TA	8,000,000	260,000,000	280,000,000	3%	3%
NIF	Moldova Road Rehabilitation project	Moldova	Transport	Grant	12,000,000	60,000,000	52,500,000	23%	20%
NIF	Capacity assessment and modernisation of the Republican Clinical Hospital (RCH)	Moldova	Social	TA/Grant	3,000,000	9,000,000	18,000,000	17%	33%
NIF	Chisinau Airport Modernisation Project	Moldova	Transport	TA	1,750,000	45,500,000	46,250,000	4%	4%
NIF	Feasibility Study for Improvement Water/Sanitation Systems in Chisinau	Moldova	Water	TA	3,000,000	45,000,000	59,000,000	5%	7%
NIF	Framework for support Financial Intermediaries	Regional	Private	TA	2,880,000	34,600,000	38,250,000	8%	8%
NIF	TA Support for Ukrainian Municipalities	Ukraine	Mixed	TA	5,000,000	108,000,000	135,000,000	4%	5%
NIF	Ukrenergo Corporate Sustainable Development	Ukraine	Energy	TA	800,000	300,000,000	301,280,000	0%	0%
NIF	Financial sector Institutional building and crisis response	Regional	Private	TA	12,000,000		12,000,000	100%	
NIF	ENBF - European Neighbourhood Small Business Growth Facility	Regional	Private	Grant	10,000,000	14,000,000	95,000,000	11%	71%
NIF	Tbilisi Railway Bypass Environmental Clean up	Georgia	Transport	TA/Grant	8,500,000	200,000,000	253,500,000	3%	4%
NIF	Ukraine Power Transmission Network	Ukraine	Energy	TA	10,000,000	800,000,000	1,110,000,000	1%	1%
NIF	Regional Energy Efficiency Programme for Corporate sector	Regional	Energy	TA	2,000,000	300,000,000	300,000,000	1%	1%
NIF	Yerevan Metro	Armenia	Transport	Grant	5,000,000	10,000,000	16,600,000	30%	50%
NIF	Armenia Small municipalities water project	Armenia	Water	TA/Grant	7,600,000	13,000,000	20,800,000	37%	58%
NIF	Hydropower rehabilitation project	Ukraine	Energy	TA	3,600,000	350,000,000	398,600,000	1%	1%
NIF	Preparatory studies for modernisation UA gas transit and storaGeorgia	Ukraine	Energy	TA	2,500,000		2,000,000,000	0%	
NIF	Water Infrastructure Modernisation	Georgia	Water	TA	6,000,000	65,000,000	86,000,000	7%	9%
NIF	SME Finance Facility	Regional	Private	TA/Grant	15,000,000	135,000,000	150,000,000	10%	11%
NIF	Enguri / Vardnili Hydro Power Cascade Rehabilitation	Georgia	Energy	TA/Grant	5,000,000	35,000,000	47,000,000	11%	14%

NIF	Water Utilities Development Programme in the Republic of Moldova	Moldova	Water	Grant	10,000,000	20,000,000	31,500,000	32%	50%
NIF	Chisinau Public Transport project	Moldova	Transport	Grant	3,000,000	10,000,000	15,450,000	19%	30%

Annex 3: NIF project examples

NEIGHBOURHOOD INVESTMENT FACILITY (NIF)				
Beneficiary country (Sector)	**Project description**	**Type of intervention**	**Contribution / Leverage**	**Expected added value for beneficiary**
Ukraine (energy)	The project consists of four key components: 1) a 750 kV overhead line between Rivne NPP and the new 750/330 kV Kiev substation, 2) a diversion of the existing Khmelnytsk to Chernobyl 750 kV line into Kiev substation, 3) Expansion and rehabilitation works at Kiev 750/330 kV substation, 4) two 60km 330kV lines from Kyiv substation.	Technical Assistance (TA).	The contribution from the NIF consists of 0,8 Million EUR, for a total budget of 301 Million EUR.	Sustainable development and management of the energy production and distribution infrastructure with a consequent positive impact on the social infrastructure, environment and market economy.
Ukraine (energy)	Expansion of oil storage capacity and construction of oil metering stations.	Technical Assistance (TA).	The contribution from the NIF consists of 2 Million EUR, for a total budget of 33 Million EUR.	Sustainable development and management of energy storage and distribution infrastructure; improvement in the efficiency and broadening access to energy services; demonstration effect in the sector and contribution to promote best practices in Ukraine and possibly in the Region.
Morocco (transport)	Construction of a tramway network with a total length of 19km and 32 stations.	Technical Assistance (TA).	The contribution from the NIF consists of 7 Million EUR, for a total budget of 346 Million EUR.	Sustainable socio-economic development; improvement of mobility and urban environment; increased transport access to low and middle income population; strong impact on 2 million people.
Ukraine (social/transport/energy)	Loan guarantees over four years to be issued to larger municipalities in order to support and leverage investments in water supply and sanitation; waste disposal; public transport; energy efficiency.	Grant.	The contribution from the NIF consists of 10 Million EUR, for a total budget of 100 Million EUR.	Increased investments in infrastructure; improved infrastructure for waste disposal, public transport and energy efficiency with a positive impact on the social welfare of the municipalities' population.
Moldova (social)	Investments in infrastructure and medical equipment for the first two phases of the Republican Clinical Hospital modernization plan.	Grant and Technical Assistance (TA).	The contribution from the NIF consists of 3 Million EUR, for a total budget of 18 Million EUR.	Improvement in the health system; promotion of public goods.
Tunisia (energy)	Feasibility study for concentrated solar power plants.	Technical Assistance (TA).	The contribution from the NIF consists of a 1 Million EUR grant, for a total budget between 90 Million EUR and 130 Million EUR.	Development of clean, regenerative energy production; creation of jobs; technology transfers.
Tunisia (environment)	Rehabilitation and extension of wastewater treatment plants and	Grant.	The contribution from the NIF consists of a 8 Million EUR, for a total	Positive impact on social infrastructure and environment.

	pumping stations.		budget of 128 Million EUR.	
Egypt (environment)	The project aims to improve the physical infrastructure of the wastewater collection system and treatment, the water supply networks and treatment plants in 4 in the delta region. It also aims to support the ongoing reform process of the Egyptian Government focusing on sanitation, and to develop the capacity of the operating companies.	Technical Assistance (TA).	The contribution from the NIF consists of 5 Million EUR, for a total budget of 295 Million EUR.	Sustainable development of the sanitation level in the water sector; positive impact on social infrastructure and the environment.
Egypt (energy)	Construction of a 200MV wind farm in the Gulf of Ezayat	Grant.	The contribution from the NIF consists of 10 Million EUR, for a total budget of 340 Million EUR.	Meeting the target of renewable energy resources; making possible to cope with increasing electricity demand.
Ukraine (energy/transport/social)	Assistance to Ukrainian municipalities (feasibility studies, corporate development, implementation assistance)	Technical Assistance (TA)	The contribution from the NIF consists of 5 Million EUR, for a total budget of 133 Million EUR.	Improved energy efficiency; skills transfer; demonstration effect; market-based conduct.
Tunisia (transport)	Transport infrastructure project (RFR).	Technical Assistance (TA).	The contribution from the NIF consists of 7.5 Million EUR, for a total budget is 550 Million. A second tranche of 21.5 Million EUR will be requested in the future.	Transport modernization; reduction of negative consequences on the environment.
Moldova (transport)	The key components of the project are: 1) Rehabilitation of 500 km of main road sections located on Moldova's north-south and east-west road axes; 2) Support reform of road sector financing and institutional strengthening aimed at improving the capacity of the State Road Administration (SRA) to manage and maintain the road network under its responsibility effectively and efficiently.	Grant.	The contribution from the NIF consists of 17.5 Million EUR, for a total budget of 89.5 Million EUR	Rehabilitation of the national road infrastructure, and increased capacity regarding road sector financing with a positive impact on the population.
Moldova (environment)	The project consist in 1) Expanding the coverage of water supply and waste water treatment network and improving its service quality; 2) Creating the capacity within public institutions to prepare and supervise water supply and waste water projects; 3) Reducing the emissions of greenhouse gases in Moldovan water sector.	Grant.	The contribution from the NIF consists of 10 Million EUR, for a total budget of 44 Million EUR.	Positive impact on social infrastructure and the environment; improved reforms in the water sector.

Georgia (energy)	Black Sea energy transmission system.	Grant.	The contribution from the NIF consists of 5 Million EUR, for a total budget of 220 Million EUR.	Economic impact: stabilization of power transmission grids, reduction of technical losses, increased efficiency and reliability of the national power supply system(s), opening up of markets for the export of environmentally clean Georgian hydro power; geopolitical impact: movement of the Caucasus countries closer towards Turkey and Europe through interlinking their power supply systems.
Morocco (social)	The project consists in supporting the reform of the education sector and entails the implementation of an "urgency" action plan involving the reinforcement of educational infrastructure throughout the country.	Technical Assistance (TA).	The contribution of the NIF consists of 15 Million EUR, for a total budget of 1.9 Billion EUR.	Achievement of a more equitable socio-economic development.
Morocco (transport)	Construction of rural roads.	Grant.	The contribution of the NIF consists of 9.8 Million EUR, for a total budget of 397 Million EUR	Improved accessibility of more than 3 million people to basic social services such as schools and healthcare; reduction of transportation costs; enhancement of economic productivity.
Jordan (energy)	Feasibility study and environmental and social impact assessment on future investments in the Jordanian electricity transmission system.	Technical Assistance (TA).	The contribution of the NIF consists of 2.2 Million EUR.	Strengthened regional interconnections and integration of renewable energies into the Jordanian grid.

Source: NIF annual reports and project sheets

Annex 4: ITF project examples

EU-AFRICA INFRASTRUCTURE TRUST FUND (NIF)				
Beneficiary country / region (Sector)	**Project description**	**Type of intervention**	**Contribution / Leverage**	**Expected added value for beneficiary**
Benin & Togo (energy)	Rehabilitation of three power lines to refurbish and extend the transmission network of the promoter, the Communauté électrique du Bénin.	Interest rate subsidy (IRS)	The contribution from the ITF consists of 12.25 Million EUR, for a total budget of 73.2 Million EUR / leverage 6:1.	Extension of the reach and quality of the transmission infrastructure in the beneficiary countries, thus creating a better environment for private sector investment and growth and, in turn, contributing to poverty alleviation. As HIPC countries, both Benin and Togo are restricted in terms of the financing costs they can bear for their respective public sector investments; the ITF grant is therefore of great importance.
Congo (transport)	The project consist in renovating the Port Autonome de Pointe Noire, and in financing the capacity building for the financial and accounting staff of the Port Authority through the upgrading of accounting information systems, improvements to internal control procedures, maintenance of the financial projection model and assistance to the financial management.	IRS & TA	The contribution from the ITF consists of 6.6 Million EUR, for a total budget of 121.7 Million EUR / leverage 20:1.	Reinforcement of the integration of the sub-region, notably the Central African Republic and the Democratic Republic of the Congo, in international trade by increasing maritime traffic under competitive and financially viable conditions in terms of price and quality of services (time limits, safety, simplification of procedures, etc.); improvement of the management of the Port Authority; reduction of the credit risk for the Port's lenders.
Kenya (transport)	Jomo Kenyatta International Airport extension.	TA	The contribution from the ITF consists of 5 Million EUR, for a total budget of 184.27 Million EUR / leverage 37:1	Increased capacity to 9.3 million passengers a year and improved security in order to comply with International Civil Aviation Authority standards.
Ethiopia (energy)	Construction and operation of a 1,870 MW hydropower plant, including the construction of a 240 m high gravity dam and related hydromechanical equipment.	TA	The contribution from the ITF consists of 1.3 Million EUR, for a total budget of 1.45 Billion EUR	Increased electricity access rate.
Ivory Coast / Ghana / Togo / Benin / Nigeria (energy)	Construction of 300 km of high-voltage transmission lines from Côte d'Ivoire to Ghana, including two new high-voltage substations to reinforce the existing Côte d'Ivoire-Ghana interconnection.	TA	The contribution from the ITF consists of 1.75 Million EUR, for a total budget of 60 Million EUR	Increased exchange of low-cost power between the countries involved.
Mozambique & SAPP countries (energy)	CESUL Regional Transmission Development Project comprising the construction of a transmission line from the main electricity	TA	The contribution from the ITF consists of 0.7 Million EUR, for a total budget of 1 Billion EUR	Reduction in power shortage; improved reliability of affordable electricity in the Southern Africa Region as a whole; creation of

	production site on the Zambezi River in northern Mozambique to the main area of consumption in Maputo and its surroundings in southern Mozambique, with scope for the development of production projects along the line.			new large-scale industrial or commercial activities along the CESUL line route; reduction of environmental and social risks.
Namibia & Southern African region (transport)	Expansion of Port of Walvis Bay.	TA	The contribution from the ITF consists of 0.45 Million EUR, for a total budget of 200 Million EUR	Increased NamPort's annual container handling capacity from 250 000 TEU to more than 500 000 TEU.
Gambia / Guinea / Guinea-Bissau / Senegal (energy)	Development of the Sambangalou Hydropower Plant.	TA	The contribution from the ITF consists of 0.35 Million EUR, for a total budget of 350 Million EUR.	Increased energy production which should reach 208 to 402 GWh per year.
Sudan / Djibouti / Somalia / Kenya / Tanzania / Madagascar / Mozambique / Mayotte / Comoros /RSA (ICT)	The East African Submarine Cable System (EASSy) project consists of a 10,000 km fibre-optic submarine cable along the East African coast, linking Sudan to South Africa with landing points in these countries as well as in Djibouti, Somalia, Kenya, Tanzania, Madagascar, Mozambique, Mayotte and Comoros.	TA	The contribution from the ITF consists of 2.6 Million EUR, for a total budget of 201 Million EUR.	Provision of reliable, fast and widespread access to international communications (including the Internet); reduced costs of international telecommunications and Internet connectivity.
Mali / Mauritania / Senegal (energy)	The Félou Hydropower project involves the engineering, construction, commissioning and operation of a run-of-the-river hydropower plant at the Félou falls, on the Senegal River, about 15 km upstream of the town of Kayes in Mali.	IRS	The contribution from the ITF consists of 9.335 Million EUR, for a total budget of 211.5 Million EUR / leverage 23:1	Achievement of the HIPC requirements; strong regional development through sustainable and clean power generation.
Ethiopia / Kenya (energy)	Construction of an interconnecting power line between Ethiopia and Kenya.	TA	The contribution from the ITF consists of 0.55 Million EUR, for a total budget of 660 Million EUR.	Increased reliability of energy supply; savings in capital and operating costs; opportunity for Kenya to cover in the short-term its power needs by importing cost-effective power from Ethiopia instead of relying on its expensive and polluting thermal power stations.
Ivory Coast / Liberia / Guinea / Sierra Leone (energy)	Construction of approximately 1,100 km of high-voltage transmission lines, as well as the extension of existing or the construction of new high-voltage substations in Man (Côte d'Ivoire); in Sannequille, Buchanan, and Monrovia (Liberia); in Nzérékore and Linsan (Guinea) and in Bumbuna (Sierra Leone).	TA	The contribution from the ITF consists of 3 Million EUR, for a total budget of 260 Million EUR.	Mutually beneficial power exchanges and a reliable electricity supply fostering economic growth and consolidating the fragile peace that has been achieved so far in the countries involved; alleviation of energy shortages; improvement in the standard of living.
Zambia / Namibia / RSA (energy)	The Caprivi project consists of the construction of a 200 MW (designed to be upgradeable to 600 MW) high-voltage direct current transmission connection from Zambia to the Namibian electricity	IRS	The contribution from the ITF consists of 15 Million EUR, for a total budget of 302 Million EUR / leverage 20:1.	Provision of a reliable route for electricity exports and imports; support for a competitive regional power market; improvement in the security of supply.

	network, interconnecting the northern and western parts of the Southern African Power Pool (SAPP) network.			
Rwanda / DRC / Burundi (energy)	Construction of a new sub-regional hydroelectric plant, Ruzizi III.	TA	The contribution from the ITF consists of 2.8 Million EUR, for a total budget of 300 Million EUR.	Generation of an additional 143 MW of power by 2013.
Mozambique / Zimbabwe / Zambia / Malawi (transport)	Rehabilitation of the transport infrastructure of the Beira corridor, including the repair of the Sena railway line and the restoration of the Beira port access channel to its original design characteristics.	IRS	The contribution from the ITF consists of 29 Million EUR, for a total budget of 189 Million EUR / leverage 7:1.	Implementation of the investments respecting the concessionality level of 35%; reopening of the Sena railway line.
Mali / Mauritania / Senegal / Guinea (energy)	The Gouina Hydropower Project (GHPP) is a transboundary initiative by the Senegal River Basin Organisation (OMVS) which aims to supply renewable electricity to the four member states.	TA	The contribution from the ITF consists of 1 Million EUR, for a total budget of 250 Million EUR.	Increased production capacity; reduced vulnerability to oil price volatility.

Source: ITF annual reports and project sheets

Annex 5: Criteria for assessment of proposals for grant operations for the ITF

PREAMBLE

The Executive Committee governs the Trust Fund and is the body responsible for the examination and approval of Grant operations[1].

Accordingly, the Executive Committee shall assess the Requests for Grant Operations from Project Financiers Group on the basis of the following criteria, which are coherent with the Trust Fund Agreement[2].

Where the Project Financiers are requesting a Clearance in Principle, the decision of the Executive Committee will be based on the fulfilment of the criteria contained in (**Error! Reference source not found.Error! Reference source not found.**) "Geographic and Sector Eligibility" and on initial assessment of the project's potential to finally satisfy the rest of the criteria.

For each specific Grant Operation request, the Executive Committee will determine which "Development Criteria" (see 3, below) will apply. To promote the efficiency of Trust Fund operations, the Committee does not seek to duplicate the detailed financial, economic and technical analysis of the projects, which remains the responsibility of the Project Financiers.

1. ADMINISTRATIVE RESPONSIVENESS

i. Grant Operations Requests can only be submitted by Project Financiers fulfilling the criteria of Art 5.1 of the implementing rules of the Trust Fund Agreement [TFA].

ii. The Request identifies the Lead Financier, in accordance with Art 5.3 of the implementing rules of the Trust Fund Agreement [TFA]

2. GEOGRAPHIC and SECTOR ELIGIBILITY

i. Projects should fulfil the requirements of "geographical coverage" [Art 1.1], namely by contributing to development, in more than one country, by improving conditions for the movement of people, goods, services or information, power trade, and the sustainable management of shared resources, through amelioration of the functioning of the relevant systems.

Such improvements are to be achieved through selective interventions, addressing capacity constraints or sub-optimal functioning

a) of critical points of the system (e.g. major power generating facilities (e.g. hydro power), ports, airports, bridges, ICT connections, etc), removal of which will facilitate the regional or international flow of people, goods, services and information

b) of parts of the network (e.g. road, railways, power transmission, oil and gas pipelines, etc or ICT transmission infrastructure) of a regional system (e.g. transport corridor) ensuring the international flow of people, goods, services and information

c) of parts of the network (e.g. energy or ICT transmission infrastructure) forming part of a regional system and improving the security, efficiency

[1] See Trust Fund Agreement (TFA) , Article 4.2

[2] See notably TFA Articles 1.1.1 ; 1.1.2 ; 1.1.3 and 4.3.3.

or reliability of the system or the open and equitable access of people to the relevant services

d) of the integrated management of water resources, for their different uses

e) of the enabling legal, regulatory, financial and/or institutional environment and its application

The above list is not exhaustive and the Executive Committee may approve operations for as long as they comply with Article 1 of the Implementing Rules. Activities can be carried out in one or more countries, depending on the specific project characteristics and requirements.

(a) At least two or more countries should be identified as benefitting from the realisation of the programme, of which at least one is named in Schedule 1 (as amended from time to time by resolution of the Steering Committee).

For the avoidance of doubt, infrastructure projects with purely national impact are not eligible.

ii. Eligible sectors for Projects are:

(a) Energy;

(b) Transport (rail, road, air, maritime and inland waterways);

(c) Water; and

(d) Information Technology (including telecommunications infrastructure where projects financed provide access to services of general economic interest).

3. AFRICAN OWNERSHIP CRITERIA

Projects should, in accordance with the underpinnings of the EU-Africa Infrastructure Partnership, fulfil the "African ownership" requirement by:

a) Being referenced in the African Union or New Economic Partnership for African Development (NEPAD) Action Plans and/or;

b) Being supported by the national and/or regional authorities of the “geographical cover” of the project. For the avoidance of doubt, in case of a national project with demonstrable impact on two or more countries, the accord of all countries concerned should be expressed, and/or ;

In the case of new initiatives not foreseen in existing programming documents or Action Plans mentioned under **Error! Reference source not found.Error! Reference source not found.**.**Error! Reference source not found.Error! Reference source not found.** or **Error! Reference source not found.Error! Reference source not found.**.**Error! Reference source not found.Error! Reference source not found.** [e.g. private sector investment in rapid response to new opportunities or increased demand], the Lead Financier should provide evidence that the relevant national and/or regional authorities support the proposed project.

4. DEVELOPMENT CRITERIA

Criteria for assessing the development impact of eligible Projects are as follows:

I. Project contribution to poverty reduction:

(a) Projects should demonstrate positive impact in the attainment of the poverty reduction objectives as defined in the regional or national Poverty Reduction Strategy Papers of the Project's "geographical cover" area and/or ;

(b) Projects shall demonstrate positive impact on the attainment of the Millennium Development Goals.

(c) In cases where the project requires anti-poverty mitigation measures, appropriate and objectively defined poverty-targeting actions should be identified, considered in the project's economic assessment and applied by the competent bodies.

II. Project contribution to economic development and trade:

Projects should demonstrate positive impact in the promotion of economic development and benefits for each of the main countries affected. The Executive Committee will also be attentive to the capacity of projects to promote trade, for example by enabling increase in exchanges of people, goods and/or services in the project's "geographical cover" area, regional complementarities and integration.

III. Economic viability of the Projects:

(a) *Economic and Financial Assessments*[3]: The Project proposals shall state the expected financial rate of return (excluding Trust Fund grants) and the expected economic rate of return. In order to assess the suitability of projects for long-term Trust Fund support, a sensitivity analysis (e.g. variation of cost, returns, longer time of implementation) shall be done.

The economic and financial assessment should provide the evidence for approving an interest rate subsidy, either for bridging the gap between economic and financial viability of a project or for respecting internationally-agreed concessional loan frameworks (e.g. IMF/WB concessional lending rules).

(b) *Non-monetary benefits:* If the project is expected to generate benefits that cannot be measured in monetary terms, the analysis should

i. state the expected qualitative outcome of the project[4] as well as quantitative outcomes where possible[5] and

ii. show that the project represents a cost effective way of attaining the stated objectives, taking properly into account all relevant elements determining project quality, period of completion, introduction of modern technologies, etc.

(c) *Debt sustainability*: Eligible projects shall be assessed against the impact they may have on the debt situation of the beneficiary region [including the Debt Sustainability framework,

[3] Study made by external consultant and/or based on analyses made by Lead Project Financier.

[4] For instance in terms of mobility of people increased safety in case of road projects; or the improvement of water quality in case of water infrastructure projects.

[5] e.g. reduction in travelling hours, increase in trade flows, reduction of transport costs, additional number of people having access to water, etc.

where applicable]. Projects should demonstrate that they will not have a significant adverse effect in this regard for the beneficiary countries.

IV. Social & Environmental Impact:

The Lead Project Financier of a Project shall confirm to the Executive Committee that

(a) Appropriate and/or legally required assessments of social and environmental impacts have been undertaken, and any necessary approvals by the competent Authorities have been granted.

(b) Impact assessments carried out as in above **Error! Reference source not found.Error! Reference source not found..Error! Reference source not found.Error! Reference source not found..Error! Reference source not found.Error! Reference source not found.** respond to international commitments of the EC or the Members States of the concerned Project Financiers, and are in accordance to the guidance provided in the Environmental Integration Handbook for EC Development Cooperation[6] or to equivalent Project Financiers documents[7] or Member States' guidelines, when such documents or guidelines exist.

(c) *Social and Environmental Externalities: T*he economic evaluation of the projects takes into account any national or cross-border externalities that may be identified by social and environmental Impact Assessments and any mitigation plan defined therein.

V. Provisions for Maintenance

The Lead Project Financier of a Project shall confirm to the Executive Committee that the legal, institutional, management, financial and administrative framework is in place – or foreseen to be timely in place - allowing the proper maintenance of the project after its completion and handing-over to the owner.

5. OTHER CONSIDERATIONS

European Co-financing: Favourable consideration shall be given to projects that promote or demonstrate co-financing by members of the Project Financiers Group.

Scope of the Grant Operations (Clarification)

Insurance premia: The Executive Committee can support with this facility mitigation measures covering project stakeholders and Project Financiers on all kinds of risk, thereby fulfilling an important catalytic role to mobilise financing for projects.

Project Design and Operation:

Design: Project must demonstrate technical, economic and financial sustainability. A decision by the members of the Project Financiers Group to submit a Grant Operation request for approval shall be based on a full feasibility study. The feasibility study should include an analysis of the wider institutional framework and the "enabling environment". Project documentation should give adequate assurance that the complementary actions which are necessary for attaining the

[6] Source: http://ec.europa.eu/europeaid/reports/environment_integration_handbook_en.pdf
[7] E.g.: EIB sustainable Development and Environment Documents, EIB, 2002

benefits (including the regional benefits in the case of “national” projects) will be taken at the time and in the manner required.

Alternative design options: Projects must demonstrate that, during their identification and formulation phase, reasonable steps were taken to identify alternative design options. The approved project design should have benefited from a comparison with alternatives in important aspects such as choice of beneficiaries, costs (including environmental costs), effectiveness, benefits, types of outputs and services, production technology, location, starting date, and/or sequencing of components. The option of involving the private sector (PPP) or co-financing with commercial banks shall be analyzed.

Annex 6: Guidance template for projects in the context of loan grant blending (LGB) facilities

A. GENERAL PROJECT INFORMATION

I. Project description This part should provide general information on the project and its rationale, including:

- the name of the project,
- details on the project promoter/beneficiary
- (name, status, activity, etc.),
- the geographical and sector coverage,
- the description of the project (the total amount of the project, its objectives and their relation to EU objectives, the expected outcome, etc.),
- the link to related projects.

In this section, other related project features should be presented such as assessing the possible crossborder impact as well as the expected development impact and demonstrating beneficiary's ownership of the project (e.g. in line with domestic strategy, etc.).

II. Macroeconomic and sector parameters

These parameters are intended to set out the environment in which the project will be implemented. These should be outlined here only to the extent they are relevant for the LGB support justification. This part should also include an ex-ante assessment of market conditions, subsidiarity aspects and potential crowding out of other sources of financing.

B. PROJECT RELATED PARAMETERS

III.General LGB request information

This part outlines the type of LGB support requested, the amount of donor support requested (both in absolute and relative terms).

IV. Financing plan This section should include financial details on:

- the main financial indicators (FNPV, IRR, etc.),
- the total contribution of each lender and donor (both in absolute and relative1 terms), including their timing,
- and the other sources of financing.

V. Grant request justification This part focuses on non-financial information on:

- conformity with instrument/policy general strategy/objectives/orientations,
- how will the grant help remove barriers and accelerate project completion?
- what are the expected externalities in macroeconomic or sectoral and other terms
- (domestic/sectoral/trans-border, etc.)?
- will the grant support help capacity building?

VI. Value added of the grant This section should include:

- An indication of quantitative aspects of the value added of the grant?
- How the grant support will help improving the project quality?

VII. Risk assessment This part is intended to identify the project related risks that might be encountered. It shall also outline how potential risk such as crowding-out, market distortions, moral hazard effect and specific project implementation risks have been taken into account and how these risks will be mitigated.

C. PROJECT IMPACT AND IMPLEMENTATION

VIII. Project implementation, monitoring and evaluation

This section should provide information on the schedule of key milestones in the project implementation, such as:

- the indicative dates of the project feasibility/appraisal process,
- the dates of the various lenders' management approval,
- the date of the signature of the contract,
- the expected timing of the start,
- the end of project implementation.

If possible a precise project implementation schedule should also be included. Key information on project monitoring and assessment as well as evaluation cycles should also be provided.

IX. Project sustainability Under which conditions will the project be sustainable when the grant support expires? Should there be any incentives to enhance the sustainability of the project?

Annex 7: Template for NIF projects

			Date of Cover Sheet:	
Contribution Request nr XX to be presented to the Board's Operational meeting of …				
Beneficiary Country				
Lead Finance Institution				
Other EU co-financier(s)				
Type of Contribution				
Amount requested (€)				
Eligible Sector				
NIF decision sought	Final Approval		Provisional Approval[8]	

A. GENERAL PROJECT INFORMATION

I. Project description

a) Title of the Operation:				
b) Promoter / Beneficiary: *(name, status, activity, etc.)*				
c) Geographical coverage:				
d) Total cost:	Project components	EUR equivalent	Amount in Project Currency	Currency
	1. Works, equipment and supplies			
	Of which: [component x]			
	[component y]			
	[component z]			
	Total investment cost			
	2. Service contracts			
	Of which: Preliminary studies, audits…			
	Technical assistance, PIU…			
	Project coordination and design, work supervision…			
	Total project cost			
e) Project objectives: *Indicate their relation to EU objectives*				
f) Project description :				

[8] subject to the finalisation of the approval procedures of the corresponding financial institutions

Activities, expected outcome, link to related projects, etc. *In this section, other related project features should be presented such as assessing the possible cross-border impact as well as the expected development impact and demonstrating beneficiary's ownership of the project (e.g. in line with domestic strategy, etc.).*	

II. Macroeconomic and sector parameters *These parameters are intended to set out the environment in which the project will be implemented.* *These should be outlined here only to the extent they are relevant for the NIF support justification. This part should also include an ex-ante assessment of market conditions, subsidiarity aspects and potential crowding out of other sources of financing.*	

B. PROJECT RELATED PARAMETERS

III. General NIF request information *This part should outline the type and amount (both in absolute and relative terms) of NIF support requested.* *For TA requests, a breakdown of estimated costs should be provided in Annex.*	

IV. Financing Plan

Finance Institution / donor	***Amount***		***Loan conditions (1)***			***Remarks (2)***
	(€ M)	***%***	Int. rate (%)	Tenor (years)	Grace period (years)	

(1) If available and/or indicative
(2) In particular, indicate if the loan is concessional (according to the IMF or OECD/DAC definition of concessionality)

Main financial indicators *(if relevant and/or available)* *FNPV, IRR, ERR, indicators of financial sustainability, etc.*	

V. Grant request justification

a) Conformity with the NIF Strategic Orientations	
b) Non financial impact *This part should focus on non-financial information on:* *- how will the grant help remove barriers and accelerate project completion* *- the expected externalities in macroeconomic or sectoral and other terms (domestic / sectoral / trans-border, etc.)* *– how the grant support will help capacity building*	

VI. Value added of the grant	
a) Quantitative aspects (leverage, softening of financing conditions, etc.)	
b) Qualitative aspects *This section should include an indication on how the grant will help improving the project quality*	
VII. Risk assessment *This part is intended to identify the project related risks that might be encountered. It shall also outline how potential risk such as crowding-out, market distortions, moral hazard effect and specific project implementation risks have been taken into account and how these risks will be mitigated.*	

C. PROJECT IMPACT AND IMPLEMENTATION

VIII. Project implementation, monitoring and evaluation	
a) Project Chronology *If possible, provide in Annex a precise project implementation schedule*	Expected start and end dates of the project feasibility / appraisal / negotiation process
	Date of appraisal mission EFIs approvals: - lead financier: - other cofinanciers: Dates of signature of the loans with the beneficiary: - lead financier: - other cofinanciers:

	Expected start of project Expected end of project implementation
b) Project monitoring and evaluation *This section should include key information on project monitoring and assessment as well as evaluation cycles*	
IX. Project sustainability *This part should outline:* *- under which conditions will the project be sustainable when the grant support expires* *- the incentives that could be necessary to enhance the sustainability of the project*	

D. CONTACTS AND SIGNATURE

Lead Finance Institution	Contact person	Phone	email
Other Eligible FI (EFI) member of the consortium	Contact person	Phone	email
Date and Signature	for the Leading Finance Institution date of signature		

Comparison by the Lead Finance Institution of the proposed project's main characteristics with the NIF Strategic Orientations

Annex

MAIN REQUIREMENTS:		**Yes**	**No**
1	Operations covered by the NIF shall benefit the following countries: -ENP countries with an ENP Action Plan in force -Other ENPI countries (and exceptionally other third countries) in particular in case of projects of cross-border and regional nature to which the Union attaches particular interest and following a unanimous decision of the Board		
2	Concern the objectives identified in the NIF Strategic Orientations		
3	Fall within the sectors identified in the NIF Strategic Orientations		
4	Contribute to the implementation of the ENP Action Plans or related thematic policy priorities		
5	Be complementary to corresponding regional, national and local strategy and measures		
6	Be fully consistent with EU principles in particular concerning the Environment (i.e. the European Principles for Environment), Public Procurement and State Aid		
7	Be ODA eligible		
8	Avoid replacing private financing or introducing distortions to the financial market (additionality)		
9	Help leverage loans (leverage)		
10	Not duplicate or overlap with EU-funded operations supporting the FEMIP; be technically and financially sound (value for money)		
11	Provide a clear justification for the size as well as the use of the NIF contribution requested		
PRIORITY CRITERIA (Under all objectives)			
1	Operations presented by Eligible Finance Institutions in a consortium		
2	Operations promoting substantial social returns or global public goods returns		
3	Operations having regional or sub-regional effects		
4	Investments in sectors with limited borrowing capacity		
5	Operations with a clearly demonstrated catalyst effect on specific sector reforms of the ENP Action Plans		
6	Operations contributing to the implementation of the Eastern Partnership		
7	Operations in line with relevant EU directives, i.a. on combustion, waste water and solid waste management		

Estimated Breakdown of Technical Assistance Costs

Annex

Project Implementation Schedule (if possible)

Annex

FIG Technical Advice and Proposal

Name of the project	

A. <u>TECHNICAL ADVICE</u>

I. Comments on project[9]	

II. Assessment of the grant request justification:	
1. Compliance with NIF objectives and priorities	
2. Leverage and non financial impact	
3. Added value for the Beneficiary and other value added	
4. Timing	

III. Conclusion:	

B. <u>FIG PROPOSAL</u>

NIF Contribution:	*from EU Budget:*	€ %	*from NIF Trust Fund:*	€ %
Type of Intervention :				

C. <u>DATE AND SIGNATURE</u>

for the Commission Chair:	for the Commission Secretariat:

[9] in case of risk capital operations in the South, check of no duplication with EU- funded operations supporting the FEMIP

Annex 8: EU-Africa Infrastructure Trust Fund: brief update of grants approved in 2007 – 2009

Grant Operation	Sector	Grant	Grant Amount	Grant Status	Total Disbursed	Lead Financier	Project	ITF Grant	Update on the ITF Grant
EASSy	ICT	TA	2,600,000	Under disbursement	999,564	EIB	Eastern Africa Submarine Cable System	The first tranche of the ITF TA Grant (EUR 172 040.98) was spent under the service contract between WIOCC and RPI for the hiring of the core management team. The balance of the Grant is used to pay the management team's costs during the construction phase of the project.	Disbursement no 5 under preparation
Felou	Energy	IRS	9,335,000	awaiting first disbursement	na	EIB	The Félou Hydropower project involves the engineering, construction, commissioning and operation of a run of the river hydropower plant at the Félou falls, on the Senegal River, about 15 km upstream of the town of Kayes in Mali.	Interest rate subsidy of up to EUR 9.3m to the EIB loan of EUR 33m. The subsidy will enable the three states (Mali, Mauritania, Sénégal) that are borrowers for the project to meet HIPC2 requirements, while contributing to strong regional development through the production of sustainable and clean power generation. The three borrowers will on-lend the loan amount to the SOGEM. The grant obtained from the ITF will allow (i) for one part that SOGEM pays a subsidized interest rate of 4,5% instead of a fully commercial rate (which is welcome at a time where the financial situation of SOGEM is improving but remains difficult) and (ii) and that the interest rate differential between 4,5% and 1,9% (which corresponds to the rate paid by the three states) be used for rural electrification along the interconnection.	The approval of the ITF Grant was renewed for a second time on 15.04.2010 hereby extending the validity of the Grant by 18 months to 15.10.2011. A first disbursement is now scheduled for August / September 2010.

Ethiopia-Kenya Interconnector	Energy	TA	550,000	fully disbursed	337,415	KfW	Construction of a power transmission line between Ethiopia and Kenya which aims to connect the grids of the two countries.	The ITF Grant supporting the project preparation of the construction of the Interconnector was used for the co-financing of a feasibility study conducted by Fichtner Germany. A full-fledged technical and financial feasibility study, as well as a detailed Environmental and Social Impact Assessment, a Resettlement Action Plan, and the choice of the proper organizational and institutional frameworks for the construction, ownership and operation of the Interconnector have been completed in June 2009.	na
WAPP - CLSG power interconnection project	Energy	TA	3,000,000	under disbursement	1,753,406	EIB	West-Africa Power Interconnection project from Ivory Coast through Liberia and Sierra Leone up to Guinea, consisting of the construction of approx. 1100 km of high voltage transmission lines, as well as the extension of existing, alternatively construction of new, high voltage substations in Man (Ivory Coast); in Sannequille, Buchanan, and Monrovia (Liberia); in Nzérékore and Linsan (Guinea); in Bumbuna (Sierra Leone).	ITF Grant will be used for the financing of the feasibility study and the ESIA. The Feasibility study was awarded to SOGREAH in September 2008 for a value of EUR 1,147,300 and is expected to be completed by the end of July 2010. The Line Route and ESIA study was awarded to Korea Electric Power Corporation (KEPCO), also in September 2008 for a value of EUR 1.441.674. Completion of this study is expected for August 2010. In October 2009, the Executive Committee approved by tacit written procedure that the WAPP may use part of the remaining balance of EUR 411,026 for the production of a functional tender package and for the financing of an expansion of the scope of the AETS SOGREAH study (connection of the Kaleta hydropower site in Guinea to the interconnection and the review of the existing bidding documents for the Kaleta project).	na

Caprivi Interconnector	Energy	IRS	15,000,000	fully disbursed	########	EIB	Construction of a 200 MW High Voltage Direct Current transmission connection from Zambia to the Namibian electricity network, interconnecting the Northern and Western parts of the South African Power Pool network.	The ITF Grant was used to subsidize the three loans from KfW, AFD and EIB to NamPower. Each loan was for EUR 35m and received a EUR 5m subsidy. At loan signature the three finance contracts stipulated that ITF grant shall be applied as a classical interest rate subsidy; it shall be transferred to the Financiers at the moment of their loan disbursement and shall be placed by the Financiers on a special account and shall be used to reduce the interest amount payable at each loan instalment until the balance of these special accounts reaches zero.	Whilst KfW and AFD have applied the ITF Grant in the way described above, EIB has amended its Finance Contract with NamPower in February 2010 so that the subsidy could be applied upfront by reducing the capital outstanding under its loan with NamPower.

Ruzizi	Energy	TA	4,200,000	under disbursement	1,675,814	EIB	Construction of a new sub-regional hydroelectric plant on the Ruzizi River which is expected to generate 143 MW of power by 2013 providing power to the Great Lakes region.	The first tranche of the ITF Grant of EUR 2.5m was used to finance additional and complementary studies, carried out by SOFRECO (France) as leader of a consortium that also includes a Canadian and a Spanish company. Up to date, the studies have mainly focused on the institutional and financial framework of the development of the Ruzizi 3 plant and concluded that the development of the Ruzizi 3 plant should be on 4 main axes: (1) The signature of a Treaty for the regulation of the use of the waters of the Lake Kivu and its rivers; (2) The creation of a Lake Kivu Basin Agency that would plan the development of the lake and rivers, apply the Treaty and take actions to protect the waters of the lake, amongst others; (3) The creation of an Entity of Coordination that would coordinate the production, purchase, and major planned maintenance of the cascade of plants in the river; (4) Structure the project under a PPP approach in order to facilitate the mobilisation of funding, limiting the recourse to the 3 countries;	The Ministers of the three countries concerned endorsed the findings of the studies, which leads the project preparation to its second phase, i.e. the preparation of a specific proposal and a financial model for the development of Ruzizi. For the financing of this second phase, the ITF Executive Committee agreed to extend the grant for Ruzizi from EUR 2.8m to EUR 4.2m in April 2010 and a modification to the SOFRECO contract was signed on 08.06.2010, increasing the contracts value to EUR 3,390,753.

Beira	Energy	IRS	29,000,000	under disbursement	4,401,992	EIB	Re-establishment of the original transport capacity of the port of Beira and of the Sena railway line, both forming part of the Beira Corridor Transport System (Mozambique): (a) rehabilitation of the Sena railway line; (b) restoration of the Beira port access channel to its original design characteristics.	The ITF Grant is applied as a classical interest rate subsidy to EIB's financing of a total of EUR 65m from EIB's own resources, channelled through the Government of Mozambique in two sovereign loans for on-lending to the promoters: one loan of EUR 42m for the Rail Component and one loan of EUR 23m for the Port Component. Mozambique is a HIPC country, and the grant was required to include a minimum concessionality element of 35%. A first disbursement under the Rail Component was made in November 2009.	A first disbursement of EUR 3.8m under the Port Component is under preparation and EIB will request the transfer of the subsidy portion of this disbursement. This will be the second transfer of ITF funds to the EIB under the Beira Grant.
OMVS Gouina Hydropower (GHPP)	Energy	TA	1,000,000	awaiting signature	na	AFD	Construction of a hydropower plant on a natural fall on the Senegal River (near Kayes, West of Mali), using water already processed and regularised by the Manantali dam.	The ITF Grant will be used to finance pre-investment studies (CIA, Complementary Sociological studies, Environmental studies, Finalization of the ESMP, the Resettlement Plan and of the Cultural Properties Preservation Plan).	The tendering is completed and offers are being analysed. AFD plans to sign the consultancy contract in the coming weeks. The deadline for a first transfer of funds was 18th June 2010 and AFD will submit a request for an extension of the validity of the grant at the next Executive Committee meeting.
WAPP - Coastal Backbone transmission lines	Energy	TA	1,750,000	awaiting signature	na	EIB	The tendering is completed and offers are being analysed. AFD plans to sign the consultancy contract in the coming weeks. The deadline for a first transfer of funds was 18th June 2010 and AFD will submit a request for an extension of the	The ITF grant is made available to the WAPP to fund (i) a Feasibility Study; (ii) the line route study, the Environmental and Social Impact Assessment, the Resettlement Action Plan and the Environmental and Social Management Plan for the project; and (iii) an audit.	The tendering is completed and two consultants have been selected. Contract negotiations are under way and the WAPP plans to sign the contracts before July 2010.

							validity of the grant at the next Executive Committee meeting.		
Update of the WAPP Masterplan	Energy	TA	935,000	awaiting signature	na	EIB	Identification of a development plan for priority power generation and transmission projects over the period 2010-2025 with a view to facilitate interconnection and promote regional integration.	The ITF grant will be made available to the WAPP to fund services related to (i) an analysis of the characteristics of the regional electricity supply system (main generation sources, transmission grid, cross border power trading), (ii) an examination of the electric energy demand and supply balance both at national, (iii) sub-regional (control areas) and regional level; (iv) the elaboration of an optimal plan for the regional generation and transmission system development while taking into consideration various constraints affecting operations of the electric utility companies; (v) updating of the dynamic and static stability studies with the view of evaluating the impact of the new electric power generation and transmission installations; (vi) preliminary assessment of environmental impacts of the envisaged projects; and (vii) the development of recommendations on the strategy for implementing the on going ECOWAS Priority Project and integrating new projects by indicating the necessary conditions for its realisation.	An international call for expression of interest was published by the WAPP at the end of 2009. Evaluation and selection of the bidders are completed and the consultant was selected. Contract signature is scheduled for July 2010.

Port de Pointe Noire	Transport	IRS	6,600,000	awaiting disbursement	na	AFD	Strengthening and extension of the external seawall; the rehabilitation of wharfs, public and access roads; the installation of a terminal for containers, and a wood storage zone	The IRS ITF Grant will be used to subsidise the interest rate of AFD's loan with the Port Autonome de Pointe Noire (EUR 29m, signed on 26.03.2009) for the financing of the 300m extension of the outer quay and related works.	The conditions precedent to a first disbursement under the AFD loan – as well as under the co-financing loans made available by EIB and BDEAC – are not fulfilled yet. A pre-selection of consultants for the technical assistance is planned to start in the 3rd quarter 2010.
		TA	2,000,000	awaiting disbursement	na	AFD		The TA ITF Grant will be used to finance consultancy services focussed towards implementing safe procedures, strengthening internal audit and capacity building for the financial and accounting staff of PAPN in order to help decreasing the credit risk for the Port's lenders. The Port Authority further needs external support for implementing an environmental management plan in the day-today operation period.	
ECOWAS Electricity Regulation	Energy	TA	1,700,000	awaiting disbursement	na	AFD	The Head of States of the ECOWAS (Bénin, Burkina Faso, Cap Vert, Côte d'Ivoire, the Gambia, Ghana, Guinée, Guinée-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo) have decided in December 1999 to set up a West African Power Exchange System, aiming at improving the deficits of power in the region through the construction of power interconnections and the development of power exchanges between the ECOWAS member states. The set-up of an institutional and legal environment is a pre-requisite for this	ITF Grant will be used to co-finance the second phase of the regional regulation of the West African power sector, implemented by the ECOWAS Regional Electricity Regulatory Authority (ERERA). Other co-financiers are the AFD with EUR 2.93m, the ECOWAS with EUR 2.3m and sector operators with a total of EUR 1,42m.	AFD is about to finalise an agreement with ARREC (Autorité de Régulation Régionale du secteur de l'Electricité de la CEDEAO), which is the regulatory organ established under phase 1 of this project. This agreement will determine the terms and conditions of the use of the ITF Grant by ARREC. A request for the transfer of the ITF Grant to the AFD will be submitted before 10th July 2010.

							initative.		
Benin - Togo Power Rehabilitation	Energy	IRS	12,250,000	awaiting disbursement	na	EIB	Refurbishing and extending the transmission networks of Togo and Benin, enabling the Communauté Electrique du Bénin to substantially improve the reliability of supply, to reduce the use of low-efficiency local generators and to decrease network losses.	ITF Grant will be used to finance an interest rate subsidy for EIB's loans of EUR 32m for the Republic of Benin and EUR 3m for the Republic of Togo. Both loans have been extended for the financing of the construction of a 161 kV line Onigbolo – Parakou, the construction of a 161 kV line Sakété - Porto Novo and the rehabilitation of the 161 kV line Lomé-Cotonou-Sakété. These three projects stretch over both countries, Togo and Benin.	The preparation of the tender documents is progressing and the tender publication is planned for the 2nd semester of 2010.

Regional Transmission Development Project (CESUL)	Energy	TA	700,000	awaiting disbursement	na	EIB	The Mozambique Regional Transmission Development Project (CESUL) is a power transmission system which will extend from Tete to Maputo, and which is expected to connect the Mozambique central and south electricity grids and to improve the reliability of affordable electricity in the urban centres along the route, including Maputo. It is anticipated that several large-scale industrial or commercial activities could materialize along the CESUL line route, based on improved access to a competitive, reliable source of electricity supply.	ITF Grant will be used to finance the preparation of a Strategic Regional Environmental and Social Assessment (SRESA) to set guidelines for investments in Tete Province, areas of influence and associated projects. The consultant is expected to prepare (i) a Draft Strategic Regional Environmental and Social Assessment (SRESA), (ii) a Draft Strategic Regional Environmental and Social Framework (SRESF), and a Draft Institutional Capacity Assessment and Capacity Building Program.	The request for expressions of interest was launched on 20th May 2010, the deadline for submission of bids is 15th July. The expected start of the SRESA consultancy is mid- September 2010.

Jomo Kenyatta International Airport Extension	Transport	TA	5,000,000	awaiting disbursement	na	EIB	Upgrading of the Jomo Kenyatta International Airport (JKIA) Terminal facilities to significantly increase annual passenger capacity. The project comprises the expansion and modernisation of the existing passenger terminal and aircraft handling facilities. The Promoter is the Kenya Airports Authority (KAA).	The ITF Grant will be used to finance consultancy services in order to enhance the KAA capacity to manage the JKIA expansion project through review of documentation, monitoring performance of the contractors and consultants and advising the Authority management on smooth project implementation to deliver the project as specified and in accordance with international standards, on time, within budget and with minimum interference in airport operations and to the environment. Furthermore the consultant is expected to ensure regular project reporting to the financing Banks.	the pre-selection of a number of potential bidders is completed; these bidders have received the ToR's and a tender bid evaluation took place between 9-11 June. KAA staff was invited to participate in the tender opening and evaluation process. EIB plans to sign a partnership agreement for this assistance between the KAA and EIB.
Expansion of Port of Walvis Bay	Transport	TA	450,000	awaiting disbursement	na	KfW	Expansion of the Port of Walvis Bay: the Namibian Ports Authority (NamPort) has launched a new container terminal project laid offshore at the south end of the port premises.	The ITF Grant will be used to assist NamPort in assessing the commercial risk and the financial sustainability of the project in various options and designing a financial model for the ports authority itself. The services entail four interrelated modules, namely a detailed market forecast study for the Walvis Bay container terminal, an economic analysis, a comparison of options for investing into and operating the new container terminal, including public-private partnerships; drafting the tender documents for the preferred option and the financial modelling for NamPort taken as a whole and for the container terminal.	An Agreement was signed between KfW and NamPort on 31.05.2010 for NamPort's financing of "expert services for an economic market study in the framework of the strategic expansion of the Walvis Bay Container Terminal". The study was tendered and 22 offers were received which are currently being evaluated.
Sambangalou Hydro Power Plant	Energy	TA	350,000	approved	na	AFD	Construction of a hydro-power plant with an installed capacity of 128 MW, to be operational by 2015. The total energy production	The ITF Grant will be used by OMVG to contract international consultant firms for the assessment of the Total Economic Value of the project including the environmental and social impacts and related mitigation measures, for the review of the mitigation	Tender documents were finalised in May 2010, contract signature is planned before year-end 2010.

							should reach 208 to 402 GWh per year.	and compensation measures contained in the Environmental and Social Management Plan and in the Population Resettlement Plan, an analyse of the sensitivity of the project profitability to flood variations and to climate and precipitation conditions variability as well as economical analysis opportunities potentially due to a responsible and sustainable management of natural resources within the Gambia River basin.	
Gibe 3 Hydro Power Plant	Energy	TA	1,300,000	approved	na	EIB	Construction of a 1,870 MW hydroelectric power plant.	The ITF Grant (EUR 1.3m) will be used to conduct a (i) Comprehensive Environmental and Social Impact Assessment study for Lake Turkana; and (ii) a Cumulative Impact Assessment.	After having been informed orally by the Government of Ethiopia about their decision not to borrow money from the EIB, EIB has put this project on-hold, awaiting the written confirmation of this decision.

Legend:	
TA	= Technical Assistance
IRS	= Interest rate subsidy
EIB	= European Investment Bank
KfW	= Kreditanstalt für Wiederaufbau
AFD	= Agence Française de Dév.
Lux-Dev.	= Lux-Development SA
LF	= Lead Financier
CF	= Co-Financier
PFG	= Project Financiers Group

This study offers an independent contribution to the European Union's (EU) internal discussions on its future mechanisms for the complementary use of grants and loans (blending). While blending has emerged rapidly and is now common practice in development finance, there is currently a limited evidence base on its effects, on how it works in practice, which methodology or procedure work best and whether a certain governance model is more effective in reaching its objectives. The study reviews the existing EU blending mechanisms, comparing their different governance arrangements, drawing lessons from each, and considers the pros and cons of possible future governance options for EU blending operations.

The study has been funded by the UK Department for International Development (DFID), as part of the Overseas Development Institute's European Development Cooperation Strengthening Programme (EDCSP). It has been written primarily by a team of researchers at the Overseas Development Institute. Comments and written inputs have been provided by the European Think-Tanks Group. Other contributors include the European Commission (EC), the European Investment Bank (EIB), KfW Bankengruppe, Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ), the Agence Française de Développement (AFD) and the UK Department for International Development (DFID).

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