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Innovative Financial Instruments in International Development Cooperation: Opportunities for Poland

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Changes in international development cooperation are heading towards the greater involvement of the private sector in achieving the Sustainable Development Goals (SDG) and stimulating growth in developing countries. One way to achieve these aims is through the wider use of innovative financial instruments (IFI). They offer also an opportunity for Poland to effectively engage national business in development cooperation. This will be served by the strengthening of institutional capacities in this area in cooperation with experienced donors from the EU.

Until now, the Polish private sector has played a limited role in development assistance projects. The primary method was to grant preferential credits under tied aid so Polish companies could supply goods or services to recipient countries. However, this form of support is criticised as ineffective by international organisations and Poland has repeatedly pledged to limit its use. In this context, new forms of cooperation with businesses constitute an attractive alternative.

Sources and Role of IFI. Blended finance, as IFI is sometimes called, is the strategic use of development finances for the mobilisation of additional finances from private or public institutions for sustainable development in developing countries. They complement traditional methods, such as grants and loans, and operate on the principle of risk minimisation for commercial entities, which encourages them to invest in countries and sectors that otherwise would not be as attractive on purely market criteria. IFI can take many forms: investment grants, guarantees, insurance, risk capital (purchase of shares in a company participating in the project), a public-private partnership, technical assistance, and others. At the same time, IFI complies with international standards and do not qualify as tied aid.

The popularity of IFI increased in the aftermath of the financial crisis of 2008 when cuts in public spending in many countries forced restrictive management of aid budgets and donors began to take their own interests more into account. At the same time, there was a growing understanding that financial flows other than Official Development Assistance (ODA) can play an important role in the fight against poverty. For example, in 2015, nearly $180 billion was transferred to developing countries in the form of ODA, much less than the remittances received from migrants, at $383 billion, or FDI, at $228 billion. Therefore, the new Agenda 2030 adopted at the UN in 2015 indicates that the key to achieving the SDGs will be the mobilisation of domestic revenues and the involvement of the private sector. UNCTAD estimates that the investment gap for the implementation of SDGs in developing countries is about $2.5 trillion annually until 2030. A way to meet these needs, therefore, can come from mobilising funds from private institutions (enterprises, banks, investment companies, insurance companies, etc.), whose assets are estimated at even $120 trillion (according to the McKinsey Global Institute).

The new financing model for development is not free of criticism. There are fears that it will lead to reductions of aid through grants and increase the share of loans, which will widen the “debt trap.” According to many NGOs, the effectiveness of IFI instruments is not sufficiently proven. There is a risk that they will simply be a tool for subsidising businesses of rich countries. In addition, most of the projects financed in this way went to middle-income countries and not to the least-developed ones. To prevent the negative phenomena, international organisations, including the World Bank, OECD and EU, have developed principles and good practices meant to guarantee, among other things, that IFI will only finance projects that pursue development objectives, bring added value, and cannot be realised without this support on purely commercial terms. Part of the offer is technical assistance to support reforms improving the investment climate and good governance to attract and absorb more investment (e.g., reducing corruption).

IFI in EU Development Cooperation. Blending is increasingly used in development cooperation policy of the European Union and a number of Member States. For the first time, the Commission launched blended instruments in 2007 and over time created several regional instruments (e.g., the Asian Investment Facility) and thematic ones (e.g., the Climate Finance Facility). Until 2016, it had allocated €3.4 billion in the form of grants for this purpose, which allowed it to mobilise €26 billion in loans for investments with a total value of €57 billion. In addition, the European Bank for Reconstruction and Development and the European Investment Bank also have their own blended instruments (such as the European Resilience Initiative).

The key role is currently played by the EU External Investment Plan (EIP), launched in 2017 in response to the mass-migration crisis and intended to support investments in Africa and the Union’s neighbourhood. Its core element—the European Sustainable Development Fund (EFSD), with capital of over €4 billion—is set to generate projects worth about €44 billion by 2020. The importance of IFI will increase further in the new financial perspective after 2020. EFSD+ is to enable investments worth €60 billion while a new “foreign investment platform” is to improve cooperation among European donors. Adopted in June 2017, the New European Consensus on Development explicitly calls on the Member States to adapt their approach “to mobilise and make effective use of all means of implementation, including through innovative financing mechanisms.” It is being used by a number of EU countries, including Germany and Sweden. In addition, EU members with their own development banks or aid agencies can also manage the EU instruments.

Polish Experience. The Development Cooperation Act of 2011 and the Multiannual Strategy for Polish Development Cooperation for the years 2016–2020 allow the private sector to participate in the implementation of development projects. However, apart from tied aid, Polish businesses have participated only to a small extent. Certain forms of support for companies on foreign markets—such as Export Credit Insurance Corporation (KUKE) investment insurance, State Development Bank (BGK) buyer’s credit, or share capital and non-recourse loans provided by the Polish International Development Fund (FEZ)—are made on commercial terms and are not treated as part of ODA.

The main barriers to the use of IFI in Polish aid are the lack of experience in this area, scarce national capabilities (knowledge, mechanisms, and institutions), and the limited presence of Polish companies in developing countries. Poland also does not have an aid agency or a development bank financing aid projects in developing countries that could naturally manage the innovative instruments.

Conclusions and Recommendations. IFI will be an increasingly popular financing method in international development cooperation in the coming years. The introduction of it to the Polish system would allow increasing private-sector involvement in assistance activities, contributing to the creation of jobs and economic growth in developing countries. It would also make it possible to move away from the traditional form of tied aid and would also be in line with the objectives of economic diplomacy, including expansion into new markets. It can be an incentive to further increase the ODA budget so that the target of 0.33% of GNI will be achieved in a short time. In a longer perspective, it could give Poland the opportunity to manage EU blended instruments.

The use of IFI will require the creation of national capabilities in this area (training of officials, preparation of instruments). Cooperation with the OECD Development Assistance Committee and other more experienced partners in the EU (such as Sweden and Germany) will be helpful in preparing for the new tasks. In the short term, commercial mechanisms developed under KUKE, BGK, or FEZ can be adapted to the requirements of development cooperation. In a long-term perspective, it is worth considering institutional changes, such as the creation of an aid agency or development bank. The adoption of appropriate regulations should ensure that the private sector’s participation will improve the quality and impact of Polish development assistance and not reduce the share of grants, especially for the poorest countries. The commencement of work on the new multiannual programme of Polish development cooperation after 2020 creates a convenient moment for this reform of the country’s aid system.