Using aid as a catalyst for FDI

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Why use scarce aid resources to support FDI (and other forms of private investment)?

- When budgets are tight, should we reserve aid for «development priorities» (e.g. spending for social sectors)?
- Or should we «divert» some of it to leverage additional finance?
- Or can such a «diversion» be productive if it contributes to growth, jobs and government revenue, to reduce the dependence on aid and provide sustainability?
- It is important to strike a balance. Recent EU development policy documents emphasise the importance of inclusive sustainable growth and suggest that a larger share of EU aid be used to catalyse investment
Why may budget funds be needed to support investment and how can they help?

- Private investors are driven by profit opportunities.
- Many factors play a role: demand/market, availability of labour, land, investment climate (including infrastructure, policies, institutions), availability of finance.
- Risk (and perception of risk) is a key factor, which may undermine access to finance or make it too costly.
- Aid can help in all these areas, by improving education and skills, by supporting infrastructure, by improving the business environment, by facilitating trade.
- It can also help catalyse finance and risk taking through mitigation of risk.
What an IFI such as the EIB can do and what it needs to do it

• Take a long view and finance for development, not for profit.
• Support riskier and innovative projects
• Fill the gaps left by private banks but also try to bring them in through risk mitigation and the provision of appropriate resources
• But in order to do that, IFIs need support from their shareholders in the form of capital, guarantees, other forms of risk mitigation and also grants (for TA and occasionally direct provision of a grant element)
A few examples from EIB

• EU guarantee with risk sharing to allow EIB to support FDI in Latin America where commercial risk is moderate but political risk considered too high for commercial banks

• Cotonou Investment Facility (revolving fund):
  – Support for SMEs with long term local currency resources
  – Equity investments in microfinance vehicles

• Risk sharing (guarantee) facilities to support SMEs in North Africa or sustainable energy in Africa
Thank you!

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