



# ODA and Private Sector Instruments: new rules raise major concerns

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## Background: what are Private Sector Instruments?

1. Private Sector Instruments (PSIs) involve offering loans or guarantees, or buying equity in private enterprises operating in ODA-receiving countries. PSIs are not new, but thus far their use has been limited, according to one [recent study](#). However, ongoing discussions at the OECD DAC have opened the door for a much broader range of PSIs to be accepted as ODA. This could, in the medium term, have a dramatic impact on ODA, shifting it away from countries and sectors which are not easily served by PSIs, particularly low-income countries and public services.
2. Terms such as 'blending' and 'leveraging' are often used for such activities, but it is clearer to use the more commonly understood term of subsidy. The WTO defines a subsidy as containing "three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit." Loans and equity investments contain direct financial contributions, and guarantees involve the promise of future financial contributions, so PSIs qualify.

## Current status of PSI negotiations

3. In 2014, the DAC [decided to](#) "undertake further work to reflect in ODA the effort of the official sector in catalysing private sector investment in effective development". It followed this with some more detailed principles on PSI in 2016 ([High Level Meeting Communiqué Annex I](#)). However, the details of these principles proved extremely contentious, and at the [2017 High Level Meeting](#) members recognised that they were not yet "able to conclude in the spirit of consensus our negotiation". The outcome of the 2017 High Level Meeting was therefore that:

*"Pending an agreement on the Implementation details of all the PSI principles, the donor effort may be measured either at the point of transfer of funds to a vehicle providing PSI to developing countries or for each PSI transaction between the vehicle and the private enterprise or institution in the partner country. We clarify that this relates to PSI that are development-oriented. Building on the progress made so far, we will in consultation with other relevant stakeholders finalise implementation rules of the PSI agreement including by collecting evidence on the impact of PSI, and revise these rules where shown appropriate."*

4. This means that donors have significant leeway to decide what to report as PSI, before agreeing how to make sure this doesn't have adverse impacts for ODA quality. Available evidence suggests that the use of PSI is increasing, and several donors are very keen to substantially increase their use, for example with the launch of new mechanisms such as the European Fund for Sustainable Development (EFSD) Guarantee Fund.

## Concerns

5. Firstly, the proposed development implementation rules risk incentivising PSI above other types of ODA that could have greater development outcomes, including a stronger impact on private sector development. To take one clear example: under the proposals an ODA concessional loan to a public sector actor would in many circumstances credit the donor with less ODA than a loan on the same terms to a private sector actor. As set out in a [recent Eurodad paper](#), in broad terms, international development cooperation has three main impacts on private investment: through its spending power to procure goods and services; through the impacts on economic growth of investments in public goods; and through subsidies to businesses. Though the first two are arguably the most important, it is the third that is dominating discussion in many international forums.

6. In addition, as a [recent paper](#) points out, there are significant issues with estimating the true impact of PSIs. For example, there are no broadly agreed ways of estimating 'additionality' (the likelihood that ODA created a type of private investment that could not have happened without the subsidy). A [recent review](#) for Oxfam International and Eurodad found that "a number of evaluations suggest that donors too easily assume additionality." Estimates of 'leverage' are sometimes just a simple ratio of ODA to total private investment, and can be used to give the impression that a small amount of ODA 'catalysed' a very large amount of private investment. However, as the same study noted: "This approach is not only wrong but it is also misleading. In reality, a high leverage ratio (e.g. 1:50) means the blending element is heavily diluted, and the more diluted it is, the less likely it is to influence the project to a significant extent."<sup>(p17)</sup> Finally, given that other uses of ODA are likely also to have catalytic impacts on private investment in addition to wider development impacts, the opportunity costs need to be carefully considered, which requires a focus on the actual development outcomes of the expenditure. At present, evidence and evaluation of the impacts of blending and other donor-supported subsidies are very [limited](#).
7. There is also a strong likelihood that donors will use their own bilateral or multilateral development banks as the default distribution mechanism for ODA subsidies, making them remote from national industrial strategies, and often tied to the interests or perspectives of the donor country. The use of subsidies to promote private investment in key sectors can be a tool of industrial policy, but needs to be managed within this national strategic framework. Traditionally, this has been done, for example, through the promotion of national public development banks. In fact, state owned financial institutions are [estimated](#) to account for around a quarter of all assets in banking systems globally. However, the rise in development motivated donor-backed subsidies for private projects has led to a growth of donor-controlled public development banks (known as development finance institutions, DFIs). For example, a [recent study](#) of the European Union's blending projects found that of the top four development banks used to implement the majority of projects were all European, including two bilaterals and the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD).
8. Finally, the DAC has not yet reached agreement on accompanying safeguards that would mitigate risks such as a lack of transparency, the risk of adverse human rights and environmental impacts and, importantly, an increase in tied aid. Tying aid dilutes the sustainable development focus of ODA, and it increases the costs of projects by an estimated 15–30 percent.<sup>1</sup> Development actors have long been committed to untying aid, beginning with a recommendation from the OECD DAC in 2001, and reinforced by successive international agreements including the Addis Ababa Action Agenda. However, in 2016 almost 17 percent of bilateral aid was still reported as tied – more than [US\\$17 billion](#) (and this is probably an underestimate, due to gaps in donor reporting). Moreover, the majority of bilateral aid falls outside the scope of the DAC's recommendation, and much ODA reported as untied may still be tied in practice, through informal barriers that prevent firms outside the donor country from competing. Such barriers may include, for example, only advertising tenders in the donor country's language, or setting very specific eligibility criteria that only a handful of firms can fulfil. It is impossible to quantify exactly how much aid is tied in practice, but of the aid contracts reported to the OECD DAC in 2014 that fell under the the scope of the DAC recommendation on untying, [46 percent](#) by value were awarded to firms in the donor country.

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<sup>1</sup> Clay, Edward J, Matthew Geddes & Luisa Natali (2009): Untying Aid: Is it working? p. 27