Centro Studi di Politica Internazionale

CeSPI

Fondazione Compagnia di San Paolo

Blended finance and European Fund for Sustainable Development: implementation and assessment

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May 2020

In the framework of the program:"L'Italia e le sfide internazionali"

SUMMARY

Introduction

In September 2016, the European Commission launched the European External Investment Plan (EIP) to support investments in Africa and the EU Neighborhood countries in order to promote decent job creation and inclusive and sustainable development and to tackle the root causes of migration.

The EIP sets out a framework to promote a new partnership and support investment in third countries, especially fragile ones. In particular, it boosts a blending agenda, which is the combination of EU grants with loans or equity from public and private financiers. Its aim is to use the EU support in a strategic way to attract additional financing with respect to the traditional development assistance and to address the funding gap to meet the Sustainable Development Goals in partner countries. The European Commission indeed defines blending as "an instrument for achieving (EU) external policy objectives, complementary to other aid modalities and pursuing the relevant regional, national and overarching policy priorities"[1].

The blending mechanisms are conceived as an instrument to leverage funds from the private sector, which should progressively assume a prominent role in financing for development.

Part of the EIP is the European Fund for Sustainable Development (EFSD). Launched in 2017, when its Regulation was adopted[2], the EFSD functions as a "one-stop shop" where the access to EU blending facilities is proposed, coupled with an additional guarantee for public and private investors and financial institutions. The guarantee is aimed at reducing investors' risks and absorbing their potential losses, so that they should be encouraged to intervene in those countries and sectors considered too risky and thus contribute more effectively to sustainable development in partner countries.

Indeed, supported projects must have a clear sustainable development objective and promote economic and social development, with a focus on environmental sustainability and job creation, particularly for young people and women.

The stated objectives are ambitious and the effectiveness of blending finance in reaching development objectives is still unproven; the body of evidence, analysis and good practices is still scant and the assessment of the EFSD as the financing arm of the EU external action is still limited.

The debate on blending opportunities and related challenges is nourished by various stakeholders, especially from the civil society organizations. It is under discussion the need to ensure a greater transparency in fund allocation, the respect of the principle of additionality between public and private resources, the added value of blending projects in terms of social, economic and environmental impacts.

In this study, we will review the documents that provide to date some evidence on the assessment of EU blending operations and of the EFSD in particular. We will thus critically analyze the opportunities and challenges linked to blending with regards to the following criteria: development effectiveness; additionality and added value; transparency and accountability; alignment; ownership and cooperation.

This analysis is especially relevant nowadays, since the EU external action is evolving by pursuing the objective to simplify its complex financial structure and to establish a single entry point for investors seeking EU support to integrate blending facilities.

The European Commission is currently proposing the establishment of a Neighborhood, Development and International Cooperation Instrument (NDICI) as a broad financial instrument

[1] European Commission (2015). Eu blending: European Union aid to catalyse investments, European Commission, Brussels

[2] Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development (EFSD), the EFSD Guarantee and the EFSD Guarantee Fund

merging several ones. Then, through the NDICI, it is envisaged to further develop of the EFSD (in the European Fund for Sustainable Development Plus), in order to create a single worldwide blending facility and a new external action guarantee, with larger geographical scope and increased resources.

With this perspective, we will conclude with some suggestions to further develop the EFSD mechanisms in a way able to ensure development effectiveness, additionality and added value, participation and involvement of local stakeholders.

The EFSD in the context of blended finance

The EFSD is a financial instrument that was introduced with Regulation (EU) No 2017/1601 of 26 September 2017 (the EFSD Regulation), which also established the EFSD Guarantee and the EFSD guarantee fund.

This instrument was founded as the **first pillar of the External Investment Plan** (EIP), alongside technical assistance as its second pillar, aimed at developing sustainable projects and attracting other investors, especially from the private sector and the improvement of the investment climate and overall policy environment in partner countries as its third pillar. The three pillars were conceived to reinforce each other in an integrated approach to create a sustained cycle of investment.

As financial arm of the EIP, the EFSD has correspondingly **ambitious aims**: "to support investments and increased access to financing, primarily in Africa and the European Neighborhood , in order to foster sustainable and inclusive economic and social development and promote the socioeconomic resilience of partner countries" in the context of the Sustainable Development Agenda (EFSD Regulation, Art. 1).

A particular focus is also given "on sustainable and inclusive growth, on the creation of decent jobs, on gender equality and the empowerment of women and young people, and on socioeconomic sectors and micro, small and medium-sized enterprises, while maximising additionality, delivering innovative products and crowding in private sector funds" (EFSD Regulation, Art. 1). The EFSD has also a strong environmental focus and thus aims to contribute to climate change mitigation and adaptation as foreseen by the Paris Agreement on Climate Change. Revealing a peculiarity against previous blending facilities, it is also focused on supporting investment "to address the specific socio-economic root causes of migration, including irregular migration…and to contribute to the sustainable reintegration of migrants returning to their countries of origins and to the strengthening of transit and host communities" (EFSD Regulation, Art. 9).

The innovativeness of the EFSD in achieving its objectives resides in the provision of different financial tools, covering a variety of risks and investment instruments. Through these instruments, the EFSD promotes blended finance: on the one hand, public resources are used to inject economic efficiency in the presence of market failures and to create new markets; on the other hand, guarantees are aimed at mobilizing additional investment, especially from the private sector, targeted to areas and sectors traditionally perceived as riskier. As those markets usually remain under-served, blended mechanisms are endorsed as an opportunity to finance activities that would not take place otherwise by concretizing the principle of public-private partnerships, according to which private sector investments are mobilized as complementary to, not competitive with, public funds.

As the EFSD's objectives are very broad in their scope, five more specific areas for investment - the so-called "**investment windows**" - were identified shortly after the EFSD's launch:

1. sustainable energy and connectivity: to attract investments in renewable energy, energy efficiency and sustainable infrastructure;
2. financing of micro, small and medium-sized enterprises (MSMEs): to improve MSME's access to finance, being these type of activities the main employers in Africa and the EU Neighborhood and thus an important and more sustainable alternatives to the informal economy;
3. sustainable agriculture, rural entrepreneurs and agroindustry: to provide better access to finance for smallholders, cooperatives and MSME sized enterprises, agribusiness and to address food security issues;
4. sustainable cities: to mobilize investments in sustainable urban development of municipal infrastructure, including urban mobility, water, sanitation, waste management, renewable energy;
5. digitalization for sustainable development: to promote investments in innovative digital solutions for local needs, financial inclusion and decent job creation.

In 2018, five **guarantee priority areas**, roughly corresponding to the above mentioned investment windows, were identified and twenty-height guarantee tools were developed for each of them:

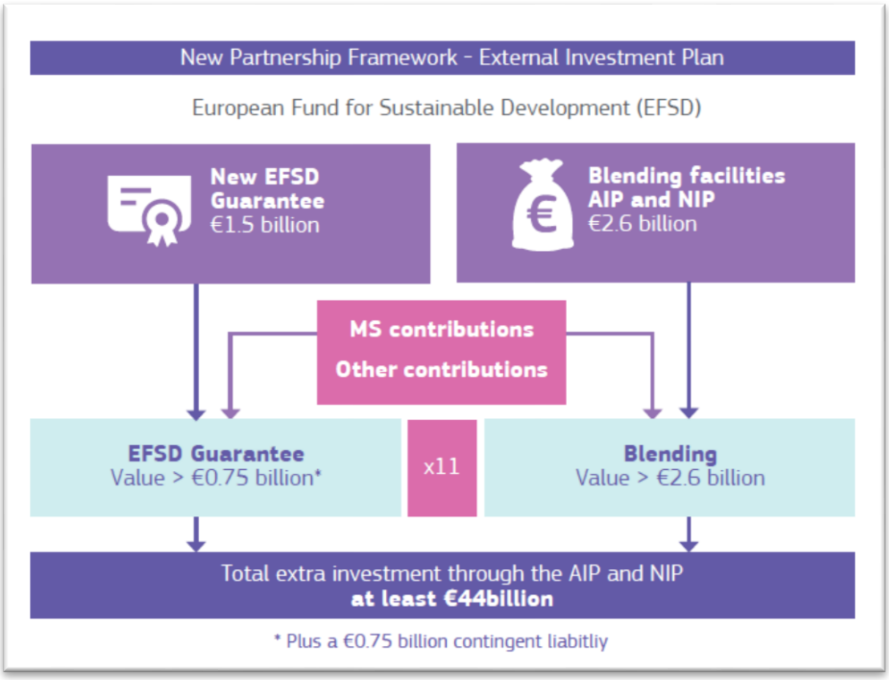
1. financing of MSMEs and agriculture (eleven guarantee tools);
2. sustainable energy and connectivity (eight guarantee tools);
3. sustainable cities (three guarantee tools);
4. digitalization (four guarantee tools);
5. local currency financing (two guarantee tools).

With regards to the **geographical coverage**, the EFSD is composed of two regional investment mechanisms established in 2017 and is based on two already existing blending facilities supporting investments in Africa and in the EU Neighborhood.

The first one is the African Investment Platform (AIP), which is based on the Africa Investment Facility (AfIF) that was created in 2015. The AIP supports investment in EU's partners in Africa. Targeted sectors are: the infrastructure, including transport, energy interconnections and renewable energy, and information and communication technologies; the private sector development, including access to finance for households and MSMEs; the environment, including water supply and sanitation, and climate change adaptation and mitigation; the agriculture; the healthcare and education (social infrastructure).

The second one is the Neighborhood Investment Platform (NIP), based on the Neighborhood Investment Facility (NIF) that came into operation in 2008. The NIP is aimed at enabling the EU´s Neighborhood countries to access loans to finance investments for the energy security, connectivity and market integration; for combatting climate change and environmental threats; for promoting sustainable, inclusive growth by boosting SMEs and by supporting the social sector and municipal infrastructure.

The **founds** of the AIP and NIP amount to 2.6 billion euro, combined with an injection of resources for the EFSD Guarantee operations that are envisaged to reach a total volume of up to €1.5 billion. By 2020, the combination of blending operations and the guarantees operations provided by the **EFSD are expected to mobilize additional public and private investment in Africa and in the Neighborhood countries for EUR 44 billion**. It is thus assumed a leverage ratio of 1:11.



Source: EFSD Operational Report 2017

Furthermore, Member States and other partners such as private investors, international financial institutions and development banks are called to match these EU contributions. If this will be the case, the European Commission estimates that the total amount of additional investment could reach a sum of EUR 62 billion, with a potential leverage effect of EUR 88 billion, that is more than EU ever invested in development aid.

In general, it is with optimism and enthusiasm that the process to develop the EFSD has been launched and is now preparing to scale up.

Despite blending as a modality of cooperation for development has still not been fully evaluated and that its development effectiveness and added value has not been demonstrated, the European Commission has the intention to increasingly rely on guarantees and blending for its external action.

Indeed, in 2018, the European Commission, in defining some proposals for the next long-term EU budget 2021-2027, included a new investment framework for its external action. **The EC proposed the establishment of the Neighborhood, Development and International Cooperation Instrument (NDICI)** as a broad financial instrument merging several ones, with a financial envelope of 89.2 billion Euros, in an effort to overhaul and simplify the system[3].

Within the NDICI, the **European Fund for Sustainable Development Plus (EFSD+)** will be a further development of the EFSD comprising a single worldwide blending facility and a new external action guarantee. The EFSD+ will have larger geographical scope and increased resources.

More in detail, the budget for the EU external action will increase from 1.087 billion Euros in 2014-2020 to 1.279 billion Euros in 2021-2027. The financial amount dedicated to the EFSD+ operations is not specified in the proposal, but it is included in the geographic envelopes which

[3]European Commission Proposal for a Regulation of the European Parliament and of the Council establishing the Neighborhood, Development and International Cooperation Instrument (NDICI) (COM(2018)460

amount to 68 billion Euros. In this regard, the current EFSD Regulation is clearer, since it states that the guarantee should not exceed 1.5 billion Euros.

The **geographic component** will consist of programs for the Neighborhood and the Sub-Saharan Africa, but also for Asia and Pacific and Americas and Caribbean, building on the experience of the already existing blending facilities. It thus aims to integrate the regional facilities that fell outside the scope of the present EFSD.

The **thematic component** (proposed financial envelope 7 billion Euros) includes several thematic programs with worldwide coverage: human rights and democracy; civil society organizations; stability and peace; and global challenges such as health, education and training, women and children, decent work and social protection, culture, migration, environment and climate change, sustainable energy, sustainable and inclusive growth, private sector and local authorities.

Also, a "**rapid response component**" (proposed financial envelope 4 billion Euros) would allow for greater flexibility in order to ensure rapid responses from the EU in crisis management and prevention, peace building, strengthening resilience, linking humanitarian aid and development action and, more generally, address foreign policy needs and priorities.

The general purpose of the EFSD+ development is then a rationalization of the actual EU external policy, to be achieved through an increasing coherence between the different available instruments granted by a new unified financial architecture and a simplification of processes.

But some issues are still under discussion. In particular, negotiations include Parliament's demand to ensure better governance by introducing democratic accountability and stronger monitoring and reporting mechanisms; clearer and more distinct objectives for the various policies that better take into account the objectives of development cooperation; budgetary measures to better reflect the strategic importance of a number of geographical and thematic issues. As well, the Council demands, among other things, to strengthen language on poverty eradication, human rights, gender and climate change; improve the monitoring system and to introduce an exclusion cause for any type of funding running counter to the Paris Agreement or investment in fossil fuels[4].

Blended finance and the EFSD implementation and assessment

The European Union has been implementing blending facilities since the 2007, with the launch of the EU-Africa Infrastructure Trust Fund (AITF) and, the following year, of the Neighborhood Investment Facility (NIF). Then, other blending facilities were developed. To date, there are eight regional facilities (for the Caribbean, the Latin American, the Neighborhood, Western Balkan, Africa, Asia, Central Asia and the Pacific) that cover the entire sphere of EU external cooperation and two thematic windows (for the energy sector and for sustainable agriculture).

In 2017, during a DAC Meeting[5], it was stated that "the increasing prominence of Blended Finance contrasts, however, with a still limited body of evidence, analysis and good practice in this area, as well as increasing concerns from a range of stakeholders about the risks of engaging in commercial transactions with the private sector".

Earlier reports drafted before the launch of the EFSD covered separately the activities of the NIF and of the EU AITF. In particular, they were the mid-term evaluations of these facilities in their first three years of operations.

[4] https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/628251/EPRS_BRI(2018)628251_EN.pdf

[5] OECD (2017), Blended Finance for sustainable development: moving the agenda forward. DAC Meeting, 09 March 2017

The first overall assessment on EU blending facilities was launched in 2014: the Court of Auditors evaluated the regional investment facilities since their launch. The audit focused on "the set-up and management of the regional investment facilities and on the extent to which the intended benefits of blending were achieved"[6]. Then, the accent was put on the procedure for assessing grant application, the selection process of projects to be financially supported, the appropriateness of the type and amount of the grants as well as the process to implement and monitor progresses of the financed projects.

The audit object consisted of 30 projects that received grants from the EU-AITF and the NIF. The two regional facilities were representative of more than 70% of the grants approved by the regional investment facilities by the end of 2013. They were also the oldest investment facilities and thus have the most advanced projects.

The Court concluded that blending mechanisms were generally an effective instrument to support the EU external action, but still there were room to improve the realization of potential benefits. In particular, project identification, relevance and design were considered positive and well aligned with the development needs of the concerned partner countries. Both instruments achieved their goal of leveraging significant financial resources as well as of promoting partnerships and of increasing coordination and cooperation among different donors. Indeed, the regional investment facilities facilitated coordination among donors, allowing launching projects that otherwise would have been too large for financing by a single donor.

However, project's approval process was assessed as scarcely transparent, also because of a lacking guidance on which criteria should be used in the decision-making process. It was pointed out that the EC monitoring performances was limited and unstructured, as mainly based on a Results Oriented Monitoring rather than be specifically focused on the principle of additionality. Indeed, for half of the projects examined by the Court of Auditor, the evaluation highlighted that there were not convincing evidence that awarding grants were necessary to enable a loan to be contracted and that, in a number of these cases, there were indications that the investments would have been possible also without an EU contribution.

The first independent assessment of blending facilities was commissioned in December 2016 by the Evaluation Unit of the Directorate-General for International Cooperation and Development of the European Commission (EC DG-DEVCO). The evaluation was focused on the strategic relevance of blending as an aid modality, the created added value and the results in terms of development objectives[7]. It was indeed based on a reconstructed theory of change, and it covered the activities of seven regional facilities[8] between 2007 and 2014.

On the one hand, the assessment concluded that blending allowed the EU to engage more broadly in countries and sectors which would have been mostly out of reach with grants alone. In particular, support was mainly given to capital-intensive infrastructure projects (which represented 75% of blending operations) and for operations in lower medium and medium income countries (over 80% of blending).

On the other hand, the assessment highlighted that, especially in the cases of early projects, projects in lower income and fragile countries and projects with specific pro-poor objectives, the blending instrument did not reach its full potential. In addition, gender issues were rarely targeted.

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[6] European Court of Auditor (2014), The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies. Luxembourg, Special Report no 16/2014

[7] ADE – Analysis for Economic Decisions (2016), Evaluation of blending. Final report. Report prepared for the Evaluation Unit of the Directorate-General for International Cooperation and Development (European Commission). December 2016

[8] The Western Balcan Investment Facility was the only regional investment facility excluded.

Despite these points, the assessment considered the majority of blending projects as successful in achieving the intended results, mainly thanks to the soundness of project design, the quality of project monitoring and, the professionalism of partners and contractors. Weaknesses in projects implementation were instead identified in the lengthiness of reform processes, administrative bottlenecks and political instability at country level. Other weaknesses, especially with reference to earlier projects, were identified in a poor conception of the logical framework and of the theory of change. For example, the indirect effects on poverty reduction that should have the infrastructure projects were taken for granted and automatic.

The assessment also identified as a challenge the need of improving the monitoring system of blending projects. For example, a limited information on job creation were provided, which is nonetheless one of the main objectives of blending mechanisms.

The EU grants were also assessed as effective in leveraging investments, being the average ratio of 1:20, with additional funds coming principally from key development finance partners, but also private sector investors. Nonetheless, according to the report, the full potential to mobilize the private sector was not reached. In particular, the capacity to reach new borrowers (and women in particular), especially if previously unbanked, was questioned.

The EFSD, according to its Regulation, should have been evaluated by the end of 2019 and then every three years, in particular for what concerns its initial functioning, its management and its effective contribution to its purposes and objectives. The evaluation reports should also contain an independent external evaluation. **To date, two operational reports have been released by the European Commission.** They still are the only source of EFSD's evaluation.

In 2017[9] a first assessment, specifically focused on the EFSD, covered the first five years of operation. A second operational report was delivered in 2018[10] and covered the second year of operation of the EIP and the EFSD. The two operational reports assessed the blended finance operations under the Africa Investment Platform and the European Neighborhood Platform. They presented the progresses reached in terms of approved projects, the total EU contribution and the leveraged funding, also with descriptive statistics about the allocations by sectors, financing type, regions.

According to the reports, in 2017, the EU agreed to invest nearly 1.3 billion Euros in 52 blending projects. These projects are to be implemented in Africa (30 projects, mostly in least developed countries, supported by a total EU contribution of 900 million Euros) and in the European Neighborhood (22 projects supported by a total EU contribution of 400 million Euros).

In 2017, these resources were expected to mobilize 10.6 billion Euros in public and private investments, of which 5.6 billion Euros in Africa and 5 billion Euros in the EU Neighborhood, corresponding to the 24.1% of the investment target of 44 billion Euros.

The allocation of assistance since 2017 was provided mainly (61%) through investment grants. Then, 23% of the support was allocated through financial instruments (loans, equity and guarantees), 15% through technical assistance and 1% through interest rates subsidies.

By the end of 2018, according to the operational report of 2018, the EU increased its contribution for blending operations. Indeed, the EFSD Guarantee was more than twice oversubscribed by Financial Institutions. Eventually, 94 blending projects were approved for a total EU contribution on 2.2 billion Euros: 51 in sub-Saharan Africa for a contribution of 1.45 billion Euros and 43 projects supported in the Neighborhood for a total contribution of 753 million Euros. These resources are expected to leverage 19.5 billion Euros of investments.

[9] European Fund for Sustainable Development – 2017 Operational Report, European Commission, 2018.

[10] European Fund for Sustainable Development – 2017 Operational Report, European Commission, 2019.

In 2018, the allocation of assistance was still provided mainly through investment grants (58%). The allocation through financial instruments rose to 29%, while the technical assistance contribution decreased to 13%.

Since 2017, the transport sector is the most targeted in Africa: 47.9% of the allocated resources are for transport projects (e.g. to upgrade and rehabilitate corridors such as Trans Saharan and the Dakar-Lagos or expansion of ports, in Congo and in Seychelles). Another 36.2% of the allocated resources are for renewable energy projects, as for example AgriFI in Sub-Saharan Africa. Since 2017 in the Neighborhood countries, resources were allocated mostly for the private sector financing (29%), for example through regional programs to support the private sector in response to the economic downturn since the Arab Spring. Another 21% was allocated for water and sanitation interventions. In 2018, the resources allocated for the private sector development became the 33% of the entire contribution, while another 20% were allocated to the energy sector, 17% to water and sanitation and 10% to the environment protection.

The operational report of 2018 provides some more information on the EFSD objectives and includes the first specific assessment of the EFSD Guarantee.

First, it reports that the EU allocated 28 guarantees corresponding to a contribution of 1.54 billion Euros, distributed among the five investment windows as follows: 36% for sustainable energy and connectivity; 26% for the financing of micro, small and medium enterprises; 14% for digitalization for sustainable development; 11% for sustainable cities and 11% for sustainable agriculture, rural entrepreneurs and agribusiness. The allocations are expected to mobilize 17.5 billion Euros in investments, much of it from the private sector. As well, the report indicates that preliminary estimates suggest that the "investments should generate about 4 million jobs, provide energy or access to energy to 8 million people, reduce carbon emissions by 6 000 kT/year – equivalent to annual emissions of more than 1 million vehicles with an internal combustion engine, add over 4 GW of new capacity, particularly in renewable energy, address gender inequality, invest in socioeconomic sectors such as education and health, address socioeconomic root causes of migration and foster sustainable reintegration of returnees".

Any other information is provided on how these estimates have been produced and on further assessment objectives.

Assessment criteria improvement linked to blending objectives

The available evidence on blending finance and in particular on the EFSD leaves some questions opened. The assessment of its functioning and qualities is increasingly crucial.

Key principles, on the basis of which blending initiatives could better be assessed, in our view, are:

- **development effectiveness**: since ultimately the blending operations success depends on whether they achieve the set development objectives, their contribution should be assessed in terms of inclusive and sustainable growth, and poverty eradication; job creation, especially in MSMEs and agriculture and especially for women and young people; gender equality and equal opportunities for the youth; climate change mitigation, sustainable energy and sustainable cities; and the contribution in tackling the root causes of migration;
- **additionality and added value**: the extent to which the grant component has leveraged investment for projects – especially from the private sector - that could not have been carried out otherwise or which achieve development objectives above and beyond what could have been achieved without it;
- **transparency and accountability** in project selection;

- **alignment**: the extent to which financed projects are aligned with EU country and regional strategies/policies and with the national/regional priorities of beneficiary countries;
- **ownership**: the extent to which beneficiaries, public sector (national/regional governments) or private sector (banks, etc.) are involved in project identification, formulation and implementation;
- **cooperation**: the extent to which blending has facilitated and promoted cooperation among different donors allowing synergies and complementarities;

The evidence on the **development effectiveness and additionality** of the EFSD operations still lacks any publicly available independent assessment, even if a full assessment should be released in the coming future since it was foreseen by the end of 2019.

The audit made by the Court of Auditors in 2014 on previous blending facilities already questioned the respect of the principle of **additionality**. The following external evaluation commissioned by the EC DG-DEVCO also confirmed that early projects should have been more explicitly focused on the additionality of blending grant. As well, sstakeholders, especially from the civil society organisations, questioned the blending facilities' capacity to meeting development objectives and to ensure the additionality of blending mechanisms, as well as a sufficient transparency, accountability and developing country ownership[11] [12].

Then, the available knowledge from previous blending operations suggests that there is room for further improvements and innovation in designing blending operations.

As a first objective, ensure that the EFSD reach under-served markets and effectively reaches its development objectives. As a second one, ensure that the EFSD leverages funds without crowding out public investment and without over subsidising the private sector.

With reference to the first objective, the operational reports of 2017 and 2018 reflect an optimistic vision according to which the EFSD has seen an innovative instrument to attract investments in countries and sectors were otherwise resources would not be sufficient. Indeed, they present blending operations with optimisms with respect to the possibility to support the EU external policy and development objectives. The reports conclude with positive notes about on the impact of supported projects on indicators such as the number of job created. Nonetheless, few details are provided on how the estimates on the development impact indicators were obtained and any detail on their disaggregation (by geographic area, sector, gender, income…) is given.

By contrast, some independent studies attempt to temper this strong optimism.

Recognising that the set objectives are numerous and ambitious in their scope (from poverty reduction to climate change, from gender equality to tackling migration causes), highlighting the EU strong commitment in addressing the global challenges, they point to a lack of a clear theory of change behind the EFSD's framework, which to date has not been clearly stated[13].

The evaluation commissioned by the EC DG-DEVCO, for example, stated that the pro-poor projects were only a minority in blending operations. The assessment let emerge that the poverty reduction objectives were indeed considered only indirectly, as the result of the growth obtained through investments in infrastructure sector. The trickle-down effect was thus taken for granted.

[11] Oxfam (2016). Private Finance Blending for Development, Oxfam internal briefing paper, October 2016

[12] Romero, MJ. (2013). A dangerous blend? The EU's agenda to 'blend' public development finance with private finance.2013. Available at http://eurodad.org/files/pdf/527b70ce2ab2d.pdf

[13] Oxfam (2016). Private Finance Blending for Development, Oxfam internal briefing paper, October 2016

In this respect, concerns are raised by stakeholders also more recently and with reference to the blending operations supported by the EFSD[14]. The five investment windows that guide the fund's operation and in which projects should fit are too broad in their scope and do not specifically address the question of under-served countries and sectors. As a consequence, it is not clear how investments in these areas should contribute to the achievement of the final objectives to support development and poverty reduction, to mitigate climate change and, in the long term, to tackle the root causes of migration.

With reference to the second objective of financial additionality, the EFSD operational reports of 2017 and 2018 conclude with positive notes about the resources leveraged with blending operations, both from the public and the private sector.

By contrast, one important aspect that has been stressed by stakeholders is that it is not clear whether the EFSD is aimed at maximising the leverage of investment or at mobilising resources in countries and sectors traditionally perceived as too risky or with low returns. The two objectives are indeed in trade-off: first, higher-risk investment requires larger financial support and, as a consequence, will achieve lower leverage[15]; second, companies are unwilling to invest in unstable countries and fragile contexts as projects are more difficult in terms of financial sustainability and development impact and they may thus fear losing the public funding[16].

Indeed, EU NGO's raised concerns about private sector priorities overriding poverty reduction objectives in partner countries and stressed that blending instruments are better suited to middle income countries and stable contexts. As a consequence, they warn against the risk to divert the traditional aid for least developed countries and more fragile environments. The debate focuses on the possible trade-off in allocating ODA to blending mechanisms and whether instruments to stimulate private investment, even if coherent with development objectives, should be counted as ODA[17].

Other concerns are raised with reference to the EU strategy for external action: blending mechanisms led to focus on project-financing in which the private sector should gain a prominent role. The project-financing orientation requires engaging in a multi-stakeholder cooperation. As a consequence, clarity on the objectives that are intended to achieve is needed to realise the bending potential and ensure complementarity with other initiatives and policies (at all level)[18].

In this frame, ensuring a clear monitoring system is essential to improve the development impact of supported initiatives as well as to guarantee more **transparency and accountability** in the process of project selection. In particular, local stakeholders should be involved in this process[19].

A framework of reliable indicators to assess the impact of the supported projects should allow tracking the progresses obtained against the contribution to achieving the SDGs, also disaggregating by income, gender, age, geographic location, ethnicity or other criteria.

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[14] Counter Balance (2017). The External Investment Plan: innovative instrument or dangerous blueprint for EU development policy?. November 2017

[15] Gavas M. and Timmis H. (2019), The EU's Financial Architecture for External Investment: Progress, Challenges, and Options. CGD Policy Paper 136, January 2019.

[16] Counter Balance. 2017. *The External Investment Plan: innovative instrument or dangerous blueprint for EU development policy?* November 2017.

[17] Lundsgaarde E. (2107). The European Fund for Sustainable Development: changing the game?. German Development Institute Discussion Paper 29/2017. Bonn 2017

[18] Ibidem

[19] Counter Balance. 2017. *The External Investment Plan: innovative instrument or dangerous blueprint for EU development policy?* November 2017.

As well, a monitoring system would ensure more transparency and accountability by clarifying rules in partnerships and projects and also to inform the adequate amount of public support, the leverage effect and the added value in blending finance.

The major risks that can be identified in blending initiatives are to subsidies the private sector or to crowd out public resources by negatively impact on local economies and in particular micro, small and medium sized enterprises, social enterprises and cooperatives. In this respect, Concord and Eurodad stressed that the risk of subsidizing international companies is very high and may lead to market distortions and "further cement corporate power were the democratic space is already dangerously shrinking"[20].

Other risks may be identified in tax avoidance, corruption and bad governance in the beneficiary countries. In this respect, the European Parliament already expressed, in a resolution of 2017 on the role of EU external action[21], the need to ensure the monitoring on the use of funding and its use for intended purposes.

With reference to the **alignment,** the EFSD as an instrument to finance the EU external action should guarantee the complementarity and coherence - from a thematic, geographical and sectoral point of view - between the internal and external policies of the EU, as well as between the external instruments themselves. In this respect, some stakeholders have emphasised, for the further regulation of the Neighbourhood, Development and International Cooperation Instrument, that the Sustainable Development Goals (SDGs) provides the most appropriate basis for increasing coherence between internal and external policies and that the EU may take a leading role in improving complementarity between various stakeholders both inside and outside the EU, between geographic and thematic programmes and between multiple instruments[22].

Even more relevantly, alignment should be granted with beneficiary countries' national and subnational strategies and initiatives. This would avoid, on the one hand, the fragmentation and multiplication of interventions. On the other hand, it would facilitate the correct understanding of local conditions, with the related challenges to address, the needs to satisfy and the stakeholder interest to fulfil.

Further, European initiatives in developing countries should build on their own strategies. To this aim, the respect of the principle of **ownership** becomes crucial.

In this regard, according to a number of civil society organisations, the EFSD seems to lack the governance dimension. Stakeholders indeed stressed the necessity to include consultations at national level with local actors – and in particular with the participation of civil society organisations, non-state actors and local private enterprises - in order to seek their views on the areas of intervention and specific projects considered under the EFSD. To support a participatory approach and to foster ownership should indeed ensure an improved process of design, implementation and evaluation of proposed projects and, as a consequence, a higher development impact in their implementation. To this aim, a simplification of the overall architecture of the EFSD and of its administrative and financial procedures to enable the involvement of civil society and local actors has been encouraged in view of enlarging the EFSD scope with the EFSD+ regulation[23].

With reference to the **cooperation**, the European Court of Auditors' assessment of 2014 on the EU blending facilities, already reported that the facilities encouraged cooperation among EU Development Finance Institutions (DFI) such as the European Investment Bank, the European

[20] Concord-Eurodad, (2019). European Parliament's position NDICI and Concord-Eurodad's 10 points on ESD+, June 2019.

[21] https://www.europarl.europa.eu/doceo/document/TA-8-2017-0124_EN.html?redirect

[22] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD:2018:337:FIN

[23] Ibidem

Bank for Reconstruction and Development, the Agence Française de Développement and Germany's KfW Development Bank, that were the main implementing partners in the supported blending operations. The operational reports on the EFSD seemed to confirm this peculiarity. In fact, as in its first year of operation, the EFSD Guarantee was over-subscribed, the EC called to an increased collaboration and the creation of partnerships among applicants. The resulted increased coordination, at least among the larger European DFIs and the consequent joint initiatives have reportedly led to higher quality proposals[24].

Nonetheless, as highlighted by Bilal and Große-Puppendahl (2018)[25], there is a need to reconcile the ambition of increased cooperation and coherence among EU Development Finance Institutions and the competition among them to stimulate innovation and diversification. As well, cooperation should also be promoted with smaller Development Finance Institutions, which to date were able to penetrate new markets only in in few cases.

Conclusions

The recent discussions about the envisaged evolution of the EU external action to establish a single entry point for investors seeking EU support by integrating blending facilities, represent an opportunity to ensure an increased transparency and accountability of blending operations as well as to finance projects which fulfill official development assistance criteria.

In this study, we have reviewed the available evidence of blending operations and related monitoring and assessment criteria. Still it is scant and needs to be further developed.

It is crucial to gain more knowledge in terms of the development effectiveness of blended finance, the additionality and added value of blending compared to tradition development assistance in terms of social, economic and environmental impacts; the process of project selection; the alignment with other strategies and policies, at all level; the participation of local stakeholders and the cooperation opportunities between different donors that have been created.

Some efforts should be made to further improve and innovate when designing blending operations, from their initial conception to their final assessment. In particular, there is room for:

- a clearer enunciation of the EFSD objectives, in order to disentangle between objectives that may be in trade-off: first, the trade-off between the aim to maximise the leverage of investment and the one to mobilise resources in countries and sectors traditionally under-served; second, the trade-off between the allocation of ODA and the financing of blending operations;
- a clearly stated theory of change (in particular with reference to their pro-poor objectives) at the basis of the supported interventions;
- the collection and dissemination of more information about the EFSD impact on development, by setting a clear monitoring and assessment system, with a defined frame of indicators (possibly disaggregated by income, gender, age, geographic location, ethnicity or other criteria);
- a participatory approach of beneficiary's countries stakeholders, in order to avoid to negatively impact on local economies and, on the contrary, facilitate the correct understanding of local conditions, with the related challenges to address, the needs to satisfy and the stakeholder interest to fulfil.

[24] Gavas M. and Timmis H. (2019), The EU's Financial Architecture for External Investment: Progress, Challenges, and Options. CGD Policy Paper 136, January 2019.

[25] Bilal S. and Große-Puppendahl S. (2018), The European External Investment Plan challenges and next steps for a game changer. Briefing Note No. 12, March 2018