European Commission

Catalysing private engagement and resources for development

- the EU's role

International Cooperation and Development

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Luxembourg: Publications Office of the European Union, 2015

ISBN: 978-92-79-48963-1
doi: 10.2841/872881

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

Printed in Belgium

PRINTED ON RECYCLED PAPER

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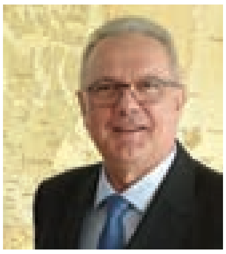
FOREWORD



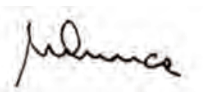
The private sector can be an engine of inclusive growth by generating jobs, contributing to public revenue and providing affordable goods and services. By investing in sustainable innovation and business models, the private sector can also help reduce poverty and improve lives by boosting productive activities. The European Union assists developing countries in their economic reforms and private sector initiatives and wants to address the constraints on private activity in order to unleash its potential to create inclusive growth and to contribute to sustainable development.

In May 2014 the European Commission adopted its Communication on “A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries”. This sets out the role of the private sector as being at the forefront of international development in its partner countries. It proposes a series of actions in areas where the Commission believes it can add value and effectively complement actions by the EU Member States and other development partners. These address better regulatory environments, business improvement and access to finance, especially for job-creating micro, small and medium-sized businesses in the formal and informal sectors.

Private sector development will be combined with other related development goals – for instance with climate change, through the EU African Investment Facility which supports vital ‘green’ capital investments. The EU’s proposed initiative for increased investment in inclusive and sustainable agriculture will promote public and private investment for a responsible value chain, smallholder and agribusiness development. With the Electrification Financing Initiative (ElectriFI), the EU, together with private business, aims to accelerate access to reliable, affordable and sustainable energy services in developing countries.

To achieve its objectives, the EU seeks cooperation with other actors. Through a structured dialogue with civil society, business and local authorities, the EU will encourage the private sector in partner countries to engage in responsible investment, sustainable trade, and in innovative and inclusive business models, as part of its core business to enhance economic opportunities for the poor. “Blending” – the combination of EU grants with loans or equity from other public and private financiers, is recognised as an important means of leveraging additional resources for development and increasing the impact of EU aid. The EU is seeking ways to act as a catalyst for private financing through greater use of financial instruments such as guarantees, equity and other risk-sharing instruments for investments.

This publication provides examples of how the EU is transforming development policy into action – catalysing its impact and facilitating private sector investment for sustainable development. It explains how the EU helps companies to build long-term relationships and confidence, as well as developing responsible supply chains. It also demonstrates how the EU supports aid-for-trade initiatives, knowing that improved access to EU markets through EU trade policy provides an important opportunity for developing countries to integrate into global value chains. Lastly, this publication shows how a higher share of EU aid is already being allocated through innovative financial instruments, including blending grants, loans and other risk-sharing instruments to leverage further resources. As such, it constitutes a valuable contribution to the debate on re-defining development financing in the post-2015 context, particularly in view of the Third UN Conference on Financing for Development – but also beyond.



Neven Mimica
European Commissioner
for International Cooperation and Development

INTRODUCTION

The EU-Commission's communication "A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries" [1] ***adopted in 2014, will address key challenges of the post-2015 agenda, and offer possible solutions as to how they can best be overcome.***

Given its capacity as an engine for sustainable growth, job creation and innovation and trade, the private sector will play a key role in poverty reduction and the transition to sustainable development. Hence implementing the post-2015 agenda requires the creation of enabling conditions and a business environment that is conducive to private sector initiatives, sustainable investments and value chains, supporting micro, small and medium-sized enterprises, empowering women, and furthering financial inclusion. It also requires a strong engagement from companies to catalyse private sector investment in areas where market gaps exist and to engage in responsible practices as part of their core business strategies. The EU is engaging in a public-private dialogue to reap the full benefit of private sector involvement.

Countries need to attract additional public and private financing to drive economic growth as a basis for poverty reduction. "The Agenda for Change"[2] emphasises the support of inclusive growth and job creation as a key priority of EU external cooperation. "Blending" is recognised as a means to this end. Blending is a method of combining EU grants with additional non-grant resources to achieve sustainable growth and reduce poverty. These resources might include loans, equity and guarantees from development finance institutions as well as commercial loans and investments. The strategic use of a limited grant element can enable projects with a high economic and social return. Blending facilities bring specific advantages to the beneficiaries in helping them achieve easier and faster access to financing, high leverage effect and more flexibility to adapt to changing conditions.

Blending is generally best suited for capital intensive sectors with high project costs, where some cash flow is generated but the cash is not sufficient to cover the financing of the targeted development objectives (e.g. access for the poor, affordability, use of new technologies). Blending projects are usually in the energy, transport and environment sectors and also cover climate related and private sector development (micro/small/medium enterprises - MSMEs or small/medium enterprises - SMEs) projects. Since 2007, EU grants worth approximately €2 billion have been committed to over 200 projects through blending. EU grant contributions have leveraged €19 billion worth of loans by European Finance Institutions, unlocking total project financing volume in line with EU development policy totalling more than €44 billion.

A well established geographic presence through EU delegations and a vast number of development instruments, some deployable on a micro- and others at a macro- level, allow the EU to make impact interventions for private sector development. Building the domestic institutions and legal frameworks that allow markets to become more efficient and fairer, requires good governance and ownership by partner governments. Possible synergies between the EU's private sector development support, the aid for trade agenda and budget support will be exploited to create maximum developmental impact.

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[1] The communication proposes concrete actions which support developmental states to create a more conducive business enabling environment and proposes possibilities to support the creation of jobs in micro, small and medium-sized businesses. The document also identifies possibilities to use private sector finance to complement European Union development assistance.

[2] In 2011 the EU adopted "The Agenda for Change" designed to make its development policy both more strategic and more targeted: the Agenda set outs changes that will make sure EU aid targets the countries in greatest need, where external support can really make a difference in terms of poverty reduction – including fragile states.

CATALYSING FOR IMPACT

Facilitating and catalysing private sector investment and financing for sustainable development will have an important multiplier effect on Official Developmental Assistance; ultimately curbing poverty and increasing living standards in low- and middle- income countries. In terms of job-creation, working together with the private sector should contribute to addressing the gap of 600 million new jobs that need to be created worldwide in the next 15 years to absorb a growing workforce, mainly in Asia and sub-Saharan Africa .

Private sector engagement should result in improving the sustainability of supply chains in sectors such as agriculture, food security and clothing manufacture, which can be mutually beneficial for EU companies and for developing countries. It can help companies build long-term relationships and confidence within their supply chains. It can also deliver important benefits for local communities and for society at large, in particular in sectors such as health and education, providing essential services and products for the most vulnerable people.

The EU is allocating over € 2 billion to private sector development for the period 2014 - 2020 through dedicated thematic and national EU programmes. This, together with increased allocations to regional programmes, will boost private sector development in partner countries. An improved business climate will lay the foundation for investment and business opportunities, allowing SMEs and large enterprises to flourish in inclusive business ecosystems. Moreover, catalysing private sector investment will alleviate the huge funding gaps that exist in infrastructure sectors such as energy, water and transport.

For the programming period, 2014-2020, the EU Commission is planning to increase the allocation for blending operations; mixing grants with debt and equity. Blending will be used as a cross-cutting instrument including funds from sector allocations in fields such as energy, agriculture, water, transport and private sector development. Increasingly, blending will also serve as a tool for improved access to finance for SMEs, particularly via the new Africa Investment Facility, which also addresses the least developed countries. The EU Commission estimates that EU grants could leverage total investments of up to € 100 billion from additional public and private sources in blending facilities.

Use of financial instruments and technical assistance to mobilise private finance through risk sharing, supports stronger integration into the global economy by firms in developing countries, allowing the EU to engage the private sector in investments for sustainable development. The EU will launch the Agriculture Finance Inititiative (Agrifi), a new initiative that increases investment in smallholder agriculture and agribusiness micro/small/medium enterprises (MSMEs). Another new initiative is the Electrification Financing Initiative (ElectriFI) which will accelerate access to reliable, affordable and sustainable energy services in developing countries by boosting private sector to yield business opportunities.

The EU acknowledges that aid-for-trade is needed particularly for the least developed countries. Access to EU markets accompanied by EU trade policy will contribute to the integration of developing countries into global trade. Capacity building for developing countries to meet EU standards and enjoy the full benefit of trade agreements and unilateral EU trade preferences needs to be pursued and enhanced. Trade facilitation will enable the inclusion of local economies, including MSMEs , into global value chains. Such small producers/operators may otherwise remain excluded from taking advantage of the multilateral trading system and its potential to generate equitable economic growth and job creation.

[3] World Bank World Development Report 2013

PRIVATE SECTOR DEVELOPMENT AND ENGAGEMENT

EU support to private sector development and engagement in 2014-2020 will be over € 2 billion, through a combination of global, thematic and national programmes. In addition to these dedicated programmes, private sector development will also be mainstreamed in other areas such as energy, agriculture, trade and social protection, through, for instance, projects involving support to agribusiness or to small and medium enterprises active in rural electrification.

The Commission will act as a facilitator to foster and leverage private funding and engagement, drawing in innovative, technical, human and financial capacities to developing countries.

The EU will ensure the right mix of initiatives which will generate a private sector response leading to dynamic growth and ultimately employment and income generation. The overarching global, regional and national programmes will be transformed into concrete initiatives for impact, including the following building blocks:

- **Support business enabling environment.** Support the improvement of business and investment climate, especially for micro, small and medium-sized enterprises. Initiatives will promote the inclusion of local enterprises into global or local value chains, identify gaps and strengthen domestic reforms, legal frameworks and institutional capacity, access to justice, contract enforcement, intellectual property rights, land rights and incentives for business formalisation. Particular attention will be given to female entrepreneurship and employment.

- **Support industrial policy.** Remove obstacles in sectors with the highest potential for private sector-led growth and job-creation, building on target countries' comparative advantages in manufacturing and services sectors. Initiatives will support upgrading these sectors.

- **Support microfinance and SME-finance.** Catalyse private funding via risk-mitigating mechanisms such as guarantees, capital finance investment, technical assistance and market information, as well as increasing support for financial inclusion. Support to access to finance also includes improving the full financial ecosystem; e.g. developing appropriate regulatory frameworks to ensure the stability of financial systems and providing incentives for sustainable investments.

- **Support high-growth entrepreneurs.** Helping high-growth entrepreneurs fulfil their potential through initiatives such as business incubation and mentoring, peer-to-peer learning and links to private equity and/or business angel financing.

- **Support market-based business development services.** Technical assistance to support the market development of local business service providers; who will in turn constitute a vital part of the local business ecosystem as providers of essential growth-oriented services to SMEs.

- **Mainstream the role of the private sector.** Mainstream the private sector's role in key sectors such as sustainable energy, agriculture and agribusiness, infrastructure, green and social sectors and catalyse private investment. Achieved through innovative forms of financing such as the EU blending facilities and sector-specific schemes such as "ElectriFI" to boost investments.

- **PPP: Public Private Partnerships.** Promote and facilitate public-private partnerships and new forms of multi-stakeholder alliances, such as addressing the skills gaps through needs-based vocational training schemes, together with national authorities and companies.

- **Innovative financing mechanisms.** Support other innovative financing mechanisms such as impact investment. With "smart capital", impact investors empower socially oriented companies which use inclusive and innovative business models to target the population at the "bottom of the pyramid".

- **Sustainable and inclusive production patterns.** Encourage sustainable and inclusive production patterns and responsible business practices, particularly in sectors where risks are high; pursue negotiations of the regulation on voluntary certification of sourcing of conflict minerals and establish a multi-stakeholder platform under the EU flagship initiative on responsible management of supply chains in the garment sector.

- **Corporate Social Responsibility.** Reinforce the external dimension aspects within the future EU strategy for Corporate Social Responsibility. Dialogue with partner countries, companies and social partners constitutes a core aspect of the the EU strategy.

- **Improved implementation of core labour and environmental standards**. Support the improved implementation of core labour and environmental standards, good governance and the fight against corruption and encourage the private sector to take part in multi-stakeholder initiatives to improve working conditions and environmental opportunities such as the "Accord on Factory and Building Safety" in Bangladesh.

- **Foster structured dialogue with the private sector**. Public-private dialogues and business fora are essential instruments for joint public-private policy development and partnerships which should build on existing experience and best practices. In such dialogue there should be emphasis on the inclusion of SMEs to give them voice and recognition.

PROGRAMME: SWITCH-ASIA

Time period: 2009-2014
Geography: Asia
EC-Contribution: 19 million
Instrument: DCI

As part of the **EU SWITCH-Asia programme,** the "Zero Carbon Resorts" project enabled tourism SMEs, such as hotels and resorts, to provide their energy services in an efficient, cost effective, and environmentally sound way. By providing the SMEs in various parts of the Philippines with access to energy-saving measures and new green technologies, the dependence on fossil fuels was reduced.

The project applied the 3R strategy: "Reduce-Replace-Redesign". The first step was to **reduce** the energy consumption in hotels and resorts; the second step was to **replace** inefficient fossil-based devices with better, greener technologies. In the **redesign** stage, a showcase "Zero Carbon Cottage" was built which used solar- and biomass- based energy generation systems.

Engineers, building and facility managers, environmental consultants, as well as hotel/resort staff have been trained in the relevant techniques. In parallel, local production of renewable materials and green technologies has been supported.

The project delivered tangible outcomes and impact:

- Targeted SMEs saved more than €4 million through more efficient practices with a 52% reduction in energy use and a 54% reduction in greenhouse gas emissions

- In 2014, 3 out of 5 of those awarded the ASEAN "Green Hotel Award" from the Philippines were participants in the project

Building on the success of the **SWITCH-Asia programme** and its individual projects, the EU is now rolling out a new **SWITCH Africa Green programme** with an allocation of €19 million.

PROGRAMME: ACP/EU MICROFINANCE II

Time period: 2010-2015
Geography: 52 ACP countries
EC-Contribution: €15 million (total cost €36M)
Instrument: EDF

An estimated 2 billion people around the world are excluded from access to financial services. This lack of access hampers economic development, increases vulnerability among low-income people and is a key feature of the poverty trap. ACP (Africa, Caribbean, Pacific) countries are particularly affected by financial exclusion. To tackle this issue, a flagship microfinance programme; "ACP/EU MICROFINANCE II", was implemented during 2010-2015, building on the previous "ACP/EU MICROFINANCE I". It provided capacity at all the levels of the financial system i.e.:

- The regulatory environment which needs to be adapted to the peculiarities of small-scale financial services;
- The support services sector which needs to build specific skills to provide sustainable backing to the stakeholders;
- The microfinance provider level, where NGOs need to build capacity and banks need to make a business case for small credits and savings;
- The client level, where financial education becomes a key skill, if financial services are to reach scale without harming clients.

The programme has improved access to financial services for 3.6 million poor people in 52 ACP countries. The technical assistance provided through the programme is specifically to leverage private investment at the provider level, so as to ensure long-term sustainability.

As an example, ACP/EU MICROFINANCE II has been a key facilitator in catalysing investment for one of its grantees, OXUS DRC, a greenfield microfinance bank in the Democratic Republic of Congo. OXUS DRC started its activities in 2013 with investments from its own holding company, from a development finance institution and from a socially responsible investment fund.

The EU grant provided the means for the initial setup and for extension of activities in rural areas outside Kinshasa, allowing a fast expansion of the client base and increased profitability. As of December 2014, the total active clients of the bank were 17,217 urban and rural poor who were previously under-served or unserved financially.

Strong quantitative progress and recognised quality of work has consequently attracted debt funding from another two socially responsible funds. The initial technical assistance provided by ACP/EU MICROFINANCE has leveraged private investment and ensured the long-term sustainability of the initiative.

TRADE

The EU "Aid for Trade" strategy was jointly adopted in 2007 between the EU and its Member States. It has been successfully implemented, with the EU collectively becoming the single largest provider of trade-related technical assistance to developing countries.

Trade is a key factor for inclusive growth and sustainable development and is therefore an important means of implementation of the post-2015 agenda. Many countries, notably emerging economies, have successfully realised the potential of an open trading system to boost their trade and to enjoy sustained GDP growth.

Not all developing countries have enjoyed gains. Least developed countries in particular remain marginalised in global trade as they face particular obstacles related to lack of capacity, inadequate infrastructure or insufficient diversification of production. They need support to further facilitate their integration into the global trading system and so derive maximum economic, social and environmental benefits. Improved market access and aid for trade play a crucial role in this respect.

Openness to trade has been a key element of successful growth and development strategies. No country has ever been able to sustain long-term growth without integrating into the world economy. Access to markets abroad enables greater economies of scale and specialisation, while access to cheaper and more varied inputs, including more efficient services, opens up new production possibilities. FDI has also become an essential contributor to economic growth and export performance. There are a number of trade initiatives and programs to enhance the trade capacity of developing countries:

- **Aid for Trade.** Support for regional economic integration of developing countries, particularly Least Developed Countries and other countries most in need ,is as a step on the road to greater participation in global trade. This flows through the implementation of the EU's nine Regional Indicative Programmes (in Asia, Central Asia, Latin America and the African, Caribbean and Pacific region and the Pan-African programme). At a global level, the thematic programme "Global Public Goods and Challenges" will support trade and development connections through global initiatives targeting particular countries most in need.

- **Trade Facilitation.** Trade Facilitation is an area where assistance to developing countries to build capacity is crucial. The EC is currently financing a number of projects related to trade facilitation around the world, most of them with a focus on customs issues and is committed to do so in the future. A major objective of these projects is to improve trade efficiency, for instance through EU support of the World Bank Trade Facilitation Support Programme which assists developing countries reform their trade facilitation laws, procedures, processes & systems.

- **Least Developed Countries.**As part of its ongoing efforts to help Least Developed Countries better integrate into the global economy, the EU has offered these countries preferential access to the EU market for a wide range of services. By doing so, the EU will help the least developed countries better integrate into the world trading system. The EU's "Generalised Scheme of Preferences" allows developing country exporters to pay lower or no duties on their exports to the EU. This gives them vital access to EU markets and contributes to their economic growth.

- **Improve aid effectiveness.** Delivery of Aid for Trade should follow principles and commitments agreed in the High Level Fora on aid effectiveness. The Busan Forum agreed that Aid for Trade should focus on outcomes and impact, build productive capacities, help address market failures, strengthen access to capital markets and promote approaches that mitigate risk faced by private sector actors. Better coordination among EU donors is essential. Improving cooperation with non-EU traditional or emerging donors will also be needed. As agreed in Busan, the EU will also focus on implementing the commitments at country level and support the new inclusive Global Partnership for Effective Development Cooperation.

- **Trade and sustainable development.** Policies in relation to skills and education, labour rights and social protection are particularly relevant for the poorest and most vulnerable sectors of society, including women and children, in particular in relation to trade reforms. This dimension must therefore be fully integrated into the EU's development cooperation programme, in line with its continuing support for proper work, human rights and social protection. Therefore the EU will continue the systematic inclusion of a trade and sustainable development chapter in all trade and investment agreements, including provisions on labour (respect of International Labour Organisation core labour standards and their fundamental conventions) and environmental aspects (implementation of core Multilateral Environmental Agreements) and it will pursue and support the effective implementation of these provisions.

- **Green goods.** The EU will pursue the negotiation of a multi-lateral agreement on environmental products and services (the "Green Goods Agreement"), while encouraging developing countries to join in. The agreement is of great relevance to Least Developed Countries (LDCs), which suffer from numerous immediate and pressing environmental challenges. The agreement establishes a link between sustainable development and opening up to trade – in order to support the concept that market opening goes hand-in-hand with environmental and social objectives.

- **World Trade Organisation.** The EU remains fully committed to the Doha Development Agenda and the implementation of the Bali package, notably the Trade Facilitation Agreement and the LDC elements, which will promote further integration of LDCs into international markets and global value chains. The EU will constructively engage in the upcoming negotiations on the post-Bali work programme with a view to completing the Round promptly.

- **Extend practical information on trade policies and market information**. As a complement to the EU Export Helpdesk, the EU supports multilateral initiatives on transparency in trade to provide similar information on all markets. This is especially useful for South-South and regional trade.

- **Improve complementarity between trade and development policies.** When trade policy measures create increased opportunities for the EU's developing partners, the EU will be ready to offer Aid for Trade to help them take advantage of them. Instruments such as sector-wide programmes or budget support could assist with economic reforms needed to be able to take advantage of trade and investment opportunities. Besides geographic programmes, new thematic programmes could be used to accompany trade openings.

- **Review the approach to supporting regional integration.** While continuing to focus on capacity building of both regional and national administrations in charge of integration, the EU should tackle these issues more strategically in its political dialogue with developing countries. Specific Aid for Trade regional programmes could be designed for trade facilitation and connectivity. Where regional organisations are streamlining their composition so as to better reflect economic and political realities, the EU stands ready to support them.

- **Boosting foreign direct investment.** While foreign direct investment in and from developing countries has surged in the past decade, it has largely evaded the countries most in need due to poor economic prospects and unfavourable investment conditions. Investors need stable, transparent and predictable regulatory environments. The EU can help improve the business environment through Aid for Trade and a range of Foreign Direct Investment related instruments, now extended by the Lisbon Treaty, which has brought investment under the framework of the EU commercial policy, an exclusive competence of the EU.

- **Step up economic partnerships, regulatory dialogues and business cooperation.** Sharing EU experience can help the EU's partner countries manage their domestic reforms and access the EU market. The new Partnership Instrument of the EU can support such initiatives, in particular in emerging economies and help foster new forms of cooperation in partner countries.

PROGRAMME: ACP-EU TECHNICAL BARRIERS TO TRADE

Time period: 2012-mid 2019
Area: ACP countries
EC-Contribution: € 15 million
Instrument: EDF
Type of support: Financing Agreement signed between the EU and the ACP States

The weakness of the Quality Infrastructure sector in ACP countries, many of which are small and vulnerable economies, creates impediments for their trade with third countries, in spite of generous duty-free and quota-free market access granted to them by the EU and some other developed countries. Addressing Technical Barriers to Trade (TBT) obstacles and building the capacity of their Quality Infrastructure sector is an important trade facilitation step in boosting exports of ACP countries.

The ACP-EU TBT programme provides support to enhance the capacity of regional and continental Quality Infrastructure institutions. The Programme also coordinates and harmonises ACP technical regulations, standards and conformity assessment procedures to facilitate intra-regional trade. Furthermore, regions' interest in TBT-related international fora will be represented, in particular the WTO TBT Committee.

Ultimately, the ACP-EU TBT programme will ensure a broadened capacity of economic operators to comply with technical regulations, standards and conformity assessment procedures set by major trading partners, in selected priority sectors.

PROGRAMME: EU-MUTRAP

Programme: EU- Mutual Trade Assistance Program (MUTRAP)
Time period: 2012-2017
Area: Vietnam
EC-Contribution: €15 million
Instrument: Development Cooperation Instrument
Type of support: Technical Assistance

The project operates in the context of the recently signed EU-Vietnam Partnership and Cooperation Agreement and of the negotiations of the Vietnam – EU Free Trade Agreement. Therefore, apart from supporting Vietnam to further integrate into the global, ASEAN and sub-regional trading systems, one of the project's main objectives is to strengthen trade and investment relations between Vietnam and the European Union.

The MUTRAP project will accompany the process of further integration of Viet Nam into the world economy and support it throughout the Viet Nam – EU FTA negotiations. It provides valuable support to Viet Nam in facilitating sustainable international trade and investment through improved capacity of the Ministry of Industry and Trade and relevant agencies for policy making, policy consultation, negotiation and implementation of related commitments, especially with the European Union. MUTRAP is also creating a greater awareness among Vietnamese exporters on how to access the European market.

BLENDING

In blending operations, private sector stakeholders can have a variety of roles. They can contribute to the financing of the investment at project level or in specific fund structures, benefit from the EU support in order to access finance which is unavailable in the market or not on the required terms. In many cases they act as agents in the implementation of projects.

BLENDING AND PRIVATE SECTOR ACTORS

While the great majority of blending operations contribute to the financing of public infrastructure, private sector financing at the project level is increasing. Over 40 projects involving private engagement have been approved to date, mainly in the areas of energy, private sector development (MSMEs) and information and communications technology.

In Public Private Partnerships (PPPs), the private financing can come from the project developer providing equity for the project company and from commercial financiers. Private financing can also be attracted in fund structures that enable the provision of financing to local private sector (MSMEs).

BLENDING'S MAIN OBJECTIVES:

Address market failures

The purpose of the EU Blending facilities is to help finance projects with high development impact that would not have been undertaken without the support from these facilities, for instance in cases where projects indicate promising development results, but are exposed to high risks and uncertainties.

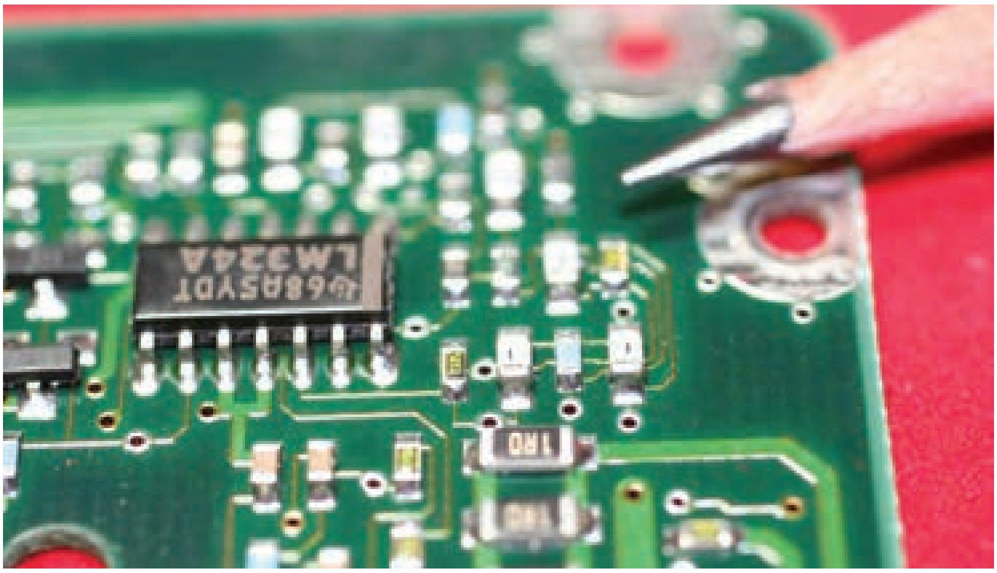
Involve financial institutions, provide additionnality and ensure leverage

The Commission's role is to ensure that the grant provided (which can for example take the form of investment grant, technical assistance, interest rate subsidy, risk capital, guarantee) brings added value to the financial institutions' loan. It should be established that the project would not have been possible in the market, without the provision of the EU grant. Blending helps leverage additional sources of financing.

Promoting local access to financing

If a project does not foresee any direct contribution from the private sector, it may still work towards catalysing private financing. Technical assistance to foster the local financial sector or to increase the capacity of local SMEs, for example, may eventually link local markets more closely with international financial markets and create investment opportunities.

Blending operations generally facilitate MSMEs' access to finance by helping firms prepare bankable business plans or incentivising local finance institutions to provide financing to unserved clients (generally because of high perceived risk or high transaction costs). This is usually done through:



- Financial facilities (programmes/ instruments) to support SMEs
- Specific private sector support (i.e. of a specific industry)
- Fund structures or guarantee facility

A SPECIFIC INSTRUMENT: THE EU-EDFI PRIVATE SECTOR DEVELOPMENT FACILITY

The EU has been committed to support the "SE4All" initiative, created by the UN in 2012 mainly to increase investments in renewable energy and energy efficiency with a particular focus on Sub-Saharan Africa. The EU-EDFI Private Sector Development Facility is one of its components. The Facility contributes to poverty reduction and economic development in Sub-Saharan Africa by promoting private sector investments and providing additional dedicated financial resources to African countries.

The EU contribution is used to support projects by partially guaranteeing the financing provided by the Financing Partners (loans, equity or early-stage development equity or seed money). The EU contribution can also serve as a risk guarantee for a loan or be used to acquire technical assistance.

PERSPECTIVES FOR THE FUTURE

The Commission actively promotes the use of innovative financial instruments. It does this by inviting its financing partners to bring forward project initiatives in which a grant contribution can unlock additional funding, improve market outcomes and lead to increased private sector support. Risk-sharing instruments (e.g. guarantees, debt funds, equity funds) are very promising ways to address inefficient market outcomes in developing countries.

A widespread consensus seems to be emerging that to achieve sustained growth, many developing countries still need to initiate a process of structural change involving industrial transformation, diversification and upgrading. Facilitating such a change by removing obstacles and correcting market failures – especially by removing coordination and information externalities – provides the rationale for industrial policy. The Commission follows a process-oriented, multi-stakeholder-driven, flexible and open-ended approach. Viewed as a "discovery process", multiple actors engage in strategic coordination to select best options for industrial diversification.

PROJECT: AFRICA SUSTAINABLE ENERGY FACILITY (ASEF)

Sector: Energy
Geography: Eastern Africa
Lead financier: European Investment Bank (EIB)
Estimated total project cost: € 50 million
EC contribution: 5 million grant and € 3 million technical assistance

The ASEF promotes private sector investment in renewable energy and energy efficiency projects. Specifically, this Project will implement the pilot phase of the wider ASEF in several East African countries and will mobilise financing from local financial institutions for smaller renewable energy and energy efficiency projects. The second phase will expand the Facility to additional countries, if the initial phase is successful. The direct grant will provide a first loss guarantee to the ASEF, needed to facilitate risk sharing/co-financing structures with local financial institutions.

The technical assistance will enable the local financial institutions to develop the technical and financial knowledge needed to structure bankable projects, because renewable energy and energy efficiency projects require expert knowledge and experience that is often not present in local financial institutions. The nature of the technical assistance provided under this project will be determined on a case-by-case basis and can include financial, legal or technical/engineering expertise, with the EIB ensuring the right skills are provided. A number of potential projects for the pilot phase have been identified and are being pursued.

PROJECT: MICROFINANCE INITIATIVE FOR ASIA (MIFA) DEBT FUND

Sector: private sector
Regional indicative programme Asia
Lead Finance Institution: KfW
Estimated total project Cost: € 18 million
EC contribution: grant € 3 million; risk capital 2 million and technical assistance € 1 million

The MIFA debt fund supports micro and small enterprises (MSEs) and low income households (private sector development) in South, East and Central Asia. The fund offers a flexible range of market-based financial instruments to sound microfinance institutions (MFIs) in the region, enabling them to provide MSEs and low income households with appropriate financial products. Particular attention is dedicated to smaller and young MFIs.

The fund improves local MFIs' access to finance, increases the risk and credit ceilings, strengthens financial intermediaries, fosters responsible financial principles and further develops financial markets. Thus indirect support through MFIs will enhance the up-scaling of micro and small enterprises into medium-sized enterprises with benefits for the development of the overall economy. The fund is designed to provide preparatory technical assistance to selected partner institutions (PIs) and put them on a path of growth and graduation by an affiliated technical assistance facility.

The EU technical assistance supports the MFIs in building up marketing and awareness raising activities. In addition, the technical assistance addresses MFIs' capacities to implement diligent credit approval and monitoring processes and to improve the financial literacy of their biogas clients.

PROJECT: FINANCING ENERGY EFFICIENCY AND RENEWABLE ENERGIES INVESTMENTS OF PRIVATE COMPANIES IN WEST AFRICA (ECOWAS COUNTRIES)

Sector: Energy
Geography: Western Africa
Lead financier: Agence Francaise de Dévelopement (AFD)
Estimated total project cost: € 45 million
EC contribution: grant € 4.5 million and technical assistance € 1.5 million

AFD will make available a concessional facility of € 30 million to help West African local banks promote the financing of energy efficiency and renewable energy investments, with a particular focus on Senegal, Ivory Coast and Togo. This banking intermediation programme will target investments made by private companies. A technical assistance programme will complete the credit facility mechanism, by supporting and stimulating the development of energy efficiency and renewable energy projects, up to the financing offer. The project will help generate and prioritise financially viable investments through softening market based financing conditions applied by commercial banks to loans provided to their clients.

The EU-Africa Infrastructure Trust Fund technical assistance will support project developers in creating bankable projects. In close coordination with local financial intermediaries, the assistance intends to improve the appetite of project developers to take on finance and increase their skills to appraise and finance projects. Project implementation will be ensured by an international consultant recruited through an international bidding process, in coordination with local institutions. The programme will not only help to identify sustainable energy investment opportunities and hence support the preparation of a project portfolio, but will assist the partner banks in achieving sustainable financing of identified investments and contribute to training, marketing campaigns, monitoring and evaluation.

IMPORTANT EU INITIATIVES

The EU is determined to create a stronger role for the private sector in achieving inclusive and sustainable growth in developing countries. To support this cause two initiatives that fall under the areas of "Sustainable Agricultural Growth" and "Access to Energy" will be up and running in 2015.

AGRIFI – AGRICULTURE FINANCE INITIATIVE

EU INITIATIVE FOR INCLUSIVE AND SUSTAINABLE AGRICULTURAL GROWTH

Agrifi is a new initiative that increases investment in smallholder agriculture and agribusiness micro/small/medium enterprises (MSMEs) to achieve inclusive and sustainable agricultural growth. A central feature of Agrifi is that the provision of EU grants will mobilise additional public and private investment. This additional investment is needed to enhance the development impact of investment projects and achieve impact at scale.

Agrifi responds to the lack of financing mechanisms adapted to farmers and agri-entrepreneurs, particularly for smallholders and agribusiness MSMEs. Agrifi will be backed-up by a robust component of technical assistance and value chains analysis capacity, to support decision making on investment, to enhance business development and advisory services for farmers and agri-entrepreneurs and to monitor the actions for accountability purposes.

Agrifi addresses this situation by providing greater risk-bearing capacity through public money, to encourage project promoters and attract private finance to viable investments which would not have happened otherwise. Agrifi is therefore about addressing a market failure and it finances those actions that have a clear development impact on those who would normally not be reached. This includes smallholders with limited market orientation, vulnerable farmers, women and young farmers and entrepreneurs.

Agrifi investments will be done within the EU blending framework. This means that a (preferably European) Development Bank or Financing Institution will be the lead financier. In Principle all blending instruments such as interest subsidies, direct investment grants, technical assistance, provision of risk capital and guarantees can be used. Grants may be combined with loans, equity financing and/or guarantees. Given the high risk environment of smallholder agriculture and agribusiness MSMEs, the use of risk sharing mechanisms (risk capital and guarantees) may be the most appropriate instruments to use.

Agrifi will be launched in 2016, together with interested parties and European Financial Institutions.

ELECTRIFICATION FINANCING INITIATIVE (ELECTRIFI)

EU FLAGSHIP FOR ACCELERATING ACCESS TO ENERGY SERVICES IN DEVELOPING COUNTRIES

Worldwide, about 1.2 billion people have no access to electricity and an additional billion can only access unreliable electricity networks. Addressing the lack of access to reliable and affordable energy services for billions of people is one of the most critical development challenges and figures prominently in the international aid agenda for the fight against poverty. At the same time access to sustainable energy services is an important component of the Climate Change policy.

Increasing cost-efficient access to clean, affordable and reliable energy services will strengthen the opportunities for the poorest of the planet to escape the worst impacts of poverty. Reaching the goal of global access through sustainable solutions is also expected to mitigate the worst impacts of climate change most affecting the poor.

Major barriers to private investment in accessing energy in developing countries are the lack of access to seed capital, as well as to mid- and long-term capital to match with business cycles for investments. This is aggravated by the reluctance of commercial banks to provide adequate lending conditions responding to the needs of investors active in such immature markets and the lack of structuring capacity for bringing projects to financial close. Putting in place a support scheme that can bridge this financial gap will significantly stimulate the private sector, mobilise the local banking sector and have a catalytic impact on economic growth.

The Electrification Financing Initiative (ElectriFI) will accelerate access to reliable, affordable and sustainable energy services in developing countries by boosting the private sector to provide business opportunities. Sustainable energy is central to inclusive and equitable economic growth leading towards poverty eradication, inter alia through the creation of new job opportunities for all.

Catalysing private engagement and resources for development - the EU's role

Publications Office of the European Union
2015 – 24 p. – 21x27.9 cm
ISBN: 978-92-79-48963-1
doi: 10.2841/872881

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MN-02-15-485-EN-N

Publications Office

ISBN 9789279489648

doi:10.2841/872881