EXPERT ANALYSIS

Financing gaps, mobilisation and the importance of enhanced cooperation between development financiers and Berne Union members

By Paul Mudde, Sustainable Finance & Insurance

Introduction

The needs for infrastructure in developing countries are enormous. There is a huge gap between these needs and the financing that is available from government's own resources and funds from Development Finance Institutions (DFIs)[1]. According to the World Bank[2] the lack of infrastructure comes at enormous economic and social cost. Over 1.3 billion people – almost 20 percent of the world's population – still have no access to electricity. About 768 million people worldwide lack access to clean water; and 2.5 billion do not have adequate sanitation; 2.8 billion people still cook their food with solid fuels (such as wood); and one billion people live more than two kilometres from an all-weather road. This strong unmet demand for infrastructure investment in developing countries is estimated at above $1 trillion a year. In addition – and further increasing the financing gap – countries face the enormous task to attract huge amounts of finance to combat climate change[3] and to achieve the UN Sustainable Development Goals (SDGs).[4]

Involvement of non-development financiers[5] such as commercial banks, official Export Credit Agencies (ECAs)[6], Private Insurers (PRIs) and capital market investors is therefore crucial. Through closer and improved cooperation more financing could become available to bridge the current financing gap. This explains why the mobilisation of non-developmental sources of capital is of great importance to developing countries and their strategic development partners among which the DFIs. It implies also a redesign of the DFI strategies.


Paul Mudde

Report of World Economic Forum' Building on the Monterrey Consensus: The Untapped Potential of Development Finance Institutions to Catalyse Private Investment" (2006).

"There remains a critical role for MDBs to make direct loans and grants, and provide policy advice. But given the potential availability of private capital in most developing countries as well as the sheer scale of investment needed to fulfill the MDG targets and infrastructure requirements in them, the overwhelming majority of the more than 200 expert participants in this project took the view that the weight of DFI activities should shift over time from direct lending to facilitating the mobilisation of resources from the world's large private savings pools – international and domestic – for development oriented investments through:

1. *wider use of risk mitigation instruments to alleviate part of the risk faced by investors; and*
2. *stronger direct support for capacity building to strengthen the enabling environment for investment"*

A pure lending focus is no longer sufficient. DFIs have to enhance their role as catalyst for development. This means among others that more resources have to be allocated to project development to increase the number

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of bankable projects. For the lack of bankable projects is currently one of the largest bottlenecks in financing infrastructure. An interesting initiative of the DFI community is the International Infrastructure Support System (IISS), which is a public project management tool enabling government and public sector agencies to improve their project preparation activities.[7] Furthermore DFIs have to develop strategies with concrete targets, the right incentives and products (e.g. guarantees) to mobilise non-developmental sources of capital. There are, however, some serious challenges regarding the current mobilisation agenda of the DFI community.

Measurement of mobilisation: What gets measured, gets done

The problem with mobilisation is that each DFI has its own definition of mobilisation and system to measure mobilisation impact. For many DFIs it is a common practice to attribute the entire (co)financing of a project to their financial intervention, which leads to unrealistically high mobilisation figures and double counting in case two or more DFIs are involved in a project, which is also partially cofinanced by commercial banks. The commercial bank financing is accounted twice as mobilised capital by two different DFIs. Furthermore DFIs do not make a distinction between the mobilisation of other developmental sources of capital (e.g. funds from other multilateral or bilateral donors) and funds from non-developmental sources (commercial banks, capital markets, ECAs private insurers), which again lead to a form of double counting. Some DFIs include in their mobilisation figures cofinancing provided by third parties even when the DFI has not played an active role in arranging the commercial (co)financing. Other DFIs require a true arranger role (with payment of an arranger fee) to distinguish mobilisation from cofinancing. Mobilisation is often misunderstood and figures reported are not comparable and do not always relate to an active catalyst (arranger or risk transfer) role of a DFI. An example is a recent press release of leading Multilateral Development Banks (MDBs) about their the joint climate finance report, which states that "climate finance totaling $81 billion was mobilised for projects funded by the world's six largest multilateral development banks (MDBs) in 2015. This included $25 billion of MDBs' direct climate finance, combined with a further $56 billion from other investors"[8]. The $56 billion concerns cofinancing in general of which the vast majority concerns parallel cofinancing, in which the MDB was not actively involved. And furthermore it is likely that a large share of the $56 billion concerns financing supported by ECAs.

World Bank Financing for development post 2015 (October 2013).

"Faced with limited direct lending capacity going forward, and the fiscal constraints of many of their major shareholders, it is increasingly important for MDBs to fully utilise their catalytic role and leveraging potential to mobilise additional financing from diverse sources."

These and other imperfections are recognised by the OECD DAC, which explains why currently discussions take place to develop a common system for the measurement of mobilisation of private capital. Thus far the OECD DAC has conducted a few pilot surveys with a joint measurement methodology for a limited number of DFI financial instruments (among which for development guarantees and A/B loans), but the suggested methodologies are unfortunately not realistic. The focus of the OECD DAC is to measure the mobilisation by DFIs, which are defined as multilateral and bilateral organisations with an explicit developmental mandate. A few ECAs / public investment insurers with a dual mandate (i.e. promotion of exports/ investments and development) are part of the OECD DAC survey's (e.g. JBIC and OPIC), but most ECAs are excluded from this exercise. The OECD DAC approach ignores that public non-developmental sources of capital (among which ECA insurance capacity) can be mobilised for the focus is on private capital. It discourages cooperation between DFIs and ECAs, which is unfortunate because ECAs are vital in financing infrastructure in developing countries.

The OECD DAC pilot methodology to measure mobilisation through development guarantees suggests that the entire principal loan amount can be reported as mobilised capital irrespective the type of cover (partial risk or partial credit guarantees) and the percentage of cover that is provided. From a technical point of view it would be better to include in the mobilisation figure only the uncovered part of the loan (e.g. 10%)[9]. By reporting the full loan amount the system ignores that the DFI itself has to allocate risk capital to provide the guarantee and the fact that the DFI already reports this guarantee exposure as its contribution to development. In a sense the current OECD DAC approach for guarantees could lead to a new form of double counting. Moreover this methodology is a disincentive for a DFI to seek reinsurance for its guarantee exposure, for the full loan amount is already captured in the OECD measurement system.

It is noteworthy that the OECD has not (yet?) developed methodologies to measure mobilisation through insurance of DFI loan exposure or reinsurance of DFI guarantee exposure, while both risk transfer techniques are very effective tools to mobilise capital from ECAs and PRIs. Only a few DFIs make use of these risk transfer techniques[10].

There are many other outstanding issues regarding DFI mobilisation practices and the OECD efforts for a common methodology for mobilisation calculations, which is quite concerning given the enormous challenges in bridging the financing gap. Successful mobilisation strategies require an adequate and realistic measurement system. Without such a system mobilisation will be suboptimal or an artificial exercise, which is obviously not in the interest of developing countries.

Mobilisation of private capital is much more than only PPP

There is tendency within the aid community to narrow the discussions on the mobilisation of private capital to the development of public private partnerships (PPPs), in particular through project finance. The latter concerns projects that have the potential to generate sufficient income to repay commercial debt financing and pay dividend to equity investors. The too narrow approach ignores four important facts, namely that (1) most infrastructure assets in developing countries are currently owned, managed and financed by the public sector[11] (2) many infrastructure projects cannot be financed on a project finance basis, because the projects do not generate sufficient cash flow and (3) many, in particular high-risk, countries lack an adequate PPP framework and/or attractive investment climate and last but not least: (4) private capital can not only be mobilised for private sector sponsored PPP projects, but also for typical public sector projects, whereby the government (sovereign) or a sub-sovereign entity (e.g. municipality) or state owned enterprise (SOE) acts as borrower or guarantor. This is for example relevant for most transport, electricity distribution, climate adaptation and water projects. Most roads, railways, regional airports, harbours, drinking water & sanitation projects are and will likely remain typical public sector projects in many developing countries[12].

In India, which is the most advanced in private sector participation in infrastructure, 64% of the country's infrastructure is financed and managed by the public sector. In most other developing countries, the share of public sector infrastructure is likely substantially higher. PPP can contribute to infrastructure, but is clearly not the panacea. DFIs' infrastructure – and mobilisation strategies should therefore also focus on public sector infrastructure.

The opportunities for the mobilisation of capital for public sector projects are substantial. Many governments in developing countries – in particular middle-income countries – have good or reasonable access to the private market and can obtain support from ECAs and PRIs for MLT financing for public sector projects. This concerns in particular countries that are rated in OECD ECA risk categories 2 to 4, but opportunities also exist in countries with a higher risk profile. The impressive overlap of exposures of for example IBRD/IDA[13] and Berne Union members on many countries show there are huge opportunities for cooperation and alignment of operations (see table I). These opportunities should be explored and utilised to mobilise more financing for development and to improve aid efficiency and aid effectiveness.

In order to avoid distortion of competition between public sources of finance caused by pricing differences and to strengthen the complementary role of DFIs, DFIs should consider applying the OECD minimum premium system for the pricing of their MLT cross-border trade related lending and guarantee operations.

Official ECAs and PRIs are an important source of capital for MLT financing of infrastructure in and trade with developing countries. The total MLT exposure of all ECAs + PRIs was in 2014 approximately $936 billion[14], which is more than two times the $422 billion exposure of all leading MDBs (see table II). The mandates of ECAs and PRIs are obviously different than those of MDBs, but they have an important developmental impact in facilitating imports and investments in developing countries. This is not measured nor communicated by the ECA community, which partially explains that their developmental role is not adequately recognised within the aid community.

Another reason why the ECA and aid communities do not know each other very well is that aid and official export credit issues and regulations are discussed in different international meetings with representatives from different ministries of governments / government agencies. There is hardly any strategic interaction between aid and export credit representatives. Furthermore, discussions in the OECD DAC focus primarily on measuring and improving social and environmental impact of development activities, which are the People P and Planet P dimensions of sustainable development. The Profit P dimension of sustainable development – how scarce development capital can be used in the most effective and efficient way and crowding out

Table I : Top 6 IBRD/ IDA borrowing countries, OECD ECA rating and BU MLT exposure (in billion U$)

Country	*OECD ECA Country risk rating (July 2016)*	*IBRD / IDA outstanding loans (July 2016)*	*BU MLT exposure at year end 2015 (*)*
Brazil	4	16.1	42.6
Mexico	3	14.7	24.9
Indonesia	3	16.8	40.1
China	2	16.5	32
India	3	37.4	23.7
Turkey	4	11.3	39

Source: World Bank and Berne Union.

(*) The figures concern MLT export credit and investment insurance exposure of all Berne Union members.

Table II: The global portfolios of leading MDBs and MLT exposure of BU members (2014 in million $)

MDB	*Exposure outstanding*	*Berne Union members*	*Exposure outstanding*
IBRD/ IDA	153,691	MLT export credits	701,657
IFC	36,622	MLT investment insurance (3)	234,580
ADB	58,492		
IaDB	74,836		
AfDB	18,906		
EBRD	29,783		
EIB (only outside EU) (2)	49,490		
Total	**421,820**	**Total**	**936,237**
BU exposure in % of MDB exposure	222%		
MDB exposure in % of BU exposure	45%		

Source: Berne Union, MDB annual reports and calculations by Sustainable Finance & Insurance

Please note:

(1) MDB exposure concerns: loans outstanding, equity investments and guarantees outstanding

(2) EIB 's portfolio regarding business outside the EU is approximately 10% of its total business portfolio

(3) The MLT investment insurance exposure of Berne Union members includes MLT insurance exposure of four multilateral insurers, i.e. MIGA (in 2014: approx. $12.4 billion), ICIEC (in 2013: approx. $898 million) and ATI (in 2014: estimated at approx. $800 million) and Dhaman (in 2014: estimated at approx. $800 million).

of market based finance be avoided (i.e. the complementary role of development finance) – is in fact not or much less discussed within the aid community. Aid efficiency and aid effectiveness are important topics in the OECD DAC, but the focus is on donor coordination and alignment of operations within the aid community. Alignment of DFI operations with non-developmental sources of capital is unfortunately not high on the international aid agenda.

The two worlds of development finance and ECA finance seem to operate in splendid isolation and opportunities for enhanced cooperation are not explored and used to their fullest potential.[15] An example of this are recent OECD G20 documents about financing infrastructure[16] in which nothing is mentioned about the important role of ECAs. The focus in these G20 reports is on the role of DFIs, ODA and the need to involve capital market investors in infrastructure. ECAs have to reach out towards important international bodies such as the G20, the UN and the aid community at large. Cooperation starts with sharing of information and knowledge.

From DFI loans to DFI guarantees

Although it is generally recognised that guarantees are the best instrument to directly mobilise private capital and many multilateral DFIs have a guarantee program (e.g. partial risk and partial credit guarantees), guarantees are hardly used. Currently less then 1,5% of the total business of leading MDBs concerns MLT guarantees. For bilateral DFIs this is much lower. The main business of most DFIs is to provide MLT loans to governments and projects in developing countries. The problem with loans is that they do not or hardly directly mobilise any additional capital from third parties. For export promotion purposes most governments around the world have been working for decades successfully on the basis of ECA guarantee schemes, strategic partnerships and risk sharing with commercial banks. This is not the case for development finance although these same governments are shareholders of MDBs and own bilateral DFIs.

Today development policymakers and DFIs discuss extensively “innovative ways” to involve capital market investors in infrastructure projects in developing countries, but most institutional investors will likely require adequate risk mitigation (e.g. through guarantees) to invest in infrastructure assets in countries with a too low credit rating. Without adequate guarantees it will be difficult to crowd in these investors in infrastructure projects in developing countries.

There are many reasons why guarantees are underutilised. For example for sovereign projects[17] – this is for most MDBs[18] approximately 90% of their business – the pricing of sovereign loans and sovereign guarantees is the same, which implies that a MDB loan is always cheaper than a commercial bank loan/ capital market bond + a MDB guarantee. The interest margin for (sovereign) MDB loans or the premium for (sovereign) MDB guarantees are not risk based, but for all MDB borrowing countries set at the same low non-market based level. It does not take into account that the administration costs of guarantee operations are in general substantially lower than for loans. In MLT guarantee business guarantors cooperate closely with commercial banks, which originate, negotiate and manage the loan and relationship with the borrower. Commercial banks also have to ensure that social and environmental risks in a project are adequately managed. DFI lenders have to do all the work by themselves and incur therefore higher administration costs than guarantors.[19]

In the commercial market PRIs offer for comprehensive cover premiums, which roughly range between 70–85% of the interest rate margin of commercial bank loans. The margin retained by banks covers the counterparty risk on the insurer, the uncovered part of the loan, administration costs incurred by the bank and a profit.

The current discriminatory pricing practices of MDBs for sovereign loans / guarantees are therefore a huge disincentive to make use of guarantees.

In the private sector operations of MDBs, lending is also the dominant form of support. MIGA is the largest multilateral guarantee provider, but then limited to political risks. IFC has a partial credit guarantee programme, which can provide comprehensive cover (including commercial risks), but it is hardly used. In DFI private sector operations lending is preferred and mobilisation of funds from third parties is mainly done through A/B loan programmes. Apart from inconsistent pricing practices and a bias towards lending there are various other internal and external constraints for the multilateral DFI community that hinder the optimal utilisation of guarantees. It is important to address these issues to enhance the guarantee operations and strengthen the mobilisation impact of multilateral DFIs.

If for example leading MDBs instead of loans would provide 90% partial credit guarantees, they would mobilise 10% of non-developmental sources of capital. Taking into account the current loans outstanding of leading MDBs, this would imply $42 billion[20] of additional finance for development, which would obviously assist in bridging the financing gap for infrastructure, climate change and UN SDGs.

The Addis Ababa Action Agenda Financing for Development (July 2015)

"An important use of international public finance, including ODA, is to catalyse additional resource mobilisation from other sources, public and private"

It can also be used to unlock additional finance through blended or pooled financing and risk mitigation, notably for infrastructure and other investments that support private sector development."

An important regulatory barrier – in particular for bilateral DFIs – is the fact that guarantees are not adequately recognised within the ODA[21] framework of the OECD DAC. ODA measures development finance flows and guarantees are contingent liabilities, which only lead to a financial flow when a claim is paid. This clearly shows that the current ODA definition is out dated and hinders innovation[22] of development finance. A revision of the definition – by including guarantees as viable ODA instruments – is therefore urgently needed.

The strategic country dialogues between developing countries and DFIs

It is common practice within the DFI community to develop together with governments of developing countries a country strategy on how to finance the development objectives of a country. In these so-called country strategy dialogues the discussion is focused on the development priorities of governments and how much development finance (only in the form of loans and grants) can be obtained from the DFI and other potential donors. This is subsequently described in a Country Strategy Paper, which outlines the cooperation between a DFI and a relevant developing country for a period between in general 3–5 years.

Whether the development objectives can be financed through other (market-based) sources of capital (e.g. commercial banks, capital market, and / or ECAs/ PRIs) and how scarce DFI capital can mobilise these other sources of capital (e.g. through guarantees and risk transfer) are unfortunately not part of this dialogue or the country strategy papers. This gap in the dialogue leads to the situation that alternative sources of finance and DFI guarantees are overlooked and that scarce non-market based DFI finance is sometimes "crowding out" market-based finance. It is even likely that for some aid recipient countries market-based finance is complementary to non market-based development finance. But should this not be the other way around?

World Bank Global Financial Development Report 2015 / 2016: Long-Term Finance.

"Mobilising private long-term finance requires a different approach than direct financing.

MDB interventions need to support, and not replace or undermine, the formation of sustainable markets"

In the world of officially supported export credits a so-called commercial viability test has been developed to avoid that tied concessional loans crowds out commercial finance[23]. This test ensures that non-market based finance operates complementary to the market. It would be in the interest of the international aid community (DFIs and OECD DAC) and developing countries to develop a similar commercial viability test for untied aid. In this way it can be avoided that scarce non-market based funds are unintentionally crowding out private capital. It will also contribute to define more precisely the complementary role of non-market based DFI finance and enhance the developmental impact of DFI operations. This is obviously of great importance to developing countries.

Other sources of capital and how they can be tapped should therefore be part of the dialogue with aid recipient countries. Given the limited knowledge about alternative (commercial) sources of finance and how guarantees can be used to mobilise these sources within many DFIs, ministries of development cooperation and aid recipient countries capacity building is crucial.

Potential topics for cooperation DFIs and Berne Union members

As explained both worlds hardly know each other. So apart from addressing the strategic DFI topics mentioned above it is important to start with a dialogue at senior level between the aid community and official ECAs and explore potential areas for cooperation. Here below follows a list of topics where DFIs and BU members could potentially cooperate with one another, but very likely the suggested dialogue will provide much more interesting opportunities.

1. Insurance for DFI loan exposure and reinsurance for DFI guarantee exposure.
Like commercial banks MDBs could cover part of their loan / guarantee exposure with ECAs and PRIs. A good example is MIGA, which reinsures approximately 40% of its gross exposure with ECAs and PRIs. If leading MDBs would follow this practice approximately $169 billion of additional finance (40% of $422 billion) could become available for development. Important is as well that through enhanced cooperation MDBs could not only mobilise additional funds for their borrowing member countries, but likely also at terms and conditions that are more favourable than what ECAs and PRIs normally offer (e.g. longer tenors and lower premiums). The preferred creditor status of MDBs warrants for a more favourable coverage than for a commercial bank loan[24]. Enhanced cooperation has therefore two important benefits namely: more capital for development and at better terms and conditions[25].

2. Development of A/B loans for sovereign borrowers.
A/B loans in which the A part is funded by a DFI and the B part is funded by commercial financiers, are currently mainly utilised by MDBs, such as IFC, EBRD and ADB, to finance private sector projects. The DFI acts as lender of record for B loan participants and B loan providers benefit from the preferred creditor protection of the DFI. Given the arranger role of the DFI the B loan can be reported as mobilised capital by the DFI. Obviously the risk mitigation provided through A/B loans is much lower than through DFI guarantees and in general the tenors and other terms of conditions of B loans are less favourable than commercial bank loans that benefit from DFI guarantees. This is mainly caused by the limited risk mitigation effect and limited solvency benefits of A/B loans.

A/B loans are currently not used for the financing of public sector infrastructure projects. It is important to explore potential cooperation between DFIs, commercial banks, ECAs and PRI's in this area. ECAs and PRIs could cover part of the sovereign B-loans. The structure implies a selective sharing of the preferred creditor status, but this is nothing new. In 2015 IBRD/ IDA shared its preferred creditor status through its revolving $400 million guarantee for a $1 billion 15 year sovereign bond for Ghana[26] and MIGA has its NHSFO cover, which has amongst others been used to cover a commercial bank loan to the government of Bangladesh.[27]

3. Blending.
Blending concerns the utilisation of ODA grant money to mobilise financing for development. In particular the EU[28] makes use of blending, but the vast majority of the grant money that is currently used is only directly mobilising finance of EU DFIs and not capital from non-development financiers, such as ECAs and commercial banks. It is important to open the blending facilities to ECAs and commercial banks in particular to increase the availability of finance to relatively high-risk markets. For example first loss guarantees to ECAs for business with high-risk countries could increase the availability of MLT finance for these countries. ECAs could also participate in untied DFI concessional loans, which benefit from ODA subsidies to achieve concessional interest rates (mixed credits). This can contribute to freeing up DFI capital, which can subsequently be used for other (non-trade related) development objectives.

4. Utilisation of OECD ECA pricing system by DFIs.
Both DFIs and ECAs are backed by financial resources from governments. Both are public sector finance institutions.

There is tendency within the aid community to narrow the discussions on the mobilisation of private capital to the development of public private partnerships (PPPs), in particular through project finance.

DFIs currently provide non-market based loans to sovereign borrowers and market based loans to other (mainly private) borrowers. They sometimes compete with ECA supported financing. In order to avoid distortion of competition between public sources of finance caused by pricing differences and to strengthen the complementary role of DFIs, DFIs should consider applying the OECD minimum premium system for the pricing of their MLT cross-border trade related lending and guarantee operations. This can be easily implemented for the private sector operations of DFIs, because they apply market based pricing, but requires likely a structural change in the practices of DFI sovereign lending.

At the same time the pricing of direct lending in the OECD premium framework needs to be reviewed, for the pricing difference with guarantees / insurance does not accurately reflect market practices and the lower operational costs of guarantors / insurers. Furthermore, an adequate premium discount for ECA cover provided to MDBs with a preferred creditor status has to be developed.

5. Strategic cooperation, coordination & information sharing.

5A. Input for country strategy dialogue.

As mentioned before the country strategy dialogues between DFIs and aid recipient countries cover currently only development finance. Market-based finance alternatives including ECA or PRI backed financing are not part of the dialogue. In the interest of developing countries it is important that DFI Country Strategy Papers[29], describe in detail all market based financing alternatives that are available for a country. This should include financing options in domestic and international bank and capital markets and international ECA support. Furthermore, it should include how DFI guarantees can be used to mobilise these sources. This will assist developing countries and DFIs to identify which development priorities can potentially be supported by ECAs/ EXIM banks. Obviously this concerns mainly projects that require imports of goods and services from abroad. DFI support can then be focused on financing development priorities of the government, which lack an import component (and therefore also likely no ECA support).

In requests for financing of individual projects DFIs should consider the potential of ECA support. They can opt to buy ECA cover for their loans or guarantees that are used to finance imports of goods of services or cooperate with commercial banks (co-arranger role?), who can arrange the ECA / PRI cover. In this way more financing could become available for development.

5B. Developmental impact of ECA business.

ECAs should consider describing in their annual reports the developmental impact of their operations and how they contribute to the UN SDGs. In this area ECAs can learn a lot from the DFI community.

5C. MLT financing issues in developing countries.

Both DFIs and ECA face challenges in financing projects in developing countries. It would be good to share experiences with one another with the objective to feed the dialogue between DFIs and developing countries so that important issues can be addressed at the appropriate government level and incorporated in country programmes of DFIs. This could include regulatory issues in a country (e.g. legal PPP framework), the role of the public sector in PPP projects and various constraints or complexities in underwriting public and private sector infrastructure projects. Obviously a structural exchange of information on country specific issues will also have benefits for both ECAs and DFIs. It will assist them in underwriting concrete projects.

5D. Reliable credit information about sub-sovereign borrowers and state-owned enterprises (SOEs).

In many countries governments are not only privatising infrastructure through a.o. PPP structures but also decentralising responsibilities to lower levels in the public sector: i.e. from central government to sub-sovereign level (e.g. municipality) or a SOE. This implies a.o. that in many PPP projects commercial banks and ECAs are supposed to accept sub-sovereign off take risks without a guarantee from the government. It also implies that more sub-sovereign entities act as borrower or guarantor in typical public sector infrastructure projects, whereas in the past these projects benefitted from sovereign guarantees. The decentralisation strategy of governments can only be successful and will allow them only to refrain from providing sovereign payment guarantees, if and when the sub-sovereign entity or SOE is financially sustainable and able to stand on its own feet. If that is not the case decentralisation and PPP's with unsustainable sub-sovereign contract parties will fail. The projects will remain unbankable. DFIs, ECAs and governments in developing countries have a joint interest to increase the number of bankable sub-sovereign public sector infrastructure projects.

DFIs and ECAs could share information with one another about acceptable and unacceptable sub-sovereign and SOE borrowers and the issues that they face in underwriting these (potential) borrowers. This information could subsequently be shared with governments in developing countries so that they – in close cooperation with DFIs – can take appropriate action

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towards self-sustainability of sub-sovereign entities and the SOE sector. Obviously experiences in underwriting sub-sovereign and SOE risks can be shared on a no names basis so that sensitivities with individual ECAs or DFIs can be avoided.

The Berne Union could play an important intermediary role in strategic dialogue.

6. SMEs and access to finance.

In many countries the SME sector is facing challenges in obtaining finance. For that reason many governments, ECAs and DFIs have developed special SME programmes to support the SME sector. In this area ECAs and DFIs can learn from each other.

Noteworthy is that various ECAs across the globe, in particular the three large private insurers Euler Hermes, Coface and Atradius, have substantial short-term (ST) credit insurance programmes that cover trade finance all over the world. The vast majority of these ST trade credit insurance business concerns supplier credits which are covered on a portfolio basis. As a consequence, the ST insurers have a large database with reliable credit information on many buyers/ borrowers all over the world among which many SMEs. This data can be used for underwriting purposes to assist DFIs and governments in developing countries to develop successful SME finance or guarantee facilities.

7. Setting up ECAs and / or EXIM banks in developing countries.

People in the business of international trade finance are fully aware how important ST and MLT credit insurance and finance are for the development of countries. Exports generate hard currency income for countries, tax income for governments and create sustainable jobs. This explains why many governments have set up ECAs and / or EXIM banks in their country. These institutions form an important part of the financial infrastructure of a country.

Still a lot developing countries lack an adequate ECA or EXIM bank. In this area DFIs, governments and ECAs could cooperate with one another in setting up new ECAs/ EXIM banks or to assist existing ECAs / EXIM banks to enhance their operations. It can create a win-win for all.

8. Supporting south-south trade and investments.

DFIs could focus their support on south-south trade and investments where the exporting country lacks an ECA / or EXIM bank or where the national ECA or EXIM bank faces constraints in insuring / financing trade and investments. DFIs could act as guarantor for south-south trade and investments or counter-guarantee guarantees from ECAs with a too low credit rating. By doing that they would support development in both exporting and importing developing countries.

Concluding remarks

As explained closer and better coordinated cooperation between DFIs and ECAs is critical to increase the availability of financing for development. This is not only in the interest of DFIs, ECAs and developing countries, but also of developed countries of which many are major shareholders of DFIs. Many developed countries increasingly face challenges in their own country, which are directly or indirectly linked to problems and challenges in developing countries. Migration caused by war and civil unrest and likely to increase due to climate change is just one example. Fundamentalism and terrorism, caused by poverty and a lack of knowledge, freedom and a sustainable future, affects all countries. Economic downturns of major developing economies negatively affect international trade and investments. Developed countries have a clear self-interest to further enhance the development of developing countries.

It is therefore time for a structural dialogue between the international aid community and BU members, which should primarily focus on what can and should be done to mobilise more resources for developing countries. Let's think outside the box, work together and create a 1+1=3 in the interest of sustainable development for both developing and developed countries.

Where there is a will, there is a way, so it must be possible to move successfully forward. The UN SDGs, which include infrastructure, climate change, partnership for development and the importance of mobilisation provides the direction about what needs to be done, so it is now primarily a matter of bringing people and organisations together and build the necessary bridges between them. ■

Notes

1 There are multilateral and bilateral DFI's the most well known multilateral DFI's are IBRD/IDA, IFC MIGA, ADB, IaDB, AfDB, EBRD and EIB. Examples of bilateral DFIs are public sector development banks / agencies such as KfW (Germany) and AfD (France) and private sector development banks such as DEG (Germany), Proparco (France) and FMO (the Netherlands).

2 See: http://www.worldbank.org/en/programs/global-Infrastructure-facility

3 At Copenhagen in 2009, developed country parties to the United Nations Framework Convention on Climate Change (UNFCCC) committed to a goal of mobilising jointly $100 billion a year by 2020 from public and private sources to support climate action in developing countries.

4 UNCTAD estimates that the UN SDGs require a total investment of $2.5 trillion a year over the next 15 years. This includes investments for infrastructure and climate change.

5 This includes private capital and capital from public non-developmental sources such as official ECAs and sovereign wealth funds.

6 Many governments in the world have set up an official ECA with the objective to support exports and foreign investments of their national business community.

7 The IISS-system has been developed by the Sustainable Infrastructure Foundation (SIF), which acts as executing agency for all participating development banks among which ADB, AfDB, BNDES, DBSA, EBRD, IaDB and the World Bank group.

8 See: http://www.worldbank.org/en/news/press-release/2016/08/09/81-billion-mobilised-in-2015-to-tackle-climate-change—-joint-mdb-report. It is interesting to note that the press release speaks about mobilisation by MDBs whereas the report itself refers to cofinancing in general.

9 Among all MDBs only ADB reports under its guarantee business the uncovered part of the loan as mobilised capital. MIGA reports the covered exposure (which includes covered principal loan amount and interest). ADB considers insurance of loan exposure and reinsurance of guarantee exposure as a viable form of mobilisation. Although MIGA is very active in reinsurance, the reinsurance business is not reported as mobilised capital.

10 For multilateral insurers such as MIGA, ATI and ICIEC risk transfer through reinsurance is a common practice. For most DFIs that mainly provide loans this is not the case. Only a few DFIs make use of risk transfer techniques, among others ADB for its ST Trade Finance Program. Risk transfer for MLT DFI financing / guarantees is less common.

11 See report " infrastructure productivity: How to save $1 trillion a year" by Mc Kinsey in 2013.

12 It is noteworthy that most PPP projects in developing countries concern electricity generation / energy and telecom projects. See the PPI database of the World Bank.

13 Not only the exposure of IBRD/IDA but also exposure of other MDBs is concentrated on middle income countries where ECA and PRI cover is in general available.

14 This figure concerns the MLT exposure of all members of the Berne Union, which is the leading global association of credit and political risk insurers. The figure covers both MLT officially supported export credits and MLT investment insurance. It is estimated that at least 80% of the MLT business of BU members concerns business with developing countries

15 For example in the OECD DAC aid donor countries discuss the developmental impact of their activities. In those discussions only multilateral and bilateral organisations with a formal developmental mandate participate. As a consequence official organisations that do not have an explicit developmental mandate such as ECAs are not part of the OECD DAC dialogue. ECAs discuss their operations a.o. within the OECD Export Credit Group and the Berne Union. DFI's do not participate in the OECD export credit and Berne Union meetings.

16 See a.o. G20 / OECD guidance note of diversification of financial instruments for infrastructure and SMEs, July 2016.

17 Sovereign projects are projects in which the central government acts as borrower or guarantor.

18 Examples of MDBs with a large sovereign loan program are: IBRD/IDA, ADB, IaDB, AfDB. The sovereign loan portfolios of EBRD and EIB are substantial as well but are lower than 90% of their total loan portfolio.

19 The operational costs of MIGA are for example substantially lower than those of lending DFIs.

20 The total exposure of IBRD/IDA, IFC, ADB, AfDB, IaDB ,EBRD and EIB (only outside EU) was in 2014 approximately U$ 422 billion.

21 Official Development Assistance (ODA) is the most important form of development aid provided by the international donor community. The current definition recognises grants, concessional loans and financial contributions to MDBs as ODA. Guarantees are only recognised in case of a claims payment.

22 Although the DFI community frequently discusses in general terms "innovative and new ways of financing", amongst others in the OECD DAC, this regulatory ODA issue has thus far not been solved.

23 See the OECD Arrangement on officially supported export credits.

24 OECD ECAs should recognise that cover for MDB loan or guarantee exposure deserves a lower premium than the regular OECD minimum premium. This deviation from OECD minimum premium rules should be included in the list of "permitted exceptions" of the OECD premium regulations. The lower premium for DFI loan or guarantee exposure is a standard practice among PRIs.

25 The topic that through closer cooperation better terms and conditions can be obtained is not part of the OECD DAC surveys on mobilisation.

26 See IBRD/IDA press release of 18 November 2015 "New World Bank Guarantee Helps Ghana Secure $1 Billion, 15-Year Bond"

27 See MIGA press release of 16 December 2015 "MIGA Guarantee Backs Sirajganj 2 Power Plant in Bangladesh"

28 For more information about EU blending it is referred to the following webpage: http://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending_en

29 Within the World Bank the Country strategy paper is called a Country Partnership Framework (CPF).

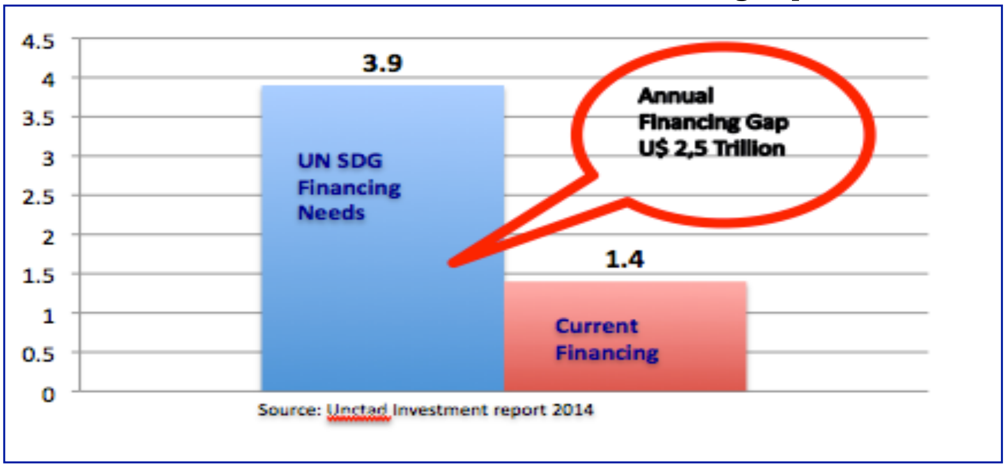
The complementary role of official development finance: some observations and recommendations.

By Paul H.J. Mudde
Consultant of Sustainable Finance & Insurance.

I. Introduction.

In various studies of the World Bank and other development finance institutions (DFIs[1].) it is highlighted that the financing needs of developing countries to meet the UN Sustainable Development goals (UN SDGs) are enormous. These SDGs cover a broad range of development topics among which infrastructure, climate change, poverty reduction, education and health. UNCTAD estimates that the UN SDGs require an additional investment of $2.5 trillion a year over the next 15 years.

Estimated annual investment needs & UN SDG Financing Gap in U$ trillion.



The international aid community broadly recognizes there is a huge financing gap between the UN SDG financing needs and the financing that is available from developing countries' own resources and funds from bilateral aid donors and DFIs. This implies that mobilization of non-developmental sources of capital – both public and private – is of utmost importance. In their joint report "from billions to trillions", published in April 2015, leading DFIs among which the World Bank Group, ADB, EIB, EBRD, IaDB, AfDB and the IMF state that "*to meet the investment needs of the SDGs, the global community needs to move the discussion from "Billions" in ODA to "Trillions" in investments of all kinds: public and private, national and global, in both capital and capacity".*

It is also recognized by leading DFIs that the SDG agenda and their efforts to mobilize non-developmental sources of capital require "*not only just more money*", but also "*a global change of mindsets, approaches and accountabilities*". In other words a fundamental redesign of the aid architecture is needed.

A substantial part of the UN SDG financing gap is caused by the lack of bankable projects. This means that more efforts have to be put into project development. An interesting initiative of the DFI community is SOURCE, which is a public project management tool

[1] There are multilateral and bilateral DFIs. The most well known multilateral DFIs are IBRD/IDA, IFC MIGA, ADB, IaDB, AfDB, EBRD, IDB and EIB. Recently two new multilateral DFIs were established, namely the AIIB and NDB. Examples of bilateral DFIs are public sector development banks / agencies such as KfW (Germany) and AfD (France) and private sector development banks such as OPIC (USA), DEG (Germany), Proparco (France) and FMO (The Netherlands).

enabling government and public sector agencies to improve their project preparation activities.[2]

II. The role of the OECD DAC.

In light of these developments the OECD Development Assistance Committee (DAC), which is the most important international forum dealing with the international aid architecture, has made some important changes that have an impact on the development finance community and other providers of finance for developing countries. The main topic in the OECD DAC concerns Official Development Assistance (ODA), which is basically a soft or concessional form of development finance. The international donor community has committed to allocate 0.7% of their Gross National Income (GNI) to ODA for developing countries, which explains the importance of ODA. ODA consists of bilateral ODA from donor countries to aid recipient countries and contributions from ODA donor countries to multilateral development finance institutions. A grant to for example IDA is recognised as ODA. Disbursements under bilateral aid loans with a minimum concessionality or grant level of 25% can also be reported as ODA. Repayments of these loans are treated as negative ODA. This is why the current ODA framework recognises gross and net ODA.

According to preliminary OECD DAC statistics the net ODA disbursements of all DAC members were in 2016 approximately U$ 170 billion, of which U$ 128.6 billion concerned bilateral ODA and U$ 41.6 billion financial contributions to multilateral institutions.

Current ODA definition.

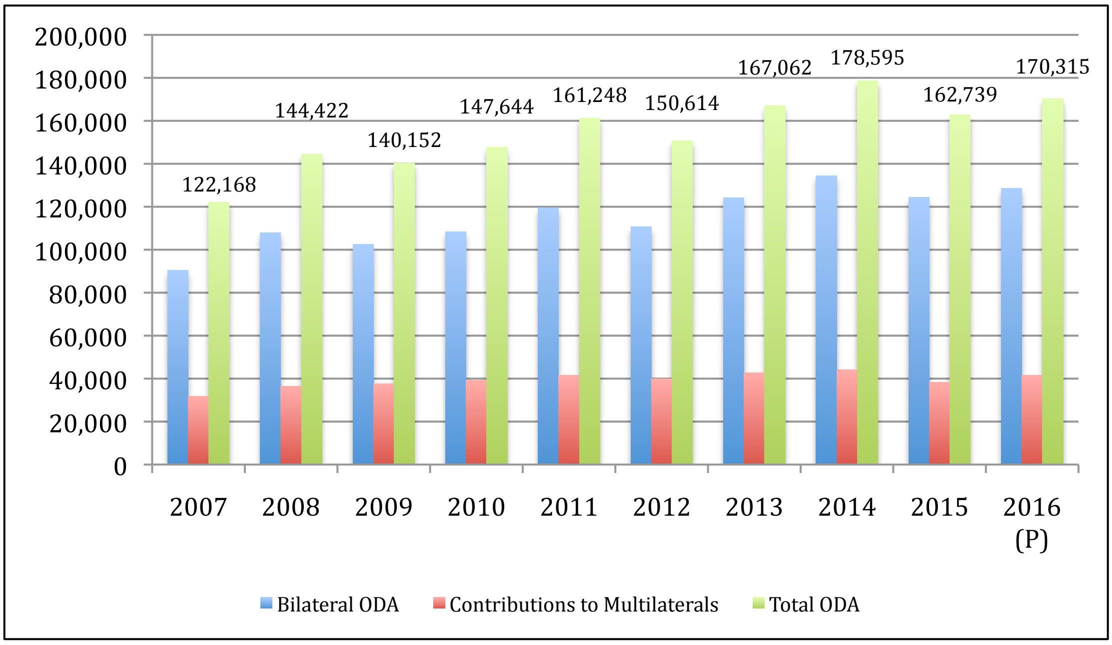
The DAC defines ODA as "those flows to (1) countries and territories on the DAC List of ODA Recipients and to (2) multilateral institutions which are:
i. ***provided by official agencies***, including state and local governments, or by their executive agencies; and
ii. each transaction of which:
a) is administered with the promotion of the **economic development and welfare of developing countries** as its main objective; and
b) is **concessional in character** and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent)."

Source: OECD DAC.

In 2014 the OECD DAC agreed to implement a new methodology to measure the minimum concessionality level for Official Development Assistance (ODA). With concessionality calculations the OECD DAC donor countries measure in essence the amount of subsidy provided by a donor to distinguish ODA from other forms of (official) financing.

[2] SOURCE has been developed by the Sustainable Infrastructure Foundation (SIF), which acts as executing agency for all participating development banks among which ADB, AfDB, BNDES, DBSA, EBRD, IaDB and the World Bank group.

Net ODA disbursements in million U$ (at current prices).



Source: OECD DAC.

III. Development of a new ODA framework.

In the current OECD DAC system to measure concessionality a grant leads to a concessionality level of 100%, whereas a commercial bank loan (without any official subsidies) leads to a concessionality level of 0%. According to the current ODA definition the minimum concessionality level for a loan to qualify as ODA is 25%, but for many years a fixed – highly doubtful – discount rate of 10% has been used, irrespective the tenor of the loan, the relevant currency and market interest rates of the financing. Today market discount rates are substantially lower than the fixed 10% of the OECD DAC. In the context of OECD tied aid regulations in the OECD Arrangement for officially supported export credits (which is governed by a different OECD forum than the DAC) more realistic discount rates are used. They are currency specific; take into account market interest rates for sovereign borrowers and the tenor of the loan. Today's discount rates for tied aid credits with a tenor between 15 and 20 years are for the Euro 1.7% and for the U$ 3.7%[3]. They are therefore substantially lower than the 10% discount rate for ODA. For many years it has been quite easy for many donors to lend at or slightly above their own long-term sovereign bond rates, while still meeting the 25% ODA concessionality threshold. The artificial high ODA discount rate led therefore to a highly inflated ODA performance of donor countries during the past decade. This was an important motive for the DAC to redefine ODA.

At the end of December 2014 OECD DAC members agreed to count only as ODA development grants and for development loans only the "grant portion" of the loan. This "grant portion" is in essence the aid subsidy involved and is calculated on the basis of new specific ODA discount rates. These new discount rates are now differentiated in three country categories, namely 9% for Least Developed Countries (LDCs) and Low Income Countries (LICs), 7% for Lower Middle Income Countries (LMICs) and 6% for Upper Middle Income Countries (UMICs). Unfortunately the new ODA discount rates are again not an accurate reflection of market interest rates and still much higher than the

[3] These are the so-called Differentiated Discount Rates (DDRs) that are published by the OECD Export credit secretariat. The DDRs vary by currency and tenor of the financing.

more realistic discount rates for tied aid credits. It implies that ODA will remain highly inflated in the future.

Interesting is that the IMF and World Bank apply a fixed 5%[4] discount rate to measure minimum concessionality levels for loans to countries that fall under the IMF / World Bank Debt Sustainability Framework (IMF/WB DSF). The DSF was developed to avoid unsustainable borrowing by developing countries. It applies to all Low Income Countries (LICs) of which many in the past two decades benefitted from debt relief.

As a consequence of these recent changes there are currently three different methodologies for concessionality calculations for aid loans of which the one for ODA is the least realistic. This is likely influenced by the desire of DAC member countries to meet the 0.7% ODA/GNI commitment.

In addition the OECD DAC agreed in 2014 to new minimum concessionality levels, which further complicate the ODA framework. For Lower Middle Income Countries (LMIC) the minimum concessionality level is set at 15% and for Upper Middle Income Countries (UMIC) it is 10%. This implies that for aid loans to these countries less aid subsidies are required than under the old ODA framework. Furthermore the concessionality level for the Least Developed Countries (LDC) and other Low Income Countries (LIC) have been increased from 25% to 45%, which implies that for these countries aid loans require a higher amount of subsidy to qualify as ODA. Important is that these new ODA rules are not only relevant for bilateral ODA loans, but also for the concessional lending activities of multilateral donors such as IDA and the regional development banks. For concessional loans of Multilateral Development Banks (MDBs) have to meet the applicable ODA minimum concessionality levels.

The rationale of the ODA changes of minimum concessionality levels is to encourage donors to provide more ODA to countries that are highly dependent on aid and less ODA to countries that have reasonable access to alternative sources of finance. But the unintended side effect could very well be that ODA loans to LMICs and UMICs will increase, because donors require substantial less aid subsidies for aid loans to these countries. The new concessionality rules could therefore be completely counterproductive. Additional measures are needed to avoid a misallocation of ODA.

Table 1: Aid architecture and concessionality calculations

	Old ODA	New ODA	IMF / WB DSF	Tied Aid
Grant Element Thresholds	25%	• 45% for LDCs and other LICs • 15% for LMICs • 10% for UMICs	35%	• 50% for LDCs • 35% for all other countries
Discount Rates	10%	• 9% for LDCs and other LICs • 7% for LMICs • 6% for UMICs	5%	• Euro: 1.7% (1) • U$: 3.7% (1)

(1) These interest rates are according to the OECD arrangement on officially supported export credits the applicable discount rates for tied aid credits with a tenor between 15 and 20 years in March 2017.

In the IMF/ WB DSF, which applies to LICs, the minimum concessionality level is 35%, while for tied aid credits the minimum concessionality levels are 50% for LDCs and 35% for all other countries. It is unclear why the DAC has opted for its own minimum concessionalty requirements. Fact is that the new ODA minimum concessionality levels and discount rates have complicated the international aid architecture.

[4] The IMF / WB adopted a 5% discount rate for simplicity reasons.

Currently the OECD DAC is discussing how ODA can be used to encourage mobilization of private sector sources of capital. This concerns a discussion on Private Sector Instruments (PSI), which includes loans, guarantees and equity investments. The focus of the current discussion is to determine the so-called ODA component (i.e. aid subsidy) of these PSI-instruments. Very arbitrary calculation methodologies are suggested to distract the ODA subsidy from these financial instruments. This ODA component can then be reported as ODA, which will likely imply an increase of the ODA performance of donors. The intention of the OECD DAC is to seek first an agreement on these ODA aid subsidy calculations and at a latter stage a discussion will take place on the complementary role of ODA. One of the problems is that again unrealistic discount rates are used to calculate the ODA component of the PSI–instruments, which has also an impact on others forms of official finance.

A challenge in all these OECD DAC discussions is that the entire new ODA framework is discussed in complete isolation without properly taking into account market realities and the potential negative impact of new regulations on alternative (non-ODA) sources of capital that are available to developing countries. Instead of crowding in non-developmental sources of capital ODA may crowd out these alternative sources. Clarity about the complementary role of not only ODA, but also other forms of officially supported development financing, is therefore of utmost importance. It is in the interest of the donor community and the SDG agenda at large to use scarce subsidized aid financing only for projects in countries that do not have adequate access to financing that requires no or less official support. The higher the aid subsidies involved the more prudency is needed to avoid crowding out.

In other words a clear understanding on the complementary role of development finance is critical and urgently needed to enhance aid efficiency and aid effectiveness and achieve the UN SDGs.

IV. ODA and other sources of finance available for developing countries.

Countries make use of various sources of finance. These sources include market based debt finance from domestic and international bank and capital markets (without any form of official support), ODA and Other Official Flows (OOF). OOF, which is also reported to the OECD, concerns official (government supported) financing, which does not meet the ODA conditions, either because it is not primarily aimed at development of developing countries or because it has a concessionality level of less than 25%. OOF includes officially supported export credits of official Export Credit Agencies (ECAs) and loans from bilateral DFIs that provide financing on non-concessional terms, either at preferential interest rates (but too high to qualify as ODA) or on market based terms. Other examples of OOF are official investment loans[5] of EXIM banks and ECAs that are in particular used in project finance, private sector market based lending of bilateral DFIs (e.g. loans from FMO, DEG, Proparco) and so-called bilateral "promotional loans[6]" to sovereign borrowers, whereby the bilateral DFI passes on the benefits of its low funding costs to the loan to the sovereign. The German development bank KfW is quite active in this area of promotional sovereign loans.

[5] Investment loans or investment guarantees from EXIM banks and ECA-insurers are formally not tied to exports from the ECA country, but tied to the nationality of the investor.
[6] It is unknown whether these bilateral promotional loans will qualify as ODA or OOF under the new ODA regime. It all depends on the level of concessionality of these promotional loans.

The role of official Export Credit Agencies (ECAs).

ECAs exist in many OECD and non-OECD countries. Their main objective is to support exports and foreign investments from their home country. Leading ECAs are member of the so-called Berne Union, which is a global association of credit and political risk insurers. Berne Union members supported in 2016 11.1% of global exports. At the end of 2016 the total MLT exposure of Berne Union members in both export credits and investments was approx. U$ 961 billion. This amount is more than 200% of the outstanding exposure of leading DFIs on developing countries, which in 2016 stood at approximately U$ 419 billion.

Outstanding exposure of leading MDBs in 2016 (in million U$)

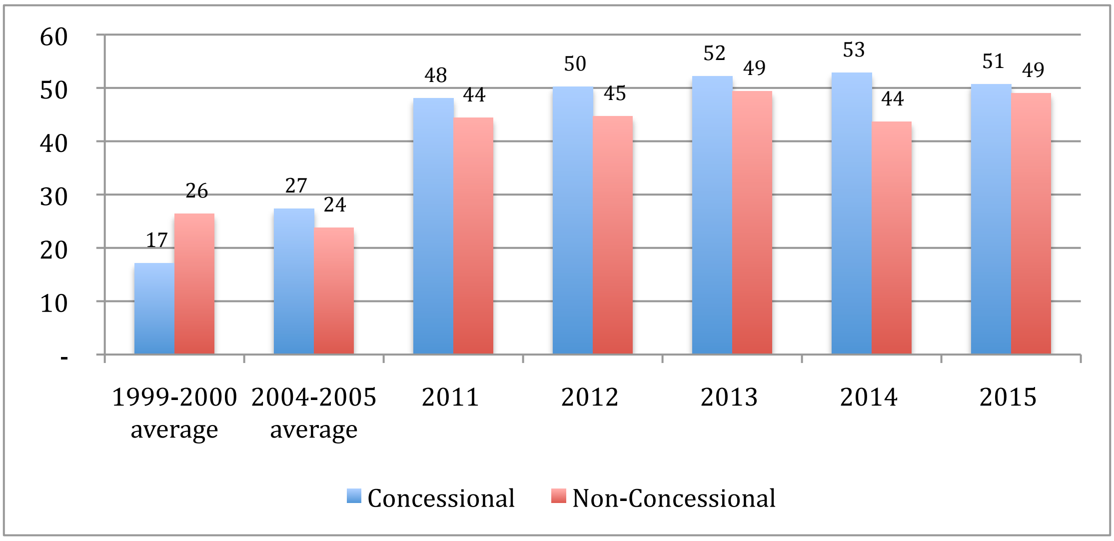
	Loans	Equity	Guarantees	Total
IBRD/IDA	167.643	0	5.198	172.841
IFC	23.910	10.793	3.478	38.181
ADB	67.599	1.187	2.105	70.891
IaDB	81.952	0	230	82.182
AfDB	21.641	104	565	22.310
EBRD	26.213	5.949	638	32.800
Total	**388.958**	**18.033**	**12.214**	**419.205**

Obviously the mandates of ECAs and DFI's differ. DFI's have a developmental mandate, whereas ECAs have primarily an export promotion mandate. It is, however, a fact that both DFIs and ECAs have an important developmental impact, for they are both key in financing the import and investment needs of developing countries.

Source: Berne Union and MDB annual reports 2016.

Developing countries borrow also substantial amounts from Multilateral Development Banks (MDBs). Such financing provided by entities like the IBRD/IDA is reported to the OECD under "multilateral concessional lending" (which is the ODA equivalent for MDBs) or "multilateral non-concessional lending" (which is the OOF equivalent for MDBs).

Multilateral gross disbursement in billion U$.



Source: OECD DAC

Non-concessional loans of MDBs include market-based loans to private sector borrowers. Examples are private sector loans provided by IFC and the private lending departments of ADB, EBRD, IaDB and AfDB and sovereign loans to the public sector at preferential subsidized interest rates. The latter concerns loans whereby the MDB passes on the benefits of its low funding costs (based upon its AAA credit rating and preferred creditor status) to the loans for their sovereign borrowers. These sovereign preferential loans are under the current ODA regime not concessional[7], but benefit from a substantial subsidy. The interest rates are not market based. Although each MDB applies its own pricing system and pricing differs among MDBs, the interest rates of individual MDBs are for all their sovereign borrowers the same, irrespective their credit standing. An IBRD loan to a country like China, Mexico, Brazil, Turkey or India has for example the same interest rate as an IBRD loan to a high risk country in Africa.

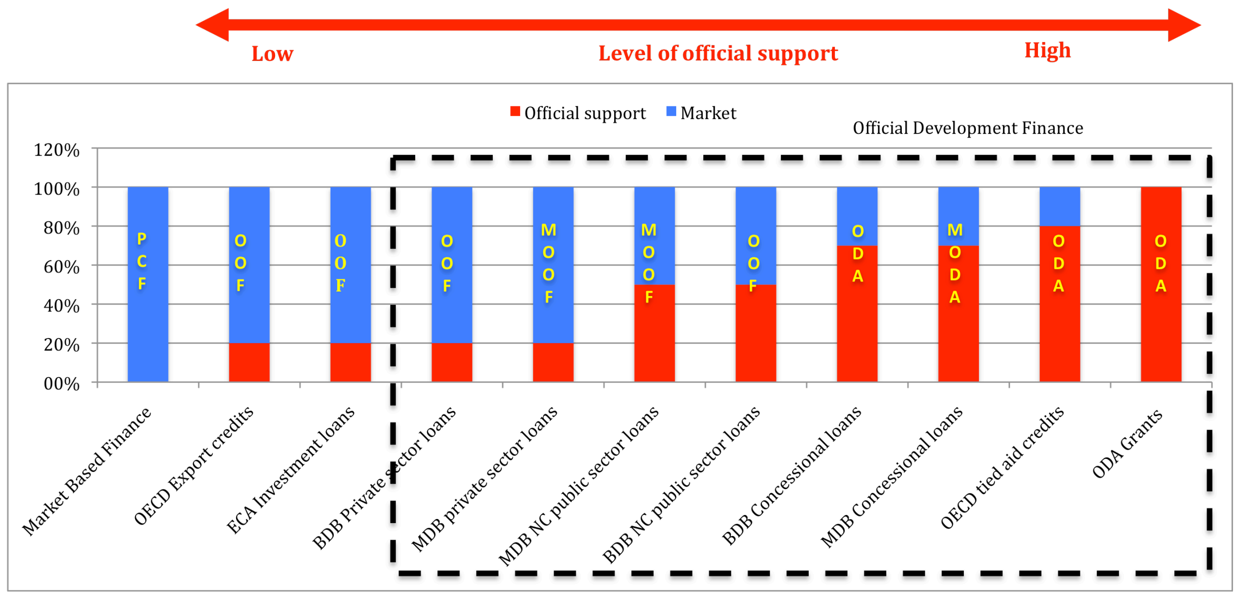
Indicative non-concessional U$ lending interest rates of MDBs for sovereign loans with an average maturity of 15 years (Sept 2017).

	IBRD	ADB	IaDB	AfDB
Floating Base Rate for U$	6 month Libor	6 month Libor	3 month Libor	6 month Libor
Base rate	50 Bps	50 Bps	85 Bps	80 Bps
Maturity premium	30 Bps	20 Bps	Not Applicable	10 Bps
Funding rebate / costs	- 5 Bps	- 5 Bps	+ 10 Bps	- 2 Bps
Total spread over LIBOR	**75 Bps**	**55 Bps**	**95 Bps**	**88 Bps**

Sources: IBRD, ADB, IaDB, AfDB.

In the OECD DAC discussions on the ODA component of PSI instruments the DAC is in fact looking at the "ODA aid subsidy" in OOF financing statistics. Would it not be easier for donors to partially reallocate ODA funds to OOF financing instruments? Most OECD DAC donors are apparently not in favor of that because this would likely negatively affect their international commitment to spend 0.7% of GNI on ODA.

Main sources of official finance for developing countries and the level of official support involved.



Source: Sustainable Finance & Insurance

PCF: Private capital flows
OOF: Other official flows
MOOF: Multilateral OOF = multilateral non-concessional lending
ODA: Official Development finance
MODA: Multilateral ODA = multilateral concessional lending.

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[7] It is unknown whether these preferential MDB sovereign loans will be reported as concessional or non-concessional loans under the new ODA framework. It will depend on the concessionality level of the MDB loans.

The table above summarizes all main forms of official financing available to developing countries. It provides also indications of the '"level of official support" for each financing modality. Obviously an "ODA grant" constitutes the highest form of official support and "market based finance", such as a commercial bank loan, involves no official support. Between "market based finance" and "ODA grants" there are various forms of official finance, with different levels of official support. Official non-development finance concerns (1) OECD ECA exports and (2) OECD ECA investment loans. The other forms of official finance concerns Official Development Finance (ODF), which is the sum of ODA + OOF provided by DFIs.

IV. How to avoid crowding out of market based finance or other sources of official finance.

Given the enormous financing needs of developing countries mobilization of private capital is high on the agenda of the international aid community. This implies that the DFIs and their guardian authorities need to be fully aware of which other sources of finance are (potentially) available to developing countries and how these other sources can be tapped.

There is tendency within the aid community to narrow the discussions on the mobilization of private capital to the development of public private partnerships (PPPs), in particular through project finance. The latter concerns projects that have the potential to generate sufficient income to repay commercial debt financing and pay dividend to equity investors. The too narrow approach ignores amongst others that private capital can not only be mobilized for private sector sponsored PPP projects, but also for typical public sector projects, whereby the government (sovereign) or a sub sovereign entity (e.g. municipality) or state owned enterprise (SOE) acts as borrower or guarantor. This is for example relevant for most transport, electricity distribution, climate adaptation and water projects. Most roads, railways, regional airports, harbours, drinking water & sanitation projects are and will likely remain typical public sector projects in many developing countries[8].

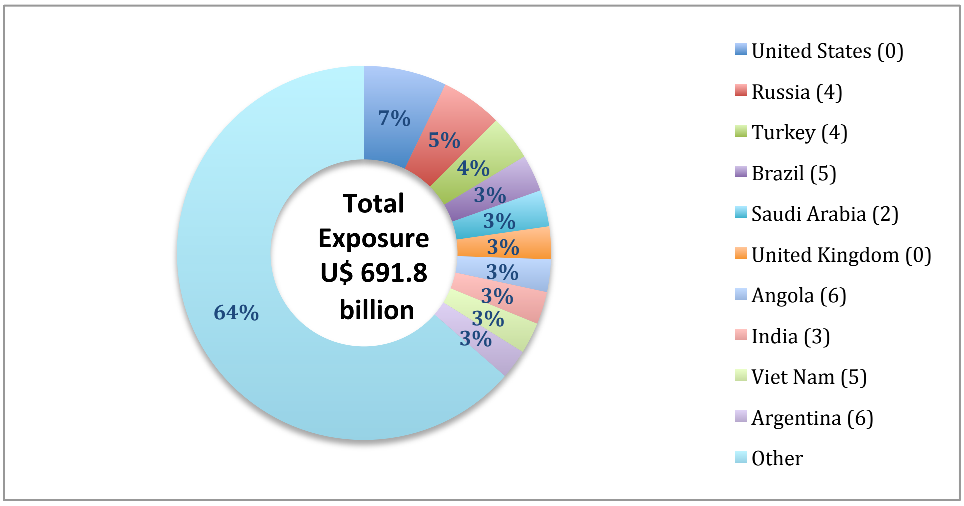
In India, which is the most advanced in private sector participation in infrastructure, 64% of the country's infrastructure is still financed and managed by the public sector. In most other developing countries the share of public sector infrastructure is likely substantially higher. PPP can contribute to bridging the infrastructure financing gap, but is clearly not the panacea. DFIs' mobilization strategies should therefore also focus on mobilizing capital for public sector projects. This is currently hardly discussed in the DFI community, whereas the opportunities for the mobilization of capital for public sector projects are substantial. Many governments in developing countries – in particular middle-income countries – have good or reasonable access to the private market and can obtain financing (support) from for example official Export Credit Agencies, commercial banks and private insurers. This concerns in particular countries that are rated in OECD ECA risk categories 2 – 4, but opportunities also exist in countries with a higher risk profile[9]. The impressive overlap of exposures of for example IBRD/IDA and Berne Union members on many countries show there are huge opportunities for cooperation and alignment of operations. More or less similar overlaps exist with the portfolios of other Multilateral Development Banks (e.g. ADB, IaDB, EBRD, EIB, AfDB).

[8] It is noteworthy that most PPP projects in developing countries concern electricity generation / energy and telecom projects. See the PPI database of the World Bank.

[9] More information about the OECD country risk classification can be found via the following link: http://www.oecd.org/trade/xcred/crc.htm

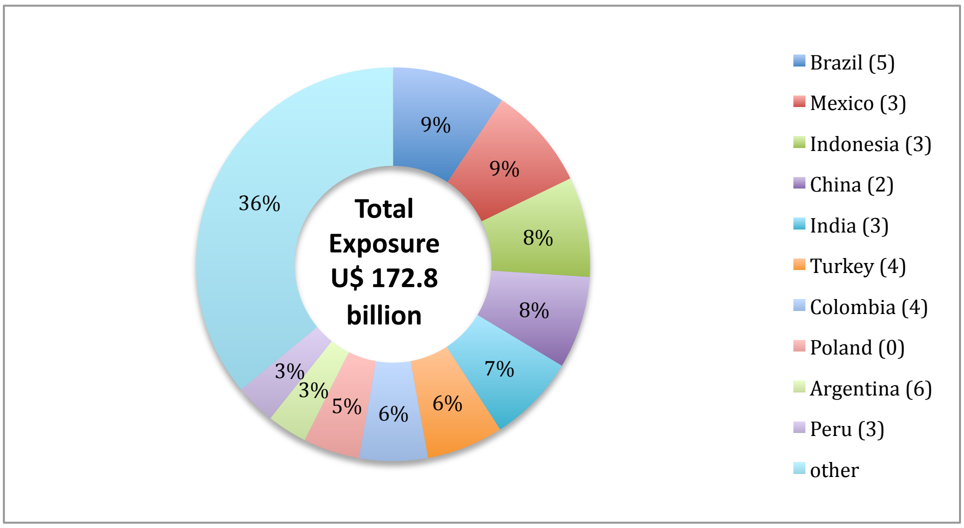
Enhanced cooperation through among others guarantee and risk transfer operations should be explored and utilized to mobilize more financing for development and to improve aid efficiency and aid effectiveness.

Top 10 MLT export credit exposure countries Berne Union members 2016.
Between brackets the OECD ECA country risk rating of Oct. 2017.



Source: Berne Union.

IBRD top 10 exposure countries in % of total exposure in 2016
Between brackets the OECD ECA country risk rating of Oct. 2017.



Source: IBRD Annual report 2016.

The aid community focuses on mobilizing private capital, but this ignores that important public – non-developmental – sources of capital can be catalyzed for developing countries, This concerns among others insurance capacity of official export credit agencies and lending capacity of EXIM banks and investment capital from sovereign wealth funds. These three public sources have substantial capital available to support SDG projects in developing countries. That's why (governments through their) multilateral and bilateral DFIs should include these potential sources in their mobilization strategies.

DFI mobilization strategies require not only clarity on which public or private funds can be crowded in, but also a clear view on how potential "crowding out" of other forms of finance without or with substantial less official support, can be avoided. In other words:

clarity about the complementary role of official finance. In this area the OECD DAC has thus far made little progress. There is the intention to discuss "additionality" in the near future, but this is limited to ODA PSI-instruments. The upcoming DAC discussion should also include additionality of non-ODA forms of official development finance and development finance for public sector borrowers.

Participants to the OECD Arrangement on officially supported export credits have made some important regulations on this topic. They have amongst others defined minimum premiums to avoid distortion of competition between various ECAs that are caused by pricing differences. Furthermore the rules have been set to avoid a credit subsidy race between OECD governments, because ultimately the ECA export promotion schemes involve scarce governments budgets and tax payers' money. These considerations are obviously also relevant for other forms of official finance, including development finance.

The minimum OECD ECA risk premiums are based upon a joint risk assessment by all OECD ECAs of the financial, economic and political situation of countries. In the design of the minimum premiums market based pricing benchmarks were also taken into account. The system is furthermore fed by the joint payment experiences of OECD ECAs with developing countries. These minimum premium rules have been highly effective to avoid pricing distortion of competition in the export finance business between OECD ECAs.[10]

The minimum OECD premium rules do not apply to bilateral investment loans provided by EXIM banks or supported by investment guarantees from ECA-insurers, because these loans or guarantees are not tied to exports but tied to the nationality of the (equity) investor. Reliable data on ECA pricing practices for these investment loans or investment guarantees are unfortunately not available. There are, however, indications that these untied investment loans are crowding out official export credits. During the past 6-8 years the volume of untied investment loans and guarantees have substantially increased[11]. They are mainly used for debt financing of greenfield project finance transactions in which foreign equity investors are involved. This concerns the largest share of Public Private Partnership projects.

The problem of crowding out of official export credits by these official investment loans / guarantees could be avoided if for these EXIM / ECA investment loans the OECD minimum premiums would apply. For the ECAs involved this should technically not be a problem, because they are already familiar with the OECD pricing system and the risks to which they are exposed under their investment programs are very similar to the risks under their export credit programs.

[10] More information about the OECD minimum premium for officially supported export credits can be found on the following website of the OECD: http://www.oecd.org/tad/xcred/

[11] Important providers of untied investment loans are amongst others JBIC (Japan), KEXIM (South Korea) and OPIC (The United States).

The complementary role of different forms of official finance

No.	Type of financing	OECD Statistics reporting	Level of official subsidy involved (Scoring 0 – 5 of which 0 means no subsidy involved and 5 concerns the highest subsidy level)	Regulations to avoid "crowding out" (e.g. minimum pricing to avoid distortion of competition?)
1	Market based financing from domestic or international bank / capital markets	Domestic: Not available International: Private capital flows (1)	**Subsidy level: 0** The market provides financing; there is no official support involved.	Not applicable
2	Officially supported financing			
2A	Officially supported Export Credits supported / provided by official ECAs /EXIM banks	OOF	**Subsidy level: 1** Official support is provided, but there are no aid subsidies involved.	Yes, for officially supported export credits the OECD ECA minimum premiums apply, which are risk based.
2B	Officially supported Investment loans (not tied to exports, but tied to the nationality of investor) supported / provided by official ECAs / EXIM banks	OOF	**Subsidy level: 2-3** Official support is provided, but the level of official support is unknown, because there is no transparency on the pricing of investment loans	No, OECD ECA minimum premiums for officially supported export credits do formally not apply,
3	Official Development Finance provided by bilateral and multilateral DFIs			
3A	DFI market based investment loans for private sector borrowers	Bilateral DFIs: OOF Multilateral DFIs: non-concessional loans	**Subsidy level: 2-3** Official support is provided, but the level of subsidies is unknown, because there is a lack of transparency on the pricing of DFI loans. DFIs price their private sector loans market based, but there is a lack of transparency on the pricing practices.	No
3B	DFI "promotional loans" (non-concessional)	Bilateral DFIs: ODA or OOF depends on concessionality level of the loan Multilateral DFIs: Concessional loans or non-concessional loans depends on concessionality level of the loan	**Subsidy level: 4** Official support is provided. DFIs pass on their funding benefits to sovereign borrowers. Pricing is not risk based but subsidized and pricing practices differ among bilateral and multilateral DFIs for each DFI has its own pricing system.	No
3C	DFI concessional loans	Bilateral DFIs: ODA Multilateral DFIs: concessional loans	**Subsidy level: 5** Official support is provided. Loans are not risk based, but concessional and benefit from substantial aid subsidies	No
4	OECD tied aid credits	Bilateral DFIs: ODA	**Subsidy level: 5** Official support is provided. Min concessionality of 35% or 50% and DDRs for concessionality calculations	OECD tied aid rules in OECD "Arrangement on Officially Supported Export Credits apply, including a "commercial viability test"
5	ODA grants	Bilateral DFIs: ODA Multilateral DFIs: concessional	**Subsidy level: 5** The highest level of official support is provided.	No

Source: Sustainable Finance & Insurance

(1) It has to be mentioned that bank loans and other forms of debt financing (e.g. bonds) that benefit from guarantee support of ECAs, DFIs and specialised multilateral insurers are in current OECD statistics included in "private capital flows". This means that a substantial part of these flows is officially supported. This concerns in particular medium and long term commercial bank financing.

Multilateral or bilateral DFI investment loans for private sector borrowers are usually provided on market based terms, but unlike the ECAs, DFIs do not have a system of minimum risk based premiums. In this area DFIs compete with market financiers (without official support) and ECA supported loans and even among each other. "Unfair competition" caused by different pricing practices could be avoided if the DFIs would implement the OECD minimum premiums for trade related foreign currency denominated export or import financing[12]. It would therefore not apply to general DFI credit lines to local banks to encourage them to lend to certain parts of the economy in developing countries. (e.g. climate friendly investments, SME sector, microfinance). For many private sector oriented DFIs this credit line business concerns approximately 25% of their total lending to the private sector. Minimum premiums for trade related business would reduce the risk of private sector DFI loans crowding out other sources of finance that require no or less official support. For private sector oriented DFIs implementation of the OECD minimum premiums should also technically not be a problem, because they currently apply market-based rates. If needed, they can, like ECAs and EXIM banks, charge higher rates. The advantage of the OECD ECA minimum premiums is also that it will reduce pricing competition among DFIs. An issue is likely that most DFIs are not familiar wit the OECD minimum premium rates and do not like to be bound by (new) rules. On the other hand the OECD export credit rules are formally already applicable to bilateral DFIs if and when they support an export transaction from their home country. It may be the case that bilateral DFIs are not fully aware of the potential relevance of export credit regulations. It is therefore recommended that ECAs and DFIs work together to compare their pricing practices and experiences.

Promotional loans of bilateral DFIs and non-concessional preferential loans from MDBs, which in general are only provided to sovereign borrowers, have a larger subsidy component than the DFI private sector loans or ECA supported export credits. They may therefore potentially not only crowd our market based financing, but also these two other officially supported sources of finance. To avoid this from happening relevant DFIs and MDBs should check whether their more favourable financing terms are indeed required. It is also in the interest of bilateral DFIs and MDBs to harmonise their pricing practices for these preferential / promotional loans, because today they differ quite substantially from one another, resulting in pricing competition among the various providers of "promotional" development loans.

Bilateral ODA loans and concessional MDB loans have even a greater risk of crowding out other forms of finance for these loans involve a substantial higher aid subsidy. These funds should therefore only be used as "finance in last resort", when other sources of finance are not (adequately) available. In this way it can also be ensured that ODA is mainly provided to the least developed countries and low-income countries, which currently fall under the IMF / WB DSF.

This complementarity ranking could help official financiers, in particular bilateral and multilateral development financiers, to allocate their subsidized development financing only for those (parts of) projects and countries that truly require subsidized development financing. The suggested additionality check will contribute to aid efficiency and aid effectiveness and achievement of the UN SDGs.

An interesting additional tool that can be introduced to check potential distortion between (highly) subsidized development finance and market based finance or ECA export credits or market based DFI loans could be the so-called "commercial viability test" that has been developed for tied aid credits[13]. This test ensures that non-market based tied aid finance operates complementary to the market. A similar commercial viability test could be introduced for non-market based untied development finance. In this way it can be avoided that scarce non-market based funds are unintentionally

[12] Due to the lack of reliable data on trade related DFI financing the volume of such DFI business activities is unknown.
[13] See the OECD Arrangement on officially supported export credits.

crowding out private capital or public capital that involves less official support. The OECD DAC could benefit from the extensive "body of experience" of OECD export credit Participants with their discussions about tied aid eligibility.

A commercial viability test for non-market based untied aid will also contribute to define more precisely the complementary role of non-market based DFI finance (including ODA) and enhance the developmental impact of DFI operations. This is obviously of great importance to developing countries and the global SDG agenda.

VI. Conclusions

Enormous amounts of financing are needed to achieve the UN SDGS, which implies that a strong alignment of development finance with other forms of finance is critical. Mobilization of non-developmental sources of capital is important to achieve the UN SDGS. The discussion should not be limited to mobilizing private capital. There are important non-developmental sources of public capital that can be catalyzed. Non-developmental sources of capital cannot only be catalyzed for private sector projects, but also for public sector projects. A focus on "crowding in" other sources of capital requires a different mindset, incentives and business approaches of DFIs. Of equal importance is the question how "crowding out" of market based finance without support or official finance with substantial less official support can be avoided.

It is therefore very important that the OECD DAC starts with a fundamental discussion on the complementary role of ODA and other forms of development finance, both for the financing of public and private sector projects. For that purpose the OECD DAC should invite non-development financiers to the table. In this way it can be avoided that new ODA regulations will be developed that negatively affect private or other official (financial) flows to developing countries. Clarity on the complementary role of development finance is also critical to improve aid efficiency and aid effectiveness.

OECD members should therefore seriously consider applying the OECD ECA minimum premiums to:

(1) untied investment loans of EXIM banks and /or untied investment guarantees for debt financing of ECA insurers.
(2) Investment loans or guarantees for debt financing from both multilateral and bilateral DFIs for private sector projects.

Furthermore a commercial viability test could be introduced for non-market based development finance with relatively high subsidy levels. This could be used to assess the need for sovereign "promotional loans" and concessional loans. Concessional loans should preferably only be provided to countries that have no or limited access to market based finance or official finance that requires less official support. This includes amongst others the IMF/ WB DSF countries.

These suggestions could assist OECD DAC members and MDBs to enhance lending to those countries that really need ODA or other forms of officially supported development loans and improve the effectiveness and efficiency of their development finance activities.

ODA can be used for project development to increase the number of bankable projects. In this way ODA can contribute very effectively to the achievement of the UN SDGs.

Last, but not least: the OECD export credit and DAC member countries and the international DFI community should reach an understanding with non-OECD countries on both export credit and development finance (tied and untied aid) topics. For some non-OECD countries have become important official financiers of the SDG needs of developing countries. These non-OECD countries are currently not bound by international export credit and aid regulations. OECD and non-OECD providers of official finance and Multilateral Development Banks should therefore work closely together on additionality of official finance. A global understanding on the complementary role of official finance is critical for the achievement of the UN SDGSs.

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Paul Mudde