EU Development Cooperation. Welcome to the blending era

Brussels - It is a silent revolution, yet irreversible, that started about 7 years ago. We are on the eve of the subprime mortgage crisis and it feels as the EU had intuited the upcoming economic crisis and its consequences on Member States and their citizens, such as the risk of affecting one of its greatest achievements: development cooperation. Although the EU remains the world's primary donor, OECD DAC statistics show that its official development aid decreased in 2010-2012, shifting from 0,46% of GDP to 0,42%. Despite positive signals registered in 2013, figures are still far from meeting the commitments made in 2005 on donating 0,7% of GDP, as stated in Millennium Development Goals. According to CONCORD, the European Confederation of Relief and Development NGOs "member States should mobilize additional €41 mln to reach the target". It is an open secret, yet in Brussels everybody knows that public aid is not enough to eradicate poverty in developing countries. That is why new forms of financing come into play, that involve the private sector, in a word: blending.

Blending loans and grants.

'Blending' is a mechanism that links a grant component from the EU budget, the European Development Fund (EDF) and Member States, with loans or equity from publicly owned institutions and private financiers, accredited by the EU. The European Commission strongly supports this mechanism as the EU grant contribution can leverage significant amounts of private financing, therefore reducing the EU budget for Development Cooperation and achieving EU external policy objectives, primarily the fight against poverty. This is in line with the so-called "to do more with less" strategy the EU was forced into due to budget cuts.

These funds are used by Financial institutions Groups (FIG) to carry out development projects proposed by private companies and developing countries governments. This, only after being assessed by a technical body composed by financial institutions (and chaired by the European Commission or Development Financial Institutions), and approved by the EU Commission and Member States in an operational board. At the top, a Strategic Board chaired by EC and Member States, provides policy direction on where grants should be allocated. The projects are regulated within 8 regional instruments – the so called "EU blending facilities", covering the areas of the European external cooperation: Africa, Caribbean, Pacific, Asia, Central Asia, Latin America, Western Balkans and the EU's Neighborhood countries.

EU grants can take the form of direct investments, interest rate subsidies (to reduce loans' interest rates, mitigating the debt of beneficiary countries), or technical assistance, ensuring the quality, efficiency and sustainability of the projects. Supporters of blending consider grants as a tool to promote the access of private companies to risky markets - particularly small and medium enterprises - by covering capital risk.

Also, other arguments in favor of blending include a significant strengthening cooperation between donors and financial institutions, a better efficiency of the EU development aid and consequently the fight against poverty - the Commission's final target. Blending is part of the Agenda for Change launched by the EC in 2011, which sets out a more strategic EU approach "to develop new ways of engaging with the private sector, notably with a view to leveraging private sector activity and resources for delivering public goods". The EU "should explore up-front grant funding and risk-sharing mechanisms to catalyse public-private partnerships and private investment".

So far, grants channeled through blending have been used for direct investments (41% of funds between 2007 and 2012), technical assistance (32%), as well as interest rate subsidies (19%).In line with the Commission's ambitions, a report published by the European Network on Debt and Development (EURODAD) says that "at the EU level, ODA money channeled through EC blending facilities has increased substantially in recent years, rising from €15 million in 2007 to €490 million in 2012" with over 300 projects approved between 2007 and 2013."

The European Commission itself states that €1.2 billion grants from the EU budget, the European Development Fund (EDF) and Member States have leveraged more than €32 billion of loans by eligible finance institutions, unlocking project financing of over €45 billion. Blending is raising so much interest "that up to a third of EU ODA could be invested through blending mechanisms", says to Afronline.org Florian Kratke, policy officer at the European Centre of Development Policy Management (ECDPM), an influent think-tank based in Brussels with a strong expertise in the field of development cooperation.

The Franco-German axis still exists

But what's behind the numbers? Are the results in line with the targets and ambitions set by the EU Commission and Members States? After seven years of implementation, the scenario is not entirely bright. Taking a look at the participating financial institutions, we have the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), which finance over half the projects approved by the EU between 2007 and 2013. Among the main financial actors, we find the German (KfW) and French (AFD) development banks, which account for one third of the projects funded during the same period. Not really a surprise: according to confidential sources in the European Council, most Member States do not even show up in the board meetings where projects are assessed and approved. France and Germany, instead, do not miss one, inevitably supporting projects proposed by their own financial institutions. Despite Italy's participation to the boards, Rome can't really compete with Paris and Berlin.

This leads to the approval of dubious projects, such as "Zenata", an eco-compatible city built in the outskirts of Casablanca, where 300 000 inhabitants will be relocated - among which 8000 shantytown families – and 100 000 jobs will be created by 2030. The project is being financed through a €4 mln EU grants and €150 mln loans from the French development Agency, and will include 1,8 billion investments on infrastructures (roads, water, sanitation, etc), coordinated by the Caisse de Dépôt et de Gestion (CGD), a state-owned financial institution in Morocco. The project has raised criticism among local residents, as they claim they will be forcefully displaced by Moroccan authorities. Also, funds are suspected to be used to build residential buildings instead of infrastructure and services, which would risk the European Commission in unclear real estate operations.

The case of SIMEST

As opposed to France and Germany, Italy has a very limited experience with blending, as it does not have a government-owned development bank such as AFD and KfW. As the Italian Development Agency is still to be created, SIMEST – 78% owned by the Italian Deposits and Loans Fund (Cassa Depositi e Prestiti) is the financial institution that acts as a development bank. But, as highlighted by Maria José Romero, policy and advocacy officer at the European Network on Development and Debt (Eurodad) "SIMEST is dedicated to promoting foreign investment by Italian companies, not development, this risks prioritizing profit rather than the development of beneficiary countries".

Among the most controversial projects co-financed by the EU is the Bii Nee Stipa wind farm built in the Isthmus of Tehuantepec, Mexico. The project, managed by Enel Green Power S.p.A., a subsidiary of the Italian power generation firm Enel, was supported by a 3,3 mln EU grant and additional investments by SIMEST and EGP (90 mln) in addition to a 25 mln loans granted by the InterAmerican Development Bank. The project, launched in 2012, raised strong criticism among the local communities. "The construction of the Bii Nee Stipa II wind farm has not had any positive social impacts in the region: employment associated with the farm was limited to hiring labourers during the construction period, and there was heavy migration of European technicians into the area. The energy generated is not intended for local communities, and therefore is not conducive to their development. No process of free, prior and informed consultation was undertaken with local communities. We have not been consulted, they do not treat us as equals, and they do not respect our rights.", complains Bettina Cruz, a Mexican human rights defender and member of the local Assembly of the Indigenous Peoples of the Tehuantepec Isthmus in Defense of Land and Territory (APIITDTT). "Windmills were built on the best land for farming crops, which affects food justice".

It is food justice what SIMEST wants to promote now in Niger through the construction of rural roads to make the transportation of agricultural products easier. The project, supported by the Italian Directorate General for Development Cooperation (DGCS), would have a total budget of €120 mln, including an EU grant of €5 mln. According to the Permanent Representation of Italy to the European Union, "the project is still under evaluation and should be approved in autumn", adding on to the long list of infrastructure projects financed by blending.

Although the project promoted by SIMEST targets a rural context (an area often forgotten by donors, who prefer investing in urban areas), according to data and reports, sectors that have attracted most of the blended investments since 2007 are energy (35%), transportation (26%) and water (20%), whereas only 19% of projects have taken place in social and small and medium enterprises sectors. This resulted in prioritizing big infrastructures, which, although necessary, favor big private and public companies, affecting small enterprises and social infrastructures (e.g. rural schools and hospitals). "I want to reverse this trend and give a greater role to the Third sector actors and SMEs" says Roberto Ridolfi, Director for Sustainable Growth and Development at the Directorate General for Development and Cooperation of the European Commission (read the interview).

Yet, there are more obstacles to face. "In addition", says Romero of EURODAD, "International standards for contracting, give no preference for local contracting, which makes things easier for European companies. This risks damaging local actors instead of promoting their development". The European Parliament also expressed concerns on blending, in particularly on the ownership of beneficiary countries, whose decisional power is currently quite marginal. Also, according to EPCDM's report *Blending loans and grants: an effective mix for the EU?*, the "criteria used for approving and prioritising projects are intransparent, in some cases also to the DFIs and partner countries involved".

"Nonetheless", says Florian Kratke, co-author of the report, "blending remains a useful tool as it increases investments in those countries who need it most". This need is regularly expressed by African leaders. According to the President of the African Development Bank (AfDB), Donald Kaberuka, wrote "the pressure on [the overseas development assistance (ODA)] means that we need to rethink the aid instruments of the future. The way forward is by leveraging private capital, and by helping countries better manage their natural resources".

To overcome these obstacles, a new Platform for blending - launched in December 2012 and composed by representatives from Member States, the European Parliament, the European External Action Services and the European Commission - is working on a reform to achieve a greater involvement of small and medium enterprises and ngos, more transparency, the adoption of new financial instruments like guarantees or risk capital participation (i.e. equity and quasi-equity) as well as easier procedures for the proposal and approval of projects.

What is at stake is the future of development cooperation 2.0.

The development agenda of the Italian semester

Private sector and civil society, migrations, post-MDGs and agriculture. These will be the topics included in the development agenda of the Italian presidency of the European Union from 1st July to December 31st 2014. One of the first events, the Informal meeting of the Ministers for Development, will be held in Florence on 14th and 15th July. It will also include a meeting between private sector and Civil Society.

The event follows two important strategic documents presented in Brussels by the EU Commissioner for Development, Andris Piebalgs: the former on the role of the private sector in International cooperation (13th May), the latter on the post 2015 agenda on Sustainable Development Goals (SDGs) that will replace the Millennium Development Goals (MDGs).

Together with Commissioner Piebalgs and EU Ministers, the Italian Minister for Agriculture Martina will participate in an informal dinner on food security and Expo 2015. On 15th July, Foreign Affairs Deputy Minister Lapo Pistelli will chair a morning meeting dedicated to private sector, civil society and Sustainable Development Goals. A lunch meeting will also be held on "migrations and development" and, finally, in the afternoon Pistelli will meet representatives of the private sector and NGOs.

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Image credit: European Commission