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FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Research Brief #7

The Private Turn in Development Cooperation

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1. Introduction

This Research Brief draws on key findings from two papers for Work Package #6 (Van Waeyenberge and Bargawi 2015; Van Waeyenberge 2015). It focuses on the implications for development cooperation of the changing financial relationships between the developed and the developing world. The Research Brief first lays out the ways in which the composition of financial flows to developing countries has changed since the 1990s. This change has been accompanied by a redefinition of the purpose of development cooperation, which is discussed subsequently. The final section considers some of the implications of the private turn for development cooperation.

2. Background

The last two decades have seen dramatic changes in the various forms of finance flowing to developing countries. Most significantly, private flows have grown rapidly since the 1990s, both in absolute terms and as a share of total financial flows to developing countries (see **Figures 1 and 2**). As a result, while official flows accounted for over half of net long-term flows to developing countries at the start of the 1990s, this share fell to an average of just over a third in the years preceding the current global financial crisis (2005-2007). Since the crisis, Official Development Assistance (ODA) has accounted for just below 40 percent of total net flows to developing countries.

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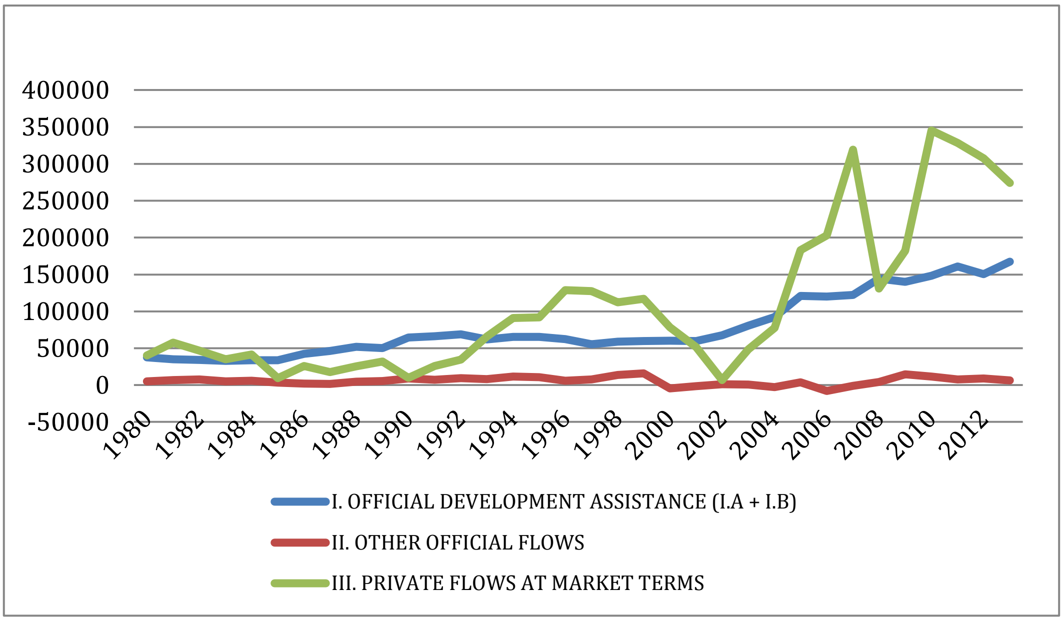
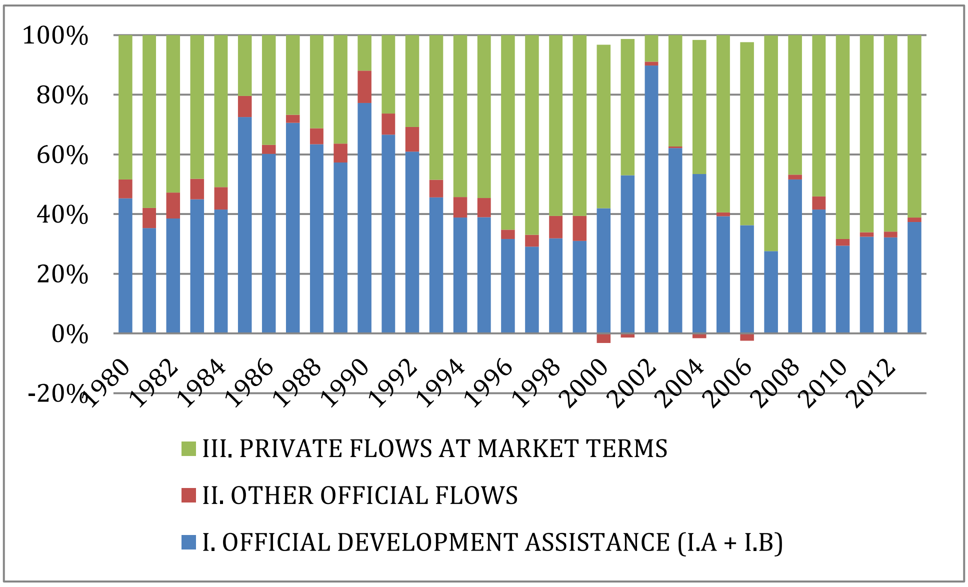
Figure 1. Total flows to all developing countries (current USD millions)



Source: Van Waeyenberge and Bargawi (2015).

Figure 2. Total flows to all developing countries (shares)



Source: Van Waeyenberge and Bargawi (2015).

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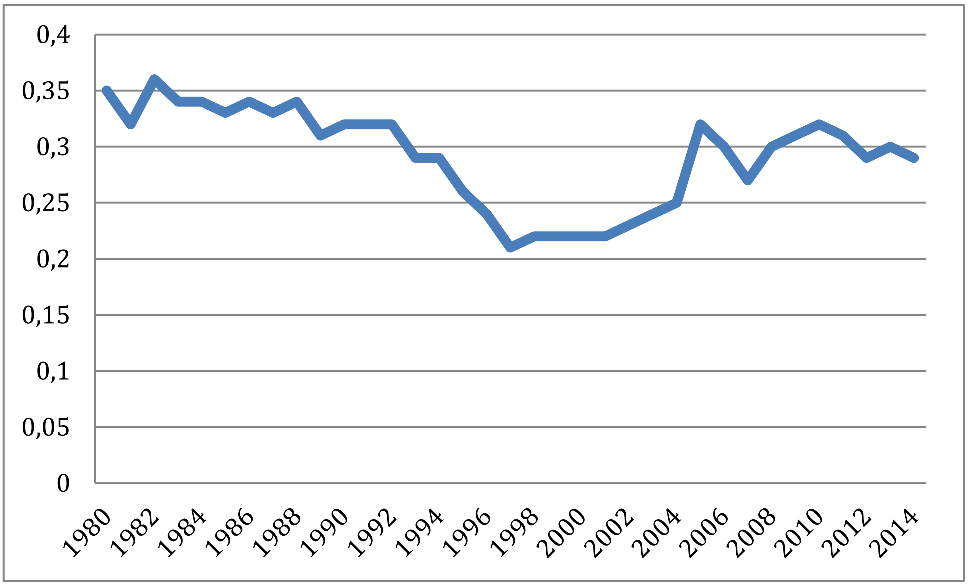
The global financial crisis (GFC) has had negative implications for the willingness of Northern donors to finance development assistance. This is evident in their lacklustre performance in terms of maintaining or boosting ODA/GNI ratios (see **Figure 3**). The average of this ratio has been on a declining trend since 2010 and stands at 0.29 percent of GNI in 2014. This level remains far below the UN target of 0.7 percent and below ratios observed in the early 1990s. The limited fiscal capacity and political willingness of Northern donors to fund official development assistance is likely to persist for the coming years, as countries invoke budgetary constraints at home and changes in the global financial landscape to justify their failure to meet the UN target.

Figure 3. ODA as a share of DAC total GNI



Source: Van Waeyenberge and Bargawi (2015).

In 2012, aid from the EU and member states represented, for example, only 0.39 percent of the EU's GNI--a level that was down from 0.44 percent in 2010 and thereby brought the aid/GNI ratio nearly back to its lowest level since 2007, namely, 0.37 percent. In absolute terms, aid has either been cut or has remained stagnant in 19 EU member states. The deepest cuts between 2011 and 2012 took place in Spain (49 percent), Italy (34 percent), Cyprus (26 percent), Greece (17 percent) and Belgium (11 percent).

Alongside these trends, there has been a redefinition of the aid landscape. Aid from non-traditional donors that do not belong to the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) has become more important. By 2013, non-DAC donors accounted for 10 percent of total aid flowing to developing countries. The main non-DAC donors include the BRICS countries (e.g., Brazil, China, India and South Africa). These donors are strong supporters of economic infrastructure (transport, power, ports, etc.) as well as commodity or general budgetary support. The rise of non-traditional donors has also resulted more recently in the creation of new multilateral institutions, including the BRICS New Development Bank, created in 2014, and the Asian Infrastructure Investment Bank, instituted in 2015.

3. The private turn in development cooperation

Accompanying the trends briefly set out above, there has been a redefinition of the purpose of development cooperation. This change has been driven by the weakening of traditional donors' commitment to the public financing of development. A strong belief in and promotion of private flows to finance development has come to prevail. Private flows are projected to be a superior substitute for aid flows, which had traditionally been considered as the more suitable form through which to engage in development finance. In this context, ODA Is increasingly deployed to mobilise private finance for development while the core role of public finance for public goods is downplayed.

The "private turn" in development cooperation has been evident in development discourse from the late 1990s onwards and has been taken forward through successive United Nations (UN) summits on Financing for Development (Monterrey 2002, Doha 2008 and Addis Ababa 2015). Mobilising private cross-border financial flows is seen as crucial in bringing about the eradication of poverty as well as in financing the broader set of Sustainable Development Goals (SDGs) agreed at the UN Summit in September 2015. The rhetoric regarding development has become focused on increasing private flows and overcoming the barriers that have held back private cross-border investments.

As a result of this celebration of private flows for development, ODA has come to play a subsidiary role focused on "leveraging" private flows. The catalytic potential of aid in mobilising non-aid official and private financial flows is now receiving strong attention. “Blending” or “leveraging” refers to the way in which official cooperation can be used to support private flows. The idea is that private sector firms seek investment opportunities on the basis of risk-return considerations and that public sector measures are necessary to decrease perceived risks or to increase anticipated returns.

The support from the donor community for the private sector has taken direct and indirect forms. Indirect support to the private sector happens through advice on policy and regulation, capacity building and public finance interventions. A new “enabling” environment includes the liberalisation of specific sectors through the scaling back of public sector involvement in the provision of public services, and reflects the idea that this change will promote cost-recovery mechanisms that are instrumental for private sector expansion. Measures for an “enabling” environment also seek to facilitate flows of foreign direct investment into a particular country. Direct support to the private sector happens through project preparation (often referred to as the building of a “pipeline” of “bankable” projects), financing of private sector projects, credit enhancement, the provision of guarantees, risk mitigation instruments and interest rate subsidies (see UKAN 2015).

The private turn in development cooperation has implied a growing interest in Development Finance Institutions (DFIs). DFIs are publically owned institutions that lend funds, either at commercial rates or on near-concessional terms to public and private sector borrowers in developing countries. Their activities traditionally do not count towards ODA as they fail the concessionality threshold and often lend directly to (or take equity positions in) private sector companies.

In the context of fostering private participation in investment in developing countries, DFIs seek to mitigate risks of private-led investments. In the context of the World Bank Group, for instance, this shift towards DFIs has entailed the fast expansion of its private sector affiliate, the International Finance Corporation (IFC). In the context of European development cooperation, the role of the European Investment Bank in development cooperation has been enhanced, in particular through Its Investment Facility. Various bilateral DFIs, including Proparco, the Commonwealth Development Cooperation, the FMO

– the Netherlands Development Finance Company and the KfW, have also seen their role expand (see http://www.edfi.be/members.html).

Finally, the private turn in development cooperation has favoured two specific sectors: financial markets and infrastructure. In particular, the arguments in favour of leveraging have been strongly promoted in the context of infrastructure financing, for which the promotion of public private partnerships has witnessed a strong revival over the last few years. This corresponds to the movement of a mass of private wealth in search of profitable international investment outlets with stable returns.

4. Implications

The private turn in aid and its associated practices of blending or leveraging raise a host of issues that need further investigation. The European Parliament has called for better evaluation of the mechanisms of blending before continuing the practice (European Parliament 13 June 2013).[1] The main concerns that have been raised are briefly discussed below.

4. 1. The dilution of ODA

The shift towards the private sector in development cooperation has to be understood against the backdrop of the negative implications of the global financial crisis for development assistance (see above). Donors have made fewer resources available for development cooperation, but expect these resources to work harder. The blending agenda seeks to allow donors to do more with less.

4.2. The specter of aid tying

Apart from indicating a declining willingness to fund development cooperation publicly, the emphasis on blending might worsen the prospects for aid tying. Some of the European blending facilities have broadly stated objectives that include the promotion of European

[1] See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0283+0+DOC+XML+V0//EN

businesses. Within this context, the danger exists that the line between the activities of export credit agencies and those of some blending facilities, including the DFIs, becomes blurred. When blending operations involve large multinational companies of EU member states, the issue of tied aid looms large.

4.3. Additionality

One of the main concerns regarding the private turn in development cooperation relates to the issue of whether the publicly backed resources are necessary to make the private investment happen ("financial additionality"). The question also arises as to whether the development impact of privately financed projects is enhanced as a result of this blending ("development additionality").

There are currently no shared methodologies across donor agencies to measure additionality and it remains a challenge to align the leveraging of private investment with aid effectiveness principles. Further, the question can arise as to who is leveraging whom. Van Waeyenberge (2015) documents how in the case of a Senegalese toll road, the private sector successfully leveraged the public sector rather than the other way round, turning the principle of leveraging upside down.

4.4. Accountability and transparency

Blending also raises issues of accountability and transparency. There is little information publicly available on the leveraging activities going on in the EU, both through the Commission's own facilities and the member states' DFIs. This lack of transparency might imply that common channels of oversight such as through parliamentary scrutiny fail to operate in the absence of adequate information.

4.5. Ownership

Blending practices might also present challenges for the "ownership of development" principle to which donors remain officially committed. Projects get selected by DFIs and the selection process tends to proceed on the basis of financial criteria rather than on the basis of a partner government's national development plan. This change also implies that financial criteria might prevail over social objectives in the design and implementation of the provision of core public services such as infrastructure facilities.

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4.6. Private sector involvement in public service provisioning

Finally, there is a set of issues that arises from the increased promotion and involvement of private sector agents in areas that were previously understood to be the preserve of the public sector. This set includes equity considerations, cost considerations, implications for fiscal sustainability and more general issues of income redistribution that could result from the increased involvement of private sector agents in the provision of essential services (see Research Brief #6).

While the involvement of the private sector implies a complex web of public (financial and non-financial) support for the private sector, it remains unclear what the public or collective benefits are from increasingly complex mechanisms of public-private interactions. Thus, we are in urgent need of a mapping of the way in which publicly-backed resources assist in the expansion of private (and often foreign) capital in particular markets or sectors in developing countries and what the ultimate effect of this support is.

5. Conclusion

This Research Brief has tied together some of the work produced for Work Package #6, in particular through Working Papers #139 (Van Waeyenberge and Bargawi 2015) and #140 (Van Waeyenberge 2015). It has sought to tease out the shift in development cooperation that has happened as the composition of financial flows from developed to developing countries has changed dramatically over the last two decades. This effort has been focused on the private turn in development cooperation, which has implied a subordinated role for ODA in the service of (foreign) private sector investment. This change raises a host of Important issues, including accountability, aid tying, ownership, additionality, the erosion of ODA and the increased role of the private sector in public service provisioning.

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