CHAPTER 3

Private development cooperation: More bang for the buck?

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A. Introduction

The role of the private sector remains controversial in development cooperation, yet it is increasingly being solicited. The architecture of ODA is evolving, as donors seek alternative sources of development finance to fund the ambitious 2030 Agenda for Sustainable Development and to supplement dwindling levels of ODA. Donors' private sector engagement strategies prioritize a toolbox of financial instruments to support private investment in a variety of developing country contexts, including in LDCs. This move has revolutionized the definition of ODA and its purpose.

Opportunities and challenges in the initiation of a new generation of private sector-led development action and its deployment in LDCs are inextricably tied to motivations external to the 2030 Agenda and should be understood within this wider context. Donors have delegated to their development finance institutions primary responsibility for supporting the private sector, using private sector instruments backed by ODA. There are potentially far-reaching consequences for traditional development actors, including the State, as the changes to the ODA architecture shift the balance of power between and across an ever-expanding cast of development actors. This chapter assesses the new expectations, of a private sector transformed into an official development actor engaged in development cooperation. It explores emerging evidence of whether the private sector can live up to these expectations by assessing how well the activities of development finance institutions generate and maximize long-term and systemic development impacts and contribute to structural transformation.

B. Public meets private: An overview of private development cooperation

1. Overview of new terminology and adapted official development assistance architecture

The for-profit private sector (companies and investors) is diverse.[1] It varies in size, scope of activity, sectoral focus and nature of products and services. Its development contribution is correspondingly varied. It has long been recognized as a complementary source of development finance alongside but separate from ODA flows, which are inherently public and concessional. In contrast, private development finance is commercial in nature. Recent changes to the ODA architecture blur this distinction and introduce a panoply of new terminology and concepts into the sphere of development finance. For example, in 2019, the grant equivalent system introduced to measure donor effort as part of the modernization exercise became the standard for measuring ODA and, accordingly, individual loans to private sector entities are reported as ODA on a cash flow basis, provided they have a grant element of at least 25 per cent, calculated using a discount rate of 10 per cent (OECD, 2019d; see box 2.1). In the past, the field of development cooperation and ODA did not overlap with the fields of commercial finance and investor strategies, yet these fields now merge, with the incorporation of various private sector instruments and investment classes and motivations (box 3.1). However, universally agreed definitions of many of the concepts linked to private sector engagement and their application in development cooperation remain lacking. One consequence, therefore, of the reform of the ODA architecture is that a good grasp of the range of development finance terminology now current is a vital prerequisite for policymakers and researchers in tracking and understanding developments in ODA.

Previously, ODA did not overlap with commercial finance and investor strategies

Donors are concentrating their efforts on mobilizing private finance for development in response to the widening gap between the ambitions of the Sustainable Development Goals and the anaemic growth in ODA, by extending ODA-backed support to the private sector and thereby giving the private sector an official role in development cooperation. The intention is to scale up investment projects with Goals-related impacts where the opportunity for private investors (both domestic and foreign) may not be clear cut. It is argued that the use of concessional finance could, in such cases, improve on the risk–return profile of investments, making them commercially investable (Schmidt-Traub and Sachs, 2015; OECD and United Nations Capital Development Fund, 2018).

The business case elaborated in support of a dominant role for the private sector in the implementation of the Goals is impressive. The private sector is lauded for its perceived potential to have a transformative impact on the world's poor. It is characterized as more

[1] The use of the terms "private sector" and "business" in this chapter aligns with the definitions of the Addis Ababa Action Agenda and OECD, which exclude actors with a non-profit focus, such as private foundations and civil society organizations (OECD, 2016a).

efficient, more innovative and better able to capitalize on economies of scale (United Nations, 2018c). However, a common understanding of what constitutes private development cooperation and to what extent the private sector should be considered as requiring ODA remains unachieved. Concerns linger about providing ODA-backed financial support to the private sector because of the attendant risks in such an approach and because the subsidization of commercial activities remains a disputed area (Atwood et al., 2018; Carter, 2015; Carter, 2017a). For example, subsidies provided by donors could substantially jeopardize competition and lead to unfavourable market structures in recipient LDCs. It has been acknowledged that when national regulatory frameworks are weak or absent, international regulations and the voluntary initiatives of companies are a poor substitute, with negative consequences for the quality of private sector development (Davies, 2011; Reality of Aid, 2012). Another concern advocated by civil society actors and others is that public funding to the private sector can be largely unregulated and is likely to flout the accepted principles of development effectiveness (Mahn Jones, 2017). In 2016, concerns were raised and subsequently addressed by a task force of the OECD Development Assistance Committee and Export Credit Group on the boundary between developmental private sector instruments and export credits (OECD, 2016b). Donors rarely use the term “subsidy”, instead using terms such as “blended finance” and “smart lever”’ in the context of development cooperation, yet implicit subsidies are commonly operationalized through interest rate discounts, reduced taxes or grants (International Finance Corporation, 2018; OECD, 2014; Savoy et al., 2016).

In the aftermath of the Third International Conference on Financing for Development in 2015, some effort was made to bound private development cooperation. Among the issues addressed by the

Box 3.1 Sustainable action in business

The field of sustainable action in business lacks standard definitions and is subject to a variety of interpretations and gaps in monitoring. Sustainable action may or may not be oriented to the public good. In addition, it is often intended to help potential investors predict future financial performance by assessing the related impact of sustainability issues. Business has an incentive to engage in cause-related marketing. Terms such as “bluewashing” (linked to the ocean economy), “pinkwashing” (women and gender-related issues), “Goals/rainbow-washing” (the Goals and their icons) and “impactwashing” (claims by impact investors) are gaining prominence alongside the older “greenwashing” (environmental sustainability issues).

Socially responsible investments consider environmental, social and governance-related factors in portfolio selection and asset management. They are also known as sustainable, socially conscious, green or ethical investments. Impact investments are a subset of socially responsible investments and aim to both influence and practice change along with accruing financial gain. Despite their social leanings, such investments are inherently for-profit, most often in the form of private equity, and therefore often less transparent, in addition to being largely a self-reported category with regard to impacts. Existing literature on impact investing largely reflects the experience of investors. Their key selling point is a perceived ability to drive inclusive and green business and to reach bottom-of-the-pyramid populations using innovative business models. Socially responsible investment instruments include a variety of social bonds across a broad number of sectors that permit private investors to put up capital to fund a social intervention, such as catastrophe bonds issued by the World Bank, among which pension funds are major investors. Such instruments often blend impact investing, results-based financing and public–private partnerships. For example, philanthropists have played a critical role in the development of social impact investment.

Corporate social responsibility is the voluntary management of policies and programmes including, but not confined to, philanthropy, of a company, which address its commitment to stakeholders and socially responsible practices. The range of issues addressed by corporate social responsibility management generally fall within the categories of environmental, social and governance-related issues widely used by investors and lenders; although the two concepts are sometimes used interchangeably, the concept of sustainability is more commonly used by companies. Corporate communication on environmental, social and governance-related issues is usually in the form of sustainability reporting.

Responsible investment practices are efforts by investors to incorporate environmental, social and governance-related issues into investment decisions and to engage with investee companies to encourage environmental, social and governance-related practices to better manage risk and generate sustainable long-term returns. Initiatives in this area include the United Nations-backed Principles for Responsible Investment (see https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment).

Sources: Global Impact Investing Network, 2018; International Financial Reporting Standards Foundation, 2019; Mandalaki and O’Sullivan, 2016; OECD, 2016a; UNCTAD, 2014a.

Development Cooperation Forum in 2016 was the definition of "private development cooperation", which was advocated as "activities by the private sector which aim primarily to support development, do not have profit as their primary aim and involve a transfer of resources to developing countries" (Martin, 2015). This definition included private activities, both financial and non-financial, in support of development, mainly provided by non-governmental organizations and philanthropic and grant-providing organizations and individuals, and excluding all other types of private flows, including FDI, not primarily aimed at development (Martin, 2015). In the lead up to the Conference on Financing for Development, similar reasoning sought to distinguish between two categories of private investment, as follows (Schmidt-Traub and Sachs, 2015):

- Private investment mobilized using international and domestic public funds to support sustainable development.
- Commercial private investment, such as foreign direct investment.

Evidence that these distinctions have gained traction or are respected in the donor development cooperation literature and in implementation is scarce. The outcome document of the Development Cooperation Forum makes no reference to an agreed definition of private development cooperation. An important question in the evaluation of development impacts is whether commercial private investment can be easily disentangled from development-conscious private investment and where the line is to be drawn in the case of unilateral action by the private sector (box 3.1).

a. How donors have repositioned the role of official development assistance in response to the 2030 Agenda

There are several modalities through which private sector engagement occurs, including knowledge and information-sharing, policy dialogue, technical assistance, capacity development and finance (OECD, 2016a). The latter modality is the focus of this chapter and includes private sector instruments. DAC pursues a strategy of private sector engagement using private sector instruments and new financing windows to leverage private investment in the Goals in developing countries based on financial additionality, that is, the fact that investment would not have materialized without the involvement of the official sector (OECD, Development Assistance Committee, 2018). Underpinning the concept of private sector engagement is the belief that the use of ODA-backed private sector instruments

Lack of a standard definition of private sector engagement hinders provision of additionality

can induce private investment to assume a development-conscious role distinct from its usual purely profit-driven focus (Martin, 2015). Additionality has thus become the cornerstone of a new era of development finance.[2] It is often disaggregated into subcomponents (see section C). However, demonstrating and proving it is hindered by the lack of a standard definition, partly because it is context and project-specific (Carter et al., 2018).

Logically, a development-conscious role for the private sector is qualitatively different from unilateral sustainable action by business. The latter is often driven by a different rationale, tied to profit, market share and reputation, with corporate governance motivated mainly by capital markets (box 3.1). This is evidenced by numerous examples of wrongdoing in the private sector. Sustainable actions can be motivated by a variety of business interests ranging from defensive, promotional and strategic to charitable and transformative. Since business has an incentive to engage in cause-related marketing, unilateral sustainable actions produce varied results with respect to development impacts. Moreover, companies have significant leeway in how they communicate their sustainable actions, and such communications can be mistaken for deeper engagement. Neither is deeper engagement nor a development focus assured by the voluntary standards that typically govern responsible practices by business. The chair of the International Accounting Standards Board has noted that there are "too many standards and initiatives in the space of sustainability reporting" and expectations about sustainability reporting as an agent for change are exaggerated (International Financial Reporting Standards Foundation, 2019). Mandalaki and O'Sullivan (2016) propose a taxonomy of "indulgence-seeking" behaviours by business linked to sustainable actions, to explain frequently observed inconsistent corporate behaviour and apparently contradictory ethical stances by businesses.

One presupposition of private sector engagement is that the balance of risk and reward for all private

[2] See, for example, https://cidpnsi.ca/additionality-in-development-finance/ and OECD, Development Assistance Committee (2018), page 6.

sector investments is discoverable in advance. This assumption is particularly problematic in the LDC context, as Goals-related financing gaps are greater and blended transactions are more difficult to implement, compared with in other developing countries. In addition, the scarcity of market data and pricing references makes it difficult to gauge the terms under which private capital would be willing to undertake a project on its own. Donors may be tempted to label any investment that combines concessional and private finance in LDCs as additional (OECD and United Nations Capital Development Fund, 2018). Whether the private sector that is deemed worthy of ODA-supported private sector instruments in LDCs should be subject to more stringent qualifying criteria than it is in other developing countries is an open question.

DAC members have not yet reached agreement on permanent implementation rules for private sector instruments (box 3.2). The provisional arrangement proposes a reporting system to distinguish development projects from purely commercially motivated flows, yet it is unlikely that the general public or LDC Governments will easily discern the difference. The risk that regular business activity may be confused with development projects is high, given evidence that concepts such as additionality and minimal concessionality and the risk of oversubsidizing the private sector have yet to be fully internalized in policy and operational conversations in LDCs (Bhattacharya and Khan, 2019). Unresolved issues include how to assure the same level of transparency in private sector instruments as in the rest of ODA, given that investment projects involving the private sector are prone to a lack of transparency stemming from challenges related to commercial confidentiality in matters linked to the private sector. Given that the DAC aim to intensify the use of private sector instruments has led to a

Box 3.2 **Development Assistance Committee: Standardized reporting on private sector instruments**

Member countries of DAC collectively account for almost 80 per cent of global aid spending. In 2014, DAC agreed on provisional arrangements to advance the standardized treatment and reporting of practices not previously eligible as ODA. This initiative was part of a broader reform process initiated in 2012 to update the concept of ODA and better reflect the proactive efforts of members in using private sector financial instruments to mobilize private sector investment. In addition, the emerging financing strategy for the Goals provided justification for a monitoring system that covered both public and private finance. In the light of the financing deficit for achieving the Goals, one of the stated aims of the modernization exercise is to incentivize all members to use private sector instruments to crowd in additional private finance for development.

The provisional arrangement puts in place a modernized DAC statistical system that captures the diversity of private sector financial instruments used by the official sector. The taxonomy of private sector instruments eligible to be counted as ODA includes grants, guarantees or insurance, debt instruments, mezzanine finance instruments and equity and shares in collective investment vehicles. Under the proposed system, FDI, officially supported export credits and other private flows in market terms, including charitable flows, are categorized as other official flows and do not qualify as ODA.

To distinguish development projects from purely commercially motivated flows, ODA measurement will be based on an institutional approach, that is, the ODA-eligible share of inflows to development finance institutions, or on an instrument-based approach, that is, the grant equivalent of individual private sector instrument flows to partner countries. ODA eligibility thresholds are based on discount rates differentiated by income group and a grant-equivalent system for the purpose of calculating ODA figures has been introduced, as follows:

- Sovereign loans will be reported on a grant-equivalent basis using discount rates of 9, 7 and 6 per cent, respectively, for LDCs and low-income countries, lower middle-income countries and upper middle-income countries, and thresholds of 45, 15 and 10 per cent, respectively. The expected outcome is that donors will be rewarded for taking on higher risks and lending more to LDCs.
- Under the institutional approach, contributions to development finance institutions and other private sector instrument vehicles may be counted at face value. If necessary, that is, if an institution is also active in countries and/or activity areas non-eligible for ODA, the share of ODA-eligible activities in the institution's total portfolio will be estimated to establish a coefficient for ODA reporting. The expected outcome is that ODA will be determined through institutional assessment of ODA-eligible activity undertaken in addition to requirements for activity-level reporting.
- Under the instrument-based approach, loans and equities made directly to private sector entities will be counted on a cash flow basis. The expected outcome is that each investment will be reported at the individual activity level only.

Sources: OECD, 2014; OECD, 2017; OECD, Development Assistance Committee, 2018.

rise in project-based initiatives, a related concern is opacity in donor project reporting (Gutman and Horton, 2015; Kindornay et al., 2018). Similarly, the standardization of the assessment and measurement of additionality, a vital concept underpinning the channelling of ODA via the private sector, remains unresolved. Instruments such as mezzanine finance and guarantees are not assessed as ODA, except to the extent that guarantees are invoked and payments made, in which case these payments are counted as ODA. Work on the details of implementation is ongoing (OECD, 2019b).

The failure to put in place a permanent governing framework for private sector engagement in a timely fashion entails risks for donors, whose approaches to ODA-backed private sector instruments could diverge on additionality, with potentially negative consequences for development impacts and value for money (Carter, 2015).

b. The role of blended finance

One element of donor private sector engagement that has captured the imagination of donors is leveraging ODA to mobilize significantly greater amounts of private finance for investment in the Sustainable Development Goals, which has led to the catchphrase "billions-to-trillions" (African Development Bank et al., 2015; Lee, 2017). Blending complements and engages a variety of sources of finance, including but not limited to the for-profit private sector. It is part of the attempt by donors to create an environment supportive of private sector engagement. Theoretically, sources of blended finance can involve entities with more diverse legal settings than other development cooperation modalities, namely, public administration, public and commercial banks, pension funds, local financial institutions, multinational enterprises, microenterprises and small and medium-sized enterprises, individual borrowers, etc. (OECD, 2018e). As noted, sustainable actions by private sector actors can often intersect with actions by donors to mobilize or leverage private finance for Goals-related projects such as development impact bonds.

In the absence of a universally accepted definition of blended finance, the multitude of actors across different sectors in the development finance market, including LDC Governments, understand and apply the concept in a variety of different ways (Blue Orchard, 2018; OECD and United Nations Capital Development Fund, 2018). As noted, the understanding of private sector engagement is shallow in LDCs, compared with concepts championed by OECD donors. Evidence from some LDCs shows that the concept of blending is not uniformly understood by actors even within a single country, let alone across all LDCs. For example, in Bangladesh, blended finance is understood as being within the framework of development cooperation and is often associated with external concessional resources mobilizing private capital for development; in Uganda it is mostly associated with public sector incentives for the private sector to invest in specific sectors, usually manifested in the form of public–private partnerships, concessional loans, grants, guarantees and technical assistance. Blended finance is sometimes characterized as the impact-driven extension of public–private partnerships because it is rooted in the rationale of using a mix of public and private finance to fund projects with a high level of development impacts (Blue Orchard, 2018). Definitions of blended finance continue to evolve, with some definitions applying a broader interpretation than that intended by the Addis Ababa Action Agenda (Attridge and Engen, 2019; Heinrich-Fernandes, 2019; OECD, 2018f; OECD and United Nations Capital Development Fund, 2018).

Understanding of private sector engagement is shallow in LDCs

The situation is further complicated by differences between accounting methodologies used for blended finance by OECD and multilateral and regional development finance institutions, including several bilateral development finance institutions (table 3.1). The methodologies yield vastly different results, which limits comparability, and work on harmonizing the two methodologies is ongoing, but is a difficult and protracted process, with the differences based on the measurement of causality and additionality (Attridge and Engen, 2019). A critical first step towards effective blended finance is therefore a common definition and methodology.

Challenges remain with regard to attracting some classes of investors, such as institutional investors, and the blended finance market remains dominated by public players, that is, public–public blending, prompting recognition of the need for a stronger focus on the mobilization of commercial resources (Blue Orchard, 2018; Lee, 2017). Scepticism about arguments for increasing the investment of ODA in blended finance and the expectations about the leveraging power of ODA is growing in the face of mounting evidence of a low leveraging ratio (Attridge and Engen, 2019; Convergence, 2018; Gottschalk

Table 3.1

Differences in use of definitions of blended finance

Resource	Definition used by the Organization for Economic Cooperation and Development	Definition used by multilateral development banks, development finance institutions and the United Nations
Own-account resources of multilateral development banks and development finance institutions (not cofinanced)	Yes	No
Other official flows, when used by entities with a development mandate	Yes	No
Concessional ODA (donor or third-party concessional finance)	Yes	Yes
Philanthropic capital, when used by entities with a development mandate	Yes	No
Impact funds (investment below market rate)	Yes	No

Source: UNCTAD calculations, based on Attridge et al., 2019.

and Poon, 2017; Heinrich-Fernandes, 2019; OECD and United Nations Development Programme, 2019; Pereira, 2017a; United Nations, 2019a).

Despite these challenges, blended finance has become mainstream in development cooperation. Trailblazers include the International Finance Corporation, multilateral development banks and international and bilateral development finance institutions. Philanthropic organizations, particularly private foundations, still play a small role (Blue Orchard, 2018; Convergence, 2018; Lee, 2017).

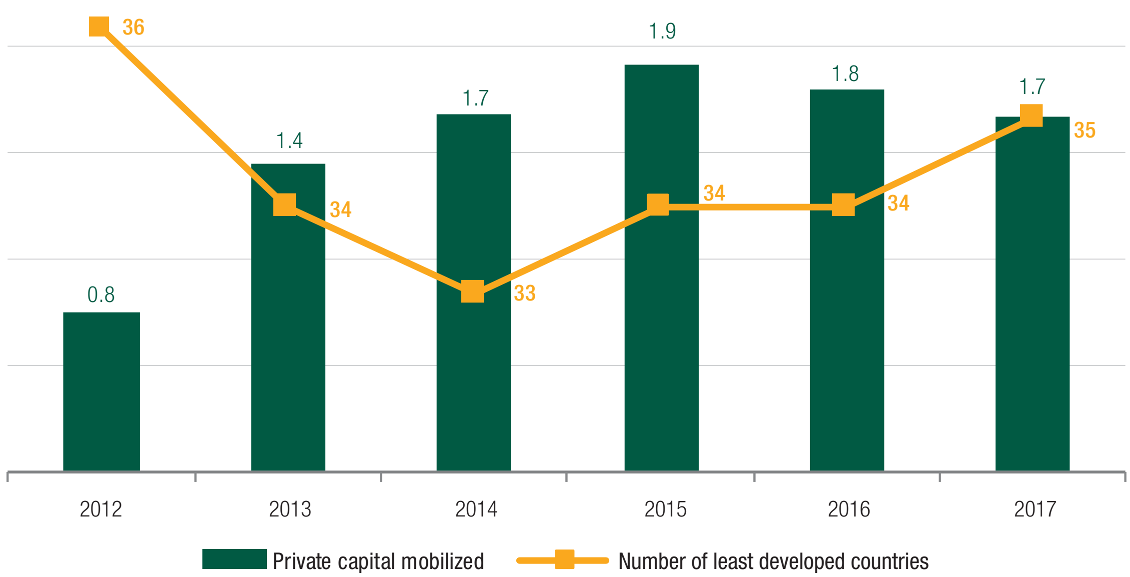
By 2018, 17 of the 23 members of OECD were engaged in blending and 167 facilities to pool finance for blending were launched in 2000–2016 (OECD, 2018g). In 2008–2017, the European Union set up eight regional investment platforms, extending blended finance to Africa, Asia, the Caribbean, Latin America, the Pacific and other countries in Europe (OECD, 2018h).

As shown in figure 3.1, the amount of capital mobilized from the private sector and channelled to LDCs reached $9.27 billion in 2012–2017 (OECD, 2019e;

Figure 3.1

Private capital mobilized in the least developed countries

(Billions of dollars)



Source: UNCTAD calculations, based on OECD data.

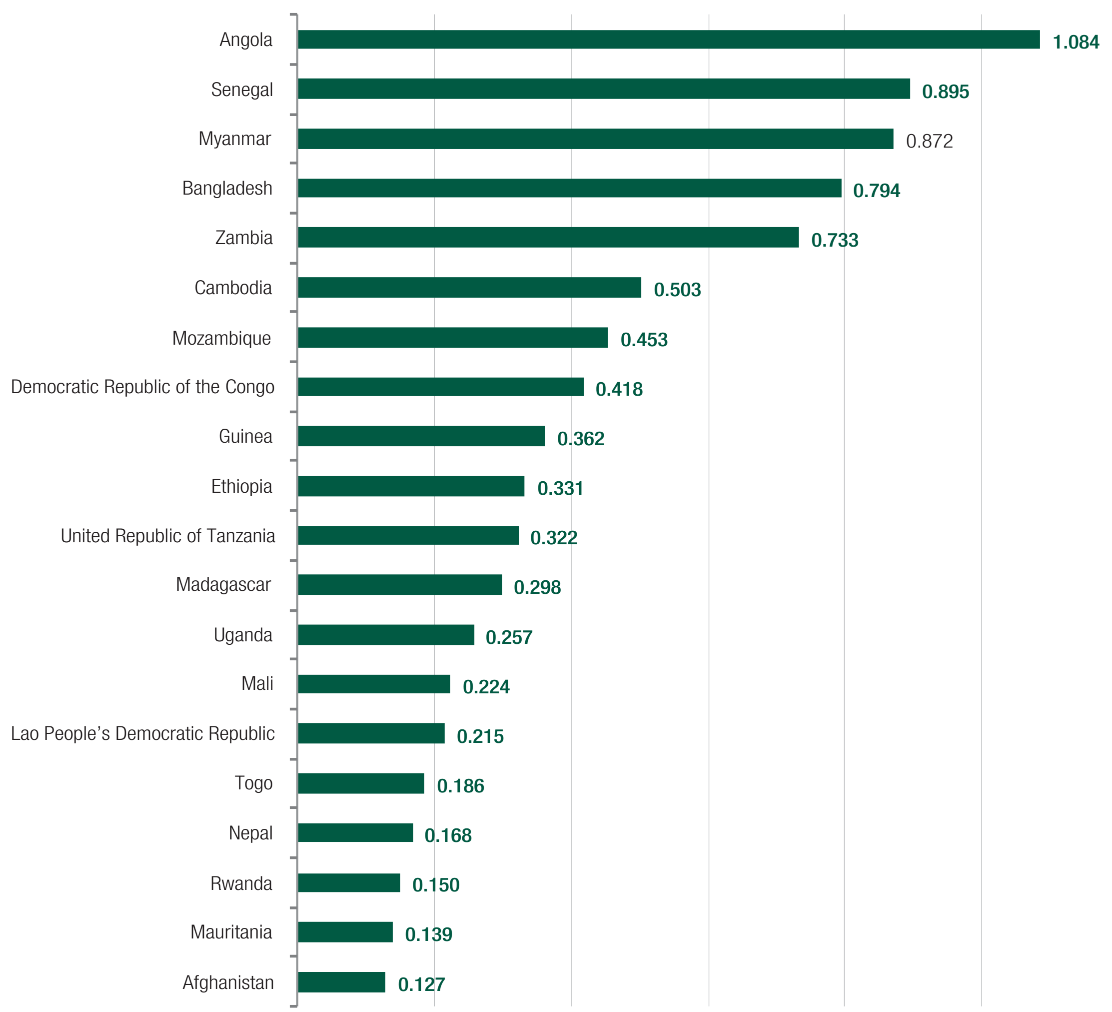
estimates of private sector engagement are valid for 2019 and data for 2016–2017 is preliminary). LDCs accounted for 6 per cent of the capital mobilized (8 per cent of private capital, excluding regional allocations), equivalent to only 5.8 per cent of the volume of ODA disbursed to LDCs. This underlines the continued need in LDCs for official development finance.

The distribution of privately mobilized capital flows in LDCs is uneven and concentrated in a few countries. The top three recipients accounted for nearly 30 per cent of all additional private finance and the top 10 countries, almost 70 per cent. In 2012–2017, among LDCs, the beneficiary country with the greatest amount received was Angola, at $1 billion, followed by Senegal, at $0.9 billion, and Myanmar, at $0.9 billion (figure 3.2). According to a statistical survey, in Angola, several guarantees granted by the World Bank Group enabled additional private investments amounting to more than $800 million. By contrast, Myanmar and Senegal attracted many smaller sized investments. Private capital participation was registered in 42 out of 47 LDCs; the five LDCs that did not benefit from mobilized private capital were the Central African Republic, the Comoros, Eritrea, Kiribati and Tuvalu. A previous survey on blended finance in 2012–2015 reported the absence of such operations in 13 out of 48 LDCs (OECD and United Nations Capital Development Fund, 2018). The increase in the number of LDCs benefiting from blended finance operations is explained by enhanced

Figure 3.2

Distribution of privately mobilized capital among top 20 beneficiary countries, 2012–2017

(Billions of dollars)

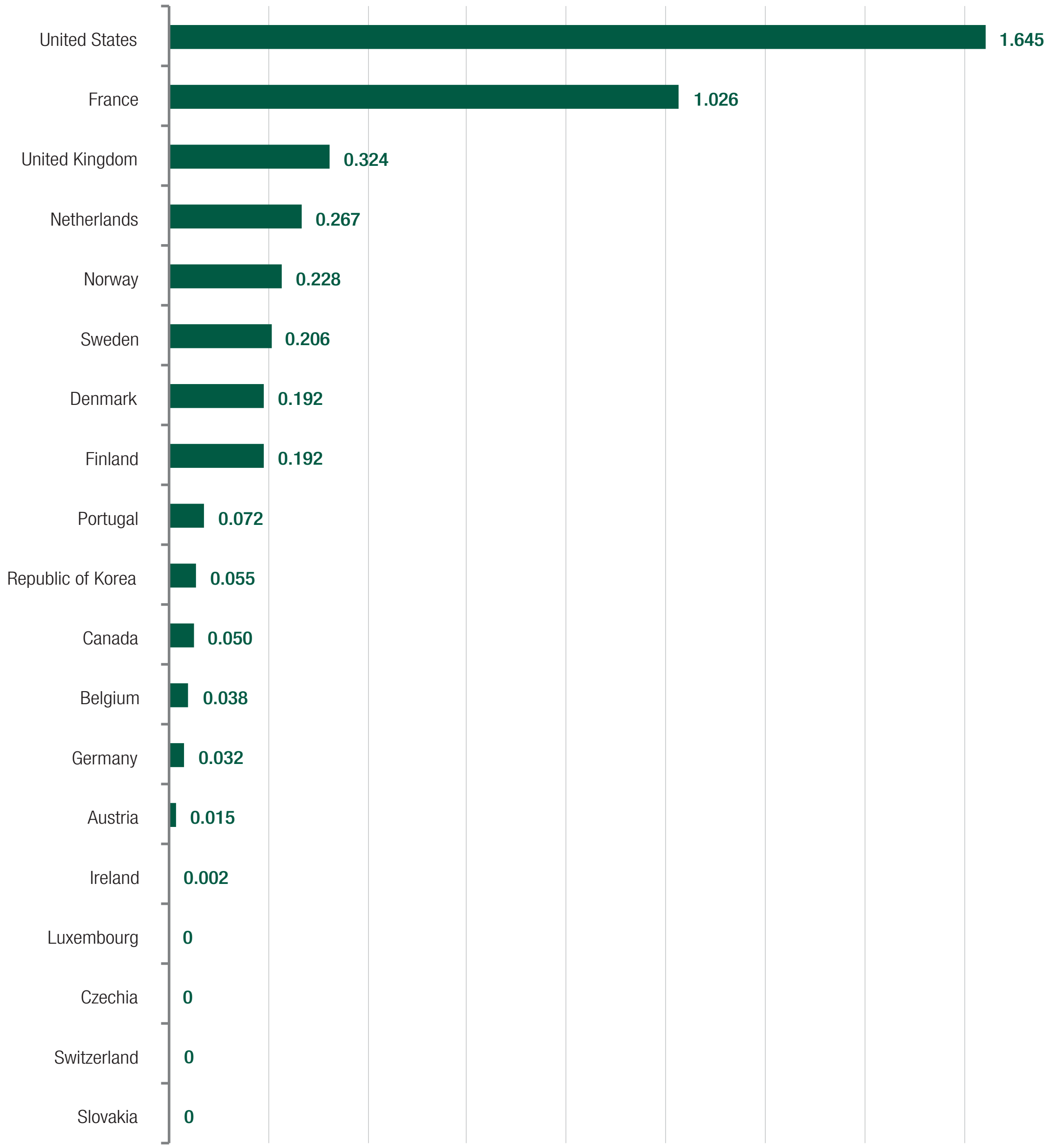


Source: UNCTAD calculations, based on OECD data.

Figure 3.3

Distribution of mobilized private capital by bilateral donors, 2012–2017

(Billions of dollars)



Source: UNCTAD calculations, based on OECD data.

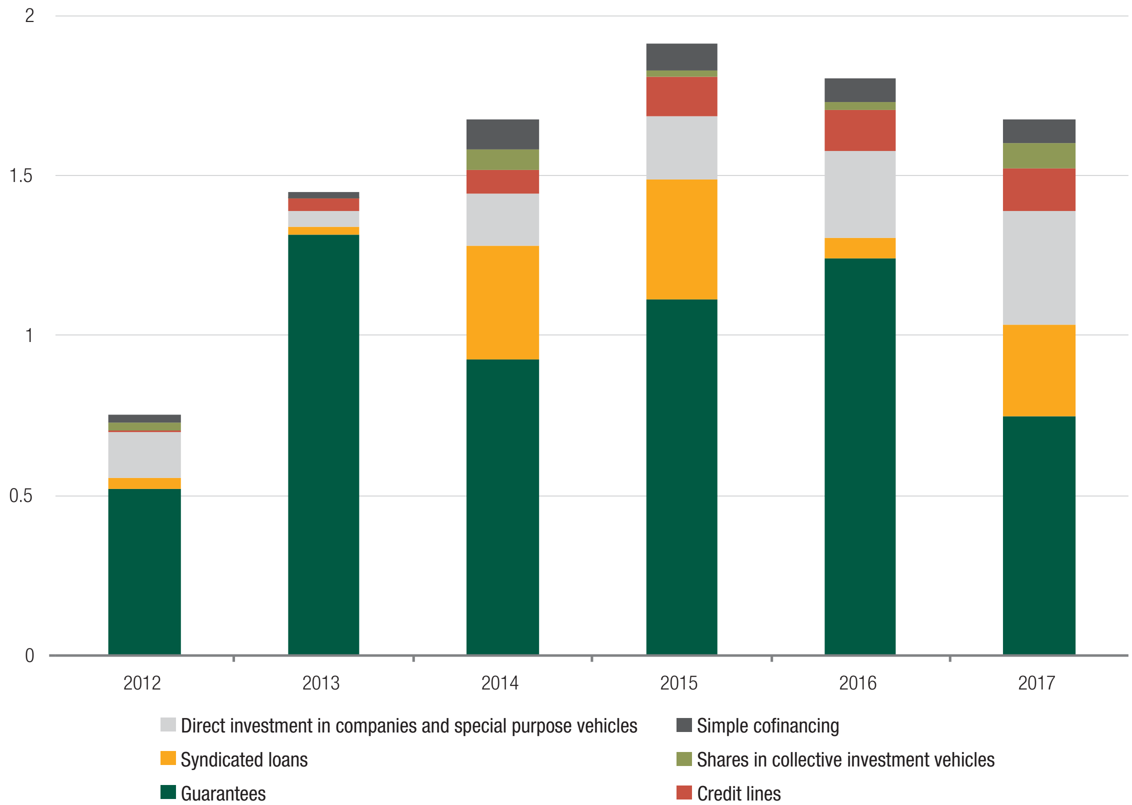
private capital engagement and the wider coverage of statistical monitoring.

Only 33–36 countries engaged additional private capital inflows each year and, year on year in 2012–2017, only 26 LDCs unlocked additional private finance. In addition, 25–30 per cent of LDCs do not attract additional private capital on an annual basis. This underlines the instability of such flows in nearly half of receiving LDCs. The data suggests that private sector engagement and blending is unlikely to compensate for the structural difficulties faced by many LDCs in attracting private capital, in particular small island developing States and landlocked developing countries. It therefore seems unrealistic to expect the private sector to be the main source of development finance in LDCs. Crucially, the 2030 Agenda does not

Figure 3.4

Distribution of mobilized private capital in the least developed countries by instrument, 2012–2017

(Billions of dollars)



Source: UNCTAD calculations, based on OECD data.

envisage a single instrument or modality to address all development problems.

With regard to blended finance, in 2012–2017, sub-Saharan Africa received the highest volume of mobilized capital, at 70 per cent ($6.5 billion), compared with 2 per cent ($2 billion) in Central and South Asia and $0.7 billion (7.8 per cent) in Far East Asia; Middle East, Central and North America and Oceania together accounted for less than 1 per cent.[3] In 2012–2017, multilateral organizations provided the largest share, at 52 per cent, of additional private capital to LDCs. To date, guarantees remain the instrument most requested by investors in LDCs. The Multilateral Investment Guarantee Agency, which accounts for 30 per cent of all additional private capital investments in LDCs, unlocked $2.8 billion of additional private capital; the International Finance Corporation unlocked $0.5 billion; and the Private Infrastructure Development Group unlocked $0.4 billion. Bilateral donors unlocked 46.9 per cent of additional private investments, with the main contributors being the United States of America, at $1.6 billion, France, at $1 billion, followed by the United Kingdom of Great Britain and Northern Ireland (figure 3.3).

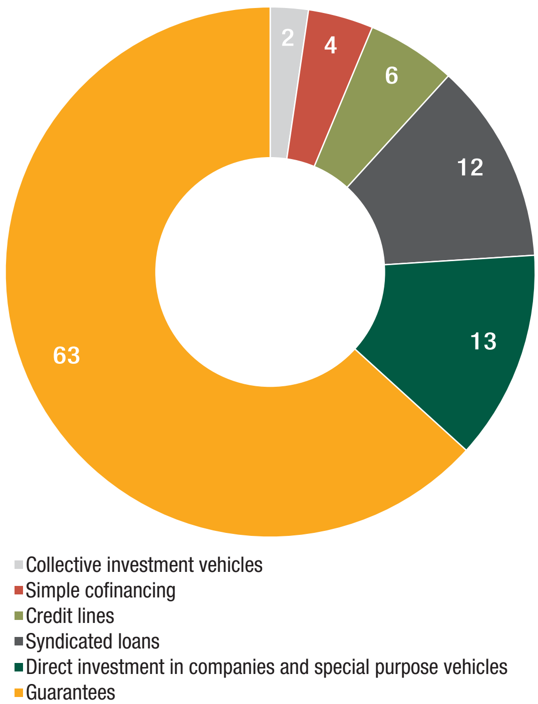
In 2017, 28.5 per cent of mobilized private capital originated from an OECD member country or another high-income country, other than an official donor or provider country. The high share of this group of countries is explained by the greater average number of operations. The second largest source was domestic private sectors from beneficiary countries, which invested 23.3 per cent of all mobilized private capital. Provider country private investors accounted for 16 per cent of private sector operations. Cooperation between official donors and private businesses from provider countries financed more than 400 projects, most of which were through simple cofinancing arrangements. In 2012–2017, with regard to leverage mechanisms, guarantees helped to mobilize $5.9 billion of private capital to LDCs (figures 3.4 and 3.5). In the same period, the share of guarantees not

3 Regional designations reflect the categories in the OECD data.

Figure 3.5

Share of selected private sector instruments in the least developed countries, 2012–2017

(Percentage)



Source: UNCTAD calculations, based on OECD data.

accompanied by official flows among all instruments in LDCs reached 63 per cent; 21 percentage points more than its share for all countries. This casts doubt on the justifications for blended finance.

The sectoral distribution of mobilized private capital shows a concentration in revenue-generating sectors in LDCs (OECD and United Nations Capital Development Fund, 2018; figure 3.6). Energy, banking and financial services and industry, mining and construction attracted $5.6 billion (60 per cent). This is of concern, not because these are not sectors with a strong development impact and likely to help achieve structural transformation, but because there may be less reason to believe that these sectors would not have been served by commercial finance or conventional public–private partnerships, which tend to target sectors aligned with development plans, implying a certain degree of recipient State leadership in contracting the private sector, compared with the propensity of donor or private sector leadership, which may be inferred by donors' private sector engagement and the implementation of private sector instruments. The institutions and regulations currently in place in many LDCs to accommodate the leveraging of private capital towards national development priorities are in the context of public–private partnerships (UNCTAD, 2016c). Public and private actors in LDCs have questioned the adequacy of existing frameworks in effectively facilitating blended operations (Bhattacharya and Khan, 2019). The historically high level of use of credit guarantees in LDCs is explained by the fact that they are the instrument of choice when a project or company can generate enough revenue, to which the guarantee can be attached, in order to service a loan. For example, regulated tariffs and long-term concessions often ensure cash flow stability for water or electricity-related infrastructure projects (OECD and United Nations Capital Development Fund, 2018).

A more detailed analysis of the purpose of mobilized private sector investments shows that the greatest share of investments goes to formal sector financial intermediaries and telecommunications, areas that are high-growth revenue generators (figure 3.7).

The volume of mobilized private sector flows is correlated with the size of the recipient economy (figure 3.8). The association is statistically significant[4] and is evidence that the hypothesis that large LDC economies could absorb or attract more investment may be valid.

c. Additional insights on guiding frameworks for operationalizing private sector engagement

Multilateral and regional development finance institutions are also pursuing increased collaboration with the private sector. Notably, in 2018, the World Bank Group, the greatest multilateral lender, instituted its maximizing finance for development, or cascade, approach (Engen and Prizzon, 2018). This approach specifies recourse first to private sector financing solutions for development finance needs in developing countries. The use of public funding is allowable only after policy and regulatory reform or after the implementation of World Bank Group risk mitigation instruments have been assessed as likely insufficient to unlock private solutions (World Bank, 2016; World Bank, 2018).[5] In instituting this approach, the World Bank Group follows the reasoning that the private sector should play a substantially greater role in development and that the public sector should act only when private solutions are not available (World Bank, 2018). As part of its

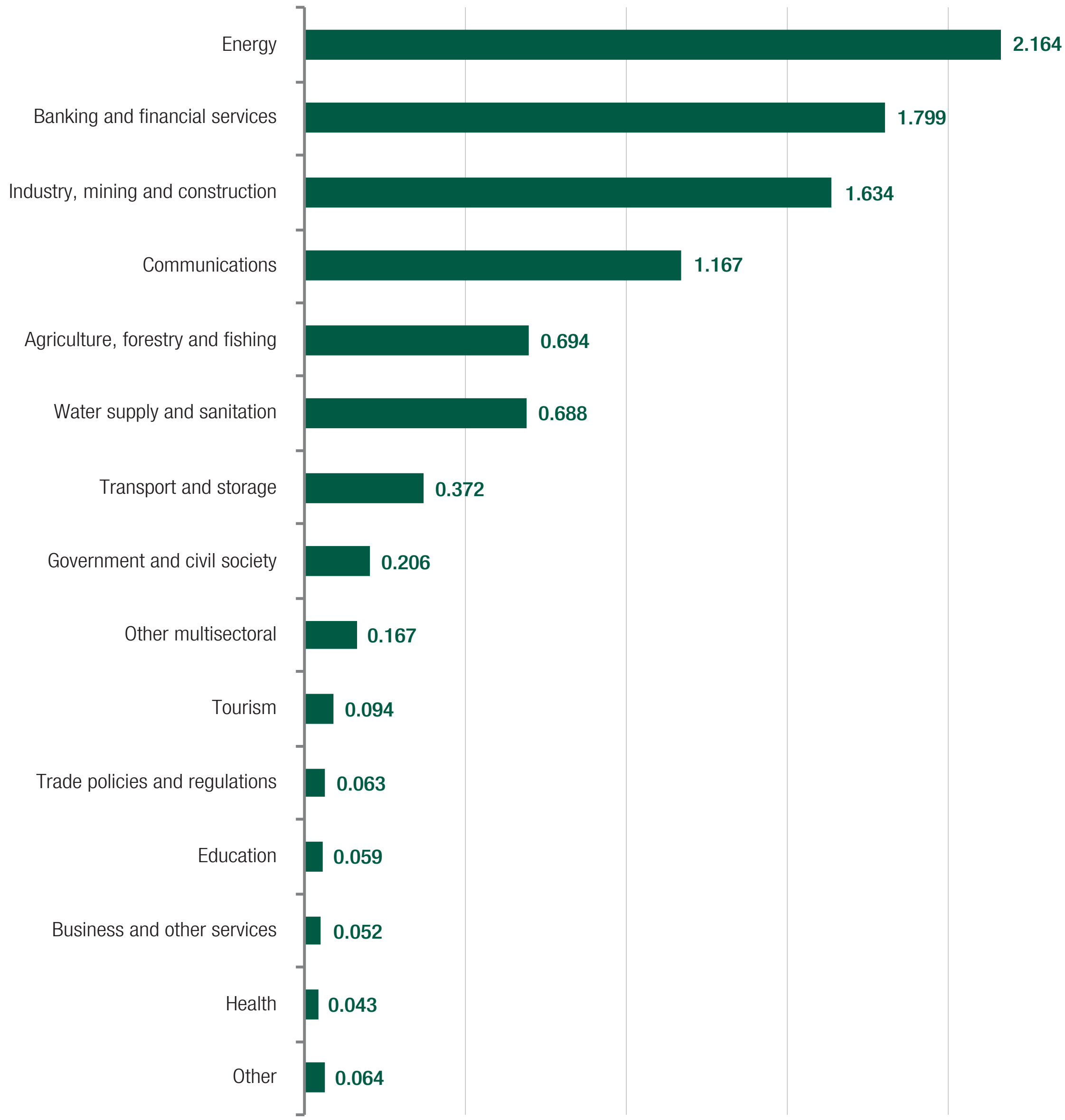
4 Due to the concentration of private capital in a few countries with a high level of GNI, these countries appear as outliers and, also given the number of countries that do not receive any private capital investment, the best fit regression line may appear misleading.

5 See https://www.miga.org/products.

Figure 3.6

Distribution of mobilized private capital in the least developed countries by sector, 2012–2017

(Billions of dollars)



Source: UNCTAD calculations, based on OECD data.

Note: "Other multisectoral" denotes private capital that cannot be assigned to individual statistical categories; "other" denotes the sum of sectors not noted separately due to low levels of investment.

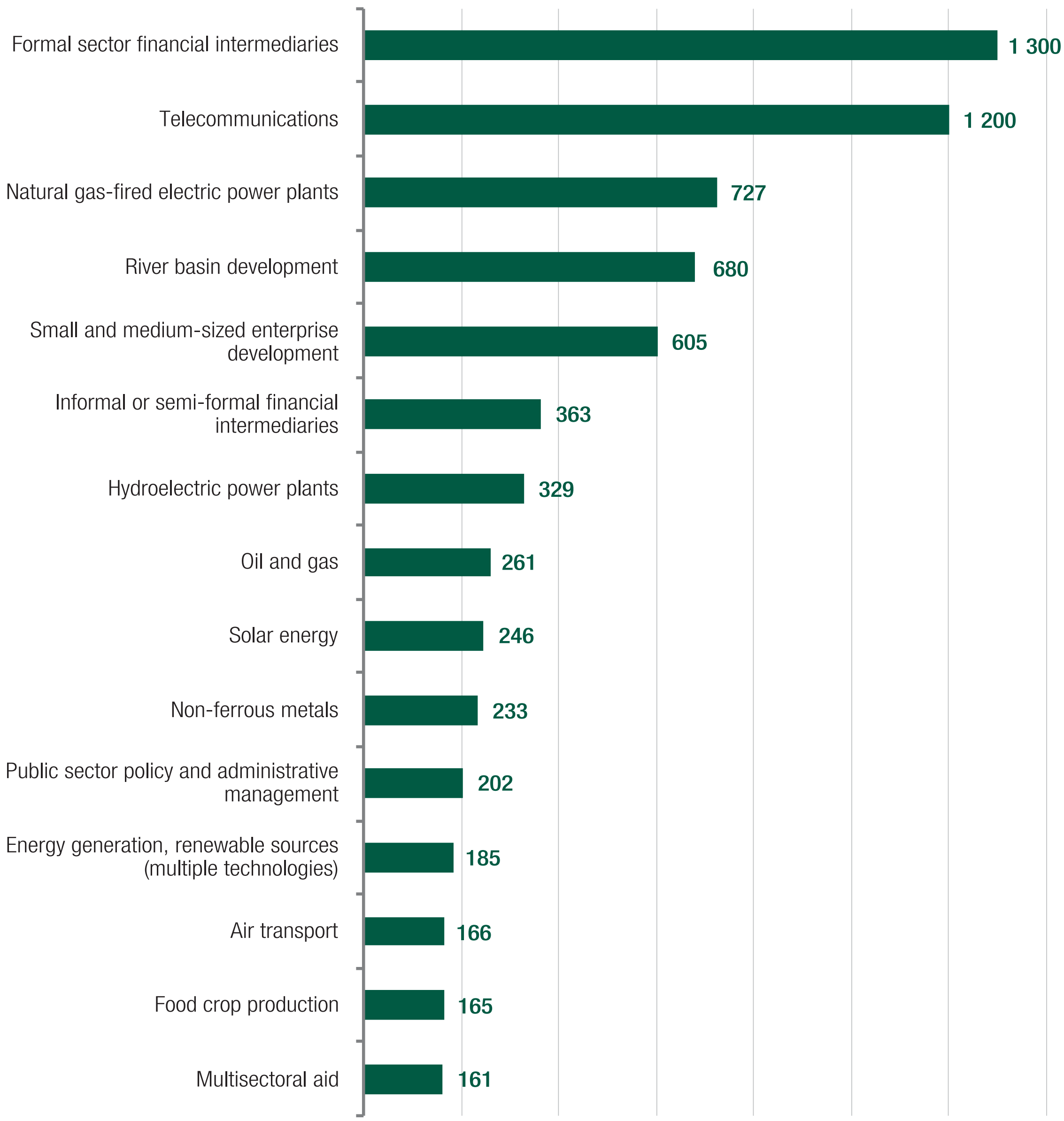
efforts to help implement the 2030 Agenda, the World Bank (2019) is developing a new strategy for fragile and conflict-affected States, to be completed in 2020, intended to help systematize its approach in complex situations that demand an increasing share of its resources.

The maximizing finance for development approach harks back to the era of structural adjustment and its associated aid conditionalities. It appears to ignore the lessons from that era and deem that private interests are always aligned with human welfare and sustainable development in developing countries. By seeking to shape domestic policies and decision-making processes in the interest of private investment, it suborns LDC ownership of development policy. The 2030 Agenda emphasizes

Figure 3.7

Purpose of allocations of mobilized private capital in the least developed countries, 2012–2017

(Billions of dollars)



Source: UNCTAD calculations, based on OECD data.

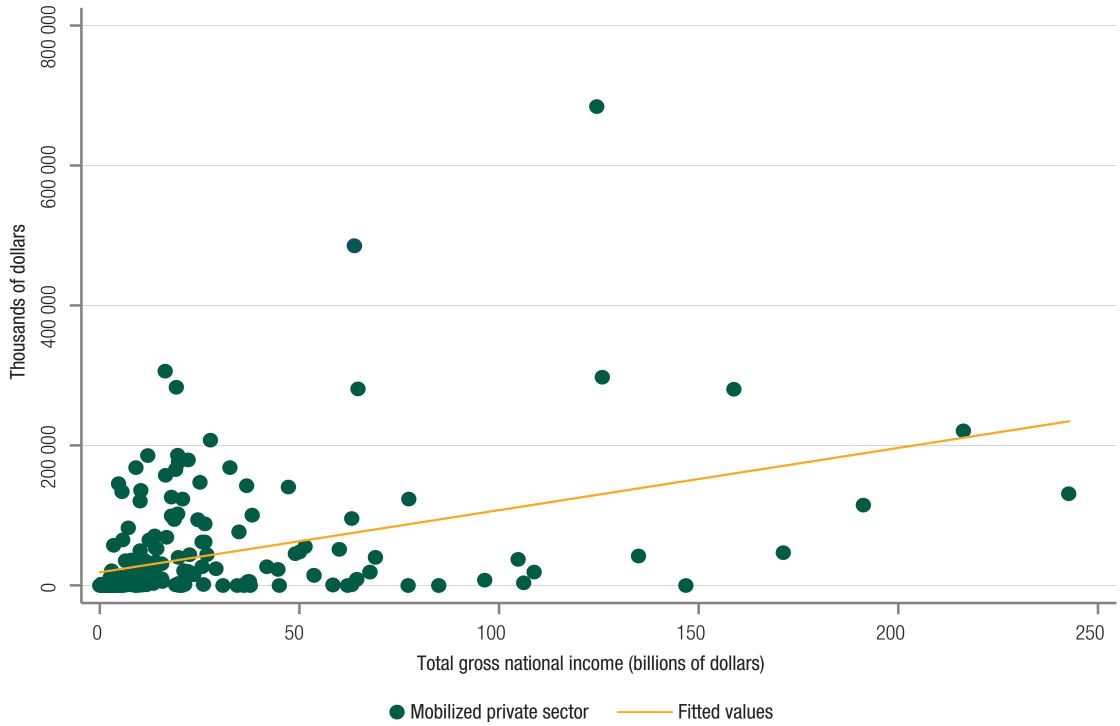
Note: Multisectoral aid denotes aid that that cannot be assigned to individual statistical categories.

the need for Governments to exercise discretion in line with national contexts and interests in such matters, and similar sentiments are echoed by others (African Development Bank, 2013; Bretton Woods Project, 2019; European Union, 2018). The maximizing finance approach limits the options for LDCs to address development challenges in a tailored manner in context-specific development settings.

The United Nations (2019e) slates what it calls an entirely one-sided solution to development financing. It is important to recall that the World Bank Group aims to assist policymakers in developing countries to design and implement policies to address development challenges and the growing list of global challenges. In this role, the World Bank Group has considerable influence on developing country policy

Figure 3.8

Distribution of mobilized private capital in the least developed countries by gross national income



Source: UNCTAD calculations, based on OECD data.

choices through its research, surveillance reports and lending programme buttressed by conditionalities (Bretton Woods Project, 2019; Brunswijck, 2019). It is also distinguished by its shareholding structure, controlled largely by a small group of countries with the greatest voting power, in comparison with other multilateral development banks.[6] This is a source of discontent among developing countries and civil society (Bretton Woods Project, 2019; Engen and Prizzon, 2018; Financial Times, 2012; Prizzon et al., 2017; Wolf, 2019).

Donors increasingly aspire to a key role in policy and political dialogue with recipients in support of regulatory, policy and governance-related reforms in the context of private sector engagement. One concern is that the Goals should not serve as a vehicle for imposing explicit or implicit conditionalities that could impinge on the right to development of LDCs and sovereignty in charting their own paths to development. Nor should the pursuit of the Goals limit the ability of LDC Governments to ensure that reforms, if necessary, are undertaken at a pace and degree that produces long-term sustainable gains. For example, in contrast to developed countries, LDCs are typically constrained in their ability to withstand pressure to liberalize sensitive areas such as public procurement or to take timely measures to protect strategic sectors (Gehrke, 2019).

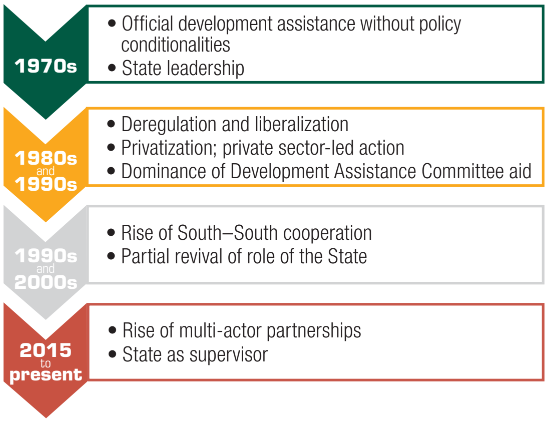
2. Development finance and assistance: Evolution or revolution?

Private sector agency in development policy and practice predates the 2030 Agenda. The Addis Ababa Action Agenda is often credited with valorizing the private sector as a development actor, yet it was built on the same foundational premises as its predecessor, the Monterrey Consensus. The latter resulted in an international commitment to generate an additional $50 billion for development assistance linked to the Millennium Development Goals, to be attained by 2015. Blended finance was already in ascendancy by 2008, as a result of the global financial crisis of 2008/09 and the abrupt lack of liquidity for many private investors (Blue Orchard, 2018).

6 As the largest shareholder, the United States retains veto power (see https://www.worldbank.org/en/country/unitedstates/overview, https://finances.worldbank.org/Shareholder-Equity/Top-8-countries-voting-power/udm3-vzz9 and https://www.worldbank.org/en/about/leadership/votingpowers/).

Figure 3.9

Evolution of the role of the private sector in development assistance



Source: UNCTAD.

Assigning the private sector with a formal role in development cooperation represents a revolution in the definition and measurement of ODA but more of an evolution in private sector involvement. For example, business involvement in humanitarian emergency preparedness, response and recovery is well documented and has attracted acclaim (United Nations Office for the Coordination of Humanitarian Affairs, 2017). Likewise, a range of actors, including donors and their entities with market-oriented operations, multilateral development banks, commercial banks and private investors have previously provided private sector instruments at market terms with a commercial motive (Bandura, 2017). DAC members are already using their development finance institutions to engage in practices characterized as blended finance and catalytic aid.[7]

The status of the private sector in development has undergone a recurrent pattern of decline and regrowth in line with the evolution of the dominant development policy doctrine (figure 3.9). The most recent reconfiguration of the cast of actors on the development assistance stage can be viewed as a further iteration in this pattern. The idea of global public goods under the Goals has reinvigorated the stance that publicly subsidized private sector-led economic growth is the key engine of development (Mawdsley, 2017). It evokes many elements of the modernization theories of the 1950s and 1960s, including the focus on energy and transport infrastructure, agro-industrial productivity and an optimistic sense of forward momentum. Important differences with earlier eras include the different articulation of power between States, firms and markets in the neoliberal era, the prominence of financial firms and interests rather than more conventional profit-seeking enterprises and the complexity of the actors involved (Mawdsley, 2017).

Figure 3.9 is a simplified mapping of the ebb and flow of the popularity of the private sector in development assistance. Prior to the late 1960s and 1970s, development and aid policies were informed by the need to industrialize and for the differentiated treatment of structurally dissimilar economies. The political economy of aid was largely informed by the cold war, the escalation of which led to the founding of DAC. The role of the State and its leadership in development remained largely unchallenged by aid policies through to the mid-1980s, despite a qualitative shift in emphasis from productive to social programmes following the development of the basic needs approach to welfare economics, as discussed later in this section. Changes to aid policy in favour of a more active role for the private sector in development assistance, mainly as a partner to aid-recipient Governments, came with the liberalization agenda and the aid conditionalities associated with the era of World Bank Group-sponsored structural adjustment programmes in the late 1980s and early 1990s. In this period, non-governmental organizations and public–private partnerships were ascendant and DAC members were the dominant source of development finance. By the mid-1990s, the perceived failure of imposed structural adjustment programmes, issues related to local ownership and aid effectiveness and concerns about the negative aspects of public–private partnerships led to waning enthusiasm for private sector-led development and the partial re-instatement of the leadership role of the State. This period also saw providers of South–South cooperation begin to play a greater role in development finance (Edwards, 2014; Fukuda-Parr, 2012; Gomes and Esteves, 2018; Gunatilake et al., 2015; Hulme, 2013; Mawdsley, 2014; Mawdsley, 2017; Vaes and Huyse, 2015).

Throughout this evolution and to date, the role of the State in developing countries has continued to be contested (Rodrik, 2013). The Sustainable Development Goals reflect a compromise between competing conceptions of the State, as a provider or

[7] Catalytic aid is aid that speeds up change processes in others, including through crowding in additional national efforts or commercial domestic and foreign private sector investment. Humanitarian aid, that is, involving programmes designed to improve living standards by providing key services, such as increased primary education or vaccinations, generally does not fit in this framework. Catalytic aid has a long-standing association with growth-enhancing or transformative change and, in this regard, graduation from aid (Rogerson, 2011).

simply a facilitator of the private sector, yet subsequent developments have seen a significant emphasis on public–private partnerships, including unilateral action by the private sector (United Nations, 2018d).

a. Strategic interests reshape aid allocation decisions and partnerships

ODA does not operate in a vacuum. Financing strategies have impacts that extend to the political dimension. The context in response to which and within which the changes to the aid architecture have arisen is thus difficult to ignore. Global solidarity with regard to the Goals is based on the concept of shared value, yet the relationship between value and strategic interests is not free of tensions. It is generally accepted that national interests are a permanent feature of development cooperation. At the conference in 1944 that led to the creation of the International Monetary Fund and the International Bank for Reconstruction and Development, Henry Morgenthau stated that the most effective way to protect national interests was through international cooperation. The debate on the place of national interest in development cooperation continues today (Gulrajani, 2017; Wolf, 2019).

Nationalist populist sentiment in many countries advocates for the greater use of aid to serve strategic national and short-term interests. Leading issues include security and migration, geographic focus and the amount of aid that should go to more advanced developing countries (Di Ciommo et al., 2019; German Development Institute, 2018; Rudolph, 2017). Security interests are a prominent explanatory factor of the focus of DAC aid policy in the post-2000 period (Crawford and Kacarska, 2019). Growing trends include the formal oversight of foreign policy, whereby donor countries increasingly opt to establish development assistance departments within their ministries of foreign affairs; and security concerns in international development strategies and humanitarian practices, such as concerns related to terrorism and migration (Bartenev and Glazunova, 2013; de Felice, 2015; Mawdsley, 2017). For example, the United States administration is seeking to restrict funding to countries that are considered as not doing enough to combat human trafficking, including LDCs (Devex, 2019a).

Since the events of 11 September 2001, weak States have been viewed as potential sources of transnational threats (Coggins, 2015; Freedman, 2006; OECD, 2016c; Patrick, 2011). One consequence of this is a renewed focus on the category of fragile and conflict-affected States, now repositioned as a critical frontier in the implementation of the 2030 Agenda. Estimates show that, without action, more than 80 per cent of the world's poorest will be living in fragile contexts by 2030 (OECD, 2018i). Consequently, there is a debate among donors on whether aid should go to the poorest countries or should follow the poor. The latter argument favours an increasing focus on non-LDC developing countries. It is important to note that there is no universal definition of state fragility. The category is elastic, with no fixed list of fragile States. Donors maintain their own individual lists of such States. For example, the internal approach of the International Monetary Fund labels about 45 per cent of low-income members as fragile (International Monetary Fund, 2018). In 2019, the harmonized list of countries in fragile situations of the World Bank Group included 51 per cent of LDCs. However, the various classifications encompass middle-income countries, and the implications for LDCs as a group may not be neutral. Among the concerns raised are scarce aid resources being diverted from development priorities in recipient countries and recipients being pushed to alter national policies in line with donor security concerns.

Managing donor self-interest is a foreseeable challenge for LDCs

Managing donor self-interest is a foreseeable challenge in LDCs because aid-based private sector instruments can incorporate strategies that promote donors' own private sectors. For example, research suggests that the impact of the European Union on reform agenda-setting in developing countries is stronger than that of any single bilateral donor (Bodenstein et al., 2017). Evidence that aid recipients have had a voice or role in the redesign of the aid architecture is lacking. A systematic mapping of what should be the role of the private sector and what should be the role of the public sector has not been agreed with aid recipients.

The total official support for sustainable development database has been proposed by OECD to complement existing statistical monitoring of ODA by providing information on additional resources above and beyond ODA, including several other types of flows such as private investment and export credits. The development of the database involved an open and inclusive process, whereby a dedicated task force was established to elaborate the statistical features of the database and prepare a first set of reporting instructions.[8] Four LDCs are

[8] See oecd.org/dac/financing-sustainable-development/development-finance-standards/tossd-task-force.htm.

represented on the task force. Bearing in mind that transparency is not a goal for its own sake but as a means to an end, disclosure of actions donors have taken is not necessarily transformational if recipient States are constrained in their ability to have a say in what should be done, evaluate what has been done and pronounce whether it should have been done. LDC Governments are set to be a third party in the DAC private sector engagement process. How far the lack of recipient State agency in private sector engagement can be compensated for by the new database is an open question.

Development practitioners continue to debate on how to enlist the support of the private sector without substituting for the State and undermining its critical role and responsibility in the provision of basic services to citizens. This area of policy represents an additional point of divergence among DAC members, with several countries having funded commercial actors in roles traditionally expected to be carried out by the public sector. To date, clarity in this area has been confined to decisions about commercial private schools, whereby the European Parliament instituted a ban on European Union development aid funding to such entities in 2018, amid concerns that the fast-paced growth of private actors in education could undermine decades of progress in public education. The ban excludes small-scale non-profit private schools such as faith-based, non-governmental organization and community schools, although the role of these actors is not uncontested (Karam, 2019; Ulleberg, 2009).[9] In June 2019, members of the multi-donor Global Partnership for Education, the largest global education fund, at $2.3 billion, agreed to prohibit funds from being used to support commercial education actors unless under exceptional circumstances (Global Partnership for Education, 2019). Commercial schools have been defined as schools with an objective to develop commercial activities out of education services including, among others, product testers, data advice companies and education publishers. While the problem is not confined to developing countries, these countries have a lower capacity to detect and legislate against inimical practices (Dempsey, 2017; Raine, 2007). The Special Rapporteur on the right to education has noted that the persistent underfunding of public education and the rapid and unregulated growth in the involvement of private, in particular commercial, actors in education, threaten the implementation of the right to education for all and the achievement of Goal 4 (United Nations, 2019e).

Avoiding relegation to a bystander role will be key for LDC Governments

As development action linked to aid is increasingly outsourced to the private sector, a key challenge for democratically elected LDC Governments will be to avoid relegation to a bystander role. The quality of the multiparty partnerships that LDC Governments will be able to broker with the private sector and other stakeholders is a key area of concern. LDC Governments are typically constrained in their abilities to fulfil their key roles. Constraints in aid absorption are often cited as an inhibitor to donor engagement. However, recent case studies present a more nuanced picture (Guillaumont and Wagner, 2014; Haider, 2018) and raise the question of whether an effort to address the problem rather than to accept it as a standard could better entrench sustainable development in the long term.

DAC donors are not homogenous in their approaches to political conditionality in development assistance, and the extent to which their development assistance policies internalize political conditionality is often shaped by domestic conditions. The evidence suggests that it remains a significant policy tool and its nature and agenda has evolved beyond foreign aid to encompass areas such as security, trade and other policy fields (Bartenev and Glazunova, 2013; Crawford and Kacarska, 2019; de Felice, 2015; de Felice, 2016; Koch, 2015; Molenaers et al., 2015).

The roles of the private sector, donors, philanthropists and civil society have become blurred.[10] Increased interdependence and new means of collaboration are the norm (Byiers et al., 2016). Such actors seek to leverage government resources and affect government policy. Large philanthropic organizations increasingly have the power to shape national policy and global development aid policy, sometimes using aggressive corporate strategies to lobby for their interests

[9] Significant political and cultural differences are also noted with regard to philanthropy. With regard to charitable donations, in the United States, 60 per cent are made to religious organizations and 2 per cent to international aid; in the United Kingdom, the figures are 8 and 14 per cent, respectively (Moran and Stone, 2016).

[10] Civil society is not homogenous, nor does it represent a single set of interests, being neither exempt from political nor power dynamics that shape its activities and scope of work. Dependence on aid often ties civil society actors to the agendas of official donors. Paragraph 20 of the Accra Agenda for Action states that civil society organizations are development actors in their own right.

(Moran and Stone, 2016). The consequences of this development are not unequivocally positive (Global Justice Now, 2016; Hay and Muller, 2014; Project Syndicate, 2019a). Not all philanthropic flows are reported, and private flows are not reported. Greater transparency is needed among these development cooperation actors.

Compared with the private sector, non-governmental organizations, including others in the broader category of civil society organizations, have long been regarded as commanding moral and ethical agency, but their role and work is not accepted uncritically (Elbers and Schulpen, 2015; Faraz et al., 2018; Gourevitch et al., 2011; Hay and Muller, 2014; Ulleberg, 2009; Werker and Ahmed, 2008). Under the new ODA architecture, non-governmental organizations, in particular international ones, are embattled on two fronts, namely, the decisive shift towards the for-profit sector and the rise of donor localization initiatives that bypass non-governmental organizations by directly funding local civil society. However, localization poses a lesser threat to international non-governmental organizations that have the option of establishing local offices (Devex, 2019b).

A fourth sector has been predicted that encompasses coalitions that blend the best aspects of the private and public sectors with civil society, to better address development challenges and maximize impacts (Bulloch and James, 2014). However, increased interdependence masks an unequal balance of power and influence between partners, such that weaker partners are brought under the sphere of influence and network of advocacy of more powerful partners. This risk is also current among donor localization strategies.

Another group of actors gaining prominence are developing countries acting within South–South cooperation frameworks. South–South cooperation advances mutual interests rather than moral obligations, as its core motivation is to achieve sustainable development. It therefore eschews the terminology of development assistance, aid and donors conventionally associated with DAC members, and adopts the concepts of development cooperation and development partnerships. In 2017, 84 per cent of countries providing South–South cooperation reported exchanging information on science, technology and innovation (United Nations, Economic and Social Council, 2018).

Donors are increasingly concerned by the developing country status of more advanced developing countries, generally with regard to the following three main issues: concern that the balance of power in

South–South cooperation involves the exchange of information on science, technology and innovation

South–South cooperation is tipped towards publicly owned or subsidized companies from more advanced developing countries, and the related perception that they crowd out other external investment; the perception of the levels of indebtedness associated with South–South cooperation; and a perceived erosion of the rules-based world order, including apprehensions related to upholding Western democratic and human rights in developing countries through possible demonstration effects (Blockmans and Hu, 2019; see section C.2). There appears to be a concerted drive to bring South–South cooperation into conformity with DAC traditions, which, absent other standards and given that DAC donors dominate global aid spending and norm-setting, may be perceived as epitomizing international best practices (Gu and Kitano, 2018). The perception that South–South cooperation could decrease the bargaining power of traditional donors is receiving attention and is linked to a related perception that the distribution of global power is gradually shifting towards Asia (Gomes and Esteves, 2018; Gu and Kitano, 2018; Jones and Taussig, 2019; Swedlund, 2017). Analysis has shown that, by 2020, economies in Asia will be larger than the economies of the rest of the world combined (Financial Times, 2019a). Similar outlooks are expressed by the European Commission and High Representative of the Union for Foreign Affairs and Security Policy (2019) and implied by the passage of the Better Utilization of Investments Leading to Development Act in the United States (Financial Times, 2018).

South–South cooperation does not discount the presence of strategic national interests (Cervo, 2010; Mawdsley, 2017). Partners in such cooperation also opt for foreign policy oversight of their South–South cooperation engagement, and major partners are not homogenous in their approaches to development cooperation (Andreff, 2016; Gu, 2009).[11] The evidence suggests that from the point of view of developing countries, their engagement with

[11] Major partners are those South–South cooperation actors prominent mainly in terms of widest global reach beyond their home regions. South–South cooperation at the intraregional level encompasses many developing countries, strategies, contexts and levels of State involvement in outward investment.

There are divergent perspectives on the question of what development is

South–South cooperation and the DAC world order is unlikely to pose a contradiction and probably reflects pragmatism.[12] Some research shows, for example, that when China plays a role in development cooperation in countries in Africa, the World Bank attaches fewer conditions to its loans in those countries and, in contrast, the World Bank generally strengthens conditionality when DAC donors provide aid (Haider, 2018; Hernandez, 2017).

b. What is development?

Many of the tensions between development actors centre on divergent perspectives on the question of what development is. Rather than prescribing a single path for development, development theory has evolved through several conventional wisdoms and remains a collection of theories about how desirable change in society is best achieved. Two main divisions stand out: structuralist theory-inspired approaches tend to emphasize structural transformation and industrialization; and basic needs approaches are premised on achieving that which is required for poor population groups to rise above the poverty line. The elimination of absolute poverty is viewed as the primary way that the previously disadvantaged can assume their place in society as dignified and economically active members that consume and save. Compared with structuralist theory, the basic needs approach centres on individual well-being and prioritizes social investments over economically productive activities, including economic infrastructure. It emphasizes individual agency, while the structuralist approach tends to advocate for a more active role for the State as a necessary condition to overcoming structural impediments to development in developing countries. These theoretical discourses have generated varied conceptualizations of development that have influenced aid and development policy. In general, South–South cooperation tends towards the structuralist approach and DAC-sponsored aid assistance aligns with the basic needs approach.

[12] See, for example, https://macauhub.com.mo/feature/china-leads-by-example-in-the-cooperation-with-angola/, https://www.theeastafrican.co.ke/news/ea/Rwanda-Paul-Kagame-endorses-Chinese-investment-Africa/4552908-4742800-5brualz/index.html and https://www.bloomberg.com/news/articles/2018-10-08/ghana-agreeing-china-deals-with-eyes-open-says-president.

Among the challenges that policymakers and development practitioners face in applying these approaches is that there is no single universally accepted definition of basic needs. As a concept that is essentially country-specific and dynamic, it is difficult to pin down what a development effort aimed at meeting basic needs should comprise. Nor is there a uniform vocabulary to describe its various elements (Hulme, 2013; OECD, 2006; Overseas Development Institute, 1978). A value judgement on the part of the adopter of the basic needs approach is therefore intrinsically implied. Similarly, rising levels of inequality sooner or later constrain a structuralist approach. The practical failures revealed in the pursuit of both approaches have contributed to the seesaw of development policy application, and continued experimentation and underline the selectivity in the translation from theory to practice (Fukuda-Parr, 2012; Pieterse, 1998).

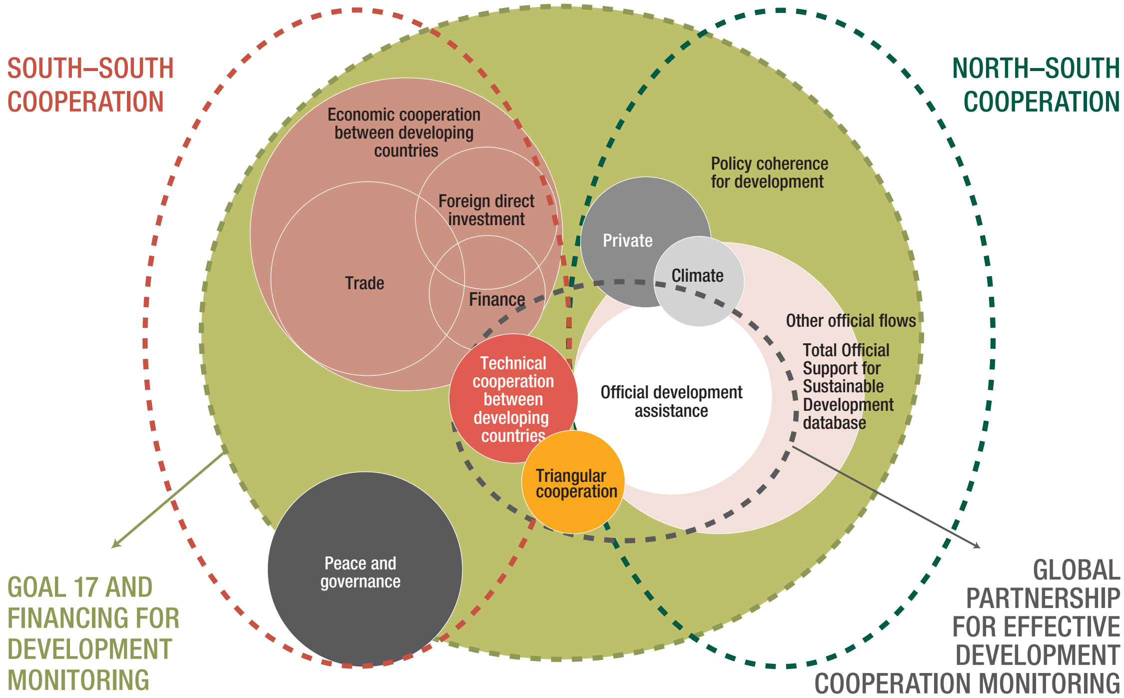
Conceptually, the Goals straddle the two main divisions of development theory and seek to achieve greater sustainability while also addressing environmental concerns. The 2030 Agenda emphasizes the interrelatedness of the Goals. The Goals may be considered as respecting the principle that igniting economic growth and sustaining it are somewhat different, albeit complementary, enterprises (Cagé 2009). Therefore, they simultaneously address employment creation (a recognized path for poverty alleviation and inclusion) and productivity change (a fundamental aspect of structural transformation), which are among the major challenges faced by developing countries.

This plays out in practice in the relationship between South–South cooperation and traditional development assistance, which are proving complementary rather than dichotomous in their contribution to development impacts (United Nations, 2018d). For example, triangular cooperation has led to joint actions with the North (figure 3.10). Moreover, as China expands its Belt and Road initiative to Africa, companies from the United States are among the beneficiaries of contracts linked to the initiative, as the technical advantages of some of these companies foster increased collaboration with companies from China on infrastructure projects in Africa (Haider, 2018; Sun, 2019). There is also evidence of cross-fertilization between South–South cooperation and traditional donors. For example, in 2009, DAC established a study group with China aimed at promoting knowledge-sharing and exchanging experiences.[13] Several DAC members have gone on to establish bilateral programmes on

[13] See https://www.oecd.org/dac/dac-global-relations/china-dac-study-group.htm.

Figure 3.10

Linking South–South and North–South cooperation for the Sustainable Development Goals



Source: UNCTAD, based on Besharati, 2018.

triangular development cooperation with a view to strengthening their development assistance interventions in developing countries (Haider, 2018). The Food and Agriculture Organization of the United Nations, for example, has over 40 years of experience as a leading promotor and facilitator of South–South and triangular cooperation in agriculture, food security and nutrition, and insights from this experience show that a high level of national ownership can be achieved, that limited technical supervision is required by the Organization, that unit costs can be substantially lower than in conventional North–South technical assistance, that sustainable cost-sharing between South–South cooperation partners is achievable and that South–South cooperation technicians are often well-seasoned practitioners in their own countries and can be immersed in rural communities to promote innovation (Food and Agriculture Organization of the United Nations, 2019).

Pro-poor and pro-growth approaches are mutually reinforcing and should go hand-in-hand (OECD, 2006). Goal 17 on a strengthened global partnership to support and achieve the 2030 Agenda encompasses both. The Global Partnership for Effective Development Cooperation is a multi-stakeholder platform for advancing the effectiveness of development efforts by all actors and monitors the smaller subset of technical cooperation between developing countries, triangular cooperation and ODA. It is the successor to the Busan Partnership for Effective Development Cooperation endorsed by 161 economies and heads of multilateral and bilateral institutions and representatives of civil society and public, private, parliamentary, local and regional stakeholders.

C. Development finance institutions assume centre stage

1. Purpose, history and performance

Bilateral development finance institutions are specialized development banks that generally form part of the overall financial and industrial policy set up of a State.[14] Such institutions operating as

[14] Reference to development finance institutions in this chapter denotes bilateral development finance institutions, unless otherwise stated. There are also multilateral and regional development banks with a similar international mandate, whose private sector arms, such as the International Finance Corporation, are part of the family of development finance institutions; bilateral development finance institutions are the focus of this chapter. See Mayer Brown (2013) for insights on opportunities for commercial lenders.

Development finance institutions are structured to be profit-driven

State-owned risk capital investment funds have sometimes been characterized as the third pillar of international development cooperation alongside donors and multilateral development banks (European Development Finance Institutions, 2016). Unlike blending undertaken directly by donors, which has an interface with recipient Governments, development finance institutions interact with business, either directly or through investment funds.

Development finance institutions are structured to be profit driven and can often reap first-mover advantages in markets with strong growth potential. For example, profits retained by European development finance institutions outstripped replenishments from Governments in 2005–2015 (European Development Finance Institutions, 2016). Development finance institutions also avail themselves of hub-based corporate structures and offshore financial centres associated with financial and tax-related optimization. It is not uncommon for the investments of such institutions to be channelled through secretive jurisdictions, raising concerns about transparency (European Commission, 2018; Jespersen and Curtis, 2016; Trade Union Development Cooperation Network, 2016). It is acknowledged that the impact of such polices is not always neutral on developing country taxation rights (box 3.3), but it has also been argued that limiting this practice could constrain the number of investments that development finance institutions could make in developing countries (Carter, 2017b; UNCTAD, 2015c). Although there is speculation that this practice could be on the decline, initiatives to clamp down on it suggest that the risks continue to warrant concerted action (Capria, 2019; European Commission, 2018). As noted by UNCTAD (2014e), tax havens are an integral part of modern business practices, which can entail “creative compliance” with national legislation and international standards. A global initiative to implement a new Standard for Automatic Exchange of Financial Account Information in Tax Matters has been launched, but a global level playing field will be slow to emerge. The necessity of securing a large number of bilateral exchange agreements, along with implementation that is costly and heavily reliant on administrative capacity and discretion, constrains the participation of most developing countries, and the benefits could be uncertain (Akhtar, 2018; Musselli and Bürgi Bonanomi, 2018; Ring, 2017; UNCTAD, 2016c).

Most development finance institutions have a focused strategy in specific sectors and geographical areas. Investees may be restricted to national companies or, for example, countries in Europe in the case of institutions in the European Union. The aims of development finance institutions are susceptible to periodic revisions in line with the strategic orientations of successive national Governments and other developments in the national political economy. In the European context, aims can be closely aligned with domestic private sector internationalization; for example, Proparco has a stated objective to prioritize companies in France. References to the private sector can therefore be ambiguous; determining whether development finance institutions prioritize domestic (donors’) private sectors may require a case-by-case examination of the actual investments of such institutions, complicated by the absence of reporting on investee ownership data. Development finance institutions continuously evolve and review their areas of comparative advantage in order to remain relevant, effective and strategic. Assets managed by such institutions have more than doubled since 2012, recording an increase of 57 per cent over the period up to 2017 (Devex, 2019c). Generally, sectoral coverage is influenced by the perceived areas of expertise and comparative advantage of development finance institutions. The analysis of sectoral preferences is complicated by the fact that such institutions do not use standardized definitions for sectors and that the use of the same terms may not guarantee consistency; as a result, the coverage of the analysis may be misleading.

2. Development finance institution portfolios in the least developed countries

a. Overview

Development finance institutions are expected to be the main vehicle for the use of private sector instruments linked to development cooperation. More DAC members are in the process of establishing or plan to establish development finance institutions in line with the incentives created by the new ODA architecture. At present, development finance institutions aim to achieve financial results alongside development impacts. They mainly provide financing to private investors investing in developing countries, with direct and indirect funding support from States. They invest using their reinvested profits, subventions from Governments through ODA and amounts mobilized from their blending activities. It

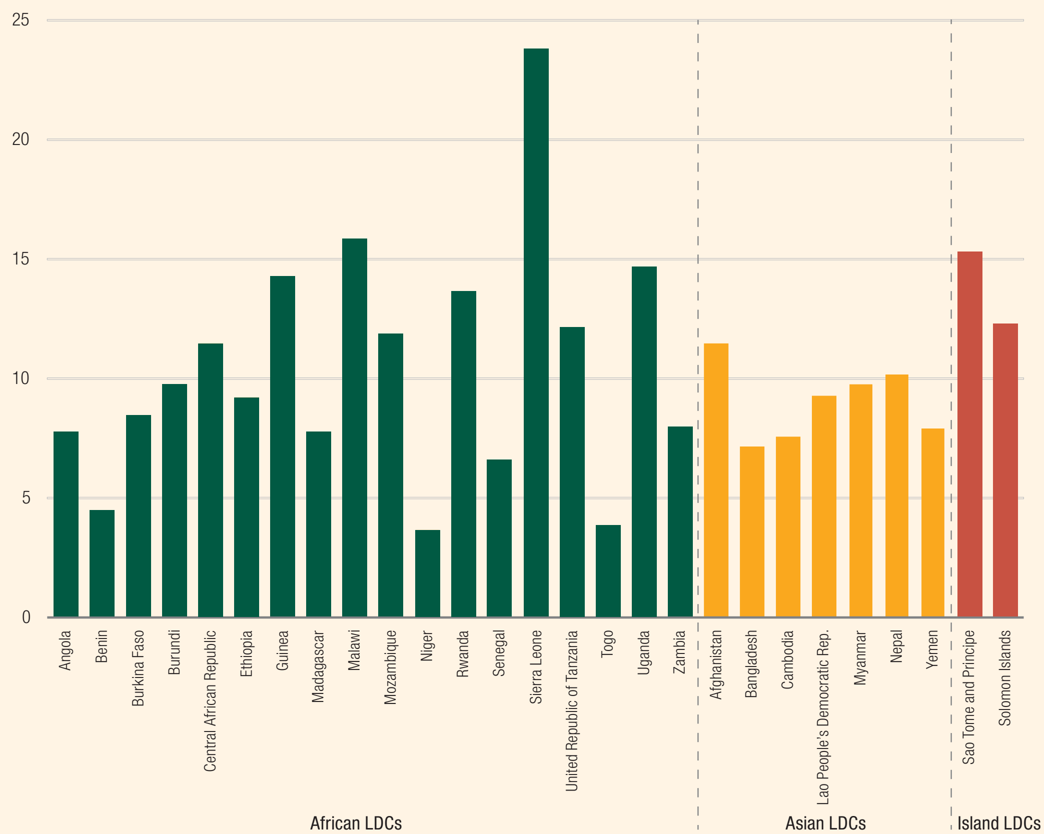
Box 3.3 **Is there a link to illicit financial flows?**

UNCTAD estimates that developing countries lose $100 billion annually due to aggressive tax avoidance through the use of tax havens. There are different types of tax evasion and tax avoidance. Cross-border tax evasion and avoidance linked to the flow of exports and imports has gained notoriety in development policy. It is more often linked to large foreign investors, as local small and medium-sized enterprises in developing countries are considered to have fewer opportunities to benefit from aggressive cross-border tax optimization schemes. Tax fraud and evasion clearly fall within the definition of illicit acts, yet the debate continues with regard to legal behaviour that has the effect of reducing tax payments or forms the building blocks of hidden money trails. Illicit financial flows stem from corruption, crime, terrorism and tax evasion, with often complex and cross-sectoral relationships across these various factors, and a wide range of policies and actions are needed to combat them. The impact of the activities of development finance institutions on illicit financial flows and their potential role in encouraging responsible corporate tax behaviour is therefore an area of critical importance for target countries of development finance institution investments that are seeking to enhance domestic resource mobilization (see chapter 4).

Illicit financial flows are a significant and persistent obstacle to achieving sustainable and equitable growth in all developing countries, accounting for over 20 per cent of developing country trade in 2006–2015. In 2015, estimates of illicit outflows from LDCs ranged from as high as 23.8 per cent, in Sierra Leone, to as low as 3.7 per cent, in the Niger, of total trade with advanced economies (see figure). The average for all developing countries is 8.4 per cent, with Georgia recording the highest outflows, at 25.6 per cent. Six LDCs feature in the top 10 developing countries ranked by illicit outflows as a percentage of total trade with advanced economies.

Potential trade misinvoicing, outflows

(Percentage of total trade with advanced economies)



Source: UNCTAD calculations, based on Global Financial Integrity data.
Note: Data available for only 27 LDCs.

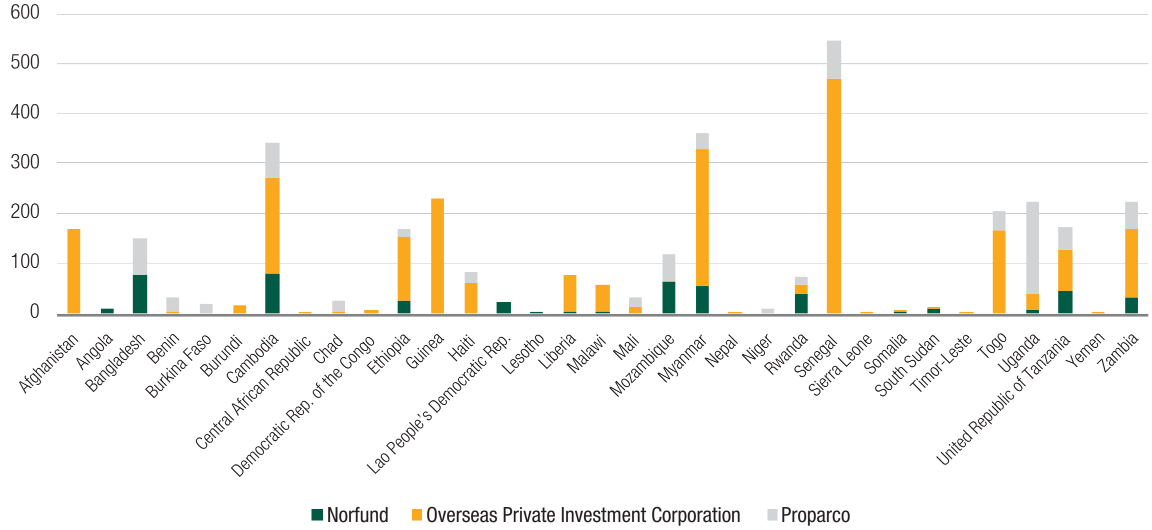
Target 16.4 of the Goals is to "significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime". The inclusion of an indicator on country-by-country reporting on corporate accountability has faced resistance.

Sources: Carter, 2017b; Cobham, et al., 2018; European Development Finance Institutions, 2018; Forstater, 2018; Global Financial Integrity, 2019; McLure, 2004; UNCTAD, 2015b; van der Does de Willebois, et al., 2011; World Bank, 2017.

Figure 3.11

Selected development finance institutions: Active investments in the least developed countries, 2017

(Millions of dollars)



Source: UNCTAD calculations, based on data from Norfund; Overseas Private Investment Corporation, 2019; and Proparco.

can sometimes take several years for deals between development finance institutions and investors to be closed (Savoy et al., 2016).

2017 marks the first year of development finance institutions reporting in line with the provisional arrangement on standardized reporting on private sector instruments. The provisional data include European Union institutions but do not capture all DAC members. Provisional OECD data show that flows linked to private sector instruments account for only about 2 per cent of total bilateral flows to developing countries as a group, with grants occupying a dominant position, at 89 per cent. The proportion is even less significant for multilateral development finance institutions, at below 1 per cent. Of the reporting non-DAC members, none declared the use of private sector instruments, with over 99 per cent of their bilateral flows being grants.

The picture changes somewhat with regard to countries reporting flows to development finance institutions in this initial cycle (13 countries, in addition to European Union institutions). The preliminary data show that private sector instruments account for a higher proportion of their total bilateral flows, at just above 3 per cent, with the grant equivalent of loans also correspondingly higher. This would seem to be in line with the projected expansion of the role of development finance institutions and private sector instruments in developing countries, including LDCs. Finland reported the greatest use of private sector instruments, at above 10 per cent of its bilateral flows, alongside bilateral grants. The dominant trend was for countries to use either private sector instruments or loans. However, for example, France reported a relatively high use of both private sector instruments (6 per cent) and the grant equivalent of bilateral loans (25 per cent).

UNCTAD analysis, based on Cornish and Saldinger (2019), of the active investments in LDCs of four development finance institutions – namely, Proparco in France, Norfund in Norway, the CDC Group in the United Kingdom and the Overseas Private Investment Corporation in the United States – suggests that a significant number of LDCs in all regions have historically benefited from the investments of development finance institutions (figure 3.11). Multi-country or regional initiatives are excluded from the analysis. Of note, experts from Senegal, during consultations with aid recipients on the OECD total official support for sustainable development database, did not support proposals for investments made at the global or regional level – to support development enablers and to address global challenges – to be attributed to intended country beneficiaries unless quantifiable cross-border inflows to specific countries could be established (Delalande and Gaveau, 2018). This stance echoes initial concerns raised during deliberations by the task force on the database on the yet-to-be-finalized reporting instructions. The overlaps between the database and the existing system are significant and concerns were raised with regard to the dangers of artificially inflating aid flows (OECD, 2018j; Pereira, 2017b).

The data provide insights on the main investment types or private sector instruments that development finance institutions typically use in LDCs. However, given the small sample size, the tendency for the investments of such institutions to be opportunistic and the fact that the use of ODA-backed private sector instruments is a new development, few conclusions can be drawn from past trends. It is not possible to separate projects that were beneficiaries of ODA-backed private sector instruments from the information provided by development finance institutions. However, all investments backed by such institutions derive an advantage from association with such institutions which, by virtue of their being public, have a level of creditworthiness that allows them to raise large amounts of funds in international capital markets and typically makes them more attractive to project sponsors than private financiers (Carter et al., 2018). A spot check of 62 active CDC Group and Proparco investments confirms the finding of European Development Finance Institutions (2016) that there is a high level of co-investment between bilateral, regional and multilateral development finance institutions.[15]

The data suggests that the size of investments can differ significantly across LDCs. Differences in investment volumes are partly explained by infrastructure projects, which are often big ticket by nature and likely to be active projects on the books of development finance institutions for much longer (figure 3.12). Collectively, European development finance institutions have been found to show a bias towards the financial sector, followed by a focus on industry and energy as the top three areas of concentration (Devex, 2019d; Kenny et al., 2018). The analysed portfolios suggest broad sectoral coverage (figures 3.12 and 3.13). Infrastructure projects, including telecommunications, energy, transport and infrastructure, account for the highest value of projects overall. Finance, namely, microcredit and small and medium-sized enterprise finance, tops the distribution of interventions across LDCs and the number of interventions in individual countries, followed by agribusiness and food. Infrastructure, including energy and communications, is listed as a priority sector by all the sampled development finance institutions. Manufacturing or industry is not a priority sector for Proparco, but agriculture or agro-industry is a common priority for all of the development finance institutions. The food subsector is a growth sector in many LDCs despite high levels of poverty, as the poor spend the bulk of their earnings on food (Financial Times, 2019b).

Development finance institutions are often criticized for investments in economic infrastructure

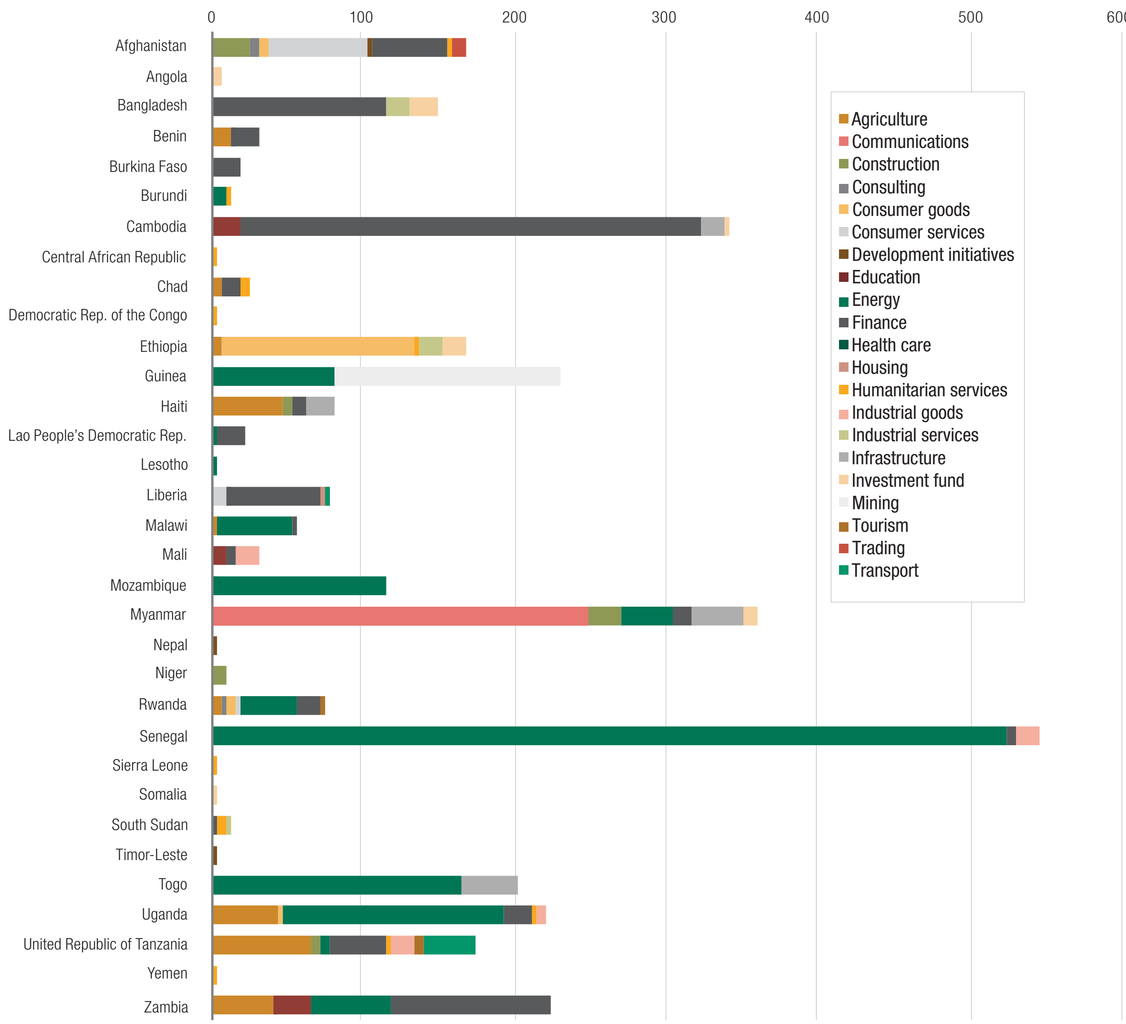
Far fewer investments by development finance institutions are made in social sectors compared with investments in economic infrastructure. The spot check of active projects revealed two investments in social sectors, both by the CDC Group through private equity funds, which the CDC Group calls intermediated investments; one in education (an international private company providing education services) and the other in health (a local pharmacy retail chain). Both target segments in the social sector are revenue-generating, echoing trends noted in blended projects (see section B).

From the perspective of structural transformation, the focus on infrastructure, industry and manufacturing is an encouraging sign that development finance institutions pay attention to issues of systemic impact and of priority to LDCs. However, development finance institutions are often criticized, in particular by non-governmental organizations, for such investments, as their link to poverty is both indirect and the effects only become evident in the medium to long term. About 23 per cent of the active projects of the CDC Group and Proparco that were spot-checked were infrastructure projects, mostly in energy.

In the sample, the CDC Group and the Overseas Private Investment Corporation were among the most active by number of projects across many LDCs (figure 3.14). The Overseas Private Investment Corporation is present across a wide range of sectors, including agribusiness, finance and infrastructure. A spot check of its active projects shows a high level of insurance among private sector instruments deployed in LDCs. The number of its interventions categorized as consultancies and as projects linked to diplomatic missions of the United States or activities of the United States Agency for International Development (specific to Afghanistan) are not insignificant. It

[15] Spot-checked regional investments were counted as single projects without regard for the number of intended beneficiary LDCs. The majority of the spot-checked regional investments of the CDC Group (11) were concentrated in infrastructure or finance; those of Proparco (3) targeted agroprocessing, small and medium-sized enterprise finance, logging and timber processing.

Figure 3.12
Selected development finance institutions:
Sectoral composition of active investments in the least developed countries, 2017
(Millions of dollars)



Source: UNCTAD calculations, based on data from Norfund; Overseas Private Investment Corporation, 2019; and Proparco.

is the only development finance institution to list humanitarian services as a sector. Differences in its portfolio may be explained partly by the fact that, in 2017, it was still not permitted by United States law to make direct private equity investments, although it provided support for the creation of privately owned and managed investment funds (Diongson, 2018).

Overall, the analysed portfolios of development finance institutions throw little light on the line of separation between, for example, investments that can and should be made using the core business model of development finance institutions, which aims to repay 100 per cent of capital and in addition generate a financial return, and those that deliver a lower risk-adjusted return, as pursued by the CDC Group (United Kingdom, 2017). Carter et al. (2018) note that whether an investment is additional cannot be known with certainty by development finance institutions.

b. Impact and accountability of development finance institutions: Implications for structural transformation in the least developed countries

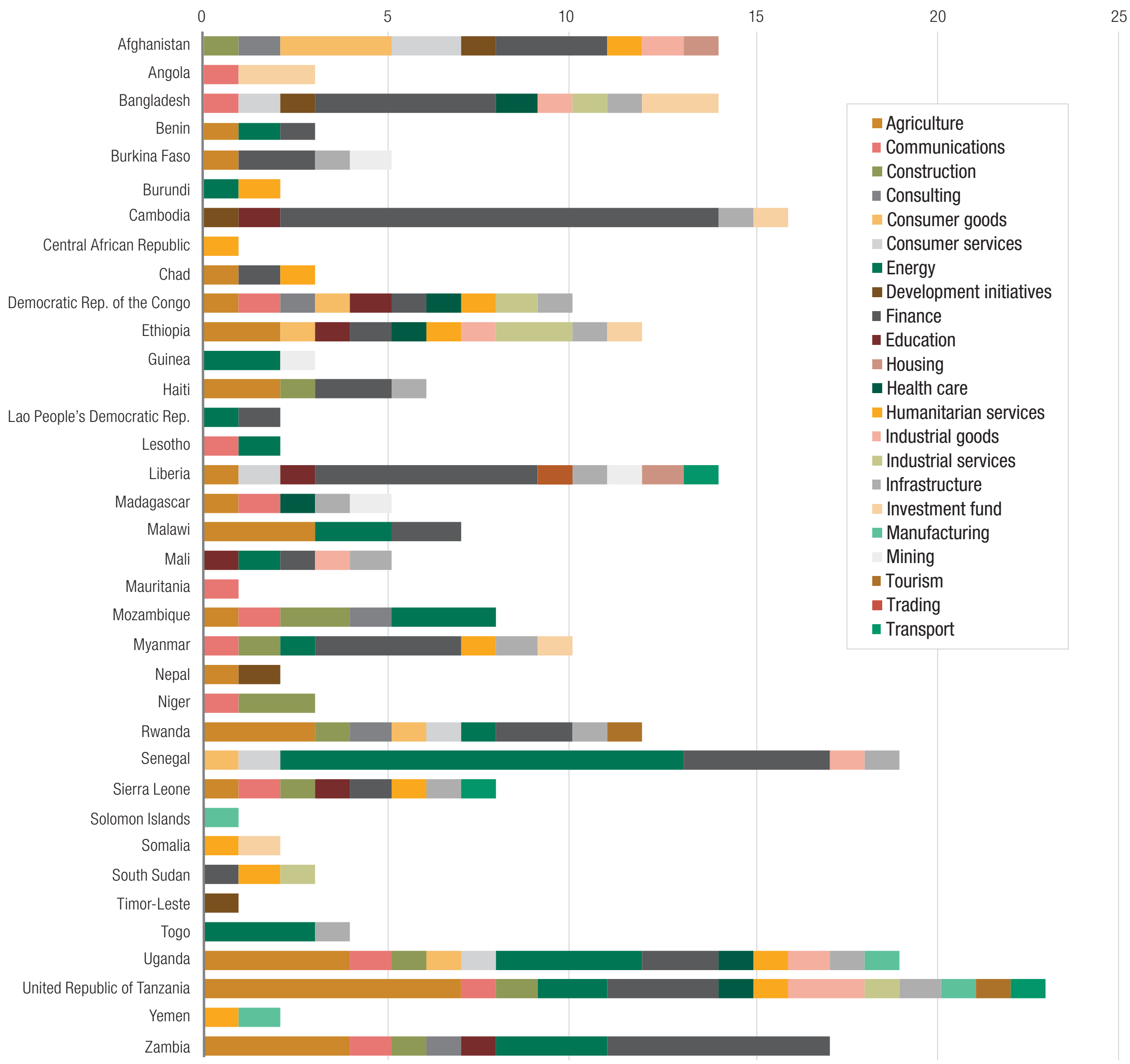
Development finance institutions do not design development projects, but rather accept applications for funding from businesses whose investment

Figure 3.13

Selected development finance institutions:

Sectoral composition of active investments in the least developed countries, 2017

(Number of projects)



Source: UNCTAD calculations, based on data from the CDC Group; Norfund; Overseas Private Investment Corporation, 2019; and Proparco.

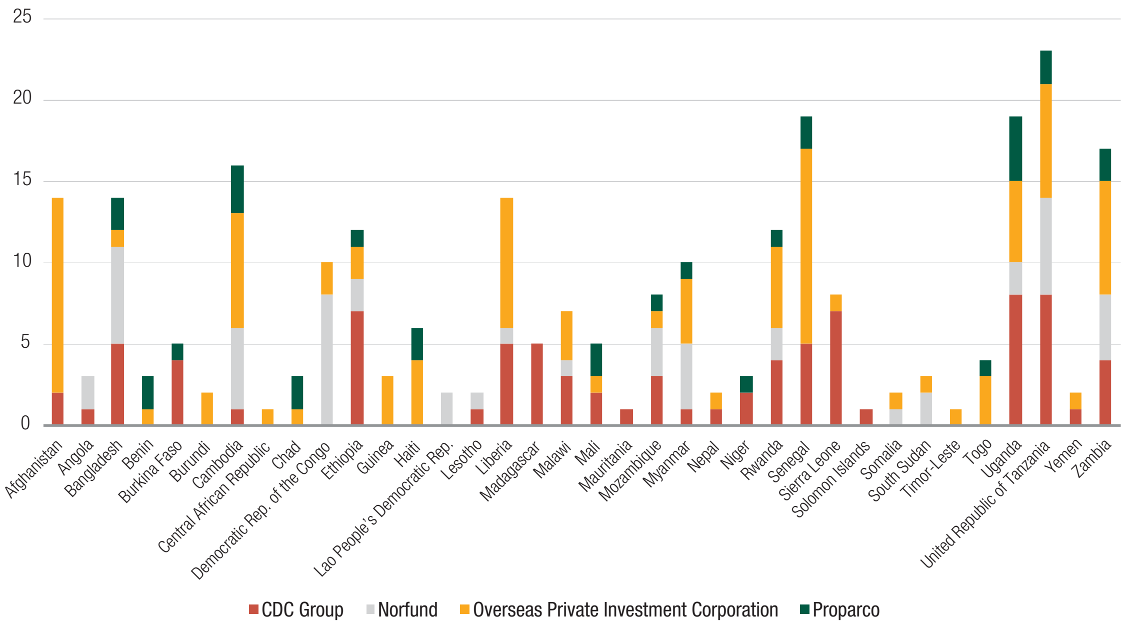
projects carry the prospect of financial returns for the institutions. They engage in confidential bilateral negotiations with project sponsors. Their business model, consequently, is disconnected from country development plans and the type of investment of development finance institutions shapes the type of development impact that is achievable. This serves to underline the concerns related to, for example, the approach of maximizing finance for development adopted by the World Bank Group and the increasing focus that donors are giving to the private sector, in particular in LDCs in which markets are difficult or pipelines of viable investment projects are narrow. Historically, development finance institutions have not displayed an interest in high-risk investments, prioritizing instead investment settings with an above 80 per cent probability of success, regardless of an investment's capacity for transformative impact (Devex, 2019c).

In the context of development policy and the 2030 Agenda, job creation, economic growth and private sector development are by far the most cited policy goals for replenishments from Governments to European development finance institutions.

Figure 3.14

Presence of selected development finance institutions in the least developed countries

(Number of projects)



Source: UNCTAD calculations, based on data from the CDC Group; Norfund; Overseas Private Investment Corporation, 2019; and Proparco.

Sustainable development and climate change (including renewable energy sources), poverty reduction and access to finance (and small and medium-sized enterprises) and catalysing private investors are also frequently cited objectives, in that order. Several European Governments also expect their development finance institutions to promote national economic interests and to mobilize the activities of domestic businesses and investors in low-income and middle-income countries (European Development Finance Institutions, 2016). The development mandate of development finance institutions necessitates that they look beyond traditionally monitored project-by-project direct outcomes, to explore a variety of impact channels. The list of policy goals continues to grow; for example, development finance institutions increasingly seek to track women's economic empowerment and job quality and to enhance their coverage of poorer and fragile countries. Member development finance institutions of the European Development Finance Institutions have reiterated a shared priority to intensify involvement in Africa and fragile States in 2019 (European Development Finance Institutions, 2019).

The shift in focus of development finance institutions to LDCs represents the pursuit of a potentially contradictory double bottom line of profits and development. On one hand, prospects of attaining the high levels of return they depend on to ensure sustainability are in middle-income developing countries and on the other hand, they are requested to advance the development of LDCs, in which the pool of investible opportunities is small and businesses are perceived as having high-risk profiles (Savoy et al., 2016). Achieving a greater distribution of private investments across LDCs and in underinvested sectors in LDCs, while an important verification factor for the rationale behind ODA-backed private sector instruments and development finance institution operations in LDCs, is not assured, unless such institutions better orient their business models to emphasize high-risk investments with inherently longer gestation periods in LDCs. For example, in line with other attempts to bound private development cooperation, Collier et al. (2018) argue that development finance institutions should be explicitly willing to accept commercial losses to achieve public benefits.

In addition, a key challenge for development finance institutions may have less to do with receiving more capital from Governments and more with their lack of capacity to deploy deep-country and specialized expertise (Emerging Markets Private Equity Association, 2018; Mirchandani, 2017).

Nevertheless, some development finance institution experts acknowledge that there may be a trade-off between expanding development impact criteria and the number of investment opportunities that qualify. There is thus reason to question whether an Africa-centred focus will lead to an unequivocal increase in investment flows to all LDCs in Africa, or even only to LDCs in Africa. However, LDCs with favourable market odds could stand to benefit. High population levels, urbanization and middle-class growth rates in LDCs tend to attract investor interest, and LDCs with smaller markets and higher rates of poverty can be expected to lose out. The case for an increased role for development finance institutions in development rests on the argument that they have a proven track record of combining strict adherence to commercial sustainability and systemic impacts. The unique ability of development finance institutions to deliver on additionality and tap a variety of impact channels is frequently referenced (Attridge et al., 2019; Carter et al., 2018; European Development Finance Institutions, 2016; OECD, 2016a; Spratt and Collins, 2012; United Kingdom, 2017). There is no standard definition of additionality, but two categories are often discussed, namely, financial and development additionality, and subcomponents of the latter have also been described by some development finance institutions, as follows:

- Financial additionality. Development finance institutions should extend investment capital to entities that cannot obtain finance from local or international private capital markets with similar terms or quantities without official support and not crowd out other investment through their subsidized pricing structure, contributing to employment growth, or if such a transaction mobilizes investment from the private sector that would not have otherwise been invested.
- Development additionality. Development finance institutions should invest in underserved geographic areas, sectors and segments by taking a long-term approach that permits higher levels of risk, including changing the nature of investments so that they become more beneficial and raising the quality of investments. Subcomponents are as follows:
    - Value additionality. Development finance institutions can contribute to knowledge enhancement in countries by supporting capacity-building, technical assistance, changes in businesses' regulatory environments and the uptake of environmental and social standards. Such support fosters better managerial and innovation capabilities, which increases the potential of firms to grow and invest in technology and skills, with associated employment opportunities. Sometimes disaggregated into operational and institutional additionality.
    - Demonstration or catalytic effects. Development finance institution projects can act as a vanguard by demonstrating the potential of new investments in difficult markets, creating a ripple effect that leads to further investments and, potentially, more employment creation, mobilizing other investors by sharing risk and experience.
    - Forward and backward linkages. Development finance institutions can support firms that have both forward and backward linkages in an economy, that is, manufacturers need inputs from suppliers (backward linkages) and can sell their products to distributors (forward linkages). Supporting growth in such firms may create both forward and backward effects, which can, in turn, affect employment.

Urbanization and high middle-class growth rates tend to attract private investor interest

These articulations of additionality and impact channels are especially useful in development policy formulation because they address the breadth and depth of intended outcomes and the complex interactions in the process of development and structural transformation, beyond reductionist metrics (Committee for Development Policy, 2015; de la Rosa Reyes, 2017). However, as they are indirect, their success, failure or relevance is dependent on a vast range of contextual factors and actors that render attribution to the interventions of development finance institutions problematic. Indirect impacts are generally more difficult to define, and evidence is difficult to uncover. For example, the literature on development finance institutions typically fails to acknowledge the counterfactual (Attridge et al., 2019). There are also trade-offs between the cost of acquiring data and the quality of the data gathered. Indirect impacts can be costlier to measure because they are not easily observable and are more dependent on response time, typically lagging behind direct impacts. Systematic investments in capacity, as well as complex evaluations by development finance institutions, are therefore unavoidable (OECD, 2018h).

Development finance institutions make assumptions to assess the impact of their operations

Consequently, development finance institutions rely on making assumptions and engaging in estimations. For example, evidence of demonstration effects is limited, with causality particularly difficult to prove (Savoy et al., 2016). Similarly, with regard to forward and backward linkages, examining effects beyond direct impacts requires either making assumptions or using deep-dive case studies of impacts, of which few exist for LDCs (Attridge et al., 2019). The variety of approaches used to assess the impact of development finance institutions include microlevel surveys and case studies, econometric studies and macrolevel econometric studies. The use of quasi-experimental studies, including randomized control trials, for example in microfinance, has also been noted.

Unlike national development banks, development finance institutions remain a comparatively understudied set of development institutions in terms of their activities and impacts from the perspective of LDC contexts. There are many expectations of what development finance institutions can deliver in terms of development impacts, particularly with regard to additionality and catalytic impacts, but the proof of their additionality remains weak. Whether they do or can make a real difference is increasingly the subject of research, with a greater emphasis on development finance institutions in development cooperation, and the evidence suggests that definitive evidence of additionality remains elusive (Attridge et al., 2019; Carter, 2017c). The following analysis highlights some issues that require additional attention or consideration to strengthen the evidence base on the development impacts of development finance institutions.

i Job creation

Job creation is one of the main objectives and indicators of development finance institutions, commonly measured as the number of direct and indirect jobs created or maintained, with indirect effects often greater than direct effects. The employment impact of the investments of such institutions follows several channels, as follows (Savoy et al., 2016):

- Direct impacts: Jobs created in companies or projects directly supported by the investment of development finance institutions.
- Indirect impacts: Jobs created through forward and backward supply chain linkages as a result of the project or company supported by development finance institutions.
- Induced jobs: Jobs created through the demand multipliers and other consumption effects of direct and indirect jobs created by development finance institutions.
- Second-order growth effects: Jobs created through growth effects, some of which relate to productivity spillover effects when third companies operate more efficiently, expand economic activities and create more jobs in the process.

The direct employment effects reported by investees are the easiest for development finance institutions to prove, but the difficulty in attribution increases along the causality chain, as a complex mix of intervening factors, including effects that may be influenced by government development programmes and strategies, or inherent to domestic entrepreneurial ecosystems, are difficult to control for.

The activity of development finance institutions is found to be correlated with a growth in jobs and higher labour productivity across countries and over time. Most evidence supporting this finding is on investments in non-LDC countries, possibly due to the limited availability and sophistication of data or limited development finance institution expertise in LDC markets (Attridge et al., 2019). Given that the ability of domestic firms in LDCs to respond effectively to the investments of development finance institutions is typically lower than those in other developing countries, due to constraints in absorptive and productive capacities, the correlation may be weaker or absent in LDCs. This gap in evidence in LDCs belies the concerted push to intensify the activities of development finance institutions in LDCs and casts doubt on the advisability of expanding their operations in LDCs (Attridge et al., 2019). The apparent tension between expectations of the development impacts of development finance institutions and what they can actually demonstrate is problematic, given public policy questions about the balance between the costs and benefits of deploying ODA through development finance institutions (Ashley, 2018).

A case in point is job quality, an area of impact assessment in which development finance institutions are currently lagging. Job quality is important in LDCs because the relationship between job creation and social progress is often not as straightforward as implied by the standard reasoning that employment leads to reductions in inequality and poverty. The poor often accept whatever work is available at whatever wage, resulting in a significant incidence of working poverty, that is, people with jobs but still poor. Working poverty rates in low-income countries are estimated at 40 per cent, compared with the global average of 9 per cent (International Labour Organization, 2019). Extreme working poverty, defined by the International Labour Organization as households with a per capita income or consumption of less than $1.90 per day, is projected to decline in Africa, the Pacific and South-East Asia, yet the rate of moderate working poverty in Africa, at around 23 per cent, is likely to remain unchanged, and a large proportion of the jobs created in the other two regions – where, in 2017, the rates of extreme and moderate working poverty were at a combined rate of 19.6 per cent – are expected to remain of poor quality (International Labour Organization, 2018).

The high incidence of informality across LDC economies continues to be a drag on prospects of reducing working poverty (UNCTAD, 2018b). The focus of development finance institutions on formal employment is thus a welcome development. However, job quality is at stake if employment is to be a driver for structural transformation in LDCs. Poor job quality can increase incentives for diversification towards less complex products and hinders the increase of the productive capacities of States (Freire, 2017). These issues and the related matter of skills development to support higher value addition are of critical concern in LDCs (te Velde, 2013). In this regard, development finance institutions are theoretically well placed in their new roles as sources of vital information for development practitioners and policymakers.

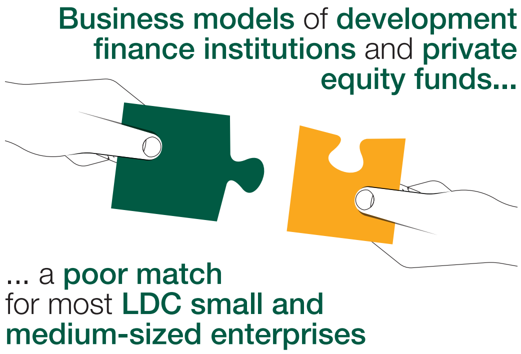
ii Access to finance

The challenge of access to finance is more acute for small and medium-sized enterprises in LDCs and is a frontline issue for development finance institutions in pursuing development policy mandates on private sector development (UNCTAD, 2018b). Many such institutions do not routinely directly support smaller projects, often because of the transaction costs involved, although they may use private sector instruments to encourage increased lending to small and medium-sized enterprises by providing earmarked finance to private investment funds and other financial intermediaries. In doing so, development finance institutions often highlight their contributions to domestic financial deepening. The spot check of the active projects of the CDC Group in LDCs in 2017 suggests a reliance on financial intermediaries such as private equity and other types of funds for this purpose. Development finance institutions and impact investors dominate mainstream private equity and venture capital fundraising in many developing countries (Divakaran et al., 2014; Oxfam International, 2018). Transforming most small and medium-sized enterprises and entrepreneurs in LDCs into viable targets of investment typically requires much more technical assistance and project preparation support, as well as financing. In LDCs, the starting points of small and medium-sized enterprises and entrepreneur profiles are uneven and are an important factor of success and growth. In theory, equity funds have more experience in providing financial and capacity-building support to small and medium-sized enterprises in a variety of sectors and therefore increase the chances of successful outcomes, but this is often highly dependent on their having specialized local expertise. Accordingly, partnering with local equity funds and other financial intermediaries becomes desirable.

Foreign fund managers are new to investing in small and medium-sized enterprises in developing countries

Among the 50 spot-checked active investments of the CDC Group made via equity funds, only one has a majority of local (indigenous) ownership. While this is no doubt partly a consequence of the lack of financial deepening in LDCs, there is evidence of other contributory factors. Global trends captured by a survey by the Emerging Markets Private Equity Association in 2017 note a tendency towards consolidation in the fund capitals of development finance institutions across fewer managers. This suggests that such institutions pursue both capital concentration and relationship consolidation. Anecdotal evidence from East Africa and Latin America indicates that many fund managers and investment teams are relatively new to the field of investing in small and medium-sized enterprises. Development finance institutions also corroborate that the breadth and scope of regionally based fund managers is suboptimal and that local fund management experience and competency needs development (Divakaran et al., 2014).

The spot check of investments by the CDC Group and Proparco shows a bias towards larger enterprises including, for example, a stated shift of focus to larger small and medium-sized enterprises by the impact programme and catalyst portfolio of



the CDC Group.[16] Larger enterprises, by virtue of their in-house capacity or ability to access specialized skills, including companies from more developed economies, tend to be better prepared to engage with equity funders and generate greater profit investments for development finance institutions and fund investors. Development finance institutions and investment funds generally prioritize businesses with a track record of profitability, and large firms are 10 times more productive than small and medium-sized enterprises in developing countries (International Trade Centre, 2015). Among the spot-checked active investments, international large firms are significant beneficiaries of investments by the CDC Group and Proparco, and development finance institutions more often make direct equity investments in such companies. In Bangladesh, for example, the CDC Group invested direct equity in local enterprises, all of which were large well-established firms. The evidence also suggests that the preponderance of family or owner-run small and medium-sized enterprises in low-income countries means that a great number of small and medium-sized enterprises are likely to eschew equity in favour of retaining full ownership, contributing to thin addressable markets for fund managers (Emerging Markets Private Equity Association, 2017).

From the perspective of structural transformation, and recognizing that not all types of small and medium-sized enterprises play a role in expanding quality employment and increasing structural transformation, the apparent bias may not be problematic if it delivers systemic gains from high-impact firms and entrepreneurs whose contribution to structural transformation is more assured than that of other types of entrepreneurship prevalent in LDCs (UNCTAD, 2018b). Nevertheless, closing the gap in support of missing-middle projects in LDCs may continue to be an issue in LDCs despite development finance institution efforts in this area.

One contributing factor that might explain an observed bias towards larger small and medium-sized enterprises is the lack of a universal definition of such enterprises. Such enterprises in LDCs tend to be quite small, and even medium-sized companies are smaller than their developed country counterparts. For example, equity investments by Norfund are normally at $4 million and above, and few small and medium-sized enterprises in LDCs are likely to be able to absorb that amount of funding, as shown by the experience of the United Nations Capital Development Fund, whereby small and medium-sized enterprises in LDCs typically need credit ranging from $50,000 to $1 million. Given the need to foster entrepreneurship and a balanced ecosystem of enterprises of all sizes in LDCs, such trends could be negative with regard to structural transformation and disadvantage high-impact microentrepreneurs that already have difficulty accessing small and medium-sized enterprise-level loans. An area that warrants further investigation, therefore, is whether development finance institutions and private equity fund business models on their own are a poor match for diverse small and medium-sized enterprise profiles and their corresponding objectives with regard to growth and equity in LDCs.

iii Ownership

A central issue raised by UNCTAD (2018b) is the role of local ownership in building a sustainable local entrepreneurial base and the endogenous responsiveness of an economy. Local entrepreneurs have many potential advantages. They typically operate in more sectors and tap more diverse segments of domestic labour across a broader range of geographical areas than foreign investors. They contribute to a robust entrepreneurship landscape encompassing different sizes of firms and help reach markets earlier and enable deeper market penetration than foreign firms. They can therefore be instrumental in strengthening local value chains,

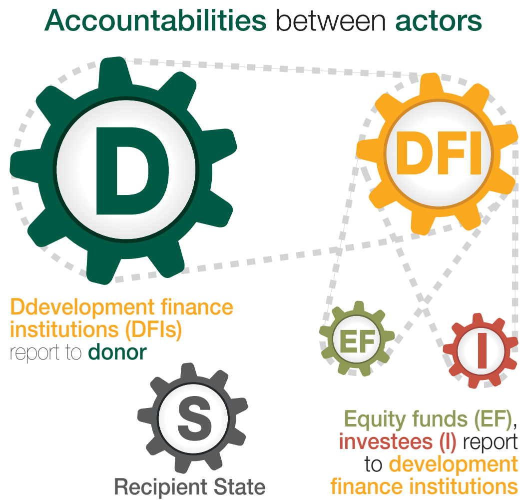
[16] The investments of the CDC Group are grouped into catalyst and growth portfolios; investments under the former are made in difficult markets, such as in LDCs, and assigned a lower profitability hurdle. The CDC Group is reportedly a pioneer among development finance institutions in adopting this approach. In 2018, its catalyst portfolio accounted for about 2 per cent of its total portfolio, compared with 62 per cent under its growth portfolio and 36 per cent under its legacy portfolio. The CDC Group manages two investment vehicles designed to serve its catalyst portfolio; investments by these funds are expected to be higher risk but hold long-term commercial potential and help to catalyse other investments (Independent Commission for Aid Impact, 2019).

contributing to higher levels of local job creation and increased revenues for both the private and public sectors. Finally, they often serve as primary vehicles of inclusion and growth and can play a critical role in reducing foreign investment risk (Devex, 2019e; OECD, 2017; UNCTAD, 2018b).

Development finance institutions emphasize the importance of investors' local operations but are largely silent on the issue of local ownership. It is also not always evident whether a stated focus on increasing access to basic goods and services coincides with fostering local entrepreneurship. Where information is provided on investments, it is often not possible to discern with certainty the distribution across national and foreign private sectors of the support extended by development finance institutions, even in the case of small and medium-sized enterprises. This is in accordance with the European Development Finance Institutions (2018) principles for responsible tax in developing countries, which specify that the responsibility of development finance institutions does not usually extend to the disclosure of the beneficial ownership of investees unless such disclosure is required by law in the host country. The automatic exchange of information standard requires countries to provide information on beneficial owners but, as noted, the capacities of developing counties and LDCs in particular to benefit from its implementation are limited.

iv Production costs

Production costs in LDCs are a significant impediment to private sector development and competitiveness. Development finance institutions often refer to their contributions to improving access to productive services as a part of development additionality. As noted, they prioritize productive infrastructure. Among the spot-checked active projects, several seem akin to conventional public–private partnerships (although at least one was unsolicited and its terms were not publicly disclosed in the country of investment), probably because subsidized tariffs are often a necessity in LDC markets (UNCTAD, 2017a). A critical issue with regard to structural transformation in LDCs is how the investments of development finance institutions impact not only the availability of services but also their costs. The poor track record of energy-related public–private partnerships in LDCs in this regard could undermine the positive impacts from the focus of development finance institutions on infrastructure. Lowering the cost of productive activities is a necessary condition to generating the indirect effects that development finance institutions estimate as part of their development impacts in LDCs, and this information should be made known.



v Transparency and accountability

Much of the information about development finance institutions is presented in forms that make aggregation and comparison difficult and time consuming (Devex, 2019b; Kenny et al., 2018). Reporting procedures, including the metrics used to evaluate performance, are not standardized. Available data sheds little light on the motivations behind the investments made. Each institution has its own parameters to define regions and financial instruments; these are often not made public and, when available, may not be consistently reported across projects or reporting periods. Commercial confidentiality and the peculiarities of business models have been cited by development finance institutions in response to requests for greater transparency. Details of private sector engagement investment projects are not made readily available to the public (Attridge and Engen, 2019). Concerns about transparency are heightened by the changing nature of the development cooperation landscape, which warrants moving beyond non-binding global principles and guidance. Saldinger et al. (2019) note the propensity of development finance institutions to tailor messages to specific audiences and the image that they wish to portray to each audience.

Of concern are accountability relationships between the different actors in private sector development in the era of private development cooperation. Development finance institutions are not obliged to share information with local authorities, and accountability flows backwards to their owners. Investees report to the institutions or to the financial intermediary. As evidenced by the experience of Bangladesh, the recipient State is often left out of the loop and this supports arguments made in this chapter (box 3.4). Information that is critical to assessing project and donor impacts, such as objectives, results and evaluations, tends to be the most difficult to find, even among top performers with regard to accountability. Collectively, donors assessed under the aid transparency index in 2018 scored 27 per cent, on average, in the performance component (Publish What You Fund, 2019).

A similar picture is seen with regard to blended finance, with most evaluations provided by private funds and facilities made on a voluntary basis (figure 3.15). The evaluation reports for most actors of blended finance are for internal purposes only and are only shared with bilateral donors. Private providers of blended finance are not obliged to evaluate their projects. As with the investments of development finance institutions, the evaluation of development impacts from blending among donors is made on a case-by-case basis (European Court of Auditors, 2014).

D. Conclusions

The ODA architecture reform and, in some cases, a single-minded focus in the private sector on some approaches to the achievement of the Goals, has brought to the fore the widening deficit of accountability in international development finance. The resulting blurring of concessional and non-concessional flows brought about by the ODA reform

Box 3.4 Case study: The experience of Bangladesh in development finance institution investment

The following points were determined based on a review of 240 private sector engagement projects:

- DAC donors dominate private sector engagement mobilized through development cooperation (37 per cent), multilateral development finance institutions (33 per cent) and bilateral development finance institutions (25 per cent).
- The predominant private sector instrument is financing, mainly debt financing, primarily in the financial sector, agriculture, manufacturing and energy. Finance underpins 71 per cent of the projects examined, with debt financing supporting 42 per cent of projects overall.
- Large domestic companies remain the most prominent partners in private sector engagement projects in Bangladesh.
- The total size of public or private contributions for private sector engagement projects cannot be determined due to a lack of transparency.
- The main activities supported by private sector engagement projects include improving access to finance for small and medium-sized enterprises and/or a specific sector, technology or research-related interventions in agriculture and financing company operations, including expansion activities and upgrades.
- The extent to which the activities of private sector engagement projects support specific sectoral policy objectives is unclear, even if the sectors chosen by development finance institutions align with the general priorities of the national development plan.
- Private sector engagement projects could benefit from more inclusive partnerships and support greater country ownership; government institutions are listed as partners for only 9 per cent of projects, while 8 per cent involve civil society organizations and less than 1 per cent involve domestic business associations.
- Private sector engagement interventions with regard to the business enabling environment tend to neglect support for government capacity to move from policy formulation to implementation, including with regard to carrying forward existing projects and programmes, ensuring compliance with laws and regulations and establishing greater coordination and consistency across the Government with regard to interaction with the private sector.
- Only a limited number of the examined projects (12 per cent) explicitly target the poor or people living in underserved or rural locations. Only 4 per cent explicitly target women.
- Most private sector engagement projects are subject to regular monitoring at annual or more frequent intervals and, to a lesser extent, through field visits. More development partners could make project-specific monitoring provisions and the intermediate and final results from evaluations publicly available.
- Only 3 per cent of examined projects provide evaluation information and another 4 per cent outline how evaluation will occur. The focus seems to be on publicizing institutional approaches and policies for evaluation, as is the case for 65 per cent of the projects.

Source: Kindornay et al., 2018.

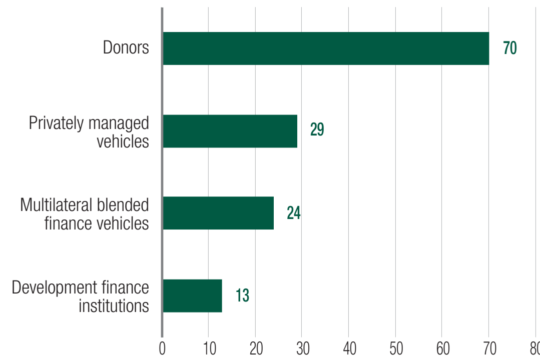
renders previously comprehensible aspects of ODA opaque. This accountability deficit could turn out to be the Achilles' heel of the Goals.

Development has many faces, and achieving the aims of the 2030 Agenda will come down to providing the answer to three key related questions, namely, what is success? Who decides on the answer? Who charts the path to success? Significant enthusiasm is being generated with regard to achieving the Goals, and current approaches to implementation provide considerable leeway for individual actors to unilaterally finetune definitions and key concepts to encompass their own efforts or favour strategic interests. As a result, scope for the divergent application of key concepts and less than meaningful success factors has widened.

Determining wherein authority lies to answer the first and third key questions and how that authority should be exercised is a pressing challenge in the implementation of the 2030 Agenda. At the level of donors, development finance institutions have been appointed as the primary vehicle for achieving ambitions related to private sector engagement. By default, they provide guidance on which activities matter and when and how they matter for development impacts. Increasingly unclear is the place of the national development plans and aspirations of recipient countries and private sectors. Recipient States, although given primary responsibility for achieving the Goals by the 2030 Agenda, have effectively vanished from the development toolbox. This flies in the face of what is intended to be a revitalized global partnership for sustainable development. The absence of a common understanding of this issue has the potential to significantly undermine development impacts at the systemic level in countries at the receiving end of donor-led private sector engagement. Crucially, opportunities to make needed investments in State capacity and ownership risk falling by the wayside.

Figure 3.15

Dissemination of evaluation reports



Source: UNCTAD calculations, based on data from OECD, 2018g.